REPORT OF THE WORKING GROUP ON GROUP INSOLVENCY

Confidential

WORKING GROUP ON GROUP INSOLVENCY

23rd September, 2019

To
Chairperson
Insolvency and Bankruptcy Board of India
Mayur Bhawan, New Delhi – 110001.

Dear Sir,

The Working Group on Group Insolvency constituted, vide office order No. IBBI/CIRP/GI/2018-19/001 dated 17th January, 2019, have the privilege and honour to present its Report to the Insolvency and Bankruptcy Board of India.

2. The Working Group adopted a consultative approach and has been benefitted considerably from the interactions with various stakeholders. It has attempted to provide a comprehensive framework for Group Insolvency, to be implemented in a phased manner, with procedural co-ordination to start with in the first phase.

3. We thank the Insolvency and Bankruptcy Board of India for providing us an opportunity of developing a framework for Group Insolvency under the Insolvency and Bankruptcy Code, 2016. We believe that the framework recommended by the Working Group would take the insolvency reform a step forward.

Yours sincerely,

(U. K. Sinha)
Chairperson

(Anshula Kant)
Member

(Shardul Shroff)
Member

(Shubhashis Gangopadhyay)
Member

(Siby Antony)
Member

(Koushik Chatterjee)
Member

(Sumit Binani)
Member

(Sumant Batra)
Invitee

(S. K. Gupta)
Invitee

(Alka Kapoor)
Invitee

(Sunil Pant)
Invitee

PREFACE

23rd September, 2019

With the enactment of the Insolvency and Bankruptcy Code, 2016 (Code), India put in place a robust market mechanism for timely and time bound resolution of corporate distress. It enables revival of companies in financial distress and facilitates closure of companies in economic distress. It, however, incentivises and empowers the stakeholders to resolve the distress when a company starts experiencing financial distress, much before it experiences economic distress. The provisions of the Code and the emerging jurisprudence reinforce revival of every company in distress and maximise its value.

A company is a legal person having its own distinct identity. Its rights and duties and powers and obligations are well defined. Depending on its assessment of risk-return associated with a company on standalone basis, a stakeholder takes a stance about the company and deals with it accordingly. Where the company gets into distress, the stakeholders attempt to resolve the distress of that company alone to maximise their interests. The Code provides a detailed framework to deal with the insolvency of a company in distress, on standalone basis.

However, there are situations where the fate of one company is linked to that of another. In such cases, the stakeholders may maximise their interests and the possibility of revival of companies may be higher, if such linked companies are resolved together. The Code, however, does not envisage a framework to either synchronise insolvency proceedings of different companies in a group or to resolve their insolvencies together.

There are difficulties of resolving distress of a group of companies together. It is conceptually difficult as the stakeholders usually deal with each company on a standalone basis. If the law requires resolution of a group of companies together, the stakeholders would conduct due diligence of a group of companies before dealing with them, which is extremely difficult, at least for stakeholders having small stakes. Further, the stakeholders may have conflicting interests in different companies in a group. For these reasons, not many jurisdictions have a comprehensive framework for resolving insolvency of a group of companies.

Given that resolution of a group of companies can be value-adding as compared to separate insolvency proceeding for each company in distress, many jurisdictions are contemplating to make available an enabling framework for the same. In this background, the Insolvency and Bankruptcy Board of India (IBBI) constituted a Working Group to recommend a complete framework to facilitate insolvency resolution and liquidation of companies in a group.

While keeping in mind the basic legal principles of separate legal personality, asset partitioning and limited liability on the basis of which modern commerce is organised, the Working Group carried out extensive consultations with various stakeholders, including insolvency professionals, professional bodies, industry chambers, law firms, banks, resolution applicants, academicians and domain experts, who provided insightful comments and suggestions. This report is a sincere attempt to present a blue-print of a 'Group Insolvency Framework' that balances competing considerations in the interests of value maximisation, credit growth and promotion of entrepreneurship.

The thrust of the framework is 'facilitation', 'flexibility' and 'choice'. It envisages an enabling group insolvency framework, to be implemented in a phased manner. The first phase may facilitate procedural co-ordination of only companies in domestic groups. Cross-border group insolvency and substantive consolidation could be considered at a later stage, depending on the experience of implementing the earlier phases of the framework, and the felt need at the relevant time. While it would be voluntary for the stakeholders of the company in distress to use the framework, the provisions relating to communication, cooperation and information sharing between Insolvency Professionals, Committee of Creditors and Adjudicating Authorities is proposed to be made mandatory for the companies which belong to a group and have been admitted into corporate insolvency resolution process.

The Working Group takes this opportunity to thank the stakeholders who participated in the consultation process. It appreciates the valuable contribution of Ms. Shreya Prakash and Mr. Oitihjya Sen from the Vidhi Centre for Legal Policy for legal research and drafting support. It also appreciates the dedicated efforts put in by Mr. Methil Unnikrishnan and Mr. Yadwinder Singh of the IBBI for collating suggestions, facilitating consultations and providing administrative and technical support for the smooth functioning of the Working Group. I thank each member of the Working Group for enriching the deliberations of the Committee and bringing different perspectives on the table, which makes this report comprehensive and practical.

I hope that the recommendations of this Working Group will help the Government of India and the IBBI to devise a Group Insolvency Framework that is suited to the needs of a fast-moving and modern economy.

(U. K. Sinha)
Chairperson, Working Group on Group Insolvency

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PART I
BACKGROUND

1. INTRODUCTION

With the introduction of the Insolvency and Bankruptcy Code, 2016 ("**Code**"), India consolidated the fragmented laws relating to reorganisation, insolvency resolution and liquidation of corporate persons. While the Code provides detailed provisions to deal with the insolvency of a corporate debtor on standalone basis, it does not envisage a framework to either synchronise insolvency proceedings of different corporate debtors in a group or resolve their insolvencies together. Consequently, the insolvency of different corporate debtors belonging to the same group is dealt with through separate insolvency proceedings for each corporate debtor. However, in the insolvency resolution of some corporate debtors, including *Videocon*, *Era infrastructure*, *Lanco, Educomp, Amtek, Adel, Jaypee and Aircel,* special issues arose from their interconnections with other group companies. In some of these cases, the Adjudicating Authority under the Code as well as the Supreme Court, in some cases, have passed orders to partially ameliorate some such issues. This highlights the need to examine the desirability and feasibility of having a group insolvency framework.

In this background, the Insolvency and Bankruptcy Board of India ("**IBBI**") constituted a 'Working Group on Group Insolvency' ("**WG**") under the Chairmanship of Mr. U. K. Sinha (Former Chairman, Securities and Exchange Board of India) through an order dated January 17, 2019 (Annexure I). The WG was required to submit a report recommending a complete framework to facilitate insolvency resolution and liquidation of corporate debtors in a group ("**framework**"). The members of the WG are Ms. Anshula Kant (Managing Director, State Bank of India), Mr. Shardul Shroff (Executive Chairman, Shardul Amarchand Mangaldas & Co. Advocate and Solicitors), Dr. Shubhashis Gangopadhyay (Founder and Research Director, India Development Foundation), Mr. Siby Antony (Chairman, Edelweiss Asset Reconstruction Company Limited), Mr. Koushik Chatterjee (Executive Director and Chief Financial Officer, Tata Steel Limited) and Mr. Sumit Binani (Insolvency Professional). The invitees to the WG are Mr. Sumant Batra (President, Society of Insolvency Practitioners of India), Dr. S. K. Gupta (CEO, Insolvency Professional Agency of the Institute of Cost Accountants of India), Ms. Alka Kapoor (CEO, ICSI Institute of Insolvency Professionals) and Mr. Sunil Pant (CEO, Indian Institute of Insolvency Professionals of ICAI).

To fulfil its mandate, the WG consulted several stakeholders and experts, and examined relevant legal and regulatory principles as well as both global and domestic market practices. Based on this, the WG submits this report ("**Report**") recommending a framework to facilitate insolvency resolution and liquidation of corporate debtors in a group.

2. Working Process

Given the potential impact of a framework dealing with insolvency of companies in corporate groups, the WG followed a transparent and consultative process to arrive at its recommendations.

The WG invited various stakeholders (Annexure II) to attend its meetings, make submissions regarding the need for a group insolvency framework and provide comments on key issues regarding the proposed framework. A summary of the comments received from stakeholders and presented to the WG is in Annexure III. A note prepared by Dr. Shubhashis Gangopadhyay (Founder and Research Director, India Development Foundation) and a member of the WG discussing 'The Economics of Group Insolvency', that was presented to the WG, is in Annexure IV. A cross country comparison of legal framework of group insolvency prepared by the ICSI Institute of Insolvency Professionals, that was presented to the WG, is in Annexure V.

The WG requested the IBBI to carry out a study of certain corporate insolvency resolution processes ("**CIRPs**") to supplement its understanding. A summary of the studies carried out by the IBBI are provided as Box Items in the Report.

The IBBI engaged the Vidhi Centre for Legal Policy to provide legal research on principles of law and international jurisprudence, and to assist the WG in drafting its report.

3. Structure of this Report

This Report contains four parts. Part I of the Report provides a background to the process of the WG. Part II of the Report explains the rationale for preferring a framework that deals with special issues arising in the insolvency of companies in a group. Part III of the Report outlines the key elements of this framework and how it may be implemented. Part IV of the Report lays down the key recommendations regarding the design of this framework, including recommendations that the IBBI and the Central Government may consider in the future.

4. Summary of Recommendations

The WG considered the need for a framework to facilitate the insolvency resolution and liquidation of companies in a group. In particular, it looked into the facets of the framework, namely, *first*, elements that enable communication, coordination and cooperation among stakeholders in the insolvency proceedings of companies in a group (i.e. procedural coordination), *second*, elements that enable the assets of companies in a group to be consolidated in limited circumstances (i.e. substantive consolidation), *third*, rules to deal with the perverse behaviour of companies in a group, and fourth, interconnection among the companies that would make them part of a group.

In this regard, the WG made the following specific recommendations:

(1) The law may envisage a framework to facilitate insolvency resolution and liquidation of companies belonging to a group. The framework may be enabling, and may be voluntarily used by relevant stakeholders of the company. Only provisions relating to communication, cooperation and information sharing may be mandatory for insolvency professionals, Adjudicating Authorities and committees of creditors ("**CoCs**") of the companies which belong to a group and have been admitted into CIRP. (Part IV, Para 1.3.1)

(2) The law may enable phased implementation of the framework. The first phase may facilitate the introduction of procedural co-ordination of only domestic companies in groups and rules against perverse behaviour. Cross-border group insolvency and substantive consolidation could be considered at a later stage, depending on the experience of implementing the earlier phases of the framework, and the felt need at the relevant time. (Part III, Para 2)

(3) For the purposes of this framework, a 'corporate group' may include holding, subsidiary and associate companies, as defined under the Companies Act, 2013. However, an application may be made to the Adjudicating Authority to include companies that are so intrinsically linked as to form part of a 'group' in commercial understanding, but are not covered by the definition of corporate group above, as well. Procedural coordination mechanisms under this framework may be applicable only to those group companies which have defaulted, and which are covered by the Code for the purpose of insolvency resolution or liquidation. However, rules against perverse behaviour may be applicable to all group companies, regardless of their solvency. (Part III, Para 3.3)

(4) The framework may provide for procedural coordination in the first phase as under:

a. The framework may have the following elements of procedural co-ordination:

i. Joint application
ii. Communication, cooperation and information sharing
iii. Single insolvency professional and single Adjudicating Authority
iv. Creation of a group creditors' committee, and
v. Group coordination proceedings. (Part IV, Paras 1.3.1 and 1.3.2)

b. A joint application may be made against all corporate debtors who have committed a default and who form part of a group. Other procedural coordination mechanisms (listed above) may be made available to those companies who form part of a group, and have been admitted into CIRP. (Part IV, Para 1.3.1)

c. While all other elements of procedural co-ordination may be voluntary, cooperation, communication and information sharing among insolvency professionals, CoC and Adjudicating Authorities may be mandatory for companies that have been admitted into CIRP. (Part IV, Para 1.3.2.5)

d. In addition to cooperation, communication and information sharing, other elements of procedural coordination may be enabled as under:

- *Joint Application for the insolvency resolution:* The law may enable a single application to be filed to commence the insolvency resolution processes of multiple companies in a group, before any Adjudicating Authority that has jurisdiction over any one of the companies. (Part IV, Para 1.3.2.1)

- *Single insolvency professional and single Adjudicating Authority:* The law may enable and encourage appointment of a single insolvency professional and designation of a single Adjudicating Authority for resolution of multiple companies admitted into CIRP, except where there are issues such as conflict of interest, lack of sufficient resources (in case of insolvency professionals) or where stakeholders would get adversely affected (in case of Adjudicating Authorities) etc. (Part IV, Paras 1.3.2.2 and 1.3.2.3)

- *Group creditors' committee:* The law may, at the option of the CoCs of participating companies, enable the creation of a group creditors' committee to support individual CoCs, and not supplant them. (Part IV, Para 1.3.2.4)

- *Group coordination proceedings:* The law may enable group co-ordination proceedings, at the option of the CoCs of the companies under CIRP. Group coordination proceedings may be governed by a Framework Agreement among the CoCs of the participating CDs. It may entail appointment of a "group coordinator" who would propose a strategy for the synchronised resolution of insolvency of the group companies. This strategy could propose invitation of a common expression of interest, resolution plan, etc. At this stage, a company may opt out of group coordination proceedings by a vote of the majority of its CoC. Once group coordination proceedings are initiated, one Adjudicating Authority (chosen as per the Framework Agreement) would have jurisdiction over the insolvency proceedings of each of the companies and the group coordination proceedings. Further, these companies may be allowed to seek an extension of the CIRP period by another ninety days to account for the additional time these proceedings may take to enable the value maximising resolution. (Part IV, Para 1.3.2.6)

e. Procedural coordination may be allowed at any stage of the insolvency resolution or liquidation process for companies. (Part IV, Para 1.3.3)

f. Procedural co-ordination at the resolution process stage may not necessarily continue to the stage of liquidation process. Such coordination at liquidation stage may be allowed on a fresh application for the same. A single insolvency professional may be appointed, a single Adjudicating Authority may be designated and group coordination proceedings may be commenced even at the liquidation stage. (Part IV, Paras 1.3.2.2; 1.3.2.3 and 1.3.2.6)

(5) The framework may have certain rules against perverse behaviour. While the provisions enabling the avoidance of certain transactions and imposition of liability for wrongful and fraudulent trading may broadly be sufficient to capture intra-group transactions that are value destructive, the framework may permit the Adjudicating Authority to subordinate the claims of other companies in a group in exceptional circumstances of fraud, etc. (Part IV, Para 2.2)

PART II

RATIONALE FOR A FRAMEWORK DEALING WITH THE INSOLVENCY OF COMPANIES IN CORPORATE GROUPS

1. LANDSCAPE

Groups have increasingly become popular structures for organisation of business. A set of entities, related by either economic dependencies or shared control, carry on business in pursuit of common objectives. This enables harnessing internal synergies and spill-over benefits within the group. Creditors prefer to lend to a company belonging to a group since it may have the ability to rely on the intra-group capital market (which is likely to be less costly than external markets) to draw financing in the event of, or to mitigate, financial distress. It is estimated that conglomerates accounted for 56 percent of the combined assets of all non-financial firms in India in 2015-16 and nearly half of corporate India's revenues and profits in fiscal year 2015-16.[1] This is notwithstanding the legal position that treats different companies in a corporate group as separate legal entities, and respects the principles of asset partitioning and limited liability.

However, the prevalence of corporate groups has thrown up special challenges which require modifications to the principle of treating companies within a group as completely separate entities. If group companies operate jointly as a single economic entity, it may be important for "*investors to get first hand information about the group as a whole for taking an informed decision for investment*"[2] in a company in the corporate group. Consequently, the Companies Act, 2013 has specific provisions requiring companies to prepare a consolidated financial statement of the company and of all the subsidiaries and associate companies in the same form.[3] Similarly, there are cases where there is concern that directors and personnel of holding companies often control the subsidiary company. Accordingly, Indian law recognises the concept of 'shadow directors' by holding that an officer in default includes any "*person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act*."[4] This provision may be used to hold directors and other personnel of a holding company liable for acts of a subsidiary company.[5] In addition, courts in India also

[1] Krishna Kant, 'The end of conglomerates?', *Business Standard* (March 17, 2017) available at: <https://www.business-standard.com/article/companies/the-end-of-conglomerates-117031700943_1.html>.

[2] Ministry of Finance and Company Affairs, Government of India, *Report of the Committee on the Companies Bill 1997*, 2002, Para 5.5 available at <http://reports.mca.gov.in/Reports/20-Joshi%20committee%20report%20on%20the%20Companies%20bill,%201997,2002.pdf>.

[3] Section 129(3), Companies Act, 2013.

[4] Section 2(60), Companies Act, 2013.

[5] Please note this is only an explanation of some instances in which the principle of separate legal personality is disregarded in the Companies Act, 2013. Different statutes disregard this principle in a myriad of situations, which has not been explored further.

pierce the 'corporate veil' in certain cases to hold the parent company liable for subsidiary companies.[6]

Thus, the WG notes that while the law typically recognises the separate legal personality of companies in a group, it recognises the interconnection among them in certain circumstances.

2. Rationale

2.1. Special Concerns arising from Insolvency of Companies in Corporate Groups

Some reports suggest that there were 47 companies that had debt in the excess of USD 100 million (representing a total of USD 70.2 billion) and attempted in-court restructuring in 2018. All of them were part of corporate groups.[7] The insolvency of most of such companies has potential of special issues, as discussed below.

First, inter-linkages especially those owing to related party transactions may be prevalent in corporate groups.[8] Stakeholders consulted by the WG brought out that these inter-linkages may take a variety of forms, and include both operational linkages where group companies are dependent on each other for supply of raw materials, etc. and financial linkages such as the provision of inter-corporate guarantees by holding companies. If each company's insolvency is dealt with entirely in isolation, the costs of recognising these inter-linkages may become extremely high since it would result in duplication of effort for the stakeholders of each entity to piece together information about interlinked entities.[9]

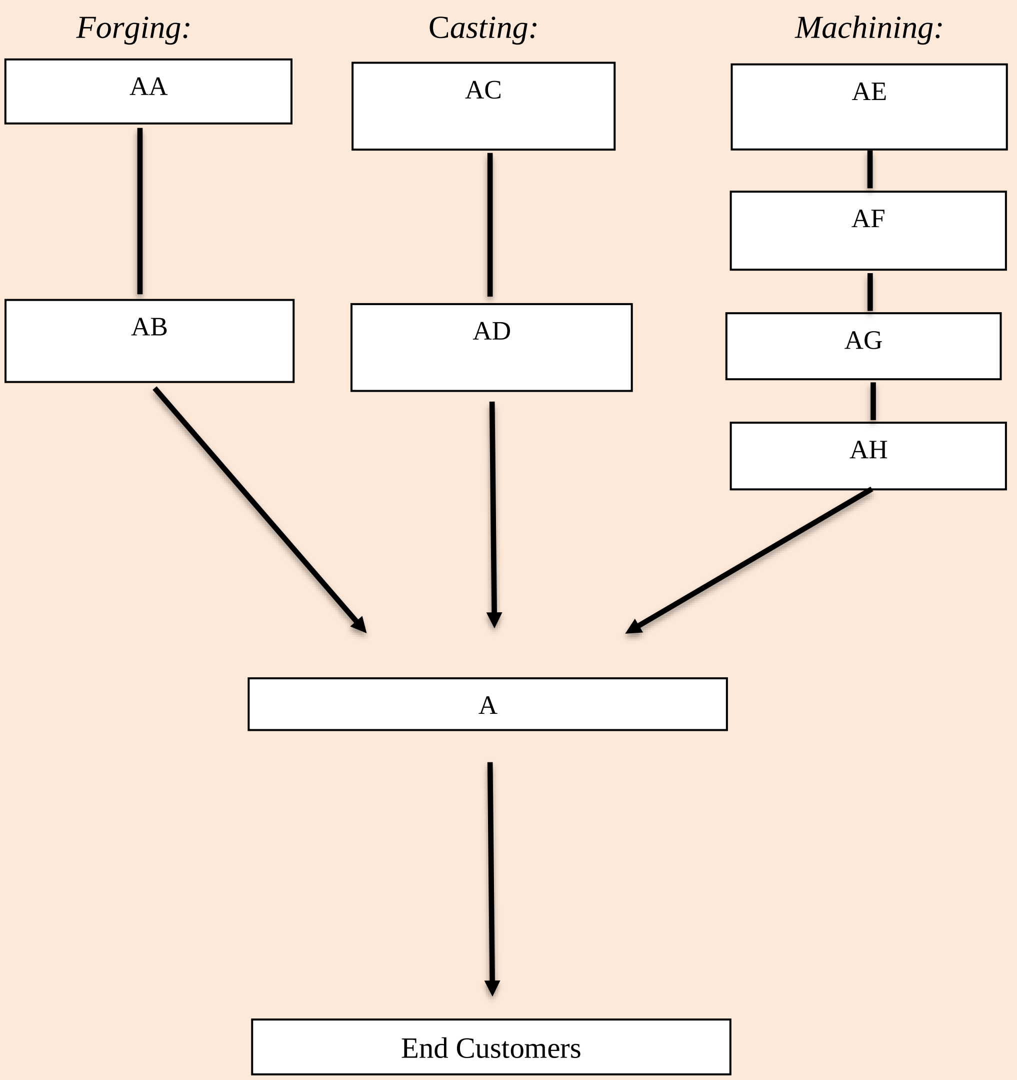
In other cases, it may be extremely costly to disentangle the inter-linkages between companies and it may be overall more beneficial for stakeholders to utilise the inter-linkages and synergies between group companies to keep the companies running as going concerns and achieve a more value maximising deal. For instance, in some cases, creditors may find that allowing resolution applicants to bid for inter-linked group companies in a single offering would result in achievement of higher value.[10] Particularly, reports suggested that it was felt that if Amtek was resolved along with its two other insolvent units belonging to its supply chain, the value realization by the creditors of all three insolvent companies would be larger than what would be realized if the three were resolved independently. The WG notes that if insolvency law does

[6] *See:* Shroff Rishi, Ginodia Shwetank, *A Corporate Governance Perspective on Lifting the Veil in Group Companies in India and the United Kingdom* (2014) 25(12) International Company and Commercial Law Review 423.
[7] Debtwire Special Report, *Asia Pacific Restructuring Advisory Mandates,* (2018). Please note, in-court restructurings may include restructurings under the Companies Act, 2013.
[8] UNCITRAL, *UNCITRAL Legislative Guide on Insolvency Law, Part three: Treatment of enterprise groups in insolvency,* (2012), Para 93.
[9] See: 'Annexure IV'.
[10] Deborshi Chaki, 'Creditors may offer to sell Amtek Auto along with subsidiaries' *Livemint,* (Mumbai 27 February 2018) available at <https://www.livemint.com/Companies/B0iQvSkRcVZrdj2Xoxoa7I/Creditors-may-offer-to-sell-Amtek-Auto-along-with-subsidiari.html>.

not facilitate the recognition and treatment of these inter-linkages in a cost-effective manner, it may reduce value for stakeholders of all entities.

Example of a group of companies with significant interdependence

The group companies of A are engaged in different stages of the supply chain in the automotive sector and non-automotive sector. For example, AA and AB are engaged in forging, AC and AD are involved in casting, AE, AF, AG, and AH are involved in machining, while A is engaged in machining and production of the final products which are shipped to the end-customers.



Significantly, while more than 10% of the total sales of the A Ltd. group are made to the entities which are part of the same group, an overwhelming percentage of the total raw materials purchased by the group are made from within the group. Further, the raw materials and essential components required for making the end products sold by A are procured from within the group as per the directions of the end-customer and the same cannot be sourced from other suppliers in a short period of time as they are based on the customized products ordered by the end-customers.

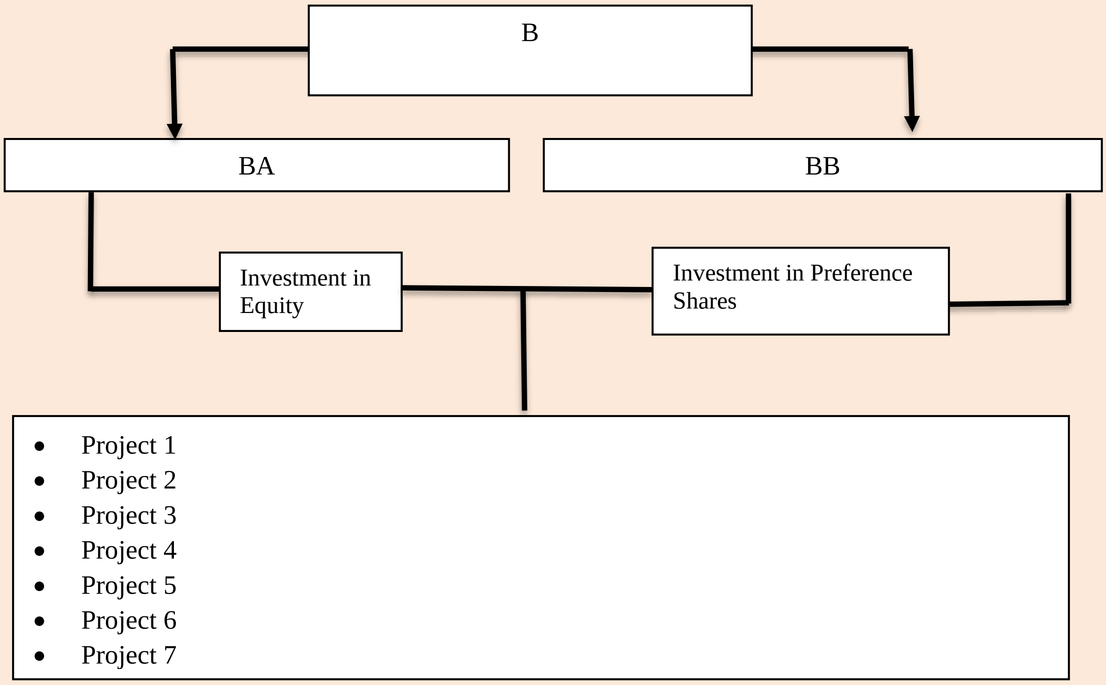
Thus, there are significant operational linkages between the different group companies. Insolvency proceedings against separate companies would have to take into account this interdependence between companies both to keep these companies running as going concerns during the CIRP and to resolve the insolvency of these companies in a value maximizing manner. It is likely to be harder to find a resolution applicant for one of these companies, if the supply/ demand from the rest of the companies is not guaranteed. However, if all companies are resolved in a coordinated/ consolidated manner, a much more value maximising resolution may be found, since the synergies among these debtors may be exploited.

Second, insolvency law, like general company law, respects the principle of separate legal personality, limited liability and asset partitioning. This is primarily because there is an expectation that creditors and all other stakeholders would have chosen to deal with (and monitor) each company in a group as separate legal entities, with its own assets and liabilities. However, the stakeholders consulted by the WG submitted that in some cases stakeholders, such as creditors tend to treat group companies as single economic entities.[11] Consequently, they may make investments and extend credit on the understanding that different group companies are only one entity. If insolvency proceedings treat group companies as a single entity, this would result in the shares of a group company taking on the risk of the entire group. It would be extremely difficult for stakeholders, particularly small investors spread across the globe, to monitor a group of companies to deal with only *one* of them. On the other hand, if the law forces the asset partitioning without having due regard to the expectation of stakeholders, it may result in an increase in costs of engagement of stakeholders with such groups *ex ante*.

Example of a group of companies that is viewed as a single economic entity

B is a company engaged in the execution of construction contracts involving engineering, procurement and construction projects. It is the holding company of several subsidiary companies by way of direct and indirect investments. B holds more than 90% shareholding in all the subsidiary companies. B along with several of its subsidiary companies have defaulted in their respective loans and CIRPs have been initiated for the same.

[11] See also: Jayati Sarkar, 'Ownership and Corporate Governance in Indian Firms' in *Corporate Governance: An Emerging Scenario,* 217- 267, Pg 228.



The interlinkages existing in the B group of companies are as follows:

1. While loans are taken in the name of B, the assets are either vested in the subsidiary companies or in the form of arbitration claims against the government or public sector undertakings. Thus, the debts taken by the parent company can be recovered only by taking over the assets of its subsidiaries and realization of the arbitration claims.
2. B has made itself liable for the loans taken by its subsidiary companies by way of several contractual instruments such as corporate guarantees, promoters' undertaking etc.
3. B has issued performance bank guarantees and other instruments of contractual comfort to government authorities on behalf of the projects undertaken by the subsidiary companies.
4. A large number of the subsidiary companies have common board members with B.
5. A large number of the subsidiary companies do not have any employees of their own and are run by the employees of B.
6. A large number of creditors have provided loans to both B and the subsidiary companies.

Since subsidiary companies share their employees and directors with B, assets of the subsidiaries appear to be owned for the benefit of B and the subsidiaries and B have common lenders, there appears to be common control, common assets and some level of interdependence between the group companies. The presence of intra-group guarantees, and the extension of loans to the holding company as against the assets held by subsidiary companies may also indicate that the lenders in fact viewed the group as a single economic entity.

If the insolvency proceedings of the companies of the B group, do not take into account that this group functions as a single economic entity, the expectations of stakeholders who would have lent to B on the strength of the assets of its subsidiaries may be undermined, and a value maximising resolution of B would not be possible if its resolution takes place without considering that B and its subsidiaries function as a single economic entity.

Third, the nature of transactions between different group companies may have relevance in insolvency, especially since there may be asymmetry of information between creditors and promoters and other members of the group.[12] For instance, some studies have indicated that there have been instances of tunneling in corporate groups in India,[13] which leads to "*possible undue diversion of created wealth… to the dominant shareholding or controlling group*."[14] There is also evidence that in some cases "*loans and advances can be given to subsidiary companies down the chain without adequate security, sometimes with unsound financial position and at low rates of interest to the advantage of the latter and detriment of the former. Similarly, improper transfer of assets of one company to another is resorted to with the object of benefiting one to the prejudice of other*."[15] The WG deliberated on whether insolvency law should deal with such transactions that result in the unfair capture of value by stakeholders of one company at the expense of stakeholders of another, in abuse of the principle of separate legal personality. Acknowledging that such transactions do take place, the WG delved into the possibility of the insolvency framework for group companies being able to prevent or reverse such transactions or impose sanctions, where required.

The WG notes that there is already evidence of such issues arising in the insolvency proceedings of companies under the Code. For instance,

- In *Venugopal Dhoot v. State Bank of India & Ors.*,[16] multiple companies of the Videocon group were being put through insolvency resolution processes. In this case, parties sought that all matters pertaining to the insolvency resolution of different Videocon companies be dealt with by the same Adjudicating Authority and that there be consolidation of separate proceedings of multiple Videocon companies to treat "*the*

[12] See: 'Annexure IV'.
[13] Marianne Bertrand, Paras Mehta, Sendhil Mullainathan, *Ferreting Out Tunneling: An Application to Indian Business Groups*, Pg. 146, (2002) 117(1) Quarterly Journal of Economics 121-148 .
[14] Department of Company Affairs, Ministry of Law, Justice & Company Affairs Government of India, *Report on Corporate Excellence on a Sustained Basis to Sharpen India's Global Competitive Edge and to Further Develop Corporate Culture in the Country,* Para 1.4, (2002).
[15] Ministry of Finance and Company Affairs, Government of India, *Report of the Committee on the Companies Bill 1997*, 2002, Para 6.11 available at <http://reports.mca.gov.in/Reports/20-Joshi%20committee%20report%20on%20the%20Companies%20bill,%201997,2002.pdf>.
[16] CA- 1022(PB)/2018- decision dated 24.10.2018.

corporate insolvency resolution process as one in respect of all of these companies".[17] The Principal Bench of the National Company Law Tribunal ("**NCLT**") ordered that all the matters regarding the insolvency resolution processes of these different companies be dealt with by the same bench of the NCLT for the purpose of "*avoiding conflicting orders and facilitating the hearing*"[18] of these matters.

- In *State Bank of India & Anr. v. Videocon Industries Ltd. & Ors.,*[19] the Adjudicating Authority ordered that the assets and liabilities of 13 Videocon companies should be substantively consolidated due to common control, common directors, common assets, common liabilities, interdependence, interlacing of finance, co-existence for survival, pooling of resources, intertwined accounts, interloping of debts, singleness of economics of units, common financial creditors and common group of corporate debtors.

- In *Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Pvt. Ltd. & Ors.,*[20] the Appellate Authority held that "*group insolvency proceedings were required to be initiated*"[21] against five companies that had been working as a joint consortium to develop a residential plotted colony. To enable successful development of this colony, the Appellate Authority ordered that "*simultaneous 'Corporate Insolvency Resolution Processes' should continue against them under the guidance of same 'Resolution Professional'*"[22] who should run the processes so that they are "*completed in one go by initiating a consolidated 'Resolution Plan(s)' for total development*".[23]

- In *Chitra Sharma v. Union of India,*[24] where insolvency proceedings had been initiated against Jaypee Infratech Ltd., but homebuyers had entered into contracts with both Jaypee Infratech Ltd. and its parent company Jai Prakash Associates Ltd., the Supreme Court ordered that the parent company which was not subject to the insolvency proceedings at that time, deposit a sum of INR two thousand crores before the court.

- In *Bikram Chatterji v. Union of India,*[25] homebuyers in projects developed by different companies of the Amrapali group filed a Writ Petition before the Supreme Court in order to protect their interests in the wake of the insolvency of different Amrapali group companies. The Supreme Court in these proceedings dealt with the group as a whole. Given the nature of the transactions between the group companies, the Court also

[17] CA- 1022(PB)/2018- decision dated 24.10.2018.
[18] CA- 1022(PB)/2018- decision dated 24.10.2018.
[19] M.A 1306/ 2018 & Ors. in CP No. 02/2018 & Ors- decision dated 08.08.2019.
[20] Company Appeal (AT) (Insolvency) Nos. 377 to 385 of 2019- decision dated 20.09.2019.
[21] Company Appeal (AT) (Insolvency) Nos. 377 to 385 of 2019- decision dated 20.09.2019.
[22] Company Appeal (AT) (Insolvency) Nos. 377 to 385 of 2019- decision dated 20.09.2019.
[23] Company Appeal (AT) (Insolvency) Nos. 377 to 385 of 2019- decision dated 20.09.2019.
[24] W.P. (Civil) No(s).744/2017- decision dated 11.09.2017.
[25] W.P. (Civil) No(s).940/2017- decisions dated 17.05.2018 and 01.08.2018.

ordered that the properties of all forty group companies in the Amrapali group be attached and the bank accounts of all companies and their directors be frozen.

Given this, the WG notes that certain special issues may arise in the insolvency of group companies, which may need to be addressed.

2.2. Provisions in the Code addressing Special Concerns arising from Insolvency of Companies in Corporate Groups

The Code largely deals with the insolvency of each company through separate proceedings for each company but has some provisions that recognise its interest in group companies. For instance:

- Sections 60(2) and 60(3) of the Code provide that the insolvency proceedings of a debtor company and its guarantor would be dealt with by the same Adjudicating Authority. This may also enable linking of proceedings in those cases where the debtor and guarantor are part of the same group of companies.

- Sections 18(f) and 36 of the Code give control of the shares of the subsidiary to the resolution professional and liquidator of the parent company.[26] The control rights given to the shareholders of a solvent company may be used by the resolution professional or liquidator to obtain information from solvent group entities easily. Further, a resolution plan of a parent company would deal with the assets of the company, which would include its shares in subsidiary companies. A successful resolution applicant could also receive the control of these securities (based on the specifics of the resolution plan).

- Some provisions in the Code target perverse behavior in group structures. The Code defines related party in relation to corporate debtors to *inter alia* include holding-subsidiary companies, companies in which directors or managers have shareholding, companies controlling each other by virtue of contracts, companies with whom there may be *de facto* association in the form of participation in policy making process, interchange of employees, etc.[27] Longer time-limits are prescribed for the application of avoidance provisions in case of transactions with related persons, and prohibitions in sections 29A and 21 target the ability of related parties to submit a plan for the resolution of the company or vote as part of the CoC. Even transactions with related parties during the insolvency resolution period require approval of the CoC by virtue of section 28.

However, the Code, lacks a comprehensive framework to deal with the insolvency of group companies.[28] The WG notes that mechanisms in other laws, such as the schemes of arrangement

[26] Sections 18(f) and 36, Code.
[27] Section 5(24), Code.
[28] Even the Draft Law on Cross-Border Insolvency proposed by the Insolvency Law Committee, which is styled on the UNCITRAL Model Law on Cross-Border Insolvency, does not provide for treatment of insolvency of group companies in a cross-border context.

under the Companies Act, 2013 may be used to deal with the special issues arising in these cases. However, these mechanisms are not used widely in practice.

To bridge this gap, the Adjudicating Authorities under the Code and the Supreme Court have used their powers to pass orders enabling coordination of proceedings, or have applied general principles of corporate law pertaining to piercing of the corporate veil to make group companies liable for each other, as discussed previously. These *ad hoc* actions involve expenditure of precious judicial time. Further, there is lack of clarity on the circumstances in which these *ad hoc* actions will be taken, which results in uncertainty for stakeholders and investors.

2.3. Advantages of and Concerns Regarding a Framework dealing with the Insolvency of Companies in a Group

The WG notes that a framework facilitating the insolvency resolution and liquidation of companies in a group may have the following advantages:

- *Promotion of information symmetry:* If insolvency law enables the exchange of information between the stakeholders of different companies, it may enable better assessment of viability and increase the chances of resolution. This exchange of information may also reduce information asymmetry amongst stakeholders.

- *Reduction in costs of insolvency proceedings:* Where the insolvency of different group companies is dealt with entirely in isolation, there is a likelihood of unnecessary duplication of work if different Benches of Adjudicating Authority, insolvency professionals and creditors individually appreciate and consider the same or similar facts in order to piece together a complete picture.[29] The resultant delay and clogging up of judicial infrastructure may have long-term negative consequences. Further in some cases groups are so interlinked, that it would be costly to disentangle their interlinkages. The creation of a group insolvency framework may reduce these costs.[30]

- *Maximization of value*: An insolvency framework that recognises special issues relating to group companies is likely to increase the efficiency of processes[31] and maximize value in two ways, one, by reducing information asymmetry and costs of administering insolvencies, and *second,* by enabling the resolution or liquidation of intrinsically linked assets together, thereby maximising synergies and not forcing a value destructive separation.[32]

[29] 'Tackling Group Insolvency' in Vidhi Centre for Legal Policy & EY, *Insolvency and Bankruptcy Code: The Journey so Far and the Road Ahead* (2018).
[30] See: 'Annexure IV'.
[31] Christoph Paulus, *Group Insolvencies- Some thoughts about new approaches*, (2007) 42(3) Texas International Law Journal 819-830.
[32] See: 'Annexure IV' and 'Tackling Group Insolvency' in Vidhi Centre for Legal Policy & EY, *Insolvency and Bankruptcy Code: The Journey so Far and the Road Ahead* (2018).

- *Reduction in costs of capital:* To the extent an insolvency framework respects the expectations of stakeholders, it is likely to *ex ante* reduce the cost of capital for the group since stakeholders would not have to adjust for a change in their position purely due to the initiation of insolvency proceedings. Further, to the extent that insolvency law effectively targets transactions between group companies that unfairly transfer value from one entity to another, it is likely to reduce monitoring costs for stakeholders, and further bring down the cost of capital.[33]

- *Increasing certainty for stakeholders and saving judicial time:* Where the insolvency framework clearly lays down rules to facilitate the insolvency resolution and liquidation of companies in a group, stakeholders have certainty on the manner in which they may be applied and also saves judicial time.

Example of the advantages of a group insolvency framework which allows for procedural coordination

The C group of companies is a set of alloys, special and construction steel manufacturing companies having significant presence in the mining and power sectors. Out of these, the CIRP was initiated for four companies, viz., CA, CB, CC, CD.

There appears to be a great degree of intermingling and consolidation of assets and liabilities among these group companies. For example, nearly 100% of all the members of the CoCs are common for all the four corporate debtors.

While separate proceedings were opened for these corporate debtors, all of them were being heard by the same NCLT bench and were initiated by the same financial creditor. The same insolvency professional was appointed as the resolution professional for all four companies. Joint meetings of the CoCs were conducted for all the corporate debtors. This saved time and reduced the costs involved and resulted in swifter and more cost-efficient decision making at the meetings of the CoC. The time and costs could have been reduced further if procedural coordination mechanisms such as a joint application process and a common public announcement (as discussed below) were also permitted in the law.

However, the WG notes that while the advantages of considering insolvencies jointly does have its advantages, there are equally significant disadvantages of treating insolvent companies together for the purpose of resolution. It noted the following concerns in particular:

[33] Andrew Brasher, *Substantive Consolidation: A Critical Examination*, 2006, Pg 18, available at <http://www.law.harvard.edu/programs/corp_gov/papers/Brudney2006_Brasher.pdf.>.

- *Potential for costs of capital to increase:* If the basic principle of asset partitioning is disregarded without justification, in those cases where the companies themselves are run distinctly without regard to each other's businesses and activities, creditors and the stakeholders of one company will have to monitor the activities of the entire group. The value of lending to one company will have to be balanced against the cost of having to monitor all the companies in the group. This may disincentivise lenders sufficiently and they may not be willing to extend credit to companies within a group. This may be of special concern where group companies are incorporated precisely because there is a need for a separate legal entity whose assets are partitioned (e.g. in the case of special purpose vehicles("**SPVs**")), [34] with limited interlinkages between them. If a majority of the groups are structured in this manner, and the law disregards the separate legal personality of companies in such groups without justification, it may increase the cost of doing business.

- *Potential for expenses of the framework to reduce recovery:* A framework dealing with the insolvency of group companies may itself require certain expenses to be incurred. For instance, if another professional is hired to assist in the creation of a group strategy for the resolution of insolvency group companies, it may require expenses for such a professional to be incurred. If the framework imposes expensive requirements that are not offset by reduction of costs for stakeholders, it may reduce recoveries for stakeholders.

- *Potential for unfair capture of value by some stakeholders:* Some stakeholders consulted by the WG suggested that if the framework for group insolvency deviates from the principle of asset partitioning unjustifiably, it may result in dominant lenders lowering their credit and monitoring standards and capturing value in group entities where the primary monitoring burden has been carried by other stakeholders.

However, the WG notes that the concerns may be substantially alleviated if the framework does not disregard the principle of asset partitioning without adequate justification and does not impose a requirement to incur burdensome expenses.

Example demonstrating the need to calibrate a group insolvency framework carefully: The case of the Infrastructure Leasing & Financial Services Ltd. Group

On October 15th, 2018 the National Company Law Appellate Tribunal ("**NCLAT**") passed an interim order declaring moratorium on all the 348 companies of the Infrastructure Leasing and Financial Services Limited Group ("**IL&FS**"), in consideration of the nature of the case, and public and economic interest. However, the order did not differentiate between different group entities on the basis of their ability to meet their obligations and continue trading.

[34] Roe & Tung, *Bankruptcy and Corporate Reorganization: Legal and Financial Materials,* (4th edn., 2016), Pg 212.

In a subsequent order dated 11th February, 2019 the NCLAT lifted the moratorium on offshore companies and 22 other entities falling under the group which could service their debt obligations. 70 entities were also classified into groups of Green, Amber and Red on the basis of their ability to discharge their payment obligations. 22 entities which were classified as 'Green', were those companies, which could service their debt obligations, while 10 firms under 'Amber' group could partly meet their obligations and 38 'Red' entities were those which could not meet any payment obligations.

The inability of green entities to trade during the moratorium period would have imposed costs on the stakeholders of these entities. This could have been avoided if there was a formal framework for resolution of companies in a group.

While the insolvency resolution of IL&FS is being dealt with outside the Code, lessons may be learnt regarding the formulation of a group insolvency framework under the Code.

2.4. NEED FOR A FRAMEWORK TO FACILITATE THE INSOLVENCY RESOLUTION AND LIQUIDATION OF COMPANIES IN A GROUP

Based on the discussion above, **the WG concludes that there is a need for a comprehensive regulatory framework to facilitate the insolvency resolution and liquidation of companies in a group.** The WG recommends that the framework should address the special issues arising in insolvency of companies in a group. However, the framework should be tailored so as to maximise the advantages, and alleviate the concerns discussed above.

PART III
ELEMENTS AND APPLICABILITY OF A FRAMEWORK DEALING WITH THE INSOLVENCY OF COMPANIES IN CORPORATE GROUPS

As discussed above, the WG is of the view that there is a need for the Code and the subordinate legislation under it to address special issues arising in the insolvency of group companies. This Part details the elements and applicability of such a framework.

1. ELEMENTS OF A COMPREHENSIVE FRAMEWORK FOR TACKLING GROUP INSOLVENCY

To comprehensively address all issues arising in the insolvency of companies in a group, the WG considered the following elements:

- *Procedural Coordination mechanisms:* These are targeted at coordinating the 'procedures' of insolvency while keeping the assets of each group company separate

- *Substantive Consolidation mechanisms:* These are targeted at consolidating the assets and liabilities of different group companies so that they are treated as part of a single insolvency estate for the purpose of reorganization or distribution in liquidation

These elements would enable the creation of mechanisms to deal with the insolvency processes of multiple group companies so that the processes can run efficiently and result in fair distributions to stakeholders.

- *Rules dealing with perverse behavior of companies in corporate groups:* This would enable the creation of mechanisms to recapture assets subject to prejudicial transactions between group members and impose liability on group companies for each other's debts, as appropriate.[35]

2. IMPLEMENTATION

The evolution of frameworks for group insolvency is a developing area of law and practice. Few countries in the world have comprehensive frameworks dealing with the vast cross-section of issues arising in group insolvency. In India too, no previous insolvency mechanisms have explicitly provided for a framework to deal with group insolvency. Given this, there is little international or domestic experience to rely on.

Further the scale of a comprehensive framework for group insolvency is likely to be immense, covering groups of different natures and having companies located in different jurisdictions.

[35] Irit Mevorach, *Appropriate Treatment of Corporate Groups in Insolvency: A Universal View*, Pg 179 (2007) 8 European Business Organization Law Review 179-194 available at <http://eprints.nottingham.ac.uk/1772/1/Mevorach_EBOR_2007.pdf>.

Given this, it is important for institutional infrastructure to be adequately developed to be able to handle cases of group insolvency effectively. It is also important for market participants to be given time to prepare for the introduction of such a framework, given that no such framework existed previously in India.

In this situation, the WG recommends that the framework for group insolvency in India should be introduced in a phased manner. It is the view of the WG that phasing should be done on two bases:

- *Jurisdictional scope*

The WG notes that the Insolvency Law Committee formed by the Ministry of Corporate Affairs has recommended changes to the provisions of the Code dealing with cross-border insolvency of debtors with assets in different jurisdictions. Given this, the implementation of the provisions pertaining to cross-border insolvency of debtors with assets in different jurisdiction is not complete. In these circumstances, it may not be possible to develop a framework for insolvency of cross-border corporate groups that aligns perfectly with the regime for insolvency of cross-border companies.

Given this, the WG recommends that in its first phase, the framework for group insolvency may cover only domestic entities.

- *Elements of the framework*

The WG notes that a comprehensive framework for group insolvency could include procedural coordination, substantive consolidation, rules against perverse behaviour and other rules. However, since substantive consolidation requires asset partitioning between different companies to be disregarded, during its consultations, the WG received divergent views on the introduction of a framework that enables substantive consolidation. Some market participants expressed reservations that a legislative framework enabling or mandating substantive consolidation may be contrary to the expectations of some market participants who may not have structured their relationships with groups keeping this in mind. In any event, in one case, the Adjudicating Authority has passed an order for the substantive consolidation of group companies,[36] and jurisprudential development of this element has commenced. Given this, the WG is of the view that a more detailed study regarding whether this framework should be implemented legislatively may need to be done on the basis of feedback received from the implementation of other elements of the framework, and further consultations.

Given this, the WG recommends that in the first phase, the framework may not include substantive consolidation. IBBI and the Central Government may consider rolling out provisions for insolvency of cross-border groups and substantive consolidation at a later stage.

[36] *State Bank of India & Anr. v. Videocon Industries Ltd. & Ors*, M.A. 1306/ 2018 & Ors. in CP No. 02/2018 & Ors- decision dated 08.08.2019.

In addition, the WG recommends that to implement the elements of the framework on group insolvency in the first phase, extensive capacity building of insolvency professionals, creditors and other stakeholders under the Code should be undertaken by IBBI and the Central Government, and necessary infrastructure, especially to facilitate communication and coordination amongst Adjudicating Authorities, should be put in place to ensure that the recommendations of the WG can be implemented seamlessly.

3. APPLICABILITY

The WG notes that it is key to define the applicability of a framework dealing with the insolvency of companies in a corporate group to prevent uncertainty. In this regard, the WG is of the view that the framework should define 'corporate group', which is not defined in the Code.

3.1. DEFINITIONS OF CORPORATE GROUP IN OTHER LEGISLATIONS

The WG notes that other Acts, Regulations in India and different Accounting Standards define the term corporate group, group company, subsidiary, etc.

Article 2.1.12 of the Foreign Direct Investment Policy defines a group company as "*two or more enterprises which, directly or indirectly, are in a position to: (i) exercise twenty-six percent or more of voting rights in other enterprise; or (ii) appoint more than fifty percent of members of board of directors in the other enterprise.*"

Section 5 of the Competition Act, 2002 which deals with combinations, gives a similar definition and provides that "5*(b) "group" means two or more enterprises which, directly or indirectly, are in a position to — (i) exercise twenty-six per cent or more of the voting rights in the other enterprise; or (ii) appoint more than fifty per cent of the members of the board of directors in the other enterprise; or (iii) control the management or affairs of the other enterprise.*"

Paragraph 2 of the Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015 issued by the Reserve Bank of India ("**RBI**"), define companies in a group to mean two or more entities which are related to each other as subsidiaries, joint ventures, associate companies, promoter-promotees or have a common brand name and an investment in equity shares of more than 20%. A similar definition has been included in the RBI Act, 1934 by the Finance (No.2) Act, 2019.[37]

On the other hand, Regulation 2(1)(t) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 defines a group company in the context of related party transactions and states that group companies include "*such companies (other than promoter(s)*

[37] Section 141, Finance (No. 2) Act, 2019.

and subsidiary/subsidiaries) with which there were related party transactions, during the period for which financial information is disclosed, as covered under the applicable accounting standards, and also other companies as considered material by the board of the issuer."

While the Companies Act, 2013 does not define a group company, it defines holding and subsidiary companies based on a relationship of control. A subsidiary company under section 2(87) of the Act is defined as the one in which *"the holding company—*
(i) controls the composition of the Board of Directors; or
(ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies…". Section 2(6) of the Act also defines an associate company in relation to another, as "*a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company*." "Significant influence" is defined to mean "*control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement.*"

Apart from these legislations, accounting standards also define the term 'group of companies.' The Indian Accounting Standard- Ind AS 110, regarding Consolidated Financial Statements, issued by the Ministry of Corporate Affairs defines a group to mean "*a parent and its subsidiaries,*"[38] wherein the parent is "*an entity that controls one of more entities*"[39] and a subsidiary is "*an entity that is controlled by another entity*".[40] It also defines control of an investee as a situation "*when the investor is exposed, or has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee."*[41] It is relevant to note that this is similar to the definitions provided in the International Financial Reporting Standard-10 regarding Consolidated Financial Statements.[42]

The WG notes that these legislations and Accounting Standards define group in reference to ownership and control. However, the WG also notes that corporate group is defined in these legislations and standards in a specific context, which may not always be applicable in the context of insolvency of group companies.

3.2. Definitions of Corporate Groups in International Frameworks dealing with the Insolvency of Companies in a Corporate Group

The WG notes that international frameworks dealing with the insolvency of companies in a corporate group also define 'corporate group'.

[38] Appendix A, Indian Accounting Standard (Ind AS) 110, available at: http://mca.gov.in/Ministry/pdf/INDAS110.pdf.
[39] Appendix A, Indian Accounting Standard (Ind AS) 110, available at: http://mca.gov.in/Ministry/pdf/INDAS110.pdf.
[40] Appendix A, Indian Accounting Standard (Ind AS) 110, available at: http://mca.gov.in/Ministry/pdf/INDAS110.pdf.
[41] Appendix A, Indian Accounting Standard (Ind AS) 110, available at: http://mca.gov.in/Ministry/pdf/INDAS110.pdf.
[42] Para 7 & Appendix A, International Financial Reporting Standard 10.

Article 2(13) of the Regulation (EU) 2015/848 on Insolvency Proceedings (recast) ("**EU Regulations**") that came into force in 2017 defines a group of companies to mean "*a parent undertaking and all its subsidiary undertakings".*

The Insolvenzordnung in Germany ("**German legislation**") on the other hand, defines a group as "*legally independent enterprises that have the centre of their main interests on domestic territory and are directly or indirectly affiliated with one another due to (i) the ability to exercise a controlling influence or (ii) consolidation under common management."*[43] This is applicable to partnerships as well as companies. Whereas, the United States Federal Rules of Bankruptcy Procedure make these frameworks applicable to "*affiliated companies*".[44]

The glossary to Part III of the UNCITRAL Legislative Guide on Insolvency Law on 'Treatment of enterprise groups in insolvency' ("**UNCITRAL Guide**") defines an enterprise group as "*two or more enterprises that are interconnected by control or significant ownership*"[45], with control being "*the capacity to determine, directly or indirectly, the operating and financial policies of an enterprise*".[46] It is relevant to note that this definition takes into account horizontal integration between companies (which occurs when there is cross-ownership) as well as vertical integration (which occurs when there are layers of parents and subsidiaries).

The WG notes that these definitions also rely on factors of control and ownership to define a corporate group.

3.3. RECOMMENDATIONS

The WG discussed various factors that could be considered while defining a corporate group for the purposes of this framework including extent of 'control', operational and financial dependency, ownership, common-brand or co-owning of intellectual property rights.

Some stakeholders consulted by the WG were of the view that factors of control and ownership are determinative and should be the basis of any definition of corporate group for the purposes of applying this framework. Some stakeholders suggested that the definition of group should be as per the Accounting Standards as discussed in Para 3.1 of this Part above since this definition is relied on to prepare consolidated financial statements which also signals the applicability of a group structure to stakeholders. Other stakeholders were of the view that the definition of corporate group should give the Adjudicating Authority discretion to determine when the framework should be applicable, taking into account interdependence between

[43] Section 3e, German legislation, translated by Schultze & Braun GmbH & Co. KG, *Insolvency and Restructuring in Germany – Yearbook 2019*, available at <https://www.schultze-braun.de/fileadmin/de/Fachbuecher/Insolvenzjahrbuecher/Insolvenzjahrbuch-2019/Insolvency_and_Restructuring_2019_rz.pdf?_=1547820263>.
[44] Rule 1015, Federal Rules of Bankruptcy Procedure (United States).
[45] Para 4, Glossary, UNCITRAL Guide.
[46] Para 4, Glossary, UNCITRAL Guide.

companies in every corporate group, and how stakeholders viewed the interrelationship between companies forming part of the group in every specific case.

The WG is of the view that corporate group should be defined so that stakeholders can assess *ex ante* if any elements of this framework could be applicable to them, without attracting litigation to determine the applicability of the framework in the first place. This will have *ex ante* benefits and avoid litigation, which would add time and costs to the insolvency resolution of companies to whom the applicability of this framework is being assessed. **Therefore, the WG recommends that a definition of group should be provided, so that a case-by-case analysis need not be made to assess the applicability of the framework.**

For the purposes of defining 'corporate group' for this framework, the WG notes that the definition should cover those companies that have interlinkages that raise special issues in the insolvency of companies in a corporate group. These interlinkages may occur in horizontally, as well as vertically integrated groups. On analysis of international and domestic definitions of corporate groups, it appears that factors of control and ownership are common across definitions. These factors are also likely to account for the horizontal and vertical interlinkages discussed above. Of the definitions discussed above, the WG is of the view that these factors are best reflected in the definitions of holding, subsidiary and associate companies in the Companies Act, 2013. Together, these take into account both horizontal and vertical integrations between group companies. Further, the WG believes that relying on the definitions in the Companies Act, 2013 which is the statute governing companies in the country, will provide certainty and clarity to all stakeholders. **Given this, the WG recommends that this framework be made applicable to a 'corporate group' that is defined to include holding, subsidiary and associate companies.**

However, the WG recognises that this definition may not include all cases where recourse to a group insolvency framework may be beneficial.[47] In such cases, **the WG recommends that an application may be made to the Adjudicating Authority to include companies that are so intrinsically linked as to form part of a 'group' in commercial understanding, but are not covered by the definitions above, as long as it can be demonstrated that this will result in maximisation of value of the insolvent company without destroying the value of the company being included, so that there is overall value maximisation.**

However, this does not mean that in all cases where companies are part of corporate groups, the framework will necessarily be applied.

Procedural coordination mechanisms are only to be applicable to those companies in a group against whom insolvency proceedings can be initiated, as discussed in Para 1.3.1 of Part IV below. **This means that companies that have not committed default, or companies that are not covered under the Code, cannot be covered under procedural coordination**

[47] See: *Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Pvt. Ltd.* & *Ors*., Company Appeal (AT) (Insolvency) Nos. 377 to 385 of 2019- decision dated 20.09.2019.

mechanisms. Further, provisions enabling procedural coordination (except co-operation, communication and information sharing) will not be mandatory. Given this, companies in a corporate group that do not have sufficient inter-linkages need not utilize procedural coordination mechanisms.

Similarly, rules against perverse behavior, will be applicable in those cases where even one company in the group is insolvent and the Adjudicating Authority passes orders pursuant to perverse behavior established on the basis of the facts and circumstances of the case. Given this, all companies in corporate groups will not be covered under this framework.

Some stakeholders consulted by the WG also suggested that the framework should include those entities that are not companies, including partnerships, trusts, etc. The WG is of the view that more evidence may be required to build a case that group structures routinely include other forms of entities such as partnerships and trusts, and a separate analysis may have to be carried out to determine how a framework dealing with the insolvency of these entities in a group, which is outside the mandate of this WG. Consequently, corporate group has been defined only in respect of companies, and not all corporate debtors, which could have included limited liability partnerships and other body corporates as well.

3.4. AMENDMENTS THAT MAY BE REQUIRED

To implement the recommendations of the WG, the Code may be amended to add a definition of ‘corporate group’ and specify the applicability of the framework.

PART IV
DESIGN OF A FRAMEWORK DEALING WITH THE INSOLVENCY OF COMPANIES IN CORPORATE GROUPS

As discussed in Part III, key elements of a framework dealing with the insolvency of companies in corporate groups include procedural coordination mechanisms, substantive consolidation mechanisms, rules against perverse behavior and other rules. This Part discusses the manner in which these elements may be designed for the Indian landscape.

1. PROCEDURAL COORDINATION MECHANISMS

Procedural coordination mechanisms refer to a set of rules that are targeted at coordinating the 'procedures' of insolvency while keeping the assets of each group company separate.

The WG notes that procedural coordination mechanisms may take different forms. These mechanisms may require the "*appointment of a single or the same insolvency representative; the establishment of a single creditor committee; cooperation between the courts, including coordination of hearings; cooperation between insolvency representatives, including information- sharing and coordination of negotiations; joint provision of notice; coordination between creditor committees; coordination of procedures for submission and verification of claims; and coordination of avoidance proceedings*."[48]

However, the key feature of procedural coordination mechanisms is that they are aimed at coordinating the administration and conduct of insolvency proceedings, and do not alter the rights and liabilities of parties.

1.1. RATIONALE

The WG notes that the value of procedural coordination lies in being able to coordinate insolvency proceedings where the entities would benefit from a unified process. Procedural coordination mechanisms help in preventing duplication of efforts by enabling information sharing between insolvency professionals, creditors and Adjudicating Authorities, and enabling coordination of proceedings, including the conduct of single proceedings. This is aimed at reducing costs of the formal insolvency process.

These mechanisms also assist in putting together complete information about all the companies in a corporate group, including information about their assets, creditors, obligations and businesses. Most importantly, "*where the ability to reorganise or sell the debtors' businesses depends on being able to convey all of the business and assets currently in different group companies to a purchaser, procedural coordination facilitates the preparation and distribution of sales particulars, identification of interested parties, negotiations with potential purchasers*

[48] Para 23, UNCITRAL Guide.

and eventual completion of a sale or sales that would otherwise have proved impossible, had a purchaser had to negotiate simultaneous transactions with a number of different office holders, each of whom would have attempted to negotiate the greatest possible consideration for the part of the business under their control."[49] This helps in value maximization of the assets of the insolvent corporate debtor.

Further, the WG notes that procedural coordination mechanisms respect the principles of separate legal personality and asset partitioning. Thus, the assets of the group companies are only put in service of the creditors of that specific entity. Since this does not involve a recalibration of the rights of the creditors, it is likely to have fewer *ex ante* effects.

Given this, the WG notes that the inclusion of procedural coordination mechanisms is recommended by the UNCITRAL Guide[50] and the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes, 2016 ("**WB Principles**").[51]

1.2. Types of Procedural Coordination Mechanisms

An analysis of international practice indicates that procedural coordination mechanisms may involve any or a combination of any of the mechanisms:

- Cooperation, communication and information sharing between insolvency professionals, creditors and Adjudicating Authorities
- Designation of single insolvency representative or Adjudicating Authority, formation of a group creditors' committee and a joint application process
- Group coordination proceedings

1.2.1. *Cooperation, communication and information sharing between insolvency professionals, creditors and Adjudicating Authorities*

Where different courts and insolvency representatives are involved, procedural coordination mechanisms typically require them to cooperate and communicate with each other for effective administration of different insolvency proceedings. Cooperation and communication allows stakeholders to efficiently collect information regarding the manner in which the business of the group of companies was conducted prior to insolvency, and to understand the state of the insolvency proceedings of other group companies.[52] This also enables coordination between insolvency professionals, the courts and the CoCs (whether single or multiple).

[49] Directorate General for Internal Policies, EU Parliament, *Insolvency proceedings in case of groups of companies: Prospects of harmonisation at EU level*, (2011), available at <http://www.europarl.europa.eu/document/activities/cont/201106/20110622ATT22322/20110622ATT22322EN.pdf>.
[50] Recommendation 202, UNCITRAL Guide.
[51] World Bank, *The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes*, 2016, Principle C 16.
[52] Paras 22-25, UNCITRAL Guide.

The WG notes that cooperation, communication and information sharing is enabled in other jurisdictions in the following manner:

1.2.1.1. European Union

The WG notes that the EU Regulations mandate cooperation and communication between insolvency practitioners, courts and insolvency practitioners and courts.

Article 56 provides for cooperation and communication between insolvency practitioners and requires insolvency practitioners to "*(a) as soon as possible communicate to each other any information which may be relevant to the other proceedings, provided appropriate arrangements are made to protect confidential information; (b) consider whether possibilities exist for coordinating the administration and supervision of the affairs of the group members which are subject to insolvency proceedings, and if so, coordinate such administration and supervision; (c) consider whether possibilities exist for restructuring group members which are subject to insolvency proceedings and, if so, coordinate with regard to the proposal and negotiation of a coordinated restructuring plan*."

Courts are required to cooperate and communicate with each other to facilitate effective administration of insolvency proceedings to the extent appropriate. This may be in respect of appointment of insolvency practitioners, administration and supervision of the assets and affairs of the members of the group, conduct of hearing and approval of protocols.[53]

Insolvency practitioners appointed in the insolvency proceedings of any group company may be heard in the insolvency proceedings of any of the members of the same group to the extent appropriate to facilitate the effective administration of the proceedings, and are required to cooperate and communicate with the court administering such proceedings. They may also request such courts for information about insolvency proceedings of other group companies, request assistance in relation to the insolvency proceedings for which they are appointed, request a stay on any measure for realization of assets of another group company to enable the creation of a coordinated restructuring plan.[54]

The costs of this are to be considered costs of the insolvency proceedings between different group companies.[55]

[53] Article 57, EU Regulations.
[54] Articles 58 and 60, EU Regulations.
[55] Article 59, EU Regulations.

1.2.1.2. Germany

The WG notes that provisions in the German legislation mandate that when there is no concentration of proceedings in a court or a single insolvency administrator is not appointed, courts and insolvency administrators are obliged to cooperate and share information with their counterparts. Courts may cooperate and share information with each other in relation to arrangement of safeguards, opening of proceedings, appointment of a liquidator, essential procedural decisions, extent of the bankruptcy estate, submission of insolvency plans, etc.[56]

The WG notes that the UNCITRAL Guide recommends that insolvency law should specify that in those cases where there are different insolvency representatives for different group companies, they should cooperate to the maximum extent possible[57] including in respect of

"(a) Sharing and disclosure of information concerning the enterprise group members subject to insolvency proceedings, provided appropriate arrangements are made to protect confidential information;
(b) Approval or implementation of agreements with respect to allocation of responsibilities between insolvency representatives, including one insolvency representative taking a coordinating role;
(c) Coordination of the administration and supervision of the affairs of the group members subject to insolvency proceedings, including day-to-day operations where the business is to be continued; post-commencement finance; safeguarding of assets; use and disposition of assets; exercise of avoidance powers; communication with creditors and meetings of creditors; submission and admission of claims, including intra-group claims; and distributions to creditors; and
(d) Coordination with respect to the proposal and negotiation of reorganization plans."[58]

1.2.2. *Group Coordination Mechanisms*

Coordination mechanisms enable a synchronized strategy to be evolved for different stages in the insolvency process. For instance, coordination mechanisms may enable the coordinated use, realization and disposal of assets of different entities so that the interests of the entire group may be taken into account especially where there are various inter-linkages between group companies. This coordination may be enabled by the creation of a 'group strategy'.

The WG notes that coordination is enabled in other jurisdictions in the following manner:

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[56] Section 269b, German legislation, translated by Schultze & Braun GmbH & Co. KG, *Insolvency and Restructuring in Germany – Yearbook 2019*, available at <https://www.schultze-braun.de/fileadmin/de/Fachbuecher/Insolvenzjahrbuecher/Insolvenzjahrbuch-2019/Insolvency_and_Restructuring_2019_rz.pdf?_=1547820263>.
[57] Recommendations 234-235, Paras 139-140, UNCITRAL Guide.
[58] Recommendation 236, Paras 139-140, UNCITRAL Guide.

1.2.2.1. European Union

The EU Regulations provide that group coordination proceedings may be opened for effective administration of insolvency proceedings of group members and in the interests of creditors on a voluntary basis.

An insolvency practitioner who is appointed in the insolvency proceedings of one group company may apply for the opening of group coordination proceedings to any court having jurisdiction over the insolvency proceedings of a member of the group. This application must propose the name of a person to be appointed 'group coordinator', provide an outline of the proposed group coordination, the costs of the coordination and how these will be shared by the companies.[59] The court may accept this application after giving insolvency practitioners a right of hearing if it is satisfied that

"(a) the opening of such proceedings is appropriate to facilitate the effective administration of the insolvency proceedings relating to the different group members;
(b) no creditor of any group member expected to participate in the proceedings is likely to be financially disadvantaged by the inclusion of that member in such proceedings; and
(c) the proposed coordinator fulfils the requirements laid down…"[60]

Insolvency practitioners for proceedings of other group companies would be able to object to the inclusion of their proceedings in the group coordination proceedings, subject to meeting requirements of national law. However, they may opt-in to group coordination proceedings at a later stage as well.

The 'group coordinator' appointed would

"*(a) identify and outline recommendations for the coordinated conduct of the insolvency proceedings;*
(b) propose a group coordination plan that identifies, describes and recommends a comprehensive set of measures appropriate to an integrated approach to the resolution of the group members' insolvencies. In particular, the plan may contain proposals for:
(i) the measures to be taken in order to re-establish the economic performance and the financial soundness of the group or any part of it;
(ii)the settlement of intra-group disputes as regards intra-group transactions and avoidance actions;
(iii) agreements between the insolvency practitioners of the insolvent group members."[61]

However, an insolvency practitioner may choose not to follow the coordinator's recommendations but would have to provide reasons for the same.

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[59] Article 61, EU Regulations.
[60] Article 63, EU Regulations.
[61] Article 72, EU Regulations.

The costs of these proceedings and the share of each group company would have to be estimated in advance. Where the costs exceed by ten per cent of the estimated costs, the insolvency practitioners of each company are informed, and prior approval of the court for group coordination proceedings must be secured.

1.2.2.2. Germany

German legislation provides for a group coordination procedure similar to one in the EU Regulations. Here, a proceedings coordinator would be appointed to synchronize the proceedings of different group companies. The remuneration of the proceedings coordinator is paid pro-rata from the insolvency estates of the debtors.[62] The proceedings coordinator is "*responsible for ensuring the coordinated handling of the proceedings relating to the group-affiliated debtors, in so far as this is in the interests of the creditors. To this end the proceedings coordinator may, in particular, present a coordination plan.*"[63]

This coordination plan may include proposals for restoring the financial standing of individual, group-affiliated debtors and the corporate group, for settling intra-group disputes and for contractual agreements between insolvency administrators.[64] This could thus result in a coordinated, overarching restructuring plan. The insolvency administrators of various group companies would then explain the coordinated plan to their creditors and propose deviations from the plan, if any. However, the creditors may demand that the restructuring plan of the company may conform to the coordinated plan.[65]

The WG notes that the UNCITRAL Guide also recommends that provision should be made for coordinated reorganisation plans to be proposed in insolvency proceedings.[66] It also

[62] Section 269g, German legislation, translated by Schultze & Braun GmbH & Co. KG, *Insolvency and Restructuring in Germany – Yearbook 2019*, available at <https://www.schultze-braun.de/fileadmin/de/Fachbuecher/Insolvenzjahrbuecher/Insolvenzjahrbuch-2019/Insolvency_and_Restructuring_2019_rz.pdf?_=1547820263>.
[63] Section 269f, German legislation, translated by Schultze & Braun GmbH & Co. KG, *Insolvency and Restructuring in Germany – Yearbook 2019*, available at <https://www.schultze-braun.de/fileadmin/de/Fachbuecher/Insolvenzjahrbuecher/Insolvenzjahrbuch-2019/Insolvency_and_Restructuring_2019_rz.pdf?_=1547820263>.
[64] Section 269h, German legislation, translated by Schultze & Braun GmbH & Co. KG, *Insolvency and Restructuring in Germany – Yearbook 2019*, available at <https://www.schultze-braun.de/fileadmin/de/Fachbuecher/Insolvenzjahrbuecher/Insolvenzjahrbuch-2019/Insolvency_and_Restructuring_2019_rz.pdf?_=1547820263>.
[65] DLA Piper, *Germany introduces legislation to facilitate corporate group insolvencies (Konzerninsolvenzrecht)* available https://www.dlapiper.com/en/africa/insights/publications/2017/06/restructuring-global-insight-july-2017/germany-introduces-corporate-group-insolvencies/; Thomas Hoffmann and Isabel Giancristofano, 'Corporate Recovery and Insolvency 2018 | Germany' (*International Comparative Legal Guides*, 25 April 2018) <https://iclg.com/practice-areas/corporate-recovery-and-insolvency-laws-and-regulations/germany>.
[66] Recommendation 237, Para 147-151, UNCITRAL Guide.

recommends that insolvency law should specify that a group company that is not subject to insolvency proceedings should be allowed to participate in a reorganisation plan voluntarily.[67] The WB principles also recommend that laws should permit coordinated resolution plans involving more than one group company in the insolvency resolution process. Even solvent group companies should be allowed to participate in these proceedings. [68]

1.2.3. *Designation of single insolvency representative or court, formation of a group creditors' committee and joint applications*

Certain procedural coordination mechanisms enable

- the appointment of a single insolvency professional subject to conflict of interest,
- designation of a single court for the insolvency proceedings of all group companies,[69]
- formation of a group creditor's committee, and
- joint applications.

The WG notes that this is enabled in other jurisdictions in the following manner:

1.2.3.1. European Union

The Preamble to the EU Regulations specifically suggest that in case of insolvency proceedings of different group companies, courts should be able to appoint the same insolvency practitioner in all proceedings concerned[70] to facilitate coordinated conduct of insolvency proceedings of different group members.

1.2.3.2. Germany

German legislation requires insolvency proceedings of different group members to be administered in a single court, where the first group company files for insolvency. However, such concentration of proceedings in one court may not take place where the first company that files for insolvency employs less than fifteen per cent of the group's employees and either its revenues are less than fifteen per cent of the group's revenues or it is worth less than fifteen

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[67] Recommendation 238, Para 152, UNCITRAL Guide.

[68] World Bank, *The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes*, 2016, Principle C 16.

[69] DLA Piper, *Germany introduces legislation to facilitate corporate group insolvencies (Konzerninsolvenzrecht).* available https://www.dlapiper.com/en/africa/insights/publications/2017/06/restructuring-global-insight-july-2017/germany-introduces-corporate-group-insolvencies/; Thomas Hoffmann and Isabel Giancristofano, 'Corporate Recovery and Insolvency 2018 | Germany' (*International Comparative Legal Guides*, 25 April 2018) <https://iclg.com/practice-areas/corporate-recovery-and-insolvency-laws-and-regulations/germany>.

[70] Paras 50 and 53, Preamble to the Regulations.

per cent of the balance sheet of the group.[71] An application to commence insolvency proceedings for other group-affiliated debtors may also be filed with this court. If this application is filed in another court, such a court may refer the proceedings to the court at the place of the group jurisdiction.[72]

Section 56b of the legislation enables the appointment of a single insolvency administrator in respect of all proceedings relating to the debtors in a corporate group. Here, relevant courts before whom applications for commencement of proceedings are lodged are required to reach an agreement as to whether it would be in the interests of the creditors to appoint only one person as an insolvency administrator. In this regard, courts must discuss whether a person may attend to all proceedings with requisite independence and if "*potential conflicts of interest can be eliminated through the appointment of special insolvency administrators.*"[73]

Further, to enable cooperation between the creditors' committees, the German legislation enables the setting up of a group creditors' committee that supports the insolvency representatives and the creditors' committees of individual debtors to pursue coordinated resolution. This committee would be formed on the application of a creditors' committees appointed in insolvency proceedings concerning the assets of a group-affiliated debtor. "*Each creditors' committee…for a group-affiliated debtor that is manifestly not merely of secondary importance for the corporate group as a whole shall appoint one member of the group creditors' committee. A further member of this committee shall be appointed from among the representatives of the employees*."[74] This committee is tasked with supporting the insolvency administrators and the creditors' committees in the individual insolvency proceedings to facilitate the synchronised handling of those proceedings.

The WG notes that the UNCITRAL Guide recommends that provision should be made for the appointment of the same insolvency representative in the best interests of the administration of the insolvency proceedings and subject to concerns regarding conflict of interest.[75]

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[71] Section 3a, German legislation, translated by Schultze & Braun GmbH & Co. KG, *Insolvency and Restructuring in Germany – Yearbook 2019*, available at <https://www.schultze-braun.de/fileadmin/de/Fachbuecher/Insolvenzjahrbuecher/Insolvenzjahrbuch-2019/Insolvency_and_Restructuring_2019_rz.pdf?_=1547820263>.

[72] Section 3d, German legislation, translated by Schultze & Braun GmbH & Co. KG, *Insolvency and Restructuring in Germany – Yearbook 2019*, available at <https://www.schultze-braun.de/fileadmin/de/Fachbuecher/Insolvenzjahrbuecher/Insolvenzjahrbuch-2019/Insolvency_and_Restructuring_2019_rz.pdf?_=1547820263>.

[73] Section 56b, German legislation translated by Schultze & Braun GmbH & Co. KG, *Insolvency and Restructuring in Germany – Yearbook 2019*, available at <https://www.schultze-braun.de/fileadmin/de/Fachbuecher/Insolvenzjahrbuecher/Insolvenzjahrbuch-2019/Insolvency_and_Restructuring_2019_rz.pdf?_=1547820263>.

[74] Section 269c, German legislation, translated by Schultze & Braun GmbH & Co. KG, *Insolvency and Restructuring in Germany – Yearbook 2019*, available at <https://www.schultze-braun.de/fileadmin/de/Fachbuecher/Insolvenzjahrbuecher/Insolvenzjahrbuch-2019/Insolvency_and_Restructuring_2019_rz.pdf?_=1547820263>.

[75] Recommendations 232- 236, UNCITRAL Guide.

To promote efficiency and reduce costs, the UNCITRAL Guide also recommends that insolvency law may specify that a joint application for commencement of insolvency proceedings against two or more group companies be made when the group companies satisfy the commencement standard. However, a joint application may be preferred by a creditor who is a creditor of each group member.[76] In this regard, the UNCITRAL Guide notes that it may be possible to include solvent members of a group, to facilitate a more coordinated resolution. However, it recommends that only those members of the group that satisfy the applicable standard for commencement of insolvency proceedings should be included in a joint application.[77]

The UNCITRAL Guide also suggests that insolvency law may enable the establishment of a single creditors' committee. However, this may be appropriate only in those circumstances where "*the interests of creditors of the different group members are not diverse and can be accommodated and appropriately protected in a single committee or where the creditors are common to the group members concerned.*"[78]

The WG notes that the WB principles also recommend that the same insolvency representative should be allowed to be appointed in respect of two or more enterprise group members, having due regard to provisions pertaining to conflict of interest. Where different insolvency representatives are appointed, they should be allowed to cooperate to the maximum extent possible.

1.3. Recommendations of the WG

1.3.1. *Applicability of procedural coordination mechanisms*

The WG notes that international practice suggests that procedural coordination mechanisms include:

- cooperation, communication and information sharing,
- group coordination for the preparation of a common expression of interest, resolution plan, etc.,
- a joint application process, and
- the designation of single Adjudicating Authority, appointment of a single insolvency professional and formation of a group creditors' committee

The WG notes that procedural coordination mechanisms are aimed at facilitating procedural synchronisation between different insolvency proceedings, to lower costs of insolvency

[76] Recommendations 199 and 200, UNCITRAL Guide.
[77] Recommendations 199 and 200, UNCITRAL Guide.
[78] Recommendation 204 and Paras 22-25, UNCITRAL Guide.

proceedings and maximise the value of assets of group companies by enabling a synchronised resolution of companies. Moreover, they are of different types.

Each mechanism may not be suitable for all types of group companies. For instance, where group companies have few inter-linkages, opening group coordination proceedings may not result in de-duplication of work, or identification of value maximising inter-linkages. Moreover, procedural coordination mechanisms may come with costs of their own, which may become unduly high in such cases. Most stakeholders consulted by the WG were of the view that most procedural coordination mechanisms may be enabled by law but should not be applicable in those cases where the costs of procedural coordination mechanisms are unduly burdensome. In some cases, however, stakeholders were of the view that procedural coordination can be mandated by law.

Procedural coordination would only be beneficial for the creditors of two or more group entities when it generates a greater value than those cases where the insolvency proceedings of such entities are completed independently, by increasing recoveries or lowering costs.Thus, mandating procedural coordination in all cases is unlikely to lower costs of insolvency proceedings or maximise value.[79]

Given this, the WG recommends that procedural coordination mechanisms (other than co-operation, coordination and information sharing) should in-principle be enabled by law, however flexibility should be granted to not opt for or apply these mechanisms in those cases where they don't help maximise value of assets or lower costs of proceedings. Thus:

- A joint application may be filed at the option of the applicant as discussed in Para 1.3.2.1 of this Part below;

- A single Adjudicating Authority may administer the proceedings, if Adjudicating Authorities transfer proceedings to one Adjudicating Authority (except where such transfer would prejudice the stakeholders) or if the committees of creditors apply to have the proceedings transferred as discussed in Para 1.3.2.2 of this Part below;

- A single insolvency professional may be appointed by the Adjudicating Authority and can be proposed by the applicant. However, there would be flexibility to appoint multiple insolvency professionals where it believes there are capacity constraints or potential of conflict of interests as discussed in Para 1.3.2.3 of this Part below;

- A group creditors' committee could be formed at the option of the committees of creditors as discussed in Para 1.3.2.4 of this Part below;

[79] See: 'Annexure IV'.

- Group coordination proceedings (which are a form of procedural coordination) as discussed in Para 1.3.2.6 of this Part below should only be commenced following an affirmative vote of majority of the CoC of each company participating in the group coordination proceeding.

However, the WG recommends that insolvency professionals, CoCs and Adjudicating Authorities should be mandated to cooperate, communicate and share information with each other, since this is likely to reduce the time taken in proceedings, lower costs by de-duplicating efforts to collect information and promote information symmetry. This would also be important to ensure that stakeholders are in a position to assess if other procedural coordination mechanisms, such as the opening of a group coordination proceeding is required. However, the degree to which they cooperate, communicate and share information can be left to the discretion and agreement of the stakeholders.

Some stakeholders consulted by the WG also suggested that procedural coordination mechanisms should be made applicable to all entities in the corporate group including entities that have not committed default, as well as financial service providers. However, the WG notes that the Code extends only to those entities that have committed default and no insolvency proceedings can commence against those companies that have not committed default. Accordingly, no procedural coordination mechanism can be envisaged where insolvency proceedings under the Code do not exist. This is also consistent with the recommendation made in the UNCITRAL Guide. To the extent that communication with and cooperation of solvent group companies is required, section 19 of the Code clearly requires that "*the personnel of the corporate debtor, its promoters or any other person associated with the management of the corporate debtor shall extend all assistance and cooperation to the interim resolution professional as may be required…*" Given this, **the WG recommends that these mechanisms should not be made applicable to solvent companies.**

In case of financial service providers whose insolvency proceedings are not governed by the existing process under the Code, procedural coordination mechanisms would have to be designed to coordinate with insolvency proceedings under their respective legislations. The WG is of the view that a separate analysis would have to be carried out to ascertain how such coordination may take place and is outside the mandate of this WG.

1.3.2. *Procedural coordination mechanisms that would be part of the framework*

Based on an analysis of international practice and consultations with stakeholders, the WG understands that procedural coordination mechanisms promote efficiency and reduce costs, and are largely facilitative in nature. In the backdrop the WG recommends that a combination of the following procedural coordination mechanisms may be provided for in the manner discussed below:

1.3.2.1. A joint application process be allowed for the insolvency resolution of multiple insolvent companies in a group

The WG recommends that a single application to commence the CIRP for multiple group companies that have committed a default (“**joint application**”) **may be made by financial creditors, operational creditors or the group companies themselves**. This will reduce the costs of making multiple applications and promote coordination of insolvency proceedings of different companies in a group, through the establishment of a single commencement date and may include a proposal for the appointment of a single insolvency professional.

However, to ensure that the framework for group insolvency is not invoked without adequate justification, all the companies listed in the joint application for the initiation of insolvency of the companies should have committed default as required under sections 7, 9 and 10, as the case may be. Such a joint application process should be in addition to the mechanism to initiate the CIRP process against each group company separately.

Where an application to commence the insolvency resolution process for multiple companies is accepted by an Adjudicating Authority, that Adjudicating Authority may order that a single public announcement be made for all companies.

1.3.2.2. A single Adjudicating Authority should administer all insolvency proceedings of companies in a corporate group

As discussed previously, the designation of a single Adjudicating Authority to administer all insolvency proceedings of companies in a corporate group will reduce judicial effort in piecing together the same information, thereby reducing the time and costs of insolvency resolution proceedings and reduce the procedural gaps between proceedings of multiple group companies. Given this, **the WG recommends that a single Adjudicating Authority should administer insolvency proceedings of companies in a group.**

The Adjudicating Authority for all insolvency proceedings for the group may be the Adjudicating Authority that first admits an application to commence the CIRP for any company of the group

While some stakeholders consulted by the WG suggested that the single Adjudicating Authority should be the Adjudicating Authority which has jurisdiction over the areas in which the corporate group’s ‘centre of main interest’ lies, **the WG is of the opinion that providing an objective trigger based on the place where an application is first admitted as discussed above is likely to lower litigation costs, save judicial resources and reduce the time taken for admission of proceedings.** Further, since the law to be applied would continue to be the Insolvency and Bankruptcy Code, 2016, concerns pertaining to forum shopping would be minimised.

Where applications for the initiation of CIRPs against group companies have been made to other Adjudicating Authorities, they may transfer the applications for admission to the Adjudicating Authority first approached for the resolution of insolvency proceedings of any company of the group either on their own motion or upon the application by any stakeholder of such companies. **However, the WG recognises that in some cases the stakeholders of the concerned companies may not want Adjudicating Authorities to transfer applications, where they believe it would unfairly affect their interests. This flexibility should be allowed as long as Adjudicating Authorities share information, cooperate and communicate with each other.** However, even in such cases, the Adjudicating Authority should be mandated to transfer the insolvency proceedings where a CoC once formed applies to have the proceedings administered by the first Adjudicating Authority.

These recommendations would apply in liquidation processes as well. Where different Adjudicating Authorities administer CIRPs for different group companies and pass orders for liquidation, the liquidators should be empowered to apply to have the liquidation proceedings administered by one Adjudicating Authority. If such an application is not made, Adjudicating Authorities should be mandated to share information, cooperate and communicate with each other.

In case group coordination proceedings are opened as provided in Para 1.3.2.6 of this part below CoCs of different companies would, by required majority, choose on the basis of their convenience, a single Adjudicating Authority to administer their insolvency resolution processes and seek transfer of all pending applications to it.

1.3.2.3. <u>A single insolvency professional may be appointed in insolvency proceedings for companies in a corporate group</u>

Based on an analysis of international practice and comments received from stakeholders, **the WG recommends that a single insolvency professional may be appointed in the insolvency proceedings of all companies in a corporate group by Adjudicating Authorities.** This would ensure maximum information symmetry, facilitate coordination of different insolvency proceedings and result in de-duplication of work, thereby lowering costs of the insolvency resolution processes and maximising value from synergies across group companies. It would also help smoothen out the process of carrying out intra-group transactions.

However, some stakeholders have suggested that there may be a case for appointing multiple insolvency professionals to ensure that there is no conflict of interest and that the insolvency professional has sufficient resources to carry out her duties in respect of multiple appointments. Therefore, **in those situations where the appointment of a single insolvency professional would result in potential conflicts of interest or the same insolvency professional would not have sufficient resources to carry out her duties in respect of multiple appointments, the WG recommends that different or multiple insolvency professionals may be appointed for different companies.** However, these insolvency professionals should be mandated to communicate, cooperate and share information with each other. The decision to appoint the same insolvency professional may also be taken at the stage of liquidation.

The insolvency professionals appointed may consider cooperating to make a single public announcement with the prior permission of the Adjudicating Authority, share information and cooperate for the verification of claims, appoint the same valuers, etc.

1.3.2.4. The formation of a group creditors' committee may be allowed

The CoCs in the insolvency proceedings of different companies in a corporate group may be different where the financial creditors of the companies are not the same. Some stakeholders consulted by the WG suggested that in these cases, a group creditors' committee should be formed to enable synchronised resolution of the insolvency of group companies. However, as is demonstrated by international practice, a group creditors' committee only supports the CoCs of each company, since the substantive rights vested in the financial creditors of each group company are not displaced by procedural coordination mechanisms. Therefore, a group creditors' committee should not be empowered to take decisions without the consent of the CoC of each company in a corporate group.

The WG is of the view that the formation of a group creditors' committee may be enabled where the CoCs are of the view that the formation of such a committee is likely to result in benefits, such as coordinated negotiation with the resolution applicants, since the costs of such a mechanism are high. **Given this, the WG recommends that the formation of a group creditors' committee, at the discretion of CoCs of each group company, may be allowed.** However, the composition, constitution and costs of the group creditors' committee may be decided by an agreement between CoCs of companies in a corporate group (or by the Framework Agreement as discussed below in Para 1.3.2.6 of this Part), the creation of which may be facilitated by the insolvency professionals.

1.3.2.5. Cooperation, communication and information sharing between CoCs should be mandated

The WG has recommended that the group insolvency framework should provide for

- the appointment of a single insolvency professional, except if there are capacity constraints and potential of conflicts of interest,
- a single Adjudicating Authority be designated, except if it would be against the interests of the stakeholders of the company (and the CoCs of the group companies do not request for such designation) and
- the creation of a group creditors' committee at the option of the CoCs of each group company

Consequently, the WG's recommendations do envisage situations where insolvency proceedings in relation to group of companies may be carried out with different insolvency professionals, Adjudicating Authorities and CoCs in place.

Cooperation and communication allows stakeholders to efficiently collect information regarding the manner in which the business of the group of companies was conducted prior to insolvency, and to understand the state of the insolvency proceedings of other group companies.[80] This also enables coordination between insolvency professionals, the courts and the CoCs (whether single or multiple). Given this, international practice typically mandates some level of communication, cooperation and information sharing between different stakeholders.

Thus, where different insolvency professionals, Adjudicating Authorities and CoCs are involved, the WG recommends that they should be mandated to cooperate, communicate and share information with each other for effective administration of different insolvency proceedings.

However, the extent to which they may want to cooperate, communicate and share information with each other would be left to their discretion. Thus, the degree of cooperation, communication and information sharing could be relatively low and restricted to sharing records for preparing reports and could also be relatively high by having meetings of different CoCs at the same time and place.

1.3.2.6. Group coordination proceedings should be enabled

As discussed previously, coordination of insolvency proceedings would enable the synchronised resolution of insolvency of group companies, including by inviting a common expression of interest, resolution plan, etc. This would aid in maximisation of value of the assets of the corporate group, by allowing resolution applicants access to synergies between different group companies.

Based on an analysis of international practice and comments received from stakeholders, **the WG is of the view that such coordination of proceedings should be enabled by a vote of majority of the CoC of each company.**

The CoC has been entrusted with the responsibility of assessing the viability of the corporate debtor during the CIRP and taking commercial decisions during this process. The CoC, would therefore, have the ability to assess if group coordination is appropriate to facilitate effective administration of the insolvency proceedings relating to the different group companies; and the advantages of group coordination are not outweighed by the estimated costs. This would also prevent the imposition of a one-size-fits all approach that may not suit the needs of each company or corporate group. Further, the first meeting of the CoC is typically conducted within

[80] Paras 22-25, UNCITRAL Guide.

thirty days from the commencement of the insolvency resolution process. At this stage of the proceedings, there is likely to be more clarity on the value of the assets of insolvent group companies, and the potential for value maximisation if they are kept together.[81]

These coordination proceedings should be governed by a Framework Agreement that is approved by the CoC of each company that participates in these proceedings, that will lay out *inter alia* the estimated costs and distribution of costs of proceedings, the group coordinator, the Adjudicating Authority that may hear proceedings, mechanisms to opt-out etc. An insolvency professional appointed in proceedings of any group company, in consultation with and with the consent of the CoC of that company may propose this Framework Agreement. The Framework Agreement should also provide for the mechanism by which a company may opt-in to group coordination proceedings at a later stage.

A person may be appointed under the Framework Agreement to propose a group strategy. This person may be called the group coordinator. The group coordinator may propose any permutation and/or combination of actions including valuation of the assets of the group together with a projected share of each separate company, the establishment of a common data room for prospective resolution applicants, the preparation of a common information memorandum, the invitation of a common Expression of Interest for some or all group companies, establishment of a group creditors' committee to negotiate with lenders, the invitation of a common resolution plan for some or all group companies, potential sharing of proceeds, settlement of intra-group debts, etc.

The group coordinator would have duties to ensure that they act professionally and impartially in the interests of all stakeholders. **The WG is of the view that only an insolvency professional should be appointed as a group coordinator, since an insolvency professional (who is registered and regulated under the Code) has the requisite knowledge and expertise in relation to the processes under the Code, and is best placed to handle group coordination.** The insolvency professional may, however, hire the services of such professionals as he considers necessary.

The CoC of each company that signs the Framework Agreement would have to approve of such a strategy for it to be applicable to their respective company. Accordingly, there would be a provision to opt-out from the group coordination proceedings at this stage. The group strategy may require that certain costs be incurred by the company and should be opted for when it is likely to be value maximising for the companies involved. As such, where the CoC of any company in its wisdom believes that the group strategy proposed by the group coordinator is unlikely to be value maximising for the stakeholders of the company, they should be allowed to opt-out from the proceedings at this stage (by a vote of the majority of the CoC). However, to maximise certainty for all group companies, no company may 'opt-out' of the group proceedings after this stage. Where the group coordinator proposes that resolution applicants should be invited to submit a common resolution plan for multiple companies in the

[81] See: 'Annexure IV'.

group, and the process ends up with approval of resolution plans by only some of the companies in the group, the companies that have rejected the plan may not be given any further time to attempt a resolution, unless sufficient time in their CIRP period remains for them to attempt a standalone resolution.

Where group coordination proceedings are opened, all Adjudicating Authorities should be intimated of the same, and all cases should be transferred to a single Adjudicating Authority chosen under the Framework Agreement. This Adjudicating Authority may settle disputes regarding the application of the Framework Agreement and ensure that actions taken pursuant to the group coordination plan are consistent with law.

In liquidation, the liquidators appointed would have to apply to an Adjudicating Authority agreed to between them to commence group coordination proceedings of the nature similar to the proceedings as discussed above. However, they should consult the stakeholders' consultation committee before applying so. These coordination proceedings may enable designation of a single NCLT as the Adjudicating Authority, the filing of consolidated reports and a consolidated sale of assets. It is relevant to note that group coordination proceedings at the stage of resolution would not be carried forward at the stage of liquidation.

1.3.3. *Stages at which procedural coordination mechanisms may be applicable*

The WG's recommendations thus allow for some form of procedural coordination in respect of all of the following:

- Application for initiation of insolvency proceedings
- Appointment of insolvency professionals
- Appointment of valuers both in CIRP and Liquidation
- Public announcement both in CIRP and Liquidation
- Moratorium
- Collection and verification of claims both in CIRP and Liquidation
- Constitution of the CoC
- Meetings of CoC
- Invitation of Expression of Interest
- Invitation for Resolution Plans
- Resolution Plans
- Transaction audits
- Sale of assets in liquidation
- Reporting in liquidation

1.3.4. *Extension of Timeframe for Group Insolvency Proceedings*

Given that the opening of group coordination proceedings involves the creation of a group strategy, it was suggested to the WG that adherence to the statutory time-frame of one hundred and eighty days (extendable by ninety days) may prove to be difficult in some cases, depending on the degree of inter-dependence among the group companies, the extent of intermingling of assets within the group and the existence of intra-group guarantees and collateralizations.

In those cases where group coordination proceedings are opened by CoCs with the belief that they would result in the maximization of the value of the assets of the corporate group, but may exceed the statutory timeline under section 12 of the Code, the WG discussed if a separate time-frame should be devised for such proceedings.

The stakeholders consulted by the WG suggested two approaches regarding extension of the time frame for the resolution process involving group companies that have opened group coordination proceedings. *First*, it was suggested that the timeframe may be extended by an additional period of up to 90 days on an application to the Adjudicating Authority. *Second*, it was suggested that the Adjudicating Authority should have the discretionary power to extend the timeframe on a case-to-case basis.

The WG recommends that the timeframe for proceedings of any company that has opened group coordination proceedings may be extended by an additional period of up to 90 days on an application to the Adjudicating Authority, such that the overall timeframe does not exceed 420 days (including time taken in litigation). This approach would help maximize the value of the assets of the corporate group by allowing adequate time to enable coordination proceedings to be conducted. At the same time, this approach ensures that there are strict timelines in place to ensure time-bound resolution of assets, so that value is not lost due to delays.

1.4. AMENDMENTS THAT MAY BE REQUIRED

To implement the recommendations of the WG, the Code, Rules notified by the Government and the Regulations framed by the Board, as well as associated legislation would require amendments. An indicative list of amendments that may be required is given below:

- <u>The Insolvency and Bankruptcy Code, 2016</u>

For a joint application process and administration of insolvency proceedings by the same Adjudicating Authority, section 60 of the Code may need to be amended to give one NCLT jurisdiction over the entire group. Further, amendments may need to be made to enable coordination, cooperation and information sharing between different insolvency professionals, NCLTs and CoCs under the Code.

Further, to enable group coordination proceedings that are additional to the insolvency proceedings of each company, provisions may need to be added to the Code.

Amendments may also need to be made to enable a person to propose a resolution plan covering multiple companies in a group.

- Rules and Regulations under the Code

For a joint application process, and the appointment of a single insolvency professional for the whole group, the Insolvency and Bankruptcy (Application to the Adjudicating Authority) Rules, 2016 would need to be amended. These Rules may also have to be amended to allow for application for procedural coordination between different group companies, if various group companies enter insolvency without a group process.

The IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 would need to be amended to enable the appointment of the same valuer(s) to value some or all of the group companies together, to mandate cooperation between multiple insolvency professionals, to allow for invitation of expressions of interest and resolution plans for the entire group. Similar amendments may also need to be made to the IBBI (Liquidation Process) Regulations, 2016.

The IBBI (Insolvency Professionals) Regulations, 2016 may also need to be amended to enable coordination, cooperation and information sharing between different insolvency professionals under the Code.

- Associated legislation

The National Company Law Tribunal Rules, 2016 may need to be amended to allow for coordination, cooperation and information sharing between the different NCLT benches. These may also need to be amended to provide a framework for joint hearings, etc.

2. RULES DEALING WITH PERVERSE BEHAVIOUR OF COMPANIES IN A CORPORATE GROUP

In order to protect the rights and interests of external creditors of a group, the WG notes that rules should be prescribed to prevent and penalize such perverse behavior by group companies. Such a rules should be aimed at *first,* reducing the costs of monitoring on creditors who may find it hard to monitor the manner in which resources and risks in a group move around, particularly when they are deployed in the interests of the group rather than the subsidiary.[82] *Second*, they should be aimed at reducing the exploitation of the group structure to conduct transactions in a manner that the risks are unduly borne by certain stakeholders i.e. creditors, while the value is unfairly captured by the shareholders.[83]

It is relevant to note that such rules would be applicable even in those cases where only a single company in a group is insolvent, since this element is not aimed at dealing with the consolidation of companies or coordination of multiple insolvent companies. Instead, this is aimed at ensuring that the Framework comprehensively addresses all issues that a company which is part of a corporate group may face while in insolvency.

[82] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principles*, Pg 584 (2nd Edn, 2009).
[83] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principles*, Pg 584-6 (2nd Edn, 2009).

2.1. Types of Rules Against Perverse Behaviour of Group Companies

The WG notes that different jurisdictions adopt different types of rules against perverse behavior by group entities. These include:

2.1.1. *Subordination of Claims*

Some rules require that, in certain circumstances, the claims of related parties of the debtor or of the other group entities be treated subordinate to the claims of the unrelated creditors, in the insolvency resolution of any one group company. This subordination of claims may be considered where "*the parent's participation in the management of the group member; whether the parent has sought to manipulate intra-group transactions to its own advantage at the expense of external creditors; or whether the parent has otherwise behaved unfairly, to the detriment of creditors and shareholders of the controlled group member*" [84] Further, a distinction may be drawn between funds provided by a parent entity as a loan *simpliciter* and funds provided in the form of long term capital contributions.[85]

The WG notes that the subordination of claims may take place in other jurisdictions in the following manner:

- United States of America

Under the US Bankruptcy Code, courts have the discretionary jurisdiction to subordinate any claim on equitable grounds.[86] The courts have used this discretionary power to subordinate the claims of parent companies provided: "*i) the claimant must have engaged in some type of inequitable conduct; ii) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; iii) equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Act*.".[87] The courts have used this jurisdiction to subordinate the claims of the controlling or dominating shareholder of the debtor. [88] For example, the US Supreme Court has on one occasion, deferred the claims of

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[84] Para 86, UNCITRAL Guide
[85] *Cork Report: Report of the Review Committee on Insolvency Law and Practice* (Cmnd 8558, 1982), Paras 1963-64.
[86] See: Section 510(c), 11 U.S. Code.
[87] *Matter of Mobile Steel*, 563 F.2d 692 (5th Cir. 1977).
[88] *Taylor v. Standard Gas and Electric Co.* (1939) 306 US 307); See: *Pepper v. Litton*, 308 U.S. 295, where the Supreme Court held that: "*So-called loans or advances by the dominant or controlling stockholder will be subordinated to claims of other creditors and thus treated in effect as capital contributions by the stockholder . . . where* [inter alia] *the paid in capital is purely nominal, and capital necessary for the scope and magnitude of the operations of the company being furnished by the stockholder as a loan.*
Though disallowance of such claims will be ordered where they are fictitious or a sham, these cases do not turn on the existence or non-existence of the debt. Rather they involve simply the question of order of payment".

the parent company to the claims of preferred stockholders on the ground that the parent company was guilty of mismanagement and under-capitalisation of the bankrupt entity.[89]

However, the WG notes that according to the UNCITRAL Guide, the claims of a related party should not be subordinated merely because it is related to the corporate debtor.[90] It suggests that an insolvency law should include a mechanism to differentiate *bona fide* claims from those which "*will deserve additional attention*".[91] It also cautions that subordination of claims of a group member "*might threaten the viability of the subordinated group member and be detrimental not only to its own creditors, but also its shareholders and, in the case of reorganization, to the group as a whole. The adoption of a policy of subordinating such claims may also have the effect of discouraging intra-group lending*."[92] Given this, the UNCITRAL Guide "*does not recommend the subordination of any particular types of claims under the insolvency law, simply noting that subordinated claims would rank after claims of ordinary unsecured creditors*"[93]

2.1.2. *Extension of liability*

In certain circumstances, the liabilities incurred by an entity which is undergoing insolvency can be extended to other entities which are related to it or are part of the same group. The rationale for extension of liabilities is based on the relationship that exists between the two entities with respect to their ownership and control.[94] Such extension of liabilities can also be based on the conduct of the solvent related entity with respect to the creditors of the insolvent company.[95] Thus, if a subsidiary was insolvent at the time of taking any debts or became insolvent as a result of such debts and if the holding company was aware or reasonably suspected to have been aware, then the holding company would be held liable for such debts.[96] However, the parent company may not be held liable where it took all reasonable steps to prevent the subsidiary from incurring the debt.[97] Liability may also be extended to the parent company or the directors of the parent company for wrongful trading where it is or they are shadow or *de facto* directors of the group company.[98] Some academics also argue that this liability should be extended on the basis of 'duties' that parents should owe to their subsidiary companies.[99]

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[89] *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307, 323 (1939); See: Matthew Nozemack, *Making Sense Out of Bankruptcy Courts' Recharacterization of Claims: Why Not Use § 510(c) Equitable Subordination?*, 56 Wash. & Lee L. Rev. 689 (1999).
[90] Para 85, UNCITRAL Guide.
[91] Para 85, UNCITRAL Guide.
[92] Para 88, UNCITRAL Guide.
[93] Para 91, UNCITRAL Guide.
[94] See: Para 96, UNCITRAL Guide.
[95] See: Para 96, UNCITRAL Guide.
[96] See: Sections 588V, 588W, Australian Corporations Act, 2001.
[97] Section 588V, Australian Corporations Act, 2001.
[98] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principles*, Pg 591 (2nd Edn, 2009)
[99] Gwynne Skinner, *Parent Company Accountability Ensuring Justice for Human Rights Violations*, (2015) The International Corporate Accountability Roundtable (ICAR), available at: <http://www.bhrinlaw.org/documents/pcap-report-2015.pdf>.

The WG notes that liability is extended to other group companies or their directors in other jurisdictions in the following manner:

- Australia

In Australia, a holding company would be held liable for the debts incurred by its subsidiary, if such subsidiary was insolvent at the time of taking such debts or became insolvent as a result of such debts, if there were reasonable grounds for suspecting the same, and if "*(i) the corporation, or one or more of its directors, is or are aware at that time that there are such grounds for so suspecting;* [or] *(ii) having regard to the nature and extent of the corporation's control over the company's affairs and to any other relevant circumstances, it is reasonable to expect that: (A) a holding company in the corporation's circumstances would be so aware; or (B) one or more of such a holding company's directors would be so aware;"*[100] Importantly, while holding companies may be liable for the debts incurred by its subsidiaries, the law does not expressly penalize other related entities in the group for the same.[101]

For the holding company to be liable, the debts incurred by the subsidiary should be partially or wholly unsecured and the creditor should have suffered a loss or damage because of the company's insolvency.[102] The holding company can be liable only to the extent of such loss or damage suffered by the creditor.[103] Further, there are certain defenses provided to the holding company in this regard. For example, the holding company and its directors are permitted to prove that there were reasonable grounds to expect that the subsidiary entity was solvent at the time of incurring the debt and that the said entity would continue to be so even after incurring the debt. The holding company is also entitled to claim that such expectation of solvency was based on the information provided by a competent and reliable person who was "*responsible for providing to the corporation adequate information about whether the company was solvent*".[104] The holding company may also take the defense that it took all reasonable steps to prevent the subsidiary from being insolvent.[105]

- United Kingdom

In the United Kingdom, the court may order that a director or a shadow director, being any "*person in accordance with whose directions or instructions the directors of the company are accustomed to act*",[106] (which may include the holding company and its directors)[107] may be

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[100] Section 588V, Australian Corporations Act, 2001.
[101] See: Ian Ramsay, *Allocating Liability in Corporate Groups: An Australian Perspective*, 13: 329 Connecticut Journal of Int'l Law.
[102] Section 588W(1), Australian Corporations Act, 2001.
[103] Section 588W(1), Australian Corporations Act, 2001.
[104] Section 588X(3), Australian Corporations Act, 2001.
[105] Section 588X, Australian Corporations Act, 2001.
[106] Section 251, Insolvency Act, 1986.
[107] Vanessa Finch, *Corporate Insolvency Law Perspectives and Principles*, Pg 590-591 (2nd Edn, 2009).

held liable to make such contributions as the court thinks fit if "*(a) the company has gone into insolvent liquidation, (b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and (c) that person was a director of the company at that time*"[108]. However, no such order would be passed if, after having known that there was reasonable prospect of avoiding insolvent liquidation, the director or shadow director "*took every step with a view to minimising the potential loss to the company's creditors*".[109]

Further, the WG notes that while the UNCITRAL Guide does not make any specific recommendations regarding extension of liabilities, it suggests that the "*mere incidence of control or domination of a group member by another group member, or other form of close economic integration within an enterprise group"* should not be the basis for invoking this remedy.[110] The UNCITRAL Guide provides a list of circumstances when the liabilities of the corporate debtor may be extended to a group company, which includes exploitation or abuse by one group member (perhaps the parent) of its control over another group member, including operating that group member continually at a loss in the interests of the parent; fraudulent conduct by the dominant shareholder, which might include fraudulently siphoning off a group member's assets or increasing its liabilities, or conducting the affairs of the group member with an intent to defraud creditors; operation of a group member as the parent's agent, trustee or partner; etc.[111] The UNCITRAL Guide also suggests that whether directors of the parent company of the debtor may be held liable should depend on: "*whether there was active involvement in the management of the controlled group member; whether there was grievous negligence or fraud in the management of the controlled group member; whether the management of the parent could be in breach of duties of care and diligence or there was abuse of managerial power; or whether there was a direct relationship between the manner in which the controlled group member was managed and its insolvency.*"[112]

2.1.3. *Contribution orders*

A contribution order is an order made by a court directing a solvent group company to contribute certain funds to another group company which is undergoing insolvency.[113] Such orders are generally issued when the solvent company has '*acted inappropriately towards the insolvent group member*'[114]. While this remedy is relatively more obscure, it aims at "*balancing the interests of the shareholders and unsecured creditors of the solvent group member with the*

[108] Section 214(2), Insolvency Act, 1986.
[109] Section 214(3), Insolvency Act, 1986.
[110] Para 98, UNCITRAL Guide.
[111] Para 97, UNCITRAL Guide.
[112] Para 99, UNCITRAL Guide.
[113] See: Para 101, UNCITRAL Guide.
[114] See: Para 101, UNCITRAL Guide.

unsecured creditors of the group member in liquidation, particularly".[115] Generally, issuing contribution orders is up to the discretion of the bankruptcy court on the basis of justice and equity.[116] Moreover, such an order is not passed at the cost of solvency of the related entity, that is to say, the order is issued only after the legitimate claims of the creditors of the solvent entity are satisfied.[117] Thus, in issuing a contribution order, the court is required to balance the legitimate interests of two sets of creditors, viz, those of the solvent and the insolvent group companies.[118]

The WG notes that the contribution orders are granted in other jurisdictions in the following circumstances:

- New Zealand

Under the Companies Act, 1993 of New Zealand, the court is statutorily empowered to issue contribution orders on just and equitable grounds, wherein the court may order that "*a company that is, or has been, related to the company in liquidation must pay to the liquidator the whole or part of any or all of the claims made in the liquidation*".[119] The court may also "*make such other order or give such directions to facilitate giving effect*" to the contribution order.[120] While issuing such an order, the court should consider "*(a) the extent to which the related company took part in the management of the company in liquidation: (b) the conduct of the related company towards the creditors of the company in liquidation: (c) the extent to which the circumstances that gave rise to the liquidation of the company are attributable to the actions of the related company: (d) such other matters as the court thinks fit*."[121] However, the mere fact that the creditors of the insolvent company relied on the fact that such solvent company was related to it, would not be a ground for issuing a contribution order.[122] While the power to issue contribution orders is wide, the courts are not permitted to issue such an order at the cost of solvency of the related entity, that is to say, such order can be issued only after the legitimate claims of the creditors of such entity are satisfied.[123] Thus, in issuing a contribution order, the court has to balance the '*equities of two sets of creditors*'.[124]

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[115] Para 103, UNCITRAL Guide.
[116] See: Section 272, Companies Act, 1993 (New Zealand); Section 140, Companies Act, 1990 (Ireland)
[117] See: *Lewis v Poultry Processors* (1988) 4 NZCLC 64,508; *Re Liardet Holdings Ltd* (1983) BCR 604.
[118] See: John H Farrar, *Piercing The Corporate Veil in Favour of Creditors and Pooling of Groups – A Comparative Study*, (2013) 25(2) Bond Law Review 31 available at <http://classic.austlii.edu.au/au/journals/BondLawRw/2013/12.pdf>. See also: Para 103, UNCITRAL Guide.
[119] Section 271(1)(a), Companies Act, 1993 (New Zealand).
[120] Section 271(2), Companies Act, 1993 (New Zealand).
[121] Section 272(1), Companies Act, 1993 (New Zealand).
[122] Companies Act, 1993 (New Zealand), Section 272.
[123] *Lewis v Poultry Processors* (1988) 4 NZCLC 64,508; *Re Liardet Holdings Ltd* (1983) BCR 604.
[124] John H Farrar, *Piercing The Corporate Veil in Favour of Creditors And Pooling Of Groups – A Comparative Study*, (2013) Bond Law Review 25.2; See: UNCITRAL Insolvency Guide, Part 3, Para 103.

- <u>Ireland</u>

Under the Companies Act, 1990 of Ireland, the court "*if it is satisfied that it is just and equitable to do so, may order that any company that is or has been related to the company being wound up shall pay to the liquidator of that company an amount equivalent to the whole or part of all or any of the debts provable in that winding up*"[125] In issuing such an order, the court should consider *"(a) the extent to which the related company took part in the management of the company being wound up; (b) the conduct of the related company towards the creditors of the company being wound up; (c) the effect which such order would be likely to have on the creditors of the related company concerned*."[126] Further, no such order can be granted unless the court is satisfied that the circumstances leading to the winding up of the company are attributable to the related party. [127] The court is also not permitted to issue such order merely on the ground that such company is related to the company being wound up or that the creditors of the company being wound up relied on the same.[128]

The WG also notes that while the UNCITRAL Guide does not make any specific recommendation on whether insolvency law should provide for contribution orders, it suggests that contribution order must balance the interests of shareholders and unsecured creditors of a solvent group member, especially in those cases where it might affect the solvency of the solvent group members.[129] Further, the UNCITRAL Guide suggests that the following factors may be considered by a court prior to issuing a contribution order: "*the extent to which the solvent group member took part in the management of the insolvent group member; the conduct of the solvent group member towards the creditors of the insolvent member, although creditor reliance on the existence of a relationship between the group members is not sufficient grounds for making an order; the extent to which the circumstances giving rise to the insolvency proceedings are attributable to the actions of the solvent group member; the conduct of a solvent group member after commencement of insolvency proceedings with respect to the insolvent group member, particularly if that conduct indirectly or directly affects the creditors of that group member, such as through failure to perform a contract involving the insolvent group member; and such other matters as the court thinks fit*."[130]

2.1.4. *Avoidance of certain transactions*

Certain kinds of transactions taking place within the group in the pre-distress period are declared null and void. These kinds of transactions can be broadly categorized as : i) transactions intended to defeat, delay or hinder the interests of the creditor ii) transactions with inadequate or nominal consideration , iii) transactions where certain creditor(s) were treated

[125] Section 140(1), Companies Act, 1990 (Ireland).
[126] Section 140(2), Companies Act, 1990 (Ireland).
[127] Section 140(3), Companies Act, 1990 (Ireland).
[128] Section 140(4), Companies Act, 1990 (Ireland).
[129] Para 103, UNCITRAL Guide.
[130] Para 104, UNCITRAL Guide.

more beneficially than their respective *pro rata* share in the debtor's assets.[131] This remedy is necessary to, inter alia, "*provide certainty for third parties*", "*equitable treatment of creditors*", and to facilitate "*the recovery of money or assets from persons involved in transactions that have been avoided*".[132] However, the circumstances under which the transaction took place should be considered by the Adjudicatory Authority, especially, the relationship between the two related entities, the degree of group integration, and the commercial rationale of the transaction in the context of the operations of the entire group.[133] In various jurisdictions, such as USA and UK, the look-back periods are relatively longer if they involve related parties of the debtor.[134]

The WG notes that avoidance rules are provided for in other jurisdictions in the following manner:

- United Kingdom

Under the Insolvency Act, 1986, "*a company gives a preference to a person if— (a) that person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities, and (b) the company does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done*".[135] For a preferential transaction to be avoided, the company should have been influenced to give such preference with the intent to put the other party in a better position during its liquidation.[136] Further, where the preference is provided to a connected person, the company is presumed to be so influenced, unless the contrary is proved.[137]

Further, "*a company enters into a transaction with a person at an undervalue if— (a)the company makes a gift to that person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration, or (b)the company enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company*." The court would not make an order to avoid an undervalued transaction if the company entered into the transaction in good faith and for the purpose of carrying on its business and if there were reasonable grounds to believe that the transaction would be beneficial to the company.[138]

[131] Recommendation 87, UNCITRAL Guide.
[132] 'Purpose of Legislative Provisions for Recommendations 87-99', UNCITRAL Guide.
[133] Recommendation 217, UNCITRAL Guide.
[134] See: Section 240(1)(a), Insolvency Act, 1986; Section 547(4), 11 U.S. Code.
[135] Section 239(4), Insolvency Act, 1986.
[136] Section 239(5), Insolvency Act, 1986.
[137] Section 239(6), Insolvency Act, 1986.
[138] Section 238(5), Insolvency Act, 1986.

Importantly, for transactions entered with connected persons, the look-back period for avoiding them is two years while for any other transaction, it is six months. [139]

- United States of America

Under the US Bankruptcy Code, a preferential transaction is defined as a "*transfer of an interest of the debtor in property—*
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made— (A) on or within 90 days before the date of the filing of the petition; or (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if— (A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title."[140]

However, a preferential transaction would not be set aside if it was intended to be and substantially a "*contemporaneous exchange for new value given to the debtor*".[141] Further, it would not be set aside to the extent it was made towards payment of a debt in the ordinary course of business or financial affairs and according to the ordinary business terms.[142] Further, preferential transactions may not be avoided if it "*creates a security interest in property acquired by the debtor— (A) to the extent such security interest secures new value that was— (i) given at or after the signing of a security agreement that contains a description of such property as collateral; (ii) given by or on behalf of the secured party under such agreement; (iii) given to enable the debtor to acquire such property; and (iv) in fact used by the debtor to acquire such property; and (B) that is perfected on or before 30 days after the debtor receives possession of such property*."[143] The look-back period for preferential transactions is 90 days from the commencement of insolvency proceedings. However, if the transaction involves an insider, the look-back period is extended to 2 years.[144]

Further, a transaction would constitute as fraudulent if it was made with the intent to hinder, delay or defraud a creditor, or if the company received less than equivalent value in the transaction and *"(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation; (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; (III) intended to*

[139] Section 240, Insolvency Act, 1986.
[140] Section 547(b), US Bankruptcy Code.
[141] Section 547(c)(1), US Bankruptcy Code.
[142] Section 547(c)(2), US Bankruptcy Code.
[143] Section 547 (c) (3), US Bankruptcy Code.
[144] Section 547(b)(4), US Bankruptcy Code.

incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business."[145] However, charitable donations to qualified religious or charitable entities would not be considered as a fraudulent transaction under this definition. The look-back period for fraudulent transactions is two years from the commencement of insolvency proceedings.

Further, the WG notes that the UNCITRAL Guide recommends that in order to determine whether certain transactions between group members should be avoided, the following factors should be considered: "*the relationship between the parties to the transaction; the degree of integration between enterprise group members that are parties to the transaction; the purpose of the transaction; whether the transaction contributed to the operations of the group as a whole; and whether the transaction granted advantages to enterprise group members or other related persons that would not normally be granted between unrelated parties.*"[146] Further, the UNCITRAL Guide recommends that the insolvency law should specify the elements to be proved, in the context of group insolvency proceedings, in order to avoid any transaction.[147]

Further, the WG notes that the WB Principles recommend that the court empowered to determine whether a particular intra-group transaction should be set aside, should be authorised to "*take into account the specific circumstances of the transaction.*"[148]

2.2. Recommendations

2.2.1. *Subordination of Claims to be permitted in limited cases of fraud, etc.*

With regard to subordination of claims, stakeholders consulted by WG suggested that ordinarily the claims of other group members should not be subordinated and that only in exceptional circumstances when the Adjudicating Authority finds an intention to defraud the creditors of the debtor or to divert the funds of the debtor, should the claims of the group member be subordinated.

The WG also notes that Adjudicating Authorities have passed orders subordinating debts in certain cases. In *J.R. Agro Industries P. Ltd v. Swadisht Oils P. Ltd,*[149] the Adjudicating Authority ordered the subordination of the claims of a related party to the claims of unsecured operational creditors of the corporate debtor. In this case, the resolution plan provided for

[145] Section 548(a)(B), US Bankruptcy Code.
[146] Recommendation 217, UNCITRAL Guide.
[147] Recommendation 218, UNCITRAL Guide.
[148] World Bank, *The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes*, 2016, Principle C 16.4.
[149] Company Application No. 59 of 2018 in Company Petition No. (IB)13/ALD/2017- decision dated 24.07.2018.

payment of "negligible amounts" to the unsecured operational creditors while the related party, being an unsecured financial creditor, was allowed 62% of its total claims. To provide justice to the operational creditors, the NCLT ordered that the claims of the related party be treated at par with 'equity shareholders or partners' under the waterfall mechanism of Section 53 of the Code.[150]

However, the WG is of the view that subordination of intra-group debts without evidence of wrongdoing is likely to have an adverse effect on the ability of individual group members to arrange for adequate finance, especially during a period of financial distress when external creditors may not be willing to provide additional finance to it. The threat of subordination of claims may also deter the parent company from undertaking measures to rescue its subsidiaries by providing additional finance. However, the WG also notes that it may be fit to statutorily empower the Adjudicating Authority to subordinate the claims of other companies in a group in exceptional circumstances such as fraud, diversion of funds, etc. **Given this, the WG recommends that the Adjudicating Authority be empowered to subordinate the claims of other companies in a group in exceptional situations of fraud, diversion of funds, etc.**

2.2.2. *Provisions on avoidance of certain transactions may be sufficient*

As discussed in Para 2.2 of Part II previously, the Code already allows for certain transactions to be avoided in insolvency proceedings, and provides for longer look back periods when such transactions are conducted within group companies. Based on an analysis of international practice, it appears that the existing provisions of the Code, which provide for an extended look-back period for related parties, are adequate to set aside fraudulent, preferential and undervalued transactions involving group members of the corporate debtor, as they would fall within the definition of a 'related party'. **Consequently, the WG recommends that no further provision is required to be made to set aside transactions between companies that are part of the same corporate group.**

2.2.3. *Extension of Liability or contribution orders need not be provided for*

The stakeholders consulted by the WG suggested that there may be a need to hold the parent company and its personnel liable if they are found guilty of improper conduct towards the debtor or its creditors, such as commission of fraud, diversion of funds, wrongful trading and mismanagement of the debtor. Apart from impropriety, it was suggested that the parent company and its directors may be held liable if they are found to be shadow or *de facto* directors of the debtor. While some stakeholders consulted by the WG were of the view that such liability may be extended through the use of contribution orders, others were of the view that this be extended in the manner provided for in Australia.

[150] *J.R. Agro Industries P. Ltd v Swadisht Oils P. Ltd*, Company Application No. 59 of 2018 in Company Petition No. (IB)13/ALD/2017.- decision dated 24.07.2018, Para 100-101.

The WG notes that a key purpose of extending liability on parent companies or its personnel is to deter perverse behavior of such companies *ex ante*.[151] The WG notes that Chapter VII of Part II of the Code has extensive provisions to hold an officer of a company liable for activities specified therein. An "officer" of a company is defined as an "*officer who is in default as defined in clause (60) of section 2 of the Companies Act, 2013*".[152] The expression "officer in default" is defined to include "*any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity*,"[153] which may include *de facto* or shadow directors of the debtor. Further, if specific transactions are preferential, undervalued etc., an application may be made to the Adjudicating Authority for avoidance of such transactions as discussed above. Given this, the WG believes that there are adequate provisions in the Code to deter perverse behaviour. **Therefore, the WG recommends that no provision may be made to extend liability to parent companies or issue contribution orders.**

2.3. Amendments that may be required

To implement the recommendations of the WG, the Code may need be amended to provide for the subordination of claims of other companies in a group and the circumstances in which the claims may be subordinated in favour of external creditors.

3. Framework For Substantive Consolidation

Substantive consolidation mechanisms are targeted at consolidating the assets and liabilities of different group companies so that they are treated as part of a single insolvency estate for the purpose of reorganization or distribution in liquidation. Such consolidation disregards asset partitioning to a partial or full extent.

The WG also notes that substantive consolidation has been allowed already by the Adjudicating Authority in *State Bank of India & Anr. v. Videocon Industries Ltd. & Ors.*,[154] In its decision dated 8th August 2019, the Adjudicating Authority ordered that 13 out of 15 companies of the Videocon group be consolidated. The Adjudicating Authority held that substantive consolidation may be ordered in those cases in which "*business operations are so dove-tailed that their management, deployment of staff, production of goods, distribution system, arrangement of funds, loan facilities etc. are so intricately interlinked that segregation may result in an unviable solution. Over and above, most important is that if segregated, the possibility of restructuring or the option of maximisation of value of assets become so bleak which shall overweigh the consolidation.*"[155]

[151] See: *Cork Report: Report of the Review Committee on Insolvency Law and Practice* (Cmnd 8558, 1982), Para 1785 in context of the imposition of liability for wrongful trading on directors.
[152] Section 5(19), Code.
[153] Section 2(60), Companies Act, 2013 r/w section 3(37), Code.
[154] M.A 1306/ 2018 & Ors. in CP No. 02/2018 & Ors- decision dated 08.08.2019.
[155] M.A 1306/ 2018 & Ors. in CP No. 02/2018 & Ors.- decision dated 08.08.2019, Para 82.

However, as discussed in Para 2 of Part III, the WG recommends that a legislative framework on substantive consolidation need not be introduced in the first phase of implementing a framework dealing with the insolvency of group companies. Based on the feedback received on the implementation of the other elements of the Framework and the felt need to provide for substantive consolidation mechanisms legislatively, the IBBI and the Government could consider the need for substantive consolidation mechanisms in India and devise the necessary framework for the same at a later date. However, the WG carried out extensive consultations on the suitability of a substantive consolidation framework, and the learnings of the WG may be helpful as a starting point to understand how substantive consolidation mechanisms may operate.

3.1. RATIONALE

The WG notes that since substantive consolidation eliminates the benefit of asset partitioning, it has the potential to "*result in unfair treatment of certain creditor constituencies*"[156] who would have contracted keeping in mind that the law typically presumes that creditors and other stakeholders rely on the separate legal personality of companies. This may unsettle the expectations of creditors and lead to litigation in each case where substantive consolidation becomes applicable. Further, if substantive consolidation is used in reorganization, it may undermine the licensing, tax and other regulatory reasons due to which the companies are organized as separate group companies.[157]

However, where applied in fit cases, the WG notes that substantive consolidation may serve three purposes. *First*, it may lower costs of insolvency processes in the interests of all stakeholders, when applied to those cases where the assets of different companies are intermingled such that they cannot be separated without disproportionate expense or delay to all creditors. Further, as a result of consolidation "*the following are eliminated: intercompany claims, subsidiary equity ownership interests, multiple and duplicative creditor claims, joint and several liability claims, and guarantees.*"[158] This may also lower the costs of the insolvency processes. *Second*, it may help fulfill expectations of creditors and other stakeholders of the companies who would have dealt with the companies as single economic entities and expect a consolidation to maximize the value of these estates collectively. *Finally*, it may help avoid the abuse of limited liability where the consolidation can rectify fraudulent schemes or activities, including the use of sham entities. Accordingly, there is a case to enable substantive

[156] American Bankruptcy Institute, *Practical Business Guidelines for Dealing with Substantive Consolidation*, available at <https://www.abi.org/abi-journal/practical-business-guidelines-for-dealing-with-substantive-consolidation>.
[157] *In re Genesis Health Ventures, Inc.*, 402 F.3d 416 (3d Cir. 2005) (United States).
[158] American Bankruptcy Institute, *Practical Business Guidelines for Dealing with Substantive Consolidation*, available at <https://www.abi.org/abi-journal/practical-business-guidelines-for-dealing-with-substantive-consolidation>.

consolidation, with the appropriate design. In fact, in the United States, research indicates that more than 50% of large public bankruptcies involve some form of substantive consolidation.[159]

3.2. SUBSTANTIVE CONSOLIDATION MECHANISMS

The WG notes that substantive consolidation mechanisms may result in different forms of consolidation of assets and liabilities. In some cases, all the assets and liabilities may be consolidated. *"The assets are thus treated as if they were part of a single estate for the general benefit of all creditors of the consolidated group members."* [160] However, where the consolidation prejudices the interests of some creditors, they may be excluded from the scope of consolidation. This is known as partial consolidation.[161] In some other cases, there is consolidation of all claims for the purposes of voting, distribution, etc., but the final entities emerging post the plan are still organized as different entities for the purpose of post-petition funding, etc. This is known as deemed consolidation and is typically utilized in cases where entity separation has value.[162] In other cases, assets of the companies may be pooled in essence for the purposes of post reorganization financing, but the claims of different stakeholders may not be disturbed.[163]

The WG also notes that the decision to consolidate may be taken in different circumstances and by different authorities (courts or creditors) in different jurisdictions:

- <u>United States of America</u>

Development of case law in the United States has empowered courts to treat "*affiliated debtors as a single entity, collapsing the affiliates into one pool of assets, with their respective claims all being paid out of the single pool.*"[164] This consolidation "*ignores the separate existence of each corporate affiliate and cancels all inter-corporate contracts and claims*."[165]

While different tests have been applied by different courts, broadly courts may order substantive consolidation when:

[159] William H. Widen, *Report to the American Bankruptcy Institute: Prevalence of Substantive Consolidation in Large Public Company Bankruptcies From 2000 To 2005*, 16(1) ABI Law Review, available at <http://commission.abi.org/sites/default/files/Law_Review_Substantive_Consolidation.pdf>.
[160] Para 105, UNCITRAL Guide.
[161] Andrew Brasher, *Substantive Consolidation: A Critical Examination*, 2006, Pg 5, available at <http://www.law.harvard.edu/programs/corp_gov/papers/Brudney2006_Brasher.pdf>.
[162] *In re Genesis Health Ventures, Inc*., 402 F.3d 416 (3d Cir. 2005) (United States).
[163] *In Re Babcock & Wilcox Co*, 250 F.3d 955 (5th Cir. 2001) (United States).
[164] Jurisdictions such as New Zealand (s. 271(1)(b), Companies Act, 1992) have statutory provisions enabling substantive consolidation.
[165] Roe & Tung, *Bankruptcy and Corporate Reorganization: Legal and Financial Materials*, Para 810 (4th edn., 2016).

- creditors dealt with the entities as a single economic unit, or

- the affairs of the debtors are so entangled that consolidation would benefit all creditors, or in other words, separating assets would be prohibitive and hurt all creditors. In this regard, the interests of all creditors would have to be balanced and minor injury to one creditor may not be a ground to carry out a separation exercise.[166]

This can be determined by taking into consideration factors such as:

- "*The degree of difficulty in separating subsidiaries' assets and liabilities*
- *The administrative benefits of consolidation*
- *The commingling of assets and business functions*
- *Whether subsidiaries used consolidated financial statements*
- *Intercorporate loan guarantees or other intercorporate financing*
- *Transfer of assets without observing corporate formalities*
- *Unity of ownership between parent and subsidiaries*
- *Common officers and directors*
- *General failure to observe corporate formality*
- *Whether creditors relied on the credit of a particular sub entity or of the whole group*" [167]

In a Chapter 7 case dealing with liquidation, "*multiple asset/liability pools are reduced to a single pool and payments are made pursuant to a claim's priority in that single pool*". In a Chapter 11 case where a reorganisation takes place, "*class voting, classification of claims, and cramdown are all adjudicated on the basis of the combined entity and, when the corporate group emerges from Chapter 11, it does so as a single corporation*".[168] However, consolidation in Chapter 11 may also take place in a manner where "*for the purposes of voting, distribution and/or cramdown, claims are estimated as if the formally distinct entities were consolidated; however, the reorganized corporate group that emerges from bankruptcy is not consolidated and may retain its pre-bankruptcy structure*." [169] This may be known as "deemed consolidation".

In other cases, courts have also applied partial consolidation where "*even if the conditions are right for substantive consolidation, a creditor that can show that it actually and reasonably*

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[166] Roe & Tung, *Bankruptcy and Corporate Reorganization: Legal and Financial Materials,* Paras 811-15 (4th edn., 2016). *See also:* SIPI, *Working Paper on Insolvency of Group Companies: From the Prism of the IBC.*
[167] Andrew Brasher, *Substantive Consolidation: A Critical Examination*, 2006, Pgs 8-10, available at <http://www.law.harvard.edu/programs/corp_gov/papers/Brudney2006_Brasher.pdf.>.
[168] Andrew Brasher, *Substantive Consolidation: A Critical Examination*, 2006, Pg 4, available at <http://www.law.harvard.edu/programs/corp_gov/papers/Brudney2006_Brasher.pdf.>.
[169] Andrew Brasher, *Substantive Consolidation: A Critical Examination*, 2006, Pg 5, available at <http://www.law.harvard.edu/programs/corp_gov/papers/Brudney2006_Brasher.pdf.>.

relied on an entity's separateness from the overall corporate group can have its claims settled solely from the assets of that entity. Thus, upon the distribution of assets in a liquidation or pursuant to a plan, the court sets aside the assets of the subsidiary to which the objecting creditor loaned and satisfies his claims from this pool within a pool. Partial consolidation usually requires the court to estimate what the objecting creditor's recovery would have been had there not been consolidation."[170] Courts however, may also permit joint administration, which is in the nature of procedural coordination of two or more proceedings.[171]

- <u>Australia</u>

Legislation in Australia allows for 'pooling', by virtue of which

"(a) each company in the group is taken to be jointly and severally liable for each debt payable by, and each claim against, each other company in the group; and
(b) each debt payable by a company or companies in the group to any other company or companies in the group is extinguished; and
(c) each claim that a company or companies in the group has against any other company or companies in the group is extinguished."

This pooling may happen in liquidation under sections 571 to 579L of the Corporations Act, 2001. Under these provisions, the liquidator is empowered to make a pooling determination, which must be approved by the unsecured creditors of each company in separate meetings. If the determination is approved by the requisite number of creditors, the pooling determination comes into force. However, a pooling determination may be modified or terminated by a court.[172]

While the legislation does not make provision for pooling outside of liquidation, courts have approved pooling arrangements to be made through deeds of company arrangements, which are to be approved by the creditors' voting. No specific approval of the court is required for this purpose, but the court has the power to set aside a deed if it is *"unfair or contrary to the interests of the creditors or the company as a whole"*.[173] Similarly, pooling arrangements may be made through schemes of arrangement that must be approved by creditors as well.[174]

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[170] Andrew Brasher, *Substantive Consolidation: A Critical Examination*, 2006, Pgs 5-6, available at <http://www.law.harvard.edu/programs/corp_gov/papers/Brudney2006_Brasher.pdf.>. See also: Henry Peter, 'Insolvency in a Group of Companies, Substantive and Procedural Consolidation: when and how?' in *The Challenges of Insolvency Law Reform in thè 21st Century Facilitating Investment and Recovery to Enhance Economic Growth* (Peter *et al,* 2006).
[171] Rule 1015, Federal Rules of Bankruptcy Procedure (United States).
[172] Getting the Deal Through, *Australia- Restructuring and Insolvency* available at <https://gettingthedealthrough.com/jurisdiction/5/australia>.
[173] Section 445D(1)(f), Corporations Act, 2001.
[174] Jason Harris, *Corporate group insolvencies: Charting the past, present and future of "pooling" arrangements* (2007) 15 Insolvency Law Journal 78.

The WG notes that the UNCITRAL Guide recommends that typically the separate legal identity of group companies should be respected, except

"(a) Where the court is satisfied that the assets or liabilities of the enterprise group members are intermingled to such an extent that the ownership of assets and responsibility for liabilities cannot be identified without disproportionate expense or delay; or
(b) Where the court is satisfied that the enterprise group members are engaged in a fraudulent scheme or activity with no legitimate business purpose and that substantive consolidation is essential to rectify that scheme or activity."[175]

The legislation should also permit the court to exclude specified assets and claims in specific circumstances.[176] The rights of security interest holders should be respected in substantive consolidation except under limited circumstances.

The WG also notes that the WB Principles recommend that substantive consolidation should only be provided where it is not possible to separate the assets of different group members or when the group is engaged in a fraudulent scheme with no legitimate business purpose. The court should be able to exclude specific claims and assets from an order of consolidation.[177]

3.3. PRELIMINARY CONSIDERATIONS FOR THE DESIGN OF THE FRAMEWORK

The WG notes that if a framework for substantive consolidation is adopted, the following preliminary features may be considered:

3.3.1. *Applicability*

Consistent with international practice, stakeholders consulted by the WGs suggested that substantive consolidation should be applicable in limited circumstances.

Some stakeholders consulted were of the view that the framework **should be applicable only in those cases where there is evidence of fraud or sham, or it would be just and equitable to order substantive consolidation.** Other stakeholders consulted were of the view that substantive consolidation may be provided for where **there is no real separation between group members, and it would not be economically feasible to separate the assets of different group members.** This may be ascertained using factors such as the profitability of consolidation at a single physical location, the co-mingling of assets and business functions leading to inter-dependency amongst the group companies, the unity of interests and ownership between the various corporate entities, the degree of difficulty in segregating and ascertaining individual assets and liability, the existence of parent and inter-corporate guarantees on loans,

[175] Recommendation 220, UNCITRAL Guide.
[176] Recommendation 221, UNCITRAL Guide.
[177] World Bank, *The World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes*, 2016, Principle C 16.

complex security structures, and the transfer of assets without formal observance of corporate formalities.

Given that substantive consolidation disregards the separate legal personality of entities, the WG also considered if it may be relevant to explicitly exclude the application of this framework to certain group companies. Stakeholders consulted were of the view that the framework for substantive consolidation should not be mandated by statute and should either be opted for by the creditors or applied by the NCLTs, as discussed below. Given this, **there may not be a need to explicitly provide for carve outs from the framework. However, stakeholders consulted also suggested that substantive consolidation should not be ordered in those cases where companies are specifically incorporated for 'bankruptcy remoteness'[178] such as SPVs, where the interdependence between group companies is merely financial, group companies have independent sustainability or the estimated costs for consolidation outweigh the incentive to have resolution under the group insolvency regime.**

3.3.2. *Authority determining the need for substantive consolidation*

On an analysis of international practice, the WG notes that substantive consolidation is either opted for by creditors of the relevant companies or is imposed by orders of courts.

Many stakeholders consulted by the WG were of the opinion that substantive consolidation could be ordered by courts on the basis of the factors suggested in Para 3.2 of this Part. However, in those cases where creditors opt for substantive consolidation, stakeholders suggested that the CoCs of all the companies proposed to be consolidated should vote in favour of such consolidation. This decision of the CoCs should be approved by the Adjudicating Authority.

3.3.3. *Types of substantive consolidation*

On analysis of international practice, the WG notes that different forms of substantive consolidation may be opted for or ordered, such as full, partial, deemed, etc., as suggested in Part IV, Para 3.2 at different stages of the processes under the Code. **The stakeholders consulted were of the view that all types of substantive consolidation may be opted for or ordered by courts. In addition, they were of the view that substantive consolidation may be allowed both in CIRP and liquidation to enable the maximization of value of the assets of the debtors.**

3.4. AMENDMENTS THAT MAY BE REQUIRED

If an explicit legislative framework is prepared for substantive consolidation, depending on the mechanisms of substantive consolidation that may be chosen, amendments may be required to:

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[178] See: Roe & Tung, *Bankruptcy and Corporate Reorganization: Legal and Financial Materials,* Pg 212 (4th edn., 2016).

- <u>The Insolvency and Bankruptcy Code, 2016</u>

The WG notes that if court-mandated substantive consolidation is envisaged, the Code may need to be amended to guide the discretion of courts to enable substantive consolidation in some cases, and to provide a framework for the administration of such consolidation. This may require introduction of new sections and amendments to provisions dealing with the jurisdiction and powers of the NCLTs, appointment of insolvency professionals, constitution of the CoCs, etc. If consensual consolidation is envisaged, new sections may need to be inserted to create mechanisms for consolidation based on the consent of the creditors within the Code. Alternatively, existing mechanisms such as schemes of arrangement may be relied on, but guidance notes may be prepared to encourage the use of such mechanisms.

- <u>Rules and Regulations under the Code</u>

Rules may need to be framed to guide an application to court for substantive consolidation. Further chapters may need to be inserted into the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 and the IBBI (Liquidation Process) Regulations, 2016 to provide the manner in which the processes would be carried out if there were substantive consolidation. If a consolidation based on creditor consent is envisaged, there may be a need to amend the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 and the IBBI (Liquidation Process) Regulations, 2016 to provide a framework within which the creditors may determine the need for consolidation and request for the same.

- <u>Associated legislation</u>

Given that substantial changes to the structures of groups may occur due to substantive consolidation, associated legislation may need to be closely examined. For instance, changes may be required to subordinate legislation issued by the Securities and Exchange Board of India (SEBI) regarding takeovers, listing, etc. Amendments may also be required to tax laws to provide for the tax consequences of such consolidations

ANNEXURE I

Insolvency and Bankruptcy Board of India
7th Floor, Mayur Bhawan, Connaught Place, New Delhi-110001

File No: IBBI/CIRP/GI/2018-19/001 17th January, 2019

Office Order

Subject: Constitution of Working Group on Group Insolvency

The Insolvency and Bankruptcy Board of India hereby constitutes a 'Working Group on Group Insolvency' as under:

Sl. No.	Name	Position and Organisation	Position in the Working Group
1	Mr. U. K. Sinha	Former Chairman, Securities and Exchange Board of India	Chairperson
2	Ms. Anshula Kant	Managing Director, State Bank of India	Member
3	Mr. Shardul Shroff	Executive Chairman, Shardul Amarchand Mangaldas & Co. Advocate and Solicitors	Member
4	Dr. Shubhashis Gangopadhyay	Founder and Research Director, India Development Foundation	Member
5	Mr. Siby Antony	Chairman, Edelweiss Asset Reconstruction Company Limited	Member
6	Mr. Koushik Chatterjee	Executive Director and Chief Financial Officer, Tata Steel Limited	Member
7	Mr. Sumit Binani	Insolvency Professional	Member
8	Mr. Sumant Batra	President, Society of Insolvency Practitioners of India	Invitee
9	Dr. S. K. Gupta	CEO, Insolvency Professional Agency of the Institute of Cost Accountants of India	Invitee
10	Ms. Alka Kapoor	CEO, ICSI Institute of Insolvency Professionals	Invitee
11	Mr. Sunil Pant	CEO, Indian Institute of Insolvency Professionals of ICAI	Invitee

2. The Working Group shall submit a report recommending a complete regulatory framework to facilitate insolvency resolution and liquidation of corporate debtors in a Group, within two months from the date.

3. The IBBI shall provide secretarial and logistics support to the Working Group.

4. This issues with the approval of competent authority.

Mamta Suri

(Dr. Mamta Suri)
Executive Director

To
Chairperson, Members and Invitees of the Working Group
CC: PS to Chairperson / WTMs, IBBI and EDs, IBBI.

ANNEXURE II
LIST OF STAKEHOLDERS CONSULTED BY THE WG

Government
- Mr. Ravinder, Joint Secretary, DPIIT, Ministry of Commerce and Industry

Economist
- Mr. Ajit Ranade, President and Chief Economist, Aditya Birla Group

Insolvency Professionals
- Mr. Vijay Kumar Iyer, Insolvency Professional
- Mr. Dinkar T Venkatasubramanian, Insolvency Professional
- Mr. Anuj Jain, Insolvency Professional
- Mr. Vinod Kumar Kothari, Insolvency Professional

Bankers
- Sh. Sunil Mehta, MD & CEO, Punjab National Bank, and Chairman, IBA
- Mr. T. Veerabhadra Reddy, DGM, Canara Bank
- Mr. Nilanjan Sinha, Head, Legal, ICICI Bank
- Mr. Sanjeev Pandey, DGM, State Bank of India
- Ms. Romi Chakravorty, DGM, IDBI Bank

Resolution Applicants/Investors
- Mr. Sunil Subramanian, Director, JM Financial Asset Reconstruction Company Ltd.
- Mr. Ravi Kumar Sabharwal, Vice President - Legal, JSW Steel Limited
- Mr. Mrinal Chandran, General Counsel, India Resurgence Fund
- Mr. Harish Chander, Executive Vice President, Edelweiss Asset Reconstruction Company Limited

Industry bodies
- Mr. Sanjeev Ahuja, Co-Chairman, Insolvency & Bankruptcy Committee, representing PHDCCI
- Mr. Rajbeer S. Sachdeva, President, Group Legal, JK Group, representing FICCI
- Mr. Gautam Saha, AZB & Partners, representing CII
- Ms. Pragya Sood, AZB & Partners, representing CII
- Mr. Ajay Sharma, Assistant Secretary General, representing ASSOCHAM
- Mr. V. G. Kannan, Chief Executive, Indian Banks' Association

Research Institution
- Ms. Anjali Sharma, Research Consultant, Indira Gandhi Institute of Development Research

Information Utility
- Mr. S. Ramann, MD & CEO, National E-Governance Services Limited

Lawyers
- Mr. Dhananjay Kumar, Partner, Cyril Amarchand Mangaldas
- Mr. Piyush Mishra, Partner, AZB & Partners
- Mr. Ashwin Bishnoi, Partner, Khaitan & Co
- Mr. Vaijayant Paliwal, Senior Associate, Shardul Amarchand Mangaldas & Co

- Ms. Swarupama Chaturvedi, Advocate on Record, Supreme Court
- Mr. Anoop Rawat, Partner, Shardul Amarchand Mangaldas & Co.

Advisory Firms

- Mr. Aviral Jain, Co-Head and Managing Director, Global Restructuring Advisory, Duff & Phelps, LLC

ANNEXURE III
STAKEHOLDER COMMENTS CONSIDERED BY THE WG [179]

1. **Is it necessary to provide an explicit framework for insolvency of group companies? Or should it evolve through jurisprudence and practice? Or a mixture of both, basic framework in statute while details emerge with practice.**

Necessary - Among the stakeholders who submitted written submissions to the Working Group, majority favored an explicit framework under the statute. These include banks like PNB, Investors like EW, representative bodies like CII, IBA, IIIPI, IPA-ICAI, Information Utility like NeSL and practitioners like CAM, AZB and VK.[180]

It was stated that such a framework would serve value maximization besides other benefits like operational efficiency & cost saving. The group entities having interlinkages, operational or financial, are expected to have comparatively high enterprise value as compared to single entity wise value. [PNB]. A combined resolution plan for debts for the group could result in maximization of value for lenders [CII].

The stakeholders suggested that basic framework containing broad principles should be laid down in the principal legislation. Procedural details could be laid down by subordinate legislation [VK & IPA-ICAI], and the rest to emerge with judicial precedence and practice [IIIPI, EW, IPA-ICAI & NeSL].

It was suggested that the legislative framework should be enabling rather than prescriptive, as it would be an exception to the principle of independent corporate personality and limited liability [CII & AZB].

There was also a view that there is a need for a comprehensive framework, involving both procedural and substantive consolidation of process. While procedural co-ordination could be made mandatory, substantive consolidation be left to the discretion of the courts [CAM].

Not necessary- One of the stakeholders expressed the view that a group insolvency framework is not necessary as it may violate the limited liability bargain and may create *ex ante* effects like (i) uncertainty for lenders while extending credit, as contractual safeguards may lose relevance in bankruptcy, (ii) incentivize dominant lenders to lower credit and monitoring standards, (iii) disincentivize smaller lenders from lending to business group entities and (iv) choke off lending to business groups or make lending terms unfavorable. It has raised an apprehension that lifting of corporate veil could become more a rule than exception. [IGIDR]. Another view is that there is no urgent or dire need of such special framework, as the need seem to have arisen due to few big cases which are essentially

[179] Comments on 30 questions circulated prior to 3rd meeting of the Working Group.
[180] Expansion of abbreviations provided at the end of this document.

outliers and may not represent the larger picture. Procedural consolidation, where felt necessary, could be agreed to, as done in the case of Videocon [PHDCCI].

2. **What is the economic rationale for providing a framework?**

(i) Value maximization - Maximization of value of assets is one of the important economic rationales for the group insolvency framework [PNB, IBA, VK, AZB, IIIPI & IPA-ICAI].

The value maximization could be in two ways, one - by reducing information asymmetry and cost of administering multiple insolvencies and second - by enabling the resolution of intrinsically linked assets together [PNB]. Further, it may maximize value, as resolution applicants may prefer to take over the entire group for operational efficiency, retention of employees with minimal costs, etc. [CAM].

(ii) *Resolution* – The framework would enable better assessment of viability and increase the chances of timely resolution [PNB]. It may provide comprehensive solution for current and imminent insolvent companies [IIIPI] and a holistic approach to reorganizing businesses [VK].

(iii) *Procedural efficiency* - The framework will reduce duplication of work and processes, resulting in reduction of time, through single RP, single Committee of Creditors **(**CoC), single AA [PNB]. It will result in minimization of time and effective administration of insolvency proceedings [VK, AZB & IPA-ICAI].

(iv) *Cost efficiency* – The framework would bring down the insolvency cost. The costs incurred for the initiation of CIRP, as well as the costs incurred during CIRP (especially in respect of administration) would be reduced, as the processes, court applications, hearings etc. would be mostly common [PNB, CAM, EW & IIIPI].

(v) *Avoid intra group battles* - The framework could help in avoidance of intra group battles and ensure that a group that acted as a whole, continue to act as one during insolvency so that claims against promoters, insiders and third parties are pursued more effectively. The level of interdependence or co-mingling of liabilities and assets may be such that insolvency of a company may often lead to insolvency of another in the Group [AZB].

(vi) *Dissuade diversion of funds* - Where creditors suspect diversion of funds to other group companies, the framework can have reach over the assets of Group Companies [NeSL & IPA-ICAI].

One of the stakeholders was of the view that a generalized articulation of economic rationale is not easy. While procedural co-ordination may be desirable from the perspective of convenience and cost containment, substantive consolidation of group may be beneficial for creditors and some stakeholders. Therefore, a case specific approach may be better from the economic perspective. Mostly, the economic reasons behind the groups make it imperative for the group to enter insolvencies for all the companies of the group. [EW].

3. **Is there a model framework?**

The following sources have been referred to as the model framework available for reference:

(i) *Germany* - The domestic law for facilitation and management of insolvencies of groups of companies dealing with 'procedural' consolidation {*Gesetzzur Erleichterung der Bewältigung von Konzerninsolvenzen}*.

(ii) *EU* – The EU Regulations providing for a framework for insolvency proceedings for members of a group of companies in a cross-border scenario which came into force in 2017 {*Regulation (EU) 2015/848 of the European Parliament and of the Council*}

(iii) *UNCITRAL* - The model framework of UNCITRAL Legislative Guide, 2012 {Part Three: Treatment of Enterprise Groups in Insolvency}

(iv) *World Bank* - The World Bank Principles for effective Insolvency & Creditors /Debtor regimes, 2016 [PNB, VK, CAM & AZB]

There are provisions in domestic laws of jurisdictions like Mexico and New Zealand dealing with group insolvency. In USA, the group insolvency framework is more case law based rather than legislative [AZB].

While there are laws of other jurisdictions for reference, India needs to have tailor-made provisions suitable for its business environment [VK]. Further, globally, procedural consolidation seems to be accepted as a norm and it can be immediately adopted and followed. However, substantive consolidation may require more debate [NeSL].

4. How should 'Group' be defined for the purposes of applying the framework?

- **Single economic entity**
- **Extent of 'control': Positive and Negative**
- **Test of operational and financial dependency**
- **Common Brand/co-owning of IPR**
- **Parent-subsidiary**
- **Joint venture**
- **Associate companies**
- **Imminence of insolvency based on inter-dependence**
- **Principle based Vs. Prescriptive for determination of group**
- **Any other**

The views of stakeholders are broadly as under:

(a) *Ownership & Control* – The Group can be defined by reference to control or ownership, and not otherwise [AZB & IPA-ICAI]. The contours of control and ownership is debatable. It is advisable to keep group threshold at ownership/voting rights above 50% and positive control along the lines of the Companies Act, 2013. Hence, only parent-subsidiary relationship will qualify for a group determination rather than joint venture or associate companies which can be part of a separate group. An expanded definition of Group beyond this is likely to give rise to complications/ legal challenges [AZB]. In companies where positive control is substantial in nature and generally leads to holding – subsidiary status, may be considered as part of the group [PNB].

(b) *Consolidation of financial statements* – The Group should be defined based on same principles as are followed in the accounting standards. IFRS - 10 and Indian equivalent Ind-AS - 110 provide for consolidation of financial statements when an entity controls one or more entities. These can be used to define the term 'Group' [VK, NeSL & IPA-ICAI].

(c) *UNCITRAL* - The definition from UNCITRAL guide may be adopted, as it takes care of majority factors [CAM].

(d) *Combination* – The suggestions from some of the stakeholders indicated an approach where combination of factors could determine 'Group' and/or may require a case to case basis determination.

These factors include -

(i) operational and financial dependency, sharing of name/brand-mark, directors, employees or existence of large number of common lenders/creditors etc. [PNB].

(ii) 100% operational and financial dependency and positive control. Ideally, a case to case approach regarding the interconnectedness and control may have to be applied [EW].

(iii) Both a prescriptive standard [to be laid down through definition of 'group'] and a subjective test [to be applied by the courts/ tribunals based on certain parameters] should determine group [ICICI].

(iv) Imminence of insolvency based on inter-dependence could be a test. Further, NCLT may also determine 'group' on a case to case basis using a Principle based vs. Prescriptive approach [IIIPI].

(v) Control; operational dependency (not mere financial dependency); and imminence of insolvency based on inter-dependency to determine Group. It may include all entities regardless of constitution, listing, location (onshore/ offshore), business line etc., without going into further granularity, however avoiding the lifting of corporate veil [IBA].

(vi) Ownership of shares, "intra-group" dependencies etc. should determine Group. Such determination should be undertaken on a case to case basis [CII].

5. What should be the scope of group insolvency framework?

- **All companies in the Group**
- **Onshore / Offshore companies**
- **Solvent / Insolvent companies**
- **Listed / Unlisted companies**
- **Financial / non-financial companies**
- **Companies /Trusts / Societies / Partnerships in the Group**
- **All entities / Persons by lifting corporate veil**
- **Carve outs from a group insolvency framework**

There have been mixed reactions from the stakeholders on the scope of the framework. Their views are broadly as under:

All group companies - The framework should not apply to all companies in a group [EW]. It should apply based on criteria like those representing single economic entity, operationally and financially dependent entities, etc. [PNB].

However, some stakeholders have stated that (i) all group companies which are undergoing CIRP, LLPs and individuals who are part of promoter group should be covered within the framework. [CAM & IPA-ICAI]; (ii) only those trusts which have been set up for business purposes need to be brought within the scope of the framework [CAM]; and (iii) NCLT may permit carve outs among group companies on a case to case basis [IIIPI].

Solvent / Insolvent – Only insolvent companies in the Group should be covered under the framework. Extending it to solvent companies will make it broader than IBC framework itself, apart from opening constitutional challenges [AZB & IPA-ICAI]. To pull solvent companies which have no dependence or synergy with the insolvent unit may be a complex issue, unless liability through corporate guarantee can be established [EW].

However, a few have suggested inclusion of solvent companies. It is stated that solvent companies in a group could be included for group insolvency where such inclusion enhances the value of the group by an amount higher than the enterprise value of the solvent company in isolation [PNB]. Another view is that the framework should be an enabling one and the creditors should have the option to apply for initiation and coordination of proceedings in respect of all or any of the insolvent companies in the group and seek inclusion of any or all the solvent companies [VK].

Domestic/Cross-Border - There is a need to distinguish domestic group insolvency framework from cross border insolvency which is the subject matter of separate deliberation [AZB]. Further, inclusion of off-shore entities needs to be backed by effective cross-border insolvency regime [VK & CAM].

Listed/Unlisted - There is no need to distinguish between listed and unlisted insolvent companies, because they are treated alike under IBC [AZB & IPA-ICAI].

6. What should be the extent of group insolvency?

- **Procedural**
- **Substantive**
- **Sequential - Procedural followed by substantive**
- **In Resolution Process**
- **In Liquidation Process**

Procedural/Substantive/Sequential – Many stakeholders have favored procedural coordination. Some have stated that procedural coordination should cover only those companies which are already in CIRP [IGIDR, PHDCCI & IPA-ICAI]. While a few have suggested sequential approach [CAM & IIIPI], some stakeholders have expressed certain reservations on substantive consolidation, namely –

(i) It be made applicable only in extraordinary/rare cases or under restricted circumstances like fraud, common securities or intertwined assets [EW, NeSL & ICICI] or the decision be left to the Courts [EW & ICICI];

(ii) It is a rarity in other parts of the world like UK and USA. For e.g. in USA, after the ruling in Owens Corning, US courts are generally reluctant to order substantive consolidation except in rare cases [VK];

(iii) To be avoided, as there is little international precedence and the system is not matured enough to work in a rewritten asset and liability scenario [AZB];

One of the stakeholders has stated that the selection of mechanism - procedural or substantive - should be based on the type of dependence between the entities. When operations of the two or more entities are connected in a manner that removing any one of them will result in destruction in a process or operational efficiency of any asset, in such cases substantive consolidation is a must [PNB].

Resolution/Liquidation process – The stakeholders have suggested that the framework should be implemented in both processes [PNB, VK & CAM].

7. Should the framework be compulsory, enabling, facilitating or incentivizing?

Most of the stakeholders have stated that the framework should be optional, enabling and facilitating [PNB, IBA, AZB, VK, EW, IIIPI & IPA-ICAI] and it should be with the consent of creditors [PNB, IGIDR & IBA].

One of the stakeholders suggested that the framework should be optional below a threshold of control or value and compulsory above such threshold [NeSL]. Another stated that procedural co-ordination must be made mandatory for all insolvent group companies, while substantive consolidation on consensual basis may be allowed upon application by resolution professionals [CAM].

8. Should the framework be rolled out in a phased manner? If yes, what is the rationale for the same and what should be the manner of phasing?

Many stakeholders expressed the view that the framework needs to be rolled out in one go and not in a phased manner [PNB, IBA, EW, CAM, VK, IIIPI & IPA-ICAI]. Many have stated that it would evolve through practice and jurisprudence over a period of time.

Few stakeholders suggested phasing, as under -

(i) To start with a higher threshold limit/s of value and modify the threshold based on experience [NeSL]
(ii) In the first phase, introduce procedural co-ordination like single court, single RP etc. and in the second phase, common EoI, Resolution Plan etc. and substantive consolidation [AZB].

PROCEDURAL COORDINATION

9. Should procedural coordination be voluntary, directory, or mandatory?

Most of the stakeholders were of the view that procedural coordination should be mandatory [PNB, IBA, NeSL CAM & IIIPI]. It was stated that section 60(2) & 60(3) of the Code already provide for mandatory procedural co-ordination in case of guarantors [CAM & IPA-ICAI].

There were also views to the effect that (i) approval of majority of creditors of each entity should be made mandatory before starting procedural co-ordination [IGIDR]; and (ii) procedural coordination, being a circumstantial process, can be voluntary - where group companies go for self-filing (u/s 10), and enabled - when a creditor/IP applies for the same and the Adjudicating Authority [AA] orders for it [VK].

One of the stakeholders made a distinction between procedural co-ordination and procedural consolidation. It was stated that procedural co-ordination (co-ordination and information sharing between the various RPs and CoCs that are involved with various companies of a group) is desirable and it should be mandatory. However, procedural consolidation (joint application, single court, singe EoI) should be made voluntary since in each case the CoC and AA should establish that the benefits outweigh the costs and disadvantage to creditors [AZB].

10. What types of procedural coordination mechanisms should be specified?

- **Cooperation and communication**
- **Coordination**
  - **Group strategy (i.e. group coordinator)**
  - **Interaction/Information sharing**
- **Joint Processes - application process, EOI, common resolution plan, etc.**
- **Appointments - single IP, single Adjudicating Authority, single CoC**
- **Should there be a provision for choice of court, if the joint COC in a group with specified thresholds decides so?**

All the stakeholders highlighted that co-operation, communication and co-ordination are essential mechanisms for the framework.

Some stakeholders have suggested joint applications [ICICI, VK, PNB, ICICI, VK & AZB], common EoI and resolution plan [NeSL, VK, CAM & CII]. One of the stakeholders has suggested flexibility in the framework for separate or common resolution plan [IGIDR]. Another was of the view that there is no explicit need for common EoI and resolution plan as conglomerate insolvency may not necessarily attract bids for the entire group and it could be left to the market [AZB].

While all stakeholders have suggested common AA, there has been mixed reaction with respect to Insolvency Professional [IP]. Some stakeholders have suggested single IP [PNB, NESL & IGIDR], while others have suggested either single or multiple IPs and a group coordinator in case of multiple IPs [VK, ICICI, CAM & AZB].

Single CoC has been suggested by a few stakeholders when creditors of different companies are same [PNB, NESL], many stakeholders have suggested multiple CoCs with appropriate co-ordination [VK, ICICI, IGIDR, CAM, CII & AZB]. Few have suggested for an overarching CoC for co-ordination [AZB & CII].

11. **At what stages of the insolvency resolution and liquidation processes, should there be procedural coordination?**

The stakeholders are broadly of the view that procedural coordination should be considered at the stage of initiation of CIRP [PNB, AZB, IIIP & IPA-ICAI]. Some of them are of the view that it could be at any subsequent stage of CIRP and liquidation stage [NeSL & IBA]. One of the stakeholders stated that procedural coordination should not be later than a 'cut off' event- say initiation of inviting plans (during resolution) [VK].

12. Who should determine if there is a need for procedural coordination?

- **The person in charge of a particular activity under the normal insolvency process**
- **Designated authority, namely, Committee of Creditors or Adjudicating Authority**

One view is that CoC should identify the need for procedural coordination and it should be followed by an order of the AA [CAM, CII, NeSL, IIIP & IPA-ICAI]. A suggestion was made that consent of more than 75% of the CoC of each insolvent company is required to trigger the framework [CII].

Another view is that at the time of commencement, the creditors may apply for procedural coordination. At a subsequent stage, RP (with requisite approval of CoC), or the Liquidator, as the case may be, may apply to AA for approval of procedural coordination [VK].

There is also a view that the need for procedural coordination should be decided by the person making the reference subject to the satisfaction of AA which will then order consolidation of all pending proceedings for the identified group in one proceeding but only till first CoC. It was also stated that permitting a creditor to make an application with respect to Group members of which it is not a creditor would be inconsistent with commencement standards of insolvency under IBC and Recommendation 14 of UNCITRAL Legislative Guide [AZB].

13. Should the regulatory mechanism provide for opting out when a company in a group does not want group co-ordination?

The stakeholders are in favour of allowing opting out by a company in a group [IBA, IIIPI & PNB] with majority consent of its creditors [IBA] or with high threshold limit for resolution of combined COC [IIIPI]. Some stakeholders have stated that withdrawal should be permitted by the AA [CAM] provided all the CoCs have approved such withdrawal [ICICI].

One of the stakeholders have stated that where a joint application has been filed, a group member not wanting inclusion, should have the right to object. The objection can be placed by shareholders and/or creditors of the group member. If the group members want exclusion at a subsequent stage, the same can be done subject to creditors' approval [VK].

Another view is to give operational flexibility to opt in and opt out based on market responses, to be decided by CoC in its very first meeting [AZB & IPA-ICAI]. Rather than opt out, it is suggested to allow Resolution Applicant [RA] to cherry pick from among the consolidated group companies if they would like to exclude any in their resolution plan [AZB].

14. How should costs of this coordination be rationalized?

A combined process is likely to save not only costs but also efforts and time [PNB & NeSL] and the cost of coordination should be shared by group members equitably on the basis of extent of indebtedness [VK & IPA-ICAI], value of assets of each company [CAM] or resolution amount allocated to each corporate debtor [IIIPI].

The costs of the cooperation, coordination and consolidation vis-à-vis the share of those costs that each group member will bear, should be adequate, proportionate and reasonable. The RPs/IRPs and the group coordinator involved should be able to control those costs from an early stage of the proceedings with the concurrence of respective CoCs [ICICI]. Another view is that being market driven, it should be left to the Group CoC [AZB].

15. Should there be clearly specified exemptions to procedural coordination mechanisms?

Some stakeholders have stated that exceptions to procedural coordination should be spelt out, like absence of interlocking of funds, guarantees etc. [NeSL, IIIPI & CAM]. Others are of the view that there is no requirement for specifying any exemption, if procedural coordination is voluntary [PNB].

SUBSTANTIVE CONSOLIDATION

16. Should a framework dealing with insolvency of group companies prescribe mechanisms for substantive consolidation?

The need for substantive consolidation under certain circumstances have been highlighted by few stakeholders [PNB, NeSL, IIIPI & IPA-ICAI]. For instance, 100% subsidiary company and having no major assets; diversion of fund/assets from insolvent to solvent group company;

complex structures, where it is difficult to segregate assets; group engaged in fraudulent schemes etc. [PNB].

One of the stakeholders has stated that such a remedy may be cautiously granted by AA [ICICI]. Another view is that there is no need for the framework to provide for substantive consolidation, as in any case it is the rarest of rare remedies, which can be ordered by the AA [VK].

There is also a view that it may be an extreme step and therefore, may be considered only after a few years [CII]. It is stated that there do not seem to be any precedents for substantive consolidation except in legal literature and to a limited extent in US and hence, the argument for substantive consolidation in India is weaker still [AZB].

17. What forms of substantive consolidation should be allowed?

- **Full**
- **Partial**
- **Deemed**
- **Pooling of assets but not liabilities**

The mode of substantive consolidation to be followed may be left to the discretion of the AA, to be decided on a case by case basis, with some guiding factors provided for in the statute [CAM & IPA-ICAI].

Few have stated that the framework may prescribe full consolidation [PNB & NeSL], but the CoC may be given liberty to decide for partial consolidation [PNB]. At the same time, there is also a view that if at all substantive consolidation is envisaged, it should be partial e.g. only for unsecured creditors since secured creditors have security or only for assets or liabilities that have a substantial interdependence [AZB]. One of the stakeholders have suggested pooling of assets but not liabilities [IIIPI].

18. At what stage should substantive consolidation be allowed?

- **CIRP**
- **Liquidation**

Substantial consolidation during CIRP stage has been favored by some stakeholders [CAM, AZB & IPA-ICAI]. Few have stated that it could be in liquidation stage as well, if the situation so warrants [PNB, VK, NeSL & IIIPI].

19. Who should decide on substantive consolidation?

- **Adjudicating Authority**
- **Committee of Creditors**

Many stakeholders have expressed the view that it should be decided by the AA, based on the application filed pursuant to the decision of CoC [CAM, AZB, NeSL, IIIPI & IPA-ICAI].

One of the stakeholders has stated that the framework should provide for substantive consolidation - both compulsory and enabling - and the decision should be made by the CoC. In case of compulsory substantive consolidation, the CoC should be given liberty to take negative decision if situation warrants and such decision should be approved by AA. In voluntary substantive consolidation, the framework should be enabling and facilitating with a simplified mechanism with the approval of CoC [PNB].

20. In what circumstances, should substantive consolidation be applicable?

Some of the circumstances where substantive consolidation could be resorted to, as broadly stated by the stakeholders, are as under –

(i) Co-mingling of assets & interdependency [PNB, NeSL, CAM & AZB],
(ii) Fraud is established, unauthorized transfer of funds/assets, preferential and fraudulent transactions between entities etc. [PNB, NeSL, CAM, AZB, IIIPI & IPA-ICAI]
(iii) No real separation between group members, unity of interests and ownership between entities [PNB, NeSL & CAM];
(iv) Consolidated financial statements [CAM];
(v) Parent and inter-corporate guarantees on loans [CAM & IPA-ICAI]
(vi) Profitability of consolidation at a single physical location [CAM]
(vii) Leads to greater return of value for creditors [PNB]

21. Should there be clearly specified exemptions to substantive consolidation?

Many stakeholders have stated that there is no need for specifying exemptions to substantive consolidation [PNB, IIIPI, CAM & VK].

There is also a view that (i) courts should be empowered to exclude assets and claims from consolidation and should have clear guidance in legislation on exercise of powers. The companies, assets and claims that are not part of fraudulent scheme and had a fairly independent existence should not be consolidated [AZB]; (ii) exceptions be spelt out by way of Regulations or Guidelines [NeSL & IPA-ICAI].

RULES AGAINST PERVERSE BEHAVIOR OF COMPANIES

22. Should companies in a group be held liable for each other's debts?

- **Contribution orders**
- **Extension of liability *simpliciter***

If yes, in what circumstances?

The circumstances under which liability of a group company may extend to other's debt, as broadly stated by the stakeholders, are as under –

(i) Fraud, diversion of funds/ assets [PNB, NeSL, CAM, AZB & IPA-ICAI];
(ii) Undue benefit from insolvent companies by solvent companies [PNB & NeSL];

(iii) Exploitation or abuse by one group member (perhaps the parent) because of its control over other member, including operating the other continually at a loss in the interests of the parent [PNB];

(iv) Undervalued, overvalued or preference transaction between group members. [PNB, AZB & IPA-ICAI];

(v) Corporate veil is lifted [AZB] or court directs solvent group member to contribute to cover the debts of other [NeSL];

(vi) Group companies are liable contractually or as per Companies Act [IIIPI].

One of the stakeholders is of the view that these remedies can be well developed through jurisprudence over a period of time [VK].

23. Should there be subordination of debts owed to group companies?

- **Intra group loans and investments**
- **Intra group corporate guarantees**
- **Non terminable leases**

If yes, in what circumstances? Who should determine this?

The stakeholders have suggested subordination of debts owed to group companies, upon an order of the AA [IPA-ICAI], under exceptional circumstances like fraud against external creditors [VK], diversion of funds [IIIPI] and where groups are promoted as subsidiary/holding/associate companies with shared capital / staff / other resources etc. [NeSL].

Other suggestions received in this behalf are:

(i) claims of related parties of the debtor or of the other group entities be treated subordinate to the claims of the unrelated creditors of the debtor [PNB];

(ii) distinction may be drawn between funds provided by a parent entity as a loan and funds provided in the form of long-term capital contributions [PNB];

(iii) avoidance proceedings in the Code to be extended to the perverse transactions undertaken collectively by group companies, or involving group companies [CAM];

(iv) all intra group corporate debts to be made subordinate to the dues to banks [IBA].

One of the stakeholders has stated that subordination of intra group loans both structural and contractual is a standard finance practice and part of financing structure and therefore, may not need a legislative sub-ordination [AZB].

24. Should directors' liability be extended to directors of group companies in the wake of insolvent trading? If yes, in what circumstances?

Extension of liability to directors of group companies has been suggested in cases of wrongful trading, shadow directorship, fraud or mismanagement [PNB, CAM, AZB, IIIPI & IPA-ICAI], breach of duties of care and diligence or abuse of managerial power [PNB] and in case of subsidiary/holding /associate companies [NeSL]. It is stated that the liability should only be on the basis of knowledge and ability to control decisions, and not otherwise [AZB].

One of the stakeholders is of view that directors' liability may generally not be extended to cover all companies in the group [IBA].

25. How should perverse behavior of companies in group structures be addressed?

The following ways have been suggested by stakeholders:

- **(i)** Empowering the AA to issue contributory orders, extending liability and debt subordination [PNB & NeSL].
- **(ii)** Extend avoidance proceedings to various perverse transactions undertaken collectively by group companies or involving group companies [CAM].
- **(iii)** Determination by AA on a case to case basis [CAM, IBA, IIIPI & IPA-ICAI].

Another view is to leave it to market participants rather than specifying under law. Lenders will have to be more vigilant about their rights, have closer look at group structures having significant interdependence and credit decisions and financing structures may address the issue. [AZB].

MISCELLANEOUS

26. Should intra group transactions be allowed during CIRP and under what circumstances?

Intra group transactions during CIRP may be allowed to keep the company in the group as a going concern, subject to CoC approval [PNB, NeSL, VK, CAM, IBA, AZB, IIIPI & IPA-ICAI]. It is suggested that there is arm's length price & genuineness of such transaction or operational dependency to keep the companies as a going concern [PNB].

27. Should insolvent group companies be allowed to extend interim finance to one another? If yes, under what circumstances?

Broadly, it is suggested that group companies may be permitted to extend interim finance to each other in order to keep the CD as going concern subject to CoC approval [PNB, NeSL, VK, CAM, IBA, IIIPI & IPA-ICAI].

While it might be expected of an 'insolvent' group member to extend finance to another insolvent group member, it is possible that a solvent group member may have adequate resources to provide interim finance to the insolvent group member [VK].

One of the stakeholders has expressed the view that such a provision be avoided, as insolvent company is in CIRP as it is unable to meet its own debt obligations and why its creditors should agree for it unless creditor group is identical. It is suggested that this may also require changes to moratorium provision (s. 14 of the Code) [AZB]

28. Should a moratorium under section 14 or the bar against suits and proceedings under section 33(5) be extended to non-insolvent group companies? If yes, in what circumstances?

Some stakeholders are not in favor of such extension to non-insolvent companies [CAM, AZB, IIIPI & IPA-ICAI]. However, few have suggested extension [NeSL & IBA] and few others under limited circumstances - such as fraud/diversion/preference transaction [PNB], intra-group guarantees/collateralization, dependence of the insolvent members' operations on the assets of the solvent member [VK].

29. Should there be different timelines for insolvency proceedings of group companies?

The general view is that there should be different timelines for insolvency proceeding of group companies. [PNB, VK, IBA, CAM, AZB, ICICI, IIIPI & IPA-ICAI]. It is suggested that 180/270 days with one additional extension of 90 days could be considered, so that overall CIRP process does not exceed 360 days [PNB, IBA, IIIPI & IPA-ICAI].

Another view is that based on the size of the balance sheet of the group as a whole and complexity of issues involved, the AA be empowered to decide the timelines in each case, within the broad parameters/timelines indicated in the framework. [NeSL]

FRAMEWORK

30. What should be the elements of the framework? What should be provided or modified in:

- **the Code**
- **Subordinate legislation**
- **Other legislations?**

Code - Separate chapter in the Code has been suggested to deal with insolvency of group companies [PNB, VK, CAM, AZB, IIIPI & IPA-ICAI]. Other changes suggested include definition of 'group company', adoption of definitions of 'associate companies', 'joint ventures', 'parent company', 'subsidiary company' from the Companies Act, 2013, modifying eligibility criteria under Section 29A [CAM] and amending section 60 dealing with jurisdiction of the AA [AZB].

Subordinate legislation - Separate regulations have been suggested to deal with the claims process, selection of insolvency professional (including eligibility criteria), composition and conduct of CoC, dealing with assets spread across different countries (upon notification of the cross border insolvency framework) and jurisdictions and powers of AA, etc. [CAM & AZB]

Other legislations – The Company Act, 2013 may need to be amended to enable substantive consolidation. [PNB].

Other issues that will impact Group Insolvency [SAM]:

1. No early warning system in relation to insolvency / group insolvency: A reporting obligation needs to be cast on the company / promoter group in relation to specific criteria e.g. default / likely default of intercompany payments or loans or deposits, as was followed under Sick

Industrial Companies (Special Provisions) Act, 1985, where the promotor had to file Form A when the net worth of the company fell below the threshold.

2. Poor quality information memorandum: There should be a statutory obligation on the part of promoters and management of a group or company in the group to have pre-prepared information memorandum or group information memorandum as a continuing obligation, once the first default is committed.

3. *Group insolvency should not be dealt with under Company Law:* An ongoing process under company law has demonstrated the problems and shortcomings which need to be plugged. When dealing with group insolvency, there must be clarity as to how the financial investors and creditors who have security interest over different assets over different companies would be protected.

4. *Extending Code to NBFCs/CICs:* The exclusion of Core Investment Companies (CIC) in a group insolvency framework has implications and it needs to be considered whether substantive law can enable consideration of resolution plan including CIC which holds shares of different companies within the group.

5. Cross-Border Insolvency: In the absence of special treaties with other countries, the proposed group insolvency framework can only be limited to local Indian groups and local Indian entities of the group. This is a serious gap, when foreign investors are being invited to participate and purchase stressed assets.

6. *Inter-se rights and priorities:* In group insolvency, it should be made clear that participating in a resolution process by creditors is without prejudice to Section 53 of the Code and does not destroy the options provided thereunder, including the right to stand outside the winding up.

There is no law yet to substitute the security over property and extend it to the monies realised from the sale of security, after proper valuation of such security and consent of the lenders, consistent with their priority of charges and on a pro rata basis. This could be an impediment in the group insolvency.

In the case of joint ventures, compelling the non-defaulting joint venture party to continue a joint venture with the corporate debtor represented by the resolution professional is contrary to law or the contractual terms agreed between the shareholding parties. No law compels a joint venture to continue business in combination with an insolvent receiver. This is a critical issue in a group insolvency, since the non-defaulting shareholder has not agreed both contractually and in law to do business and continue on a going concern basis.

7. Lifting of corporate veil: In the absence of obvious fraud or criminal activity, whether mere occurrence of insolvency affecting a group necessitates the stripping of corporate veil of all members of entire group for treating it as single economic entity by the AA, is a significant question to be considered. Further, whether jurisdictional hearing is necessary as a matter of natural justice before commencement of group insolvency, is also relevant.

Abbreviations

PNB	Punjab National Bank
EW	Edelweiss Asset Reconstruction Company Ltd.
CII	Confederation of Indian Industry
IBA	Indian Banks' Association
IIIPI	Indian Institute of Insolvency Professionals of ICAI (IIIPI)
IPA-ICAI	Insolvency Professional Agency of Institute of Cost Accountants of India
CAM	Cyril Amarchand Mangaldas & Co.
SAM	Shardul Amarchand Mangaldas & Co.
AZB	AZB & Partners
VK	Vinod Kothari & Team
IGIDR	Indira Gandhi Institute of Development Research (IGIDR)
PHDCCI	PHD Chamber of Commerce and Industry
NeSL	National E-Governance Services Ltd.

ANNEXURE IV
THE ECONOMICS OF GROUP INSOLVENCY: A NOTE

Shubhashis Gangopadhyay

1. Corporate debtor as a legal entity

A major objective of commercial law is to ensure credibility of commitments made by contracting parties. Contractual arrangements are promises to undertake a series of sequential actions that will generate value only after all the actions have been carried out. Each action is controlled by, or is the responsibility of, one of the contracting parties. Every member agreeing to the contract and carrying out actions as agreed upon in the contract is what finally generates value. This final value is, of course, uncertain since the value will come in the future; what is important to appreciate is that, at least some of, the actions are undertaken before the final value is realized.

Actions are privately costly to each party undertaking each action and the agreed upon distribution of the final value (among the contracting parties) is the compensation to the party undertaking the action. However, for an agent to be compensated in the future for an action taken today, all following actions must be undertaken as promised. This raises a serious problem: an action that is costly today will be compensated tomorrow provided everyone else carries out all later actions as promised. In such a situation, one needs to know that promises made by others will be kept; commercial law is the institution that provides that assurance.

In the simplest possible case, the contracting parties are a corporate debtor or, a borrower of funds, and a lender or, a provider of funds. Funds are invested by the lender today and operated by the borrower to generate value tomorrow, a part of which will be given to the lender as compensation for the use of its funds in this project. Once the funds have been transferred from the lender to the borrower, the return on the funds (or the value generated) is a function of the effort put in, or actions undertaken, by the borrower. Since the borrower's actions are costly to the borrower, it is possible that the 'level of action' optimal for the borrower is not necessarily what the borrower was expected to undertake at the time the loan was made. This opportunism on the part of the borrower is one of the major concerns of the lender. The optimal method of addressing this issue is by offering what the literature refers to as 'a standard debt contract with covenants' (SDC-C).[181] The concept of the standard debt contract is inseparable from the legal concepts of the corporate debtor as a legal entity and, that of the debtor's limited liability. Any anticipated dilution of these legal concepts at the time of insolvency, destroys the optimality of the standard debt contract and, in particular, withholds funds from positive net present value projects. This, in turn, negatively affects employment and growth.

Another way to interpret the SDC-C is as an instrument for trading control rights. Both equity owners and creditors to a project are the investors and, hence, owners of the project. As

[181] Hart and Moore (1998), Tirole (2006).

owners, they are entitled to take decisions on how to run the project. However, through a SDC-C, the creditors (partially) give up their control rights to equity holders in return for seniority of claims. As we have mentioned in the previous paragraph (see references in footnote 1), this is an efficient way to do things. This method restrains opportunistic behaviour by managers (representing equity owners) and, hence, prevents what is termed in the literature as moral hazard. Consistent with this interpretation, we say that equity owners lose control to the creditors when the project is unable to meet the creditors' claims. Further note that this also implies that when creditor claims cannot be met, equity has no value. This is a direct result of the fact that creditors have priority of claims over equity holders. Thus, if creditor claims cannot be met, it must mean that there is not enough money to pay creditors. Alternately put, even if all the value in the project is paid out to the creditors, it is less than what their claims are. And, since creditors have priority in claims, there is nothing left for equity holders when creditor claims cannot be met.

There is a very specific situation where a creditor's claim is not met but the shareholders can still command a positive value on their shares. This is what we term in the literature as financial distress, as opposed to economic distress. Suppose a creditor has a claim, of amount 100, that is due today. For some reason, the project has no liquid funds to make this debt repayment. Tomorrow, however, there will be enough liquidity in the project or, cash inflow to meet all of tomorrow's claims plus the unpaid 100 of today. This would be a simple case of financial distress. In such a situation, if capital markets are frictionless, the 100 required today to avoid bankruptcy can be raised in the market and today's debt claim can be refinanced --- new borrowings are taken today to pay off the loan due today and the new loan is paid back at a later date. The new loan giver will do so if she is convinced about the future cash flows and the credibility of the debtor to repay. Of course, the erstwhile lender whose claim was due today could itself be the new lender, i.e., it could "roll over" the debt to allow the repayment at a later date.

By contrast, inability to pay the creditor today could be due to economic distress. In this situation, not only can today's claim *not* be met by today's cash flow, neither can it be met by future cash flows. In this situation, clearly, shareholder value is zero. The usual argument is that if future cash flow is more than sufficient to pay today's creditor claims and future creditor claims, then the firm is in financial distress only and not in economic distress. Some entity in the market will be willing to offer cash flow today for a return at a later date. On the other hand, if the firm is in economic distress, no entity will be willing to refinance the loan that is due today and, hence, the valuation of the project is less than what the creditor claims are. This, in turn, implies that under economic distress, shareholder value is zero.

The IBC's overall objective is to facilitate this process of renegotiation between debtor and creditor when cash inflow does not match creditor claims. Such an institution is effective only when the transaction cost of renegotiating between creditors and debtors is brought down in the presence of this institution as opposed to a situation where it does not exist. Alternately put, the job of the IBC is to reduce costs of modifying contractual arrangements that are beneficial to both.

Finally, what are covenants in a debt contract (the second 'C' in SDC-C) and what role do they play? Covenants are constraints on the borrower the creditor puts in place to safeguard creditor interests as it gives up operational control of the project to the equity holders. These covenants address the conflicts of interest among creditors and shareholders --- for example while creditors want to reduce risk, shareholders gain from increasing risk. This follows from the observation that a debt contract is equivalent to an option held by the shareholders on the firm value with an exercise (or strike) price equal to the debt claim. If the value of the firm is greater than the debt claim, shareholders will exercise the option by paying off the exercise price (which is the debt claim) leaving them some additional value. We know that the value of an option increases as the risk increases. At the same time, we know that the debt holder loses value if the risk increases and, hence, the conflict of interest between the shareholders and creditors.

Covenants are also necessitated by the fact that managers acting on behalf of shareholders have more information than creditors and, hence, can undertake actions that transfer value from creditors to shareholders without the former's knowledge. For solvent firms this does not raise any concern; however, when firms are about to become insolvent, and the manager knows this before the creditors, she is capable of transferring value out of the firm to shareholders reducing what the creditors can get from the bankrupt estate. Covenants are ways to prevent such value transfers from creditors to shareholders. In many countries, breach of covenants is sufficient to trigger a loan recall and, even, initiation of bankruptcy proceedings. The priority of creditor claim plus these covenants are the 'concessions' the debtor makes to enable the shareholders to take control of the daily operations of the project and maintain the optimality of the SDC-C.[182]

2. Companies in groups

As companies get big, they tend to reorganize themselves into a number of separate legal entities belonging to one group. According to a Business Standard report, "conglomerates accounted for 56 per cent of the combined assets of all non-financial firms in India in 2015-16, up from 37.5 per cent in 2000-01. They accounted for nearly half of corporate India's revenues and profits" in fiscal 2015-16.[183] This is not unique to India. Squire (2011), writing about American corporations in 2010, mentions that the top 100 public corporations "with the highest annual revenues reported an average of 245 major subsidiaries".

Companies form groups, both for internal synergies and spill-over benefits within the group, as well as strategic benefits of each member company vis-à-vis its rivals outside the group (Cestone and Fumagalli, 2005). Group companies also help in diversifying risks of the promoter shareholders. The question that immediately crops up is why do companies within a group operate as separate entities rather than simply being different divisions within *one* entity.

[182] Tirole (2006).
[183] https://www.business-standard.com/article/companies/the-end-of-conglomerates-117031700943_1.html.

A major reason is that creditors find it more easy to identify specific risks in subsidiary activities and, hence, lend to that subsidiary activity. Such compartmentalization of risk enables creditors to specialize in understanding and evaluating the risks involved in their lending activities. Ring-fencing risks in subsidiaries gives a certain degree of security to the lender of the subsidiary. Indeed, creditors prefer to lend to a group company not only because of the reputation (or credit worthiness) of successful groups but also because of the access to internal financial markets that a group company has. For instance, a group company of a successful group is less likely to face financial distress as the within group financial market is not only more efficient than external (to the company and group) financial market but also less costly than going through a bankruptcy institution. Second, a group company can pledge returns from another company in the group to mitigate the credit risk faced by the first group company. This knowledge of why group companies are formed, along with why creditors are more at ease with group companies, is important not only to understand the implications faced by creditors in extending loans to member companies in a group but, most importantly for us, the implications for capture of asset value by creditors when a particular debtor of a group is under insolvency.

Using the value of a group company A to guarantee loans to another group company B is, obviously, attractive to the lender of B. However, there are two issues that need to be understood here. First, under what conditions is this indeed helpful to B's creditor? Second, is it possible for the group to manipulate B's creditor into a false sense of security? These are real issues as one of the most important characteristic of group companies is the set of intragroup guarantees rampant within group companies.

3. Asymmetric information

The advantages of group companies to the shareholders and to the creditors, discussed in the last section, are valid only as long as there is no asymmetry of information between creditors and shareholders. The management team of the corporate debtor, termed as 'insiders' for being in control of the entity and exercising decision-making powers, is always better informed than those who are not in direct control, or 'outsiders', like the creditors. This gives an informational advantage, or information asymmetry, to the management at the expense of the creditors. If management interests are perfectly aligned with (at least those who are insider) shareholders, then such information asymmetry can lead to opportunistic behaviour by the management, on behalf of the shareholders and to the detriment of creditors.

For instance, suppose that company A and B both belong to group G and A guarantees the loan that B has taken from creditor C_B. In principle, such a guarantee reduces the extent, if not the risk, of default on the loan by C_B. This improves the value of the loan instrument and, hence, lowers the cost of capital in B and, thereby, improves shareholder value. In other words, creditors are assured, and shareholders are better-off and such an intragroup guarantee is good for both groups of investors. Without the guarantee, credit default happens whenever B fails. With the guarantee, credit default happens whenever B fails and A fails. For, if A succeeds when B fails, A can pay at least some of the value to C_B. The probability of both failing is (weakly) less than only B failing. The impact of this guarantee by A on the quality of the loan to B is maximized if the projects being run in A and B are perfectly negatively correlated. That is, whenever B fails, A succeeds. Given the extent of the guarantee, whenever B becomes insolvent (because B fails), the guarantee kicks in and it has positive value because A necessarily generates a surplus when B fails.

But, this example also tells us when the guarantee has no value! If, contrary to our assumption in the last paragraph, A and B are perfectly positively correlated, then A also fails whenever B fails. The guarantee has no value to B's creditor since A will have nothing to give to B and, under limited liability, will not have to give anything to B when A has no value in the project. Now suppose that B knows the nature of this correlation but C_B does not (information asymmetry). Then there will be a mismatch between the valuation of the loan by C_B and what its true valuation is. This could benefit shareholders at the expense of creditors.

> "As long as the group stays solvent, the guarantees benefit the shareholders by lowering the interest rates on the guaranteed loans. And if the group falls insolvent and defaults on its loans, the triggering of the guarantees makes no difference to the shareholders, because their equity stakes in the guarantor entities are wiped out anyway. Instead, liability on the guarantees dilutes the bankruptcy recoveries of the group's nonguaranteed creditors." (Squire, 2011)

These effects are compounded when both A and B guarantee each other. Under asymmetric information, it is entirely possible that perfectly positively correlated projects guarantee each other while the respective creditors do not have the knowledge of this correlation as accurately as the managements do. Also observe that guarantees are often in the form of other assets, or financial instruments. Thus, for a guarantee to be properly valued, creditors need to know not only what the instrument is but also its risk-return profile and the correlation of this risk to what is being guaranteed. In other words, while under symmetric information, groups can benefit both creditors and shareholders, asymmetric information can lead to opportunistic behaviour in group companies at the expense of creditors. Creditors, therefore, need to be vigilant and undertake due diligence to be able to evaluate the true nature of a guarantee. There is no free lunch; lending to group companies may improve the quality of the loan instrument but only if the creditor is willing to do its due diligence in evaluating the risk and return profile of other (related and unrelated) group companies.

In addition to the example on which the discussion in this section has been anchored so far, there are many other ways that opportunistic group management behaviour can harm creditors. For instance, assets in group company A may be booked in group company B so that when A becomes insolvent, A's creditors are unable to extract this value. Once again, observe that this becomes meaningful to management simply because it has prior information about impending insolvency which creditors do not have. This allows a window of opportunity to management to move assets away without the knowledge of the creditor.

However, this problem is there in any stand-alone firm also and it is commonly known as 'asset stripping'. Recall the discussion on covenants in the very first section. Debt covenants are standard methods to prevent such transfer of value, as well as, transfer of risk in a way that harms creditors after they have entered an agreement with a company.

This leads us to the basic questions being posed here. Can insolvency procedures protect the creditor to a group company from opportunistic behaviour by group management? Does this involve any additional insolvency rules that are not necessary for stand-alone firms? Alternately put, are debt covenants, specifically intended for group companies not enough and, we need additional rules for group insolvency? If group insolvency rules can be different from that of stand-alone firms, is it desirable in terms of growth and employment generation?

These questions are important because any attempt to consider different entities together is in contradiction to the fundamental assumption that a company is a legal entity and, correspondingly, that it has limited liability. We have already argued that this is the basic premise on which all rules and regulations are based and it is under this that debt is an optimal investment contract. If we are to violate this for group companies when they fall under insolvency proceedings, not only do we need to think carefully, we also need to ensure that there are no contradictions generated in the rules and contractual agreements that govern solvent firms!

4. Group insolvency

Here we would like to distinguish between two sets of questions. First, should two insolvent companies which belong to the same group be resolved together? Second, when a company, that belongs to a group of companies, becomes insolvent, should one include any, or all, of the assets of the entire group (that includes solvent companies) rather than what is there in the bankruptcy estate of the insolvent company alone?

Let there be two insolvent companies, A and B, both belonging to business group G. We look at the economic implications of resolving them jointly and singly. A has creditors C_1^A and C_2^A, while B has creditors C_1^B and C_2^B. Let the best value of independent resolution of the bankruptcy estate of A be V^A and that of B be V^B. These values are the best that the insolvent company can get, either by sale as a going concern or, through a liquidation sale. Let the cost of the resolution process be Z^A and that of B be Z^B. Then the value that will be distributed between the creditors of A, or the net value N^A will be $V^A - Z^A$ and that between the creditors of B will be given by $N^B = V^B - Z^B$. The amounts distributed, D_1^A, D_2^A, D_1^B and D_2^B will, obviously depend on the priority of each in the company. The columns marked A and B in Table 1 is a numerical example of an independent set of resolutions in these insolvent companies, both belonging to group G. The last three rows of Table 1 give the values distributed to each creditor according to their priorities.[184]

One can think of two reasons why the insolvency procedures of companies A and B may need a joint resolution (column marked AB in Table 1). First, because they are group companies and have related assets, considering them jointly may generate greater value, V^{AB}, than considering them separately, i.e., $V^{AB} > V^A + V^B$. Another reason could be that one or more of the creditors in the two companies are the same and that having the same entity as the resolution professional valuing related companies may reduce the total transaction costs, i.e.,

[184] Much of the discussions in the Working Group, and what is mostly relevant for the IBC, is the last row or equal priority. For completeness, we have also given the other two possibilities.

$Z^{AB} < Z^A + Z^B$. In both cases, unless legally forbidden, it is in the interest of (at least some of the) creditors to consider the two insolvent entities together.

Suppose that all creditors of both insolvent companies agree to a joint resolution. One then needs an enabling regulation that allows creditors to consider the insolvency resolution of the two companies as a joint activity. The question that remains to be addressed is how to distribute the value $V^{AB} - Z^{AB}$ among the four creditors C_1^A, C_2^A, C_1^B and C_2^B. Of course, each creditor must get in the joint resolution at least as much as in an independent resolution. One way to guarantee this is if we require the creditors in each company to decide whether it should be a joint resolution or not.

Observe that we are concerned only with the value extractable from the insolvent estate by the creditors with no mention of the shareholders. This is for two reasons. First, we had mentioned in Section 1 that the standard debt contract with covenants (SDC-C) is the optimal financial contract for external finance. This optimality is driven by the strict enforcement of control rules --- when the company is solvent (i.e., creditors' financial claims are met) the shareholders have full control while for an insolvent company control passes completely to the creditors. Any dilution of this exchange of control against priority in value distribution aggravates the moral hazard (opportunistic behaviour by managers in favour of shareholders) rather than mitigating it. This, in turn, reduces the ability of good borrowers to credibly signal their 'goodness' and, hence, reduces the amount of external funding to projects. Credit become more 'rationed' and this affects aggregate investment and growth.

The second reason for not considering shareholders under bankruptcy is the definition of bankruptcy. An insolvent firm is unable to meet its obligations to its creditors, implying that there is not enough value in the insolvent firm to pay off its credit claims, i.e., the value of shares is zero (since they can get paid only after creditors are paid off). If the insolvency is due to financial distress and not due to economic distress (see Section 1 for the difference in the two), shareholders have 270 days to find a willing financier to extend the money needed to pay off the creditors. If they cannot, then the firm is in economic distress.

Suppose, some creditors in A decide that they should go jointly with B. First, they have to convince other A-creditors to accept this. For this, they have to commit to giving them at least as much as they would get in an independent resolution. Second, creditors in B must accept this. Again, to get their acceptance, all A-creditors must convince B-creditors that their payments will be no less than what they get in an independent resolution. In other words, such procedural consolidation has to be decided upon jointly by the creditors in both companies.

The reason why procedural consolidation should be allowed, or enabled, rather than made mandatory is for the simple reason that a crucial assumption has been made in the numerical example above and, this assumption is not likely to be valid in most cases. That assumption is that the values for V^{AB} and Z^{AB} are *known*, before the decision to consolidate is taken. A large part of the resolution proceedings is precisely to determine the maximum value and, hence, not just V^{AB}, even V^A and V^B are unknown when the resolution process begins. Hence, it is difficult to come to an *informed* decision about the type of resolution before the resolution begins!

If we are sure that $V^{AB} - Z^{AB} \geq (V^A - Z^A) + (V^A - Z^A)$ then procedural consolidation is both desirable and will be agreed upon by all creditors. Unfortunately, this is not obvious.

The value of a stressed asset depends on the market conditions in that sector as well as in other sectors. If the assets of the insolvent entity are specific to the economic activity that was being carried out by the entity, then the overall condition of that particular economic activity becomes relevant for the valuation of the entity's assets. For instance, airplanes are assets that are specific to a commercial airliner. If the airline company is insolvent, the value of its airplanes will depend on how well other airline companies are doing. This is because these airplanes are specific to the commercial aviation industry and if this sector is depressed the buyers of the insolvent company's airplanes are themselves facing a squeeze. However, if the airline also had a fleet of cars that ferried its pilots to and from the airport, the valuation of these cars will not be significantly affected by the condition in the airline industry as cars can be used in a number of economic activities and, as assets, they are not specific to the airline industry. The point being made here is that the value of the insolvent asset is not determined within the entity but by what other entities are willing to pay. This latter is very much a part of the resolution process and cannot be decided upon before the process begins.

There is a second complication. Continuing with the airline company, suppose it belongs to a group of companies that include entities that provide ground transportation, engineering services, catering services, etc.[185] Suppose that the airline and the catering services are two group entities that have become insolvent. In this particular instance, the highest bidder for the airline company alone may not enter the bid if it is bundled with the catering services company. In other words, V^{AB} may actually be less than $V^A + V^B$.

Also, recall that one of the main reasons for groups to be organized into separate entities, rather than being in an integrated enterprise, is to enable specialized creditors to better evaluate the risk-return prospects of each separated entity. Forcing them to come together may actually result in greater confusion than clarity or, simply put, even Z^{AB} may be more than $Z^A + Z^B$.

We now come to the second question posed at the beginning of this section: should the creditors of an insolvent group company be allowed to lay a claim on the assets of another solvent company of the same group. Our discussions in the previous paragraphs strongly suggest that this should not be mandatory even between two insolvent companies. Does this reasoning extend to an insolvent and solvent company in the same group?

Let I be the insolvent company and S be a solvent company, both belonging to group G. If the creditors of company I are allowed to lay a claim on the assets of S, then S also falls under the resolution plan of I. This has to disrupt decision making in S as all their decision-making will now have to be shared with the resolution professionals; if not, the group resolution makes no sense as S remains under the control of its shareholders and, at least some of, its assets can 'legally' be moved out of S defeating the purpose of combining S with I.

5. **Conclusions**

Companies operating in groups have become an integral part of doing business, both globally and in India. While group companies generate externalities through management synergies, internal financial markets and market power, bankruptcy institutions consider insolvent group

[185] Most airlines outsource complementary activities to other companies and, often, some of these belong to the same group of companies as the airline. This is true, for example, of Air India.

companies in the same way as they would deal with a stand-alone insolvent company. In other words, the group identity becomes irrelevant during insolvency proceedings of a group company. In this note, we explore this issue.

Our major conclusion is that this irrelevance of what the rest of the group is doing is, in most cases, the preferred option. Specifically, when a group company becomes insolvent, activities in other solvent group companies should not be interfered with during the former's bankruptcy resolution process. When more than one company of the group are insolvent, some, or all, of them may be considered together but that too if creditors of all the individual companies (being considered jointly) agree.

The SDC-C is an optimal contract for external finance and any forced consolidation of companies disturbs that optimality. The SDC-C is optimal in that it encourages the maximum amount of external finance in a world characterised by borrower's moral hazard. This, in turn, relaxes the credit constraint and, hence, maximises the funding of positive net present value projects. Any dilution of the SDC-C tightens the credit constraint and has a negative aggregate (macro) effect on investment, growth and employment. The ability of group companies to move value away from creditors is better controlled by due diligence by creditors *before* a company becomes insolvent and this can be effected through a judicious use of covenants that enables information sharing by management and, hence, the monitoring of management decisions that can lead to destruction of creditor value.

Table 1: Numerical Example

	A	B	AB
Value	$V^A = 100$	$VB \ = 200$	$V^{AB} = 350$
Creditor 1 of A	$C_1^A = 100$		$C_1^A = 100$
Creditor 2 of B	$C_2^A = 150$		$C_2^A = 150$
Creditor 1 of B		$C_1^B = 120$	$C_1^B = 120$
Creditor 2 of B		$C_2^B = 180$	$C_2^B = 180$
Transaction cost	$Z^A = 20$	$Z^B = 50$	$Z^{AB} = 60$
Net value	$N^A = 80$	$N^B = 150$	$N^{AB} = 310$
Creditor 1 has priority over 2	$D_1^A = 80$ $D_2^A = 0$	$D_1^B = 120$ $D_2^B = 30$	
Creditor 2 has priority over 1	$D_1^A = 0$ $D_2^A = 80$	$D_1^B = 150$ $D_2^B = 0$	
Equal priority	$D_1^A = 32$ $D_2^A = 48$	$D_1^B = 60$ $D_2^B = 90$	

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ANNEXURE V

ICSI INSTITUTE OF INSOLVENCY PROFESSIONALS

LEGAL FRAMEWORK FOR GROUP INSOLVENCY: A CROSS-COUNTRY COMPARISON

S. No	Country	Particulars
1	USA	• The Courts, generally, find authority for the remedy in the broad powers of “*Equity*” conferred under section 105(a) of the Bankruptcy Code, which authorizes the Court to “*issue any order, process, or judgment that is necessary or appropriate to carry out the provisions*” of the Bankruptcy Code. • US Bankruptcy Courts developed the *Factor Test* or the *Checklist Approach* for the application of Substantive Consolidation.
2	Austria	• There is no concept of “*Group Insolvency*” under the Austrian Insolvency Law; each legal entity is to be assessed individually. The EU Insolvency Regulations and Rules on cooperation within Group Insolvencies have been included in the Insolvency Code. • There is a completely new detailed legal framework on the cooperation and coordination of cross-border insolvency proceedings over the estate of members of a Group of Companies.
3	Australia	• The Principal legislation governing insolvency in Australia is the Corporations Act, 2001. Under section 588V of the Corporations Act, 2001, a holding company may, in certain circumstances, be held liable for the insolvent trading of its subsidiary. • There is no formal legal mechanism for initiating proceedings on a Group basis. Once insolvency proceedings have been commenced in respect of individual group companies, "pooling" of those proceedings may be available in certain circumstances. • Australian Courts sanction the use of pooling arrangements for Groups in administration proposing to carry out a pooled DOCA (Deed of Company Arrangement).
4	Canada	• The legislations that deal with “*Insolvency*” are Bankruptcy and Insolvency Act (BIA) and The Companies' Creditors Arrangement Act (CCAA).

		• As per the CCAA, the Court will allow a consolidated plan of compromise and arrangement to be filed for two or more related companies in appropriate circumstances. • Case-law development led to three factor approach to decide whether consolidation would be the appropriate solution or not. The Court will consider whether consolidation is fair and reasonable based on the facts and circumstances of each case.
5	Brazil	• The current Brazilian legislation on Corporate Insolvency Law is the Federal Law 11,101. It covers three types of court proceedings: judicial reorganisation, expedited reorganisation and bankruptcy liquidation. • An analysis of requests for Substantive Consolidation filed before the Brazilian Courts reveals that, in majority of cases, such requests are based on the companies being part of the same economic group; the existence of a common management of the companies; and the existence of cross-guarantees among the requesting companies.
6	European Union	• Regulation (EU) 2015/848 of the European Parliament and of the Council on the subject of "*Insolvency Proceedings*" is the legislation governing Group Insolvency. Chapter V of the Regulations (Article 56 to Article 77) talks about Insolvency Proceedings of Members of Group Companies. • The Regulations provide for a detailed framework of Group Procedural Co-ordination. • The European Courts have ruled that the European Insolvency Regulation can be interpreted, under certain conditions, to allow for insolvency proceedings of a member state to cross borders (to a certain extent) and include another company from another member state.
7	Netherlands	• The Dutch Bankruptcy law recognizes the *Legal Entity* principle of a corporate, and thus requires that the assets of a legal entity are to be disposed of for the benefit of its own creditors only. If a Group (of companies) files for insolvency, each member company shall be addressed as a separate case. • The Dutch Supreme Court has held that, in cases wherein separate administration of the estates of separate entities (insolvent) is onerous, there can be a joint administration of such estates. The European Insolvency Regulation obligates the Dutch Courts to automatically recognize insolvency proceedings opened elsewhere in the EU.

8	Germany	• The German Legislator had on 9th March 2017 introduced the concept of Group Insolvency into the German Insolvency law. German Insolvency law allows insolvency proceedings to be initiated in respect of companies within a Corporate Group at a single German Insolvency Court and/or to be administered by a single Insolvency Administrator. • The Regulations have provided for some key innovations, *viz.*, (i) a Group venue; (ii) the option to appoint the same person as (Group) Insolvency Administrator/receiver; and (iii) Group Coordination proceedings.
9	China	• The governing legislation is The Enterprise Bankruptcy Law of the People's Republic of China (Effective from 1st June, 2006). • The minutes of National Court Work Conference on Bankruptcy Trials in Shenzhen, Guangdong Province have become guidelines on the subject of substantive consolidation and the rarity with which it should be used in China. • There are no circumstances in which a parent or affiliated Corporation assumes the responsibility for the liabilities of subsidiaries or affiliates. In practice, however, the parent Corporation should bear the responsibility for its subsidiary, if such a subsidiary is not an independent entity, or it has conducted an abnormal transaction. • Combining of bankruptcy procedures of the parent company and its subsidiaries is permitted in general practice. Under such circumstances, the assets and liabilities belonging to the companies may be pooled for the purpose of distribution of their assets.
10	UK	• Every member of a Group is treated as a distinct legal person as far as its assets and liabilities are concerned. • There is a common practice, however, to appoint the same administrator or liquidator with respect to multiple companies within a Group which amounts to elements of procedural coordination. • As each Group Company has a distinct legal personality, there is no requirement/obligation on a company's affiliate to proceed under the same type or location of insolvency proceeding as other Group members.