

GROUP INSOLVENCY FRAMEWORK: NEED OF THE HOUR

DR. S K GUPTA
MANAGING DIRECTOR
ICMAI REGISTERED VALUERS' ORGANIZATION

Presently, the Insolvency and Bankruptcy Code, 2016 (IBC) does not provide for a consolidated mechanism to synchronize insolvency proceedings of corporate debtors procedurally or substantively within the same group. In spite of this, adjudicating authorities under the IBC have passed orders taking into consideration corporate debtors and their interconnections with other group companies such as in cases of Sachet Infrastructure, Videocon, Amtek Auto, Jaypee etc.

Codifying a Framework can have advantages such as reduced cost of proceedings, exchange of information, more certainty for stakeholders and maximization of value.

The Perspective

The recognition of a company's separate juristic personality by the UK's House of Lords in its landmark ruling in *Salomon v. Salomon & Co Ltd* remains the basis for modern corporate law. The ruling in effect drew a *corporate veil* around the legal personality of the company thereby establishing the separate legal identity of a corporate. While India also follows the separate juristic personality of corporates as a general principle, exceptions have been incorporated over the years by way of legislative action and juridical pronouncements. In the context of insolvency law, the corporate veil is typically lifted in instances where a group company could be held liable for the debts of its associate and subsidiary companies, or if a group of companies functioned as a collective.

Market data suggests that a significant percentage of Indian businesses are structured as intrinsically linked group entities that operate as a single economic unit. It comes as no surprise that according to a World Bank Report, India ranked 20th on the related party transaction index out of 190 jurisdictions. It is common business practice for group entities to regularly engage in related party transactions such as inter-corporate loans, cross collateralization and significant influence arrangements. While such structures largely respect the separate legal status of the group companies. Practice suggests such interlinkages in business, operations and management often raise significant challenges when individual group entities become insolvent.

The increased consolidation in India Inc over the last few years has led to numerous instances of situations wherein the group holding company lands into indebtedness and is on the verge

of being insolvent, thereby impacting all its subsidiary companies, or vice-versa, wherein indebtedness of a subsidiary creates risk for the larger group. Such instances are categorized as 'group insolvency', which refers to the process of clubbing together the assets and liabilities of individual companies and undertaking the insolvency proceedings as one substantive consolidation of the holding company, its associates, and its subsidiaries.

With group structures holding prominence in the business scene of India, there has been a need to outline and frame a comprehensive group insolvency framework. There are situations where the stakeholders may expand their interests and the chance of revival of organizations might be higher if organizations in a group are settled and resolved together. However, the Insolvency and Bankruptcy Code, 2016 ('IBC') doesn't conceive a structure to either synchronize indebtedness procedures of various organizations in a group or to resolve their insolvencies together. As of late, the need was acknowledged in the insolvency resolution of some corporate debtors like Videocon, Era Infrastructure, Lanco, Educomp, Amtek, Adel, Jaypee and Aircel, where uncommon issues emerged from their interconnection with other group organizations. In a portion of these cases, the Adjudicating Authority under the Code just as the Supreme Court, have passed orders to partially enhance such issues.

Group Company Insolvency

A Group Company is a cluster of corporate entities of parent and subsidiary companies in a vertical structure or horizontal structure format that functions as a single economic entity with common control. According to the Reserve Bank of India, Group Company means two or more enterprises which, directly or indirectly, are in position to exercise twenty-six per cent, or more of voting rights in other enterprise or appoint more than fifty per cent, of members of board of directors in the other enterprise. Group companies with financial relations, like interlinked corporate guarantees, loans and advances are more prone to group company insolvency rather than group companies with operational relations. When one of the group companies becomes insolvent, all the other companies financially linked with the insolvent company gets dragged for insolvency proceedings.

Where one entity of a corporate group enters insolvency, these links may make the operations of the entire group difficult. The insolvent entity's insolvency process may itself become affected due to the corporate group's behaviour. Therefore, where there is a default by one or more companies in a corporate group and on the existence of such links, common law prefers the consolidation of all the defaulting group entities' insolvencies. Typically, group insolvencies aim to ensure value maximization, procedural and cost efficiency, and the protection of all stakeholders' interests.

The practitioners of Insolvency Law would have come across situations where the corporate debtor in a CIRP does not have assets for insolvency resolution in a meaningful way, but there would be holding companies or associate or subsidiary companies of the same group who have good assets. But those assets cannot be touched because they belong to a different entity, though that entity is either promoted or controlled by the same or substantially same

promoters. This is because IBC does not have provisions or a mechanism to consolidate the assets and liabilities of group companies or to consolidate CIRPs and work together for insolvency resolution of more than one company belonging to the same group.

Approaches to Group Insolvency

While the approaches to achieving group-focused insolvency resolution or liquidation may be many, there are essentially two major ones – procedural consolidation, and substantive consolidation.

Procedural consolidation is where the proceedings of insolvency of different entities are coordinated, even if before different judicial or adjudicating authorities. This has successfully been done in several major insolvencies involving cross-border entities, such as BCCI, Maxwell.

Substantive consolidation disregards the separation of entities and pools the assets and liabilities of various entities into a common hotchpot. This extreme remedy is rarely used, even though UNCITRAL has been aggressively working on developing the principles for the same. Basically, substantive consolidation is ordered by courts where pooling of assets and liabilities is to larger benefit of different creditors, and generally not prejudicial to any. Mostly, this is done under circumstances similar to those inviting “lifting or piercing the corporate veil”, even substantive consolidation is different from veil lifting or piercing.

Mechanics of Group Insolvency

The IBBI Working group on Group Insolvency has recommended that “corporate group” ought to have two essential ingredients as Ownership and Control. In addition to that, the Working group suggests that even organizations which are not covered under the definition however are characteristically connected will form some part of a ‘group’ in commercial understanding. Here, the principal factor in deciding whether the organization will be incorporated or not will rely on the value addition to be the other organization in the indebtedness without destroying the value of the organization being incorporated. Another critical view is that the framework has been made regarding the organizations; along these lines, other corporate structures like limited liability partnerships or other body corporate have not been incorporated.

IBBI Working Group, among several recommendations, has suggested the implementation of the group insolvency framework in a phased manner.

- **Phase 1:** The first phase should initially be applied only to companies in a domestic group with adoption of procedural coordination mechanisms as a trial mechanism. Procedural coordination mechanisms are rules which coordinate the different insolvency processes of various group companies, without disturbing the division of assets and substantive claims of creditors of each of the group companies. This mechanism lowers costs and reduces the time associated with different insolvency processes. It consists of the following elements:

- Joint application process for insolvency of multiple companies
- Communication, cooperation and information sharing between different insolvency professionals, NCLTs and CoCs under IBC
- Single Adjudicating Authority to administer insolvency proceedings
- Single insolvency professional for companies in a corporate group
- Creation of a group creditors' committee
- Enabling of group coordination proceedings
- Extension of overall time frame for conclusion of CIRP of group entities to 420 days
- **Phase 2:** The second phase should introduce mechanisms of group insolvency in cross-border group insolvencies and substantial consolidation, depending upon the implementation of first phase of framework. The concept of substantive consolidation seeks to consolidate the assets and liabilities of group companies so that they are considered as a single economic unit for the insolvency process.

The Working group suggests that procedural coordination mechanisms (other than co-operation, coordination and data sharing) ought to on a fundamental level be empowered by law, anyway adaptability ought to be allowed to not decide on or apply these mechanisms in those situations where they don't help expand the value of assets or lower expenses of procedures. Further, working group suggests that insolvency professionals, CoCs (committees of creditors) and Adjudicating Authorities ought to be ordered to coordinate, communicate and share data with one another, since this is probably going to decrease the time taken in procedures, lower costs by de-copying efforts to gather data and promote data balance.

The working group has recommended amending the IBC, the corresponding rules and regulations and other relevant laws to enable its recommendations for the Framework. The key working group recommendations are set out below:

- **Co-operation, communication and Information sharing:** The IPs, each committee of creditors ("CoC") and AAs will have to cooperate, communicate and share information with each other, in case of insolvency of group companies.
- **Joint application process:** A single application to commence CIRP for multiple group companies that have committed defaults can be made. Such a joint application process should be in addition to the mechanism to initiate the CIRP against each group company separately.
- **Designation of a single AA:** A single AA is required to administer the insolvency proceedings of different companies in a group. This will be the AA that first admits an application to commence the CIRP for any company in the group. However, the CoCs of different companies may, by the required majority, choose the AA as per their convenience. If any CoC opts out of the group insolvency process, the AAs must share information, cooperate and communicate with each other.
- **Designation of a single IP:** The AA will have to appoint a single IP in the insolvency proceedings of all companies in the corporate group. Multiple IPs can be appointed if a single IP has potential conflicts of interest or insufficient resources to carry out his duties. The different IPs will have to communicate, cooperate and share information with each other.

- **Formation of a group creditors' committee and signing a framework agreement:** The group creditors' committee will be formed at the discretion of the CoCs of each group company. The composition, constitution, and cost of the group creditors' committee can be decided by an agreement between the CoCs or by a framework agreement.
- **Group coordination proceedings:** Such coordination proceedings should be enabled by a vote of the majority of each CoC and governed by the framework agreement. The parties to the framework agreement can appoint an IP as a group coordinator. The group coordinator will be required to propose the actions to be taken by the group. Each CoC can opt-out of the group coordination proceedings if it does not approve of the strategy of the group coordinator. When group coordination proceedings are opened, all AAs should be intimated of the same and all cases should be transferred to a single AA chosen under the framework agreement.
- **Extension of CIRP timeframe:** The timeframe for proceedings of any company that has opened group co-ordination proceedings may be extended to 420 days (including time taken in litigation) on an application to the AA. (The timeframe presently available for a company to complete CIRP under IBC is 330 days.)
- **Rules against perverse behaviour of group companies:** While the WG pondered over-rules against perverse behaviour from various jurisdictions which could be incorporated in the Framework, the only amendment that the WG has finally recommended is to allow subordination of intra-group debt in exceptional circumstances of fraud, etc. No other rules against perverse behaviour have been recommended on account of provisions regarding preferential and fraudulent transactions already being covered in the present IBC. Further, the subordination of intragroup claims may be allowed in respect of all group companies, regardless of their solvency.

Despite broad proposed structure for Group Insolvency being outlined by the Working Group there remain concerns that need to be addressed:

- Definition of the term 'corporate group' provided by the Working Group for the purpose of this framework so as to include holding, subsidiary and associate companies, is vague and fails to be inclusive
- Inherent ambiguity between jurisdictional issues arising due to the recommendation of a single Adjudicating Authority to mandatorily monitor the group insolvency process and the liberties provided to stakeholders to have different Adjudicating Authorities during the process of transfer of their applications.
- Applicability of cross-border insolvency provisions with relation to group insolvency since the development of provisions related to cross-border insolvency is itself at a nascent stage
- Non-settlement of the application of the principle of extension of liability as far as the Indian jurisprudence related to group insolvency proceedings is concerned
- Lack of consideration of issues relating to provisions for dealing with multiple tax jurisdictions, the concept of group moratorium, the procedure to move out from group insolvency proceedings in case of settlement between creditors and

corporate debtors, the feasibility of insolvency proceedings of a corporate debtor having cross investments and backward or forward linkages with other group entities without consolidation, alignment of management of multiple group companies by single RP, etc.

Nonetheless, the recommendations of the working group, if implemented with caution, will be a definite step towards taking the insolvency reforms forward. The working group report will serve as a guiding principle for the proposed phased implementation of the group insolvency regime for effectively tackling the substantiated issues which have arisen in cases of group insolvency.

Challenges in its way

This new advancement of Group Insolvency accompanies its own set of challenges and issues which should be remembered and kept in mind while it is drafted. Issues must be settled in regard to organizations with a gigantic turnover, which is monetarily independent and self-sufficient in running their organization as a going concern but is being dragged in the insolvency because of the group members. For instance, KAIL was one of the fifteen Videocon group entities which were requested to be consolidated. The court chose to keep it out of the union or consolidation since KAIL was an independent and self-sufficient organization with an immense turnover and was autonomously equipped with keeping up itself as a going concern.

Whenever merged with different entities, KAIL's asset value would have diminished which would have harmed its creditors' enthusiasm and interest leaving them uncertain about their share in the combined asset of the Group. On the off chance that creditors are left insecure, at that point that would reflect in either their eagerness to give credit or their raise in the amount of intrigue or interest. In the case of operational creditors, on the off chance that the assets are consolidated, at that point their chances to hold **10% of the aggregate** due sum diminishes. Henceforth, their opportunity to be a part of Committee of Creditors goes down and on the off chance that operational creditors are overlooked or ignored, at that point, no one would give merchandise and services on credit. There would be a demand for advance payment which would be terrible for the Indian economy.

Conclusion

Individual Insolvency procedures against different organizations of the same group in the different jurisdictions over the world result in an undue delay to the innocent creditors. In such a situation, the union of the subject matter would act in the advantage of creditors and the resolution procedure of such group insolvency would be quick and in an ideal way. The group insolvency system is required to address different developing worries, as was apparent from recent indebtedness cases. However, as the Code develops from the idea of 'entity' to 'enterprise', the stakeholders, including the administrators and the legal executive, will contribute as well as gain from the experience it brings to the table. Further, the usage of the group framework is in a phased manner which will prompt the improvement of law and development of jurisprudence alongside the cases. Along these lines, the input obtained from the execution of the gathering structure will assist the administrators with devising fundamental revisions in the equivalent.

Separately, in light of the Report, modifications to the Prudential Framework for Resolution of Stressed Assets released by the Reserve Bank of India on June 7, 2019, may also be considered in relation to asset restructuring for group entities. For instance, introduction of provisions catering to group structures for governing the synchronization of asset classification norms amongst entities, pre-IBC restructuring and specialized asset classification, will aid in the growth of a symbiotic relationship between the Code and RBI norms. This may serve in expediting the revival of group entities.

In India, however, the Code doesn't accommodate and provide for specific arrangements or provisions identified with group insolvency, the courts, through its capacity of legal translation or judicial interpretation, have acted as the hero to rescue and settle a few cases accordingly. In any case, specific provisions identified with this concept should be incorporated in the code so as to get sureness and consistency in the law. Investors shall accordingly plan their investment; otherwise, pointless deferral or delay in courts and different complexities would make India a less alluring investment destination.

-----*****-----

End-Notes:

- Bankruptcy No. 79-224-A United States Bankruptcy Court E.D. Virginia.
- Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Pvt Ltd, Company Appeal (AT) (Insolvency) No.377 of 2019 (India).
- Insolvency and Bankruptcy Board of India, The report of the Bankruptcy Law Reforms Committee
- State Bank of India v. Videocon Industries Limited & Ors. MANU/NC/2290/2020 (India).
- Report of the Insolvency Law Committee, Ministry of Corporate Affairs, Government of India,
- Reserve Bank of India, A.P. (DIR Series) Circular No.68, RBI/2013-14/356.