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

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ABSTRACT

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

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

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I. INTRODUCTION

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

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

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

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

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

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

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

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

II. IBC AND THE ENVIRONMENT

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

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

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

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

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

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

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

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

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

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

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

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

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

III. DEFINING AN ENVIRONMENTAL CLAIM

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

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

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

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

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

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

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

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[33] ibid.
[34] Reg 7, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016.
[35] ibid. Reg. 14.
[36] Subhankar Bhowmik v. Union of India 2022 SCC OnLine Tri 208 [17]; Subhankar Bhowmik v. Union of India 2022 SCC OnLine SC 764 [2,3].
[37] M. P. Ram Mohan & Sriram Prasad, 'Environmental Claims under Indian Insolvency Law: Concepts and Challenges' (2023) 59 Tex Int'l L J 105.

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

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

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

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

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

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

V. SECTION 238: A BARRIER TO ENVIRONMENTAL CONSIDERATIONS?

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

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

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

VI. A COMPARATIVE ANALYSIS WITH OTHER JURISDICTIONS

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

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

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

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

[51] r14, Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations 2016 (n 34).
[52] Namrata Nair and Medha Shekar, 'Green Insolvency: Perspective and Policy Prescription' in *Exploring New Perspectives on Insolvency* (IBBI 2022) 351 https://www.ibbi.gov.in/uploads/publication/599cf8fb50be73f518fca467311304db.pdf accessed 15 October 2024.
[53] Subhankar Bhowmik [17] (n36).
[54] Sanjay Kumar, 'Has the Judiciary Abandoned the Environment to Neoliberalism?' (2023) *Economic and Political Weekly* https://www.epw.in/engage/article/has-judiciary-abandoned-environment-neoliberalism accessed 15 October 2024.
[55] ibid.
[56] Orphan Well Association v. Grant Thornton Ltd., 2019 SCC 5, [2019] 1 S.C.R. 150 (Canada).

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

A. Treating Environmental Claims as a Separate Claim Beyond Moratorium

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

B. Prioritising Environmental Claims Over Other Claims

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

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

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

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

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

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

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

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

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

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

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

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

[65] Virender Gaur (n12).

A. Exclusion of Environmental Claims from the Moratorium Period

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[86] Pramati Educational & Cultural Trust v. Union of India (2014) 8 SCC 1 (India), [53].
[87] Rainbow Papers [57] (n82); Paschimanchal Vidyut Vitran Nigam Ltd. [47-51] (n78); Ghanashyam Mishra [71] (n43).
[88] Nimmo and anr [67] (n).
[89] s 23, Indian Contract Act, 1882. (India).

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

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

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

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

[90] Gherurlal Parakh v. Mahadeodas Maiya AIR 1959 SC 781 (India).

[91] Equator Principles Association, *The Equator Principles III* (June 2013) https://www.loyensloeff.com/the_equator_principles_iii_june2013.pdf accessed 18 October 2024.

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

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

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

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

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

VIII. CONCLUSION

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

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

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