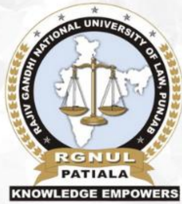

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EMERGING TRENDS IN INSOLVENCY AND BANKRUPTCY LAWS

SPECIAL ISSUE

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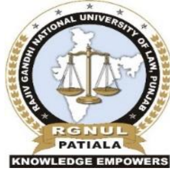

RGNUL FINANCIAL AND MERCANTILE LAW REVIEW

4th RGNUL-SAM CONCLAVE

ON EMERGING TRENDS IN INSOLVENCY AND BANKRUPTCY LAWS

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FOREWORD

Enactment of the Insolvency and Bankruptcy Code in 2016 ('IBC') has been one of the most significant structural reforms introduced in India's corporate law landscape in the 21st century, which has been instrumental in reducing non-performing asset levels in the banking sector and increasing not just recoveries for banks, but also boosted the investor confidence in the Indian economy. As Justice Nariman observed most aptly in *Swiss Ribbons v. Union of India* (2019), '*the defaulter's paradise is lost. In its place, the economy's rightful position has been regained.*'

It is worth highlighting that since its inception, 8175 corporate debtors have been admitted into corporate insolvency resolution processes ('CIRPs'), of which 6192 cases have been closed and 1983 corporate debtors are under various stages of resolution.* In terms of the break-up between resolutions and liquidations, it is noted that around 13.69% CIRPs have resulted in approved resolution plans by the adjudicating authority, 13.82% CIRPs have been withdrawn under Sec 12A of IBC and in 33.11% of the cases, liquidation orders have been passed. It is pertinent to highlight that while a significant number of cases may have resulted in liquidation, but a large majority of these cases were inherited from the earlier Board for Industrial and Financial Reconstruction ('BIFR') regime or were already defunct units where substantial value erosion had taken place before admission under IBC.

The IBC has become the most preferred route for creditors to maximise their recoveries from distressed companies. It is also a great avenue for strategic and financial investors to acquire valuable companies in an expeditious legal process, with the benefit of cramdown of dissenting creditors

* The Quarterly Newsletter of the Insolvency and Bankruptcy Board of India, October-December 2024.

and whitewashing of the past dues. One of the most significant outcomes of the IBC has been the substantial behavioural shift ushered in by the IBC, due to the credible 'threat of insolvency' leading to the promoter losing control over his company. This has strengthened the negotiating power of the creditors, in the absence of which it is most likely that the debtors' defaults would have lingered longer, resulting in value destruction. IBC has not just led to huge recoveries but has facilitated preservation of economic value of assets through effective resolution or unlocking of capital which is stuck in unviable businesses.

The practical working of the law has, over the years, thrown up various unique issues and challenges. The government, the regulator IBBI as well as the judiciary have shown great alacrity and deftness in addressing such issues, ironing out the creases to streamline the law and the jurisprudence around it.

A fundamental question that has arisen time and again is whether there is a need for sectoral insolvency laws. While originally the operation of the IBC was contemplated only to resolve the insolvency of non-financial firms, however, its operation has now been extended under a special set of rules to the financial service providers as well, leading to successful resolutions of several financial service providers under the IBC. There have been demands for special sectoral considerations in several sectors, such as airlines, power, roads and other strategic sectors. From time to time, several alterations have been introduced in the IBC to address certain gaps where required to meet the policy considerations. Even the judiciary has come up with several innovative approaches to address the complex issues with the ultimate aim of meeting the objectives of the IBC.

Consider for example the real estate sector, one of the most sensitive sectors in the Indian economy. Various factors have led to distress within real estate

entities, impacting allottees, investors and developers alike. This sector, having been plagued by a high quantum of debt, has attracted attention of the judiciary as well as the legislature, spurring innovative home-grown policy solutions. Some of the innovations introduced through judicial intervention include resolution approach limited to the affected project(s) and the introduction of reverse CIRP. Some of these solutions have also been introduced into the IBC. Insolvency scholars should closely analyse the implications of these innovative policy measures on real estate insolvencies, to suggest future reforms to further enhance the efficacy of real estate insolvencies.

A promising feature of the IBC was the promise of quick admission into the corporate insolvency resolution process. Section 7(4) requires the Adjudicating Authority to ascertain the existence of a default from the records of an IU or on the basis of other evidence furnished by a financial creditor within 14 days of receipt of such application. However, as per IBBI's own data, the average time taken for admission from date of filing was 468 days in 2020-21 and 650 days in 2021-22. Such significant delay at admission stage itself is one of the biggest drawbacks of IBC.

A critical reason for this unwarranted delay at admission stage is the low reliance on information utilities ('IUs'). The BLRC had suggested 14 days as the outer limit for admission on the assumption that the admission process will be based on the IU data on default and the evidentiary standards attached to that data by law. However, the uptake of IUs has left a lot to be desired and even today, significant time is expended at the admission stage by the adjudicating authority dealing with the objections from the corporate debtors on their admission into CIRP. Over time, this has become the Achilles Heel of the entire IBC framework.

Delays associated with IBC resolutions extend post-admission too. CIRPs have been marred with delays, especially on account of multifarious litigations. As on December 31, 2024, the average time taken for closure of corporate insolvency resolution processes under IBC was 701 days. This delay is closely related to the incentive misalignment inherent within IBC when the existing promoter/management is replaced by an insolvency professional at the time of commencement of CIRP. An expert committee constituted by the IBBI has recommended a new framework for a Creditor-Led Resolution Process (CLRP) to address this challenge. This suggested framework has some unique advantages which holds much promise. The CLRP is proposed to be a light touch framework, with limited role of the adjudicating authority and will allow for the debtor to remain in possession, in sharp contrast to the creditor in control regime under the CIRP.

Another subject which has drawn the attention of scholars and practitioners alike is cross-border insolvency. Although the IBC provides only enabling provisions for cross-border insolvencies, judicial innovation has come to the rescue to iron out the creases in practical matters involving cross-border insolvencies. For instance, in the *Jet Airways* case, the NCLAT facilitated the development of a consensual cooperation protocol between the Dutch Trustee and the Indian resolution professional for the harmonious running of the parallel processes. The Delhi High Court in *Toshiaki Aiba v. Vipan Kumar Sharma (2022)* has recognized the liquidation order passed in Japan and provided asset restoration remedies to the Japanese Trustee.

Corporate insolvency remains a dynamic space and the jurisprudence around it is evolving at a fast pace to respond to newer challenges. The insightful articles in this RGNUL-SAM Conclave Special Edition address many such new and upcoming questions ranging from emerging technologies

to crypto exchanges, and environmental claims to personal guarantees. Insolvency law scholarship must play an active role in debating and exploring such contemporary issues so that policymakers and practitioners both may benefit from fresh insights on the subject. With this hope, I invite all of you to actively engage with all the articles in this special issue.

SAURAV PANDA
Equity Partner
Shardul Amarchand Mangaldas & Co.

EDITORIAL NOTE

Lord Mishcon once said, "*Insolvency is not a very thrilling or amusing subject.*" Yet, as Edward Jenks, the distinguished English jurist, astutely observed, "*... uninteresting as it may be, it is nevertheless a very important subject area.*" Few legal domains have experienced as profound a metamorphosis as insolvency law, particularly in the wake of the Insolvency and Bankruptcy Code, 2016 "IBC". The enactment of this seminal legislation heralded a paradigm shift from the 'debtor-in-possession' regime to a 'creditor-in-control' framework, recalibrating the contours of liquidation. Over the years, the evolution of the IBC has been marked by judicial dynamism, legislative refinements, and global jurisprudential shifts, compelling a recalibration of insolvency jurisprudence in India.

In this milieu, the RGNUL Financial and Mercantile Law Review "RFMLR" — one of India's preeminent law reviews takes immense pride in presenting this Special Issue on Emerging Trends in Insolvency and Bankruptcy Laws, 2024. This compendium embodies the legal erudition and intellectual vigor that define RFMLR. It features meticulously curated articles from the 4th RGNUL-SAM Conclave on Emerging Trends in Insolvency and Bankruptcy Laws, organized in collaboration with Shardul Amarchand Mangaldas & Co. in November 2024. We extend our profound appreciation to SAM & Co. for their unwavering support in fostering critical discourse on this ever-evolving legal landscape.

The Special Issue reflects the pressing need to analyze and refine the IBC's existing framework in light of emerging challenges. Cross-border insolvency and its global ramifications, the treatment of contingent claims in corporate insolvency, and the disruptive potential of emerging technologies such as

blockchain and artificial intelligence in insolvency proceedings are but a few of the pivotal themes that seek attention. The deliberations of the Expert Panel at the Conclave, comprising esteemed luminaries — Mr. Saurav Panda, Mr. Vaijayant Paliwal, Mr. Sagar Dhawan, Mr. Pratik Datta, and Mr. Navneet Gupta were instrumental in conversing these complexities. Their profound insights on Green Finance's use of IBC for Responsible Debt Restructuring and Recovery, the Value Maximization Potential of Avoidance Applications in insolvency proceedings, and the influence of emerging technologies on insolvency and bankruptcy enriched the discourse immeasurably. We express our deepest gratitude for their invaluable contributions.

This Special Issue also examines the fraught intersection of insolvency and environmental claims. India's insolvency jurisprudence, while priding itself on expediency and economic efficiency, has yet to fully reconcile corporate insolvency with environmental obligations. Section 53 of the IBC, with its waterfall mechanism, accords primacy to financial creditors, relegating environmental claims to a residual status. This not only imperils corporate accountability but also raises constitutional concerns vis-à-vis Article 21, which enshrines the right to a clean environment. Further, the IBC's non-obstante clause in Section 238 has, at times, been judicially interpreted to override environmental liabilities, thereby exacerbating the tension between corporate interests and public rights. The imperative for a principled reconciliation of these competing considerations is thus paramount.

Another focal point of this Issue is the nascent yet complex realm of cryptocurrency exchange bankruptcies. The foundational question of whether crypto assets qualify as 'property' under bankruptcy law is now overshadowed by more intricate concerns: the valuation of crypto assets, the enforceability of digital wallets, and the interplay between traditional insolvency

mechanisms and decentralized finance. With regulatory frameworks still crystallizing, navigating crypto bankruptcies necessitates a robust, avant-garde approach that this Issue seeks to explore.

Further, the treatment of Intercreditor Agreements under the IBC remains a topic of deliberation, with jurisprudence grappling with the delicate balance between creditor rights and the overarching objective of insolvency resolution. The Issue also delves into the IBBI's proposed overhaul of insolvency regulations, which aspires to streamline processes and bolster institutional efficacy. Additionally, a comparative analysis of global insolvency paradigms contextualizes India's legal framework within the broader international spectrum, offering invaluable insights into best practices and potential reform trajectories.

The landmark Lalit Kumar Jain case has reignited deliberations on the enforceability of third-party guarantees in insolvency proceedings. Should insolvency jurisprudence mandate their absolute enforcement, or should a nuanced, case-by-case approach prevail? This Special Issue endeavors to dissect this contentious question, drawing upon domestic and international precedents.

At RFMLR, we remain steadfast in our commitment to fostering scholarly discourse that is both doctrinally rigorous and practically relevant. The Editorial and Advisory Boards of RFMLR have been instrumental in upholding the Journal's legacy of excellence, and I extend my deepest gratitude to each member for their unwavering dedication. My sincere appreciation also extends to our Patrons and our esteemed readership, whose engagement and critical reflections continue to shape the intellectual trajectory of this Journal.

Insolvency law is no longer merely an esoteric domain of liquidation and debt recovery, rather it is the fulcrum upon which financial stability and economic resilience hinge. As India continues to refine its insolvency architecture, it is incumbent upon legal scholars, practitioners, and policymakers to engage in informed and pioneering discourse. This Special Issue aspires to be a catalyst in that endeavor.

YUVRAJ MATHUR
Managing Editor
RGNUL Financial and Mercantile Law Review

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I. NAVIGATING CRYPTO EXCHANGE BANKRUPTCIES: A PRACTICAL GUIDE TO ASSET SEGREGATION AND VALUATION

Yash Arjariya and Aishwarya Tiwari[*]

ABSTRACT

This paper advances the discourse on cryptocurrency exchange bankruptcies beyond the foundational question of whether crypto assets qualify for bankruptcy proceedings - a matter now settled affirmatively across jurisdictions. The authors offer practical guidance for crypto investors navigating exchange bankruptcies, focusing on asset segregation and recovery strategies. Through analysis of emerging global jurisprudence, the authors identify two competing approaches to establishing trust relationships for asset segregation that are the "segregation test" and the "intention test," predicting the latter's likely prevalence due to its grounding in common law principles. The paper provides actionable insights for investors in selecting crypto exchanges and managing their investments to maximize asset recovery prospects in bankruptcy scenarios. The authors also address the complex challenge of crypto asset valuation in bankruptcy proceedings, evaluating the KO model and blockage method while proposing in-specie distribution as a potential solution. This comprehensive analysis fills a critical gap in existing literature by moving beyond theoretical frameworks to provide practical strategies for investor protection and asset recovery in crypto exchange bankruptcies. The findings contribute significantly to the evolving jurisprudence and regulatory framework surrounding cryptocurrency bankruptcies while providing practical guidance for stakeholders in the crypto ecosystem.

Keywords: Asset Segregation, Crypto Assets Valuation, Crypto Exchange Bankruptcy

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[*] Yash Arjariya and Aishwarya Tiwari are fourth-year students at Hidayatullah National Law University, Raipur. Views stated in this paper are personal.

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I. INTRODUCTION

A. Trading in the Crypto Market

There exist two different ways in which a trader may opt to trade in a crypto market and exchange currencies. The trader may opt for a peer-to-peer direct transaction with his counterpart executing a transaction while keeping the private key of the traded currency safe in his own custody, or for the sake of convenience, he may hop on to an intermediary-based exchange like CoinDCX or WazirX, creating a wallet to store money. This mode of exchange involves a third party to whom the customer puts a request of trade, upon which the exchange executes the said transaction, buying the cryptocurrencies and then holding them and the associated keys in its custody for safekeeping

and convenience. The first protocol is what we call a decentralized exchange, whereas the latter intermediary third-party protocol is known as a centralized exchange.

B. Crypto Winters: The Collapse of Centralized Crypto Exchanges

In recent times, such crypto exchanges offering intermediary services in the trade of cryptocurrencies have encountered twin difficulties, resulting in bankruptcy proceedings being filed against them. The first issue is the prevalence of cryptocurrency hacking. Recent instances of crypto exchanges like WazirX, BitGrail, etc. subject to cyberattacks and consequential loss of crypto assets from their custody have led to the opening of bankruptcy proceedings against such exchanges.[1] Second have been the cases where such crypto exchanges have been unable to return the crypto assets under their custody owing to mismanagement and loss owing to poor business management. Such instances include the crypto exchanges such as FTX and Voyager cases.[2] Consequently, either of the two factors has led to the inability of the crypto exchanges to pay out their users, traders, creditors, etc. and results in initiation of bankruptcy proceedings. The bankruptcy courts faces the novel issues in these crypto exchange cases with respect to segregation of the crypto assets, valuation issues, treatment of users/investors/customers etc.

While there has been substantial academic discourse about whether cryptocurrency qualifies as an asset or object of ownership to be subjected

[1] Adam J. Letivin, 'Not Your Keys, Not Your Coins: Unpriced Credit Risk in Cryptocurrency' (2023) 101 Texas Law Review 877; Information Society Project (ISP), Yale Law School '*The Death of Cryptocurrency: The Case for Regulation'* (2022).

[2] Thomas Conlon *et* al, 'The collapse of the FTX exchange: The end of cryptocurrency's age of innocence' (2023) British Accounting Review 101,277; *See also* Jonathan C. Lipson and David Skeel, 'FTX'd: Conflicting Public and Private Interests in Chapter 11' (forthcoming 2025) 77 Stan. L. Rev.

under bankruptcy proceedings.[3] The discourse has culminated in the affirmative findings of the global jurisprudence alike that cryptocurrency qualifies as an asset and is a valid subject of ownership.[4] Thus, the authors in writing this paper build on this legal position that cryptocurrency qualifies as an asset and therefore will qualify to be part of the debtor's estate in the event of a bankruptcy proceeding, which has been accepted by courts of respective jurisdictions while deciding this question.[5]

C. High-Stakes Questions: Segregation and Valuation of Crypto Assets

It is submitted that the literature attempting to study cryptocurrency and insolvency has been majorly restricted on the question of how and should the crypto assets will qualify as assets and therefore be subject to bankruptcy proceedings. The authors, thus, in this paper attempt a novel analysis forward to this already discussed and sufficiently settled position. The authors will attempt to critically analyse the nature of relationships between investors/users/customers and the crypto exchanges and what implication this determination of relationship has on the bankruptcy proceeding of the exchange. The authors prefer to make this analysis from the trader's/user's/customer's perspective and comment on how segregation claims can be made by them to recover their crypto assets before they are made debtor's pooled estate and thus how satisfaction of their claim can be done without diminution in their claim during liquidation proceedings where they

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[3] Renato Mangano, 'Blockchain Securities, Insolvency Law and the Sandbox Approach' (2018) 19 Eur. Bus. Org. L. Rev. 715; Renato Mangano, 'Cryptocurrencies, Cybersecurity and Bankruptcy Law: How Global Issues Are Globalizing National Remedies' (2020) 27 U. Miami Int'l & Comp. L. Rev. 355; Douglas W. Arner *et al*, 'The Financialization of Crypto: Lessons from FTX and the Crypto Winter of 2022-2023' (2023) UNSWLRS 31.

[4] AA v. Persons Unknown [2020] EWHC 3556 (QBD); ReQuadriga Fintech Solutions Corp. [2019] NSSC 65; Quoine Ptd Ltd v. B2C2 Ltd [2020] SGCA(I) 02; *Re Voyager Digital Holdings, Inc [2023] US Bankruptcy Court NY*; Re *Celsius Network LLC [2024] US Bankruptcy Court NY.*

[5] ibid.

will only participate as unsecured creditors. In the alternative, authors analyse that if such segregation claims fail, how the bankruptcy courts must decide the valuation issues associated with the crypto assets. In doing so, authors analyse various models of valuation that may be employed in the liquidation of crypto assets and suggest a workable model for the same.

II. TRUST OR NO TRUST: IMPLICATIONS OF THE NATURE OF THE CLAIM

It is pertinent to ascertain that whether in the event of bankruptcy proceedings opening against a crypto exchange, a crypto-investor's claim against a crypto exchange will qualify as a contractual one or that emanating from a trust relationship. By a trust relationship, it is meant qualification as a property law claim that the ownership of the assets (crypto coins) rests with the investors or users of crypto exchange and the exchange is merely custodian of the assets. This relationship in the nature of a trust will permit the right of segregation to be exercised by the investors, as property held in trust by the debtor does not form part of the debtor's estate in the event of bankruptcy and accordingly is not distributed amongst the creditors,[6] but the investor can claim repossession or delivery of the cryptocurrency from the debtor.[7]

A contractual relationship, on the contrary, will reduce the status of the investors or users of crypto-exchange to unsecured creditors, and their claim would rank *pari pasu* with the crypto-exchange's other unsecured debt. Accordingly, the crypto coins of the investors or users be pooled in for distribution during restructuring or liquidation as it shall form a constituent of the insolvency estate of the debtor.

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[6] Insolvency & Bankruptcy Code 2016, s 34(3).
[7] Bankruptcy Act 2004, art 62.

Thus, it can be conclusively said that from the investor's perspective, a relationship in the nature of trust with the crypto exchange is both favourable and desirable, as in the event of bankruptcy. The investors will be able to segregate their crypto coins without having to claim them/their value fro1m the debtor's estate as unsecured creditors. Needless to say, such categorization as unsecured creditor is least preferred in the hierarchy of claims and that the claims are ordinarily satisfied with a heavy deduction in the original amount of the claim. Contrary to this, the right to segregation will accord delivery of the entire asset without any diminution on account of bankruptcy of the crypto exchange.

In cases involving bankruptcy of crypto exchanges, the customers of the exchange have advanced that their relationship qualifies that of a trust. The end goal behind such contention was of course exercising the right to segregation with respect to their crypto coins. Thus, majorly the cases have been contested on two approaches whether there was a trust relationship (that the investors contend) or a contractual one (that the exchange contend) and accordingly whether right to segregate crypto coins can be exercised. However, there is also a third approach preferred by the investors as evident in the case of *Zettai Pte. Ltd. in re*[8] wherein the investors contended for establishing trust relationship between WazirX (the crypto exchange) and the investors but did not claim any right to segregation.[9] Instead, the investors sought to establish themselves in the rank of secured creditors in the bankruptcy proceeding. In such a scenario, though the crypto coins will form part of the debtor's estate, the investors will have priority right in their distribution. However, there seems no practicality in adopting such an

[8] *Re Zettai Pte Ltd* [2024] SGHC.
[9] ibid.

approach by the investors, as they chose to forgo the right of segregation even while arguing a trust relationship. Needless to say, that in any probability the amount of realisation will be higher in segregation through recovery of the crypto coin itself.

A. *Establishing the trust relationship*

In the *MtGox* case,[10] the plaintiff, who was a user of an online bitcoin exchange, brought a claim of segregation against the defendant, which was an online bitcoin exchange. When the bankruptcy proceedings were instituted against the bitcoin exchange, the plaintiff, *inter alia,* claimed the return of its bitcoins in the exchange's possession. The plaintiff sought such transfer under the right of segregation provided by the Bankruptcy Act of Japan. Article 62 of that legislation provided: "The commencement of bankruptcy proceedings shall not affect a right to segregate property from the bankruptcy estate that does not belong to the bankrupt." Though the request was denied owing to the court's decision that bitcoin cannot be the object of ownership and hence the right of segregation cannot be exercised over bitcoin, which the law does not recognize as a subject matter of ownership. However, in the aftermath of the judgment, amendments were introduced in the Payment Services Act of Japan, which defined cryptocurrency as proprietary value.[11] Therefore, cryptocurrencies such as bitcoin can now validly be claimed as object of ownership. The authors in the subsequent part of this part of the paper further analyse that if the bitcoin was recognized as an object of ownership, what could be the determination of such a right to segregation as claimed by the plaintiff in MtGox.

[10] *Re MtGox Co. Ltd* [2015] Tokyo DC.
[11] Payment Services Act 2009, art 2(5).

The right to segregate cryptocurrency coins from the estate of a crypto exchange was first authoritatively decided by the Court of Florence in the *BitGrail* case,[12] as the court was conclusive on the point that cryptocurrency does form an object of ownership and decided the segregation claim. In a sequence of events, BitGrail, an online crypto exchange platform, lost seventeen million Nanos (cryptocurrency traded on the platform) due to a cyberattack. Subsequently, bankruptcy proceedings were opened against the exchange. Customers moved an application to segregate their crypto coins from the overall estate of the exchange. Their application contended that BitGrail held the cryptocurrency on behalf of its customers and the ownership always rested with the customers; accordingly, the application was justified in requesting that BitGrail return the possession of Nano coins owned by customers and that they do not form part of its estate.

In effect, the customers claimed that the relationship between them and the exchange was that of a trust, and the exchange held their crypto coins custodian with no transfer of ownership. The court, however, answered in negative. It was explained that once the user's crypto coins were directed towards the exchange, they no longer bore distinctive elements and they became interchangeable goods. This can be explained through the following illustration: User A purchases a Nano coin bearing the unique ID ABCXYZ; however, when this coin is submitted to BitGrail, A will own the value of the Nano coin and not a specified Nano coin with a unique ID. Therefore, A's account balance on BitGrail will reflect the value of a Nano coin but he does not own a particular Nanocoin. Accordingly, when he wishes to withdraw or transfer a Nano coin, BitGrail will exchange any Nano coin with any unique ID number and not necessarily the one that A bought or submitted to it. Simply

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[12] Eirik Ulseroy v. Firano Franceso, [2019] Court of Florence.

put, BitGrail is obligated to return items of the same type, quantity, and quality (*tantundem eiusdem generis*), rather than individualized items, back to the user.

In such kind of deposits, where the deposited assets do not bear distinctive elements associated with ownership by a single user but the own value of the assets so deposited (such as user X owns the current market value of Nano coin and not a particular Nano coin itself), the ownership of crypto coins gets transferred to the exchange.[13] Therefore, investors only own value of their crypto coin and not a specific crypto coin. Accordingly, since the users do not own the crypto assets themselves, there cannot be a case for the subsisting of a a trust relationship between the exchange and the users. Therefore, there cannot be a claim for segregation as there are no particular assets segregated against the name of a particular user.

B. The 'Segregation Test'

It is conclusive to say that when the crypto exchange holds individualised crypto coins (identified through a unique key, etc.) attributed to specific investors, there will exist a trust relationship between the exchange and the investors as per the ratio laid out in *BitGrail*. Since the basis of determination of trust relationship is segregation of crypto coins,[14] it is hereinafter referred to by the authors as 'segregation test'.

Although the court did not rule on the segregation application in the case of *MtGox*, as previously mentioned in this document. However, the claim was likely to fail if the court were to apply the segregation test in this case. The deposit of crypto coins in the case was held fungibly by the bankrupt

[13] ibid 2.7.

[14] ibid.

company, that is, deposited together with other commingled assets. Simply put, in the arrangement, crypto investors deposited crypto coins of the same kind, and the exchange stored these by mixing the coins together and not as individualised assets.

C. Failure of segregation claims: Divergent approaches

It flows from the cases of *MtGox* and *BitGrail* that the test for establishing a trust-like relationship between platform and customers is whether the crypto assets have been segregated and each customer owns a specified coin (identified through a unique key or code, etc.). The authors in this section will analyse the segregation test against the evolving jurisprudence in the world, particularly in the jurisdictions of Singapore and Hong Kong, which have applied the common law principles of creation of trust and adopt divergent approaches.

The case of *Quoine Ptd Ltd v. B2C2 Ltd*[15] ('Quoine') has seemingly contrasted and discarded the segregation test. In the facts of the case, crypto coins were held separately as assets of an individual user of the platform. Thus, the users owned specified assets rather than the mere value of assets in their portfolio. Accordingly, it was advanced that there existed a trust between the platform and its users. If the court was to apply the segregation test as applied elsewhere, it was to conclude the existence of a trust. However, the court held, "*The mere fact that Quoine's assets were segregated from its customers cannot in and of itself lead to the conclusion that there was a trust*."[16]

To analyse the reasoning in *BitGrail*, segregation of crypto assets would ipso facto lead to the determination of trust relationships. In *Quoine*,

[15] Quoine Ptd Ltd v. B2C2 Ltd [2020] SGCA(I) 02.
[16] ibid 145.

however, the court distinguished the concepts of segregation of assets and trust. It relied on *Vintage Bullion DMCC v. Chay Fook Yuen*[17] to hold that "*…segregation is a necessary but not a sufficient condition to give rise to an express trust over the Sums in favour of the Customers. What is further required is to establish that the Company had the requisite certainty of intention for the funds to be held on trust …*" (emphasis supplied).[18] Thus, it was the intention of parties along with segregation of crypto coins that were held to be decisive factors. Since, the contract between the platform and users did not make clear any such relationship between parties in express terms, the claim of trust relationship was accordingly rejected.

There seems to be a growing acceptability to the criteria of 'intention' in determination whether the platforms held the crypto coins in trust or not. For example, in *Re Gatecoin Ltd.,*[19] the court of first instance endorsed the '*Three Certainties*,' a common law principle for the creation of a trust, which necessitates the satisfaction of threefold conditions: certainty of subject matter, of object, and of intention.[20] The court held that there was indeed certainty of subject matter, which could be derived from a claim to share of the undivided bulk (value of crypto coins reflected in the platform's ledger).[21] This needs to be contrasted with the jurisprudence in the *BitGrail* case, where it was held that there existed no certainty of subject matter as the customers only held value in their portfolio without holding any specific coin, and accordingly the relation in the sense of trust was not accepted.[22] Thus, the test

[17] Vintage Bullion DMCC v. Chay Fook Yuen [2016] 4 SLR 1248.
[18] Quoine (n 15) [145].
[19] *Re Gatecoin Ltd* [2023] 2 HKLRD 1079.
[20] ibid 60-65.
[21] ibid 62.
[22] Bitgrail (n 12).

in the *BitGrail* case was that of "*certainty of subject matter*," and it was considered the sole factor for establishing the trust relationship.

However, the court in *Gatecoin* did not hold the relationship to be that of a trust even after accepting certainty of subject matter.[23] The determinative factor in *Gatecoin* was that of intention between parties, as flowing from the terms and conditions agreed between them.[24] Thus, since the contract did not postulate relation as that of a trust and accordingly no claim for segregation, customers will be categorized as unsecured creditors, and the allocation was to be done between them by the *pari passu* method from the debtor's pooled estate.

D. Probable trend: Primacy to the Intention test

It needs to be emphasized that in arriving at the conclusions and giving conclusive effect to the 'intention' of parties as flowing from contract to determine whether trust relationship exists or not, the courts in *Gatecoin* and *Quoine* have relied on common law jurisprudence[25], which *inter alia* gives primacy to intention.[26] In the facts of the case, since the contract in clear terms did not envisage such a relationship, the claims were denied. This, in the opinion of the authors, is a restrictive approach, as the gauge of the intention of parties has been the cornerstone of express terms agreed in the contract, and the *de facto* treatment of crypto coins has been of no significance. For example, an attempt to establish a trust relationship through inferential creation of trust based on the circumstances of the case was rejected in *Ruscoe*

[23] Gatecoin (n 19).
[24] ibid 66-75.
[25] Gatecoin (n 19); Quoine (n 15)
[26] John Mcghee and Steven Elliott, *Snell's Equity* (34th edn, Sweet & Maxwell 2019) [22-012]; *R v Clowes* [1994] 2 All ER 316 [326d].

v. Cryptopia Limited[27] on the ground that the contract did not stipulate such a relationship. Safe to conclude, thus that since such an outcome of the cases is directly attributable to reliance on the widely accepted common law principle of '*Three certainties'* by the courts, the intention test will likely prevail over the segregation test.

III. SEGREGATION CLAIMS UNDER INSOLVENCY AND BACKRUPTCY CODE, 2016

In accordance with section 155(2)(b) of the Insolvency and Bankruptcy Code, 2016 ('IBC'), the bankrupt's estate does not include "property held by the bankrupt on trust for any other person." Similarly, section 36(4) of the IBC provides that "assets owned by a third party which are in possession of the corporate debtor, including—(i) assets held in trust for any third party; (ii) bailment contracts," will not be included in the liquidation estate and shall not be used for recovery in liquidation. Further, the explanation to section 18 also precludes "assets owned by a third party in possession of the corporate debtor held under trust or under contractual arrangements including bailment" from the definition of the "assets" of the debtor. Thus, the framework envisaged under IBC precludes from the debtor's estate any property held in trust or under bailment in event of its bankruptcy.[28] Logically, therefore, the right to segregation accrues to the owner of the property whose property is held by the debtor in trust or under bailment from these provisions of the IBC.

The authors submit that the jurisprudence analysed in the preceding parts of this paper will be relevant and serve as guiding principles for adjudicating authority when it faces the question of establishing the nature of

[27] Ruscoe vs. Cryptopia Limited [2020] NZHC 728.
[28] Insolvency & Bankruptcy Code 2016, s 158(3).

relationship between crypto exchange and crypto investors, which the later will contend as trust and denied by the other. An inquiry, however, needs to be made into segregation claims arising from the relationship in the nature of bailment between crypto investors and crypto exchanges, as bailment under IBC gives rise to segregation claims.

It needs to be emphasised that in the cases analysed in the preceding sections, the relevant statutory framework did not envisage relationships in the nature of bailment to qualify for making a claim of segregation.[29] For example, Article 1782 of the Italian Civil Code defines irregular deposit as "the deposit ... of an amount of money or other fungible things, which the depository is authorised to make use," similar to the definition of the bailment under Indian Contract Act. However, in the event of bankruptcy, segregation claims cannot be allowed for such irregular deposits (bailment). Logically, thus, the investors couched their claims as trust relationships, and consequently, various approaches were laid by courts.

The term "bailment" is not defined in IBC but in the ICA, 1872, which defines it as "bailment" is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them."[30] The authors submit that the adjudicating authority in all likelihood will apply the segregation test even in segregation claims based out of bailment as "*It is the duty of the bailee to return, or deliver according to the bailor's directions, the goods bailed*" (emphasis supplied).[31] Thus, for segregation claims to be successful even in the contractual

[29] Bankruptcy Act 2004, art 62; Insolvency, Restructuring and Dissolution Act 2018, s 64.
[30] The Indian Contract Act 1872, s 145.
[31] ibid s 160.

arrangement in the nature of bailment, the crypto exchanges must be obligated to return individualised crypto coins. Accordingly, in line with the global jurisprudence that deposit of crypto coins of the same kind and quality where crypto exchange stores these by mixing the things together does not merit segregation claim, the position of India will in all likelihood be the same.

IV. GUIDE TO INVESTORS: EVALUATING THE OUTCOME OF SEGREGATION CLAIMS

A. An overview of the potential outcomes

Summarily, based on the analysis of the relevant jurisprudence, the following is the probable list of outcomes based on different permutations and combinations of facts and circumstances:

	Segregation of crypto assets	Ownership	Trust	Result	Comment
Case I:	No	The value of crypto coins.	No	No segregation claim	
Case II:	Yes	Specific crypto coins.	Yes	The segregation claim will be successful.	Additional requirement: establish intention of creating a trust as per agreed terms and conditions.

Case III:	No	The value of crypto coins.	Yes	Secured creditor	See *Zettai Pte Ltd.*

Clearly, the users or traders of crypto assets enjoy the highest amount of protection in Case II scenarios where they can successfully pursue segregation claims. Case III scenario offers them an opportunity to claim value of their asset in liquidation proceeding as secured creditors-a less favourable case scenario than Case II. Finally, Case I scenario is the least favourable outcome, as the claims will rank *pari pasu* with other unsecured debt of the crypto exchange.

B. Impact of Crypto Asset Fungibility

Ordinarily, crypto exchanges provide the users an opportunity to earn reward points or other benefits by depositing or transferring their crypto assets to the exchange. It is in such a scenario that the crypto assets become 'fungible' as between the users/treaders and the exchange, i.e., the exchange will continue to owe them the value of their asset but not a specific crypto asset. In such a deposit or transfer, the exchange pools the crypto assets of its users and uses them for various purposes, such as investing in hedge funds, lending, etc. This can be illustrated by an insolvency case against Celsius (a US crypto exchange). In the case of *Celsius,*[32] by using the 'Earn Services' feature, the clients could 'lend' crypto-assets to Celsius in return of a fee, called 'rewards' in the form of crypto-assets. Celsius terms and conditions also provided that "*once [crypto assets] are received by Celsius into your Earn*

[32] Celsius n 2.

balance, they shall be Celsius' property, in every sense and for all purposes."[33]

Similarly, even in the case of *Voyager,*[34] the contract provided that by depositing the crypto assets with the exchange in return for a reward, the customers grant Voyager the right to hold cryptocurrency held in the customer's account in Voyager's name and to pledge, sell, lend, or otherwise transfer or use any amount of such cryptocurrency with all attendant rights of ownership. Therefore, the customers will only have the right to value their crypto asset and not an individualised asset.

Thus, by subscribing to the rewards program of crypto exchanges, the users and traders effectively forego their right to bring a segregation claim in the event of the exchange's bankruptcy owing to the treatment of crypto assets (which are then pooled and utilised by the exchange, therefore no segregation). In the aforementioned case of *Celsius*, segregation claims of the users against the exchange were allowed for the users who did not subscribe to the 'Earn Services' feature, as their assets were not pooled but kept segregated. Contrary to their treatment, users opting for the 'Earn Services' feature were only able to pursue their claims as unsecured creditors of the exchange.

C. Best Practices for Investors: Protect Your Crypto Assets

Thus, users or traders may want to avoid using such features offered on the crypto exchanges to ensure full recovery of their claims by successful segregation of their crypto assets in the event of the crypto exchange's bankruptcy. Secondly, users or traders of crypto assets may wish to choose a platform which through its terms and conditions, establishes a trust

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[33] ibid.
[34] Voyager n 2.

relationship with respect to custody of crypto assets. For example, the custody agreement of Gemini provides to its users, "*Your Custody Account will have one or more associated unique Blockchain Addresses in which your Assets will be (i) segregated from any and all other assets held by us [...]'. '[...] at a minimum, separate Blockchain Addresses are utilized to segregate your Assets from such other property*."[35] Thus, pursuing crypto transactions on such platforms offers security of recovery of crypto assets in event of the exchange's bankruptcy. Further, traders transacting in huge volumes of crypto assets may wish to negotiate terms of contract with the crypto exchange for such clauses safeguarding their right to segregation with respect to their crypto asset.

V. REALIZATION OF VALUE: THE TIMING AND VALUE CONUNDRUM

In the event of the crypto exchange's bankruptcy, first the investors will try to segregate their crypto coins from the possession of the crypto exchange. However, if such segregation claims are unsuccessful, the coins will form part of the exchange's estate and consequently pooled together with other assets of the exchange (debtor) for distribution amongst the exchange's creditors. At the cost of repetition, it is again emphasised that crypto investors will inevitably be classified as unsecured creditors, placing them lower in the creditor hierarchy when it comes to the distribution of the exchange's assets.

In this scenario, the problem faced by the crypto investors is the realization of their claims considering the issues associated with the valuation of their claim against the debtor. Valuation issues emerge because jurisdictions have consistently mandated the distribution of assets under

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[35] 'Custody Agreement' (*Gemini*, 31 July 2013), <https://www.gemini.com/legal/custody-agreement#section-introduction> accessed 10 October 2024.

insolvency in their native currencies as opposed to in-specie payment.[36] Thus, the distribution from the debtor's estate will be made in the domestic currency of the jurisdiction, and therefore the investment into cryptocurrency by investors needs to be valued for the distribution of the debtor's estate.

Concerning the valuation issue of their claims, it is difficult to ascertain the market value of crypto currencies at any point in time. This issue arises from the fact that there exists no objective value to these tokens; they have a certain value because people perceive their value to be such. Their market faith, not their physical state or economic value, determines their value.[37] Appropriately explained by Mohamed Faizal J., these have "*value for being valuable,*" as these have no intrinsic value.[38]

A. Points of determination

Numerous crypto exchanges consider a myriad of factors to come at different values for the same currency at the same point in time. This crypto valuation problem is caused by great volatility and a lack of backing with such currencies. Thus, there is a seismic gap between the actual economic value and the perceived value of the cryptocurrencies. Therefore, there are two points of determination in the context of insolvency proceedings[39]: (i) The

[36] Harish Natarajan, Andres F. Martinez and Maksym Iavorskyi, 'Fear, uncertainty and doubt: Global regulatory challenges of crypto insolvencies' (*World Bank*, 23 February 2023) <https://blogs.worldbank.org/en/psd/fear-uncertainty-and-doubt-global-regulatory-challenges-crypto-insolvencies> accessed 11 October 2024.
[37] ByBit FinTech Limited v. Ho Kai Xin & Others [2023] 5 SLR 1748 [32].
[38] Fantom Foundation Ltd v. Multichain Foundation Ltd [2024] SGHC 173 [39].
[39] UK Jurisdiction Taskforce, 'Legal Statement on Digital Assets and English Insolvency Law' [98] (UKJT, 17 April 2024) <https://27221500.fs1.hubspotusercontent-eu1.net/hubfs/27221500/LawtechUK%20archive%20reports/UKJT%20Legal%20Statement%20on%20Digital%20Assets%20and%20English%20Insolvency%20Law.pdf> accessed 10 October 2024 (UK Taskforce).

time at which the valuation concerning crypto currency is to be made and (ii) how such valuation is to be made.

B. Timing of valuation

To answer the first issue, case laws point out two essential dates, relevant to the present context, on which the bankruptcy court could determine the asset value. These are (i) the date when the resolution professional brings the recovery action or (ii) the date of the bankruptcy petition.[40] The timing of valuation critically affects the value of crypto assets, particularly given their volatile nature and sensitivity to market sentiment. If valuation is determined on the date of the bankruptcy petition, it reflects the market value of the assets at the moment the proceedings are initiated. This approach provides a fixed reference point, safeguarding creditors from the unpredictable fluctuations that might occur later. However, the mere initiation of bankruptcy proceedings often erodes market confidence, leading to a depreciation in the value of crypto assets. As a result, petition-date valuation might preserve the higher, pre-collapse value of the assets before the adverse effects of the bankruptcy announcement fully materializes. On the other hand, if valuation is determined at the later date of the recovery action by the resolution professional, it reflects the market value closer to the time of realization. While this approach allows creditors to benefit from any potential market recovery, it also risks capturing the diminished value caused by prolonged proceedings and reduced market trust. Thus, petition-date valuation is often more advantageous in preventing creditors from being affected by the negative market sentiment triggered by the bankruptcy process itself, whereas recovery-action valuation aligns with the actual liquidation value but could reflect the fallout of the proceedings.

[40] *Re Falcon Prods Inc.,* [2024] US Bankruptcy Court NY.

These considerations highlight the importance of carefully choosing the timing of valuation to ensure equitable outcomes for all stakeholders.

Some literature holds that the timing depends upon how the particular jurisdiction sees the crypto assets, arguing that if the same is considered currency, then the valuation at the petition date is appropriate; however, if these are considered commodities, then the same is to be done at the date of recovery action.[41] However, with the exception of El Savador[42] and the Central African Republic[43], no country has granted the status of legal tender or currency to crypto coins. Thus, the crypto coins are treated like commodities across jurisdictions, with the International Monetary Fund also advising the member countries not to give crypto coins legal tender status.[44] Accordingly, therefore, since crypto coins are commodities, the valuation must be done at the date of recovery action.

C. Method of valuation

The second issue of valuation is not straightforward and has not been dealt with conclusively by the courts. The literature on it though has flagged the issue but has not engaged with the issue to suggest any particular procedure

[41] Joanne Molinaro and Susan Poll Klaessy, 'Bitcoin as a "Commodity" and the Resulting Impact on Bankruptcy Proceedings' (*American Bar Association*, 5 March 2019) <https://perma.cc/KW9E-9MAW> accessed 12 October 2024.

[42] Fernando Alvarez, David Argente and Diana Van Patten, 'Are cryptocurrencies currencies? Bitcoin as legal tender in El Salvador' (2023) 382 Science 6677, 2844.

[43] 'Central African Republic adopts bitcoin as an official currency' (*Reuters*, 28 April 2022) <https://www.reuters.com/world/africa/central-african-republic-adopts-bitcoin-an-official-currency-2022-04-27/> accessed 13 October 2024.

[44] International Monetary Fund, 'Elements of Effective Policies for Crypto Assets' (IMF Policy Paper, February 2023) <https://www.imf.org/en/Publications/Policy-Papers/Issues/2023/02/23/Elements-of-Effective-Policies-for-Crypto-Assets-530092?cid=pr-com-PPEA2023004> accessed 10 October 2024.

or methodology.[45] It is clear that the established asset valuation mechanisms, established through practice and solidified in international instruments are the (a) cost or asset approach, (b) income approach, or (c) market approach[46], which are not fit per se to account for the various peculiarities inherent in the crypto assets (as explained earlier in this part)[47], and as such, their principle-based approach must be adopted to tweak them to accommodate the advent of new technologies.

The authors analyse two methods of valuation of the crypto assets considered: (i) the KO Model (the transaction cost model) and (ii) the blockage method (gradual volume liquidation model), which also formed part of the discussion in the *FTX trading*[48] case.

D. KO Model

It is important to note that since the distribution to the creditors and investors is to be done in the native currency, the crypto currency will have to be traded in the market, leading to their increased liquidity and thus causing a huge fluctuation in the market. Against the backdrop of the idea that when a large position in an asset is being liquidated into the market, the price takes a huge dip. In such a scenario, the exercise of asset liquidation discounting is resorted to. The KO model takes majorly into account the downward pressure this liquidation may exert by calculating the "price impact cost" and the "bid-

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[45] UK Taskforce (n 39); Janis Sarra and Louise Gullifer, 'Crypto-Claimants and Bitcoin Bankruptcy: Challenges for Recognition and Realization' (2019) 28 Int'l Insolvency Rev. 233.

[46] International Valuation Standards Counsil, 'IVS 105: Valuation Approaches and Methods' <https://www.ivsc.org/wp-content/uploads/2021/10/IVS105ValuationApproaches.pdf> accessed 12 October 2024; International Financial Reporting Standards, '13 Fair Value Measurement' <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-13-fair-value-measurement/> accessed 11 October 2024.

[47] T Kostoula, 'Valuation of cryptoassets in EU insolvency: Challenges and prospects' (2023) 32 International Insolvency Review 8.

[48] *Re FTX Trading Ltd*. [2024]US Bankruptcy Court Delaware.

ask spread cost," which are together called the "transactional cost." This transactional cost is then assimilated through the discounting of the current prevailing pricing in the market to get the original price in the market as of the date of the petition.[49] Simply put, the KO model envisages adjustments to the valuation price of cryptocurrency to adjust the negative effect on their price owing to the sale of such assets in the market.

Therefore, in the event that the prevailing market price is not the correct parameter to value crypto assets, the KO model, better described as the 'discounting method', aims to restore the value of the assets by discounting various risk factors like the volatility or liquidity of the asset in the market.

E. Blockage method

The blockage method takes a distinct approach based on the underpinning idea that the liquidation of the holdings may be done without affecting the prices significantly in the market if the same is done gradually with the proper volume of assets per day. Thus, the blockage study includes the determination of the appropriate volume that would be appropriate to trade by comparing similar tokens in the market. This is later followed by the estimation of the value, after the gradual liquidation, with respect to the petition date by taking out the average of the values of discounting calculated by the Chaffe[50] and Finnerty[51] calculations.

The blockage method suffers from two significant deficiencies: (a) in case of bankruptcy against the debtor owning a huge amount of crypto assets,

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[49] Albert S. Kyle and Anna A. Obizhaeva, 'Market Microstructure Invariance: Empirical Hypotheses' (2016) 84 Econometrica 1345.
[50] David B. Chaffe, 'Option Pricing as a Proxy for Discount for Lack of Marketability in Private Company Valuations' (1993) 12 Business Valuation Review 182-88.
[51] John D. Finnerty, 'An Average-Strike Put Option Model of the Marketability Discount' (2012) 19 (4) The Journal of Derivatives 53-69.

a gradual offer of such assets in the market will significantly delay the liquidation of such assets and consequent recovery to the creditors and investors; and (b) by the very event of opening a bankruptcy proceeding against the debtor (crypto exchange), the value of cryptocurrencies will automatically decrease in the market, thus even a gradual sale of such assets in the market will not reflect the correct valuation of the assets. Therefore, the KO model may seem preferrable in the sense that it is less susceptible to market fluctuations and brings forth the true valuation of the crypto assets through robust mathematical and statistical analysis, which sets off any impact of the market fluctuations on the valuation so achieved.

It is suggested that the valuation of the assets be done taking into consideration the facts of the case at hand and the peculiar nature of the assets at issue, thereby a best-fitted valuation approach considering all the proposed models must be devised in each case. However, it is suggested that the simple solution to all these problems is to just stay away from going into all these intricacies of valuation and allow for an in-specie distribution of asset[52], i.e., the distribution be done not in the fiat native currency but rather in the same digital currency in which the claim lies. This shall save the court from non-precise calculations and also from the frustration of the restorative goals of any bankruptcy law that could occur in case of strong appreciation or depreciation of the value of the asset. However, this shall mandate a change of law in the domestic statutes, which prefer liquidation of assets in domestic currency (as also provided earlier in this part of the paper). The authors suggest that an exception on this line be deliberated that claim involving liquidation

[52] Alan Rosenberg & Ross Hartog, 'Creditor Considerations in Crypto Cases' (2024) 40 Emory Bankr Dev J 435.

of crypto assets be satisfied through in-specie distribution of these crypto assets themselves.

V. CONCLUSION

This paper contributes to the existing literature by analysing the treatment of crypto assets in bankruptcy proceedings and addresses the resultant issues related to their valuation. While much of the current scholarship focuses on the debate surrounding the inclusion of these assets in bankruptcy frameworks—which has been concluded in the affirmative across various jurisdictions[53]—this paper shifts the discourse towards the treatment of these crypto assets and the complexities of valuing crypto assets within these proceedings, thereby filling a critical gap in the literature.

In conclusion, this paper critically analyses the unique challenges posed by cryptocurrency exchanges in bankruptcy proceedings, particularly regarding the nature of claims by investors and the treatment of crypto assets. The paper has underscored that users' or traders' success in claiming segregation of their crypto assets in the event of a crypto exchange's bankruptcy hinges on the establishment of a trust-like relationship, while highlighting the divergent judicial perspectives that were categorised as the "segregation test" and the "intention test," with the authors predicting that the latter shall gain more recognition owing to it being premised upon common law principles. The authors have provided a practical guide to investors in choosing the appropriate crypto exchanges and deciding to opt-out of the reward program of the crypto exchanges offered against the deposit of their assets and how the choice shall have material bearing on the outcome of

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[53] n 4.

segregation claims and realisation of users' or traders' claims in the event of the crypto exchange's bankruptcy.

Additionally, the paper addresses the complexities of crypto asset valuation in bankruptcy by proposing alternative models, like the KO model and the blockage method, to account for the inherent volatility of cryptocurrencies. Ultimately, the authors advocate for a potential shift towards in-specie distribution of crypto assets to resolve valuation issues and better align with the objectives of bankruptcy law. The paper thus offers a comprehensive guide for navigating the evolving landscape of cryptocurrency insolvency.

II. SUPPORTING GUARANTEES AND CORPORATE INSOLVENCY: IBBI'S PROPOSED OVERHAUL AND A COMPARATIVE EXPLORATION OF GLOBAL INSOLVENCY PARADIGMS

Kim Korwani[*]

ABSTRACT

Imagine a boardroom disarray- executives scrambling as corporate giant teeters on the edge of insolvency. Among the chaos, personal guarantors-often key promoters or third parties-brace for the financial storm about to engulf them. India's Insolvency and Bankruptcy Code (IBC) has been a transformative force in corporate distress resolution, but its latest chapter addressing the liability of personal guarantors, has introduced a dramatic new twist. Recent rulings, such as the pivotal Lalit Kumar Jain case, coupled with regulatory protocols, have ignited a fierce debate: Should third-party guarantees be mandatorily enforced or should flexibility reign in insolvency proceedings?

This paper ventures into the labyrinth of guarantor liability, tracing its evolution from the Indian Contract Act 1872 to the IBC's current framework. It juxtaposes India's legal landscape with global perspectives, from the United States' flexible Chapter 11 to the UK and Singapore's approaches to balancing creditor recovery with corporate rehabilitation. As India contemplates amendments mandating the enforcement guarantees, questions loan over the potential for heightened litigation, delays, and unique challenges.

From a comparative perspective, strict enforcement can obstruct effective resolutions and undermine the overarching goals of the IBC. Instead, it champions a more adaptable framework that grants creditors greater discussion while protecting guarantors from excessive burdens. By weaving together international lessons and India's evolving legal context, this paper charts a path toward a balanced, resilient insolvency framework for the future.

Keywords: Personal guarantor liability, Third-party guarantees, Creditor Recovery, Comparative Insolvency frameworks.

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I. INTRODUCTION

SETTING THE STAGE: THIRD-PARTY GUARANTEES IN INSOLVENCY

The framework for insolvency law has seen significant change in recent decades, necessitated by the need to adapt to more intricate financial

structures and linkages. The transition is primarily driven by the adoption of laws concerning personal guarantors and third-party guarantees, which broaden the scope of obligation beyond the corporate debtor, so altering the legal framework of creditor-debtor relations.[1] In contemporary corporate finance, the function of personal guarantors has grown essential. A personal guarantor, often a promoter, director, or controlling shareholder, willingly accepts responsibility for the corporate debtor's obligations, thereby offering creditors an additional level of assurance.

The incorporation of personal guarantor clauses in bankruptcy law formalizes this connection, guaranteeing that guarantors are responsible for the financial commitments they have assumed.[2] This development signifies a substantial shift from the conventional debtor-centric paradigm of insolvency law, which largely emphasized the liquidation or reorganization of the corporate entity's assets. The legislation, under Section 60(2) holds personal guarantors accountable, ensuring that individuals with a vested interest in the corporate debtor's financial arrangements are responsible in the case of failure. This provision aligns the insolvency resolution process of the corporate debtor and the guarantor, streamlining accountability and enforcement.[3] Third-party guarantees include pledges of repayment to creditors from people or organizations outside the bankrupt corporation.[4] Such assurances often emerge in intricate commercial agreements where financial risk is distributed among several parties. When a corporate debtor goes

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[1] *Craise On Statue Law* (Goodman and Greenberg (eds), 7th edn 1999, Indian reprint,) 219.

[2] Y Honjo, A Ono and D Tsuruta, 'The Effect of Physical Collateral and Personal Guarantees on Business Startups.' (2022) *SSRN Electronic Journal* <https://doi.org/10.2139/ssrn.4292922 > accessed 8 October 2024.

[3] Insolvency Bankruptcy Code, s60.

[4] B Bulkat, 'What Happens to A Personal Guarantee in Bankruptcy: Learn How to Discharge A Personal Guarantee in Bankruptcy,' *ALLLAW* <http://www.allaw.com/articles/nolo/bankruptcy/personal-guarantee-bankruptcy.html > accessed 9 October 2024.

bankrupt, the presence of a third-party guarantor provides creditors with an alternative means of recovery, therefore reducing the risk of financial loss. The integration of third-party guarantees into insolvency law reflects an acknowledgment of the complex financial networks that support contemporary commerce and the necessity for legal frameworks capable of addressing the varied relationships inherent in corporate borrowing.

The ramifications of these laws are far more substantial and extensive for personal guarantors.[5] The expansion of obligation to personal assets elevates financial exposure, substantially amplifying the risks linked to offering guarantees. Personal guarantors must now contend with the potential for their private assets to be implicated in bankruptcy procedures, so obscuring the distinction between corporate and personal financial liability. By treating the liabilities of corporate entities and their guarantors as interconnected, the framework blurs traditional boundaries, challenging the separation of financial risks and increasing the stakes for personal guarantors. This transition significantly impacts corporate governance and personal financial planning, as people must meticulously assess the dangers of offering personal guarantees against the prospective benefits of their engagement with the corporate debtor.

Indian courts have regularly affirmed the legitimacy of actions filed against personal guarantors, confirming that their obligations remain intact notwithstanding the corporate debtor's bankruptcy.[6] This jurisprudence indicates an increasing acknowledgment that personal guarantors, having willingly accepted the debtor's financial responsibilities, must face the repercussions of failure. Such verdicts underscore the need for bankruptcy law

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[5] M Lockwood, 'When (and Why) Should You Sign a Personal Guarantee to Secure Financing?' *BPLANS,* <http://articles.bplans.com/personal-guarantees-to-securefinancing/> accessed 7 October 2024.

[6] State Bank of India v. V. Ramakrishnan & Anr. [(2018) 17 SCC 394].

to maintain a nuanced equilibrium between safeguarding creditor interests and ensuring that guarantors fulfil their legal obligations.

The implications of personal guarantor and third-party guarantee clauses are numerous and complex. They improve the effectiveness of the bankruptcy system by offering creditors more options for debt collection, therefore reducing the risk of financial loss.[7] This twofold consequence requires a reassessment of risk management techniques for creditors aiming to protect their interests and for guarantors who must now traverse a more complex legal environment.[8] The current legal framework, while offering certain safeguards to creditors has left room for ambiguity regarding the continued enforceability of guarantees, raising concerns about potential discrepancies in the interpretation of creditor rights. It arises from the lack of clear guidelines regarding the enforceability of personal guarantees within the insolvency process. While the IBC allows creditors to initiate actions against personal guarantors, it is unclear whether such guarantees can be enforced during the corporate debtor's resolution process or only after its conclusion. Additionally, the role of personal guarantors in the moratorium period and how their obligations interact with the corporate debtor's insolvency proceedings remains uncertain, leading to varying interpretations of creditor rights and the scope of recovery.

In response to the uncertainties, proposed amendments to the CIRP Regulations 2016 aim to provide much-needed clarity. Specifically, these amendments seek to reinforce creditors' rights to proceed against guarantors and enforce guarantees independently, even when the resolution plan reduces

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[7] M. A. Kamath, 'India: Personal Guarantors Now Subject To IBC: A Brief Overview of the Insolvency Resolution Process.' (2 December 2019) Delhi, India.

[8] *Mahapatra, d. (2021, May 22). Guarantors for loans liable unde IBC proceedings: SC. Times of India.*

the amounts recoverable from the corporate debtor.[9] By preserving the enforceability of guarantee agreements, these changes would significantly strengthen the recovery mechanism available to creditors, ensuring that personal guarantors remain liable for their obligations despite any reductions in the debtor's liabilities under the resolution plan.[10] This regulatory shift promises to enhance creditor protection while fostering greater accountability among guarantors within the insolvency framework.

This study highlights the complexities of personal guarantor clauses and third-party guarantees within the context of bankruptcy, offering a critical analysis of their origins, legal foundations and practical consequences. It explores the evolution of these laws and their impact on corporate finance, the dynamics between creditors and debtors and the core principles of bankruptcy law. This review seeks to clarify how personal and third-party guarantors have become integral to modern bankruptcy practice, providing a refined method for reconciling the interests of creditors, debtors, and guarantors. It will enhance the knowledge of the changing role of guarantors in contemporary insolvency frameworks, highlighting their significance in promoting a more just and efficient debt settlement system.

II. INDIA'S LEGAL LANDSCAPE: UNPACKING THE FRAMEWORK FOR GUARANTOR LIABILITY

A. Tracing guarantor liability from the Indian Contract Act 1872 to the Insolvency Bankruptcy Code 2016

From the Indian Contract Act of 1872 **(ICA)** to the revolutionary Indian Bankruptcy Code **(IBC)**, the development of guarantor responsibilities

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[9] Robert W. Stetson, 'Four Tips for Drafting Enforceable Personal Guarantees' *Bloomberg Law* (2 May 2014), <http://www.bna.com/four-tips-drafting-n_17179890142.> accessed 4 October 2024.

[10] Lawrence Gardner, 'Getting Personal: What If the Banker Needs a Loan Guarantee Beyond the Assets of the Business?' [1997] PRE 43.

in India is a remarkable legal adventure that traverses the country. The notion of suretyship, in which a guarantor takes on the responsibility of accounting for the debt or default of another individual, is at the core of the voyage.[11] This concept has been subjected to a dramatic reinterpretation over the course of many decades, and it has been transformed by both judicial reasoning and legislative change.

1. THE INDIAN CONTRACT ACT 1872: THE GENESIS OF GUARANTOR LIABILITY

The ICA delineates the legal framework governing suretyship within Sections 126 to 147.[12] Section 126 highlights the tripartite relationship between the creditor, debtor, and guarantor, while Section 128 establishes the principle of co-extensive liability, indicating that the guarantor's obligation mirrors that of the debtor unless explicitly specified otherwise.[13] This enables creditors to pursue repayment directly from the guarantor in the event of the debtor's default.

2. JUDICIAL INTERPRETATION OF GUARANTOR OBLIGATIONS IN THE PRE-IBC ERA

Indian courts have consistently upheld the interconnected nature of guarantor liability. Significantly, the Supreme Court determined creditors are entitled to pursue immediate action against guarantors without first depleting their options against the debtor.[14] In instances where the agreements between the debtor and the creditor are modified without the guarantor's approval,

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[11] Sam Thacker, 'Personal Guarantees Required in Small Business Loans' <http://www.allbusiness.com/technology/software-services-applications-markup/1 0753236-1. html> accessed 4 November 2014.

[12] Indian Contract Act 1872, s126.

[13] Indian Contract Act 1872, s128.

[14] ICICI Bank v. APS Star Industries Ltd. [(2010) 10 SCC 1].

judicial decisions as seen in *State Bank of India v. Ramakrishnan*[15] have established that such alterations absolve the guarantor of any liability. This judicial balancing act guarantees that guarantors fulfil their obligations while safeguarding them against unexpected alterations in the contract.

B. The Insolvency and Bankruptcy Code 2016: A Watershed in Guarantor Liability

The IBC has fundamentally transformed the dynamics between creditors and debtors, especially concerning guarantors. According to Section 60(2)[16], the NCLT possesses concurrent jurisdiction regarding insolvency proceedings for both the debtor and the guarantor, thereby facilitating the management of creditor claims. Section 14 of the IBC, which establishes a moratorium on proceedings against the debtor, clearly does not apply to guarantors, thereby permitting creditors to pursue or commence actions against guarantors during insolvency proceedings.[17] This guarantees that guarantors continue to bear responsibility even amidst the debtor's insolvency proceedings. However, this protection does not extend to personal guarantors. The liabilities of personal guarantors are treated as distinct and independent, allowing creditors to initiate or continue recovery proceedings against them even while the corporate debtor is undergoing insolvency resolution. This distinction ensures that the moratorium safeguards the corporate debtor's assets without restricting creditors' rights against guarantors.

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[15] ibid.
[16] Insolvency Bankruptcy Code 2016, s 60(2).
[17] Insolvency Bankruptcy Code 2016, s 14.

1. THE DOCTRINE OF CO-EXTENSIVE LIABILITY IN THE POST-IBC ERA

Within the context of the post-IBC framework, the liability of guarantors has been significantly strengthened.[18] The Supreme Court has consistently upheld this principle in various rulings, notably highlighting that a guarantor's liability is co-extensive and independent of the debtor's financial circumstances.[19] Personal guarantors continue to bear responsibility, irrespective of whether the debtor experiences restructuring or resolution, reinforcing their crucial role in the creditor-debtor relationship under the IBC.

Table 1: Examining Judicial Interpretations: An Empirical Analysis of Creditor Recovery in Guarantee Disputes

Case	Year	Types of Guarantees	Creditors Post-Resolution Plan	Judicial Interpretation of Creditor Rights	Rates for Creditors from Guarantors	Length of Litigation Process
BRS Ventures Investments Ltd. v. SREI Infrastructure Finance Ltd.	2024	Corporate Guarantee	Guarantor liability remains intact despite the debtor's resolution.	Co-extensive liability of guarantor and principal borrower	Partial recovery, as per the approved resolution plan	2 years
Puro Naturals JV v. Warana Sahakari Bank & Ors.	2023	Corporate Guarantee	Security interests and guarantees can be extinguished in resolution plan.	Guarantor liabilities extinguished as per creditor agreement.	Partial or no recovery based on the plan	2.5 years

[18] Nitin Chandrakant Naik v. Sanidhya Industries LLP (Company Appeal (AT) (Insolvency) No. 257 of 2020).

[19] Vijendra Kumar Jain, Resolution Professional of the Television Network Limited v. Sab Events & Governance Now Media Ltd.

Eldweiss ARC v. V Mahesh IRP, Vasan Healthcare	2023	Corporate Guarantee	Rejection of claim overturned guarantor held liable.	Establishment of a corporate guarantee is confirmed.	Moderate recovery allowed.	2 years
SVA Family Welfare Trust & Anr. v. Ujaas Energy Ltd.	2023	Personal Guarantee	Liability was addressed within resolution plan; some guarantees were relinquis hed.	Guarantors' liabilities may be varied within the resolution plan.	Partial recovery based on the agreed plan.	3 years
J.C Flowers Asset Reconstruction v. Deserve Exim	2023	Corporate Guarantee	Guarantor liable post-demand issuance, not before.	Default arises only upon demand by the creditor	Limited recovery, post-demand notice.	1.5 years
Lalit Kumar Jain v. Union of India & Ors.	2021	Personal Guarantee	Guarantors were held liable even after resolution plan approval	Approval of the resolution plan does not absolve guarantors of their liability.	Full recovery pursued by guarantors	3 years
State Bank of India v. V Ramakrishnan & Anr.	2018	Personal Guarantee	Section 14(3) IBC moratorium does not apply to guarantors.	Moratorium is not appliable to personal guarantors under IBC.	Full recovery from personal guarantors.	3 years
Economic Transport Organization v. Charan Spinning Mills	2010	Personal Guarantee	Subrogation rights of the guarantor recognized upon debt discharge	Doctrine of subrogation upheld, allowing guarantors to claim securities.	Full recovery due to subrogation rights	4 years

The table presents a thorough comparative examination of diverse judicial cases concerning personal, corporate, and bank guarantees in creditor recoveries post-resolution plans, focusing on key variables: a) type of guarantee, b) the outcome for creditors following resolution, c) judicial interpretation of creditor rights, d) recovery rates for creditors, and e) the duration of the litigation process.

The nature of the guarantee significantly influences the results for creditors. Personal guarantees, as illustrated in *Lalit Kumar Jain v. Union of India*[20] and *State Bank of India v. V. Ramakrishnan,*[21] invariably lead to enhanced recovery rates for creditors, with judicial bodies confirming that the endorsement of a resolution plan does not exempt guarantors from their obligations. Corporate guarantees demonstrate a notable variability in recovery rates, as illustrated in *BRS Ventures Investments Ltd. v. SREI Infrastructure Finance Ltd.,*[22] where only a partial recovery was realized, and in *Puro Naturals JV v. Warana Sahakari Bank & Ors.,*[23] where the liabilities of the guarantor were nullified following the creditor agreement.

The judicial interpretation of creditor rights has consistently upheld the principle of guarantor liability, albeit with variations that reflect the specific characteristics of the guarantee and the stipulations outlined in the resolution plan. In the case of *J.C. Flowers Asset Reconstruction v. Deserve Exim Pvt. Ltd.,*[24] the court elucidated that the liability of the guarantor is contingent upon a formal demand from the creditor, thereby influencing the temporal aspects of recovery. Comparably, the *Economic Transport Organisation v. Charan Spinning Mills*[25] case underscored the principle of subrogation, allowing guarantors to reclaim from securities following the discharge of debt, thereby facilitating complete recovery.

Recovery rates for creditors illustrate a notable pattern: personal guarantees generally, yield complete recovery, as evidenced by various cases,

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[20] Lalit Kumar Jain v. Union of India AIRONLINE 2021 SC 40.

[21] State Bank of India v. V. Ramakrishnan & Anr. AIR 2018 SCC 3876.

[22] BRS Ventures Investments Ltd. v. SREI Infrastructure Finance Ltd CIVIL APPEAL NO. 4565 OF 202.

[23] Puro Naturals JV v. Warana Sahakari Bank (Company Appeal (AT) (Insolvency) Nos.661-663 of 202.

[24] J.C. Flowers Asset Reconstruction v. Deserve Exim Pvt. Ltd. (NATIONAL COMPANY LAW APPELLATE TRIBUNAL) MANU/NL/0413/202.

[25] Economic Transport Organisation Delhi v M/S Charan Spinning Mills (P) Ltd.& Anr on 17 February, 2010 CIVIL APPEAL NO.5611 OF 199.

including *State Bank of India v. V. Ramakrishnan*, whereas corporate guarantees frequently culminate in partial or restricted recovery, as observed in *Edelweiss ARC v. V Mahesh IRP, Vasan Healthcare*.[26]

Ultimately, the duration of legal proceedings is contingent upon the nature of the guarantee and the intricacies involved in the case. Cases involving personal guarantees typically have a prolonged duration, averaging between 2 to 4 years, as evidenced in the instances of *Lalit Kumar Jain* and the *Economic Transport Organisation*. Cases involving corporate guarantees tend to resolve in a relatively swift manner, generally within 1.5 to 2.5 years, as evidenced by *J.C. Flowers Asset Reconstruction* and *Puro Naturals JV*. Due to their direct nature and judicial clarity, personal guarantees yield more stable and advantageous results for creditors. Creditors can independently pursue personal guarantors, as their liabilities are co-extensive with the debtor's, ensuring predictable recovery paths. In contrast, corporate guarantees depend heavily on the specifics of resolution plans, which may restructure or extinguish the guarantor's liability, leading to variable outcomes. Additionally, personal guarantor's private assets are more accessible, whereas corporate guarantees often involve interdependent liabilities tied to the debtor's insolvency process, making recoveries less certain and subject to judicial interpretation.

C. IBBI's Proposed 2024 Amendments to the CIRP Regulations: Clarifying the Treatment of Guarantor Liability in Insolvency Resolution

The Insolvency and Bankruptcy Board of India **(IBBI)** released a discussion paper on June 19, 2024, outlining significant amendments to the

[26] Edelweiss ARC v. V Mahesh IRP, Vasan Healthcare Company Appeal (AT) (CH) (INS) No. 226 of 2021.

Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 **(CIRP Regulations)**. The purpose of these amendments is to elucidate the handling of guarantees and guarantors within corporate insolvency resolution plans, with a particular emphasis on the rights of creditors to enforce guarantees against both personal and corporate guarantors. This proposal arises in light of divergent judicial interpretations regarding the matter, highlighting the need for regulatory clarification to achieve coherence within the insolvency framework.

1. Analysis of the Suggested Revision to the CIRP Regulations

The proposed amendment by the IBBI focuses on Regulation 37(f) of the CIRP Regulations, detailing the content and structure required for resolution plans submitted by resolution applicants.[27] The amendment incorporates a stipulation that forbids a resolution plan from obstructing creditors in their pursuit of rights against the guarantors of the corporate debtor. Essentially, it prohibits resolution applicants from incorporating provisions in their plans that would eliminate the liability of guarantors, thus preserving the interconnected nature of guarantor obligations.

2. Legal Framework and Historical Context

The proposal put forth by the IBBI arises from the necessity to address the ambiguities engendered by the disparate rulings issued by the NCLT, the National Company Law Appellate Tribunal **(NCLAT)**, and the Supreme Court.

[27] Insolvency And Bankruptcy Board Of India, '(Insolvency Resolution Process For Corporate Persons) Regulations, 2016' (2016) <https://ibbi.gov.in/webadmin/pdf/legalframwork/2018/Apr/word%20copy%20updated%20upto%2001.04.2018%20CIRP%20Regulations%202018_2018-04-11%2016:12:10.pdf> accessed 10 October 2024.

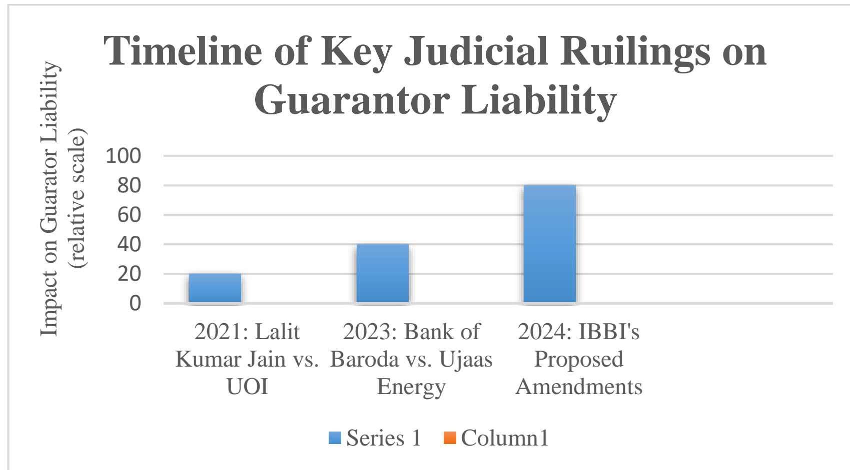
In the matter of *SVA Family Welfare Trust & Anr. v. Ujaas Energy Ltd & Ors,*[28] the NCLAT overturned a decision made by the NCLT's Indore Bench, which had dismissed a resolution plan on the basis that it included provisions for the extinguishment of guarantor obligations. The NCLAT affirmed the legitimacy of the resolution plan, determining that the extinguishment of the guarantor's liability may be permissible. The Supreme Court later upheld this ruling in *Bank of Baroda v. Ujaas Energy Limited & Ors.*[29], establishing a precedent that the elimination of guarantees within resolution plans is legally permissible.

Nevertheless, this stance diverges from a prior Supreme Court decision in *Lalit Kumar Jain v. Union of India*, wherein the Court determined that the endorsement of a resolution plan for a corporate debtor does not inherently absolve the guarantors of their responsibilities. In this instance, the Court reiterated the principle that guarantors continue to bear responsibility for the obligations of the corporate debtor, notwithstanding the approval of the debtor's resolution plan.

There is a lack of clarity about the processing of guarantees within bankruptcy procedures due to the discrepancy among these decisions, which has led to various interpretations being offered by different tribunals. As a result of the misunderstanding that ensued, the IBBI proposed a regulation modification to provide specific advice on the enforcement of guarantees, bringing the approach into alignment across a variety of circumstances. The amendment aims to establish a consistent framework, thereby facilitating a harmonious approach among courts and tribunals, which would diminish the potential for conflicting judgements that have, in the past, resulted in

[28] Sva Family Welfare Trust & Anr v. Ujaas Energy Limited and Ors Company Appeal (AT) (Insolvency) No. 266 of 2023.
[29] Bank of Baroda v. Ujaas Energy Limited & Ors, CA No. 6602 of 2023.

considerable confusion. This holds particular significance in instances where guarantors contend for the release of their obligations subsequent to the endorsement of a resolution plan for the primary debtor.



The timeline above outlines significant court decisions that have influenced guarantor liability in India. The first decision, *Lalit Kumar Jain v. Union of India* (2021), confirmed the autonomy of guarantor liability. The second case, *Bank of Baroda v. Ujaas Energy* (2023), permitted the extinguishment of guarantees under specific resolution plans. The goal of the 2024 IBBI revisions is to strengthen creditors' ability to enforce guarantees independent of resolution plans by standardizing and defining the handling of guarantors.

3. Examination of the Suggested Modification

The suggested modification to Regulation 37(f) signifies an important transition in safeguarding the rights of creditors during the insolvency resolution process.[30] The proposed amendment reinforces the principle of guarantor liability as codified under Section 128 of the Indian Contract Act

[30] Ananya Rao, 'Resolving Inconsistencies in Insolvency: The Role of Regulatory Clarity' (2023) Insolvency Review <https://www.insolvencyreview.com/articles/resolving-inconsistencies-in-insolvency > accessed 20 September 2024.

1872, which establishes that a guarantor's obligations are co-extensive with those of the principal debtor. By explicitly affirming that resolution plans cannot absolve guarantors of their commitments, the amendment ensures that creditors retain the right to enforce guarantees irrespective of the outcome of the debtor's insolvency resolution. This approach not only secures an additional layer of recovery for creditors in cases where the corporate debtor is unable to fulfill its obligations but also addresses inconsistencies in judicial interpretations regarding the enforceability of guarantees.

4. Harmonizing the Interests of Stakeholders

The proposed amendment, while designed to safeguard the rights of creditors, also carries significant ramifications for the equilibrium of interests among creditors, guarantors, and resolution applicants.[31] The restriction on nullifying guarantor liability may be perceived as placing a considerable obligation on guarantors, who could find themselves accountable for the full debt even after the debtor's insolvency restructuring. This may be viewed as positioning guarantors unfavourably, particularly in instances where the debtor's responsibilities are considerably diminished or reorganized within the framework of the resolution plan. Guarantors play a crucial role in the dynamics of the creditor-debtor relationship, as their liability offers creditors essential confidence in the likelihood of repayment. The amendment consequently guarantees that creditors retain this essential protection.

5. Promoting Uniformity and Minimising Legal Disputes

The amendment seeks to rectify the discrepancies in judicial opinions, thereby enhancing legal certainty. This amendment's clarity is poised to diminish disputes regarding the enforceability of guarantees within insolvency

[31] Sharma, 'The Evolution of Insolvency Law in India' (Oxford University Press 2024) 78.

resolution, thereby promoting more efficient resolution proceedings.[32] Both creditors and resolution applicants will possess a more defined understanding of the parameters and constraints of the resolution plan, thereby diminishing the chances of extended legal disputes.

6. Wider Consequences of the Amendment

The proposed amendment introduces a potential challenge for guarantors, as they could remain liable for substantial debts even after the debtor's restructuring.[33] This additional burden might discourage both individuals and corporations from offering guarantees, potentially affecting lending practices and limiting access to credit. The balance between safeguarding creditor rights and ensuring fair treatment of guarantors poses a significant test for judicial interpretation as the regulation comes into force.

Nevertheless, the amendment provides a crucial clarification in the context of guarantor liabilities within the insolvency resolution process, addressing inconsistencies in previous judicial interpretations. By affirming that resolution plans cannot nullify guarantors' obligations, it reinforces the interconnectedness of guarantor liabilities and corporate insolvency. This step enhances the enforceability of guarantees, protecting creditors while ensuring the foundational role of guarantors in the financial ecosystem.

[32] Amitabh Kyotesev, 'Contemporary Reforms in Insolvency Law: An Analytical Approach to the Evolving Landscape of Creditors' Rights and Corporate Guarantees' (Oxford University Press 2023) 10.
[33] Neha Bansal, 'Navigating the Complexities of Insolvency and Bankruptcy: A Critical Examination of Creditor Protections in India' (Cambridge University Press 2024) 76.

III. GLOBAL PLAYBOOK: COMPARATIVE PERSPECTIVES ON THIRD-PARTY GUARANTEES

A. Guarantor Liability and Subrogation Rights in the United States under Chapter 11 Bankruptcy

In the United States, the Chapter 11 provisions of the Bankruptcy Code present a methodical approach to corporate restructuring, establishing a framework that thoughtfully weighs the interests of debtors, creditors, and guarantors.[34] It facilitates the reorganization of debts for companies facing financial distress, enabling them to maintain operations with the primary objective of rehabilitation instead of liquidation.

According to Chapter 11, guarantees typically retain enforceability unless explicitly altered in the reorganization plan. The Bankruptcy Code allows the debtor to engage in the renegotiation or restructuring of its obligations, potentially encompassing third-party guarantees. In specific instances, an approved reorganization plan may encompass clauses that facilitate the discharge of guarantors from their obligations, especially when such discharges are essential for the debtor's effective recovery.[35] Nonetheless, these releases generally require the consent of creditors and may lead to disputes, as they significantly affect the creditors' capacity to reclaim the sums owed by guarantors.

It is essential to recognize that creditors maintain the authority to seek recourse from guarantors without being contingent upon the debtor's reorganization process. Should a guarantor fulfil the debt obligation for the debtor, the principle of subrogation permits the guarantor to assume the position of the creditor and pursue reimbursement from the debtor. The

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[34] United States Bankruptcy Code, Chapter 11.

[35] Mark A. McNeilly, 'The Impact of Chapter 11 on Personal Guarantees' (2020) 45(2) *American Bankruptcy Law Journal* 239-261.

principles of this doctrine were further solidified in the case of *Stearns v. United States*[36], which established that a guarantor who fulfils the debt obligation is entitled to the rights of the creditor against the principal debtor. Subrogation guarantees that guarantors retain avenues for recourse after meeting their obligations, offering a protective measure that recognizes their equitable rights.

The U.S. Chapter 11 framework provides significant insights for India regarding the management of guarantor liability within the context of corporate insolvency proceedings. The capacity to renegotiate or eliminate guarantees, along with the safeguarding of subrogation rights, as illustrated in cases such as *Stearns v. United States*, establishes a sophisticated framework that harmonizes the interests of creditors, protections for guarantors, and relief for debtors. As India advances its insolvency framework, it may benefit from this methodology to establish a fairer system that safeguards the interests of all parties involved, thereby enhancing the effectiveness and resilience of the insolvency resolution process.

B. The Role of Guarantors in Corporate Rescues: Navigating UK Insolvency Law

The legal framework that delineates guarantor obligations within the realm of corporate insolvency in the United Kingdom is principally articulated in the Insolvency Act 1986.[37] The legislation establishes a thorough framework for addressing third-party guarantees within the context of insolvency proceedings, to achieve an equilibrium between the recovery of creditors and the rehabilitation of debtors. The primary concern pertains to the

[36] Stearns v. United States, 291 U.S. 54 (1934).
[37] Insolvency Act 1986 (UK) (c45).

degree of liability that a guarantor retains once the obligations of the principal debtor have been fulfilled via insolvency proceedings.

One of the fundamental tenets of UK insolvency law is that the legal discharge of the principal debtor does not inherently absolve the guarantor of their obligations. The principle was reiterated in the case of *In re Fitzgeorge Ex parte Robson,*[38] wherein the court determined that a guarantor's liability endures despite the discharge of the principal debtor. This ruling, underscores the perpetual nature of the guarantor's responsibilities, highlighting that creditors maintain the authority to seek recourse from guarantors for any outstanding debts, irrespective of the debtor's discharge from insolvency.

The handling of guarantor liabilities within the framework of UK insolvency law is elucidated in the 1976 study conducted by the Commission of the European Communities, titled "*The Law of Suretyship and Indemnity in the United Kingdom of Great Britain and Northern Ireland and Ireland*."[39] The research offers a comprehensive examination of the legal doctrines that regulate suretyship and indemnity contracts. This emphasizes that a contract of guarantee essentially constitutes a commitment by the guarantor to assume responsibility for the principal debtor's obligations to the creditor.

The insolvency law in the UK establishes a distinct separation between the responsibilities of the principal debtor and those of the guarantor, thereby ensuring that the obligations of the guarantor are not automatically nullified by the insolvency of the debtor. The legal framework safeguards the interests of creditors by allowing them to pursue repayment from guarantors, even in instances where the principal debtor has been absolved of their financial obligations. Concurrently, it facilitates corporate recovery by enabling debtors

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[38] In re Fitzgeorge Ex parte Robson, [1905] 1 K.B. 462.

[39] Commission of the European Communities, 'The Law of Suretyship and Indemnity in the United Kingdom of Great Britain and Northern Ireland and Ireland' (1976).

to reorganize their obligations under judicial oversight, while safeguarding the rights of guarantors to pursue reimbursement or subrogation after they have satisfied the commitments.

The United Kingdom's methodology regarding guarantor responsibilities in the realm of insolvency provides significant insights into the development of India's emerging insolvency framework. The focus on preserving guarantor liability, exemplified in *In re Fitzgeorge*, presents a framework that harmonizes the concerns of creditors with the potential for corporate recovery. Through an examination of the UK's legal framework regarding suretyship and indemnity, India has the opportunity to cultivate a more sophisticated methodology for addressing third-party guarantees, thereby ensuring that guarantors are held responsible while simultaneously fostering the effective rehabilitation of debtors.

C. Singapore's Approach to Guarantees and the Insolvency Restructuring Framework

The legal framework in Singapore that regulates guarantees in bankruptcy and restructuring is mostly outlined in the Bankruptcy, Restructuring, and Dissolution Act **(IRDA).**[40] This extensive legislation, implemented to optimize bankruptcy processes and reconcile the interests of debtors, creditors, and guarantors, demonstrates Singapore's dedication to cultivating a business-friendly atmosphere while maintaining robust creditor safeguards. A significant case in Singapore that illustrates the implementation of subrogation rights concerning guarantees is *United Overseas Bank Ltd v. Lippo Marina Collection Pte Ltd.*[41] The Singapore Court of Appeal determined that a guarantor who discharges the debt of the primary debtor is

[40] Insolvency, Restructuring and Dissolution Act 2018 (Singapore).
[41] United Overseas Bank Ltd v. Lippo Marina Collection Pte Ltd [2019] SGHC 23.

entitled to subrogation rights. This theory permits the guarantor to assume the creditor's position, thus inheriting the rights to collect the debt from the primary debtor. The verdict confirms the equitable character of subrogation, ensuring that guarantors are not left at a disadvantage after meeting their responsibilities and upholding the notion that they should be able to reclaim their contributions from the debtor.

Under Singapore's IRDA, the legal position on guarantees is consistent with the overarching objective of reconciling company rehabilitation with creditor recovery.[42] The Act permits restructuring procedures that may amend or eliminate specific commitments; nonetheless, promises typically remain enforceable until explicitly modified in a restructuring plan.[43] This method guarantees that creditors may continue to seek repayment from guarantors for unpaid obligations, regardless of whether the principal debtor has completed restructuring. Furthermore, after the guarantor has settled the obligation, the right of subrogation ensures their ability to pursue reimbursement from the debtor. Singapore's bankruptcy regime offers a systematic equilibrium between facilitating company recovery and safeguarding the interests of guarantors and creditors.

Table 2: Drawing Parallels: A Cross-Jurisdictional Comparative Snapshot

Aspect	**United Kingdom**	**United States**	**Singapore**	**India**
Legal Framework	Insolvency Act 1986	Bankruptcy Code, Chapter 11	Insolvency, Restructuring, and Dissolution Act **(IRDA)**	Insolvency and Bankruptcy Code 2016

[42] Insolvency, Restructuring and Dissolution Act 2018 (Singapore) ss 25-26.
[43] Insolvency, Restructuring and Dissolution Act 2018 (Singapore) s 2.

Guarantor Liability	Guarantor remains liable-post discharge	The guarantor remains liable unless modified.	Guarantor remains liable; subrogation rights upheld	Guarantor remains liable.
Subrogation Rights	Confirmed; guarantor can seek reimbursement	Confirmed; guarantor can pursue debtor after payment.	Confirmed; guarantor can seek reimbursement	Recognized, but varies based on case specifics.
Creditor Rights	Can pursue guarantors despite debtor's discharge	Can pursue guarantors independently.	Can pursue guarantors even during debtor's restructuring	Can pursue guarantors; rights recognized.
Debtor's Rehabilitation	Focus on corporate recovery	Focus on corporate recovery	Focus on corporate recovery	Focus on corporate recovery
Judicial Oversight	Courts mediate disputes	Courts oversee reorganization	Courts oversee restructuring	NCLT oversees proceedings.

In corporate insolvency, the treatment of guarantees plays a pivotal role in balancing guarantor obligations, debtor rehabilitation, and creditor rights. This analysis examines the approaches adopted by the United Kingdom, the United States, Singapore and India in enforcing guarantees within their insolvency frameworks. Insights from these jurisdictions highlight both commonalities and differences, offering valuable lessons for India as it refines its insolvency regime.

1. COMMUNALITIES

i. Enduring Guarantor Liability: Across all four jurisdictions, guarantors remain obligated even after the discharge of the principal debtor. This ensures that creditors can pursue unpaid debts, preserving their rights to recovery. Additionally, the principle of subrogation, enabling guarantors to

recover payments made on behalf of debtors, is universally recognized as safeguarding their financial interests post-payment.

ii. Focus on Corporate Recovery: All jurisdictions prioritize corporate recovery by establishing frameworks to facilitate debt restructuring for distressed entities, underscoring the collective emphasis on economic stability and creditor repayment.

2. DIFFERENCES

i. Flexibility in Guarantee Renegotiation: The U.S. insolvency framework, particularly under Chapter 11, offers greater flexibility in renegotiating or terminating guarantees during restructuring. In contrast, the UK and Singapore adhere more strictly to existing guarantee obligations unless explicitly altered in restructuring plans.

ii. Judicial Role in Dispute Resolution: The U.S. judiciary tends to adopt a flexible approach, actively mediating disputes and shaping outcomes during insolvency proceedings. However, courts in the UK and Singapore emphasize adherence to statutory guidelines and legal precedents, reflecting a more restrained approach.

iii. Variances in Subrogation Implementation: While subrogation rights are universally acknowledged, their application varies significantly. In India, the enforcement of these rights often depends on case specific interpretations, reflecting a less standardized approach compared to the consistency observed in the other jurisdictions.

This comparative analysis underscores the need for India to address its unique challenges while incorporating best practices from international insolvency systems. Strengthening clarity around guarantee enforcement and subrogation rights can enhance creditor confidence and align the Indian framework with global standards.

i. **Insights for India:** The comparative analyses from these jurisdictions provide numerous enlightening lessons for India as they enhance, its insolvency framework: India stands to gain from more precise regulations concerning the enforcement of guarantees and the distinct rights afforded to guarantors. This level of clarity would significantly improve the predictability for all stakeholders engaged in insolvency proceedings.

ii. **Striking a Harmonious Balance**: Embracing a more adaptable strategy, similar to that of the United States, may allow India to facilitate the renegotiation of guarantees while ensuring that accountability for guarantors remains intact. This adaptability would cultivate a setting favourable to organizational rejuvenation. By fortifying subrogation rights, India can safeguard guarantors who intervene to meet debtor obligations, thus fostering equity in the insolvency process and protecting the interests of those who assist distressed entities.

IV. BALANCING THE SCALES: CREDITOR RIGHTS V. INSOLVENCY EFFICIENCY

A. Equilibrium of Interests: The Rights of Creditors Concerning the Efficiency of Insolvency

Insolvency frameworks worldwide endeavour to harmonize creditor recovery with the effective resolution of distressed assets, and this intricate equilibrium frequently depends on the treatment of guarantors and their associated obligations. IBC, especially in light of its developing jurisprudence regarding personal and corporate guarantees, underscores the intricate balance between the rights of creditors and the fundamental objectives of insolvency law, which include the revitalization of distressed enterprises and the fair treatment of all stakeholders involved.

B. *Dual Avenues for Rehabilitation: Sureties and Corporate Obligors*

Creditors typically have two concurrent avenues for recovery: targeting corporate debtors and enforcing claims against guarantors. The mechanisms of personal and corporate guarantees within the IBC afford creditors enhanced security, guaranteeing access to secondary assets in the event of a default by the primary debtor. Nonetheless, one must consider whether these dual recovery paths compromise the integrity of the insolvency resolution process.

Within the framework of the IBC, the resolution plan for a corporate debtor frequently encompasses stipulations regarding creditor recovery from guarantors. The decision in *Lalit Kumar Jain v. Union of India* underscored the continued liability of guarantors following the endorsement of a resolution plan, thereby affirming that the rights of creditors concerning guarantors are inherently aligned with their rights against the principal borrower. This duality enables creditors to enhance recovery rates by leveraging various sources. Nonetheless, it prompts apprehensions regarding the pressure it exerts on guarantors, potentially overwhelming individuals and entities already associated with the financially troubled borrower.

Strict regulations regarding the implementation of guarantees may, in certain instances, hinder the adaptability required for successful insolvency resolutions. Strict enforcement of guarantor liabilities, devoid of any possibility for negotiation, could potentially dissuade guarantors from engaging in the resolution process, thereby obstructing consensual restructuring initiatives.

Striking a balance between the rights of creditors and the efficiency of insolvency necessitates a meticulous evaluation of the functions of guarantors and corporate debtors within the insolvency structure. Although creditors should be given the chance to reclaim their dues, an inflexible application of

guarantees may hinder the fundamental objectives of the IBC facilitating effective resolution and the rejuvenation of distressed enterprises.

V. CONCLUSION

The relationship between third-party guarantees and insolvency law in India, particularly under the IBC, underscores a critical need for a balanced approach to protect creditors while maintaining fairness to guarantors and facilitating effective debtor rehabilitation. The IBC's transformative provisions on guarantor liabilities, which are rooted in the principle of co-extensive liability under the Indian Contract Act 1872, have strengthened creditor recovery mechanisms. However, ambiguities surrounding subrogation rights and inconsistent judicial interpretations have created challenges, necessitating a nuanced, more predictable legal framework.

Recent reforms proposed by the IBBI, which mandate the enforcement of guarantees even post-corporate resolution, significantly enhance creditor recovery mechanisms. These proposals strengthen creditor confidence and enforceability by ensuring that guarantor liabilities remain unaffected by the resolution of principal debtor obligations. However, they also raise critical concerns regarding their broader implications, including the potential escalation of litigation, procedural inefficiencies, and limitations on commercial adaptability. These complexities necessitate a delicate balancing act to uphold creditor rights while addressing procedural justice and economic efficiency issues.

Global Insolvency frameworks offer invaluable lessons for India as it refines its insolvency regime to meet the demands of a dynamic and complex economic environment. The Chapter 11 framework in the United States showcases a dynamic and debtor-focused approach, enabling renegotiation or termination of guarantees as a pivotal element of corporate restructuring. In

contrast, The United Kingdom enforces a more rigid approach, ensuring steadfast creditor protections unless explicit modifications to guarantees are embedded in restructuring plans. Singapore with its insolvency, Restructuring and Dissolution Act adopts a sophisticated integrative model that balances procedural precision with judicial oversight, harmonizing creditor recoveries with debtor rehabilitation and guarantor protections. In unison, these jurisdictions demonstrate the imperative of striking a delicate balance among creditor recoveries, financial responsibility, and corporate rehabilitation to cultivate a sustainable insolvency ecosystem.

India's path forward lies in drawing from these international paradigms while tailoring its insolvency framework to its unique socio-economic and legal milieu. Addressing ambiguities in subrogation rights through statutory clarification and harmonized judicial interpretation is paramount to reducing litigation and fostering legal certainty. Additionally, embedding provisions for equitable renegotiation of guarantor liabilities would not only enhance procedural fairness but also promote adaptability in insolvency proceedings. The creation of streamlined dispute resolution mechanisms, alongside fostering collaboration between creditors and guarantors could significantly bolster recovery outcomes while safeguarding credit accessibility and fostering economic stability.

III. REIMAGINING THE IBC: PRIORITIZING ENVIRONMENTAL CLAIMS IN INDIA'S CORPORATE INSOLVENCY AND BANKRUPTCY FRAMEWORK

Souhardya Roy and Vishal Myneni [*]

ABSTRACT

The Insolvency and Bankruptcy Code, 2016 ("IBC") has an insidious effect on corporate environmental liability. The IBC was created to streamline insolvency resolution for financially distressed companies, and this has led to the claims of a creditor being prioritized over environmental claims, which are classified as contingent claims and receive negligible compensation during insolvency resolution proceedings. This raises concerns about the application of the "polluter pays" principle as propounded by the Supreme Court of India on several occasions. The waterfall mechanism in Section 53 of the IBC prioritises financial creditors' claims over environmental claims, which creates a caveat for corporations to avoid environmental responsibility. This threatens the sanctity of Article 21 rights, which mandates the right to a clean environment. Also, IBC's non-obstante clause in Section 238 has been interpreted to circumvent environmental liabilities. In the present framework, corporate interests supersede public rights. Adopting a "green" approach is necessary to revitalise the IBC. This involves prioritising environmental claims over categories in the waterfall mechanism in favour of public interest. Furthermore, excluding environmental ligitation from the moratorium period is also advisable while enhancing the obligations of the adjudicating authority and the resolution professional to prioritise environmental claims. All these measures will act as contributing factors to bring about an insolvency framework that is compliant with the environmental, social, and governance framework while adhering to the Equator Principles. Hence, ensuring corporate accountability within a harmonious insolvency framework that mandates the preservation of public interest is a necessity.

Keywords: Green Insolvency, CIRP, Environemental Claims, Waterfall Mechanism, Moratorium Period

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I. INTRODUCTION

The Insolvency and Bankruptcy Code (IBC) of 2016 ("**IBC**") marked a transformative moment in Indian economic legislation, providing a unified and streamlined approach to insolvency resolution for corporations, partnerships, and individuals.[1] The Code established a creditor-in-control model, allowing creditors to direct the insolvency process and enhance recovery rates for financial institutions. The IBC has also helped alleviate the significant backlog of cases stuck in the judicial system.[2] The establishment of the Insolvency and Bankruptcy Board of India ("**IBBI**") enhanced the framework by offering oversight to professionals and entities involved in

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[1] Insolvency and Bankruptcy Code, 2016 (India).
[2] Kumar R and Sekhri DG, 'IBC: Evolving Role in Improving Investment Climate in India', *Insolvency and Bankruptcy Regime in India A Narrative* (Insolvency & Bankruptcy Board of India 2020).

insolvency proceedings.[3] The Resolution Professional ("**RP**") also assumes a vital administrative function during the Corporate Insolvency Resolution Process ("**CIRP**").[4] Also, the IBC has significantly benefited the commercial sphere, particularly by offering financially distressed companies a "fresh start". However, it has also raised significant concerns regarding corporate environmental liabilities. The current rules of the IBC clearly indicate that its primary emphasis is on the debt restructuring procedure with the involvement of creditors, and throughout the entire process, there is no obligation for the RP or any other entity to adhere to Environmental, Social & Governance principles ("**ESG**") which is a framework for a more holistic view of sustainability.[5] The NCLT has no obligation to adhere to ESG principles while authorising a resolution plan. This indicates a discrepancy in the communitarianism approach it aims to adopt and is a predominantly creditor-centric approach. This prioritisation of creditor claims by the IBC has led to environmental claims being categorised as contingent claims, which has led to the marginalisation of penalties levied by regulators for environmental degradation, and this has led to companies evading their liability for the same.

The "polluter pays" principle ("**PPP**") asserts that those responsible for environmental damage must bear the costs of remediation. The Supreme Court ("**SC**") has upheld this principle in numerous cases, recognising the absolute liability of polluters. Despite this strong environmental jurisprudence, the IBC's framework often allows companies to escape these

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[3] Insolvency and Bankruptcy Code 2016 s 188.
[4] Insolvency & Bankruptcy Board of India, 'Frequently Asked Questions on CIRP' https://www.ibbi.gov.in/uploads/faqs/CIRPFAQs%20Final2408.pdf accessed 15 October 2024.
[5] Tuula Linna, 'Business Sustainability and Insolvency Proceedings - The EU Perspective' (2020) 2(2) Journal of Sustainability Research https://helda.helsinki.fi/server/api/core/bitstreams/d7f1c341-07d8-4df2-9360-057bc5bda66d/content accessed 18 October 2024.

liabilities when they undergo insolvency. A growing discourse surrounding "green insolvency" advocates for reforms to the IBC to address this imbalance between financial and environmental interests. Part II of this paper aims to study this discourse while understanding how different aspects of the IBC interplay with the prevalent environmental jurisprudence in India. This moves into how environmental claims may be defined in the context of the insolvency framework in India, as there is no existing definition across legislation. This is discussed in part III, along with a proposal as to how environmental claims should be defined in the context of the IBC.

A case is made in part IV to point out the flaws in the present insolvency framework in India, which calls for a re-imagination of the same through the lens of environmental jurisprudence while underlining how the present interpretation of this interplay by the judiciary is causing significant harm to the principles of sustainability, by undermining public interest in favour of corporate interests. A further study of the same is done in part V by highlighting the application of section 238 of the IBC, which is the non-obstante clause, and cements the supremacy of the IBC over any conflicting legislation, which has over-arching implications on environmental action and compliance. Thereafter, a thorough analysis of international jurisprudence is done in part VI to understand how these present issues may be resolved. This provides a comprehensive framework for putting up viable solutions, which are proposed in part VII. These solutions include proposing excluding environmental claims from the moratorium period and, *in arguendo*, elevating these claims to a higher position within the waterfall mechanism, followed by enhancing the obligations on the RP while formulating a resolution plan and the adjudicating authority ("**AA**") while sanctioning such a resolution plan. These proposals, although not exhaustive, make a compelling case for reforming the IBC to make it compliant with the existing ESG principles

enshrined in the Equator Principles. Part VIII puts forth concluding remarks and summarises the entire paper.

II. IBC AND THE ENVIRONMENT

The IBC is aimed at consolidating and revising the laws governing the insolvency resolution process for corporations, partnerships, and individuals within a specified timeframe.[6] Prior to the IBC, India's insolvency legislation was disjointed and ineffective, resulting in extended legal disputes and protracted resolution of financial distress. The IBC had a favourable and almost immediate effect on India's Ease of Doing Business ("**EoDB**") ranking.[7]

The principal reason for this is the stringent timeline for resolution, mandating that the corporate insolvency resolution process, or CIRP, has to be completed within 180 to 270 days, thereby enhancing system efficiency and bolstering investor confidence.[8] The RP largely plays an administrative role. It is the RP's role to manage the affairs of the corporate debtor as a going concern during the insolvency resolution process, appoint and convene meetings of the Committee of Creditors ("**CoC**"), and, in general, administer the CIRP.[9] Thus, the RP serves as a facilitator of the resolution process, with their administrative functions supervised by the committee of creditors and the AA.[10] During this period, the RP possesses the authority to impose a moratorium period, which prohibits the initiation of lawsuits or the continuation of ongoing litigation.[11] This essentially gives the RP the power

[6] Insolvency and Bankruptcy Code 2016 (n1).
[7] Kumar R and Sekhri DG (n2).
[8] s12, Insolvency and Bankruptcy Code 2016 (n 1).
[9] Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta and Ors. (2020) 8 SCC 531 (India), [48].
[10] Mahender Pal Arora and Vikalp Shrivastava, 'Pivotal Role of Resolution Professional in CIRP under IBC' (2023) 11(3) Russian Law Journal https://russianlawjournal.org/index.php/journal/article/view/2137 accessed 15 October 2024.
[11] Ibid.

to put all contingent claims against the company on the back burner so that the secured creditors are taken care of first in the CIRP, even if contravening essential legal principles such as the PPP and multiple supreme court judgements that have held that article 21 of the constitution, encompasses within it a right to a clean environment which grants it the sacrosanct status of a fundamental right.[12]

The PPP asserts that those responsible for pollution must incur the expenses associated with handling it in order to avert harm to human health or the environment. So, should a factory discharge harmful waste material into a local river, under the PPP, the factory will be held responsible and will be made to bear the cost of the river being cleaned up of the harmful materials. This principle was first introduced by the Organisation for Economic Cooperation and Development ("**OECD**"), which decided to frame its environmental policies on the PPP.[13]

The Supreme Court of India ("**SC**") laid down the foundation for this principle in the case of *MC. Mehta v. Union of India*.[14] The court stated the need to develop new principles and establish new norms to effectively address the emerging issues in a "highly industrialised economy."[15] The PPP was further developed and applied by the SC in the case of *Indian Council for Enviro-legal Action v Union of India.*[16] The court declared that the restoration of the damaged environment is integral to sustainable development; therefore, the polluter has absolute liability not only for compensating the individual

[12] MK Ranjitsingh v. Union of India 2024 SCC OnLine SC 570 [35]; Virender Gaur v. State of Haryana (1995) 2 SCC 577 [7].
[13] Organisation for Economic Co-operation and Development, *Recommendation of the Council on Guiding Principles concerning International Economic Aspects of Environmental Policies*, OECD/LEGAL/0102 (1972).
[14] MC Mehta v. Union of India (1987) 1 SCC 395 [31-32].
[15] Ibid.
[16] Indian Council for Enviro-Legal Action v. Union of India (1996) 3 SCC 212 [65-67].

victims but also for the expenses associated with the ecological restoration of the polluted biodiversity.

The PPP signifies that absolute liability for environmental harm encompasses compensation for the victims and the expenses associated with restoring environmental degradation. The restoration of the impaired environment is integral to sustainable development.[17] The SC in *Vellore Citizens Welfare Forum v. Union of India*[18] reaffirmed that the PPP is a fundamental component of the country's environmental jurisprudence, consistently upholding it in subsequent cases, including *Vedanta Ltd. v. State of Tamil Nadu*,[19] and the *NTPC Ltd. v. Uttarakhand Pollution Control Board* case.[20]

Upon a company's admission to insolvency under the IBC, a moratorium is enacted on all proceedings against the company.[21] If this company is facing a claim for pollution and loss of biodiversity under the PPP, such claims must then be submitted to the appointed RP, who will then classify them as "contingent claims". The IBC prioritises the organisation of creditor rights to provide the distressed company with a second chance.[22] The IBC categorises and defines various types of creditors and establishes a hierarchy through what is known as the "waterfall mechanism".[23] The lower a creditor's position in this hierarchy, the diminished priority they hold in the

[17] ibid.
[18] Vellore Citizens Welfare Forum v. Union of India (1996) 5 SCC 647 [11-14].
[19] Vedanta Ltd v. State of Tamil Nadu 2024 SCC OnLine SC 230 [24].
[20] NTPC Ltd v. Uttarakhand Pollution Control Board 2021 SCC OnLine NGT 361 [8,11].
[21] s 14, Insolvency and Bankruptcy Code 2016 (n 1).
[22] Swiss Ribbons (P) Ltd v. Union of India (2019) 4 SCC 17 [27,28].
[23] s 3(10), Insolvency and Bankruptcy Code 2016 (n 1); s 53, Insolvency and Bankruptcy Code 2016 (n 1).

recovery process. Contingent claims are positioned among the lowest tier and yield minimal returns if any.[24]

Environmental claims are classified as "government dues", which are accorded a lesser priority than "financial debts owed to creditors", as evidenced by the hierarchy of the waterfall mechanism.[25] The inferior status of contingent creditors, particularly "government dues"within the waterfall mechanism of the IBC creates a loophole for companies. In response to a substantial environmental claim, companies may strategically initiate the insolvency process to evade payment of the claim. Coal companies that face large environmental claims in the USA often end up filing for Chapter 11 strategically, liquidating their assets and thereby absolving themselves of environmental responsibilities.[26]

III. DEFINING AN ENVIRONMENTAL CLAIM

The development of environmental law in India reflects a progressive path marked by significant court actions and legislative changes to enhance environmental protection and promote sustainable development. The Water (Prevention and Control of Pollution) Act of 1974 and the Environmental Protection Act of 1986 established the legal framework in India for pollution prevention, control measures, and accountability over environmental damage.[27] However, no statute has precisely defined what constitutes an 'environmental claim,' and courts have, in the past, characterised them as

[24] Shivam Chaturvedi and Divya Sehgal, 'Ignorance Is Bliss (?): Analysing the Treatment of Contingent Claims under the Insolvency and Bankruptcy Code, 2016' (IndiaCorpLaw, 4 November 2023) https://indiacorplaw.in/2023/11/ignorance-is-bliss-analysing-the-treatment-of-contingent-claims-under-the-insolvency-and-bankruptcy-code-2016.html accessed 15 October 2024.
[25] s 53, Insolvency and Bankruptcy Code 2016 (n 1).
[26] Joshua Macey and Jackson Salovaara, 'Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law' (2019) 71 Stanford Law Review 879.
[27] Water (Prevention and Control of Pollution) Act 1974; Environmental Protection Act 1986.

claims resulting from environmental harm.[28] Environmental claims can be of a very wide variety, each possessing its distinct characteristics. This is evidenced by examining several cases adjudged by the National Green Tribunal ("**NGT**"), such as *K.K. Muhammed Iqbal v. Kerala State Pollution Control Board*, wherein a corporation was permitted to sell or relocate only after compensating for the polluting adjacent farmlands.[29] Similarly, there is a possibility for future climate change-related claims, comparable to loss and injury, to arise as environmental claims and these are even more difficult to validate and even more arduous to corroborate before a liquidator or resolution specialist.

A thorough review of the literature surrounding the issue indicates that any claim resulting from environmental liability becomes an environmental claim.[30] When following this rationale, punitive fines levied by the government and clean-up costs for environmental damage may be categorised as 'environmental claims'; however, this is inaccurate, as government fines are classified as CIRP Costs, which receive absolute precedence in the waterfall system.[31] These are being considered CIRP costs as the goal of the moratorium is to preserve the company's assets and ensure the creditors' interests are safeguarded while also providing the company with a "fresh start" after the conclusion of the CIRP.[32] If a governmental entity threatens to revoke a bankrupt company's licenses due to pollution caused by the company and demands that the bankrupt company first pay a fine, the insolvent company

[28] AP Pollution Control Board v. MV Nayadu (1999) 2 SCC 718 [33-35].
[29] KK Muhammed Iqbal v. Kerala State Pollution Control Board 2020 SCC OnLine NGT 2400 [5,6].
[30] Deborah E Parker, 'Environmental Claims in Bankruptcy: It's a Question of Priorities' (1995) 32 San Diego Law Review 221.
[31] Insolvency and Bankruptcy Code 2016 (n 1); s 53(1)(a), Insolvency and Bankruptcy Code 2016 (n 1).
[32] s 14, Insolvency and Bankruptcy Code 2016 (n 1).

may pay the fee to maintain operations, which would then be classified as CIRP costs paid by the company to keep itself operational.

When CIRP is initiated, the moratorium brings all pending litigations (and potential new ones) against a CD to a halt.[33] It is in this situation where the erstwhile management of the company is deposed, and the RP takes charge of the operations of the company and, in the meantime, collates all the claims being filed by claimants against the company.[34] This essentially conjoins and brings environmental claims under the ambit of insolvency law. Usually, environmental claims are of two types – ongoing environmental litigations and court orders. In the first category, the claims are not fructified, and hence, they are classified as "contingent claims" as their value has not crystallised. As a result, the RP assigns a notional value to such claims within, a resolution plan and, as mentioned, deals with CIRP costs, which is necessary for the company to stay afloat and functioning amidst the moratorium period.[35] However, in the case of a decree, the present law is clear owing to the SC case of *Subhankar Bhowmik v. Union of India* ("***Subhankar Bhowmik* case**"), which states that these claims are to be classified as "other creditors".[36] As a result, the CIRP process would follow without providing due recognition of the seriousness of environmental claims. Under the absolute liability principle, compensation is prioritised for the environment and related damages, but the present insolvency framework disregards this and prioritises financial creditors.[37]

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[33] ibid.

[34] Reg 7, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016.

[35] ibid. Reg. 14.

[36] Subhankar Bhowmik v. Union of India 2022 SCC OnLine Tri 208 [17]; Subhankar Bhowmik v. Union of India 2022 SCC OnLine SC 764 [2,3].

[37] M. P. Ram Mohan & Sriram Prasad, 'Environmental Claims under Indian Insolvency Law: Concepts and Challenges' (2023) 59 Tex Int'l L J 105.

IV. A CASE FOR A "GREEN" APPROACH TO INSOLVENCY

Indian courts have built up a robust series of environmental jurisprudence that stands on the principles of "absolute liability" and PPP. The legislature has also come up with the IBC to strengthen the economic system by making it substantially easier to conduct business and by proposing a rugged mechanism that aids a failing company and gives it a second chance. However, what has been overlooked is that no previous liabilities are carried over when a CIRP is successfully implemented and a new lease of life is breathed into the business.[38] Labelled as the "fresh start" principle, and this principle is aimed at giving companies an opportunity to start a new business without being hindered by past liabilities.[39] This principle, however, permits economic policy to take precedence over environmental policy.[40]

A non-obstante clause enables the precedence of insolvency over other laws, which supersedes conflicting statutes.[41] The IBC has also superseded taxation statutes and regulations governing asset confiscation by the government.[42] This non-obstante clause was also recently upheld by the Supreme Court of India in the case of *Ghanashyam Mishra & Sons Private Limited v. Edelweiss Asset Reconstruction Company Limited* ("**Ghanashyam Mishra case**").[43] In this case, the company facing liquidation had claims filed against them by the District Mining Officer ("**DMO**") concerning dues under the Mines & Minerals (Development & Regulation) Act, 1957, as penalties for environmental degradation. The National Company Law Tribunal

[38] Insolvency and Bankruptcy Code 2016 s 31 and 32A.
[39] Essar Steel [105,107] (n9); M. P. Ram Mohan (n37).
[40] ibid.
[41] s 238, Insolvency and Bankruptcy Code 2016 (n 1); Innoventive Industries Ltd v. ICICI Bank & Anr (2018) 1 SCC 407 [34].
[42] Sundaresh Bhatt, Liquidator of ABG Shipyard v. Central Board of Indirect Taxes and Customs (2023) 1 SCC 472 [57].
[43] Ghanashyam Mishra & Sons (P) Ltd v. Edelweiss Asset Reconstruction Co Ltd (2021) 9 SCC 657 [71].

(“**NCLT**”) had reviewed and subsequently dismissed these claims for not being supported by sufficient documentation. The SC judgement held that even if the claims filed by the DMO had merit in them, the provisions of §238 of the IBC, viz. the non-obstante clause in the IBC, would have overridden such claims under the IBC.[44]

The implementation of the IBC over another economic policy, such as taxation laws, may affect a country's economic landscape without having a major impact on the larger populace. However, when the legislative scales start outweighing the fundamental rights in favour of an economic policy, then there is a cause for significant concern. When a company enters the CIRP, the imposition of the moratorium period mandates that all claimants must submit their claims to the RP, including environmental claims under the jurisdiction of the IBC.[45] These claims include everything from court orders directing compensation to ongoing cases. The RP is then required to assess and assign a notional value to these claims. All claims and creditors against the company are organised according to the waterfall mechanism outlined in the IBC, where other contingent claims are overlooked due to their subordinate position to other superior claims like Financial or Operational Creditor claims.[46] Contingent claimants whose claims remain unrealised upon a company's liquidation typically receive minimal amounts, as the CIRP framework is not obligated to satisfy all the submitted claims.

V. SECTION 238: A BARRIER TO ENVIRONMENTAL CONSIDERATIONS?

By virtue of being a non-obstante clause, S. 238 of the IBC, 2016 overrides any other legislation or law, and this has been laid down as a

[44] ibid.
[45] s14, Insolvency and Bankruptcy Code 2016 (n 1).
[46] s 53, Insolvency and Bankruptcy Code 2016 (n 1); *Swiss Ribbons* [27,28] (n 22).

justification by multiple courts in India for relegating environmental claims to the last rung within the waterfall mechanism.[47] Although it is clear the legislative wisdom behind establishing the IBC was to "provide a fresh start" to companies facing insolvency, it cannot be the sole basis to allow the application of the IBC to overrule any legislation that serves to safeguard the public interest. However, in the *Ghanashyam Mishra* case, the SC stated that S. 238 of the IBC, 2016 would have an overriding effect over any provision.[48] This poses a unique threat where corporations are not held accountable for their malafide conduct. The right to a clean environment has been held to be a fundamental right multiple times.[49] When the non-obstante clause is used as a justification for superseding claims that ensure fundamental rights, it creates a conundrum regarding the viability of the IBC. However, a comprehensive framework that is necessary for regulating insolvency in India cannot be simply discarded on the basis of a single aspect. Hence, a more nuanced approach has to be undertaken instead of claiming that the entire ambit of IBC is unconstitutional.

VI. A COMPARATIVE ANALYSIS WITH OTHER JURISDICTIONS

The framework under the IBC, 2016 contains a significant degree of ambiguity when the nature of claims is considered. This is especially true when it comes to the question of the inclusion of government regulators coming under the definition of secured creditors.[50] With respect to non-environmental legislations like the Customs Act, Income Tax Act, etc. the SC has clarified the position of the government regulators in this regard. However, when it comes to environmental regulators, the answer is still not present since no environmental claim has been collated within a CIRP as an individual

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[47] M P Ram Mohan (n 37).
[48] *Ghanashyam Mishra* [57] (n 43).
[49] *M K Ranjitsinh* (n 12); *Virender Gaur* (n 12).
[50] State Tax Officer v. Rainbow Papers Ltd (2023) 9 SCC 545 [29,57].

category of claims, and are classified as "contingent claims", either arising from decrees or a claim which is undergoing litigation.[51] This is primarily due to the lack of a clear demarcation of an environmental claim within the IBC 2016 framework. These claims are assigned a nominal value at the time of being included within the resolution plan.[52] It was in the *Subhankar Bhowmik* case that it was mandated that the claims which have been crystallised through a court order should be classified within the ambit of the "other creditors" category, which relegates a legitimate claim to a lower realm than claims of financial creditors.[53]

Furthermore, the judiciary approached the question of balancing environmental claims and financial claims predominantly from a neo-liberal perspective, wherein financial claims have taken precedence over environmental ones.[54] Most jurisdictions follow this approach where environmental claims often are not collated and remain unaddressed.[55] However, there have been a few exceptions made by different courts across jurisdictions, where environmental claims have been given primacy over financial claims, citing reasons like public interest, which adds a new dimension to the existing question of balancing claims in insolvency.[56] Hence, two types of approaches have been studied in this part - in section A, where the court mandated that environmental claims ought to be considered a

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[51] r14, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016 (n 34).

[52] Namrata Nair and Medha Shekar, 'Green Insolvency: Perspective and Policy Prescription' in *Exploring New Perspectives on Insolvency* (IBBI 2022) 351 https://www.ibbi.gov.in/uploads/publication/599cf8fb50be73f518fca467311304db.pdf accessed 15 October 2024.

[53] Subhankar Bhowmik [17] (n36).

[54] Sanjay Kumar, 'Has the Judiciary Abandoned the Environment to Neoliberalism?' (2023) *Economic and Political Weekly* https://www.epw.in/engage/article/has-judiciary-abandoned-environment-neoliberalism accessed 15 October 2024.

[55] ibid.

[56] Orphan Well Association v. Grant Thornton Ltd., 2019 SCC 5, [2019] 1 S.C.R. 150 (Canada).

separate claim beyond the moratorium, and in section B, where the court has elevated the position of the environmental claims to the highest layer of the United Kingdom's ("**UK**") equivalent of the waterfall mechanism.

A. Treating Environmental Claims as a Separate Claim Beyond Moratorium

The Canadian case of *Orphan Well Association v. Grant Thornton Ltd.* ("**Redwater case**") is a case that comprehensively addresses this question of balancing claims.[57] In this case, the Supreme Court of Canada put forth the following decision – a S 14.06(4) of the Bankruptcy and Insolvency Act ("**BIA**") should not be interpreted broadly, and the bankrupt corporation cannot shed its environmental liabilities which right from its disclaimed assets; b. the Alberta Energy Regulator ("**AER**") was not be classified as a creditor within the bankruptcy proceedings, rather AER exercised its power to enforce a public duty. Hence, no conflict arose; c. Insolvency professionals must form their resolution plans in accordance with provincial laws, which include AER's orders of a non-monetary nature, and these will be binding on the bankrupt estate of the corporation.[58] This decision cemented the green insolvency jurisprudence in Canada and allowed for environmental claims to be heard within the ambit of bankruptcy claims as an obligation which needs to be prioritised by the corporation at the time of liquidation.

B. Prioritising Environmental Claims Over Other Claims

Another case which significantly strengthens the argument in favour of prioritising environmental claims is the Scottish case of *Nimmo and anr as the Joint Liquidators of Doonin Plant Limited* ("**Doonin Plant case**"), where Lord Doherty upheld the PPP.[59] In this case, the Scottish Environmental

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[57] ibid.
[58] ibid.
[59] Nimmo and Anr as the Joint Liquidators of Doonin Plant Limited [2018] CSOH 89 (Scotland).

Protection Agency had made environmental degradation claims against the corporations and sent notices to them in pursuance to S. 59 (1) of the Environmental Protection Act (EPA) 1990. The questions in front of the Court were:

a. Was the liquidator to utilise the remaining funds toward remediation?
b. How should environmental claims be categorised as contingent debt or liquidation expenses? And finally,
c. If treated as liquidation expenses, would the liquidator's remuneration take precedence as per the insolvency framework?[60]

Lord Doherty considered the cost of remediation as a liquidation expense rather than a contingent debt and justified the same by expressing that statutory language allowed for the inclusion of the PPP and the EPA, 1990, which complied with the EU waster Framework Directive of 2008.[61] Hence, the environmental claim was brought up in the priority ladder of the resolution plan.[62] Thus, it is clear that trends in green insolvency have taken root in different jurisdictions, wherein the goal is to accommodate environmental consideration within the insolvency framework to ensure that corporations' accountability is maintained.

VII. A WAY AHEAD: POSSIBLE SOLUTIONS TO THE PRESENT ISSUES

The concept of “green insolvency” has been gaining traction in recent years, especially with organisations like the World Bank making this debate

[60] ibid.
[61] Directive 2008/98/EC of the European Parliament and of the Council of 19 November 2008.
[62] Nimmo and Anr. [67] (n59).

mainstream through their working reports.[63] Also, this interplay of environmental concerns and insolvency law was legitimised across jurisdictions that the PPP must be applicable to insolvency proceedings, as the balancing of rights concerns a public interest versus a private/corporate interest.[64] Upholding the right to a clean environment is a major consideration that needs to be continued in India.[65] This calls for substantial changes to the insolvency framework. This can be achieved in multiple ways – by ensuring that such environmental claims continue even when a moratorium is imposed or, in arguendo, by granting environmental claims priority under the waterfall mechanism.

Hence, section A of this part proposes the exclusion of the environmental claims from the moratorium period following the existing environmental and insolvency jurisprudence in India while drawing from international jurisprudence like the *Redwater* case. Thereafter, section B takes a similar approach to determine how environmental claims deserve to be at a higher rung in the waterfall mechanism and advocates for studying the existing jurisprudence in India and using the reasoning in the *Doonin Plant* case to make a case for the same. In the last part, section C, a case is made for expanding the duties of the RP and the AA to detect and prevent instances of malafide litigation by corporate debtors meant to bypass environmental liability, and this is contextualised with the help of a UK case.

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[63] Devendra Mehta, 'It's Time for a Green Insolvency and Bankruptcy Code' *Economic Times* (15 August 2021) https://economictimes.indiatimes.com/news/economy/policy/view-its-time-for-a-green-insolvency-and-bankruptcy-code/articleshow/84262923.cms?from=mdr accessed 15 October 2024.

[64] Tribunal on its own motion-SUO MOTU v. Union of India, 2020 SCC OnLine NGT 3054 (India), [9].

[65] Virender Gaur (n12).

A. Exclusion of Environmental Claims from the Moratorium Period

The idea behind the imposition of a moratorium period is to ensure asset preservation of the CD so that it is utilised to repay the creditors.[66] When the aspect of pollution comes into the fray, the claims arising are often extinguished owing to the lack of funds at the end of the CIRP.[67] Here, the state has the financial responsibility to ensure that environmental degradation is remedied, which in turn becomes an unfair imposition on the public exchequer. Therefore, the polluter is not held accountable and is let off without any penalties, while ecological degradation affects the general populace in terms of health hazards.

As per the *Swiss Ribbons v. UOI* case ("**Swiss Ribbons case**"), the SC held that the financial creditors ("**FC**") play an instrumental role in lending credit to the CD, i.e., the polluter in the present context.[68] This credit is only granted after an assessment of the CD's operations, which includes the trade practices they undertake, which are potentially ecologically hazardous.[69] Providing such credit even after a thorough assessment of a non-sustainable CD, demonstrates one of two things – a gross oversight on the part of the FCs or a general trend of impunity. This calls for an offset of the FCs' right of repayment in favour of the wider public interest in the form of access to clean environmental rights. Since most environmental legislations envision criminal

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[66] S 14, IBC 2016 (n1).
[67] Punjab National Bank v. Bhushan Power & Steel Limited, 2019 SCC OnLine NCLT 18702 (India), [53].
[68] Swiss Ribbons [85] (n22).
[69] Viral Acharya, Heitor Almeida, Filippo Ippolito and Ander Pérez Orive, 'Bank Lines of Credit as Contingent Liquidity: Covenant Violations and Their Implications' (2020) 44 *Journal of Financial Intermediation* 100817 https://doi.org/10.1016/j.jfi.2019.03.004 accessed 15 October 2024.

and civil liability for the offence, the aspect of the criminal penalty also needs to be considered.[70]

This may be contextualised in terms of the UK case of *Lindsay Cooper v. Natural Resources Body for Wales* ("**Lindsay Cooper**"), where the court barred the company from liquidation, as there was ongoing environmental litigation with both criminal and civil consequences for the company.[71] The bench also stated that even if a monetary penalty were imposed, it would be in the pursuit of a criminal proceeding, and while it may adversely impact the creditors' interests, it would be necessary to uphold in favour of greater public interest.[72] This may be equated with the Delhi High Court case of *Enforcement Directorate v. Axis Bank* where it was held that the objective of the PMLA, 2002 was different from that of the IBC and that they operate separately, as even if assets of the company were to be seized, it would be a part of the criminal proceedings which would be beyond the scope of the moratorium, as it addressed a larger public interest.[73] Although the SC case of *P. Mohanraj v. Shah Bros. Ispat* differentiated between the cause of action and the nature of civil and criminal penalties, the determinant factor for ascertaining the kind of proceedings would have to be the interest which sought to be addressed by such action, viz. a proceeding would of a civil nature if it addressed private rights, it would be rendered into a criminal proceeding if it sought to remedy a public right.[74]

Hence, it is necessary to take a similar approach as the *Lindsay Cooper* case to preserve the greater public interest in environmental protection and

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[70] Chapter III, EPA 1996 (India) (n27).
[71] Lindsay Cooper v. Natural Resources Body for Wales, [2019] EWHC 2904 (Ch) (United Kingdom).
[72] ibid.
[73] Enforcement Directorate v. Axis Bank, 2019 SCC OnLine Del 7854 (India), [139, 171].
[74] P. Mohanraj v. Shah Bros. Ispat (P) Ltd., (2021) 6 SCC 258 (India), [83].

thereby exclude environmental claims from the moratorium period.[75] Therefore, for any environmental claims that arise instead of these above-mentioned circumstances, the FCs should also be proportionally held accountable for their role and lack of due diligence, especially when their investment affects the public interest. This also calls for the adoption of the reasoning that was applied in the *Redwater* case to ensure that the environmental claims survive separately from the moratorium period and are deliberated upon separately from the CIRP.[76] Hence, environmental claims must be kept separate and beyond the scope of the moratorium period imposed upon the CD.

B. Improving the Position of Environmental Claims in the Waterfall Mechanism

The waterfall mechanism is laid down in section 53 of the IBC, which delineates the priority of payments under liquidations, and per S. 30 (2)(b) and S. 30 (4), the same mechanism has to be followed in a CIRP.[77] The IRP/liquidation costs have to be clear first, followed by workmen's dues and debts owed to secured financial creditors, then followed by employee's dues and unsecured financial creditors, and finally by operational creditors, government authority dues, and lastly, equity shareholders and partner, and other contingent claims.[78] The present interpretation classifies environmental claims as claims of "other creditors", which is the last category to be compensated.[79] These claims often get extinguished following the "Clean Slate" theory, recognised in the *Committee of Creditors for Essar Steel India*

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[75] LIC v. Escorts Ltd., (1986) 1 SCC 264 (India). [90,91].
[76] Orphan Well Association [209,231] (n56).
[77] s 53, IBC 2016 (n1).
[78] Paschimanchal Vidyut Vitran Nigam Ltd. v. Raman Ispat (P) Ltd., (2023) 10 SCC 60 (India), [47-51].
[79] ibid; s 53, IBC, 2016 (n1).

Ltd. v. Satish Kumar Gupta & Ors ("**Essar Steel case**").[80] This framework allows the CD to initiate CIRP and have the claims classified as contingent claims, which, in most cases, do not receive any funds from the proceeds.[81] However, an interpretation put forth in the case of *State Tax Officer v. Rainbow Papers Ltd.* ("**Rainbow Papers case**") may prove to be useful, where the SC held that statutory dues under state legislation relating to taxation would be considered under the ambit of the claims of a "secured creditor".[82] However, this has been overruled by the SC in the case of *Paschim Anchal Vidyut Vitran Nigam Ltd. v. Raman Ispat Private Ltd. and Ors* ("**PAVVNL case**"), which laid out three criticisms – a. the *Rainbow Papers* bench overlooked the waterfall mechanism stated in S. 53 of the IBC, 2016; b. The legislative wisdom was to relegate statutory dues, and; c. there should be limited applicability of *Rainbow Papers* case to avoid a broad definition of "Secured Creditors" in S. 53 (1)(b)(ii) in all cases.[83] Also, this interpretation followed the cases of *PR Commissioner of Income Tax v. Monnet Ispat and Energy Ltd.* and *Sundaresh Bhatt v. Central Board of Indirect Taxes and Customs*, both of which deal with the conflict of IBC and Income Tax Act and Customs Act, respectively.[84] The conflict herein was clearly between two private rights, which did not affect public interest at large; rather, it was solely within the ambit of the transaction between the State and the CD.[85]

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[80] s 31 (1), IBC 2016 (n1); Essar Steel [105].
[81] Debajyoti Ray Chaudhuri and Radhika Agarwal, 'Litigation Funding: A Breakthrough for Avoidance Proceedings under IBC' in *Quinquennial of Insolvency and Bankruptcy Code, 2016* (IBBI 2021) 305 https://ibbi.gov.in/uploads/resources/7e99c866b866e02fa7b8549752e55914.pdf accessed 15 October 2024.
[82] State Tax Officer v. Rainbow Papers Ltd., (2023) 9 SCC 545 (India), [57].
[83] Paschimanchal Vidyut Vitran Nigam Ltd. [47-51] (n78).
[84] PR Commissioner of Income Tax v. Monnet Ispat and Energy Ltd. (2018) 18 SCC 786 (India), [2]; Sundaresh Bhatt (India), [57] (n42).
[85] ibid.

However, when it is an environmental degradation claim, the fallout affects a larger public interest, wherein fundamental rights are harmed. This needs to be dealt with on a priority basis, as the economic quantum of remedying environmental costs far outweighs the financial costs of customs or tax evasion. The SC's view in the case of *Pramati Educational and Cultural Trust v. UOI* can be adopted, where the interests of private unaided schools under Art. 19 (1) (g) was superseded by the constitutional goal of ensuring quality education to all, as envisioned in Art. 21A.[86] Hence, this principle needs to be applied to present jurisprudence to allow for an exception to S. 238 of the IBC, 2016, wherein public rights are safeguarded even if they harm the corporate rights of financial creditors. This would satisfactorily address the point of ambiguity created by the criticism of the *Rainbow Papers* case in the *PAVVNL* case, which essentially would go on to address issues arising out of cases like *Ghanashyam Mishra*.[87] This also calls for the adoption of the reasoning used in the *Doonin Plant* case, where the PPP supersedes the claims of creditors.[88] As explained earlier, since financial institutions are aware of their debtor's business practices, a certain onus befalls the FCs to ensure that the impugned project is in compliance with sustainability standards. Furthermore, in the question of public rights vs private rights, it can be argued that the public interest of a clean environment outweighs the corporate interests of profit maximisation. The "public policy" exception to a valid contract enshrined in section 23 of the Indian Contract Act can be the basis for the same.[89] In *Gherurlal Parakh v. Mahadeodas Maiya*, where the court stated that principles in statutes would constitute a valid component of "public

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[86] Pramati Educational & Cultural Trust v. Union of India (2014) 8 SCC 1 (India), [53].

[87] Rainbow Papers [57] (n82); Paschimanchal Vidyut Vitran Nigam Ltd. [47-51] (n78); Ghanashyam Mishra [71] (n43).

[88] Nimmo and anr [67] (n).

[89] s 23, Indian Contract Act, 1882. (India).

policy", and when the consideration for a contract is opposed to public policy, it would be deemed as void.[90] As several environmental statutes prohibit the environmentally degrading practices followed by several infrastructural companies, and a significant number of financial institutions serve as their FCs, it is only pertinent that the imposition of "public policy" be used as justification to improve the position of environmental claims in favour of the claims of the FCs. Hence, environmental dues need to be classified as CIRP costs as the first wrung of the waterfall mechanism instead of being classified as claims filed by "other creditors".

At first glance, it may seem that it may affect investor confidence in the market, however, certain considerations need to be made in this regard. However, in the long run, mandating a higher threshold of compliance for financial institutions in order to issue credit will amount to an enhanced adoption of the Equator principles that lay down guidelines for best practices for desired ESG outcomes within the IBC framework that align with India's national goal of achieving sustainable economic development.[91] This is necessary to establish an insolvency framework which safeguards public interest rights life, the right to a clean environment and ensures the accountability of corporations.

C. Expanding the Role of the Resolution Professional and Adjudicating Authority to Ensure Environmental Compliance in CIRPs

Environmental claims are of two types – ongoing litigations and court decrees. For the first category, since the claims are not fructified, the RP

[90] Gherurlal Parakh v. Mahadeodas Maiya AIR 1959 SC 781 (India).
[91] Equator Principles Association, *The Equator Principles III* (June 2013) https://www.loyensloeff.com/the_equator_principles_iii_june2013.pdf accessed 18 October 2024.

assigns a notional value within a resolution plan.[92] However, in the case of a decree, the law is clearly laid down in the *Subhankar Bhowmik case*, which classifies the environmental claimants as "other creditors".[93] As a result, the CIRP process is unable to provide due recognition of environmental claims. This process also creates an opportunity for abuse by CDs evading their environmental dues, where a CD may initiate CIRP via a financial creditor.

In a UK case, it was observed that a similar loophole existed in the UK insolvency framework, which was exploited by a company facing the threat of insolvency due to hefty environmental penalties.[94] In order to avoid this liability, the company paid significant dividends to its parent company, which was the sole stakeholder, and subsequently faced bankruptcy, thereby avoiding environmental liability.[95] This method may also be employed in India, especially where the waterfall mechanism relegates environmental dues to the lower rungs. Hence, a proactive approach has to be undertaken, and these instances need to be addressed by ensuring that the onus of preventing this malpractice is two-fold: the initial onus is on the RP to ensure such malicious CIRPs are not initiated to escape liability, and the other is on the AA to ensure that such resolution plans are not approved. A solution is to expand the role of the RP within section 30 (2) of the IBC and regulation 13 of the IBBI Regulations, which need to be modified to mandate a thorough review of the environmental claims.[96]

On the other hand, the interpretation of section 31 (2) of the IBC must be expanded beyond the examination of merely financial markers like default

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[92] Regulation 13, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016 (India) (n34).
[93] Subhankar Bhowmik [17] (nXX).
[94] BTI 2014 LLC v. Sequana SA [2022] UKSC 25, [2019] Civ 112 (England), [140, 172].
[95] ibid [367].
[96] Regulation 14, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016 (India) (n34).

and debt for approving a resolution plan. Tribunals must be empowered to identify resolution plans which are not directly in contravention of any law but are presented with the malicious intent of forgoing one's environmental liability. A precedent which may be utilised in this regard is the case of *Hytone Merchants (P) Ltd. v. Satabadi Investment Consultants (P) Ltd*., where the National Company Law Appellate Tribunal rejected a resolution plan as it was found that the CD and the creditor were colluding to abuse the CIRP process.[97] The Mumbai bench of NCLT also rejected the resolution plan when it was discovered that the CD was significantly operational despite the existing debt and subsequent default.[98] A question may arise that this clearly strays away from the principle enshrined in *Swiss Ribbons*, i.e., to determine the admissibility of a resolution plan by solely applying the "twin-test" of existing debt and subsequent default.[99] However, it is necessary for tribunals to be granted this leeway, as this present interpretation is restrictive and often allows CDs to exploit this legislative loophole. Hence, it is necessary to empower the tribunals to examine external issues apart from applying the "twin test" in order to fulfil the legislative intent of the IBC, i.e., an efficient insolvency and bankruptcy framework, while maintaining harmony with environmental statutes.

VIII. CONCLUSION

It is undeniable that the Insolvency and Bankruptcy Code (IBC) of 2016 has significantly transformed India's corporate insolvency framework, augmented efficiency, and refined the business environment by offering financially distressed enterprises a renewed opportunity. However, its IBC's

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[97] Hytone Merchants (P) Ltd v. Satabadi Investment Consultants (P) Ltd, 2021 SCC OnLine NCLAT 598 (India), [49].
[98] Canara Bank v. GTL Infrastructure Ltd, NCLT Mum C.P.(IB)-4541(MB)/2019 (India), [49].
[99] Swiss Ribbons [64] (n22).

framework, especially its waterfall mechanism and the hierarchy of creditor claims, has resulted in the relegation of environmental liabilities. Environmental claims, which are typically categorised as contingent and subordinate to financial creditors' claims, are often disregarded or nullified during insolvency proceedings, enabling companies to evade their environmental obligation claims. This challenge highlights significant issues regarding the equilibrium between economic recovery and environmental preservation. India's legal framework, encompassing the "polluter pays" principle, mandates accountability for polluters regarding the damage inflicted; however, the IBC frequently overrides this principle, enabling corporations to evade liability. Proponents of "green insolvency" advocate for reforms that incorporate environmental considerations into insolvency procedures. Utilising international precedents, such as the *Redwater* and *Doonin Plant* cases, it is evident that environmental claims merit prioritisation. Integrating environmental accountability into the IBC would guarantee the preservation of corporate responsibility. Prioritising environmental claims in the insolvency resolution process is essential to harmonise India's economic and environmental policies. These reforms would guarantee that the fundamental right to a clean environment is maintained while concurrently addressing the financial restructuring of businesses, fostering a more equitable and sustainable framework for insolvency law in India.

IV. DIGITAL DILEMMAS: HOW EMERGING TECHNOLOGIES ARE SHAPING THE FUTURE OF INSOLVENCY AND BANKRUPTCY

Aditya Sushant Jain *

ABSTRACT

The advent of technological advancements in Artificial Intelligence (AI), Machine Learning (ML), Big Data, and Blockchain are profoundly transforming the legal and regulatory landscapes. This research paper delves into the significant opportunities and challenges that these disruptive technologies introduce into the domains of insolvency, bankruptcy, and restructuring on an international scale.

The paper begins by offering a detailed taxonomy of emerging technologies relevant to insolvency, categorizing them into five distinct segments. This taxonomy is technology non-neutral and focuses particularly on the 'type' of technologies used. This structured approach serves as a foundation for a comprehensive analysis on how each technology can enhance the efficiency and effectiveness of insolvency practitioners (IPs), resolution professionals (RPs), and adjudicating authorities. Thereafter, the paper proceeds to address the myriad challenges that accompany these technological advancements. These include the risks of automation bias, issues with the translation of laws into rule based codes by programmers and treatment of diverse data as an asset, and the complexities associated with defining, recognising and managing cryptocurrencies as assets within the insolvency estate (or outside it). Each challenge is examined with a view to understand their implications for current insolvency practices and the broader legal framework.

In response to these challenges, the paper proposes a set of regulatory strategies designed to effectively govern the integration of emerging technologies within insolvency regimes. Emphasizing a 'new functionality, new rules' approach, it argues for the creation of adaptive regulatory frameworks that can evolve in tandem with technological advancements. This approach aims to harness the benefits of innovation while mitigating potential risks. In broader strokes, this paper illuminates the expansive possibilities that modern technologies have to offer for enhancing insolvency practices worldwide. It also urges regulators to adopt a proactive stance in addressing the challenges posed by these technologies, ensuring that the regulatory environment remains robust, flexible, and conducive to positive change. Through its nuanced analysis and forward-looking recommendations, the paper provides a roadmap for navigating the intersection of technology and insolvency in the 21st century.

Keywords: Artificial Intelligence, Insolvency, Bankruptcy Prediction, Blockchain, Digitization

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I. INTRODUCTION

We are in the midst of full-scale techno-social revolution today – the epicentre of which is 'Artificial Intelligence'. Artificial intelligence, much like mobile phones and the internet, is poised to not only make our lives more efficient but also change the social and economic edifice of the society. AI along with other emerging technologies like blockchain, big data, cloud computing and predictive analytics today have pervaded all disciplines. A particularly profound impact has been observed in the fields of finance and law through emerging technologies such as 'Fintech[1],

[1] Fi Bernardo Nicoletti, 'The future of Fintech: Integrating finance and technology in financial services' [2020] Springer; Di Pietro, F.: Deciphering crowdfunding. In: Lynn, T., Mooney, J.G., Rosati, P., Cummins, M. (eds.) *Disrupting Finance.* PSDBET, (Springer, Cham 2019).; B Financial Innovation Network, Artificial Intelligence and Machine Learning in Financial Services - Market Developments and Financial Stability Implications, https://perma.cc/K348-89EA, accessed 3 March 2024.

Blockchain[2] and 'RegTech'.[3] Particularly in finance, these technologies allow resources to be efficiently re-allocated across the world at the speed of light.[4] On the other hand, a litany of scholars such as Kenneth Bamberger[5], Frank Pasquale.[6] Deans Keats Citron[7] and Christophe K. Odinet[8] highlight the problematic characteristics of this technological revolution such as large scale 'automation bias', 'Algorithmic discrimination', 'use of Black Box Algorithms', 'Data Privacy concerns' and 'a crises of due process' as reasons to espouse concern in technological advancements through automation in finance and law.[9]

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[2] Kakavand, Hossein, Nicolette Kost De Sevres and Bart Chilton. "The Blockchain Revolution: An Analysis of Regulation and Technology Related to Distributed Ledger Technologies." *IRPN:* Innovation & Cyberlaw & Policy (2017) https://perma.cc/K348-89EA, accessed 3March 2024; Tanwar, Sudeep. "Blockchain revolution from 1.0 to 5.0: technological perspective." In Blockchain Technology: From Theory to Practice, (2022) Springer Nature Singapore; Fenwick, Mark, Wulf A. Kaal, and Erik PM Vermeulen. "Legal education in the Blockchain revolution." Vand. J. Ent. & Tech. *L.* 20 (2017): 351.

[3] See for example, Vicki Waye, 'Regtech: A New Frontier in Legal Scholarship' (2019) 40 Adel L Rev 363; Buckley, R.P., Arner, D.W., Zetzsche, D.A. *et al.* The road to RegTech: the (astonishing) example of the European Union. *J Bank Regul* 21, 26–36 (2020); Armstrong, P. (2018). Developments in RegTech and SupTech. *Paris: Paris Dauphine University.* Arner, D. W., Barberis, J., & Buckey, R. P. (2016). FinTech, RegTech, and the reconceptualization of *Nw. J. Int'l L. & Bus.*, *37*, 37; Arner, D. W., D. A., R. P., & Weber, R. H. (2020). The Future of Data-Driven Finance and Regtech: Lesson from EU Big Bang II. *Stan. JL Bus. & Fin.*, *25*, 245; Barberis, J., Arner, (2019) D. W., & Buckley, R. P. *The REGTECH Book: The Financial Technology Handbook for Investors, Entrepreneurs and Visionaries in Regulation*. John Wiley & Sons; Narang, S, (2020). Accelerating Financial Innovation through Regtech: A new wave of fintech. In*Fostering Innovation and Competitiveness with FinTech, RegTech, and SupTech* (pp. 61-79). IGI Global.

[4] ibid at 96

[5] Bamberger, Kenneth A. "Technologies of compliance: Risk and regulation in a digital age." *Tex. L. Rev.* 88 (2009): 669.

[6] Frank Pasquale, *The black box society: The secret algorithms that control money and information* (Harvard University Press 2015).

[7] Citron, Danielle Keats. "Technological due Process" (2008) 85 Wash. UL Rev.

[8] Odinet, Christopher K., Fintech Credit and the Financial Risk of AI. in Kristin Johnson & Carla Reyes (eds), *Cambridge Handbook of AI and Law* (Cambridge University Press 2024).

[9] See for example a previous writing of the author on this subject Jain, Aditya Sushant. "An inter-disciplinary approach to automation technology in finance-what can history, law and data science teach us?." *ICTACT Journal on Soft Computing*14, no. 01 (2023): 3154-3164.

The discipline of Insolvency is no exception to this technological revolution. In the words of another scholar, Insolvency practices today are undergoing a 'digital disruption.'[10] Insolvency and bankruptcy laws are 'economic legislations' that help company's restructure in the event of bankruptcy and provides critical palliative care so as to revive them, as a last resort, they provide an orderly and systematic liquidation proceeding so as to prevent the tragedy of commons during the sale of assets by balancing the interests of various creditors and stakeholder, and further insolvency law ensures value maximation of assets thus ultimately benefitting the economy tremendously. More importantly, Insolvency law helps to free up stuck assets and quickly put them to better use and hence they prevent the opportunity cost an economy suffers due to 'idling of assets'. Insolvency and bankruptcy regimes today however suffer from various systematic problems – information asymmetry, litigatory delays, red-tapism, lack of an extensive market for stressed assets, overwhelming documents, data sets etc. Scholars thus argue that emerging technologies such as risk predicting models, Technologically Aided Review (TAR), Blockchain and smart contracts, big data and cloud storage could potentially solve all of such problems and are even being hailed so far as catalysts for a metamorphosis in insolvency and restructuring practices.[11] However, there adoption comes with its own challenges. A 2019 study by Insol International found that while most insolvency professionals agreed technology would be central to their future work, its adoption remained low.[12] Akshay Kamalanatha attributes this to two factors: a lack of training and technological skills among professionals, and

[10] Trakman and Walters, Contemporary issued in Finance and Insolvency (Taylor and Francis 2023).

[11] Toms and Colston, 'The role of Artificial Intelligence and technology in Global Bankruptcy and restructuring practises', Insol International Special Report (2019).

[12] Jane Colston, Christian Toms, 'The Role of Artificial Intelligence (AI) and Technology in Global Bankruptcy and Restructuring Practices' (2019) Insol International.

the cost-effectiveness concerns of smaller firms. Similarly, a survey by Jennifer Dickfos showed that insolvency professionals were often unprepared or unaware of technological advancements. She also points to the "AI Fallacy" by Susskind & Susskind, which suggests that many believe AI cannot replace human reasoning in insolvency work.[13]

As *insolvency practices* are in the process of a gradual revolution, at the same time however, due to the rapid technological changes in economies and the creation of new asset classes such as 'crypto' and 'data', *insolvency laws* across the globe are being criticized for not being able to 'keep up'. Hence, the two most important questions that insolvency scholars must engage with today are (a) how we can automate, innovate and streamline the insolvency and restructuring practices globally through technology and (b) how we can 'update' and modernize insolvency laws, so that they are ready to deal with the challenges of tomorrow which arise from the creation of digital economies and new 'technological' asset classes. The goal of this paper is thus to locate the discipline of insolvency and bankruptcy within the *global tech discourse* and convey to the reader a nuanced analysis of firstly, opportunities that technology today offers for us to innovate and automate insolvency practices and secondly concerns engendering from the impact of AI and allied technologies to the field of insolvency and bankruptcy, showcasing and urgent need to update insolvency laws so as to prevent them from becoming anti-quated.

Hence, in broader strokes this paper shall analyze two focal questions: firstly, how can *insolvency practices* innovate and update using technology and what opportunities can be exploited for the same and secondly how *insolvency laws* can update and innovate themselves to keep up with rapid

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[13] Richard Susskind and Daniel Susskind, *The Future of the Professions: How Technology Will Transform the Work of Human Experts* (1st edn OUP, 2015).

technological advancements and creation of new digital assets. For that purpose, section I provides a brief introduction to the subject matter of this paper, Section II aims to create a taxonomy for insolvency technology by harmonizing the opportunities and risks, Section III analyses the 5 different kinds of technological disruptions in insolvency namely (a) Artificial intelligence in bankruptcy prediction; (b) Big data, data analysis and cloud computing, (c) Blockchain technology (d) RegTech and LLM's & (e) process reforms through automation. Section IV then scrutinizes these five technological disruptions and showcases the critical risks and threats that they pose insolvency regimes. Section V then concludes.

II. TOWARDS CREATING A TAXONOMY FOR INSOLVENCY TECHNOLOGY

In the past there have been scant attempts by scholars to postulate a 'taxonomy' for classifying innovative technologies in insolvency technology. Creating a taxonomy or in the very least a conceptual categorization of various kinds of technological disruptions in insolvency and restructuring practices is important to realize both the opportunities and the broader risks posed by such innovations. While significant attempts have been made to create 'fintech' taxonomies such as by Imerman and Fabozzi[14] & Ratecka,[15] a taxonomy for insolvency resolution technologies remain peculiarly absent – perhaps due to its inceptive nature. Through this paper, I aim to create a taxonomy of 'technological disruptions' in insolvency that can be of assistance to both insolvency practitioners in terms of ascertaining the opportunities as well as to regulators for ascertaining risks. The earliest attempt at creating a taxonomy

[14] M.B. Imerman and F. Fabozzi, "Cashin in on Innovation: A Taxonomy of Fintech" (2020) 21 Journal of Asset Management 167.

[15] P. Ratecka, "Fintech-Definition, Taxonomy and Historical Approach", (2020) 45 MSE in Tarnow Research Papers Collection 55.

for technological innovations in insolvency was by Jennifer Dickfos in 2018[16]. Jennifer used Susskind and Susskind's model and divided technological innovations in insolvencies under either automation or innovation. She classified RegTech and opportunities opened by cloud computing under 'automation', and predictive technologies as under 'innovation'.[17] Her work was taken forward later by Loiacano and Rulli who in their paper 'ResTech: Innovative technologies for crisis resolution' postulated another unique taxonomy for resolution technologies called 'ResTech'[18] partly inspired by 'FinTech' and 'RegTech'. Loiacano and Rulli thus created four functional areas of ResTech:

- Technology that supports resolution planning activities.
- Technologies that support execution of resolution actions.
- Technology that supports cross border insolvencies.
- Technologies that assist financial firms in compliance with resolution authorities.

Building on the work for Loiacano and Rulli, I posit a fivefold model of ResTech where I classify five different kinds of broad and umbrella technological disruptions currently revolutionising insolvency practices across the world:

- **Bankruptcy Prediction Technology**: Comprising of Machine learning modes, Deep/and Neural Networking models that predict the risk of bankruptcy and flag red alerts before a company goes insolvent.
- **Big Data Analytics:** Use of AI, and Big Data analytics as an allied technology to analyse vast amount of documents and synthesise and store data

[16] Dickfos, Jennifer. "AI and the Insolvency Profession: The State of Play."2018 (4) INSOLVENCY LAW JOURNAL 172.
[17] ibid.
[18] Loiacono, G., Rulli, 'E. Restech: Innovative Technologies for Crisis Resolution' (2022) 23 J Bank Regul, 227.

on online cloud servers. These can be used to categorize, analyse and filter huge sets of financial and miscellaneous documents during insolvency.

- **Block Chain & Distributed ledger:** These technologies store information on distributed ledgers and automatically verifies it. These technologies reduce information asymmetry and increase security. They can help in asset tokenization during asset sale, help in voting for the Committee of creditors (‘**COC**’) especially for large scale insolvency where creditors are enumerable etc.
- **LLM’s and RegTech:** These technologies use rule based algorithms to automate compliance with laws and offer solutions that mimic human linguistic logic and reasoning. These can offer advisory services to resolution professionals (‘**RP**’) and analyse contracts and laws.
- **Technology assisted Process reforms**: These include simple automation and streamlining of insolvency procedures using non-sophisticated technology.

These technologies in cumulation have produced various services and products such as, Bankruptcy prediction softwares TAR (technologically aided review), ROSS intelligence, Blockchain Tokenization, cloud data storage etc. that are today re-shaping insolvencies by reducing information asymmetries, automating contract review, managing data and advising RPs. At the same time however, these technologies present significant risks particularly with respect to how insolvency laws should respond to new digital assets created by such technologies. The next section shall provide a detailed analysis towards how these technologies are shaping insolvency practises or could shape insolvency and restructuring practices in the future.

III. OPPORTUNITIES AND POTENTIAL FOR INSOLVENCY AND RESTRUCTURINGS

This chapter shall highlight the multifarious opportunities and potential that emerging technologies present to insolvency and restructuring practises worldwide. The section follows the 5-fold technological taxonomy created in section II and showcases the current technological developments and potential developments in insolvency practises globally.

A. Bankruptcy Prediction Technology

The insolvency and restructuring process starts even before bankruptcy of a firm is declared. The EU directive 2019/1023 on Preventative Restructuring framework and EU (Preventative Restructuring regulations) 2022[19] introduces the concept of 'early warning mechanisms' designed to warn directors of pending insolvency. A number of jurisdictions today have introduced the idea that companies and banks should enter into insolvency not when they fail but when they are likely to fail.[20] India has also recently introduced the concept of Early Warning System limited to fraud detection in banks with the help of Artificial Intelligence.[21] It is precisely at this juncture that bankruptcy prediction technologies, and the accuracy with which they can make predictions, can come in handy. Bankruptcy prediction technology utilises probabilistic modelling, data visualisation and machine learning techniques to ascertain solvency of a firm. Bankruptcy prediction software have a fascinating history, which is inter-twined with the history of financial ratios. Their journey starts from the path setting work of Beaver and Altman.

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[19] Directive (EC) on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Restructuring and Insolvency Directive), OJ L 172.
[20] n 16.
[21] Reserve Bank of India 'Master Directions on Fraud Risk Management in Commercial Banks (including Regional Rural Banks) and All India Financial Institutions' (2024).

Beaver conducted a univariate analysis of 30 financial ratios from 79 pairs of companies. He found out that working capital/debt ratio followed by net income/total assets ratios were the best determinants of solvency. Beaver's research focused on univariate analysis however, he highlighted the importance of multi-variate analysis in risk predictions by highlighting that multiple ratios considered simultaneously may have a higher predictive ability that single ratios. Univariate means that response variable are influenced by only one factor whereas multivariate means it is influenced by multiple factors. Beaver suggested that multiple ratios considered together may have a higher predictability than single ratios. This axiom was then put to action by Altman in 1968 with his Z-Score model which was the first multi-variate model. Post, which, various alternatives of multivariate technologies started to be used such as logistic regression, Logit and probit regression. The complexity of such models reached its peak when neural networking models based on deep learning and back propagation started to be used. These models are self-learning and extremely accurate however the downside is their 'black box' nature as will be explained in the Section IV. Artificial neural networks use highly complex nodal relationships to mimic connections between sets of data – simulating the neural network found in the human brain.[22] According to Bešlić et al, neural networking models today have become one of the most common bankruptcy prediction methodologies.[23] While insolvency (financial stress) prediction algorithms are not new, the widespread use of Neural Network and deep learning AI in bankruptcy predications is particularly notable.

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[22] Owen Hall, Owen, Charles McPeak, 'Using Neural Net Technology to Analyze Corporate Restructuring Announcements' 2003 12 JIIM 1.

[23] Bešlić Obradović, D., Jakšić, D., Bešlić Rupić, I., & Andrić, M. (2018) 31(1) 'Insolvency Prediction Model of The Company: The Case of the Republic of Serbia' *Economic research-Ekonomska istraživanja*, 139.

The use cases of predictive AI goes beyond insolvencies to even managing a restructure. Ordinarily, when a company undergoes a restructure, it will record an 'estimated' expense on its balance sheet, and a reserve is then set up for that amount. Firms use a routine financial technique while selling an operating unit[24]. Whenever such a sale occurs during restructuring – it results in a single gain in the firms balance sheets that could cause a spike in earnings. To avoid this, the firm usually records a 'restructuring charge' in their sheets that is almost equal to the gain. This charge is ordinarily seen as an estimate of future expense that arises on account of the restructuring. In this manner there are constant estimating future valuations, future risks and future variables to be computed by a firm both before bankruptcy and during restructuring so as to ensure efficiency and quick resolution of assets. Predictive technologies built on Artificial Neural Networking models can be of tremendous assistance here. Lastly, predictive technologies can provide assistance even post the creation of resolution plan by creating artificial 'simulations' in digital environment and predict how likely in the resolution plan to succeed. As financial markets become more complex, insolvencies become large and complex and technologies become further advanced - Insolvency practitioners are bound to find themselves in an era of 'big data'.[25] Supplementing human intelligence with modern AI is perhaps the only way for firms to compete and survive in this age. Having said that, risk prediction models are not completely infallible – they have certain inherent problems that will be demonstrated in section IV. Therefore, the most mindful approach would be to use AI prediction software as complimentary to human intelligence.

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[24] ibid.
[25] Christian Toms, Jane Colston, 'The Role of Artificial Intelligence (AI) and Technology in Global Bankruptcy and Restructuring Practices' (2019) Insol International.

B. Big Data Analytics

Insolvency and the creation of a resolution plan demands a huge amount of data and documentary information – both quantitative and qualitative. Further, this data can be structured (e.g. Accounting data) and unstructured data (voice mail and e-mails). The inputs to a resolution plan also include data from commercial databases, information from other resolution authorities, unstructured web sources, routine reports from financial firms, and occasional findings from on-site inspections. Traditionally, resolution authorities use in house based data warehouses. Most insolvency practitioners and resolution authorities work with overwhelming amount of data sets – usually in the form of spreadsheet based applications such as Microsoft Excel. The methods of data processing and data storing hence needs to be revolutionised in insolvency and restructuring so as to ensure timely resolution. The following are some of the current technologies that are revolutionising data processing and storage:

Technology aided review ("TAR"): TAR technology is used to conduct an automated review of any documents, books or records of the company being assessed using big data analytics and machine learning. TAR technology is able to cluster documents by concepts so humans can quickly begin to review concepts and subject areas. A report by INSOL International[26] provides five clear use cases for TAR technologies in insolvencies – when investigating complex and large insolvencies; when the resources and time is limited to establish working of a business; in turnaround scenarios to develop the most effective strategy; when tracing assets; when considering potential litigations to identify key trends, anomalies and time periods of specific interest. Additionally, TAR technologies when integrated with machine learning can be made to learn what human reviewers consider relevant and

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[26] n 14.

what they don't by 'training'. Bayesian updating[27] and predictive coding can then be utilised to apply this learning to the rest of the data set and cut back a lot of the delays in data analysis. However, the same Insol report in their survey found that a small percentage (35%) of IP's had confirmed using TAR technologies and further a meagre 28% had confirmed using the more sophisticated machine learning capabilities of TAR.[28] The reasons for such law adoption is lack of education and awareness and perceived cost effectiveness of TAR softwares. However, partly driven by competition from other firms and partly by time and cost saving TAR assisted reviews can help make as compared to human only review – the ubiquity of TAR assisted document reviews in inevitable.

Cloud Storage: Storage of data and accessibility of data to multiple participants whilst insuring data privacy and integrity can further be bolstered by using 'cloud services'. In the survey conducted by Insol, almost half of the Insolvency Practitioners assented to having used often or have encountered cloud computing technologies within their insolvency practices indicating the already wide-spread use of cloud storage technologies in insolvency practise. However, the use of cloud computing technologies comes with certain concerns as well namely, data integrity and security; risk of deletions and corruptions; the difficulties inherent in seeking to secure and access a virtual server, who might lawfully have access and passwords to the cloud service, whether the insolvent entity or in reality another party; and finally jurisdictional issues that stem of where the servers hosting the cloud is physically located. Many of these issued can be solved by integrating private

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[27] Bayesian updating is a method of revising probabilities based on new evidence. Starting with an initial belief (prior), you adjust this belief by considering how likely the new evidence is if the belief were true (likelihood). This process yields a revised probability (posterior), which incorporates both the initial belief and the impact of the new evidence.

[28] n 14., 9.

ledger technologies within cloud servers however that is an area of speculation as of yet. However, various convincing suggestions have been made to include blockchain technology in the Indian Information Utility database such as infusing trust in the NeSL system, making the data more secure and possibility of introducing smart contracts.[29] Whether that instrumentalises in actual reality is something to look out for.

There could be many other use cases for data analytics and big data computation in insolvency practices. Furthermore, big data can be integrated into any of other technological methodology such as TAR etc. to produce innovative solutions. What justifies having 'data analytics and big data' as a separate disruptive technology amongst the five its focus on 'data' that gives such technologies a unique distinguishing feature. Data today has become arguably, a separate asset class. Corporates (or Data Fiduciaries as per the Indian Digital Personal Data Protection Act) collect and sell our data each millisecond. In fact, certain business models such as Social Media Direct Marketing and Biotechnology cannot function without data as an asset class. How insolvency is to deal with this new asset class is a moot question. Corporation Insolvency Resolution Process ('CIRP) is similarly deeply contingent on the availability and analysis of financial data. This focus on 'data' as a separate asses class will become clearer in section IV where I shall address its challenges.

C. Distributed Ledger Technologies (Blockchains)

Blockchain is defined as a technology that is secure, immutable, decentralized and distributed string of unique 'blocks' carrying data. These blocks are chronologically arranged and each is given its own time stamped

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[29] Ankeeta Gupta, 'Information Utilities And Blockchain: An Unlikely But Holy Partnership' (2022) IBBI Research Initiative https://ibbi.gov.in/uploads/publication/6b683482bf24ca7023aa99c8ef198bd8.pdf accessed 6 March 2024.

code. The block are then verified using hashing with all the other blocks in a chain – this ensures data immutability and security. The fundamental use case blockchain serves is the 'digital trust' is offers by eliminating the need for a third party to facilitate information exchange. The ledger can thus be programmed to conclude transaction automatically once a certain condition is met. However, smart contracts and data storing using distributed ledger is still in its infancy as the Insol survey indicated where only a meagre 10% of the surveyed IP's stated to have come across smart contracts or data storage in distributed ledgers. Most IP's and insolvency lawyers and practitioners are unaware of the potential opportunities blockchain technology created for the insolvency profession. In this sub-section I discuss four use cases of block chains namely, Tokenization of assets as a solution to the problem of the distressed debt market; resolution voting on a blockchain; security/automatic validation and smart contracts; and finally upgradation of data storage via ledger integration in Information Utility (IU's).

D. Tokenization Of Assets To Make Distressed Debt Market More Liquid

One of the seminal reasons plaguing insolvency resolutions and liquidation proceedings is the absence of a market for distressed debt. Ultimately when assets are sold off in liquidation or on account of restructurings – the market ultimately finds a lack of investors to purchase such assets.[30] Hence, under IBC, asset sale goes through rounds of 'haircuts' that greatly reduces the value of the asset and militates against the claim of asset maximization. Assets sold off during insolvency or liquidation proceedings tend to have a high entry barrier gives their high costs. These assets can be made more attractive to a major chunk of investor is the entry

[30] Navrang Saini's, 'IBC: Developing a Market for Distressed Assets' (From Chairperson Desk) https://www.ibbi.gov.in/uploads/resources/b7d255fa23b6d70f3dda575e9ec0dfae.pdf.

barrier is reduced through fractional ownership – this is precisely the benefit asset tokenization on a blockchain would offer.[31] Asset tokenization refers to the process of recording the rights to a given asset into a digital token that can be held, sold, and traded on a blockchain. Tokenization of real estate interests is a win-win for both investors and fund businesses acting as the issuing entity because it frees investors from the illiquid, long-term confinement and high entry barrier while simultaneously reducing the transaction costs and providing an automated and facilitated tax and regulatory compliance process for companies issuing tokens.[32] To summarize – tokenization via fractional ownership creates liquidity in an otherwise illiquid market. The usage of blockchain could be particularly in auction sales under 11 U.S.C. §363 which demands the debtor or resolution professional to market its assets to potential buyers and further involves several intermediaries that are necessary for the verification and approval of the debtor's sale of his assets. Blockchain has an added advantage of taking away these intermediaries in the process of asset sale. Smart contract automation within blockchains can for instance lower the cost of a transaction by eliminating the fees paid to multiple intermediaries.[33] An added advantage that comes from the elimination of intermediaries is the two contracting parties can ascertain a trues 'Net Asset Value' for their investment. However, 'blockchain securities' themselves pose significant harms to insolvency regimes – not so much in its assistance during the asset sale but rather when the estate that goes bankruptcy itself consists of blockchain securities like

[31] George Sazandrishvili, Asset Tokenization on Blockchain Explainedin Plain English, *(Medium,* 19 May 2018) https://medium.com/coinmonks/asset-tokeniization-on-blockchain-explained-in-plain-english-f4e4b5e26a6d accessed 8 March 2024.
[32] Ryan M. Mardini, 'Point of Intersection Where Blockchain Meets Bankruptcy: Can the Ingenuity of Blockchain Restructure and Streamline the Bankruptcy Process' (2020) 3 Wayne St UJ Bus L 8.
[33] ibid (n 25).

crypto. Such assets may present two principled problems – one, they conceal the identity of the 'owner' and the 'buyer' thus making it hard to determine ownership especially with regards to ascertaining which assets to include within the bankruptcy estate and which assets to exclude. Further the 'immutable' nature of transaction conducted on a blockchain can be a serious challenge for the courts or resolution authorities in dealing with avoidance transactions.[34] These challenges from blockchain bases securities are later analysed in section IV.

E. Voting on a Blockchain

During the approval of a resolution plan, the creditors ordinarily are to vote on the reorganization plan (applicable to creditor in control insolvencies). Only when a plan is approved can the restructuring be undertaken. Due to automatic verification and the immutable nature of blockchain ledges, there has been considerable talk of how the electoral voting process can be conducted on blockchains.[35] The same reasoning can be attributed to the voting during the approval of resolution plans. Voting process during approval of resolutions plans are highly complex because they include differential rights based on the nature and volume of credit owed. This complexity becomes increasingly pronounced in large scale insolvencies involving a huge number of creditors. Distributed ledgers are flexible and governed by code-based rules – hence algorithms can be programmed into the ledges that only allows votes to be counted if the system allows it. Thus, proportional voting rights can be automated and coded into the blockchain, which could automate much of the voting process during resolution approval process without human

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[34] Renato Mangano, 'Blockchain Securities, Insolvency Law and the Sandbox Approach' (2018) 19 Eur Bus Org L Rev 715.

[35] Mike Montgomery, One Place Where Blockchain Could Really Help: Voting' *(Forbes,* 21 February 2018), https://www.forbes.com/sites/mikemontgomery/2018/02/21/one-place-where-blockchain-could-really-help.

errors. While some may argue that implementing such a blockchain architecture and then scale is not cost efficient especially for large insolvencies, however a bespoke cost effective blockchain system can be designed using existing cost-mitigating strategies. For example, one may use a 'private or permissioned blockchain' to reduce transaction fees, using a Proof of Stake (PoS) consensus mechanism instead of Proof of Work which would require less expense on compute power and using automated smart contracts to save external costs such as vote counts and result tallying. Most of these blockchain architecture are available today as 'open source' codes hence, I would argue that in the long term, such technologies are cost-saving.

F. Updation of Information Utility

The India on September 25. 2017 introduced a 'one of a kind' concept of 'Information Utility' to integrate with its ins.[36] The success of the corporate insolvency resolution process hinges on the availability of complete, up to date and correct information and data about the debtor, his assets, and the totality of credit inter alia. This data and information is usually not available to every creditor and stakeholder in equal measure – leading to asymmetry of information. The non-availability of information may significantly compromise on the value maximising goal of insolvency resolution process and information asymmetry may lead to uneven sharing and discrimination amongst various stakeholders. To combat precisely this problem, the Indian Insolvency and Bankruptcy Code introduced the concept of 'Information Utility' that functions a transparent and efficient repository relevant data for the purposes of insolvency resolution. In India there is, as of now, only one registered informational utility under the name of 'National E-Governance services limited or NeSL' While there is no evidence to show that NeSL itself

[36] T.K. Vishwanathan 'Banking Legislative Reforms Committee Report' (2015).

has faulty technology, the system in fact has a good 'muti-tier security feature' however it is also a truism that the Information Utility technology has not picked up significantly in India. The problem largely seem to be one of trust.[37] This is precisely where block chain can be utilised. The 'trust affirming' use case of blockchains through its decentralised, transparent and automatic verification process can be a revolution in the Information Utility system in India. Ankeeta Gupta, in her paper has made a valiant case for introducing block chain technology to solve the problem of 'trust' in the IU ecosystem in India.[38] The decentralized nature of blockchains, built on consensus algorithms that require data verification across all nodes rather than by a centralized authority, ensures data immutability, transparency, and auditability. This technology enables blockchain-based Information Utilities (IUs) to function securely and democratically, as Ankeeta argues, by preventing data control by any single authority. Blockchain's design allows IU users equal rights and access, fostering transparency. As Ankeeta explains, blockchain can enhance IUs in two ways: first, by timestamping, verifying, and authenticating data upon entry; second, by recording any changes in new blocks verified by all participants, blocking unauthorized alterations and preserving data integrity and trust. India's premier policy adjudicatory body Niti Ayog has re-affirmed the enormous use cases provided by blockchain technology.[39] There are various other advantaged Blockchain technologies offer to Information Utility such as, (a) A faster reference of determining whether a debt is in existence (b) facilitate the IPR/RP during Corporate Insolvency Resolution Process to collate all the transaction from the ledgers

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[37] Ankeeta Gupta, 'Information Utility and Blockchain: An Unholy Partnership' (2022) IBBI Research Initiative.

[38] ibid at Pg. 48-55.

[39] Mr. Rajiv Kumar, Blockchain: The India Strategy Part 1, (2020) https://niti.gov.in/sites/default/files/2020-01/Blockchain_The_India_Strategy_Part_I.pdf.

and (c) The decentralized structure of the database eliminates the need for the IU entity to obtain acknowledgment of the debt from both the debtor and creditor. Instead, the transaction is simply recorded with a coded or hashed identifier, serving as unalterable proof of an acknowledged transaction between the two parties.[40] Blockchain has significant use cases in record keeping of credit information by disaggregating information asymmetry and procedural delays[41]. At the same time however, there are certain harms that blockchain based ledgers pose poses such as 'anonymity', 'lack of scalability' and a potential threat to sovereignty hence the implementation of blockchain technology must be calculated and modified through various algorithmic permutations such as utilizing private/permissioned blockchains to offer the maximum advantage.

G. LLM's and RegTech

The name 'RegTech' comes from the rather uncreative combination of the words 'regulation' and 'technology' and represents a great leap towards automation and streamlining of regulatory compliances.[42] These technologies automate legal compliance through the use large language models. The Financial Conduct Authority in the UK, defines RegTech as 'technologies that may facilitate the delivery of regulatory requirements.[43] These technologies use 'natural language processing' through 'rule-based algorithms'. Here a

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[40] Akaant KM, 'Blockchain Technology – can it be a panacea for the Ills ailing the IBC', in *IBC: Evolution Learnings, and Innovation* (IBBI 2023).

[41] Debanshu Mukherjee and Aditya Ayachit, 'IBC, Delays and Information Assymetries: Can Blockchains help?', in Quinquennial of Insolvency and Bankruptcy Code, 2016, IBBI (2021) "certain attributes inherent to blockchain (e.g., trust, security, transparency, immutability and cost reductions) make it a superior method of recordkeeping which could aid the insolvency framework under the Code".

[42] Saule T. Omarova, '*Dealing with Disruption: Emerging Approaches to Fintech Regulation'* (2020) 61 Wash. U. J.L. & Pol'y 25, 48.

[43] Financial Conduct Authority, "Feedback Statement, Call for Input on Supporting the Development and Adopters of Regtech" (2015) Available athttps://www.fca.org.uk/publication/feedback/fs-16-04.pdf, Accessed in 2015.

written 'rule' (think a law) is interpreted by a programmer and is coded into algorithm. Using decision tables and decision trees which provides the algorithm 'logic'.[44] Hence, these AI based technologies are trained on language and are 'generative' and not predictive – think in terms of ChatGPT but for law! They generate analysis through text based on interpreting other texts.[45]. Insolvency practices today have also been disrupted through these ingenious 'RegTech' technologies. As 'generative' AI becomes more advanced in inferential reason, logic and language analysis the use cases of RegTech will extend beyond mere compliances to actual legal advisory and legal assistance. An example of this is 'ROSS Intelligence' Ross can respond perspicaciously to legal questions after searching and scrapping data from legal databases integrating the information to its logic based rules system.[46] Similar to ROSS Intelligence, multiple RegTech technologies utilising natural language processing and employing large language can automate much of legal compliance and advisory work performed by lawyers in insolvency professionals and can provide quick legal advice to IRP's.

H. Process reforms through automation and digitization

Process reforms are essentially 'nuts and bolt reforms' that are done to simplify processes for a certain activity of a sector at a very micro-scale. They

[44] Jain, Aditya Sushant. "An inter-disciplinary approach to automation technology in finance-what can history, law and data science teach us?" *ICTACT Journal on Soft Computing* 14, no. 01 (2023): 3154-3164. I have explained the simple working of RegTech softwares earlier, "software codes in RegTech are largely based on declarative statements which can then be combined into decision like tree branches, for example rules such as 'Do not offer mortgage requiring monthly payment of over $... to an applicant making less than $...".

[45] Ibid. See also John W. Bagby & Nizan G. Packin, 'RegTech and Predictive Lawmaking: Closing the RegLag between Prospective Regulated Activity and Regulation' (2021) 10 Mich Bus & Entrepreneurial L Rev 127.

[46] Amit Chowdhry, 'Law Firm Baker Hostetler Hires A 'Digital Attorney' Named ROSS' (*Forbes*, 17 May 2016) <https://www.forbes.com/sites/amitchowdhry/2016/05/17/law-firm-bakerhostetler-hires-a-digital-attorney-named ross/?sh=51c5e0d278c4>.

are small-scale tweaks but they can have a major impact overall[47]. It is my position, that the functioning of courts, resolutions authorities and administrative processes in insolvency and restructuring can be revolutionised using technology to users in 'process reforms'. This can be done through several ways - Firstly, the filling system for the initiation of CIRP should be made completely online through digitization. The system can make certain field to be filled necessarily; the registered office address and the corporate identification number can be populated automatically through the Ministry of Corporate Affair's portal and finally the IU certificate can be procured from the national NeSL portal.[48] India already has two portals – the MCA Portal and the NeSL IU portal from where data can be automatically procured online.[49] Once the filling process has been completed online, is rendered defect free and is numbered – an algorithm can be quickly coded which would automatically send intimation notices to the creditor(s), the debtor and other stakeholder digitally signed by the officer in charge of the registry. This automation of 'hearing notices' has two benefits, – *first*, that it will reduce the delays that arise after the application is listed but hearing notices are yet to be sent and *second,* that it will preclude the pleas by the corporate debtor that no intimation was received by her and thus do away with the practice of obtaining 'affidavits of service.' Once the order for the commencement of CIRP is approved by the AA, it is ready for pronouncement the next day. This procedure can be automated to automatically add the digital signatures of the members on the pronouncement day, with a digitally signed copy being directly sent to the counsel of record[50]. A digitally signed copy of the order

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[47] Sanyal, Sanjeev and Arora, 'Akanksha Process reforms: Fixing the Nuts and Bolts' (2023) Delhi School of Public Policy & Governance <http://dsppg.du.ac.in/our-publications/>.
[48] V.K. Rajasekhar, 'Use of Technology in to improve NCLT functioning', in *IBC: Evolution Learnings, and Innovation* (IBBI 2023).
[49] ibid.
[50] ibid.

guarantees the integrity and immutability of the order, while simultaneously lowering litigation costs. The replacement of certified copies demanded by the AA can be replaced with digitally signed copies – these digital signatures can be recorded on a blockchain that will ensure utmost security and immutability.[51] As per the current principle in Insolvency framework in India, for Section 7 application - the adjudicating authority is to only apply its mind with regards to the existence of a debt. Once the threshold of the debt is met, the CIRP is bound to begin. This process can further be systematised by identifying certain standard elements in the orders passed by the AA's and further using machine learning software to automatically populate the order so that the AA will only have to apply its mind to the existence of debt.[52] There are various other process reforms that can be undertaken such as by using technology in case scheduling, making hybrid hearing the norm rather than exception, completely doing away with physical documents or physically signed documents and utilising digitally signed documents, and many more!

IV. CHALLENGES POSED BY EMERGING TECHNOLOGIES

Having recognised the multifarious advantages and efficiencies emerging technologies present towards revolutionising, streamlining and fastening up the insolvency and resolution process in countries – they also come with significant threats. The threats posed by such technologies have been acutely absent from the academic discourses surrounding the impact of emerging technologies in insolvency practices. This is precisely the gap this section aims to fulfil. Before venturing on to the exact perils of technology within insolvency practices it is important to set the scope. Each of these 'challenges' such as those emanating from crypto or cloud computing can

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[51] ibid.
[52] ibid.

make for a whole individual paper – this paper would only offer a brief overview of such challenges and shall accustom the reader to the most significant harms that these technologies present, hence this section is does not purport to be exhaustive.

In this section, I have categorized the perils of technologies in insolvency and bankruptcy practices into three buckets namely:

- Perils of AI in predictive bankruptcy
- Perils of RegTech in insolvencies
- Perils of insolvencies of 'new technological asset classes'

I believe these three buckets cover most if not all of the current threats technologies pose towards insolvency and bankruptcy practices cross-jurisdictionally. It is my position that such 'technological threats' arise from the inherent and unique characteristics of the underlying technology and the used & the consequent human reactions to them and thus I have eschewed from utilising a 'technology neutral' position throughout this section.

A. Perils of AI in predictive bankruptcy:

1. AUTOMATION BIAS

Risk prediction technologies' are not infallible and often can produce errors; nevertheless, our financial and other institutions suffer from a deep and pervading automation bias.[53] This 'automation bias' amongst those working in finance was a key reason in the 2008 global financial crisis. Take for example VAR (value-at risk) risk predicting technology that were used almost ubiquitously during the 2000's. Even the Basel accords permitted VAR reports to be submitted a sufficient measure of risk.[54] The software used

[53] A. Bamberger, Kenneth, "Technologies of Compliance: Risk and Regulation in a Digital Age" (2010) TLR 88.

[54] See Minimum Capital requirements for market risk Standards (2016) Basel Committee on Banking Supervision accessible at: https://www.bis.org/bcbs/publ/d352.pdf "*Where a bank*

regression and correlation methods to analyse "market risks" and chart out its 'probabilistic interconnectedness' in a certain time usually by representing them as percentage points called 'confidence levels.' In summary, it uses ML to create simulations of various risk sources and uses regression to distribute risk amongst a large number of outcomes. Traditional financial models face a major flaw: they are "backward-looking," relying on past data to predict future events. This approach is problematic, especially as economic cycles shift; data from an up-credit cycle is unreliable for down-credit predictions. Financial markets often behave irrationally and are influenced by "black swan" events, such as extreme fiscal reactions to geopolitical crises, as seen in 2008. Value-at-Risk (VAR) models, based on data from earlier events, inaccurately showed rising mortgage prices during the 2008 crisis and failed to capture extreme market risks beyond their 95%-99% confidence limits. Nevertheless, financial firms, overly confident in VAR's complexity and efficiency, began to replace risk analysts and relied heavily on VAR for issuing Credit Default Swaps on mortgage-backed securities. This exemplifies "automation bias"—the tendency to overly trust AI-driven systems and disregard suspicions, even when there is evidence of malfunction. When high stakes are involved, automation bias can lead to wishful thinking, sham business practices, and a dangerous abdication of oversight and regulatory responsibility, creating a "crisis in due process."[55]

Complex Bankruptcy prediction models thus can lead to market wide 'automation bias' due to their ever increasing complexity. While predicting insolvencies or defaults, often prediction models can give wrong warnings due to error in data sets. As these fast becoming neural networking models using

has a VaR measure that incorporates specific risk and that meets all the qualitative and quantitative requirements for general risk models, it may base its [specific risk capital] charge on modelled estimates . . . ".

[55] Danielle Keats Citron, "Technological Due Process", (2008) *85* Wash. U. L. Rev. 1249.

in default prediction false alerts in financial sectors or a false predictions of health in otherwise unhealthy companies will go un-questioned. Bankruptcy Risk predictions models not only suffer from expired data sets but also through problems of overfitting, underfitting, modelling on fallible human assumptions[56] and human bias integrated in the code[57]. Hence, while the efficiency of these models cannot be discounted – they must not lead 'automation bias's and must not be used as replacement to human risk analysis.

2. Black Box Models

As I have discussed previously, Bankruptcy predictions have been historically moving to more 'complexity' where now the models are constantly using advanced AGI such as Neural Networks or Deep Learning models – which ultimately are 'black boxes' – i.e. those whose reasoning cannot be understood due to their sheer complexity. Frank Pasquale, in his book 'the Black Box Society: The secret algorithms that control money and information' has elucidate to a great many length about the harms posed by such black box models.[58] Black Box models simply refers to those models,

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[56] See for example John H. Walsh's statement, ohn H. Walsh, Assoc. Dir.–Chief Counsel, Office of Compliance Inspections & Examinations of U.S. Sec. & Exch. Comm'n, Remarks Before the NRS 21st Annual Spring Compliance Conference (April 18, 2006) (transcript available athttp://www.sec.gov/news/speech/2006/spch041806jhw.htm). "*If you set their parameters too high, they could miss important red flags. For example, if you have an electronic report that monitors for investment time horizons, but you assume that only investors under age 50 have investment time horizons, you could miss a lot of red flags relating to the elderly. Also, an electronic report cannot find red flags in data it does not have. For example, if you rely on your clearing broker for mutual fund exception reports, but do most of your business with the fund companies by way of "check- and-app," those clearing broker reports will not do you much good"*.

[57] Frank Pasquale, *The black box society: The secret algorithms that control money and information* (Harvard University Press 2015) "*Software engineers construct the datasets mined by scoring systems; they define the parameters of data-mining analyses; they create the clusters, links, and decision trees applied; they generate the predictive models applied. Human biases and values are embedded into each and every step of development. Computerization may simply drive discrimination upstream"*.

[58] n 54.

which have attained such high level of complexity that they are beyond human understanding. Human may observe their outcomes but fail to infer causality. These algorithms hide biases and discriminatory modelling until perpetuity, especially with regards to personal bankruptcies. For instance, a default prediction algorithm may give a low score to black person than a white person due to the black community having a higher rate of default historically in the given data set. These could happen because the data set within the model was un-representative. These default risk predictions can affect interest rate on loans for individuals and thus further inequality.[59] These algorithms when employed on a large scale lead to crisis of transparency, and maximises 'automation bias' in markets hence these algorithms must be employed in a controlled and careful fashion.

B. Perils of RegTech in insolvencies

Large Language Models (LLMs), like ROSS Intelligence, introduce significant challenges in legal contexts, particularly in insolvency practice. Similar to predictive AI, LLM-based RegTech tools encounter two primary issues: the "problem of translation" and the "Tower of Babel" dilemma. The translation issue arises because laws must be coded into the AI by engineers who may lack the nuanced interpretive skills that legal analysis demands. This mismatch was evident with Digital Rights Management (DRM) software, where engineers failed to encode the "fair use" doctrine properly, leading to restrictions that inadvertently contradicted copyright law. In insolvency law, LLMs might similarly struggle with subjective determinations, like assessing whether a "true sale" in a securitized transaction excludes it from a debtor's estate—a question that requires interpretive expertise beyond rigid coding.

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[59] n 9.

The Tower of Babel issue refers to the overwhelming variety of financial terminologies, akin to the biblical story where linguistic diversity impeded communication. For LLMs to effectively address cross-border insolvency, there must be a standardized financial lexicon, as they are currently limited by regional language variations in financial law. Without such standardization, LLMs may struggle to deliver the global applicability necessary for handling cross-border insolvency cases, where diverse financial systems and terminologies intersect.

C. Perils in the insolvency of new 'technological asset classes'

As technology has progressed, it has led to the development and wide spread adoption of various 'new' asset classes such as crypto currencies and data. These new asset classes fall well out of the regulatory ambit of insolvency and bankruptcy frameworks across the worlds. Here, I shall briefly discuss certain problems regulators may face when they try to fit in these new asset classes within their traditional regulatory frameworks.

1. CRYPTO

The literature surrounding the problems faced by insolvency and resolution authorities and courts in dealing with crypto assets is rich[60]. Bitcoin (crypto) is a decentralized digital currency that allows peer-to-peer transactions over the internet on a blockchain without the need for a central authority like a bank or government. Scholars have realised that the peculiar nature of blockchains which renders these ostensible currency decentralised, pseudonymous and causes mercurial price fluctuations. These characteristics

[60] See for example, Megan McDermott, 'The Crypto Quandary: Is Bankruptcy Ready?' (2021) 115 Nw U L Rev 1921; Polina Lyadnova; Polina Lyadnova; Ekaterina Dorokhova; Hannah Whitney, "Cryptocurrencies in Insolvency: Evasive Reality," (2019) Pratt's Journal of Bankruptcy Law; Matthias Haentjens et al., The Failed Hopes Of Disintermediation:Crypto-Custodian Insolvency, Legal Risksand How To Avoid Them, (2020) Singapore Journal of Legal Studies; Lee Pascoe, "Digital Currency Exchanges, ICOs and Insolvency: The Story So Far," (2019) Insolvency and Restructuring International 13.

of crypto make it particularly hard to deal with crypto currencies especially in the context of insolvencies and liquidations. Crypto-currencies engender a heightened risk that debtors will use crypto to shield assets from creditors, they may pose grave valuation risks for liquidators especially due its intense price fluctuations which militate against the value maximisation purpose of Insolvencies and liquidations. The problem however starts on a definitional front – is crypto an asset, a currency or property.[61] The case *Re Hashfast Technologies* highlighted the ambiguity around classifying cryptocurrency in insolvencies. In this U.S. liquidation, the trustee argued that Bitcoin should be treated as a commodity, and thus liquidated, while the debtor argued it behaved as a currency and should be excluded from the estate. The court's lack of a definitive ruling underscored the challenges insolvency practitioners face in categorizing crypto assets. This ambiguity affects whether crypto is

[61] The definitional issues was seen poignantly in Re Hashfast Technologies, a US Liquidation court case concerning a tech copay that developed a technology that allowed bitcoin miners to outpace their competitors. The debtors possessed 3000 bitcoins which were sought to also be liquidated. The insolvency trustee argued that bitcoin should be treated as a commodity like gold etc that fluctuates in price placing reliance on an order from the Commodity Futures Trading Commission requiring cryptos to be regulated under its purview. Hence, the trustee argued that it should be taking within the insolvency estate and liquidated. On the other hand, the debtor argued that bitcoin should be treated as a currency since it 'behaves' as such, and thus should be exclude d from the insolvency estate. Even through the court did not conclusive answer this question however insolvency practitioners were made acutely aware of the ambiguousness of crypto currencies with respect to their insolvencies. Right at the outset – determining the character of crypto, whether they are to be treated assets, currencies, commodities, or property will determine whether they are included or excluded for the insolvency estate. If it is the former, the question remains as to how to liquidate them since a conversion of crypto in fiat currency would lead a sudden fall in its prices especially if the wallet size is particularly large and if it is the former, it can open an easy route to avoidance transaction by the debtor given that crypto is stored anonymously thereby shielding assets from creditors In fact, as has been argued by a scholar that certain decisions such as In re Peeples and In re Schultz which showcase a debtor friendly approach of bankruptcy courts encourage precisely the latter. Further, as was highlighted by the insolvency of crypto exchange Quadriga and Mt. Gox, crypto currencies give a false façade of liquidity. During the liquidation proceedings of Mt Gox, the price of bitcoin rose multifield and unsurprisingly the creditors asked the trustee to pay them in crypto, however the law did not permit payment in crypto – and hence, due to the lengthy process of liquidation, and converting bitcoin into fiat, the price of crypto fell leading to huge value loss to creditors.

included in an insolvency estate and raises concerns over liquidation impact, potential for avoidance transactions, and liquidity risks, as seen in high-profile cases like Mt. Gox and Quadriga. Hence, some scholars argue that requiring creditors to accept payment in bitcoin seems more fair then payments in fiat currency.[62] Yet another problem with crypto currencies is its ownership[63] especially with respect to crypto exchanges and wallets. Clearly, the anonymous, decentralised, and volatile nature of crypto currencies pose many problems for insolvency experts. Today, there are thousands of bitcoin exchanges, wallets, currencies etc. and due to its intense volatility some are bound to be bankrupt. For example, a famous crypto exchanged called Wazir X in India recently filed for insolvency in the Singaporean court after a 320 Million hack Problems arose in maying back the creditors of Wazir X in India since payment in fiat currency would have eroded the value of their coin altogether. A closed approach of bankruptcy laws towards crypto thus would not suffice. It has to clearly lay out how decentralised assets and currencies functioning over a blockchain are to be treated.

2. DATA AS AN ASSET

Economies today are data driven. Data in today, in effect, modern gold. Capital structures of companies in the 21st century will be starkly different from those of the past century. Once driven by hard assets, such as real estate, natural resources and machinery, modern businesses become highly dependent and valued on the basis of intangible assets – claims, licenses, know-how and goodwill. Increased value of data (e.g. customers' databases) in debtors' insolvency estates together with the expansive process of digitisation and data collection (big data) bring data protection issues to the

[62] ibid.

[63] Matthias Haentjens et al 'The Failed Hopes of Disintermediation: Crypto-Custodian Insolvency, Legal Risksand How To Avoid Them' SJLS, (2020).

forefront of legal and insolvency practice."[64] There are entire industries that revolve around storage and use of data – take for example biotechnology firms. However, a moot question that arises is that in the event such a firm goes bankrupt – what is to happen to its data? According to data privacy laws such as General Data Protection Regulation, EU (‘**GDPR**’) and Digital Data Protection Act (‘**DPDP**’), the data subjects have a right to withdraw or delete their data however, in the event the data controller (firm) undergoes insolvency – a moratorium is attached to the disbursement of their assets for the company to remain a going concern. What would happen to their data as an asset? Further, an ethical question yet again arises as to whether consumer data can be sold off during a CIRP, especially if it consists of sensitive personal data? Some scholars argue in favour of the data subject and posit that the relationship between host and the user with respect to data collection is that of bailee/bailor. Hence, the host possesses the data solely for the purposes of storage and the data subject maintains its ownership stake.[65] Since the data controller has no ownership stake, the date of the users would be excluded from the bankruptcy estate. However, Rebecca Perry disagrees. She argues that the concept of Bailment only applies to tangibles and hence would not apply to data.[66] The answer, I believe, ultimately lies on harmonization of data privacy laws and insolvency, restructuring and bankruptcy codes.[67]

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[64] Wessels, B., & Kokorin, I. Cross-Border Cooperation and Communication: How to Comply with Data Protection Rules in Matters of Insolvency and Restructuring (2019) 16(2) International Corporate Rescue 98.

[65] Matt Hafter, ‘Data in the cloud: What if the cloud provider goes bankrupt’ (*Thompson Coburn LLP* 7 March 2018) https://www.thompsoncoburn.com/insights/publications/item/2018-03-07/data-in-the-cloud-what-if-the-cloud-provider-goes-bankrupt.

[66] Re Hashfast Technologies (n 61).

[67] See for instance, Wessels, B., & Kokorin, I. (2019). Cross-Border Cooperation and Communication: How to Comply with Data Protection Rules in Matters of Insolvency and Restructuring. *International Corporate Rescue*, *16*(2), 98-103; Ronny Hauck, "Personal Data in Insolvency Proceedings: The Interface between the New General Data Protection Regulation and (German) Insolvency Law," (2019) 16 European Company and Financial Law

V. CONCLUSION

This paper underscores the transformative potential of emerging technologies, such as AI, ML, Big Data, and Blockchain, in reshaping insolvency, bankruptcy, and restructuring processes on a global scale. By offering a detailed taxonomy of these technologies, the research provides a framework for understanding how they can improve efficiency and decision-making for insolvency practitioners, resolution professionals, and adjudicating authorities. However, the integration of these tools also brings substantial challenges, including automation bias, complexities in codifying legal rules, and the novel issues posed by cryptocurrencies as assets. Ultimately, the findings of this paper highlight both the opportunities and the responsibilities of regulators and practitioners, providing a roadmap for the responsible integration of technology in insolvency practices. Through this roadmap, stakeholders are better equipped to harness innovation while safeguarding the integrity and stability of insolvency regimes in the 21st century.

Review (ECFR) 16: 724-745; Michael R. Fabrizio, "Data Privacy in Cross-Border Insolvency: A Fundamental Right or a Threat to Open Access," (2019) 2 NY International Law Review 32, 65.

V. PUBLIC INTEREST v. CONTRACTUAL WAIVER DEEP DIVE INTO INTERCREDITOR AGREEMENTS UNDER THE IBC

Kushagra Dwivedi *

ABSTRACT

This paper provides an in-depth analysis of the legal and policy implications of enforcing Intercreditor Agreements (ICAs) under the Insolvency and Bankruptcy Code, 2016 (IBC), focusing on the tension between contractual waivers and statutory rights. ICAs, agreements among creditors to coordinate their actions in cases of debtor default, have become a critical tool in India's evolving insolvency landscape. However, their enforceability, particularly regarding the waiver of a creditor's right to initiate insolvency proceedings under Section 7 of the IBC, raises important legal questions. Section 7 allows financial creditors to file for insolvency against a defaulting debtor, a right grounded in the public interest to maintain financial order and creditor protection. The paper investigates key judicial decisions, including *Rakshit Dhirajlal Doshi v. IDBI Bank Ltd*. and *Amitabh Kumar Jha v. Bank of India*, to illustrate the courts' treatment of ICAs and their implications for creditor rights. In Rakshit, the court rejected the Section 7 application, citing obligations under a Security Trustee Agreement, demonstrating that consortium loan agreements can bind creditors to collective action, limiting individual recourse. This reflects a nuanced approach to statutory rights, recognizing the complexity of loan arrangements while balancing contractual freedom with the public interest objectives of the IBC. Additionally, the paper examines the doctrine of waiver in the context of insolvency, considering whether the right to file for bankruptcy can be waived and if such waivers conflict with the IBC's goals of asset maximization and equitable treatment of creditors. The study highlights concern about protecting the interests of junior creditors, who may lack negotiating power in ICAs and suffer disproportionately high losses during insolvency proceedings. The paper proposes a factor-based approach for assessing ICA enforceability, focusing on considerations such as equitable treatment, the duration of restrictions, and the separation of debtor involvement. By navigating these legal complexities, the study aims to contribute to the broader debate on balancing creditor autonomy with public interest in India's insolvency regime.

Keywords: Contracts Law, Insolvency Law, Section 7, Doctrine of Waiver.

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I. INTRODUCTION

The Insolvency & Bankruptcy Code, 2016 (**'IBC'**) was introduced with the intent to bolster entrepreneurship and raise the overall rate of recovery from failing and bankrupt companies. While it has succeeded in raising the rate of recovery, there have been concerns about the IBC being abused to further monopolistic practices and the Significant reductions in the repayment amounts (or 'haircuts') have led to concerns for creditors have warranted a closer look into other means of corporate debt restructuring.

Intercreditor Agreements ('**ICAs**') play a crucial role in the landscape of corporate finance and insolvency, particularly in the context of India's Insolvency and Bankruptcy Code, 2016 (IBC). These agreements, which are typically entered into by creditors of a common debtor, seek to regulate the rights and obligations of the parties in situations of financial distress. ICAs are designed to provide a structured framework for resolving conflicts among creditors, thereby facilitating smoother debt restructuring processes.

However, the enforceability of ICAs, particularly about the rights of creditors under Section 7 of the IBC, has emerged as a contentious issue. Section 7 allows financial creditors to initiate insolvency proceedings against a defaulting debtor, a right that is often seen as fundamental to the creditor's protection. The question then arises: to what extent can creditors, through ICAs, waive or limit this statutory right without contravening the public interest objectives embedded within the IBC?

This paper seeks to explore the legal and policy considerations surrounding the enforceability of ICAs under the IBC. It will examine key judicial decisions that have shaped the discourse on this issue, analyse the potential conflicts between contractual freedom and statutory rights, and propose a framework for evaluating the validity of ICAs in the context of insolvency proceedings. By doing so, the paper aims to contribute to the ongoing debate on how best to balance the interests of creditors while ensuring the broader goals of the IBC are upheld.

II. RAKSHIT DHIRAJLAL DOSHI AND OTHER JUDGEMENTS

In the case of *Rakshit Dhirajlal Doshi v. IDBI Bank Ltd (**'Rakshit'**)*[1] a consortium of four banks gave a loan to the lendee - Doshion and entered into a Security Trustee Agreement with Infrastructure Leasing & Financial Services (**'IL&FS'**) Trustee Company Ltd. The banks also entered into an inter-se agreement with each other regarding their obligations and priority of debt amongst other details relevant to inter-creditor relations. Doshion was lent a sum to the tune of 422 crores by the banks and ended up defaulting on the amount due towards IDBI Bank, which was a member of the consortium of lenders. IDBI Bank, therefore, ended up sending a notice to Doshion and

[1] Rakshit Dhirajlal Doshi v. IDBI Bank Ltd [2022] NCLAT SCC OnLine 4579.

its guarantor - Fivebro International Private Limited (**'FIPL'**), and subsequently filed for the initiation of Section 7 Insolvency proceedings against Doshion. The NCLAT in its order set aside a prior judgement of the NCLT where the Section 7 application against FIPL was admitted and set aside IDBI Bank's application. This enforcement of an inter-se agreement to reject the initiation of insolvency was in stark contrast to the court's previous stance. In judgements like *Bank of India v. TD Toll Road Ltd*[2] and *Amitabh Kumar Jha v. Bank of India*[3] (**'Amitabh'**), the NCLT and the NCLAT have refused to recognize the enforceability of an inter-se agreement to trump their statutory right to file for Section 7 when a default can be reasonably gleaned. A deeper analysis of the court's reasoning may be necessary to clarify this issue. The determining factor in the Rakshit judgement is the Security Trustee Agreement (**'STA'**) between IL&FS and the consortium of banks. A Security Trustee holds the charge on assets that have been put up as collateral by the debtor, essentially functioning as the sole representative on behalf of the creditors.

In the Rakshit case, the court denied the Section 7 application filed by IDBI Bank because it was in contravention of the STA. According to the court, by not notifying the Trustee before filing the Section 7 application, IDBI Bank effectively initiated the Corporate Insolvency Resolution Process (CIRP) on behalf of all members of the consortium. This was because the STA made the rights of all participants interdependent, and the assets held in trust by IL&FS were to be managed collectively. The court observed that IDBI Bank, by agreeing to IL&FS managing the secured assets, had essentially committed to

[2] Bank of India v. TD Toll Road (P) Ltd *(NCLAT Mumbai*, 25 November 2019) CP (IB) 2803/MB/2019.
[3] Amitabh Kumar Jha v. Bank of India (NCLAT Delhi, 22 May 2020) Company Appeal (AT) (Insolvency) No 1392 of 2019.

a structure where filing for Section 7 would amount to filing on behalf of all participants of the STA. Consequently, this involuntary filing of a joint Section 7 led to the rejection of the Rakshit application.

Traditionally, the denial of such contractual waivers is based on the principle that the statutory right to initiate insolvency proceedings is in the public interest and therefore cannot be waived. However, the Rakshit decision reflects a more nuanced scenario. Here, the court's rejection of the Section 7 application was not merely about the non-waivable nature of the right but was deeply tied to the specific obligations under the STA. The court's decision underscores the complexity of managing rights and obligations within a consortium structure, where actions by one party can inadvertently bind others. This case demonstrates the importance of adhering to the procedural requirements set out in agreements like the STA, especially when dealing with collective rights and responsibilities. As we discuss the nature of the right to initiate insolvency proceedings later, it's crucial to recognize that the Rakshit decision hinges on the particularities of the consortium arrangement rather than a broader principle of the right being non-waivable.

A. *Enforcing a personal right v. Enforcing rights non-consensually*

The court's reasoning in the cases of Rakshit and Amitabh can be further understood through the decision in *IDBI Bank Ltd. v. Textrade International Ltd.*[4] In Textrade, the court upheld the Section 7 application filed by the applicant because the consortium of banks did not object to the filing. The court determined the consortium’s consent towards the application through their behaviour. The court noted that:

[4] IDBI Bank Ltd v. Textrade International Ltd. (NCLT Mumbai, 4 July 2023) CP (IB) 166/MB-IV/2023.

When the lead bank, on behalf of the consortium, served the debtor with a demand notice, and upon the debtor's default, symbolic possession was taken of the debtor's assets.

- The recall notice delineated the amount of default for each participant of the consortium.
- While a formal event of default had not been declared according to the Common Rupee Agreement, the banks' behaviour emphatically demonstrated such a default.

The Textrade judgement reinforces the court's original reasoning in Rakshit where the rejection was based on the non-consensual enforcement of the entire consortium's debt due to the Security Trustee Agreement, which made the participants' rights interdependent. The court observed that the participant banks had not objected, indicating implicit consent to the Section 7 filing. The Textrade judgement shows the importance of proper calculation and delineation of each party's contractual liabilities and rights. While this may seem redundant in situations like the Rakshit case—where the purpose of a Security Trustee Agreement is to simplify the management of charges on assets for a large debtor—it highlights how different loan structures interact with insolvency frameworks. In the Rakshit decision, it might appear that the court was moving towards recognizing the contractual waiving of Section 7. However, this interpretation is a result of the mingled rights and interests created by loan structuring conventions and the miscommunication among loan participants. The NCLAT has consistently held that the right to file for Section 7 is a statutory right intended for public benefit, which cannot be subject to the doctrine of waiver.[5] Therefore, an analysis of Section 7 through

[5] Amitabh Kumar Jha v. Bank of India (NCLAT Delhi, 22 May 2020) Company Appeal (AT) (Insolvency) No 1392 of 2019.

the lens of the doctrine of waiver is warranted to determine whether the courts are not endorsing the contractual waiving of this right but are rather navigating complex loan arrangements where the rights and obligations of participants are tightly interwoven.

B. The Doctrine of Waiver & The For-Public-Benefit Nature of Section 7

The doctrine of waiver essentially means that a person may waive a right available to them in return for some consideration, provided that they have full knowledge of the right they are about to waive and have full intention to do so. It has long been established in cases like *Shalimar Tar Product Ltd. v. H.C. Sharma*[6] and *Lachoo Mal v. Radhe Shyam*[7] that in order for a statutory right to be waived, it must be a right solely for the benefit of the individual waiving such right, and not for the benefit of the public or be a matter of public policy. Such a waiver must directly benefit the individual waiving such right.

While the court's approach towards admitting Section 7 applications has been concrete and unwavering, contractual restrictions upon such rights have not been discussed upon much. The standing on the matter mirrors the court's standing on the validity of *ipso facto* clauses. In *Gujarat Urja Vikas Nigam Ltd. v. Mr. Amit Gupta & Ors.*[8] (**'*Urja*'**), the court expressed its concerns over the wide overriding power of the now-replaced Sick Industrial Companies Act, 1985 that allowed for a wide-ranging suspension of contracts applicable to the insolvent company. The SICA Act was the precursor to the IBC, a major reason for the overhaul of the SICA Act into the IBC was the rampant abuse of Section 22(3) of the act that allowed for the suspension of

[6] Shalimar Tar Products India Ltd v. H C Sharma (Delhi 1973) SCC OnLine 205.
[7] Lachoo Mal v. Radhey Shyam (1971) 1 SCC 619.
[8] Gujarat Urja Vikas Nigam Ltd v. Mr Amit Gupta & Ors (SC, 8 March 2021) Civil Appeal No 9241 of 2019.

contracts if a scheme under Section 17 was pending or an inquiry into the feasibility of the company was ongoing under Section 16 of the act.[9] This served as a medium for companies to wiggle out of contractual obligations by initiating insolvency proceedings. While the main question of law in *Urja* was not based around the legal validity of such clauses, the court recognises the complex problem of determining whether conditional terminations upon insolvency through *ipso facto* clauses is a point worth discussing.

Section 14 intends to halt all legal proceedings and forbids the operational creditors from ceasing the supply of essential goods so that the company does not die as a result of the initiation of insolvency. It also places a halt on any legal proceedings going on against the insolvent subject. The legislative intent behind Section 14 is managing the operations of the insolvent firm as a going concern.[10] While *ipso facto* clauses directly contravene the legislative intent behind Section 14 of the IBC which imposes a moratorium upon the insolvent companies, the enforcement of ICAs does not contravene so directly upon the base intent behind the IBC. In Vidarbha Industries[11], the Supreme Court recognised that the intent of the IBC is not to penalise defaulting companies but rather to help recover the defaulted amount. While in the same judgement, the court also states that the adjudicating authority has little discretion in choosing to admit a Section 7 application. There is no mandate on necessarily filing a Section 7 application by the creditor. ICAs focus primarily on the pre-petition stage of the default. They ensure that, when a Section 7 application is filed, creditors act with unity and fairness, ensuring a speedy resolution.

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[9] ibid.
[10] Innoventive Industries Ltd v. ICICI Bank Ltd [2017] (11) SCALE 4.
[11] Vidarbha Industries Power Ltd v. Axis Bank Ltd (SC, 2022) SCC OnLine SC 841.

Since creditors would derive gain in the form of contractual consideration if such waivers were allowed, our goal lies in determining whether the right to file for insolvency under Section 7 is a right for the benefit of the public or simply for the benefit of the individual. By determining this, we can check if the right to file for bankruptcy is waivable or not. The Apex court has held in *Innoventive Industries Limited v. ICICI Bank Limited*[12] (**'Innoventive'**) that the threshold for successful admission of Section 7 must only be the existence of a debt and the existence of a default towards the repayment of that debt because the legislative intent of the IBC was the protection of the interests of the creditors and the availability of credit and maximisation of value. However, the nature of this right has not been discussed much. Having explored the theoretical underpinnings of the doctrine of waiver, particularly its application to statutory rights like those under Section 7 of the IBC, it becomes evident that these principles are not merely abstract. They directly inform the practical challenges faced by courts when determining the enforceability of ICAs. As we move into Part III, we will examine how these theoretical considerations manifest in real-world scenarios, particularly when balancing the rights of creditors against the broader objectives of the IBC.

III. PRIMARY CONCERNS REGARDING SUCH ENFORCEMENT

One important observation from these judgements is that in each case, the Corporate Debtor ("**CD**") uses the inter-se agreement to invalidate the creditor's Section 7 application. As a result, we do not have an explicit statement as to the court's reasoning for not enforcing such agreements. We only have the court's decision to not let the CD use an agreement between the

[12] Innoventive Industries Ltd v. ICICI Bank Ltd [2017] (11) SCALE 4.

creditors to enforce the debt. However, from the aforementioned case laws, the common lines of reasoning that can be gleaned are:

A. Section 238 of the IBC would override any inter-se agreement
B. Enforcing such agreements would be contrary to public benefit and would defeat the legislative purpose of the IBC

The concerns of the court can be satiated by applying a factor-based approach towards determining what a rightful waiver of the right to initiate CIRP would be, similar to how a true sale and derecognition of assets is governed by the RBI[13]. Such an approach would allow the courts to revert agreements that seem in contravention to the IBC's intent while empowering creditors with potential for much more unambiguous inter-se relations. But first, we must discuss the aforementioned issues and how the rights of creditors across the entire industry may be balanced.

A. The overriding effect of Section 238

The overriding effect of Section 238 has been talked about in judgements like Amitabh, however, the main contention of the court has focused upon the *locus standi* of the party trying to invalidate the Section 7 application. To date, only CDs have tried to use prior inter-se agreements to escape contractual liability. The court's rationale for not granting a consortium of creditors the right to refute an application filed in contravention of the ICA by a consortium participant remains unclear. However, cases like *B. K. Educational Services Pvt Ltd v. Parag Gupta & Associates*[14] show that the overriding effect of Section 238 does have reasonable restrictions and that it does not serve as a blanket to override any and all provisions it encounters.

[13] Chiraag Agarwal, 'Bankruptcy Remoteness in Indian Securitisation/Direct Assignment Transactions' in *Legal Research on Structured Finance* (2023) 18.
[14] B K Edu Services Pvt Ltd v. Parag Gupta & Associates (SC October 11 2018) Civil Appeal No 23988 of 2017.

The apex court in Parag Gupta recognized the need for the Limitations Act to be applicable to Section 7 and 9 of the IBC in order to ensure that the limitation periods followed in such cases are logically consistent. Additionally, in the case of *Securities and Exchange Board of India v. Rajkumar Nagpal*,[15] the Apex court has held that such reasonable restrictions can also be implemented in the interest of asset maximisation and enhancing credit availability. In the context of Section 238 of the IBC, which grants overriding effect to the provisions of the IBC over any other law in force, the courts have recognized that this provision is not an automatic or blanket exception to all contractual or legal rights. The overriding effect of Section 238 is intended to further the objectives of the IBC, particularly in the insolvency resolution process, but this power must be exercised in a way that respects and upholds the fundamental legal rights and interests of parties to an agreement, including bona fide purchasers.

The decision in Rajkumar Nagpal elaborates on the limitations of Section 238, particularly where there is a conflict between the statutory provisions of the IBC and prioritising speedy resolution and safeguarding the statutory rights of creditors. In certain situations, like the case of *Sobha Limited v. Pancard Clubs Ltd*.[16] the court has recognized that the intent of the parties and the protection of bona fide purchaser rights can outweigh the automatic application of Section 238. In *Sobha Limited v. Pancard Clubs Ltd*., the court gave priority to the enforcement of the specific performance of a real estate contract, reflecting the intention of the parties and safeguarding the rights of Sobha Limited as a bona fide purchaser. The court held that despite

[15] Securities and Exchange Board of India v. Rajkumar Nagpal & Ors (SC August 30 2022) Civil Appeal No 5247 of 2022.

[16] Sobha Limited v. Pancard Clubs Ltd SC, 4 December 2017) Company Appeal (AT) (Insolvency) No 162 of 2017.

the potential conflict with other legal provisions, including the IBC, it was important to respect the contractual obligations and the rights that arise out of those obligations, especially where one party has acted in good faith and fulfilled their part of the agreement. The key takeaway here is that Section 238 of the IBC should not be used indiscriminately to override every other legal provision or agreement, especially where the legislative intent of the IBC is not compromised and the rights of bona fide purchasers or innocent parties are at stake. Courts, therefore, have recognized that the wide powers granted under Section 238 need to be tempered with judicial discretion and should not override legitimate contractual rights, especially when enforcing the intent of the parties to a contract.

While Section 238 of the IBC is designed to ensure that the insolvency resolution process is not hindered by conflicting laws, courts have also emphasized that the legal intent of the parties to a contract is a critical factor. If the enforcement of an agreement, such as a contract for the sale of property, is consistent with the legitimate intent of the parties and does not obstruct the objectives of the IBC, then the application of Section 238 may be restricted. In Rajkumar Nagpal, the courts essentially highlighted that Section 238 should not be used as a "blanket provision" to override all other laws, especially when it could undermine important legal protections such as the enforcement of contracts or the rights of bona fide purchasers. This is consistent with the idea that the legislative intent of the IBC should be respected, but it should not be used to unjustifiably negate other significant legal protections.

Given this ambiguity in the court's stance, it is essential to examine how public benefit and creditor rights are balanced in such agreements. In this context, several key concerns arise, particularly regarding the protection of creditor interests, which will be explored in the following section.

B. Public Benefit and Creditor Rights

Agreements that allow CDs to negotiate with creditors to waive rights would be blatantly harmful for creditor's rights because of an imbalance in negotiating power between the two and therefore are excluded from the ambit of this paper. Therefore this paper focuses on the enforceability of ICAs when there is a dispute between the participants of that ICA i.e. like in the Rakshit case where IDBI Bank's application was disputed by the other participants of the consortium of banks that had entered into an inter-se agreement with them. The concerns regarding creditor rights in such arrangements are threefold.

Firstly, and primarily, will the interests of the junior lenders be protected and will it be ensured that senior lenders do not get away with imposing their will upon the junior lenders?

The interests of all creditors are not rightly protected in the current form of CIRP. Cases like Committee of Creditors of *Essar Steel India Limited v. Satish Kumar Gupta*[17] (**'Essar Steel'**) and India Resurgence *ARC Pvt. Ltd. v. Amit Metaliks*[18], elucidate how the rights of junior lenders can often be sidelined and trampled upon due to their lack of voting share in the Committee of Creditors ('**CoC**'). Additionally, the wisdom of the CoC has been considered supreme and more often than not, cannot be subject to judicial review, as has been held in judgements like *Jaypee Kensington Boulevard Apartments Welfare Association v. NBCC (India) Ltd*.[19] There is no way for creditors belonging to a junior class to dispute the decisions of the CoC and plans approved in such cases often lead to a higher haircut for smaller lenders.

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[17] Committee of Creditors of Essar Steel India Limited v Satish Kumar Gupta (SC, 15 November 2019) Civil Appeal Nos 8766-67 of 2019.
[18] India Resurgence ARC Pvt Ltd v Amit Metaliks (SC May 13, 2021) Civil Appeal No 1700 of 2021.
[19] Jaypee Kensington Boulevard Apartments Welfare Association v NBCC (India) Ltd (SC 2021) SCC OnLine 253.

If the enforceability of such ICAs would be recognized, being subject to a factor-based analysis of the agreement if a dispute were to arise, junior lenders would have newer avenues for consideration in exchange for waivers. The approach discussed in Part IV would provide enough elasticity so that each dispute can be judged on its own merits while accounting for the necessary nuance in the differing relations between creditors across industries. While the CoC's supremacy is well-established, this raises a further question: if Security Trustee Agreements already provide similar enforceability, why should additional recognition of ICAs be necessary? The next concern addresses this issue by exploring the costs and benefits associated with such recognition.

Secondly, if Security Trustee Agreements allow creditors to get essentially the same legal enforceability as seen in the Rakshit case, then why is the recognition of ICAs needed and whether the costs are worth the benefits provided by such recognition?

While the Insolvency Law Committee (ILC) has discussed the enforcement of ICAs with respect to an inter-se agreement determining the priority of debts beforehand, the current paper focuses solely on the initiation of insolvency proceedings and majorly on the pre-petition stage. The ILC has stated that valid ICAs under Section 53 of the IBC can be enforced to change the priority of debts during the liquidation stage.[20] Therefore, if subordination agreements and ICAs are already valid under Section 53 of the IBC, then extending that enforceability to the pre-petition stage seems to be the only logically consistent choice. Just like how Section 53 cardinally states that any contractual agreement disturbing the stated order of priority would be disregarded, the same prohibition can be imposed upon ICAs that significantly

[20] Insolvency Law Committee, *Report of the Insolvency Law Committee* (March 2018) para 21.6.

curb a junior creditor's right to initiate a Section 7 application. The method proposed by the second concern, while it has been recognized by the court in Rakshit, simply ends up being a much more uneconomical and tedious way of ending up with the same result. Not to mention that entering into a Security Trustee Agreement would require additional costs from lenders, which would end up being out of reach for junior lenders that want the same uniformity of approach towards resolving the debt and maximising value in complex bankruptcies. It would also provide industry lenders a whole new avenue of cooperation and help reduce the multiplicity of bankruptcy proceedings in the country. Creditors would also be empowered with more control over their rights and can waive them as they see fit in return for fair consideration. Additionally, such agreements can serve as a much-needed out-of-court corporate debt restructuring mechanism for Indian players. The RBI already mandates entering into an ICA for RBI-regulated entities if they want to opt for an informal method of resolution.[21] The Supreme Court in *Securities and Exchange Board of India v. Rajkumar Nagpal & Others*[22] also upholds the legal validity of the RBI's mandate passed via a circular released by them. Even in the circular, the interests of dissenting creditors are preserved and the CD is not allowed to repay an amount lesser than that demanded by them. Such judgements only serve to show that the court is even willing to recognise the validity of an enforced waiver onto creditors, provided that the value of the asset subject to insolvency is maximised and as long as the interests of all parties are preserved.

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[21] Reserve Bank of India, '*Prudential Framework for Resolution of Stressed Assets*' (RBI/2018-19/203, 7 June 2019).
[22] Securities and Exchange Board of India v. Rajkumar Nagpal & Ors (SC August 30, 2022) Civil Appeal No 5247 of 2022.

The enforcement of such ICAs could also lead to a better medium for enforcing the rights of junior lenders because as can be seen in judgments like *Maharashtra Seamless Limited v. Padmanabhan Venkatesh and Others*[23] here is very little power of judicial review provided to the courts once the Resolution Plan (**'RP'**) is passed. The fate of dissenting creditors is often left to the hands of senior creditors with greater voting share and they are often only left with protection guaranteed up to a percentage of their claim proportionate to their class of creditors. Such agreements can provide junior creditors with a way to demand fairer compensation even before insolvency as consideration for temporary waivers. Such agreements can also be subject to the review of the court much easier when compared to their jurisdiction over a passed Resolution Plan therefore, giving junior creditors a better avenue to enforce their rights.

Such agreements could also revive the Pre-Packaged Insolvency Resolution Process (**'PPIRP'**) in India. PPIRPs are an informal plan worked out between the debtor and the creditor before the filing of insolvency. The main intent behind such plans being that the approval process would be expedited if a plan had already been agreed upon by both parties. Inter-se agreements between creditors would allow them to come up with a mutually approved insolvency plan much faster which is one of the main reasons for the failure of PPIRP implementation in India. The same can be seen in the case of Enn Tee International Limited[24] where the approval from the CoC took more than a year. The approval from the CoC would be much faster if the insolvency had arisen from a united front of creditors that had ample time to calculate

[23] Maharashtra Seamless Ltd v. Padmanabhan Venkatesh and Ors (SC January 22 2020) Civil Appeal No 4242 of 2019.
[24] ENN TEE Intl Ltd v. Ritu Rastogi Resolution Professional of ENN TEE Intl Ltd (NCLT Delhi October 19 2023) IA NO 4313 (PB)/2023.

them inter se relations. The initiation of insolvency from the unilateral action of any one creditor naturally leads to a time constraint on all other creditors to calculate their claims and take further action. Granting ICAs legal enforceability would ensure inter-creditor relations are taken more seriously, allowing restructuring plans to form more efficiently. While this would allow provide for a much more uniform and even-footed start to insolvency proceedings in general, in the case of widespread PPIRP implementation ICAs could pave the way for an expedited plan of approval since a preliminary consortium of creditors would already exist therefore eliminating the deliberation phase of the CoC ensuring faster approval. Given these potential benefits, it becomes crucial to establish a framework for determining when an ICA aligns with legislative intent and public policy. This leads us to consider a factor-based approach that courts may use to evaluate the validity and enforceability of such agreements.

IV. A FACTOR-BASED APPROACH

In determining whether an ICA runs astray of the legislative intent of the IBC and is contrary to public benefit, the courts would need to consider all the nuances and context of each agreement. However, through an analysis of the doctrine of waiver and the legislative purpose of the IBC, some determining factors can be gleaned. The Vidarbha judgement already grants the court discretionary powers over admitting a Section 7 application.[25] Moreover, a possible safe harbour provision could also be enacted to prima facie avoid an increase in litigations surrounding the enforceability of ICAs. Priority can be given to quantifiable factors like the consideration agreed upon and the scope, duration, and purpose of the ICA, and only if the ICA is not conducive to normal market practices and is seen to be exploitative or

[25] Vidarbha Industries Power Ltd v. Axis Bank Ltd (SC 2022) SCC OnLine SC 841.

encroaching upon the statutory right of either side should the Adjudicating Authority step in to inquire about the ICA. The primary factors that the courts must consider may be as follows.

A. Separation of debtor

Due to the imbalance of bargaining power between the two, the separation of the debtor from the ICA negotiations is crucial in order to prevent the proliferation of unfair credit agreements where junior creditors may be required to waive their right to file for bankruptcy. The complete absence of the debtor in the negotiation of the ICA is needed or the agreement must be entered into by the creditors after the debt agreement has been completed. The inter se agreement must be solely within the creditors and must only govern the relations between them, the debtor must not be a party with any locus rooted in the ICA. As seen in cases like Amitabh and Textrade, the courts have repeatedly emphasised the non-existence of any locus arising on part of the debtor with regards to an ICA between the creditors.

B. Material advantage over junior creditors

The level of control and imbalance in bargaining power needs to be a key consideration in whether the junior debtor's rights were encroached upon or if they were forced into a waiver. The agreement must not be less economically viable for the creditor at a lower standing than a traditional choice like a secured loan. The RBI circular mandating that creditors enter into ICAs if they want to opt for an out-of-court restructuring[26] and the court's standing in Essar Steel both echo the reasoning where it is mandated that the junior creditors must be guaranteed an amount equal to the amount owed to

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[26] Reserve Bank of India, '*Prudential Framework for Resolution of Stressed Assets*' (RBI/2018-19/203, 7 June 2019).

them in proportion with the percentage amount recovered by the same class of creditors. While this approach does have its flaws and often ends up leading to huge haircuts for junior creditors, it does give some clarity as to how the economic outcome for the junior creditors can be calculated if the traditional CIRP was to be initiated. The ICA, therefore, must guarantee an outcome that is proportionate to the economic outcome for the senior lenders. There must be no inequity in the material gain enjoyed by different classes of participant creditors.

C. Scope & duration

The courts have often relied upon the overriding effect of Section 238 to invalidate any contract or prior arrangement to supersede the right to initiate bankruptcy. Therefore, the scope of the restraint and the duration of how long the restraint upon the creditor's rights is imposed needs to be reasonable. An agreement that permanently waives the creditor's right to file for bankruptcy or in general puts them in a detrimental position for an unreasonable amount of time would run aground of the legislative intent of the IBC to maximise value and boost credit availability. This is because of the negative effect the enforcement of such agreements would produce on the credit market in general. The scope of restriction of the agreement also needs to be taken into consideration. While standstill agreements that restrain the ability to initiate insolvency for certain reasonable periods of time may be accepted, or restrict the filing till the completion of a certain project or in the event of the failing of a risky business move may be considered valid after considering all other determinants, a blanket ban on the right to initiate CIRP would certainly be too restrictive and unreasonable in the eyes of the law.

D. Equitable consideration

The consideration that the junior lender receives must be equitable and at the very least must be greater than the mean economic outcome for the creditor. The mean economic outcome is the amount that the creditor would, on average, recover had the CIRP been initiated. This can be calculated by estimating the percentage that the creditor would receive based on what class of creditors they fall into. Since the rate of recovery via conventional CIRP is already low for dissenting debtors, they must be given a sum that is visibly greater than such amount to compensate for the waiver of such right. The consideration received is to play a key role since it is the main driving force for waiving the right from the creditor's side. The NCLAT has in Avil Menezes[27] recognized the importance of equitable distribution of assets between secured creditors and there is no realm of possibility that the same would not continue regarding such waivers.

E. Junior creditor rights

The rights of the junior creditors after the agreement are paramount to its legality. In *DBS Bank v. Ruchi Soya*,[28] the Apex Court recognized the need to protect the rights of junior financial creditors and operational creditors even after taking into consideration the supremacy of the commercial wisdom of the CoC. The same ratio, therefore, would carry over into judging the consortium of creditors in the ICA as acting like a pseudo-CoC i.e. in the capacity of a body of creditors defining the debt's relation towards each other. The junior creditors must always have the right to recover the amount of the

[27] Avil Menezes v. Principal Chief Commissioner of Income Tax Mumbai (NCLAT July 12, 2024) Company Appeal (AT) (Insolvency) No 258 of 2024.
[28] DBS Bank Ltd v. Ruchi Soya Industries Ltd. (SC January 3 2024) Civ App No 9133 of 2019.

secured loan issued by them to the CD. While proportionate voting rights may not be guaranteed, the economic interest must always be secured.

F. Purpose & context

The purpose of the ICA and the context behind entering into such an agreement by each creditor must also be taken into account. If the facts surrounding the agreement point to the intention exclusively being to lead a creditor into waiving away their rights or put them at a disadvantageous position post hoc, the agreement may be subject to judicial review. The situations surrounding the ICA also need to be taken into consideration, such an agreement must be entered to account for a specific scenario and not as a blanket restriction upon the creditor's right. The restraint must be calculated and limited in nature in order for it to be valid. Intent plays a crucial role in determining the intent of the agreement.[29] It is imperative that such disputes be solved in the pre-CIRP stage because as seen in judgements like Kalpraj Dharamshi[30] the commercial wisdom of the CoC is held paramount and the extent of protection afforded by the Essar Steel judgement only exists up to the percentage recovered by the proportionate class of creditors, which can often be dominated by senior creditors through voting percentage.

G. Transparency

The intent and consideration for entering into such an agreement for all parties must be transparent in order to accurately determine that the intent of all parties was legal. Inspiration can be drawn from the international treatment of relational contracts like in the case of *D&G Cars Ltd v. Essex Police Authority*[31] to ensure that the agreement was entered into in good faith.

[29] G T Girish v. Y Subba Raju (SC January 18 2022) Civ App No 380 of 2022.
[30] Kalpraj Dharamshi v. Kotak Investment Advisors Ltd (SC March 10 2021) Civ App No 2943/-2944 of 2020.
[31] D&G Cars Ltd v. Essex Police Authority, [2015] EWHC 226 (QB).

The enforcement of such agreements can also follow the review process followed to scrutinise true sale transactions in India like *Reliance Nippon Life Asset Management Limited v. Dewan Housing Finance Corporation Limited* and Ors.[32] Judgements like *Infrastructure Leasing and Financial Services Ltd. v. Hdfc Bank Ltd. & Anr.*[33] provide a suitable approach for the post hoc analysis of an agreement with relation to such determinants.

V. CONCLUSION

The enforceability of ICAs within the framework of the Insolvency and Bankruptcy Code, 2016, represents a nuanced intersection of contractual freedom and public interest. The case law demonstrates that while courts have generally been reluctant to allow ICAs to override statutory rights, particularly the right to initiate insolvency proceedings under Section 7, they also acknowledge the complexities of creditor relations and the potential benefits of more structured, consensual agreements among creditors.

The primary challenge lies in balancing the statutory rights of creditors with the public policy objectives of the IBC, which aim to maximise asset value and ensure equitable treatment of all creditors. The doctrine of waiver, when applied to Section 7, must be carefully considered to avoid undermining these objectives. A factor-based approach, which considers the separation of debtor involvement, the protection of junior creditors, the reasonableness of the agreement's scope and duration, and the equitable nature of the consideration received, could provide a framework for assessing the validity of such agreements.

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[32] Reliance Nippon Life Asset Mgmt v. Dewan Housing Finance Corp (High Court Bombay November 13 2019) Commercial Suit(L) No 1034 Of 2019.

[33] Infrastructure Leasing & Financial Services Ltd v. HDFC Bank *Ltd* (SC October 19 2023) Civil Appeal No(S) 4708 of 2022.

Ultimately, while ICAs offer potential for more efficient and cooperative debt restructuring, their enforceability must be aligned with the overarching goals of the IBC. Courts must ensure that such agreements do not compromise the legislative intent of protecting creditor rights and fostering a healthy credit market. By adopting a nuanced and context-specific approach, the judiciary can strike a balance between contractual autonomy and public interest, paving the way for more robust and fair insolvency practices in India.

VI. EVOLVING LIABILITY OF PERSONAL GUARANTORS UNDER THE IBC: BALANCING CREDITOR'S RIGHTS AND GUARANTOR PROTECTIONS AMIDST EMERGING TRENDS

Aniruddha Kishore and Akshay Nasi[*]

ABSTRACT

The Insolvency and Bankruptcy Code (IBC) has been pivotal in streamlining insolvency resolution in India, reducing case timelines, and recovering distressed assets. However, the 2019 Amendment, which brought personal guarantors under the IBC's scope, has introduced new challenges. Recovery rates from personal guarantors remain low, and the Code lacks provisions for asset tracing, leaving creditors exposed to fraudulent transfers of guarantor assets before proceedings. Furthermore, ambiguity around personal guarantor liabilities, especially following their death, has led to inconsistent judicial interpretations, complicating creditor recovery. This study uses a doctrinal approach and identifies critical gaps in the current framework, emphasizing the need for targeted reforms. Despite the IBC's success in bolstering creditor confidence, personal guarantors face heightened risks, and enforcement remains weak. The paper advocates for establishing specialized tribunals to handle guarantor disputes, introducing robust asset-tracing mechanisms, and clearer liability rules for personal guarantors, including after death. These reforms are essential for creating a balanced and efficient insolvency regime that protects creditors while addressing the vulnerabilities faced by personal guarantors in India's evolving financial landscape.

Keywords: Insolvency and Bankruptcy, Liability of a Personal Guarantor, Personal Guarantor to a Corporate Debtor, Insolvency Resolution Process, Cross-Border Insolvency

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I. INTRODUCTION

The Insolvency and Bankruptcy Code ("IBC"), introduced in 2016, serves as a comprehensive legal framework designed to "*address the insolvency and bankruptcy of corporate entities, partnership firms, and individuals within a specified timeframe*".[1] Before the implementation of the IBC, provisions related to insolvency and bankruptcy were scattered across multiple laws, including the Sick Industrial Companies (Special Provisions) Act of 1985, the Recovery of Debt Due to Banks and Financial Institutions Act of 1993, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002, and the Companies Act of 2013. This fragmented legal environment often led to significant procedural complexities, resulting in delays in insolvency resolutions.

[1] The Insolvency and Bankruptcy Code 2016.

The IBC, aims to "*maximize the value of assets, promote entrepreneurship, ensure the availability of credit, and balance the interests of all stakeholders*".[2] It furthers main objectives of streamlining and consolidating the existing insolvency resolution laws, facilitates the reorganization of distressed assets, and ensures the timely resolution of cases. Additionally, the Code establishes the Insolvency and Bankruptcy Board of India ("IBBI") to regulate and oversee the insolvency process. The National Company Law Tribunal ("NCLT") serves as the adjudicating authority for resolving cases under the Code, ensuring timely and effective resolution.

One of the most significant achievements of the IBC is the considerable reduction in the time taken to resolve insolvency cases. As highlighted by a report from the Standing Committee on IBC, published in August 2021, the average time required for resolution dropped from 4.3 years to just 1.6 years between 2017 and 2020, following the Code's implementation.[3] This reduction has allowed for faster recovery and resolution of distressed assets, benefitting both creditors and debtors.

Since the enactment of the Code, lenders have successfully recovered over ₹3.5 lakh crore through insolvency proceedings, with more than 1,000 resolution plans being approved by the NCLT.[4] "*The recovery rate has also significantly improved, rising from 26 cents to 71.6 cents on the dollar*".[5] This

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[2] The Insolvency and Bankruptcy Code 2016.

[3] Standing Committee on Finance, *Implementation of Insolvency and Bankruptcy Code – Pitfalls and Solutions* (August 2021) < https://ibbi.gov.in/uploads/resources/fc8fd95f0816acc5b6ab9e64c0a892ac.pdf> accessed 6 October 2024.

[4] PTI, 'Lenders Have Recovered Rs 3.5 Lakh CR under IBC: Ravi Mital' *The Economic Times* (1 October 2024) <https://economictimes.indiatimes.com/news/economy/finance/lenders-have-recovered-rs-3-5-lakh-cr-under-ibc-ravi-mital/articleshow/113852515.cms?from=mdr> accessed 6 October 2024.

[5] PIB, '"Insolvency and Bankruptcy Code (IBC), 2016 a Gamechanger Reform": Shri Piyush Goyal' (*Press Information Bureau 25November 2021*) <https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1775096> accessed 6 October 2024.

increased efficiency in recovery has bolstered the confidence of financial institutions and investors in the insolvency resolution process, thereby contributing to the overall stability of the financial ecosystem.

The IBC was designed to resolve insolvency issues for both corporate entities and individuals in a time-bound manner, with the goal of maximizing asset value. Although the IBC primarily targets corporate insolvency, it also encompasses individuals. The insolvency resolution process for individuals, prior to the enactment of the IBC, was regulated by the Presidency Towns Insolvency Act of 1909 and the Provincial Insolvency Act of 1920. However, both these acts were repealed effective from August 19, 2016 by virtue of Section 243 of the Code.[6]

Section 5(22)[7] of the IBC defines a "Personal Guarantor" (“PG”) as an individual who acts as the surety in a contract of guarantee for a corporate debtor. Section 128 of the Indian Contract Act, 1872[8], stipulates that “The liability of the Surety is co-extensive with that of Principal Debtor unless mentioned in the Contract”. This provision also applies to PGs who act as sureties for corporate debtors. One important Amendment to the IBC in 2018 categorized individuals into three groups: PGs to corporate debtors, partnership firms and proprietorship firms, and other individuals, and made provisions of the code applicable to this group. In November 2019, the Central Government introduced provisions under the IBC to address the insolvency

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[6] Parijat SB and, ‘Supreme Court’s Verdict on the Constitutionality of the Provisions of Personal Guarantors under the IBC’ (*Live Law*, 8 February 2024) <https://www.livelaw.in/law-firms/law-firm-articles-/supreme-court-personal-guarantors-ibc-presidency-towns-insolvency-act-cirp-nclat-resolution-professional-248885#:~:text=its%20personal%20guarantors.-,IRP%20OF%20PERSONAL%20GUARANTORS,proceedings%20of%20a%20personal%20guarantor.> accessed 6 October 2024.

[7] Insolvency and Bankruptcy Code 2016, s 5(22).

[8] Indian Contract Act 1872, s 128.

resolution and bankruptcy process for PGs of corporate debtors.[9] This move allowed creditors to initiate insolvency proceedings against both corporate debtors and their Personal Guarantors simultaneously, as both are linked to the same debt. By enabling concurrent proceedings, this Amendment strengthened creditors' chances of recovery and promoted a more cohesive and integrated approach to resolving insolvency matters.

According to Section 60[10] of the code the NCLT is the Adjudicating Authority ("AA") in case of insolvency and bankruptcy proceedings of the PGs to corporate debtors. Under Section 95[11] of the Code, both PGs and Creditors can file an application for the insolvency resolution process of PGs, either by themselves or through a Resolution Professional, before the NCLT. The Resolution Professional appointed by the AA examines the application and submits a report to the AA. The AA then decides whether to accept or reject the application. If the application is accepted, the Resolution Professional calls for claims from creditors and devises a debt repayment plan. This proposed plan requires approval from the majority of creditors; failure to obtain such approval will result in bankruptcy proceedings against the PGs. The interpretation and enforcement of PG liability, however, have been continuously shaped by judicial decisions. To understand the evolving nature of this liability, it is essential to examine the landmark cases where courts have clarified the scope and responsibility of personal guarantors under the IBC.

II. EVOLUTION OF PERSONAL GUARANTOR LIABILITY IN INDIAN JUDICIARY

With the foundation of PG liability established in the IBC, the Indian judiciary has played a crucial role to shape the accountability of PGs under the

[9] The Insolvency and Bankruptcy Code (Amendment) Act 2019.
[10] Insolvency and Bankruptcy Code 2016, s 60.
[11] Insolvency and Bankruptcy Code 2016, s 95.

Code. In the following section, we will explore landmark cases that have influenced the liability of PG, further clarifying their role in the insolvency resolution process and the procedural aspects of insolvency proceedings under the IBC. One such significant case is *Vishnu Kumar Agarwal v. Piramal Enterprises Ltd*[12] in which the court held "*that once a petition under Section 7*[13] *of the IBC is filed against the principal debtor or guarantor and once the Corporate Insolvency Resolution Process (CIRP) has been initiated, the financial creditor cannot file another application on the same set of claims against the other debtor*". The court also clarified that it is not necessary to initiate CIRP against the principal borrower before commencing it against the corporate guarantor. The Hon'ble Appellate Authority in the case of *SBI v. Athena Energy Ventures (P) Ltd*[14] affirmed that the IBC permits the concurrent initiation of Corporate Insolvency Resolution Process (CIRP) against both the principal borrower and the corporate guarantor it held that "*Referring to Section 5(8)(a), (h) and (i) of IBC, it is argued that IBC treats the principal borrower and guarantor similarly".* Section 14[15] of the IBC "*In which the AA by order declares moratorium for prohibiting all of the following*

(a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority (b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;

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[12] Vishnu Kumar Agarwal v. Piramal Enterprises Ltd [2019] SCC OnLine NCLAT 542 (NCLAT).
[13] Insolvency and Bankruptcy Code 2016, s 7.
[14] State Bank of India v. Athena Energy [2020] SCC OnLine NCLAT 774 (NCLAT).
[15] Insolvency and Bankruptcy Code 2016, s 14.

(c) 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 Act, 2002 (54 of 2002);

(d) the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor."

In *State of Bank of India v. V. Ramakrishnan & Anr.*[16] the Supreme Court ruled that "*the moratorium does not apply to personal guarantors of corporate debtors*". In 2019, the Union Government issued a notification addressing the liability of personal guarantors. Prior to this, personal guarantors were not directly subject to insolvency proceedings. However, following this Amendment, creditors can now initiate insolvency proceedings against the personal guarantor of a corporate debtor. According to Section 95[17] of IBC, creditors may initiate bankruptcy proceedings against the personal guarantors of a corporate debtor. Under Section 96,[18] an interim moratorium applies to personal guarantors once an insolvency application is filed. This interim moratorium is similar to the moratorium under Section 14,[19] which applies to corporate debtors. Numerous petitions were filed across the country challenging the notification. The Supreme Court consolidated all the petitions and delivered its ruling in the landmark case of *Lalit Kumar Jain v. Union of India*.[20] The petitioners argued that the notification involved "excessive delegation" and was *ultra vires* the powers conferred upon the Union Government. They also contended that it violated Article 14 of the Constitution and was manifestly arbitrary, as it singled out personal guarantors

[16] SBI v. V. Ramakrishnan [2018] 17 SCC 394 (SC).
[17] Insolvency and Bankruptcy Code 2016, s 95.
[18] Insolvency and Bankruptcy Code 2016, s 96.
[19] Insolvency and Bankruptcy Code 2016, s 14.
[20] Lalit Kumar Jain v. Union of India [2021] 9 SCC 321 (SC).

to corporate debtors without any intelligible differentia or rational basis for such classification. Furthermore, the petitioners argued that personal guarantors were being denied their rights of subrogation. The Court held "*that the provisions in question were not ultra vires the legislatures that enacted the law containing those provisions*". It reasoned that the Amendment was necessary because personal guarantors of corporate debtors undergoing insolvency proceedings should also be subjected to the same adjudicatory process. To achieve this, the required Amendments were made. The Court further clarified that personal guarantors would remain liable, even if the corporate debtor is discharged from its obligations.

The constitutional validity of Sections 95-100 of the IBC was challenged in *Dilip B. Jiwrajka v. Union of India*[21] the petitioners argued that personal guarantors were not given an opportunity to present their case during the filing of the insolvency application or at the time of appointing a resolution professional. However, the court ruled that these provisions do not violate Article 14 and are not manifestly arbitrary.

The Supreme Court's recent decision is particularly advantageous for banks and financial institutions that utilize public funds, as it equips them with another mechanism for recovering bad debts. Following the notification dated November 15, 2019, foreign assets held by personal guarantors of corporate debtors can also be seized in insolvency or bankruptcy proceedings. Additionally, "*the NCLT has the authority to attach such foreign assets during the corporate debtor's insolvency process. The judgment establishes a solid legal framework for creditors, particularly banks and financial institutions, to efficiently recover bad debts. However, this raises concerns about the potential dominance of lenders and the importance of adopting a balanced*

[21] Dilip B. Jiwrajka v. Union of India [2024] 5 SCC 435 (SC).

approach, especially when addressing minor defaults by smaller borrowers with limited resources. While the ruling favours creditors, it presents significant challenges for personal guarantors, including promoters and directors, whose assets may now be at risk in insolvency proceedings. The impact of this decision on settlement options and the protection of guarantors' rights will be key considerations as the legal landscape evolves”.[22] The ruling supports the need to boost credit and lending to recharge the economic engine. However, the increased risks for guarantors may lead to a more cautious stance on offering personal guarantees. Striking a balance between the interests of creditors and guarantors is critical for economic development. In contrast to India’s creditor-friendly framework under the IBC, both the United States and the United Kingdom have increasingly adopted a debtor-centric approach, prioritizing the protection and rehabilitation of distressed businesses.

III. COMPARATIVE ANALYSIS OF INSOLVENCY LAWS: THE TREATMENT OF PERSONAL GUARANTORS IN INDIA, THE US, AND THE UK

Countries like the US and the UK have also enacted codes for insolvency and bankruptcy which are the Bankruptcy Code[23] in the US and the Insolvency Act 1986[24] in the UK. There are major differences between all the three codes. The most significant difference is that the code in India is made to favour the creditor. Meanwhile, the US follows the ‘debtor in possession’ approach, and after the enactment of Corporate Insolvency and the

[22] Indulia B and Ridhi, ‘Upholding the Validity of Provisions Related to Personal Guarantors under IBC - Good for Lenders, Bad for Guarantors’ (*SCC Times*, 3 January 2024) <https://www.scconline.com/blog/post/2024/01/03/upholding-the-validity-of-provisions-related-to-personal-guarantors-under-ibc-good-for-lenders-bad-for-guarantors/> accessed 15 October 2024.

[23] U.S. Bankruptcy Code 1978.

[24] Insolvency Act 1986.

Governance Act, 2020[25] the UK also shifted to a debtor-centric approach. In the 'Debtors in Possession',[26] the control of the assets remains under the debtor's control even when insolvency proceedings have been initiated against him, whereas it is quite the opposite in the 'creditor in control' approach.

A. Definitions

There are interpretational differences among three countries for the term 'personal guarantor'. In IBC Section 5(22)[27] it is defined as *"an individual who acts as the surety in a contract of guarantee to a corporate debtor*." In the US and the UK, there is no specific provision that defines a personal guarantor for a corporate debtor. In US law the term is defined broadly as a 'guarantor' *which is the person who is secondarily liable for another's debt*."[28] A definition similar to this is prevalent in British legislation. The term guarantor in the US and UK also includes guarantors who are sureties for a corporate entity in a contract.

B. Extent of Liability

The liability of the personal guarantors in the US remains largely based on the contracts that they have entered with the surety. If the contract is silent on the fact, then the court will decide the extent of the liability categorised as either limited liability or absolute liability. There is no cap on the amount that the guarantor has to pay in the latter and the former are those under which there are limitations on the extent of the liability of the guarantor. "*The most common limitations of the guarantor's liability are contingent guarantees,*

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[25] Corporate Insolvency and the Governance Act 2020.

[26] Priyanshu Fauzdar, "IBC Laws - Comparative Analysis of the Two Insolvency Framework Models, i.e.,'Creditor-in-Control' and 'Debtor-in-Possession' " (*IBC Laws*, 24 July 2023) <https://ibclaw.in/comparative-analysis-of-the-two-insolvency-framework-models-i-e-creditor-in-control-and-debtor-in-possession-priyanshu-fauzdar/> accessed 13 October 2024.

[27] The Insolvency and Bankruptcy Code 2016.

[28] Henkel C, "Personal Guarantees and Sureties between Commercial Law and Consumers in the United States" [2014] 62 AJCL 333.

which may include the guarantee of collection or payment."[29] Under Chapter 7[30] of the Bankruptcy Code, there is a distinction between the bankruptcy of the guarantor and the principal debtor. The code further states that both guarantor and debtor can file for bankruptcy. Debts are discharged only for the filing party, and if both parties want their debts to be discharged, they have to file for insolvency. Chapter 11[31] of the code, states that the guarantors are still liable for corporate debts even if the company has restricted its debts. Personal guarantors' liability remains largely strict, and the guarantor remains fully liable unless they file for bankruptcy.

The UK has an Insolvency Act, 1986, that deals with the procedures under which a personal guarantor can file for insolvency and discharge his liability. There is another option available to personal guarantors in the UK, which is an Individual Voluntary Arrangement, which allows them to negotiate a repayment plan with creditors over some time. This can protect the guarantor from legal action, but only if creditors agree. In the UK the liability of the personal guarantor remains largely to the extent of his contract.

In India, the debt recovery systems are stricter as the creditor has been given more power under the IBC. The liability of personal guarantors of the corporate debtor is largely co-extensive as explicitly provided under section 128 of the Indian Contract Act, 1872.[32] The SC clarified this in the case of, *Lalit Kumar Jain v. Union of India*[33] stating "*It is, therefore, clear that the sanction of a resolution plan and finality imparted to it by Section 31 does not per se operate as a discharge of the guarantor's liability*". This shows that

[29] Henkel C, "Personal Guarantees and Sureties between Commercial Law and Consumers in the United States" [2014] 62 AJCL333.
[30] U.S. Bankruptcy Code 1978, s 701-784.
[31] U.S. Bankruptcy Code 1978, s 1100-1174.
[32] Indian Contract Act 1872, s 128.
[33] Lalit Kumar Jain v. Union of India [2021] 9 SCC 321 (SC).

legislation and courts in India favour creditors when it comes to the recovery of debt.

C. Right to Subrogation

Indian courts in the case of *Lalit Mishra and Others v. Sharon Bio Medicine Ltd*[34]., held that guarantors cannot enforce their rights of subrogation under the IBC because this can only be given under recovery proceedings. Supreme Court reiterated this view in the *Committee of Creditors of Essar Steel Ltd. vs Satish Kumar Gupta.*[35] Though IBC does not completely override the choice of the personal guarantors to sue for their rights under the doctrine of subrogation, still, no remedy remains open to the personal guarantor after the resolution plan is accepted.

The Bankruptcy Code in the US explicitly talks about the right of subrogation under Section 506 to Section 509.[36] "*Furthermore, Section 509 of the US Bankruptcy Code, is fairly mechanical in its application. The guarantor only has to establish that it is liable to the debtor on a claim made against the debtor by the creditor and that the guarantor has paid off that claim. Unlike the US, India does not have a statutory provision in the Code solely dedicated to the principle of subrogation"*.[37]

Indian courts envisage the revival of a company and the rehabilitation of assets rather than the guarantor's rights. This claim stems from the misunderstanding of the personal interest of guarantors, which has been reflected in corresponding court decisions ignoring the latter's rights. Denial

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[34] *Lalit Mishra v. Sharon Bio Medicine Ltd* [2018] SCC OnLine NCLAT 669 (SC).

[35] *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta* [2020] 8 SCC 531 (SC).

[36] U.S. Bankruptcy Code 1978, s 506-509.

[37] Sampriti & Sugi Malati Murmu, "Subrogation Rights of Personal Guarantor: A Comparative Analysis" (*NUALS Law Journal*, 29 June 2021) <https://nualslawjournal.com/2021/06/29/subrogation-rights-of-personal-guarantor-a-comparative-analysis/> accessed 13 October 2024.

of guarantor rights can deter other individuals from offering personal guarantees in the future, cause problems for companies to mobilize funds, and hamper any economic development.

While insolvency and bankruptcy laws across the US, UK, and India share some similar concepts, the treatment of personal guarantors shows some differences, particularly in the extent of liability and rights of subrogation. The US and UK tend to adopt a more debtor-centric approach, offering personal guarantors broader protections and options, such as the right to negotiate repayment plans or discharge liability through voluntary arrangements and subrogation. In contrast, India's IBC leans heavily in favour of creditors, imposing stricter liability on guarantors.

IV. EVOLVING DYNAMICS OF PERSONAL GUARANTOR LIABILITY: INCONSISTENCIES AND CHALLENGES

The role of personal guarantors in insolvency proceedings has become increasingly important in India following the 2019 Amendment to the IBC, which allows creditors to pursue guarantors even after the resolution of corporate debt. This has led to a surge in litigation, as seen with over-recovery lawsuits. However, several challenges persist, including low recovery rates, the absence of provisions for asset tracing, ambiguities regarding liability after a guarantor's death, and cross-border insolvency

A. Rising Trend in Litigation against Personal Guarantor

NCLAT data shows lenders filed over 428 recovery lawsuits against personal guarantors in FY23. The claims total 35,765 cr. of dues, which shows a surge in the number of cases compared to previous years.[38] The NCLAT was

[38] Burugula P, "Surge in Personal Guarantor Cases under IBC in FY23" *Economic Times* (22 February 2023) <https://economictimes.indiatimes.com/news/economy/finance/surge-in-

reluctant to admit the cases against guarantors because many promotors approached the SC challenging the constitutionality of the provisions of the 2019 Amendment, which brought personal guarantors under the ambit of insolvency proceedings, enabling creditors to pursue them for recovery even after the resolution of corporate debt. Before this amendment, personal guarantors were often able to shield themselves from liability, leaving creditors with limited options for recourse in case of defaults. SC upheld the provisions of the amendment further solidifying the position of creditors in pursuing recovery from personal guarantors. This judgment gave lenders additional confidence, as it confirmed that the personal guarantor's liability would persist despite the discharge of the corporate debtor. Consequently, creditors have increasingly turned to the National Company Law Appellate Tribunal for legal remedies, leading to a significant rise in the number of cases filed.

B. Low Recovery Rate

According to the IBBI, creditors have recovered only 2.16% of their admitted claims, amounting to ₹102.78 crore,[39] from personal guarantors under IBC, despite its potential to balance debtor relief with creditor recovery.

The data shows that of the 383 admitted personal guarantor insolvency cases, 124 have been closed, with only 26 repayment plans receiving approval have raised concerns about the low recovery rate, pointing out that a lack of scrutiny and weak enforcement of repayment plans could create a moral hazard, encouraging debtors to evade responsibility.

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personal-guarantor-cases-under-ibc-in-fy23/articleshow/98160847.cms> accessed October 13, 2024.

[39] Chitravanshi R, "Only 2% Personal Guarantee Claims Recovered under IBC so Far: IBBI" *Business Standard* (21 May 2024) <https://www.business-standard.com/finance/news/creditors-recovered-2-of-claims-against-personal-guarantors-till-march-124052101110_1.html> accessed 13 October 2024.

A significant improvement has been the IBBI's decision to allow the same insolvency professional to manage both the company and its guarantor's insolvency processes, promoting better coordination. However, the recovery mechanisms under alternative laws like the SARFAESI Act have proven time-consuming, often allowing personal guarantors to shield their assets.

C. Lack of Provisions for Asset Tracing

A notable inconsistency in the treatment of personal guarantors under the IBC is the absence of provisions that allow for the recovery of assets in cases of avoidance or fraudulent transactions. Although such mechanisms exist for corporate debtors and individuals undergoing bankruptcy, they are notably missing for personal guarantors. This legal gap raises concerns about the potential diversion of assets before a resolution professional assumes control over the guarantor's estate.

Without the ability to reclaim assets that have been fraudulently transferred or otherwise diverted, the personal guarantor’s estate could be significantly diminished, leaving creditors with fewer resources to recover. This shortfall in the law allows personal guarantors to transfer assets out of the reach of creditors, jeopardizing the fairness and effectiveness of the insolvency process.

D. Discharge of Liability

A trending legal debate regarding the duties of personal guarantors in situations where the underlying debt is discharged as part of the corporate debtor’s resolution plan. Personal guarantors often try to escape liability by arguing that the resolution plan relieves them from their obligations, as the borrower’s debt has been settled.[40] A recent ruling by the *State Bank of India*

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[40] Jan, “Challenges Resolving Insolvencies of Personal Guarantors under IBC” (*LawAsia,* 21 June 2022) <https://law.asia/resolving-insolvencies-personal-guarantors/> accessed 13 October 13 2024.

v. Prashant Ruia,[41] the Debts Recovery Tribunal ("DRT") at Ahmedabad discussed this challenge. The DRT rejected an application to recover debt from a personal guarantor, citing the complete discharge of the corporate debtor's underlying liability under the resolution plan. This judgment was different from the judicial trend because it was accepted that the personal guarantor would not be set off from his liability even if the debt is repaid, but in this judgment, the DRT held that it can be set off if the debt is transferred to a third party.

While creditors generally retain the right to enforce personal guarantees even if the corporate debtor's obligations are extinguished by law, complexities arise when debt assignments or transactions result in repayment through cash or other means, such as capitalization. In these cases, the discharge of the underlying debt may impact the creditor's ability to pursue claims against the guarantor. If the assignee of the debt has been repaid under the terms of the resolution plan, creditors may face obstacles in recovering from the guarantor, as the fundamental basis for the guarantee—the underlying debt—no longer exists. This problem needs to be addressed by the courts and the legislature.

E. Cross-Border Insolvency

The citizenship of a personal guarantor holds little significance under the IBC. Insolvency proceedings are initiated in the jurisdiction where the corporate debtor or guarantor is located, irrespective of their citizenship. Despite this, many personal guarantors try to escape their obligations by fleeing the country and getting foreign citizenship.

[41] Prashant Shashi Ruia v. SBI, (2021) SCC OnLine Guj 3056 (HCG).

In the case of *Sudip Dutta v. State Bank of India,*[42] the NCLAT held that getting foreign citizenship does not discharge a personal guarantor of their financial dues. The tribunal stated that a guarantor cannot escape their dues merely by relocating or renouncing their citizenship. This interpretation upholds the principle that statutes should be written in a manner that supports their intended function—ensuring that guarantors cannot exploit legal gaps to avoid their obligations.[43]

However, a significant gap remains in the IBC regarding cross-border insolvency. While the IBC treats domestic and foreign creditors equally, there is a lack of comprehensive legal provisions governing cross-border insolvency, especially in cases where creditors or guarantors are located outside India. This is especially pertinent in multinational corporate structures where Indian companies often serve as guarantors to foreign creditors. The lack of a strong cross-border insolvency framework complicates matters when creditors seek to enforce their claims across borders, as the enforcement of judgments or recovery of assets outside India remains challenging. Without a proper framework to handle such cross-border insolvency situations, personal guarantors could still find ways to escape their liability in other countries.

F. Liability after Death of the Guarantor

A critical emerging issue in the insolvency framework is whether legal heirs are liable for the personal guarantor's obligations after their death. This matter was recently examined in the case of *Bank of Baroda vs. Divya Jalan,*[44] where the appellants approached NCLT to recover dues from the legal heirs

[42] Sudip Dutta v. SBI [2022] SCC OnLine NCLAT 4264 (NCLAT).
[43] K M Thomas and Ananya Arun, "IBC Laws - Personal Guarantors - Liability beyond Death and Borders: An Analysis of the Legal Position of a Guarantor upon Death and Change of Citizenship –" (*IBC Laws*, 26 August 2022) <https://ibclaw.in/personal-guarantors-liability-beyond-death-and-borders-an-analysis-of-the-legal-position-of-a-guarantor-upon-death-and-change-of-citizenship-by-k-m-thomas-and-ananya-arun/> accessed 13 October 2024.
[44] Bank of Baroda v. Divya Jalan [2022] SCC OnLine NCLT 191 (NCLT).

of the personal guarantor based on a clause in the personal guarantee agreement. The clause specified that, upon the guarantor's death, the liability could extend to their heirs.

However, the tribunal, after examining Section 5(22)[45] of the IBC, held that personal guarantors are defined as individuals who act as sureties in contracts of guarantee for corporate debtors. Importantly, the tribunal noted that neither Section 5(22) nor the related regulations include legal heirs within the definition of a personal guarantor.[46]

In its ruling, the tribunal invoked Section 238[47] of the IBC, which grants the Code overriding authority over conflicting contracts or laws. As a result, the tribunal concluded that legal heirs cannot be held liable for the personal guarantor's obligations under the IBC, even if a contract states otherwise. This case highlights an uncertainty on whether the legal heirs can be held liable for the dues of the personal guarantors.

V. STRENGTHENING THE PERSONAL GUARANTOR FRAMEWORK: POLICY REFORMS FOR A BALANCED INSOLVENCY REGIME

The ever-evolving dynamics of the personal guarantors to a corporate debtor have led to an Amendment to the IBC. Despite this, there remain large loopholes in the mechanism that make way for the wrongdoing on the part of either the guarantor who wants to dispose of his liability illegally or a creditor who wants to overuse his powers. These suggestions are wide-ranging from

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[45] Insolvency and Bankruptcy Code 2016, s 5(22).

[46] K M Thomas and Ananya Arun, "IBC Laws - Personal Guarantors - Liability beyond Death and Borders: An Analysis of the Legal Position of a Guarantor upon Death and Change of Citizenship" (*IBC Laws*, 26 August 26 2022) <https://ibclaw.in/personal-guarantors-liability-beyond-death-and-borders-an-analysis-of-the-legal-position-of-a-guarantor-upon-death-and-change-of-citizenship-by-k-m-thomas-and-ananya-arun/> accessed 13 October 2024.

[47] Insolvency and Bankruptcy Code 2016, s 238.

drafting a clear policy on the death of a guarantor, also addressing a need for a different tribunal that would deal with mostly guarantor cases, and cooperating with foreign countries to fight cross-border insolvency.

A. Clear Legal Provisions for the Death of a Personal Guarantor

The IBC is silent on the matter of handling the liability of a personal guarantor after their demise. There is a current debate going on about whether legal heirs can be held liable for the liabilities of the deceased guarantor. Supreme Court in the matter titled *Vinayak Purushottam Dube (Deceased), versus Jayashree Padamkar Bhat & Ors*[48] gave a verdict stating that an estate cannot be held liable for the default of a deceased. The same was reiterated by NCLAT *Alchemist Asset Reconstruction Company versus Deepak Puri.*[49] Despite this, there a different opinion of some NCLTs on this and to prevent uncertainties and disputes, there should be an explicit provision clarifying how the deceased guarantor's estate will be treated in ongoing insolvency proceedings. The government can consider implementing laws that seamlessly transfer liability to the guarantor's estate, along with clear timelines for creditors to make claims.

B. Provision for Off-Court Settlements

One of the greatest drawbacks of IBC has been that it puts a lot of burden on the NCLTs of different states and it can be seen with the ever-increasing backlog of cases in NCLTs. The solution to this problem could be providing off-court settlement mechanisms to the creditors and the debtors who are willing to cooperate. In, *Lokhandwala Kataria Construction Pvt. Ltd.*

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[48] Vinayak Purushottam Dube v. Jayashree Padmakar Bhat [2017] SCC OnLine SC 2202 (SC).

[49] Alchemist Asset Reconstruction Co. Ltd. v. Deepak Puri [2021] SCC OnLine NCLT 22414 (NCLT).

v. Nisus Finance and Investment Managers LLP,[50] the SC held that the IBC is a tool for debt recovery but off-court settlement can be used, if the parties are satisfied.[51] The report of IBBI[52] advocated for these reforms but are yet to be enacted by the legislature.

Introducing an Individual Voluntary Arrangement model, like that used in the UK, An IVA is a legally binding agreement in which a debtor commits to repaying a portion or all of their debts to creditors over a period, typically under terms favorable to the debtor. This could also bring considerable advantages to India's framework if adapted thoughtfully to its legal and financial landscape and could allow personal guarantors to negotiate flexible repayment plans with creditors outside of formal insolvency proceedings. For the UK's debtor-centric system, which prioritizes helping individuals regain financial stability, IVAs are a natural fit and are already widely used. The flexibility of an IVA aligns well with the UK's focus on protecting debtors from excessive creditor pressure. IVAs allow debtors to repay a manageable portion of their debt, often reducing the total owed, and enable them to avoid the stigma and severe consequences associated with bankruptcy.

In India's creditor-centric system, which emphasizes the rights and interests of creditors in debt recovery, IVAs could be a powerful tool for increasing debt recovery rates. Since an IVA encourages debtors to repay as much as they are able rather than defaulting entirely or declaring bankruptcy, creditors may recover a larger portion of the owed amount than through

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[50] Lokhandwala Kataria Construction Pvt. Ltd. v. Nisus Finance & Investment Manager LLP 2017 SCC OnLine NCLAT 406 (NCLAT).

[51] Aayush Mitruka "Supreme Court on Settlement of Insolvency Proceedings" (*IndiaCorpLaw,* 29 July 29 2017) <https://indiacorplaw.in/2017/07/supreme-court-on-settlement-of.html> accessed 15 October 15 2024.

[52] "Framework for Use of Mediation under the Insolvency and Bankruptcy Code, 2016".

liquidation, where assets are often sold below value. This could reduce the burden on the courts and lead to better-negotiated settlements, which would save a lot of time and resources.

C. Establishing a Guarantor-Friendly Subrogation Framework

To match with international standards, India should make clearer provisions for subrogation rights which are mentioned in S506 TO S509[53] of the Bankruptcy Code of the US, which clearly defines the right of subrogation meanwhile, it has been present in India as a common law principle. Incorporating it into law would give guarantors the power to recover the dues from the corporate debtor after fulfilling their duties to creditors. The right of subrogation, allowing the guarantor to take the position of a guarantor after the dues are paid, is limited to the extent of the payment made by the guarantor. The Supreme Court upheld the decision of the NCLAT in *Kanwar Raj Bhagat vs. Gujarat Hydrocarbons and Power SEZ Ltd*.[54] This would incentivize personal guarantors to settle their dues, knowing that they can later pursue the debtor for recovery, thus creating a more just and equitable system.

D. Creating a Specialized Tribunal for Guarantor-Related Disputes

There has been a significant problem of jurisdiction overlapping of insolvency proceedings under the IBC, particularly regarding personal guarantors of corporate debtors. Section 60[55] of the IBC assigns the NCLT as the primary adjudicating authority for both corporate debtors and their personal guarantors. However, this has led to a procedural ambiguity due to the potential involvement of the DRT for individual insolvencies.[56] The

[53] U.S. Bankruptcy Code 1978, s 506-509.
[54] Kanwar Raj Bhagat v. Gujarat Hydrocarbons & Power SEZ Ltd [2021] SCC OnLine NCLAT 157 (NCLAT).
[55] Insolvency and Bankruptcy Code 2016, s 60.
[56] Shivam Singhal, "To File or Not to File: Understanding the Jurisdictional Dilemma in Personal Guarantor's Insolvency Resolution Process" (*SCC Times*, 21 February 2022)

conflicting jurisdictions between these tribunals not only create operational inefficiencies but also slow the resolution process, complicating the path to justice for all parties involved.

Initially, Section 60(2)[57] of the IBC mandated that the insolvency proceedings for personal guarantors be heard before the NCLT, especially when a corporate insolvency process was already underway. However, this has led to legal challenges from personal guarantors, who argue that if no corporate insolvency is pending, the DRT should retain jurisdiction.[58] Recent rulings, notably by the Supreme Court in the *State Bank of India v. Mahendra Kumar Jajodia*[59] case, have clarified that the NCLT is the appropriate venue even when no corporate insolvency proceedings are active. Yet, this decision remains contested, with critics citing concerns over due process and natural justice, particularly regarding the appointment of resolution professionals without adequate opportunity for the guarantor's input.

The jurisdictional confusion can be solved by a clearer, more systematic framework. Establishing a specialized tribunal or a special court dedicated exclusively to handling insolvency cases. Such a tribunal could provide the necessary expertise to handle the nuances of both corporate and personal insolvency, allowing for a cohesive application of the IBC across cases and ensuring more consistent and timely outcomes.

By centralizing the jurisdiction in a specialized court, India's insolvency framework could more effectively uphold the principles of natural

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<https://www.scconline.com/blog/post/2022/02/21/understanding-the-jurisdictional-dilemma-in-personal-guarantors-insolvency-resolution-process/> accessed 14 October 2024.

[57] Insolvency and Bankruptcy Code 2016, s 60(2).

[58] Saurav Panda "Challenges Resolving Insolvencies of Personal Guarantors under IBC" *(Shardul Amarchand Mangaldas & Co,* 27 June 2022) <https://www.amsshardul.com/insight/challenges-resolving-insolvencies-of-personal-guarantors-under-ibc/> accessed 14 October, 2024.

[59] SBI v. Mahendra Kumar Jajodia [2022] SCC OnLine NCLAT 58 (NCLAT).

justice while expediting the resolution process. This would not only benefit creditors seeking redress but also maintain fairness for personal guarantors, fostering a balanced, predictable insolvency landscape.

E. Introduction of Cross-Border Insolvency Provisions

India doesn't have robust mechanisms to deal with Cross-Border Insolvency. The Indian courts face this problem because they have to implement older precedents in recent insolvency cases in India, involving companies with assets and creditors abroad, which have highlighted the need for clear cross-border insolvency laws. A historical case from 1908, *P. MacFadyen & Co.,*[60] In re, demonstrated early cross-border cooperation between English and Indian courts, but India's current legal framework lacks the structured regulations needed to address the complexities of modern global insolvency cases effectively. There exists a universal guide to insolvency laws which was prescribed by the UN in 1997 and the government can make law on the lines of this UNCITRAL Model Law.[61] "*The Model Law seeks to provide a uniform approach to cross-border insolvency proceedings by harmonizing national insolvency laws dealing with it. It does not provide for substantive unification of insolvency laws, rather it respects the diversity found in the laws relating to insolvency of various jurisdictions and allows the States to draft their national laws in consonance.*"[62] After making a uniform law for the country the government may consider signing MOUs regarding the trial and extradition of offenders with some countries where they try to escape

[60] In re P. Macfadyen & Co. Ex parte Vizianagaram Co. Ltd., [1908] 1 K.B. 67.

[61] UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation, (Model Law with Guide) 1997.

[62] Editor_4, "India's Tryst with Cross-Border Insolvency Law: How Series of Judicial Pronouncements Pave the Way?" (*SCC Times*, 16 April 2021) <https://www.scconline.com/blog/post/2021/04/16/cross-border-insolvency-law/> accessed 15 October 2024.

VI. CONCLUSION

The IBC 2016, particularly after the 2019 Amendments, has introduced a stricter framework for holding personal guarantors accountable for corporate debts. The inclusion of personal guarantors in insolvency proceedings, which can be initiated concurrently with corporate debtors, significantly strengthens the position of creditors. However, this creditor-centric approach raises an important question about the fairness and sustainability of the insolvency regime, especially for personal guarantors.

The Indian judiciary through landmark judgments such as *Lalit Kumar*[63] *and V. Ramakrishnan,*[64] has reinforced the liability of personal guarantors, making it clear that their obligations persist even after corporate debts are resolved. This stands in stark contrast to the debtor-centric insolvency frameworks in the U.S. and U.K., where personal guarantors are afforded more protection through mechanisms like voluntary repayment plans and the right to subrogation. India's legal framework, while efficient in debt recovery, places personal guarantors under significant pressure, often exposing them to full liabilities even after the corporate debtor's resolution.

One of the major challenges in the framework dealing with personal guarantors is the low recovery rate from personal guarantors, which, according to recent reports, stands at just 2.16%. This indicates systemic inefficiencies in the enforcement and monitoring of debt repayment plans, as well as a lack of robust mechanisms to trace and reclaim assets that have been fraudulently diverted. Additionally, the absence of clear provisions regarding asset tracking and the death of guarantors presents challenges, especially in cases involving

[63] Lalit Kumar Jain v. Union of India [2021] 9 SCC 321 (SC).
[64] SBI v. V. Ramakrishnan [2018] 17 SCC 394 (SC).

cross-border insolvency, where there are few legal frameworks in place to pursue guarantors or assets located outside India.

The study also raises concerns about the potential abuse of power by creditors and the need for more balanced legal provisions. As personal guarantors face increasing risks, particularly after the Amendments, there is a growing need for reforms that could mitigate excessive creditor control and provide guarantors with better options for settling their liabilities. Proposals such as the establishment of a specialized tribunal for personal guarantor disputes, clearer subrogation rights, improved asset recovery mechanisms, and clearer provisions on cross-border insolvency would help create a more just and equitable insolvency regime.

Conclusively, while the IBC has proven effective in speeding up the insolvency process and enhancing recovery rates, there is still a long way to go in addressing the concerns of personal guarantors. Strengthening legal protections for guarantors and incorporating global best practices will ensure that the Indian insolvency regime is both efficient and fair.

VII. GREEN FINANCE: RESTRUCTURING DEBT FOR A SUSTAINABLE FUTURE

Ananya Sinha and Purushraj Patnaik[*]

ABSTRACT

The neo-classical approach to economic development, which is primarily based on demand-supply theory, seems to lose its relevance in the current era. The major reason behind it is its short-sightedness and corrective approach, whereas we are currently looking towards a more preventive approach based on ecological economies. Green Finance is gaining huge momentum in the Indian economy, as it will play a crucial tool in its transition towards net zero emissions and financial decision-making. The integration of environmental concerns into financial decision-making is a crucial step for sustainable development as well. This will have a significant impact on debt restructuring and recovery as well, as the Insolvency and Bankruptcy Code (IBC)[*] primarily deals with the financial aspects, so the provisions have to incline with sustainability and environmental concerns. The evolution within the framework, which favours green finance under IBC, will signify an important step towards intertwining the challenges of financial distress and environmental concerns. The Environmental, Social, and Governance (ESG) trends are playing a growing role in restructuring, considering the enhanced market litigation about sustainability suits concerning ESG-related issues, which have significantly grown by more than 25% over the last three decades.[*] In the first section, the author aims to explain the intersection of IBC and Green Financing. In the second section, the author examines the restructuring of environmental liabilities within IBC. In the third section, the author highlights the conflict between the inclusion of ESG principles against the basic principles of IBC. The fourth section examines the compliance of debt restructuring under IBC with the sustainability goals. Sustainability-linked debt restructuring has a significant role in the inclusion of the ESG principles with the Code as harmonizing such incorporation with the Sustainable Development Goals (SDG)[*] is a very essential factor in this remarkable leap. The fifth and final section will deal with India's stance on environmental claims and its settlement under IBC. This will bring in a significant aspect of the use of green finance in responsible debt restructuring and recovery.

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[*] The Insolvency and Bankruptcy Code 2016 (India).

[*] Polina Lyadnova and Thomas S Kessler, 'Navigating the Shifting ESG Risks in Insolvency and Restructuring' (Cleary Gottlieb, 2023) <https://content.clearygottlieb.com/corporate/global-restructuring-insights/navigating-the-shifting-esg-risks-in-insolvency-and-restructuring> accessed 11 October 2024.

[*] United Nations, 'Transforming Our World: The 2030 Agenda for Sustainable Development' (2015) <https://sdgs.un.org/publications/transforming-our-world-2030-agenda-sustainable-development-17981> accessed 11 October 2024.

Keywords: Debt-restructuring, Green Finance, Environmental, Social and Governance (ESG), Sustainability, Insolvency Resolution, Sustainable Development Goals (SDG).

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I. INTRODUCTION

The United Nations[1] has successfully incorporated green financing in its decisions, while at the same time delivering several of the sustainable development goals, which will help align with its broader agenda. The 2030 agenda[2] paved the way for crystalizing the values and concepts, which will determine the sustainable and responsible development system across the economies. The environmental wing[3] is continuously working with the public and private sector organizations to align international financial systems to the

[1] Sean Fleming, 'What is Green Finance and Why is it Important?' (World Economic Forum, 9 November 2020) <https://www.weforum.org/agenda/2020/11/what-is-green-finance/> accessed 5 October 2024.
[2] United Nations, 'Transforming Our World: The 2030 Agenda for Sustainable Development' (2015) <https://sdgs.un.org/publications/transforming-our-world-2030-agenda-sustainable-development-17981> accessed 11 October 2024.
[3] United Nations Environment Programme, 'Supporting Resource Efficiency: Green Financing' <https://www.unep.org/regions/asia-and-pacific/regional-initiatives/supporting-resource-efficiency/green-financing> accessed 11 October 2024.

sustainable development agenda. The macroeconomic benefits of ecological economies cannot be denied. Green Finance as a wider arena emphasizes the assessment and mitigation of environmental risks, the promotion of environment-friendly practices and its alignment with restructuring the outcomes with the sustainability goals.

Insolvency and Bankruptcy Code, 2016 (**IBC**) addresses environmental claims through a waterfall mechanism while differentiating between secured and unsecured creditors.[4] The claims are often dispersed through resolution plans, side-lining the environmental concerns. This raises a major question of harmonizing the IBC with other frameworks, as it is crucial to address environmental and social issues in a holistic manner. IBC's role in providing a legal framework for resolution and restructuring offers various opportunities to maximize the value of distressed assets while incorporating environmental concerns.

There is a huge concern as to the restructuring of environmental liabilities under IBC, as the Code per se does not explicitly prioritize environmental claims, which leads to conflicts between the environmental obligations and creditor interests. The prioritization of such claims under the Corporate Insolvency Resolution Procedure (**CIRP**) has significant legal and pragmatic implications. The major reality around the globe is the adoption of the Environmental, Social and Governance (ESG) principles under the restructuring and recovery framework of respective countries to address their environmental, social and governance concerns. The piece aims to elaborate on the intersection of IBC and green finance, incorporate the ESG principles

[4] Vinit Bachwani and Arunima Sao, 'ESG in IBC: Over-Enthusiasm or the Most Practical Approach: Critical Analysis' (IBC Law Blog, 2024) <https://ibclaw.blog/esg-in-ibc-over-enthusiasm-or-the-most-practical-approach-critical-analysis-vinit-bachwani-arunima-sao/> accessed 11 October 2024.

within the IBC framework to resolve environmental liabilities and provide a more sustainable way of debt restructuring and its potential alignment with the Sustainable Development Goals (SDG) goals.

II. INTERSECTION OF IBC AND GREEN FINANCE: THE BIG LEAP

Insolvency and Bankruptcy Code, 2016 was a major leap forward, which contributed to some of the most significant reforms as stated by the Finance Minister in her latest budget speech.[5] The Code aligns with the UNCITRAL Model Law[6] on Insolvency of Revival and the time-bound resolution process. The Code has rightly provided a reliable and predictable framework for insolvency resolution and has made quite great advancements. IBC has provided a major structural reform, but there has been a strong vocalization by the experts and Insolvency and Bankruptcy Board in India (IBBI) professionals to incorporate ESG principles into the Code. The parading of the idea of integration is well supported by the idea of integration of the ESG in the corporate law framework in the country in its complete entirety.

Section 135 of the Companies Act, 2013[7] provides a mandate for some specific companies earning profit to contribute towards Corporate Social Responsibility (CSR). Schedule VII of the Companies Act, 2013[8] provides for the expenditure of the sum contributed towards CSR in various activities, which includes fulfilling ESG goals such as social business projects,

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[5] Alekh Shah, 'Budget 2024: Finance Minister Announces Integrated Tech Platform to Transform IBC' (Economic Times, 23 July 2024) <https://cfo.economictimes.indiatimes.com/news/governance-risk-compliance/budget-2024-finance-minister-announces-integrated-tech-platform-to-transform-insolvency-and-bankruptcy-code-ibc/111961804> accessed 11 October 2024.

[6] UNCITRAL Model Law on Cross-Border Insolvency, United Nations Commission on International Trade Law, 1997.

[7] The Companies Act 2013, s135.

[8] The Companies Act 2013, s7.

environmental sustainability etc. SEBI has also mandated Business Responsibility and Sustainability Reporting (BRSR) for the top 1000 companies, which is a much-advanced way than previous environmental reporting methodology.[9]

The enhanced alignment of economic activities with ESG, has increased the need of clarity as well. Indian Green Social and Sustainability bond has recorded a growth of 585% to reach $75 billion in 2021.[10] India's sustainable funds in comparison to retail assets held amounts to be ₹ 110 billion.[11] The recent developments have highlighted the significant need to incorporate ESG principles as a mandatory component of the Resolution plan approved under Section 31 of the IBC.[12] The code does not expressly require for the resolution plan to provide for incorporation of ESG. IBC for the purpose of settling environmental claims puts in use the waterfall mechanism, which differentiates between secured and unsecured creditors. Unsecured creditors also include environmental claims and this leads to them receiving the same funds, which they would receive during liquidation. The concern in the picture shifts to the fact that environmental claims fall under contingent or decree holders, and they are low-priority unsecured creditors whose claims will be eliminated by the resolution plan. This will ultimately result in side-

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[9] Securities and Exchange Board of India (SEBI), Business Responsibility and Sustainability Reporting by Listed Entities (SEBI Circular No. SEBI/HO/CFD/CMD-2/P/CIR/2021/562, 10 May 2021) <https://www.sebi.gov.in/legal/circulars/may-2021/business-responsibility-and-sustainability-reporting-by-listed-entities_50096.html> accessed 15 October 2024.

[10] Chirag Madia, "Assets of ESG funds rise 5x in four years to Rs 12,450 crore, shows data", (Business Standard, 24th April 2022) <https://www.business-standard.com/article/markets/assets-of-esg-funds-rise-5x-in-four-years-to-rs-12-450-crore-shows-data-122042400997_1.html > accessed 13 October 2024.

[11] Prasad Thakur and Labanya Prakash Jena "Rejuvenating India's ESG investment landscape", (The Economic Times, September 24, 2023) < https://bfsi.economictimes.indiatimes.com/blog/rejuvenating-indias-esg-investment-landscape/103872998> accessed 13 October 2024.

[12] Insolvency and Bankruptcy Code 2016, s 31.

lining the environmental concerns associated with the claims. The incorporation of a responsible debt restructuring method is needed here to address such social and environmental concerns.

III. RESTRUCTURING OF THE ENVIRONMENTAL LIABILITIES WITHIN THE INSOLVENCY AND BANKRUPTCY CODE, 2016

The treatment of environmental liabilities under IBC is an issue, which has remained a grey area for a prolonged time now and requires much clarity. The liabilities such as fines and penalties can be restructured under a resolution plan in a similar way as ordinary trade and statutory liabilities of a company. Nevertheless, all the liabilities of a company as per Indian law cannot be restructured and extinguished. However, India follows the principle of "absolute liability" when it is dealing with extremely hazardous waste or "inherently dangerous" activity, and it is most likely for the Courts to find that absolute liability cannot be restructured under a resolution plan.[13] The principle of "absolute liability" gained its recognition when the Supreme Court affirmed the principle in the Bhopal Gas Tragedy Case[14] stating that an entity engaged in inherently dangerous activities would have absolute liability.

A pertinent fact to consider in the given resolution regime under IBC is the principle of "absolute liability" in relation to a company which is undergoing insolvency proceedings. It is quite an unreliable and untested model because of the nascent nature of the legislation. India follows the principle of "polluter pays", which states that an entity that pollutes the environment must pay to reverse the damages caused by its acts. There lacks a sense of clarity under Indian Insolvency law with regards to the treatment of

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[13] INSOL International, 'ESG in Restructuring - India' (2023) <https://www.khaitanco.com/sites/default/files/2023-09/ESG%20in%20Restructuring%20-%20India.pdf> accessed 15 October 2024.

[14] Union Carbide Corporation v. Union of India, (1992) AIR 248.

certain environmental liabilities, although fines and liabilities imposed by the governmental authorities would fall within the ambit of operational dues. This will eventually result in a low ranking under the liquidation waterfall, which is prescribed as per IBC.

A resolution of a company and settlement of claims under IBC has to abide by the waterfall mechanism, which differentiates between secured and unsecured creditors. The Supreme Court in the case of Swiss Ribbons v. Union of India[15] differentiated between secured and unsecured creditors and held that unsecured creditors would only be legally obliged to obtain the amount they would have received if the company were liquidated. Environmental claims can only be extinguished if environmental claimants are not legally obliged to obtain compensation under the waterfall mechanism.[16] There have been several cases in which contingent claims have been extinguished via a resolution plan. A harmonious construction between IBC and environmental laws could find its way into India's Public Liability Insurance Act, 1991.[17]

The Act mandates companies, which are handling hazardous chemicals to get insurance protection against the accidents involving hazardous chemicals. The compensation is mostly determined on the basis of no fault liability, which means the owners are responsible for providing compensation to victims of accidents, irrespective of the presence of negligence. The Act also established the Environment Relief Fund within it to provide for victims of accidents, and the contributions are from the industries, which subscribe to the Act. The National Green Tribunal (NGT) for

[15] Swiss Ribbons v. Union of India, (2019) 3 SCR 535.
[16] Sriram Prasad, Environmental Claims in Insolvency in India (Oxford Business Law Blog, 17 May 2023) <https://blogs.law.ox.ac.uk/oblb/blog-post/2023/05/environmental-claims-insolvency-india> accessed 15 October 2024.
[17] Public Liability Insurance Act 1991 (India).

environmental damages awards compensation in such cases.[18] The schemes under the Act, although does not tackle a situation in full clarity provide a two-way balance between resolving environmental claims and adhering to insolvency policies.

IV. CONFLICT BETWEEN THE INCLUSION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) PRINCIPLES AGAINST THE BASIC PRINCIPLES OF IBC

The objective served by the Code as stated in the preamble is to focus on the reorganization and insolvency resolution of the business in a specified time. ESG compliance on the other hand is mostly associated with the long drawn-out method and at the same time affects the time-bound nature of the act.[19] The act of requiring an ailing company to adhere to the ESG parameters can act as a huge barrier towards achieving efficiency and profitability. This will lead to a resultant loss of entrepreneurship capabilities and a loss of economic interest with respect to the primary stakeholders of the company.

This will somewhere lead us to digress from the broader aim, which is to preserve the economic value of the companies and promote a sustainable method of business practices. ESG caters towards a lot of needs in the given scenario and as their increasing hold in the financial markets is at an all-time high, there is a strong need to include them in the restructuring arena[20] through IBC. Companies in recent times have sought to include new ESG methods and

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[18] Prasad (n 19).

[19] Corey B Shapiro, Green Funds in a Gray Area (2023) 48 (2) Columbia Journal of Environmental Law <https://journals.library.columbia.edu/index.php/cjel/article/view/11734> accessed 15 October 2024.

[20] Carlo Ghia, Thiago Braga Junqueira, Mariam Zaidi, and Gabriel L Olivera, Sustainability in Insolvency and Restructuring Procedures (International Insolvency Institute, 9 June 2024) <https://www.iiiglobal.org/file.cfm/156/docs/sustainability%20in%20insolvency%20and%20restructuring%20procedures.pdf> accessed 5 October 2024.

angles in debt issuances, and before we include it in the Code or develop a restructuring method, the conflict has to be sought in a two-fold manner.

A. ESG Vis-À-Vis Basic Principles of IBC

The integration of ESG principles within the Code and applying it to restructuring and insolvency procedures requires a dynamic interplay between the ESG criteria and financial recovery. The business environment stimulating the operation of companies in India has a very microscopic view of corporate responsibility and at the same time micro-management of the business responsibilities. The excessive supervision and regulation compliances included in the process would lead to a negative impact on the entire concept of ease of doing business. It will overburden the already financially ill companies and defeat the purpose of the Insolvency Resolution under CIRP.[21]

The primary goal of IBC is to ensure efficient resolution of insolvency and maximise focus on asset recovery for creditors. The incorporation of ESG principles would prioritize long-term sustainability over short-term creditor returns. It will increase the complexity of the insolvency procedure as well for the insolvency professionals and creditors. The ESG standards are not clearly defined which leads to a lot of ambiguity and would result in potentially unfair outcomes. The incorporation of the ESG principles might lead to a significant shift from creditors to a broader range of stakeholders, which will include employees, the environment and the community at large. This will lead to the dilution of the rights and interests of the creditors, whose major objective is debt recovery.

The regulatory landscape around ESG is evolving and although incorporation of the principles could lead to significant legal uncertainties, it

[21] Bachwani (n 7).

is an essential step towards sustainable business. The objective of green finance can be adhered to if these principles are incorporated after careful deliberation in order to balance creditor rights and insolvency resolution efficiency with long-term sustainability goals. India's legislative advancements provide a lucrative avenue for incorporating ESG factors in future insolvency resolutions.

B. ESG Principles against the Objectives of IBC

The inclusion of ESG as mandatory compliance can have a contradictory effect on the objectives stated in the preamble of the code. Firstly, the incorporation of excessive regulatory compliances and approvals from the environment, society and various other stakeholders even before a resolution plan could hold up the negotiation process with various stakeholders. This will not fulfil the objective of it being time-bound and following a strict timeline of 330 days[22] in which a CIRP should be completed, which usually gets extended due to overburdened tribunals. The resolution plan before the approval itself by the adjudicating authority takes time beyond the stated timeline, so the added compliance will further increase its complexities.

Secondly, the provision of making ESG compliances a mandatory measure in the approval of a resolution plan could lead to increased pressure upon the distressed assets and give a finite financial space to adhere to the various environmental and social regulations. It will affect the overall productivity and lead to a reduction in the value of the asset. Thirdly, ESG affects productivity and profitability, while it gives major value to environmental, social and governance norms. This will hamper the economic interests of the primary stakeholders of the company i.e. shareholders,

[22] Insolvency and Bankruptcy Code, s12.

creditors, employees etc. The incorporation of ESG principles could on one hand lead to sustainable business growth and will protect the basic values of business through its compliance, but at the same time will affect the primary economic interests of the stakeholders. It will create a huge imbalance in promoting stakeholder's interest on one hand, which will lead to the defeating of the objective of credit availability in the market.

The concerns with regards to the incorporation of the principles to the Code, in order to promote the bigger objective of green finance have huge long-term business growth whereas at the same time defeat the objective of the Code. The integration could lead to a positive insolvency resolution landscape, which goes far beyond the web of compliances. A conscious approach by the legislators can help to strike a perfect balance between the ESG principles and the Code. The alignment of the ESG principles[23] in business operations not only contributes towards social welfare but also aligns the country's motto towards sustainable business and community growth. The ESG principles will help in harmonizing the objectives of green finance and will help in the successful integration of sustainability growth in the Indian debt restructuring and recovery landscape.[24]

V. COMPLIANCE OF DEBT RESTRUCTURING UNDER IBC WITH THE SUSTAINABILITY GOALS

Sustainability-linked debt restructuring within the framework of India's IBC represents a ground-breaking step toward embedding ESG objectives in the financial recovery process. By integrating ESG principles, this approach aligns the Code with the United Nations' Sustainable

[23] INSOL INT. (n 16).

[24] Ulka Bhattacharyya, Understanding the Regulatory Framework for Sustainable Finance in India (NLS Business Law Review, 19 April 2024) <https://www.nlsblr.com/post/understanding-the-regulatory-framework-for-sustainable-finance-in-india> accessed 5 October 2024.

Development Goals (SDGs) for 2024, particularly in supporting sustainable growth, resilience, and responsible business practices. Sustainability-linked debt restructures are in essence, designed to incentivize companies to meet specific ESG milestones during insolvency and recovery, placing India's corporate sector on a path to achieve long-term ecological and social value alongside financial recovery.

IBC's approach to corporate distress has traditionally prioritized creditor rights, emphasizing efficient recovery mechanisms over environmental or social concerns. However, India's ambitious SDG goals demand a more balanced framework that not only ensures creditors' interests are met but also addresses sustainability challenges, such as emissions reduction, waste management, and energy transition. Notably, the IBC has yet to mandate any explicit ESG consideration, underscoring a significant gap that sustainability-linked restructuring could fill by transforming distressed companies into more environmentally conscious entities, thus meeting the country's commitment to net-zero emissions.[25]

In practical terms, sustainability-linked restructuring could employ various ESG-focused mechanisms to drive corporate transformation. For example, a resolution plan could include criteria such as reducing emissions or increasing renewable energy usage, with penalties for non-compliance or incentives for exceeding targets.[26] Such provisions could be tailored by sector, ensuring that high-impact industries adopt stricter sustainability requirements. The use of sustainability-linked bonds and loans could also help companies secure financing based on their ESG performance, thereby embedding

[25] M. P. Ram Mohan and Sriram Prasad, 'Environmental Claims under Indian Insolvency Law' (2023) Indian Institute of Management Ahmedabad Research and publication, <https://www.iima.ac.in/publicationenvironmental-claims-under-indian-insolvency-law-concepts-and-challenges-0> accessed 7 October 2024.

[26] INSOL IND. (n 16).

sustainability directly into the recovery process. These bonds, by tying financial incentives to meeting sustainability milestones, would enhance accountability and make environmental and social goals intrinsic to debt restructuring.[27]

Aligning IBC with the SDGs could also prioritize environmental claims within the hierarchy of creditors, which are currently treated as low-priority, and often sidelined behind secured creditors. By elevating the status of environmental liabilities, IBC could ensure that companies address the full scope of their environmental impacts during restructuring, harmonizing the goals of financial recovery with ecological integrity. Studies advocate for restructuring plans to include clear standards and metrics that enable distressed companies to adapt sustainably, thus creating a robust framework for monitoring compliance and progress.[28]

However, integrating sustainability within IBC is not without challenges. Sustainability-linked restructuring could complicate insolvency procedures, as the additional requirements may extend the resolution timeline beyond the 330-day limit mandated by the Code. Further, mandating ESG compliance might place undue financial strain on already distressed companies, potentially counteracting the Code's objective of efficient creditor recovery. Addressing these concerns requires careful calibration to ensure that

[27] Shilpy Sinha, 'NARCL plans to separate sustainable part of Simplex Infrastructures debt', (Economic Times, 2023) <https://economictimes.indiatimes.com/industry/indl-goods/svs/construction/narcl-plans-to-separate-sustainable-part-of-simplex-infrastructures-debt/articleshow/112663094.cms> accessed on 8 October 2024.
[28] M. P. Ram Mohan and Sriram Prasad, 'Environmental Claims under Indian Insolvency Law' (2023) Indian Institute of Management Ahmedabad Research and publication, <https://www.iima.ac.in/publicationenvironmental-claims-under-indian-insolvency-law-concepts-and-challenges-0> accessed 7 October 2024.

sustainability-linked restructuring does not compromise the core objectives of IBC while still promoting long-term resilience and growth.

In conclusion, sustainability-linked debt restructuring presents a unique opportunity to align India's insolvency framework with its SDG commitments. By embedding ESG metrics within the resolution process, India can create a more resilient, responsible corporate landscape that supports both financial recovery and environmental stewardship. This approach not only strengthens the Code's impact but also enhances India's global standing as a leader in sustainable business practices.

VI. PROPOSED SOLUTIONS FOR INTEGRATING ENVIRONMENTAL CLAIMS INTO INDIA'S INSOLVENCY FRAMEWORK

India's approach to environmental claims under its insolvency regime, led by IBC reveals a progressive but complex interplay between creditor priorities and environmental accountability. The treatment of environmental liabilities in insolvency cases has long been a topic of legal debate, with such claims often relegated to lower priority within IBC's waterfall mechanism. This system, which places secured creditors at the top and environmental liabilities as contingent claims near the bottom, has spurred criticism that environmental concerns are inadequately addressed within insolvency proceedings.[29]

In response to growing environmental challenges, Firstly, India could prioritize environmental claims within the creditor hierarchy. The "polluter pays" principle—embedded in Indian environmental jurisprudence—supports the idea that entities responsible for environmental damage should be held liable for remediation costs. However, conflicts arise when companies under

[29] Mohan (n 28).

insolvency, obligated to pay for ecological damage, have limited resources, often insufficient to satisfy both creditor claims and environmental liabilities. This clash between creditor interests and environmental responsibility has prompted calls for legislative amendments that would increase the standing of environmental claims in the insolvency process.[30]

A potential avenue for reform involves recognizing environmental liabilities as "operational dues" under the IBC. By reclassifying these claims, they could receive higher priority in the recovery process, ensuring they are addressed alongside other critical operational expenses. Legal experts argue that India's insolvency framework could incorporate environmental liabilities in a manner akin to the Public Liability Insurance Act, 1991, which mandates insurance for industries handling hazardous substances and establishes an Environmental Relief Fund to compensate victims of environmental damage. This model provides a structured mechanism for compensating environmental harm, aligning with India's commitment to sustainable business practices.[31]

Secondly, India's judicial system, notably through the National Green Tribunal (NGT), has reinforced the significance of environmental accountability by imposing penalties on companies for ecological damages. While these penalties fall under operational dues in the IBC framework, they often fail to achieve substantial compensation due to the Code's prioritization of secured creditors. Recent cases have demonstrated that environmental

[30] Aditi Bharadwaj & Pratishtha Shrivastava, 'Redefining Insolvency: A Case for Prioritizing Ecological Concerns' (The Indian Review of Corporate and Commercial laws, 2024) <https://www.irccl.in/post/redefining-insolvency-a-case-for-prioritizing-ecological-concerns> accessed 8 October 2024.

[31] ibid.

claims are rarely prioritized within the restructuring plan, leaving ecological and social concerns secondary to financial recovery.[32]

Recent policy recommendations propose that IBC consider environmental liabilities alongside other claims of public interest, particularly within industries prone to environmental risks. By prioritizing ecological concerns, the Code could better balance financial recovery with environmental stewardship, facilitating sustainable corporate restructuring that aligns with both domestic legal principles and international best practices.

Thirdly, the Courts in India have previously refused to admit companies under insolvency. There stands a huge possibility that the courts may go on to refuse insolvency against a company that strategically defaults to evade environmental claims, regardless of the pre-existence of default and debt. The possibility in the pertaining case might remain a valid situation to refuse environmental claims, but it does not prove to be an efficient solution for environmental claimants. A company, which has caused environmental harm, if not accepted to insolvency, although it faces many environmental claims. The creditors in the given case would naturally seek other remedies, such as enforcing their security interests and among other actions in order to secure their debt. This will ultimately result in the company's assets being stripped off and difficult for it to continue in a going concern. The environmental claimants might also have to be involved in litigation against the financial creditors, but with a slight upper hand, as they would have greater time and resources to expend on litigation as compared to environmental claimants.

[32] Mohan (n 28).

A. Recommended Approach for Insolvency Courts when Choosing Liquidation over Reorganisation

In India, directing a company to liquidate rather than reorganise will result in running into a waterfall mechanism, in which gains from liquidation are distributed according to the waterfall mechanism as per the IBC. It can be concluded that directing a company to liquidation rather than reorganisation is not an efficient solution in trying to solve the distress of the environmental claimants under IBC. The Courts have refused the application of a few specific provisions of insolvency laws if they clash with the environmental policy. There are insolvency regimes, which allow the liquidator to abandon onerous property or contracts.

There are several instances, where insolvency and environmental policy clash, the liquidators have tried to abandon environmentally onerous properties, and courts have often not allowed the power of disclaiming onerous property.[33] The application of IBC in India showcases that the environment claimants may not even have any real advantage if the company refuses insolvency, as the Courts have upheld in various other jurisdictions. It appears essential to devise a workable solution for the treatment of environmental claims in insolvency, as it upholds the future of green finance in India.

India's stance on environmental claims within the insolvency framework is evolving, with growing recognition of the need to integrate ecological accountability into the recovery process. By amending the IBC to prioritize environmental claims, India could ensure a more responsible insolvency landscape that aligns with its broader commitment to sustainable development and environmental protection. This shift towards a balanced insolvency framework could pave the way for responsible corporate practices

[33] Mohan (n 28).

that respect both creditor rights and environmental obligations, further solidifying India's role as a leader in sustainable finance.

VII. CONCLUSION

Modern insolvency legislation aims to provide a chance for a failing company to revive. In the current scenario, insolvency acts as a defence against much of environmental liability. The entire objective of the waterfall mechanism is the fact that insolvency prioritizes financial debt over environmental claims and insolvency prioritizes economic policy over social goals. The given concern about the potential burden and distraction from business goals will be in existence but the strategic incorporation of ESG principles in the IBC will enhance the effectiveness of the insolvency resolution process, making it more comprehensive and aligning it with the evolving methodology of finance, which helps in a sustainable and environmentally friendly way of business operation.

The prioritization of environmental claims during such bankruptcy proceedings could provide better alternatives for the stakeholders, who are left high and dry in many situations. Sustainability is the key to taking ahead any business operation and the integration of ESG principles could lead to a healthy debt restructuring and recovery way out for the companies. India's commitment towards providing a better avenue for fostering the development of green finance could lead to better investments and make the application of IBC in a much better manner. This long-term integration requires a conscious approach by the legislators, in order to strike a perfect balance between the ESG principles and IBC and towards its healthy adoption in the Indian legal system. Insolvency is complex and it is sceptical towards social issues by its very design, which makes it oblivious to environmental policies. In such scenarios, the way forward, which can be applied, would be the application of

the Public Liability Insurance Act, 1991.[34] It is not a fool proof way but at the same time provides for a better balance between environmental policies by resolving environmental claims, while at the same time respecting insolvency policies. It can also help with the better integration of the components of green finance in the IBC for a sustainable debt restructuring and recovery method.

[34] Mohan (n 28).

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

Arushita Singh[*]

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]

[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.

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[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

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[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

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[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.

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[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

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[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.*

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[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.

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