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Justice Sanjay Karol
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16, Tughlak Road,
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FOREWORD

April 5, 2025

Rajiv Gandhi National University of Law's Financial and Mercantile Law Review is a commendable student run initiative, now in its eleventh year. Over the years, with thanks to the diligent efforts of the concerned faculty and students, this journal has made a name for itself in publishing well-researched pieces of contemporary relevance, contributing to the literature on the numerous ideas and analyses it has featured. It gives me great pleasure to be writing the foreword for its XIIth volume.

At the outset, it is important to highlight, why, a dedicated space encouraging critical thinking and exchange of dialogue between experts, scholars and students in and around these areas is necessary- The interplay between economic forces—market dynamics, fiscal policies, global trade, and labor markets—constitutes a pivotal determinant in shaping the trajectory of both national and global affairs. The tension between supply and demand, capital accumulation, and regulatory frameworks dictates the pace and direction of innovation, wealth distribution, and geopolitical relations. Moreover, the intricate relationship between consumption, production, and investment decisions exacerbates disparities, influencing social stability and political ideologies. Economic forces not only govern the immediate realities of employment, growth, and poverty but also project the long-term stability or volatility that can either perpetuate or disrupt the existing global order.

It is these myriad interactions and effects that have given rise to the need for a vast body of laws, rules and regulations, and even the setting up of expert bodies meant solely to examine and adjudicate the issues arising therefrom and therein. This volume, like its predecessors reflects the variety-the contributions deal with issues with the Insolvency and Bankruptcy Code, 2016; *'shadow banking'* ; the study of the working of one particular tribunal; the impact, positive or negative of technology upon the commission; prosecution of financial crimes; or climate finance and Environmental Social Governance; and others. Each of these issues is interesting and in their own way, make for stimulating reading.

Justice Sanjay Karol
Judge
Supreme Court of India

16, Tughlak Road,
New Delhi - 110 011

The jurisprudential examination of the powers of the NCLT to decide disputes and what remains wanting; the analysis of Articles I and III of the GATT, the comprehensive analysis of the twin-faced impact of technology on white collar crimes, exploring the steps taken by India in travelling the ESG path as also climate related financial disclosures- all these, I'm certain will prove to be greatly though-provoking for all readers and thinkers, as they were for me.

I extend congratulations to all the authors featured in this volume, and equally so, ask all those who could not have their work published here, to persevere on their path of exploration, study and analysis. It will undoubtedly yield results.

Felicitations also the team at the RGNUL *Financial and Mercantile Law Review* for their painstaking efforts in reading, analyzing, suggesting changes to the papers submitted and an all-round enterprise in bringing out this volume of scholarship.

(SANJAY KAROL)

EDITORIAL NOTE

In the ever-evolving montage of global legal systems, the law must be both a custodian of practice and an emissary of evolution. The pages of the *RGNUL Financial and Mercantile Law Review* have long strived to facilitate this dialectic, with each Issue, we renew our solemn commitment to academic excellence, jurisprudential integrity, and expansive scholarly engagement. As I pen this Editorial Note to Volume XII Issue I of the RFMLR, I am pervaded with a profound sense of pride and conviction - pride in the scholarly integrity that enlivens the work of the editorial board and authors, and conviction in the transformative potential of law when examined with precision and purpose.

Over the past decade, RFMLR has established itself as a bastion of incisive analysis and thematic breadth, earning a deserved place among the top law reviews in the country. RFMLR distinguishes itself not just by its selection of topics, but by the rigour with which it subjects them to analytical scrutiny, spirited by a peer-review mechanism of unimpeachable standards and supported by a cohort of scholars and practitioners who treat the law as both instrument and interlocutor.

The present Issue stands as a testament to this ethos. It engages with contemporary legal quandaries not in isolation but as part of a broader intellectual and regulatory structure, thereby advancing not just arguments but discourse. In this respect, Volume XII Issue I performs a stellar function. The article on contested asset claims within the IBC regime, often relegated to the peripheries of insolvency discourse, is here re-examined with startling clarity, revealing not just a procedural lacuna but a foundational asymmetry in the Code's underlying assumptions. The study of the National Company Law Tribunal's adjudicatory conduct in M&A contexts, especially through the lens of the Chandigarh Bench, offers a rare empirical and normative examination of the divergence between statutory mandate and judicial conduct.

The evolution of global trade norms is captured through an astute lens in the analysis of the *Like Product* conundrum under GATT's non-discrimination principles, evincing a doctrinal dexterity that compels us to revisit not merely the positive content of treaty obligations but their philosophical coherence. The discussion is not confined to the boundaries of private commercial law either; the article on climate-related financial disclosures delves into the symbiotic relationship between ESG norms and regulatory accountability, illuminating how transparency must become not just a corporate virtue but a legal mandate.

In the words of Oliver Wendell Holmes, "*The life of the law has not been logic; it has been experience.*" In this Issue, that experience is richly textured not only by doctrinal rigour but also by interdisciplinary sensitivity. The comparative study on shadow banking in India and China, for instance, frames financial regulation as a function not only of statutory precision but of political economy in a post-Bretton Woods world. Similarly, the regulation of crypto-assets as securities in the digital age challenges us to rethink foundational concepts of asset-hood and regulatory legitimacy.

The intellectual arc of this Issue culminates with profoundly written articles on white-collar crime in the technological age, and the evolving jurisprudence around homebuyer protection and creditor rights in real estate insolvency, issues that exemplify the law's duality as both protector and arbiter. Likewise, the examination of compromise and arrangement schemes during liquidation raises unsettling questions about the residual value of corporate entities and the jurisprudence of economic rescue, questions that lie at the heart of insolvency discourse.

Indeed, Volume XII, Issue I aspire to be more than an intellectual ledger of contemporary legal debates. It is a juridical cartography charting the shifting borders between public law and private interest, between policy ambition and institutional capacity. Through these articles, we glimpse the evolution of commercial law not as a linear progression but as a series of epistemic ruptures, each requiring not just doctrinal resolution but normative introspection.

As we look forward, it is imperative to recognise that the enduring value of a law review lies not in the ephemerality of its themes, but in the permanence of its commitment to excellence. RFMLR, in this sense, is not simply a journal. It is a scholarly institution, a locus of critical engagement, and a torchbearer of rigorous legal review. In an era where attention is increasingly monetised and analysis is often truncated to fit the rhythms of digital brevity, RFMLR remains defiantly committed to deliberation and discursive clarity.

In the final cadence of this reflection, I extend my deepest gratitude to the Advisory Board, whose sagacity and unwavering vision have indelibly shaped our scholarly identity and intellectual direction; to the Peer Review Board, whose discerning insights elevate each published piece, ensuring it meets the highest standards of academic excellence; and to the Editorial Board, whose intellectual stewardship and editorial precision give this journal its distinctive character. I also wish to express our deepest appreciation to our patrons and readers, whose steadfast engagement not only enriches our scholarship but ensures that it resonates with real-world significance and drives meaningful discourse.

Let this Issue serve not merely as a compendium of contemporary legal debates, but as an exhortation to think more expansively and to argue more rigorously. For it is only through such engagement that law may fulfil its most noble function: not merely to govern conduct, but to shape the conditions of justice. In a time when markets outpace regulation and rights collide with restructuring, legal academia must be more than a mirror to the law—it must serve as its conscience. May this Issue carry forward that solemn obligation with intellectual sincerity and doctrinal precision.

YUVRAJ MATHUR
Managing Editor
RGNUL Financial and Mercantile Law Review

TABLE OF CONTENTS

EFFICACY OF A SCHEME OF COMPROMISE & ARRANGEMENT DURING LIQUIDATION: CAN COMPANIES BE RESCUED FROM INEVITABLE VALUATION DOOM

- *Dr. Anand Kumar Singh*[*]

ABSTRACT

Schemes of compromises and arrangements as operative under Section 230 of the Companies Act, 2013 can prove to be an effective means of resolving the insolvency of a stressed entity, which allows the entity to emerge financially stronger from a corporate insolvency process, rather than an undesirable commercial death. The importance of schemes of compromise and arrangement under the Indian insolvency mechanism is further bolstered by the inclusion of Regulation 2B of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016. On the other hand, while the comprehensive Insolvency and Bankruptcy Code ["**the Code** or **IBC**"], introduced in 2016, has solved a major policy issue that had been tormenting the Indian commercial setting until the Code's adoption – i.e., the multiplicity of laws that would apply to insolvency matters – recent data released by the statutory regulator has painted a picture indicating that the Code has not been as successful in achieving the primary commercial objective – i.e., ensuring maximization of the value of the assets of the stressed entity, as well as the recoveries made by the creditors of such stressed entity.

As is indicated by the data released, a large chunk of insolvency proceedings end up in liquidation (following either a lack of interest by Committee of Creditors in accepting the Resolution Plan presented before it, or due to lack of interest on part of the public to submit a plan for the resolution of the entity based on valuation concerns), leading to minimal recoveries being made by the creditors. Now, this situation, in the opinion of the author, can be resolved aptly if persons from the previous management of the company are allowed to submit a 'bona fide revival plan' at the juncture of the Corporate Insolvency Resolution Process ["**CIRP**"] failing, and liquidation being initiated. However, with the blanket ban put on the participation of previous promoters through the operation of Section 29A of the IBC and the ruling of the Supreme Court of India on this matter, this approach is not permitted

[*] Dr. Anand Kumar Singh is an Assistant Professor of Law at NLU Jodhpur. Views stated in this paper are personal.

under Indian law. Accordingly, through this article, the author aims to bring to light certain fallacies in the position as it exists, through a critical examination of the data as made available by the statutory authority, weighing the benefits and disadvantages that pertain to lifting this blanket ban, and an analysis of the shortfalls in the pronouncement given by the Supreme Court of India through the case of Arun Kumar Jagatramka v. Jindal Steel and Power Limited.

I. INTRODUCTION

Corporate restructuring in a debt-ridden company is an ostensible task. Balancing the interests of the various stakeholders makes it difficult to ascertain the right way forward. To tackle this issue and provide a consolidated approach, the statutory provisions governing mergers and acquisitions enshrined in Sections 230-232 were introduced under the Companies Act, 2013 ["**CA, 2013**"]. Accordingly, schemes of compromise and arrangements positions itself as one of the most important instruments at the helm of any stressed entity to resolve impending financial issues which would have a detrimental effect on the operation of the company.

Apart from corporate restructuring, companies can also resort to the mechanism set forth under the IBC. The Code provides for a step-wise resolution of the debt-ridden company's revival through the CIRP process. Where CIRP fails to bring about the desired results, an alternative but mandatory path that an entity is required to take is that of liquidation.

The primary purpose for the introduction of the Code was to correct the issue that had been ensuing in the Indian environment for decades through the operation of multiplicity of laws being applicable in insolvency cases – namely, the Sick Industrial Companies Act, 1985,[1] the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act,[2] 2002, and the Board for Industrial and Financial Reconstruction.[3] Accordingly, the Code brought about a breath of fresh air for companies existing, or evaluating an entry into the Indian market, by bringing into picture a consolidated and reorganised resolution mechanism for insolvent and bankrupt persons.

The Code has always functioned on the principle "Revival before Liquidation," which is ensured through the Corporate Insolvency Resolution Process. However, once the company goes into liquidation, is there a hope for its revival? The inclusion of Section 2B in the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, which provides a 90-day timeline which shall be applicable in cases where a revival scheme is proposed after commencement of liquidation of the corporate debtor, has

[1] The Sick Industrial Companies (Special Provisions) Act 1985 (No 1 of 1985).
[2] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (No 54 of 2002).
[3] The Sick Industrial Companies (Special Provisions) Act 1985 (No 1 of 1985), s 4.

paved the way towards opening judicial discourse on the matter; which will be aptly discussed in this article. However, what becomes troubling is that, if a company fails to attract any prospective resolution applicants in the CIRP process itself, then what happens to (i) the position of the company in the eyes of the market forces which ascertain its viability; (ii) the position of the promoters in in regards to the creditor; (iii) the valuation of the company; and (iv) the final efficacy of the scheme that is finally entered into with such a background?

Another issue which merits discussion is the intersection in the operation of Sections 230-232 of the CA, 2013, and Regulation 2B r/w Section 29A of the IBC. Section 29A disqualifies a promoter from submitting resolution plans or acquiring the assets of the entity in liquidation. Hence, this article seeks to also discuss the issue of "how the possibility of a scheme of arrangement co-exists with the principle of promoter disqualification?"

This article's central argument is structured around several key research questions, including the prioritization of settlement mechanisms over the initiation of the liquidation process under the IBC, the determination of voting shares in compromise and arrangement matters, and the extent of intervention permissible for majority stakeholders post the CIRP process. Additionally, it critically examines the compatibility of schemes of arrangement with the principle of promoter disqualification under the IBC.By delving into these multifaceted issues, the article aims to offer insights into optimizing the functionality of the IBC and CA, 2013, thereby facilitating smoother corporate restructuring processes and fostering a conducive environment for business rehabilitation in India.

Hence, this article follows the roadmap enumerated subsequently, so as to provide an all-encompassing and convincing argument to change the legal set-up as it exists when it comes to the rescue of a commercial entity out of the compulsory liquidation process put into place by the Code.

While this part has introduced the primary issues that will be addressed in this article, Part II provides an overview of the intersection between scheme of compromise and arrangements with insolvency law as it exists in India. Accordingly, this part will consist of a close examination of the legislative operations in place and the legal holdings influencing the subject-matter.

Part III seeks to examine the compatibility of the existing criteria for admitting an entity into insolvency, and through a multi-jurisdictional analysis, seeks to determine the existence of a better alternative (if any) for the Indian set-up.

Part IV delves and presents a critical view of the concerns which, in the opinion of the author's opinion require addressing. Accordingly, the issues relating the feasibility of a blanket ban on promoters from participating in the process of revival post-CIRP and the valuation concerns that may arise if the same is not permitted will be commented upon.

Lastly, in Part V contains a summary of the arguments presented, pitfalls addressed and the solutions that may be available with India, to continue striving towards a better and more effective insolvency law system.

II. TRACING THE INTERSECTION BETWEEN SCHEME OF COMPROMISE & ARRANGEMENTS AND INSOLVENCY

A. The Existing Legislative Set-Up

In India, the provisions governing and allowing the effective implementation a scheme of compromise and arrangement in general, are enshrined under Sections 230-232 of the Companies Act, 2013.[4] The point of intersection between the Code and CA, 2013 occurs through the operation of

[4] Companies Act 2013 (No 18 of 2013), ss 230–232.

Section 230 r/w Regulation 2B of the IBBI (Liquidation Process) Regulations, 2016. Below is a discussion regarding the primary regulations that deal with the intersection between liquidation and scheme of compromise and arrangements, for the purpose of this paper.

1. THE INSOLVENCY AND BANKRUPTCY CODE, 2016

Section 29A

Section 29A is one of the most contentious provisions which is part of the Code. Through this, an all-encompassing bar is affected on the previous promoters of the corporate debtor, on the grounds of possession of non-performing asset accounts with the Reserve Bank of India;[5] for being an undischarged insolvent;[6] or a wilful defaulter;[7] or even on grounds for being part of preferential, fraudulent or undervalued transactions;[8] or being connected to persons disqualified under the different grounds given;[9] amongst others. This provision serves as the principal point in question in this research paper, and an assessment of its effectiveness, viability, and placed in the Code has been examined.

Chapter III

Post the failure of CIRP, under the Code, the AA has been empowered to immediately pass an order for liquidation in order to maximise the recoveries made through asset sales. Accordingly, a waterfall mechanism has also been placed to ensure that priority of payments are followed (considering that the haircuts would lead to a shortage of cashflow). So, as indicated Chapter III includes a comprehensive procedure put into place for the compulsory

[5] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(c).
[6] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(a).
[7] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(b).
[8] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(g).
[9] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(j).

liquidation process as directed in the Code post the failure of the CIRP process.[10]

2. THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (LIQUIDATION PROCESS) REGULATIONS, 2016

This is the principal regulation that will be under scrutiny in this research paper. Various provisions exist which deal with scheme of arrangements and liquidation at the juncture of CIRP failing. They are as follows:

Regulation 2B

This provision directly deals with the subject-matter of compromise and arrangements proposed through Section 230 of the Companies Act. However, due to the presence of the disqualifying factor due to the insertion of the wording through the IBC (Amendment) Act, 2020,[11] this regulation acts as the primary hurdle for bona-fide previous promoters from submitting a revival scheme before the Committee of Creditors.

Regulation 32(e)

This regulation serves as a further discussion point in this paper. Through this, the tribunal-appointed Liquidator is allowed to sell off the company as a going concern while in liquidation. This point is essential for examination as the regulation showcases the primary objective of the Code, i.e., Revival not liquidation. In fact, multiple cases exist where the courts in India have emphasised on this objective. For example, in ***Arcelor Mittal India Private Limited* v. *Satish Kumar Gupta***, the SC stated that –

"*If there is a resolution applicant who can continue to run the corporate debtor as a going concern, every effort must be made to try and see that this is made possible*."[12]

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[10] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), ch III.
[11] Insolvency and Bankruptcy Code (Amendment) Act 2020 (No 1 of 2020).
[12] *Arcelor Mittal India Private Limited v Satish Kumar Gupta* [2018] ibclaw.in 31 SC [83].

In another example, the SC further pointed out the fact that the preamble of the Code in no manner mentions liquidation, indicating that the same is a last resort move when all efforts of revival have failed.[13]

3. COMPANIES ACT, 2013: SECTION 230

Section 230 of the Companies Act, 2013, grants the NCLT the power to sanction compromise or arrangement between a company and its creditors or shareholders. This provision enables the restructuring of companies so as to put their affairs into place, and satisfy the requirements of its members/creditors in a situation where the company is operating in a stressed-state (i.e., possible brink of insolvency)

In the context of the IBBI (Liquidation Process) Regulations, Regulation 2B facilitates the sale of assets of the corporate debtor through electronic means, ensuring transparency and maximizing value realization for creditors. Section 230 of the Companies Act can be invoked to seek NCLT's approval for a scheme of arrangement or compromise that includes the sale of assets under Regulation 2B. This synergy between Section 230 of the Companies Act and Regulation 2B of the IBBI (Liquidation Process) Regulations enhances the flexibility and effectiveness of the liquidation process under the IBC in general, but restricts the entry potential of bona-fide previous promoters of the company. This is done through the explicit mention of the barring provision of Section 29A of the Code, as part of the regulation provision itself.[14]

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[13] *Swiss Ribbons Private Limited v Union of India* [2019] 4 SCC 17.

[14] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations 2016, reg 2B.

B. The existing Judicial Pronouncements on the Intersection of Insolvency and Schemes of Compromise and Arrangements

The first set of directions observed to be passed by the NCLAT, ordering the liquidator to take steps under Section 230 of the Act before going ahead with the liquidation of the entity, was observed through the case of ***S.C. Sekaran* v. *Amit Gupta***.[15] In fact, through the application of the Companies Act, 1956 as well,[16] with the ***Meghal Homes*** case seeing an order being passed, where the liquidator was first required to examine any scheme proposed before it, only post which the sale of the assets of the CD would be permitted.[17] In ***Ajay Agarwal* v. *Ashok Magnetic Ltd.***,[18] the NCLAT further clarified that during liquidation, the liquidator is under an obligation to ensure that they explore the option of compromise or arrangement, which is provided through Section 230 of the 2013 Act.

Now, the support for settlement instead of liquidation has been seen to be a settled point in law. However, with the landmark ruling of ***Arun Kumar Jagatramka v. Jindal Steel and Power Ltd.***, the Supreme Court closed the path for previous promoters to present settlement/revival schemes before the CoC. The Court stated that Section 29A of the Code would also apply to cases where schemes are proposed through Section 230 of the Companies Act.[19] Further, the application of Section 35(1)(f) was also attached to the Code.[20]

Therefore, it becomes essential to examine whether this step by the Supreme Court can validly be stated to be the best possible move for the economic Code; which, due to its economic nature should be allowed to

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[15] *S C Sekaran v Amit Gupta* [2018] NCLAT Comp App (AT) (Insolvency) 495 & 496.
[16] Companies Act 1956 (No 1 of 1956), s 391.
[17] *Meghal Homes Pvt Ltd v Shree Niwas Girni K K Samiti* [2007] AIR 2007 SC 3079.
[18] *Ajay Agarwal v Ashok Magnetic* [2018] NCLAT Comp App (AT) (Insolvency) 792 & 793.
[19] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474.
[20] ibid.

operate to serve the best needs of corporate entities that come before it for the purpose of revival?

III. INDIAN INSOLVENCY APPROACH: ADEQUACY AND EFFECTIVE IMPLEMENTATION

Applications to initiate the corporate insolvency process against an entity under the Indian Code can be brought forth by either its financial creditors,[21] its operational creditors,[22] or by the corporate entity itself through an application presented by the management of the CD or by persons authorised by it.[23]

The satisfaction of the legislation and sectoral authority with the test put in place is made evident in various places. The 'default-based test' was defined as objective criterion,[24] and as stated by Shri T.K. Viswanathan in his considered view, is the driving rationale behind the implemented Insolvency and Bankruptcy Code.[25] The setting apart factor for the Code, as compared to its predecessors in Sick Industrial Companies Act, amongst others; was the ability to detect sickness in an entity at an earlier stage, instead of implementing the worth erosion test, etc.[26]

But what requires further examination is the need additional qualifying factors which would serve as effective means to not only bring forth the best possible means for revival, and at the same time decrease the burden on the Tribunals while dealing with matters pertaining to CIRPs. A further

[21] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 7.
[22] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), ss 8–9.
[23] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 10.
[24] Ministry of Corporate Affairs, 'Notice File No. 30/38/2021-Insolvency' (1 January 2023) para 2.1 https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf
[25] Lok Sabha Secretariat, Report of the Joint Committee on the Insolvency and Bankruptcy Code (28 April 2016) para 2 https://ibbi.gov.in/16_Joint_Committee_on_Insolvency_and_Bankruptcy_Code_2015_1.pdf.
[26] ibid.

requirement that would also be examined is prospective inclusion of a benchmark for assessing the viability of the CD, so as to streamline the admission process.

Now, the principal reason for the inclusion of this discussion in the research paper is to analyse the question that – if default is the only test that is required, what will happen if the proceedings are already in an advanced stage of negotiations. Hence, should India add another qualifying test to ensure that compulsory admission of application u/s 7 and 9 do not take place if negotiations are at an advanced stage?

IV. A CRITIQUE OF THE JINDAL STEEL CASE AND THE CONCERNED LEGISLATIONS

In the case of *Arun Kumar Jagatramka* v. *Jindal Steel and Power Ltd.*,[27] through its judicial pronouncement, the Supreme Court has, *inter alia*, quite clearly provided that-

(i) The disqualification as given under Section 29A of the IBC will be applicable to the regulations governing scheme of compromise and arrangements as envisaged in the IBC processes;

(ii) The incorporation of the barring clause for promoters in Regulation 2B of the IBBI Liquidation Regulations are *in continuum* with the provision of Section 230 of the Companies Act, 2013. Hence, the barring effect of Section 29A would be applicable to any resolution that is sought through the IBC mechanism;

(iii) The incorporation of the barring clause in Regulation 2B is constitutionally valid.

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[27] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474.

Now, while the author accepts that the interpretation of the Court was in line with the harmonious principle of interpretation adopted,[28] at the same time, the author is of the opinion that the courts, the legislature and the statutory regulator have erred in dealing with the actual problems being faced while implementing a scheme of compromise and arrangements at the juncture of liquidation under the IBC. This is because the author found that all the explanations and/or justifications for any change in law, regulation or precedent with respect to the IBC have been fixated with aligning them with the objectives of the IBC, even though there may be evident hurdles that may be faced. Further, there also exists an unsaid weightage difference given to the various objectives of the IBC, which, in the opinion of the author, in fact turns to defeat major objectives of the IBC. Lastly, it is also the author's opinion that the *status quo* has resulted in an additional hurdle in achieving what they feel is the primary goal of the Code, that is 'revival before liquidation.'[29]

A. Feasibility of Blanket-Bans on Promoters in a Scheme of Arrangement during Liquidation

At the outset, the author finds it pertinent to clarify that the operation of the barring provision under the Code is only being criticised with respect to the application of sub-clause (j),[30] while taking into consideration a scenario where a CD has emerged unsuccessful from the resolution process.

The examination in this sub-part presents the argument that the operation of sub-clause (j) of Section 29A prevents entities and creditors from exploring an alternative and viable option – i.e., settlement of the dispute post the

[28] ibid para 70.
[29] *K N Rajakumar v V Nagarajan* [2021] SCC OnLine SC 1792, para 16; *Gayatri Polyrub Pvt Ltd v Anil Kohli* [2023] NCLAT Comp App (AT) (Insolvency) 650, para 6; *Ghanashyam Mishra and Sons Private Limited v Edelweiss Asset Reconstruction Company Limited* [2021] SCC OnLine SC 313, para 86.
[30] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 29A(j).

unsuccessful resolution process, and prior to the initiation of the liquidation process. Neither does this sub-part advocate for the removal of the barring provision in its entirety, nor does it advocate for the inclusion of promoters barred under sub-clauses (a) – (h) of the Section of the Code. The analysis is purely on the lines of whether the extension of application of sub-clause (j) should be allowed to prevent bona-fide revival schemes offered to creditors a previous promoter of the entity.

B. Bringing Clarity to the Matter: The Primary Object of the Code

As was stated in the introduction to this research article, the primary goal of the IBC is "Revival before Liquidation." However, as displayed by the discussion in Part II, there now exists various statutory and judicial obstacles to allow for such cases of revival to occur where a bona-fide previous promoter, not disqualified under Sections 29A(a)-(g) of the Code brings forth a *bona-fide* revival plan.

It is essential to note that the IBC is an economic code. It serves the purpose of ensuring that a sick company gets effective revival, and where the company is a majorly gone-case, its aim is to maximise the assets of the CD, so as to ensure that the creditors of the entity make the highest amounts of recoveries of their dues. However, it may be noted that through the discussions made in the cases of *Swiss Ribbons* and *Arun Kumar*,[31] the economic objective has taken a sort of a back-seat when it comes to the revival of companies under the Code.

While the author does understand that the responsibilities of the AA are vast, with objectives having to be *creditor-centric* here, *central-objective centric* there. However, through-out all of this, in the opinion of the author,

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[31] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474; *Swiss Ribbons Private Limited v Union of India* [2019] 4 SCC 17.

the contributions made by a commercial entity in the economy of the country is severely disregarded in the opinion of the author. In their opinion, while the persons in the previous management of the company should not be a priority; yet, effecting the revival of the entity while putting the interest of the CD also at par (to the extent possible), could lead to an eye-opening moment, which inevitably allows for the realisation of the true object behind the Code.

Another objective of the Code which is pushed for heavily through its provisions is the ensuring the completion of the CIRP process in a timely manner. Due to this, various directory timelines have been provided under the IBC, which, even though not mandatory, can only be extended through an application made to the Adjudicating Authority.[32] Now, with sticking to the timeline being a further objective, the operation of Section 29A is justified as preventing unnecessary litigation initiated by previous promoters, along with the immense time taken by a Resolution Professional in conducting the due diligence for the admission of resolution plans. However, the author has observed that this cannot be one of the primary considerations justifying the application of Section 29A, when the alternative that exists leads to an even worse output[33] –

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[32] *Surendra Trading Co v Juggilal Kamlapat Jute Mills Co Ltd* [2017] 16 SCC 143.
[33] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 15.

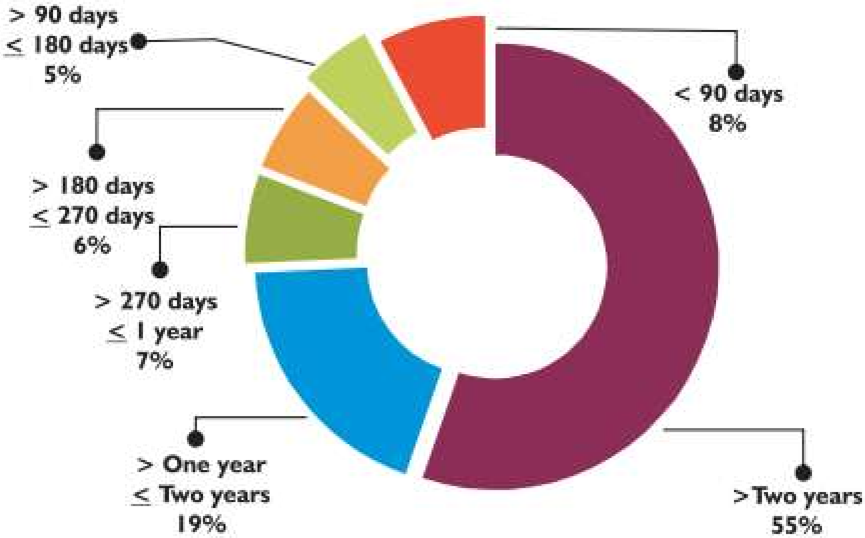

Figure: *Actual timeline for liquidation under the Code*

As observed by the above, it is evident that liquidation at the same time has not had a positive impact on the timeline objective of the Code, with more than half of the cases taking more than 2 years to be settled. While the timeline under the Code may be directory, in the opinion of the author, it cannot be made individually directory in some cases, and be considered a boon in others.

1. THE ULTRA VIRES NATURE OF THE REGULATION 2B AMENDMENT & ALTERNATE OPERATION THROUGH COMPANIES ACT, 2013

It is mooted that the application of Regulation 2B, which is the only provision of law under the Code which permits the disqualification under Section 29A to be operable in the cases of schemes under Section 29A, is ultra vires of the Code due to the following reasons –

(i) The IBBI overstepped in their regulations by making an incorporation by reference to Section 230 of the Companies Act through Regulation 2B;

(ii) The general application of the Code and its regulations should ideally only be for matters dealing with insolvency, and not get overarching powers over other primary legislations.

(iii) The dual role of the Adjudicating Authority

2. APPLICATION OF THE CODE: SOLELY FOR INSOLVENCY MATTERS?

The author contests that the procedure as enshrined under the Companies Act should remain independent from that of the Code. This is as two different mechanisms have been put into place in the two Acts, requiring different level or approvals, and also from different set of parties. Now, as there is no mention of scheme of compromise and arrangements in the principal Code, and as a mention is only found in regulations, it is necessary for only matters pertaining to insolvency *'which are mentioned in the Code'* to be brought for adjudication before it, rather than bringing any process involving elements of insolvency in its purview.

An example of what the author is trying to point out is made evident through the Competition Act itself.[34] It is pertinent to note that the Competition Act differs from the Code on the point that there is in fact an actual mention of schemes of compromise and arrangements (through the use of words such as mergers, amalgamations and acquisitions) present in the Act. However, even though this may be the case, the Act deals solely with matters pertaining to competition laws, and all matters of scheme of compromise and arrangements are dealt through the application of Section 230 of the Companies Act itself. Now, here, while the disqualifications to schemes under the Companies Act is done when adverse impact on competition in the market is detected through such a proposal,[35] there is still no overarching operation of the Act on the Companies Law.

Accordingly, since there is no explicit mention of scheme of arrangements in the primary Code, there should be a removal of the application of the bar under Section 29A on matters pertaining to Section 230 of the Companies Act.

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[34] Competition Act 2002 (No 12 of 2002), ss 5–6.
[35] Competition Act 2002 (No 12 of 2002), s 3.

3. DUAL ROLE OF THE ADJUDICATING AUTHORITY

It has already been noted in practice that the bar imposed by Section 29A can be lifted by the Adjudicating Authority if required under the circumstances. This move was seen in the case of *Arcelormittal India Private Limited* v. *Satish Kumar Gupta*,[36] where, the Supreme Court permitted ArcelorMittal and Numetal to remove their disqualification and present a resolution plan.[37] In fact, the dual role played by the Tribunal in the cases of Section 230 being operative along with the Code is in two ways – (i) as the authority overseeing liquidation under the Code; and (ii) as the Tribunal issuing orders for the carrying out of the arrangements under Section 230.[38]

Now, if the dual role of the Adjudicating Authority is recognised, and adjusted according to the principal legislation that the subject-matter of the case is related, then why is there a difference in the manner that the barring provision of 29A of the Code is applied? Hence, it becomes essential to put the dual Adjudicating Authority's powers of supervision under the Code and scrutiniser in terms of the Companies Act into use, and ensure that the creditor's interests are more aptly protected by the courts of India instead of having an all-encompassing barring provision.

4. EQUITABLE OPERATION OF BARRING PROVISION CONTAINED IN SECTION 29A

Comparison to Section 12A withdrawals

Section 12A of the Code allows for the withdrawal of an application for CIRP, if the requisite 90% voting in terms of credit value is achieved.[39] Withdrawal can be a consequence of a full settlement with the applicant,

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[36] *Arcelormittal India Private Limited v. Satish Kumar Gupta* [2018] ibclaw.in 31 SC.
[37] *Aggarsain Spinners Ltd v Shreeji Cotfab Ltd* [2022] ibclaw.in 141 SC; Insolvency and Bankruptcy Board of India, *Emerging Ideas on IBC* (2023) 88.
[38] *Y Shivram Prasad v S Dhanapal* [2018] SCC OnLine NCLAT 692.
[39] Insolvency and Bankruptcy Code 2016 (No 31 of 2016), s 12A.

through a full settlement with other creditors, through an agreement to settle in the future, amongst others. Enumerated below is the data released by the IBBI indicating the reasons for withdrawals witnessed in the Indian climate[40]

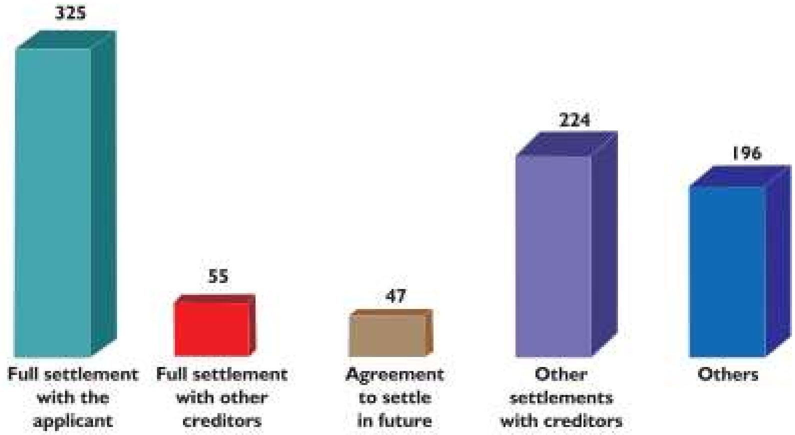

Figure 1: *Reasons for Section 12A withdrawals*

The consequence of a Section 12A withdrawal is the re-instating of the entity with its previous management, following an understanding which in most cases concerns a settlement through Section 230 of the Companies Act, 2013. Hence, as the withdrawal application is a part of the settlement mechanism and not the resolution mechanism, the Section 29A disqualification does not apply to it. Accordingly, it can be contested that since a scheme of compromise and arrangement at the juncture of initiation of liquidation should be considered as a part of the settlement process, relieving it from the barring nature of Section 29A of the Code.

Further, it has been held by the Supreme Court that since a Section 12A withdrawal occurs at the initiation of the CIRP process, it can be withdrawn without much thought. Translating the same logic onto the case of a Section

[40] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 15.

230 scheme at the liquidation juncture would make the Section 29A barring provision inapplicable.

Comparison with the case of MSMEs

Considering the requirements of Micro, Small & Medium Enterprises ["**MSMEs**"], and a separate resolution mechanism was introduced in the form of Pre-packaged Insolvency Resolution Process.[41] In this process, the disqualification u/s 29A has been made inapplicable, as "*excluding such industries from disqualification under 29A (c) and (h) is because qua such industries other resolution applicants may not be forthcoming which thus would inevitably lead not to resolution but to liquidation*."[42]

Further, it has also been observed by the Supreme Court as a matter of fact that MSMEs are able to attract lesser consideration from prospective resolution applicants than companies. However, considering the situation of an entities being referred to in this paper (i.e., ones which received no resolution through the CIRP processes and where liquidation has been initiated), it also becomes an essentiality to consider the position of promoters in their own regard.

The Court in this case also stated that the reasoning behind the relaxation afforded is that "*the business of an MSME attracts interest primarily from a promoter of an MSME and may not be of interest to other resolution applicant*."[43] The same can be said about a similarly placed CD which fails to attract successful resolution applicants and is doomed for an inevitable liquidation.

The Commercial Morality Element: Threatened?

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[41] Insolvency and Bankruptcy Code (Amendment) Act 2021 (No 26 of 2021) para 8; Insolvency and Bankruptcy Code 2016 (No 31 of 2016) ss 54A-54P.

[42] *Hari Babu Thota v X* [2023] SCC OnLine SC 1642.

[43] ibid.

A term that was time and again mentioned in the judgment, either through the arguments of the counsels taking the opposing stand, or through the pronouncement of the Court,[44] that allowing the previous promoters to gain a backdoor entry to the helms of the company would lead to a case threatening commercial morality. This, in their opinion would occur owing to the haircuts that an entity receives through the process as enshrined under the Code, to effect a settlement of the dues.

While this logic stands in a case where unscrupulous elements from the previous management enter the process, it operates as flawed in cases where the promoters themselves were not at fault for the insolvent status of the company.[45] It is also made evident from the data presented below that most of the companies entering into the insolvency process are directed towards the same through the actions of the creditors and not the management of the company itself-[46]

[44] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474, para 64.
[45] *For example*, see section IV.A.v ('Digitalisation of IBC').
[46] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 12.

Figure 2*: Share in initiation of CIRP figures from the different stakeholders*

This, while not sufficient data (owing to different factual scenarios of differing cases), can act as persuasive value to show that the haircuts that occur in the process is a result of natural economic degradation, and that such haircuts if even accepted, would be a result of the collective decision of the Committee of Creditors. This ensures that the commercial morality element that is generally threatened through such an arrangement would not see operation. Further, the inclusion of honest promoters to the helm of the company would be a result of a CoC-approved 'front-door entry.'

5. ROLE OF THE COMMITTEE OF CREDITORS

The role of the Committee of Creditors in the mechanism laid down under the IBC is paramount. It is the ultimate decision-making body for determining the faith of the corporate entity in distress. Since the Committee of Creditors consists of creditors representing all the admitted claims against a CD, it becomes the perfect body to make decisions regarding settlement of dues, ascertaining the viability of the corporate debtor, as well as a resolution plan adding the requirement of 90% of the Committee of Creditors instead, would serve to ensure that an economically viable and suitable plan is accepted by the Committee, even if it has been submitted by a previous promoter. Further, considering the fact that the elevation of the previous management back into the management of the CD was the concern of the creditors post which the barring provision was added,[51] their consent itself would have paramount weightage on the authenticity and workability of the settlement plan. If an overwhelming majority of the creditors feel that the revival plan is apt and suitable for the stressed entity, then the Statement of Objects behind the introduction of Section 29A should not be blindly followed.[52]

Apart from this requirement, the following should also be incorporated to ascertain the *bona fide* nature of the revival scheme –

- A voting share representing 90% of the total credit value should approve the settlement plan. This ensures that the plan is approved by an absolute almost majority, and allows for only the most suitable plan to be approved through the Committee of Creditors.
- Full and final settlement of all dues that are owed by the entity for the agreed upon consideration.
- Where full and final settlement of amount is to be made at a future date, a guarantee covering the overall value of debt owed, with the guarantor being a solvent person with no defaults in payment in the preceding 5 years (or a time-period which is deemed to be appropriate).

[51] *Arun Kumar Jagatramka v Jindal Steel and Power Limited* [2021] 7 SCC 474, para 44.
[52] *Swiss Ribbons Private Limited v Union of India* [2019] 4 SCC 17, para 53.

Outcome	Description	CIRPs initiated by			
		FCs	OCs	CDs	Total
Status of CIRPs	Closure by Appeal/Review/Settled	264	688	7	959
	Closure by Withdrawal u/s 12A	232	609	7	848
	Closure by Approval of Resolution Plan	380	241	56	677
	Closure by Commencement of Liquidation	927	896	207	2030
	Ongoing	1109	831	113	2053
	Total	**2912**	**3265**	**390**	**6567**
CIRPs yielding Resolution Plans	Realisation by Creditors as % of Liquidation Value	182.7	125.8	147.5	168.5
	Realisation by Creditors as % of their Claims	34.2	17.6	18.3	31.8
	Average Time taken for Closure of CIRP	613	632	541	614
CIRPs yielding Liquidations	Liquidation Value as % of Claims	6.4	9.1	8.6	7.0
	Average Time taken for Closure of CIRP	476	450	390	456

Figure 3*: Data depicting the haircuts faced through CIPS yielding Liquidation, as under the Code (as on March 31, 2023)*[53]

Considering the haircuts faced on a regular basis, if the previous promoters can come up with a concrete solution (considering that CIRP process takes a total of 180 days, it may be a possibility that future opportunities come up), then the same should be allowed to be subject to the evaluative mechanism set-up under the Code. It is only when a case comes up in the court that this argument can be put forth.

6. CASE STUDY: GO FIRST

It is essential to note that the situation that this research paper seeks to address requires the following pre-requisites for its arguments to be accepted-

- The CIRP process for the corporate entity should have failed, leading to an order of liquidation being passed by the Adjudicating Authority;

[53] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 13.

- A previous promoter [excluding those disqualified u/s 29A(a)-(i) of the Code] presents a revival scheme for the company through Section 230 of the Companies Act, 2013, r/w Regulation 2B of the Code.
- The revival scheme must be *bona fide* in nature.[54]
- The revival scheme is approved with a voting share representing 90% of the total claim value of the Corporate Debtor.

Now, while no precedence has been set as the courts in India have not had an opportunity to examine a case with such specific facts involved, there does exist an example in the form of the case study of Go First.

Go First was a revolutionary budget airline established under the name of Go Air. One of the early entrants in the Indian pocket-friendly airlines business line, Go First dominated the market, attracting customers in masses, just like its primary competitor IndiGo. In fact, the success that the company amassed was such that they had even expressed their intent to become a publicly traded company.[55]

However, the company was thrown into troubled waters for no fault of their own. In the year 2022, they were faced with a peculiar problem with their lead engine manufacturer – Pratt & Whitney ["**P&W**"]. Numerous airline companies supplied by P&W faced this issue where a rare powder metal defect,[56] which could potentially lead to the cracking of the engine components of the aircraft, left the companies with no option but to ground

[54] *See* section IV.A.iv ('Compliance Requirements').
[55] Kala Vijayaraghavan and Rajesh Mascarenhas, 'GoAir Plans IPO to Raise Rs 3,000 Crore' *The Economic Times* (8 February 2021) <https://economictimes.indiatimes.com/industry/transportation/airlines-/-aviation/goair-plans-ipo-to-raise-3000-crore/articleshow/80739170.cms?from=mdr>.
[56] FE Online, 'IndiGo Takes Strategic Measures to Address Pratt & Whitney Engine Problems' *Financial Express* (4 November 2023) <https://www.financialexpress.com/business/airlines-aviation-indigo-takes-strategic-measures-to-address-pratt-amp-whitney-engine-problems-grounding-leasing-and-more-3296808/>.

the affected air vehicles.[57] Go First faced the misfortune of having to ground 4,118 flights as P&W refused to repair or provide replacements for the defective components.[58] This led to a sudden cash crunch for the corporate entity, with the occurrence of defaults occurring as a direct consequence.

Owing to the above scenario, the Wadia Group, principal owners of Go First at that time, were forced to file for bankruptcy u/s 10 of the Code. Now, it has been reported that the Wadia Group were attempting to re-instate themselves as the owner of the airlines group, owing to the defaults in payment occurring due to no misconduct of their own. Further, due to not being disqualified u/s 29A(c) of the Code, the Group was mooting for the barring application of Section 29A of the Code to be removed in their case.

However, taking into consideration the construct of the provision itself, supplemented by judicial interpretation, an entry for such a '*prospective reviver*' becomes impossible. The all-round barring application of Section 29A of the Code has the potential to prevent a lot of *bona fide* attempts at revival of a corporate entity, which would in fact be the most viable solution for the entity. Just like in the case of the Wadia Group, various such insolvencies may be faced where the previous promoter who brings forth a revival scheme is not disqualified through the application of 29A(a)-(i) of the Code, and are thrown into the deep-end for no fault of their own. They may also possess enough credit-value to be able to facilitate the execution of guarantees for future settlement, or even to offer a scheme of full and final

[57] Daniel Martínez Garbuno, 'The Global Impact of the Pratt & Whitney Engine Issues' (*Simple Flying,* 17 November 2023) <https://simpleflying.com/global-impact-pratt-whitney-engine-issues/>.

[58] Trisha Shreyashi, 'Go First Insolvency: A Prospective Case for a Precedent in Bidding for Control of Insolvent Entity' *News18* (23 May 2023) <https://www.news18.com/opinion/opinion-go-first-insolvency-a-prospective-case-for-a-precedent-in-bidding-for-control-of-insolvent-entity-7861711.html>.

payment, which may be satisfactory for the creditors. This would ensure that the multi-faceted objective of the code is satisfied –

- The *economic objective* of ensuring the revival of a distressed corporate entity;
- The *creditor-centric objective* of maximising the realisation of the debt owed to them; and further satisfying the criteria of treating the proceedings as a *right in rem* by providing a mechanism requiring the approval of an absolute-majority of the creditors (represented through credit value).
- The *promoter-centric objective* of allowing persons not at fault for the insolvency to present a scheme for approval before the Committee of Creditors constituted; as well as for ensuring that the effective revival of the entity is allowed by placing it in the hands of persons familiar with the entity.

V. VALUATION CONCERNS

> "*In India, it is widely accepted that liquidation is a weak link in the bankruptcy process and must be strengthened as part of ensuring a robust legal framework.*"[59]

It has been stated time and again that the primary objective of the Code through its liquidation is to provide a mechanism for the "orderly exit"[60] of the sick and distressed companies that come under the purview of the legislation. But what happens in the case where the company is not able to find a successful resolution applicant through the CIRP process? Well, while the direct answer to this question, as laid down in the Indian insolvency code is liquidation, the author is of the opinion that blindly following the route of

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[59] Bankruptcy Law Reforms Committee, *Report of the Bankruptcy Law Reforms Committee: Volume I* (Government of India, November 2015) para 5.5.

[60] Insolvency and Bankruptcy Board of India, *Discussion Paper on Streamlining the Liquidation Process* (Insolvency and Bankruptcy Board of India, 14 June 2022) para 43.

liquidation might not lead to the most favourable outcome for the company, the valuation of its assets, or the creditors.

A. The data speaks for itself.

The author contests that the data speaks for itself when it comes to weighing the success rate of the Indian Code in the revival and liquidation of the companies under its framework. According to the data released by IBBI regarding the IBC process up to March 31, 2023, it was observed that since 2016, out of 6,571 CIRPs initiated, only 4,515 CIRPs were closed.[61] Out of these, 2,030 cases resulted in orders of liquidation.[62]

Compared to the earlier scattered insolvency regime, distressed companies have fared better under the new comprehensive code. However, while the difficulty faced in the earlier regime was the erosion of the value of the company and its assets due to the inordinate delays faced owing to multiple stages of appeal present under the different legislations; in the current Code, the primary issue is the high number of resolutions made through the second stage of liquidation rather than the first stage of attempting company revival. This situation has led to some troublesome numbers being brought into picture. Hence, it is essential to examine whether the framework as it exists currently serves the correct purpose; considering that the numbers show that the application of the IBC has departed from its principal object.[63]

1. GOING CONCERN SALES: A POSSIBLE REDEMPTION POINT?

An alternate path which can be the tipping point determining the faith of a CD under the purview of the IBC has been provided for through the

[61] Insolvency and Bankruptcy Board of India, '*Digitalisation of IBC*' [2023] *Insolvency and Bankruptcy News* 1, 11.
[62] ibid.
[63] *See*, *n* 53.

introduction of Regulation 32(e),[64] and Regulation 32A of the IBBI (Liquidation Process) Regulations, 2016.[65] Further, a very recent amendment to the Regulations has to add an additional method of running the CD as a going concern, by granting authority to the Liquidator to run a CD which is found to be viable on evaluation, following approval from the Stakeholders Consultation Committee (SCC).[66]

It is pertinent to note that a going concern sale brings the stressed entity in a better position; considering that the collective value of the assets while also weighing the future growth expectations would yield more maximization of the value than following the process of disposal of assets separately.

It is widely recognized in economic discourse that many entities derive greater value from continuing operations as a functioning entity rather than undergoing asset disposition. Liquidation, as a collective remedy, contrasts with the individual enforcement of security interests by creditors. The rationale behind liquidation, typically overseen by a liquidator acting in a fiduciary capacity for all creditors, hinges on the belief that selling the business as a going concern or via a slump sale is likely to yield superior value for all involved stakeholders.[67]

A notable advantage of selling a business as a going concern lies in the potential transfer of various intangible assets integral to the enterprise, including contracts, leases, licenses, concessions, operational assets, human resources, and technological resources. In contrast, merely selling the physical

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[64] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations 2016, reg 32(e).
[65] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations 2016, reg 32A.
[66] Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations 2024, para 5.
[67] Vinod Kothari & Company, 'Enabling Going Concern Sale in Liquidation' in IBC: Ushering in a New Era (2019) 175 <https://vinodkothari.com/wp-content/uploads/2019/06/Enabling-Going-Concern-Sale-in-Liquidation.pdf>.

assets of a business may render several of these intangible assets non-transferable or subject to third-party approval for each transfer, thereby complicating the liquidation process significantly.[68]

However, it may be noted that while the above-stated points may be true; again, a daunting image is brought to the forefront from the data released by IBBI is analysed.[69]

In fact, various examples exist, even on an international level indicating that a going concern sale through liquidation may also not lead to the results that an acquirer desires. One such example is that of the Barclays group, which acquired a part of the business of the culprit of the 2008 Financial Crisis, Lehman Brothers Inc. While the Barclays group was able to acquire the portion of business at a majorly discounted rate, the process of integration of the acquired business proved to be a challenging one, with the acquired assets not proving to be as valuable as expected, in the longer run.[70] Hence, through this illustration, it becomes evident that a going concern sale does not necessarily lead to *'wasted assets being applied more fruitfully elsewhere.'*

While the author is not trying to dismiss the viability of exploring this alternative at the juncture where no other means of reviving the CD is available, the primary point that is being mooted is that if an effective and viable means of resolution, addressing all the concerns of the creditors and the company's distressed state is made by a previous promoter (who was not at the helm of any wrongful conduct in their own capacity, and is submitting a *bona fide* plan) should be prioritised over the sale of the entity or its assets.

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[68] ibid.

[69] Insolvency and Bankruptcy Board of India, 'Digitalisation of IBC' [2023] 26 *Insolvency and Bankruptcy News* 1, 16.

[70] Chitru S Fernando, Anthony D May and William L Megginson, The Value of Investment Banking Relationships: Evidence from the Collapse of Lehman Brothers (Unpublished) https://www.ou.edu/dam/price/Finance/files/Lehman_paper_resubmit_JF_mar170.pdf.

2. THE VIABILITY FACTOR

Lastly, it may be noted that the viability/unviability of the company in the eyes of any prospective resolution applicant or buyer of its assets is completely based on market forces.[71] There are no guidelines for what makes a company viable/unviable because it is completely based on the valuation reports referred to by the prospective buyer of the company or its assets. Hence, when a company undergoes the processes of CIRP and comes out with no successful resolution applicant, it is but obvious that the perception of the company and its resources in the eyes of the market would most likely depreciate, and result in the determination of the same as '*unviable*.' Further, while bearing in mind this point, it does not come as a shock that the total recoveries made through the liquidation process enshrined in the IBC is not at par with expectations.[72]

Hence, in the opinion of the author, it is essential to align the process under IBC and Companies Act, 2013 when it comes to compromises and arrangements made. As has been stated in the previous sub-part, in a situation where the revival mechanism under CIRP does not come to fruition, and it is seen that liquidation would not render desirable results for the creditors of the company, a blind disqualification under Section 29A of the IBC against a scheme of arrangements as proposed by a previous promoter would not be the most viable economic move.

VI. CONCLUSION

In mature legal systems, the perception surrounding corporate insolvency has evolved from a moral failing to an acknowledgment of economic circumstances. It is now acknowledged that notwithstanding genuine business

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[71] MS Sahoo and CKG Nair, 'The Soul of the IBC' Financial Express (3 August 2023) <https://www.financialexpress.com/opinion/the-soul-of-the-ibc-critics-must-see-that-ibc-is-meant-to-enable-the-market-to-determine-viability-of-a-company/3197270/>.
[72] *See*, n Part IV.B.i.

decisions and reasonable risks taken by company promoters and management, external factors such as technological advancements, heightened competition, and shifts in government economic policies can lead to financial losses. To foster entrepreneurship, many jurisdictions have implemented legal frameworks to support entrepreneurs and offer them opportunities to revive their businesses. Moreover, there is empirical evidence suggesting that entrepreneurs can leverage their experiences and learnings from failures to accelerate the growth of their enterprises in terms of revenue generation and job creation.

In light of these considerations, the authors contend that affording second chances to promoters uninvolved in fraudulent activities within insolvent companies will promote entrepreneurship and enhance the resolution of distressed firms. Accordingly, it is proposed that default-based disqualifications be eliminated from the Insolvency and Bankruptcy Code (IBC). The author posits that the intent behind sections 29A(c) and 29A(h) of the IBC, aimed at barring individuals who contributed to a company's defaults from participating in its resolution process, can be addressed through appropriate revisions to existing legal provisions, even independently of section 29A of the IBC.

However, to fortify the effectiveness of section 29A(g) of the IBC, amendments should be considered within the framework of the IBC and Corporate Insolvency Resolution Process (CIRP) Regulations. These amendments would clarify that the timelines prescribed for the resolution professional (RP) under regulation 35A of the CIRP Regulations to evaluate potential avoidance transactions by the corporate debtor (CD) are mandatory rather than discretionary and must be adhered to. This approach ensures that the adjudicating authority promptly determines whether the previous management of the CD engaged in misconduct, thereby warranting disqualification from submitting a resolution plan under section 29A(g) of the IBC.

Through the discussion which ensued in the preceding parts, the author has tried to advocate for the waiver of the all-encompassing bar on participation of promoters enforced through Section 29A of the Code, in specific circumstances – and specifically, a revisiting of Section 29A(j) of the Code. These circumstances are those where a *bona fide* revival scheme is presented before, and approved by the Committee of Creditors (with a vote share representing 90% of the credit value), and where the promoter proposing such a scheme has not played an unscrupulous role leading up to the corporate entity's insolvency.

However, the only way to ensure the waiver is by revisiting the object of the Code. The author has noted that with a bundle of objectives of the Code ranging from the *economic objective* of maximisation of value of assets and prioritising revival of the corporate debtor, to the *creditor-centric* objective of ensuring the settlement of dues to the fullest extent and ensuring creditor protection from unscrupulous elements, to trying to remove unscrupulous elements from a company's management; the primary purpose of the economic nature of the Code has been lost. The legislature and judicial interpretation provided the easiest solution to the problem through Section 29A. However, limiting of the overarching nature of Section 29A is necessitated to put the economic objective more in the forefront, and allow bona-fide revival plans from honest previous promoters (as observed through the case study on the insolvency proceedings of Go First). Now, what would be the opinion of the courts on the matter would only be brought to the picture when a case with such particular set of facts is presented before them.

CONUNDRUM OF LIKE PRODUCT ANALYSIS UNDER NON-DISCRIMINATION PRINCIPLES OF GATT

- *Aniruddh Panicker*[*]

ABSTRACT

The non-discrimination principle informs the cornerstone of international trading regime. Non-discrimination principle is enshrined through two prominent principles. The principle of Most Favored Nation (MFN) as well as the National Treatment Principle are the two essential components of non-discrimination principle under GATT regime.

The main purpose of the non-discrimination principles is to regulate trade restrictive measures under GATT regime. The overarching principle to maintain competitive relation in market. Most Favored Nation principle seeks to maintain origin neutrality among various member nations. The purpose is to ensure that the products are not differentiated on the basis of the origin that they belong to. It mainly covers border measures for the same purposes. National Treatment ensures a parity between importers as well as domestic players in the market. It is for this purposes that it covers internal measures in the form of fiscal as well as non-fiscal measures.

Most Favored Principle as well as the National Treatment principle incorporate like product test to identify the relevant products. The main purpose is to maintain non-discrimination among such products which are similar in nature. Thus, the concept of like products is fundamental in analyzing the general scope of non-discrimination principles of GATT regime. The purpose of the present paper is to scrutinize the general ambit of like products under GATT regime.

GATT doesn't provide for a precise definition for the term "like product" under its text. Moreover, the term "like products" is used under different contexts. There is no authority to differentiate various contexts for the term. This creates a certain amount of ambiguity with respect to the scope of non-discrimination principles. The fundamental question is to identify the precise level of similarity that is demanded by the like product test. The present paper delves over such varied facets of like product analysis. Appellate Body as well as the Panel have devised several approaches to apply like product test. The present paper would also reflect upon the merits and demerits of such varied approaches.

[*] Mr. Aniruddh Panicker is a Research Scholar (Ph.D) at NLU Jodhpur. Views stated in this paper are personal.

I. INTRODUCTION

Non-discrimination principle remains an important concept under International Law. The principle ensures sovereign equality within the international realm. The World Trade Organization (hereinafter, "*WTO*") incorporates such non-discrimination principles to further liberalize the international market. Such non-discrimination principles are recognized under a number of covered agreements.

While negotiating GATT, the Contracting Parties recognized the need to maintain a parity under international market. The main purpose was to encourage trade creation and discourage trade diversion. Adverse implications of discriminatory measures were well recognized by the Contracting Parties. It is for this reason that such non-discrimination principles informed the core obligations of GATT. The main purpose was to reduce discriminatory measures under international trade. Thus, trade was to be liberalized in environment of competitive equality and fair competition.[1]

A. Non-Discrimination Principles in GATT

Under the GATT regime, the non-discrimination principle is mainly manifested in two principle forms. One exit in the form of Most Favored

[1] Agreement establishing the World Trade Organization, Preamble.

Nation Treatment (as enunciated under GATT Article I) and the other in the form of the principle of National Treatment (as enunciated under GATT Article III). National Treatment obligation (hereunder, "NT principle") prohibits member states from discriminating imported products in comparison to the domestic products.[2] On the other hand, the Most Favored Nation principle (hereunder, "the MFN principle") precludes the member nations from discriminating among like products of GATT member nations on the basis of its origin.[3]

The MFN principle is enshrined under Article I and National Treatment is enshrined under Article III of GATT. Both the articles protect the international arket from discriminatory measures. However, the two articles are meant to fulfil different set of purposes. The main purpose of the MFN principle is to ensure origin neutrality within the international realm. Thus, the product of one country is compared with another. On the other hand, the national treatment principle is enshrined to protect foreign producers from discriminatory measures. Such foreign producers are compared with the domestic players in the market. Thus, it mainly regulates various forms of domestic measures.

Both the articles incorporate a distinct "*like product*" analysis. The like product analysis informs the panel about the relevant traders that are to be compared to one another. Like product analysis identifies the relevant products that are to be compared. Thus, a like product analysis would indirectly compare those traders that are similarly situated. The second step is to provide for a standard of treatment.

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[2] European Communities - Measures Prohibiting the Importation and Marketing of Seal Products, WT/DS401.
[3] General Agreement on Tariffs and Trade 1947, art 3.

The two principles employ different terms to impose the obligation. Article I provides for an obligation to accord such advantage on an immediate and unconditional basis. This indicates that the MFN principle is enshrined as an unconditional principle under GATT regime. Thus, the MFN principle is antithetical to the notion of reciprocity. This is the departure that GATT takes from a number of other international agreements.

Article III provides a general obligation under the first paragraph. The general objective behind the article is to ensure that the internal measures are not applied in a manner to "*afford protection to the domestic players*" in the market. This general obligation is further defined through a number of substantive obligations arising out of various paragraphs under Article III. Each paragraph covers a distinct set of measures. In particular, the second paragraph covers internal taxes or other forms of internal charges. The second paragraph is further bifurcated int two parts. The first part compares like products with one another. The second paragraph precludes a state from imposing a charge "*in excess of*" the charge imposed on domestic players. The second part of the second paragraph compares "*directly or substitutable products*" with one another. The second part imposes an obligation to similar charges. The fourth paragraph covers internal laws or regulations. Unlike the second paragraph, the fourth paragraph covers non-fiscal measures. The paragraph compares "*like products*" to one another. It imposes an obligation of "*no-less favorable treatment*" upon various member nations.

It can be observed that GATT uses the term "*like product*" in different contexts. Each context provides for a new set of measures that are covered under a particular provision of GATT. This brings in a lot of ambiguity with respect to the interpretation of like product analysis. Moreover, the panel as well as the appellate body have provided for different approaches to conduct the like product analysis. The purpose of the present article is to critically examine such approaches to the interpretation of the term "*like products*". Further, the author would suggest an interpretation which furthers the object and purpose of the agreement. The article is mainly divided into two parts to expound upon the MFN as well as the National Treatment Principles of GATT. The purpose is to delve over the existing jurisprudence around the two non-discrimination principles. The author would conclude the article to further clarify the general principles around the non-discrimination principles of GATT.

B. Most Favoured Nation Principle

The MFN principle is not a recent development in the international realm. It traces an ancient pedigree.[4] The MFN principle became a common provision under most of the international bilateral arrangements by the early 18th century.[5] Initially, the United States was reluctant to adopt the MFN principle under its domestic policies. However, post the First World War, United States departed from its initial position to become a sustained proponent of the MFN principle.[6] The MFN principle was framed as a fundamental principle under *US Reciprocal Trade Agreements Act of 1934* ("The Reciprocal Agreement"). The Reciprocal Agreement was used as a blueprint for framing GATT provisions.[7]

The MFN principle exists as a cornerstone of the GATT agreement. It imposes an obligation upon its member states to extend the unconditional treatment of "like products" among other member nations on an origin- neutral

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[4] Michael Trebilcock, Robert Howse and Antonia Eliason, *The Regulation of International Trade* (4th edn, Routledge 2013); *see also,* John H Jackson, *World Trade and the Law of the GATT* (Bobbs-Merrill Company 1969) 249.
[5] Treaty of Paris 1814, art 12.
[6] Michael Trebilcock, Robert Howse and Antonia Eliason, *The Regulation of International Trade* (4th edn, Routledge 2013) 56.
[7] Richard Carlton Snyder, *The Most-Favored-Nation Clause: Analysis with Particular Reference to Recent Treaty Practice and Tariffs* (Columbia University Press 1948).

basis.[8] The principal rationale behind the MFN principle can be traced back to the principle of sovereign equality as enshrined under the United Nations Charter.[9] The principle of sovereign equality itself requires the international economic relations to be based on the principle of equality. In addition to the principle of sovereign equality, MFN principle can also be justified on an economic basis. The MFN principle protects the market by eliminating economic distortions. The MFN principle eliminates "bilateral opportunism", a tendency between states to negotiate bilateral agreements on such terms that seem to benefit their policies and thereby create trade externality in the market.[10] The underlying principle is to allow the market to operate without undue hindrance. In a multilateral system it precludes a country from gaining unfair competitive advantage over the products originating in other member nations.[11]

While interpreting the MFN principle, the Appellate Body has observed that there are several MFN clauses enshrined under the GATT agreement.[12] Thus, the MFN principle is pervasive under various GATT obligations.[13] Under the present chapter, the researcher mainly emphasizes upon the general MFN principle as enshrined under Article I GATT.

1. MEASURES COVERED UNDER ARTICLE I GATT

Article I is termed broadly under the GATT Agreement. Thus, all forms of measures having an effect on international trade are subjected to the MFN principle. Essentially, the principle covers all forms of border measures having

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[8] US Appropriations Act, s 211.
[9] United Nations Charter, art 2(1).
[10] Kyle Bagwell and Robert W Staiger, *The Economics of the World Trading System* (MIT Press 2002).
[11] Warren F Schwartz and Alan O Sykes, 'The Positive Economics of Most-Favoured-Nation Obligation and its Exceptions in the WTO/GATT System' (1998) Economic Dimensions in International Law 43.
[12] Canada — Certain Measures Affecting the Automotive Industry, WT/DS139
[13] ibid.

an effect on the import or export of goods.[14] In addition to such border measures, Article I also covers such internal measures which are applicable upon the goods once they enter into the market.[15] Therefore, the member nations are prohibited from imposing such unilateral measures which affect the competitive relations of like products originating among various member nations. While applying the MFN principle, the Dispute Settlement Body is expected to analyze whether the concerned measured in its *"design, structure and expected operation"* has a detrimental impact upon the competitive conditions of members' "*like products*".[16]

The term "*Custom Duties and charges of any kind imposed or in connection with importation or exportation*" can collectively be referred to as tariffs. Member nations are under an obligation to provide for equal treatment while imposing such tariffs upon imports from other countries or exports to other countries. The obligation of equal treatment applies upon bound duties[17] as well as to unbound duties. Such obligation is also applicable upon tariffs which are lower than the bound rate. Therefore, when a member nation sets its tariff rate lower than the bound rate then it is under an obligation to extend such lower rate to all like products.[18] The MFN obligation is not only restricted to positive actions but also covers such omissions which confer a certain form of advantage to the member nation.[19]

MFN obligation also extends to non-fiscal border measures. Therefore, imposition of a less complex license procedure was also recognized by the

[14] General Agreement on Tariffs and Trade, art I (1).
[15] ibid.
[16] EC — Seal Products (n 2)
[17] General Agreement on Tariffs and Trade 1947, art 2.
[18] Spain—Tariff Treatment of Unroasted Coffee (27 April 1981) L-5135 - 28S/102.
[19] United States Customs User Fees (25 November 1987) L/6264 - 35S/245.

panel as a violation of Article I:1.[20] Furthermore, Article I:1 explicitly clarifies that it covers measures referred under para 3 and para 4 of Article III. Therefore, internal measures imposed in the form of internal taxation as well as internal regulations are also covered within the ambit of Article I. Therefore, a member nation is prohibited from imposing both border measures as well as internal measures in a discriminatory manner to affect the MFN obligation.[21] It is also important to note that MFN obligation extends to advantages granted to non-WTO members as well.

2. ADVANTAGE, FAVOR, PRIVILEGE OR IMMUNITY UNDER ARTICLE I

Article I is termed so broadly that it covers all forms of advantage accorded to a member nation. Any such measure which benefits a member's access to market or impacts the competitive relationship in the market can be construed as a measure conferring advantage under Article I.[22] A similar interpretation was given by the Appellate Body by emphasizing upon the broad term "*any advantage…*" used under Article I text.[23] Thus, backdating of a revocation order pertaining to imposition of countervailing duty without an additional requirement of review was construed as an advantage under Article I.[24] Similarly a measure exempting certain imports from custom duty was also construed as a matter of advantage.[25] A measure providing for a less onerous procedure may also be covered as measure conferring an *"advantage"* under Article I GATT.[26] Similarly in another dispute, the Panel observed that

[20] European Communities- Regime for the Importation of Bananas (22 May 1997) WT/DS 27/R, para 7.188.
[21] China- Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products (21 December 2009) WT/DS363/AB/R.
[22] United States- Certain Measures Affecting Imports of Poultry from China (5 November 2010), WT/DS 392/AB/R, para 7.415.
[23] Canada-Autos (n 12).
[24] United-States- Denial of Most-Favored Nation Treatment as to Non-Rubber Footwear from Brazil (10 January 1992) L/6439 - 39S/128, para 6.12.
[25] Canada-Autos (n 12).
[26] EC — Bananas III (n 20).

granting of market access to certain importers could also be qualified as a grant of "*advantage*" under Article I GATT.[27]

II. LIKE PRODUCT ANALYSIS UNDER *GATT PRINCIPLES*

The application of MFN treatment is limited to such products which are "*like*" in nature. Therefore, member nations have the right to treat *"unlike*" products differently. However, GATT does not provide for any form of definition of "*like products*" under its text. Since, the policy objective behind Article I is to ensure equality in competitive relationship, the like product test must also be interpreted within the context of protecting equality of competitive opportunities in the market.[28]

However, various GATT provisions have used the "*like product*" test in different contexts depending upon the subject matter covered under the concerned provision. The interpretation of "*like product*" must also differ with such varied contexts.[29] In comparison to Article III, a very narrow context is provided for the term "*like product*" under Article I.[30] While making a comparison, the Panel observed that the term *"directly substitutable product"* as used under Article III is not contained under Article I.[31] The Panel then

[27] EC — Seal Products (n 2).
[28] Philippines - Taxes on Distilled Spirits (25 January 2012), WT/DS396/11, para 170; *see also,* European Communities - Measures Affecting Asbestos and Asbestos, (11 April 2001), WT/DS135/12, para 99.
[29] Case 270/80 *Polydor Limited and RSO Records Inc v Harlequin Records Shops Limited and Simons Records Limited* [1982] ECR 329, para 15.
[30] Robert E. Hudec, '"Like Product": The Differences in Meaning in GATT Articles I and III' in Thomas Cottier and Petros C. Mavroidis, eds., Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law (Ann Arbor: University of Michigan Press, 2000) 101–23, arguing that the concept of 'like product' in Art. I *"should be interpreted to allow rather fine distinctions between products when it is applied to product distinctions made by tariffs."*
[31] EEC Measures on Animal Feed Proteins (2 December 1977), L/4599 - 25S/49 paras 4.1-4.2.

inferred that the scope of *"like product"* must be narrower in comparison to its scope under Article III.[32]

Under the GATT jurisprudence, a common set of considerations is adopted to compare the relevant products. Following considerations are to be considered as essential while analyzing the "like product" criteria:

- The end use of a product under a given market,
- Various habits and preferences of consumers. Such tastes and habits may vary from a country to country,
- Various properties, quality and nature of a given product,
- The relevant tariff classification.

None of the above-mentioned considerations are to be considered as determinative in nature. Rather, a "*like product*" determination would always involve a certain amount of individual discretion.[33] Out of the above mentioned four criterions, the first three were for the first time enunciated under a Working Party on Border Tax Adjustments (hereinafter, "The Working Party Report"). The report was adopted by GATT contracting parties in 1970.[34]

The Appellate Body in Japan Alcohol Beverages II added another test of tariff classification to the list provided under the Working Party Report.[35] Tariff classification arises out of a domestic policy and is generally independent of market forces. However, the relevant tariff classification can always have an impact on the consumer preference in the market and thereby influence the relevant market. Relying upon a similar reasoning, the Appellate Body also took into consideration the domestic regulatory regime while

[32] ibid.
[33] Japan — Taxes on Alcoholic Beverages (9 January 1998), WT/DS8/18 20.
[34] Working Party Report, *Border Tax Adjustments* (1970) BISD 18S/97, para 18.
[35] Japan—Alcoholic Beverages II (n 33).

determining the likeness of a product in the market.[36] Given the narrower context of "*like product*" under Article I, tariff classification holds special importance within the context of Article I.[37]While emphasizing upon the role of tariff classification, the Panel observed that tariff classifications are based upon Harmonized System of Classification, established under the World Customs Organization, and they allow for a very narrow classification of goods. Directly Competitive as well as substitutable goods can also be classified differently under the Harmonized System of Classification. Further, the panel observed that when such claim of likeness is raised by a member nation then such a claim must be based upon the relevant classification adopted by the importing country.[38] However, the tariff classification cannot be considered as the sole test and has to be observed along with other considerations.[39] Furthermore, non-product related aspects may also impact consumer preferences, and thereby affect the likeness of goods.

A. Hypothetical Like Product Analysis

Under the GATT jurisprudence, the dispute settlement body has often applied a hypothetical like product test to examine measures which are proved to differentiate on the basis of the origin.[40] In such an event the Panel would assume likeness without even identifying the specific imported product.[41]Thus, in a dispute pertaining to importation of poultry products,

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[36] Philippines—Distilled Spirits (n 28)
[37] Canada/Japan—Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber, L/6470, GATT BISD (36th Supp) 167 paras 5.13-5.15.
[38] ibid.
[39] Spain - Tariff Treatment of Unroasted Coffee (27 April 1981), L/5135 - 28S/102, paras 4.7-4.10.
[40] China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products (12 August 2009), WT/DS363/R, para 7.1446.
[41] Indonesia - Certain Measures Affecting the Automobile Industry (2 July 1998), WT/DS64/R, para 14.113; *see also,* Canada—Autos (n 12); India – Measures Affecting the Automotive Sector, (21 December 2001), WT/DS175/R, paras 7.174-7.176.

once the Panel found the relevant measure to be solely targeting imports coming from China it assumed likeness without specifically identifying relevant imported products. Thus, it straightaway examined whether the advantage accorded to all other members was extended *unconditionally* to imports from China.[42] The main purpose is to facilitate the complainants against such measures which are inherently against the very spirit of the MFN obligation.

B. Origin Neutrality

Article I imposes a general obligation upon the member nations to provide equal treatment to like products "*irrespective of the origin that they belong to*". Determination of origin can be ambiguous under certain instances. The same product can be manufactured, produced, packaged etc under different nations. Determination of origin would then depend upon the relevant criteria adopted by a particular nation.

1. UNCONDITIONAL AND IMMEDIATE TREATMENT

The MFN principle mandates the member nation to accord any form of advantage on an *immediate* and *unconditional* basis. The term *immediate* provides for a very strict requirement. Thus, a member nation can demand for the equal treatment from the very moment that an advantage is conferred at the very first instance.

The unconditional standard requires a member state to extend the advantage to all member nations. Such advantage may be conditional or unconditional in itself. GATT jurisprudence seems to be divided upon the proper interpretation of conditional MFN. Certain dispute settlement reports seem to suggest that member states are precluded from imposing any form of

[42] United States – Certain Measures Affecting Imports of Poultry from China (29 September 2010), WT/DS392/R, paras 7.431-7.432.

a condition upon the advantage so extended.[43] However, in a later report, the Panel clarified that the term "unconditional" is not to be interpreted as a prohibition against any form of condition.[44] Rather, the Panel explained that a determination of unconditional MFN cannot be independent of the non-discrimination analysis. Further, it differentiated between a conditional advantage and an advantage extended conditionally. An advantage can be subject to a condition but at the same time extended to all other members on an unconditional basis.[45] This interpretation of unconditional MFN seems to be in conformity with GATT principles.[46] The main purpose of the MFN obligation is to preclude discrimination among like products. Thus, the term *unconditionally* should be interpreted within the context of such discrimination. This interpretation was further confirmed by the Appellate Body in a subsequent dispute.[47] The Appellate Body explained that the overarching principle behind Article I is to ensure equal competitive opportunities in the market. Thus, only such conditions must be prohibited which have an adverse effect upon the competitive advantage of like products in the market.[48]

C. De Jure and De Facto Discrimination

Under Article I member nations are prohibited from imposing all forms of discrimination among the like products. It does not matter whether such discrimination exists in law or in fact. The Appellate Body explained that the scope of Article I is not limited to measures which appear to be discriminatory

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[43] *European Economic Community—Imports of Beef from Canada*, L/5099, GATT BISD (28th Supp) 92 paras 4.2 and 4.3.
[44] Canada-Autos (n 12).
[45] Canada-Autos (n 12).
[46] Petros C. Mavroidis, *The Regulation of International Trade, Vol. 1: GATT* (MIT Press 2015).
[47] EC — Seal Products (n 2)
[48] ibid.

by its explicit terms. It also covers measures which are discriminatory in fact or are *de facto* discriminatory.[49] The main purpose is to protect competitive opportunities in the market. It is not necessary to show the concerned measure was implemented with the intention to discriminate.[50] Thus, the non-discriminatory obligation is based on an objective test of equality in competitive opportunities. This interpretation is also in consonance with the principles of state responsibility under International Law.[51]

III. NATIONAL TREATMENT PRINCIPLE

The National Treatment Principle ("NT Principle") is one the most important application of the non-discrimination principle enshrined under GATT. The National Treatment principle mandates a state to treat the foreign product on a non-discriminatory basis in comparison to the domestic products. However, it is impossible to maintain non-discrimination between imported and domestic products without further qualifying the principle of non-discrimination. One major distinction between the foreign producer and the domestic producer would always lie in the fact that only a foreign producer is under an obligation to incur the cost of border measures such as tariffs. Thus, National Treatment principle is applied only when the concerned product enters into the domestic market of the host nation.[52] Article III of GATT clarified in its text that only such goods that have transgressed the border customs and entered into the local market are not to be discriminated

[49] Canada-Autos (n 12).
[50] EC — Bananas III (n 20).
[51] General Assembly resolution 56/83 of 12 December 2001, and corrected by document A/56/49 (Vol. I)/Corr.4: *'There is an internationally wrongful act of a State when conduct consisting of an action or omission: (a) is attributable to the State under international law; and (b) constitutes a breach of an international obligation of the State'*. There is no mention of intention while attributing state responsibility for a wrongful act.
[52] Canada-Chile Free Trade Agreement (6 February 1997), art 1; *see also*, North American Free Trade Agreement (17 December 1992), art. 300-301.

against.[53]Thus, it is important to differentiate between "internal measures" (state measures which are applicable once the good enters into the market) and "border measures" (measures which are applied at the stage of crossing the border) while interpreting Article III of GATT.[54]

A. National Treatment under Article III of GATT

Article III GATT prohibits a state to adversely affecting competitive conditions between imported products and domestic products through its domestic laws or domestic regulations. Article III covers all such measures which either favor domestic products or disfavor imported products in the market. The overarching aim is to ensure that the competitive relationship between the imported products and domestic products remains protected in the market. However, the purpose of Article III is not limited to the actual trade volume in the market. Thus, a discriminatory measure not having an impact on the actual volume of trade could still be in violation of Article III. GATT Article III covers measures having an actual impact as well as measures having a potential to affect the competitive relation.[55]It covers both measures having a direct impact as well as measures resulting in an indirect impact on the competitive relation. It covers *de jure* discriminatory measures[56] as well as de facto discriminatory measures[57]. Additionally, it is important to observe that a measure not yet enforced can also be covered under the broad ambit of Article III.[58]

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[53] Italian Discrimination Against Imported Agricultural Machinery, L/833, GATT BISD (7th Supp) 60 para 5.
[54] *India— Autos* (n 41); see also, Canada - Administration of the Foreign Investment Review Act (25 July 1983), L/5504 - 30S/140, para 5.14.
[55] Canada-Autos (n 12).
[56] Korea- Various Measures on Beef (24 April 2001), WT/DS161/12.
[57] Japan—Alcoholic Beverages II (n 33).
[58] *US—Section 337 Tariff Act*, L/6439, GATT BISD (36th Supp) 345 para 5.13.

Article was drafted with the intention to preclude a member state from using its internal measures to offset benefits arising out of tariff concessions to the foreign producers.[59] However, the sole purpose of Article III cannot be reduced to the protection of such tariff concessions.[60] The overarching purpose behind Article III is to prohibit protectionism. Thus, it seeks to protect the expectations of a foreign producer to face fair competition in the domestic market once it passes through the tariff barriers imposed at the border level. The Appellate Body explained the principle by observing that Article III prohibits a member from imposing its domestic regulations in manner that affords protection to the domestic producer in the market.[61] The article seeks to ensure equality of opportunity for the importers of foreign products in the market.[62] Article III covers all such measures which might have an influence over the competitive relationship between the imported product as well as the domestic product. It also covers such products for which no tariff commitment is made under Article II GATT.[63]

B. Internal Taxation under Article III paragraph 2

Article III paragraph 3 imposes an obligation upon the member states to implement its taxation regulations in accordance with National Treatment requirement upon foreign producers.[64] Where on the one hand the custom tariffs are generally bound under Article II of GATT, there is no such

[59] ibid.
[60] Tariff Act, (n 58).
[61] EC—Asbestos (n 28).
[62] Tariff Act, (n 58); *see also,* Japan—Alcoholic Beverages II (n 33).
[63] Working Party report, *Brazilian Internal Taxes*, GATT/CP.3/42, BISD II/181 para 4.
[64] Article III (2) states, *"The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1."*

corresponding provision to bind the internal taxes imposed by a member state. Such taxation measures are unilateral measures imposed by a member state within its domestic regime. Thus, a member state has the freedom to charge as high or as low a tax rate as it is possible to charge. However, member states are restricted under Article III to ensure that such regulations are applied in a non-discriminatory basis upon the like products arising out of the other member states when compared to its domestic products.[65] Therefore, Article III is not to be extended to cover tariffs or other such measures which are imposed in relation to the imports or exports of various products.[66] Article III is only applicable on *"imported product"* and does not cover such goods which are destined for importation.[67] Article III would also cover such internal taxes or charges of any other kind which are collected at the point of importation of imported products as long as they also apply to domestic products in the market.[68]The character of such internal charges or taxes would not change just because they happen to be collected at the time of importation.[69] The determining criteria remain that such charges or taxes must arise due to some internal event. Examples of such internal events can arise due to sale, distribution or transportation of such imported products.[70] As an instance one such measure a border tax adjustment would also be covered under wide ambit of Article III.[71]

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[65] Indonesia—Autos (n 41).
[66] China – Measures Affecting Imports of Automobile Parts (15 December 2008), WT/DS342/AB/R, para 162; see also, China – Measures Affecting Imports of Automobile Parts, (18 July 2008), WT/DS342/R, para 7.212.
[67] ibid.
[68] General Agreement on Tariffs and Trade, art 3(1).
[69] China – Auto Parts (n 68).
[70] ' India—Additional Import Duties (Appellate Body), para. 153, fn. 304 of the judgement explicitly clarifies that "*Whether a measure is a "charge" to which Article II:2(a) applies, or an "internal tax or other internal charge" referred to in the Ad Note to Article III, has to be decided in the light of the characteristics of the measure and the circumstances of the case.*"
[71] Working Party Report, *Border Tax Adjustments*, L/3464, GATT BISD (18th Supp) 97 para 14.

Article III primarily covers taxes applied upon imported products. Such products generally take the form of indirect taxes for example, excise tax, sales tax or a value added tax etc). As such income tax generally falls outside the ambit of Article III paragraph 2.[72] However, if imposition of income tax happens to affect the competitive relations of foreign good and domestic good in the market then such measure would also be covered under Article III paragraph 2.[73] Similarly administrative taxation measure can also be covered within the ambit of Article III paragraph 2.[74] However, "*internal taxes*" under Article III paragraph 2 cannot be interpreted to also include such charges which are applied in the form of a penalty to incentivize a certain form of conduct from the foreign producers.[75] Thus, it is not correct to interpret every form of charge or governmental levies as internal taxes under paragraph of Article III.

Article III

While interpreting the first sentence of Article III:2, the Appellate Body observed that the sentence mandates for a two-step analysis to cover a measure. First, it must be examined whether the imported good and domestic good are "*like*" in nature and secondly, it must be examined whether the tax imposed upon the imported good happens to be in "excess" in comparison to that imposed upon the domestic good.[76] Therefore, the author would firstly interpret the "like product" requirement and then secondly, interpret the import of "in excess of" under Article III:2.

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[72] ibid.
[73] Canada - Certain Measures Concerning Periodicals (30 June 1997), WT/DS31/AB/R.
[74] Thailand – Customs and Fiscal Measures on Cigarettes from the Philippines (17 June 2011), WT/DS371/AB/R, para 114.
[75] United States - Measures Affecting the Importation, Internal Sale and Use of Tobacco (12 August 1994), DS44/R, para 80.
[76] Chile – Taxes on Alcoholic Beverages, (27 February 2001), WT/DS87/17/Add.2; *see also,* EC–Asbestos (n 28); Korea –Taxes on Alcoholic Beverages (17 January 2000), WT/DS75/18; Thailand—Cigarettes (n 74); Japan—Alcoholic Beverages II (n 33).

1. LIKE PRODUCT ANALYSIS

Article III:2 requires a member state to prove that the concerned measures is discriminatory among "*like*" domestic and foreign products. Thus, a like product analysis is fundamental to develop a proper understanding of Article III. However, there is no definite or precise interpretation of the term "*like products*" under Article III.[77] Further, the Appellate Body has clarified that it is not possible to provide for a definitive or an exhaustive definition of the term "like product" under the agreement.[78] However, it is possible to outline the broader parameters of likeness enshrined under Article III:2 by interpreting various decisions. The term likeness provides for the precise scope, degree and extent of the competitive relationship that is sought to be protected under Article III:2 of GATT.[79]

In a broader context, all forms of products are at least indirectly competitive to one another since the disposable income would always remain limited in extent.[80] However, the concept of "*likeness*" or *"directly competitive and substitutable"* is restricted to cover such products which are directly competitive in nature.[81] It is in this regard, that in general four conditions have been carved out to determine the likeness of products. These criteria are- the end use of the product, consumer taste and preference, product characteristics and tariff classification.[82] The Appellate body has clarified that none of the four conditions can be construed as more fundamental than the other. Rather, these criteria must be examined in conjunction with each other

[77] Japan—Alcoholic Beverages II (n 33).
[78] ibid.
[79] Philippines—Distilled Spirits (n 28).
[80] ibid.
[81] EC—Asbestos (n 28).
[82] Border Tax Adjustments (2 December 1970), L/3464.

to analyze the scope and extent of the competitive relation between the domestic and imported product in the market.[83]

IV. CONCLUSION

The term "Like products" informs the general scope of non-discrimination principles of GATT. The entire non-discrimination principles is fundamentally based upon the examination and identification of comparable products. This is because the member states are under a mandate to treat comparable products in a non-discriminatory manner. This principle of non-discrimination is crucial in fulfilling the overarching objective of liberalizing and enhancing trade relations. Moreover, the non-discrimination principle helps in maintaining a level playing field for all the nations.

However, fundamental basis of such non-discrimination principle seems to be unclear and ambiguous. This is largely because of the ambiguity arising out of the like product analysis. The general practice is to carve out an objective standard to identify the relevant products. WTO report on Border Tax Adjustment provided a context to carve out such common standards to identify the relevant products. The panel as well as the appellate body have emphasized upon the fact that the application of such standards would be from one case to another. More recently, the panel as well as the appellate body have emphasized upon the need to interpret such standards along the lines of competitive relations between the parties. Thus, the recent trend is to employ a functional approach to interpret the objective standards of comparison.

However, the panel as well as the appellate body have failed to comprehensively expound the policy objectives of Article I as well as Article III. It seems as if the identify of comparable products is independent of the specific objectives that the two articles seem to fulfil. It is extremely important

[83] Philippines—Distilled Spirits (n 28).

to read in such policy framework while applying the interpretative standards. Indeed it is true that the overarching purpose is to maintain a fair competition within international market. However, the true import of such competition might vary according to the specific objectives of the two articles.

It is in this regard important to note that general policy of Article III is indicated by the opening line of the first paragraph of the article. The first paragraph clarifies that the main purpose is to ensure that such measures are not applied in a manner to "*to protect the domestic players*". Thus, Article III explicitly incorporates a "*non-protectionist*" goal while implementing the principle of non-discrimination under GATT.

It is in this regard important to note that the MFN principle has a much wider ambit. It is broad enough to cover tariff measures as well as measures falling under the second and fourth paragraph of the third article. The policy considerations with regard to internal measures can be similar under both the Articles. However, a tariff measure is to be understood in a different context. The application as well as the implications of such tariff measures are very different from the application of internal measures.

This is mainly because of the fact that the entire focus under Article III is to eliminate all forms of distortions in the international market. Tariff measures are also inherently distortive in effect. GATT allows the member nations to maintain tariffs.[84] Thus, the regulative policy of such measures cannot be confined to the aspect of market distortions.

Member nations are allowed to frame their own policies for tariff measures. Member nations are allowed to select an optimum level of tariff measure for a certain product category. Furthermore, member nations also have the freedom to determine their own product categorization while

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[84] General Agreement on Tariffs and Trade, art 2.

imposing such tariff measures. The schedules can be defined in a manner to further differentiate between various product lines. This aspect of product differentiation and product categorization is missing from the general framework of internal measures. Thus, Article I and Article III incorporate different set of policy considerations.

Another important distinction arises because of the general principle of "*Progressive Reduction of* Tariff *Measures*". GATT imposes an obligation upon its member nations to further negotiate to reduce their tariff measures. Such negotiations are conducted on the basis of reciprocity principle. This allows the member nations to take specific measures against various forms of free-riders in the political community.

The author suggests that the Panel as well as the Appellate Body must be mindful of such policy-based distinctions. Like product analysis must reflect the policy considerations that are inherent in the two articles. The difference between MFN principle and the National Treatment principle must be well represented under the Like Product analysis. In particular, the role of tariff classification must be more prominent while assessing a tariff measure along the lines of MFN principle.

DISPUTED CLAIMS ON ASSETS IN INSOLVENCY: A BLIND SPOT IN THE INSOLVENCY AND BANKRUPTCY CODE, 2016?

- *Sanjana M and Dharshini Sugumaran*[*]

ABSTRACT

This paper examines the jurisprudence of Section 60(5) of the Insolvency and Bankruptcy Code, 2016 ('Code') and the powers of the National Company Law Tribunal ('NCLT') to decide disputes over assets in insolvency. While the Supreme Court has held that the NCLT, administering specific functions under the Code through summary proceedings, cannot adjudicate disputes arising outside of the Code, we find that NCLTs often travel beyond their jurisdiction and decide such disputes where the asset is crucial to the revival of the Corporate Debtor. The Code and the jurisprudence on the issue do not clarify when and how such disputes are to be adjudicated, given the moratorium on suits against the Corporate Debtor during insolvency and the "Clean Slate Doctrine" that prevents any fresh proceedings against the Corporate Debtor post-insolvency.

We propose statutory amendments to the Code to allow for disputes over assets in insolvency to be adjudicated by the civil court or other appropriate authority even after the conclusion of insolvency. The civil court's jurisdiction to so adjudicate the dispute may be made contingent on the NCLT prima facie finding that we propose statutory amendments to the Code to allow for disputes over assets in insolvency to be adjudicated by the civil court or other appropriate authority even after the conclusion of insolvency the dispute is valid. The inclusion of the asset in question in the CIRP and Resolution Plan may be made subject to the outcome of such adjudication. While not being without its own limitations, such an approach limits the jurisdiction of the NCLT and balances the needs of effective resolution of the Corporate Debtor with the right of third-party claimants to have their disputes adjudicated.

[*] Sanjana M is a Principal Associate at Keystone Partners, and Dharshini Sugumaran is an Associate at Keystone Partners. Views stated in this paper are personal.

I. INTRODUCTION

The Insolvency and Bankruptcy Code, 2016[1] ('the Code') made a fundamental switch in India's approach to insolvent corporate entities with a shift in focus from winding up to revival through a time-bound process of resolution of the Corporate Debtor ('Corporate Debtor'). The shift in favour of efficiency and quick revival has left a blind spot in the Code on the fate of disputed claims on assets in insolvency. This paper argues that in the absence of a statutory mandate in this regard, there has been no uniform approach in the jurisprudence on the power of the National Company Law Tribunal ('NCLT') under Section 60(5)[2] of the Code to decide disputes concerning the assets of the Corporate Debtor. While a series of judgments have conclusively held that the NCLT, tasked with administering specific functions under the Code through summary proceedings, cannot adjudicate disputes concerning claims and rights arising outside of the provisions of the Code, many NCLTs have often proceeded to decide such disputes where the asset is crucial to the revival of the Corporate Debtor.

[1] Insolvency and Bankruptcy Code 2016
[2] Insolvency and Bankruptcy Code 2016, s 60(5).

The inconsistency in the positions taken across NCLTs and the National Company Law Appellate Tribunals ('NCLAT') in this regard leaves several questions unanswered, including the question of when the NCLT can exercise its jurisdiction in a summary proceeding under Section 60(5) of the Code to decide disputes over assets in insolvency. If such disputes are not to be decided by the NCLT and only by the civil courts, another question that arises is when such disputes can be adjudicated, given the moratorium on any suits against the Corporate Debtor under Section 14[3] of the Code during the Corporate Insolvency Resolution Process ('CIRP') and the "Clean Slate Doctrine" that wipes the Corporate Debtor clean of all such claims being raised post-insolvency. Further, what is the treatment of such disputed assets in Resolution Plans for revival of the Corporate Debtor? The Code does not provide any answers to these questions.

This paper traces the jurisprudence on the jurisdiction of the NCLT under Section 60(5) of the Code to adjudicate disputes on assets in insolvency and proposes the adoption of an approach that balances the interest of resolution of the Corporate Debtor with the right of third parties to have their legitimate claims over assets in insolvency to be adjudicated by the civil court or such other appropriate authority through trial.

II. SHIFT IN STATUTORY REGIME OF INSOLVENCY AND WINDING UP WITH THE INTRODUCTION OF THE CODE

The Code was enacted with the objective of consolidating and amending all laws relating to reorganization and insolvency resolution of corporate persons including the Sick Industrial Companies (Special Provisions) Act,

[3] Insolvency and Bankruptcy Code 2016, s 14.

1985,[4] the Presidency Towns Insolvency Act, 1909,[5] Provincial Insolvency Act 1920,[6] and the Companies Act, 2013.[7] As stated in its Objectives, the Code was intended to make the insolvency process time bound for maximisation of the value of assets, promote entrepreneurship, and balancing the interest of all stakeholders.

The Code grants the NCLT the jurisdiction to preside over the Corporate Insolvency Resolution Process and liquidation (in the event of failure of the CIRP except in voluntary liquidation) of the Corporate Debtor under the Code. Previously, the Board for Industrial and Financial Reconstruction that was set up under the Sick Industrial Companies (Special Provisions) Act, 1985 was the only statutory body and legislation that allowed for revival of sick industrial companies. The Companies Act, 1956[8] and subsequently the Companies Act, 2013 did not provide for insolvency resolution and in turn only allowed creditors to apply for winding up of a company where the debtor was unable to pay the debt due to the applying creditor.

Unlike the Companies Act, 1956 and 2013 that provided only for winding up, and the Sick Industrial Companies (Special Provisions) Act, 1985 which provided for revival but only of certain select debtors, the Code consolidated the law to provide at the first instance, a mechanism for insolvency resolution of the Corporate Debtor, only failing which, the Debtor would be liquidated. The applying creditor no longer needs to establish that the Corporate Debtor is unable to pay its debt as required under the Companies Act, 2013. Under the Code, the mere existence of the debt and the default is sufficient for a

[4] The Sick Industrial Companies (Special Provisions) Act 1985.
[5] The Presidency Towns Insolvency Act 1909.
[6] Provincial Insolvency Act 1920.
[7] Companies Act 2013.
[8] Companies Act 1956.

Corporate Debtor to be admitted into the Corporate Insolvency Resolution Process.

Upon admission of a Corporate Debtor into CIRP, the management of the Corporate Debtor stands suspended and vested with the Interim Resolution Professional[9] ('IRP') and a moratorium comes into operation under Section 14 of the Code[10] which inter alia prohibits the institution or continuation of pending suits or proceedings against the Corporate Debtor and other actions towards debt recovery from the Corporate Debtor. The CIRP of the Corporate Debtor is complete only upon the approval by the Committee of Creditors and thereafter the NCLT, of a Resolution Plan for the revival of the Corporate Debtor.[11]

Key to this resolution process is the certainty of the position of claims against the Corporate Debtor. The operation of the moratorium under Section 14[12] brings to a halt all separate recovery action against the Corporate Debtor and instead provides only one remedy to all creditors to recover their dues – by submission of claims with the IRP.[13] The Resolution Applicant, therefore, at the time of submitting its Resolution Plan,[14] is well aware of the exact extent of the Corporate Debtor's liabilities. Following the resolution of the Corporate Debtor, the slate is wiped clean, with no further claims being permitted to be made for pre-CIRP defaults of the Corporate Debtor. The "Clean Slate Doctrine" as interpreted in Committee of Creditors of *Essar Steel India Limited v. Satish Kumar Gupta and Others* ('Essar Steel') prevents any new suit or action against the Corporate Debtor after the

[9] Insolvency and Bankruptcy Code 2016, s 17.
[10] Insolvency and Bankruptcy Code 2016, s 14.
[11] Insolvency and Bankruptcy Code 2016, s 31.
[12] ibid.
[13] Insolvency and Bankruptcy Code 2016, s 18(b).
[14] Insolvency and Bankruptcy Code 2016, s 30.

approval of the Resolution Plan.[15] Several subsequent judgments such as *Ghanashyam Mishra & Sons (P) Ltd. v. Edelweiss Asset Reconstruction Co. Ltd.*[16] have followed the footsteps of Essar Steel in holding that no undecided claims can exist post resolution save for those admitted by the IRP/ Resolution Professional during the CIRP. Consequently, the "Clean Slate Doctrine" would prevent the continuation or filing of suits against the Corporate Debtor for claims arising from the pre-CIRP period.

III. POSITION OF DISPUTED CLAIMS IN INSOLVENCY

The Code is a complete code on all aspects concerning insolvency of the Corporate Debtor[17] with Section 238[18] providing that the Code will have effect notwithstanding anything inconsistent in any other provisions of existing law. Under Section 63,[19] the Code also explicitly bars the jurisdiction of the civil court or authority from entertaining any suit or proceeding in respect of any matter on which the NCLT or NCLAT would have jurisdiction under the Code.

Moratorium under Section 14[20] prevents the continuation of an existing suit during the period of moratorium. The "Clean Slate Doctrine" also disallows the Resolution Applicant being faced with new claims post-insolvency. While the erstwhile company courts were to decide all suits pertaining to a company being wound up as per the unamended Section 446(3) of the Companies Act, 1956,[21] the NCLT does not exercise such

[15] *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta* (2020) 8 SCC 531 (SC).
[16] *Ghanashyam Mishra & Sons (P) Ltd. Ṅ Edelweiss Asset Reconstruction Co. Ltd.* (2022) SCC OnLine 2241 (SC).
[17] *M/s Innoventive Industries Ltd v. ICICI Bank* AIR (2017) SC 4084 (SC).
[18] Insolvency and Bankruptcy Code 2016, s 238.
[19] Insolvency and Bankruptcy Code 2016, s 63.
[20] Insolvency and Bankruptcy Code 2016, s 14.
[21] Companies Act 1956, s 446(3).

jurisdiction under the Code. The NCLT is not conferred with the jurisdiction to conduct trials to decide disputed claims against the Corporate Debtor. While the NCLT has the limited jurisdiction[22] to decide, through a summary proceeding, the admission or rejection of claims by the Resolution Professional[23] in terms of the provisions of the Code, it cannot adjudicate on the rights and liabilities of parties concerning disputed questions of fact arising outside of the Code.[24] The fate of disputed claims was therefore left uncertain, with the NCLT not having the jurisdiction to decide such claims and the moratorium along with the "Clean Slate Doctrine" preventing the civil court or arbitral tribunal from deciding these claims during or after resolution under the CIRP.

The Supreme Court addressed this uncertainty in *Fourth Dimension Solutions v. Ricoh India*, holding that certain pre-existing arbitration proceedings between the Corporate Debtor and a third party can continue to be decided on merits as per law even after revival of the Corporate Debtor.[25] This judgment understandably caused confusion as to the scope of the "Clean Slate Doctrine" and the impact of any arbitral award passed on the resolution of the Corporate Debtor, given the possibility of the Resolution Applicant being presented with a fresh claim post CIRP.

Subsequent to Fourth Dimension, the Jharkhand High Court in *Electrosteel Steel Ltd. v. Ispat Carriers Pvt. Ltd.*,[26] while deciding whether an arbitral proceeding can resume subsequent to resolution of the Corporate Debtor post CIRP, held that since the arbitration proceeding was pre-existing

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[22] Insolvency and Bankruptcy Code 2016, s 60(5)(b).
[23] Insolvency and Bankruptcy Code 2016, s 18(b).
[24] *Embassy Property Developments Pvt. Ltd. v State of Karnataka* (2020) 13 SCC 308 (SC).
[25] *Fourth Dimension Solutions v Ricoh India* MANU/SCOR/48929/2021 (SC).
[26] *Electrosteel Steel Ltd. v. Ispat Carriers Pvt. Ltd.* (2023) SCC OnLine Jhar 1035 (JHC).

the CIRP and has also been noted in the Resolution Plan, it can resume after completion of the CIRP. However, the Court also noted that the claim preferred by Electro Steep, which was partly admitted by the IRP, was not earmarked for a 'Nil' payout in the Resolution Plan. On the basis of this distinction, the Court held that the claim of Electro Steel was never actually decided by the Resolution Professional or the NCLT and hence, the arbitral tribunal can decide the said claim. However, the judgment was again silent on how an award arising out of this claim can be executed, since the Resolution Plan did not specifically provide for any payout pursuant to the result of this arbitration or even factored it as a contingent claim. The judgment in Electro Steel has been appealed before the Supreme Court[27] and has been reserved for judgment at the time of writing of this article.

The dilemma created by Fourth Dimension was subsequently clarified by the Supreme Court in *Adani Power Ltd. v. Shapoorji Pallonji & Co Pvt Ltd*[28] wherein, when deciding the fate of pre-existing arbitration proceedings involving the Corporate Debtor, it was held that while the parties to the arbitration may choose to proceed with the arbitration even after CIRP, the final arbitral award would be subject to the terms of the approved Resolution Plan. Unless a contingent claim towards the claim in the arbitration was factored in the Resolution Plan, any subsequent arbitral award will have no bearing on the successful Resolution Applicant. Additionally, if such a contingent claim was provided for, then the successful party in the arbitration will be entitled under the award, an amount only to the extent of the contingent claim, even if the actual award was to be significantly higher. This balancing act ensured the certainty of the position of the debts of the

[27] *Electrosteel Steel Ltd. v. Ispat Carriers Pvt. Ltd. MANU/SCOR/110820/2023* (SC)
[28] *Adani Power Ltd. v. Shapoorji Pallonji & Co Pvt Ltd* [2023] ibclaw.in 338 (SC).

Corporate Debtor for the Resolution Applicant but also allowed the claimant to pursue its claim.

In *Power Grid Corporation v. Jyoti Structures Ltd*,[29] the Delhi High Court tried to make a distinction between arbitration proceedings to decide a claim and subsequent execution proceedings for enforcing an arbitral award against the Corporate Debtor during CIRP. The Delhi High Court in this case had held that, (i) the moratorium under Section 14 only barred proceedings which lead to dissipation of the assets of the Corporate Debtor; and (ii) an arbitration proceeding or proceedings under Section 34 of the Arbitration and Conciliation Act, 1996 are not barred by the moratorium .[30] In the event an award is passed against the Corporate Debtor, the restriction under Section 14 of the Code will act against the execution of the said award. However, the court also further observed that since the IRP is in control of the Corporate Debtor at this instance, it is necessary that the IRP is made aware of the proceedings and consents to it. This requirement of the IRP's consent does not find basis in the Code itself. This judgment however, came to be set aside by the Supreme Court in *P. Mohanraj v. Shah Bros. Ispat (P) Ltd*,[31] by noting that even proceedings under Section 34[32] of the Arbitration and Conciliation Act, 1996 are 'proceedings' covered by Section 14[33] of the Code as it may lead to an award under which the Corporate Debtor may have to pay monies.

The Delhi High Court had also followed a similar reasoning in the subsequent judgment in *SSMP Industries Ltd. v. Perkan Food Processors*

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[29] *Power Grid Corporation v. Jyoti Structures Ltd* (2017) SCC OnLine Del 12189 (DHC).
[30] The Arbitration and Conciliation Act 1996, s 34.
[31] *P. Mohanraj v. Shah Bros. Ispat (P) Ltd* (2021) AIR 2021 SC 1308 (SC).
[32] Arbitration and Conciliation Act 1996, s 34.
[33] Insolvency and Bankruptcy Code 2016, s 14.

Pvt. Ltd.,[34] where it observed that if the nature of a counter claim by the defendant against the Corporate Debtor in a suit initiated by it requires proper pleadings to be filed, defences and stands of both parties to be considered, evidence to be recorded and then issues to be adjudicated, the NCLT cannot be bogged down with deciding these claims as the Resolution Professional cannot conduct trial and the NCLT only conducts summary proceedings. Accordingly, the Delhi High Court refused to stay the adjudication of the counter claim and opined that the restriction under Section 14[35] will be triggered only when the decree is passed against the Corporate Debtor. The Delhi High Court, in these cases, did not give clarity on the effect of the "Clean Slate Doctrine" on an award passed post CIRP.

IV. NEED FOR CERTAINTY OVER THE ASSETS OF THE CORPORATE DEBTOR

As held in Essar,[36] the prospective Resolution Applicant has a right to receive complete information as to the assets and debts of the Corporate Debtor prior to its admission into CIRP. This information is contained in the information memorandum published by the IRP under Section 29 of the Code.[37] The proposed Resolution Plan is required to maximize the value of the Corporate Debtor's assets – this may include the transfer or sale of assets or part thereof. To this end, the exact rights of the Corporate Debtor over the assets in CIRP is important to provide certainty to the resolution process.

The IRP, in addition to collating the claims of the Corporate Debtor, is also required to take control of the assets of the Corporate Debtor over which

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[34] *SSMP Industries Ltd. v. Perkan Food Processors Pvt. Ltd.* (2019) SCC OnLine Del 9339 (DHC).
[35] Insolvency and Bankruptcy Code 2016, s 14.
[36] Essar (n 15).
[37] Insolvency and Bankruptcy Code 2016, s 29.

it has ownership rights, including in terms of Section 18(f)(vi),[38] i.e., "assets subject to the determination of ownership by a court or authority". To this end, the Resolution Professional under Section 25(2)(b)[39] of the Code is also empowered to represent and act on behalf of the Corporate Debtor and exercise rights for its benefit in judicial, quasi-judicial or arbitration proceedings. Therefore, the Code makes it clear that the IRP and the Resolution Professional can continue to prosecute the rights of the Corporate Debtor over its assets in judicial proceedings. The moratorium only bars the institution or continuation of suits by third parties against the Corporate Debtor.[40] When seen through the "Clean Slate Doctrine," the moratorium attempts to consolidate all claims and recovery against the same to be routed through the NCLT and the CIRP without leaving the Corporate Debtor to defend multiple proceedings. The definition of "Claim" under the Code refers to a right of payment or right to remedy for breach of contract, if such breach leads to a right to payment.[41] The Code is silent on disputed claims (including non-monetary claims) over the assets included as part of the CIRP and consequently the Resolution Plan.

For instance, we may consider a pending title dispute suit pertaining to an immovable property over which the Corporate Debtor also claims ownership as a defendant. If during the pendency of such suit proceedings, the Corporate Debtor is admitted into insolvency, Section 14[42] of the Code would prevent the continuation of such suit and consequently the adjudication of this title dispute. What would be the fate of the immovable property in question – would it automatically be considered the property of

[38] Insolvency and Bankruptcy Code 2016, s 18(f)(vi).
[39] Insolvency and Bankruptcy Code 2016, s 25(2)(b).
[40] Insolvency and Bankruptcy Code 2016, s 14.
[41] Insolvency and Bankruptcy Code 2016, s 3(6).
[42] Insolvency and Bankruptcy Code 2016, s 14.

the Corporate Debtor and included as part of the Resolution Plan, or would it be excluded from the CIRP entirely? Further, would the question of title be decided by the NCLT or would the property be included in the CIRP subject to subsequent determination by the civil court of the dispute as to the title of the property?

If the "Clean Slate Doctrine", rendered in the context of wiping the slate clean against all Claims (as defined under Section 3(6) of the Code) against the Corporate Debtor post CIRP, is taken to not be extended to claims (not strictly monetary as provided in the Code) on the assets in insolvency, then it may be argued that the suit, though stayed during the CIRP, may be revived and decided by the civil court post resolution of the Corporate Debtor. Section 60(6)[43] of the Code hints at such provision being available when providing that in computing the period of limitation specified for any suit or application by or against the Corporate Debtor, the period for which the moratorium is in place shall be excluded. However, it may also be argued that Section 60(6)[44] is only confined to circumstances where the Corporate Debtor is not resolved through CIRP and instead where the debts are settled through intervening circumstances such as a settlement under Section 12A[45] of the Code or where the order admitting the Corporate Debtor into CIRP is set aside in appeal.

There is no explicit provision either permitting or disallowing revival of the suit proceedings post CIRP or conversely allowing the NCLT to decide on these disputes during insolvency. Consequently, there is no clarity on the fate of such assets and their inclusion in the assets of the Corporate Debtor for the purpose of the CIRP where such dispute remains. The exclusion of

[43] Insolvency and Bankruptcy Code 2016, s 60(6).
[44] ibid.
[45] Insolvency and Bankruptcy Code 2016, s 12A.

the disputed asset may well have the effect of the corporate death of the Debtor if the asset is vital to its revival. The lack of any statutory clarity on this has naturally led to the reliance on Section 60(5)[46] which provides inter alia that the NCLT shall have the jurisdiction to entertain or dispose of "(a) any application or proceeding by or against the Corporate Debtor or corporate person; (b) any claim made by or against the Corporate Debtor or corporate person, including claims by or against any of its subsidiaries situated in India" to decide disputed claims (including non-monetary claims) including on assets in insolvency. Section 60(5) itself, however, does not clarify the extent of the NCLT's jurisdiction to decide questions of fact concerning rights and obligations outside of the Code.

V. THE POSITION LAID DOWN BY THE SUPREME COURT ON THE NCLT'S JURISDICTION UNDER SECTION 60(5) TO ADJUDICATE DISPUTES OVER ASSETS IN INSOLVENCY

The Supreme Court in *Embassy Property Developments Pvt. Ltd. v. State of Karnataka, ('Embassy')*[47] examined the extent of jurisdiction of the NCLT under Section 60(5) in the context of an order passed by the NCLT directing that the refusal to grant a deemed extension of a mining lease in favour of the Corporate Debtor under the Mines and Minerals (Development and Regulation Act), 1957[48] ('MMDC Act') was violative of the moratorium under Section 14[49] of the Code. The Supreme Court found that if the NCLT did in fact have the jurisdiction to decide all types of claims to property of the Corporate Debtor, Section 18(1)(f)(vi)[50] of the Code would not provide

[46] Insolvency and Bankruptcy Code 2016, s 60(5).
[47] Embassy (n 24).
[48] Mines and Minerals (Development and Regulation Act) 1957.
[49] Insolvency and Bankruptcy Code 2016 , s 14.
[50] Insolvency and Bankruptcy Code 2016 , s 18(1)(f)(vi).

for the Resolution Professional to take control and custody of assets of the Corporate Debtor "subject to the determination of ownership by a court or other authority". The Court further relied on the duties of the Resolution Professional under Section 25[51] which places an obligation on the Resolution Professional to represent the Corporate Debtor before judicial and quasi-judicial authorities towards preserving and protecting the assets of the Corporate Debtor, to conclude that the Code made it evident that wherever the Corporate Debtor has to exercise rights that fall outside the purview of the NCLT it could not do so under Section 60(5)[52] of the Code. The Supreme Court accordingly ruled that the actions taken under the MMDC Act being administrative actions taken by statutory or quasi-judicial authorities would only be subject to judicial review of administrative actions and not review by the NCLT.

The Supreme Court also noted particularly that the NCLT is not a civil court which has jurisdiction by virtue of Section 9 of the Code of Civil Procedure, 1908, to try all suits of a civil nature except where barred under law. The NCLT can only exercise such jurisdiction within the contours of the jurisdiction as prescribed in the Code, the law in respect of which it is called upon to administer its functions.

Though rendered in the context of the NCLT reviewing actions taken in the realm of public law, it would appear from a reading of Embassy[53] that the position is settled that the NCLT cannot adjudicate on any rights and disputes arising outside of the Code. While in the context of Embassy, the remedy for the Resolution Professional would lie in approaching the High Court in a writ against the administrative action taken by the state under the MMDC Act (as

[51] Insolvency and Bankruptcy Code 2016, s 25.
[52] Insolvency and Bankruptcy Code 2016, s 60(5).
[53] Embassy (n 24).

this remedy is not affected by the moratorium), the judgment is silent on any other disputes involving the assets of the Corporate Debtor where the remedy otherwise available under law, such as the filing of a civil suit, is barred under Section 14 of the Code.[54]

In the context of a contractual dispute, the Supreme Court in *Gujarat Urja Vikas Nigam v. Amit Gupta and others* ('Gujarat Urja')[55] Once again had the opportunity to consider the jurisdiction of the NCLT under Section 60(5)(c)[56] of the Code to consider the validity of termination of a Power Purchase Agreement ('PPA') with the Corporate Debtor by Gujarat Urja Vikas Nigam using an ipso facto termination clause in the PPA that allowed it to terminate the Agreement in the event of insolvency of the Corporate Debtor. The Supreme Court, while carefully setting out that its decision was on the limited context of the facts before it, found that the NCLT had the jurisdiction to decide the issue under Section 60(5)(c)[57] as in the said case, the termination of the PPA had been solely on the ground of insolvency of the Corporate Debtor and second, as the effect of the termination of the PPA in the instant case would push the Corporate Debtor into liquidation.[58] The Supreme Court further added that the jurisdiction of the NCLT would not be invoked in matters where a termination may occur on grounds unrelated to insolvency. The finding in Gujarat Urja also, therefore, remained consistent with the finding in the Embassy[59] that the NCLT could only decide the contractual dispute where the issue arose directly under the insolvency, but added an additional condition that it could invalidate such termination by a third party

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[54] Mines and Minerals (Development and Regulation Act) 1957, s 14.
[55] *Gujarat Urja Vikas Nigam v. Amit Gupta and others* (2021) 7 SCC 209 (SC).
[56] Insolvency and Bankruptcy Code 2016, s 60(5)(c).
[57] ibid.
[58] Insolvency and Bankruptcy Code 2016, s 33.
[59] Embassy (n 24).

only in the event that the contract was of such nature that its loss would spell the death of the Corporate Debtor.

The Supreme Court in Gujarat Urja also distinguished its earlier judgment in *Municipal Corporation of Greater Mumbai v. Abhilash Lal ('Abhilash Lal')*[60] by observing that while Abhilash Lal concerned disputes over the property of a statutory authority, the dispute in Gujarat Urja concerned the property of the Corporate Debtor. The Supreme Court made it clear that the principles in Gujarat Urja[61] would not be directly applicable to property not belonging to the Corporate Debtor. The Supreme Court in Abhilash Lal was concerned with land owned by the Municipal Corporation of Greater Mumbai ('MCGM') on which the Corporate Debtor had been contracted to develop a hospital following which a lease deed would be executed by MCGM in favour of the Corporate Debtor. The Supreme Court was deciding the rights of the Corporate Debtor over the property in circumstances where the development was not complete and the lease in favour of the Corporate Debtor was not created when it was admitted into insolvency. The Supreme Court, on an examination inter alia of Section 92 of the Municipal Corporation of Greater Mumbai Act 1888,[62] which governed the question of disposal of property belonging to MCGM, concluded that Section 238 of the Code[63] could not be read to override MCGM's right to control and regulate how its properties are to be dealt with, and further that Section 238[64] would be of relevance only where the properties and assets belong to the Corporate Debtor and not when a third party like MCGM is involved. It therefore decided against the asset

[60] *Municipal Corporation of Greater Mumbai v Abhilash Lal* (2020) 13 SCC 243 (SC).
[61] Gujarat (n 55).
[62] Municipal Corporation of Greater Mumbai Act 1888, s 92.
[63] Insolvency and Bankruptcy Code 2016, s 238.
[64] Insolvency and Bankruptcy Code 2016, s 238

automatically being included in the CIRP of the Corporate Debtor where there was a dispute as to the parties' rights to the asset.

The Supreme Court in *Tata Consultancy Services Ltd v. SK Wheels (P) Ltd ('TCS')*[65] was faced with the termination by the Tata Consultancy Services Ltd ('Tata') of a facility agreement with the Corporate Debtor under which the Corporate Debtor was required to provide premises to Tata for conducting examinations. The termination notice was issued by Tata during the period of CIRP, albeit for reasons of non-performance by the Corporate Debtor unrelated to insolvency. The Supreme Court, while considering the powers of the NCLT under Section 60(5)[66] of the Code to set aside the said termination, relied on Gujarat Urja and found that the termination in the instant case, being unrelated to the factum of insolvency of the Corporate Debtor, did not satisfy the narrow test laid down in Gujarat Urja[67] in order for the NCLT to exercise its jurisdiction under Section 60(5) of the Code. The Court, however, did not proceed to determine how disputes concerning assets and contracts of the Corporate Debtor would be determined where they were outside of the jurisdiction of the NCLT.

A reading of the above makes clear that, (i) the NCLT cannot adjudicate on rights claimed outside of the Code; (ii) even when faced with contractual disputes arising from application of ipso facto clauses arising directly from the insolvency event, the NCLT can exercise its jurisdiction and pass directions only where loss of the asset would lead to the death of the Corporate Debtor; and that (iii) the NCLT cannot exercise its jurisdiction

[65] *Tata Consultancy Services Ltd v SK Wheels (P) Ltd* (2022) 2 SCC 583 (SC).
[66] Insolvency and Bankruptcy Code 2016, s 60(5).
[67] Gujarat (n 55).

under Section 60(5)[68] by relying on Section 238[69] and Section 14[70] of the Code to have the NCLT adjudicate claims arising on properties belonging to third parties; and further, (iv) disputed rights over assets cannot automatically be decided in favour of the Corporate Debtor for inclusion in CIRP on account of the moratorium under Section 14.[71]

VI. BLIND SPOT OVER DISPUTED ASSETS IN INSOLVENCY WHERE THE RIGHTS CLAIMED ARISE OUTSIDE OF THE CODE

While holding that the jurisdiction of the NCLT is not to extend outside of adjudicating rights and liabilities arising directly under the Code, the current jurisprudence does not answer how disputes over assets or contracts with the Corporate Debtor are to be decided. This lacuna is of concern given the moratorium under Section 14 of the Code, which bars the adjudication of such disputes by a civil court during the CIRP and the Clean Slate Doctrine, which prevents such adjudication after resolution of the Corporate Debtor. The judgments in Gujarat Urja,[72] TCS,[73] and Embassy[74] involved the Resolution Professional taking steps to protect the assets of the Corporate Debtor. The solution to the issue in the facts of these decisions may be as simple as that the Resolution Professional is not prohibited under Section 14[75] from initiating proceedings to protect the assets of the Corporate Debtor and therefore could have initiated a suit or other appropriate proceedings to adjudicate the issue. However, what of disputes raised against the assets of

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[68] Insolvency and Bankruptcy Code 2016, s 60(5).
[69] Insolvency and Bankruptcy Code 2016, s 238.
[70] Insolvency and Bankruptcy Code 2016, s14.
[71] ibid.
[72] Gujarat (n 55).
[73] Tata (n 65).
[74] Embassy (n 24).
[75] Insolvency and Bankruptcy Code 2016, s 14.

the Corporate Debtor by third parties, which are most certainly barred by the moratorium from being decided during the period of CIRP and thereafter on account of the Clean Slate Doctrine?

Whilst relying on the aforementioned judgments, there has not been a consistent approach by the NCLT, NCLAT and the Courts in considering the question of the jurisdiction of the NCLT under Section 60(5)[76] in deciding disputes concerning the assets of the Corporate Debtor. The Supreme Court in *Victory Iron Works Ltd v. Jitendra Lohia & Others*,[77] in fact, sought to distinguish the judgments in Embassy,[78] Gujarat Urja[79] and TCS[80], holding that they were not concerned with immovable property belonging to the Corporate Debtor, and accordingly affirmed the order of the NCLT in passing restrictive orders on certain disputed assets in insolvency.

In *KL Jute Products Pvt Ltd v. Tirupati Jute Industries Ltd*,[81] the NCLAT was deciding the question of a Resolution Plan that provided for the cancellation of the lease deed of the Corporate Debtor leasing out one of its properties to a third party and the jurisdiction of the NCLT under Section 60(5) of the Code to order eviction of the said third party. The NCLAT categorically found that it was not within the NCLT's jurisdiction to order eviction of a third party, and the appropriate forum would have to be moved for the same. The NCLAT also found that the approval of the Resolution Plan by the Committee of Creditors had been in disregard of Section 30(2)(e)[82] of

[76] Insolvency and Bankruptcy Code 2016, s 60(5).
[77] *Victory Iron Works Ltd v Jitendra Lohia and others* (2023) 7 SCC 227 (SC).
[78] Embassy (n 24).
[79] Gujarat (n 55).
[80] Tata (n 65).
[81] *K.L. Jute Products Private Limited v. Tirupti Jute Industries Ltd.* (2021) 15 Comp Cas-OL 663.
[82] Insolvency and Bankruptcy Code 2016, s 30(2)(e).

the Code, which provides that the Resolution Plan cannot contradict any provision of law in force.

In a similar vein, the NCLAT in *SICOM Ltd v. Kitply Industries Ltd*,[83] while deciding a dispute surrounding an agreement to sell immovable property to the Corporate Debtor, relying on the tests in Gujarat Urja[84] found that the issue was not one that could be decided in a proceeding under the Code and would need to be examined by a Court of competent jurisdiction.

In *Dynepro Pvt Ltd v. V Nagaraj ('Dynepro')*,[85] the NCLAT, while deciding a dispute concerning the ownership of material in the possession of the Corporate Debtor, held that the issue concerned claims and counter claims made by several parties on certain materials and that the dispute could not be decided by the NCLT under Section 60(5).[86] The NCLAT instead held that it is open to the persons in the dispute to file a suit before the appropriate forum after the moratorium was lifted and after "it is finally decided that the material belongs to the Corporate Debtor."

The above decisions, while holding that the NCLT did not have the jurisdiction to decide the disputes in question, did not answer the question as to how these disputes would in fact be decided. The judgment in Dynepro[87] however, while not considering the applicability of the Clean Slate Doctrine to disputes on assets in insolvency, it does go on to suggest that a suit would be maintainable post-resolution. The treatment of this asset in the insolvency is itself not answered in explicit terms.

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[83] *SICOM Ltd. v. Kitply Industries Ltd.* (2023) SCC OnLine NCLAT 1066 (NCLAT).
[84] Gujarat (n 55).
[85] *Dynepro Private Limited v. V. Nagarajan* (2019) 6 Comp Cas-OL 672.
[86] Insolvency and Bankruptcy Code 2016, s 60(5).
[87] Dynepro (n 85).

Contrary to the above, there has been a separate host of decisions of the NCLT and NCLAT which use the exceptions carved out in Gujarat Urja[88] to exercise jurisdiction under Section 60(5)[89] to decide disputes against the Corporate Debtor.

In Sangam (India) Ltd v. Aarti Suitings Pvt Ltd,[90] the question faced by the NCLT was whether it had jurisdiction to order the eviction of a tenant from the property of the Corporate Debtor. On a narrow reading of Gujarat Urja[91] and Section 238[92], 63[93] and 60(5)[94] of the Code, the NCLT found that its jurisdiction under Section 60(5)[95] could be exercised to protect the Corporate Debtor from certain corporate death as the property in this case was the only asset of the Corporate Debtor. Accordingly, the tenants were directed to hand over possession of the property to the Corporate Debtor. In this selective reading of Gujarat Urja,[96] the NCLT ignored the primary ratio of Gujarat Urja, namely that only where the issues and rights arose directly under the Code could the NCLT exercise jurisdiction under Section 60(5).[97] Instead, it was only the immediate contingency of keeping the Corporate Debtor out of liquidation that was given primacy in deciding to exercise jurisdiction.

The NCLAT, Delhi in *Ramesh Singh Rawat v. SPG Global Distributions Pvt Ltd ('Ramesh Singh Rawat')*[98] in another such instance of a selective

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[88] Gujarat (n 55).
[89] Insolvency and Bankruptcy Code 2016, s 60(5).
[90] *Sangam (India) Ltd. v. Aarti Suitings (P) Ltd*. (2021) SCC OnLine NCLT 12298 (NCLT).
[91] Gujarat (n 55).
[92] Insolvency and Bankruptcy Code 2016, s 238.
[93] Insolvency and Bankruptcy Code 2016, s 63.
[94] Insolvency and Bankruptcy Code 2016, s 60(5).
[95] ibid.
[96] Gujarat (n 55).
[97] Insolvency and Bankruptcy Code 2016, s 60(5).
[98] R*amesh Singh Rawat v. SPG Global Distribution (P) Ltd*, (2024) SCC OnLine NCLAT 1984 (NCLAT).

reading of the judgment in Gujarat Urja[99] and in a similar context of an application seeking eviction of third parties from the property of the Corporate Debtor, found that as the issue related to the title of assets in CIRP, it was a question relating to insolvency resolution as was the case in Gujarat Urja. Accordingly, the NCLAT held that the NCLT was within its jurisdiction under Section 60(5) of the Code to direct the eviction of the third party from the property owned by the Corporate Debtor. The NCLAT in adopting this misreading of Gujarat Urja, entirely failed to appreciate that the rights and obligations in dispute were entirely outside of the Code. Further, to reason that any asset in insolvency would bring disputes concerning such asset within the jurisdiction of the NCLT under Section 60(5)[100] would be squarely opposed to the position in Embassy[101] and Gujarat Urja.[102]

A similar interpretation has also been followed by the NCLAT, Delhi in *Gloster Cables v. Fort Gloster Industries Ltd & Others*[103] where the NCLAT proceeded to affirm the jurisdiction of the NCLT in deciding a dispute as to the ownership of a trademark by the Corporate Debtor under Section 60(5).[104] Similar to the reasoning by the NCLAT in Ramesh Singh Rawat,[105] the NCLAT reasoned that the question relating to the assets in insolvency would come within the tests laid down in Gujarat Urja[106] for the NCLT to exercise its jurisdiction.

[99] Gujarat (n 55).
[100] Code, section 60(5).
[101] Embassy (n 24).
[102] Gujarat (n 55).
[103] *Gloster Cables Ltd. v. Fort Gloster Industries Ltd.* (2024) SCC OnLine NCLAT 147. As on date of writing of this paper, this judgment has been stayed by the Supreme Court in C.A. 2996 of 2024.
[104] Insolvency and Bankruptcy Code 2016, s 60(5).
[105] Ramesh (n 98).
[106] Gujarat (n 55).

The aforementioned judgments make it evident that there has been no consistent approach in deciding where the NCLT can exercise jurisdiction under Section 60(5)[107] in deciding disputed questions on the assets of the Corporate Debtor. Where the NCLT has proceeded to exercise its jurisdiction, the same has often been on the basis of a selective reading of Gujarat Urja[108] on the vitality of the concerned asset in reviving the Corporate Debtor. A convoluted reading is often adopted of the second test in Gujarat Urja, laying down that the NCLT can only exercise its jurisdiction where the rights in dispute arise directly from the insolvency to find that as long as the dispute was regarding an asset in insolvency, the same could be decided by the NCLT.

On the contrary, the decisions rejecting the NCLT's jurisdiction to decide disputed questions concerning assets of the Corporate Debtor in finding that the same would have to be decided by a civil court or appropriate authority, have not proceeded to engage with when such dispute may be decided given the moratorium against any suits against the Corporate Debtor and the Clean Slate Doctrine that prevents any subsequent claims post resolution of the Corporate Debtor. Furthermore, there is no certain position on the inclusion of such disputed assets in the proposed Resolution Plan of the Corporate Debtor – or in the liquidation if it comes to follow.

Therefore, a few of the questions that arise are:

- Would the disputed asset stand entirely excluded from the CIRP, to be included only once a decision is made in favour of the Corporate Debtor's rights in such asset?

[107] Insolvency and Bankruptcy Code 2016, s 60(5).
[108] Gujarat (n 55).

- When would such a suit be instituted and decided? If such suits are permitted to be prosecuted post resolution, would it be permissible for any and all persons to initiate such proceedings post resolution or would the same be restricted to only those claimants who made such claims prior to the completion of CIRP or even prior to the declaration of moratorium?
- If the claim or dispute on an asset in insolvency is to be brought prior to resolution, is it sufficient for such claims to be intimated to the Resolution Professional, or would the NCLT have to find prima facie merit in such claim in order to have the asset either removed from insolvency or to provide necessary caveats for the Resolution Applicant that the rights of the Corporate Debtor over the asset would be subject to determination in judicial proceedings?

As elaborated above, a carve-out has been facilitated on proceedings concerning monetary claims against the Corporate Debtor in Adani Power[109] where proceedings were permitted to continue post-resolution of the Corporate Debtor while limiting the final award to the extent provided as a "contingent claim" in the Resolution Plan. This limited carve out does a balancing act between the need for certainty for the Resolution Applicant on the liabilities of the Corporate Debtor while also allowing for effective dispute resolution before the appropriate authority (and not a summary proceeding before the NCLT).

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[109] Adani (n 28).

VII. BALANCING ACT BETWEEN THE NEED FOR CERTAINTY WITH EFFECTIVE ADJUDICATION OF DISPUTES OVER ASSETS

The core understanding behind the Clean Slate Doctrine, as stated in Essar[110], was to prevent the uncertainty of undisclosed claims arising after CIRP and the resolution of the Corporate Debtor. It is arguable that the Clean Slate Doctrine is applicable only to "Claims" being monetary claims as defined under Section 3(6)[111] of the Code. However, even keeping aside this question, the prospect of undisclosed but previously existing claims on assets of the Corporate Debtor in insolvency, arising post resolution would defeat the goal of having certainty on the assets and liabilities of the Corporate Debtor when a Resolution Plan is put forward and thereby defeats the chances of successful resolution. This is particularly the case where the asset in question is vital to the resolution of the Corporate Debtor. On the contrary however, foreclosing all resolution of disputes on assets of the Corporate Debtor, including those disclosed either before or during the CIRP, when seen in light of the settled position that the NCLT is not to adjudicate rights and claims arising outside of the Code, often also leads to a situation where the issue is prejudged in favour of the Corporate Debtor merely by virtue of the moratorium. Consequently, the asset is included in the CIRP or the NCLTs are forced to decide the issue on a summary basis under Section 60(5)[112] without any trial or appreciation of evidence and in a manner entirely outside of its jurisdiction.

While not deciding on all the questions raised above, the NCLAT in *Maharashtra Industrial Development Corporation v. Santanu Ray ('Santanu*

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[110] Essar (n 15).
[111] Insolvency and Bankruptcy Code 2016, s 3(6).
[112] Insolvency and Bankruptcy Code 2016, s 60(5).

Ray'),[113] while deciding the question of revocation of a lease of property by the Corporate Debtor on account of a breach of the terms of the lease by it, held that on account of the moratorium under Section 14,[114] the Lessor could not have taken possession of the property leased to the Corporate Debtor. However, the NCLAT went onto observe that there is no fetter on the right of the lessor to initiate such proceedings after the CIRP was over, on the cause of action of such breach of terms of the lease by the Corporate Debtor. The NCLAT further observed that even upon inclusion of this land in the Resolution Plan, the Resolution Applicant could not acquire a better right to this property than the Corporate Debtor or wash out its liability merely on the approval of the Plan. This position appears akin to the balancing act adopted in Adani Power[115] where the need for certainty of the Resolution Applicant is balanced with the right of the claimant to have its rights and claims adjudicated by the appropriate authority through the course of a full trial and not the NCLT in summary proceedings.

While it is important that the NCLT does not assume jurisdiction to adjudicate disputes outside of the Code during the CIRP or alternatively to have assets removed from the CIRP merely because of the existence of dispute which cannot be adjudicated by the NCLT, permitting fresh and previously undisclosed disputes over the assets in CIRP to be raised post CIRP before the civil court would defeat the Clean Slate Doctrine and prejudice resolution. For the purpose of ensuring that the Resolution Applicant is not bogged down by frivolous litigation after resolution, the Code may be amended to provide that any claims made by third parties on the assets of the Corporate Debtor be filed before the NCLT. The NCLT may

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[113] *Maharashtra Industrial Development Corpn. v. Santanu T. Ray* (2022) SCC OnLine NCLAT 180 (NCLAT).

[114] Insolvency and Bankruptcy Code 2016, s 14.

[115] Adani (n 28).

assess and arrive at a prima facie view of whether a valid dispute exists as to the rights of the Corporate Debtor to the asset. Such contingent claims and disputes over the assets may be included in the Information Memorandum issued by the IRP under Section 29 of the Code. Where the NCLT is of the view that prima facie a valid dispute exists as to the asset in question, the inclusion of the asset in the CIRP and the Resolution Plan may be made subject to the final adjudication by the civil court or such other appropriate authority under law of the rights of the Corporate Debtor over the asset. The Resolution Plan may also mention the nature of the claim and dispute as to the asset in question. Therefore, the Resolution Applicant will not acquire better rights over the asset than the Corporate Debtor would have had, merely on account of the CIRP of the Corporate Debtor. At the same time, the Resolution Applicant at the time of submitting its Resolution Plan is aware of the exact claims on rights to assets in the CIRP and will not be bogged by additional such claims after resolution.

VIII. CONCLUSION: THE NEED FOR STATUTORY AMENDMENTS TO CORRECT THE BLIND SPOT OF DISPUTED CLAIMS OVER ASSETS IN INSOLVENCY

Despite 8 years of operation of the Code, a review of the jurisprudence on Section 60(5)[116] makes it unfortunately clear that there remains a blind spot in the Code on the adjudication of disputes concerning assets in insolvency, particularly where the rights in the dispute arise outside of the Code. In the absence of a statutory mandate, the line often adopted is – how vital is this asset for the resolution of the Corporate Debtor? If the non-inclusion of this asset in the CIRP would lead to liquidation, the NCLT and

[116] Insolvency and Bankruptcy Code 2016, s 60(5).

NCLAT through a selective reading of Gujarat Urja[117] have often leaned in favour of deciding that the asset being part of the insolvency would be subject to the NCLT's jurisdiction under Section 60(5) of the Code to decide disputed rights over this asset.

Despite liberal misreading of these judgments, the position in Embassy,[118] Gujarat Urja,[119] Abhilash Lal[120] and TCS[121] remain good law - the NCLT cannot decide disputes outside of rights and claims arising directly under provisions of the Code. Where such disputed questions arise, they are to be decided by the civil court or the appropriate authority under law. The NCLT exercising jurisdiction under Section 60(5)[122] of the Code to decide disputed questions of fact without trial or appreciation of evidence is a leap of jurisdiction not envisaged under the Code. While prohibiting the exercise of such jurisdiction by the NCLT, these judgments are silent on the interplay of this position with the moratorium under Section 14[123] which prevents the initiation or continuation of suits during insolvency and the Clean Slate Doctrine that mandates that no fresh claims are made post-resolution.

The judgment in Santanu Ray[124] attempts a balancing act in proposing that the asset is included in the Resolution Plan with a caveat that the Resolution Applicant cannot secure a better right than the Corporate Debtor had. The suit proceedings to adjudicate the dispute over the asset may continue post-resolution of the Corporate Debtor. When read with Adani

[117] Gujarat (n 55).
[118] Embassy (n 24).
[119] Gujarat (n 55).
[120] Municipal (n 60).
[121] Tata (n 65).
[122] Insolvency and Bankruptcy Code 2016, s 60(5).
[123] Insolvency and Bankruptcy Code 2016, s 14.
[124] Maharashtra (n 115).

Power,[125] an inclusion of the nature of the claim over the asset in the Resolution Plan could be used to limit the nature of claims over the asset that may be made in post-CIRP proceedings where the cause of action arose before resolution. This provides certainty to the Resolution Applicant of the existence and extent of claims on the assets of the Corporate Debtor.

In the absence of a statutory mandate in this regard, NCLTs and NCLAT have taken widely different positions in the exercise of their jurisdiction under Section 60(5)[126] in deciding disputes concerning assets in CIRP. In the absence of a statutory amendment, there has also been no certainty on the fate of proceedings pending before courts against the Corporate Debtor's assets when the Corporate Debtor is admitted into CIRP. The NCLT exercising jurisdiction beyond that prescribed under Section 60(5) has also deprived claimants of their legitimate right to have their disputes adjudicated as provided for under law.

There is a need to correct this blind spot through statutory amendments to the Code to ensure that disputes over assets in insolvency are adjudicated only by the civil court or appropriate authority under law, while also ensuring that frivolous disputes are not raised post resolution only in order to defeat revival of the Corporate Debtor. The Code may instead be amended to allow pre-existing disputes on assets in insolvency to be adjudicated even after resolution through CIRP where such disputed claims have been brought to the attention of the NCLT and affirmed by it as prima facie being a genuine dispute as to the rights over the asset. Such contingent claims over the assets shall be included in the Information Memorandum published by the IRP.[127] Such claims once affirmed, may be included as a caveat to the rights of the

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[125] Adani (n 28).
[126] Insolvency and Bankruptcy Code 2016, s 60(5).
[127] Insolvency and Bankruptcy Code 2016, s 29.

Corporate Debtor over such asset in the Resolution Plan, with the Resolution Applicant being bound by any adjudication of rights over the disputed asset. Such inclusion balances the Resolution Applicant's need for certainty over the position of assets and liabilities of the Corporate Debtor – with claims of rights over assets in insolvency being restricted to those prima facie found to be genuine disputes by the NCLT, while also ensuring that assets are not included in the CIRP and Resolution Plan despite the existence of genuine disputes, only on account of the Corporate Debtor being admitted into CIRP. Such an approach also limits the jurisdiction of the NCLT to examine the validity of the dispute only to the limited extent necessary to determine whether inclusion of the asset in CIRP is to be made subject to the adjudication of such dispute.

The above approach however also has its limitations – first, a Resolution Plan is required to maximize the value of assets of the Corporate Debtor, including through the transfer or sale of its assets.[128] Where the rights of the Resolution Applicant are subject to final determination, it may limit the possibility of resolution if the Resolution Applicant is unable to freely put to use the said asset, particularly where the asset is vital to the revival of the Corporate Debtor. Second, in the event of liquidation of the Corporate Debtor, if the dissolution of the Corporate Debtor were to be kept pending the decision of the civil court as to rights of the Corporate Debtor over the said asset, the Code may meet the same inefficiency that plagued winding up proceedings under the Companies Act, 1956.

The position under the Code is clear that the NCLT cannot adjudicate disputes outside of the rights and obligations arising under the Code. Given

[128] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg 37.

the limitations to the jurisdiction of the NCLT, there is a need for legislative rethinking to correct this blind spot of how disputes over assets in insolvency and liquidation are resolved, while ensuring the rights of third-party claimants to have their disputes adjudicated effectively without compromising the resolution of the Corporate Debtor. The statutory amendments to the Code proposed in this paper are an attempt at addressing this blind spot while balancing the interests of the stakeholders in the insolvency.

FUNCTIONING OF THE NATIONAL COMPANY LAW TRIBUNAL IN MERGERS AND ACQUISITION CASES: INSIGHTS FROM THE CHANDIGARH BENCH

- *Tamanna Bansal and Dr. Ankit Srivastava*[*]

ABSTRACT

The Company Law Board was set up under the Companies Act 1956, and after that, the National Company Law Tribunal was incorporated by virtue of Section 408 of the Companies Act 2013. This tribunal was established after a recommendation from the V. Bala Krishna Eradi Committee, and later, National Company Law Tribunals were constituted on 1 June 2016. The National Company Law Tribunal mainly deals with insolvency, bankruptcy, and company law matters. The laws for mergers and acquisitions are provided under sections 230-232 of the Companies Act, 2013. Further, the Companies (Compromise, Arrangement and Amalgamations) Rules, 2016. The paper shall focus on the jurisdiction and procedure followed by the National Company Law Tribunal in sanctioning the proposed scheme of merger/amalgamation/ demerger /acquisition. Further, the paper shall specify the powers and functions of the National Company Law Tribunal. Lastly, the paper will specify the case studies and their analysis pertaining to the notable judgments passed by the National Company Law Tribunal, Chandigarh bench.

[*] Tamanna Bansal is a Ph.D. Scholar at Rajiv Gandhi National University of Law, Patiala, and Dr. Ankit Srivastava is an Assistant Professor at Rajiv Gandhi National University of Law, Patiala. Views stated in this paper are personal.

I. INTRODUCTION

Earlier, there was a Company Law Board set up under the Companies Act 1956, and after that, the National Company Law Tribunal was incorporated by virtue of the Companies Act 2013. It was established by the government in the year 2016 under Section 408 of the Companies Act, 2013[1] which provides the setting up of the tribunal across the country for subject-related matters, specifically company and insolvency bankruptcy matters. This tribunal was established after a recommendation from the V. Bala Krishna Eradi Committee, and later, National Company Law Tribunals were constituted on 1 June 2016. A total of 11 benches are set up all over the country with the Appellate Authority at New Delhi and Chennai. The National Company Law Tribunal and its Appellate Authority are governed by the Ministry of Corporate Affairs. The National Company Law Tribunal is a quasi-judicial body which generally operates for corporate disputes of a civil nature under the Companies Act. The appeal under the Companies Act 2013 from a National Company Law Tribunal lies with the National Company Law Appellate Tribunal.

The laws for mergers and acquisitions are provided under Sections 230-232 of the Companies Act, 2013. Further, the Companies (Compromise, Arrangement and Amalgamations) Rules, 2016 provide the rules which specifically the companies have to follow for filing the application of the merger and acquisition before the appropriate authority and further, the rules which are to be followed by the Authority while passing the final order. There are various types of processes that the company follows, including mergers, acquisitions, amalgamations and demergers. All are prescribed under Chapter XV of the Companies Act, 2013, which was notified vide notification dated

[1] Companies Act, 2013, s 408.

14.12.2016 by the Ministry of Corporate Affairs, and all the Sections came into force on 15.12.2016.

There is a thin line difference between mergers, acquisitions and amalgamations. A merger is a process in which two corporate entities combine to form a single new entity. The acquisition is a process where the second entity acquires the first entity completely or partially, and the second entity still persists. The amalgamation is a process where there is full control of the company taken by another company, including all the assets and liabilities. A demerger is a process where one or more companies are completely dissolved and form a new resulting company. There are various types of mergers, including: horizontal merger, vertical merger and conglomerate merger. The horizontal mergers are mergers where two or more companies where there is direct competition amongst the companies and both companies are in the same industry. A vertical merger is a merger where the companies are in the same industry, but their area of operation is divided at different levels. The vertical merger can be further divided into a backward merger or a forward merger. The conglomerate mergers are mergers where the companies are unrelated, and they merge only for the business benefits, like expansion of business or synergy benefits. The main objective behind the merger is to maximise the business and growth, improve the company's performance and financial stability, lower the cost of the invested capital, increase the market standing and share in the market to attain tax deductions. The process of mergers and acquisitions is more effective after the evolution of the Companies Act, 2013, and it has helped to make the mergers a time-bound process with more effective participation of the stakeholders, employees, board management and debenture holders.

II. JURISDICTION AND PROCEDURE OF APPROVAL OF THE MERGER AND ACQUISITION MATTERS BEFORE THE NATIONAL COMPANY LAW TRIBUNAL

A. Jurisdiction

The National Company Law Tribunal has the jurisdiction to entertain merger and acquisition cases under the Companies Act, 2013, under Section 230-232.[2] The jurisdiction of the companies lies where the company is registered with the Registrar of Companies. The National Company Law Tribunal entertains matters according to the registration of the company with the Registrar of Companies as the territorial jurisdiction. The National Company Law Tribunal can reject or approve the merger/ acquisition/ amalgamation/ demerger under the Companies Act, 2013. Further, the National Company Law Tribunal can keep a check on the actions of the companies.

B. Procedure

The main thing for the mergers and acquisitions is to be seen is the Articles of Association and Memorandum of Association of the company. In case the Articles of Association and Memorandum of Association provides that the transferor company as well as the transferee company has the power to merge the companies, then the merger can proceed and in case the Articles of Association and Memorandum of Association does not provide any such clause, then an amendment is required to be made in the Articles of Association and Memorandum of Association for providing the clause for the merger. Then once the Articles of Association and Memorandum of Association are clear, then the companies have to send the notices for the

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[2] Companies Act, 2013, s 230-232.

convening of the board meeting specifying the agenda, date and time of the meeting for at least not less than 7 days prior to the meeting as specified under Section 173 of the Companies Act, 2013[3]. The Board Meeting is to be convened involving the Board of Directors for obtaining the consent for the proposed scheme of merger and for passing a resolution with a minimum 50% present and voting in the meeting conducted. Once the resolution has been passed, the application is to be made before the National Company Law Tribunal for the approval of the mergers/ acquisitions/ amalgamation/ demerger.

There are two motions involved in the approval of the mergers/ acquisitions/ amalgamation/ demerger.

The first motion application is filed by the companies before the National Company Law Tribunal in Form NCLT-1, seeking convening or dispensation of the meetings of the shareholders for approval of the merger. The 1st Motion application filed by the companies should be accompanied by the relevant documents necessary for the merger, including:

- Basic documents of the company including: Memorandum of Association, Articles of Association, Incorporation certificate, Master Data
- Copy of the Proposed Scheme
- Valuation Report of assets and liabilities by the certified Statutory Auditor
- Share Entitlement Ratio certificate issued by the certified Statutory Auditor
- Board meeting resolution where the scheme was approved

[3] Companies Act, 2013, s 173.

- Audited Balance sheets for the last F.Y.
- Provisional Financial Statements for the last quarter.
- Affidavit under Section 133 of the Companies Act, 2013, that the companies are in consonance with the Indian Standards.
- Affidavit that no proceedings are pending against the companies
- List of all the shareholders and creditors certified Statutory Auditor
- Consent affidavits of all the shareholders and creditors giving consent to the scheme of arrangement/merger/amalgamation or acquisition

Once the relevant documents are filed before the National Company Law Tribunal, after perusal of the records, in case a minimum 90% consent from the shareholders and creditors have been received, then the meetings are dispensed, and the First Motion order is passed. In case there is less than 90% consent from the shareholders and creditors, then the directions are given to convene the meeting of the shareholders and creditors whose consent is less. The meeting is headed by Chairperson, Alternate Chairperson and Scrutiniser, who would record the votes for, against and abstain from the approval of the Proposed Scheme and thereafter, a report has to be filed before the National Company Law Tribunal in Form CAA 5 stating the voting status including: percentage voted for, percentage voted against and percentage of shareholders or creditors abstained from voting.

Then, once the first motion application is approved and the consent of the shareholders and creditors has been received, the second motion application is to be filed before the National Company Law Tribunal for the final approval of the proposed scheme. In the second motion application, first the interim prayer regarding the publication of the notices for inviting the objections to the approval of the Scheme from the general public and for sending the notices to the statutory authorities like: Regional Director, Central Government;

Jurisdictional Income Tax Department, Official liquidator and concerned Registrar of Companies is made. On the perusal of the record by the National Company Law Tribunal, the interim prayer is allowed in accordance with the law and the publication of the notices for inviting objections to the approval of the Scheme from the general public is made by the petitioner companies. Further, the notices are sent to the statutory authorities like: Regional Director, Central Government; Jurisdictional Income Tax Department, Official liquidator and concerned Registrar of Companies inviting their report on the proposed scheme so as to know any dues/penalty/investigation/proceedings pending and inviting objections from the authorities to the proposed scheme. Once the reports are received in Form CAA-4 from the statutory authorities, in case there are any extreme observations made by the statutory authorities which would impact the companies, stakeholders or any other related party, then the petitioner companies have to file their reply to such observations clarifying the same. Thereafter, the perusal of the record is done by the National Company Law Tribunal, and the final approval of the proposed scheme is granted.

III. POWERS AND FUNCTIONS OF NATIONAL COMPANY LAW TRIBUNAL IN MERGERS AND ACQUISITIONS MATTERS

The main functions of the National Company Law Tribunal under the Companies Act, 2013 are as under:

Registration of a company, which involves new companies being incorporated along with the registration of the Memorandum of Association and Articles of Association under the provisions provided in the Companies Act, 2013. Once the merger and acquisition order is passed by the National Company Law Tribunal, then the registration of the new entity takes place by submitting the copy of the order with the Registrar of Companies. Further, the

National Company Law Tribunal has the vested power to cancel the registration of the company and dissolve the company in case the company does not comply with the relevant laws.

The earlier Act only focused on the transfer of the shares by the company or the reduction of the share capital. However, now the new Companies Act, 2013 has also provided the power to the National Company Law Tribunal to pass orders related to the reduction of the share capital under Section 66 of the Companies Act, 2013[4]. The National Company Law Tribunal has the power to pass an order related to the transfer of shares or the reduction of the share capital.

Further, the National Company Law Tribunal has the power to wind up the company once the merger or acquisition has taken place. The liabilities and assets of the companies as specified in the scheme of the merger or amalgamation shall be complied with, and the earlier entity will be dissolved.

The National Company Law Tribunal has the power to approve or reject the proposed scheme. After the perusal of the record, if it is found that the documents, as well as the proposed scheme, are genuine and in the interest of the public, then the proposed scheme shall stand approved. In case the companies are bogus in nature or the proposed scheme is not in consonance with the interest of the public or the stakeholders, the National Company Law Tribunal has the power to reject the said proposed scheme. Further, in case any liabilities or proceedings are pending on the part of the companies or there are any objections from the statutory authorities, the National Company Law Tribunal has the power to reject the proposed scheme. The National Company Law Tribunal can also give directions which are to be followed after the approval of the scheme such as filing of the Form CAA-7 before the National

[4] Companies Act, 2013, s 66.

Company Law Tribunal submitting the schedule of assets and then they can issue a formal order which is required to be filed before the Registrar of Companies for changing the status of the transferor as well as the transferee company. Further, the National Company Law Tribunal can also give directions related to the filing of the latest Income Tax Returns and Audited Financial Statements, etc.

IV. NOTABLE CASES OF THE CHANDIGARH BENCH: CASE STUDIES AND ANALYSIS

In the present case, there were fifteen transferor company including:- Adeline *Builders & Developers Private Limited, Armand Builders & Constructions Private Limited, Americus Real Estate Private Limited, Dlf Commercial Developers Limited, Elvira Builders & Constructions Private Limited, Eastern India Powertech Limited, Lada Estates Private Limited, Lear Builders & Developers Private Limited, Melosa Builders & Developers Private Limited, Mens Buildcon Private Limited, Narooma Builders & Developers Private Limited, Nudhar Builders & Developers Private Limited, Rachelle Builders & Constructions Private Limited, Royalton Builders & Developers Private Limited, Saket Holidays Resorts Private Limited With Transferee Company i.e. Dlf Home Developers Limited CP (CAA) No. 7/Chd/Hry/2021*[5] under Sections 230-232 of the Companies Act, 2013[6] and other applicable provisions of the Act read with Companies (Compromises, Arrangements and Amalgamations) Rules, 2016[7]. The notices were sent to the statutory authorities including: - Regional Director Central Government, Registrar of Companies, Official Liquidator, Income Tax Department, Competition Commission of India, Director, Department of Town and

[5] *Dlf Home Developers Limited* CP (CAA) No. 7/Chd/Hry/2021.
[6] Companies Act, 2013 (n 2).
[7] Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

Country Planning, Haryana at Chandigarh, Real Estate Regulatory Authority (RERA), Haryana, and Greater Mohali Area Development Authority (GMADA). The approval of the Competition Commission of India was not required as the petitioner companies stated that under sub-clause (2) of Section 6 of the Competition Act, 2002[8] they were exempted vide Entry 9 to Schedule 1 in terms of Regulation 4 of the Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011. Moreover, no reply from the Director, Department of Town and Country Planning, Haryana at Chandigarh, Real Estate Regulatory Authority (RERA), Haryana, and Greater Mohali Area Development Authority (GMADA), which was presumed that they have nothing to say in the present matter. Therefore, the Tribunal approved the scheme of Amalgamation.

In the case of *PepsiCo India Holdings Private Limited, PepsiCo Panimex Inc. CP and PepsiCo Investments Ltd. (CAA) No.13/Chd/Hry/2023*[9], the scheme of amalgamation was filed between the companies under Section 230-232 and 234 of Companies Act, 2013[10] and other applicable provisions of the Act read with Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, out of which PepsiCo India Holdings Private Limited was the transferee company being the Indian entity and rest two companies which were transferor companies being the foreign entities with their registered offices situated at Mauritius. It was a case of an inbound merger. The scheme of amalgamation was sanctioned by the bench after the perusal of the records, including the Financial Statements, Audited Accounts, Share Entitlement Ratio, Valuation Report, and Statutory Auditor's certificate. Further, the reports from the statutory authorities, including the Regional Director Central

[8] Competition Act, 2002, s 66.
[9] *PepsiCo India Holdings Private Limited, PepsiCo Panimex Inc. CP and PepsiCo Investments Ltd.* (CAA) No. 13/Chd/Hry/2023.
[10] Companies Act, 2013, s 230-232 and 234.

Government, Registrar of Companies, Official Liquidator, Reserve Bank of India, and Income Tax Departments, were received. Moreover, the director of the petitioner company filed an affidavit that the scheme of amalgamation is in compliance with Section 230 to 232 and Section 234 of the Companies Act, 2013[11] read with Companies (Compromises, Arrangement and Amalgamations) Rules, 2016 along with the Foreign Exchange Management (Cross Border Merger) Regulations, 2018 under the Foreign Exchange Management Act, 1999. Therefore, the scheme of amalgamation was allowed.

In the case of *AIX Connect Private Limited with Air India Express Limited*, the composite scheme of arrangement was filed before the bench under Sections 230 to 232 of the Companies Act, 2013,[12] read with Rules 3 and 5 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016[13]. The company was engaged in the business of cargo service and aircraft passengers and was a wholly owned subsidiary of Air India Ltd. The reports from the Regional Director, Central Government, Registrar of Companies, Official Liquidator, and Income Tax Departments, along with the report from the Ministry of Civil Aviation were received by the bench before giving approval for the sanctioning of the scheme. The report of the Ministry of Civil Aviation, had given a minimum time of 8 months for the completion of the arrangement procedure, along with the filing of the requisite documents with the respective departments from the date of approval of the Tribunal's order. Therefore, after going through the reports of the statutory authorities and obtaining the required 90% consent from the shareholders and creditors, the bench approved the composite scheme of arrangement.

[11] Companies Act, 2013 (n 10).
[12] Companies Act, 2013 (n 2).
[13] Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, r. 3 and 5.

In the case of *Triputi Infrastructure Private Limited with Milkfood Limited CP (CAA) No. 54/CHD/PB/2022*[14], the scheme of amalgamation was filed before the Tribunal. For this amalgamation, a notice to the statutory authorities, including the Regional Director of Central Government, Registrar of Companies, Official Liquidator, Income Tax Departments, and Food Safety and Standards Authority of India, was sent. The notice was sent to the Food Safety and Standards Authority of India as the nature of the business of companies was related to the manufacturing of food items. The reports were received from the statutory authorities. The report of the Food Safety and Standards Authority of India wherein it was stated that, "*they had no role in the Amalgamation between the two Petitioners. However, subsequent to amalgamation, in case of any changes involving the information that would need changing in the records of FSS Act, the same must be done on priority and appropriate amendments shall be made in the FSSAI License/ Records*". Moreover, the appointed date for the scheme was 01.04.2020, which was ante-dated beyond one year from the date of filing i.e. 16.09.2021. As per the definition of the 'appointed date' as mentioned in Part I of the scheme, it states that, "*11. "Appointed Date" means April I, 2020 or such other date as may be approved by the Hon'ble National Company Law Tribunal (NCLT) or Hon'ble National Company Law Appellate Tribunal (NCLAT), or any other competent Court (s), judicial or quasi-judicial authority or any other competent authority having power to sanction the Scheme, as the case may be.*[15]" Moreso, during the course of arguments, no valid justification was given by Ld. counsel for the petitioner companies. It was submitted by Ld. counsel for the petitioner companies that, on instructions, he has no objection if the appointed date is

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[14] *Triputi Infrastructure Private Limited v. Milkfood Limited* CP (CAA) No. 54/CHD/PB/2022.

[15] ibid.

changed from 01.04.2020 to 01.04.2023. Therefore, in view of the above discussion, the appointed date is changed from 01.04.2020 to 01.04.2023 by the Tribunal. Thus, the scheme of Amalgamation was sanctioned by the bench.

In the case of *Confirm Ticket Online Solutions Private Limited and Le Travenues Technology Limited CP (CAA) No. 35/Chd/Hry/2023*[16], the scheme of Amalgamation under Sections 230-232 of the Companies Act, 2013[17] and other applicable provisions of the Act read with Companies (Compromises, Arrangements, and Amalgamations) Rules, 2016, were filed before the Tribunal. The notices were published in the newspaper inviting any objection to the Scheme from the public and similarly, notices were sent to the statutory authorities including: Central Government through the Regional Director (Northern Region), Ministry of Corporate Affairs; (2) Registrar of Companies for New Delhi and Haryana; (3) Official Liquidator (attached to the Hon'ble High Court of Punjab and Haryana); and (4) jurisdictional Income Tax Departments. After receiving the reports from the authorities. No adverse observations were made to the scheme. Therefore, the said scheme of Amalgamation was approved by the bench.

In the case of *Hologram Holdings Private Limited and Swen Holdings Private Limited with Sulphur Securities Private Limited CP (CAA) No. 20/Chd/Hry/2022*[18], the scheme of the merger was rejected by the bench. In the present case, the report of the Income Tax Department indicated that the outstanding demand of Rs. 3,98,48,160/- for AY 2012-13 against the Transferor Company (Hologram Holdings (P) Ltd.) was pending along with

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[16] *Confirm Ticket Online Solutions Private Limited and Le Travenues Technology Limited* CP (CAA) No. 35/Chd/Hry/2023.
[17] Companies Act, 2013 (n 2).
[18] *Hologram Holdings Private Limited and Swen Holdings Private Limited v. Sulphur Securities Private Limited CP (CAA)* No. 20/Chd/Hry/2022.

the proceedings. Further, the learned counsel for the Income Tax Department also stated that in view of the proceedings, the assessment against the company has been reopened. Therefore, the National Company Law Tribunal ordered the companies to furnish the documents, including the GST Returns, Income Tax Returns, Financial Statements, and Statutory Audited Report, in order to showcase that the company is carrying on the business and is working. Sufficient time to submit the documents was granted by the National Company Law Tribunal. Further, the Registrar of the Companies in its report pointed out that the company was a shell company, considering the same, the physical verification of the registered office of the company alongwith the physical verification of the available documents at the office was ordered by the National Company Law Tribunal which was to be conducted by the Registrar of the Companies as per Rule 25B of the Companies (Incorporation) Rules, 2014 and the provision of Section 12(9) of the Companies Act, 2013[19]. Further, there was manipulation in the Financial statements of the company. The Transferee Company's income jumped from NIL to Rs. 118.09 crores in 01 year, and the tax on the same was shown as Rs. 1.02 lakhs. Further, the National Company Law Tribunal analysed that, *"the Company claimed in its Schedule of Significant Accounting Policies and Notes on Account that during the FY 2023-24, the Company made a revenue from operations amounting to Rs. 11,809.28 lakhs as Long Term Capital Gain and earned a net profit (Before Tax) of Rs. 11,257.56 lakhs. The earnings per share having a nominal value of Rs. 10/- per share was stated to have gone up from NIL as on 31.03.2023 to Rs. 263.62 lakhs for the period ending on 31.03.2024. The non-current investments as on 31.03.2024 amounting to Rs. 40,076.14 lakhs are made mostly in the group companies, which are subsequently found sharing the same addresses. From the Profit & Loss Account for the year ended*

[19] Companies Act, 2013, s 19.

31.03.2024, the office expenses have gone up to Rs. 3.27 lakhs from a mere Rs.11,000/- for the immediately preceding year[20]*"*. The entries were controlled by one individual. It was observed that the share premium amounted to Rs. 528.24 crores in FY 2023-24, and moreover, the profit earned by the company was counted in the Long Term Capital Gains. The shares were issued with the large-scale manipulation of accounts. Further, the bench observed that the profits on the income in case of the Transferee Company were not backed by a reliable source of the investment or were not supported by the actual assets owned by the company. The expenses of the company shockingly were very less amounting to Rs. 3.27 lakhs against the revenue of Rs. 118.09 crores which is a clear indication of the speculative income based on the share transactions only available on papers and hence, it does not require large contingent of employees as compared to the employees in the normal business entity. The main aim of the merger is to reduce the cost pertaining to the business; however, in the present case, the cost was already minimal and not as per the industry standards. Moreover, the transactions appear to be accommodation entries as the group companies are exchanging the transactions amongst themselves. Therefore, the scheme of the merger was rejected by the bench, stating that there are only paper transactions being carried out to increase the value of the shares of the company and to avoid the payment of taxes. Therefore, the scheme is not in consonance with the public interest as it is a clear case of money laundering.

V. CONCLUSION

The National Company Law Tribunal follows a regulatory framework that helps corporate institutions as well as businesses to grow and expand their businesses. By way of merger/acquisition/amalgamation/demerger, the

[20] *Hologram Holdings* (n 18).

National Company Law Tribunal provides an edge to the businesses to merge with their entities or to form a new one, which helps them to generate more employment opportunities and improve the synergy value and financial status of the company. By way of merger/acquisition/amalgamation/demerger, the companies get an edge to expand their business, thereby reducing the cost of the workforce, infrastructure and capital invested. The Companies Act upholds the basic structure of the Constitution of India and follows the rule of law, ensuring that the interests of all Stakeholders, employees, shareholders, creditors, and members are protected. The corporate strategies are followed by the companies along with rules and procedures prescribed under the law for achieving the maximum profit in the business. The regulatory bodies help the corporates to grow and also keep a check on the day-to-day functioning of the businesses. A quasi-judicial body like the National Company Law Tribunal is aimed at providing a speedy resolution to the subject-related company law matters in a time-bound manner. The main aim of setting-up of National Company Law Tribunal was to resolve the disputes which are arising out of specific subject and in a manner, the objective of setting up of the Tribunal has been achieved as National Company Law Tribunals across the country are speedily disposing of the matters and are delivering the landmark judgments which act as a precedent for the future. Thus, the formation of the National Company Law Tribunal has made a tragic shift in the corporate field. The National Company Law Tribunal, Chandigarh Bench, has held to cull out the loopholes in the company law by way of delivering landmark judgments, which have helped the other Benches across the country to dispose of the matters with more effectiveness. The landmark case of *Hologram Holdings Private Limited*[21] passed by the Chandigarh Bench has set a benchmark by ordering physical verification of the Offices as well as the documents of the

[21] *Hologram Holdings* (n 18).

company by the Registrar of Companies. It has helped to check the authenticity of the existence of the company as well as to introspect their financial records. Another case of *Triputi Infrastructure Private Limited with Milkfood Limited*[22] has set another standard for checking the appointed date which should not be the ante-dated as sometimes the Schemes are filed before and the passing of the order takes two to three years during which, the financial status of the Company changes and leads to loopholes in the Scheme as well as in working of the company. The change date would now disclose the true financials of the company. In another case of *AIX Connect Private Limited with Air India Express Limited*[23] the special approval from the Ministry of Civil Aviation was sought for the approval of the Scheme which has set a benchmark for the other Tribunals to look into the all the possible statutory authority's approval to be sought before the approval of the Scheme. All the landmark cases specified above show that the National Company Law Tribunal, Chandigarh Bench, has set precedents for the other Tribunals and has made effective use of the law.

[22] *Triputi Infrastructure* (n 14).
[23] *AIX Connect Private Limited v. Air India Express Limited* CP (CAA) No. 1/Chd/Hry/2024.

REAL ESTATE REGULATION AND INSOLVENCY: THE CLASH BETWEEN HOMEBUYER PROTECTIONS AND CREDITOR RIGHTS IN INDIA

- *Aditi Mittal and Nitya Shukla*[*]

ABSTRACT

Insolvency and Bankruptcy Code (IBC) and Real Estate (Regulation and Development) Act (RERA), both of which were introduced in 2016, are at odds with one another, and this conflict affects India's real estate industry. While the IBC concentrates on monetary recovery for creditors, RERA seeks to safeguard homeowners by guaranteeing responsibility and transparency in real estate transactions. Conflicts have arisen because Section 238 of the IBC, which gives it superintendence, has occasionally disregarded RERA's safeguards for homebuyers in bankruptcy proceedings. By enabling project-specific resolutions and enhancing financial transparency, recent judicial and regulatory initiatives, such as Project-wise Corporate Insolvency Resolution Processes and CIRP regulation modifications, aim to resolve these problems. Through a more integrated approach to real estate insolvencies and proper attention to project completion and financial recovery, these developments seek to strike a balance between the interests of creditors and homebuyers.

[*] Aditi Mittal and Nitya Shukla are third-year students at Rajiv Gandhi National University of Law, Punjab. Views stated in this paper are personal.

I. INTRODUCTION

In the ever-evolving landscape of India's economy, the real estate sector balances the interests of creditors, developers, and purchasers in a perilous way, serving as both a pillar of development and a house of cards. Prior to 2016, homebuyers were essentially powerless against irresponsible builders and faced a situation akin to being trapped in a maze from which there was no way out. The only options left to them were protracted legal lawsuits or a claim for damages under the Consumer Protection Act, 1986,[1] neither of which could guarantee the delivery of their long-awaited homes.

The introduction of the Real Estate (Regulation and Development) Act (RERA) in 2016[2] marked a turning point, ensuring greater fairness and transparency for prospective homeowners. This was further bolstered by the Insolvency and Bankruptcy Code (IBC) of 2016, which after significant revisions acknowledged homeowners as financial creditors—akin to giving them a safety net in a high-wire act.[3] Because of their categorization under the IBC, homeowners can file for bankruptcy against developers who are in default, ensuring their spot in the creditor's queue.

Yet, even this seemingly progressive framework is not without its cracks. Stakeholders are frequently left in a state of legal confusion by the ongoing tug-of-war between the creditor-centric approach of the IBC and the homebuyer-centric safeguards of RERA, with Section 238 of the IBC making efforts to integrate the two statutes more difficult. The industry is seeing a

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[1] Consumer Protection Act 1986.
[2] Real Estate (Regulation and Development) Act 2016.
[3] Jyoti Singh and Vishnu Shriram, *Insolvency and Bankruptcy Code, 2016: Concepts and Procedure* (Bloomsbury 2017).

piecemeal settlement of real estate insolvencies—an attempt to reestablish confidence brick by brick—as the judiciary steps in with creative solutions like Project-wise Corporate Insolvency Resolution Process (CIRP). But the path to recovery is still long and convoluted, with over 7,000 corporate insolvency cases documented as of September 2023 and an astounding amount of real estate projects that have stopped.

II. UNRAVELING THE STALEMATE: IBC AND RERA'S POWER STRUGGLE IN REAL ESTATE

The continuing battle for dominance in India's complex real estate market between the Real Estate (Regulation and Development) Act (RERA) and the Insolvency and Bankruptcy Code (IBC) is akin to a battle between two titans. In 2024, the conflict is still as vital as ever, with both laws vying for supremacy in deciding who gets the keys to justice in cases involving financially distressed developers. The struggle between these regulations not only draws attention to legal issues but also emphasizes the practical ramifications for creditors, developers, and purchasers who are caught in the crossfire.[4]

A major point of friction stems from Section 238 of the IBC which states that "*the provisions of this Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law*."[5] Hence, this provision gives the Code an overriding effect over any other law in case of conflict. Consequently, its provisions acquire primacy, and cannot be read as subordinate to the RERA Act. This has made it difficult to fully integrate IBC

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[4] Vidushi Puri and Kandarp Jha, 'Empowering the Revival of the Real Estate Sector: The Transformative Impact of the Insolvency and Bankruptcy Code' (*IBC Laws*, 7 March 2024) <https://ibclaw.in/empowering-the-revival-of-the-real-estate-sector-the-transformative-impact-of-the-insolvency-and-bankruptcy-code-by-vidushi-puri-kandarp-jha/> accessed 13 September 2024.

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

and RERA, as insolvency proceedings often halt the remedies that RERA provides to homebuyers. Despite their recognition as financial creditors under IBC, homebuyers' claims can be sidelined when creditors' recovery takes center stage.[6]

In response, courts have adopted creative solutions like the Project-wise Corporate Insolvency Resolution Process (CIRP). This project-specific approach allows incomplete real estate projects to be completed even as broader insolvency processes for developers continue. These judicial innovations aim to restore confidence in the sector, but the tussle between IBC and RERA continues, with Section 238 often tipping the scales in favor of insolvency over regulatory protections.[7]

At the heart of the conflict lies the question: Which law should prevail? Oftentimes, IBC puts liquidation ahead of project completion, serving as the creditors' guardian angel and concentrating on cash recovery through corporate insolvency resolution.[8] By guaranteeing the delivery of homes and providing compensation for delays, RERA, on the other hand, advocates for the interests of homebuyers. IBC stresses prompt resolution, whereas RERA offers protection; yet, the two are not necessarily complementary. It's like two sides of the same coin.

Even while courts have decided that in cases of dispute, the Insolvency and Bankruptcy Code (IBC) takes precedence over other legislation, actual

[6] Dr. Anup P. Shah, 'IBC or RERA? And the Winner is...!' (2019) Bombay Chartered Accountant Journal <https://bcajonline.org/journal/ibc-or-rera-and-the-winner-is/> accessed 13 September 2024.

[7] Devashish Bhattacharyya, 'Reimagining Insolvency Resolution: Reverse CIRP A Game-Changer For India's Real Estate Sector' (*LiveLaw*, 28 October 2023) <https://www.livelaw.in/articles/reimagining-insolvency-resolution-reverse-cirp-a-game-changer-for-indias-real-estate-sector-241056> accessed 13 September 2024.

[8] Winnie D'Monte, 'Homebuyers under the Insolvency and Bankruptcy Code, 2016' (2022) 3(1) Jus Corpus Law Journal <https://www.juscorpus.com/wp-content/uploads/2022/10/46.-Winnie-DMonte.pdf> accessed 13 September 2024.

home has frequently been reduced to an unending game of snakes and ladders, where every advancement is followed by a fall back to the starting point due to delayed projects, stalled development, and dishonest business methods.

Unfortunately, a lot of vulnerable homebuyers are forced to engage in drawn-out legal fights in consumer forums in an attempt to make up for the lack of service. Further, due to the conflict between IBC and RERA, which both give priority to different stakeholders, there is a complex web of legal and practical issues that continue into 2024.[12]

A. The Evolving Status of Homebuyers under the IBC

The Indian Bankruptcy Code **(**IBC) categorizes creditors into two groups: financial and operational. Under Section 9, operational creditors, such as suppliers of goods or services, can initiate the Corporate Insolvency Resolution Process (CIRP).[13] Section 7 allows financial creditors, typically lenders, to initiate the process.[14] Initially, real estate buyers were not directly included in these categories and were merely spectators in the insolvency proceedings, as their legal status remained ambiguous under the IBC framework. The NCLT ruled in early cases such as *Col. Vinod Awasthy v. AMR Infrastructure Ltd.[15]* that homeowners were not eligible to be considered operational creditors, so directing them to pursue remedies under consumer protection legislation. This decision highlighted the uncertainty surrounding homebuyers' status in insolvency proceedings.[16]

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[12] Shreyas Kulkarni and Rajvardhan Pathak, 'Analysis of Overlapping Provisions in RERA and IBC' (2024) 2(16) White Black Legal International Law Journal <https://www.whiteblacklegal.co.in/details/analysis-of-overlapping-provisions-in-rera-and-ibc-by---shreyas-kulkarni-rajvardhan-pathak> accessed 13 September 2024.
[13] Insolvency and Bankruptcy Code 2016, s 9.
[14] Insolvency and Bankruptcy Code, 2016, s 7.
[15] *Col. Vinod Awasthy v AMR Infrastructure Ltd.* [2017] SCC OnLine NCLT 16278.
[16] Hariharan Venkateshwaran, 'Financial Creditor, Operational Creditor and An Overview on Home-Buyers under Indian Bankruptcy Code' (2020) 15 Supremo Amicus Journal

The winds of change began to blow with the case of *Nikhil Mehta and Sons (HUF) v. AMR Infrastructure Ltd.,*[17] the NCLT initially ruled that homebuyers were not financial creditors, reasoning that their transactions did not involve the "time value of money." Instead, the NCLT viewed these as simple sale transactions.[18] However, the NCLAT overturned this decision, holding that funds invested by homebuyers should be treated as financial debts under Section 5(8)[19] of the IBC and money obtained from homebuyers through guaranteed return programs had the commercial flavor of borrowing, making them eligible to receive Section 5(7)[20] of the IBC compensation as financial creditors. This ruling marked a significant shift, acknowledging that homebuyers are indeed financial creditors.[21]

This principle was further reinforced in *Anil Mahindro & Anr. v. Earth Iconic Infrastructure (P) Ltd.*[22], where the NCLAT again emphasized that homebuyers who had been promised assured returns would qualify as financial creditors. However, this led to confusion regarding the status of homebuyers not assured of returns, as they were not classified as financial creditors or operational creditors under the Code.[23] At this stage, homebuyers could only file claims as "other creditors," without the ability to initiate insolvency

<https://supremoamicus.org/wp-content/uploads/2020/01/A11.v15.pdf> accessed 13 September 2024.

[17] *Nikhil Mehta and Sons (HUF) v AMR Infrastructure Ltd.* [2017] SCC OnLine NCLAT 219.

[18] Ministry of Corporate Affairs, *Report of the Insolvency Law Committee* (March 2018) <http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf> accessed 13 September 2024.

[19] Insolvency and Bankruptcy Code 2016, s 5(8).

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

[21] *Yadubir Singh Sajwan & Ors. v Som Resorts Private Limited*, Company Petition No. (IB)-67(ND)/2022 (National Company Law Tribunal, 2 August 2022).

[22] *Anil Mahindro & Anr v Earth Iconic Infrastructure (P) Ltd*, Company Appeal (AT) (Insolvency) No. 74 of 2017 (National Company Law Appellate Tribunal, 2 August 2017).

[23] Pratik Datta, 'Value Destruction and Wealth Transfer under the Insolvency and Bankruptcy Code, 2016' (2018) NIPFP Working Paper Series, No. 247 <https://www.nipfp.org.in/media/medialibrary/2018/12/WP_247.pdf> accessed 13 September 2024.

proceedings.[24] To address this issue, the Insolvency and Bankruptcy Board of India (IBBI) introduced Form CA in 2017, allowing homebuyers to file claims within a specialized framework.[25]

B. Judicial and Legislative Milestones

The judiciary's role as a knight in shining armor for homebuyers was further cemented by the Supreme Court in *Chitra Sharma v. Union of India.*[26] In a historic ruling, the Court recognized homeowners as financial creditors and designated a senior attorney to protect their rights before the Committee of Creditors (CoC).[27] With this landmark decision, homebuyers were guaranteed to take an active role in the insolvency resolution process rather than being passive observers.[28] Additionally, in *Jaypee Orchard Resident Welfare Society v. Union of India,*[29] the Supreme Court reassured homebuyers by affirming that the Court would do everything in its power to protect their interests.

Quickly after, legislative changes were made. A clarification was added to Section 5(8)(f) of the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, which states that "*any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing*", so the funds raised from homebuyers in real estate projects would be regarded as having the commercial effect of borrowing.[30] With the help of this legislative change, homeowners' rights as creditors were

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[24] *Rubina Chadha & Anr. v AMR Infrastructure Ltd.*, Company Appeal (AT) (Insolvency) No 8 of 2017 (National Company Law Appellate Tribunal, 21 July 2017).
[25] Insolvency and Bankruptcy Code 2016, Reg 8A; Form CA.
[26] *Chitra Sharma v Union of India* [2018] 18 SCC 575.
[27] Insolvency and Bankruptcy Code 2016, s 21(2).
[28] Insolvency and Bankruptcy Code 2016, s 30(4).
[29] *Jaypee Orchard Resident Welfare Society v Union of India*, Writ Petition (Civil) No 854 of 2017 (Supreme Court, 18 September 2017).
[30] Insolvency and Bankruptcy Code 2016, s 5(8)(f).

strengthened, and developers were held responsible for any delays or defaults.[31] However, the amendment did not escape scrutiny. In *Pioneer Urban Land and Infrastructure Ltd. v. Union of India,*[32] the Supreme Court upheld the amendment's constitutionality, ruling that it merely clarified existing provisions rather than undermining any fundamental legal principles. This marked yet another victory for homebuyers in the judicial arena and further solidifying their position in insolvency proceedings.

The evolution of this legal battleground continued with *Vishal Chelani and others v. Debashis Nanda,*[33] where the Supreme Court decided that homebuyers could not be treated differently from other financial creditors under the IBC, even if they had received favourable verdicts under RERA. This decision marked the continuation of the growth of this legal conflict. By guaranteeing that RERA orders wouldn't impair homebuyers' standing under the IBC, this ruling upheld the equity between them and other creditors. Similarly, in *Tarun Ahuja & Ors. v. Puri Construction Private Limited,*[34] the NCLT Delhi reaffirmed that homebuyers' status as financial creditors under Section 5(8)(f) of the IBC remained intact, regardless of whether they had previously sought remedies through RERA or the National Consumer Disputes Redressal Commission (NCDRC).[35]

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[31] Ministry of Corporate Affairs, 'President Approves Promulgation of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018' (*Press Information Bureau*, 6 June 2018) <https://pib.gov.in/PressReleasePage.aspx?PRID=1534497> accessed 13 September 2024.

[32] *Pioneer Urban Land & Infrastructure Ltd. v Union of India* [2019] 8 SCC 416.

[33] *Vishal Chelani & Ors. v Debashis Nanda*, Civil Appeal No 3806 of 2023 (Supreme Court, 6 October 2023).

[34] *Tarun Ahuja & Ors. v Puri Construction Private Ltd.*, Company Petition (IB) No. 755/PB/2020 A/W IA No 6091/ND/2022 (National Company Law Tribunal, 24 January 2024).

[35] Aryan Raj, 'NCLT Delhi: 'Homebuyers' Seeking Redressal Through 'RERA' Or 'NCDRC' Prior To Approaching 'NCLT' Retain Their Status As Financial Creditors' (*LiveLaw,* 27 August 2024) <https://www.livelaw.in/ibc-cases/nclt-delhi-homebuyers-seeking-redressal-through-rera-or-ncdrc-prior-to-approaching-nclt-retain-their-status-as-financial-creditors-248297> accessed 13 September 2024.

C. The Dual Implications of Financial Creditor Status

The recognition of homebuyers as financial creditors has indeed equipped them with a powerful tool to hold developers accountable, yet it has simultaneously woven a complex web of challenges. Homebuyers can now put pressure on developers, but they are now in direct rivalry with bigger financial players inside the Committee of Creditors thanks to their unique standing. Due to their emphasis on financial recovery, banks and other institutional creditors could prefer liquidation in order to recover their investments, while purchasers understandably want to see the project completed.[36] All parties involved must carefully navigate the delicate balancing act of aligning these frequently at odds interests, which makes achieving harmony and a successful resolution a huge and ongoing struggle.

The primary question still stands: which should come first, the IBC or RERA? This legal battle was made very clear in the *Jaypee Infratech case*,[37] when the Supreme Court raised serious concerns in *Chitra Sharma v. Union of India* about the potential for egregious unfairness if the IBC's waterfall mechanism put homebuyers at the bottom of the creditor hierarchy.[38] The Court issued a dire warning, stating that making house buyers into nothing more than puppets in the bankruptcy proceedings would tip the scales against justice. While the IBC's overriding provisions often cast a shadow over these protections, RERA is intended to safeguard homebuyers by guaranteeing project completion and compensating for delays, creating a complex legal environment for all parties involved.[39]

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[36] Shweta Bharti and Jatin Chadda, 'Journey of Home Buyers under IBC' (*Bar and Bench,* 7 May 2024), <https://www.barandbench.com/law-firms/view-point/journey-of-home-buyers-under-ibc> accessed 13 September 2024.
[37] Ministry of Corporate Affairs (n 31).
[38] Insolvency and Bankruptcy Code 2016, s 30(4).
[39] L Viswanathan, Srideepa Bhattacharyya, Aditya Marwah & CAM Disputes Team, 'Resetting the Clock: Supreme Court Sends Jaypee Infratech Limited Back to NCLT for CIRP'

As the tension between RERA and IBC persists, the CIRP is tasked with managing these competing interests. In the CIRP, homebuyers' role—now acknowledged as financial creditors—has grown in importance. Nevertheless, managing insolvency with institutional creditors presents unique difficulties since it necessitates a careful balancing act between project completion and financial recovery.[40]

D. Homebuyers as Secured or Unsecured Financial Creditors

The difference between secured and unsecured debt is not merely a legalese quirk; it has important implications for homebuyers. In the language of finance, a "secured creditor" is a person who has a security interest, a legal lifeline over property, to ensure that a debt or loan is repaid. This security interest may be represented by any kind of encumbrance on the property, such a mortgage, charge, hypothecation, assignment, or other. The party who gains from this charge is known as the "secured creditor," and the property that is subject to it is called "security."[41]

A landmark decision was rendered by the National Company Law Appellate Tribunal (NCLAT) of New Delhi in the landmark case of *Flat Buyers Association v. Umang Realtech Pvt.* Ltd.[42] It stressed that the corporate debtor (CD) builds the units or infrastructure in a real estate project with the

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(*Cyril Amarchand Mangaldas,* 27 August 2018) <https://corporate.cyrilamarchandblogs.com/2018/08/resetting-clock-supreme-court-sends-jaypee-infratech-limited-back-nclt-cirp/> accessed 11 September 2024.

[40] Ms. Mehreen Garg & Prof. Arjya B. Majumdar, 'The Homebuyers' Conundrum in Real Estate Insolvency' (*Insolvency Law Academy*) <https://insolvencylawacademy.com/the-homebuyers-conundrum-in-real-estate-insolvency/> accessed 11 September 2024.

[41] Aditya Khadria and Sivaprakasam Babu, 'Are Home Buyers Secured Financial Creditors or Unsecured Creditors under IBC?' (*The Economic Times*, 10 August 2018) <https://economictimes.indiatimes.com/wealth/real-estate/are-home-buyers-secured-financial-creditors-or-unsecured-creditors-under-ibc/articleshow/65332287.cms> accessed 11 September 2024.

[42] *Flat Buyers Association Winter Hills v Umang Realtech Pvt. Ltd. and Ors.* [2020] 10 SCC 549.

intention of selling them to homebuyers. They cannot get these assets, which are technically collateral for secured creditors.[43] Rather, they have to be distributed to the allottees, or homeowners, who fall under the category of unsecured creditors. The truth is that banks would usually prefer not to have their loans secured by the property of houses or apartments. On the other hand, purchasers who lack secured credit have a legitimate interest in these properties. *Rajesh Goyal v. Babita Gupta*, the case that followed, confirmed and reinforced this interpretation.[44]

Upholding the Rajasthan High Court's position, the Supreme Court weighed in on this matter in *Union Bank of India v. Rajasthan Real Estate Regulatory Authority*[45]. The court confirmed that RERA complaints are still eligible to be filed even in cases when a bank seizes a project as a secured creditor under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) because of a promoter's delinquency.[46] The court made the sensible decision to uphold RERA's provisions in recovery proceedings if they conflict with those of the SARFAESI Act.[47] In the High Court's ruling, the provisions of RERA were also covered. After a promoter enters into an agreement to sell an apartment, they are not allowed to mortgage the property or place any kind of charge on

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[43]Harshit, 'Homebuyers as Financial Creditors under IBC: An Analysis of Pioneer Urban Case' (*Centre for Business and Financial Laws*, 19 July 2023) <https://www.cbflnludelhi.in/post/homebuyers-as-financial-creditors-under-ibc-an-analysis-of-pioneer-urban-case> accessed 11 September 2024.

[44] *Rajesh Goyal v Babita Gupta*, Company Appeal (AT) (Insolvency) No 1056 of 2019 (National Company Law Appellate Tribunal, 19 November 2019).

[45] *Union Bank of India v Rajasthan Real Estate Regulatory Authority*, Civil Writ Petition No 13688/2021 (High Court of Rajasthan, 14 December 2021).

[46] 'RERA Can Entertain Complaints Filed by Home Buyers Against Banks' (*India Law*, 18 February 2022) <https://www.indialaw.in/blog/real-estate/rera-can-entertain-complaints-filed-by-home-buyers-against-banks/> accessed 11 September 2024.

[47] Moneylife Digital Team, 'Unity amongst Home-buyers is Important in Insolvency Cases' (*Moneylife*, 16 August 2021) <https://www.moneylife.in/article/unity-amongst-home-buyers-is-important-in-insolvency-cases/64874.html> accessed 11 September 2024.

it, as per Clause (h) of Sub-section 4 of Section 11 of the RERA Act, 2016.[48] The allottee's rights and interests who have already secured or agreed to secure the apartment or flat cannot be compromised by any such mortgage formed later.[49]

In many cases, homebuyers take out loans to purchase their flats and mortgage these properties to the lending bank. While they are generally considered unsecured creditors, it is crucial to ensure their interests are not left hanging in the balance.[50] This protection is often secured through judicious judicial interpretations of relevant statutes, which help in defending homebuyers' rights robustly.

E. Reconciling RERA and IBC in Insolvency Law

The 2020 Amendment to the IBC introduced a threshold for homebuyers to initiate insolvency proceedings.[51] This requirement was upheld by the Supreme Court in the case of *Manish Kumar v. Union of India,* and it required at least 100 homebuyers, or 10% of allottees, to combine to file an application.[52] To promote equitable treatment, the NCLAT's decision in *Puneet Kaur v. K V Developers Private Limited*[53] guaranteed that even homebuyers' unfiled claims would be taken into account in the corporate debtor's information memorandum, if it was recorded.[54]

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48 Real Estate (Regulation and Development) Act 2016, s 11(4)(h).

49 G S Bajpai and Neha Kapur, 'The Primacy of Homebuyers over Financial Institutions: The RERA and SARFAESI Conundrum' (*The Leaflet,* 19 June 2022) <https://theleaflet.in/the-primacy-of-homebuyers-over-financial-institutions-the-rera-and-sarfaesi-conundrum/> accessed 11 September 2024.

50 *Hadley v Baxendale* [1854] 9 Exch. 341.

51 Insolvency and Bankruptcy (Amendment) Act 2020.

52 *Manish Kumar v Union of India* [2021] SCC OnLine SC 30.

53 *Puneet Kaur v K V Developers Private Limited*, Company Appeal (AT) (Insolvency) No. 390 of 2022 (National Company Law Appellate Tribunal, 1 June 2022).

54 Mitali Ingawale and Sumit Kulkarni, 'Deconstructing the Threshold Requirements for Homebuyers under IBC' (*SCC Online,* 20 June 2021)

The difficulty of reconciling the goals of RERA and IBC highlights how intricate India's real estate regulatory environment is. The ruling in *Bikram Chaterji v. Union of India*[55] by the Supreme Court emphasizes the continuous necessity of striking a balance between these conflicting interests. Given this context, a thorough grasp of the bankruptcy landscape necessitates an awareness of how CIRP handles these problems.

IV. PROJECT-WISE CIRP: AN INNOVATIVE JUDICIAL APPROACH

The Corporate Insolvency Resolution Process ('CIRP') as given in the Insolvency and Bankruptcy Code (IBC), 2016 is a mechanism for the recovery of debts from the corporate debtors to the creditors. Earlier, when the CIRP of a real estate company was initiated then all the projects of that company were stalled for the CIRP process. This process would inevitably uncover cash flow problems; drive out possible resolution applicants; and cause homebuyers even more suffering. Moreover, the resolution applications would have to make huge financial commitments in order to succeed. Hence, there were some inherent issues in the regular CIRP process which would not work in every case of real estate insolvency when the resolution process was initiated.

This position changed in the case of *Flat Buyers Association v. Umang Realtech Pvt. Ltd*.[56] wherein for the first time, the National Company Law Appellate Tribunal (NCLAT) introduced the concept of project-wise CIRP.[57]

<https://www.scconline.com/blog/post/2021/06/20/homebuyers/> accessed 11 September 2024.

[55] *Bikram Chaterji v Union of India* [2019] SCC OnLine SC 901.

[56] *Rajesh Goyal v Babita Gupta* (n 44).

[57] Sumite Chatterjee, 'Reverse CIRP Under the Insolvency and Bankruptcy Code: NCLAT's Innovative Approach to Protect the Interests of Homebuyers' (January, 2023) Indian Journal of Projects, Infrastructure and Energy Law <https://ijpiel.com/index.php/2023/01/06/reverse-cirp-under-the-insolvency-and-bankruptcy-code-nclats-innovative-approach-to-protect-the-interests-of-homebuyers/> accessed 13 September 2024.

The court's reasoning was that in order to secure the interest of the allotees as well as the real estate companies and also, to not hamper the completion of other projects that also provide a large number of jobs, the reverse CIRP has to be followed in that particular case. This concept was further reiterated in the case of Manish Kumar v. Union of India[58] wherein the court explained that project-wise CIRP would be at different stages of completion. Hence, it would be burdensome to include all the projects in the CIRP process. However, in the case of *N Kumar v. M/S Tata Capital Housing Finance Limited,*[59] the NCLT held that the mechanism that was adopted by NCLAT in the Flat Buyer's Association case was based on the facts and circumstances of that particular case and it cannot be applied in the present case. But again, in the case of *India Bulls Asset Reconstruction Company Limited v. Ram Kishore Arora and Ors,*[60] the court supported the concept of reverse CIRP. It said that instead of ordering the CIRP of all the ongoing projects which will lead to the stoppage of these projects, it is better to find a solution which is viable as well as beneficial to all. And the solution is project-wise CIRP. Moreover, if the court orders the CIRP of all the projects, it will cause injustice to the parties especially because it will affect the homebuyers because the ongoing projects will not be completed.

In *Rajesh Goyal v. Babita Gupta and Ors*,[61] the corporate debtor's operations were managed as a continuing concern in order to finish the defaulted project and deliver it to the allottees. The Supreme Court subsequently noted in *Anand Murti v. Soni Infratech Private Limited and*

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[58] Mitali Ingawale and Sumit Kulkarni (n 54).

[59] *N Kumar v M/S Tata Capital Housing Finance Limited*, Intervention Application (I.B.C) No. 1245(CHE)/2020 (National Company Law Tribunal, 25 April 2022).

[60] *India bulls Asset Reconstruction Co. Ltd. v Ram Kishore Arora & Ors.* [2023] SCC OnLine SC 436.

[61] *India Law* (n 46).

Anr.[62] that the corporate debtor's promoter's project completion proposal will serve the interests of the allottees. The Apex Court further stated that there is a good chance that the already-estranged allottees would have to pay greater escalations in a third-party Resolution Plan if regular CIRP was carried out. Thus, the promoter was subsequently given permission to invest in and finish the ailing housing project while being watched over by the Resolution Professionals and the Court. This shows the courts' solution-oriented approach of the sectoral concerns.

Further, the Supreme Court in *Swiss Ribbons Private Limited and Anr. v. Union of India and Ors.*,[63] opined that the Insolvency Code is a piece of legislation that addresses economic issues and, more broadly, the national economy and thus, it is extremely important to continue economic experimenting, and denying someone the freedom to do so could have dire repercussions for the country. All these recent judgements show the judicial support for the concepts such as project-wise CIRP.

The Insolvency and Bankruptcy Board of India (IBBI) proposed amendments to the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 through two consultation papers in November, 2023. These two papers addressed the issue of real estate insolvency[64] and measures to be taken to streamline the corporate insolvency resolution process (CIRP)[65] respectively. Then, finally in February 2024, some of the proposals

[62] *Anand Murti v Soni Infratech Private Limited & Anr*. [2022] SCC Online SC 519.

[63] *Swiss Ribbons Private Limited & Anr. v Union of India & Ors.* [2019] SCC Online SC 73.

[64] Insolvency and Bankruptcy Board of India, *Discussion Paper: Real-Estate Related Proposals – CIRP & Liquidation* (November, 2023), <https://ibbi.gov.in/uploads/public_comments/Discussion_Paper_Real_Estate_November2023_Final.pdf> accessed September 13, 2024.

[65] Insolvency and Bankruptcy Board of India, *Discussion Paper on Amendments to Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Process) Regulations, 2016* (November, 2023), <https://ibbi.gov.in/uploads/whatsnew/b70daeb0fbec8cc61d1afc52e9e9fbb8.pdf> accessed September 13, 2024.

that were mentioned in these consultation papers were incorporated in the CIRP regulations[66] through a notification by the IBBI. One of the effects of the amendment is that separate bank accounts would be maintained for each real estate project by the Interim Resolution Professionals (IRP) or Resolution Professionals (RP) which is given in the newly inserted Regulation 4-D of the CIRP Regulations.[67] This is in line with the Real Estate (Regulation and Development) Act, 2016. There will be a separate record of financial transactions and other such details of each real estate project. This will help in tracking the records of each project including the receipts and payments.[68] Furthermore, it will help in checking the issues if there are any and will further improve the decision-making process. It will also bring accountability.

Another amendment with respect to the CIRP is Regulation 36-A (1), which says that there may be a separate resolution plan for each real estate project or group of projects of the corporate debtor.[69] This amendment takes into account the fact that a real estate company may have different projects going on at the same time and they may be at different stages of completion. Hence, project wise CIRP would be a better approach as it would be justice for the homebuyers as they would want the possession of the house as early as they can get rather than it being delayed.

The Amendment is a reflection of a continuous endeavour to hone and enhance the insolvency resolution process in order to fulfill its goals of openness, value maximization, and equitable treatment of stakeholders. It

[66] Insolvency and Bankruptcy Board of Inia (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations 2024.
[67] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations 2024, Regn. 4-D.
[68] Satyasrikant Vutha and Vaidehi, 'Real Estate: IBBI Notifies Project Wise Resolution Rules' (*Lexology*, March 21, 2024) <https://www.lexology.com/library/detail.aspx?g=4d79aaaa-3ca1-45de-8db5-eb5dd04501e8> accessed September 13, 2024.
[69] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations 2024, Regn. 36-A (1).

emphasizes taking a proactive approach to improve the CIRP's efficacy and efficiency. With a focus on filling in gaps in the insolvency resolution process across the country, these amendments demonstrate the IBBI's commitment to addressing issues that impede the efficiency of CIRP in India as well as its awareness of real-world difficulties. But there are still important factors to take into account. For insolvency resolution in India to be effective and efficient, more clarification and changes are required.

V. CHALLENGES OF DELAYS AND RESOURCE CONSTRAINTS: THE SYSTEM'S BOTTLENECKS

IBC is a complex process because of multiple stakeholders, resolution plan which in itself is a long process, legal proceedings and timelines. This adds to the financial and emotional suffering to the homebuyers. Section 7 of the IBC states three ways in which a financial creditor which includes homebuyers can initiate the CIRP. These are either by itself, jointly with other financial creditors or any other person on behalf of the financial creditor.[70] This enabling provision allowing the financial creditor itself to initiate the CIRP by filing an application for it was a welcome provision until the 2020 Amendment. The amendment added the proviso which prescribes that the minimum number of creditors should either be hundred or ten percent of the total creditors of the same class whichever is less.[71] This took away the right of the financial creditor to file an application by itself for initiating CIRP proceedings against the corporate debtor as now a certain number of creditors are required to do so. This is a clear violation of the right of a homebuyer to recover the debt as the proviso further complicates the process and causes distress to him who is already struggling to get justice.

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[70] Insolvency and Bankruptcy Code 2016, s 7.
[71] Insolvency and Bankruptcy (Amendment) Act 2020.

In the case of *Pankaj Mehta v. M/s. Ansal Hi-tech Township Limited*[72], the NCLAT held that CIRP cannot be initiated because the petitioners in this case are from different projects of the corporate debtors and hence, they fail to establish their case as creditors of a class and fulfil the minimum requirement given under Section 7 of the IBC. In this case, the project was not completed even after twelve years. Hence, the homebuyers wanted the recovery of their debt. However, since the minimum requirement for initiating CIRP was not fulfilled, they were not allowed to initiate the proceedings.

Every law is created with practical concerns and implementation-related risks in mind. It is very impractical to expect a homebuyer who wants to initiate CIRP to collect ninety-nine more such persons or ten percent of the total creditors with the same interest and that too of the same project.[73] It is very uncertain that the homebuyer would be able to collect such number of creditors as it is difficult to get the information of such creditors. This is also because generally, such information is with the corporate debtor and there is no reason for keeping information of other creditors. There may also be the case that a single homebuyer has the grievance and other creditors might not be interested in assisting or helping him. Hence, convincing them to file an application for beginning the CIRP against a Corporate Debtor is both unnecessary and unrealistic.

Homebuyers are categorized as unsecured creditors under IBC as evident by various judgements of the court. They are placed below secured creditors in the priority list of debt repayment or proceeds of asset sale. Moreover, IBC also does not prescribe the order of repayment among secured creditors.

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[72] *Pankaj Mehta v M/s. Ansal Hi-tech Township Ltd.*, Company Appeal (AT) (Insolvency) No. 248/2023 (National Company Law Appellate Tribunal, 1 April 2024).

[73] Shweta Bharti and Jatin Chadda (n 36).

An additional source of strain on the system is the lack of benches and judges in the courts, which causes delays in the resolution of bankruptcy cases.[74] Due to backlogs caused by this lack of judicial resources, homeowners' misery is exacerbated when the settlement process takes longer than expected. Despite the IBC's goal of streamlining insolvency procedures, homebuyers frequently find themselves on the receiving end of the system's current design.[75] The 2020 Amendment, judicial resource limitations, and procedural hold-ups combine to make the supposed recovery process into a hard and protracted battle. Legislative and procedural changes are therefore desperately needed to address these issues and enhance the protection of those homebuyers who are in the last stages of bankruptcy.

VI. CONCLUSION

Homebuyers' experience under the Insolvency and Bankruptcy Code (IBC) has been marked by both advancements and difficulties. The recent amendment of 2024 by incorporating project-wise CIRP is a welcome step. However, there are many other challenges and uncertainties that IBC and RERA face. Therefore, it is not the end here. There is a need to bring a few more amendments that cater to the needs of homebuyers and also address other challenges that are currently present in the acts. One such amendment can be to settle the position of the homebuyers as primary secured creditors so that

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[74] Shweta Bharti and Aeshwarya Sisodia, 'IBCs Efforts to Accommodate Real Estate Sector Challenges' (*Mondaq*, February 9, 2024) <https://www.mondaq.com/india/real-estate/1422364/ibcs-efforts-to-accommodate-real-estate-sector-challenges> accessed September 13, 2024.

[75] Aastha Roy and Rohan Mitra, 'Navigating Crossroads of IBC and RERA: Are We There Yet with Addressing Homebuyers Woes?' (*Mondaq,* June 7, 2023) <https://www.mondaq.com/india/insolvencybankruptcy/1326206/navigating-crossroads-of-ibc-and-rera-are-we-there-yet-with-addressing-homebuyers-woes> accessed September 13, 2024.

their interest is protected and they do not suffer because of the corporate debtors.

The principle of Pari Passu, which suggests that creditors in a bankruptcy proceeding be treated equally, is one of the main goals of insolvency proceedings. The tension between secured and unsecured debt in the context of India's real estate sector reveals deep-seated complexities that impact both financial institutions and homebuyers. Legislative amendments should be introduced to harmonize the IBC and RERA, ensuring that both secured creditors and homebuyers' interests are fairly represented. Developing detailed judicial guidelines can help courts balance these interests consistently. Additionally, creating a specialized insolvency mechanism for real estate projects, enhancing RERA's provisions to address insolvency scenarios, and improving coordination between regulatory bodies can provide more equitable outcomes.

In this way, a more safe and successful future for the real estate industry can also be imagined by proactively removing current obstacles and encouraging cooperation between all parties involved, including developers, homebuyers, and regulatory agencies.

SECURITIES AND REGULATORS IN THE DIGITAL AGE: RESOLVING THE 'RIPPLE' EFFECT OF CRYPTO-ASSETS

- *Vinish Maheshwari and Pranay Agarwal*[*]

ABSTRACT

In this technology-driven market, crypto-assets have gained much popularity globally in recent years. Crypto-assets in India are popularly recognised as 'cryptocurrencies ICOs and VDAs owing to their nature and the legal treatment under various statutes. While the high volatility has been questioned by several investors, the high return factor is indeed successful in appealing to household investors. However, the recent crypto crashes and the priority to investor safety have led the regulators to adopt a broader approach to enhance the scope of their jurisdictional powers. The battle that began between the crypto exchanges/companies and regulators culminated in the recent judgment of the US Supreme Court in the *Ripple* case where the narrow interpretation by the judiciary took over the basic objective of investor protection.

It will be contended in this paper that the judicial interpretations in the US including the *Howey* test have majorly failed to broaden the horizon of 'securities' and enhance the level of regulator protection. Rather, the rules of literal interpretations are unsuitable in the present case for accommodating technological advancement. Therefore, a different approach by the combined efforts of legislature and judiciary should be adopted. This is particularly essential in light of blanket bans on the assets by the regulators and government. Nevertheless, it will be argued at the same time that lack of judicial consensus among the market's recourse can either be found in the principles adopted in India and the EU which are comparatively more liberal or the legislature can step up to draft new regulations for the crypto-assets. This approach will give them both inclusive and differential treatment and therefore will be more effective in the coming times as well.

[*] Vinish Maheshwari and Pranay Agarwal are fifth-year students at Gujarat National Law University, Gandhinagar. Views stated in this paper are personal.

I. INTRODUCTION

In a technology-driven economy, the dynamism of the market is at its new height with the investors looking for new ventures and instruments to invest in. A significant factor for such market change is the introduction of crypto assets in the global economies as an attractive investing venture among both short-term and long-term investors. Crypto-assets had initially started as a medium of exchange in the market in the form of 'cryptocurrency'. However, the scepticism as well as the lack of regulatory institutions resulted in worldwide prohibitions on such assets. In India, the Reserve Bank of India (**RBI**) which acts as a nodal agency for the regulation of currencies and the money market has already reserved its decision on banning cryptocurrencies like Bitcoin and Ethereum due to the complexity of blockchain technology.[1] Nonetheless, the concept of virtual digital assets has been accepted in a more regulated form. The crypto-assets not having governing laws have therefore

[1] Nidhi Bhardwaj, 'RBI gov calls for an outright ban on cryptocurrency as Union Budget 2023 approaches' (*India Today,* 16 January 2023) <https://www.indiatoday.in/cryptocurrency/story/rbi-gov-calls-for-an-outright-ban-on-cryptocurrency-as-union-budget-2023-approaches-2322146-2023-01-16> accessed 19 August 2023.

remained largely unregulated by both the Securities and Exchange Board of India (**SEBI**) and RBI.

In the United States of America (**USA**), the situation is not much different where the crypto assets were out of the ambit of both the central bank and Securities and Exchange Commission (**SEC**). However, the crypto exchanges are regulated as per the Bank Secrecy Act, 1970 (**BSA**) under which the exchanges are required to be registered with the Financial Crimes Enforcement Network (**FinCEN**), maintain appropriate records and submit them to the relevant authorities.[2] The recent recommendations are to amend Article 12 of the Uniform Commercial Code to include virtual currencies in the definition of 'controllable electronic records' (**CER**).[3]

The inclusion though is subjected to the inclusion of the assets under the definition of 'control' which consists of substantial benefits derivation and exclusive derivative powers of the investor.[4] The problem if simply stated, is that not all assets can be classified under this criterion leaving some digital assets to remain unregulated. In this context, the nature of the assets can be specifically called into question. The exclusive derivation of benefits from any investment is possible only on the underlying contract between the investor and the issuer. With the anonymity issue of the crypto-assets unresolved, it is highly impractical to enforce such rights under the BSA which is more intermediary-centric.

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[2] 'FinCEN issues Guidance on Virtual Currencies and Regulatory Responsibilities' (*Financial Crimes Enforcement Network*, 18 March 2013) <https://www.fincen.gov/news/news-releases/fincen-issues-guidance-virtual-currencies-and-regulatory-responsibilities> accessed 2 September 2023. See also Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets, 85 Fed. Reg. 83840 (Proposed 23 December 2020)

[3] 'Securing the Digital Bag: Newly Promulgated UCC Article 12 and Amendments to UCC Article 9 Provide Guidance on Ownership of and Security Interests in Cryptocurrency and Other Digital Assets' (*JD Supra,* 26 April 2023) <https://www.jdsupra.com/legalnews/securing-the-digital-bag-newly-8901295/> accessed 2 September 2023.

[4] Uniform Commercial Code 1952, art 12, s 12-105.

In the post-COVID world, the economic reconstruction has been largely focused on welfare programmes and boosting market sentiments. In such a case, the regulatory mechanism concerning the crypto-assets is gradually shifting towards a more inclusive approach. As has been shown by recent studies and trends, crypto-assets are one of the much sought-after investment options in majorly middle-class households which see a big opportunity in these hard times of inflation and economic recessions.[5] In this sense, the crypto-assets play an important role in the reconstruction of the economies and raising the investor sentiments in the global markets.

However, the large amounts of investments in this sector which is still largely unregulated could be risky given its highly volatile nature. The fact is not hidden from the regulators and government as well which readily seeks to bring the assets within the ambit of their regulations for the sake of a general scheme of market integrity and investor protection. Considering the risks involved, it is necessary to examine how an inclusive approach can be adopted along with the role of the judiciary to play in this regard.

A. The Tale of SEC v. Ripple

The tussle of SEC v. *Ripple* (***Ripple***) had long been in due, dating back to 2020,[6] When SEC had filed a complaint in the District Court for the Southern District of New York. The *Ripple* case is important to understand considering the recent approach by the SEC towards the crypto-assets companies like Telegram[7] and Kik.[8]

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[5] Deren Aiello and others, The Effects on Cryptocurrency Wealth on Household Consumption and Investment' (2023) National Bureau of Economic Research Working Paper No. 31445 <https://www.nber.org/papers/w31445> accessed 10 September 2023.
[6] Securities and Exchange Commission, 'SEC charges *Ripple* and Two Executives with Conducting $1.3 Billion Unregistered Securities Offering' (*Press Release*, 22 December 2020) <https://www.sec.gov/news/press-release/2020-338> accessed 21 September 2023.
[7] *SEC v Telegram Grp. Inc* 448 F Supp. 3d 352 (S.D.N.Y. 2020).
[8] *SEC v Kik Interactive Inc* 492 F Supp. 3d 169, 175–80 (S.D.N.Y. 2020).

The SEC contended that is sale of XRP tokens was represented as an Investment Contract and is coming under the ambit of the securities. However, the previous conduct of SEC with *Ripple* is in paradox with their current litigation where they had told that XRP is not a security when *Ripple* was seeking permission to list XRP. The different summary judgements have brought different findings which have drawn the effects on the token's price. The judgement accounting for all the exhibits has given two brief points. Firstly, *Ripple's* issuance of XRP tokens is partly a security. However, such kind of ruling has brought a lot of debates from different experts.

The proponents of crypto-assets are of the view that in furtherance to the proactive approach of the SEC of not embracing a culture of decentralized finance, it has tried to adjudicate on the line of investor protection. In the cases of *Telegram* and *Kik*, the approach of the SEC has been to deploy fines on the companies who are not complying with the supposed mechanism. While Judge Torres has decided that the XRP token is not a security, certain transactions fall within the foul of the investment contract which is *Ripple's* conduct to do institutional sales. Moreover, the distribution of XRP is an unregistered transaction and is subject to Securities Act registration requirements. The consequence is that the American regulator has not settled with the judgement and has decided to file an interlocutory review on the adverse question of programmatic offers and sales to XRP market participants over such platforms and another distribution channel.[9]

Considering the danger posed by the judgment on its regulatory approach, the SEC has initiated a complaint before Binance and Coinbase on grounds of

[9] Jacquelyn Malinek, 'SEC Bites Back, to Appeal Federal Court Ruling in XRP Case' (*TechCrunch*, 10 August 2023) <https://techcrunch.com/2023/08/10/sec-appeal-federal-court-ruling-xrp-case-2023/#:~:text=In%20mid%2DJuly%2C%20a%20federal,was%20a%20security%20or%20not.> accessed 12 August 2023.

operation on unregistered exchange and involvement in the trading of crypto-assets, thus presuming them as 'security'. It is interesting to note that the approach taken in the *Ripple* case has not been accepted in the case of *SEC v. Terraform Labs* wherein adopting a pro-active approach, the differentiation between the purchasers of crypto-assets and other securities has been avoided to focus on the objective analysis of "*promise of profits based on their efforts*".[10]

B. Laws and Regulations for Crypto-assets

The lacuna left by the US Supreme Court has to be filled by the SEC and other market regulators through laws and regulations. The risk posed by the crypto-assets is large and with the US, India as well as other international regimes allowing to trade in crypto, it is essential to look into this aspect on an urgent basis.[11] With trading in crypto gaining momentum and the 2020-21 bubble burst of Bitcoin, regulators from both financial and commercial sectors are trying to exercise jurisdiction over the assets.[12] The financial regulations and the RBI guidelines in this respect, have proven subpar when it comes to the investing and trading activities in the country.

The crash of 2020-21 was eventually covered under the guise of the COVID-19 market fall and the resultant reduction of investing sentiments.[13]

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[10] *Securities and Exchange Commission v. Terraform Labs Pte Ltd.,* 1:23-cv-01346, (S.D.N.Y.).

[11] Vikas Dhoot, 'G20 could pave the way for crypto regulation, financial inclusion push' *The Hindu,(*New Delhi 6 September 2023) <https://www.thehindu.com/business/Economy/g20-reaches-consensus-on-crypto-regulation-financial-inclusion/article67277900.ece> accessed 10 September 2023.

[12] Tomy Wilson, 'Bitcoin plummets as cryptocurrencies suffer in market turmoil' (*Reuters,* 12 March 2020) <https://www.reuters.com/article/us-health-coronavirus-bitcoin/bitcoin-plummets-as-cryptocurrencies-suffer-in-market-turmoil-idUSKBN20Z1GA> accessed 9 September 2023

[13] Emily Flitter, 'It's hard to tell when the crypto bubble will burst or If there is one' *The New York Times (*New York 27 January 2022)

The solution to the problem was found in a complete blanket ban on dealing in the asset in the form of strict prohibitions.[14] However, the wisdom behind the step has been questioned by several scholars and eventually, the regulator itself which changed its stance from prohibition to regulation.

In this regard, the judgment given by the US Supreme Court can be said as a missed opportunity to offer the crypto-assets an inclusive treatment to a stricter regulatory framework designed for the 'securities'. Following the crypto bubble of 2021, faith in the crypto markets has severely suffered with a trickledown effect on other investing spheres as well. The Biden administration responded with the enhanced investor protection with the first-ever executive order on digital assets in 2022 which focuses on six key priorities: (1) investor protection; (2) financial stability; (3) illicit finance; (4) U.S. leadership in the global financial system; (5) financial inclusion; and (6) responsible innovation. See Executive Order, this is itself based on the premise that the government and the regulators are keen to maintain the market integrity while the judicial premise is instead towards balancing the rights and following the traditional principles of *Howey*.

For that purpose, the paper proposes insights into the interpretive value of the *Howey* test concerning the American jurisprudence on securities and market principles. Part II of the paper will specifically deal with the US jurisprudence along with the various course of interpretations which follow from the *Howey* test. The detailed analysis will lead to the conclusion that a wider and purposive interpretation keeping in mind the contemporary developments and the special circumstances in the case of *Ripple.* Part III will provide an in-depth analysis of the international outlook towards the term

<https://www.nytimes.com/2022/01/27/business/crypto-price-bubble.html> accessed 9 September 2023.

[14] Bhardwaj (n 1).

'securities. In this regard, the jurisprudence along with the legislative and regulatory framework of India as well as the European Union (**EU**) will be detailed. It will be contended in the part that though the judicial as well as the regulatory frameworks of these jurisdictions are against the complete inclusion of the crypto-assets, the broad definition given to 'securities' as well as the recent government actions has left some scope for future opportunity.

Part IV will mainly deal with the investigation of the different approaches from which the *Howey* judgment as well as the steps taken by India and EU can be seen. It is argued that the preventive approach taken by both India and the EU conforms with the international outlook towards crypto-assets. The preventive approach nevertheless, can be judged as the protectionist approach towards working a sustainable solution for such assets and the rapid technological advancements therefore, contemporary rules of interpretation as well as different factual circumstances of *Ripple* and similar assets should be taken into account. While the paper in the ultimate part presents the final thoughts over the issue along with relevant solutions, the recommendations are rather broad and conflicting with the banking regulations, the resultant possible contradictions as well as the specific regulatory suggestions are not dealt with in this paper.

II. CRYPTO-ASSETS IN THE US REGIME

Regulating the new elements in the securities market has not been a new phenomenon. With the introduction of crypto-assets in the market, the cautious US regime also reacted to control and regulate the new form of investment. Though the actions of the SEC are not any different to regulators of other nations, the approach taken differs depending on the powers and philosophy of that market regulator.[15] Where Japan adopted to establish the Japan Virtual Currency Exchange Association **(JVCEA)** as a self-regulatory body[16] and specialised laws,[17] The Financial Conduct Authority **(FCA)** of the United Kingdom **(UK)** preferred conventional mechanisms of anti-money laundering and terrorist financing procedures to achieve the desired objective.[18] The US regime however is a different one with changing dynamics over the years and therefore has been examined in more detail to provide insights on the real intention behind devising the *Howey* test.

A. Evolution of Securities Law in the US

The US has been a major forerunner when it comes to economic development and financial markets since the dawn of the 20th century.[19] While the nation got the resources it needed to progress including efforts from the immigrant workforce, a major factor behind the success was the rising tension and scepticism among the European powers.[20] Nonetheless, the securities markets as well as trading companies were thriving in this age as well necessitating the state to regulate the huge amount of investments coming into the securities market.

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[15] Eddy Wymeersch, 'Global and Regional Financial Regulation: The Viewpoint of a European Securities Regulator' (2010) 1(2) GLOBAL POLICY 201, 203.
[16] Clark Sonksen, Cryptocurrency Regulations in ASEAN, East Asia & America: To Regulate or Not to Regulate (2021) 20 WASH. U. GLOBAL STUD. L. REV. 171, 178.
[17] Kamshad Mohsin, 'Cryptocurrency Legality and Regulations – International Scenario' (2022) 2(1) INT. J. CRYPTOCURRENCY *Res.* 19, 23.
[18] Sherena Seng Huang, 'Crypto assets regulation in the UK: An assessment of the regulatory effectiveness and consistency' (2021) 29(3) J. FIN. REG. COMPLIANCE 336.
[19] Michael Dennis and Anand Toprani, 'The financial foundations of U.S. hegemony: Rethinking modern monetary theory' (*Centre for International Maritime Security,* 14 October 2021) <https://cimsec.org/the-financial-foundations-of-u-s-hegemony-rethinking-modern-monetary-theory-part-1/> accessed 23 August 2023.
[20] Christopher Layne, 'The warning of US hegemony – myth or reality? A review essay' (2009) 34(1) INT. SECURITY 147, 168.

In this respect, the US substantive law being influenced by the high liberalist and capitalistic ideals preferred the *'contracting regime'* to facilitate the entrepreneurs and shareholders by providing a standard set of rules and regulations[21] thus reducing transaction costs and *lubricating the bargain* between the contracting parties. It may be though contended that the disclosure requirements were still in place, the mandatory disclosure mechanism for public offerings focused on hidden profits of promoters or brokers who claimed to be acting on behalf of investors.[22] The US legal position was soon altered by the Wall Street crash of 1929 and its far-reaching ramifications.

The introduction of the Investment Companies Act of 1940 marked the start of a *'regulatory regime'* where the state instead of *lubricating* began *restricting* the contracting or bargaining.[23] The result was due to the change in the ideology regarding the securities market which was then seen as highly volatile and beset by market failures, thus crashing the investing sentiments. Further, the disclosures were made more stringent making it difficult for companies to avoid these regulations without incurring the wrath of the SEC.[24] While the change in the approach has been questioned by various economists and finance experts on the grounds of its effectiveness and failure in achieving the desired objective,[25] It remained undisputed that the change brought a major

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[21] Rafael la Porta, Florencia Lopez de Silanes and Andrei Shleifer, What Works in Securities Laws? (2006) 61 J FIN 1, 5-20; Paul G Mahoney, 'The Development of Securities Law in United States' (2209) 47(2) J ACCOUNTING RES 325, 325-27.
[22] Donald C. Langevoort, 'Taming the Animal Spirits of the Stock Markets: A Behavioural Approach to Securities Regulation' (2002) 97 NW U L REV 135, 142-47.
[23] Mahoney (n 21).
[24] Paul G. Mahoney, 'Mandatory Disclosure as a Solution to Agency Problems' (1995) 62 U CHICAGO L REV 1047, 1049-53.
[25] Mahoney (n 21); Gregg A. Jarrell and Michael Bradley, 'The Economic Effects of Federal and State Regulations of Cash Tender Offers' (1980) 23(2) J LAW ECON 371.

transition in the US securities law regime which was to be felt in the coming years.[26]

One of the many repercussions was the beginning of shareholder activism in the US in 1942 which was a consequence of a *regulatory* rule of the SEC which allowed the shareholders to submit proposals for inclusion on corporate ballots.[27] The movement itself saw a tremendous evolution where the domination changed from individual investors to institutional investors.[28] Thus indicating greater protection for public funds. The changing dynamics were further triggered by the '*millennium scandals'* which led to the highest levels of protection under corporate governance laws.[29] and the contentious Sarbanes-Oxley Act (**SOX**)[30] Which showcases the erroneous '*guns-blazing'* approach of the Congress.[31]

B. Howey Test and Crypto Assets: A Contemporary Approach

1. JUDICIAL INTENTIONS BEHIND *SEC* V. *HOWEY*

From the above discussion, a contemporaneous understanding of the *Howey* test can be derived which was also the victim of the *regulatory* philosophy and market scepticism. The *Howey* test which was derived in the

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[26] Allen Ferrell, 'Mandated Disclosure and Stock Returns: Evidence from the Over-the-Counter Market' (2007) 36 J LEGAL STUD 213.
[27] Stuart Gillan and Laura Sharks, 'The evolution of shareholder activism in the United States' in William Braton and Joseph Mccahery (eds), *Institutional Investor Activism: Hedge Funds and Private Equity: Economics and Regulation* (OUP 2007).
[28] ibid, 4-18.
[29] Steven Davidoff, 'Paradigm Shift: Federal Securities Regulation in the New Millennium' (2007) 2 BROOK J CORP FIN & COMP *L* 339, 339-340.
[30] Pub. L. No. 107-204, 116 Stat. 745 (2002).
[31] John Coates, 'The goals and promise of the Sarbanes-Oxley Act' (2007) 21(1) J ECON PERSPECTIVES 91. See also Christian Leuz, 'Was the Sarbanes-Oxley Act of 2002 Really This Costly? A Discussion of Evidence from Event Returns and Going-Private Decisions' (2007) 44(1-2) J ACC ECON 146; Craig Doidge, Andrew Karolyi and Rene M. Stulz, 'Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time' (2009) 91(3) J FIN ECON 253.

celebrated case of *SEC v W.J. Howey*[32] Is the leading authority for not only US markets but also for the European markets to define the term 'investment contract' and determine the regulatory jurisdiction of the market regulator.[33] The definition of securities in the European markets has undergone several changes concerning the regional markets and different conventions like the Hague Securities Convention. In this respect, the *Howey test* has been a major inspiration for the major European nations and their regulators to define the term While the test dates back to 1946, the flexibility given to the common law courts has made it broad enough to imbibe several instruments as securities and therefore contemporaneous exposition of the test calls for a careful analysis of the facts and reasonings given at the trial stage.

The situation before the test was not a rosy one with the absence of a statutory definition of investment contracts and higher judicial discretion and statutory critique following it. The discretion mainly followed the common law principles along with the main *regulatory* philosophy of investor protection through mandatory disclosures. An insight towards the intent behind the Howey test can be found in the observation of the US Supreme Court where quoting *State v. Gopher Tire & Rubber Co.*,[34] it stated –

"Form was disregarded for substance and emphasis was placed upon economic reality. An investment contract thus came to mean a contract or scheme for "the placing of capital or laying out of money in a way intended to secure income or profit from its employment."[35]

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[32] *SEC v WJ Howey Co*, 328 US 293 (1946).
[33] Guiliano Castellano, 'Towards a general framework or a common definition security: Financial markets regulation in multilingual contexts' (2012) 17 UNIF L REV 449, 461-73.
[34] *State v Gopher Tire & Rubber Co* 177 NW 937, 938 (1920).
[35] ibid.

If seen from the historical perspective, the SEC governed by the *regulatory* ideology has brought several actions on the same for a broad interpretation thus intending to have an inclusive definition broad enough to include a variety of financial instruments.[36] The facts of the case though simple are complicated enough for the then judicial system which was struggling to provide a definite answer. As per SEC, the facts were that –

"[T]he two companies under the same common control, with the same officers, facilities, and personnel, and substantially the same stockholders, were engaged in carrying on an investment business, to wit, the growth and cultivation of citrus trees and the marketing and sale of fruit therefrom; that by the device of deeds from the Howey Company to the groves, and cultivation and management contracts from the Service Company, they were in substance and effect selling investment contracts to customers in that, though the purchasers of groves paid their money in form as purchasers of specific tracts of land, they were, in fact, investors with the Howey Companies in a citrus growing and marketing enterprise."[37]

While claiming for violation of the Securities Act, 1933 due to the sale of unregistered securities, the SEC desired offerings to be adjudged investment contracts. In this respect, the adverse ruling of the trial court shows the ambiguous judicial thinking of the US regime where the opinion was influenced by the established nature of the industry. Based on the ideology of the trial courts along with the Supreme Court decision based on the historical interpretations, it can be inferred that the intention behind the test can be twofold. First, to protect the investors and their expectations from the corporate tactics and second, to provide a definite and inclusive test for a higher level of *lubrication* as well as *regulation*.

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[36] *SEC v CM Joiner Leasing Corp* 320 US 344, 351 (1943).
[37] *SEC v WJ Howey Co,* 151 F2d 714, 715 (5th Cir 1945).

However, if seen from the judicial history post the *Howey* judgment, the definition has given wide discretion to the common law courts of the US. Further, no clear explanation apart from the then ideals as well as judicial thinking was given by the Apex Court in determining the four prongs of the test. While each prong is a matter of concern for the courts in terms of their interpretation, the flexibility given by the '*expectation of profits solely from the efforts of others*' in addition to the bright-line tests have instead created inconsistent outcomes in contemporary times *thus* nullifying the objective. While the extensive flexibility provided by the Howey test is a major positive, the high room given to courts to manoeuvre has the potential to nullify the purpose of the law. The implied costs of the flexibility can therefore be called the potential for a very real difference in the kinds of protections offered to investors depending on where they buy the interests in question. The same can also be inferred from the instance of the Viatical Settlement industry where different interpretations of commonality by the Court of Appeals have led to an uncertain position. [38]

2. APPLICATION OF *HOWEY TEST*: TRADITIONAL APPROACH

The traditional interpretation of the *Howey* test involves segregation of the principle in four prongs i.e. (a) Investment of money; (b) Commonality; (c) Expectation of profits and; (d) Solely from the efforts of others.[39] It is pertinent to note that the traditional analysis though has been followed since the *Howey* judgment, it has been more comprehensively reiterated in the 2019 Framework

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[38] *SEC v Life Partners* 87 F.3d at 549; *SEC v. Mutual Benefits Corp.* 408 F.3d 737 (11th Cir. 2005); Miriam Albert (n 46).

[39] *Howey* (n 32), 298-99.

for "Investment Contract" Analysis of Digital Assets where the SEC gave a rules-based application of the test to the Initial Coins Offering (**ICO**).[40]

The decision if the crypto-assets qualify as a security under the *Howey* test depends on the analysis of the crypto as well as the purposive interpretation of the four prongs. In this regard, the first prong is *prima facie* understood to be applicable in the case of crypto-assets based on the universally accepted interpretation,[41] it is not debatable in this article. Further, the investment in crypto-assets is in a *common enterprise.* It is pertinent to note that the commonality has been understood as both horizontal and vertical with the changing times.[42] While the former requires investors to share the risk by pooling resources,[43] the latter and more recent model concentrates on the dependence of the investment on the efforts of the promoter.[44] Over the years, the vertical commonality has been given much attention as the correct interpretation of the second prong.[45] However, the silence of the Supreme Court as well as the equal importance given to horizontal commonality by the circuit courts still makes it a valid interpretation in terms of technological and corporate advancements.[46]

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[40] U.S. Security & Exchange Commission, *Framework for "Investment Contract" Analysis of Digital Assets* (3 April 2019) <https://www.sec.gov/corpfinframework-investment-contract-analysisdigital-assets[https://perma.cc/99KD-XG4P]> accessed 15 July 2023.
[41] Larry Soderquist, 'Reach of the Securities Act Regulation' in *Securities Regulation* (St Paul, MN: Foundation Press 2005), 119.
[42] *Wals v Fox Hills Dev Corp* 24 F3d 1016, 1017 (7th Cir. 1994); Jonathan E. Shook, 'The Common Enterprise Test: Getting Horizontal or Going Vertical in Wals v Fox Hills Dev Corp' (1995) 30(4) TULSA *L J* 727, 733 (1995).
[43] *SEC v SG Ltd* 265 F3d 42, 49 (1st Cir 2001).
[44] *SEC v Goldfield Deep Mines Co* 758 F2d 459, 463 (9th Cir 1985).
[45] Christopher L Borsani, 'A "Common" Problem: Examining the Need for Common Ground in the "Common Enterprise" Element of the Howey Test' (2008) 10 DUQ BUS *L J* 1, 8.
[46] *Curran v Merrill Lynch, Pierce*; *Fenner & Smith, Inc*. 622 F.2d 216, 222 (6th Cir. 1980), aff'd, 456 U.S. 353 (1982). See also *Hirk v Agri-Research Council, Inc.* 561 F.2d 96, 101 (7th Cir 1977); *Wasnowic v Chi Bd of Trade* 352 F Supp 1066, 1070 (M.D. Pa. 1972), affd, 491 F.2d 752 (3d Cir. 1973); *Eberhardt v Waters* 901 F.2d 1578, 1580 (11th Cir. 1990); *Brodt v. Bache & Co* 595 F.2d 459, 461 (9th Cir. 1978); *SEC v Koscot Interplanetary, Inc* 497 F2d

The third prong calls for expectation of profits by the investors for which a multi-factor test or the *Munchee* analysis[47] (I know it when I see it) has been suggested in the framework by SEC as well as US courts.[48] However, the uncertainty caused due to several line-drawing problems is a hinderance. Therefore, a better mechanism will be to inspect the intentions of the seller than the scattered buyers.[49] While SEC's actions still have not resulted into certainty, the 'substantial steps test' as has been proposed by Henderson and Raskin[50] can be of great help. The focus therefore shifts from the marketing of the asset to its production, creating certainty. As long as the promoter is working on the underlying asset for which it may be redeemable in the future, it is not a security.[51] Thus, though crypto in its currency form may not be treated as security, the investments in the token treating it as an 'asset' will fulfil the test.

Nonetheless, the disadvantage of decentralised databases makes it a hard work for the regulator and thus unfavourable to give it the colour of 'securities'. Therefore, the focus of the fourth prong is to determine whether the asset is *"sufficiently decentralised."* The foundations of the *Bahamas test*

473, 479 (5th Cir. 1974); Miriam R. Albert, 'The Howey Test Turns 64: Are the Courts Grading this Test on a Curve?' (2011) 2 WM. MARY BUS. L. REV. 1, 16-17.

[47] Munchee Inc, *Securities Act Release No. 10445* (*SEC*, 11 December 2017) <https://www.sec.gov/litigation/admin/2017/33-10445.pdf [https://perma.cc/Q4JY-RD2Q]> accessed 20 August 2023.

[48] *Jacobellis v Ohio* 378 US 184, 197 (1964) (Stewart, J, concurring).

[49] Securities & Exchange Commission, *Guidelines as to the Applicability of the Federal Securities Laws to Offers and Sales of Condominiums or Units in a Real Estate Development* (Securities Act Release No. 5347, 4 January 1973), <https://www.sec.gov/rules/interp/1973/33-5347.pdf [perma.cc/U9M4-ZNA9]> accessed 15 August 2023.

[50] M. Todd Henderson & Max Raskin, 'A Regulatory Classification of Digital Assets: Toward an Operational Howey Test for Cryptocurrencies, ICOs, and Other Digital Assets' (2019) 2019 COLUM BUS L REV 443, 483.

[51] ibid.

was, indeed, laid down by William Hinman in his speech on digital assets as securities where in the second part of the speech he told:

"If the network on which the token or coin is to function is sufficiently decentralized – where purchasers would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts – the assets may not represent an investment contract. Moreover, when the efforts. of the third party are no longer a key factor for determining the enterprise's success, material information asymmetries recede. As a network becomes truly decentralized, the ability to identify an issuer or promoter to make the requisite disclosures becomes difficult, and less meaningful" [52]

A plain reading of the prong implies the managerial efforts behind the enterprise activities on which investment has been made. From a literal interpretation, the Bahamas test gives an idea of crypto-assets being securities. In this regard, as long as sufficient efforts are made by people other than promoters, it suffices the '*efforts of other*s' prong. For instance, the open-source Bitcoin network has over 600 contributors who have written code for the software.[53] The crypto-assets being working on blockchain technology and therefore not controlled by a single enterprise but decentralised databases through mining, therefore cannot be said to be influenced by the entrepreneurial or managerial efforts, not qualifying as 'securities.' Further, the crypto-assets having no official issuers and working on blockchain mining, offers no technical barrier to entry. Such a scenario may have adverse

[52] William Hinman, 'Digital Asset Transactions: When Howey met Gary (Plastic)' (*US Securities & Exchange Commission*, 14 June 2018) <https://www.sec.gov/news/speech/speech-hinman-061418> accessed 18 August 2023.

[53] 'Bitcoin Core Integration /Staging Tree' (*GITHUB*) <https://github.combitcoinlbitcoin> accessed 12 August 2023. See also Ludwig Von Mises, *Human Action: A Treatise on Economics* (4th ed., Lightning Source, Inc 2007), 290-91.

consequences on privity and disclaiming liability,[54] further proving decentralised nature of the assets.

3. CRYPTO AND ADOPTION OF CONTEMPORARY APPROACH

With the changing capital formation landscape and growing chances of fraud and exuberance, the scepticism of the investors and regulators can be seen in the recent times.[55] While the profit motive of the investors neutralises the sense of such risk, the market regulator remains adamant to the traditional approach due to regulatory difficulties. With respect to crypto, the problems are even higher. The information asymmetry due to the uncertain and volatile nature of the crypto-assets is a major hinderance to investor protection. While other financial instruments are compelled to provide optimal amount of information through disclosure regulations,[56] it is quite difficult with the crypto-assets running on decentralised blockchains. Furthermore, the police power problem which stems from the *regulatory* philosophy of the securities law coupled with the high degree of regulatory mechanism required incentives the state to instead prohibit trading in such assets.[57]

Nevertheless, the lack of regulation cannot be ignored with the increasing transactions in these assets and probability of any future mishap. In this respect, inclusion of the crypto-assets as 'securities' is useful for not only the investors but also the US market and economy. The traditional approach to interpret the four prongs of *Howey* test however has answered it in negative and thus left the state with the only option to frame a separate legal framework for the crypto-assets similar to the treatment given to the cryptocurrencies.

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[54] Henderson & Raskin (n 50), 465.
[55] Sangmi Chai, Minkyun Kim and H. Raghav Rao, 'Firms' information security investment decisions: Stock market evidence of investors' behavior' (2011) 50(4) DECISION SUPPORT SYSTEMS 651.
[56] Securities Act 1933, ch 38.
[57] Henderson & Raskin (n 50), 448.

However, from a perspective of contemporary approach, the purposive interpretation can be given effect to provide a higher inclusivity to the Howey test.

The flexibility which was provided by the Supreme Court in the *Howey* test was not limited or subject to literal derivations.[58] In this respect, it is pertinent to note that the object behind the test was to give a contemporary meaning to the term 'securities' to *"variable schemes devised by those who seek the use of money of others on the promise of profits."*[59] The real meaning of the securities was brought by US Apex court where it was observed that economic reality behind the financial instrument means *"the economic realities underlying a transaction, and not on the name appended thereto."*[60] Therefore, the important economic considerations are economic substance of the transactions in the assets and expectation of profits from those investments. While the latter is the very reason for any investment, thus *prima facie* validating the point, the economic substance of investments in digital assets (security tokens) is the pooling of resources for the digitally represented investments and registered on blockchain.[61]

The economic rationale behind the digital assets therefore indicates that this categorisation of crypto was in particular intended to act as 'securities' in the market. The Courts and the Congress have remained silent on these points and instead chose to ignore the need for a contemporary approach on strict adherence of the principle of separation of powers than to protect the investors

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[58] *Howey* (n 32), 299. Commissioner, Troy A. Paredes, 'Remarks before the Symposium on "The Past, Present and Future of the SEC"' (*US Securities & Exchange Commission*, 16 October 2009) <https://www.sec.gov/news/speech/2009/spch101609tap.htm> accessed 29 August 2023.
[59] *Forman* (n 62), 849.
[60] *Howey* (n 32), 298; *Tcherepnin v Knight* 389 U.S. 332, 336 (1967).
[61] Evezen Yasman and Hossein Sharif, 'Categorisation of cryptoassets' in J. Mark Munoz and Michael Frenkel (ed.), *The Economics of Cryptocurrencies* (Routledge, 2021) 19.

by effective and unambiguous regulations., the Supreme Court while giving one of the first interpretation to the *Howey* test noted that, in defining the term "security," Congress was not attempting to:

"*[A]rticulate the relevant economic criteria for distinguishing "securities" from "non-securities".... The task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes*[62]

However, it is pertinent to note that the SEC has gradually realised the invalidity of the 'one size fits all' approach of the *Howey* test in technically and financially dynamic markets.[63] This was further highlighted in the Decentralized Autonomous Organization Report (**DAO Report**) of 2017 of SEC, specifically disregarding the *"form of the organization or technology used to effectuate a particular offer or sale"* based on facts and circumstances while identifying crypto-assets as securities.[64]

III. DEFINING SECURITIES: A LEGAL CHALLENGE

Every market legislation around the world provides for a definition of securities. Generally, the definition is though made from a broader perspective to enhance the scope of the regulator. However, the judicial limitations often narrow down their powers which is the bone of contention seen in every jurisdiction.[65] The solution to the problem lies only in providing a definite interpretation given to the term and therefore, it is argued in this part that apart from the definition given under the Securities Act, the term should also be

[62] *United Housing Foundation, Inc. v Forman* 421 U.S. 837, 847-48 (1975).
[63] Securities & Exchange Commission, *Report on investigation pursuant to Sec. 21(A) of the Securities and Exchange Commission Act of 1934: The DAO* (25 July 2017), 10.
[64] ibid.
[65] Stephane Rosseau, 'Endgame: The Impact of the Supreme Court's Decision on the Project to Create a National Securities Regulator' (2012) 52 Can Bus LJ 186.

looked from two other perspectives by the US regulators. The first is the common parlance usage which gives a general meaning of the securities when it comes down to the basic understanding of the history and the law itself. The second perspective is the approach taken by other advanced marketplaces like India and EU where the legal inclusivity gives enough scope for the inclusion of crypto-assets as well.

A. Origins of 'Securities': Insights from the past

The word security has gone in different stages of evolution all around the world. A simple yet different perspective is preferred at all places where there exists such efficient market-based system. A common meaning attracted to this word is related to the evidences of obligations to pay money or of rights to participate in earnings and distribution of corporate, trust, and other property.[66] It is observed by the scholars that earlier people used to also trade in variety of transaction which resulted into nature of characteristics which were intrinsically defined under the security. Earlier nation states of Venice and Genoa and other cities such as Switzerland started to issue debt instruments to qualify citizens as tax payers.[67] Gradually a shift among such markets resulted into the creation of the secondary market for such type of trading.[68]

Under the second phase of development of securities, states used this platform to finance the state rather than benefitting it to the economy.[69] The major change occurred during the phase of industrialisation which prompted

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[66] Bryan A. Garner, *Black's Law Dictionary* (11th edn, Thomson Reuters 2023) <https://karnatakajudiciary.kar.nic.in/hcklibrary/PDF/Blacks-Law-Dictionery.pdf> last accessed 20 August 2023, 1522.
[67] Michele Fratianni and Franco Spinelli, 'Italian City-States and Financial Evolution: European Review of Economic History' (2006) 10(3) EUR REV ECON HIS 257.
[68] ibid at 264.
[69] Tony Porter, States, *Markets and Regimes in Global Finance* (Springer 2016) 24.

many companies to raise funds due to the capital-intensive corporate activities. The choice to opt for raising funds gave the market of securities a new development.[70] The legislative institutionalisation of the Companies was first done by France under the French commercial code, which took an initiative to regulate the Joint Stock Companies.[71] The formal market was not developed due to lack of infrastructure and little was known to the people. Further there was not any pro-active role played by government which suggests that there were not lot of companies who resorted to such kind of financing.

The Industrialisation phase all over the world in the Nineteenth century prompted for need to have more capital. In this regard, the need for raising funds or capital by the state was first realised in the wake of growing need of the development and state welfare.[72] While the effects of wars made the European Securities market important,[73] the rise in personal wealth coupled with rise of big companies prompted such development in the US.[74] The bank finance used to be dominant in this sphere which was changed with the increasing growth of capital market as an easier means to raise funds, thus making the west overflowing with capital and investments.[75]

The historical intention behind the securities as a replacement instrument of bank finance to raise funds, in this regard, can be looked into in two aspects. The analysis in generality leads to the conclusion that the evolution being influenced different factors give rise to different interpretations and usages. However, a common link of twin intentions of capital raising and profit can

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[70] ibid.
[71] Charles E. Freedman, 'Joint stock business organisations in France, 1807-1867'(1965) 39(2) BUS HIS REV 184.
[72] Porter (n 70), 146.
[73] Bruno S. Frey and Marcel Kucher, 'History as Reflected in Capital Markets: The Case of World War II: The Journal of Economic History' (2000) 60(2) J ECON HIS 468, 471.
[74] Sylla Richard, 'US Securities Market and Banking System, 1790-1840' (1998) 80 REV FED RESERVE BANK ST LOUIS 83, 85.
[75] Porter (n 69), 26.

be deduced in all phases over the globe and therefore should be preferred for the purpose of interpreting the term.

B. 'Marketability' Test: The Indian Solution

The securities in the Indian scenario are often seen with the same eyes as by the rest of the world. However, the Indian securities regime cannot be called as similar to that in US. If seen from theoretical perspective, two contrary observations can be made in this respect. The object behind the establishment of SEBI was to instil confidence among the investors through higher forms of protection norms.[76] Further, the appointment of an expert body for ensuring efficient dealing of market issues derives much resemblance from the SEC and Federal Exchange Commission (**FEC**).[77]

Nonetheless, the historical perspective provides a different observation regarding the regulatory philosophy of the state. Contrary to the US approach, the Indian securities law have transitioned from a *regulatory* to *developmental* framework.[78] In this regard, the highest level of protection can be seen during the aftermath of World War II in the form of the Capital Issues (**Control**) Act, 1947.[79] However, the situation changed in the wake of the Liberalisation Privatisation and Globalisation (**LPG**) policies of 1991 and the resultant growth in complexity in human affairs and trade & commerce when the state realised to hand over the control to an independent regulator.[80]

While the developments in the securities regime do not coincide with those in the US, the higher level of similarities with respect to disclosure requirements which shows investor protection objects as well as the

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[76] Securities and Exchange Board of India (SEBI), *SEBI Annual Report* (1988-89), p 1.
[77] *Swedish Match AB v SEBI* (2004) 11 SCC 641, [46], [51].
[78] Securities and Exchange Board of India (SEBI), *SEBI Annual Report* (1991-92), p 7, Securities Contracts (Regulation) Act 1956, preamble (SCRA).
[79] Capital Issues (Control) Act 1947, s 3(2).
[80] LM Bhole, *Financial Institutions and Markets* (Tata McGraw Hill 2009), 224.

interconnected markets in the globalised world makes the analysis pertinent. Unlike the US laws on the eve of the establishment of the SEC in 1930, the Securities Contracts (**Regulation**) Act, 1956 (**SCRA**) provides for the definition of securities.[81] Though in such a case, the work of the common law courts should have been affected, the high degree of inclusivity of the provision coupled with the rapid advancements in investment sectors have led to several interpretations and amendments.[82]

The frequent amendments are often considered to be discouraging and unwarranted by both practitioners and the courts.[83] However, Section 2(h) of SCRA is an exception to this behaviour given several committees report[84] and court decisions[85] recommending desired changes proving the inclusive nature of the law. The inclusivity has been provided in two ways. The first is through the declaration of the government under Section 2(h)(iia)[86] and the second is through the broad categorisation in the wordings *"other marketable securities of a like nature"* used after instruments like shares, scrips, stocks, bonds and debentures.[87] While the former is not subjected to interpretation being totally the discretion of government to avoid frequent amendments to the law, the broad wordings under clause (i) gave rise to the famous 'marketability test'.

The debate in this respect was started between the High Courts of Bombay and Calcutta which differed on the point of necessity of listing on a stock

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[81] SCRA, s 2(h).
[82] Securities and Exchange Board of India (SEBI) Act 1992, Sch, part II. See also Securities Laws (Amendment) Act 1999, s 2; Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act 2002, s 41; and Securities Laws (Amendment) Act 2004, s 2.
[83] Nani Palkhivala, *The Law and Practice of Income Tax* (8th edn, LexisNexis 2008), vii (preface).
[84] Securities Laws (Amendment) Committee, *Report of Justice Dhanuka Committee on Securities Laws* (1997), Part I.
[85] *Sudhir Shantilal Mehta v. CBI* (2009) 8 SCC 1 [41].
[86] SCRA, s 2(h)(iia).
[87] SCRA, s 2(h)(i).

exchange for giving the instrument colour of 'marketability'.[88] The Bombay High Court in *Norman J. Hamilton v Umedbhai S. Patel*[89] (**Norman Hamilton**) applied the doctrine of *noscitur a sociis* in this respect while holding that the listing in stock exchange provides transferability to the financial instruments thus making them 'marketable' in true sense. Therefore, the 'securities' was narrowly constructed to mean only those instruments *"which enjoy a high degree of liquidity and can be freely bought and sold in open market."*[90] The Calcutta High Court on the other hand gave high consideration to the dictionary meaning equating the term 'marketable' to 'saleable' thus providing a broad and practical meaning to 'securities' as *"whatever is capable of being brought and sold in market."*[91]

The debate started in early 80's was continued by the special courts[92] and tribunals[93] with different interpretations preferred by the different judges. In this period of ambiguity, the focus was primarily on the capability principle given by the Calcutta High Court[94] and the further derivations given to the term 'open market' used by the Bombay High Court.[95] Such efforts along with the invention of the new tests and interpretation[96] gives an idea of the efforts to reach a middle ground in defining securities. However, the debate was ultimately settled by the Bombay High Court giving a different colour to the

[88] Kaushik Laik, *Unfair Trade Practices in Securities Market* (Taxmann 2013) 83.
[89] Vasant Investment Corporation Ltd. vs Official Liquidator [1979] 49 Comp Cas 1 (Bom)
[90] ibid [25].
[91] *BK Holdings (P) Ltd v Prem Chand Jute Mills & Ors* [1983] 53 Comp Cas 367 (Cal) [21].
[92] *BOI Finance v The Custodian & Anr* [1994] 81 Comp Cas 508 (Special Court).
[93] J*agdishchandra Champaklal Parekh v Deccan Paper Mills Co. Ltd. & Ors* [1994] 80 Comp Cas 159 (CLB) [11].
[94] *BOI Finance* (n 92) [529]. See also *Karnavati Fincap Ltd & Alka Spinners Ltd. v SEBI* [1996] 87 Comp Cas 186 (Guj) [5]; *Brooke Bond India Ltd v UB Limited & Ors* 1999 (2) Bom CR 429.
[95] *Fascinating Leasing & Finance Pvt Ltd v SEBI* [1998] 17 SCL 204 (SAT – Mum) [24].
[96] *Essar Steel Ltd v Gramercy Engineering Market Fund* [2003] 116 Comp Cas 248 (Guj) [17.5].

observation made in *Norman Hamilton case*[97] along with Supreme Court denying necessity of listing for marketability,[98] thus giving present value to the 'marketability test'.

Nevertheless, the marketability test was explained conclusively in the *MCX Stock Exchange Ltd. v SEBI,*[99] where going over the history of the market as well as the debate, it was clarified that in judging the capability of marketability, the *"size of market is inconsequential"*[100] and the test mainly lies in the fact that instrument can be bought or sold in the securities market though it may not actually the case.[101] The application of the 'marketability' test has been quite inclusive with respect to the changes in the securities market and investment instruments in the market with securities like shares of private unlisted companies[102] and Optional Fully Convertible Debentures (**OFCD**)[103] covered within the ambit of Section 2(h).

From the perspective of the capability to be marketable, the crypto-assets have to satisfy two conditions for being classified as 'securities' – (a) Market for trading of crypto-assets and (b) Capability of being traded. The stock exchanges are common but not the only market and therefore general markets where buyers and sellers legally interact can also be included in the definition. In this regard, the crypto-assets are separately traded on the crypto exchanges

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[97] *Mysore Fruit Products Ltd. & Ors v The Custodian & Ors* (2005) 107 Bom LR 955 [8]. See also *Sushil Suri v CBI & Anr* (2011) 5 SCC 708 [20].
[98] *Naresh K Aggarwala & Co v Canbank Financial Services Ltd & Anr* (2010) 6 SCC 178 [20]. See also *Himachal Pradesh State Industrial Development Corp v PAMWI Tissues Ltd. & Anr* 2011 SCC OnLine HP 3519.
[99] *MCX Stock Exchange Ltd. v. SEBI* 2012 (114) Bom LR 1002 [79].
[100] *Bhagwati Developers Pvt. Ltd v Peerless General Finance & Investment Co Ltd* (2005) 62 SCL 574 (SC) [19].
[101] *MCX* (n 100) [61]. See also Whole Time Member's order in the matter of Sahara India Real Estate Corp. Ltd, Ref No. WTM/KMA/CFD/392/06/2011 dated June, 23, 2011 [14.5.3].
[102] *East Indian Product Ltd. v Naresh Acharya Bhaduri & Ors* [1988] 64 Comp Cas 259 (Cal).
[103] *Sahara India Real Estate Corp Ltd & Ors v SEBI & Anr* [2013] 1 SCC 1.

and other platforms[104] which though may not be as open as compared to stock exchanges. Further, the second condition is *prima facie* fulfilled in the event of actual transactions as the case of crypto-assets shows. Moreover, the digital instrument though may not be a physical asset, the same has garnered the interest of investors thus generating huge demand and saleability due to its rare nature.[105]

While the Indian courts have not faced any dilemma regarding the inclusion of the digital assets as well within the ambit of 'securities', the high degree of inclusivity accorded by the 'marketability' test makes it possible. In the context of the US regime, the test can be adopted either through suitable amendment in the definition of securities provided under Securities Act, 1933[106] or through wider interpretation of the *Howey* test to include the marketability test. While the former seems highly impractical in the legislative and political context, the latter shares the same case in terms of judicial unwillingness as was reflected in the *Ripple case*.

C. Treatment of Crypto under EU laws

The securities law under EU encapsulates its own requirement for the qualification of an instrument as security. While the major legislations and directives indirectly govern the securities, the qualification criteria of "transferable security" are prescribed under Article 4(1)(44) of MIFID.[107] For that purpose, the three essential tests of transferability, negotiability and

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[104] Andrea Minto, 'The Legal Characterisation of Crypto-Exchange Platforms' (2021) 22(1) GLOBAL JURIST <https://doi.org/10.1515/gj-2020-0085>accessed 28 August 2023.
[105] M. Ángeles López-Cabarcos and others, 'Bitcoin Volatility, Stock Market and Investor Sentiment: Are they connected?' (2021) 38 FIN RES LETTERS <https://doi.org/10.1016/j.frl.2019.101399> accessed 28 August 2023.
[106] Securities Act, s 2(a)(1) (US).
[107] EU Directive of Parliament and Council 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ 2 173/0. (MiFID).

standardization is adopted. The transferability is interpreted with reference to the common parlance[108] and therefore is much similar to the 'marketability' test of India. Nevertheless, the difference is created through the second test of negotiability in the capital market due to which the listing in a recognized stock exchange becomes necessary.[109] The scope is further restricted through the fungibility attribute where the same class of securities should have same characteristics.[110]

The definition provided in MIFID is however not read in isolation and therefore other directives and tests to classify the crypto-assets are equally important. In this regard, it is pertinent to mention that the test is devised for the application of MIFID. With the European jurisdiction providing for other legal schemes, the analysis of these schemes will give a complete understanding. The first approach taken by the EU courts is related to the American test of *Howey.*[111] While the test has long been adopted for defining the securities, the significance of the test is not immaterial given the high movement of ICO in the European jurisdiction. However, the effect is more in negative than affirmative with the new legislations being enacted to neutralize the effect of the test and its subsequent usage by the courts.[112]

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[108] Article 2(1)(a) of Prospectus Directive. Directive of Parliament and Council 2003/71/EC of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ 2 345/64; Article 2(a) of the Prospectus Regulations. Regulation of Parliament and Council (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC [2017] OJ 2 168/12.
[109] MiFID, art 4(1)(18).
[110] ibid.
[111] Philipp Maume & Mathias Fromberger, 'Regulations of Initial Coin Offerings: Reconciling US and EU Securities Laws' (2019) 19 CHI J INT'L L 548, 566.
[112] ibid. at 566-68. See also Philipp Hacker and Chris Thomale, 'Crypto-securities regulations: ICOs, token sales and cryptocurrencies under EU financial law' (2018) 15(4) EUR CO FIN L REV 645.

Unlike the US, the any controversy on the classification of tokens under the ambit of security, however due to their attempt to draw a formidable market for such ICO it has made certain changes and it has enabled them to regulate the Tokens. The intention of the legislature is aligned with the global principles as enshrined in the IOSCO preamble.[113] The challenge is addressed by their launch of Digital Finance Package in 2020[114] which is the first step towards the innovation in finance sector as well as includes different strategies at the same time making it more inclined towards financial stability. The objective of the Digital Finance package can be said to be four fold – (1) removing fragmentation in the Digital Single Market; (2) adapting the EU regulatory framework to facilitate digital innovation; (3) promoting data-driven finance and; (4) addressing the challenges and risks with digital transformation, including enhancing the digital operational resilience of the financial system.[115] Moreover, the market in crypto regulations which generally calls for an affirmative action has been adopted after various companies such as telegram and facebook started to issue their own ICO.[116]

If seen from a philosophical perspective, EU has not adopted a retributive approach towards this token but rather has divided such companies in the application of such regulations by not subjecting them to the MIFID Regulations. According to this approach, there are different kind of tokens which exists in the regulations. Where payment tokens which are issued by

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[113] Technical Committee of International Organization of Securities Commission, 'Supervisory Framework for Markets' (*OICD-IOSCO*, 1 May 1999) <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD90.pdf> accessed 12 September 2023.
[114] Directorate-General of Financial Stability, Financial Services and Capital Markets Union, 'Digital Finance Package' (*European Commission*, 24 September 2020) <https://finance.ec.europa.eu/publications/digital-finance-package_en> accessed 12 September 2023.
[115] ibid.
[116] Dirk A Zetzsche and others, 'The ICO Gold Rush: It's a Scam, It's a Bubble, It's a Super Challenge for Regulators' (2019) 60(2) HARV INT'L L J 267.

the website to the users who are contributing towards the work of the company, utility token grants certain utility in terms of products or services of the issuer of the crypto-asset and cannot be substituted in form of payment in form of virtual currency.[117] However, the main bone of contention are this last kind of tokens which are known as investment token or security token which typically grants the holder property-like rights and/or claims on positive future cashflows from the issuer.[118] The classification of these three tokens has been generally referred all across Europe.[119]

In this respect, the investment tokens are separately governed under the Market in Crypto Asset regulations (MiCA) which prefers a *regulatory* approach than the *prohibitory* approach.[120] It is observed by the authors that there are different types entities who can issue crypto assets to trading on the platform, this has collaborated the power of the prospectus directive because such regulations have specifically talked about their disclosure requirements. The MiCA regulations however, make a case for gap in regulatory framework as crypto assets which are not under purview of financial instrument or E-Money directive (EMD2)[121] will not be subjected to any law. The problem persists with the regulations applicable to those ICO with the nature of

[117] Maume (n 111), 558.

[118] Benjamin Geva, 'Cryptocurrencies and the Evolution of Banking, Money, and Payments' in C Brummer (ed), *Cryptoassets: Legal, Regulatory, and Monetary Perspectives* (OUP 2019) 12.

[119] 'AMF Public Consultation on Initial Coin Offerings (ICOS)' (*Autorité des Marchés Financiers*, 26 October 2017) <https://www.amf-france.org/en/news-publications/public-consultations/amf-public-consultation-initial-coin-offerings-icos> accessed 12 September 2023.

[120] Regulation of Parliament and Council (EU) 2023/1114 on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937 [2023] OJ 2 150/40.

[121] EU Directive of Parliament and Council 2009/110/EC of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC [2009] OJ 2 267/7.

investment token making them comply with burdensome regulations which would entail costs to the issuer and will only disregard to the Ease of Doing Business.

With the European legal regime on crypto-asset gradually evolving, it can serve as a leading precedent for the US as well as India. In this regard, though the difference can be created from the common law nature of both the countries, the *prohibitory* approach adopted by them can be transformed into *regulatory* approach from such example. However, the definition of securities in the European jurisdiction is still at a primitive level and therefore inclusion through other laws is being tried by the legislators. In our opinion, such an approach is peculiar to the EU jurisdiction and therefore only the philosophical and not practical aspects of the steps can be taken back.

IV. ADOPTING A DIFFERENT APPROACH: LESSONS FROM INDIA AND EU

India and the EU have been largely poling apart when it comes to their legislative frameworks due to the former being a common law and the latter civil law jurisdiction. However, the veracity of the high legal transplantations between these jurisdictions cannot be challenged,[122] thus highlighting the compatibility between the common law and civil law nations in terms of substantive principles of commercial world. The similar position can be taken in respect to the securities and investment law where the status of the crypto-assets as well as the principle of 'transferability' is followed in a similar fashion.

While the legal principles adopted in both the jurisdiction with highly securities market are inspiring in interpreting the term 'securities', the

[122] Jean Louis Halpérin, 'Western Legal Transplants in India' (2010) 2(1) JINDAL GLOBAL L REV 14.

aloofness from the crypto-assets and the *preventive* approach adopted by both the jurisdictions which can also serve as good lessons to the US courts has been analysed below along with the different modes of interpretation which can be relied upon for reaching to a more contemporary solution.

A. Preventive Approach of India and EU

The legal regime in both India and EU provides for ample means to secure the rights of crypto-investors and have the potential of gaining the required inclusivity. However, the scepticism from both the jurisdictions raises several questions on the approach adopted and the impact it creates on the markets. The article discusses this preventive approach by the regulators of both the jurisdictions in terms of the steps taken and the reasons behind such "escapist" behaviour.

The attraction of the Indian investors towards the digital assets like Bitcoins and XRP is tangible. The initial reaction towards these developments was *prohibitory* due to the uncertain nature of the cryptocurrencies.[123] However, even after gradual acceptance of these changes, the Indian regulator i.e. SEBI as well as the government is shy in recognising crypto-assets as securities and rather desire to classify them as a separate class of instruments subject to different laws and regulations as was done by other nations. In this respect, the problems can be classified into two spheres – (a) Taxation and (b) Regulation.

The crypto-assets are formally classified as the Virtual Digital Assets (**VDA**) for the purposes of taxes by the government.[124] The tax regime for VDA is in this regard, quite stringent with profits from selling, swapping, or spending VDAs subjected to a flat 30% tax, regardless of a short or long-term

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[123] Ministry of Finance, *Report of the Committee to propose specific actions to be taken in relation to Virtual Currencies* (28 February 2019) 41. (SC Garg report).
[124] Finance Act 2022, s 3(b).

gain.[125] Further, losses from VDAs cannot be offset against profits or carried forward.[126] The rigidity provided by the Income Tax (**IT**) Department can therefore be called an offshoot of the *prohibitory* reactions by the Ministry of Finance and thus an effort towards disincentivising investments in this unregulated sector. It is pertinent to observe that on the other hand, the capital gains are subjected to a fairly lower levels of tax and provides for greater flexibility. The securities which are classified as the capital assets is taxed quite flexibly like other assets. The long-term capital asset is taxed under the 15% tax slab while the short-term capital asset is taxed under the 20% tax slab. Moreover, the application of the taxes is subjected to the general rules of set-off in the next assessment year than the exception provided for the VDAs[127]

A change in the stance of the SEBI therefore can be highly adverse for the intentions behind the rigid and unfair tax classification. The regulatory difficulties faced by the Indian regulators due to high technical complexities and uncertain nature of the crypto-assets is the second problem. With regard to this problem, the Ministry of Finance and Reserve Bank of India are in consensus about prevention of circulation of such currencies as a redeemable or financial instrument of any other kind in the Indian market.[128] The initial recommendations of banning of the cryptocurrencies was similarly based on the lack of regulatory techniques and the resultant lack of protection measures for the investors.[129]

The case of EU is however a different one. The absence of appropriate regulations in the beginning instead led to trading of ICOs in the European

[125] Income Tax Act 1961, s 115BBH(1)(a) (as amended by the Finance Act 2022).
[126] Income Tax Act 1961, s 115BBH(2)(b).
[127] Income Tax Act 1961, s 112(1)(b).
[128] Reserve Bank of India, *Prohibition of dealing in Virtual Currencies (VC)* (Notification no. RBI/2017-18/154, 6 April 2018); *Internet and Mobile Association of India v. RBI* Writ petition (2018) SCC OnLine SC 3554 (SC).
[129] SC Garg report (n 123), 11.

jurisdiction which were not otherwise tradeable under the US regime which makes their approach rather *liberal*. There was not complete absence of laws with MIFID II, the AIFMs directive and the ESMA guideline and the prospective directive having the ability to regulate the ICO. However, the judicial creativity was absent from the civil law courts. Further, a too creative interpretation would have defeated the objective and substance of the law.[130] With the MiCA regulation proposal, the approach was changed to that of *regulatory* with effective regulations in place for the crypto market transactions. While the approach of EU was never strictly *preventive,* the long regulatory and legislative silence can be attributed to the initial scepticism.[131]

The approach taken by the Indian regulator SEBI is though in the same direction, the scepticism is much higher. In this regard, although the blockchain technology as whole has not been rejected by any regulator, the main concern of SEBI lies within the distributed ledgers (mining of currency), leading to anonymity and high volatility in the crypto market. SEBI has reported that "*As crypto assets are maintained in decentralised distributed ledgers, which are nested in computer nodes spread all across the globe, there is a great likelihood of execution of unauthorised trades not in consonance with any regulatory framework*".[132] In this respect, the approach of SEBI can be correctly referred to have changed from *prohibitory* to *preventive* by proposing a blanket ban or prohibitions on the crypto-assets due to technical

[130] Gikay Adimi, Asress, 'How the New Generation Cryptocurrencies Decoded the Investment Contract Code: Analysis of US and EU Laws' (2018) 10 BOCCONI LEGAL PAPERS 313, 331.
[131] Emily Nicolle and Lyubov Pronia, 'EU crypto proposal seen as de facto Bitcoin ban fails in vote' (*Bloomberg,* 15 March 2022) <https://www.bloomberg.com/news/articles/2022-03-14/eu-crypto-proposal-seen-as-de-facto-bitcoin-ban-fails-in-vote#xj4y7vzkg> accessed 19 August 2023.
[132] Sriram Srinivasan, 'Explained What are SEBI's concerns around crypto assets?' *The Hindu,* (New Delhi, 12 June 2022)<https://www.thehindu.com/business/Economy/explained-what-are-sebis-concerns-around-crypto-assets/article65517621.ece> accessed 10 July 2023.

complexities and anonymity issues rather than for the *regulatory* philosophy of the regulator like higher disclosure compliances.

Nonetheless, the approach can be modified to *regulatory* instead through separate regulations with jurisdiction conferred on SEBI to solve the peculiar problem as has been highlighted above. Further, it is important to note that the welfare of the investors is not ensured through a blanket ban which instead may be detrimental in the long run without any effective regulations in place. Therefore, the need for proper regulations as well as an inclusive definition and other additional amendments to the laws cannot be rebutted. In this respect, the approach taken by the EU by bringing MiCA regulations in 2024 for regulating the issuance and trading of crypto-assets can be a great lesson for both India and the US.

B. Protectionist Approach as the 'New' Approach

Protectionism is not new to commercial legislations and serves the central idea behind the security laws and regulations across the globe. In this respect, the US regime calls for protectionism in a conventional sense under the Securities Act for providing the disclosure requirements and prevent frauds.[133] The Indian jurisdiction on the other hand give a broader meaning to the approach by mentioning the term 'undesirable transactions'[134] which can be construed in different manner in different context. The protection offered by the state and regulators however, converge on the same object of giving higher investor protection and prevent failing of markets.

Moreover, it is hereby pertinent to analyse the importance of the preamble or the statement of objects and reasons of a statute for a higher understanding. The object of a statute represents the 'soul' of the law, highlighting the

[133] Securities Act, preamble.
[134] Securities Contracts (Regulation) Act 1956, preamble.

legislative intent behind the framework and procedure.[135] Nevertheless, the provision of a statute is not solely governed by the object behind the enactment of the law but by the objective behind the addition of that provision. In this respect, court decisions that follow give equal consideration to both objectives in a harmonious manner.[136]

The definition clause is generally construed for providing objectivity to the technical terms mentioned under the statute.[137] The traditional view therefore leads to a narrow interpretation of the definitions. The amendments in the light of the dynamic world can only be made by legislative actions or executive actions if provided. While the traditional approach seemed to be perfect given the high discretion misuse among the common law courts, the legislative inactions and need for contemporary interpretations led to further interpretations of the elements included in the definition. The *Howey* test which itself defines 'investment contracts' and not 'securities' per se therefore serves as an epitome.

In contrast, the Indian courts provide for two methods of interpretation of the definition clause. The first mechanism is the straightforward approach where the inclusivity embedded in the definition itself is given a wider meaning to keep the law in pace with contemporary changes.[138] The second mechanism involves a rather twisted mechanism involving a harmonious construction of the definition with the provisions of general legislation (e.g.

[135] *Sussex Peerage case,* (1844) 11 Cl & Fin 85, 8 ER 1034 (HL) (Tinder CJ). See also *Commissioners for Special Purposes of Income tax v. John Frederick Pemsel,* (1891-94) All ER Rep 28, 36, 1891 AC 531 (HL) (Halsbury LJ); *Bhola Prasad v. Emperor* AIR 1942 FC 17 (Gwyer CJ).
[136] *Nga Hoon v R* (1857-59) 7 MIA 72, 4 WR (PC) 109. See also *Secy Of State for India v Maharajah of Bobbili* AIR 1919 PC 52, (1919) 46 IA 302; *Bhola Prasad v King-Emperor* AIR 1942 FC 17, (1942) FLJ (FC) 17.
[137] *Raval & Co v KG Ramachandran* (1974) 1 SCC 424 (Bhagwati J). See also *Cadija Umma v Manis Appu* AIR 1939 PC 63, 180 IC 971.
[138] Banking Regulation Act 1949, s 6(1)(a). See also SCRA, s 2(ac); Sale of Goods Act 1930, s 2(7).

General Clauses Act, 1897 or Companies Act, 2013) along with the dictionary meanings as well as meanings given in common parlance.[139] The 'marketability test' to define 'securities' is the result of the former approach. However, while the technique of such contemporary interpretation is long adopted by the US courts, the distinction is created by the role of courts in gap filling in a legal regime and the focus on *protectionism* in the market. In this respect, SEBI like SEC is though concerned with the developments in the technology and its impact on the market, the protectionism is instead sought through a separate classification, thus rejecting its capability to regulate such level of technical advancements.

A contemporary interpretation of the definition clause under the Securities Act results into a more inclusive definition which has been indicated in the previous parts of the article.[140] A harmonious meaning given to the general object of the statute thus indicates the intention behind the law to promote investor sentiments through higher level of protections. In this regard, huge amounts are being traded in the crypto exchanges by the young-minded investors in the expectation of higher returns than the conventional securities.[141] Such load cannot be disregarded by either SEBI or SEC in the guise of technical incompetencies and a "new" approach of modified protectionism can be adopted for furthering the objectives of the law.[142]

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[139] Vepa P Sarathi, *Interpretation of Statutes* (5th edn, Eastern Book Company 2018) 367.
[140] *Gollaleshwar Dev v Gangavma Kom Shantayya Math* (1985) 4 SCC 393, 401, AIR 1986 SC 231.
[141] Raynor de Best, 'Crypto Trading Volume per Day 2021-2023' (*Statista*, 10 August 2023) <https://www.statista.com/statistics/1272903/cryptocurrency-trade-volume/> accessed 20 August 2023.
[142] 'The AFM and DNB Recommend Regulation of Cryptos at an International Level' *l*, (*AFM*,1 December 2018) https://www.afm.nl/en/sector/actueel/2019/jan/adviesrapport-crypto#:~:text=an%20international%20level-,The%20AFM%20and%20DNB%20recommend%20regulation%20of%20cryptos%20at%20an,money%20laundering%20and%20terrorist%20financing. accessed 22 September 2023. See also 'Initial Coin Offerings: Advisory Letter on the Classification of Tokens as Financial Instruments' (*BaFin*, 28 March 2018)

C. Transition from 'Casus Omissus' to 'Contemporanea Expositio'

The inclusion of crypto-assets in the statutory definition of 'securities' is a legal endeavour in all three jurisdictions of the US, India and Europe. While the market regulators in such a case take the lead in giving them a separate special status in terms of regulation, the *Howey* test in the American jurisdiction still lingers on as a major hindrance in the same. In this regard, the rules of interpretation guide the courts to remain aloof in providing a higher level of inclusivity to the already broad provision to create even higher market uncertainty.[143]

A careful analysis of the definition of the term in the US jurisdiction given under the Securities Act of 1933[144] implies that the term 'digital assets' or terms of similar kind have not been inserted. Further, the explicit of mention of the other instruments, missing the terms like 'of like nature' or 'as may be notified by the government' along with no recent amendments on the matter made the inclusion of crypto-assets a lost cause in the recent judgment.[145] The same can also be inferred from the definitions provided under the Indian regime where although the law has been amended several times, the government has neither amended not notified such a change with respect to crypto-assets.[146] The European jurisdiction being already complex and strict

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<https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/WA/dl_hinweisschreiben_einordnung_ICOs_en.html> accessed 22 September 2023.

[143] AGM Duncan (ed.), *Green's Glossary of Scottish Legal Terms*, (3rd edn, 1992), 15. See also *R v Oakes* [1959] QB 350, 354 (Parker LJ); Derek Auchie, 'The Undignified Death of the *Casus Omissus* Rule' (2004) 25(1) STAT L REV 40.

[144] Securities Act, s 2(a)(1).

[145] *Reves v Ernst & Young* 494 U.S. 56, 60–61 (1990).

[146] Anirudh Gotety, 'The Future of Cryptocurrency Regulation in India' (2019) 136 BANKING LJ 481.

in terms of interpretation nevertheless do not allow court induced inclusivity.[147]

In this respect, the judgment conferred in the *Ripple case* is in perfect adherence to the laws of both common and civil law. However, a different colour can be provided to the judgment by referring to two important approaches of contemporaneous exposition and 'always speaking'. The contemporaneous exposition which is often quoted as the "interpretation rule specifically for the old laws"[148] focuses on the contextual circumstances at the time of enactment of the statute. The rule of *Contemporanea expositio est optima et fortissinia in lege* believes that a statute's or any other document's finest explication comes from contemporary authority and therefore practice or usage developed under a statute is suggestive of the meaning prescribed to it by modern opinion[149] The main assumption behind it lies in thinking that those who were alive during or immediately after that time can be reasonably assumed to have a better understanding of those circumstances than their descendants do, as well as the meaning that was at the time given to legislative expressions[150] which has also become the reason for its gradual downfall.

Nevertheless, the rule can still hold good if combined with the 'always speaking' rule which results in a more contemporary interpretation. As per the Anglo-Antipodean custom of interpretation, the law is always speaking and therefore should be constructed with assumption that even though the language's meaning cannot change over time, the context or application of the

[147] Benito Arrunada & Veneta Andonova, 'Common Law and Civil Laws as Pro-Market Adaptations' (2008) 26 WASH U J L & POL'Y 81, 85-86.
[148] *People v Lawrence* (2000) (US) 24 Cal4th 219, 230, 99 Cal Rptr 2d 570, 6 P 3d 228 (Coke J).
[149] *Ashley v State* 757 N.E. 2d 1037, 1039-1040; Dan Meagher, 'The Principle of Legality and *Contemporanea exposition est optima fortissimo en lege*,' (2017) 38(1) STAT L REV 98.
[150] ibid. See also *Yusuf v. Obasanjo* (2003) All FWLR (Pt. 172) 1862.

statutory language may change[151] Such a combination will modify the interpretation rule to mean that the *contextual circumstances* during the time of enactment should also be understood in such colour to safeguard its *dynamic nature*. The application of such interpretation is not new in the commercial regimes where dynamism of the statute is instead inferred from its historical background in the form of 'legislative intent'.[152] In this respect, the application of the rule has been given to both the Securities Act and the *Howey* test.

The Securities Act as has been discussed earlier, was enacted in the wake of 1929 Wall street crash and in response to the change of economic ideals to Keynesian policies of state intervention.[153] However, the main objective was to safeguard market and its investors from such disastrous crisis in the future through an active disclosure system.[154] The *Howey* test on the other hand was propounded to provide flexibility to a highly stringent regulation in the age of economic reconstruction post World war II.[155] If strictly viewed from *contemporaneous exposition,* the construction should be apposite to the general view of non-inclusivity with higher focus on corporate governance and safeguards to investors in the present times.

Nonetheless, combined rule of 'a*lways speaking'* presents a different picture with dynamism added to the construction of the historic context of the

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[151] *R v Secretary of State for the Home Department; ex p Simms* [2000] 2 AC 115, 131. See also F. Stroud, *Maxwell on the Interpretation of Statutes* (5th edn, Sweet & Maxwell: London 1912), 489.
[152] Victoria F Nourse, 'Elementary Statutory Interpretation: Rethinking Legislative Intent and History' (2014) 55 BC L REV 1613.
[153] James M Landis, 'Legislative History of the Securities Act of 1933' (1959) 28 GEO WASH L REV 29, 30-31.
[154] Securities Act, preamble; Barbara D. Merino, Bruce S. Koch and Kenneth L. MacRitchie, 'Historical Analysis – A Diagnostic Tool for "Events" Studies: The Impact of the Securities Act of 1933' (1987) 62(4) ACC REV 748. See also Senate Committee on Banking and Currency, *Senate Report* (S. Rep. No. 7347, 1933), 1.
[155] Travis Stegemoller, 'Refocusing Commonality: An Economic Approach That Shares Something in Common with *Howey'* (2012) 46 VAL U L REV 657, 666-76.

law. The market crash if seen from the contemporary context is not an uncommon phenomenon. Moreover, the relaxation of the state regulations in the current context can also be attributed to the same line of object to safeguard the market and promote investments and economic growth.[156] The intentions behind the economic reconstruction do not develop in the aftermath of a crisis but after every time market failures take place. In this respect, the market failures in the millennium as well as current times are not a rare phenomenon with markets worldwide experiencing great deal of fluctuations based on the geopolitical inconsistencies (e.g. Ukraine war),[157] complex trading networks[158] and new technological innovations (e.g. Artificial Intelligence).[159]

A more comprehensive understanding of the securities market gives an implication on the consistent market failures in the current as well as future world in which economic reconstruction is repeatedly needed from both legislative and judicial efforts. In such a scenario, the application results into a more dynamic interpretation of the statute as well as the *Howey* test of investment contracts. As has been propounded in the *Howey case* as well, the economic substance of the instrument in the commercial law like Securities Act which faces a high level of dynamism is more important the form.[160] The importance thus lies not in the contextual intentions behind the law and the test but in the dynamic world in which investors as well as the regulator has to see and interpret them. Therefore, a more correct, comprehensive, and

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[156] ibid.

[157] Marwan Izzeldin and others, 'The impact of the Russian – Ukrainian War on Global Financial Markets' (2023) 87 INT REV FIN ANALYSIS 102598.

[158] Spyros Galanis, 'Financial complexity and trade' (2018) 112 GAMES ECON BEHAV 219.

[159] Lenore E. Hawkins, 'What to know about the growing impact of AI in financial services' (*NASDAQ,* 13 April 2023) <https://www.nasdaq.com/articles/what-to-know-about-the-growing-impact-of-ai-in-financial-services> accessed 29 August 2023.

[160] *Howey* (n 32), 298.

dynamic approach can be adopted by the courts than giving way to the rule of *casus omissus* and thus legislative inaction.

D. Possibility of Reasonable Classification in Ripple case

The case of *Ripple* issued XRP as a cryptocurrency is quite unique when it comes to a comparison from other counterparts. In this respect, the system of working as well as issuance can be taken into account while noting the differences which are more similar to any other digital token currency issued by the centralised bank (**CBDC**) like e₹ or 'Digital Pound'.[161] While ensuring a faster mode of payment, *"the solution offers a cryptographically secure, end-to-end payment flow with transaction immutability and information redundancy."*[162]

In this instance on application of the first prong of the *Howey* test can still be satisfied with investments being made in the currencies with the intent of getting higher returns.[163] However, the literal reading of the substantial steps test provides for the differentiation between investing in currencies and securities. The test essentially requires two elements – (a) Underlying asset and (b) Redemption. In this regard, the functioning of the XRP depends on the ledgers (blockchain technology) and therefore should be noted to be similar to the other crypto-assets. With no asset backing, the redemption of such currencies can be made in respect to any other asset. From a different angle therefore, XRP can be called as a financial instrument issued by the Ripple Labs which also has a redeemable value in other markets.

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161 V and Innet S, 'Blockchain Application for Central Bank Digital Currencies (CBDC) - Cluster Computing' (*SpringerLink*, 16 January 2023) <https://link.springer.com/article/10.1007/s10586-022-03962-z> accessed 7 April 2025.

162 'XCurrent: A Brief Technical Overview for Financial Institutions on Ripplenet' (*Ripple,* 2017) <https://ripple.com/files/xcurrent brochure.pdf> accessed 4 December 2024.

163 *Uselton v. Commercial Lovelace Motor Freight* 940 F.2d at 574; *SEC v. Shavers* No. 4:13-CV-416, 2014 WL4652121.

Moreover, Ripple provides for the missing piece of centralization to provide additional security.[164] In this respect, the reliance of management in the operations of XRP and not being sufficiently decentralised satisfies the second prong and the Bahamas test with respect to the fourth prong of the *Howey* test. While the reasoning of the US Supreme Court can be termed as erroneous in analysing XRP from the eyes of the other crypto-assets like Bitcoins and Ethereum, a reasonable classification could have been made. In Furtherance, Doctrine of Reasonable Classification is essentially a constitutional law principle mainly used to interpret state's power to make reasonable differentiation on the basis of Right to Equality, the spirit behind the principle can be applied beyond state actions to the court interpretations in commercial and investment issues where public interest is involved.[165] The purview of the doctrine mainly rests on the *arbitrariness* of the state action. The arbitrariness in this regard can be tested in two stages – (a) Purpose Identification Stage where decision's purpose has to be identified and (b) Relation Evaluation Stage where the relation between the differentiation and the people affected is analysed.[166]

On the first stage, the purpose of the securities law across the globe is quite uniform to protect the interests of the investors and market integrity to keep pace with the economic developments. The same can also be safely concluded for the *Howey* test and the approach of Supreme Court even in the case of

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[164]'Ripple Escrows 55 Billion XRP for Supply Predictability' (*Ripple: Insights*, 7 December 2017), <https://ripplc.com/insights/ripple-escrows-55-billion-xrp-for-supply-predictability/> accessed 29 August 2023. See also 'The Ripple Story' (*BitMex: BitMex Research,* 6 February 2018) <https://blog.bitmex.com/the-ripple-story/> accessed 29 August 2023.

[165] J.K. Mittal, *Right to Equality in India: An Introduction* (1st edn, Satyam International 2012).

[166] Marcus Teo, 'Refining Reasonable Classification' (2023) 2023 SING J LEGAL STUD 83, 84.

Ripple.[167] Further, high levels of investments in XRP suggests a profit motive relation between differentiation and the investors[168] coupled with the security measures taken by the *Ripple* Labs. The relation in this case is of an ordinary investor and company or establishment which is motivated by the returns from both the sides. From this lens, the court had the discretion to give a different observation with respect to XRP. Moreover, the higher level of protection given by the *Ripple* could therefore have been a major game-changer which was unfortunately ignored by the Supreme Court.

V. CONCLUSION AND RECOMMENDATIONS

In the recent years, crypto-assets have been a major investing option for both the household and commercial investors. Even after the crash of 2021, the cryptos are likely to strive and thrive with the markets being highly volatile. While the safe haven conferred to the investors comes at the cost of the macro risks weighing heavily on them. The same is applicable not only on the token coins backed by the central bank but also coins out of the formalised system which are more volatile in nature and has caused the recent crash of FTX exchange.[169] From an Indian perspective, the demand of the crypto has got affected from the resultant government reactions in terms of tax liabilities and prohibitions. However, the importance of digital assets and the quantum of investments cannot be ignored in the light of the technological advancements and dynamism.

In this respect, the recommendations can be divided into three segments. From a specific perspective of *Ripple* case, the lacuna left by the US Supreme

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[167] Lewis D. Lowenfels, 'Recent Supreme Court Decisions under the Federal Securities Laws: The Pendulum Swings' (1977) 65 GEO L J 891.
[168] *Oconer v. Ripple Labs, Inc.* No. 18CIV03332 (Cal. Super. Ct. filed June 27, 2018).
[169] Kalley Huang, 'Why did FTX collapse? Here's what to know' *The New York Times,* (New York, 18 November 2022) <https://www.nytimes.com/2022/11/10/technology/ftx-binance-crypto-explained.html> accessed 15 September 2023.

Court has instead created a lose-lose situation for both regulator and asset company. The opportunity lost by the court can be therefore referred to as the mislead judgment with wrong terms of interpretation used to partially include the crypto-assets as ‘securities. While the obvious solution is to correct the judicial approach through a different case with similar facts, a proper and more definite rectification can instead be made through the legislative framework. For that purpose, it is proposed that the framework may include both legislative amendments in the existing codes as well as passing of new executive orders by the government as well as the SEC. Even India can adopt this strategy for not only assets backed by fiat currencies by also informal assets as well rather than waiting for a judicial pronouncement. It is further suggested that the proposed framework should provide for different classification with a sense of inclusivity. In this respect, a reference instance can be taken from the Companies Act, 2013 where it provides the mixed aspect of stringency and inclusivity for filing an application for oppression and mismanagement under the Companies Act 2013, s 241[170]. Further, a same kind of stance can also be seen in IBC where debenture holders are treated as financial creditors subject to the fulfilment of the provided condition. Insolvency and Bankruptcy Code 2016, s 7(1) proviso.[171]

However, the existing regulations against crypto-assets in both India and US are still comprehensive with all regulators having different perspectives including central bank, market regulator, tax authorities, anti-money laundering (**AML**) department, etc. With many players at the ground, it is important that the efforts are harmonised and synergised to produce greater outcomes. Considering the different jurisdictions of different regulators, the second set of suggestions is based on the differential treatment offered based

[170] The Companies Act 2013, s 241.
[171] The Insolvency and Bankruptcy Code 2016, s 7(1).

on purpose for which the asset is issued and used and not technical nature. The classification should not be done as per formal and informal category which is based on technical characteristics. For that purpose, the classification suggested by the EU legislations can be taken as an imperfect example. Nonetheless, the classification should be more refined to the purpose without considering the technical nature like tokens, currencies, assets, etc which will be further classifiable[172] Moreover, special rules can be made for the crypto exchanges to confer relevant powers and supervision over the assets and prevent a crash like FTX.

The final suggestion is more relatable from a worldwide perspective and the role of countries like India, the US and EU for an inclusive treatment of crypto-assets. In this regard, the report of International Organisation of Securities Commission (**IOSCO**) can prove to be a uniform guiding principle for regulations. The report has encouraged to analyse the applicability and adequacy of their regulatory frameworks, and the extent to which: (1) crypto-assets are, or behave like substitutes for, regulated financial instruments, and (2) investors have substituted other financial instrument investment activities with crypto asset trading activities.[173] The report also deals with the disclosure requirements with respect to both, exchanges and issuers which is necessary and therefore in consonance with the basic feature of capital market.[174] While such a soft approach may be objected on several grounds, the consensus built by the report cannot be undermined. It has been noticed that the Consultation paper on Digital Finance by the IOSCO has incorporated under them a survey wherein it asked responses from member regulators to respond under the

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[172] Yasman and Sharif (n 61).

[173] International Organisation for Securities Commission, 'Policy Recommendations for Crypto and Digital Asset Markets Consultation Report' CR 01/2023 (IOSCO-OICD, May 2023) 14.

[174] ibid at 15.

questionaries. Most of the member regulators have said that if the crypto asset is a financial Instrument, the existing regulations will be applied and there will not be need for a new legislation to deal with ICOs[175]

The countries like US and India have a huge role to play in this respect. The superiority of the US in the sphere of financial services is unarguable with the country responsible in the establishment of the IOSCO itself.[176] On the other hand, India having one of the largest investment base and biggest and fastest stock markets shares the responsibility. In the regulatory sphere, India has even surpassed the US with IOSCO being more inclined towards the practices of SEBI than SEC.[177] However, the implications of such appreciation come with an expectation at a global stage where the financial regulators as well as international bodies look forward to a more advanced approach from both SEBI and SEC on the issue of implementing efficient regulations for crypto inclusion. Therefore, it is proposed that the regulations should be framed in conformance with the seven principles provided by the IOSCO to ensure global uniformity and transplant ability.[178]

The cynical mechanism of investment multiplier has been an apparent phenomenon for a quite long time among the scholars and practitioners. While

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[175] International Organisation for Securities Commission, 'Policy Recommendations on Decentralised Finance (DeFi) Report' CR 04/2023 (IOSCO-OICD, September 2023).

[176] Janet Austin, 'The Power and Influence of IOSCO in Formulating and Enforcing Securities Regulations' (2015) 15 ASPER REV INT'L BUS & TRADE *L* 1, 3.

[177] 'SEBI Has Robust Measures for Proper Functioning of Securities Market: Iosco Report' (*The Economic Times*, 13 February 2019) <https://economictimes.indiatimes.com/markets/stocks/news/sebi-has-robust-measures-for-proper-functioning-of-securities-market-iosco-report/articleshow/67973559.cms?from=mdr> accessed 12 September 2023.

[178] International Monetary Fund, 'India: Financial Sector Assessment Program-Detailed Assessments Report on Basel Core Principles for Effective Banking Supervision' CR 2013/267 (*IMF*, August 2013). See also MS Sahoo, 'Securities law and Markets - Global benchmarking' (2013) 33rd national conference of companies secretaries <https://www.icsi.edu/media/webmodules/programmes/33nc/bck-33pilotpaper-mssahoo.pdf> accessed 12 September 2023.

the multiplier can go both ways flowing with the market sentiments, the responsibility on the lawyers and regulators is to think of ways of minimal damage and ways to prevent the potential threats of tomorrow. For that purpose, a global framework to ensure trans-border uniformity in the laws and perception towards the digital assets and similarity in the legal framework to provide effective control to regulators for every possible situation is the key. It is important to mention that the development of law as a social engineer is an all-time function and the history has at times, manifested the distance covered by the law from share certificates to depositories as an essential market investment institution. In this sense, a long road awaits the unavoidable differential inclusion of crypto-assets requiring harmony between lessons of past and actions and needs of present.

DIGITAL DOUBLE-EDGED SWORD: HOW TECHNOLOGY FUELS AND FIGHTS WHITE-COLLAR CRIME

- *Rishabh Tomar*[*]

ABSTRACT

Globalization and the evolving world of computerized financial systems, digital technologies, crypto currencies, and blockchain are both the sword and shield catalyzing and combating white-collar crimes. On one side due to the anonymity and decentralization of crypto currencies, many criminals are able to use virtual currencies for money laundering, tax evasion and performing fraudulent transactions across the borders which can take the advantage of the generic regulations. Dark Web being an advocate of virtual business facilitates social evils such as insider trading, identity thefts and corporate spying and such other unlawful deeds and thus the offenders can easily work in secrecy. On the other hand, the advancement in technology has been proved to help in fighting these crimes too. Blockchain technology has placed more transparency and security which helps the authorities to track the transactions and know which of them is suspicious. Remote Digital forensic and artificial intelligence are widely employed for identifying fraudulent behaviors, analyzing big data and risk prediction. There are increasing changes in the regulation systems to incorporate the new technologies as new ways of monitoring and reporting noncompliance emerge. But the faster development of technology is also a problem, as criminals are not standing still and actively use new methods, tools, which means that legal and regulatory activities can become relevant only to a certain point. This article focuses on the concept of technology within white-collar crime and the potential of using technology with the relevant risks controlled.

[*] Rishabh Tomar is an Assistant Professor at UILS, Chandigarh University. Views stated in this paper are personal.

I. INTRODUCTION

A. Background

Internationalization has quickly advanced the process of interaction and enforcement of economic activities which includes imports, exports, services and capital investment. This integration has greatly impacted on growth of e-financial systems that play a critical role in the creation of trade and investment links worldwide. Technological advances, especially in the form of digital banking, payment applications, and the likes of Bitcoin have changed traditional business transactions in the financial sector to be faster and efficient.[1] Currently, PayPal, Venmo, and blockchain system enable cross-border operations to occur at lower costs and with increased convenience.[2]

As the COVID-19 outbreak escalated the process of remote working and online trading, the digitalization of finance advanced even more by popularizing fintech solutions.[3] Crypto currencies most importantly Bitcoin and Ethereum are considered as options to conventional banking techniques since they provide decentralized as well as international transactions.[4] However such a fast evolution causes legal issues because the dominant models fail in adapting to the modern techniques of financial systems.

The digitalization of finance has brought many opportunities to financial institutions and their customers; however, various risks, such as a higher risk of fraud and money laundering and cyber risk, have emerged and require sustainable forms of regulation.[5]

B. Significance of Technology in White-Collar Crimes

It can therefore be noted that technological opens new doors for white-collar crimes and also opens up new form of approaches in combating crimes. The relative obscurity of operations in new media coupled with the use of Bitcoin and others brings lose control in power states due to features such as

[1] X Zhao, Y Li and Z Wang, 'Globalization and its Impact on the Evolution of Digital Finance: An Empirical Study' [2023] 64 GLOBAL FIN. J. 102312.
[2] P Sharma and R Singh, 'The Role of Digital Payment Systems in Globalized Economies: A Comparative Study' [2022] 5(3) FIN 147.
[3] D W Arner, R P Buckley and D A Zetzsche, 'FinTech for Financial Inclusion: A Framework for Digital Financial Transformation' (2021) 7(1) J FINANC REGUL1.
[4] J Frost and others, 'Regulating Crypto-Assets: The Impact of Technological Innovation on Financial Markets' (2022) 60 J. FINANC. STAB.100941.
[5] D K Nguyen, 'Digital Finance and the Future of Financial Regulation' (2022) 10(2) INT. J. FINANCIAL STUD. 36.

anonymity and decentralization that enhance global money laundering, tax evasion, and Identity theft. To carry out crimes such as insider trading and corporate espionage which require secrecy, the dark web provides a background.

At the same time, technology has also developed the capacity for fighting these crimes. Blockchain transparency aids in tracking of suspicious financial flows, and digital forensics and AI analysis enable identifying fraud-associated big data trends. Real-time observations of anomaly detection may help the combating of unusual activities in financial institutions by using AI tools. These innovations have a capacity of operating on paradoxical qualitative as they present new ways through which the white-collar offenders can work in their unlawful capacity, as do they provide the regulators and the law enforcement agencies with new ways that they can track, investigate and prevent financial illegalities.

C. Purpose of the Article

The purpose of this paper is to analyze the positive functions of digital platforms, crypto currencies, and blockchain technology in the field of white-collar crime. While these technological development in financial crimes have brought about new means through which financial criminals can perpetrate their evil deeds, they also present new ways through which such crimes could be controlled. On the one side, the lack of the physical representation of crypto currencies and the decentralized system of their functioning allow such manipulations as money laundering, evasion of taxes, and cross-border fraud. Social networks and the dark web effectively offer opportunities for the stealing of identity, inside trading and the perpetration of fraud. On the other hand, blockchain introduces new possibilities for tracing suspicious transactions based on high levels of openness and accountability, while computer forensics, and AI help in identifying and analyzing fraudulent intentions. This study is interested in illuminating these two opposing dynamics, how technology can be harnessed for 'good Governance' and regulatory purposes and the constant evolution of the dangerous threats that technology poses.

II. THE DARK SIDE OF TECHNOLOGY IN WHITE-COLLAR CRIMES

A. The Role of Crypto currencies in Financial Crimes

Crypto currencies are the digital assets used as an innovation and as a form of money frauds because of the current structure and anonymous plans for operations. The new financial systems such as currencies are free from intermediaries hence it is impossible to map users' identities. The feature has a lot of appeal to people who get involved in questionable legality such as money laundering and tax evasion. Such actors use crypto currencies to conceal amid funds' origin and avoid supervision.[6]

These procedures might include what is referred to as "Bitcoin mixing" or 'tumbling.' These methods utilize the services of a crypto-mixer that combines several transactions received from distinct persons and then creates an additional transaction, thereby masking the transaction path. An example is Helix Bitcoin tumbler that was closed by the representatives of the United States in 2020 after laundering over $300 million Bitcoins for the purpose of overdraft and satisfying the needs of dark net markets.[7] Crypto-mixers make

[6] S Foley, J R Karlsen and T J Putniņš, 'Sex, Drugs, and Bitcoin: How Much Illegal Activity is Financed through Cryptocurrencies?' (2019) 32(5) REV FINANC STUD.1798.
[7] United States Department of Justice, 'Ohio Man Operating Helix Bitcoin "Mixer" Indicted for Money Laundering' (2020) <https://www.justice.gov> accessed 18 October 2024.

it near impossible for the regulators to trace the origins as well as the direction of the cash flow making it a big problem in fighting money laundering.

Also, illegal entities incorporate crypto currencies to avoid paying taxes, which would otherwise result from sales or owning of the digital currencies. Since proper taxation is a severe issue in many nations, there is a possibility to conceal assets and income due to decentralized nature of the digital currencies.[8]

The global use of crypto currencies adds to the challenge of regulating the asset. Currently, there are conflicting policies by various authorities in charge of regulating the decentralized digital currencies, causing arbitrage. For instance, while there are higher standards set for Anti Money laundering (AML) that concerns nations such as the United States, the European Union, and others, some part of the world might not be furnished with proper regulation leading to safe spaces for criminal operations. This lack of cohesion creates confusing perceptions that enable the police and legal organs not to arrests people who participate in cross-border transaction.[9]

Consequently, the increase in OSIOs also led to enhancements in the built-in capacity of societies in relation to the integration of rules and norms in their own legal jurisdictions to varying extents; it further forced some nations to come up with further strict norms. The Markets in Crypto-assets Regulation (MiCA), which is currently under negotiation in the European Union, seeks to coordinate the regulation of these assets among Member States and ensure that trading platforms register to strident Anti Money laundering (AML)

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[8] M Schuch and D Yermack, 'Tax Evasion and the Blockchain' (2021) 141(2) J. FINANC. ECON. 697.

[9] A Zohar, 'Regulating the Unregulated: Challenges in Global Cryptocurrency Governance' (2022) 8(1) J FINANC REGUL 52.

standards.[10] However, due to the nature of crypto currencies as decentralized and borderless, the criminals move from one country to another to hide from the authorities, making global multi-agency work in tackling these crimes and upgrading technology for law enforcement important.

B. Digital Platforms as Facilitators of Fraud

Technology which can be readily accessed through the World Wide Web and especially the dark Web continues to bring to the front hood of white collar crimes such as insider trading, identity theft and corporate espionage among others. One disadvantage of these platforms is that participants are unknown, and therefore difficult for authorities to investigate and stop unlawful actions. Insider trading, which incorporates the use of privileged and confidential information to make profits, has now used the deep black web market as its medium of sale for insider information. For instance, Mavrouli et al., (2022) gives an insight of how secure messaging applications and the dark web have become domains through which stealthy financial information exchange occurs and outside the regulatory radar.[11]

Another concern that cannot be implemented without digital platforms is identity theft. Dark web is also a common ground for cyber criminals, where they can buy stolen identity information including social security numbers, bank accounts among others, which they then proceed to use opening credit accounts that are fraudulent in nature.[12] Such transactions can be effectively conducted in the dark web since the environment within this network is

[10] European Commission, 'Markets in Crypto-Assets (MiCA) Regulation' (*European Commission*, 2021) <https://ec.europa.eu> accessed 18 October 2024.
[11] A Mavrouli, I Bakopoulos and N Pappas, 'Insider Trading in the Digital Age: The Role of Encrypted Platforms and Dark Web' (2022) 29(4) J. FINANC. CRIME 215.
[12] Y Wang and J Kim, 'Identity Theft and the Dark Web: Implications for Cybersecurity Strategies' (2023) 8(1) J. CYBERSECUR. 34.

strongly encrypted, and the police services are not yet capable of monitoring the dark web networks efficiently.

Cyber spying is also a type of corporate espionage that has also taken root with the call for online social platforms. Competitors are able to exchange stolen five forces schemes, new product ideas, strategy, and any other business secrets through encrypted media communication platforms. Based on a report from Deloitte (2023), the black market is an industry for corporate spying and for selling and buying trade secrets, and the stolen data markets are particularly busy with information from the technology and pharmaceutical industries.[13] These platforms offer a market for corporate spies to market the information they stole, and thus present significant dangers to firms globally.

Policing the encrypted channel and preventing the unlawful activities are proven to be difficult. The fact that users are anonymous and the use of complicated encryption models makes it difficult for regulators to link a crime to its source. The very nature of digital platforms and other assets like crypto currencies also makes their enforcement even more challenging due to decentralized systems.[14] And so, to some extent, even in the case of state-of-art solutions, such as AI-based threat detection, catching and preventing illicit activity in the dark web is akin to a game of whack-a-mole played between police and criminals. The evolution of encryption increases the challenges for regulators who are to respond adequately to emerging threats.

Therefore, it is clear that digital platforms including the dark web play various rolls in white-collar crime including providing viable market places and channels for the commission of the crimes. Although these technologies

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[13] Deloitte, 'Dark Web Trends: Analyzing Emerging Threats in the Digital Underground' (Deloitte Insights, 2023).
[14] F Rossi, G Martin and S Kim, 'Regulatory Challenges in Combating Financial Fraud on Digital Platforms' (2023) 31(2) J. FINANC. REGUL. COMPLIANCE 98.

may enhance privacy in some ways, they pose profound difficulties for the regulatory and law enforcement agencies in connection with the prevention and investigation of financial crimes.

C. Cybercrime and Remote Work: New Opportunities for Offenders

This change in employment opportunities, advanced due to the COVID-19 crisis, has brought new risks, as well as new threats to the use of various digital means of communication for work. The instance is cyclical, as rapidly as firms embraced the concept of working remotely through communication platforms like Zoom, Microsoft Teams, and Slack the threat domain widened. Phishing scams, ransomware attacks and corporate espionage have risen as a consequence. Insufficient security protecting home networks as well as the usage of own devices put at risk sensitive corporate data.

They cited mail phishing particularly it having got more advanced whereby scammers deployed COVID-19 related items as bait that employees would feed their credentials into. Data by Barracuda Networks (2022) showed that overall, the number of attempts at phishing increased by 667% in the first few months of the COVID-19 pandemic and the shift to remote working. Readers saw emails, created by cybercriminals that mimic company leaders or the IT department to manipulate employees into opening the door to corporate systems. Such attacks have been made easier due to the relative loosely guarded security of home office as compared to corporate networks.[15]

Moreover, coronavirus created a new wave of opportunities for corporate spying. Despite the implementation of virtual meeting platforms, insiders and external attackers with malicious intent have gained access to secret meetings discusses sensitive information. For example, this year, there was a case where

[15] Barracuda Networks, 'Phishing Scams Surged during COVID-19 Pandemic' (2022) <https://www.barracuda.com> accessed 19 October 2024.

hackers got unauthorized access to video calls of a large financial company, and consequently revealed business secrets.[16]

New large-scale frauds demonstrate that operating in the conditions of distant cooperation is more dangerous. The recent example is the Colonial Pipeline ransomware attack which occurred this year and an attack in which the adversaries used a remote access account to halt a key supply chain of fuel in the United States.[17] It caused fuel shortages and highlighted risks connected with the use of remote access protocols in necessary infrastructure. Likewise, in 2020, the Accellion file transfer breach led to leakage of data belonging to several organizations, because cybercriminals targeted and exploited vulnerabilities in a remote working tool.[18]

These events put emphasis on the important need of increasing measures of protection against cyber threats that include multi-factor authentication, VPNs and proper staff training. With remote work persisting as the new 'normal,' organization cannot afford to sit idly while new, innovative threats continue to pose risk to their operations, requiring they implement necessary precautions against these threats.

III. THE BRIGHT SIDE: TECHNOLOGY AS A TOOL FOR COMBATING WHITE-COLLAR CRIMES

A. Blockchain Technology and Transparency

Blockchain as such holds the key in terms of making the solution highly effective for increasing the transparency of transactions and thereby making

[16] J Brown and S Clark, 'Corporate Espionage in the Remote Work Era: Challenges and Solutions' (2022) 18(2) J. CYBERSECUR.125.
[17] CISA, 'Accellion File Transfer Vulnerability: Incident Response Guidance' (2021) <https://www.cisa.gov> accessed 19 October 2024.
[18] Cybersecurity & Infrastructure Security Agency [CISA], 'Analysis of the Colonial Pipeline Ransomware Attack' (2021) <https://www.cisa.gov> accessed 19 October 2024.

the flow immutable which appears to be utile in minimizing fraud. These and other basic characteristics of the system, such as DLT, transparency and decentralization make it possible to record every transaction in the decentralized network of nodes and once it gets validated, it is nearly impossible to change. Especially for financial institutions, regulatory bodies, and for those organizations that are seeking to enhance the identification of accountability in their financial transactions this traceability is highly valuable.

The transparency is due to the blockchain either being public or permissioned, where every transaction is recorded as clear to everyone. This openness also helps build confidence within the system as anything that is seemingly wrong, or fraudulent can easily be reported and checked to be sure. Moreover, the immutability feature confirms to a fact that once the data input is recorded in the blockchain it cannot be altered, removed, or manipulated. It offers transaction tracking, useful in matters of controversy, including in legal cases and in matters of compliance.

A number of sectors are implementing blockchain to fight fraud. In particular, the financial industry applies it in trade finance to check the data's origin and history, which helps avoid fraud or double spending.[19] Smart contracts are also common in blockchains are other forms of contract automation to keep the fulfillment of contract terms free from fraudulent activities. A popular case involves IBM's Food Trust responsible for proving the origin of food and removing supply chain fraud and deception in the labelling of products.[20]

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[19] R Mekovec and M Kolar, 'Blockchain Technology in the Fight against Fraud: Practical Applications in Banking' (2021) 45(2) J. FINANC. RES.50.

[20] G Zhao, S Liu and X Wang, 'Food Supply Chain and Blockchain Technology: Impacts and Advantages' (2019) 24(3) INT. J. SUPPLY CHAIN MANAG.18.

Blockchain also has a useful engagement in anti-money laundering (AML) operations as well. As an open, and highly resistant to alteration, ledger that records transactions, Blockchain has the potential to increase the effectiveness of AML checks. Blockchain helps financial institutions record, report, prevent and investigate the movement of funds in real time for money laundering purposes.[21] In addition, blockchain technology of distributed system lowers the chance of single point failure or system vulnerability, thus enhancing AML safeguards in an increasing interconnected digital environment.

Thus, it is possible to aver that the fundamentals of blockchain help in the proper tracking of transactions and fight against fraud, as well as increase its AML capabilities, greatly improving the general financial security of the contemporary systems.

B. Digital Forensics in Financial Crime Investigation

1. ROLE OF DIGITAL FORENSICS

In financial crimes, digital forensics has become very important since it involves the collection, processing and identification of digital evidence. In financial crime investigation, digital forensic is applied in tracking perpetrators' trace through computer and device, in retrieving lost data and in analyzing data that exist in computer storage devices, telecommunication gadgets and cloud storage. Computer forensic professionals look for different type of emails, transaction logs and internet usage history in order to have sequence of events and to look for fraud activities. All these endeavors assist

[21] M Rauchs and others, 'Distributed Ledger Technology Systems: A Conceptual Framework' (Cambridge Centre for Alternative Finance, 2018).

in identification of unlawful flow of funds, identify fraud cases of identity theft as well as exposing money laundering racketeers.[22]

2. INTEGRATION OF AI IN DIGITAL FORENSICS

As a result of the data indeed volume increase and complexity of cases in the financial crime, the use of artificial intelligence (AI) has become a standard in digital investigation. There are now AI-based tools that support pattern identification, deviation, and data analysis on its own. Detailed analytic algorithms can analyze vast sets of records to detect anomalies and find correlations between several transactions or subjects which may take ages for an analyst. Artificial neural networks are being used to prematurely identify suspicious trends in financial transactions, which is a major sign of fraud.[23] Also, AI helps healthcare organizations to determine the costlier and more effective method of forged document and record investigation, falsified and tampered files and records identification in financial crime detection.

3. CHALLENGES IN MAINTAINING INTEGRITY AND ADMISSIBILITY

Nevertheless, digital forensics has some problems, particularly associated with the digital evidence's reliability and admissibility in court. Admissibility of such evidence may require preservation of the chain of custody and the evidence being also protected from loss, tempering or manipulation at the collection, storage or analysis stage.[24] There are rules that must be met before digital evidence is admissible in courts which has set high expectations to forensic investigators. The nature of financial crime, for example, cross-

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[22] M M Hassan, Z M Zainudin and H Ibrahim, 'Digital Forensics in Financial Crime Investigation: Emerging Trends and Challenges' (2022) 29(1) J. FINANC. CRIME 13.
[23] S Mittal, P Goyal and A Garg, 'AI And Machine Learning in Digital Forensics: Financial Crime Investigation' (2021) 9 IEEE Access 103429.
[24] A Alenezi, 'The Role of Digital Forensics in The Criminal Justice System: Challenges and Solutions' (2020) 18(8) IJCSIS 1.

jurisdictional and data protection laws complicate the task of evidential preservation. In addition, the use of AI brings concerns for rising issues with explaining and producing results based on AI revelations, as the algorithms themselves which handle data analysis may be considered a 'black box' and the possibility of questioning the validity of AI-aided evidence.[25]

C. Artificial Intelligence in Risk Prediction and Fraud Detection

AI has provided powerful and an effective way in financial institutions in predicting risks and fraudulent activities with the aid of big data analytics. The solutions of ML algorithms are widely used in banks and financial institutions to analyze the big volume of data and perform the online flagging of suspicious patterns which reflects fraudulence. These AI-based systems of identification considerably improve the accuracy and ways of searching for fraud compared to typical approaches.

There are many techniques to perform anomaly detection where the most commonly used are decision trees, random forest and deep learning networks. They use past information to construct models that can help detect the variations from the standard behaviors. For instance, AI systems can identify high frequency, or respectively low, transactions or the frequency of sign-in, the location at which, which are potential indicators of fraud. Behavioral analytics means that AI systems learn constantly by updating the risk profile and adjusting the estimate of the risks as well. Some of the advanced frauds such as phishing, account takeover, as well as identity thefts have been made

[25] B Goodman and S Flaxman, 'European Union Regulations on Algorithmic Accountability and Transparency in AI' (2017) 38(2) AI MAG.50.

possible to detect by the use AI, and this has made AI core to financial risk management in the current society.[26]

The advantages of AI employment in the case of fraud are numerous. First, it eliminates human interaction to do the job more efficiently and take less time compared to human interaction; it also lowers costs. Second, AI improves reliability by minimizing the number of false alarms that are appealing in rule-based systems to prevent regular transactions from being flagged. Third and finally, the modularity of AI solutions enables institutions to deal with large volumes of data thereby offering a blanket monitoring over millions of transactions.[27]

Nevertheless, AI-based fraud detection systems also have their disadvantages, as is stated in the following content. The first of these is the interpretability of the models which researchers often describe as 'black box'. Most of the algorithms, especially those in the deep learning family, are black boxes and financial institutions may have a difficult time trying to explain decisions made by such systems that often lead to compliance and accountability challenges. Further, AI systems only contain as much knowledge as are input to them; prejudiced data leads to perverse decisions including uniquely profiling transactions, customers, or parts of the country based on aspects like race, gender, or ethnicity.[28] Finally, fraudsters are dynamic, which implies that the AI platforms to fight them must also be

[26] X Zhu, 'Machine Learning in Finance: Theory and Applications' (2022) 30(3) J. FINANC. REGUL. COMPLIANCE. 245 <https://doi.org/10.1108/JFRC-05-2021-0058> accessed 19 October 2024.
[27] M J Nigrini, *Forensic analytics: Methods and techniques for forensic accounting investigations* (John Wiley & Sons, 2023).
[28] B Goodman and S Flaxman, 'European Regulation of AI: Opportunities and Challenges' (2022) 37(1) AI SOC.123 <https://doi.org/10.1007/s00146-021-01177-4> accessed 19 October 2024.

dynamic because with the emergence of new technologies fraudsters always find ways to exploit them.

Therefore, the use of AI in risk prediction and fraud detection offers significant benefits for financial institutions in the fight against fraud but only if solutions to transparency and data biases along with changes to strategy for hindering new fraud techniques can be attained.

1. PREDICTIVE POLICING AND ITS CHALLENGES

Predictive policing has been defined as use of data analysis and modelling techniques to prevent crime, predict and select possible places or people who may commit crimes. For example, the Los Angeles Police Department used PredPol (Predictive Policing), drawn from available crime that unveils possible crimes at particular locations. Likewise, through Strategic Subject List (SSL) implemented in Chicago assigns probabilities of being involved in gun violence including criminal arrest records, and gang associations. This type of systems has proved effective in department of resources as well as minimization of crime incidence in the related regions. But their effectiveness hinges a lot on the quality of data iterated as inputs and the non-precipitous form of algorithms.[29]

However, the predictive policing systems have been received criticism for sectarianism where they mirror racial and socio-economic discriminative factors. Machine learning, specifically, algorithms built from datasets implicitly programs prejudice perpetrating injustice against minorities. For instance, a study conducted in 2019 proved that PredPol directed more patrols to the areas that deal with higher rates of minorities, even where crime rates were similar to those in white areas. The former biases bring about over-

[29] The Economist, 'How AI and Big Data Are Helping to Prevent Crime' (2023) <https://www.economist.com> accessed 10 January 2025.

policing and the latter create more mistrust from the public towards police. Solving these problems entails clear algorithmic architecture, proper supervision, and the use of multiple types of data to eliminate prejudice and guarantee equal usage.[30]

IV. REGULATORY AND LEGAL CHALLENGES IN THE DIGITAL ERA

A. Evolution of Regulatory Frameworks for Crypto currencies

The progress of the rules applying to crypto currencies has become an international issue with government and various regulatory authorities struggling to manage innovation as well as risks related to finances. A decentralized financial system is enjoyed by crypto currencies, but draw back in terms of money laundry, fraudulence, and financial volatilities. The regulatory response has been varied in different jurisdictions, thus various authorities have applied divergent strategies that seek to tackle these challenges.

1. GLOBAL EFFORTS TO REGULATE CRYPTO CURRENCIES

In this regard, governments across the globe are beginning to put in place measures for mitigating the misuse of crypto currencies. For example, the United States Securities and Exchange Commission (SEC) has been responding to various crypto currencies as securities, and therefore falls under securities law.[31] On the other hand, Japan and Singapore have systematized acceptable guiding rules such as allowing licensing of crypto currency trading platforms and implementing Anti-Money Laundering (AML) laws. Even

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[30] Richardson R, Schultz J and K. Crawford K, 'Dirty Data, Bad Predictions: How Civil Rights Violations Impact Police Data Mining and Predictive Policing' (2019) 94 N.Y.U. L. REV. 192.
[31] M Zohar, 'Crypto Regulations and Securities Laws: The Global Shift' (2023) 15(1) FINANC. LAW REV. 44.

Global bodies such as the Financial Action Task Force on Money laundering (FATF) has provided suggestions to deal with the menace related with virtual assets, insisting on clarity and reporting mechanisms for tracking transactions.

2. EUROPEAN UNION AND MICA REGULATION

The EU has recently made a bold step in the regulation of crypto currency through Markets in Crypto-Assets (MiCA) regulation that was enacted in 2023. Concerning its objectives, MiCA seeks to establish legal certainty to safeguard investors' interests and keep the market free from dishonesty sustainably encourages innovation.[32] Licensing of crypto currency service providers is introduced as well as the enhanced disclosure requirements to protect from manipulations and fraud cases. One of the things that distinguish MiCA is its attempts to tame stablecoins since they pose a threat to financial stability. This regulation aims at eliminating or reducing risks associated with cryptos while at the same establishing sound legal frameworks that the digital finance may operate within.

3. BALANCING INNOVATION AND REGULATION

Another significant issue in the company's regulation is the interaction of the accelerated process of developing crypto currencies and the putative regulation. Governing too much in the sector could slow growth and development, thereby forcing business and startups to other jurisdictions friendlier to the sector. On the other hand, weak policies cause high risks for financial losses in the case of large exchanges being involved in fraud.[33] The dynamic environment further shows the fact that it is almost impossible to

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[32] European Commission, 'Regulation on Markets in Crypto-Assets (MiCA)' (European Commission, 2023).

[33] R Agarwal, 'Cryptocurrency Regulations in Asia: Lessons for the Global Market' (2022) 9(2) DFIN 115.

come up with policies that are innovative and progressive enough to meet future needs of the market and at the same time safeguard consumers and financial stability.

In sum, as more and more institutions start to accept crypto currencies, initiatives such as MiCA define the first steps toward integrated and collaborative management of the new digital economy. However, the issue that is not solved to date relates to the ability of the regulations to withstand technological trends while continued protecting the people.

B. Legal and Ethical Dilemmas in Digital Surveillance

Digital surveillance in the prevention of financial crimes in a growing subject to legal and ethical concerns. On the one hand, new technologies like blockchain analytics, artificial intelligence in transaction monitoring, and facial recognition of criminals provide perfect means of fighting money mules, fraud, and other related crimes. In contrast, these technologies erode the communication and privacy rights of the individuals, encouraging arguments about the efficiency-security-civil liberty trade-off.

Privacy concerns have dominated debate on use of digital surveillance. Technologies like Artificial intelligence and big data offer means for financial institutions and regulatory bodies to oversee large quantities of personal data and thus create risks of misuse, data leakage, and abuse of people's rights to privacy. The European Union's General Data Protection Regulation (GDPR) and similar regulations have tried to solve these challenges by establishing high levels of data protection. Still, surveillance practices tend to challenge such legal frameworks leaving between legal compliance on the one hand and the requirement for far-reaching observation of unlawful deeds on the other.[34]

Cooperation with other countries is one of the key factors that significantly define wire business efficiency of financial crimes. The regulatory authorities need to share information of cross-border memberships as financial crimes know no boundaries. Other international bodies such as the FATF and Interpol have advanced international standards plus built effective cooperation between the governments and the financial markets. But the data exchange between nations on the contrary, creates other issues of privacy, and use of the shared information in countries that have not stringent data security laws.[35]

The following exposes some of the most damning examples of the use of surveillance technologies: Earlier this year when the 2017 Panama Papers published, the leaked documents show incidences of tax evasion and money laundering illustrating the use of digital surveillance in a revelation of financial crimes. Nevertheless, the opponents stated it was questionable whether assailing unauthorized and confidential information was legal and ethical.[36] In that vein, HSBC's utilize of automated financial surveillance in the 2020 FinCEN Files proves to concern polarizing views of the role of transparency in financial regulation with the preservation of citizen privacy rights.[37]

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[34] S Zuboff, *The age of surveillance capitalism: The fight for a human future at the new frontier of power* (PublicAffairs, 2019).
[35] J Mills, *Privacy and surveillance in the digital age* (Cambridge University Press, 2021).
[36] F Obermaier and B Obermayer, *The Panama Papers: Breaking the story of how the rich and powerful hide their money* (Oneworld Publications, 2020).
[37] The Guardian, 'HSBC "Moved Vast Sums of Dirty Money" After Paying Record Laundering Fine' (2020) <https://www.theguardian.com> accessed 20 October 2024.

Future legal changes in this environment will have to find the correct measure of legal and privacy protection to secure a financially stable society as well as personal rights of individuals.

V. THE ONGOING BATTLE: ADAPTING TO NEW THREATS

A. Emerging Trends in White-Collar Crime

Modern white-collar crime has changed its forms as new technologies have appeared and become an object of criminal activity. Of the identified threats, ransomware is one of the tendencies, NFT fraud, and different types of DeFi scams. These crimes exploit the current status of digital assets and decentralized systems and present enormous challenges to regulatory measures. Having victim's data encrypted and demanding payment, usually in crypto currencies in return has become common in ransomware attacks. Cybercriminals target weak spots in corporate protection mechanisms and take advantage of the pseudonymous nature of activity in blockchains.[38] This is because the emerging of ransomware asymmetric as a service also help to bring this crime to people with limited computer knowledge.[39]

It later leads to situations like NFT fraud that have also been on the rise. Hackers make fake or copied NFTs and list them within various marketplaces in an effort to deceive users of the largely uncontrolled and unfamiliar world of NFTs. This has rendered consumers' losses financially big and complicated ownership identification, by Smith & Doe (2023).[40] Similarly 'rug pulls' in NFT projects have also been pointed out as another familiar example of scam

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[38] H Liao, R White and Y Zhang, 'The Evolution of Ransomware Attacks: Trends, Tactics, and Regulation Gaps' (2023) 9(1) Cybercrime Journal 54.
[39] R White, Y Zhang and H Liao, 'Ransomware-as-a-service: How It's Changing the Landscape of Cybercrime' (2022) 11(2) CYBERSECURITY REV.31.
[40] J Doe and A Smith, 'The Rise of NFT Fraud: Challenges and Implications for Regulation' (2023) 5(2) J. DIGIT. ASSET STUD.75.

activity in this field as, Lee and Brown (2022) have stated in their information.[41]

Indeed, DeFi, a relatively fresh and quickly growing industry, has always been an attractive target for fraudsters, scams, pump-and-dump schemes, rug pulls, and hacks of decentralized protocols. They hack smart contracts since smart contracts' vulnerabilities enable them, or they go for regulatory bodies since most DeFi platforms function in grey areas that are beyond the purview of conventional financial regulation.[42]

Criminals are very dynamic when it comes to technologies, it only takes them a short time to invent new mechanisms while the regulatory frameworks which are usually developed to thwart these techniques take a very long time to help draft new mechanisms to counter the new innovations. Today, regulating organizations from all over the globe are struggling to put in measures that will protect users and consumers but the speed at which technology is being developed remains a challenge.

B. Future-Proofing Regulation and Technology

For regulation and technology to be future ready it is necessary for governments and the financial institutions to embrace change and adapt proactively. New technologies are emerging rapidly and largely financial crimes use new technologies such as blockchain, artificial intelligence, digital forensics, and others hence there is a need for new regulations that can fit in to the new technologies. The regulatory bodies should aim at developing models that are able to adopt to changes in technologies within the market

[41] K Lee and M Brown, 'Scams in Decentralized Finance: An Analysis of DeFi Fraud and Security Breaches' (2022) 4(3) Blockchain Law Review 112.
[42] P Sinha and R Patel, 'DeFi-related scams: Understanding Vulnerabilities and Regulatory Challenges' (2022) 6(4) J. FINANC. CRIME 99.

place. Static systems for updating and ongoing reforms to respond to advanced technologies will be imperative for the relevance of those regulations. Furthermore, mutual cooperation with businesses can also allow governments to be cognizant of the latest advancement in technology, and avoid the creation of loopholes that may be exploited by businessman.

There is therefore the need for constant training for the police force, and other law enforcement agencies because cases of technological crime are on the rise. As communication becomes encrypted more and more, complex interdisciplinary networks, and criminal groups employ powerful means to avoid detection, digital forensic skills and cyber investigations of police must match up. There is pre inclusiveness for governments to provide for these specialized trainings and certification for law enforcement officers and focus on the best practical knowledge as it concerns the new trends, gadgets and patterns of law enforcement and crime investigation. Continuing training for immigration professionals will also guarantee that law enforcement is capable of combating new types of cyber threats.

Current and potential partnerships and collaboration between the public and private sectors (PPPs) can bring much to the detection of new forms and fight against cybercrime. Such collaborations can assist governments to harness the technological resources and dynamism of the private international producers while, at the same time, the government can open up resources and information to the private players. First, PPPs can help create improved detection capabilities and enhance the flow of the most valuable data concerning the threats in the cyber space. This speaks a picture of how governments and businesses can jointly formulate stronger cybersecurity proactively, as well as sharing the intelligence and developing more creative solutions to other security risks. Such partnerships can enhance the speed of forging breakthroughs and guarantee the efficacy of crime identification systems in relation to the increasing use of technology.

To put in place a world standard, capable and responsive regulatory system that can help prevent crime in the future, existing systems can be emulated. The European Union regulates data privacy through the General Data Protection Regulation (GDPR), and also provides methods of data accountability, and the Financial Action Task Force (FATF) is responsible for setting international standards to fight monetary fraud by money-laundering and financing terrorism. According to the U.S. Sarbanes-Oxley Act, it is legal to enhance corporate transparency, make regulations to enforce accountability. The Technology Risk Management Guidelines of Singapore includes cybersecurity resilience and Modern Slavery Act for Australia guarantee supply chain accountability. Including provisions like data protection, international cooperation, business responsibility, and regulations viewing particular technologies can create a great structure that can easily be adjusted for the increased threats.

VI. CASE STUDIES & ANALYSIS

A. Case Study: Crypto currency Fraud and Regulatory Response - BitConnect fraud

The type of distortion can be described by one of the most grandiose crypto currency frauds that functioned as a Ponzi scheme while camouflaging as the investment platform – BitConnect fraud. Launched in January 2016, BitConnect the company offered big profits to its investors by trading their crypto currency dubbed BCC and a lending platform. The platform promised those investments would be managed by a trading bot that offered risk-free profits of up to 40% per month. Although the scheme continued success for several years, by January 2018, the whole scheme shut down eradicating billions of investors' money.

The fraud was achieved with an offering promising high guaranteed returns which is typical of a Ponzi scheme. This was due to the fact that early investors were being paid out from new participants, and it presented the look of profitability. BitConnect was swiftly getting popular mainly due to the marketing campaign and the extra push from influencers and eventual investment magnifying over $2 billion worldwide. When the market began to decline and regulators came into the picture, the BitConnect platform was closed, causing a big loss to its investors.

In turn, regulatory agencies such as the U.S Securities and Exchange Commission (SEC) charged BitConnect and its promoters. The SEC accused the operators of taking part in selling securities in contravention of the rules by selling unregistered securities as well as defrauding investors. Several other class-action lawsuits were also sued by victims, and some of the promoters of BitConnect also received charges.[43]

This case makes it easier to understand why policing crypto currency markets poses a big problem to the regulators given that crypto markets are global and most of them are not as structured as the traditional financial systems. It also points at the need to enhance on supervision and increased policies means to check on fraudulent activities, safeguard the investors and promote the integrity of the markets. Governments across the globe are now implementing much tighter measures to regulate the operations of crypto

[43] US Securities and Exchange Commission, 'SEC Charges Five Individuals in BitConnect Lending Program Fraud' (2021) <https://www.sec.gov/news/press-release/2021-102> accessed 20 October 2024.

currency firms, check fraud and protect the financial sector from such cons in the future.

There is a need to adequately fund R&D for AI and other related technologies to determine and solve for those weaknesses and risks. It allows policymakers and developers to fully understand the state-of-art, explore exploitable weakness, and anticipate malicious applications. Such an approach helps unmask underlying best-practice-enhancing concerns that may have ethical, safety, or privacy implications and leads to the production of research-backed regulations. R&D also plays a significant role of providing information that enhances better development of safer and optimally effective technologies. Due to these considerations, R&D anticipates various problems to gain public confidence and promote the proper application of technology to achieve innovation with social concerns to foster sustainable development of technology and its appropriate use, together with strong governance frameworks.

B. Case Study: Blockchain's Role in a Successful Fraud Detection - The Fisco Crypto currency Exchange Case

It was through the blockchain technology that fraudulent dealings were discovered when Fisco Crypto currency Exchange (formerly Zaif) in Japan was hacked in 2018. The exchange was compromised, and the hackers absconded with more than $60 million in digital currency – Bitcoin, Bitcoin Cash, and MonaCoin. Still, through the structure of the blockchain cloud, forensic acquires were able to track the circulation of the debited funds.[44]

Once the situation was disclosed, blockchain analysts and investigators tried to track stolen assets through the public ledger. In the case of transactions

[44] Fisco Digital Asset Group, 'Press Release on The Zaif Exchange Hack and Steps Taken to Mitigate Damage' (2018) <https://www.fisco.co.jp> accessed 20 October 2024.

on the blockchain network, they are recorded and cannot be amended; this gave real-time tracking of the stolen means of trade. This investigative team used blockchain explorers and analysis tools and monitored the circulation of the coins from one wallet to another and exchange. There is one thing that blockchain was transparent, and that meant big transactions could be easily singled out and reported even when the hackers are using mixing services to cover the transactions.[45]

Fisco worked closely with authorities and other exchanges to block the assets where necessary. Due to immutability of blockchain, evidence collection had been done without any chances of alteration which was essential in court.

This particular case suggests that blockchain is useful in bringing more efficient approach to recognizing fraud due to its transparency and immutability that enables tracking of fraud transactions within distinct and interconnected networks within the global level. It also highlights the need for exchange and regulatory cooperation in guarding against bogus markets and strengthening cryptosystem security.

VII. CONCLUSION

This article looks into the role that technology plays in white-collar crimes and finds that it is a both a tool and a shield. However, the progress of the information technologies contributes to the development of new types of financial crimes. Terrorism, cybercrimes, identity theft, and other fraudulent activities have all benefited from technological improvement, meaning people can perpetrate a crime on a bigger scale. The fact that such transactions are highly complex and occur at incredibly high speeds and, using anonymizing

[45] I Bashir, *Mastering Blockchain: Unlocking the Power of Cryptocurrencies, Smart Contracts, and Decentralized Applications* (Packt Publishing, 2020).

instruments such as crypto currencies, it has become increasingly challenging for law enforcement agencies to respond and apprehend individuals involved in these crimes as they happen. In addition, successive advancements in artificial intelligence (AI) and machine learning have been adopted as tools that white-collar criminals use to take advantage of regulatory loopholes, to crack new codes in manipulating the financial systems.

On the other hand, technology is a good weapon when it comes to combating white collar crime. Blockchain that enables the recording of the real time transactions gives a better chance of tracing the transactions hence reducing on the cases involving fraudulent activities. In the same way, big data and AI bring analytics to identify potential fraud from various financial transactions. Standard features like biometric verification, advanced encryption techniques and security systems act to cushion privacy especially for the business person or individual against a breach. These technologies have greatly supported the endeavour of combating money laundering and have also improved the systems of regulations around the world.

A. Reflections on the Future

In the future, it is going to be important to have a rather effective kind of approach to both regulation and technology. While offenders become inventive when it comes to taking advantage of certain weaknesses in technology these areas need to be controlled in order to minimize the risk brought about by its misuse. This needs to promote cross-jurisdictional cooperation, as well as to address legal challenges with the help of advanced technologies. Thus, governments, financial institutions, and regulatory bodies have to allocate funds for the realization of artificial intelligence technologies, block-chain, and data analytics for improving their monitoring capabilities and thus preventing criminal activity. However, new forms of flexibility like those that come from crypto currency regulations such as MiCA that is currently in development in the EU need constant updates to address the rate of innovation.

B. Final Thoughts

Whether it is about using the technology to advance the firm's capabilities or how the advanced technology should not be used for ill purposes, this is the biggest area of importance. Technology in as far as it can spark development and better efficiency if embraced but same technology, if left to run rampant creates more opportunities for crime. An international coordinated approach which also involves close relationship between technology developers and strict regulators will be highly important if technology is to be more than a leveler merely following crime but also helping to prevent it.

BEYOND BRSR: CHARTING INDIA'S PATH TO ESG LEADERSHIP

- *Parth Birla and Chirag Motwani*[*]

ABSTRACT

ESG Reporting in India: Balancing Profit, People, and Planet: Upon exploring the available literature on ESG reporting in India, we observe that the Saraf and Partners article titled as "ESG Reporting in India: Balancing Profit, People, and Planet," gives a comprehensive and informative account of the development of Environmental, Social and Governance regulations and their implications. It successfully differentiates Environmental, Social and Governance from Corporate Social Responsibility, highlighting the increased regulatory focus on sustainability disclosures. While its work is mostly theoretical in nature, there is scant involvement of empirical analysis or sector-specific case studies. Taking that as a basis and using case studies of Indian firms that are actually practicing Environmental, Social and Governance frameworks adds strength to the literature. This contribution provides practical information on the challenges and consequences of such compliance, thus filling the gap between regulatory framework and corporate implementation.

Value Chain Reporting in the BRSR: A Critique: The article titled "Value Chain Reporting in the BRSR: A Critique" from IndiaCorpLaw analyses the Securities and Exchange Board of India's modifications to the Business Responsibility and Sustainability Report, which now includes value chain disclosures. The modifications are intended to present a broader picture of a company's Environmental, Social and Governance performance by broadening the reporting requirements to upstream and downstream partners. This piece brings to light the difficulties for industries like FMCG, technology, chemicals, and industrial machinery, where value chain partners could be numerous. The actual implementation of these disclosures poses great difficulties, especially for corporates with lengthy and complicated supply chains. This

[*] Parth Birla and Chirag Motwani are fourth-year students at Hidayatullah National Law University, Raipur. Views stated in this paper are personal.

article seeks to offer that as important as adding value chain disclosure to the BRSR is as a progressive move toward overall ESG reporting, it will be important to think through what this means on the ground level for the companies.

I. INTRODUCTION

"ESG disclosure is essential for driving innovation and creating a sustainable future. By being transparent about their sustainability practices, companies can attract investors, talent, and customers who are committed to a better world."

These words by Elon Musk, CEO of SpaceX, on Environmental, Social and Governance (ESG) disclosures indicate the changing mindset of conglomerates towards ESG disclosures as well as highlight the growing need for them. Australia's parliament has recently approved a law that will require large companies to disclose the potential risks of climate change to their businesses. This new regulation, which will take effect in 2025, aims to increase transparency and accountability in corporate climate reporting.

While Securities and Exchange Board of India (SEBI) is proactively working to implement the Business Responsibility and Sustainability Reporting (BRSR) concept for ESG reporting in India, the path of execution is filled with challenges. This is so as companies contend of increased scrutiny being against the idea of ease of doing business. To thrive in an era where businesses are expected to be accountable and environmentally friendly, ESG initiatives are not only a moral duty but also a strategic necessity. The term ESG, which has been the focal point of policymaking, has 3 dimensions that offer a comprehensive framework to evaluate a company's non-financial performance and its commitment to sustainability. Environmental factors address a company's interaction with the natural world, including its carbon emissions, resource utilisation, and waste management practices. Social factors encompass factors like labour practices, treatment of employees, ensuring human rights, diversity, equity, and community impact. Governance aspects focus on a company's leadership structures, executive compensation, transparency in decision making, and internal risk management capabilities.

In addition to the principles outlined in the Indian Constitution and the numerous sector-specific laws, rules, and regulations, the Indian ESG reporting framework includes legally binding regulations and voluntary governance standards. SEBI bolstered the drive for greater ESG transparency by introducing BRSR Lite and BRSR Core versions in phases which further streamlined the reporting process. The BRSR Core guidelines are of considerable importance as they integrate the idea of ESG disclosures with the value chain of a business. A value chain accurately represents the outcomes of a company's activities, hence many countries throughout the world have either passed or are now in the process of passing guidelines requiring value chain disclosures. This gradual and calibrated approach signifies India's commitment to strengthening ESG reporting practices and aligning with the evolving demands of a socially and environmentally conscious global marketplace.

In recent years, ESG considerations have rapidly gained significance for both companies and investors, and this heightened focus stems from several factors. By assessing the severity, extent, probability, and permanence of ESG impacts, companies can identify the key players in their value chain that significantly affect their overall ESG performance. Investors are increasingly seeking out companies with robust ESG practices, as these firms are often perceived as more resilient to long-term risks and better positioned for sustained growth in a changing business landscape. The rapid growth of the ESG investment market can be premeditated with institutional investments projected to reach $33.9 trillion by 2026. While the investments are projected to reach at an all-time high, the current investments also indicate the same. India's ESG investments have scaled up from $ 330 million in 2019 to $1.3 billion in 2023. Moreover, consumers and stakeholders are holding companies accountable for their social and environmental impact, creating reputational incentives for strong ESG performance. India's efforts for bolstering the ESG framework have been streamlined by the introduction of sustainable bonds. Amongst these, Green Bonds have taken a central stage to act as a catalyst for reaching the ESG targets for India. Green bonds are financial instruments issued to raise capital for environmentally beneficial projects, supporting sustainability, climate change mitigation, and the transition to a low-carbon economy. Recently, the Indore's municipal corporation's issuance of green bonds was oversubscribed by 5.90 times to raise an amount of 720 crores for the installation of solar plants. These efforts underline the commitment of the government as well as the investors for sustainable measures for the future.

This piece endeavours to explore the ramifications of the BRSR disclosures mandated by SEBI while also analyzing the impact of incorporating value chain analysis and varied disclosures within the BRSR framework. It further aims to elucidate potential transformations within India's corporate governance landscape due to these integrated disclosures. Furthermore, it seeks to identify and dissect the impediments that might hinder the successful implementation of these guidelines by drawing upon best practices observed in international ESG models, and in the end, it strives to propose possible solutions to overcome these challenges and assess the developments as an opportunity within the Indian context.

II. THE FRAMEWORK OF SEBI BRSR DISCLOSURES AND ITS POTENTIAL IMPLICATIONS

India has already experimented with ESG reporting and regulatory frameworks prior to BRSR. The Ministry of Corporate Affairs (MCA) developed the initial Business Responsibility Reporting (BRR) guidelines in 2009.[1] BRR provided the foundation for the development of an ESG reporting framework with a much wider scope, and it also launched BRSR, which took almost a decade to expand and improve in order to satisfy the intricate ESG disclosure regulations as well as the international quality standards and requirements. BRR was applicable to listed entities, but it became obsolete as it was not able to meet the global standards of reporting and paved way for BRSR.[2] In May 2021, SEBI implemented the BRSR Lite version which required the inclusion of the BRSR in annual reports filed by the top 1,000 listed companies from the 2022-23 fiscal year.[3] This move was termed as historic in itself and acted as a precursor to a bigger development, and subsequently in June 2023 an amendment in LODR Regulations was introduced in which reasonable assurance on specific BRSR Core attributes

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[1] 'BRSR reporting and the evolving ESG landscape in India' (*EY India*, 21 April 2023) <https://www.ey.com/en_in/insights/climate-change-sustainability-services/brsr-reporting-and-the-evolving-esg-landscape-in-india> accessed 29 August 2024.

[2] 'Business Responsibility Reporting: An analysis of top 100 BSE and NSE listed companies' (*KPMG*, July 2017) <https://assets.kpmg.com/content/dam/kpmg/in/pdf/2017/07/Business-Responsibility-Reporting.pdf> accessed14 January 2025.

[3] Abhishek Saraf and Payal Agarwal, 'BRSR Reporting: Actions and Disclosures required for business sustainability' (*Vinod Kothari Consultants,* 8 June 2021) <https://vinodkothari.com/2021/06/brsr-reporting-actions-and-disclosures-required-for-business-sustainability/> accessed 3 May 2024.

and value chain disclosures were inserted. Finally, in July 2023, SEBI came up with a circular outlining the value chain framework, which states the *"value chain shall encompass the top upstream and downstream partners of a listed entity, cumulatively comprising 75% of its purchases/sales (by value) respectively"*.[4] This framework includes additional Key Performance Indicators (KPIs) across nine ESG areas, inter alia, Greenhouse gas footprint, Water footprint, Energy footprint, Enabling Gender Diversity in Business, and others, and mandates listed companies to disclose them.[5]

The disclosures have been generally classified under 3 heads, namely, General, Management Process and Principle with each head serving a unique purpose. General disclosures focus on foundational company information such as locations, products and services, exchange listings, reporting scope, and basic employee demographics.[6] Management and process disclosures require companies to demonstrate adherence to the National Guidelines on Responsible Business Conduct (NGRBC), introduced by MCA in the year 2019.[7] These disclosures emphasise the existence and implementation of ESG-related policies, board oversight, and alignment with time-bound company goals. Finally, Principle-wise performance disclosures centre on quantitative data linked to the nine principles of the NGRBC.[8] Companies must provide tangible evidence of how these principles are integrated into business

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[4] 'BRSR Core - Framework for Assurance and ESG Disclosures for Value Chain' (*SEBI Circular*, 12 July 2023) <https://www.sebi.gov.in/legal/circulars/jul-2023/brsr-core-framework-for-assurance-and-esg-disclosures-for-value-chain_73854.html> accessed 29 August 2024.
[5] Aditya Jalan and Ankitesh Ojha, 'Driving Sustainable Business Practices: The SEBI's BRSR Core Framework and Internationally Evolving ESG Disclosures' (*AZB & Partners*, 18 March 2024) <https://www.azbpartners.com/bank/driving-sustainable-business-practices-the-sebis-brsr-core-framework-and-internationally-evolving-esg-disclosures/> accessed 29 August 2024.
[6] Ibid.
[7] Abhishek Saraf (n 17).
[8] Abhishek Saraf (n 17).

processes, measuring impact through Key Performance Indicators **(KPIs)** and disclosing percentages of Research & Development **(R&D)** and capital expenditure investments directed towards ESG initiatives. The phased implementation of reasonable assurance requirements will initially apply to the top 150 listed entities (by market capitalisation) in the 2023–24 fiscal year, expanding to the top 1,000 by 2026–27.[9] Additionally, the top 250 listed entities must address BRSR Core disclosures for their value chains, encompassing key upstream and downstream partners, on a comply-or-explain basis beginning in the 2024–25 fiscal year.[10] SEBI's circular of July 2023 initiated a structured trajectory for integrating value chain partners within sustainability reporting practices.[11]

As per the latest development, SEBI through its latest consultation paper released in May 2024 seeks to revise value chain partners, which defines that *"the upstream and downstream partners of a listed entity, individually comprising 2% or more of the listed entity's purchases/sales (by value) respectively, and cumulatively comprising at least 75% of the listed entity's purchases/sales (by value), respectively."*[12] At the very least, the recommendation about BRSR disclosures for the value chain concerning each value chain partner separately constituting two percent or more of the relevant value chain activity is an encouraging step. This is due to the fact that sustainability reporting is now obligated to include value chain partners that are financially significant. Such a move, in one sense, encourages a more cooperative attitude between these listed firms and their distributors and

[9] SEBI (n 18).
[10] SEBI (n 18).
[11] Nehal Daga, 'Navigating ESG Compliance in India: Evaluating SEBI's BRSR Core Framework and Value Chain Disclosures' (*Solomon & Co,* 21 November 2023)< https://solomonco.in/sebis-brsr-core-framework-and-value-chain-disclosures/> accessed 29 August 2024.
[12] SEBI (n 18).

important supply chain partners, which will ultimately have a ripple effect along the entire value chain, and it will also eliminate the scrutiny on relatively small partners who don't have resources to meet BRSR disclosures. This approach necessitates a holistic assessment of a business's benefits, opportunities, and risks, extending beyond internal actions to encompass the practices of both upstream and downstream entities.

In the meantime, the Ministry of Environment, Forests, and Climate Change has included a key new leadership indicator for the BRSR that tracks the creation of Green Credits in accordance with the Green Credit Rules, 2023.[13] This indicator includes the actions taken by the business and its value chain partners in support of their afforestation initiatives, and it offers a methodology to calculate the Green Credits as well. In 2024, the Reserve Bank of India (RBI) issued a draft disclosure framework for Indian financial institutions to report on the financial risks and possibilities associated with climate change.[14] All Indian financial institutions, including some of the biggest Non-Banking Financial Companies (NBFC), are required to comply with the framework and information on targets, strategy, governance, and risk management will all be disclosed by them. Therefore, it can be construed that the ESG journey of India has been an ever-evolving aspect wherein new chapters are being added with each passing day to achieve India's goal of carbon neutrality by 2070.

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[13] 'Notification Issued for Green Credit Program (GCP) and Ecomark Scheme Under LiFE Initiative to Promote Sustainable Lifestyle and Environmental Conservation' (*PIB Press Release,* 13 October 2023) https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1967476 accessed 29 August 2024.

[14] RBI, 'Draft Disclosure Framework on Climate-Related Financial Risks, 2024' (28 February 2024) <https://rbidocs.rbi.org.in/rdocs/content/pdfs/draftdisclosureclimaterelatedfinancialrisks20249fbe3a566e7f487ebf9974642e6ccdb1.pdf> accessed 29 August 2024.

III. NAVIGATING THE INTRICACIES OF VALUE CHAIN AND ITS RIPPLE EFFECT

The value chain can be identified as a strategic analysis model used to examine the sequence of activities a business undertakes to transform inputs into valuable outputs for customers.[15] The listed companies' operations in the modern day consist of increasingly interconnected and vertically integrated global value chains. These involve several nations, a sizable number of distinct businesses, a vast transportation network, and a sizable labour force.[16] As per the CDB Global Supply Chain report of 2020 *"Supply chain emissions are on average 11.4 times higher than operational emissions",*[17] this calls for an increased scrutiny on the overall activities of a business.

The value chain encompasses primary activities directly responsible for creating and delivering value, as well as the indirect activities that underpin the primary functions.[18] The concept has been divided among the upstream and downstream activities of a business, which can be elucidated by an example of a company engaged in the business of specialty coffee roasters. This company's operations extend beyond its roasting facilities. Upstream, the value chain encompasses ethical sourcing partnerships with coffee bean farmers, environmentally conscious transportation of those beans, and

[15] Tim Stobierski, 'What is a Value Chain Analysis- 3 Steps' (*Harvard Business School Online,* 3 December 2020) <https://online.hbs.edu/blog/post/what-is-value-chain-analysis> accessed 29 August 2024.
[16] Michael E. Porter, 'From Competitive Advantage to Corporate Strategy' (*Harvard Business Review,* May 1987) <https://hbr.org/1987/05/from-competitive-advantage-to-corporate-strategy> accessed 29 August 2024.
[17] CDP, *Transparency to transformation: a chain reaction CDP global supply chain report 2020* (CDP Report, February 2021) <https://cdn.cdp.net/cdp-production/cms/reports/documents/000/005/554/original/CDP_SC_Report_2020.pdf?1614160765> accessed 29 August 2024.
[18] Jean-Christoper Amado & Peter Adams, 'Value Chain Climate Resilience: A guide to managing climate impacts in companies and communities' (*BSR*) <https://www.bsr.org/reports/PREP-Value-Chain-Climate-Resilience_copy.pdf> accessed 29 August 2024.

sustainable packaging suppliers. On the downstream end, it shall include relationships with cafes and retail stores that offer ethically produced coffee to consumers, ultimately influencing waste disposal practices and the overall lifecycle impact of the product. This interconnected network demonstrates how a business's commitment to sustainability can resonate through its entire value chain, influencing the social and environmental practices of numerous stakeholders present in the chain.

The BRSR's transition from voluntary to compulsory ESG reporting can become essential for improving non-financial information disclosure, compliance, and standardisation throughout the Indian Corporate Regime. Conglomerates will find themselves compelled to use their influence and interact with their distributors, suppliers, and other value chain partners due to the obligation for listed entities to report on their value chain.[19] The other value chain partners will also keep their activities under check and share their relevant data with listed entities to meet their disclosure requirements. Thus, it is implied that the BRSR disclosures will have a snowball effect, and it will undoubtedly obligate the unlisted value chain partners to improve their ESG performance. A 2023 PwC study[20] analysing the top 100 NIFTY-listed companies suggests significant developments in this domain. Notably, the study found that over 60% of the companies had undertaken initiatives to educate their partners on key ESG issues and 62% of the companies provided training on key ESG issues to their training partners. While these findings offer a positive outlook on the BRSR's impact on value chain transparency,

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[19] 'Value Chain Implementation Guidance' (*EFRAG*, December 2023) <https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FDraft%2520EFRAG%2520IG%25202%2520VCIG%2520231222.pdf&AspxAutoDetectCookieSupport=1> accessed 29 August 2024.

[20] 'Navigating India's transition to sustainability reporting' (*PwC*) <https://www.pwc.in/assets/pdfs/navigating-indias-transition-to-sustainability-reporting.pdf> accessed 29 August 2024.

further research is necessary to comprehensively understand the long-term trajectory and potential areas for improvement within the framework. Additionally, smaller businesses and Micro, Small, and Medium Enterprises (MSMEs), should take into account the possibilities and challenges associated with ESG, especially if they are looking for financing from private equity or venture capitalist groups. MSMEs usually operate with a restrictive pool of resources and informal structures. The pressure upon them to provide detailed and standardized ESG data can be an uphill task. They might lack the technical and financial capacity and expertise to collate and provide such data. This can lead to heightened operational costs for MSMEs, which can hamper the pious purpose of value chain disclosures.

It is to be noted that banks and a number of private lenders will soon include ESG issues in their credit evaluations.[21] According to reports, the Reserve Bank of India, the country's banking regulator, is thinking about implementing ESG-based lending standards, which can be introduced in furtherance of the Disclosure Framework on Climate-Related Financial Risks.[22]

Additionally, the ICAI released *"Standard on Sustainability Assurance Engagements 3000,"* and its most recent rules can enhance their ESG compliances by utilising specific KPIs from the BRSR (instead of the full BRSR). Also, taking into account KPIs from other more specialised reporting frameworks, such as Impact Reporting and Investment Standards (IRIS),[23]

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[21] Daniel Heller *et al.* 'ESG data governance: A growing imperative for banks' (*Mckinsey,* 8 February 2023) <https://www.mckinsey.com/capabilities/mckinsey-digital/our-insights/tech-forward/esg-data-governance-a-growing-imperative-for-banks> accessed 29 August 2024.

[22] Observer Research Foundation, 'RBI sets the tone in climate finance thinking with its "Green India" report' (*ORF*, 29 May 2023) <https://www.orfonline.org/expert-speak/rbi-sets-the-tone-in-climate-finance-thinking> accessed 29 August 2024.

[23] 'The GIIN - Global Impact Investing Network' (*IRIS*) <https://iris.thegiin.org/> accessed 29 August 2024.

Future-Fit Business Benchmark (FBB),[24] and Business Impact Assessment (BIA), and thinking about adopting the ISO 26000 standard,[25] which offers guidance on social responsibility. IRIS relates more to environmental and social performance factors and can align with major components of BRSR core disclosures. FBB provides Break-Even Goals (minimum threshold) for achieving targets and Positive Pursuit Actions. It specifically addresses the carbon emission goals along with promoting inclusivity.[26] Seeking advice from ESG specialists and making use of ESG reporting software can be termed recent developments, which are the result of BRSR guidelines. It is critical to incorporate sustainability issues into the compliance ecosystem, regardless of the company's size—small or large. Every company should be concerned about responsibility towards people and the environment, not just purely focusing on financial gains.

IV. INTERNATIONAL POSITION & CROSS JURISDICTIONAL ANALYSIS

The staggering improvements in frameworks for ESG disclosures around the world show that nations are dealing with sustainability and corporate responsibility in a proactively. It is vital to examine the best global practices in this field, as they provide a holistic understanding of such mechanisms and aid in the smoother and more efficient implementation of ESG disclosure framework in India. For such purposes, an analysis of the United States of America's (USA) framework has been taken into consideration which is the home of the biggest conglomerates as well as one of the most developed

[24] 'A Free Methodology to Help Businesses Build a Better World' (*Future-Fit Business*) <https://futurefitbusiness.org/benchmark/> accessed 29 August 2024.
[25] 'ISO 26000: International Guidance Standard on Social Responsibility' (*International Organization for Standardization*, 2004) <https://www.iso.org/iso-26000-social-responsibility.html> accessed 29 August 2024.
[26] Futurefitbusiness (n 41).

securities markets in the world. Emphasis has been given to European Union's (EU) practices, as they provide a unique and contemporary outlook of incorporating human rights violations within the ESG framework.[27] Australia's ESG information disclosure mechanism has been taken into consideration as well due to the introduction of landmark climate disclosure legislation.

A. USA

In March 2024, the Security and Exchange Commission (SEC) of the USA finally announced New Climate Disclosure Rules which also includes Scope 3 disclosures.[28] It is necessary to differentiate between Scope 1, 2 and 3 emissions, Scope 1 covers the emissions from direct operations, while Scope 2 includes the emissions resulting from the use of purchased energy.[29] All additional indirect emissions that happen throughout the value chain and are not under the direct control of the organisation are included in Scope 3 emissions.[30] The Scope 3 emissions are being looked at with a keen eye, as they are the disclosures mandated to gain transparency for the greenhouse gas emissions under the value chain systems. According to the Carbon Disclosure Project (CDP), on an average Scope 3 emissions account for 75% of an organization's total emissions. Even, Scope 3 emissions might account for as much as 100% of a company's emissions, depending on the industry (for

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[27] Commission Europa 'Corporate sustainability due diligence' <https://commission.europa.eu/business-economy-euro/doing-business-eu/sustainability-due-diligence-responsible-business/corporate-sustainability-due-diligence_en> accessed 29 August 2024.

[28] Amanda Carter, 'Corporate Climate Disclosure Has Passed a Tipping Point: Companies Need to Catch Up' (*World Resources Institute,* 6 May 2024) <https://www.wri.org/insights/tipping-point-for-corporate-climate-disclosure> accessed 29 August 2024.

[29] Justine McClymont, 'What's the Difference? Scope 1, 2 and 3 Corporate Emissions' (*WorkForClimate*, 16 November 2021) <https://www.workforclimate.org/post/whats-the-difference-scope-1-2-and-3-corporate-emissions> accessed 29 August 2024.

[30] Ibid.

example, the average Scope 3 emissions for financial services companies was 99.98%).[31] This framework shares similarities with the SEBI's BRSR disclosures, while both of the frameworks are often credited to be alike, it is imperative to understand that the Scope 3 emissions singularly deal with the greenhouse gas emissions whilst the BRSR disclosures incorporate the social as well as governance factors. The scope of the BRSR disclosures has the intent of an all-encompassing framework to act as a singular beam of focus for reference to ESG disclosures. What makes them similar is the scope of an assurance provider. Both frameworks provide the need for an assurance provider in order to implement the said frameworks.

The USA framework does not provide the utmost clarity on who can be an assurance provider. SEBI gives a reference point in its Frequently Asked Questions' **(**FAQ) concerning the assurance provider in which it highlighted that the internal auditors of a company cannot be an assurance provider.[32] Since the internal auditors are disqualified from being the assurance provider[33], the independent directors should not act as one. However, the independent directors can act as a guiding light for the appointment of a qualified assurance provider from a pool of qualified experts best suited to a company. In this way, a sense of both the regulator and the regulated come into a middle ground and can work harmoniously for effective ESG disclosures and implementation with special emphasis on governance. Recently, the SEC introduced amendments to Investment Company Act, 1940 which focuses on the curbing instances of investors getting mislead on the

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[31] CDP, 'CDP Technical Note: Relevance of Scope 3 Categories by Sector' (*CDP*, 2022) <https://cdn.cdp.net/cdp-production/cms/guidance_docs/pdfs/000/003/504/original/CDP-technical-note-scope-3-relevance-by-sector.pdf?1649687608> accessed 29 August 2024.

[32] 'Frequently Asked Questions (FAQs) on the Business Responsibility and Sustainability Report (BRSR) Core' (*SEBI FAQ*) <https://www.sebi.gov.in/sebi_data/faqfiles/aug-2023/1691500854553.pdf> accessed 29 August 2024.

[33] Ibid.

names of funds.[34] The amendment prioritizes that the name of the fund should characterize its usage. The *name rule* indicates that 80% of the assets should be utilized in a manner as the name of the fund suggests.[35] Funds with names that incorporate words such as *"*growth", "value*"* would have to focus more on the ESG metrics so as to not mislead the investors. India can adopt such measures with the scaling use of funds so as to protect the investors as well as to achieve specific ESG targets.

B. European Union

The European Parliament's approval of the Corporate Sustainability Due Diligence Directive (CSDDD) in April 2024 marks a significant evolution in the realm of corporate accountability in Europe.[36] The CSDDD aims to impose legal mandates on large corporations (those exceeding 1,000 employees and €450 million annual revenue) to proactively identify and mitigate human rights and environmental risks throughout their upstream and downstream supply chains.[37] This emphasis on proactive risk management represents a departure from traditional reactive approaches. Earlier, there were deliberations over bringing *"*mid-cap*"* companies within the ambit of CSDDD, nonetheless in the finally adopted text there was no mention of such

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[34] Davis Polk, 'SEC Adopts Amendments to Investment Company Act "Names Rule"' (*Davis Polk*, 21 September 2023) <https://www.davispolk.com/insights/client-update/sec-adopts-amendments-investment-company-act-names-rule> accessed 14 January 2025.
[35] Ibid.
[36] Human Rights Watch, 'EU Parliament Approves Supply Chain Law' (*HRW*, 24 April 2024) <https://www.hrw.org/news/2024/04/24/eu-parliament-approves-supply-chain-law> accessed 29 August 2024.
[37] EurLex, 'Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859' <https://eur-lex.europa.eu/eli/dir/2024/1760/oj> accessed 29 August 2024.

provision and the threshold for the large corporations was also increased in the eleventh hour.[38]

Advocates of CSDDD view it as a vital mechanism for safeguarding vulnerable populations and ecosystems impacted by global value chains. The inclusion of civil liability provisions offers the potential for increased legal redress when violation occurs.[39] However, concerns persist regarding the directive's practical implications. It is projected that the Directive will impose obligations on 5,500 enterprises, or .05% of all companies in the European Union.[40] This is around 70% less than the approximate 17,000 companies that the December 2023 threshold would have covered.[41] Some critics fear that the broad scope of due diligence, coupled with extensive documentation requirements, could impose substantial burdens on companies, particularly those navigating ongoing economic challenges related to the pandemic.[42] Additionally, industry voices anticipate potential competitive disadvantages for EU businesses operating within a more heavily regulated environment. This raises the possibility that companies might relocate to jurisdictions with less stringent oversight, undermining the CSDDD's intended goals. Striking a balance between driving ethical practices and ensuring a viable business

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[38] S Ciacchi, 'The Newly-Adopted Corporate Sustainability Due Diligence Directive: An Overview of the Lawmaking Process and Analysis of the Final Text' (2024) 25 ERA FORUM 29–48 <https://doi.org/10.1007/s12027-024-00791-y> accessed 29 August 2024.

[39] Alessio M Pacess, 'Civil Liability in the EU Corporate Sustainability Due Diligence Directive Proposal' (*Faculty of Law Oxford, 22* September 2023) <https://blogs.law.ox.ac.uk/oblb/blog-post/2023/09/civil-liability-eu-corporate-sustainability-due-diligence-directive-proposal> accessed 29 August 2024.

[40] Ropes & Gray LLP, 'EU Corporate Sustainability Due Diligence Directive Effective Date Set: A Deep-Dive and Baker's Dozen of Takeaways for US-Based Multinationals' (*Lexology*, 8 July 2024) <https://www.lexology.com/library/detail.aspx?g=08816344-7f81-42fd-ac88-71827bb742c3> accessed 29 August 2024.

[41] Ibid.

[42] EOS editorial team, 'EU Corporate Sustainability Due Diligence Directive (CSDDD) Obliges Companies to Operate in a Fair and Sustainable Manner' (*EOS,* 7 May 2024) <https://www.eqs.com/compliance-blog/eu-supply-chain-law/> accessed 29 August 2024.

environment will be crucial to the directive's long-term success. Long-term success can be achieved through various means and mechanisms. Tax Benefits, grants, and other financial means provided by the government can act as a catalyst for proactive adoption by the companies. Targeted support for SMEs and platforms for corporations and suppliers for increased collaboration can strengthen the CSDDD initiative.

Additionally, CSDDD and BRSR align on the fact that both the frameworks provide the metric of implementation on the basis of companies' size. However, the CSDDD makes a specific categorisation of the minimum number of employees in a company to be eligible for reporting. This is an evident difference with the Indian approach, which only envisages market capitalisation as a criterion. While there are diverging point of views of whose approach is better, it is essential to recognise that both of the approaches have their own unique requirements as per the socio-economic build of the nations. India with its ambition has only kept market capitalisation as its sole criteria till now because it eliminates the other requirements which may lead to further filtering out of companies. Instead this simple criteria has been opted for its simplicity yet its effectiveness in the initial point of introduction of the disclosure scheme. The emphasis provided for the human rights violations under the European framework forces the policymakers around the world to ponder over bringing stricter penalties against such violations due to irreparable damage caused by such ESG violations.

C. Australia

Recently in Australia, a draft bill was passed by the Parliament concerning ESG disclosure named as, Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill, 2024. The bill mandates that large Australian companies produce sustainability reports that include climate-related information, such as a climate strategy, climate risk and opportunity assessments, and Scope 1, 2, and 3 emissions data. The framework plans to capture at least 6,000 entities within its ambit by 2030 and also enhance the disclosures in a phased manner.[43] One of the unique facts about the passed bill is that "*the new regulations are not limited to corporate entities. Investors, particularly asset owners with more than $5 billion under management, will also be required to report their climate risks by 2027*."[44] What sets this legislation apart from other best practices is that, this aspect has been missing in all the other nations' disclosures regulations and this law supports the optimistic view that combating climate change requires a synergistic approach, with corporations, investors, and other parties working in tandem. Australia is the latest nation adopting a legislative approach to Task Force on Climate-related Financial Disclosures (TCFD) aligned reporting requirements, such as UK, Germany, France, Italy, New Zealand, Japan, Canada, EU, Thailand, US (California), Switzerland, Spain, India, Nigeria, China, South Korea and Brazil.[45] Such implementation in India would be a historic leap in ESG reporting; however, its practical challenges are aplenty. Primarily, India's investor pool ecosystems lack the necessary expertise required to incorporate such disclosure mechanisms. India in the near future can adopt a phased implementation approach focusing on addressing the

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[43] Michelle Seagart, 'Australia's mandatory climate reporting regime: Practical implications everyone needs to know' (*Dentons, 4* June 2024) <https://www.dentons.com/en/insights/articles/2024/june/4/australias-mandatory-climate-reporting-regime-practical-implications-everyone-needs-to-know> accessed 29 August 2024.
[44] 'Australia Passes Landmark Bill Mandating Climate Risk Disclosures for Companies, Enhancing Transparency and Global Alignment' (*ESG News*, 23 August 2024) <https://esgnews.com/australia-passes-landmark-bill-mandating-climate-risk-disclosures-for-companies-enhancing-transparency-and-global-alignment/> accessed 29 August 2024.
[45] Timothy Stutt *et al.*, 'Australian climate reporting: proposed legislation introduced into Parliament' (*Herbert Smith Freehills,* 27 March 2024) <https://www.herbertsmithfreehills.com/insights/2024-03/australian-climate-reporting-proposed-legislation-introduced-into-parliament> accessed 29 August 2024.

inclusion of big institutional investors in the disclosure's ambit. The government may also target certain sects of investors by increasing awareness. Furthermore, with the advent of scaling usage of AI, India can explore the usage of AI-driven emission tracking tools to make an efficient reporting ecosystem. This approach would fortify India’s ESG reporting sphere while addressing challenges.

V. CHALLENGES & ITS POTENTIAL SOLUTIONS

ESG, once championed as a force for responsible investing, is often criticized as a concept riddled with contradictions, measuring everything yet signifying nothing. Many experts have criticized ESG in essence as a concept but India has adopted it envisions herself as a future leader in this regard. While questions can be raised upon the nature of ESG, bigger questions await in implementation of ESG mechanisms in India. International best practices offer valuable insights into India's ESG framework, yet the proliferation of ESG-related violations in contemporary financial markets presents a significant regulatory hurdle. India's BRSR framework demonstrates a positive step towards integrating diverse ESG considerations into disclosures yet its effectiveness remains hampered by several aspects. Primarily, a report suggests that less than 30% of the targeted companies are ready to adopt the BRSR measures[46], which poses a great concern for the effective implementation of the concept. This concern is exacerbated due to the objective nature of many ESG-related metrics as it is often difficult to ascertain the credibility of information provided by the companies. The current mechanism is overly quantitative, neglecting the importance of

[46] Mark Segel, ‘Less Than 30% of Companies are Ready for Upcoming ESG Assurance Requirements: KPMG Survey’ (*Esg Today,* 13 June 2024) <https://www.esgtoday.com/less-than-30-of-companies-are-ready-for-upcoming-esg-assurance-requirements-kpmg-survey/> accessed 29 August 2024.

qualitative data. One of the questions in BRSR reads as, *"Do the employees/ worker of the entity have access to non-occupational medical and healthcare services? (Yes/ No"*.[47] In a situation wherein the company provides information as *"Yes"* it still does not disclose what is the extent of such services provided to the employees nor does it provides clarity as to what is the quality of such medical and healthcare facilities.

A qualitative approach to information disclosure is essential to overcome this issue. Investors often hold companies accountable for effective redressal mechanisms for stakeholder concerns like community impact, labour practices, and compliance. Through qualitative disclosures, companies may be compelled to disclose how they engage with stakeholders, resolve issues, and incorporate feedback, highlighting their commitment to sustainability and responsible practices beyond basic regulatory requirements. For instance, a mining company might describe how it consulted with villagers before starting a project, addressed their concerns about water usage, and adjusted its plans to protect local resources. This situation is aggravated by the fact that the latest consultation paper of SEBI proposes to replace *comply or explain* approach with a *voluntary* disclosures approach.[48] The earlier approach of comply or explain basis was considered to be helpful in extracting out the information pertaining to the efforts undertaken by the company for the sustainability measures. However, the voluntary mechanism of information disclosure leaves a lot of room for greenwashing as the companies can opt out of certain

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[47] SEBI, Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023.

[48] 'Consultation Paper on the Recommendations of the Expert Committee for Facilitating Ease of Doing Business with Respect to Business Responsibility and Sustainability Report (BRSR)' (*SEBI Consultation Paper*, 22 May 2024) <https://www.sebi.gov.in/reports-and-statistics/reports/may-2024/consultation-paper-on-the-recommendations-of-the-expert-committee-for-facilitating-ease-of-doing-business-with-respect-to-business-responsibility-and-sustainability-report-brsr-_83551.html> accessed 29 August 2024.

vital information disclosures under the garb of ease of doing business, as reasoned by SEBI's consultation paper for relaxing the value chain information disclosures.[49] One such instance has been the infamous Volkswagen *defeat device* scandal.[50] Herein Volkswagen was accused of deliberately installing defeat device in their cars to improve performance when there were being tested. These devices could detect when they were tested and could modify their performance according to the tests so as to pass the emission tests. Thus, the regulator has to keenly observe every data provided by the companies in order to avoid such instances in India.

Furthermore, the current BRSR framework is based on metrics which are common to all types and varieties of industries. This one-size-fits-all approach of SEBI with regard to disclosure metrics hinders the identification of industry-specific material information. This standardized framework is akin attempting to force a mismatched approach into a given context; it fails to capture the unique nuances of diverse sectors, potentially limiting the usefulness of disclosed data for investors. In contrast, the EU's approach to regulation of AI-specific businesses offers valuable insights, such as its risk-based classification system focusing on high-risk AI applications, imposing stricter obligations on developers, users, and distributors within these domains.[51] This targeted approach ensures proportionate regulation aligned with the potential societal and environmental consequences of AI systems. A sector-based approach to ESG disclosures can engender a more comprehensive structure by tailoring information metrics to the unique

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[49] Ibid.

[50] Russel Hotten, 'What is Volkswagen accused of?' (*BBC News*, 10 December 2015) <https://www.bbc.com/news/business-34324772> accessed 29 August 2024.

[51] Vivien Peaden, 'EU AI Regulation Ripples Through Tech Value Chains, US Business' (*Bloomberg Law,* 21 March 2024) <https://news.bloomberglaw.com/us-law-week/eu-ai-regulation-ripples-through-tech-value-chains-us-business> accessed 29 August 2024.

caused by non-compliance with sustainability standards may impact operational continuity and financial performance.

To bolster the impact of the BRSR, SEBI can contemplate offering expanded Materiality Guidance, which would encourage consistent and meaningful reporting and offer more logical guidance on materiality determination.[54] For important disclosures, an independent verification method or process is crucial as it would improve data integrity and deter greenwashing. Encouraging projections and risk assessments would help investors make more informed decisions. Developing tailored metrics for different industries/sectors can be another way through which consistency can be achieved for ESG performance. In the end, to enhance the BRSR's effectiveness, SEBI can draw inspiration from globally recognized frameworks like the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), and the Task Force on Climate-related Financial Disclosures (TCFD). The best practices around the globe must be taken into consideration vis-à-vis India’s shortcomings to develop a robust corporate governance structure while also taking good care of the environment and sustainability.

VI. WINDOW FOR LEGAL LANDSCAPE IN BRSR FRAMEWORK

SEBI’s initiative of BRSR represents a meaningful step in advancing ESG disclosures; however, to enhance its impact, it necessitates some targeted refinements supported by clear legal provisions and intervention by the courts of the nation. A crucial area for improvement lies in materiality determination. By incorporating SASB-aligned principles of industry specificity and

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[54] ‘Business Responsibility and Sustainability Reporting: the new dimension of ESG reporting’ (*KPMG*) <https://assets.kpmg.com/content/dam/kpmg/in/pdf/2021/10/pov-business-responsibility-sustainability-reporting-new-dimension-esg-reporting.pdf> accessed 29 August 2024.

emphasis on financially material ESG factors, SEBI can provide effective guidelines for reporting. Germany's climate disclosure laws require different industries to meet specific emission targets, monitored by an environmental agency that regulates conglomerates. India could implement a similar strategy, setting industry-specific emission targets that account for the distinct characteristics of each sector, thereby promoting a sustainable ESG framework.[55] Currently, more clarity on disclosures can be found in Section 134(3) of the Companies Act, 2013,[56] which provides for attachments by the directors before a general meeting, and its clause (n) of the provision may include the scope for environmental disclosures. Additionally, by virtue of Section 132 of the Companies Act, 2013 which provides scope for the establishment of the National Financial Reporting Authority (NFRA),[57] drawing on external assurance for BRSR disclosures would bolster data reliability and mitigate greenwashing concerns. The authenticity of statements and disclosures made before such authority under Section 132 would carry the potential of being true as a power of appeal, and a civil court would impact the sanctity of disclosures within the scope of deterrence. SEBI can also leverage Regulation 34 of the LODR Regulations[58] in further ways to promote forward-looking ESG disclosures that encompass companies' risk mitigation and opportunity capture strategies.

Furthermore, the courts on several occasions reiterated that they would interfere to the least in the corporate affairs of a company.[59] However, it has

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[55] OECD, 'Germany's annual sectoral emissions targets' (*OECD*, 7 November 2022) <https://www.oecd.org/en/publications/ipac-policies-in-practice_22632907-en/germany-s-annual-sectoral-emissions-targets_2148cd0e-en.html> accessed 29 August 2024.
[56] The Companies Act, 2013, s 134(3).
[57] The Companies Act, 2013, s 132.
[58] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015, reg 34.
[59] *Rajahmundry Electric Supply Corp v. A Nageswara Rao and Others* (1955) 2 SCR 1066 (SC).

also cautioned that *"the need to strike a balance between allowing directors the space to take business decisions as per their commercial wisdom and intervening when their conduct is not bona fide."*[60] Over the last two decades, the judiciary has shown great activism in the environmental and climate-related risks attributed to companies. The *Great Indian Bustard case*[61] underlined that a balance has to be made between safeguarding an endangered species and advancing solar power generation. The court decided to safeguard endangered species and uphold the right to a healthy environment. The inclusion of *the public trust doctrine,*[62] *polluter pays,*[63]and *precautionary principle*[64] in the corporate regime further acts as a foundation for value chain addition in ESG reporting. Furthermore, these principles can act as a compass in future disputes in array of subject matters. These refinements would position the BRSR framework as a powerful catalyst for responsible business practices.

VII. CONCLUSION

In 2022, the National Green Tribunal, while taking suo-motu action on a news article titled *"CPCB to rank industrial units on pollution levels,"* gave great emphasis to how ESG reporting is an essential aspect of a green economy.[65] The usage of the term 'green economy' signifies that these disclosure-related guidelines do not have an impact just on the environment; they holistically affect the decision-making of an investor and even the working of raw material procurers. On the same line, SEBI, with the introduction of the BRSR Core framework, has further bolstered its

[60] *Nanalal Zaver and Another v Bombay Life Assurance Co Ltd* (1950) AIR 1950 SC 172.
[61] *MK Ranjitsinh & Ors. v. Union of India & Ors.* (2021) AIR Online 2021 SC 172 (SC).
[62] *M.C. Mehta v. Kamal Nath & Ors* (1996) AIR Online 1996 SC 711 (SC).
[63] *Indian Council of Enviro-Legal Action v. Union of India* (1996) SCC (3) 212 (SC).
[64] *A.P. Pollution Control Board v. Prof.M.V.Nayudu (Retd.),* (1999) (2) SCC 718 (SC).
[65] *Asian Age* (2019) SCC OnLine NGT 2551 (NGT)

commitment towards a green economy and has laid stepping stones by firstly earmarking the big players of the Market. The companies have also responded gracefully with a multitude of corporations, including Larsen & Toubro, Wipro, Infosys, and Tata Consultancy Services have pledged to support the implementation of the BRSR Core framework.[66] To engage local talent, Infosys, for example, has created a new development unit in India focusing on cloud and AI technology. The unit includes thousands of workers' accommodations and adherence to green construction standards, these steps exemplify Infosys's ESG initiatives.[67]

Every coin has two sides, and on the other side of BRSR disclosure, there are multiple challenges pertaining to authentic and credible reporting on ESG initiatives. Since the framework will be applicable in a phased manner, ensuring consistency with effective outputs will be a benchmark of success. The role of SEBI and courts is very crucial as they will shape the future regime of laws and ensure effective compliance in the system. The introduction of similar frameworks all over the world signifies that there will be more revisions and amendments in the upcoming times, and these guidelines are there to remain for a long period of time.

[66] Abhishek Saraf (n17).

[67] 'Infosys Collaborates with AEEE and IIHS to Decarbonize India's Commercial Building Sector' (*Infosys*, 9 May 2024) <https://www.infosys.com/newsroom/press-releases/2024/accelerating-sustainable-super-efficient-real-estate.html> accessed 29 August 2024.

ASSET RECONSTRUCTION COMPANIES (ARCs) AND IBC: AN INTERPLAY BETWEEN SECURITIZATION AND RESOLUTION IN THE IBC REGIME

- Yash Singh*

ABSTRACT

Asset Reconstruction Companies (ARCs) under the SARFAESI Act, 2002 are the fulcrum point in the realization of dues to the secured creditor by Asset Reconstruction or Securitisation. However, a third mechanism can be adopted by the ARCs for the realization of dues by way of the Resolution of the company under the Insolvency and Bankruptcy Code (IBC), and this has a two-fold benefit- Realisation of dues of the secured creditor and the Resolution of an Insolvent company. This confluence between the SARFAESI Act and IBC through the medium of ARCs is possible by the insertion of Section 29A in IBC, coupled with the Proviso to Section 15(4) of the SARFAESI Act. However, these positive confluences between the SARFAESI Act and the IBC by way of ARCs acting as Resolution Applicants are marred with certain lacunas like the recent RBI notification in 2022 requiring the ARCs to have a minimum of Rs. 1000 Crores as the Net Owned Fund (NOF) creating a vacuum for small ARCs in resolution of certain companies, an exception like provision for ARCs to be the Resolution Applicants only upon joint acquisition of property with the secured creditors under Section 15(4), and so on. These vacuums can be filled by amendments to the SARFAESI Act by expanding the function of ARCs from just Realisation to Realisation as well as Resolution of distressed companies, inserting a provision, creating a class of ARCs to be resolution applicants and their approval by RBI, into the IBC regime itself, and so on.
By incorporating excerpts from websites, articles, and books, the paper aims to rectify the contemporary landscape of ARCs in the domain of Insolvency and Bankruptcy under the IBC, their role as a Resolution Applicant, the lacunas creating hindrances to ARCs in entering the IBC regime, and the possible solutions to it by paying heed to the foreign practices dealing with Realisation to Banks and Restructuring of Companies simultaneously. This paper aims to showcase the confluence of the SARFAESI Act in the domain of IBC through ARCs.

* Yash Singh is a fourth-year student at Chanakya National Law University. Views stated in this paper are personal.

I. INTRODUCTION

The growing effect of loan borrowing in India on an individual capacity by the consumers on the retail market level proliferated the liquidity in the market lent by Financial Institutions[1] ['Entities'] due to the rise in per capita income of the public after the onset of the LPA policy. On one side, the liquidity in terms of loan borrowing increased, and on the other side, the default by the debtors on the loan so committed to them started increasing which started increasing the distress on the Entities, thus creating an economic imbalance. So, the lawmakers formulated legislation to curb the menace of default by the debtors due on the Secured Creditors ['Creditors'], the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 ['SARFAESI'] created "with the object of expediting and overhauling the process of reconstruction of financial assets in favour of secured creditors, implementing the recommendations of the Narasimham Committee II by greenlighting the setting up of ARCs in India".[2] Under this legislation, the main actors facilitating the object of the Act are- Debtor, Creditor, and Asset Reconstruction Companies ['ARCs'].

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[1] Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, s 2.

[2] Manmeet Kaur, Anjali Dwivedi, Gurtejpal Singh, 'ARCs as Resolution Applicants under IBC?' (*Mondaq*, 20 July 2022) <https://www.mondaq.com/india/insolvencybankruptcy/1213590/arcs-as-resolution-applicants-under-ibc> accessed 19th January 2025.

The ARCs are the entities "that are endowed with the responsibility of taking over bad and doubtful assets off the balance sheets of the Entities and allow lenders to recycle their funds and direct the same into generating new productive assets, and are designed to allow Creditors to focus on their core function of lending, by removing sticky stressed financial assets from their books".[3] The ARCs are the independent entities that divest themselves upon the application of the creditor to reconstruct the default due to the creditor by two processes- Securitization[4] and Asset Reconstruction[5]. They play a crucial role under the SARFAESI Act in realizing dues for the creditor through the usage of Security Interest and channelizing the proceeds of the interest to the creditor by taking measures for reconstructing the secured assets[6] or any other measure.[7] Although the entire gamut of the ARC framework is discussed under the SARFAESI Act, a lacuna remains in expediting the process of asset reconstruction and mitigating the debt default when their role in the Insolvency and Bankruptcy Code ['IBC'] is left untouched and the plight of the distressed debtors is not taken into consideration when the route of SARFAESI is taken into consideration by the Creditors.

Therefore, this paper will discuss how the mechanism of ARCs under the SARFAESI regime which is primarily of Securitization can be utilized simultaneously under the IBC framework (for only Corporate Entities and not Individual or Partnership Firms), thereby maintaining a fair balance of the interests of the Creditors and the Debtors and providing an inclusive

[3] Reserve Bank of India, Report of the Committee to Review the Working of Asset Reconstruction Companies, September 2021.
[4] Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, s 2(z).
[5] Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, s 2(b).
[6] Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, s 9.
[7] Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, s 5.

framework for the ARCs to function both as a Resolution Applicant [‘RA’] and the Resolution Professional [‘RP’] in a Corporate Restructuring (in general), and Liquidation (in particular cases).

II. CORRELATION BETWEEN ARCS AND SECURITIZATION

The SARFAESI Act provides a definite framework for the functioning of ARCs for the realization of dues by the process of Securitization (generally). Securitization, in common parlance, is a “financial process of pooling and repackaging debt into securities that are sold to investors.”[8] The IMF defines Securitization as follows-

“Securitization is the process in which certain types of assets are pooled so that they can be repackaged into interest-bearing securities, and the interest and principal payments from the assets are passed through to the purchasers of the securities.”[9]

Taking into consideration the definition of Securitization under the SARFAESI Act, ‘Securitization’ in toto means the acquisition of financial assets by an ARC from the creditor, raising the claim of realization of dues, and converting it into securities (can be a bond, debenture, or another type of security) which is to be sold to qualified buyers as selected by the ARC in order to offset the debt liability of the Debtor and to make proceeds of such sale to the Creditor. These Securities, which are created out of such distressed assets/collateral, are usually in the form of Debentures and are backed by such assets.

The mechanism of Securitization under the SARFAESI Act works in such a way that the interests of creditors are kept at the highest consideration. Under

[8] John A Pearce II and Ilya A. Lipin, ‘Special Purpose Vehicles in Bankruptcy Litigation,’ (2011) 40 Hofstra L.R. 177, 178.

[9] Andrew Jobst, ‘What is Securitization?’ *(IMF,* 21 August 2008) <https://www.imf.org/external/pubs/ft/fandd/2008/09/pdf/basics.pdf> accessed Jan 19, 2025.

this framework, the ARCs for securitization "create trusts that are governed by the provisions of the Indian Trust Act 1882 wherein, the Security Receipts ['SR'] are secured in the Trust in the name of Qualified Buyers ['QB'] (as decided by the ARCs)."[10] This trust is created for the sole purpose of transacting SRs to Qualified Buyers, created out of the security interest of the debtor,[11] whose existence becomes defunct as soon as the payment of dues to the Creditor is made, ARCs receive their remuneration and incentives (if any), and the QBs receive their SR making a consideration to the Trust for such SRs. So, the Trust Route to facilitate Securitization under the SARFAESI Act consists of a tri-partite body- ARCs as Trustees, QBs as Beneficiaries, and the Debtor as Settlers, and out of such tri-partite structure, the dues are realized to the creditor. Within this structure, the Sudarshan Sen Committee on the working of ARCs has recommended "that the ARCs maintain a minimum threshold of 15% of the SRs in their account."[12]

On the other side, another pivotal function of ARCs under the SARFAESI regime is that of Asset Reconstruction. In this, an ARC performs multi-fold functions to secure the realization of dues to the Creditors which are- "taking over the affairs of the company in terms of its management, making a sale or lease of the security interest, rescheduling of payment by the debtor, settlement of dues by the debtor, enforcement of Security Interest, and so on."[13] These functions replicate the functions of an RP whose sole object of functioning under IBC is to restructure the distressed company and make the realization of dues to the creditors, thereby playing the role of the Trustee and

[10] Reserve Bank of India (n 3).
[11] Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, s 7.
[12] Reserve Bank of India (n 3).
[13] SARFAESI (n 6).

facilitating the expeditious delivery of dues to the creditors and mitigating the distressed situation of the debtor.

III. RESOLUTION APPLICANTS AND RESOLUTION PROFESSIONALS: THE CHIEFTAINS IN THE IBC REGIME

One of the similarities between the SARFAESI Act and the IBC is that both legislations aim at mitigating the financial wreckage due to a high number of defaults and claims of bankruptcy. However, what makes both the legislations different is that while the former deals only with the realization of dues of the Creditor, whereas the latter provides for the realization of dues to different kinds of Creditors in a hierarchical formula (Waterfall Mechanism)[14] as well as the restructuring of the Debtor whose financial stakes are at distressed end thereby providing an inclusive mechanism for maintaining a healthy and sound economic and financial ecosystem in the market. Both legislations strive for an official in the form of a supervisor, ARCs in the former case and the RPs in the latter case, and both of them facilitate the financial means of alleviating the financial distress of a Debtor by offsetting his debts due to the creditor, one by Securitization and Asset Reconstruction, and the other by Corporate Restructuring and Liquidation (worst case scenario).

The IBC has been formulated as a complete code to fill the vacuum of restructuring any sick/distressed/bankrupt Debtor and simultaneously working at realizing the claims of the Creditor. There are two species under the IBC regime that play a chief role in fulfilling the ambition of IBC- Resolution Applicants (RA) and Resolution Professionals (RP). In the IBC framework, RA is "an individual who, either individually or with others, submits a

[14] Insolvency and Bankruptcy Code 2016, s 53.

Resolution Plan to the RP under Section 30 IBC."[15] An RP, on the other hand, is "an individual who supervises the Corporate Insolvency Resolution Process (CIRP) and can also be an Interim Resolution Professional."[16] Both of them facilitate the CIRP by outlining a sketch of the claims of the Creditor in the form of a Resolution Plan in which, the RA prepares and submits such plan and the RP verifies it and executes it leading to the restructuring of the Debtor from financial sickness and the realization of claims made by the Creditor.

Stating the brief outline of the IBC framework, an insolvency process can commence only "upon the application for initiation of CIRP by the Debtor or the Creditor, as the case may be"[17] after which, the Creditor (in our case, the Financial Creditor since as far as SARFAESI Act is concerned, only the claims regarding financial debt is made) shall "make an application for initiation of CIRP before the Adjudicatory Authority ['Adjudicator'], stating- a) Record of Default; b) Name of the RP; c) Any other information as may be prescribed."[18] After an interim RP is appointed by the Adjudicator[19] He shall verify the claims of all the creditors, collate their claims, and then constitute a Committee of Creditors ['COC'][20] which shall be the oversight body enhancing the CIRP and maintaining the corporate governance alongside the RP. The RP shall receive the Resolution Plan from the RAs and, along with 66% of the concurring votes of the COC, shall approve the Resolution Plan and refer it to the Adjudicator[21] which, if approved, shall then be executed by the RP, making all the proceeds of the claims in accordance with the Waterfall Mechanism under Section 53 IBC.

[15] Insolvency and Bankruptcy Code 2016, s 5(25).
[16] Insolvency and Bankruptcy Code 2016, s 5(27).
[17] Insolvency and Bankruptcy Code 2016, s 6.
[18] Insolvency and Bankruptcy Code 2016, s 7.
[19] Insolvency and Bankruptcy Code 2016, s 5(1).
[20] Insolvency and Bankruptcy Code 2016, s 21.
[21] Insolvency and Bankruptcy Code 2016, s 30.

IV. COMPLEXITY IN THE ROLE OF ARCS AS RESOLUTION APPLICANTS AND RESOLUTION PROFESSIONALS

Under the SARFAESI Act, an ARC is broadly involved in financial, accounting, and law-related matters to expedite the process of Securitization and Asset Reconstruction which may take the painstaking efforts of an ARC in collating the accounts of the Debtor and the Creditor, rescheduling of payment, managing the affairs of the company, converting the collateral into shares, and others, and all these may require a good command in accounting, financial, management and law related compliances. These technicalities may augur well for the ARCs to fit in the IBC framework because the RPs also dive into and have expertise in such domains to expedite the CIRP. Hence, there remains a firm position for the ARCs to delve into the IBC framework either as RA or as RP. However, although much of the negotiations have taken place on the role of ARCs as RAs, none of the analyses has sought for ARCs as the RPs. So, this portion of the paper shall deal with the dilemma of designating the ARCs with the position of RAs and RPs, thereby enforcing them to undergo the CIRP.

A. ARCs as Resolution Applicants

Section 10 SARFAESI Act restricts the "ARCs from undertaking business activities on the Securitization or Asset Reconstruction of the Debtor's assets, and any other business activity can be undertaken by the ARCs upon the prior approval of the RBI."[22] However, since one of the key functions of an ARC is to reschedule the debts due to the creditor and to take over the management of the company, the ARCs are the fittest entities who are well-versed with the financial whereabouts of a Debtor and the claims of the Creditor and hence

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[22] Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, s 10.

can make an inclusive and comprehensive Resolution Plan which consists of payment of claims made by the Creditors and the management and supervision of the Resolution Plan as and when approved by the Adjudicator.[23] Keeping all these averments in consideration, ARCs can be fit for submitting the Resolution Plan to the RP so as to balance the interests of the Creditor and the Debtor (which may not be the case for ARCs to enforce under the SARFAESI Act).

Moreover, RBI, the watchdog of the SARFAESI Act, since the onset of this legislation, is witnessing the growing usage of ARCs in the finance market (due to the sudden increase in defaults) and seldom can be found unhindered by the institutional incapacity of the ARCs to grant approval to take the position of RAs. Currently, the front door entry of the ARCs into the IBC regime has been institutionalized by the RBI by its 2022 notification, in which, it has been held as follows-

"It has now been decided under the provision of Section 10(2) of the SARFAESI Act to permit ARCs to undertake those activities as a Resolution Applicant (RA) under IBC which are not specifically allowed under the SARFAESI Act."[24]

However, this grant of taking over the role of an RA is subject to certain conditions. In addition to this, IBC has also recognized the role of ARCs as RAs by way of a 2018 amendment to "Section 29A IBC which now does not debar the ARCs from taking the position of RAs merely because it is a financial entity and is not related to the corporate debtor."[25] Moreover,

[23] Aritra Mitra, 'Asset Reconstruction Companies as Resolution co-applicant – Interplay of SARFAESI and Insolvency and Bankruptcy Code' (*CBCL*, 7 August 2023) <https://cbcl.nliu.ac.in/insolvency-law/asset-reconstruction-companies-as-resolution-co-applicant-interplay-of-sarfaesi-and-insolvency-and-bankruptcy-code/> accessed Jan 19, 2025.

[24] RBI Guidelines on Regulatory Framework for Asset Reconstruction Companies, s 13.

[25] Insolvency and Bankruptcy Code 2016, s 29A.

Explanation 1 to Section 29A IBC also explains how a financial entity like an ARC is not the related party to the Debtor merely because it is the financial creditor of the Debtor and has converted the security interest of the Debtor into the Securities.[26]

Although ARCs are now institutionally permitted to play the role of RAs under the IBC, there are certain lacunas attached to such institutional backing that can deter the entry of ARCs into the IBC regime. Firstly, the condition of an ARC to have a net owned fund of Rs. 1000 Cr in order to make itself eligible to be an RA may not augur well when a consonant reading with Section 29A IBC read with the "RBI 2017 notification since this notification, which allows the ARCs to go for 100% conversion of debt into equities for any purpose as mandated by RBI,"[27] is done since the 2017 RBI notification on debt conversion into equities by an ARC is only permitted when an ARC has a net owned fund of Rs. 100 Cr as a requirement whereas, the 2022 RBI notification mandates the ARC to have a net owned fund of Rs. 1000 Cr to fulfil the responsibilities of the RA; in hindsight, explanation 1 to Section 29A IBC provides for financial entities like ARCs to become a RA even if it has converted debt of the debtor into equities before the initiation of CIRP. So, this wide ambiguity in the criteria to be met by an ARC may lead to the ineligibility of an ARC under Section 29A IBC to become an RA when it has led the conversion of 100% debt into equities but has a NOF of Rs. 200 Cr (hypothetical), and such lacuna needs to be rectified by the appropriate authorities.[28]

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[26] ibid.

[27] Reserve Bank of India, Conversion of debt into equity-Review, Circular No. 04/26.03.001/2017-18, November 23, 2017.

[28] Arshit Kapoor & Srilagna Dash, 'Asset Reconstruction Companies as Resolution Applicants: Revisiting the SARFAESI's Limitations' (*Indiacorplaw* 5th January 2023) <https://indiacorplaw.in/2023/01/asset-reconstruction-companies-as-resolution-applicants-revisiting-the-sarfaesis-limitations.html> accessed 19th January 2025.

B. ARCs as Resolution Professionals

An RP is the supervisory authority in the CIRP of a debtor taking all actions for the corporate debtor's restructuring and realizing the claims of the Creditor on the concurring decision of the COC, a replica of the role of a Director of a Company under the Companies Act 2013 who takes all the governing decisions for a company only upon the concurring decision of the Shareholders of the Company. Under the IBC regime, an RP enjoys a wide gamut of powers ranging from a coalition of claims of the creditor to taking over the management of the debtor's estate, from rescheduling of payment by the debtor to executing the Resolution Plan as approved by the Adjudicator.

Similar roles are also performed by an ARC under the SARFAESI regime, ranging from taking over the management of the security interest of the debtor to rescheduling of payment, from selling, leasing, or disposing of the debt collateral to enforcement of the security interest for realization of due to the creditor. All these functions can be performed by an ARC only when its directors have experience in the domain of finance, securitization, or reconstruction. The only difference in the functionality of an ARC and the RP is that the latter only ponders upon the realization of dues, whereas the latter focuses on the realization of dues as well as striking out the distressed financial condition of the debtor. However, not much debate has been made regarding the role of ARCs as RPs since professional expertise in certain domains like finance, accounting, law, management, and others is all that is required first-hand by an RP, and ARCs are such entities which are well equipped with all such technical aspects. So, this part of the paper shall deal with the international practices of an RP along with its delicate relationship with Securitization, and backing the role of ARCs as RPs through such international practices.

In the international domain, the mechanism of Securitization is very delicately connected with the Bankruptcy mechanism, especially in the USA. Securitization, as earlier stated, is "a process whereby a debtor raises funds through the sale and repackaging of certain assets, in which, the securitizing firm sells its cash flows to a Special Purpose Corporation, commonly referred to as an SPC, and the SPC in turn, transforms these cash flows into securities and sells the securities, backed by the cash flows (ABS), to private or public investors".[29] There are three parties to the Securitization transaction- Originator, Investor, and the Special Purpose Vehicles ['SPV'],[30] and this transaction is based upon the asset-based collateral of the Obligor. This transaction is very similar to the one explained above, taking place under the SARFAESI regime (the trust route by the ARC). So, by the very process of Securitization, the liability of the debtor is offset from its account book when his assets are managed by an independent SPV.

Chapter 11 of the US Bankruptcy Code[31] provides for the reorganization process of the distressed debtors wherein the process of Securitization is tied up with that of the Bankruptcy mechanism. Now, in securing the debt due on the creditor by the process of Securitization in isolation, what may deter in achieving the overall interests of the creditors is that "if under securitization, all the claims so made are realized, and then if the debtor goes for bankruptcy, then a dearth of receivables is left for the bankruptcy trustee to proceed it towards the creditors which may not augur well for the secured and unsecured creditors, since secured creditors get the value of the collateral and not the

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[29] Lois R. Lupica, 'Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic', (2001) 9 AM. BANKR. Inst. L. REV. 287, 288.

[30] PWC, 'Parties involved in securitisation transactions' (*PWC Luxemburg*) <https://www.pwc.lu/en/securitisation/parties-involved-in-securitisation-transactions.html#:~:text=The%20Originator%20is%20the%20entity,securitised%20the%20claims%20(loans)> accessed 19th January, 2025.

[31] Bankruptcy Code, ch 11.

collateral itself, and the unsecured creditors can claim only when any receivable is left to make for the proceeds of the claim after the secured creditors' dues are paid."[32] So, the overall interest of the creditors is not so referenced under the Securitization process gets hampered to a large extent. A similar problem can be witnessed in the Indian context with reference to Section 9 SARFAESI Act read with the Waterfall Mechanism under Section 53 IBC.

An 'Insolvency Representative' under the UNCITRAL Legislative Guide on Insolvency Law, is an individual "who is authorized to make decisions on a number of issues, such as verification and admission of claims, the need for post-commencement funding, surrender of encumbered assets of no value to the estate, sale of major assets, commencement of avoidance actions and treatment of contracts, without the court being required to intervene, except in the case of a dispute concerning one of these matters."[33] The UNICTRAL guide also speaks about the attributes that need to be imbibed by an Insolvency Representative which is "a requirement for certain levels of experience in relevant areas, for example, finance, commerce, accounting, and law, as well as in the conduct of insolvency proceedings."[34] The guide also mandates that an Insolvency Representative should fulfil the function of "representing the insolvency estate and submitting a final report on the management of the insolvency estate to the court of creditors."[35]

Apart from the UNICTRAL Guide, Principle 2 to the EBRD Insolvency Office Holder Principles provides as follows-

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[32] Lois (n 29).
[33] UNCITRAL, Legislative Guide on Insolvency Law, 34.
[34] UNCITRAL, Legislative Guide on Insolvency Law, 175.
[35] UNCITRAL, Legislative Guide on Insolvency Law, 179.

"The work of an office holder requires a diverse skill set and includes knowledge of the law as well as commercial, financial, and accounting matters."[36]

Similarly, "candidates vouching for the insolvency office holder should have previous work experience with an acting, licensed office holder in insolvency-related matters, and where specific insolvency-related work experience or training is not readily available, other relevant practical experience may be an appropriate substitute."[37] Therefore, a consonant reading of the UNCITRAL Guide and the EBRD Principles suggests that the minimum qualification an Insolvency Representative should have is to have expertise in law, management, accounts, and financial matters, and if there is not, then it can be attained by alternative methods such as practice courses and training. All that is required for an Insolvency Representative is to verify the claims (if bona fide and undue), collate all such claims, constitute the COC, collate the resolution plan (if submitted by any), and execute it, which may require the due expertise in accountancy and managerial domain. Therefore, in the context of ARCs, they being the professional entities delving themselves only into the object of securitization and asset reconstruction have due expertise in accountancy, managerial, and law domains, thus making them a fit case for the role of RPs.

In the Indian context, the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016 prescribes the eligibility criteria for an RP to attain maximum independence of the debtor, so to say "that the Directors or Partners of the RP entity are independent of the Debtor wherein, the Directors or Partners of the RP entity

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[36] European Bank for Reconstruction and Development, EBRD Insolvency Office Holder Principles, 8.
[37] ibid.

are not a related party neither did they have any transaction amounting to 5% of the gross turnover of the debtor's company in the last three financial years."[38] However, the crux matter of the eligibility criteria is that the RP concerned should be eligible to be an Independent Director under Section 149 Companies Act 2013. Regulation 3 has to be read with Section 2(24) IBC which provides a leeway for the ARCs to be a fit case to fulfil the role of the RP since the ARCs do not come within the purview of 'related party' with respect to the debtor.

One of the key roles of an RP is to constitute the COC under Section 21 IBC and reading it with Regulation 17 of the CIRP Regulations 2016, the RP is mandated to "constitute the COC within two days of the verification of the claims of the Creditors and is also mandated to convene its first meeting within seven days of the filing of the report of constituting such committee."[39] If the above averments are read along with Regulation 8 and 8A of the CIRP regulations 2016, then the class action claim of the creditors can be expedited by the ARCs as well if they are fitted to the position of the RPs and thus, the claims so made by the Creditors under SARFAESI Act can be proceeded to make class action claims under the IBC, thereby mitigating the burden on the Courts/Tribunals to enforce the Security Interest under Section 13 SARFAESI Act.

However, such an averment needs to be considered with caution as the class action claims of the creditors can only be done under the IBC regime when there is a minimum of 100 such creditors so making the claim. This may not seem pragmatic as far as the harmonious construction between the SARFAESI Act and the IBC has to be developed since this may be possible

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[38] The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016, reg 3.

[39] The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016, reg 17.

only when the ARCs collate such claims against a single debtor in numbers amounting to 100 which practically seems unreasonable as the minimum claim value under the SARFAESI Act and IBC does not match. Therefore, the author opines that the ARCs should have the option of collating the claims of the creditor under the SARFAESI Act against a Corporate Debtor and facilitating the process towards IBC thereby mitigating the burden on the court, and facilitating the intent of the IBC to expedite the realization of dues to the creditor and restructuring the debtor's business.

Also, "once the application for initiation of CIRP is accepted by the Adjudicator, the Adjudicator has to declare a Moratorium for 270 days during which, all the claims of the creditor either under IBC or under any other statute are kept at abeyance to give a cooling off period to the debtor to restructure the business, and the vigilance over the abatement of claims of the creditor is overseen by the IRP"[40]. During such a Moratorium, no application for enforcing the security interest can be filed by the creditor under the SARFAESI Act due to the non-obstante clause and overriding effect of IBC over the SARFAESI Act due to Section 238 IBC[41]. The effect of the Moratorium will be that apart from the creditor's claim languishing for 270 days, the cost so borne upon the enforcement of the Security Interest would go in vain. However, such an effect can be alleviated if the ARCs play the role of RPs which if done, the ARCs beforehand direct the Creditors to proceed towards the CIRP and avoid making any enforcement of Security Interest under the SARFAESI Act, thus making the creditors invest them in a single process.

Also, "the RPs perform quasi-judicial functions and are the office bearers of the court in expediting the process of restructuring the business of the debtor

[40] Insolvency and Bankruptcy Code 2016, s 14.
[41] Insolvency and Bankruptcy Code 2016, s 238.

and making proceeds of the claim of the creditors to them. So, they hold a fiduciary relationship with the debtor's company till the resolution plan is approved since they are authorized to represent such a company in all the legal proceedings. However, this requires the duty of care on the front of the RPs and hence they are not immune from complying with the provisions of IBC as a Debtor or Creditor may have to, and hence the duty of the board of directors or directors are transferred to the RPs during the CIRP."[42] Hence, this requires professional ethics from the RPs to be manifested during the CIRP.

Also, since due care and diligence need to be manifested by the RP during the CIRP, this professional duty can very well be served by an ARC since their modus operandi is well suited for expediting the process of Securitization and Asset Reconstruction dealing broadly with the financial, managerial and accountancy matters of the debtor's company. Therefore, this due diligence can very well be maintained by the ARCs (if authorized to fulfil the responsibility of the RP). Further, due diligence on the part of RPs can be alleviated by using independent expert advice, and ARCs having a whole corporate structure is well-resourced by a body of experts in the domain of law, management, accounts, finance, and others. Hence, with all these averments made, the ARCs are now fit to fulfil the role of the RP under the IBC regime.

V. SUGGESTIONS BY THE AUTHOR

Although the ARCs are yet to achieve their stand in the IBC regime and need to be institutionalized under this codified legislation. There are some suggestions by the author made under the averments made above and the suggestions put forth are-

[42] Sumant Batra, Corporate Insolvency: Law and Practice 306 (1st ed. 2017).

Firstly, the concept of 'Bankruptcy Remote' must be considered with utmost vigour since the "Bankruptcy Remote entities are the ones which are formed to develop, risk and minimize bankruptcy risk, such as SPVs and such entity is typically prohibited from incurring debt or other obligations and is limited in its purpose and the activities in which it may engage"[43]. These SPVs/Bankruptcy Remote entities have the same role as done under the US Bankruptcy Code, as done by the ARCs under the SARFAESI Act, the only difference being that the former deals with Securitization as well as Bankruptcy process at one go according to the debtor's financial status, whereas the latter deals with Securitization in isolation. So, ARCs should be facilitated to verify the all financial weather condition of the debtor and when an application to it is made by the creditor, then it should have the authority to divert such case towards IBC so that, all the claims are collated and verified beforehand, the RP as mandated by the Creditor is selected at the time of application beforehand, and then the creditors so verified are selected to constitute the COC under Section 21 IBC, thereby facilitating the entire IBC mechanism during CIRP.

Secondly, as stated earlier, Section 29A IBC needs to be seen to give a harmonious reading of Section 10(2) of the SARFAESI Act read with the 2017 RBI notification allowing 100% debt conversion into equities by the ARCs, and the 2022 RBI notification allowing the ARCs to be selected as RAs since if both the guidelines are not brought in consonance to each other, then the ARCs so institutionally getting an entry into the IBC regime, may become ineligible to become a RA under Section 29A IBC (since this discrepancy may lead to ARCs being designated as a related party to the debtor).

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[43] Thomson Reuters, 'Glossary' (*Thomson Reuters Practical Law*) <https://uk.practicallaw.thomsonreuters.com/8-386-1827?transitionType=Default&contextData=(sc.Default)&firstPage=true> accessed 19th January, 2025.

Thirdly, to facilitate the role of ARCs as RPs and give them a front-door entry to the IBC framework, the minimum number of creditors to make claims to the RP under IBC needs to be reduced from a count of 100, so that the creditors against the single debtor (very often under SARFAESI Act) even if not in such numbers, can make their claims to the RPs, or thereby to the ARCs to enable them to undergo CIRP.

Fourthly, although the ARCs have a slightly different role and modus operandi in their current functioning under the SARFAESI Act with reference to the RPs under IBC, a separate training program and separate set of provisions needs to be instituted in IBC on the lines of the EBRD Insolvency Office Holder Principles wherein, they are mandated to undergo a test as well as licensing program including training and developing some professional skills and ethical code of conduct which takes place for the RPs under the IBBI (Insolvency Professional) Regulations 2016.

VI. CONCLUSION

IBC as a code of rules aims at providing a comprehensive mechanism for debt restructuring as well as the debtor's restructuring which is not the case under the SARFAESI Act. The IBC comprises RAs and the RPs as the chief proponents facilitating the restructuring process of the debtor by the concurring decision of the COC, thereby maintaining Corporate Governance on the other side, ARCs under the SARFAESI regime strive for debt restructuring and making expedited proceeds towards the claim of the Creditors. However, the role of ARCs though now institutionalised for the position of RAs subject to certain conditions, no such deliberation has been taken towards the role of the ARCs as Resolution Professionals which if done, may augur well in lubricating the harmonious construction between the SARFAESI Act and the IBC.

Therefore, the ARCs which have institutionalised their place as RAs have yet to become eligible for the designation of RPs and due to the growing trend of interplay between the SARFAESI Act and the IBC, it is hoped to be seen in future. ARCs which traditionally have been playing the role of facilitating only the process of Securitization, must also be given some authority in restructuring the debtor's business with its prior professional skills and the debtor and creditor database (created out of the Securitization process), so as to lessen the burden on the courts, mitigate the labour of the creditors towards SARFAESI as well as IBC (if opted), and lastly adding professionalism to the Restructuring process under IBC due to the whole body of experts present in an ARC company having knowledge across different domains be it law, management, accounts, finance, etc. In conclusion, the role of ARCs is gaining trend to be institutionalised into the IBC regime since the "IBC mechanism is proving to be more cost-friendly, efficient and wealth maximizing since in 2022-23 alone, the recovery rate of IBC is 52.8% as compared to 30.5% under the SARFAESI mechanism, and this rate of recovery is further the highest for resolution and liquidation among the Scheduled Commercial Banks (the largest recipient in the SARFAESI Act)."[44]

[44] Ministry of Finance, Economic Survey 2022-23, January, 2023, 94.

THE CONTRASTING TRAJECTORIES OF SHADOW BANKING IN INDIA AND CHINA

- *Shantanu Vyas and Anvesha Mishra*[*]

ABSTRACT

India and China demonstrate contrasting trajectories in their shadow banking industries. India is currently placing significant attention on the launch of Jio Financial Services Ltd., a separate entity derived from Reliance Industries Ltd. This has generated investor optimism, despite an initial decline in stock prices, as indicated by a valuation of $19 billion. The strong performance of Bajaj Finance Ltd. emphasises the significance of India's Non-bank lending sector, surpassing even the State Bank of India in terms of total value. China's shadow banking system emerged as a response to post-financial crisis caution. It involved a complicated network of lending through trusts, focusing on real estate and local governments. Nevertheless, nonbank issuers are currently facing a significant decline in the real estate market, as seen by recent instances of failed payments and apprehensions regarding the potential spread of financial hazards. The shadow banking crisis that occurred in India in 2018 caused a disruption in the availability of credit for the real estate sector. However, the current situation, which is influenced by the increasing digitization of the consumer economy, shows potential for improvement. Jio Financial intends to take advantage of technology in order to benefit from Ambani's extensive business network and deep understanding of consumer behavior. India's regulatory framework appears to be more conducive to the development of domestic industry leaders, in contrast to China's strict regulations. The future of India's shadow banking sector hinges on the adoption of technical advancements, digitalization of consumer services, and effective regulation to ensure sustainable expansion while avoiding systemic concerns. This might potentially lead to a preference for nonbank lenders with advanced technological capabilities, perhaps overshadowing smaller deposit-taking institutions that are government-controlled.

[*] Shantanu Vyas is a fifth-year student at Bennett University and Anvesha Mishra is a fifth-year law student at GGSIPU. Views stated in this paper are personal.

I. WHAT CONSTITUTES SHADOW BANKING?

The concept of "shadow banking," which was first presented by Paul McCulley in 2007, has been interpreted in a number of ways, but its exact meaning has not been widely agreed upon and a clear consensus regarding its precise essence remains elusive.[1] There is a lack of consensus across different countries, which makes the theoretical conversation inside certain institutional contexts more difficult. For instance, in China, the phrase "shadow banking" refers to wealth management solutions given or marketed by banks, whereas in Europe, it refers to the lending operations of insurance firms. This includes loans made by financial businesses connected to banks in India. Notwithstanding these discrepancies, examining noteworthy attempts to characterize shadow banking improves comprehension of its essential traits across various conceptualizations. During the 2007 Annual Jackson Hole Conference, McCulley first characterised shadow banking as *"the entire*

[1] Paul McCulley, 'The Shadow Banking System: The New Paradigm?' (2007) 92(4) Federal Reserve Bank of Kansas City Economic Review 5, 23.

alphabet soup of levered-up non-bank conduit systems."[2] The significance of the *"non-bank"* dimension within the realm of shadow banking was notably highlighted by the Financial Stability Board (FSB) in its 2013 report, which delineated it as *"credit intermediation involving entities (fully or partially) outside the regular banking system or nonbank credit intermediation for short."*[3] These explanations portray shadow banks as distinct from traditional commercial banks, implying that they engage in illicit financial activities such as tax avoidance and tax evasion by using unofficial and unauthorized financial networks. This sort of illegal activity is not central to shadow banking institutions, according to researchers like Guttmann (2016) and Mehrling et al. (2013).[4]

Expanding on these fundamental principles, authors such as Mitchell, Guttmann, and others identify two main definitional categories within the language of shadow banking literature.[5] The initial perspective, referred to as the "market view," focuses on the processes of securitisation and the intricate web of market-mediated financial transactions. From this perspective, shadow banks, much like traditional banks, serve as intermediaries bridging the gap between savers and investors. The shadow banking system, in conjunction with its traditional counterpart, constitutes a complex web of specialised financial institutions and vehicles that facilitate the flow of capital from savers to investors. This occurs through an array of securitisation and secured funding methodologies, all within a framework characterised by minimal regulation. These intermediary entities execute four essential transformations maturity,

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[2] ibid.
[3] Financial Stability Board, *Shadow Banking System: Scoping the Issues* (Financial Stability Board, 2013) https://www.fsb.org/uploads/r_110412a.pdf accessed 31 March 2025.
[4] Robert W Guttmann, 'The Shadow Banking System: Is It a Threat to Financial Stability?' (2016) 21 Journal of Financial Stability 1, 14.
[5] Mark Mitchell, 'Defining Shadow Banking' (2016) Journal of Financial Intermediation 15–27.

liquidity, leverage, and credit risk transfer similar to traditional banks, though lacking direct access to explicit public sources of liquidity and risk insurance from central banks or organisations such as the US Federal Deposit Insurance Corporation (FDIC).[6] The alternative approach, known as the "money view," regards shadow banking as comparable to the conventional commercial banking system. Beyond the realms of maturity and credit transformation, shadow banks engage in the issuance of *"near monies"* or *"liquid short-term stores of wealth."* Mitchell (2016) posits that traditional banking is responsible for the creation of new credit money, whereas shadow banks play a pivotal role in the dissolution of this credit money. This occurs when savers opt to exchange bank money for liabilities issued by shadow banks, which serve as a repository for credit claims that surpass the limitations of conventional bank balance sheets.[7] These sophisticated definitions clarify the many functions shadow banks play in conjunction with standard banking systems and provide a variety of insights into the process of credit creation and intermediation.

II. SHADOW BANK'S MECHANISM

The financial ecosystem, which has traditionally relied on conventional banking systems to act as mediators between savers and investors, has seen the rise of shadow banking. Shadow banking companies differ from traditional banks in that they operate in a more fragmented structure, facilitating the connection between lenders and borrowers by acting as intermediaries. A critical examination of shadow banking mechanisms is essential to elucidate their operational dynamics and systemic implications. This study adopts a dual analytical lens, focusing on market structures and monetary flows, to

[6] GA Vento and P La Ganga, 'Bank Liquidity Risk Management and Supervision: Which Lessons from Recent Market Turmoil?' [2009] 10 Journal of Money, Investment and Banking 78–125.
[7] Mark Mitchell, 'Defining Shadow Banking' (2016) 27(1) Journal of Financial Intermediation 15–27.

comparatively assess the functioning, regulatory challenges, and economic consequences of shadow banking systems in India and China. By dissecting institutional frameworks, sectoral vulnerabilities, and technological integration, the analysis seeks to advance empirical understanding of how

These mechanisms drive financial innovation while posing risks to stability in emerging economics. Figure 1 provides a schematic illustration of this.

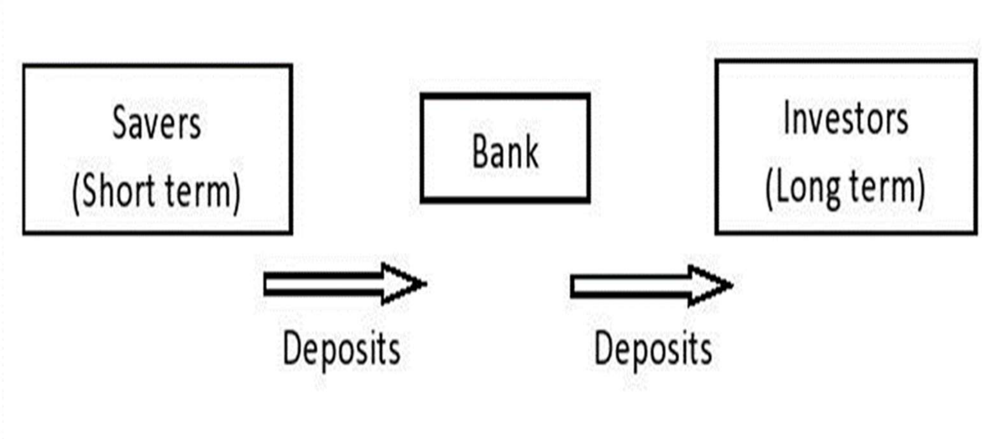

Figure 1

A. Market Analysis

Within the formal financial architecture, scheduled commercial banks (SCBs) as institutionally defined by the Reserve Bank of India[8] perform essential intermediation functions by efficiently allocating capital between surplus and deficit units while mitigating pervasive information asymmetries and transaction cost frictions inherent in financial markets. However, their core maturity transformation function, which involves the conversion of short-term, liquid deposit liabilities into long-term, illiquid loan assets, engenders

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[8] Reserve Bank of India, *Report of the High Level Steering Committee for Review of Supervisory Processes for Commercial Banks* (2023) https://www.rbi.org.in/scripts/PublicationReportDetails.aspx?UrlPage=&ID=663 accessed 31 March 2025.

fundamental liquidity risk exposures and capital adequacy vulnerabilities.[9] These structural limitations of traditional banking have precipitated the organic evolution of a parallel financial ecosystem characterized by heterogeneous non-bank financial intermediaries including pension funds and insurance companies, that operate beyond the regulatory perimeter of conventional banking oversight while performing analogous credit intermediation functions.[10]

A fragmented and diverse financial structure would help in bypassing limitations of traditional banking by spreading the financial activities across multiple entities, including shadow banks. This would reduce the systemic dependency on traditional banks and would enhance the liquidity, as these entities manage large pools of capital that can be invested flexibly. Fragmentation also diversifies risk across varied financial players, minimizing vulnerabilities tied to concentrated banking systems. Specialized institutions address niche financial needs – such as long-term investments or high-risk ventures – often overlooked by conventional banks. Additionally, shadow banks operate under different or lighter regulatory frameworks, enabling them to innovate and fill funding gaps during crises or in the undeserved sectors, which ultimately fosters resilience and efficiency in the financial system.

Shadow banks function as intermediaries, amassing deposits from lenders and supplying funds to conventional banks. They also play a crucial and transformative role in credit intermediation, going beyond merely acting as intermediaries between lenders and traditional banks. They bridge the gaps in the financial system by facilitating the flow of credit directly to the borrowers, often serving sectors and markets undeserved by conventional banks.

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[9] Jean Tirole, 'Illiquidity and All Its Friends' [2011] 49(2) Journal of Economic Literature 287–325.

[10] RU Arora, 'Links between Financial Inclusion and Financial Stability' in *Handbook of BRICS and Emerging Economies* (Oxford University Press 2020) 222.

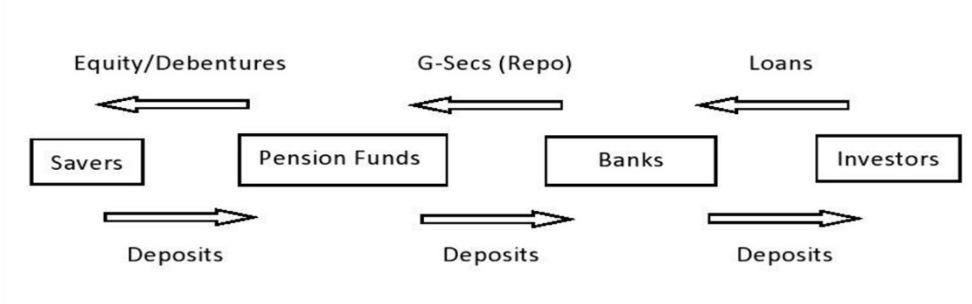
Significantly, in order to ensure the safety of these financial transactions, banks enter into repurchase agreements (repos) with shadow banks, which entail the sale of government securities. This arrangement provides lenders with security and earns cash by taking advantage of pricing differences in the repo contracts. Nevertheless, difficulties emerge, namely with the limited availability of government securities and the requirement for rigorous surveillance of security prices, prompting modifications in agreements between shadow banks and conventional banks.[11]

Figure 2 provides a schematic illustration of this-

B. Continuation of Market View Perspective

Moreover, the system's evolution entails the establishment of special purpose vehicles (SPVs) by banks. These *Special Purpose Vehicles* (SPVs) engage in the procurement of loans from banking institutions, subsequently restructuring them into *Asset-Backed Securities (*ABS). and distribute them to different market lenders, such as financial organisations like mutual funds and pension funds. While improving market liquidity, this complex system raises

issues regarding the quality of ABS and the transfer of risk from banks to SPVs and subsequently to other entities. The consequences of these intricacies

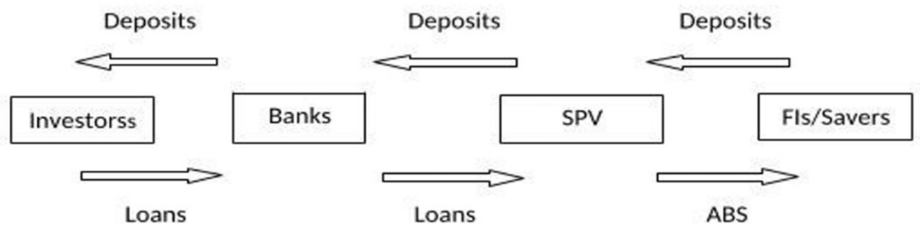


[11] VV Acharya and others, 'Shadow Banking: An Analysis of Lending Through Structured Finance Conduits and Asset-Backed Commercial Paper' (2010) 100(5) American Economic Review 2284, 2313.

became clearly apparent during the Global Financial Crisis (GFC), which played a role in a prolonged economic decline.[12] These parallels underscore the urgent need for cross-border regulatory coordination to mitigate shadow banking's systemic threats. Figure 3 provides a schematic illustration of this.

C. Financial Viewpoint

Figure 3



In contrast, the money view perspective defines shadow banks as firms that temporarily modify the flow of money by replacing bank deposit liabilities with loan liabilities from borrowers. This process entails banks generating currency, distributing it throughout the economy, and ultimately gathering these funds, which are then credited to deposit accounts maintained by banks. Subsequently, banks exchange these deposits for loans with shadow banks through repo transactions. This financial manoeuvre effectively renders the capital produced by banks void until the shadow banking entity retracts the repo transaction.[13] To summarise, the market perspective examines the functional mechanics of shadow banking, highlighting its ability to mitigate

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[12] Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (2011) https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf accessed 31 March 2025.

[13] S Sivramkrishna and others, 'Shadow Banking in India: Nature, Trends, Concerns and Policy Interventions' (2019) 12 Review of Economics and Business Studies 29, 46 https://www.researchgate.net/publication/338296508_Shadow_Banking_in_India_Nature_Trends_Concerns_and_Policy_Interventions accessed 30 March 2025.

the constraints of conventional banking while also raising apprehensions over the quality of assets and the transfer of risks. In contrast, the money view examines the complex financial system that encompasses deposits, loans, and transactions between banks and shadow banking firms. Gaining insight into these viewpoints establishes a strong basis for conducting thorough qualitative and quantitative assessments of shadow banking. This is crucial for fully grasping its characteristics and expansion, particularly within the framework of the Indian financial environment. Figure 4 provides a schematic illustration of this.

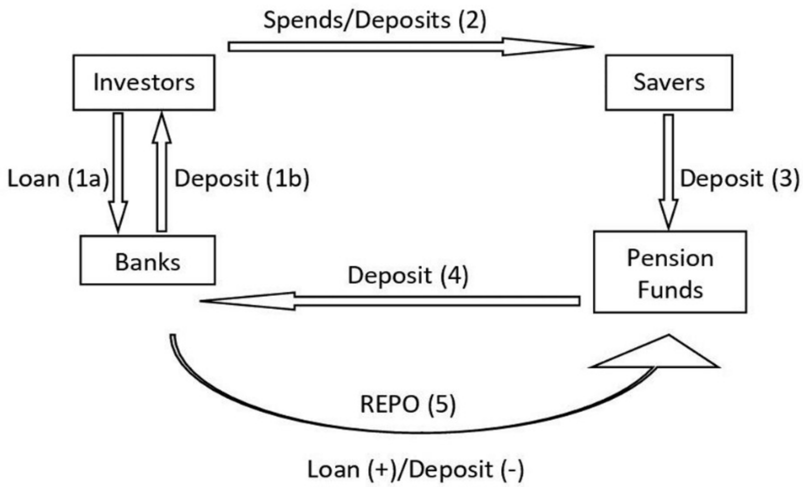
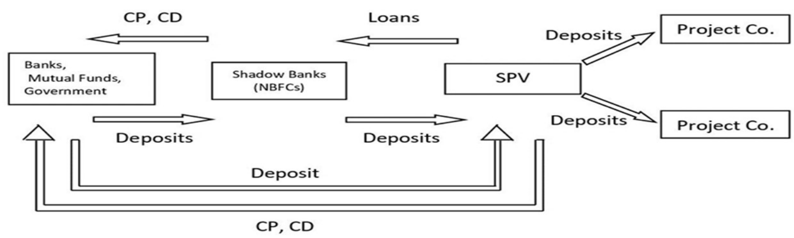


Figure 4

III. THE GROWTH AND IMPACT OF INFORMAL FINANCIAL NETWORKS IN INDIA

The standing of shadow banking in India has experienced considerable upheaval, primarily due to a series of recent high-profile scandals, notably the collapse of Infrastructure Leasing & Financial Services Limited (IL&FS).[14] Prior to discussing concerns arising from these events, it is crucial to establish the definition of shadow banking within the Indian context. According to the Reserve Bank of India (RBI), shadow banking refers to the activities of non-banking financial companies (NBFCs) involved in lending, selling/purchasing assets, and operating revolving savings and credit societies, which are called chit funds in India.[15] India's credit environment is distinctive, marked by a substantial informal structure based on familial ties, social hierarchy, and reliance on trust. However, the available data mostly focuses on the formal sector, which is the main subject of our investigation. According to market analysis, Indian shadow banks or NBFCs function as intermediaries that facilitate the transformation of credit.[16] Their principal function involves the practice of short-term borrowing, chiefly through the issuance of commercial paper (CP), to facilitate the financing of long-term infrastructure projects, including highways, power plants, ports, and real estate endeavours. The operational mechanism of Indian Non-Banking Financial Companies



[14] V Kothari, *Shadow Banking in India: Creating Opportunity Out of a Crisis* (Vinod Kothari Consultants, 20 January 2020) https://vinodkothari.com/wp-content/uploads/2020/01/shadow-banking-in-India.pdf accessed 1 April 2025.
[15] *Business Standard*, 'Growth of Shadow Banks Poses Threat to Financial Stability: RBI Report' (5 December 2020) https://www.business-standard.com/topic/rbi-annual-report accessed 17 October 2024.
[16] Financial Stability Board, *Global Shadow Banking Monitoring Report 2017* (2018) https://www.fsb.org/uploads/R050318.pdf accessed 17 October 2024.

(NBFCs), as illustrated in Figure, revolves around utilizing short-term borrowing to finance infrastructure development.

Figure 5

This is motivated by the accessibility of cash and the cost-efficiency of short-term borrowing in comparison to issuing long-term bonds or stock. The activity appeals to individuals who save money and are looking for greater returns, even though it comes with increased dangers. This is mainly affected by the decrease in interest rates and the limited availability of government bonds. Supporting this pattern, there has been a consistent decrease in the Reserve Bank of India's benchmark repo rate, dropping from 8.5 to 5.40 per cent since 2012. Concurrently, the proportion of public debt relative to GDP has experienced a modest decrease, shifting from 69.6 to 68.7 percent during the same timeframe. Shadow banking in India, led by non-banking financial enterprises, uses short-term borrowing to fund long-term infrastructure investments and promote credit reforms. The system has attracted depositors by offering high returns despite low interest rates and limited government bonds. However, recent events, such as the bankruptcy of IL&FS, highlight potential concerns. Understanding the complexities of India's shadow banking system is crucial for recognizing its unique issues.

IV. THE EMERGENCE SHADOW BANK INSTITUTIONS IN INDIA

The tremendous rise of shadow banking in India may be linked to a variety of variables, primarily the economic reforms of 1991 that brought about liberalization, privatization, and globalisation. Financial liberalization allowed the emergence of non-banking financial companies (NBFCs) in the formal sector, which had previously been dominated by informal lenders. The reforms also fostered competition in the commercial banking industry, as private banks entered the market in search of new lending opportunities. The reforms necessitated the exploration of alternate sources of money, going beyond the conventional commercial and informal channels.[17] The pursuit of alternative finance in India has been propelled by a transformation in its growth trajectory, the expansion of industries, and the constrained access to traditional credit for small and medium enterprises (SMEs). Moreover, the proliferation of housing and automotive loans, the increasing engagement of the private sector, constraints on budget deficits, and partnerships between private and public entities for infrastructure endeavours have created a significant demand for channelling credit towards lucrative ventures. In India, Non-Banking Financial Companies (NBFCs) are categorised into various groups according to criteria such as their capacity to accept deposits, their status as non-deposit-taking entities, and their associated risk levels.[18] Non-banking financial companies of systemic importance are required to comply with specific regulatory frameworks, which include the maintenance of statutory liquidity ratios, capital adequacy ratios, and non-performing asset ratios. The study examines the historical background of India's economic reforms, emphasizing the transition from borrowing based on production in the 1980s to a financialized economy in the 1990s, where the expansion of money exceeded GDP.[19] Throughout this timeframe, a decline was observed in the market share of public sector banks, with a corresponding increase in the prominence of non-banking financial companies and private banks. Non-Banking Financial Companies (NBFCs) exhibit a significant reliance on commercial banks for their funding needs, with their share of the total bank credit steadily increasing

[17] Prachi Agarwal, *Shadow Banking in India: Nature, Trends* (The Fair India 2019).
[18] VV Acharya, *The Growth of a Shadow Banking System in Emerging Markets: Evidence from India* (NYU Stern School of Business 2014).
[19] Reserve Bank of India, 'Non-Banking Financial Companies' (10 January 2017) https://www.rbi.org.in/commonman/english/scripts/FAQs.aspx?Id=1167 accessed 6 December 2023.

over time. The strong correlation between banks and NBFCs underscores their function as intermediaries for commercial bank lending. Furthermore, mutual funds have a substantial impact on the financing of Non-Banking Financial Companies (NBFCs), with their total investment in NBFCs amounting to almost INR 2,300 billion as of March 2018.[20] The recent surge in investments in mutual funds, particularly from private sector entities, corresponds with the expansion of non-banking financial companies (NBFCs) and the broader trend of financialisaton within the Indian economy. The article thoroughly investigates the growth of commercial paper issuance by non-banking financial companies, highlighting a remarkable tripling of the amount over a seven-year period. The employment of short-term, unsecured debt instruments raises concerns regarding the susceptibility of the financial system, given that the values of the assets backing these instruments are subject to fluctuations in market and macroeconomic conditions.[21]

V. EMERGING ISSUES PRESENTED BY THESE INSTITUTIONS IN INDIA

Despite the benefits of shadow banking in providing alternative investments, efficiently channeling resources, and diversifying risk, significant concerns have emerged regarding its potential to induce financial instability. A key issue stems from the exchange of pre-existing credit claims, which establishes a hierarchical structure of indebtedness. In this structure, the fulfillment of financial obligations depends on the accessibility and liquidity of assets positioned at the apex. This refers to the ability of financial institutions to monetize high-ranking collateralized assets and leverage them to meet obligations. When these assets become illiquid or devalued, financial

[20] Financial Stability and Development Council, *Report of the FSDC Sub-committee on Non-Bank Financial Companies* (RBI, August 2020).
[21] ibid.

distress propagates through the system, exacerbating risks of default and contagion effects across the economy.[22] This phenomenon is particularly concerning in the case of Non-Banking Financial Companies (NBFCs), which often rely on short-term funding sources to finance long-term assets. The issue discussed here pertains to asset inadequacy against NBFCs' exposure, where liquidity mismatches create systemic vulnerabilities.[23] The dependence on ephemeral financial resources to sustain enduring initiatives further compounds inherent weaknesses, as evidenced by the 2018 Infrastructure Leasing & Financial Services (IL&FS) crisis. The IL&FS crisis was marked by defaults on commercial papers, certificates of deposit, and inter-corporate deposits, exposing the insolvency of a major NBFC and triggering widespread panic in the financial markets.[24] This incident underscored the "dark" side of shadow banking, characterized by poor governance, lack of transparency, and inadequate risk management practices. The crisis necessitated government intervention to prevent a systemic collapse, revealing significant deficiencies in the regulatory oversight of shadow banking in India.[25] Another critical issue is the "greening over" of poor-quality loans, where distressed financial institutions extend new credit to borrowers to cover up non-performing assets

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[22] Financial Stability Board, *Shadow Banking: Regulatory Framework and Risk Assessment* (3 July 2017) https://www.fsb.org/uploads/P300617-1.pdf accessed 25 March 2025.

[23] VK Manda and S Rao, 'Lessons from the IL&FS Financial Crisis' (2nd International Conference on Business and Management, 2019) https://doi.org/10.17605/OSF.IO/5TZU3 accessed 23 March 2025.

[24] J Bawa, S Basu and A Saha, 'Shadow Banking in India: Do Bank Sponsored Asset Management Companies (AMCs) Perform Liquidity Transformation Through Exposure to Non-Banking Finance Companies (NBFC) in Their Debt Oriented Schemes and Will This Increase the Systemic Risk of a Bank Due to a Possible Joint Exposure to NBFCs?' (VIII Congresso de Investigacion Financiera FIMEF, EGADE Business School 2018) https://repository.iimb.ac.in/bitstream/2074/13940/1/Basu_IIBF_RP_2019.pdf accessed 1 April 2025.

[25] Reserve Bank of India, *Financial Stability Report 2020* (24 July 2020) https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=50122 accessed 25 March 2025.

(NPAs). This practice, often referred to as an inherent weakness of shadow banking, obscures the true financial health of NBFCs and weakens the stability of the financial system.[5] It creates an illusion of solvency while increasing the sector's exposure to risky assets, further exacerbating financial fragility. In response to these challenges, the Reserve Bank of India (RBI) has introduced several initiatives to inject liquidity into the NBFC sector and enhance financial stability.[26] One notable initiative is the Partial Credit Guarantee Scheme (PCGS), which aims to provide liquidity support to NBFCs through government-backed credit guarantees on asset-backed securities. Additionally, the RBI has undertaken measures such as Targeted Long-Term Repo Operations (TLTRO) to ensure that funds flow into the NBFC sector, mitigating liquidity constraints and reducing systemic risks. Furthermore, regulatory reforms, including stricter capital adequacy requirements and enhanced risk assessment mechanisms, have been implemented to strengthen the resilience of NBFCs.[27] Moving forward, policymakers must adopt a multi-faceted approach to address the risks associated with shadow banking in India. This includes enhancing regulatory oversight, strengthening corporate governance practices, and enforcing stricter risk management frameworks. A robust regulatory framework, combined with transparent financial reporting and prudent lending practices, will be crucial in mitigating the systemic vulnerabilities posed by shadow banking and ensuring long-term financial stability in India.[28]

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[26] Reserve Bank of India, *Policy Environment, Report on Trend and Progress of Banking in India 2023–24* (December 2024) https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=23074 accessed 25 March 2025.
[27] T Ashokamithran, 'NBFC Stress May Lead to System Liquidity Due to Interconnectedness: IMF' *The Hindu* (Mumbai, 4 March 2025) https://www.thehindu.com/business/nbfc-stress-may-lead-to-system-liquidity-due-to-interconnectedness-imf/article69290797.ece accessed 25 March 2025.
[28] ibid.

VI. COMPARATIVE ANALYSIS WITH CHINA

A. What were the characteristics of the Chinese credit system before the emergence of shadow banking?

The development of China's credit system prior to the rise of shadow banking marked a notable shift from a government-regulated banking sector to a more varied financial environment. Prior to the emergence of shadow banking in the 2000s, banks mainly regulated the credit system in China. The development of this control was influenced by certain crucial attributes and regulatory limitations. At first, banks occupied a privileged position in the financial ecosystem.[29] They had a significant clientele, especially among State-Owned Enterprises (SOEs), who had a dominant presence in the economy. In China's tightly controlled economy, the availability of legal alternatives for finance was restricted, thereby strengthening the dominance of banks over deposits and loans. Banks also profited from implicit guarantees as the state was considered to protect depositors, promoting confidence and allowing them to amass significant deposits despite giving meagre interest rates. Furthermore, regulatory procedures effectively governed interest rates for both deposits and loans, thereby guaranteeing substantial profit margins for banks.[30]

Nevertheless, the banking system was restricted by governmental rules. The People's Bank of China (PBOC) imposed restrictions on individual banks' lending amounts in order to govern the overall money supply by controlling the quantity of loans provided. The loan allocation in smaller banks with strong government connections was significantly affected by the

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[29] K Hachem, 'Shadow Banking in China' (2018) 10 Annual Review of Financial Economics 287, 308.

[30] D Elliott, A Kroeber and Y Qiao, *Shadow Banking in China: A Primer* (Brookings Institution 2015).

excessive control and surveillance of the loan process, although this has been less common in recent years. Furthermore, loan growth was restricted by restraints such as loan-to-deposit ratios, and banks were required to retain considerable reserves with the PBOC due to elevated reserve requirements, resulting in financial pressures. Prior to the 2000s, the credit system was characterised by a limited bond market, exclusive government control of large banks, and a bias towards lending to State-Owned Enterprises (SOEs) rather than Small and Medium Enterprises (SMEs). The banks preferred state-owned businesses (SOEs) because of their perceived trustworthiness, market dominance, low loan default penalties, and the prospect of social or political pressures. Despite their major influence on employment and GDP, SMEs face bias due to a number of factors, including insufficient collateral, a poor credit history, and higher loan default penalties than state-owned businesses (SOEs). However, changes in the financial environment were occurring despite these limitations. Joint stock banks, influenced by their historical function as corporate bankers, functioned in a somewhat deregulated setting, offering loans to the private sector. Urban and rural commercial lenders had limitations in their ability to access State-Owned Enterprise (SOE) lending prospects, which forced them to provide loans to Small and Medium Enterprises (SMEs). Analysts saw advancements in targeted risk evaluation for small and medium-sized enterprises (SMEs), while acknowledging ongoing difficulties faced by SMEs when interacting with banks, which exceed those seen in other nations. The rise of shadow banking marked a transition away from conventional financial frameworks. Shadow banking firms provided alternative financial products, posing a challenge to the prevailing dominance of traditional banks. This transition was driven by the necessity for varied funding alternatives, particularly for small and medium enterprises (SMEs) that have been overlooked by the conventional banking industry. In a nutshell, the Chinese credit system prior to the emergence of shadow banking was marked by the predominance of banks, strict regulatory measures, preferential treatment towards state-owned enterprises (SOEs), and restrictions on financing for small and medium-sized enterprises (SMEs).[31] As the traditional banking sector remained dominant, changes in financial dynamics and regulations were creating opportunities for the rise of shadow banking, which brought new aspects to China's credit environment.

B. What is the present/contemporary condition of shadow banking in China?

Stringent regulatory measures and severe economic conditions have recently brought about substantial changes in the landscape of shadow banking in China.[32] Although shadow banking has experienced a 20% decline in assets, it continues to exert significant influence in the financial sector, albeit on a smaller scale. Significantly, essential operations such as trust loans and wealth management products (WMPs) continue to exist, but they are now subjected to more stringent regulations and a heightened focus on diversification. Amid economic downturns, the e-commerce finance sector is growing and making the shifting picture more challenging for the industry. Nevertheless, despite its reduced condition, shadow banking in China still presents significant hazards to the financial system, necessitating ongoing attention and thorough regulatory supervision. Precisely defining the parameters of shadow banking in China presents a formidable challenge, as varied interpretations lead to contentious debates regarding its operations and overall magnitude. Shadow banking comprises a multitude of financial activities, each contributing to the intricate tapestry of modern finance.

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[31] D Awrey, 'Law and Finance in the Chinese Shadow Banking System' (2015) 48 Cornell International Law Journal 1, 50.

[32] ibid.

a) Trust loans and leases are financial transactions overseen by trust firms, which are a distinctive type of organisation in China that combines characteristics of both banks and fund managers. Although these businesses demonstrate adaptability, regulatory bodies are gradually imposing more stringent restrictions on their activities.[33]

b) Non-financial firms facilitate entrusted loans through banks for legal purposes, offering banks protection against the credit risk of the borrower. These loans, commonly utilised by State-Owned Enterprises (SOEs), are mostly directed within business groups, causing the line between internal and external lending to become indistinct.

c) Banker's acceptances (BAs) are documents issued by banks that provide a guarantee of future payments within a specified period of time.[34] These instruments can be employed to increase the amount of loans beyond what is shown on a bank's financial statement, however labelling all BAs as shadow banking exaggerates its scope.

d) Interbank entrusted loan payments refer to a situation when one bank lends money to a client of another bank, on behalf of the latter, and transfers both the main amount and the interest when the loan matures.

e) Microfinance institutions specialise in providing small-scale loans, primarily in rural areas, with the aim of enhancing credit availability for persons residing in these locations.

f) Financial leasing refers to the practise of leasing assets that are not included in a bank or trust company's financial statement for extended periods of time. Recently, there has been a boom in the establishment of e-commerce

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[33] Kerry Liu, 'Chinese Financial Holding Companies: A Review' (2021) 54 Chinese Economy 217, 231 http://hdl.handle.net/10.1080/10971475.2020.1848469 accessed 17 October 2024.

[34] A Gozlan, 'BA's: The Practice and Law of Bankers' Acceptance' (Master's thesis, Université de Montréal 2007) https://umontreal.scholaris.ca/items/a13fdf66-9a6a-4224-aa8f-360c597558d2 accessed 17 October 2024.

finance firms, specifically aimed at providing financial services to Small and Medium Enterprises (SMEs) associated with e-commerce platforms.

g) Guarantee companies enable shadow banking by offering financial guarantees, transferring credit risk to these corporations, and lowering capital requirements for participating banks. Certain guarantee firms may offer unlicensed direct loans.

h) Pawn shops and informal lenders serve as key financial resources for specific households and small businesses. Nevertheless, accurately assessing their impact on shadow banking is difficult due to the scarcity of available data.

i) Trust Beneficiary Rights (TBRs) are financial instruments that enable purchasers to obtain profits earned by a trust. These instruments are commonly utilised by banks to retain the economic advantages of loans without including them in their financial statements, therefore affecting their capital needs.

j) Wealth Management Products (WMPs) monitor broad portfolios and have developed to incorporate a modest equity allocation. While subject to some limitations, securities firms and asset managers provide alternative options that have less restrictions, making them attractive to investors who are looking for higher returns. Although not explicitly classified as shadow banking, activities in the interbank market exhibit similarities with wealth management products (WMPs) and enable transactions such as TBR acquisitions.

Although it has declined, shadow banking remains a prominent presence in China's financial sector.[35] Trust loans, wealth management products (WMPs), and emergent sectors such as e-commerce financing continue to

[35] J Gruin and P Knaack, 'Not Just Another Shadow Bank: Chinese Authoritarian Capitalism and the "Developmental" Promise of Digital Financial Innovation' (2019) 25 New Political Economy 370, 370–387.

exist but are now subject to more stringent rules. In order to deal with economic uncertainties and regulatory concerns, it is essential to have ongoing monitoring and efficient policy management. This is necessary to reduce possible risks related to shadow banking and guarantee the long-term stability of the financial system.

VII. CASE STUDY OF ZHONGZHI ENTERPRISE GROUP (ZEG)

The recent disclosure made by Zhongzhi Enterprise Group (ZEG) regarding its severe insolvency and inability to repay outstanding debts in China's shadow banking industry has highlighted a significant sociological intersection involving financial institutions, market dynamics, and socioeconomic repercussions. In China's dynamic financial climate, this recent occurrence highlights the delicate interplay between economic systems, institutional fragility, and the inherent complexities of asset management. ZEG's financial upheaval has far-reaching implications. It not only implies a crisis in the shadow banking industry, but it also emphasizes the impact on investor confidence, consumer mood, and the socioeconomic disparity among wealth management professionals. This situation displays a complicated social picture in which systemic weaknesses coexist with corporate malfeasance, market demands, and societal confidence in financial products. This sociological study investigates the relationship between economic systems, institutional behavior, and the societal implications. It offers an analytical perspective that may be utilised to understand the intricate network of relationships that are creating the present financial ecosystems in China and the social consequences of these ecosystems. A prominent wealth management, non-banking financial institution (NBFC), firm in China has, in recent past notified investors of its inability to fully repay its outstanding debts.[36]

A. Broader Implications of ZEG's Crisis on China's Shadow Banking & Economy

This development has rekindled concerns that the persistent downturn in the real estate market in China may be impacting the shadow banking industry, which is estimated to have a value of approximately $3 trillion. Zhongzhi Enterprise Group (ZEG) conveyed to its investors on Wednesday that it finds itself in a state of *"severe insolvency,"* as reported by a state-owned news outlet in China.[37] The article alluded to a correspondence originating from the shadow bank, which was likewise made publicly available by the shadow bank itself. Reuters has verified that it has indeed examined the letter, which bears a striking resemblance to the report in question. CNN finds itself unable to verify the authenticity of the letter's contents, while ZEG has not provided a response to the inquiry for comment. The letter remains unverified by CNN. In the correspondence, the organisation, situated in Beijing and deeply engaged in the struggling Chinese real estate domain, characterised its liabilities as "significantly massive." The total asset value stands at 200 billion yuan, while projections suggest that total liabilities could ascend to 460 billion yuan, a figure that parallels approximately $65 billion. ZEG has conveyed that the process of collection presents significant challenges, with the anticipated recoverable amount being negligible, cash reserves having been exhausted, and the extent of asset impairment being considerable. The rationale behind

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[36] D Madhok and J Liu, 'Chinese Shadow Bank Says It Has "Huge" Debt and Can't Pay Its Bills' CNN (23 November 2023) https://edition.cnn.com/2023/11/23/business/zhongzhi-enterprise-group-china-insolvent-hnk-intl/index.html accessed 17 October 2024.

[37] Huang Yujie, 'Zhongzhi Group Issued a Letter of Apology to Investors, and the Principal and Interest of Related Liabilities Were as High as 460 Billion Yuan' *Lanjinger* (22 November 2023) https://www.lanjinger.com/d/223047 accessed 17 October 2024.

this lies in the fact that the assets of the group are predominantly concentrated on debt and equity investments, which exhibit a notable duration.[38] The corporation is a prominent private conglomerate in China, with extensive activities in the mining, financial services, and electric car sectors. Initial worries regarding its financial condition were raised in August, when a trust in which it holds some ownership disclosed its failure to fulfil obligations to corporate investors. China boasts a vast number of wealth management institutions that provide investors relatively substantial returns. Zhongrong International Trust is among these companies, and as of the conclusion of 2022, it has overseen assets valued at $87 billion for corporate clients and affluent people. Analysts' estimations indicate that the trust industry, commonly referred to as the "shadow banking" sector, has a value of $2.9 trillion, surpassing the size of France's economy.[39] In essence, shadow banks serve to provide funding through mechanisms that remain unrecorded on the balance sheet or via non-bank financial entities like trust companies. China's economy is currently facing a prolonged real estate crisis, prompting concerns about its future. The "shadow banking" sector, a substantial and covert component of China's financial system, has attracted attention due to these issues. Analysts indicate that individuals from the middle and higher middle classes often constitute the majority of investors in wealth management products in China. The occurrence of late payments could potentially undermine consumer confidence, leading to defaults and worries. In the letter addressed to investors on Wednesday, ZEG expressed remorse for the financial challenges it has encountered. The corporation has recognised its

[38] Laura He and Mengchen Zhang, 'China's "Lehman Moment?" Big Investment Firm Misses Payments' CNN Business (18 August 2023) https://edition.cnn.com/2023/08/18/economy/china-zhongrong-trust-protest-intl-hnk/index.html accessed 17 October 2024.
[39] ibid.

persistent challenges with what it deems "ineffective" internal management, a situation that has endured since the passing of its founder in 2021, further exacerbated by the subsequent departures of senior executives.

VIII. CONTRASTING REGULATORY APPROACHES

The regulatory frameworks governing shadow banking in India and China are interesting examples that provide important insights into the sophisticated tactics taken by these economic powerhouses. Both nations are dealing with the intricate and hazardous nature of shadow banking. However, when comparing their regulatory solutions, it becomes clear that there are significant differences and some underlying parallels. The shadow banking sector in India is characterized by its diversity, consisting of several non-banking financial institutions such as NBFCs, NBFC-Ds, and NBFC-ND-SIs. The variety of options available in this sector demonstrates its progression in order to address the complex and diverse developmental requirements of the nation. China's regulatory approach, in contrast, demonstrates a stricter and more formalized framework aimed at reducing the risks related to liquidity, leverage, and regulatory arbitrage. The differences in the structure and level of regulation of shadow banking companies create an opportunity for a revealing comparison. India's regulatory evolution is characterized by a dynamic tale in which prudential regulation is carefully balanced against the demand for financial inclusion. The Reserve Bank of India's response to the Shah Committee report in 1997 exemplifies this delicate and smart approach. Non-Banking Financial Companies - Deposit taking (NBFC-Ds) encountered rigorous regulation, but the other companies functioned under a somewhat less strict regulatory framework. In contrast, China has adopted comprehensive regulatory measures, including policy reforms that highlight a commitment to resilience in response to systemic concerns about shadow banking. The discrepancy in regulatory evolution emphasizes the diverse philosophies that govern these states.

The comparison primarily focuses on the different strategies employed in risk management. The shadow banking sector in India, which consists of many entities, as challenges related to pro-cyclicality and liquidity issues during periods of economic growth. The regulatory response has been carefully adjusted, in accordance with the changing environment. China's focus on strict liquidity requirements and capital adequacy ratios, along with a ban on specific financial instruments such as CDOs and CDS, demonstrates a proactive strategy to manage and limit risks. The comparison illuminates the distinct risk reduction techniques implemented by the two governments. The proactive government intervention in China is notably different from the measured approach taken by India. The Chinese government's role goes beyond mere inspection, as it also includes implementing significant regulatory changes aimed at strengthening risk management and governance. The rigorous limitations on financial operations and foreign control emphasize a strong commitment to prevent any dangers linked to shadow banking. As deeply strategic and multifaceted measure involving as much as an interventionist role by government, it contrasts hugely with what was more measured and adaptive regulatory framework in pursuit of autonomous growth and higher standards of living in India. Beyond supervision, Chinese government policies are comprehensively reformative, designed to counteract systematic risk and guaranteeing the financial sector's long-term stability. Controlling liquidity through strict 'requirements on liquidity', high capital adequacy ratios and outright barring high risk financial instruments such as Collateralized Debt Obligations (CDOs) and Credit Default Swaps (CDS) is a key part of China's approach. This proactive approach represents the effort to preventively deal with vulnerabilities of the shadow banking sector instead of responding to the crises. The Chinese government's active role in planning macroeconomy is a case of a double-edged sword. On the one hand, leading and controlling from the top down facilitates rapid and hard implementation of regulatory changes which limits the risks. It has shown flexibility, for instance, by making some of its provisions less stringent, including requirements for high loan losses, in line with international standards and encouraging conventional lending while easing tight budget constraints. Yet, this calculated compromise is of course, a delicate balancing act between keeping the option to control, and assigning it to the marketplace while keeping it within clearly defined limits. In addition, China's approach to liberalization of interest rate and currency is cautious but intentional. Market based interest rates and more flexible exchange rate are considered to be instruments to control systemic risks because market correction can be dynamically adjusted rather than reactive government interventions. Progress in this area has been slow due to the conservative position of the People's Bank of China (PBC), yet these incremental reforms signal a vision for modernizing financial systems that is of prolonged term, but not at the expense of economic stability.[40] On the other hand, India's regulatory changes seem to be more responsive, as they are adjusted in response to new difficulties rather than proactively changing the regulatory framework. At the government intervention side, both proactive and preventive measures taken in China are comprehensive and multifaceted, compared to the measured and adaptive strategies we have encountered in India. Comparing India's largely reactive regulatory adjustments to China's extensive, and leading reforms that go beyond oversight, including structural reforms focusing on strengthening risk

[40] Megan Lindgren, *Regulating the Shadow Banking System in China* (University of Chicago International Immersion Program Papers 2018) https://chicagounbound.uchicago.edu/international_immersion_program_papers/78 accessed 1 April 2025.

management and governance, thus regulation in China is proactive. The interventions are distinguished by extremely disciplined constraints on financial activities like stringent liquidity requirements, capital adequacy rules and equally active prohibition of very high-risk financial instruments (CDO and CDS). China's indication of the need to restrict foreign over control of its financial institutions reflects its emphasis on ensuring systemic stability and insulating it against the risks of shadow banking. The way the Chinese government has approached this issue, in deliberate and strategic terms, is very much in contrast to the way in which India often responds—in a more reactive fashion—to problems that have emerged.

In the end, the analysis of shadow banking regulations reveals the divergent strategies that China and India have adopted. India's strategy is distinguished by the way it successfully manages risks while giving careful consideration to a number of variables, including diversity and financial inclusion. This contrasts sharply with China's stringent and proactive regulatory strategy, which tries to get rid of potential threats before they happen.[41] The comparative study gives a complete review of existing regulatory frameworks while also demonstrating the evolving dynamics of shadow banking in two major Asian economies. Understanding these minor variations is critical for policymakers, financial institutions, and academics seeking to navigate the complicated world of shadow banking in diverse economic circumstances.

[41] Financial Stability and Development Committee, *Opinions on Promoting the Healthy Development of the Financial Market* (2018).

IX. POTENTIAL IMPACT OF DIVERGENT REGULATORY APPROACHES

The divergent regulatory strategies employed in India and China may lead to different degrees of risk reduction in their respective shadow banking industries. China's adoption of a stricter regulatory approach has the potential to reduce the liquidity and leverage issues linked to shadow banking. Conversely, India's strategy of including both strongly and loosely regulated Non-Banking Financial Companies (NBFCs) may create opportunities for regulatory arbitrage, hence increasing the likelihood of vulnerabilities within the system.[42] Regulatory difference can also impact market dynamics and innovation in the shadow banking sector. Imposing more stringent laws in China has the potential to create a market that is better regulated and more stable. On the other hand, India's combination of regulatory systems may encourage innovation, but it also raises the possibility of regulatory loopholes and misconduct. The divergent regulatory approaches may have varying effects on investor trust in the two countries. Increased regulatory oversight in China has the potential to bolster investor confidence, whereas the diverse regulatory landscape in India may result in varied levels of trust among investors, based on their interactions with certain Non-Banking Financial Companies (NBFCs).

X. ASSESSING THE INFLUENCE OF NON-BANKING FINANCIAL INSTITUTIONS ON FINANCIAL INTERMEDIATION IN INDIA AND CHINA

The rise of shadow banking in India and China poses an intricate interaction of possibilities and difficulties for the future of financial mediation.

[42] R Nagaraj, 'Shadow Banking in India: Regulation and Risks' (2020) 55 Economic and Political Weekly 45, 51.

Although alternative financial institutions have contributed to significant economic growth by addressing the gaps left by traditional banks, their ambiguous nature and lack of control have raised worries over financial stability and systemic dangers.[43] In India, the growth of shadow banking is driven by multiple factors. The swift process of converting the consumer economy into digital format provides opportunities for financiers, particularly those skilled in utilising technology to their advantage. Digital platforms such as Jio Financial and Paytm utilise vast amounts of customer data to tailor loan packages specifically for underserved segments, ensuring accuracy and precision.[44] India's regulatory stance, which is very permissive, promotes innovation and growth in this area. The growth has multiple consequences for India's financial sector. Shadow banks have the potential to promote financial inclusion by providing loans to marginalised communities and small businesses, hence facilitating economic progress. In addition, they foster rivalry, hence potentially improving efficiency and promoting product innovation. Nevertheless, this expansion gives rise to apprehensions regarding financial stability owing to the lack of transparency and regulatory deficiencies. Consumers and the broader financial system may face risks due to vulnerabilities resulting from asset losses or exploitative practises. Conversely, China's shadow banking sector encounters substantial obstacles. The present decline in the real estate market reveals vulnerabilities in shadow banks that have significant investments in this sector, which could result in defaults and economic turmoil. Stringent regulatory measures aimed at addressing concerns over financial stability could potentially hinder the

[43] P Knaack and J Gruin, 'From Shadow Banking to Digital Financial Inclusion: China's Rise and the Politics of Epistemic Contestation within the Financial Stability Board' (2021) 28 Review of International Political Economy 1582, 1606.

[44] L Kulik and V Korovkin, *India Goes Digital: From Local Phenomenon to Global Influencer* (SKOLKOVO Institute for Emerging Market Studies 2021) https://ssrn.com/abstract=3829789 accessed 1 April 2025.

growth of the business and its ability to lend. Furthermore, the current financial regulations in China impede competition between conventional banks and shadow banks, hence intensifying the dangers connected with them.[45] The future prospects of shadow banking in China are still ambiguous. Increased regulation has the potential to bring together the industry, promoting stability while possibly diminishing competitiveness. Although heightened oversight endeavours to alleviate hazards, it may impede innovation. The progressive integration of shadow banks into the regular system has the potential to improve supervision and reduce systemic risk. However, this shift is complex and requires careful supervision. The influence of shadow banking on financial intermediation in India and China is determined by a variety of factors, including economic conditions, regulatory requirements, and technology advancements. Even with the promise of financial inclusion and innovation, it is critical to provide stability and consumer safety. To ensure the financial system's long-term stability and sustainability, policymakers must carefully balance promoting responsible development in shadow banking while limiting possible risks. While this paper examines shadow banking through the *market* and *money* views, their relevance to India and China becomes clear when contextualized within each country's financial ecosystem. In India, the *market view* explains how NBFCs like IL&FS leveraged short-term commercial paper to fund long-term infrastructure and real estate projects, creating liquidity mismatches. The *money view* underscores how these entities intermediate credit by absorbing bank deposits into shadow liabilities (e.g., repos), amplifying systemic risks when asset quality deteriorated—exemplified by the 2018–2020 NBFC crisis. China's shadow banking, meanwhile, thrived on trust loans and wealth

[45] Z Song and W Xiong, 'Risks in China's Financial System' (2018) 10 Annual Review of Financial Economics 261, 286.

management products (WMPs) tied to real estate, exposing vulnerabilities when property markets slumped, as seen in the Zhongzhi collapse. To address these risks, India's RBI introduced liquidity-boosting measures like the Partial Credit Guarantee Scheme (PCGS) and Targeted Long-Term Repo Operations (TLTROs), specifically aiding NBFCs.[46] China's stricter crackdowns on trust loans and WMPs reflect a preventive approach, though recent real estate defaults reveal lingering gaps. A sharper focus on such sectoral impacts particularly real estate and regulatory responses would strengthen the comparative analysis, ensuring the theoretical frameworks (*market/money views*) are consistently tied to empirical outcomes in both economies.

XI. GLOBAL AND SYSTEMIC IMPLICATIONS

Because the global financial system is interdependent, differences in regulatory methods between India and China may result in cross-border spillover effects. International financial institutions may face various levels of risk, potentially leading to increased instability in global financial markets. Global regulatory divergence can lead to regulatory arbitrage, which refers to the practice of financial companies taking advantage of variations in legislation across different jurisdictions. As a result, financial activity may shift to jurisdictions with less stringent rules, thus raising the total risk to the system. The various regulatory approaches highlight the challenges of international collaboration in dealing with systemic risks. To effectively limit the impact of shadow banking on the global financial system, countries must collaborate to develop standard regulatory rules and frameworks. Without such collaboration, regulatory gaps and injustices may persist. The likelihood

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[46] Reserve Bank of India, 'Reserve Bank Announces Targeted Long-Term Repo Operations 2.0 (TLTRO 2.0)' (17 April 2020) https://rbi.org.in/commonperson/English/Scripts/PressReleases.aspx?Id=3207 accessed 25 March 2025.

of diverging regulatory tactics towards shadow banking in India and China emphasizes the importance of these two major economies in ensuring global economic stability. Any instability in their financial systems might have a considerable impact on international commerce, investment, and overall economic growth. The prevalence of shadow banking globally necessitates the development of global regulatory principles to provide consistency and prevent systemic risks. International institutions such as the Financial Stability Board (FSB) play an important role in encouraging collaboration and developing recommendations to address the global concerns raised by shadow banking. Ultimately, the distinct regulatory strategies employed by India and China have consequences that extend beyond their respective countries.[47] The worldwide and comprehensive consequences emphasize the necessity for synchronized endeavors to build uniform regulatory structures that tackle the difficulties presented by shadow banking on a global level.

XII. CONCLUSION

In both India and China, clandestine financial entities have historically functioned to address unique credit needs that remain unmet by formal banking institutions. Unlike their counterparts in both industrialized and developing nations, these institutions were initially governed by more stringent regulations and did not pose systemic risks to the financial systems. Nonetheless, as the trajectory of financial deregulation advanced, these entities grew more interconnected and augmented their systemic importance. China's reaction to the crises in the US and EU, particularly by largely depending on growth generated by exports, resulted in the implementation of a substantial stimulus program. This emphasised the dangers of over-

[47] Y Chen, X Li and SJ Wei, 'Shadow Banking in China: Regulatory Reforms and Challenges' (2020) 13 China Economic Journal 265, 295.

dependence on exports and the resulting economic disparity. The crisis illuminated fundamental issues, including the failure to provide affordable lending options for small and medium-sized enterprises, the paltry returns on bank deposits, and the allure of substantial gains from unregulated financial entities, all of which played a significant role in the rapid growth of China's shadow banking sector. The movement towards liberalisation in India facilitated the incorporation of shadow banking entities into the formal banking framework. The absence of stringent regulation, especially concerning microfinance institutions, failed to prevent crises like the one seen in Andhra Pradesh. The notable economic marginalisation, evidenced by limited access to financial services, has played a role in the expansion of shadow banking in India. Both nations necessitate enhanced regulatory oversight specifically designed for the operations of shadow banks, even if it entails sacrificing certain levels of economic growth in favour of regulatory stability. Traditional prudential standards like Basel II might not be as effective as intended. Enforcing more stringent capital requirements or additional buffers could hinder the capacity of small and medium-sized enterprises to secure credit, as it may increase the cost of capital for established banks. Enhancing structural constraints and implementing tailored policies for various industries within shadow banking institutions are crucial for managing their explosive growth. Sustaining this regulatory environment requires a favorable macroeconomic environment, which is typified by low inflation and favorable real interest rates. It is crucial to implement measures such as setting limits on interest rates for financial instruments offered by shadow banks and promoting a fairer distribution of national revenue in order to prevent financial exclusion. One of the scholars named Ghosh, has pointed out that the Financial Stability Board stresses the importance of continuous monitoring as the global economy adjusts to evolving legislation and economic conditions. Constant attention is essential for effectively navigating the ever-changing dangers and linkages within the financial system.[48] To summarise, the rise and development of shadow banking in India and China highlight the necessity for customised regulatory frameworks to tackle their systemic significance. To ensure long-term financial stability, it is crucial to balance economic development with regulatory stability, promote fair financial inclusion, and uphold a supportive macroeconomic climate. Continual monitoring and adjustment to evolving financial environments are crucial to protect against rising risks and interconnectedness in the global economy.

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[48] S Ghosh, I Gonzalez del Mazo and İ Ötker-Robe, *Chasing the Shadows: How Significant is Shadow Banking in Emerging Markets?* (World Bank Economic Premise No 88, 2012) 1, 7.

FROM OPAQUE TO ACCOUNTABLE: REVOLUTIONIZING CLIMATE-RELATED FINANCIAL DISCLOSURES IN THE ESG ERA BY INTEGRATING SUSTAINABILITY AND TRANSPARENCY

- *Vidushi Jaiswal and Swadha Chandra*[*]

ABSTRACT

The remarkable words by the eminent financial advisor and investor Stuart Kirk, "In the finance industry, virtue signalling has no place. As a writer, researcher, and investor, I am also aware of the limitations of language and stock trading." have an impacting connotation which suggest that investing is hard and so is saving the planet. In February 2024, RBI came up with its draft disclosure norms that were an aftermath of many appalling attempts at by the market participants and the confusion over the existing climate change norms.

The lack of a comprehensive and clear regulatory compliance system for climate governance has led to a tussle between the Environment, Social and Governance ("ESG") enthusiasts and companies, when the priority of the discourse should lie in ensuring a sustainable future for this planet. Undertaking a methodological triangulation coupled with a reform-oriented approach towards research, this paper will discuss and analyse the nuances of climate disclosure norms in the context of Indian banking landscape along with a special reference to the technological aspects of climate related risk monitoring and opportunities. The authors try to trace the background of the climate disclosure norms by delving into the concept of sustainable finance and climate transparency, reiterating the importance of channelling funds towards sustainable projects. Further, authors attempt to decode the novel regulations laid down in the RBI and SEBI climate disclosure norms and BRS Reporting respectively. Analysing the best practices across jurisdictions, the authors attempt to derive a standardised methodology and working model especially suited for the Indian banking infrastructure and for the investors who perform a crucial function as far as ESG reporting standards are concerned. Subsequently, an overview of the investor's perspective on these disclosures has been provided with specific emphasis on the prevailing instances of Greenwashing. Therefore, the authors assess the climate disclosure norms suggesting key challenges and ultimately

[*] Vidushi Jaiswal and Swadha Chandra are fourth-year students at National Law Institute University, Bhopal. Views stated in this paper are personal.

endeavour to provide solutions through an open dialogue, responsible leadership, and decision-making.

I. INTRODUCTION

The film "Who Killed the ESG Party," directed by Financial Times, was not the first one to address the elephant in the room—that is, the eddy of finance and ESG.[1] This film looked at the emergence and reappraisal of ESG investing, highlighting the factors that initially made it popular as well as the ones that are currently making many asset managers and banks covertly reevaluate their pledges. Exploring the intricate and dynamic realm of sustainable finance, where performance realities collide with idealism and have taken innumerable forms, academicians and regulators have given different definitions to sustainable finance.[2] "Sustainable finance," which refers to the practice of fairly taking environmental, social, and governance (ESG) aspects into account when making investment decisions in the financial industry, leads to increased longer-term investments in sustainable economic

[1] Financial Times, 'Who killed the ESG party? | FT Film' (*Financial Times*, 17 July 2024) <https://www.ft.com/video/1eeebd90-25d4-4421-a175-deedcdbf9c18> accessed 6 October 2024.
[2] Marco Migliorelli, 'What Do We Mean by Sustainable Finance? Assessing Existing Frameworks and Policy Risks' (2021) 13(2) Sustainability 975.

activities and projects.[3] As a matter of due diligence for banks, finance institutions and investors working towards sustainable finance it becomes important that a proper framework on sustainable finance is devised. This can be best explained by way of an example, the sustainable finance framework by the Deutsche bank entails four pillars where, policies and commitments are focused on along with good corporate governance.[4] The new wave of transparency and leadership in the financial sector, consequent to the DWS fiasco, allowed many regulatory bodies across jurisdictions to revamp their persisting climate change disclosure frameworks into a systematic and evolved framework that could accommodate the varied needs of its stakeholders.

The Indian regulatory agencies, the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI), have taken one such step in this direction by putting in place frameworks meant to improve accountability and transparency in the financial sector, integrate climate-related financial risks, and bring India's regulatory regimes into compliance with international standards.[5] The RBI draft guidelines enlist four thematic pillars while the SEBI guidelines mention nine key performance indicators.[6] In terms of reporting and from the governance perspective under these

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[3] 'Sustainable Finance' (*World Bank Group,* 5 August 2021) <https://www.worldbank.org/en/topic/financialsector/brief/sustainable-finance> accessed 6 October 2024.

[4] Deutsche Bank, 'Sustainable Finance Framework' (2024).

[5] Draft Disclosure framework on Climate-related Financial Risks, 2024, Reserve Bank of India, RBI/2023-24/ DOR.SFG.REC. / 30.01.021/2023-2024; Business Responsibility and Sustainability Reporting by Listed Entities, 2021, Securities and Exchange Board of India, SEBI/HO/CFD/CMD-2/P/CIR/2021/562.

[6] BRSR Core-Framework for Assurance and ESG Disclosures for Value chain: Annexure I - Format of BRSR Core, 2023, Securities and Exchange Board of India, SEBI/HO/CFD/CFD-SEC-2/P/CIR/2023/122.

regimes, clear leadership is important which is aligned with robust sustainability strategies.

Here the relevance of frameworks like the Basel Committee on Banking Supervision ("BCBS"), Task Force on Climate Related Financial Disclosures ("TCFD"), Network for Greening the Financial System ("NGFS") and International Financial Reporting Standards ("IFRS") cannot be underestimated as these frameworks put in place the discourse for eradication of climate change related crises. A third of the European Union investments went specifically to green investments so that they were not contradicting their green objectives.[7] Climate change is not only experienced through gradually rising sea levels but also through significant economic disruptions. Thus, the recovery methods need to take into account to ensure resilience. These inquiries have been resolved in this paper categorically.

The central idea of the paper is introduced in Part I, where the authors discuss the execution of Sustainable Financing and its implications on the relevant decisions of the investors. Further, it gives an insight into the mining landscape delving into the prospective mining practices and investment in the domain, such as the deep seabed mining. There is a significant demand from international investors and asset managers for additional disclosures concerning sustainability and as a result, it is critical to evaluate how foreign banks will handle this situation and ensure that Indian banks are ready for such turbulent markets. Financial institutions around the world are being compelled to assess their investments in sectors of the economy that have the potential to exacerbate environmental degradation due to the growing focus on environmental, social, and governance (ESG) criteria. When making financing

[7] 'Public Statement: A Social and reen investment plan for a prosperous and just transition' (*Climate Action Network*, 15 May 2024) <https://caneurope.org/public-statement-a-social-and-green-investment-plan-for-a-prosperous-and-just-transition/> accessed 6 October 2024.

and investment decisions, banks need to weigh the potential for major ecological effect as well as the chances for resource extraction that come with deep seabed mining. For Indian banks, this entails creating strong risk assessment frameworks in addition to conforming with international sustainability norms in order to reduce potential financial and reputational risks related to financing ecologically sensitive businesses.

Part II is dedicated to the climate-related disclosure framework in the Indian context and the role of SEBI in providing standardised and quantifiable disclosures on ESG factors. It analyses the implications of the same in ensuring cross-industry and cross-sector comparisons of data and allowing investors to make better investment choices. The four thematic pillars, especially risk management and metrics and targets are the focus of the study and a nuanced observation has been made for the tools that may be employed by the RBI in the future as suggestions and recommendations. This involves both theoretical as well as empirical understanding of the scenario analysis and screen tests to be made by all the regulated entities to ensure adherence to responsible banking principles under other frameworks including and not limited to that of the BCBS, TCFD and NGFS.[8] The latter half of the same chapter gives an overview of ESG metrics by SEBI.

Further, Part III lays a thorough analysis of the reporting standards that need to be followed by companies and methods employed by them to mitigate climate crisis and combat climate related risks which are prevalent in different jurisdictions like that of the United States of America, European Union, United Kingdom, Singapore and New Zealand. The chapter's essence captures the increasing need for companies that are transitioning into low carbon

[8] Scale Based Regulation: A Revised Regulatory Framework for NBFCs, 2022, Reserve Bank of India, RBI/2021-22/112 DOR.CRE.REC.No.60/03.10.001/2021-22.

economies. The regulatory bodies will be required to assess these financial market players for better regulation.

Part IV covers the investor's perspective on ESG Disclosures and how greenwashing puts external pressure on sustainability reporting. The role of an investor becomes especially significant when the topic of sustainability is touched upon as the investor's practice of allocating the money to specific investments or divesting the money from specific investments will have an impact on the Banks' lending process etc. This makes an investor highly influential and the investing patterns of the stakeholders must be systematically tracked to ascertain how investors can affect corporate behaviour. Regardless of what form greenwashing takes, whether intentional or unintentional which might also include green hushing, it has a severe impact on all the stakeholders.

Lastly, Part V is dedicated to suggestions stating that a comprehensive and coordinated approach is necessary to achieve long-term environmental and economic sustainability in the ever-evolving field of sustainable finance. The significance of investors' decisions in shaping business conduct and the whole market's trajectory towards sustainability cannot be understated. It can be guaranteed that economic progress does not compromise the health of our planet by promoting a transparent, accountable, and robust financial disclosure system. This will pave the way for a future that is more egalitarian and sustainable.

II. EXPLORING SUSTAINABLE FINANCING: IMPLICATIONS AND CHALLENGES FOR THE FINANCIAL SECTOR

Despite the prevailing awareness surrounding sustainability in the past few decades, quantifiable outcomes are only possible if adequate funding and regulations are ensured, especially in the carbon-intensive sectors. The role of the financial sector in the shift towards a green economy cannot be understated. The size and range of financial instruments that are being channelled towards green initiatives in recent years clearly encapsulate the shift towards a low-carbon and, resultantly efficient economy. Sustainable Finance is a concept defined as the '*integration of environmental, social, and governance issues into financial decisions.*[9] While sustainability was previously understood as an ancillary issue to the functioning of the businesses and undertaken voluntarily as part of the Corporate Social Responsibility (CSR) initiatives, they are now being mandated across jurisdictions. Ensuring compliance with the sustainability objectives allows the commercial entity to retain credibility and perception in an increasingly competitive financial market. It seeks to allocate capital towards investments that contribute to a sustainable future, while mitigating risks associated with climate change and social inequality.[10] Therefore, sustainable finance includes various initiatives such as prioritisation of the investments that would be capable of generating positive environmental and social outcomes, issuance of debt securities that raise funds to be channelled into ESG-compliant projects, and inclusion of ESG into both the process and end goals sought from investment decisions.

However, adequately mapping the potential risks associated with certain investment decisions requires a thorough understanding of the climate-related risks implied within those transactions as a prerequisite. Amidst several risks like that of market, operational, reputational, financial, and transitional, certain sectors such as deep seabed mining ("DSM") have often confused the

[9] Alex Edmans and Marcin Kacperczyk, 'Sustainable Finance' (2022) 26(6) Review of Finance 1309.

[10] Jean-Stéphane Mésonnier and Benoît Nguyen, 'Showing off Cleaner Hands: Mandatory Climate-Related Disclosure by Financial Institutions and the Financing of Fossil Energy' (2021) Banque De France Working Paper Series No. 800 <https://ssrn.com/abstract=3733781> accessed 6 October 2024.

academicians, regulators, as well as investors, with its scope and viability in the long run as far as financial players are concerned. Utilising massive gear, deep-sea mining is a contentious method of extracting minerals and metals from potato-sized nodules on the ocean floor, including cobalt, nickel, copper, and manganese. These minerals are used in many different applications, including as solar panels, wind turbines, and batteries for electric vehicles.[11] According to Alka Anbarasu, associate managing director at Moody's Investors Service, there is a substantial demand from global investors and asset managers for additional disclosures about sustainability and the route towards low-carbon economies.[12] Therefore, it is important to assess the trajectory of deep-seabed mining and its treatment as a sector by banks from other jurisdictions and prepare Indian banks for a volatile market.

Serious doubts and a great deal of risk surround the DSM landscape. These include uncertainties about market demand brought on by advancements in electric batteries, large cost increments since 2021 for the DSM process, competition from well-established terrestrial mining economics, price volatility for metals, and legal ramifications for both causing and repairing environmental damage to the seafloor.[13] Those who are interested in investing in DSM run the risk of tarnishing their reputations by funding an untested sector in spite of growing resistance from major financial institutions in the

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[11] Sam Meredith, 'Sustainable Future Norway defends deep-sea mining, says it may help to break China and Russia's rare earths stronghold' (*CNBC*, 29 January 2024) <https://www.cnbc.com/2024/01/29/norway-defends-deep-sea-mining-as-a-necessary-step-into-the-unknown.html> accessed 6 October 2024.

[12] Jaspreet Kalra and Siddhi Nayak, 'Indian banks assess carbon risk of loan book amid investor, central-bank push, sources say' (*Reuters*, 12 October 2023) <https://www.reuters.com/sustainability/sustainable-finance-reporting/indian-banks-assess-carbon-risk-loan-book-amid-investor-cenbank-push-sources-2023-10-12/> accessed 6 October 2024.

[13] Nicky Jenner and others, 'Update to an assessment of the risks and impacts of seabed mining on marine ecosystems' (Fauna & Flora 2023).

hope of making profits.[14] Although the international DSM regulatory framework is not yet complete, the draft regulations come with high costs and serious liability concerns.

Financial institutions are, often in such a scenario, advised to consult non-mining companies that might use DSM metals and persuade them not to support the industry by (i) endorsing proposals for an international moratorium on DSM activities; (ii) keeping an eye on and tracking the sources of minerals they use for their operations; and (iii) removing DSM-obtained minerals and metals from their supply chains.[15]

The financial institutions should further extend their ESG strategy to incorporate biodiversity concerns. As a result, Banks as well as the investors should carry out satisfactory due diligence in order to assess their own exposure (both direct and indirect) to the financing of DSM activities.[16] Given the significant uncertainty surrounding the economic results and feasibility of DSM activities, financial institutions should consider any connection with the DSM industry to be high risk.[17] Technically, since these climate disclosure norms will come into play in 2025 and 2026, it is significant for countries like India to devise methodologies that would provide solutions to such mineral-intensive activities. It would be necessary for the RBI to work on a climate risk assessment framework for assessing both operational and climate risks related to these mining activities and integrating its principles accordingly.

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[14] P A J Lusty and others, 'Deep-sea Mining Evidence Report' (British Geological Survey 2021).
[15] 'Business Statement Supporting a Moratorium on Deep Seabed Mining' (*Stop Deep Seabed Mining*, 29 June 2024) <https://www.stopdeepseabedmining.org/statement/> accessed 6 October 2024.
[16] Stefano Esposito and others, 'Deep Seabed Mining: WWF's guide for financial institutions' (World Wide Fund for Nature 2024).
[17] Nicky Jenner (n 13).

III. INDIAN REGULATION ON CLIMATE RELATED FINANCIAL DISCLOSURES (CFRD): A COMPREHENSIVE APPROACH TO ENVIRONMENTAL ACCOUNTABILITY AND FINANCIAL TRANSPARENCY

The Indian regulatory landscape governing sustainable and responsible business practices has significantly developed over the course of the last two decades. While mandating certain Corporate Social Responsibility (CSR) requirements was already in place to ensure corporate philanthropy for larger commercial entities, incorporating ESG requirements into this framework is a relatively new phenomenon. ESG considerations differed from the CSR initiatives in the involvement of environmental, social, and governance considerations in the value chain of the product itself as opposed to an ancillary function. It focuses largely on the impact of businesses and aims to streamline the same towards a low carbon economy.

A. The Reserve Bank of India Climate Disclosure Guidelines

The ongoing revision of the RBI's climate disclosure guidelines is substantial proof of the scope for assessment within the prevailing norms. This can be most suitably done by taking into consideration the relevant subsisting climate disclosure norms from other jurisdictions that could be used as a yardstick for their Indian counterparts.

The key components of the Basel Committee on Banking Supervision's ("BCBS") planned Pillar 3 climate risk disclosure framework are incorporated into the RBI's proposed framework.[18] Although the Draft Disclosure Framework ("DDF"), which tries to mirror the BCBS in terms of its adoption of certain metrics and targets concomitant with climate change risks, lacks

[18] Bank of International Settlements, 'Consultative Document: Disclosure of climate-related financial risks' (BIS 2023).

indication of the bank's actual risk exposure.[19] While the DDF entails in its purpose and rationale that related entities should disclose information about their climate-related financial risks, they hardly provide an assessment or methodology which are best suited for them in light of fostering the market discipline. Since the BCBS is still considering to re propose the Pillar 3 disclosure norms, it means that details about the disclosure's purpose shall be provided in due time.

In 2021 Climate Bond Initiative had monitored and reported a robust framework and recommended certain suggestions that the RBI could incorporate for an improved system for monitoring climate related financial risks.[20] Many of those recommendations have not been applied in the DDF. For instance, the report clearly broke down the nitty-gritties of an efficient and prudential regulation, which would require the RBI to assess brown assets causing substantial harm in the near future along with other persisting thresholds. Nowhere in the DDF, there is a mention of the assessment for the kind of assets that might substantially harm the financial system.

The Climate scenario analysis and screen testing are the two postulates of an effective analysis of climate change risks on the economy and financial system. The act of determining and evaluating the possible effects of a variety of conceivable future situations in the face of ambiguity is known as scenario analysis.[21] Since they are speculative in nature, scenarios are not intended to

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[19] BL Mumbai Bureau, 'Climate-related financial risk: RBI to release guidance notes on scenario analysis, stress testing' (*The Hindu Business Line*, 25 July 2024) <https://www.thehindubusinessline.com/money-and-banking/climate-related-financial-risk-rbi-to-release-guidance-notes-on-scenario-analysis-stress-testing/article68445310.ece> accessed 6 October 2024.

[20] Prashant Vaze and others, Identifying, Managing and Disclosing Climate-related Financial Risks: Options for the Reserve Bank of India (ODI 2022).

[21] Lewis Holden and others, 'Measuring climate-related financial risks using scenario analysis' (*Bank of England*, 17 April 2024) <https://www.bankofengland.co.uk/quarterly-

produce exact results or projections. Alternatively, scenarios give organisations an opportunity to think about what the future might hold if specific conditions are met or particular trends persist. For instance, scenarios in the context of climate change enable an organisation to investigate and comprehend the potential long-term effects on its operations, plans, and financial performance of different combinations of climate-related hazards, including both physical and transitional threats.

India takes lessons from the NGFS guidelines as well as the Task Force on Climate related disclosures.[22] By 2100, there may be a 3°C or greater rise in temperature if no additional steps are taken. This would probably have irreversible effects like sea level rise and worsen living conditions in many places of the planet. Disruptions to supply chains, infrastructure, health, and ecosystems could pose physical hazards to the economy.[23] Conducting a scenario analysis is not bereft of challenges. This suggests that it is highly important that a common reference framework should be accordingly changed in the best interest of the Indian context.

Stress testing is an additional crucial factor that needs careful consideration.[24] To determine how resilient investment portfolios and institutions are to probable future financial losses, a simulation technique known as stress testing is employed. Banks accomplish this by applying specific harsh but realistic climatic scenarios to their balance sheets. Financial

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bulletin/2024/2024/measuring-climate-related-financial-risks-using-scenario-analysis> accessed 6 October 2024.

[22] Draft Disclosure framework on Climate-related Financial Risks, 2024, Reserve Bank of India, RBI/2023-24/ DOR.SFG.REC./30.01.021/2023-2024, at 9.

[23] Network for Greening the Financial System, 'NGFS Scenarios for Central Banks and Supervisors' (2022).

[24] Stefano Battiston and Irene Monasterolo, 'Enhanced Scenarios for climate stress tests' (2024) London School of Economics Policy Briefing Paper 16 <https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2024/04/INSPIRE-Sustainable-Central-Banking-Toolbox-Paper-16.pdf> accessed 6 October 2024.

institutions can prepare for long-term losses or capture the funding market by stress-testing scenarios because they are unable to raise money when they are all losing. Their main purpose is to prevent dangers from accumulating within the system by acting as an ex-ante front-stop mechanism. Prudent regulators are changing the stress scenarios to modify the minimum capital requirements for banks.[25] Stress testing might be the most effective prudential instrument available to us for preserving the resilience of the financial system, as Cecchetti observes.[26]

There are jurisdictions that have conducted several stress tests to derive their potential for assessing climate change risks.[27] India can take these tests into consideration to ascertain the appropriate stress testing tool for assessing both physical and transition risks. In the USA, certain banks and Systemically Important Non-Financial Institutions (SIFIs), as identified by the Financial Stability Oversight Council (FSOC), are subject to stress tests by the Federal Reserve Board.[28] Under the guidelines of the Comprehensive Capital Analysis and Review (CCAR) and the Dodd-Frank Act Stress Tests (DFAST), the Federal Reserve Board conducts these stress tests. Although since 2018, there has been a decrease in the number, range, and rigour of stress tests conducted at these institutions.[29] The FSOC states that various testing regimes are available for use. Scenario analysis may be done in a looser manner with no

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[25] Michel Aglietta and Étienne Espagne, 'Climate and Finance Systemic Risks, More than an Analogy? (2016) The Climate Fragility Hypothesis' Centre d'Etudes Prospectives et d'Informations Internationale Working Paper No. 10) <https://www.cepii.fr/PDF_PUB/wp/2016/wp2016-10.pdf> accessed 6 October 2024.

[26] Stephen G Cecchetti, 'On the Separation of Monetary and Prudential Policy: How much of the pre-crisis consensus remains?' (2016) 66(C) Journal of International Money and Finance 157.

[27] Stefano Battiston and others, 'The price of complexity in financial networks', (2016) 113(36) Proceedings of the National Academy of Science 10031.

[28] Dodd–Frank Wall Street Reform and Consumer Protection Act, 2010, 12 USC s 5301.

[29] The Economic Growth, Regulatory Relief and Consumer Protection Act, 2018, 15 USC s 1601.

regulatory ramifications, using exploratory frameworks rather than prescriptive ones. As an alternative, "traditional" stress tests could be employed; these are usually short-term and strongly connected to supervisory expectations and regulatory requirements in ways that directly influence decisions, like raising the amount of capital that can absorb losses or altering financial institutions' liquidity profiles.[30] Usually conducted over a longer time horizon, this type of scenario analysis provides information about how resistant the business models of financial institutions are to medium- and long-term material hazards.[31]

The EU has already looked into stress testing banks and other enterprises for climate-related risk. In 2021, the ECB centrally carried out stress tests for the entire economy using internal datasets and models.[32] In the UK, the Bank of England started the Climate Biennial Exploratory Scenario (CBES) exercise to assess how resilient major banks, insurers, and the wider financial system are to several climate scenarios.[33] By examining the amount of their financial exposures, barriers to the businesses' business models, and the quality of their risk management, banks and other financial institutions will be assessed for their climate resilience in the CBES.[34]

[30] Stefano G Battiston, 'DebtRank: Too Central to Fail? Financial Networks, the FED and Systemic Risk' (2021) 541(2) Scientific Reports 1.

[31] 'Press Release: Financial Stability Oversight Council Releases Factsheet on Climate-Related Financial Risk Efforts' (*U.S. Department of the Treasury*, 28 July 2022) <https://home.treasury.gov/system/files/261/FSOC_20220728_Factsheet_Climate-Related_Financial_Risk.pdf> accessed 6 October 2024.

[32] Luis de Guindos, 'Shining a light on climate risks: the ECB's economy-wide climate stress test' (*The European Central Bank Blog*, 18 March 2021) <https://www.ecb.europa.eu/press/blog/date/2021/html/ecb.blog210318~3bbc68ffc5.en.html > accessed 6 October 2024.

[33] European Central Bank, 'Presentation: 2022 climate risk stress test' (2022), 4.

[34] S Alogoskoufis and others, 'ECB economy-wide climate stress test: Methodology and results' (2021) ECB Occasional Paper Series No. 281, <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op281~05a7735b1c.en.pdf> accessed 6 October 2023.

In order to perform stress testing and scenario analysis, the central banks attempt to present the idea that they can use certain instruments and designs. However, the real question is whether those tools can be used effectively themselves to answer the issues under consideration. Therefore, it must be emphasized how urgent it is to develop comprehensive frameworks to meet the changing problems brought on by financial risks associated with climate change in order to increase the resilience of the global financial system. In the light of this, it is important that India accommodates to its scenarios in accordance with the changes introduced by the NGFS system from Phase 3 to Phase 4. The changes introduced by the same are as follows. The post-covid economic recovery and the Russian war in Ukraine are two recent shocks that have altered the short-term macroeconomic outlook since Phase III was implemented. Because of this, the models' Phase IV calibration has been adjusted to take into account these shocks and their effects on energy and inflation. In these NGFS phase IV scenarios, there is a hot house world, orderly, disorderly and too little, too late.[35] These scenarios would have a significant impact on the Indian financial system as well.

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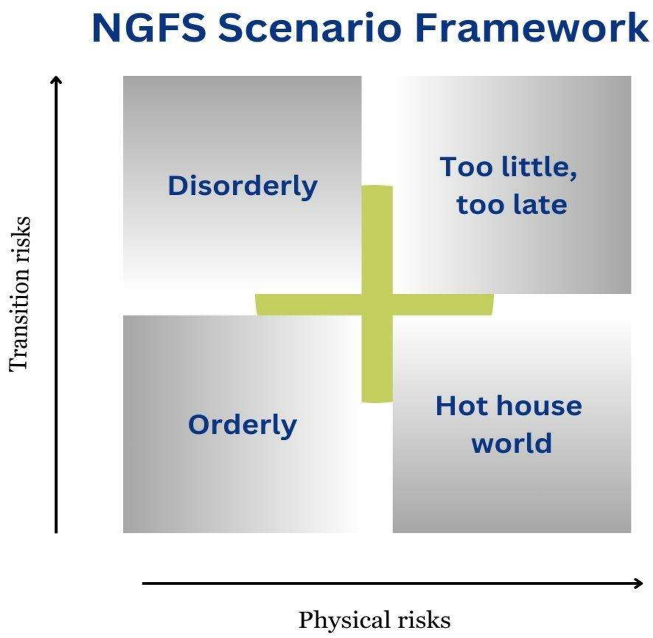
[35] Livio Stracca and others, 'NGFS Climate Scenarios Technical Documentation' (Network for Greening Financial System 2023).



Network for Greening the Financial System, 'NGFS Scenarios for Central Banks and Supervisors' (2022). The figure illustrates the different scenarios from Phase IV of the network for greening the financial system.

The fourth pillar of the RBI Draft Disclosure Framework on Climate related Financial Risks, 2024 is the pillar of metrics and targets which puts forth the accounting for greenhouse gas emissions.[36] The Scope 3 emissions are the particular category of emissions that require more transparency with respect to the methodology to be employed. Regulations around the world are changing and calling for the disclosure of emissions more often. For instance, certain large corporations, including banks, are required to provide Scope 3 disclosures under the EU's new Corporate Sustainability Reporting Directive

[36] Draft Disclosure framework on Climate-related Financial Risks, 2024, Reserve Bank of India, RBI/2023-24/ DOR.SFG.REC./30.01.021/2023-2024.

(CSRD).[37] In Europe, banks are required by the European Banking Authority to provide information on financed scope 3 emissions. The Basel Committee on Banking Supervision (BCBS) is working to create a set of Scope 3 disclosure criteria that are unique to banks in order to support the efforts of the International Sustainability Standards Board (ISSB).[38] While financial institutions' Scope 3 reporting rates are among the highest across all industries, only a third disclose their financed emissions – often only covering parts of their portfolios.[39]

Guidance must be sought from the banks in South Asian countries where the banks have employed specific methodology to counter the challenges posed by such financed emissions. Banks in Hong Kong showcase that the scope 3 emissions, or the emissions produced throughout the supply chains of the businesses they invest in, are not well documented.[40] Until the banks in South Asia have fully developed their potential for calculating scope 3 emissions, regulators can take lessons from the existing accounting methods established by banks in the USA and UK.

As a result of growing awareness of net zero pledges and Scope 3 emissions, regulators are showing an increased interest in tracking these emissions through the implementation of mandatory disclosures and goal setting. It has already been urged by authorities in the US, EU, and New Zealand that listed corporations be required to disclose their Scope 3

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[37] Dr. Alexander Schmidt and Evan Farbstein, 'Corporate Sustainability Reporting Directive (CSRD), explained' (*Normative*, 19 August 2024) <https://normative.io/insight/csrd-explained/> accessed 7 October 2024.
[38] Bank of International Settlements, 'Discussion Paper: The role of climate scenario analysis in strengthening the management and supervision of climate related financial risks' (2024).
[39] Carbon Disclosure Project, 'CDP Financial Services Report 2023: Nature in Green Finance' (2023).
[40] Carbon Disclosure Project, 'CDP Financial Services Disclosure Report 2020: The Time to Green Finance' (2020).

emissions. Central banks are also considering more exposure to climate change.

B. The SEBI Business Responsibility and Sustainability Report (BRSR)

The Securities and Exchange Board of India (SEBI) introduced the ESG metrics known as the Business Responsibility and555 Sustainability Report (BRSR Core)[41] under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations).[42] While this reporting standard was previously introduced in 2021, the same was replaced with the Business Responsibility Report (BRR). The subsequent introduction of the BRSR Core in July, 2023 can be largely attributed to the growing demand for sustainability-centric disclosures for investors and other stakeholders. These guidelines elevate the Indian ESG reporting regime to match those practiced globally and cater to the growing demand for sustainability-centric financial products. Owing to the voluntary nature of the BRR Framework, there were concerns regarding data comparability and consistency. On a larger scale, it was also essential to ensure that the Indian reporting standards align with the international best practices.

The BRSR Core is based on Nine Principles, each of which has essential and leadership indicators, wherein the former are mandatory in nature and the latter are voluntary. Under the environmental aspect of this framework, the companies are required to disclose essential information such as the greenhouse gas emissions, water and energy footprints, while also detailing how they are incorporating more sustainable practices such as effective waste management and protection of biodiversity into their value chains. Further,

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[41] BRSR Core-Framework for Assurance and ESG Disclosures for Valuechain, 2023, Securities and Exchange Board of India, SEBI/HO/CFD/CFD-SEC-2/P/CIR/2023/122.

[42] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, F No. SEBI/LAD-NRO/GN/2015-16/013.

within the social considerations, businesses must provide adequate information about employee welfare, initiatives to ensure health and safety, community development and general openness and transparency with regards to customers as well as suppliers. Lastly, under the governance practices, organisations must reveal relevant information such as board structures, executive compensation and initiatives to resolve conflicts of interest.

The recommendations by the Expert Committee that were subsequently adopted were recently brought forth for public consultation.[43] Amongst the key changes brought about by way of this recommendation is the redefining of upstream and downstream value chain partnerships with an entity to concisely demarcate the extent of compliance mandated. Further, they have introduced the Green Credits system in line with the suggestions of the MoEFCC, which shall assess the number of Green Credits by both the company as well as its value chain partners.[44] Lastly, they have incorporated the shift from a voluntary assurance to a mandatory assessment. This ensures uniformity in the data while also allowing for flexibility where the stakeholders demand specific assurance. With the exception of the inclusion of Scope 1, 2 and 3 emissions data, the BRSR mandate does not include certain key components of the TCFD recommendations, in its current. Alignment with the international standards is essential to ensure data comparability for the investors and other stakeholders. However, the gap is addressed by the RBI Climate Disclosure Framework which includes within its ambit the four thematic pillars of TCFD Recommendations. Therefore, proper execution and

[43] Securities and Exchange Board of India, Consultation Paper on the Recommendations of the Expert Committee for Facilitating Ease of Doing Business with Respect to Business Responsibility and Sustainability Report (BRSR) (2024) <https://www.sebi.gov.in/reports-and-statistics/reports/may-2024/consultation-paper-on-the-recommendations-of-the-expert-committee-for-facilitating-ease-of-doing-business-with-respect-to-business-responsibility-and-sustainability-report-brsr-_83551.html> accessed 6 October 2024.
[44] Ministry of Environment, Forest and Climate Change, 2024, S.O. 884(E).

harmonisation of the overall framework is essential to ensure that there are no regulatory lacuna within the ESG reporting system applicable in India.

IV. GLOBAL APPROACHES TO CLIMATE-RELATED FINANCIAL DISCLOSURE: JURISDICTIONAL DIFFERENCES AND COMMONALITIES

The recent expansion of the CFRD regimes across jurisdictions reflects the global trend shifting towards a mandated system for climate risk reporting to ensure risk mitigation. However, this proliferation of climate-related regulations across jurisdictions can have both positive and negative implications for businesses and investors. Financial institutions and listed entities operational in two or more countries must account for the possible repercussions adequately in such a scenario.

In the European Union, the Corporate Sustainability Reporting Directive (CSRD), 2023 is brought forth to update the longstanding Non-Financial Reporting Directive (NFRD), 2014.[45] Under the previous regime, the applicable entities were required to consider a 'double materiality perspective' wherein they would have to assess the impact of their initiatives on both the people and the environment. However, under the new framework, the reporting standards have been largely standardised by requiring compliance with the European Sustainability Reporting Standards (ESRS).[46] These standards are accordingly divided into environmental, social and governance standards. The reports must be publicly available and must include key information regarding the entity's business model, sustainability goals and

[45] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting [2022] OJ L322.
[46] European Financial Reporting Advisory Group, 'Implementation Guidance on Materiality Assessment' (2023).

policies, due diligence and value chain components. The CSRD also retains the double materiality requirement as under the NFRD. Accordingly, the EU member states are required to enforce the Directive into their domestic laws with subsequent requirements for implementation. Member states within the EU have also undertaken stringent initiatives to combat.

Alternatively, the UK provides for a robust disclosure regime constituting various legislations and regulations within its ambit. The disclosure regime of the UK has been in effect since 2022 and stipulates certain parameters to be disclosed within the company's Non-Financial and Sustainability Information Reporting.[47] These parameters include, amongst others, governance arrangements and mechanisms for identifying and assessing climate related risks, the actual and potential impacts of the principal climate related risks and analysis of the business model's resilience against the same. Further, the greenhouse gas emissions of each listed company or LLP are required to be disclosed as part of their obligations under the Streamlined Energy and Carbon Reporting (SECR) regime.[48] However, it is important to note that the SECR regime requires disclosure of only Scope 1 and 2 emissions and provides for a caveat where the companies or LLPs can refrain from disclosure of certain information that they deem to be "*seriously prejudicial*" to their interests.

Lastly, the Sustainability Disclosure Requirements (SDR) in place since November 2023, requires key distributors of investment products to disclose sustainability related information for the purpose of the investors.[49] There are

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[47] Department for Business, Energy & Industrial Strategy, 'Mandatory climate-related financial disclosures by publicly quoted companies, large private companies and LLPs' (2022).
[48] HM Government, 'Environmental Reporting Guidelines: Including streamlined energy and carbon reporting guidance' (2019).
[49] UK Financial Conduct Authority, 'Sustainability Disclosure Requirements (SDR) and investment labels, Policy Statement PS23/16 (2023).

four key disclosures required to be made under the SDR, which are consumer-facing disclosures for the products with sustainability labels or terms, pre-contractual disclosure within the fund prospectus or prior documents, ongoing-product level disclosures which are annual disclosures of the firm's usage of sustainability labels and terms, and entry-level disclosures which are applicable on asset managers beyond certain thresholds of Assets under Management (AUM) regarding the assessment of potential sustainability risks. These multifaceted and layered application of disclosures allows for all the various stakeholders to be adequately accounted for while assessing ESG compliance. In addition to clear demarcation of the disclosures required, the FCA has also laid down four sustainability labels, namely 'Sustainable Focus', 'Sustainable Improvers', 'Sustainable Impact' and 'Sustainable Mixed Goals'. These ensure that the labels and terminology used for advertising certain products as sustainable have to undergo the relevant qualifiers and thereby curb chances of misleading claims and greenwashing.

In the United States, the US Securities and Exchange Commission (SEC) in March 2024, introduced the requirement for all domestic and foreign registered entities to disclose key climate-related information within their annual reports.[50] These disclosures, subject to materiality qualifiers, shall include climate related risks that are likely to impact business strategies or financial conditions, the role of management and board of directors in assessing and managing the same and climate related goals and targets if any. With regards to greenhouse gas emissions, Scope 1 and 2 emissions are required to be reported by the Large Accelerated Filers (LAFs) and Accelerated Fillers (AFs), to a 'minimum assurance standard'. The entities are

[50] 'Press Release: SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors' (US Securities and Exchange Commission, 6 March 2024) <https://www.sec.gov/newsroom/press-releases/2024-31> accessed 6 October 2024.

also expected to disclose any significant costs, expenditure and losses accrued due to the severe weather conditions or to curb such effects by means of carbon offsets, renewable energy credits or certifications.

Under the regime in Singapore in force since 2022, each company listed on the Singapore Exchange (SGX) is required to provide climate-related disclosures as part of its annual report. Such a report will have to comply with the overarching TCFD standards on a 'comply or explain' basis. Further, from the upcoming financial year, entities operating in five key industries, including energy, transportation, materials and construction, agriculture and financial sectors, will be required to a higher standard of disclosures. The SGX has also laid down 27 core ESG metrics for issuers to utilize as a starting point for sustainability reporting.[51] The regime provides for compliance with the reporting requirements under the International Accounting Standards Board (IASB) IFRS standards, which are meant to ensure uniformity and comparability between financial data across jurisdictions.[52] The relevant companies are also expected to conduct external verification by a registered auditor, on their emissions reporting, albeit only up to scope 1 and 2 emissions. Implementation of the regulation by the listed companies is ensured by the SGX Regulation (RegCo), which holds numerous executive and administrative powers. Therefore, the regime ensures compliance by intricately weaving the reporting requirements into the SGX Listing Rules, thereby mandating the same.

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51 'Sustainability Reporting' (SGX) <https://www.sgx.com/sustainable-finance/sustainability-reporting> accessed 6 October 2024.

52 'Supporting materials for IFRS Accounting Standards' (IFRS) <https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standards/> accessed 8 October 2024.

In New Zealand, the Financial Markets Conduct Act of 2013 was amended in 2023 to include their scope of application to certain key registered banking institutions, managers of investment schemes, licensed insurers and crown financial institutions beyond a certain threshold. The External Reporting Board (XRB) issued the Aotearoa New Zealand Climate standards, encompassing the four pillars of the TCFD, namely governance, strategy, risk management, metrics and targets. The standards also contain a materiality threshold that requires disclosure of information which could materially affect or influence the decisions of the primary users if the same is omitted, misstated or obscured.[53] The regulator also laid down guidelines on the independent assurance of greenhouse gas emissions with a specified standard for scope 1-3 emissions. The Financial Markets Authority (FMA) is responsible for the implementation of this regime and imposes hefty penalties in cases of non-compliance with the same.

V. NAVIGATING THE INVESTOR'S PERSPECTIVE ON ESG DISCLOSURES AND GREENWASHING

With the demand for sustainable financial products on the rise, ensuring compliance for the same by means of proper disclosure and reporting is of paramount importance.[54] The number of exchange traded funds (ETFs) that bear ESG labels and claims have nearly doubled in the past two years to nearly 1,300.[55] Disclosure of ESG related information has significant implications on

[53] 'What is ESG in New Zealand' (*ESG Impact*) <https://www.esgimpact.com.au/esg-in-new-zealand#:~:text=In%20conclusion%2C%20ESG%20considerations%20are,greater%20ESG%20disclosure%20and%20reporting> accessed 6 October 2024.

[54] 'Press Release: FCA acts to help investors make more informed ESG investment decisions' (*UK Financial Conduct Authority*, 3 November 2021) <https://www.fca.org.uk/news/press-releases/fca-acts-help-investors-make-more-informed-esg-investment-decisions> accessed 6 October 2024.

[55] Chris Flood, 'Investors warned of 'greenwashing' risk as ESG-labelled funds double' (*Financial Times*, 24 April 2024) <https://www.ft.com/content/79772342-d260-4dd5-b943-5e75bc27878c> accessed 6 October 2024.

the decision making on the part of the investors - both retail and institutional. It allows them to make adequate comparisons when considering the sustainability practices of various entities and ensure that their financial contributions are in line with their larger ethos. It has also been found in a study by the Singapore Exchange that the sustainability reporting of a company is positively related to the firm's market value.[56] On a larger scale, ESG disclosures serve the purpose of channelling funds towards more sustainable-compliant projects and fostering a sustainable economy.

However, persistent concerns such as the lack of uniform methodologies of reporting, vague or exaggerated claims and false branding continue to hinder genuine progress in the right direction. Sustainability is increasingly becoming a dogma for both businesses and financial actors, with instances of fraudulent and misleading claims in the garb of compliance becoming common.[57] Claims and disclosures of such information have more often been found to be a facade, with numerous instances of greenwashing being discovered. Greenwashing refers to "*a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services.*"[58] Within the context of asset management, this takes the form of marketing and advertising funds as ESG compliant without the

[56] 'Investor Guide to Reading Sustainability Reports' (*SGX*) <https://api2.sgx.com/sites/default/files/2022-04/Investor%20Guide%20to%20Reading%20Sustainability%20Reports_1.pdf> accessed 6 October 2024.

[57] Chiara Cremasco and Leonardo Boni, 'Is the European Union (EU) Sustainable Finance Disclosure Regulation (SFDR) effective in shaping sustainability objectives? An analysis of investment funds' behaviour' (2021) *Journal of Sustainable Finance and Investment 1*.

[58] 'Press Release: ESAs put forward common understanding of greenwashing and warn on risks' (European Securities and Markets Authority, 1 June 2023) <https://www.esma.europa.eu/press-news/esma-news/esas-put-forward-common-understanding-greenwashing-and-warn-risks> accessed 6 October 2024.

required initiatives. Not only does this disrupt the flow of capital to sustainable businesses, but it also erodes the trust in genuine businesses that are making efforts towards a low carbon economy. The European Supervisory Authorities in June 2023, released a report highlighting the risks that firms might face in instances of greenwashing and the need to ensure regulatory compliance.[59] Amongst others, these risks included litigation risks due to misleading ESG claims and product claims by insurers and so on.

The Coordinating Body of Indigenous Organisations of the Amazon Basin (COICA) and the watchdog group Stand Earth collaborated to develop the report. The organisations charted the scope of five major fossil fuel operators' funders' environmental and social governance (ESG) commitments in the South American biome.[60] According to the report, the risk management strategies of the five banks including JP Morgan Chase concerning climate change, biodiversity, forest cover, and the rights of indigenous peoples and local communities, on average, do not adequately preserve 71% of the Amazon.[61] The report further states that JPMC is excluded from project finance and other asset-specific funding within UNESCO World Heritage Sites, which make up only 2% of the Amazon and are often off-limits to development, according to the research.[62]

Adverse effects in the Amazon have ripples in neighbouring ecosystems. These effects work together to start a cascade of changes that affect the planet, so if the Amazon tips, it might trigger a severe chain of events that affects the

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[59] Mark Segal, 'EU Regulators Find Growing Greenwashing Risk for Banks, Asset Managers', (*ESG Today*, 5 June 2023) <https://www.esgtoday.com/eu-regulators-find-growing-greenwashing-risk-for-banks-asset-managers/> accessed 6 October 2024.
[60] Angeline Robertson and others, 'Banking on Amazon Destruction' (Stand.earth 2021).
[61] Angeline Robertson and others, 'Greenwashing the Amazon: How Banks Are Destroying the Amazon Rainforest While Pretending to be Green' (Stand.earth 2024).
[62] JPMorgan Chase, '2022 Environmental Social Governance Report' (2022).

entire world.[63] This case indicates that major private banks like JP Morgan Chase, CitiBank and Goldman Sachs are also inept at maintaining their ESG standards and risk management tools let alone small banks or public banks that do not have the capacity to incorporate adequate metrics and climate risk tools. It is of the utmost importance that such banks do not encourage lending in activities or promote investors that do not invest in assets that adhere to ESG standards.[64] Globally, governments have enacted ESG regulatory frameworks, as well as unique and advantageous reporting and compliance requirements, that complement their overall regulatory environment. As a result of regional differences in economic, social, and political environments, each bank within various jurisdictions has created its own unique set of ESG rules and standards.[65]

The notion of greenwashing traces its origin from the DWS Bank fiasco where Deutsche Bank (DB) and its asset management division (DWS) were raided by the German police.[66] The US Securities and Exchange Commission (SEC) and the Swiss Financial Supervisory Authority (BaFin) were notified of the same. Another such instance recently emerged in the context of the asset manager Blackrock misleading investors within the garb of their climate

[63] Yvette Sierra Praeli, 'In the western Amazon, oil blocks eat away at Indigenous lands, protected areas' (*Mongabay*, 24 October 2022) <https://news.mongabay.com/2022/10/in-the-western-amazon-oil-blocks-eat-away-at-indigenous-lands-protected-areas> accessed 6 October 2024.

[64] Kenza Bryan and Emma Dunkley, 'HSBC to stop new oil and gas project funding after backlash' (*Financial Times*, 14 December 2022) <https://www.ft.com/content/5ba4b75f-bbd8-4b3d-b962-60126754e2fa> accessed 6 October 2024; Iain Withers and Simon Jessop, 'UK's Lloyds ditches project finance for new oil and gas fields' (*Reuters*, 20 October 2022) <https://www.reuters.com/business/finance/uks-lloyds-ditches-project-finance-new-oil-gas-fields-2022-10-20/> accessed 6 October 2024.

[65] Ramya Suresh and Amitabh Abhijit, 'ESG Reporting in India: Balancing Profit, People and Planet' (2024) 2(2) *The Indian Business Law Review* 1.

[66] Ines Gendre, 'Lessons Learned From the "Deutsche Bank" Affair' (*Greenly Institute*, 15 March 2024) <https://greenly.earth/en-us/blog/ecology-news/greenwashing-what-mistake-did-deutsche-bank-make> accessed 6 October 2024.

policies.[67] The firm is a signatory to the Net Zero Asset Managers (NZAM) initiative, under which the firm is expected to adopt ESG considerations in all their funds. However, the information provided by them does not substantiate these claims. There have also been findings that the firm includes ESG considerations into non-ESG funds, thereby misleading the investors. In addition, they have also portrayed their ESG funds as financially beneficial while it has been found to be admitted that these funds do not perform better than other alternatives.

Misleading claims and portrayals often constitute a majority of the instances of greenwashing in cases where the practices of the firms are not consistent with their claims. The German competition regulator Wettbewerbszentrale ("BGH") recently took action against the misleading claims of a German sweets manufacturer. They had advertised their products to have been produced in a 'climate neutral' manner, despite the fact that the process employed for production was compliant. They undertook services of a third party that reduced their carbon footprint by indulging in climate protection projects. The BGH not only classified this as a misleading advertisement but also set substantiation standards for claims such as 'climate neutral' to ensure that vague terminology is not employed to exploit the investors. The German Federal Court of Justice (FCJ) went on to opine those vague terminologies such as 'climate neutral' can only be permissible to the extent that the exact intended meaning is clarified in the advertisement itself.[68]

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[67] Lamar Johnson, 'Mississippi hits BlackRock with cease-and-desist order over ESG investments' (*ESG Dive*, 28 March 2024) <https://www.esgdive.com/news/mississippi-hits-blackrock-with-cease-desist-over-esg-investments-larry-fink/711653/> accessed 6 October 2024.

[68] Sarah Jolly, 'German greenwashing case rules against corporates in 'climate neutral' claim' (*Commercial Risk*, 28 July 2024) <https://www.commercialriskonline.com/german-greenwashing-case-rules-against-corporates-in-climate-neutral-claim/> accessed 6 October 2024.

Subsequent to this ruling, the EU Directive regulates claims such as 'climate neutral', 'CO2 neutral certified', 'carbon positive' and so on. The Directive requires such claims to be substantiated with quantifiable impacts within the lifecycle of the products in question and not outside of their value chain. Similarly, the Green Claims Directive under the European Commission prescribes for certain disclosures to be explicitly made in case of environmental claims being made.

Regulators across jurisdictions are taking note of the increasing instances of greenwashing and aiming to combat the same with stringent legislation. The US SEC has drafted their new climate disclosure rules requiring verifiable and comparable data to be disclosed by public companies.[69] Similarly, the EU Taxonomy Regulation, which has been in force since 2021, provides for six environmental objectives, of which at least one would have to be satisfied for the product to be considered 'sustainable' or 'taxonomy aligned'.[70] The attempt at carving out clear definitions and degrees of compliance with the taxonomy ensures that the burgeoning landscape ESG financing is easier for the asset managers as well as investors to navigate. Further, specific regions such as the United Kingdom, have enforced separate requirements to combat greenwashing within the financial markets. The Sustainability Disclosure Requirements (SDR) enforced by the Financial Conduct Authority (FCA) attempts to tackle such instances by requiring all sustainability-related claims to be 'clear, fair and not misleading'.[71] Under this regime, internal taxonomies

[69] Kathrine Hafner and Dr. Frederik Winter, 'Germany: BaFin aims to tackle greenwashing with its new Sustainable Finance Strategy' (*Linklaters*, 7 July 2023) <https://sustainablefutures.linklaters.com/post/102iiul/germany-bafin-aims-to-tackle-greenwashing-with-its-new-sustainable-finance-strat> accessed 6 October 2024.
[70] 'EU taxonomy for sustainable activities' (*European Commission*) <https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en> accessed 6 October 2024.
[71] HM Government, *Environmental Reporting Guidelines: Including streamlined energy and carbon reporting guidance* (2019).

and concise definitions for any claims are encouraged to ensure both compliance and comprehension at the external level.

The field of sustainable investing is growing rapidly, but also faces challenges from greenwashing. Recent legal actions and hefty fines show the serious consequences of misleading investors. As ESG factors become more important in investment decisions, transparency, honesty, and careful investigation are essential. Investors and asset managers need to be vigilant to distinguish genuine sustainability from false claims. To combat greenwashing, financial institutions need to follow stricter standards. They should disclose information transparently, set realistic goals, and ensure accountability. This helps protect investors and promotes genuine sustainable practices.

VI. CONCLUSION AND SUGGESTIONS

As investors increasingly prioritize sustainability and ethical considerations, climate disclosures by various stakeholders across industries, provide valuable insights into a company's performance and long-term prospects. However, the effectiveness of ESG disclosures depends on their accuracy, consistency, and comparability across industries and sectors. With each jurisdiction coming up with their own regulations, it is essential to ensure that it is facilitated by means of clear and concise thresholds. The harmonisation of various reporting requirements within jurisdictions is of paramount importance as the lack of clarity on this issue causes regulatory loopholes. This lacuna not only has implications on the credibility lent by investors but also makes compliance within the jurisdiction more burdensome.

This is exemplified by the Climate Disclosure mandate under French law that was adopted in 2015, in the run up to the Paris Agreement.[72] Under Article

[72] *The Energy Transition for Green Growth Act,* 2015 (992 of 2015).

173, the legislation requires companies to disclose three key pieces of information, that is the entity's carbon footprint and emission, their identification and assessment of the climate-related risks and the initiatives undertaken to combat the same. The legislation being adopted on a 'comply or explain' basis is not mandating such disclosures. However, after an analysis of the effectiveness of the legislation after two years, it was found that the voluntary nature of the disclosures posed a significant hurdle in ensuring incentivisation and uniformity within such disclosures.[73] The adoption of a comply or explain approach may therefore, be supplemented with the delegation of monitoring and verification authorities to ensure compliance. Lack of clarity on the quantifiable information needed to be provided within each indicator must also be considered.

Within the context of India, in order to align with the proposed frameworks, the RBI must incorporate the principles and standards laid down in the aforementioned frameworks. As far as the BCBS is concerned the RBI should evaluate the comments on the consultation paper released by the BCBS on the disclosure of climate related financial risks to be able to match with the changes introduced.[74] It is unclear whether the disclosures put forth by the RBI are meant to (1) comply with Pillar 3 prudential disclosure requirements by incorporating the International Sustainability Standards Board (ISSB) corporate disclosure standard,[75] or (2) promote market discipline by disclosing publicly the information about banks' capital structure, capital adequacy, and

[73] Julie Evain and others, 'Article 173: Overview of climate-related financial disclosure after two years of implementation' (2018) Institute for Climate Economics Climate Brief No. 59 <https://www.i4ce.org/wp-content/uploads/1210-I4CE2949-PC59-Article173-nov18-VA.pdf> accessed 6 October 2024.

[74] Nicky Jenner (n 13).

[75] Alan Reinstein and others, 'The ISSB's New Sustainability Disclosure Standard' (*The CPA Journal*, April 2024) <https://www.cpajournal.com/2024/04/03/the-issbs-new-sustainability-disclosure-standards/> accessed 6 October 2024.

risk management. It is a matter of concern that the proposed disclosure does not adhere to Pillar 3 prudential disclosure guidelines or corporate disclosure goals. It must be ascertained that these disclosures support the proposed objective. Similarly, in order to identify assets subject to climate hazards, the Climate Bond Initiative had proposed that the RBI must ask banks to tag assets and project finance loans (often known as "brown assets"). The potential of climate change should be emphasised, as demonstrated by the Green Loan Principles that ensure traceability within the relevant Indian taxonomy.[76]

With regards to scenario analysis, India should rely on the analysis framework proposed by the Network for Greening the Financial System (NGFS). Due to their distinctive qualities, the NGFS scenarios are especially well-suited for a variety of applications.[77] They blend physical and transition hazards with macro-financial changes, yield internally consistent results, are globally applicable, and are publicly available. They thus supplement current scenarios, like those found in the IPCC database.[78] Similarly, any stress-testing regime must include input stressors that go beyond the "transition risks" that are the focus of the majority of discussions on environment-related stress testing at the moment. Stress tests are especially helpful in situations where there is a large degree of uncertainty surrounding the physical dangers associated with climate change, as well as the possibility of fat-tailed scenarios involving quick losses.[79] It may therefore, be reasonable to stress test the banking system in light of adverse climate scenarios and to include regulatory

[76] 'What you need to know about Green Loans' (*World Bank Group*, 4 October 2024), <https://www.worldbank.org/en/news/feature/2021/10/04/what-you-need-to-know-about-green-loans> accessed 6 October 2024.
[77] S Alogoskoufis (n 34).
[78] Reserve Bank of India, Draft Disclosure Framework on Climate-related Financial Risks 2024, RBI/2023-24/DOR.SFG.REC./30.01.021/2023-2024.
[79] Hugh Miller and Simon Dikau, 'Preventing a 'climate Minsky moment': environmental financial risks and prudential exposure limits' (London School of Economics and Political Science 2022).

risk in addition to the minimum amount of capital that banks must maintain.[80] To determine their capacity for evaluating the hazards associated with climate change, certain jurisdictions have carried out multiple stress tests. Such methods can help India determine thPe best stress-testing instrument for evaluating transition and physical hazards.

Therefore, the authors believe that the climate-related financial disclosures have emerged as a critical tool for investors, regulators, and society at large to assess and manage climate-related risks and opportunities. While significant progress has been made in recent years, there is still room for improvement in the quality, consistency, and comparability of disclosures. There is a long way to be made in measures such as ensuring compliance with international standards, enhancing the quality of data that is utilised and fostering climate-related technologies. By addressing these areas, we can unlock the full potential of climate-related financial disclosures and drive sustainable economic growth.

[80] Charles AE Goodhart, 'In praise of stress tests' in Ronald W. Anderson (ed), *Stress Testing and Macroprudential Regulation: A Transatlantic Assessment* (Centre for Economic Policy Research 2016).

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