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Journal on Governance

FOREWORD

On behalf of the editorial board, it gives us extreme pleasure to present Volume VI, Issue 2 of the Journal on Governance. The current issue marks the successful culmination of the inaugural edition of the 1st NLUJ-Khaitan & Co Corporate Law Review Summit, 2023 ("the Summit") sponsored by the Reserve Bank of India (RBI), and in collaboration with the Insolvency and Bankruptcy Board of India (IBBI) and SCC Online-EBC. The Summit received an impressive one hundred and twenty submissions and served as a crucial platform for diverse perspectives and valuable insights to converge, bridging the theory-practice gap and deepening understanding of corporate law. The selected papers presented at the Summit are published in this issue.

The first article titled "Decoding the Proposed Amendment to UPSI: Equitable or Archaic?", authored by Jay Shah and Shivangi Desai, concerns with the amendments introduced to the Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015 in light of strengthening the regime of prevention of insider trading. SEBI's responsibility, inter alia, includes maintenance of information symmetry and the regulation of Unpublished Price Sensitive Information (UPSI) is essential to achieve this. In this regard, the complex interaction of SEBI's Prohibition of Insider Trading Regulations ("PIT") and LODR Regulations, particularly, the criteria of '*credible*' and '*concrete*' information is discussed in light of the Jio-Facebook case. The authors argue that the measures introduced by SEBI are antiquated as they create a reverse burden on assessees to demonstrate that they do not have price-sensitive information. They conclude that, although the amendments underpin SEBI's aim of achieving the perfect information symmetry, this objective should not be pursued at the expense of imposing additional costs on corporations and limiting directors' participation in the securities market.

The second article, "Investigating the Proposals for Early Liquidation and Resolution in Parts: Is it the Equilibrium between COC 'Commercial Wisdom' and IBC Objectives?," authored by Mohammad Atik Saiyed and Shukla Pooja Sunilkumar examines the twin proposals made by the Insolvency and Bankruptcy Board of India ("IBBI") relating to '*Resolution in Parts*' and '*Early*

Liquidation' and an investigation into the committee of creditors' ("CoC") commercial wisdom, its misuse, and its control by a code of conduct is made. The authors provide recommendations for installing the twin proposals hand-in-hand allowing 'Parallel-Partial Resolution cum Liquidation'. Parallelly, they suggest certain structural reformations for safeguarding the fine balance between the objectives of the Code, such as the adoption of a comprehensive and dynamic cross-regulatory strategy, the constitution of a stakeholder consultation committee, the appointment of an independent member and its use as an enforcement tool of the CoC code of conduct, the appointment of an administrator by the Central Government and lastly, investing efforts for liquidation as a 'going concern'.

The third article, titled "Attachment of Unsecured and Secured Properties of the Corporate Debtor: A Tussle between PMLA & IBC" is authored by Tejas Kandalgaonkar. The author underscores concerns within the Insolvency and Bankruptcy Code, 2016 ("IBC") framework, where the moratorium period, crucial for preserving a corporate debtor's assets during the Corporate Insolvency Resolution Process ("CIRP"), is allegedly disregarded by the Directorate of Enforcement ("ED"). The ED, authorized by the Prevention of Money Laundering Act, 2002 ("PMLA"), attaches assets during CIRP if suspicions of money laundering arise. This practice, the author argues, significantly hampers the successful rehabilitation of the corporate debtor, as it diminishes available assets and undermines creditor confidence. To remedy this, the author suggests limiting ED interference to cases involving offenses by the erstwhile management. To address these challenges, the author proposes applying the moratorium period to PMLA attachment proceedings, considering them 'civil' in nature, thereby establishing a bar on such proceedings against the corporate debtor's assets.

The fourth article titled "Rightful Investors or A Rueful Fan Club? The Quandary of Regulating Community Stock Ownership Plans In India," by Aditya Hiremath and Ishwaryah Manikandan. The authors delves into the intriguing realm of Community Stock Ownership Plans (CSOPs) as a pivotal instrument for garnering public funds in India's thriving startup ecosystem. The authors argues that despite their prominence, the intricacies of CSOPs remain veiled in the obscure corners of the internet, prompting the authors to unravel its essence. Beginning with a historical perspective tracing back to its originator, Louis Kelso, the article endeavors to define CSOP in relation to conventional financial instruments such as securities, derivatives, and SARs, using the startup Tyke as a case study to illustrate CSOP terms. The narrative navigates through the current regulatory landscape, scrutinizing the position of the consumer-investor within its confines while pinpointing gaps in the existing framework. The author advocates for legislative recognition of the significance of CSOPs and emphasizes the need for intervention to rectify the prevailing disparities in the interest of justice and equity. Balancing the imperative of investor protection with the imperative of fostering startup growth, the article cautions against an excessively stringent regulatory approach that could impede progress and run counter to the legislature's overarching goal of ensuring a fair and conducive environment for investment.

The fifth article titled "Securitization of Stressed Asset: A Half-Baked Bread for the Indian Market," by Aditi Singh. The author meticulously examines the prospects and challenges surrounding the Securitization of Stressed Asset Framework (SSAF) introduced by the Reserve Bank of India (RBI) on January 25, 2023. The Discussion Paper serves as a crucial focal point, delineating the expansive opportunities inherent in the scheme and addressing the burgeoning menace posed by the Non-Performing Loan (NPL) market to the Indian Banking Sector. Delving into the historical context, the author scrutinizes past endeavors to securitize stressed assets, pinpointing inherent flaws in the regulatory framework. Factors such as the absence of a robust investor base, the lack of unified legislation, and a dearth of judicial opinion are thoughtfully considered in the analysis of the SSAF. Drawing upon international comparisons with regions like Europe, China, and Korea, the author seeks to unravel the complexities of stressed asset securitizations abroad. The article not only elucidates the fundamental principles of NPL securitizations but also assesses their applicability within the Indian context. By identifying potential impediments to the successful implementation of securitization of stressed assets, the author paints a comprehensive picture. The article concludes with a pragmatic framework, proposing solutions such as the incorporation of

Minimum Retention Risk and leveraging the Insolvency and Bankruptcy Code, 2016 to streamline the integration of SSAF.

The sixth and final article in this issue, titled "Rethinking the moratorium clause under IBC: An Anatomization of Aviation Insolvency," by Reema Jain and Apsara Sridhar. The authors delve into the intricate dynamics of aviation insolvency and the strategies employed by aircraft financiers when faced with the imposition of a moratorium on airlines. Notably, a significant majority of Indian airlines favor aircraft leasing, constituting 80% of commercial aircraft, in stark contrast to the global average of 53%. The paper challenges the applicability of the Insolvency and Bankruptcy Code (IBC) in addressing aviation insolvency, scrutinizing its inherent principles and procedures while advocating for a distinct approach tailored to the unique challenges of the aviation sector. The article critically examines the impact of the moratorium on lease agreements and the invocation of bank guarantees within the existing legal framework. Additionally, it conducts a thorough analysis of the Cape Town Convention Bill, 2018 (CTC Bill 2018), questioning its adequacy in safeguarding the interests of lessors and airlines. The proposed Protection and Enforcement of Interests in Aircraft Objects Bill, 2022 is brought into focus, with the authors contending that the current form of the CTC Bill is insufficient for implementation, underscoring the need for a balanced and customized legislation to effectively address the complexities of aviation insolvency.

All in all, we are sure that this issue should offer a wealth of information and insight to a reader, and some of the suggestions and observations may also assist in provoking a constructive discussion and deliberations on addressing these emerging issues in the field of corporate law.

We take this opportunity to thank certain persons who made the publication of this issue a success. Our first and foremost thanks go to our collaborators who shared and supported our vision, placing immense trust in us—The RBI, whose generous sponsorship ensured that the Summit's objectives were not only met but exceeded; Khaitan and Co; the Insolvency and Bankruptcy Board of India; and our knowledge partner, SCC-Online EBC.

Our heartfelt thanks to our patron and vice-chancellor, NLU-Jodhpur, Dr. Harpreet Kaur and the distinguished members of the Journal's Board of Advisors for their unwavering support. Special recognition is extended to Mr. Mohan Venkateswaran K. Deputy Legal Advisor at RBI, Ms. Vidushi Gupta. Partner at Khaitan & Co, and Ms. Ruth Vaiphei, Assistant Professor at NLU-Jodhpur) who meticulously adjudicated the paper presentation competition at the Summit. Mr. Venkateswaran was also instrumental in facilitating the collaboration with the RBI and his insightful suggestions greatly enhanced the Summit. On the same note, we would like to thank Ms. Saranya Mishra, Senior Associate at Khaitan & Co, Ms. Namisha Singh, Manager at IBBI and Ms. Bhumika Indulia, Senior Associate Editor at SCC Online-EBC for their roles in collaboration with their respective organisations. Our gratitude further extends to our Chief Editor, Dr. Manoj Kumar Singh. We believe that it is his keen interest, timely reminders and contributions that have propelled the Journal to its current success over the years. Our thanks are extended to Mr. Chandraveer Singh Deora, Infotech staff, NLU-Jodhpur who has assisted in the printing of the Journal.

Next, we thank the participants of the Summit – for all the one hundred and twenty submissions we received, we are grateful for the trust placed in us. Congratulations are in order for the winners of the Summit and the authors of this issue for emerging victorious through the rigorous selection process.

Finally, our heartfelt appreciation goes to the Editorial Board of 2023-24, the backbone of this Journal. Editors across different tiers of the review process devoted countless hours to the myriad tasks essential for the successful culmination of this issue. Being a part of the Journal is a source of immense pride, and the success of the Journal is undoubtedly a reflection of the collective efforts of its devoted members. We hope that the vision of the editorial board in advancing the discourse on corporate law resonates with our readers.

Deesha Reshmi & Ojasav Chitranshi

Editors-in-Chief, Journal on Governance

National Law University, Jodhpur

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TABLE OF CONTENTS

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DECODING THE PROPOSED AMENDMENT TO UPSI: EQUITABLE OR ARCHAIC?

*Jay Shah & Shivangi Desai**

ABSTRACT

The watchdog of the securities market, Securities and Exchange Board of India ("SEBI"), was established in order to serve as a regulator to the growing securities market amidst globalization and capital market scams. One of the most prominent violations of the securities market is insider trading as the whole market works on information. SEBI intends to create a level playing field for various players and reduce information asymmetry. SEBI has brought several amendments to what constitutes Unpublished Price Sensitive Information ("UPSI") since the past two decades. The proposed amendment envisages the inclusion of the definition of 'material information' under LODR regulation 30 into the Insider trading regulations. This can have several implications due to the inherent nature of the definition of material information. The definition of material information implicitly mandates disclosure of premature information and reduces the threshold of any information to be categorized as insider information drastically. This increases the burden on corporations for disclosure. The tyranny manifests itself from the dual issue of whether a corporation should protect itself from allegations under regulation 30 and insider trading, or PFUTP regulations for disclosing information which can influence public opinion. Further, the categorization of virtually any business activity can impose a blackout period on the designated person encroaching their limited opportunity to participate in the market. This demands a reconsideration of the proposed amendment. The jurisprudence developed in the other jurisdictions provide a trail for a more balanced development of the definition, in order to protect all the players in the securities market. The authors thus propose reconsideration of the definition, with relevant authorities and juridical development so that the objectives envisaged in the preamble of SEBI can be safeguarded and an archaic regime can be prevented.

* Jay Shah is a fourth-year student at Gujrat National Law University and Shivangi Desai is a fourth-year student at ILS Law College, Pune.

Keywords: Stock market, regulations, disclosure, fair market, transparency.

TABLE OF CONTENTS

I. INTRODUCTION

The Corporate Governance committee report 2017 states that:

> "*Equal access to information and information symmetry is the cornerstone of efficient functioning of any securities market. This, in fact, is the genesis and foundation of the market conduct laws in India, and specifically the laws curbing communication of UPSI and insider trading. The law does, however, facilitate asymmetric access to UPSI for legitimate purposes, performance of duties and discharge of legal obligations. These are subjective standards requiring event-based determination.*"[1]

[1] Committee on Corporate Governance, (Sec. & Exch. Bd. Of Ind.), Report of the Committee on Corporate Governance, 56(2017), https://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html

The importance of having regulation regarding UPSI stems from the need to create a level playing field amongst people who are outside the company, and participants who are within the range of acquiring price sensitive information.

Stock markets are classified as per information assimilation into strong, semi-strong and weak markets. The categories can be easily understood in the form of the analysis it would demand for prediction of price movements. A weak market is a market which would be completely driven on the information entering the market on the same day, and the past candles are of no significance in order to speculate the trend, thus only fundamental analysis and real-time news determine the price. A strong market signifies that only a technical analysis of the candlesticks would be sufficient to determine the price movement of a scrip, as every candle is indicative of all the information available. A semi-strong market thereby implies a market wherein both technical and fundamental analysis needs to be applied, as the candles do not represent all the information. India is classified as a semi-strong market.[2]

The general modus operandi of an insider is purchasing of scrip before release of positive information, and sharing of shares before release of negative information. This is in contravention to the International Organization of Securities Commissions (**"IOSCO"**) provisions which envisages (i) protecting investors and (ii) ensuring fairness and transparency in markets.[3]

II. BACKGROUND OF THE AMENDMENT

SEBI on various instances had observed that certain informations, which were potentially UPSI, were not disclosed in a timely fashion as scope of existing definition did not encapsulate the said situation. This became a playground for

[2] Ramachandran, R., *A study on Semi-Strong Efficiency of Indian stock market*, 3 INT. J. OF SCI. AND RESEARCH PUBL'N, 1, 3 (2013).
[3] Alexander, K., *The Law of Insider Dealing- A Tale of Two Jurisdictions*, 112 ZEITSCHRIFT FÜR VERGLEICHENDERECHTSWISSENSCHAFT, 262, 292 (2013).

insiders to reap super normal profits by trading in the market until the closure of the trading window. Subsequent to the amendment in Listing Obligations and Disclosure Requirement (**"LODR"**), the same definition of material information is proposed to be added to the definition of UPSI. SEBI has provided a summary of its findings wherein, in the period between January 2021 and September 2022, there were 1099 press releases out of which 227 led to a price change of 2% or greater. Out of the 227 merely 18 were categorized as UPSI while remaining 209 were not. The reasoning of 'uniform practice' of non-disclosure of various business activities fails to create obligation on companies to disclose such activities, on account of the precise and concise definition of UPSI. This non-categorization is detrimental to investors thus the said amendment is proposed.[4]

III. THE MAJOR CHANGES BROUGHT UNDER REGULATION 30

For critical analysis three amendments are taken into account:

- Amendment to regulation 30(4) – SEBI observed that companies were reluctant in their approach towards disclosures and did not disclose price sensitive information. Even after the requirement of disclosure for material and super material companies was made mandatory by stock exchange, companies did not disclose much material information. Thus, the quantitative thresholds such as:

[4] Sec.& Exch. Bd. of Ind., Consultation Paper on Proposed Review of the Definition of Unpublished Price Sensitive Information (UPSI) under SEBI (Prohibition of Insider Trading) Regulations, 2015 to Bring Greater Clarity and Uniformity, 3 (2023), https://www.sebi.gov.in/reports-and-statistics/reports/may-2023/consultation-paper-on-proposed-review-of-the-definition-of-unpublished-price-sensitive-information-upsi-under-sebi-prohibition-of-insider-trading-regulations-2015-to-bring-greater-clarity-and-uni-_71337.html

- Two per cent of the turnover, as per the last audited financial statements; - this is exercised over the consolidated balance sheet;

- Two per cent of the net worth as per the last audited financial statements;

- Five per cent of the average profit or loss of the past three years. – here the absolute value of the profit is taken, which implies that only the numeric values are subjected to arithmetic operations in ignorance to their sign.

Were inserted in the mandatory disclosure regime even if the transactions are 'expected' to meet such thresholds.[5]

- Amendment to 30(6) pertaining to the timeline of disclosures. The SEBI envisaged the same in the backdrop of the lackadaisical approach of companies regarding disclosing information, which was not done until the last hour or until demanded by the stock exchanges. The new timeline is:

    - Thirty minutes from the board meeting;

    - Twelve hours from information emanating from the company;

    - Twenty-four hours from information emanating from outside the company.

The conundrum here pertains to the meaning of 'emanating from the company'. There is no definition provided for emanating from the company in either LODR or any parallel regulation.[6]

[5] SEBI LODR (Second Amendment) Regulations, 2023, Gazette of India, pt. III sec. 4, Reg. 30(4) (Jun. 14, 2023).

The American jurisprudence provides certain guiding principles which can be adopted for determining whether information arises from the company or not. The source of information can be determined on mainly two parameters:

- Whether the information arises from an authoritative source like company records, board meetings or official communication within the company;
- Whether such information was given in direct or indirect corporate action, or execution of any company operation.

The parameter of information being concrete is eliminated as there are several instances where information may arise from a third party analysis like sampling or mosaic theory and be concrete in nature, but cannot be said to arise from within the company.[7]

- Amendment to 30(11) makes it mandatory for top 100 firms and top 250 firms to either affirm, deny or clarify market rumour with effect from 1st October 2023 and 1st April 2024 respectively. This amendment is the outcome of widespread and rapid dissemination of information due to social media. Social media leads to spread of fragmented and inaccurate information which increases the volatility in the market. The amendment sheds light on the fact that any event which has incepted but continues to extend after the provided date also requires to be clarified. Market rumour refers to any information which is present in mainstream media,

[6] SEBI LODR (Second Amendment) Regulations, 2023, Gazette of India, pt. III sec. 4, Reg. 30(6) (Jun. 14, 2023).

[7] Kripke, Harold, *Inside Information, Market Information and Efficient Markets*, 36 N.2 FIN. ANALYSTS J., 20, 24 (1980).

which is defined at 2(r) of the 2023 Second Amendment, which fundamentally implies newspapers, new channels, social media etc.[8]

IV. PFUTP AND LODR: BETWEEN A ROCK AND A HARD PLACE

A. UNDERSTANDING PFUTP

The SEBI (Prohibition of Unfair and Fraudulent Trade Practices) Regulation, 2003 ("**PFUTP**") aims to prevent market abuse[9] which includes market manipulation[10] and insider practices which hamper investor confidence and market integrity.

The Supreme Court in N Narayanan v. Adjudicating Officer, SEBI[11] observed the importance of giving wide powers to SEBI for in order to check market abuse and protect investor interest. The Section 11(2) of the SEBI act empowers SEBI to curb manipulative practices and insider trading. The Court observed:

> *"Prevention of market abuse and preservation of market integrity is the hallmark of securities law. Section 12-A read with Regulations 3 and 4 of the 2003 Regulations essentially intended to preserve "market integrity" and to prevent "market abuse". The object of the SEBI Act is to protect the interests of the investors in securities, and to promote the development and regulate the securities market, so as to promote orderly and healthy growth of the securities market and to promote investors' protection. Securities market is based on free and open access to information; the integrity of the market is predicated on the*

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[8] SEBI LODR (Second Amendment) Regulations, 2023, Gazette of India, pt. III sec. 4, Reg. 30(11) (Jun. 14, 2023).
[9] Committee on Fair Market Conduct, (Sec. & Exch. Bd. Of Ind.) Report of Committee on Fair Market Conduct, 1(2018),https://www.sebi.gov.in/reports/reports/aug-2018/report-of-committee-on-fair-market-conduct-for-public-comments_39884.html
[10] SEBI v. Rakhi Trading (P) Ltd., (2018) 13 SCC 753 (Ind.)
[11] N. Narayanan v. Adjudicating Officer, SEBI, AIR 2013 SC 3191.

> *quality and the manner on which it is made available to the market. "Market abuse" impairs economic growth and erodes investor's confidence. Market abuse refers to the use of manipulative and deceptive devices, giving out incorrect or misleading information, so as to encourage investors to jump to conclusions, on wrong premises, which is known to be wrong to the abusers. The statutory provisions mentioned earlier deal with the situations where a person, who deals in securities, takes advantage of the impact of an action, may be manipulative, on the anticipated impact on the market resulting in the "creation of artificiality". The same can be achieved by inflating the company's revenue, profits, security deposits and receivables, resulting in price rise of the scrip of the company. Investors are then lured to make their "investment decisions" on those manipulated inflated results, using the above devices which will amount to market abuse."*

When it comes to interplay of PFUTP and LODR the most prominent sections of the PFUTP are Section 4(2)(f), Section 4(2)(k) and Section 4(2)(r) which are as follows:

S.4(2)(f)[12] – this section categorizes as an offence the reporting or publishing of information which is not true or believes to not be true, in the course of dealing in securities.

S.4(2)(k)[13] – this section categorizes as an offence the dissemination of information which is false or misleading, in a reckless or careless manner, which can influence the decisions of investors to deal in the scrip.

S.4(2)(r)[14] – this section categorizes as an offence the planting of false or misleading news which can induce trading in the scrip.

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12 SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003, Gazette of India, pt. III, sec. 4, Reg. 4(2)(f) (Jan. 25, 2022).
13 SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003, Gazette of India, pt. III, sec. 4, Reg. 4(2)(k) (Jan. 25, 2022).

B. CASE ANALYSIS- JIO FACEBOOK CASE

On 4th March 2020 Jio and Facebook signed a non-binding term sheet for a multi-million-dollar investment by Facebook into Jio. The company's setup a timeline for disclosure, as per which by 18th April 2020 the companies would complete negotiation and enter into a binding contract, on 21st April 2020 they would execute a transaction document, and on 22nd April 2020 disclosures would be made to the stock exchanges.[15]

On 24th March, Financial times covered the information in an article which led to increase in the share price of Reliance by 14.72%., on basis of this price movement SEBI levied charges on Reliance under regulation 30(11) of LODR and principle 4 of Schedule 1 of the SEBI (Prohibition of Insider Trading) Regulations 2015 ("**PIT**").[16]

The important aspect of this case is that:

1. Understanding the nature and types of information

SEBI did not distinguish between market speculation and information generated on basis of concrete information. SEBI put greater emphasis on mere disclosure rather than assessing the nature of information.

In the present case the information on which SEBI took action is not concrete, and the price movement are speculative in nature, and did not occur

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[14] SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003, Gazette of India, pt. III, sec. 4, Reg. 4(2)(r) (Jan. 25, 2022).

[15] Prashant Gupta & Rudresh Mandal*, To Disclose or Not to Disclose: SEBI's Order in Jio-Facebook,* MONDAQ (Aug. 08, 2023) https://www.mondaq.com/india/securities/1248196/to-disclose-or-not-to-disclose-sebis-order-in-jio--facebook.

[16] Shreejith R, Amudavalli Kannan & Shreyas Bhushan, *SEBI orders public disclosure at M&A negotiation stage: Compromises deal certainty and amplifies directors' liabilities*, RESOLUT PARTNERS (Aug. 05, 2023) https://resolutpartners.com/2022/09/06/sebi-orders-public-disclosure-at-ma-negotiation-stage-compromises-deal-certainty-and-amplifies-directors-liabilities/.

due to genuine dissemination of concrete and positive price sensitive information.

Information to be categorized as UPSI depends of the reliability of the information, which is broadly divided into two categories: Soft information and Hard information. In *Basic Inc. v. L Levinson*[17]*,* the United States ("**US**") Supreme Court explained that soft information was information which was premature in nature and usually forward looking. Such information cannot usually be verified, and contains opinions or judgements which make it less reliable. On the contrary hard information is generally backward looking and an accurate representation of an event which has taken place. This information is objective in nature. Thus, soft information bears the potential to become material information.

In *TSC Industries v. Northway Inc.*[18] the US Supreme Court provided two tests to determine when an information can be termed as material. The first test is the probability-magnitude approach which implies that an information is material when the probability of an event happening is high and the magnitude of such event on price of scrip in substantial. Both the conditions are mandatory. Thus, mere negotiations of merger, though can have substantial impact on share prices, would not be considered a probable event, and thus should not be treated as material information. While, supposing a company which has over 100 manufacturing units, starts establishing one more manufacturing unit is an event of high probability, but it would not affect the share prices of the company substantially, therefore even this information would not be considered material.[19]

2. Biased application of PIT provisions

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[17] Basic Inc. v. Levinson, 485 U.S. 224 (1988).

[18] TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438. (1976)

[19] Shantanu Dhingra, *Unraveling "Materiality" in SEBI's Consultation Paper: Legal Perspectives and Recommendations*, IND. CORP. L. (Aug. 08, 2023) https://indiacorplaw.in/2023/04/unraveling-materiality-in-sebis-consultation-paper-legal-perspectives-and-recommendations.html.

SEBI levied penalty on basis of rule 4 of schedule A rather than rule 1 of the same schedule:

- Rule 4 deals with prompt disclosure of UPSI, and constitutes selective disclosure as an offence.

- Rule 1 requires prompt disclosure as and when it generates the potential to impact share prices, but such information is required to be credible and concrete.

The understanding, regarding what constitutes 'credible', can be acquired from *Caspary v. Louisiana Land and Exploration*[20]*,* that credible information is information which arises from a reliable source. Hence the amount of confidence it inspires becomes determinative of credibility. Though mainstream information may inspire confidence, it does not find its source from an authoritative source. Thus, derivations based on theories by analyst may be accurate but do not constitute credible information as they are largely based on limited information, and hence the conclusions of such analysis are in deficit of corporate information which play pivotal role for decision making.[21] The inference it leads to is that even theoretical and scientific deductions and research do not constitute credible information, the deficit of any relationship giving access to such information makes such inference self-generated.[22]

The understanding regarding what constitutes 'concrete' can be acquired from N K Sodhi committee report[23], which stated that concrete information would be information which is crystallized and unlikely to change. The effect of publication of information which is not crystallized is that if it is compelled to be

[20] Caspary v. Louisiana Land and Exploration, 707 F.2d 785, (1983)
[21] *Supra* note 7.
[22] Boston Company Institutional Inves tors, Inc., CCH T80, 729.
[23] Committee to Review the SEBI (Prohibition of Insider Trading) Regulations, Report of the High Level Committee to Review the SEBI (Prohibition of Insider Trading) Regulations, 1992, 6 (2013).

disclosed then it is capable of harming the disclosing company, and thus would be unreasonable and impractical. The circular notified by SEBI on 9th September 2015 specifically categorized the events which have 'occurred' to be material, and not information which was premature or speculative. Thus, information is concrete when it is based on knowledge and not conjecture[24]. It is corporate wisdom that general corporate dealing often is clouded with uncertainties due to which they do not constitute material information.

3. Overlap of continuous disclosure and prompt disclosure regime

In the Jio Facebook case the disclosures were contemplated to be disclosed as per the prompt disclosure regime and abides the mandate of rule 1. This leads to assessing the overlap between the continuous disclosure under LODR and prompt disclosure regime under PIT. Thus, this sort of overlap in disclosure regime leads to unnecessary burden on the companies[25].

The regulator has contributed to creation of additional burden and vagueness with respect to disclosures. As per the principle, of how information serves as indicators in the securities market, has led to the threshold of any information being material to be greater than for the information to be UPSI. In Shelter Infra Projects Ltd. SEBI specifically looked into when any information turns into UPSI. SEBI here observed that a corporate action becomes UPSI when the event is "most likely" to happen. This would mean finalization of "price deal", or even when the transaction modalities are being worked out. Hence it is established that UPSI may come into existence even when substantial transaction documentation has progressed, while the commercial issues remain uncertain. The current inclusion of definition of LODR stretches the ambit of what would

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[24] SEBI Circular on Continuous Disclosure Requirements for Listed Entities Regulation 30 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.
[25] ARMAN PATKAR, INSIDER TRADING LAW & PRACTICE (EBC 2019).

constitute UPSI, as it reduces the threshold of material information even below UPSI to include premature information.[26]

In the landmark judgment of *Rakesh Agarwal v. SEBI*[27], Securities Appellate Tribunal ("**SAT**") provided a quantitative checkpoint for information to take the nature of UPSI. It was held that UPSI would come into existence before the official conclusion of negotiations. SAT elucidated that negotiations fall apart many times and thus the information is still in a fluid state. However, a negotiator can foresee the direction of negotiation midway, due to which UPSI has been determined to arise at such a time.

This issue can be understood by the case of *Starkman v. Marathon Oil Co.*[28]In 1981 Marathon Oil company ("**MOC**") recognized that it was a potential target for a hostile takeover, and at same time Mobil made an offer to acquire MOC. On 10th November, MOC entered negotiations with US Steel. On 11th November, MOC made public announcement rejecting the offer of Mobil. On 17th November, the negotiations between MOC and Steel came to an end. On 18th November, MOC received board approval and public announcement was made on 19th November. Starkman, the owner of Mobil, filed a suit contending that MOC did not disclose its ongoing negotiation with Steel in the public announcements on 11th November. The US court held that the duty to disclose arises when soft information virtually takes shape of hard information and not before it. This would mean when a deal reaches a level of certainty, only then does it constitute material information.

In light of the comparative threshold of UPSI and material information, it can be deduced that public mergers fructify at a very later stage, as the price of a

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26 Harshit Singh & Akshata Modi, *SEBI's Plan to Amend Material Disclosure Mandates: Needless Escalation of Compliance Burden*? THE HNLU CCLS BLOG (Aug. 03, 2023), https://hnluccls.in/2023/01/22/sebis-plan-to-amend-material-disclosure-mandates-needless-escalation-of-compliance-burden/.

27 Rakesh Agarwal v. SEBI, (2004) 49 SCL 351 (SAT)(Ind.)

28 Starkman v. Marathon Oil Co., 772 F.2d 231.(1982).

deal in based on historic price movement of the market value of the shares of the company.

B. SECTIONAL CONCLUSION

The issue with disclosures under LODR is that they make the company vulnerable to PFUTP, which aims to prevent market abuse on account of misleading information, while on the other end premature disclosure can lead to Merger deals being disarrayed. As observed in 2017, in the case of Amazon acquiring Whole Foods Market, wherein the disclosure led to a price surge of 29% in the price of Whole Foods, but later after the critical analysis of the financial analyst drove down the price, the stock price settled for a price lower than the acquisition price.[29]

The second issue with such a disclosure regime is that it will lead to an overflow of information.[30] This will not only lead to volatility in the market, but also create problems for determining what would constitute UPSI, and would lead to prohibition on trading under Section 4 of PIT. An overflow of information leads to miscellaneous information entering the market, and also material information becoming undiscoverable due to an excessive flow of information. This is counterproductive as it opens the scope for insiders to feed market with excess information and escape the bar on prohibition of trading.[31]

Inclusion of the definition of material information into the definition of UPSI would thus be counter-intuitive, not only to the definition but also the aim

[29] Lauren Hirsch, *A Year After Amazon Announced Its Acquisition of Whole Foods, Here's Where We Stand*, CNBC (Aug. 08, 2023) https://www.cnbc.com/2018/06/15/a-year-after-amazon-announced-whole-foods-deal-heres-where-we-stand.html.
[30] Sharad Abhyankar & Vaibhav Mittal, *SEBI Enhances Disclosure and Governance Requirements of Listed Entities*, KHAITAN & CO. (Jul. 28, 2023) https://www.khaitanco.com/thought-leaderships/SEBI-enhances-disclosure-and-governance-requirements-of-listed-entities.
[31] *Supra* note 16.

and objective of SEBI[32], as it would further create ambiguity in the market and reduce market participation. The companies would then find ways to avoid declaration of premature information, which can create obstruction in trading of employees, due to categorization of fluid information into UPSI. Thus, enlarging the definition in such an inorganic manner, while imposing extravagant allegiance towards "prompt" disclosure, loses out on the nature of information being "concrete" and "credible".[33]

V. EFFECTS OF PROPOSAL VIS-À-VIS INSIDER TRADING PROVISIONS

A. EVOLUTION OF THE DEFINITION OF UPSI

In August 2017, the Securities and Exchange Board of India (SEBI) established the Fair Market Conduct Committee ("**FMC Committee**"), with the primary aim of recommending amendments to the SEBI Prohibition of Insider Trading Regulations. As a part of its evaluation, the FMC Committee observed that the definition of Unpublished Price Sensitive Information included material events in line with the listing agreement. However, it proposed the elimination of material events from the UPSI definition. This recommendation was subsequently implemented, and it took effect on April 1, 2019.[34]

Following the amendment, SEBI noticed that certain listed entities tended to restrict the classification of specific events or information as UPSI in their public announcements. An analysis of press releases conducted by SEBI and the stock exchanges revealed that only a limited number of press releases were categorized as UPSI, while numerous others with potential sensitivity were excluded.

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32 Securities and Exchange Board of India Act, No.15 of 1992, Preamble, (Ind.).
33 ARMAN PATKAR, INSIDER TRADING LAW & PRACTIce (EBC 2019).
34 Committee on Fair Market Conduct, (Sec. & Exch. Bd. Of Ind.) Report of Committee on Fair Market Conduct (2018) https://www.sebi.gov.in/reports/reports/aug-2018/report-of-committee-on-fair-market-conduct-for-public-comments_39884.html

Companies seemed to confine their identification of UPSI to matters explicitly outlined within the SEBI PIT Regulations.[35]

To address these inconsistencies and establish a more consistent compliance framework, SEBI proposed further amendments to the definition of UPSI. The objective of this proposal is to incorporate disclosures mandated under Regulation 30 of the SEBI (LODR) Regulations, 2015, within the scope of the UPSI definition. This initiative aims to provide regulatory clarity and uniformity to listed companies in determining certain events or information as UPSI.

It is important to note that while the UPSI definition is comprehensive, it is not exhaustive. The various matters listed within the definition serve as guiding principles for identifying events or information as UPSI. SEBI's approach emphasizes enhancing transparency and promoting stakeholder participation in the affairs of listed companies, aligning with its broader policy of fostering greater market transparency.[36]

The SEBI PIT Regulations not only prohibit trading while in possession of UPSI, but also regulate the communication of UPSI to external parties unless necessary for legitimate purposes on a "need-to-know" basis. These regulations mandate the establishment of Chinese Wall procedures within market entities, and apply to listed companies, market intermediaries, and fiduciaries handling UPSI. SEBI has the authority to impose penalties for insider trading violations;

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[35] Harman Khorana & Nishchal Joshipura, *Insiders Beware: SEBI Proposes Changes to the Definition of Unpublished Price Sensitive Information*, NISHITH DESAI ASSOCIATES (Jul. 27, 2023), https://www.nishithdesai.com/NewsDetails/10620.

[36] Payal Agarwal, *Getting Material on "Material" Events and Information*, VINOD KOTHARI CONSULTANTS (Jul. 29, 2023) https://vinodkothari.com/2022/11/proposed-amendments-to-materiality-of-events-and-information/.

with penalties being either ₹25 crores or three times the gains from such violations, whichever is higher.[37]

The historical evolution of the UPSI definition can be traced back to August 2017, when SEBI constituted the FMC Committee. The committee submitted its report on August 8, 2018, recommending various amendments to the SEBI PIT Regulations. Regarding the UPSI definition, the FMC Committee recognized that it encompassed 'material events in accordance with the listing agreement' as UPSI. Additionally, the committee observed that Regulation 682 of the SEBI LODR Regulations required disclosures of material events or information, which may or may not be price-sensitive. The committee concluded that not all material events under Regulation 68 of the LODR Regulations would necessarily constitute UPSI under the SEBI PIT Regulations. Consequently, the FMC Committee proposed the removal of the explicit inclusion of 'material events in accordance with the listing agreement' from the UPSI definition under the SEBI PIT Regulations. Following market feedback, this amendment was enacted, taking effect from April 1, 2019.

In a recent development on May 18, 2023, SEBI issued a consultation paper seeking public feedback on the review of the UPSI definition under the SEBI PIT Regulations. The purpose of this consultation is to propose amendments to the UPSI definition that will promote clarity and uniformity in compliance.[38] The key proposal is to consider a "material event in accordance with Regulation 30 of SEBI LODR Regulations, 2015" as UPSI under Regulation 2(1)(n) of the SEBI PIT Regulations.[39]

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[37] Committee to Review the SEBI (Prohibition of Insider Trading) Regulations, 1992, Report of the High Level Committee to Review the SEBI (Prohibition of Insider Trading) Regulations, 1992, (Securities and Exchange Board of India, 2013).

[38] Vijay Bhutada & Manisha Tejwani, *New Insider Trading Norms - Tightening the Noose!*, LAW STREET INDIA (Aug. 01, 2023) http://www.lawstreetindia.com/experts/column?sid=288.

[39] Securities and Exchange Board of India, Circular No. SEBI/HO/CFD/CFD-PoD-1/P/CIR/2023/123 (Issued on Jul. 13, 2023).

B. UNDERSTANDING INSIDER

Section 2(g) of the PIT regulations define 'insider'. From the definition we derive two sets of persons. Firstly, connected person and secondly who can be in possession of UPSI. On greater perusal of the regulations, we understand that a person acting on UPSI can either possess UPSI, or can be expected to possess UPSI. A designated person, which is usually an employee, would be assumed to trade on insider information even if he is expected to possess UPSI, immaterial to whether he actually possesses UPSI. The same is applicable to connected person. Similarly, even if connected persons are not associated with the company directly, they cannot trade if they are expected to have access to UPSI.

C. BLACK-OUT PERIOD

The blackout period is a specified timeframe during which individuals with access to sensitive information are prohibited from trading their company's securities. This measure is implemented to prevent insider trading and is enforced by regulatory bodies like the SEBI.[40] Typically, the trading window remains closed from the conclusion of the financial period until 48 hours after the official results' announcement. Compliance officers of listed companies are responsible for enforcing blackout periods during which employees may have access to confidential information. The inclusion of a blackout period is a critical aspect of corporate policies aimed at deterring insider trading. It ensures that trading occurs only during specific windows in accordance with the SEBI PIT guidelines. Insider trading constitutes a financial crime where non-public information is exploited for the benefit of a select few, often at the expense of the broader market. In response, SEBI has established the PIT Regulations to regulate and restrict trading activities by individuals with access to significant inside information, particularly high-level executives and employees. In addition to the trading window closure, some companies may also observe a quiet period

[40] Denis, D.J. & Xu, J., *Insider trading restrictions and top executive compensation*, 56(1) J. OF ACC.&ECO., 91,112 (2013).

during which senior management and investor relations officers refrain from engaging with institutional investors, analysts, and the media. This quiet period is implemented to maintain objectivity and prevent any appearance of sharing insider information with specific parties.

It is essential to differentiate between the quiet period and the trading window closure. The latter prohibits employees from trading based on insider information, while the former restricts the company's representatives from interacting with investors and analysts to prevent unauthorized information leakage. The duration of the quiet period may vary depending on the company's practices.[41] In India, the issue of insider trading dates back to the 1940s, and regulatory efforts have been ongoing to address this problem. Guidelines and regulations, such as the PIT Regulations and the Guidelines for Investor Relations for Listed Central Public Sector Enterprises, have been introduced to combat insider trading and maintain fair practices in the securities market. Sections 307 and 308 had been incorporated in the Companies Act of 1956, and aimed to maintain a register of directors' shareholdings and required disclosure of such shareholdings. However, these provisions proved insufficient to curb insider trading, allowing directors and managing agents to exploit insider information without consequences. In 1979, the Sachar Committee highlighted the potential misuse of price-sensitive information by directors, auditors, and company secretaries, recommending amendments to restrict or prohibit dealings by employees.

The Patel Committee in 1986 defined insider trading and proposed amendments to the Securities Contract (Regulation) Act to curb such unfair practices. In 1989, the Abid Hussain Committee suggested the implementation of civil and criminal penalties for insider trading. Subsequently, in 1992, the SEBI (Insider Trading) Regulations were introduced to address fraudulent

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[41] Aisha Begum Ansari, *Understanding Silent Period for Listed Entities*, VINOD KOTHARI CONSULTANTS (Jul. 29, 2023) https://vinodkothari.com/2021/07/understanding-silent-period-for-listed-entities/.

practices in insider trading. These regulations were later amended in 2002 to further strengthen the framework for combating insider trading. In 2013, SEBI formed a panel led by former Chief Justice N. K. Sodhi, which proposed the internal disclosure of trades by promoters, employees, directors, and their immediate relatives to the company. The Justice Sodhi Committee aimed to enhance the predictability, precision, and clarity of insider trading regulations by adopting a combination of principle-based regulations and rules. Recently, in May 2023, SEBI had issued a consultation paper with the objective of reviewing the definition of UPSI under the SEBI PIT Regulations. [42] The purpose of this consultation is to seek public opinions and inputs, and to bring about clarity and uniformity in the compliance ecosystem. Overall, these developments demonstrate SEBI's continuous efforts to strengthen the regulatory framework surrounding insider trading, improve disclosure practices, and ensure fair and transparent practices in the Indian securities market.[43]

The restrictions imposed on individuals during access to UPSI are pertinent to understand the impact of the proposed amendment. Section 4(1) of the PIT regulations put restriction on trading when in possession of UPSI, this would be applicable on all insiders including designated person and their immediate relatives. They are further barred from communication of UPSI as per Section 3, blackout periods are applicable only on designated persons and their immediate relatives. Any designated person is subject to a trading window. In the open period, the designated person is believed to have no UPSI, and is subject to general restrictions like pre-clearance and contra trade, and is allowed to trade in the capital market. In black period, they are completely barred from trading, and these occur in both recurring and non-recurring forms. Recurring form denotes declaration of financial results, declaration of dividends, etc and non-recurring includes mergers, takeovers, buybacks etc. After the amendment in PIT

[42] Sonakshi Das & Sanjana Sahu, *The Know-All of Insider Trading – Decades of Corruptive Prevention*, Academike (Aug. 2, 2023) https://www.lawctopus.com/academike/know-insider-trading-decades-corruptive-prevention/.

[43] *Supra* note 43.

regulations, certain group of personnel like promoters are presumed to have access to UPSI irrespective of their involvement in the activities of the company. The discretion of compliance officer with respect to closing of trading window is reduced, and is mandated to be applied from the end of every quarter to 48 hours until declaration of financial results.

The effect of a black-out period is that "trading" is halted. This includes buying, selling or agreeing on any sort of transaction in securities, even with a trading plan. The outcome of the same is that currently a designated person loses almost 195 days a year of trading, due to the black out period imposed, due to occurrence of recurring form of UPSI. The proposed amendment to UPSI which contemplates inclusion of the definition of material information in insider information will further reduce the open period, as the definition of material information directs companies towards premature declaration. This implies that even soft information could lead to trade window restrictions. The current law allows various transactions like block deals and exercise of stock options but the same are up to the discretion of the compliance officer.

The decrease in threshold of what constitutes material information may be suitable for disclosure and information symmetry, but when the same is incorporated in a punitive law like that of insider trading it holds greater risks. Not only does it reduce trading opportunities for designated persons but also provides a very premature level of culpability. This creates a hindrance in trade and the potential of same can be repelling promoters from market which would affect the liquidity of the market.

D. ANALYSIS

The analysis of the proposed amendment to the definition of Unpublished Price Sensitive Information under the SEBI (Prohibition of Insider Trading) Regulations, 2015 highlights several important points. The recent approval by SEBI for the review and rationalization of the disclosure of material events or information by listed entities, along with the introduction of quantitative thresholds to determine materiality and disclosure for certain types of agreements, played a significant role in suggesting the amendment to the UPSI definition. This initiative is aimed at bringing clarity and uniformity to the compliance framework for listed companies in response to the changes made to Regulation 30 of the SEBI LODR Regulations.

It is crucial to comprehend that the UPSI definition under the SEBI PIT Regulations is comprehensive but not exhaustive. The listed matters in the definition serve as guiding principles for listed entities to categorize events or information as UPSI. SEBI's overarching goal is to reduce information asymmetry between listed entities and market participants while promoting transparency and stakeholder participation in the affairs of listed companies. The proposed amendment aligns with SEBI's broader approach towards transparency and consistency in disclosure requirements.[44]

The consultation paper seeks public comments on the proposed amendment, specifically focusing on the nature of information released by the top 100 listed companies through press releases and its impact on share prices and notional profits. This analysis forms the rationale for including information related to material events under Regulation 30 of LODR within the definition of UPSI.

Overall, the proposed amendment reflects SEBI's commitment to enhancing market transparency and ensuring a fair and level playing field for all stakeholders. By actively seeking public feedback and implementing these regulatory improvements, SEBI aims to foster investor confidence and maintain the integrity of the Indian securities market.

E. APPLICABILITY AND IMPLICATIONS

[44] Sachar, R. & Wani, A., *Regulation of Insider Trading in India: Dissecting the Difficulties and Solutions Ahead* 2(11) JCIL 3,4 (2017).

The proposal to reintroduce the inclusion of "material event in accordance with Regulation 30 of SEBI LODR Regulations, 2015" within the definition of UPSI is aimed at addressing the existing disparity in disclosures by entities. However, debt listed companies will continue to adhere to their current practices regarding disclosures.[45]

The suggested change will extend the scope of the same regulation to encompass events considered material, but not necessarily in the nature of UPSI. As a result of the proposed amendments under Regulation 30 in conjunction with Schedule III, several new items will be added to the list of events requiring disclosure. Consequently, the frequency and likelihood of disclosure notifications will increase.[46]

The expansion of disclosure requirements will lead to additional formalities and compliance obligations, such as entries in the System for Digital Disclosure and the closure of the trading window, even for events that do not qualify as Unpublished Price Sensitive Information.[47]

It is important to note that SEBI has recognized that all information related to material events may not necessarily be price-sensitive, and thus, such information has been removed from the scope of UPSI. However, if an individual trades in a company's securities, while in possession of UPSI, the amended Regulations presume guilt of that person. Additionally, the amended

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[45] Securities and Exchange Board of India, Circular No. SEBI/HO/CFD/CFD-PoD-1/P/CIR/2023/123 (Issued on July 13, 2023).

[46] Anand Jayachandran & Supriya Aakulu, *SEBI Amendments to the LODR – An Overview of Key Changes*, CAM (Jul. 25, 2023), https://corporate.cyrilamarchandblogs.com/2023/07/sebi-amendments-to-the-lodr-an-overview-of-key-changes/.

[47] Harman Khorana & Nishchal Joshipura, *Insiders Beware: SEBI Proposes Changes to the Definition of Unpublished Price Sensitive Information*, NISHITH DESAI ASSOCIATES (Jul. 27, 2023), https://www.nishithdesai.com/NewsDetails/10620.

Regulations allow block deals between individuals in possession of UPSI, as long as both parties have made a conscious and informed trade decision.[48]

The recent developments of SEBI showcase a draconian pattern with vague definitions and harsh regulations. The recent consultation of Prohibition of Unexplained and Suspicious Trade Activities regulations is an example of the same. The PUSTA regulations have two important nods. Firstly 'suspicious trade activities'; which refers to trades which are unusual in nature and are based on MNPI. Unusual trade pattern would mean any trading pattern which SEBI finds to be repetitive and involves substantial change in risk. Not only is substantial change in risk undefined but the vagueness of this term could include virtually any trade. MNPI deals specifically with information which can have reasonable impact of scrip prices. This again mirrors the same flaw of being vague as to how much impact constitutes reasonable. The second aspect which makes the regulations extremely archaic is the reverse burden of proof, wherein any person would have to prove absence of guilt. This virtually means proving to have no possession of UPSI. Moreover, SEBI provides no clear standard for the same which raises alarm as to how can an accused prove to 'not' have UPSI or MNPI during trading. There is no clarification as to the application of limitation periods, for the consideration of time frames pertaining to unusual trade pattern.[49]

Thus, hypothetically this can result to SEBI imposing allegations on an individual, wherein the individual has to provide detailed documentary evidence, for the absence of unfair means of information which was premature in nature, and would generally not constitute UPSI, but was a mere delay in declaration of non-concrete and non-credible information.

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[48] *Supra* note 19.

[49] Harshit & Jay, *SEBI (PUSTA) Regulations: An Indeterminate Shifting of Evidentiary Burden?*, Ind. Corp L. (Jul. 29, 2023) https://www.irccl.in/post/sebi-pusta-regulations-an-indeterminate-shifting-of-evidentiary-burden.

Although PUSTA is not notified as of now, the current developments show that the potential impact of SEBI's legislative powers can create an unsustainable atmosphere for trading in Indian securities market. The watchdog would create a concentrated regime of over-regulation, which not only goes against constitution but also natural justice.

An effective method for SEBI can be legal transplantation of the US standard of total mix of information. This standard prescribed not only quantitative standards but also qualitative standards, to strike a balance between overflow of information and liberalized landscape, which can be a playground for insiders. This was observed in the case of Matrixx Initiaitves Inc.[50], wherein it was held that the total mix of information regime prevents a generalized regime which can be easily evaded, and it doesn't create an archaic burden on companies too. Given the dynamic nature of securities market, the same would also be transplanted by changes and should be tailor made for Indian markets.

VI. CONCLUSION

By allowing the Board of Directors ("**BOD**") to determine the scope of "designated persons" and "legitimate purposes," SEBI has acknowledged that deciding the appropriate recipients of UPSI is a subjective matter best left to the BOD. This approach aligns with the recommendations made in the Report of the Committee on Corporate Governance in October 2017, and the Report of the Committee on Fair Market Conduct in August 2018, advocating for such power delegation to the BOD. Pairing this power with the duty to act, in the best interests of the listed company, SEBI aims to establish a transparent yet

[50] *Supreme Court Reaffirms "Total Mix" Standard for Assessing Materiality in Federal Securities Actions*, Willkie Farr & Gallagher LLP (August 09, 2023), https://www.willkie.com/~/media/Files/Publications/2011/03/Supreme%20Court%20Reaffirms%20Total%20Mix%20Standard%20For%20A__/Files/SupremeCourtReaffirmsTotalMixStandardpdf/FileAttachment/Supreme-Court-Reaffirms-Total-Mix-Standard.pdf.

flexible framework for UPSI disclosure, bringing clarity to the Regulations and facilitating business operations in India.

However, SEBI's mandate for the creation of databases and the disclosure of a wide range of information has resulted in an overzealous approach, and significantly increased compliance burdens for all market entities. It remains to be seen whether SEBI can effectively enforce these obligations and achieve the desired outcomes. In conclusion, the proposed reintroduction of "material event in accordance with Regulation 30 of SEBI LODR Regulations, 2015" within the definition of UPSI holds the potential to curtail insider trading practices by making it more difficult for insiders to trade in confidential information. This measure envisages a more level playing field for all investors, promoting fairness and integrity in the securities market but is also counter-intuitive when tested in the general modus operandi of securities trading.

To further strengthen insider trading regulations in India, SEBI could consider implementing certain additional measures which are rather equitable, and vouch further towards prevention of insider trading, without created a draconian regime for promoters and other designated persons. The threshold of the prompt disclosure regime could be strengthened rather than reducing the thresholds of disclosure. This could include enhancing surveillance mechanisms, incorporating recent technological developments to identify copy trading, or algo trading based on insider information. A higher deterrence can be incorporated in order to prevent insider trading instead of demanding an array of disclosures. For instance, increasing the minimum penalty for insider trading violations could act as a stronger deterrent and send a clear message of zero tolerance towards such misconduct.

Furthermore, the establishment of a dedicated enforcement unit solely focused on investigating insider trading cases would enhance the efficiency and effectiveness of enforcement efforts, ensuring that offenders are swiftly brought to justice rather than imposing an unnecessary burden of disclosures on companies given the vagueness and overspread requirements of disclosure. By redeeming the proposed amendment with these supplementary measures, SEBI can reinforce its commitment to maintaining market integrity, safeguarding investor interests, and fostering a transparent and equitable securities environment in the country.

INVESTIGATING THE PROPOSALS FOR EARLY LIQUIDATION AND RESOLUTION IN PARTS: IS IT THE EQUILIBRIUM BETWEEN COC 'COMMERCIAL WISDOM' AND IBC OBJECTIVES?

Shukla Pooja Sunilkumar & Mohammad Atik Saiyed[*]

ABSTRACT

With the sequenced irreversible transformations in the utility forces of the prosumers, we are swirling in the corporate concentric which is dynamically adapting to the intertwined economic needs. IBC has a central three-dimensional objective of revival for the benefit of stakeholders, value maximization, and fast-track resolution. However, firstly, there have been instances where the aspect of the 'benefit of all the stakeholders' is compromised by the CoC in the exercise of their powers. Conflictingly, the CoC mischievously escalates the process by not voting in favor of any resolution plan and initiating the liquidation process, when there are chances of their own higher recovery by virtue of the waterfall mechanism. But at the same time, no compromise to the commercial wisdom of the CoC is acceptable.

Secondly, on the flip perspective, there are occasions wherein there is no scope for the revival of the company and no availability of any viable resolution plans, still, the Resolution Professional and the CoC are compelled to continue with the unreasonable CIRP process in obedience to the procedure established by the Code as there are no spaces for escalating liquidation in the Code. Consequently, the CIRP process is wasting time and resources even when there is no scope for revival and furthermore, delayed liquidation is leading to the decreased realization of the value of assets.

Thirdly, there are traces where Potential Resolution Applicants are interested in a particular part of the business rather than resolving as a whole. Summing up, the IBC development is currently playing billiards, with all three essential elements clustered and

[*] The authors are fourth year students at Gujarat National Law University.

colliding together. Therefore, contrasts, conflicts and commendations have been raised in the paper for the dilemma - How to strike a reasonably balanced equilibrium between all the aspects to deliver the central objectives of the IBC?

The paper examines twin proposals recently made by the IBBI relating to 'Resolution in Parts' and 'Early Liquidation', and some associated sharp edges that the body must explore insight into have been raised. An investigation into the CoC 'Commercial wisdom', its misuse, and its control by a code of conduct has also been made. Summing up the analogy, for enhanced efficiency, a recommendation for installing the twin proposals hand-in-hand allowing 'Parallel-Partial Resolution cum Liquidation' has been given. Parallelly, some structural reformations for safeguarding the fine balance between the objectives of the Code have been suggested, such as the adoption of a comprehensive and dynamic cross-regulatory strategy, the constitution of a Stakeholder Consultation Committee, and the appointment of an Independent Member and its use as an enforcement tool of the CoC Code of Conduct, the appointment of an 'Administrator' by the Central Government and lastly, investing efforts for Liquidation as a 'Going Concern'.

Keywords: Stakeholders, Liquidation, Independent, Asset, Resolution Professional

TABLE OF CONTENTS

I. INTRODUCTION

With the sequenced irreversible transformations in the utility forces of the prosumers[1], we are swirling in the corporate concentric which is dynamically adapting to the intertwined economic needs leading to the evolution of novel outlooks, conflicts and compromises, dilemmas, and legal methods of interpretation and application. Harmonizing with the invisible hand of the market[2], the Law is also constantly attempting to reflect the structural balance[3]. Efficiently dissolving and facilitating the business entities to channel the limited resources[4] to a higher-valuing alternative is an integral part of constructing a business environment. On the congruent foundation, the *Insolvency and Bankruptcy Code, 2016* ("**IBC**" *or the* "**Code**") was introduced with a bird-eye view of reorganizing and resolving the corporate debtors in a timely manner for optimizing the worth of assets to serve the benefit of all stakeholders.[5]

Within the matrix, the Committee of Creditors ("**CoC**") comprised of the financial creditors is the driving body constituted under Section 21[6] of the Code and is empowered with the authority to carry forward the resolution[7] as well as the liquidation[8] process. Constructing a bare substructural understanding, Corporate Insolvency Resolution Process ("**CIRP**") is designed to resolve the insolvency of corporate entities by formulating a resolution plan to revive the company and pay off its creditors.

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[1] James Mclelland, *The Utilities Industry is at the Center of a Massive Global Shift,* FORBES (Jun.23, 2021) https://www.forbes.com/sites/sap/2021/06/23/the-utilities-industry-is-at-the-center-of-a-massive-global-shift/?sh=12a57e04351b.

[2] Emma Rotschild, *Adam Smith and the Invisible Hand*, 84 JSTOR, 319 (1994).

[3] Jonathan Anomaly & Geoffrey Brennan, *Social Norms, The Invisible Hand, And The Law,* SSRN (2014) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2527984

[4] Olanrewaju Olamide, *The Meaning and Features of Law,* DIET LAWYER (Mar. 21, 2016) https://djetlawyer.com/meaning-and-features-of-law/

[5] The Insolvency and Bankruptcy Code, No. 31 of 2016 (Ind.).

[6] The Insolvency and Bankruptcy Code, No. 31 of 2016, §33 (Ind.).

[7] The Insolvency and Bankruptcy Code, No. 31 of 2016, §33 (Ind).

[8] The Insolvency and Bankruptcy Code, No. 31 of 2016, §33 (Ind).

In stark contrast, in liquidation, the company's assets are sold off and the proceeds are used to pay off its creditors. In the insolvency regime, the IBC was introduced with the background of expanding challenges being faced by the Banking arm because of the fragmented legislation. We stand in the transitory gestation period of the Code evolving from the Pre-IBC jurisprudence and ergo, disagreements over some structural reformations would satisfy the objective in a comprehensive manner.

II. NAVIGATING THE PERSPECTIVES EVOLVING FROM OBJECTIVES

Lucidly outlined earlier, IBC has a central three-dimensional objective of revival for the benefit of stakeholders, value maximization, and fast-track resolution. Paramountly, the commercial wisdom of the CoC is indispensable for an effective resolution process and the same has been constantly affirmed by the judicial direction. However, *firstly,* there have been instances where the aspect of the 'benefit of all the stakeholders' is compromised by the CoC in the exercise of their powers. Conflictingly, the CoC mischievously escalates the process by not voting in favor of any resolution plan and initiating the liquidation process under Section 33[9]of the Code, when there are chances of their own higher recovery by the virtue of the waterfall mechanism[10] enshrined under Section 53 of the Code. But at the same time, no compromise to the commercial wisdom of the CoC is acceptable as the financial creditors are the primary aggrieved parties.

Secondly, on the flip perspective, there are occasions wherein there is no scope for the revival of the company and no availability of any viable resolution plans, still, the Resolution Professional ("**RP**") and the CoC are compelled to

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[9] The Insolvency and Bankruptcy Code, No. 31 of 2016, §33 (Ind).

[10] *The relevancy of "Waterfall mechanism" in 2022 under IBC*, KHURANA AND KHURANA ADVOCATES AND IP ATTORNEYS, https://www.khuranaandkhurana.com/2022/12/12/the relevancy-of-waterfall-mechanism-in-2022-under-ibc/.

continue with the unreasonable CIRP process in obedience to the procedure established by the Code as there are no spaces for escalating liquidation in the Code. Consequently, the CIRP process is wasting time and resources even when there is no scope for revival and furthermore, delayed liquidation is leading to the decreased realization of the value of assets.

Thirdly, there are traces in composite businesses where Potential Resolution Applicants ("**PRA/s**") are interested in a particular part of the business rather than resolving as a whole. Nevertheless, the PRAs do not wish to additionally invest in the other parts of the business, which is eliminating a chance of efficient realization plans and forcing the business to liquidate, which yields comparatively lesser from a panoramic perspective of all the stakeholders.[11] Summing up, the IBC development is currently playing billiards, with all three essential elements clustered and colliding together. Therefore, contrasts, conflicts and commendations have been raised in the paper for the dilemma - How to strike a reasonably balanced equilibrium between all the aspects to deliver the central objectives of the IBC?

III. CONSTRUCTING THE SUB-STRUCTURE: CONTEMPORARY STRUCTURAL REVIEW

The IBC has constructed a legal superstructure to provide a time-bound and efficient process for resolving insolvencies and reorganizing financially distressed businesses. In alignment with the IBC Procedure, a creditor or the debtor itself may initiate the insolvency process by filing an application with the National Company Law Tribunal ("**NCLT**"). On application and admission, the CIRP has 180 days to come up with a resolution plan as provided in Section 12,[12]which

[11] Probability of high yield only to the financial creditors because of the waterfall mechanism under Section 53.
[12] The Insolvency and Bankruptcy Code, No. 31 of 2016 §12 (Ind.).

must be approved by the CoC under Section 30(4),[13] before being presented to the NCLT within the ambit of Section 31[14] for final approval.

If the CoC does not approve the plan within the specified time, the company may be liquidated under Section 33 of the Code. Extracting the essence, the objectives of the Code can be lucidly outlined as, *firstly,* value maximization of the assets[15] of the Corporate Debtor ("**CD**"), *secondly,* timely insolvency resolution[16] and reorganization[17] and *thirdly,* balancing the interest of all the stakeholders[18] and conclusively, liquidation of an entity or debt recovery was never a direct objective of the IBC.[19]

A. DISINTEGRATING THE COMMITTEE OF CREDITORS

The Committee of Creditors is constituted under Section 21 of the Code and the primary responsibility for establishing the corporate debtor's viability and developing a resolution strategy to allow it to continue operating as a going concern rest with the CoC[20]. Within the statutory frame[21], the CoC is embarged with crucial commands essential to the resolution process such as the functioning of the CD, the appointment and replacement of an interim resolution professional ("**IRP**"), the adoption of the resolution plan, the

[13] The Insolvency and Bankruptcy Code, No. 31 of 2016, §30(4) (Ind).
[14] The Insolvency and Bankruptcy Code, No. 31 of 2016, §31 (Ind).
[15] The Bankruptcy Law Reforms Committee, The Report Of The Bankruptcy Law Reforms Committee Volume I: Rationale(2015), https://www.ibbi.gov.in/BLRCReportVol1_04112015.pdf
[16] M/s Innoventive Industries Ltd. v. ICICI Bank and Ors., (2018) 1 SCC 407(Ind.).
[17] Swiss Ribbons Pvt. Ltd. v Union of India, (2019) 4 SCC 17(Ind.).
[18] The Insolvency and Bankruptcy Code, No. 31 of 2016, Preamble (Ind).
[19] SUMANT BATRA, CORPORATE INSOLVENCY: LAW AND PRACTICE 40 (LexisNexis, 1st edn, 2017).
[20] Arcelor Mittal India Pvt. Ltd. v. Satish Kumar Gupta & Ors, (2019) 2 SCC 1 (Ind.).
[21] The Insolvency and Bankruptcy Code, No. 31 of 2016, §21, 22, 27, 30 & 33 (Ind.).

distribution of proceeds to creditors and the liquidation of the CD.[22] Adding weight, the judicial precedents have exponentially expanded the supremacy of the commercial wisdom of the CoC.

B. UNEARTHING THE 'COMMERCIAL WISDOM' OF THE COC

Progressing to unfold judicial behavior, the apex court in the case of *K Sashidhar v. Indian Overseas Bank and Others*[23] provided for the obligation of NCLT to warrant the resolution plan already approved on the commercial wits of the CoC, as it stands "non-justiciable". Along similar lines, the Supreme Court tightened the reins of the tribunal by limiting the scope of judicial review within the ambit of Section 30(2) and Section 32 read with Section 61(3) of the Code in the case of the *Committee of Creditors of Essar Steel India Ltd v. Satish Kumar Gupta & Ors.*[24]

Moving further parallelly, the disability of the tribunal to review commercial prudence was further reasserted in a line of judgments such as the case of *Kalpraj Dharamshi & Anr v. Kotak Investment Advisors Ltd & Anr*[25] and *Maharashtra Seamless Ltd v. Padmanabhan Venkatesh & Ors.*[26] Shading the analytical color of precedents, recently, the apex court in *Ghanashyam Mishra & Sons Pvt Ltd through the Authorized Signatory v. Edelweiss Asset Reconstruction Co Ltd through the Director & Ors.*[27] reminded the primacy of the CoC wisdom.

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[22] Megha Mittal, *Financial Creditors and Committee of Creditors : What, Why and How?,* VINOD KOTHARI CONSULTANTS (Sep. 15, 2008) https://vinodkothari.com/2018/09/financial-creditors-committee-of-creditors-what-why-and-how/

[23] K Sashidhar v. Indian Overseas Bank and Others, (2021) 2 SCC 469 (Ind.).

[24] Committee of Creditors of Essar Steel India Ltd v. Satish Kumar Gupta &Ors., (2019) UKSC 53, (2020) 1 WLR 2875.

[25] Kalpraj Dharamshi & Anr v. Kotak Investment Advisors Ltd &Anr, (2019) SCC OnLine Bom 3092 (Ind.).

[26] Maharashtra Seamless Ltd v. Padmanabhan Venkatesh &Ors, (2020) SCC OnLine Bom 977 (Ind.).

[27] Ghanashyam Mishra & Sons Pvt Ltd through the Authorized Signatory v. Edelweiss Asset Reconstruction Co Ltd through the Director &Ors, (2019) SCC OnLine NCLAT 7 (Ind.).

In a landscape outlook, the roots of the authority can be traced to the *BLRC Report*[28], which sketched that the CoC alone should be in charge of deciding the proper course of action for a defaulting corporation. Convincingly, it is reasonable to deduce that the commercial wisdom of the CoC has been granted considerable gravity in the resolution process. Emphasis supplied, it is the pivotal objective of the IBC to revive the insolvent unit and the alternative of liquidation has been kept on the last pedestal.

Nonetheless, there have been observations (Elaborated extensively as the paper flows further) where the CoC has exercised unfettered discretion in the veil of *'Commercial wisdom'* to advance their own objectives as the claims of secured financial creditors have the highest priority under the waterfall mechanism enshrined in Section 53.[29] Leading the same boat in a distinct direction, though the RP does not have voting rights, there have been occurrences where the RP has manipulated the process by carrying on the CIRP over liquidation, even when there exists no horizon of revival. Cumulatively, both are negatively impacting the objectives of the IBC.

C. UNDERSTANDING THE RESOLUTION PROCESS

Proceeding further, the aspect of the resolution plan gets initiated with the submission of the information memorandum followed by the invitation for expressions of interest.[30] Consequently, the resolution professional is mandated to issue the Evaluation Matrix[31] as well as the Request for resolution plans ("**RFRP**") under *Regulation 36B* of the IBBI Regulations, 2016. The CoC

[28] Ministry Of Finance, Government Of India, The Report Of The Bankruptcy Law Reforms Committee, Volume I: Rationale And Design (2015) https://dea.gov.in/sites/default/files/BLRCReportVol1_04112015.pdf.
[29] The Insolvency and Bankruptcy Code, No. 31 of 2016, §53 (Ind.).
[30] Insolvency Resolution Process For Corporate Persons Regulations, 2016, Gazette of India, pt. III sec. 4 Reg. 36 & 36A (Nov. 30, 2016).
[31] Insolvency Resolution Process For Corporate Persons Regulations, 2016, Gazette of India, pt. III sec. 4 Reg. 2(HA) (Nov. 30, 2016).

considers the resolution plans and votes on the plan that it deems suitable which must be approved by at least 66%[32] of the voting share of the CoC. Alternatively, in consonance with the powers derived from *Regulation 36B(7),*[33] the resolution professionals possess the authority to re-issue the RFRP with the CoC's consent, if the plans received are unsatisfactory.

The re-issue highlight holds importance as the Insolvency and Bankruptcy Board of India ("**IBBI**") has recently released a discussion paper[34] that seeks to explore partial resolution plans for particular parts of the business at the stage of re-issue of RFRP, which has been extensively analyzed eventually. Accordingly, the insight into the current legal framework supplied forms the foundation of the legal analogy and the recommendations.

IV. DESIGNING THE DILEMMA: ASSOCIATED INSOLVENT ISSUES

The insolvency code was headed with an optimistic outlook of consolidating the insolvency laws towards efficiency, however, the factual matrix substantiates otherwise. Throwing light on the same, recently the CoC headed by IDBI bank approved a plan agreeing to a haircut of 93.25% and settled the admitted claims of INR 4,863.87 Crore in the case of ***Vallal** RCK v. Siva Industries and Holdings Limited*[35]. Congruently, the CoC assented to take a haircut of 95.85% in the case of *SBI v. Videocon Industries Ltd.*[36]. In observation, it is essential to highlight that

[32] The Insolvency and Bankruptcy Code, No. 31 of 2016, §30(4) (Ind).
[33] Insolvency And Bankruptcy Board Of India (Insolvency Resolution Process For Personal Guarantors To Corporate Debtors) Regulations, 2019, Gazette of India, pt. III sec. 4 (Nov. 20, 2019).
[34] Insolvency and Bankruptcy Board of India, *Discussion Paper On Changes In The Corporate Insolvency Resolution Process To Reduce Delays And Improve The Resolution Value (2020)* https://ibbi.gov.in/uploads/whatsnew/9a71f15c9b21a7dd626a8ca47846a113.pdf.
[35] Vallal RCK v. Siva Industries and Holdings Limited (2019) SCC OnLine Mad 3579 (Ind.).
[36] State Bank of India v. Videocon Industries Ltd. (2018) SCC OnLine NCLT 13182 (Ind.).

the same path has been followed throughout every insolvency proceeding in the nation.

Examining the statistics, an aggregate of 6,199 CIRPs were allowed before several NCLT benches. Of these, 894 CIRPs were challenged, revised, or resolved; 793 were withdrawn under Section 12A; resolution plans for 611 were granted; and 1907 CIRPs led to the commencement of dissolution.[37] In spite of the fact that 30% of all CIRPs ended in liquidation, many of these organizations were already "dead, and the corporate worth of corporate borrowers had already eroded."[38]

On that sub-structure, while taking note that astonishingly around 71% of the total cases have failed to comply with the statutory timeline of 180 days[39], the *32nd Finance Committee Report*[40] alluded to huge divergence from the principal parliamentary intent owing to diverse associated issues leading to unreasonable delays and reduced realizations, which can be highlighted as follows:

A. PARTIAL RESOLUTION FOR REVIVAL AND VALUE MAXIMIZATION

A resolution plan is a proposal put out by the resolution applicant for the insolvency resolution of the corporate defaulter as a going concern under Section 5(26) of the IBC. The phrase "going concern" suggests that the resolution plan should culminate with the disposition of the complete business

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[37] Insolvency and Bankruptcy Board of India, *IBBI Quarterly Newsletter* 25 October - December, 2022 https://ibbi.gov.in/homdownloads.

[38] ASSOCHAM, *Insolvency And Bankruptcy Code, 2016 - Looking Back To Advance Forward assocham – Part IV (Prevailing Issues In Insolvency Resolution And Investment In Stressed Assets | Knowledge Architect Of India* (2022) https://www.assocham.org/uploads/files/Knowledge%20Report-%20Compressed.pdf.

[39] The Insolvency and Bankruptcy Code, No. 31 of 2016 , §12(Ind.).

[40] Insolvency and Bankruptcy Board of India, *Thirty-second Report of Standing Committee on Finance* (2020-21).
https://www.ibbi.gov.in/uploads/whatsnew/fc8fd95f0816acc5b6ab9e64c0a892ac.pdf.

and activities of the CD under one framework, according to the general understanding of Resolution Professionals, CoCs, and some NCLT rulings.[41]

The stance remains topsy-turvy as the reality suggests that the bidders can be more interested in specific business divisions or assets than the overall company. The contemporary complex corporate structures can be disintegrated into diversified businesses and locations in the economy, consisting of all units which might be well-performing, functional, or non-functional.

On that paradigm, there have been instances where the PRAs are rationally interested in investing in particular business units/assets owing to varied reasons such as functionality, location, etc. However, since the mechanism under the IBC only facilitates a "resolution plan as a whole", reasonably, the higher valuing PRAs are eliminated when the cost of additional investment in the non-functional assets/different location assets outweighs the benefits being derived from the resolution of the business/asset that the PRAs are interested in.

In economic terms, with limited availability of resolution plans because of such disability, the overall efficiency and realizable value diminish. Alongside, there have been examples when no resolution plans are received even when some parts of the business/assets are performing extremely well, and are in a position to realize significantly. Because of an inefficient system evaluating diverse businesses in the same matrix is not leading to the equilibrium value. Resultantly, limited resolution plans are received because of the elimination of PRAs not interested in reviving all the arms of the CD, pushing the CD to liquidation. Inevitably, the realization of assets is relatively lower with liquidation, and also, the *"interests of all the stakeholders"* are not valued because of the waterfall mechanism.

[41] *Id.*

B. Balancing early liquidation with the CoC Powers

Moving further in the prism, the fabric of the legislation (IBC) establishes a process that provides for attempting CIRP for the revival of the company before going into liquidation. In obedience to the law, there are times when there is no chance for the company to be revived and no viable resolution plans are available, but the Resolution Professional and the CoC are still required to proceed with the unreasonable CIRP process in compliance with the procedure set forth by the Code because there are no provisions in the Code for escalating liquidation. In those circumstances, the CIRP procedure is a waste of time and money even when there is no chance of revival, and supplementarily, delaying liquidation reduces the value of assets that may be realized.

Quite the opposite, there have been cases where the element of the 'benefit of all the stakeholders', specifically of the shareholders who are lowest in the waterfall mechanism, is not considered by the CoC in the exercise of their powers. While there is a prospect of their own higher recovery because of the waterfall mechanism codified in Section 53 of the Code, the CoC, in contrast, maliciously escalates the process by refusing to vote in favor of any resolution plan and starting the liquidation process under Section 33.[42]

Condensing the essence, it can be highlighted that the CoC is an oscillating pendulum towards either CIRP when higher recovery is possible or liquidation when favorable otherwise. Nevertheless, to ensure fast-track resolution and maximum realization, the ambit of CoC wisdom cannot be curtailed but has to be rather expanded to include the power to call for early liquidation. Parallel to increasing the capacity of the CoC, conversely, the mechanism for checks and balances should also be installed to safeguard the interests of all, which has been strived in the subsequent part.

[42] The Insolvency and Bankruptcy Code, No. 31 of 2016 , §33(Ind.).

V. IBBI PROPOSAL OF AMENDMENT TO REGULATIONS

In alignment with the inadequate dimensions of the Code highlighted and to comprehensively deal with the same, the regulating body - IBBI has released a discussion paper[43] recently which outlines diverse challenges being faced and attempts to deal with those challenges in an effective manner. Thereby, it is cardinal to examine the proposals being made for the amendment to the regulations[44] and to highlight fallacies as well as multi-dimensional recommendations, as it will define the legal anatomy in the future course.

Navigating further, the following analysis will flow in two phases: *Firstly,* Efforts for the resolution of functional/operating parts of the CD *(Third Proposal),* and *Secondly,* the Guiding factors for the CoC to decide on early liquidation *(Fourth Proposal).*

A. EXPLORING PARTIAL RESOLUTION OF BUSINESSES/ASSETS

As noted earlier, bidders can be more interested in specific business divisions or assets than the overall company, and reasonably, the higher valuing PRAs are eliminated leading to reduced overall efficiency and realizable value. Taking the same into account, the IBBI has proposed an amendment to the regulations by way of the insertion of *Regulation 37A,* which reads as follows:

"37A Resolution of assets of the corporate debtor

(1) The resolution professional and the creditor may in cases where there were prospective resolution applicants expressing interest in the corporate debtor but no resolution plan was received after the time for submission of resolution plan has lapsed explore to resolve part of the assets of the corporate debtor.

[43] Insolvency and Bankruptcy Board of India, *Discussion Paper On Changes In The Corporate Insolvency Resolution Process To Reduce Delays And Improve The Resolution Value* (2022), https://ibbi.gov.in/uploads/whatsnew/9a71f15c9b21a7dd626a8ca47846a113.pdf.
[44] *Supra* note 30.

(2) A resolution under this regulation shall be enabled by modification of the request for resolution plan issued as provided in regulation 36B." (Discussion Paper dated June 27, 2022)

Broadly, the proposal is a positive step towards higher realization in line with the recommendation of the *32nd Finance Report*[45], leading to superior commercial outcomes from the insolvency process. The parliamentary purpose can be lucidly understood in harmony with the introduction of *Regulation 36B(6A)*[46], which empowered the RP to re-issue RFRP for part assets, read with the IBBI press release[47]. Parallelly, the CD's assets may be transferred in whole or in part to one or more people under *Regulation 37* implying that there is no legal impediment. Practically, the partial sale of assets was being practiced during the liquidation stage but the proposal will open avenues for efficient part businesses/assets resolution.

Essentially, there are some positive as well as normative aspects revolving around the proposal that needs scrutiny, which is as follows:

1. **Preference for resolution plan as a whole:**

The proposal provides that the option of resolution of part assets/businesses has to be exercised at the stage of the re-issue of RFRP. Reasonably, even after the change in effect, a preferential attempt would be made to resolve the CD as a whole at the EOI stage and therefore, the same would not alter the central structure of the Code.

45 *Supra* note 40.
46 Insolvency Resolution Process For Corporate Persons Regulations, 2016, Gazette of India, pt. III sec. 4 Reg. 36B(6A) (Nov. 30, 2016).
47 *Supra* note 30.

2. **<u>Lack of precision about CoC consent:</u>**

The proposal is silent on whether the issue of an RFRP in accordance with the aforementioned regulation will require the consent of the CoC holding fifty-one percent (51%)[48] or sixty-six percent (66%)[49] of the voting share.

3. **<u>Criteria for exploring resolution in parts:</u>**

Reiterating the proposal, the revised RFRP for resolving parts of assets/businesses can only be issued if no resolution plan has been received. However, the proposal should also take into account the probability that a need for part resolution would arise even when the plans received are not efficient to the expectations of the CoC and the CD should not be pushed to liquidation.

4. **<u>A mechanism for division and attribution of liabilities:</u>**

Lucidly, the resolution process of a CD as a whole involves clearing/settling encumbrances and reviving the business. Incomparably, when the assets/businesses would be resolved in parts, there should be some skeletal mechanism for dividing and determining liabilities that are to be attached to the particular asset which should be several and restricted to obligations under their own resolution plan only.

5. **<u>Scope of part resolution 'as a going concern':</u>**

A resolution plan is *"a proposal put out by the resolution applicant for the insolvency resolution of the corporate defaulter as a going concern"* under Section 5(26) of the IBC. Consequently, with the amendment in force, there appears a technical issue with regards to the sale of parts of the assets/businesses as a 'going concern'. Therefore, if the IBC being the parliamentary statute is amended to include

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[48] Insolvency and Bankruptcy Code, No. 31 of 2016, §21(8) (Ind.).
[49] *Supra* note 30.

horizons of *Regulation 37* (Subordinate legislation) for the resolution process[50], the same effect has to be made in the definition.

Consonantly, the proposal attempts to deal with the issue effectively and can be the turning point for value maximization and time-boundness in the insolvency regime. Nevertheless, the proposal is optimistic but its practicality needs to be assessed[51], wherein, the highlighted edges have to be considered by the regulatory and the impact can be further enhanced by complying with the recommendations supplied consequently.

B. FRAMEWORK GUIDING THE CoC FOR EARLY LIQUIDATION

With the perspective of reducing the chances of wastage of time and resources when there are no hopes and viability of revival and coordinately, also eliminating the risk of lesser realization because of the delayed liquidation, the IBBI has proposed an amendment to the regulations by way of the insertion of *Regulation 40D*, which reads as follows:

"*40D. Decision for liquidation*

(1) The committee while considering the liquidation of the corporate debtor may consider factors such as non-operational status for preceding 3 years, goods produced or service offered being obsolete, the technology employed being obsolete, lack of intangible assets like brand value, intellectual property, accumulated losses/depreciation, investments that are yet to mature that reflect the viability of the corporate debtor.

[50] *Supra* note 40.

[51] Sahyaja S, *Is the government's latest attempt to revive insolvency law any good?* BQ PRIME (2023) https://www.bqprime.com/law-and-policy/governments-latest-attempt-to-revive-insolvency-law-is-it-any-good.

(2) Such consideration may be recorded and submitted in the application for liquidation order submitted by the resolution professional to the Adjudicating Authority."[52] (Discussion Paper dated June 27, 2022)

Paramountly, the proposed amendment seeks to exclude wastage of time and resources in unreasonable CIRP process, when the entity has no scope of the resolution. Lucidly, the proposal in effect will add considerable value to the objectives of the Code. Without entering into the investigation of the grounds for early identification as they are still under deliberation, we would like to highlight aspects revolving around the proposal that requires insight.

1. **CoC and its wisdom in Liquidation**

The Committee of Creditors is the fundamental arm carrying forward the insolvency process and therefore, they are also empowered with the teeth of 'Commercial wisdom' by the legislative structure in consonance with the judicial interpretation, which cannot be compromised as corroborated in the case of *Committee of Creditors of Essar Steel India Ltd v. Satish Kumar Gupta &Ors.*[53]and *Jaypee Kensington Boulevard Apartments Welfare Association and Ors. v. NBCC (India) Ltd. and Ors.*[54] Regardless, the CoC must not be granted uncontrolled authority to infringe on the essence of the Code.

2. **Excessive wisdom infringing the IBC Objectives**

Foremostly, it is important to highlight that there have been instances where the CoC has exercised unreasonable wisdom by pushing the corporate debtor to liquidation for its own benefit as they hold the highest priority in the waterfall

[52] Insolvency and Bankruptcy Board of India, Proposal 4, *Discussion paper on changes in the corporate insolvency resolution process to reduce delays and improve the resolution value* (2022) https://ibbi.gov.in/uploads/whatsnew/9a71f15c9b21a7dd626a8ca47846a113.pdf.
[53] Committee of Creditors of Essar Steel India Ltd v. Satish Kumar Gupta & Ors., (2019) UKSC 53, (2020) 1 WLR 2875.
[54] Jaypee Kensington Boulevard Apartments Welfare Association and Ors. v. NBCC (India) Ltd. and Ors., (2019) 1 SCC 505 (Ind.).

mechanism under Section 53. Unquestionably, as observed in the case of *Jayanta Banerjee v. Shashi Agarwal*[55], *"Liquidation is like a death knell for the corporate entity, and the CoC wisdom is reduced to nullity when it vitiates the objective of the Code."*

The excessive commercial wisdom is undermining the IBC[56] which can be traced in diverse judgments including *Vallal RCK v. Siva Industries and Holdings Limited*[57] and *Jindal Saxena Financial Services Pvt. Ltd. v. Mayfare Capital Pvt. Ltd.*[58]. Along similar lines, the principal bench of NCLT in *SBJ Exports & Mfg. Pvt. Ltd. v. BCC Fuba India Limited*[59] observed and reprimanded the behavior of the financial creditors in the CoC.

In congruent application of the situation that we are forecasting, recently, the NCLT Delhi Bench encountered an instance in the case of *Rajesh Narang v. Durha Vitrak Pvt. Ltd. &Anr.*[60] where the Resolution Professional and the CoC conspired together to liquidate a hospital, which had the scope of revival. Therefore, the proposal will open floodgates of interpretation as the CoC will further advance their own objectives wherever possible and will liquidate the company in contravention of the objective of revival. On that note, there is a need to tighten the reins of the commercial wisdom to warrant the interest of all the stakeholders and to reduce haircuts.[61]

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55 Jayanta Banerjee v. Shashi Agarwal (2021) CompCas 291(Ind.).

56 *Is commercial wisdom undermining IBC? experts call for Relook*, ZEE BUSINESS (2021) https://www.zeebiz.com/india/news-is-commercial-wisdom-undermining-ibc-experts-call-for-relook-161994.

57 Vallal RCK v. Siva Industries and Holdings Limited (2019) SCC OnLine Mad 3579 (Ind.).

58 Jindal Saxena Financial Services Pvt. Ltd. v. Mayfair Capital Pvt. Ltd., OMP (I) (COMM) 523/2018(Ind.)

59 SBJ Exports & Mfg. Pvt. Ltd. v. BCC Fuba India Limited, Order No. IBBI/AA/003/2017(Ind.).

60 Rajesh Narang v. Durha Vitrak Pvt. Ltd. &Anr., (2022) 12 NCLAT CK 0033 (Ind.).

61 Tamanna Inamdar, *View: Strike balance between commercial wisdom and judicial wisdom to minimise haircuts under IBC*, THE ECONOMIC TIMES (Nov. 23, 2021) https://economictimes.indiatimes.com/news/company/corporate-trends/view-strike-balance-

3. Safeguarding the wisdom as well as the stakeholder interests

Unquestionably, non-compliance to the timeframe leads to erosion of confidence[62], but that interest has to be rightfully balanced with the aspect of revival as well as benefit to all stakeholders, modes of which have been provided in the recommendations. Therefore, the scope of judicial review of commercial wisdom is quite narrow within the four walls of the IBC, following which, the IBBI has issued a discussion paper for the code of conduct[63] of the CoC which should include some form of enforcement mechanism[64], such as empowering the Adjudicating Authority to impose penalties[65].

Alternatively, in a comparative global outlook, for protecting the stakeholders, the legislation can consider making an identical provision to the USA, wherein, a resolution plan can only be authorized if it satisfies specific requirements, including the approval of at minimum one impaired class when there are classes that are impaired under the plan, according to Section 1129(a)(7)[66] of the US Bankruptcy Code ("**US Code**").[67]

Summing up, the proposal constructs a pragmatic foundation for fast-track resolution, but at the same time, opens space for the exploitation of the

between-commercial-wisdom-and-judicial-wisdom-to-minimise-haircuts-under-ibc/articleshow/87863487.cms.

[62] Insolvency and Bankruptcy Board of India, *Effective Implementation of the Insolvency and Bankruptcy Code, 2016 - Some Issues and Challenges, Discussion Paper* (2021) https://ibbi.gov.in/Discussionpaper-CIRP-27Aug2021.pdf.

[63] *Supra* note 30.

[64] *Code of conduct for COC – need of the hour?* (PART-I) RFMLR (2022) https://www.rfmlr.com/post/code-of-conduct-for-coc-need-of-the-hour-part-i.

[65] Ministry of Corporate Affairs, *Proposal 05 - Invitation of comments from the public on changes being considered to the Insolvency and Bankruptcy Code, 2016 (2023)*, https://www.mca.gov.in/content/dam/mca/pdf/IBC-2016-20230118.pdf.

[66] US Bankruptcy Code, 11 U.S.C. § 1129(a)(7), LEGAL INFORMATION INSTITUTE (2021).

[67] Gaargi Singh, *Need for Judicial Scrutiny of the Commercial Wisdom of COC,* IRCCL (2022) https://www.irccl.in/post/need-for-judicial-scrutiny-of-the-commercial-wisdom-of-coc.

commercial wisdom by the CoC. On that reasonable account, the option of early liquidation has to be entrenched in a manner that will balance multiple dimensions of the timely resolution, revival, and stakeholders' interest, a few of which are suggested hereinbelow.

VI. RECOMMENDATIONS

Perceiving the Proposals for amendment to the Regulations from an analytical prism, some aspects require deliberation from the Board. The IBBI has made a positive attempt to holistically justify the Objectives of the IBC, ergo, the restructuring regime in the nation is bound to proliferate, in economic terms, with the implementation of the proposal. Per contra, the Proposals bring with themselves some parallel concerns, highlighted at the outset, which can be resolved, and more efficiency can be pulled in with the consideration of the following recommendations:

A. PARALLEL-PARTIAL RESOLUTION CUM LIQUIDATION

In our perspective derived from the logical and legal analogy, the best outlook for a balanced insolvency regime would be achieved by dissolving the positive parts of the two proposals into one 'twin-proposal' which facilitates a structure for holistic and simultaneous resolution as well as liquidation. Within the present legislative anatomy, the discussion paper establishes that even if the proposal is in effect, there must be one resolution plan which provides for the whole CD as a going concern. However, distinct catastrophic effects can be forecasted if the proposals are implemented in isolation leading to the wastage of time, and resources and diminished realization because of delayed liquidation.

Essentially, we are of the opinion that when the RFRP is re-issued for the resolution of parts of assets/businesses and resolution plans are not received after the expiry of the period for the non-functional parts of the business or for some specific locations, the regulatory body should design the framework for simultaneous early liquidation under *Regulation 36B(6A)* for the non-functional assets/businesses.

Unquestionably, such a change in structure would be a fundamentally challenging breakthrough, but in the long-run perspective, this would be the most reasonably balanced equilibrium point to satisfy the dimensions of maximum realization along with a timely process.

For a bare example, if on a certain date, X is a corporate debtor holding two businesses - A and B, wherein, the RFRP has been reissued and on the expiry of the period to receive resolution plans, the revival plan for only unit A has been received. On the flip perspective, rather than waiting for the CIRP to be accomplished, there should be some skeletal standard/framework for the CoC to proceed with for the early liquidation of unit B, which would result in timely completion as well as value maximization. Nevertheless, such power to the CoC should be granted in a controlled manner with entrenchment[68] for the benefit of all the stakeholders.

B. COMPREHENSIVE AND DYNAMIC CROSS-REGULATORY STRATEGY

Paramountly, to ensure that the evolving structure contributes to value addition congruent to the expectation, it is important to tighten the reins of the CoC against any unwarranted actions infringing the principal objectives of the Code. On the contrary perspective, the control cannot be a quantitative form of penalty or punishment as it would contribute to hindrance in the 'Commercial wisdom'.

Reflecting on the aspects of the dilemma, it has been noted that the majority of the financial creditors who are CoC members are either banks or financial

[68] Controlling the "Commercial wisdom of COC" has been dealt in detail in subsequent recommendations, specifically, Recommendation B, C, D & E.

institutions that fall under the strict regulation of the RBI or SEBI. Hence, it would be advisable to create a prescriptive guideline for the CoC, guarantee that financial creditors abide by it, and do so by expanding their regulatory framework to the bankruptcy resolution process.

1. **Maintaining a dynamic Creditor Insolvency Conduct Classification Ratio 'directly proportional' to the Loan-to-value Ratio or any similar form of qualitative control:**

Lucidly outlined earlier, the financial creditors are regulated by the RBI and the regulator is empowered to control liquidity ratios under the ambit of the *RBI Act, 1934*[69]. Escalating two steps in advance of the global jurisdiction, preliminary efforts should be made to integrate the information utilities and create depositories of information that include the behavior of the creditor in diverse insolvency proceedings.

Adding to the flame, the resolution professional could be mandated to prepare a report on the members of the CoC based on some prescriptive guidelines. Consequently, this integration could be employed to maintain a dynamic *'Creditor Insolvency Conduct Classification Ratio'* ("**CICC**"), which would share a directly proportional relationship with the *'Loan-to-value Ratio'* ("**LTV**")[70]**.** In essence, the directly proportional relationship implies that the higher the creditor acts in obedience to the objectives of the Code, the higher the ratio he would have, and consequently, the higher the quantum of loan he can lend out for the same value of the collateral.

Such a qualitative control will ensure perpetual compliance with the Code and will yield twin benefits, *firstly,* with dynamic and continuous impact on the

[69] The Reserve Bank of India Act, 1934, No. 2 of 1934 (Ind.).
[70] Reserve Bank of India, QUANTUM OF LOAN (NOTIFICATION RBI/2022-23/95 DBR.NO.BP.BC/7/21.04.048/2022-23, https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12243&Mode=0).

ratio for every misbehavior, higher collateral would be required for the same amount of loan and resultantly, a lesser quantum of debtors will choose that mode of financing. *Secondly,* presuming a stance when even with the higher collateral requirements, some debtor is choosing that alternative for some other trade-off, which implies that a company is in a financially healthy condition leaving a lesser probability of insolvency. This directs that the misbehaving creditors will have a diminished chance to negatively impact the stakeholders by seating in the CoC.

C. CONSTITUTION OF STAKEHOLDER CONSULTATION COMMITTEE AND APPOINTMENT OF AN INDEPENDENT MEMBER

As highlighted earlier, early liquidation yields exponential advantage to the process, however, it can also act detrimental to the interests of the stakeholders if a streamlined prism for balancing the powers of the CoC is not safeguarded. Parallelly, it has been observed that the majority of insolvency litigation traces its root to an inefficient channel of communication. In alignment with the substructure with our perspective, the regulatory arm should mandate the formation of a 'Stakeholder Consultation Committee' ("**SCC**") if the CoC has resolved for early liquidation.

Furthermore, a standard framework providing quantitative thresholds analogous to Section 149[71]of the Companies Act, 2013 should be formulated for the appointment of an independent member to head the committee. Flowing further, the CoC will have to substantiate why liquidation could be the best alternative and satisfy itself on what grounds are they liquidating with a written record. Following this, to ensure equal representation, the resolution to liquidate has to be approved by the SCC with the majority which may be specified, by all

[71] The Companies Act, No. 18 of 2013, §149(Ind).

the stakeholders, wherein, the voting share has to be determined on a fully-diluted basis[72].

Parallelly, it is paramount to ensure that such an entrenchment does not result in dilution of the 'Commercial wisdom'; On that premise, even if the liquidation resolution is not approved, then also, the CoC should be retained with the discretion to proceed with liquidation, if they deem fit, provided that the CoC has to be placed under an obligation to preserve a provision for the dissenting stakeholders with the 'least value' received from various Resolution Plans.

D. INDEPENDENT MEMBER AS AN ENFORCEMENT TOOL OF THE CODE OF CONDUCT

The insolvency domain is currently stuck in the muddled saga of the enforcement of the Code of Conduct. As highlighted, it is quite impossible to install enforcement mechanisms for the Code of Conduct, however, the regulator should explore the viability of mandating approval of the independent member for every non-obedience to the Code of Conduct and can also construct a structure obliging the CoC to provide for written reasons of each act of the creditor, including the selection of a particular plan, to amplify transparency and accountability.

E. APPOINTMENT OF AN 'ADMINISTRATOR' BY THE CENTRAL GOVERNMENT

Unfolding extensive control in matters of 'Public importance', either the legislative arm or the regulator should stipulate a quantitative threshold for the appointment of an administrator carrying out the insolvency process. For instance, if the cumulative admitted claims exceed INR 150 Crores, then the

[72] FULLY DILUTED BASIS | PRACTICAL LAW, https://uk.practicallaw.thomsonreuters.com/0-574-9408?contextData=(sc.Default).

Central Government is directed to appoint an administrator to navigate and lubricate the insolvency process.

F. EFFORTS FOR LIQUIDATION AS A 'GOING CONCERN'

When an entity is sold as a "going concern,"[73] it is implied that it will continue to operate under the same identity and structure as it did before the transaction was initiated. Regulation 32(e) and 32(f) of the Insolvency and Bankruptcy Board of India (Liquidation Process) Rules, 2016,[74] which address the sale of the corporate debtor or its company as a continuing concern, have been recommended for deletion and appropriate change by the Standing Committee on Finance.

In contrast, we respectfully disagree with the Standing Committee's position and argue that eliminating the option of a going-concern sale based solely on the existing provisions' lack of alignment would be excessive and have a negative impact on the extensive advantages of going-concern sales, such as value maximization and timeliness.[75]

VII. CONCLUDING PERSPECTIVE

Dissolving the legal, logical, and commercial balances highlighted with the alignment of the central IBC objective, it can be concluded that it is considerably difficult to strike an equilibrium between the colliding interests of the stakeholders. Essentially, the protection of 'Commercial wisdom' of the CoC is of paramount importance corroborated by the legislative fabric as well as the judicial interpretations. Reflecting further dimensions of the prism, it can be

[73] Ashmika Agrawal*, Liquidation as going concern under insolvency and Bankruptcy law,* SSRN (2020) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3527389.
[74] Insolvency and Bankruptcy Board of India, Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017, Gazette of India, pt. III sec. 4 Reg. 36B(6A) (Mar. 31, 2017).
[75] Staff, *Concerns on Going Concern Sale under IBC*, VINOD KOTHARI CONSULTANTS (2021) https://vinodkothari.com/2021/08/concerns-on-going-concern-sale-under-ibc/#_ftn1.

derived that the proposals made by the IBBI are optimistic to serve the interests of the IBC by ensuring timely resolution by facilitating early liquidation parallel with value maximization by way of constructing a structure for partial resolution of the parts of the assets/businesses.

Lucidly substantiated earlier, the IBC development is currently playing billiards, with all three essential elements, i.e., efficient realization, timely resolution, and interests of all the stakeholders, clustered and colliding together. Undoubtedly, the proposals made by the regulatory authorities are a step in the correct direction, however, there are some associated sharp edges that the body must explore insight into. Alongside, the CoC cannot be granted unfettered authority to determine the fate of the Corporate Debtor, thereby, all the aspects of the process have to be entrenched in obedience to the principal objectives of the Code.

In conclusion, for enhanced efficiency, the twin proposals can be installed hand-in-hand allowing 'Parallel-Partial Resolution cum Liquidation'. Parallelly, there are some suggested structural reformations that the IBC regime needs to install to safeguard the fine balance between the objectives of the Code such as the adoption of a comprehensive and dynamic cross-regulatory strategy, constitution of Stakeholder Consultation Committee and appointment of an Independent Member and its use as an enforcement tool of the CoC Code of Conduct, appointment of an 'Administrator' by the Central Government and lastly, investing efforts for Liquidation as a 'Going Concern'.

'To be or not to be' can only be resolved with actual application, evolution, and disagreements.

ATTACHMENT OF UNSECURED AND SECURED PROPERTIES OF THE CORPORATE DEBTOR: A TUSSLE BETWEEN PMLA & IBC

Tejas Kandalgaonkar[*]

ABSTRACT

The courts and tribunals have attempted to harmoniously interpret Prevention of Money Laundering Act, 2002 and the Insolvency and Bankruptcy Code, 2016 to not give overriding effect to either statute. Even though the attachment proceedings initiated by Directorate of Enforcement are civil in nature, the courts have given them a criminal character. Moreover, the courts have come to the conclusion that attachment of properties is not allowed only after the approval of a resolution plan. This has led to Directorate of Enforcement being given the right to attach and confiscate properties of corporate debtor undergoing corporate insolvency resolution process. The secured creditors are the only class of creditors that are allowed to exercise right over the attached property if they prove their prior bona-fide interest. This arrangement has caused detriment to the insolvency resolution process of the corporate debtor and hindered the recovery of debt by unsecured creditors.

As the Directorate of Enforcement provisionally attaches the assets, the corporate debtor faces the risk of being pushed into liquidation. On the other hand, the unsecured creditors face the issue of non-recovery of debt as the pool of assets gets reduced. The Insolvency and Bankruptcy Code, 2016 was enacted to revive companies having stressed finances. However, presently, the objective of the new insolvency regime is not being achieved. To reinstate the trust of creditors in the new insolvency resolution law, the attachment proceedings should be considered as 'civil' in character to bring them under the ambit of moratorium period under the Insolvency and Bankruptcy Code, 2016.

Keywords: enforcement, laundering, moratorium, attachment of assets, PMLA, IBC.

[*] The author is a fifth year law student at Maharashtra National Law University Mumbai.

TABLE OF CONTENTS

I. INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 ("**IBC**") was introduced to reform the insolvency resolution model in India. The new regime revolutionised the insolvency resolution of companies under stress by entrusting creditors with the power to steer the company towards revival and minimising judicial interference throughout the process. The scheme of IBC is such that the assets of the corporate debtor are kept under the control and custody of the resolution professional[1] and a moratorium is announced to preserve the assets' value.[2] The moratorium period is a fundamental feature of the new insolvency law that helps the corporate debtor to remain as a 'going concern'[3] while the committee of creditors finalises a resolution plan for the insolvent company.[4] During Corporate Insolvency Resolution Process ("**CIRP**"), the creditors look forward

[1] The Insolvency and Bankruptcy Code, No. 31 of 2016, §18(f) (Ind.).
[2] Swiss Ribbons v. Union of India, (2019) 4 SCC 17 (Ind.).
[3] Gujarat Urja Vikas Nigam Ltd. v. Amit Gupta, (2021) 7 SCC 209 (Ind.).
[4] The Insolvency and Bankruptcy Code, No. 31 of 2016, §30(Ind.).

to recovery of debt and the corporate debtor hopes for a fresh start after the approval of the resolution plan.

The Directorate of Enforcement ("**ED**") has often disregarded the moratorium period by attaching the assets of the corporate debtor undergoing CIRP when it suspects that the corporate debtor in involved in money laundering. The Prevention of Money Laundering Act, 2002 ("**PMLA**") has bestowed the authority upon ED to provisionally attach assets of companies[5] and continue the pending investigation against the accused.[6] The provisional attachment orders and subsequent confiscation of properties of the corporate debtor are seen as a huge disadvantage to corporate debtor in its successful rehabilitation. This is because the corporate debtor, who is already under financial stress, is left with fewer assets than before. Involvement of the ED can also generate distrust within the creditors in the insolvency regime as the recovery of debt is jeopardised by the reduced pool of assets. The attachment of properties by ED is often criticised as it is claimed to be in violation of the provisions of IBC.

Presently, the settled position of law is such that the ED can attach the assets of the corporate debtor before the approval of resolution plan.[7] However, if the creditors can prove that they had a prior bona-fide interest in the assets, then such secured assets can be released by ED even without an approved resolution plan.[8] The author will argue that the current arrangement runs contrary to the objective of the IBC and should be reconsidered by the courts. The courts should consider that the CIRP is a time bound process and a provisional attachment of property on mere suspicion can derail the

[5] The Prevention of Money Laundering Act, No. 15 of 2002, §5(1) (Ind.).
[6] ABHIMANYU BHANDARI AND KARTIKA SHARMA, A CRITIQUE OF THE PREVENTION OF MONEY LAUNDERING ACT, 2002 chp. 3.2.1 (LexisNexis 2020).
[7] Rajiv Chakraborty Resolution Professional of Eiel v. Directorate of Enforcement, 2022 SCC OnLine Del 3703 (Ind.).
[8] Directorate of Enforcement Delhi v. Axis Bank, 2019 SCC OnLine Del 7854 (Ind.).

rehabilitation process. The public perception towards the company after ED investigation will create difficulties for the company to regain momentum in the market. The moratorium bars the attachment proceedings and that the provisions of IBC such as Section 32A and Section 14 should not be read in isolation. Finally, the courts should balance the objectives of both statutes and not create an eco-system that discourages creditors from investing in companies.

The paper is divided into six chapters. *Firstly*, the author will briefly explain the offence of money laundering and the use of PMLA in curbing the said offence **(Part II)**. *Secondly*, the author will discuss the nature of proceedings under PMLA and whether the same should be considered falling within the ambit of moratorium under IBC **(Part III)**. *Thirdly*, the author will delve into the safeguards provided by the IBC to protect the corporate debtor and its assets **(Part IV)**. *Fourthly*, the author will explain how the two conflicting non-obstante clauses are generally interpreted **(Part V)**. *Fifthly*, the author will analyse the attachment of assets of corporate debtor under PMLA **(Part VI)**. This chapter will be divided into two parts to effectively deal with the issue of attachment of secured and unsecured assets respectively. *Lastly*, the author will discuss issues with the current interpretation of the concerned laws and why the courts should reconsider the position of law with respect to the interplay between IBC and PMLA. Here, the author will attempt to present arguments in favour of giving precedence to IBC over PMLA **(Part VII)**.

II. THE SCHEME OF PMLA

Money laundering is a process through which illicit wealth is transferred through a series of deceptive transactions which blurs its illegal origin and makes it reappear in the market in a legitimate form.[9] Laundering of money by criminals in usually done in three steps: placement, layering and integration.[10] At the stage

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[9] Vandana Kumar, *Money Laundering: Concept, Significance, and its impact* 4(2) EJBM 114 (2012).
[10] MC MEHANATHAN, LAW ON PREVENTION OF MONEY LAUNDERING IN INDIA chp. 2 (LexisNexis 3rd ed. 2022)

of placement, the illicit wealth is introduced in the legitimate financial channel and the origin of such wealth is made obscure. During the second stage, the money is made to flow through various legitimate financial channels so that tracking the origin of the money becomes difficult. At the third stage, the illicit money is integrated with legitimate money of the criminal and showed as untainted.[11] As money laundering is an effective way to conceal illegal money, it is majorly used in organised crimes that generates significant proceeds.[12]

To prevent money laundering and to confiscate properties conveyed from the proceeds of crime, PMLA was introduced in India.[13] Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976, and Benami Transactions (Prohibition) Act, 1988 are examples of legislations that were enacted with a similar purpose. Section 3 of PMLA defines the 'offence of money laundering'[14] and the term 'proceeds of crime' forms the heart of the Section 3.[15] The term 'proceeds of crimes' means any property or asset obtained as a result of a criminal activity.[16] This property is provisionally seized by the authorities to protect it from getting disposed of by the accused. The offence of money laundering is dependent upon a 'predicate offence' or 'schedule offence' whose proceeds are shown as untainted by the offender.[17] For the offence of money laundering there has to be 'proceeds of crime'.

If it is found that the property of the accused person is 'proceeds from crime', then the ED can provisionally attach the properties under Section 5 of PMLA.[18] The Supreme Court of India in Binoy Viswam v. Union of India[19]

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[11] *Id.*
[12] *United Nations Global Programme against Money Laundering*, IMOLIN (Aug. 8, 2023) http://www.imolin.org/imolin/gpml.html.
[13] The Prevention of Money Laundering Act, No. 15 of 2002 (Ind.).
[14] The Prevention of Money Laundering Act, No. 15 of 2002, §3 (Ind.).
[15] J. Sekar v. Union of India, (2018) 145 SCL 637 (Delhi) (Ind.).
[16] The Prevention of Money Laundering Act, No. 15 of 2002 §2(u) (Ind.).
[17] Kiran Shah v. Enforcement Directorate, 2022 SCC OnLine NCLAT 2 (Ind.) ¶67.
[18] The Prevention of Money Laundering Act, No. 15 of 2002, §5(1) (Ind.).

observed that by whatever extent possible, unearthing of tainted money must be achieved. Therefore, the ED has been conferred extensive power to investigate matters related to money laundering, and to attach tainted properties of the accused. The ED has the authority to attach 'alternative attachable properties' or 'deemed tainted properties' as well.[20] A tainted property is a property that was "*acquired or obtained directly or indirectly from proceeds of criminal activity constituting a scheduled offence*".[21] Whereas, an 'alternative attachable property' or 'deemed tainted property' does not contain any 'taint' but has nexus with the offence or offender of money laundering. The ED can attach an 'alternative attachable property' or 'deemed tainted property' when the tainted property is not traceable.[22] Using the said powers, the ED can attach assets of the corporate debtor undergoing CIRP under IBC.

III. NATURE OF PROCEEDINGS UNDER PMLA

The paramount function of the adjudicating authority under PMLA is to confirm the provisional attachment of properties made by the ED. This exercise of attachment of property does not declare the accused person guilty of money laundering but it ensures that the property is not disposed of by the accused. The ED provisionally attaches properties under Section 5 and the adjudicating authority confirms the said attachment under Section 8.[23] The investigation continues after the confirmation of attachment as the ED seeks to determine whether the accused is liable of committing an offence punishable under PMLA.[24] Once the ED finds incriminating evidence against the accused, the accused is made to appear against the Special Court established under PMLA.

[19] Binoy Viswam v. Union of India, (2017) 7 SCC 59.
[20] Directorate of Enforcement Delhi v. Axis Bank, 2019 SCC OnLine Del 7854 (Ind.) ¶171(iii)
[21] *Id.*
[22] *Id.*
[23] Directorate of Enforcement v. Manoj Kumar Agarwal, 2021 SCC OnLine NCLAT 121 (Ind.) ¶55.
[24] ABHIMANYU BHANDARI AND KARTIKA SHARMA, *supra* note 6.

The offences are triable in the Special Courts[25] and are non-bailable and cognizable under the statute.[26] Thus, under PMLA, there are two distinct adjudicating mechanisms that run parallel;[27] one assesses attachment of property by the ED, and the other tries the accused charged with offences categorised under PMLA. There are two separate adjudicating bodies set up under the law i.e., adjudicating authority and Special Court.

The object of the proceedings before the adjudicating authority under PMLA is merely concerned with safeguarding of accused person's property.[28] The Appellate Tribunal for Prevention of Money Laundering Act ("**ATPMLA**") in Bank of India v. Deputy Director Directorate of Enforcement,[29] came to the conclusion that attachment proceedings under PMLA are civil proceedings. Moreover, the civil nature of proceedings under PMLA can be noticed by a bare reading of certain provisions under said law. Section 11 states that the adjudicating authority has the same powers as a civil court under the Code of Civil Procedure, 1908.[30] In addition, Section 41 of PMLA explicitly bars the jurisdiction of the civil courts and confers jurisdiction on adjudicating authorities under PMLA.[31] Even from the scheme of PMLA, it can be inferred that the adjudicating authority under PMLA undertakes civil proceedings and the Special Court undertakes criminal proceedings.

Nevertheless, some orders by tribunals and courts have categorised attachments proceedings under PMLA as criminal proceedings. The NCLAT in

[25] The Prevention of Money Laundering Act, No. 15 of 2002, §44 (Ind.).
[26] The Prevention of Money Laundering Act, 2002, No. 15 of 2002, §45 (Ind.).
[27] J. Sekar v. Union of India, (2018) 145 SCL 637 (Delhi) (Ind.) ¶36.
[28] Navdeep Singh v. Assistant Director, Directorate of Enforcement, MANU/PH/1764/2018 (Ind.) ¶15.
[29] Bank of India v. Deputy Director Directorate of Enforcement, 2019 SCC Online ATPMLA 23 (Ind.).
[30] The Prevention of Money Laundering Act, 2002, §11, No. 15 of 2002 (Ind.).
[31] The Prevention of Money Laundering Act, 2002, §41, No. 15 of 2002 (Ind.).

Varrsana Ispat v. Deputy Director, Enforcement Directorate,[32] opined that Section 14 of IBC is not applicable to any act having essence of crime or crime proceeds. The tribunal was of the opinion that the ED cannot be prevented from attaching properties of the corporate debtor even if moratorium is announced under IBC as attachment proceedings are 'criminal' in nature. Later, the Hon'ble High Court of Delhi in Directorate of Enforcement Delhi v. Axis Bank ruled that attachment of property under PMLA is a "*civil sanction which runs parallel to investigation and criminal action vis-a-vis the offence of money-laundering*".[33] However, it was also observed that the Recovery of Debts and Bankruptcy Act, 1993 ("**RDBA**"), the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI**") and IBC do not override PMLA as the objective of penalising money laundering offences cannot be undermined by any other law.[34]

IV. SAFEGUARDING ASSETS OF THE CORPORATE DEBTOR UNDER IBC

The IBC was introduced in India to revive companies under stress and to protect the creditors of such companies. The new insolvency regime initiated in 2016 brought with it some stellar changes to the corporate law of India. It gave precedence to the insolvency resolution process over any other civil proceeding under other statutes. For this purpose, the IBC provided for measures such as moratorium period[35] and no liability for prior offences[36].

[32] Varrsana Ispat Limited v. Deputy Director of Enforcement, 2019 SCC OnLine NCLAT 236 (Ind.).
[33] Directorate of Enforcement Delhi v. Axis Bank, 2019 SCC OnLine Del 7854 (Ind.) ¶171(i).
[34] *Id.* ¶171(vi).
[35] The Insolvency and Bankruptcy Code, , No. 31 of 2016, §14 (Ind.).
[36] The Insolvency and Bankruptcy Code, No. 31 of 2016, §32A (Ind.).

A. MORATORIUM PERIOD

In 2015, the Bankruptcy Law Reform Committee ("**BLRC**") published a report which proposed for a 'calm period' for insolvency resolution. Under the said calm period, the BLRC suggested a halt on all recovery actions and filing of new claims against the insolvent company.[37] The BLRC also prescribed for an insolvency professional to take over the management of the insolvent company.[38] Under IBC, moratorium comes into effect on the date of commencement of CIRP. Once an order to this effect is passed by the tribunal, existing recovery and legal proceedings against the debtor are stayed and the insolvency professional takes charge of reviving the debtor.[39] The objective of moratorium is essentially to protect the value of the insolvency estate from debtor and creditors and facilitate fair and orderly administration of insolvency proceedings.[40] As seen in above chapter, a moratorium order results in a stay on proceedings which are mainly civil in nature. Recently, the courts have extended the effect of moratorium to proceedings under Section 138 Negotiable Instruments Act ("**NI Act**") as the proceedings under the NI Act are categorised as quasi-criminal proceedings.[41]

When moratorium is declared, the insolvency estate gets under the control of the resolution professional.[42] All the creditors must submit claims for repayment of their debt according to the provisions of the IBC, and they cannot enforce a right over the assets of the debtor once CIRP begins.[43] The IBC has classified

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[37] IBBI, *The Report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design* 32 (2015) https://ibbi.gov.in/BLRCReportVol1_04112015.pdf.
[38] *Id.*
[39] The Insolvency and Bankruptcy Code, No. 31 of 2016, §14 (Ind.).
[40] SUMANT BATRA, CORPORATE INSOLVENCY LAW AND PRACTICE 242 (EBC 2017).
[41] P. Mohanraj v. Shah Brothers Ispat Pvt. Ltd., 2021 SCC OnLine SC 152 (Ind.).
[42] AKKANT KUMAR MITTAL, INSOLVENCY AND BANKRUPTCY CODE LAW AND PRACTICE 529 (EBC 2021).
[43] SUMANT BATRA, *supra* note 40.

government as an operational creditor[44] which means that the pending dues of the government and its agencies are repaid according to the procedure laid down in the law. However, we can notice that the ED takes a different approach to recover proceeds of crime without entering the CIRP under IBC.

B. SECTION 32A: NO LIABILITY FOR PRIOR OFFENCES

One of the principles on which the IBC was enacted is the clean slate theory. The 'fresh start theory' absolves the insolvent company from offences committed prior to commencement of rehabilitation process.[45] Section 32A of IBC provides that the corporate debtor cannot be held liable for offences committed before the commencement of CIRP once the resolution plan is approved by the adjudicating authorities.[46] The further requirement as envisaged under the provision is that after the approval, there must be a change in management of the corporate debtor and the persons mentioned in sub-section 1 of Section 32A should not gain control.[47]

In Anil Goel, Liquidator of Varrsana Ispat v. Deputy Director, Director of Enforcement,[48] the NCLT has broaden the scope of Section 32A. The Tribunal said that the non-obstante clause in Section 32A is also applicable to liquidation proceedings. According to the Tribunal, reading Section 32A(2)[49] with the object behind enacting Section 32A in conjunction makes the provision applicable to liquidation proceedings. Thus, the introduction of Section 32A in IBC, the corporate debtor can no longer be held liable for offences committed after a resolution plan under CIRP or sale of assets under liquidation process. While

[44] The Insolvency and Bankruptcy Code, No. 31 of 2016, §2(20), (21) (Ind.).
[45] Sagar Manju, Hitoishi Sarkar & Naman Katyal, *Analysing the Fresh Start Doctrine: A South Asian Perspective through the Lens of India*, NLSBLR (2022).
[46] The Insolvency and Bankruptcy Code, No. 31 of 2016, §32A (Ind.).
[47] The Insolvency and Bankruptcy Code, No. 31 of 2016, §32A(1) (Ind.).
[48] Anil Goel, Liquidator of Varrsana Ispat v. Deputy Director, Director of Enforcement, 2020 SCC OnLine NCLT 9981 (Ind.).
[49] The Insolvency and Bankruptcy Code, No. 31 of 2016, §32A(2) (Ind.).

this provision resolves various issues connected with actions against property of the corporate debtor after the approval of the resolution plan, there is still uncertainty pertaining to actions against the assets of the corporate debtor during CIRP but before approval of a resolution plan or during the liquidation process but before the sale of assets.[50] The effect of attachment of properties of a company undergoing liquidation becomes a concern when the corporate debtor is sought to be sold as a 'going concern'.[51]

V. CONFLICT BETWEEN TWO NON-OBSTANTE CLAUSES

Non-obstante clause is inserted in statutes to give them overriding effect over other statutes or provisions. Today, several statutes exist that contain non-obstante clauses to give them precedence over other laws. Due to multiplicity of non-obstante clauses, conflict between two or more statutes is bound to happen.

The Hon'ble Supreme Court of India in Solidaire India Ltd. v. Fairgrowth Financial Services Ltd.[52] resolved the conundrum enumerated above. The Hon'ble Apex Court while considering the effect of non-obstante clauses found in Sick Industries Companies Act, 1985 and Special Court Act, 1992 said that the newer statute prevails over the older statute.[53] In other words, the non-obstante clause present in Special Court Act, 1992 overrides the non-obstante clause in Sick Industries Companies Act, 1985. The rationale behind this decision is that the parliament is aware of the existing laws, and inserting a non-obstante clause in a new statute means that the parliament want the earlier laws to not have an overriding effect on the new law.

[50] Misha and Shreya Prakash, *PMLA Actions against Company Property during the CIRP*, 1 J. OF CORP. AFFAIRS 79, 81 (2021).
[51] *Id.*
[52] Solidaire India Ltd. v. Fairgrowth Financial Services Ltd., (2001) 3 SCC 71 (Ind.).
[53] *Id.* ¶11.

Section 238 of IBC contains a non-obstante clause which has overriding effect on laws that contravene the provisions of IBC.[54] Similarly, Section 71 of PMLA contains a non-obstante clause which bars any other statute to have an overriding effect on PMLA.[55] An issue between the two statutes arises when the ED attaches assets of the corporate debtor undergoing CIRP and liquidation. Due to the provision of moratorium under IBC, the question of whether attachment of properties under PMLA be allowed is raised multiple time before the adjudicating authorities. As both statutes contain non-obstante clauses, *prima facie* the principle explained above becomes applicable which leads to IBC having an overriding effect on the PMLA as the former was introduced in 2016 while the later was passed in 2002. However, the jurisprudence regarding the conflict between the impugned laws is more complex. The same is discussed in the following chapter.

V. ATTACHMENT OF ASSETS UNDER PMLA

The provision for attachment of properties was framed with the view of ensuring that the tainted properties remained within the reach of the law.[56] The conversion of proceeds of crime into legitimate or untainted wealth is done in secrecy and stealth. It takes a detailed investigation into the transactions of the accused to determine how money was laundered. For this purpose, the ED attaches those properties which it thinks are proceeds of crime. The law for attachment of secured and unsecured properties is not the same. The difference is discussed in detail below.

[54] The Insolvency and Bankruptcy Code, 2016, No. 31 of 2016, §238 (Ind.).
[55] The Prevention of Money Laundering Act, No. 15 of 2002, §71 (Ind.).
[56] Deputy Director Deputy Director of Enforcement, Delhi v. Axis Bank, 2019 SCC OnLine Del 7854 (Ind.) ¶105.

A. ATTACHMENT OF UNSECURED ASSETS OF THE CORPORATE DEBTOR

In Varrsana Ispat Limited v. Deputy Director of Enforcement (Varrsana Ispat), the ED attached the properties of the corporate debtor before the commencement of the moratorium period.[57] The NCLAT held that Section 14 of IBC is not applicable to proceedings initiated under PMLA as 'proceeds of crime' are involved.[58] Moreover, as the attachment of properties happened before the initiation of corporate insolvency resolution process, recourse of moratorium could not be availed to safeguard the impugned properties.[59] The Appellate Tribunal concluded that both statues can be invoked simultaneously and the non-obstante clause in IBC does not bar the jurisdiction of the PMLA.[60] A contrary view was however taken by NCLAT in Directorate of Enforcement v. Manoj Kumar Agarwal[61] (Manoj Kumar Agarwal). Here, the Appellate Tribunal observed that proceedings under PMLA regarding attachment orders are civil in nature.[62] As these proceedings are civil proceedings, they can be brought under the ambit of Section 14 of IBC.[63] Thus, according to the NCLAT bench, the moratorium provision is attracted to the proceedings under PMLA which brings back the attached properties of the corporate debtor under the purview of the IBC.

Later, a larger bench of NCLAT in Kiran Shah v. Enforcement Directorate[64](Kiran Shah) rendered a view that supported the position established by Varrsana Ispat case. In Kiran Shah case, the Appellate Tribunal

[57] Varrsana Ispat Limited v. Deputy Director of Enforcement, 2019 SCC OnLine NCLAT 236 (Ind.).
[58] *Id.* ¶12.
[59] *Id.* ¶13.
[60] *Id.* ¶14.
[61] Directorate of Enforcement v. Manoj Kumar Agarwal, 2021 SCC OnLine NCLAT 121 (Ind.).
[62] *Id.* ¶56.
[63] *Id.*
[64] Kiran Shah v. Enforcement Directorate, 2022 SCC OnLine NCLAT 2 (Ind.).

overruled the Manoj Kumar Agarwal case by stating that the order does not follow the precedent judgements.[65] It was held that Section 14 of IBC goes not hinder the authority of the institutions performing their role under the PMLA.[66]

A recent judgement on the issue came from the Hon'ble High Court of Delhi in November 2022. In Rajiv Chakraborty Resolution Professional of Eiel v. Directorate of Enforcement[67], the corporate debtor was Era Infra Engineering Limited ("**EIEL**") against whom CIRP began in 2018. Later, the ED secured an order for attachment of properties of the corporate debtor under PMLA. The resolution professional claimed that ED had no jurisdiction to exercise its powers under the PMLA once the corporate debtor is under moratorium period. The Hon'ble Delhi High Court observed that the ED cannot be considered as a creditor who seeks to enforce a debt. This is because 'proceeds of crime' as stated in PMLA cannot constitute as debt.[68] When ED provisionally attaches properties under PMLA, it is not acting as a creditor rather it is safeguarding the properties which are 'proceeds of crime'. The objective of such attachment as explained by the Court is to put a restraint on the property during the pendency of trial. Furthermore, the Court observed that the objective of moratorium under IBC is to put a temporary embargo on the recovery of debt. However, attachment of properties under PMLA does not constitute as an action of 'recovery of debt' by the ED. The provisions under PMLA are essential to ensure that the tainted assets are not transferred or alienated further and beyond the reach of the ED.[69] Giving precedence to Section 14 over attachment of properties under PMLA would run contract to the efforts of the legislative to combat money laundering.

[65] *Id.* ¶112.
[66] *Id.* ¶98.
[67] Rajiv Chakraborty Resolution Professional of Eiel v. Directorate of Enforcement, 2022 SCC OnLine Del 3703 (Ind.).
[68] *Id.* ¶71.
[69] *Id.* ¶85.

On the effect of non-obstante clauses in conflicting legislations, the Court, using harmonious interpretation, viewed that the non-obstante clause under IBC would be effective after the adoption of resolution plan by the committee of creditors which would bar the applicability of PMLA.[70] As the resolution plan was not yet adopted for EIEL, the attachment of properties in the present case were held valid.

Accordingly, there are three possible scenarios involving attachment of unsecured assets of corporate debtor undergoing CIRP by ED:

i. Attachment of assets before commencement of CIRP
ii. Attachment of assets after commencement of CIRP
iii. Attachment of assets after approval of resolution plan

In conclusion, attachment of properties of the corporate debtor before the approval of resolution plan is valid. However, the ED cannot attach properties of the corporate debtor once the resolution plan is approved. Similarly, as Section 32A applies to liquidation proceedings as well, the ED cannot attach properties after the sale of assets has taken place under IBC.

B. Attachment of Secured Assets of the Corporate Debtor

In the assets pool of a corporate debtor, some or all properties can be secured against debts in favour of creditors. When the corporate debtor defaults, the creditors can satisfy their unpaid debt by taking ownership of the properties secured in favour of the creditors. When ED attaches such properties, the secured creditors have a recourse under PMLA. The statute states that the confiscated property can be released if the claimant proves that it has legitimate interest in the property or a part thereof, and it has suffered a quantifiable loss as

[70] *Id.* ¶114.

a result of money laundering.[71] It is pertinent to note that an order of provisional attachment is not illegal merely because a third party had interest in the property.

The adjudicating authorities have concluded that when properties of a corporate debtor are secured in favour of creditors, then the brunt of the PMLA should not bore by innocent creditors. In Punjab National Bank v. Deputy Director, Directorate of Enforcement[72], the ATPMLA observed that once moratorium is initiated under the IBC, the adjudicating authorities under PMLA cannot continue with the proceedings where secured properties of the corporate debtor are attached. In this case, the ED attached properties of the corporate debtor before the moratorium, however the ATPMLA opined that the non-obstante clause in IBC overrides the PMLA as the proceedings under Section 8 of PMLA are civil in nature. It is pertinent to note that in this case, the properties attached by the ED were hypothecated to banks i.e., secured creditors. As the banks were innocent parties and had a right over the properties, the same could not be attached. Similar is the case of Bank of India v. Deputy Director Directorate of Enforcement[73] where the tribunal ruled that proceedings under Section 8 of PMLA are civil proceedings which are stayed when moratorium is initiated by NCLT.[74] In this case, the attached properties were mortgaged to public sector banks, thus creating a security interest on those properties.

In 2022, the Hon'ble Delhi High Court in Deputy Director Directorate of Enforcement Delhi v. Axis Bank[75] revisited the conflict between the two laws. Herein, the Court distinguished the treatment of secured properties from

[71] The Prevention of Money Laundering Act,No. 15 of 2002, §8(8) (Ind.).
[72] Punjab National Bank v. Deputy Director, Directorate of Enforcement, 2019 SCC Online ATPMLA 5 (Ind.).
[73] Bank of India v. Deputy Director Directorate of Enforcement, 2019 SCC OnLine ATPMLA 23 (Ind.).
[74] *Id.* ¶44.
[75] Deputy Director Directorate of Enforcement Delhi v. Axis Bank, 2019 SCC OnLine Del 7854 (Ind.).

unsecured properties under PMLA. It was held that moratorium period does not obstruct the ED from attaching properties. However, "*an interest in the property of an accused, vesting in a third party acting bona fide, for lawful and adequate consideration, acquired prior to the commission of the proscribed offence evincing illicit pecuniary benefit to the former, cannot be defeated or frustrated by attachment of such property to such extent by the enforcement authority in exercise of its power under Section 8 PMLA*".[76] Similarly, if the ED has attached alternative attachable properties or deemed tainted properties, then bona fide creditor's interest shall be protected.[77] Considering a situation in which only a part of the attached property is secured by the creditor, then the ED can keep the remaining part of the property attached under PMLA.[78] In conclusion, if the properties attached by the ED are secured in favour of *bona-fide* creditor and such interest was established prior to the commission of the offence, then secured creditors can satisfy their unpaid debt from the interest in those properties.

VI. ISSUES WITH ATTACHMENT OF PROPERTIES OF CORPORATE DEBTOR

A. INSOLVENCY RESOLUTION AS A TIME BOUND PROCESS

The CIRP is time bound[79] with the intention of reviving the corporate debtor by the end of the process. Under Regulation 37 of Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016[80], a resolution plan can provide for sale or transfer of assets. If certain assets of the corporate debtor are attached by the ED, the creditors would not be willing to deal with those assets. This becomes detrimental to the interest of creditors as well as the revival of corporate debtor.

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[76] *Id.* at ¶163.
[77] *Id.* at ¶165.
[78] *Id.* at ¶164.
[79] The Insolvency and Bankruptcy Code, No. 31 of 2016, §12(1) (Ind.).
[80] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Gazette of India, pt. III sec. 4, Reg. 37 (Dec. 1, 2016).

B. PUBLIC PERCEPTION TOWARDS ED INVESTIGATION

Even if the corporate debtor is successfully revived, the public perception regarding insolvency and ED investigation might make the revival of the company and its business cumbersome. Recently, shares of Manappuram Finance fell by 12% after reports of ED investigation were released in the media.[81] Similarly, Hero Moto Corp's shares fell by 4% once reports of ED investigation came out in the public.[82] The IBC regime aims to maintain the corporate debtor as a 'going concern' and subsequently revive the company through a rehabilitation plan. However, the corporate debtor may not be able to fully recover because of the ED investigation at the insolvency resolution stage.

C. SECTION 14 COVERS ACTIONS OF ATTACHMENT INITIATED BY ED

As discussed earlier, moratorium under IBC does not cover criminal proceedings. The proceedings for provisional attachment of properties under PMLA cannot be termed as criminal proceedings. It has been established through various cases that proceedings of attachment of properties are civil in nature. The courts have given a different view in recent cases to fulfil the objectives of the PMLA. It should be considered that the matters pertaining to attachment of properties is not adjudicated upon by a criminal court but a tribunal having powers of a civil court. Moreover, attachment of properties leads to restrictions on civil rights of the accused which include transferring or selling the concerned property. The orders of courts giving precedence to PMLA have negative ramifications on IBC and affects the creditors' trust in the insolvency

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[81] Amit Mudgill, *Manappuram Finance shares tank 12% as ED conducts searches at promoter residence*, BUS. TODAY (Aug. 7, 2023), https://www.businesstoday.in/markets/company-stock/story/manappuram-finance-shares-tank-4-as-ed-conducts-searches-at-promoter-residence-379821-2023-05-03.

[82] *Hero MotoCorp shares fall over 4% after searches at chairman Pawan Munjal's residence,* IND. TODAY (Aug. 7, 2023), https://www.indiatoday.in/business/story/hero-motocorp-shares-fall-4-percent-ed-raids-pawan-munjal-residence-2414670-2023-08-01.

and recovery process. The courts should re-consider the interpretation of Section 14 and alter the current position of law.[83]

D. SECTION 14 SHOULD BE READ WITH SECTION 32A

Section 14 and Section 32A of IBC should not be read in isolation. Section 32A protects the companies from any action against offences committed by it before the commencement of CIRP if the resolution plan is approved.[84] The provision was enacted because there was a looming concern that prosecution of a company undergoing CIRP for offences committed before initiation of CIRP will adversely affect the rights of the third parties i.e., creditors.[85] Prosecution for offences committed before CIRP would lead to burden being put on the company which is already suffering from financial stress.

The courts should read IBC as a whole and not in part as it is a well-established rule of interpretation.[86] If the courts allow the attachment of properties of corporate debtor which is undergoing CIRP, it would defeat the objective of Section 32A and could land the insolvency company in liquidation. Thus, defeating the objective of IBC to revive the company.

E. BALANCING THE OBJECTIVES OF THE TWO LEGISLATIONS

The provisions of the PMLA are structured in a way that it creates corporate criminal liability. The case of Standard Chartered v. Directorate of Enforcement[87] had affirmed the position of the law that even a corporate entity can be prosecuted for the crimes with punishment requiring imprisonment. However, considering the company is going under CIRP, the conflict between

[83] Misha and Shreya Prakash, *PMLA Actions against Company Property during the CIRP*, 1 J. OF CORP. AFFAIRS 79, 85 (2021).
[84] The Insolvency and Bankruptcy Code, No. 31 of 2016, §32A (Ind.).
[85] Misha and Shreya Prakash, *supra* note 83, at ¶86.
[86] Union of India v. Elphinstone Spinning and Weaving Co. Ltd., (2001) 4 SCC 139 (Ind.).
[87] Standard Chartered Bank v. Directorate of Enforcement, (2006) 4 SCC 278 (Ind.).

PMLA and IBC should be mitigated to a greater extent to achieve the objective of the both legislations. One way of achieving this is by punishing the erstwhile management of the corporate debtor responsible for the offences, and leaving the assets of the insolvent company for the creditors. If the government through its agencies keep interfering with insolvency resolution process, then it would lead to distrust in the IBC and legal system. Pursuant to the objective of PMLA, the authorities should interpret the law to punish those who are involved in money laundering and not the innocent creditors.

VII. CONCLUSION

In conclusion, the current position of law as interpreted by courts and tribunals is detrimental for insolvent companies and their creditors. The present arrangement treats secured creditors and unsecured creditors differently even though it is unlikely that any creditor would encounter 'money laundering' during the due-diligence stage of investment. If the creditors are unaware of the offences committed by the erstwhile management of the corporate debtor, then there should be no reason to interfere with the insolvency resolution process of the insolvent company. Attachment of assets disadvantages the corporate debtor and its creditors. If the involvement of the ED is not curbed in CIRP then insolvent companies might get pushed into liquidation resulting in failure of IBC.

The courts and tribunals should interpret the laws harmoniously and give effect to their objectives. PMLA was not enacted to punish innocent creditors and insolvent companies. The ED should proceed against the erstwhile management of the corporate debtor responsible for money laundering and leave the assets of the corporate debtor for the creditors. The moratorium period should apply to the attachment proceedings under PMLA as they are 'civil' in nature. This would create a bar on the attachment proceedings against the corporate debtor's assets. Finally, the courts should not interpret provisions of IBC in isolation. Section 14 and Section 32A IBC should be read together along with other provisions to safeguard the assets of the corporate debtor from the commencement of CIRP.

RIGHTFUL INVESTORS OR A RUEFUL FAN CLUB? THE QUANDARY OF REGULATING COMMUNITY STOCK OWNERSHIP PLANS IN INDIA

Aditya Hiremath & Ishwaryah Manikandan[*]

ABSTRACT

*The Community Stock Ownership Plan ("**CSOP**") as an instrument used to raise public funds is a subject of profound intrigue. The seemingly innocuous instrument originated with the primary intent to serve the purpose of social welfare as funds were raised from benefactors of community welfare projects to serve in the completion of projects that served them. In understanding their application, the nature of CSOPs must be discussed. An analysis of the instrument by way of comparison to securities and derivatives reveals that the same qualifies under those definitions. In the Indian context, the instrument has been in the limelight in recent months with the advent of retail investment platforms that act as new age matchmakers of demand and supply between start-ups and the public. The instruments have been coupled with community benefits, serving to capitalise on consumers' affinity for companies' products. However, these instruments are not regulated except by regular civil contract law. The terms and conditions of these contracts indicate a great degree of possibility of investor manipulation. Certain terms and conditions as displayed in sample CSOP agreements by a start-up named 'Tyke' are certainly arbitrary in nature. Despite this, the instrument has not attracted the ire of regulators yet. Considering the lack of regulation and the impending danger of investor manipulation, the authors of this paper propose solutions ranging from an amendment in the companies act to incorporate CSOPs to the creation of a regulatory sandbox mechanism with the inclusion of an impartial auditing mechanism and the installation of entry barriers to ensure legitimacy of such investment platforms.*

Keywords: Stock, securities, share, investor, agreement, contract.

[*] Aditya Hiremath is a third-year student and Ishwaryah Manikandan is a second-year student at Hidayatullah National Law University, Raipur.

TABLE OF CONTENTS

I. TRACING THE BEGINNINGS OF "COMMUNITY AS AN INVESTOR"

CSOPs have become a buzzword in the blossoming startup ecosystem of India yet the details as to its functioning are shrouded in the deep crevices of the internet.[1] Conceptually, CSOPs are not too difficult to understand- it is simply a tool of raising capital through which a startup can leverage its customer base's love for its product by providing them an avenue to 'invest' directly. Platforms such as Tyke Invest and Infubiz have fashioned this as a contract exclusively for the investors to be entitled to a range of benefits such as exclusive meetings with the founders, invitations to high-profile networking events, discounts on their products, etc. Though seemingly superficial, the bigger picture quite easily

[1] Tushaar Talwar, *Shark Tank India phenomenon triggers a wave of risky investments by retail investors*, THE KEN (Feb. 6, 2023) https://the-ken.com/story/shark-tank-india-phenomenon-triggers-a-wave-of-risky-investments-by-retail-investors/ [hereinafter Shark Tank India phenomenon triggers a wave of risky investments by retail investors - The Ken].

portrays the relationship between the startup and customer as a simple purchase of benefits. But it is so much more. The theoretical beginnings of the CSOP explain why it came into being, and how exactly its use in the way that it is being used, is far from its intended purpose.

Louis Kelso, a man audacious enough to write a book titled 'The Capitalist Manifesto', stands behind the conception of the very popular ESOPs.[2] Despite what the name of his work may indicate, Kelso's innovative financial instruments were meant to empower the common man to thrive in a capitalist paradigm.[3] In the case of ESOPs, it's very evident how it seeks to strengthen the employee; by giving him a stake in the company, he is made a direct beneficiary of the company's growth.[4] Not only does this diversify the cost to company,[5] but it also produces positive results because the employee has skin in the game. In essence, this aspect of ESOP is more of a corporate strategy than any substantial change as the employee always had skin the game but by making it an evident source of income, the corporation can leverage better performance out of him.[6] When Kelso first pitched this idea, and its pilot turned out successful, corporates loved the idea, and it became wildly successful off the patronage of both the employees and corporations.[7]

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[2] LOUIS O. KELSO& MORTIMER J. ADLER, THE CAPITALIST MANIFESTO (2017).
[3] Robert Buchele et al, *Show Me the Money: Does Shared Capitalism Share the Wealth? In Shared capitalism at work: Employee ownership, profit and gain sharing, and broad-based stock options*, CHICAGO SCHOLARSHIP ONLINE 351, 351 (2010) https://www.nber.org/system/files/chapters/c8096/c8096.pdf
[4] Louis O. Kelso, *Corporate Benevolence or Welfare Redistribution*, 15 THE BUS. LAWYER 259, 259 (1959).
[5] Dickson C. Buxton & Ronald J. Gilbert, *ESOP: A Four-Letter Word? Liquidity and Perpetuation Pros and Cons.*, 58 J. OF FIN. SERVICE PROF. 2, 6 (2004).
[6] Ronald J. Gilbert et al, *Navigating through Tough Times with the Aid of Employee Ownership*, 63 J. OF FIN. SERVICE PROF. 57, 58 (2009).
[7] Robert H.A. Ashford, *The Binary Economics of Louis Kelso: The Promise of Universal Capitalism*, 22 RUTGERS L. J. 3, 38 (1990).

Along the lines of the ESOP, he had developed a near-parallel to empower consumers this time - called the CSOP or the Community Stock Ownership Plan.[8] Now, the CSOPs in the context of Indian startups and Tyke Invest- a startup that claims to democratise startup investment culture in India, is a topic shrouded in mystery owing to the novelty and lack of information surrounding it. But the beginnings of the CSOP, though not particularly popular, is a story that sheds much light on the functioning of this new instrument that has entered the markets.[9] This time, a bunch of farmers in California Central Valley approached Kelso with their grievances about the exorbitant price of fertilisers. At this point in time, oil companies and certain big names held monopolistic control of fertilisers in the area- so the problem faced by the farmers was not a seemingly transcendent issue of a price hike but rather a structural issue.

On the lines of the ESOP- a tool he had developed just two years prior to this, Kelso suggested forming a 'community' of these farmers who wished to obtain fertilisers at a subsidised rate.[10] Kelso formulated the CSOP to pool the 'interests' of all these farmers. Having brought this 5000-strong community together, the leader of the Valley farmers confessed to not having enough capital to launch a fertiliser manufacturing plant alone. Kelso instead flipped the concept of ESOP to apply to consumers the same way it applied to employees under the former scheme. The consumers of the fertiliser plant so proposed were tied to the company as long-term consumers (to the extent antitrust and contract law of the US permitted, a maximum of seven years) thus 'dependent' on the enterprise.[11] He then made the consumers shareholders in the enterprise

[8] Jens Lowitzsch, *The CSOP-Financing Technique: Origins, Legal Concept and Implementation*, ENERGY TRANSITION: FINANCINGCONSUMER CO-OWNERSHIP IN RENEWABLES 163, 164 (2019).
[9] Jens Lowitzsch, *Consumer Stock Ownership Plans (CSOPs)—The Prototype Business Model for Renewable Energy Communities*, 13 ENERGIES 118, 118 (2020).
[10] INTERCENTAR: CONSUMER STOCK OWNERSHIP PLAN, http://www.intercentar.de/en/projects/consumer-stock-ownership-plan-csop/consumer-stock-ownership-plan/ (last visited May 17, 2023).
[11] Lowitzsch, *supra* note 9 at 26.

so built, to which each contributed proportional to their projected long-term consumption.

Showing these 'subscriptions' of the consumers as proof of a co-operative like structure existing in the newly formed Valley Nitrogen Producers Inc., he was able to obtain a loan of USD 100 million from a co-operative bank.[12] In essence, they were able to build their own fertiliser plant in which the consumers were empowered shareholders, though not in a conventional sense. This is the same concept that is being applied to startups and startup investment at Tyke Invest[13]- a platform launched to enable people to invest in startups directly with capital investments as small as Rs. 5000. With the rise of Shark Tank India[14] and the buzz around the world about investing in startups alongside India's status as a burgeoning middle-class country, the formula of a CSOP as marketed by Tyke has shot to fame almost overnight. Though the structural basis of the CSOP[15] has been borrowed from that of Kelso, Tyke cannot quite replicate the same for a plethora of reasons.[16] The glaring one being the narrowed applicability of CSOP as envisaged originally- the aspect of 'dependence' was made pivotal for the CSOP to come into being.[17] But in Tyke's paradigm, that is not quite the case. Consumers of a company selling hair care products aren't tied to their brand as strongly as farmers are to fertilisers (on which they are dependent for their very existence). Which is exactly why Tyke's CSOP, unlike Kelso's which envisaged a socio-political tool for collective advantage, runs off something as fleetingly as the loyalty of its everchanging customer base.

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12 Kelso, *supra* note 4 at 25.

13 Louis O. Kelso & Patricia Hetter, *Employee Stock Ownership Plans: A Micro-Application of Macro-Economic Theory*, 26 AM.UL REV. 521, 521 (1976).

14 Shark Tank India phenomenon triggers a wave of risky investments by retail investors - The Ken, *supra* note 1 at 25.

15 Lowitzsch, *supra* note 9 at 26.

16 Ashford, *supra* note 7 at 26.

17 Jens Lowitzsch, *The Consumer at the Heart of the Energy Markets?*, ENERGY TRANSITION: FINANCING CONSUMER CO-OWNERSHIP IN RENEWABLES 59 (2019).

In more ways than one, Tyke typically reduces the meaning of CSOPs to that of a marketing campaign.[18] In such a case, it becomes immensely difficult to ascertain what exactly this arrangement means for the investor. Now, CSOPs remain an unrecognised instrument in the eyes of the SEBI, which is responsible for the regulation of all like instruments. This leaves the investors in a state of identity crisis- are they full-fledged shareholders who can claim their rights and take recourse of the Courts when they are denied the same? Or are they but a glorified 'fan club' that, despite holding these SARs, are unable to enforce them in any substantial way? Tyke's way of using the conception of the CSOP has come far from its intended purpose- what started out as an initiative to bring together a community to fund an essential utility for themselves has now been used in place of an elite club among the customers of nascent startups. Through the course of this paper, we set out to analyse how these instruments function currently, while grappling with the dilemma of how to regulate them with the investors' interests as the paramount concern.

II. EMPOWERING OR SWINDLING CONSUMERS? AN ENQUIRY INTO THE NATURE OF CSOPS

CSOPs, as defined by the platform Tyke, is a contractual agreement between a startup and the subscriber that entitles the subscriber to community benefits (such as discounts on products, access to exclusive season-end sales, periodical offers etc.,) and grant of Stock Appreciation Rights in exchange. As it stands today, CSOPs are not expressly regulated under any statutory legislation- which is why, the authors of this paper strongly advocate that this is an opportune time to acknowledge this instrument in the eyes of law. To come up with a legislative framework to accommodate such an instrument, an enquiry into the nature of the CSOP is required; and thus, we embark on one hereunder;

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[18] Tushar Talwar, *Are Startup Community Funding Platforms Gaming The System?,* ECON. TIMES PODCAST (Feb. 15, 2023), https://www.boomplay.com/episode/3392911?srModel=COPYLINK&srList=WEB.

A. WHETHER CSOPs ARE SECURITIES

Firstly, securities essentially represent claims that are capable of being enforced against the issuer, "particularly in relation to return on investments."[19] Although the nature of a contract CSOP is that it is an agreement enforceable by law, a CSOP is not capable of being enforced in the sense that the investor is not guaranteed of any return either by cash or by shares. The company reserves the right to make a cash payment to the CSOP holder at its own pleasure. It is only in the instance of an exit that the CSOP holder is entitled to compensation to the tune of a value equivalent to the fair market value of the CSOP or of a multiple of the Minimum SAR value as expressly agreed to in the CSOP agreement. From a return on investments point of view, apart from the immediate availability of community benefits that include such offerings such as discounts on products of the company, the investor is left in the dark as his investment may prove to bear no fruit.

Secondly, securities do not necessarily represent ownership over the assets of the issuer but rather an "investment interest" in the issuer.[20] This means that owning a share of a company does not entail that the shareholder is the owner of say, the fixed assets of the firm. A CSOP characterises this feature.

Thirdly, such securities are usually issued in denominated smaller parts and series,[21] enabling them to be acquired or disposed of with ease. Although CSOPs do not represent ownership of a company, they do resemble monetary denominations that are easier to buy and sell. Securities are essentially a cumulative bundle of rights that are issued in exchange for capital.[22] Such a bundle of rights includes rights, such as rights to ownership interests, dividends and voting. However, not all securities are required to bear all these

[19] Park McGinty, *What is a Security?*, 4 WISCONSIN L. REV. 1033, 1054 (1993).
[20] Securities and Exchange Commission v. W.J. Howey & Co., 328 U.S. 293 (1946).
[21] United States Uniform Commercial Code, 1952, Art. 8, § 8-102(a)(15).
[22] John G. Sobieski, *What is a Security?*, 25 MERCER L. REV. 382, 382 (1974).

characteristics in order to qualify as securities. The Companies Act, 2013 allows public limited companies to issue shares with differential rights as to voting, dividend or otherwise.[23]CSOPs do not entail right to voting or to receive dividends.

B. WHETHER CSOPS ARE DERIVATIVES

CSOPs qualify as "derivatives" under the SCRA, 1956[24] as a contract that derives its value from underlying securities since its value is derived from the underlying value of the shares of the company (whether listed or unlisted). The Securities Laws (Amendment) Act, 1999 has had the effect of making the definition of 'securities' inclusive of 'derivatives' by virtue of Section 2 (h)(ia) of the SCRA.[25]

Additionally, in defining what a 'security' is under the Securities Contract (Regulation) Act, 1956, the Gujarat High Court has ruled that an instrument used by a business entity to 'raise capital' or 'finance substantial investments' and which is accompanied by a mutual expectation of profit from the investor in lieu of such an instrument, is "likely to be a security."[26]

It is also important to note that startups that raise funds from investors by way of CSOPs on Tyke, do not necessarily have to disclose the reason (other than creating a "vibrant community") for raising such funds either to investors or the general public. It is unclear as to the exact formalities that must be followed by startups that intend to be listed on the Tyke platform with Tyke claiming that it runs its own due diligence and plays its role as a "facilitator that

[23] INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA, https://kb.icai.org/pdfs/PDFFile5b28cd1d5fe029.91584958.pdf (last visited May 18 2023).
[24] Securities Contracts (Regulation) Act, No. 42 of 1956, §2(ac)(B) (Ind.).
[25] Securities Contracts (Regulation) Act, No. 42 of 1956, §2(h)(ia) (Ind.).
[26] Essar Steel Ltd. v Gramercy Emerging Market Fund, (2003) 116 CompCas 248.

matchmakes demand and supply"[27] This supposed due diligence is obscure and nothing beyond what Tyke willingly publishes to the investor. In essence, there is no mechanism to ensure, through legal sanction, that such a procedure is conducted.

C. CSOPs AND SARs

CSOPs consist of two components-SARs and the right to community benefits. Essentially, this would mean that there is a simultaneous purchase of benefits alongside that of securities- the recognition of the equity component of the transaction would inevitably need acknowledgment of the benefits accrued to the investor too. While CSOPs are not expressly regulated by the SEBI or any other legislation, SARs of listed companies are regulated by the SEBI (Share Based Employee Benefits) Regulations, 2014. With respect to regulation of SARs when it comes to unlisted entities, there remains no clarity.[28]

S. 2 (1)(ze) of the SEBI (Share Based Employee Benefits) Regulations, 2014 ("**SBEB**") defines a SAR as "a right given to a SAR grantee entitling him to receive appreciation for a specified number of shares of the company where the settlement of such appreciation may be made by way of cash payment or shares of the company".[29] The SARs component under CSOPs are essentially cash-settled SARs. It is pertinent to note that although the CSOPs do contain an element of a SAR, they do not qualify as a SARs scheme under the definition of the same. This is because CSOPs are not specifically offered to employees of the organisation and the very purpose of the SBEB was to govern inter-corporation

[27] As stated by Mr Karan Mehra, the Founder of Tyke Invest, in an interview https://www.youtube.com/watch?v=23ND2XdcyCo.
[28] Jagrat Rawal, Shivani, *Stock Appreciation Rights: An Unregulated Alternative to ESOPs*, BAR AND BENCH (Nov 29, 2022) https://www.barandbench.com/law-firms/view-point/stock-appreciation-rights-an-unregulated-alternative-to-esops.
[29] Securities and Exchange Board of India (Share Based Employee Benefits) Regulations 2014, Gazette of India, pt. III sec.4, Reg. 2(1)(ze) (Oct. 28, 2014).

transactions in securities and benefits.[30] The aim of the CSOP scheme is to ensure that the early community associated with a start-up may be presented with an opportunity to invest with a vested interest in the growth of the company.[31] Despite their uncanny similarity to ESOPs, it is to be understood that the key point of difference between the two actually divides the two by a chasm in terms of questions surrounding its regulation. Attempting to fit CSOPs within the framework of the SBEB, while it may solve disclosure and transparency related concerns, dilutes the application of the SBEB whilst overly restricting the terms of use with regards to CSOPs- a classic lose-lose that the Parliament must avoid.

III. THE TRANSFERABILITY OF CSOP RIGHTS AND OBLIGATIONS

The concept of assignment of rights allows a party not originally a party to a contract, a right to obligations and rights arising out of such a contract. However, the courts have determined that such an assignment of rights only happens through a novation of the contract[32] (which entails a substitution of a contract for another one) and that such a novation may only take place upon receiving assent from the counter party to the agreement. Tyke, in its public communications, asserts that rights and obligations associated with CSOPs are transferrable through this concept of "assignment of rights" enshrined in the Indian Contract Act, 1872.

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[30] Pravesh Aggarwal*, Examining the Scope and Regulatory Framework Concerning Employees Benefit Schemes in India*, 10 NUJS L. REV. 109, 109 (2017).

[31] Tushaar Talwar, *Shark Tank India Phenomenon Triggers a Wave of Risky Investments by Retail Investors*, THE KEN (Feb. 6, 2023), https://the-ken.com/story/shark-tank-india-phenomenon-triggers-a-wave-of-risky-investments-by-retail-investors/.

[32] Krishnendu Kanungo, Pritisha Chakraborty, *Assignment of Rights and Its Practical Relevance in Financial Transactions: A Lender's Perspective,* MANUPATRA (May 16, 2023), http://docs.manupatra.in/newsline/articles/Upload/E915DA6B-361C-493B-91D1-96D8EB703128.pdf.

Considering how CSOP agreements are incentive based schemes to reward companies' community evangelizers, investors do have obligations towards the companies they invest in. The Indian Contract Act prescribes that obligations are not transferable. If they are transferred, it shall amount to a novation of the contract.[33] If a CSOP holder were to transfer his rights and obligations to another person, the original CSOP agreement would stand to be substituted by the contract that ensures the transfer of such rights and obligations. In a case before the Supreme court,[34] the court laid down the basic principle behind 'novation' by explaining that novation is the "substitution of a contract by a new contract only through the consent of both parties." Such consent may be through actions, conduct, or through a written agreement. It would be difficult to ascertain consent given in an implied manner and could have the deleterious consequence of eliminating all sorts of rights and obligations between the company and its investors. The law is clear on the fact that a transfer of obligations from one party of an agreement to a third party can only take place upon receiving consent from the counterparty to the agreement.

IV. STATUS OF CASH SETTLED SARS VIS-À-VIS CSOPS: A POSSIBLE MISREADING?

Upon request for informal guidance, the SEBI issued informal guidance letters addressed to Mindtree Ltd. and Saregama India Ltd. on the question of whether their SARs schemes were to be governed by the SBEB regulations or not. The guidance letters to both these companies mentions that the SBEB regulations shall only be applicable on companies that have listed shares on a

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33 *Id.*

34 H.R. Basavaraj v. Canara Bank, (2010) 12 SCC 458.

recognised stock exchange in India.[35] The SBEB has no applicability with respect to unlisted shares of companies. Even if it were to be assumed that SBEB were to be made applicable to unlisted shares, the regulations would still remain inapplicable to SARs schemes as those offered by way of CSOP agreements since the informal guidance letter issued by the SEBI states that the SBEB would not apply to Mindtree Ltd.'s cash settled SARs scheme since it "does not involve dealing in or subscribing to or purchasing securities of the company, directly or indirectly."

However, the SEBI seems to have missed the boat with this informal guidance. It may be argued that cash-settled SARs also derive their benefits from the appreciation in the value of shares of the relevant company, as is the case with equity-settled SARs. As stated earlier in the essay and by extension, it is pertinent to note that cash settled SARs also fit into the framework definition of securities-the Supreme Court has held in the case of *SEBI v. Pan Asia Advisors Ltd.*[36] that GDRs (Global Depository Receipts) were also considered to be 'securities' under sub-clause (iii) of Section 2 (h) of the SCRA[37] which states that "*rights or interests in securities will also be construed as securities*." The inapplicability of SBEB regulations to cash-settled SARs leaves open a huge regulatory void on this subject, allowing for the manipulation of investors and arbitrariness on the part of the various associated stakeholders. Since cash settled SARs are technically backed by the value of underlying shares of the issuing company, such SARs must also be considered to be 'securities' for all regulatory purposes.

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[35] SEBI https://www.sebi.gov.in/sebi_data/commondocs/sebisaregamajuly24_p.pdf (last visited Jul. 17, 2023); K LAW, *Phantom Stock Options – An Alternative Employee Incentive* https://www.klaw.in/phantom-stock-options-an-alternative-employee-incentive/(last visited Jul. 14, 2023); Dhruv Somayajula, *SEBI Regulation on Phantom Stock Options*, INDIA CORP L. (Apr. 7, 2018), https://indiacorplaw.in/2018/04/sebi-regulation-phantom-stock-options.html (last visited Mar. 22, 2023).
[36] SEBI v. Pan Asia Advisors Ltd., (2015) 14 SCC 71.
[37] Securities Contracts (Regulation) Act, No. 42 of 1956, §2(h) (Ind.).

V. CURRENT REDRESSAL SCHEME FOR INVESTORS

As previously mentioned, CSOP schemes available on platforms like Tyke resemble public offerings but lack the required legal acknowledgment and do not fall under legitimate regulatory supervision. Analysing a model CSOP agreement ~~on the Tyke Invest platform re~~veals that Tyke does not classify CSOPs as securities, likely to evade regulatory scrutiny. Essentially, the CSOP plan serves as an incentive-based program developed by the company to reward its community evangelisers, devoid of being considered a security as per the Companies Act of 2013. Consequently, investors do not hold any rights as security holders in relation to the company. Currently, Tyke is able to evade any liability, a fact evident in a clause within the model CSOP agreement which states that "the Company and the Founder/s shall not be liable in any manner to me in relation to the Pay-out Amount for the SARs held by me." This is a concerning indicator that investors face significant risk, even during exit scenarios.

Characterized as speculative bets, investors are left exposed, lacking avenues for recourse beyond traditional channels, specifically through initiating legal proceedings in civil courts for breaches of explicit terms within CSOP agreements. The protracted nature of civil litigation proceedings in India, coupled with the socioeconomic power disparity between small retail investors and corporations, renders the current status quo unfavourable for these investors. What is urgently needed in this current landscape is a fundamental shift that underscores companies' responsibility towards investors, fostering increased public confidence and allaying their concerns. This shift would promote a balanced and more secure investment environment, fostering trust and benefiting all stakeholders involved.

A. IN-BUILT MECHANISM IN THE STATUS QUO

While there is no semblance of a regulatory framework through any precedent so far, the framework in and of itself is a loosely arranged system of checks and balances. The development of securities and the law of securities has brought about the existence of two forms of sanctions- legal and implied. At the moment, the startups are not bound by any legal sanction but the implied sanctions of erosion of reputational value is still functional.[38] There are two sides to this coin-the companies that raise funds through the platform are bound to make good their promise by virtue of their reputational value in the market. However, considering how the companies we are discussing here are startups that may already be burning venture capitalist money,[39] trusting reputational value as the single chokehold[40] to compel compliance is not something that would serve its purpose in the long run.

B. PLATFORM'S LIABILITY

The fact that Tyke assumes no liability for transactions on its platform or for any connected transaction related to CSOP investments is a matter of great concern for investors who might not be aware of such risks. Most investors involved in CSOP schemes are regular consumers of the company's products and services. The start-ups that invite subscriptions by way of CSOPs capitalise on this human behaviour of seeking community and a sense of belonging while offering such investors an opportunity to make monetary gains on their investment. On the face of it, this arrangement seems ideal- the startups get their

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38 Donghua Chen et al, *Securities Regulation and Implicit Penalties*, 4(1-2) CHINA J. OF ACC.& R. 47, 47 (2011).

39 Sagar Malviya, *Mishry Announces Csop to Enable Users to Invest in Company*, THE ECON. TIMES, (Mar. 17, 2022), https://economictimes.indiatimes.com/tech/funding/mishry-announces-csop-to-enable-users-to-invest-in-company/articleshow/90291609.cms?from=mdr (last visited May 17, 2023).

40 Carl E Gershenson, *Organizational Reputation and the Securities and Exchange Commission's Failed Regulatory Revolution*, 34 SOCIOLOGICAL FORUM 1, 1 https://onlinelibrary.wiley.com/doi/epdf/10.1111/socf.12518.

funds on time and the consumer is elevated to a superficial shareholder of the company that he supports. But the problem arises with regards to two aspects:

One, the enforceability of such an agreement. As highlighted above, since the investors are left with none but civil remedies for the enforcement of their rights as shareholders, the bargain becomes increasingly one-sided with the startups being able to pool their loyal consumers' money whereas the investors themselves being left to the whims and fancies of the company.

Two, with regards to information that is made available-Listed securities are bound by SEBI Regulations that mandate a plethora of disclosures made to the public, while in startup jargon this is simply 'regulatory burden', 'bureaucratic trouble' or 'red tape', it is precisely this plethoric amount of paperwork that ensures the shareholders are amply aware of the kind of company they are investing in.

Tyke charges a 2% service fee for all transactions on the platform and serves to be a "matchmaker" that takes up no liability for investments made on its platform. In essence, it fashions itself as a company that simply brings to potential investors information about the startups- thus, holds no liability whatsoever for the bankability of such transactions carried out on the platform.

But this aspect has seen positive changes in the recent past with two companies being slapped with penalties by the Registrar of Companies for having raised capital through Tyke Invest.[41] Both these companies- Anbronica Technologies Pvt. Ltd. and Septanove Technologies Pvt. Ltd. were slapped with penalties for raising funds through Tyke in violation of the Companies Act of 2013. In essence, the Companies Act deals with private placement of securities- whereas listing companies on stock exchange and regulatory compliances required for these companies is dealt with by the SEBI. Using Tyke as a platform

[41]Anupam Shukla, *The Legal Danger to Crowdfunding Platforms*, BQ PRIME (Mar. 17, 2023), https://www.bqprime.com/law-and-policy/the-legal-danger-to-crowdfunding-platforms.

to publicise and invite subscription to Compulsorily Convertible Debentures is a patent violation of the 'private' character of these shares and would bring about a conflict in who regulates such a transaction- the SEBI or the Companies Act.

In dealing with this question, the Registrar of Companies ("**ROC**") in its order, recognised Tyke to be more than just a platform- in every aspect of the transaction, Tyke was a facilitator at best.[42] By way of enabling subscription of CCDs by the users in setting up the escrow bank account or in getting the information of a company willing to offer such an instrument far and wide beyond its immediate interaction[43]- Tyke has played a vital role in the process of these two companies raising money and therefore in contravention of the 'private' character envisaged for these instruments[44] and by extension, the Companies Act of 2013.

According to Tyke's privacy policy, Tyke claims to have an internal mechanism[45] by which it restricts the number of investors that get to view the detailed profile of companies to 200. On the basis of this, they claim that they are compliant with all applicable laws relating to securities. However, the same is hardly believable. A simple download of the Tyke Invest app and a subsequent sign up using a mobile number and an OTP would allow a user to view such documents as the risk report of the company, an investment pitch to potential investors, the Certificate of Incorporation and so on. It is hard to imagine how the same would not qualify as an advertisement or offer to the public much like an Initial Public Offer ("**I.P.O**").

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42 *Id.*

43 Sarvesh Mathi, *Explained: Why a Startup Was Fined for Raising Money through Tyke*, MEDIANAMA (Mar. 10, 2023 https://www.medianama.com/2023/03/223-tyke-online-fundraising-platform-deciwood-order/ (last visited May 17, 2023).

44 Bipin Sony & Saumitra Bhaduri, *Information Asymmetry and the Choice between Rights Issue and Private Placement of Equity*, BASE UNIVERSITY (Jul. 29, 2023) https://www.base.ac.in/wp-content/uploads/2020/10/BASE-University-WP-01-2020.pdf.

45 Roberta S Karmel & Claire R Kelly, *The Hardening of Soft Law in Securities Regulation*, 34 BROOK. J. INT'L L. 883, 883 (2008).

The order of the Ministry of Corporate Affairs rightly calls out the dubious nature of such a claim. The provisions of Tyke's privacy policy attribute liability upon the companies offering CSOPs on their platform - "it is the company's responsibility to comply with the provisions of applicable laws including the Companies Act, 2013 and the private placement rules thereunder." The order by the ROC states that section 42(7) provides that "no company issuing securities under this section shall release any public advertisement or utilize any media, marketing or distribution channels or agents to inform the public at large about such issue". The order also reiterates the fact that a private placement may not be made to members in excess of 200[46] and that the explanation to Section 42 (3) explains that "private placement" is inclusive of an offer, or invitation to subscribe, or issue of securities to a select group of persons by a company. Therefore, it is no surprise that companies offering CSOP subscriptions on the platform are in violation of Section 42 of the Companies Act, 2013.

In more ways than one, the order of the ROC[47] has brought to the fore the conundrum of regulating a platform like Tyke. A close examination of a model CSOP agreement on the Tyke platform reveals that "the CSOP Plan is an incentive-based scheme designed by the Company to reward its community evangelizers." These evangelizers are essentially investors functioning as 'shadow employees' who are rewarded for their efforts at marketing the company's products. There is no objective rule on the classification of investors as evangelizers and the scheme bears eery similarities with multi-level marketing schemes that have been notoriously associated with scams.[48] However, this worrying sign has not attracted the slightest ire from regulatory bodies. Instead of having to choose between fitting it into the definition of a stock exchange and

[46] The Companies Act, No. 18 of 2013, §2(68) (Ind.).

[47] Sugata Ghosh, *Crowdfunding for Startups Gets Caught in Regulatory Glare*, THE ECON. TIMES (Mar. 13, 2013) https://economictimes.indiatimes.com/markets/stocks/news/crowdfunding-for-startups-gets-caught-in-regulatory-glare/articleshow/98591764.cms?from=mdr.

[48] OUTLOOK INDIA, https://www.outlookindia.com/national/amway-scam-what-is-pyramid-scheme-and-amway-s-multi-level-marketting-news-192255 (last visited May 16, 2023).

subjecting it to multitudes of regulatory burden as under the SEBI or leaving it as is and letting such companies flout provisions that circumvent fundamental tenets of corporate governance, recognising the imperative need for a consistent regulatory framework for these companies is the appropriate approach that must be taken.

VI. FORMULATING A REGULATORY FRAMEWORK

In the preceding sections of this paper, we delved into the notion of CSOPs and how their advantageous position outside the jurisdiction of SEBI gives rise to a perplexing set of inquiries about the parity between investors in CSOPs and equity shareholders. This section aims to propose innovative remedies to address the ambiguous status that CSOPs currently inhabit.

Firstly, it is crucial to acknowledge that the unregulated standing of CSOPs serves the interests of various stakeholders. These parties encompass platforms like Tyke, which efficiently tap into the market of individuals seeking to engage in transactions involving these unlisted securities. Additionally, small private investors seek to capitalize on their brand loyalty or product affinity, benefiting from this unregulated space. Nonetheless, leaving a substantial portion of this market devoid of regulatory oversight poses significant risks.

The ascent of Tyke and the burgeoning trend of investing in startups can be contextualized within the backdrop of a complete regulatory void concerning CSOPs. Initially, unlisted securities and CSOPs might appear analogous – both escape regulatory scrutiny and offer limited information to investors. However, a fundamental distinction lies in their pitch and target audience. Notably, there exist three categories of investors: retail, institutional, and High Net-Worth Individuals ("**HNIs**").[49]

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[49] IIFL KNOWLEDGE CENTER, https://www.indiainfoline.com/knowledge-center/share-market/what-Is-an-accredited-investor (last visited May 14, 2023).

While unlisted securities, given their high minimum token amount (usually between Rs. 25000-50000) are usually bought by the latter two; the primary audience of CSOPs remains the former- the retail investor. And this is discernible from their very low token amount. Another aspect pertaining to the difference between the two is that of the manner in which these instruments are made available. In the case of unlisted securities, the investor (usually a HNI or an institutional investor) gets in touch with a high-end brokerage company that secures these securities over-the-counter. These shares are illiquid, yet see high investment from its target audience primarily driven by a speculative motive. The very process is ridden with exclusivity to the extent of unlisted securities, though not by any rule or statute, becomes in practice limited to the more aware classes of investors as against a CSOP, which is offered at a minimum token price of Rs. 5000 on a digital platform through an app that can be downloaded by any layman. The legal requirements that Tyke subjects a prospective investor to is that of a KYC and PAN Card verification- once again, indicative of the inclusive intent of this venture.[50]

Therefore, there is a strong cause to leave unlisted securities as they are by virtue of the fact that their investors do not quite fit the title of 'vulnerable' and are not in need of SEBI's rescuing.[51] On the other hand, CSOPs are extremely accessible instruments that have, thanks to the thrust that the startup ecosystem[52] has been witnessing in the past decade, permeated to a large number of investors that enter into these contracts without full information of the kind of investment they are getting into. This warrants the involvement of the SEBI,

[50] Malvika Maloo, *This Fintech Co Helps Startups Digitise Their Fundraise,* YOURSTORY.COM (Jan. 13, 2022) https://yourstory.com/2022/01/this-fintech-co-helps-startups-digitise-their-fund.
[51] *Regulating Unlisted Companies*, THE ECON. TIMES (Apr 17, 2010) https://economictimes.indiatimes.com/opinion/et-commentary/regulating-unlisted-companies/articleshow/5824081.cms?from=mdr.
[52] *Funding Slowdown Takes Startups to Alternative Finance Platforms*, FIN. EXP (Mar. 3, 2023) https://www.financialexpress.com/industry/funding-slowdown-takes-startups-to-alternative-finance-platforms/2998054/.

and the authors of this paper propose that the current system has already accommodated such instances across several legislations.

A. AN AMENDMENT TO THE COMPANIES ACT

A 2021 report by the Company Law Committee included amongst a list of various recommendations, that SARs be included in the Companies Act, 2013.[53] The authors are of the opinion that such a recommendation originates from a great deal of appropriate deliberation and expertise and was proposed for the reason that such SARs derive their value from underlying shares of the companies that issue them. By logical extension, the committee was of the opinion that such employee benefit schemes (amongst others such as ESOPs) must find mention in the companies act so as to encourage and legitimise the same. Along the very same line of reasoning, we propose that a new legislation be devised to address the issue through an amendment in the Companies Act 2013 to include SARs schemes for unlisted shares along the lines of the definition of SARs as mentioned in the SEBI Share Based Employee Benefits Regulations, 2014[54] ("**SBEB**"). Essentially, the authors propose that an amendment be made to include "SARs" and "SARs schemes" under Section 2 of the Companies Act, 2013 with a proviso that such definitions of a SAR and SARs schemes are inclusive of unlisted securities. It is pertinent to include that the definition includes the words "offered to the general public" and "unlisted securities" in order to differentiate the new definition in the Companies Act from the definition as under the SBEB regulations that is restricted to schemes concerning listed securities offered to employees by the company.

In doing so, the SEBI shall have civil enforcement powers for violations of the provisions of the Companies Act, 2013 as under Section 11, 11A, 11B and

53 TAXMANN, https://www.taxmann.com/post/blog/analysis-of-key-changes-proposed-by-company-law-committee-report-2022-clc-2022/ (last visited Jul. 6, 2023).

54 Securities and Exchange Board of India (Share Based Employee Benefits) Regulations 2014, Gazette of India, pt. III sec.4, Reg. 2(1)(ze) & 2(1)(zf) (Oct. 28, 2014).

11D of the SEBI Act, 1992. However, the possible downside to this move could be that in doing so, the companies offering SARs schemes by way of CSOPs may be subject to all other such provisions under the Companies Act, 2013 as companies dealing with listed securities are. This would have the pernicious and excessive effect of eliminating the very uniqueness of CSOPs in allowing companies an easy and informal manner of fundraising from private investors whilst capitalising on their community involving various stakeholders such as early customers to further increase their brand value.

It is pertinent to note that CSOPs are institutionalised as against ordinary unlisted securities. This is because CSOPs are contracts that are expressly governed by the provisions of the Indian Contract Act, 1872 and are specifically offered with the intent to offer them to consumers of a company (although the offer is to the public in general). There is a certain nuanced structure to the offer of such securities. Also, the very nature of unlisted securities entails that the average token amount or face value of securities are comparatively higher than those associated with CSOPs. An important point of differentiation between trading in unlisted securities and in CSOPs is the fact that investors in unlisted securities tend to include individuals such as FPIs (Foreign Portfolio Investors), HNIs (High Net-worth Individuals) and others who are not necessarily retail investors, whereas investors in CSOPs tend to be small retail investors who are vulnerable to being exploited by virtue of legalese. The legislature must keep this in mind in drafting such an amendment to make sure that a middle ground is sought. The uniqueness of private fundraising in the unlisted market must not be tampered with. There is a strong cause to introduce a quasi-regulatory mechanism concerning the subject to allow investors an alternative form of relief other than through the civil courts. A clause may be added, excepting companies dealing in unlisted securities and raising funds by way of CSOPs from certain provisions of the Companies Act that may prove to be unnecessary and an excessive burden on such companies (such as those provisions containing guidelines on matters such as issue of prospectus, matters to be contained in the prospectus and so on as mentioned under chapter III of the Act dealing with public issue of shares).

B. THE CREATION OF AN ALTERNATIVE EXCHANGE/SANDBOX REGULATORY MECHANISM

Another possible solution is the creation of an alternative exchange that specifically deals in the trading of unlisted securities. There is an established precedent of formal recognition of markets dealing with unlisted securities. The over-the-counter exchange of India was one such institution that allowed small companies which could not meet the minimum listing requirements under the Stock exchanges' listing requirements to raise funds through issues to the public. The exchange was created with a view to impart greater liquidity to shares, increase investor transparency and to safeguard the interests of investors. The exchange was recognised as a 'recognised stock exchange' under Section 4 of the SCRA.[55]It was only in 2015 that the OTCEI was derecognized by the SEBI vide its order on the 31st of March 2015 due to a change in trading and net worth norms by the SEBI. However, the creation of such an alternative exchange solely for trading in CSOPs or those securities of a small volume may seem like a rather unlikely move by the legislature. Creating another exchange for unlisted securities in general (along the lines of the OTCEI and the Chicago curb exchange) would be a better option. However, that may impose an inordinate burden on the legislature in the current scenario.

Derivatives may be traded on an exchange, or they may be privately traded over the counter ("**OTC**").[56] As earlier stated in the paper, CSOPs are derivatives and there is a history of regulatory oversight concerning dealing in such derivatives. The Supreme Court in the case concerning the Sahara scam[57]

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[55] Securities Contracts (Regulation) Act, No. 42 of 1956, §4 (Ind.).

[56] TAXMANN, https://www.taxmann.com/post/blog/beginners-guide-to-the-derivatives-market-of-india/ (last visited Jul. 6, 2023).

[57] Sahara India Real Estate Corpn. Ltd. v. SEBI, (2012) 10 SCC 603.

dealt with the question of whether the SEBI had jurisdiction over unlisted public companies and whether the provisions of the Securities Contracts (Regulation) Rules, 1957 would apply to such companies. The court answered in the affirmative by laying down the test of determination of 'securities' and held that when a public company raises money from more than 50 investors (at that time), it would be required to comply with the requirements in relation to public issues. This interpretation resolved the question regarding jurisdiction and brought the regulation of such marketable instruments under the SEBI's radar. It would not be an unprecedented move to introduce a sandbox framework involving a certain degree of regulatory oversight on the subject of CSOPs.

In a podcast by the Economic Times titled "Are startup community platforms gaming the system?" the former executive director of the SEBI – Mr. Sandeep Parekh recommended that a solution to the current predicament concerning CSOPs must be arrived at by way of deliberation between the companies raising funds through such private investment platforms and the SEBI. The authors of this paper second this thought- the Supreme Court has followed the rationale that companies which raise funds through public issues, involve the public at large and must therefore, adhere to the necessary compliances in order to protect the interests of investors.[58] This is not to conclude that companies raising funds by way of CSOPs be mandated to follow those requirements surrounding public issues. However, it is pertinent to ensure that there is a certain degree of regulatory oversight by the SEBI – the same may be executed through imposing liabilities on crowdfunding and private investment platforms such as Tyke to arrive at a middle ground.

The authors propose that such investment platforms be mandated to follow a specified due diligence process for vetting companies that seek to raise funds through such platforms, submit periodic disclosures of statements issued by

[58] CYRIL AMARCHAND MANGALDAS, TREATISE ON SECURITIES LAW 110 (Thomson Reuters 2021); Sahara India Real Estate Corpn. Ltd. v. SEBI, (2012) 10 SCC 603.

companies that raise such funds on the platform, and set up a separate audit mechanism under the SEBI via the appointment of a special auditing firm under the aegis of the SEBI. This would ensure that the companies themselves are not disadvantaged through a longer and more burdensome regulatory mechanism, whilst ensuring that investors' interests are protected. The ideal road ahead would involve close co-operation from companies, platforms such as Tyke, as well as the SEBI to create a regulatory sandbox mechanism that allows the various concerned stakeholders the freedom to make changes in line with their collective interests.

C. INSTALLING ENTRY BARRIERS TO ENSURE LEGITIMACY

Approaching the issue with a view to set up entry barriers to such investment platforms would be wise. A parallel may be drawn to the 1971 American television advertising ban - the United States forbade tobacco companies from advertising their products in 1971 which led to a considerable drop in advertising expenditure by such companies and the level of competition in the industry.[59] A regulatory addition in the current context could serve as a positive entry barrier. Retail investment platforms such as Tyke must be mandated to fulfil special disclosure requirements required to be met by the SEBI. Since the financial year 1995-96, the SEBI has been carrying out inspections of stock exchanges on an annual basis.[60] The SEBI must essentially carry out the same annual inspections of investment platforms as it does in the case of recognised stock exchanges. However, the SEBI must be weary not to tread on the path to over-regulation (an approach that would defeat the very importance of a CSOP). This would help ensure that only legitimate platforms seeking to serve as retail investment platforms be allowed to go about their business.

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[59]Harold Mulherin, J., *Measuring the costs and benefits of regulation: Conceptual issues in securities markets*, 13(2-3) J. OF CORP. FIN. 421, 423 (2007).

[60] SEBIGOV.IN, https://www.sebi.gov.in/sebi_data/commondocs/ar97983a_h.html (last visited Jul. 6, 2023).

VII. CONCLUSION

In this paper, the authors endeavoured to shed some much-needed light on the concept of CSOP- a novel instrument that has garnered much attention in the last few years. At the very outset, they established a theoretical framework of how CSOPs were intended to work when they were first founded. Hereon, the authors embarked on an enquiry as to what exactly they are by using their familiarity and understanding of pre-existing instruments as yardsticks to ascertain their position. The central idea of the paper revolved around how the concept of CSOPs, as it has evolved in the Indian context, is almost diametrically opposed to its form as first imagined by Kelso. Yet it has the potential to stir the burgeoning startup ecosystem of the country which makes the issue of regulation all the more complex because now the government must focus on balancing the macroeconomic benefits this instrument brings as against the microeconomic strains it may create on individual investors. Capital markets and securities law has always worked with these considerations, but in the case of CSOPs- the authors argue that regulation is pertinent and urgent.

In highlighting the need for regulation, the authors also set out to answer why CSOPs warrant such a framework vis-à-vis unlisted securities, which are primarily identified by their leniency and unregulated nature. They identified the vulnerability of stakeholders involved in CSOPs- which are usually pitched to retail investors who may or may not have access to full knowledge and expertise on capital markets as against unlisted securities that usually hold the favour of HNI and Institutional Investors. The authors then laid down the nucleus of their arguments in favour of regulating these instruments and took a rights-based approach in navigating the sea of questions that came with it.

Through the course of this paper, the authors have mooted three different solutions to the problem of regulating CSOPs- from passing a new legislation to taking inspiration from pre-existing statutes and the amendment of the Companies Act to bring in a provision identifying their unique position against the backdrop of India's burgeoning startup ecosystem. Regardless of what solutions are implemented, the object of the legislature must be three-fold- to prevent fraud and investor manipulation, set up entry barriers for investment platforms such as Tyke and lay down a clear due diligence process for investment platforms to ensure that companies raising funds from private investors via such mediums are legitimate and provide details as necessary to increase investor confidence. Should the current status quo remain without any change, the probable erosion of investor confidence in the instrument would act to the detriment of the companies legitimately seeking to capitalise on their early communities as investors.

It is important that the legislature recognises the value of the instrument of CSOPs and seeks to intervene to make changes to the current status quo in the interest of justice and equity. Adopting an iron hand approach to regulation would only serve to act contrarily to the objectives of the legislature (primarily to ensure investor protection whilst not impeding upon start-up growth). A certain framework governing these instruments would help set investor expectations prior to making crucial decisions. Thus, in the paradigm that we propose, we envision a much healthier retail investment environment wherein the CSOP isn't simply an unregulated outlier but a powerful tool in the hands of small retail investors to double down on their affinity towards a certain company's products with a view of making long-term gains.

SECURITIZATION OF STRESSED ASSETS: A HALF BAKED BREAD FOR THE INDIAN MARKET?

*Aditi Singh**

ABSTRACT

*Stressed Assets and Non-Performing Loans ("**NPL**") have been a liability upon economies around the world. Resolution and recovery of NPLs, has seen a number of creative schemes being launched by Governments of various countries. Similarly, taking heed of India's 15 billion US dollar, NPL market,[1] the Reserve Bank of India ("**RBI**"), has proposed the Securitization of Stressed Asset Framework ("**SSAF**") through its Discussion Paper ("**DP**") dated 25th January, 2023.*

*SSAF suggests to establish a secondary market for stressed assets, and initiate securitization of NPLs through the Asset Reconstruction Company ("**ARC**") route. The DP lays down the opportunities for the scope of the scheme and the manner of expanding the NPL market. The paper engages with the viability of the proposed scheme, by understanding the nuances and the challenges in the Indian legal system. The lack of a stable investor base, absence of unified legislation, and the dearth of judicial opinion is considered to analyse SSAF.*

The author explores foreign jurisdictions like Europe, China and Korea, to understand the nuances of stressed asset securitizations abroad. Highlighting upon the basic principles of NPL securitizations, the paper tests its efficacy in the Indian diaspora. Further, the potential roadblocks that prevent successful implementation of securitization of stressed assets are investigated.

The author concludes by providing a suggestive framework, that assists in a speedy implementation of SSAF. The questions regarding the scope of the framework and the

* The Author is a student at Damodaram Sanjivayya National Law University.

[1] Alvarez and Marsal, *Indian Stressed Asset Market: The Next Investment Wave in India*, p. 7. (2019) https://www.alvarezandmarsal.com/sites/default/files/97845_09902_indiares_stressed_asset_investors_report_v1i.pdf

*responsibility of Minimum Risk Retention ("**MRR**") are attempted to be answered by the author. The paper, proposes adaptation of the existing laws like the Insolvency and Bankruptcy Code, 2016 to accommodate SSAF. The current literature is an attempt to highlight SSAF's practicality and efficient functioning.*

Keywords: asset, financial, debt, risk, security, transaction.

TABLE OF CONTENTS

I. INTRODUCTION

The Non-Performing Asset ("**NPA**") market in India stands at 15 billion US dollars.[2] It highly reflects upon the untapped potential market for stressed assets and foreign investors in the country. According to the RBI Financial Stability Report of June 2023, the Gross Non-Performing Assets ("**GNPA**") ratio stood at 3.9%. and the NPA ratio declined to 1.0%.[3] Though, the ratio has gone down owing to the improved recovery rates, the numbers continue to soar because of redundant and inefficient schemes for dealing with stressed assets.

[2] *Id.*
[3] Reserve Bank of India, Financial Stability Report. (Jun. 28, 2023).
Available at: https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=55943 e

Stressed Assets are recognized as loan exposures that fail to provide the promised principal and outstanding balance remains continuously in excess of the sanctioned amounts or drawing power.[4] A stressed asset eventually results in an NPA, becoming a burden on the Indian economy. An NPA has been defined as, "a credit facility in respect of which the interest and/or instalment of principal has remained 'past due' for a specified period of time"[5]. NPAs are further sub-categorised as sub-standard assets, doubtful assets and loss assets.[6] The accumulated interest and principal, cause a credit crunch and a decrease in the financial system's overall efficiency and effectiveness.[7]

India follows a prudential framework for the restoration and recovery of stressed assets. The system permits early recognition of the default of large borrowers. One of the key methods of recovering the NPAs, is through the resolution by the Insolvency and Bankruptcy Code, 2016 ("**IBC**"). However, the lack of judicial man-power and the over-arching burden on National Company Law Tribunals ("**NCLT**"), has rekindled the need of recovery of stressed assets, outside the IBC framework. An under-utilized route of recovery is through the securitization of stressed assets.

"Securitisation involves the pooling of loans and selling them to a special purpose entity ("**SPE**"), which then issues securities backed by the loan pool."[8] Securitization has been a revolutionary step while dealing with standard assets.

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[4] Rakesh Nangia and Sunil Gidwani, *Stressed Assets in India- Opportunity for Investors*, NANGIA ANDERSON LLP, p.7. (2022). https://nangia-andersen.com/wp-content/uploads/2022/02/Stressed-assets-in-India-Opportunity-for-investors.pdf

[5] Harinakshi and Dr. Narayan Kayarkatte, *The Emergence of the Concept of 'Bad Banks' – A Boost to Strengthen the Indian Economy* 14 J. OF MAN. R. 29,40 (2022).

[6] Reserve Bank of India, *Prudential Norms on Income Recognition, Asset Classification and Provisioning – Pertaining to Advances* (2001) https://files.caclub.in/wp-content/uploads/rbi-master-circular-2022-2023-15-dt-01-04-2022-prudential-irac-norms-consolidated-upto-31-03-2022.pdf.

[7] P. Rajani, Bad *Banks – Right Way to Improve Loan Recovery?* L. STREET IND. (2020) http://www.lawstreetindia.com/experts/column? sid=444

[8] Reserve Bank of India, *Discussion Paper on Securitisation of Stressed Assets Framework* (Jan. 25, 2023) https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=21728

However, the same goes untapped with respect to stressed assets. Securitization can be done either directly through Specific Purpose Vehicles ("**SPV**") or through registered ARC. Turning NPAs into performing assets or recovering the maximum allowed principal is guided through the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest ("**SARFAESI**") Act, 2002. Currently, there is no corresponding mechanism for securitisation of NPA through the SPE route. RBI recently released a DP describing the broad features of the proposed SSAF.

The current paper engages with the proposed scheme of securitization of stressed assets and aims to explore the possibility and pitfalls of the same. The paper answers two major concerns regarding the SSAF. First, the question regarding the scope of SSAF to include standard assets or not, is discussed by the author. Second, the concept of MRR with respect to the liability of the originator and the Resolution Manager ("**RM**") has been analysed. The paper is divided into seven parts, each catering towards a better understanding and contributing towards a more efficient working of SSAF.

Part I of the article is the Introduction. This section lays down the basis of securitization and stressed assets in India. **Part II**, Historical Advancement of NPA Recovery, caters to the current inadequate mechanisms of recovering stressed assets. **Part III**, Proposed Regime of Securitization, briefly describes the proposed SSAF and introduces the loopholes that the scheme portrays. **Part IV:** aims to answer the loopholes in the proposed SSAF by taking lessons from countries like France, Greece and Korea. **Part V** focusses on how India is under-prepared for SSAF and the challenges that prevent its efficient implementation. **Part VI**, Suggestive Framework, offers a customised framework of secured asset securitization in India through active Government participation. **Part VII**, Conclusion, concludes by analysing the future of the proposed scheme and opening the gates of future research in the area.

II. HISTORICAL ADVANCEMENT OF NPA RECOVERY

Stressed assets resolution was introduced in India, through the Sick Industrial Companies (Special Provisions) Act ("**SICA**"), 1985[9]. The extremely lengthy process and the intervention of courts, made the legislation ineffective.[10] Soon after in 1993, the Government came up with the Recovery of Debts Due to Banks and Financial Institutions Act, 1993[11] to expedite the process of recovery of the assets. The burden of growing NPAs in the economy could not be sustained through Debt Recovery Tribunals ("**DRT**") as well. In order to reduce the intervention of courts, the SARFAESI Act, 2002[12] was passed. It allowed banks to realise and resolve the stressed and standard assets through private auctions. Pre-insolvency resolution through bilateral work-out mechanisms was experimented by the Indian government. This led to the development of short-lived schemes like Corporate Debt Restructuring ("**CDR**") and Strategic Debt Restructuring ("**SDR**").[13] post-2014, to place specific focus upon stressed assets the Scheme for Sustainable Structuring of Stressed Assets ("**S4A**"),[14] was introduced. Lack of credit flow and buyers, did not allow the scheme to progress, leading to S4A withdrawal and the final introduction of the IBC, 2016. Primarily based on the debtor-creditor relationship, the Code, assists companies to recover from bankruptcy through successful resolution plans.[15] The private ARC method as being currently utilized in India, has not proven to be successful. The private players and SPVs,

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[9] Sick Industrial Companies (Special Provisions) Act (SICA), No.1 of 1985 (Ind.).
[10] Dixit Yadav, *Evolution of Resolution Framework for NPAs in India, : A Study of Asset Reconstruction Companies and Bad Bank Proposal* 42 BUS. ANALYST 142, 153 (2012).
[11] Recovery of Debts Due to Banks and Financial Institutions Act, No.51 of 1993 (Ind.).
[12] *Supra*, note 8.
[13] Rekha Mishra, Rajmal & Radheshyam Verma, *Determinants of Recovery of Stressed Assets in India: An Empirical Study* 51 EPW 62, 68 (2016).
[14] Link Legal, *Scheme For Sustainable Structuring Of Stressed Assets*, MONDAQ (Nov. 26, 2016) https://www.mondaq.com/india/financial-services/546436/scheme-for-sustainable-structuring-of-stressed-assets
[15] Insolvency and the Bankruptcy Code, No.31 of 2016 (Ind.).

lack the capital and investor base to recover stressed assets.[16] The low recovery rate, called upon the Government to improve the reconstruction framework for stressed assets.

The COVID-19 jolt, further made the country realise the need for efficient resolution of NPAs. The Government set up a Bad Bank, 'National Asset Reconstruction Company Ltd.' ("**NARCL**"), to handle the NPAs of the Indian banking sector. The bad banks operate as ARC under SARFAESI act. ARC is a special purpose company established by a government, bank, or private investors to purchase loans and other assets, the majority of which are typically impaired, for a specific purpose afterwards (including reorganising), and frequently, a sale to investors.[17] Bad Banks are set apart from the ARCs, as the banks merely transfer their stressed assets to the bad bank instead of buying the same. The management of stressed assets is then handled by the bad banks. NARCL, functions on the basis of transferring of loans instead of clearing the same. Mere transfer of stressed assets from the balance sheet of financial institutions, does not help in writing them off from the country's economy.[18] According to the data from Central Bank, only 3.2% of total bad loans were sold to ARCs at the end of 2022, making the scheme inefficient for the Indian framework.[19] The proposed framework, simply reduces the burden on financial institutions, but, fails to provide a procedure for efficient recovery.

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[16] Reserve Bank of India, *Report of the Committee to Review the Working of Asset Reconstruction Companies* 36 (2021) https://ibbi.gov.in/uploads/whatsnew/fba385910d34d21ebc14549ae5e4a41e.pdf

[17] G. Akerlof, *The Market for Lemons: Quality Uncertainty and the Market Mechanism* 84 THE QUARTERLY J. OF ECON., 125, 132 (1970).

[18] *Supra* note 14.

[19] Saloni Shukla, *Foreign investors, others edge out ARCs in India's bad loan market*, THE ECON. TIMES. (Dec. 29, 2022) https://economictimes.indiatimes.com/markets/stocks/news/foreign-investors-others-edge-out-arcs-in-indias-bad-loan market/articleshow/96582435.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

The existing frameworks allow the economy to resolve stressed assets, through restructuring and liquidation. It has resulted in an "all roads lead to IBC" phenomenon, putting immense pressure on already struggling bandwidth and infrastructure at NCLTs.[20] "The 1,497 ongoing cases in CIRP as at 30 September 2019, continue to be unresolved and over 36% of them are running beyond 270 days without a resolution."[21]. The case of *Gujarat NRE Coke Ltd*, is an appropriate example of the failure of resolution schemes in India.[22] The company attempted recovery under Section 230[23] of the Companies Act, 2013 as well as the Section 10[24] of IBC. None of the plans could revive the company, ultimately leading to its liquidation in 2018.[25] Until 2021, the company continued to operate as "Going Concern", putting both the creditors and the debtor in a lurch.[26]

The RBI also has time and again come up with guidelines that help banks to resolve the stressed assets. Loan restructuring, has been proposed, to change the terms of repayment, which includes altering the payment schedule of loans or interest rates.[27] It gives the defaulter an opportunity to convert the stressed asset into a standard one, through reduced interest rates and lenient timelines. Joint Lenders Forum, exists to evolve an action plan for the defaulting company.[28] The guidelines combined with the legislative action, has attempted to

[20]Abizer Diwanji, *Evolving Landscape of Corporate Stress Resolution*, ERNEST AND YOUNG 34 (2019) https://assets.ey.com/content/dam/ey-sites/ey-com/en_in/topics/transaction-advisory-services/pdfs/evolving-landscape-of-corporate-stress-resolution.pdf?downloadf
[21] *Id.*
[22] Ravi Prakash Mundhra & Saurabh Agarwal, *Gujarat NRE Coke Ltd.: Revival of Companies in Distress*, EMERGING ECON. J., 35 (2021).
[23] The Companies Act, No.18 of 2013, § 230 (Ind.).
[24] The Insolvency and the Bankruptcy Code, No.31 of 2016, § 10(Ind.).
[25] *Supra* note 22.
[26] *Supra* note 22.
[27] Gayatri Mann & Roshni Sinha, *Context to Supreme Court's Order on Stressed Assets of Banks*, PRS LEG. RESEARCH (Apr. 3, 2019) https://prsindia.org/theprsblog/context-to-the-supreme-court-order-on-stressed-assets-of-banks
[28] *Id.*

revolutionize the stressed asset market. However, the same has not been effective in developing a secondary market for NPAs, nor has it improved the shareholder base. RBI's discussion paper on SSAF, comes as the newest development, that allows India to incorporate a beneficial framework for stressed asset securitization.

III. PROPOSED REGIME OF SECURITIZATION

The RBI, released the Discussion Paper laying down the contours of the proposed SSAF. In the absence of any mechanism for securitisation of NPAs through the SPV route, the DP provides the broad framework and features of the same.

The framework proposes setting up of an independent SPV, that buys NPAs from banks and issues securitization notes of the same on acquisition.[29] The SPV issues notes based on the liquidity and nature of the NPA. The older the asset, the lower is the degree of securitization return on the same. After successful classification of the stressed assets into securitization notes, the SPV sells them in the market. The revenue generated in the process of re-sale is utilised in writing off stressed assets from the economy. The SPV charges fees for maintaining the assets and also for resolving the same. A RM is the contribution authority, that differentiates between assets, manages them till they are realised and also assists in its accounting.[30]

For proper rating of securitization notes, the valuation of securitisation notes has been left to be determined as per the board approved policies.[31] The write down and market value of the securitized asset should be based on a minimum

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[29] Reserve Bank of India, *Discussion Paper on Securitisation of Stressed Assets Framework* (Jan. 25, 2023) https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=21728
[30] *Id.*
[31] Basel Committee, *Securitization of Non-Performing Loans,* https://www.bis.org/basel_framework/chapter/CRE/45.htm?inforce=20230101&published=20201126

20% write-down of the outstanding value.[32] A five-year base period is provided for the successful resolution, keeping in mind the deteorating value of the asset.[33] The concept of MRR, is also put forth in the proposed framework. Following the standard asset guidelines, a minimum of 55 credit risk is borne by the sponsors.[34] However, in the case of stressed assets, the banks, no longer wish to be associated with the assets or their recovery. The liability of the sponsors through credit risk retention shall be determined to maximize the recovery.

The credit risk and the uncertainty in the process of stressed asset securitization make the framework susceptible to damage. The DP puts forth questions to be answered in order to propagate a detailed framework for the same. The scope of the framework, to attach a certain degree of standard assets, in the framework is put forth by the authorities. The inclusion of standard assets, creates a sense of security, and aims to enlarge the investor base for the buyers.[35] Re-performing loans, like that of small enterprises and the ones involved in retail business, provide the necessary impetus to the framework.[36] Lessons can be taken from global experiences that have successfully developed a stressed asset securitization framework.

IV. LESSONS FROM ABROAD

Securitization of Stressed Assets is not a new phenomenon, countries around the world have benefited immensely from adopting effective yet flexible schemes. India being at its nascent stages of adoption of SSAF, shall cherry pick

[32] *Supra* note 20.

[33] Gary B. Gorton & Nicholas S. Souleles, *Special Purpose Vehicles and Securitization*, NAT. BUREAU OF ECON. RESEARCH 549, 553 (2007).

[34] *Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021*, RESERVE BANK OF INDIA (Sept. 24, 2021) https://rbidocs.rbi.org.in/rdocs/notification/PDFs/85MDSTANDARDASSETSBE149B86CD3A4B368A5D24471DAD2300.PDF

[35] KENDALL, LEON T & MICHAEL J. FISHMAN, *A PRIMER ON SECURITIZATION* 482 Cambridge University Press (1996).

[36] *Supra* note 20.

the principles enunciated in foreign nations and adopt an appropriate scheme for the country. The author analyses three international frameworks that have assisted countries in improving their recovery rate and in successfully creating a secondary market for stressed assets.

A. EUROPEAN STRESSED-ASSET SECURITIZATIONS

Europe has been one of the founding structures for NPL securitizations around the world. There are a number of countries in Europe that have developed a fully functioning network and system of secondary market. Italy entered into the race of securitization, through the *GaranziasullaCartolarizzazionedelleSofferenze ("**GACS**")* scheme. Similarly, Greece followed a comparable pattern by introducing the *Hercules Scheme***.**

A. GARANZIASULLACARTOLARIZZAZIONEDELLESOFFERENZE ("GACS")

GACS was one of the earliest and most successful securitizations of stressed assets schemes. GACS introduces the Italian State to offer a guarantee on the repayment of the senior notes in rated Non-Performing Loans Securitization Transactions. It was first launched in February 2016 and has been extended multiple times through March 2019.[37] GACS provides government guarantees for senior-level notes and trances. The scheme propagates the sale of lower-grade notes, in order to obtain government-backed guarantees for the higher-grade ones. The scheme furthers the creation of a secondary market of stressed assets. The heavier amounts that contribute majorly to the bad loans in the country are being tackled by the Government.

The issuance of a specified guarantee amount, based on the level of the tranche note, invites investor interest. To date, 25 GACS transactions have been

[37] KPMG, *GACS tool in the Italian Non-Performing Loans space* 8 (2019) https://assets.kpmg.com/content/dam/kpmg/it/pdf/2019/07/GACS-crediti-deteriorati.pdf

completed, accounting for an overall gross volume of approximately €71 billion.[38] The investors feel secure buying assets that are backed by the Government. "The guarantee's objective is to reduce the bid-ask price spread between originators (selling banks) and investors and increase the number and the volume of NPL transactions."[39] Safeguarding the riskiest tranches enlarges the base, and builds trust among the general public to invest and buy more tranches.

The scheme focussed on operational returns in a high-performing economy. The maximum returns of the scheme have been generated from real estate loans.[40] The mortgages and the immovable properties make it easier for the scheme to generate certainty, and in case of negligible cash flow, the properties can be sold to generate revenue. The Credit Default Swap ("**CDS**") facility of remuneration by the SPV to prevent the discrepancy with state aid. The insurance against credit default, by the SPV, creates a sense of responsibility among the investors to generate maximum revenue. The baseline of paying back the face value of the stressed bonds, in case of failure of recovery, mandates market involvement at all levels.[41]

The positive results of GACS, have made the Government to extend it from time to time. The most recent extension under the new regulatory wave is for an additional 24 to 36 months while allowing for increased participation of special servicers in the execution of upcoming transactions.[42] GACS has been reducing

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[38] *Id.*
[39] *Id.*
[40] Deloitte, *NPL securitisations and related governmental guarantee schemes in Europe* 29 (Oct., 2020) https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/corporate-finance/deloitte-uk-npl-securitisation-report.pdf
[41] *Id.*
[42] Partha Pal et al., *Non-Performing Loans and Securitisation in Europe*, ROPES AND GRAY (Apr. 7, 2016) https://www.ropesgray.com/en/newsroom/alerts/2016/april/non-performing-loans-and-securitisation-in-europe

the burden on the Italian economy by re-stabilizing the stressed assets and being an inspiration for foreign nations.

B. HERCULES SCHEME

Greece adopted the Hercules framework similar to that of GACS, to help banks securitize and remove NPAs from their balance sheets. The plan calls for the purchase of non-performing loans from the bank by a privately managed securitisation vehicle, which will then sell notes to investors. For the senior notes, the State will offer a public guarantee. The State will be compensated in return at market rates. In addition, to helping the banks in their continuous efforts to lower the amount of non-performing loans on their balance sheets, the goal is to draw in a broad variety of investors.[43]

The scheme defines the types of contracts involved in securitization. The Transfer Agreement, represents warranties, exposure to potential indemnities to the SPV, and the potential economic and time horizon limitations. The Servicing Agreement, lays down the servicing fee scheme, incentive mechanisms and tools to engage the servicer. Lastly, The Offering Circular, strategizes the payment mechanism and the hedging structure.

The scheme is based on the GACS model, but differs in the level of senior-level tranches. The Hercules scheme provides a guarantee for senior notes of BB- rating. The scheme puts the interests of the main parties, i.e., the originator, investor and servicer before the third parties. To protect the leisure wastage of Government money, the State aid is only provided when at least 50% plus one share of the junior tranche and an amount of the mezzanine notes are successfully securitised.[44] The secondary market is only activated when a

[43] European Commission, *State Aid: Commission approves prolongation of market conform asset protection scheme for banks in Greece*. (Apr. 9, 2017) https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1661
[44] *Supra* note 27.

considerable sale has happened in the primary market. Thus, the scheme would not succeed unless a market is in place. Thus, the success of Hercules can be attributed to the high-performing nature of the economy.

"Greek banks reduced their combined NPE stock by circa 39%, on a pro-forma basis, over the period January to September 2020, as the Hercules scheme facilitated sizeable volumes of NPE securitisations."[45] Thus, the scheme has been delivering positive results to assist the Government in innovating new ideas to reduce the financial burden on the economy.

C. CHINESE STRESSED-ASSET SECURITIZATIONS

The second largest growing economy in the world has managed to develop one of the largest securitization markets for NPL. The scheme originally began with a set of registered and government backed Asset Management Companies, turned into an exchange between private players and potential investors. Having experienced exponential growth since 2012, the Chinese market accounted for US$65.8bn of issuance in 2015, a 30.7% rise from 2014, according to SIFMA Securitization Group.[46] Since the inception of the scheme in 2016, nearly 243 NPL transactions have been successfully granted. As of 31st July 2022, CNY 130 billion currency in notes has been issued in the process of clearing an outstanding balance of CNY 32 billion.[47] China aims to expand the NPL market by including joint-stock banks in the securitization schemes.[48]

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[45] Morningstar, *DBRS Morningstar: Hercules Helps Greek Banks Lower their NPE Stock, But Not a 'Job Done' Yet* (Mar. 7, 2021) https://www.dbrsmorningstar.com/research/374711/dbrs-morningstar-hercules-helps-greek-banks-lower-their-npe-stock-but-not-a-job-done-yet
[46] *Non-Performing Loans Securitizations China*, HOULIHAN LOKEY. (June, 2016) https://www.mergermarket.com/assets/Houlihan_Newsletter_No9.pdf
[47] Jolie Ho, *Revised China NPL securitization scheme may attract more sellers, but not buyers*, S & P GLOBAL (Feb 20, 2017) https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/revised-china-npl-securitization-scheme-may-attract-more-sellers-but-not-buyers-39494355
[48] *Id.*

The growth of Chinese securitization has not been steady and swift. Though the concept of securitization was introduced in the country in 1996, the guidelines for the Pilot Projects, were not released until 2005.[49] The guidelines equate SPVs as trusts. The powers and duties of SPVs are flexible yet undefined. China did not have a specific law that governs Trusts until Oct 2001.[50] Thus, the process of securitization continued to be haphazard and under-performing. Another roadblock in China's journey of securitization is the customary legal system. The politicised government, further makes it difficult to structure SPVs. The redundant legal system and the lack of market further adds to the miseries of securitizations. Chinese securitization is the perfect example of progress with pitfalls, proving the world a guide of what not to adopt during their journey.

D. KOREAN STRESSED-ASSET SECURITIZATIONS

Korean Government, progressed a step forward. Besides proposing a mechanism for securitization of stressed assets, the Government created a body that could govern assets and their improvement, i.e., Korea Asset Management Corporation ("**KAMCO**"). Having a body for managing assets and revising their liquidity standards, would not only improve the recovery rate, but also take the burden off the shoulders of the banks. KAMCO worked in creating liquidity among assets and fostering a healthy competition among buyers, thus creating a secondary market for stressed assets.[51]

KAMCO also worked as an information facilitator. Market for stressed assets ends up under-performing owing to the price asymmetry. Buyers are

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[49] Nidhi Bothra, *Development in the Securitization Markets in India*, VINOD KOTHARI AND ASSOCIATES. (2020) https://vinodkothari.com/wp-content/uploads/2015/11/Developments_in_Securitization_India_Nidhi-Bothra.pdf

[50] Rebecca Lee, *Conceptualizing the Chinese Trust* 58 THE INT'L AND COMPARATIVE L. QUARTERLY 655, 659 (2009).

[51] Harsh Vora, *The NPA Problem: Lessons from South Korea*, LIVE MINT (Aug 16, 2017) https://www.livemint.com/Opinion/y0YcQqmanqipOLXJ6ZblOI/The-NPA-problem-Lessons-from-South-Korea.html

hesitant to buy assets, in the absence of a fair price regulator. KAMCO assisted in providing a transparent dissemination of data that attracted investors and improved the market conditions. According to an IMF report of 2004, up until mid-1999, with an opaque and limited involvement of KAMCO, investors paid higher than the average value for bad loans.[52] Soon after, with an open information display, KAMCO started inviting realistic prices drawing interest from private players, thus enlarging the scope of the secondary market for distressed assets.[53] Standardised data transactions and a centralised determination of prices for stressed assets proved beneficial in enhancing liquidity in the market. KAMCO furthered the economic objectives of the scheme keeping in mind the public interest and well-being. The slow yet steady advancement of KAMCO's securitizations led to the first international NPL securitization between Korea and Cayman Islands.[54] KAMCO began as an entity aimed to resolve distressed companies majorly through restructuring or winding-up. However, through constant government support and regular private investment, it has successfully created a secondary market through securitization of stressed assets.

V. ROADBLOCKS IN IMPLEMENTATION

The prospect of Stressed Asset Securitization in India is not a straight path. Similar to that of the Chinese Securitization, the developing economy is riddled with roadblocks and uncertainties. The legislative framework is inadequate to deal with the broad and distorted idea of stressed assets securitization. The over-burdened judicial system and the archaic laws prevent a healthy growth of

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[52] Dong He, *The Role of KAMCO in Resolving Nonperforming Loans in the Republic of Korea*, INTERNATIONAL MONETARY FUND, 17 (2004) https://www.imf.org/external/pubs/ft/wp/2004/wp04172.pdf

[53] *Id.*

[54] Prof. Ian H. Giddy, *Financial Institution Risk Management: The Impact of Securitization*, SEMINAR ON RISK MANAGEMENT IN FINANCIAL INSTITUTIONS. (2001) https://pages.stern.nyu.edu/~igiddy/cases/absdealsinkorea.html

stressed asset markets in the country.[55] One of the causes of the lack of activity in the securitisation sector in India is the lack of appropriate legislation and legal clarity, unclear accounting treatment, high incidence of stamp duties making transactions unviable, and lack of understanding of the instrument among investors as well as originators.[56] Almost all of the market's transactions so far have been privately arranged, with the bulk of them being bilateral completely bought out arrangements, placing the early adopters like ICICI, TELCO, and Citibank at jeopardy.[57] The lack of a structured legal system for the benefit of the financial markets, is necessary to implement a scheme for the stressed asset securitizations.

There are currently no specific regulations that control how the revenue of different organisations involved in a securitization transaction is recognised. In fact, some trust SPE arrangements might lead to double taxation and render a transaction unprofitable. When it takes effect, the Securitization Act should cover all tax issues related to securitization. The lack of a legislation, leads the country to the lack of a stable domestic investor base. The same also acts as a blockage for foreign investors to enter into the Indian market.

Further, the level of Government involvement, needs to be regulated. The invasive nature of the Government, prevents a free-flow of revenue. Unlike developed countries, India continues to be a government regulated economy, making the process a tedious one. The expansion of securitization in India is further hindered by the absence of strong foreclosure legislation. Because it is

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[55] *GACS Securitisation deals in the Italian NPL space*, KPMG 9 (2020) https://assets.kpmg.com/content/dam/kpmg/it/pdf/2020/04/GACS-Securitisation-deals-in-the-Italian-NPL-space.pdf

[56] V. Sridhar, *Securitization in India – Opportunities & Obstacles*, VINOD KOTHARI AND CONSULTANTS (2020) https://www.vinodkothari.com/wp-content/uploads/2013/12/india_article_iimc.pdf

[57] Radhika Merwin, *RBI diktat on stressed assets sees ICICI Bank slippages surging*, BUS. LINE (May 7, 2018) dubusinessline.com/money-and-banking/rbi-diktat-on-stressed-assets-sees-icici-bank-slippages-surging/article23805030.ece

difficult to transfer property in situations of failure, the current foreclosure regulations are not lender friendly and raise the risks associated with securitizations.[58]

Another hinderance in the proposal of stressed asset securitization, is the capital erosion cushion. Depending upon the variety of the stressed asset, the buyers and the resolution takes a long period of time. By the time, the resolution is complete, the market value of the capital has eroded.[59] Thus, the banks, prefer sitting upon NPAs, instead of opting for resolution methods. India needs to develop a stable investor base to allow the progress of stressed asset securitizations. "The presence of a stable domestic investor base that includes institutional investors is thought to contain yields and foster stability in bond prices and yields."[60] Moving beyond the poverty ridden population, and developing an informed investor base is one of the major roadblocks that the country needs to overcome.

VI. SUGGESTIVE FRAMEWORK

The characteristics of SSAF as discussed in Part III do not present a clear and functioning picture. The RBI proposed framework poses certain questions. The section attempts to resolve the two major uncertainties presented by RBI. The scope of the scheme to generate maximum revenue and to fixate upon an MRR is explored by the author to provide a suggestive framework. Further, the chapter proposes to adopt the international principles in order to facilitate an efficient Indian framework.

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58 *Securitization in India*, MINISTRY OF FINANCE 4 (2019) https://www.mof.go.jp/policy/international_policy/research/fy2005tyousa/0603indiabond_9.pdf

59 Jochen R. Andritzky, *Government Bonds and Their Investors: What Are the Facts and Do They Matter?*, INTERNATIONAL MONETARY FUND 12 (2012) https://www.imf.org/external/pubs/ft/wp/2012/wp12158.pdf

60 *Id.*

A. GOVERNMENT SUPPORT

The current Indian regime for stressed assets, is based out of private players. The lack of market can be attributed to the lack of confidence and security in the sale and re-sale.[61] The Incentivization of Stressed Asset Resolution would be a good starting point for developing a market. The Government support, not only attracts investors and provides security, but also motivates banks to resolve the stressed assets.[62] Just like Chinese Securitizations and the Hercules Scheme, Government can lay down the guidelines of funding securitization of stressed assets. 50% of the senior level tranches, as adopted by GACS, furthers the sale of lower-level tranches.[63] To enable the same, the valuation of assets, needs to be done in a proper manner. The notes shall be divided in categories for efficient perusal, making the involvement of Government easier and efficient.[64] The private players, should be assisted by the Government and not taken over by the same. For the success of securitization of stressed assets, a combined effort of the Government and private players is needed.

B. SCOPE OF SSAF

To enable the framework to work efficiently, the scheme's scope should be defined. The framework needs to limit its scope to either stressed assets, or expand its reach by including standard assets. Stressed Assets do not generate revenue by their nature. It becomes difficult to find investors that buy assets that have negligible possibility of performing. Thus, limiting the framework to merely

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[61] Ashima Goyal, *Indian Banking: Perception and Reality* 52 ECONOMIC AND POLITICAL WEEKLY, 77, 78 (2017).

[62] J. Stiglitz, *Lessons from the Financial Crisis and their Implications for Global Economic Policy*, COLUMBIA UNIVERSITY PRESS 47, 56 (2018) https://doi.org/10.7916/d8-1b0v-m790

[63] Deloitte, *NPL securitisations and related governmental guarantee schemes in Europe* 29 (Oct., 2020) https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/corporate-finance/deloitte-uk-npl-securitisation-report.pdf

[64] Suhas Ketka & Dilip Ratha, *Securitization of Future Flow Receivables: A Useful Tool for Developing Countries* 38 INTERNATIONAL MONETARY FUND. (2001) https://www.imf.org/external/pubs/ft/fandd/2001/03/ketkar.htm

stressed assets and NPLs would not be suitable for the Indian economy. The financial status of the Indian economy is neither stable nor aware to invest in buying stressed assets, when half of the population continue to be aloof from the Banking institutions altogether. The lower certainty of cash flow and increased liquidity factor make SSA non-viable to survive without standard assets.[65]

Inclusion of all the standard assets in the SSAF, would create more problems than solutions. People will continue to invest merely in standard assets and the focus will be diverted. The stressed assets will be sidelined not only in their investments but also in their resolution. Thus, the entire purpose of the SSAF will be futile.

To ensure efficient functioning and maximum return from the scheme. A limited number of standard assets should be included. To decide upon the nature of standard assets, India can take lessons from abroad. GACS included, re-performing real estate and asset backed securities as a part of the standard assets. The large and promising nature of such standard assets invites maximum investors. At the same time, the limited nature of standard assets does not snatch away the investors of stressed assets. For example, in June 2017 the GACS scheme allowed, the inclusion of a ReoCo, alongside the SPV, to manage real estate assets; acquisition of real estate leasing contracts; and for the provision of further finance to specific positions when it would be value accretive to the note holders.[66] Real Estate forming a huge part of re-performing loans becomes lucrative for investors and increases the base of the scheme.

[65] Stephen C Goss, *The Future Financial Status of the Social Security Program* 70 SOCIAL SECURITY BULLETIN (2010) https://www.ssa.gov/policy/docs/ssb/v70n3/v70n3p111.html
[66] Philippe Steffens, *A Global Guide to Legal Issues in Securitization*, BAKER MCKENZIE 71 (2021) https://www.bakermckenzie.com/-/media/files/insight/guides/2021/securitisation-guide-2021_29092021.pdf

Inclusion of standard assets that are backed by mortgages, and real estate commercial loans have been discussed to provide more liquidity to assets.[67] Regulatory capital requirements against those assets, can be utilised to increase the financial inventory of the scheme.[68] Further, the innate nature of securitization is to gain mortgage financing.[69] India developing its "investor culture" can take guidance from the US. Incorporating mortgage-backed securities in the US framework, attracted more than $7 trillion of both agency and non-agency investments.[70] A similar trend could be observed in India, on incorporating mortgage-backed securities in SSAF. The Government propagated investment in asset and mortgage securitizations instead of institutional gains.

Incorporating mortgage-backed loans as standard assets, would be viable in consolidating the existing structural framework in India. The existing investor base of mortgage-backed loans, would be helpful in attracting investors or stressed assets. The National Housing Bank ("**NHB**") guaranteeing senior Residential Mortgage-Backed Securities ("**RMBS**") to improve their rating, would be helpful in supporting the SSAF.[71] "Securitisation volumes are estimated to have jumped 58 per cent to Rs 1.17 lakh crore in April-December 2022."[72]

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[67] Securitization of Assets: Problems and Solutions, U. S. GOVERNMENT PUBLISHING OFFICE (2014) https://www.govinfo.gov/content/pkg/CHRG-111shrg56262/html/CHRG-111shrg56262.htm

[68] *Id.*

[69] Andreas Jobust, *What is Securitization?*, INTERNATIONAL MONETARY FUND 2 (2008) https://www.imf.org/external/pubs/ft/fandd/2008/09/pdf/basics.pdf

[70] *Asset Backed Securities*, SECURITIES AND EXCHANGE COMMISSION 289 (2018) https://www.sec.gov/rules/proposed/2010/33-9117.pdf

[71] Nidhi Bothra, *Development in the Securitization Markets in India*, VINOD KOTHARI AND ASSOCIATES (2020) https://vinodkothari.com/wp-content/uploads/2015/11/Developments_in_Securitization_India_Nidhi-Bothra.pdf

[72] *Securitisation Volumes Likely To Jump To Rs 1.70 Lakh Crore In FY23: ICRA*, OUTLOOK INDIA (Jan. 12, 2023) https://www.outlookindia.com/business/securitisation-volumes-likely-to-jump-to-rs-1-70-lakh-crore-in-fy23-icra-news-252945

C. MINIMUM RISK RETENTION

The SSAF puts forth the level of MRR. The stressed assets have already stopped performing, thus, lack any responsibility on part of the originator. The origination requirements may not play a significant role in evaluating the likelihood of recovery for these assets because they have already defaulted, and as a result, the originator's economic interests may not necessarily coincide with those of investors. Additionally, the quality of mortgages and hypothecated assets as well as the sort of loans they are all factors that may be reasonably confirmed by investors through due diligence.

In the scenario of originators not being associated with the assets, the responsibility is to the RM. RM works closely with the stressed assets and should be incentivised for their early resolution.[73] Early resolution and higher securitisation sales, can be a good starting point for effective framework management. MRR cannot be same for SSAF as for SSA. Complete market regulation would add to the uncertainty of the scheme, making it a dubious stand to be invested in. The stressed assets need a special retention incentive. The Government should come up with a specific set of guidelines to define the MRR requirements for Stressed Assets. A shared MRR, between the originator and the RM would be appropriate. Adopting a similar approach as that of KAMCO, to incentivize the RM on early recovery might turn out to be suitable for India.

The proximity of the RM makes him the most appropriate person to expand the reach and effectiveness of the framework. Incentivization of the RM can be in accordance with the existing framework of Liquidator fees with added perks. The payment of Liquidator fees, under Regulation 2 of the Liquidation Regulations, in accordance with the amount realised in liquidation, can be modified for the stressed asset framework.[74] The RM would work in a similar

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[73]*Supra* note 6.

[74] Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Gazette of India, pt. III sec. 4,Reg No. 2.(2016).

capacity as that of a liquidator, thus, incentivising him, for better realisation and quicker resolution. Priority payment to the RM, in accordance with the principle laid down in *Union Bank of India v. Dinkar T. Venkatasubramanian*,[75] could be the foundational stone of incentivized perks. To align the incentives for RMs, prudentially, it may be justifiable to stipulate that RMs retain a share of the risk by investing in securitisation notes.[76] An enabling mechanism for the RM, alongside the Government guarantees for the senior-level notes, would ensure a strategic securitisation of stressed assets. Similarity to liquidators can also be associated with their independent nature. The independency of the RM puts out the trust in the investors. The central role of RM in the SSAF resembles the portfolio of a liquidator in traits and management. The perks and pitfalls of the RM shall be similar to that of liquidation recovery.

The suggestive framework is limited to answering the questions regarding scope and MRR. The same is decided upon the extent of accessibility of the scheme. Further, the involvement of the Government, can both elevate and digress the scheme. Thus, the utilization of the principles needs to be done in an appropriate manner to gain maximum efficiency.

VII. CONCLUSION

Stressed Assets have been a hinderance in the Indian economy, the current regime, inadequately resolves the same. RBI proposed, Securitization of Stressed Assets Framework, serves a two-fold purpose, of resolving NPAs in the market and developing a secondary market for securities in India.

The proposed framework by RBI, is vast and broad. Deciding upon the scope of the scheme alongside the credit risk, would provide the basis of successful securitization. It is not India's first attempt to NPA securitization. In

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[75] Union Bank of India v. Dinkar T. Venkatasubramanian(2022*)*, Company Appeal (AT) Insolvency No. 729 of 2020.

[76] *Supra* note 6.

2004, the IDBI Stressed Asset Stabilization Fund provided with a bailout package to shift its bad loans to a SASF.[77] The same was backed by the Government but controlled by independent market managers. The Fund recovered less than half of the NPAs at INR 4,000 crore out of the INR 9,000 crore at the end of March 2013.[78] Laying down specific guidelines for stressed asset framework, would make the proposed regime a successful one.

The paper concisely analyses the proposed framework of SSAF. By tracing its necessity, history and features, the author acquaints the readers with the basics of securitization in the stressed asset market. The international aspect and the challenges highlight that no scheme is perfect, each country has had its own pitfalls, India to adopt relevant lessons from each jurisdiction and propagate its own specific scheme. Lastly, the suggestive framework, ideates and streamlines the framework posed by RBI. It would be interesting to see, how the final SSAF, would shape the Indian economy and provide an efficient resolution mechanism.

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[77] Public Accounts Committee, *One Hundred and Twenty-Fifth Report-Stressed Asset Stabilisation Fund (SASF)*, MINISTRY OF FINANCE 37 (December, 2018).

[78]Deolitte, *Bad Banks in India* 18 (November, 2020) https://www2.deloitte.com/content/dam/Deloitte/in/Documents/finance/in-fa-bad-bank-note-noexp.pdf

RETHINKING THE MORATORIUM CLAUSE UNDER IBC: AN ANATOMIZATION OF AVIATION INSOLVENCY

Reema Jain & Apsara Sridhar[*]

ABSTRACT

*Aviation industry is extremely capital-intensive owing to high cost of aircraft equipment, its maintenance and fuel costs inter alia. In light of that, lease-financing is the most convenient manner in which airlines acquire their aircrafts. While the procedure for Aircraft Leasing and Financing is adequately stressed upon in the Indian Legal framework, there are several lacunae when it comes to the remedies available to the aircraft financiers in the event of insolvency. On one hand, the Section 14(1)(d) of the Insolvency and Bankruptcy Code 2016 ("**IBC**") prohibits the recovery of the assets by the lessor while in the possession of the Corporate Debtor upon the imposition of the moratorium. This Provision gives adequate ground to the cash-strapped corporate debtor to restructure itself while preserving its assets. On the other hand, the Cape Town Convention 2001 ("**CTC**") provides for deregistering the aircraft and transferring the possession back to the lessor in the event of insolvency upon the completion of the waiting period. The former is corporate debtor-centric and the latter is creditor-centric. The Bill enforcing CTC in India has been introduced but has not been enacted yet. This Paper shall study the DGCA Guidelines, Aircraft Rules 1937, IBC and CTC at length to outline the contrast in the objective that each legislation seeks to achieve. However, most importantly the authors shall discuss the need for a new legislation to harmonize the differences in order to resolve insolvency in a manner that balances the interests of the corporate debtor and the creditors alike. Lastly, the central questions that this Paper seeks to answer is whether the lease of the aircraft must terminate despite the imposition of moratorium upon the admission of the matter and if there is a need for a sector-specific insolvency code.*

[*] The Authors are students at Symbiosis Law School Hyderabad.

Keywords: Aviation, insolvency, cape town, lease, mortarium, convention.

TABLE OF CONTENTS

I. INTRODUCTION

The domestic market for flight travel in India is burgeoning as a result of competitive prices of air travel and economic growth of the country. It is estimated that by 2031, India would be the fifth largest market for domestic travel with 9.9% being the annual growth rate in terms of Revenue Passenger Kilometers.[1] The airlines operating within India prefer aircraft-leasing over other manners of possessing or acquiring aircraft and the same is reflected by the fact that 80% of commercial aircraft in India is leased as opposed to a global average of 53%.[2] In light of prospective growth, there must be active efforts by the Government and industry regulators alike to make the industry more lucrative and the process less complex. One of the crucial areas where the legal framework requires an overhaul is aviation insolvency.

[1]AIRBUS, *Global Market Forecast 2012-2031*, 39 (2012) https://www.airbus.com/en/products-services/commercial-aircraft/market/global-market-forecast.
[2] PRIMUS PARTNERS, *Aircraft Leasing Industry: Has India Nailed the Landing* (May 2023) https://www.primuspartners.in/docs/documents/KVsaluunn0EVD2PZId8P.pdf (Last visited on 6th August, 2023).

The recent Go Airlines insolvency serves as a testimony to the need for a more tailored and balanced legislation for restructuring insolvent airlines. This case makes us question whether a sector-specific insolvency legislation is the need of the hour. This Paper shall first argue that IBC is a misfit for dealing with aviation insolvency by studying the essence and procedure enshrined in it and highlighting the need for a different approach. In order to establish that, the effect of moratorium on lease and invocation of bank guarantees under current framework will be thoroughly outlined. Additionally, the CTC Bill 2018 shall be analyzed to check whether it is sufficient in its current form and if it is in the best interests of the lessors and the airline. Based on the findings, the way forward shall be charted out.

II. AVIATION INSOLVENCY AND IBC: FITTING A SQUARE IN CIRCLE

The Corporate Insolvency Resolution Process ("**CIRP**") is essentially a negotiation where though both the debtor and creditors endeavor to maximize the value of the assets, there is conflict of interest. Conflict tends to arise as the creditor would aim to close out the investment and avail alternative investment opportunities and the debtor would aim to hold on to the assets and utilize them for risky ventures to get greater returns.[3] This is illustrated in the aviation industry where upon the default in payment by airlines to lessors, the lessors approach the civil aviation regulator, Directorate General of Civil Aviation ("**DGCA**") to deregister the aircraft and export it to the lessor. While on the other hand, the airlines choose to hold on to the aircraft in order to generate revenue and repay the dues.

[3] IBBI, MINISTRY OF CORP. AFFAIRS, GOV'T OF IND, THE REPORT OF THE BANKRUPTCY LAW REFORMS COMMITTEE VOLUME I: RATIONALE AND DESIGN, 21,22 (2015), https://ibbi.gov.in/BLRCReportVol1_04112015.pdf.

D. UNDERSTANDING MORATORIUM IN LIGHT OF AVIATION INSOLVENCY

It has been averred in a plethora of judicial pronouncements that IBC is not a debt-recovery mechanism, rather it is a tool to restructure the corporate debtor.[4] In light of that, even upon the admission of the matter, the affairs of the corporate debtor are carried out as a going concern.[5] In order to maintain the corporate debtor as a going concern, immediately after the application is admitted, moratorium is imposed under Section 14 of IBC.[6] As per Section 14(1)(d), there cannot be recovery of any property by the owner or the lessor where such property is occupied or is in possession of the corporate debtor. Further, Section 14(1)(a) bars any proceedings against the corporate debtor. The ambit of Section 14 is wide and therefore no proceedings, transfer, alienation or termination of any legal right or beneficial interest can take place against the interests of the Corporate Debtor.[7] In addition to this, post the enactment of IBC (Second Amendment Bill) 2020, Section 2A has been inserted under Section 14(2) of IBC. Prior to this amendment, the scope of essential goods and services was limited and the threshold for its ambit was based on "Survival of humankind" as opposed to "making profits".[8] However, consequent to the amendment, essential goods include all such goods and services that are imperative to preserve the value of assets of the corporate debtor and maintain the affairs as a going-concern. The intent behind the amendment was to reduce the time taken for insolvency resolution and a better recovery rate.[9] Therefore,

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[4] Invent Securitization and Reconstruction Pvt. Ltd. v. Girnar Fibres Ltd., 2022 SCC OnLine SC 808 (Ind.).
[5] Swiss Ribbons Pvt. Ltd. v. Union of India, (2019) 4 SCC 17 (Ind.).
[6] Sunil Kumar Agrawal v. New Okhla Industrial Development Authority, 2023 SCC OnLine NCLAT 33 (Ind.).
[7] P. Mohanraj v. M/s Shah Brothers Ispat Pvt. Ltd., (2021) 6 SCC 258 (Ind.).
[8] ICICI Bank v. Innoventive Industries, 2017 SCC Online NCLT 7 (Ind.).
[9] STANDING COMMITTEE ON FINANCE, MINISTRY OF CORP. AFFAIRS, GOV'T OF IND., REPORT ON INSOLVENCY AND BANKRUPTCY (SECOND AMENDMENT)BILL 2019, 2.6 (2020), https://ibbi.gov.in/uploads/whatsnew/20ef77b3a1200f12ad19cee1c2c3dba9.pdf.

based on the current framework on moratorium, two aspects shall be elaborated upon: (2.1.1) The aircraft leased by the airlines from the lessors constitute as "essential goods" and (2.1.2) The effect the imposition of moratorium has on the lease between aircraft lessors and the airlines.

1. Aircraft lease as an essential service under IBC

The amended Section 14(2A) of IBC gives statutory protection to the Corporate Debtor from the risk of termination of contract by the supplier of essential goods upon default in payment. The Resolution Professional ("**RP**") determines whether a particular good or service is essential and no guidelines are framed neither in the IBC framework or in the CIRP Regulations, 2016. It is material to note that IBC provides no guarantee against the payment made by the suppliers during the moratorium period. Parallels can be drawn between the observations made in the case of Gujarat Urja Vikas Nigam Ltd. v. Amit Gupta[10] ("**GUVNL**") and Section 14(2A). In the said case, the termination of sole power purchase agreement (contract) was dismissed by the adjudicating authority under Section 60(5)(a) as the said termination solely on the grounds of initiation of CIRP would lead to corporate death of the corporate debtor. This implies that the aircraft lease is an essential service and its termination could lead to the corporate death of the airline.

2. Correlation between ongoing lease and imposition of moratorium

The correlation between the aforementioned can be understood by studying the *Jet Airways* and *Go Airlines* insolvency matters. While in the former case, the airline lessors had time to repossess their aircraft through the Irrevocable Deregistration and Export Request Authorization ("**IDERA**") process, the same was not possible in the latter.[11] The IDERA mechanism that was envisaged by

[10] Gujarat Urja Vikas Nigam Ltd. v. Mr. Amit Gupta, (2021) 7 SCC 209 (Ind.).
[11] Press Trust of India, *DGCA de-registers seven aircraft of Jet Airways, allows lessors to take them back*, TIMES OF IND. (Apr. 10, 2019).

the Cape Town Convention 2001 ("**CTC**") under Article IX was strengthened by the Aircraft (Third Amendment) Rules, 2005. Under Section 3 of the Amending Act, the Rule 30 of the said Rules was amended and sub-rule 7 was inserted. As per Rule 30(7), the aircraft to which CTC applies shall be de-registered by the Central Government upon receiving an application from an IDERA-holder before the expiry of the lease.

The question that now arises is whether IDERA process can take place upon the imposition of moratorium. In Awas 39423 Ireland Ltd. v. DGCA[12]it was held that upon termination of the lease, DGCA is required to cancel the registration of the aircraft. Most importantly, it was held that deregistration was a ministerial act. In light of that, when an IDERA-holder approaches the DGCA and the airline refuses to give possession, the lessor in that case can approach the High Court under Article 226 and pray for the issue of a writ of Mandamus. However, this was a pre-IBC judgment. In Accipiter Investments Aircraft v. Union of India[13], the aircraft lessors of Go Airlines approached the Delhi High Court to enforce their IDERA. It was contended by the Petitioners that upon the submission of IDERA, DGCA had no alternative but to de-register the aircraft. The wording of the legislation in Rule 30(7) employs the word "shall" as opposed to "may" in Rule 30(6), which reflects that it is a mandatory obligation[14] of DGCA to deregister an aircraft within 5 days of receiving an application.

It must further be noted, that in the *Go Airlines* case, several lessors terminated their leases prior to the admission of the matter by NCLT.[15] The assets over which RP can exercise control includes assets owned by a corporate debtor in a foreign country under Section 18(f)(i) and assets that may or may not

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[12] Awas 39423 Ireland Ltd. v. Directorate General of Civil Aviation,2015 SCC OnLine Del 8177 (Ind.).

[13] Accipiter Investments Aircraft 2 Ltd. v. Union of India, 2023 SCC OnLine Del 3895 (Ind.).

[14] Wellington Associates Ltd. v. Kirit Mehta, (2000) 4 SCC 272 (Ind.).

[15] Ashmit Kumar & Kanishka Sarkar, *GoFirst Leases were terminated before Moratorium Order*, CNBCTV18 (May 11, 2023) https://www.cnbctv18.com/aviation/go-first-crisis-bankruptcy-protection-lessor-smbc-aviation-seeks-nclat-stay-on-moratorium-16627291.htm.

be in possession of the corporate debtor under Section 18(f)(ii) of IBC. Upon termination of the lease, the aircraft is no longer under the possession of the corporate debtor and it does not exercise any ownership rights over the aircraft. Moratorium can be imposed upon only those assets that are in possession of the Corporate Debtor at the time when moratorium is imposed. However, all the above contentions fall sour to Section 63 and Section 238 of IBC. It has been held that IBC is a complete code[16] and Section 238 of IBC is said to have an overriding effect over all other laws in force. Therefore, even if IDERA proceedings have been initiated, the moratorium imposed under Section 14(1)(d) of IBC shall override it. This Provision gives an interesting perspective of the manner in which businesses are using IBC as a tool. Go Airlines filed for insolvency under Section 10 of IBC before the loans were declared as NPAs and after several lessors terminated their leases to repossess their aircraft. It is thus advisable for financial creditors to pre-empt the insolvency of the corporate debtor and include such clauses in their credit arrangement that mandates the compliance to certain threshold limits. Insolvency law must ideally strike a balance between the needs of the creditor and the debtor and must ensure that neither the creditor nor the debtor abuse the law and for that appropriate law must be chalked.[17] The usage of IBC as a business strategy tool makes us question whether the moratorium clause warrants revamping. The most visible example is the marked difference between Go Airlines case and Jet Airways case was that Go Airlines strategically applied for insolvency under Section 10 of IBC and Jet Airways did not which was reflected by the fact that the size of its fleet shrunk from 124 planes to just 11 by July, 2019.[18]

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[16] M/s. Innoventive Industries Ltd. v. ICICI Bank, AIR 2017 SC 4084 (Ind.).

[17] United Nations Commission on International Trade Law (UNCITRAL), *Legislative Guide on Insolvency Law* 11,12 (2005) https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf.

[18] INSOL INTERNATIONAL, *Aircraft Repossession upon a Default - A Review of the issues in the United Kingdom, USA, India and Nigeria*, Technical Paper Series no. 45, 14 (Nov., 2019).

The corporate debtor-centric insolvency regime is not unique to India, but has been followed in multiple jurisdictions. Brazil ratified CTC and the same has the force of law. Countries that adopt CTC have options under Article XI: Alternative A, Alternative B or neither. As per Alternative A, the possession of the aircraft is given to the airline no earlier than the end of the waiting period and the date on which the possession would revert to the lessor, had the Article not been applied. The waiting period determined by Brazil is 30 days. In the case of *OceanairLinhas*[19] in accordance to sub-part (a) of Article XI(2), a stay of 30 days was granted to all aircraft leases. However, it has been contended that such stay should not have been granted, considering as per the Bankruptcy Law of Brazil, leases cannot be granted any stay.

Currently, under Section 14(1)(d), owner cannot claim the property while the corporate debtor has its possession. Lessors on the other hand are prohibited from claiming the property, irrespective of whether Corporate Debtor has actual or constructive possession of the leased asset.[20]

E. AIRCRAFT LESSORS INITIATING AND PARTICIPATING IN CIRP

As of 2021, there were no aircraft leasing companies in India.[21] Therefore, it is imperative to understand the legal framework for foreign aircraft leasing companies to approach NCLT or become a part of the Committee of Creditors ("**CoC**"). The process of initiating CIRP shall be studied in two tranches (1) Application by a foreign person under IBC and (2) Application for liquidation of foreign assets in a foreign nation (cross-border insolvency).

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[19] Oceanair Judicial Recuperation And Bankruptcy, Case No 1125658-81.2018.8.26.0100 (Brazil).

[20] Rajendra K Bhutta v. Maharashtra Housing and Area Development Authority 2018 SCC OnLine NCLAT 850 (Ind.).

[21] PwC India., *Aircraft Leasing in India: Ready to take off*, PwC (Feb. 2021, 13) https://www.pwc.in/assets/pdfs/research-insights/2021/aircraft-leasing-in-india-ready-to-take-off.pdf.

1. **Application by a foreign person under IBC**

Upon a cursory reading of Sections 7 and 8 of IBC, it is abundantly clear that the Code does not differentiate between Indian or Foreign persons to file an application to initiate CIRP. In *Stanbic Bank Ghana Ltd. v. Rajkumar Impex Pvt. Ltd.*[22], the financial creditor (Ghana-based bank) extended a loan to the wholly owned subsidiary of Indian company in Ghana, of which the Indian holding company was the corporate guarantor. Upon default, the English Court passed an Order against the holding company. The financial creditor approached the NCLT under Section 7 and the insolvency application was admitted. It has been held that Article 14 of the Constitution includes foreigners under its fold and operational creditors cannot be excluded based on their foreign residency.[23] Therefore, aircraft lessors can approach the Indian Adjudicating Authorities under Sections 7 or 8, based on the nature of the lease.

2. **Application for liquidation of foreign assets in a foreign nation**

Typically, a foreign insolvency proceeding or a concurrent proceeding takes place when there are foreign assets and foreign liabilities.[24] In the *Jet Airways case*[25] NCLT explicitly addressed the absence of a provision within IBC that facilitated the recognition of judgments rendered by foreign insolvency courts. In this specific instance, Jet Airways had become subject to concurrent insolvency proceedings in both the Netherlands and India. The Dutch Administrator applied to NCLT to recognize the proceedings of the Dutch court. Upon dismissal, the Appeal before NCLAT led to the "Cross-border Insolvency Protocol" between the Resolution Professional and the Dutch Court

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[22] Stanbic Bank Ghana Ltd. v. Rajkumar Impex Pvt. Ltd., 2018 SCC OnLine NCLAT 22994.
[23] Macquarie Bank v Shilpi Cable Technologies, (2018) 2 SCC 674.
[24] MINISTRY OF CORPORATE AFFAIRS, GOV'T OF IND. REPORT ON THE RULES AND REGULATIONS FOR CROSS-BORDER INSOLVENCY RESOLUTION 21, 27 (2020) https://ibbi.gov.in/uploads/whatsnew/202111232152060clh96e353aefb83dd0138211640994127c27.pdf.
[25] State Bank of India v. Jet Airways (India) Limited, 2019 SCC OnLine NCLT 7875 (Ind.).

Administrator. This protocol recognized India as the 'centre of main interests' and acknowledged the Dutch proceedings as 'non-main insolvency proceedings.' Despite this, the Dutch Administrator's participation in CoC meetings was limited to observation to avoid redundancy of authority.

Similarly, amidst the insolvency proceedings concerning *Videocon Industries*[26], notable reports have indicated that Videocon, in a notable turn of events, approached the NCLT with a plea to encompass its overseas assets within the ongoing CIRP. In response, a recent ruling by the NCLT has accorded approval for the integration of Videocon's foreign business operations into the overarching corporate insolvency resolution proceedings conducted within India.

All in all, it must be noted that despite the huge amounts that Indian airlines owe the foreign leasing or financing companies, these foreign persons cannot become a part of the CoC. The imposition of moratorium does not allow them to repossess their assets and the non-inclusion in CoC, does not let the creditors to be a part of the resolution process either, making the law extremely lop-sided and unfavourable.

F. AIRCRAFT LESSORS AS OPERATIONAL CREDITORS

There are several leasing options available like financial lease, operating lease and Sale and Leaseback. The most common route for Indian airlines is the Sale and Leaseback option where the airline sells its aircraft to a leasing company or to a Special Purpose Vehicle ("**SPV**") that is formed by the lessor.[27] In order to initiate CIRP or be a part of CoC, it is material to classify the debt as operational or financial. A financial lease meets certain requirements like (i) Transfer of lease at the end of the term, (ii) option to purchase at a price lower than fair value (iii) lease term equates to major part of the "economic life" of the asset and (iv) the

[26] State Bank of India v. Videocon Industries Ltd., 2019 SCC OnLine NCLT 745 (Ind.).
[27] PRIMUS PARTNERS*, supra* note 2.

impugned asset is "specialized" and caters specifically to the needs of the lessee.[28] Any lease other than financial lease is an operational lease.[29] It has been held by the Apex Court that Financial Leases are akin to loans and are in fact loans in disguise.[30] Upon a combined reading of Sections 5(7) and 5(8) of IBC, it is evident that a financial creditor must be owed a financial debt, which is debt along with interest that is disbursed against time value of money. This leads to the conclusion that a financial lease would allow the lessor to approach NCLT under Section 7 as a financial creditor. The CoC is comprised of the financial creditors only[31] and therefore only when there is a financial lease, the aircraft lessor can be a part of the CoC. It has been held multiple times by various fora that a lessor is typically an operational creditor only.[32] Therefore, even when India has industry players in aircraft leasing in future, they would merely be operational creditors. Operational creditors in the moratorium period are largely dependant upon the commercial wisdom of the financial creditors and have little say in the restructuring process. In case, an Order of liquidation is passed by the adjudicating authority under Section 33 of IBC, the operational creditors would receive the proceeds at a very low priority under water-fall mechanism enshrined under Section 53 of IBC.

G. INVOKING BANK GUARANTEES DURING MORATORIUM

Under Section 10(1), the RBI can delegate the duties of approving foreign aircraft leasing and financing to Authorized Dealer ("**AD**") Banks. As per Regulation 3(iii) of Foreign Exchange Management (Guarantees) Regulations 2000, an AD may give a corporate guarantee in favour of foreign airlines. A no-

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28 Indian Accounting Standards, Ind AS 17.
29 *Id.*
30 Association of Leasing & Financial Services Co. v. Union of India, (2011) 2 SCC 352 (Ind.); Asea Brown Boveri Ltd. v. Industrial Finance Corpn. of India, (2004) 12 SCC 570 (Ind.).
31 Insolvency & Bankruptcy Code, Act No. 31 of 2016, §21(2) (Ind.).
32 Mobilox Innovations Pvt. Ltd. v. Kirusa Software Pvt. Ltd., (2018) 1 SCC 353 (Ind.); SarlaTantia v. Nadia Health Care Ltd., 2019 SCC OnLine NCLT 24175 (Ind.).

objection issued by an AD is typically relevant for operating leases. Financial Leases are classified as "External Commercial Borrowings" and require RBI approval on the basis of whether such transaction forms a part of "approval route" or "automatic route". The security deposits with regard to payment for lease rental, airlines can remit upto USD$ 1,000,000 without any need to furnish letter of credit or guarantee.[33] It was observed in *IDBI v. Indian Oil Corporation Ltd.*[34], that bank guarantees can be invoked even during the moratorium period as guarantees constitute an independent contract between the applicant and respondent banks. However, in the case *Jet Airways*[35] NCLAT refused to invoke the performing bank guarantee against the Successful Resolution Applicant ("**SRA**") and advised the applicant to coordinate with the SRA to revive the corporate debtor. It is therefore being voiced that airport authorities should insist upon bank guarantees in place of grounding the aircraft upon default.

III. THROUGH THE FAULT-LINES OF IBC: WAY FORWARD?

The Ministry of Civil Aviation proposed to introduce "Protection and Enforcement of Interests in Aircraft Objects Bill, 2022" in a move to implement the provisions of CTC. One of the chief objectives of the Bill is to reduce the risk that intending creditors face. This would lead to reduction in cost of aircraft financing and eventually the benefits would pass onto the passengers.[36] It has been discussed that Indian Courts presently do not recognize foreign insolvency proceedings. However, as per Article 30 of the said Bill, international interest would be effective provided the interest is registered. The most path-breaking

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[33] RESERVE BANK OF INDIA, MASTER CIRCULAR, IMPORT OF AIRCRAFT ON OPERATING LEASE - SECURITY DEPOSITS 3 (2005) https://femaonline.com/cms/import_of_aircraft_on_operating_lease__security_deposits_/c:887/w:1/p:2.

[34] IDBI Bank v. Indian Oil Corporation Ltd. & Anr. Company Appeal (AT) (Insol.) No.543 of 2021.

[35] State Bank of India v. The Consortium of Murari Lal Jalan & Mr. Florian Fritsch2023 SCC OnLine NCLAT 1988 (Ind.).

[36] Protection and Enforcement of Interests in Aircraft Objects Bill, 2022, art. 2(e).

change is encapsulated in Article 19(2), which forms an exception to the moratorium clause under Section 14 of IBC. As per this, the corporate debtor or insolvency administrator must give possession to the creditor (lessor) by the end of the waiting period. The waiting period matches the global standards and is determined as two calendar months and the date on which creditor would repossess the aircraft but for the application of the said provision.[37] Therefore, the crucial question that arises is whether the waiting period of 60 days constitutes a balanced approach (3.1).

A. WHETHER 60 DAYS CONSTITUTES AN EFFECTIVE WAITING PERIOD?

The Section 1110 of US Bankruptcy Code, a lessor can have immediate repossession of the aircraft unless the lessee under security agreement undertakes to perform all obligations. However, it must be understood that airlines have huge debts and giving repossession within 1-2 months would dismantle any chances of revival of the business. The mechanism under CTC and the moratorium under Section 14 of IBC constitute two ends of the spectrum and embody lop-sided interests. The CIRP process must be completed in 180 days and can be extended by further 90 days, making it 330 days.[38] Therefore, the possibility of harmonizing the waiting period and CIRP period must be considered. During the CIRP, the airlines must under security agreement undertake to pay for lease amount during CIRP. Post the CIRP, if the past dues are not paid, then the repossession and export aircraft could take place. Additionally, new terms and conditions of the lease contract can be renegotiated that balances the interests of the lessor and the lessee.

[37] Protection and Enforcement of Interests in Aircraft Objects Bill, 2022, art. 19(7) (Ind.).
[38] Insolvency & Bankruptcy Code, 2016, §12 (Ind.).

B. AVIATION-SPECIFIC INSOLVENCY CODE

Several factors set apart the insolvency in aviation sector like cross-border elements, high capital outlay and variation in the nature of lease or credit arrangement *inter alia*. Real estate serves as a good example for sector-specific insolvency legislation. *Firstly*, IBC (Second Amendment) Act 2018 was passed that recognized real estate allottees as financial creditors and the same was held constitutionally valid.[39] *Secondly*, certain real-estate specific amendments are possibly being proposed by the Government. The most significant one being "customized resolutions" for insolvent real estate developers. These customized resolutions would cater to nature and terms of each project.[40] In light of this, certain aviation specific amendments can be made to IBC. In tandem with a previous recommendation, the waiting period can be synchronized with CIRP period, *i.e.*, 180 days. However, during the CIRP period, financial lessors must be allowed voting rights in CoC and the strict stance on commercial wisdom can be relaxed. This is owing to the fact that aircraft lessors are one of the biggest creditors of the airline and their needs and conditions require representation. This need is further bolstered by the imposition of moratorium period, where the aircraft lessors do not have access to their aircraft. Furthermore, the Delhi High Court allowed the aircraft lessors access to their aircraft, allowed inspection and interim maintenance during the moratorium period.[41] This can be reduced as an amendment to the existing law as a breather to the aircraft financiers and lessors.

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[39] Pioneer Urban Land and Infrastructure Limited v. Union of India, (2019) 8 SCC 416 (Ind.).
[40] Banikinkar Pattanayak, *Customised IBC Resolutions for Real Estate on the Cards*, ECO. TIMES (Jun. 9, 2023) https://realty.economictimes.indiatimes.com/news/industry/customised-insolvency-bankruptcy-code-resolutions-for-real-estate-on-the-cards/100864145.
[41] Nupur Thapliyal, *Delhi High Court Permits Lessors To Carry Out Inspection, Interim Maintenance Of Aircrafts On Lease With Go First*, LIVE LAW (JULY 5, 2023) https://www.livelaw.in/high-court/delhi-high-court/delhi-high-court-lessors-deregister-aircrafts-lease-go-first-231957?infinitescroll=1.

IV. CONCLUSION

India has been tagged as a "risky jurisdiction" and the Aviation Working Group has put India on the watchlist amidst the Go Air Insolvency matter.[42] Therefore, India has to rework its insolvency law, specifically the moratorium clause. It is an obvious fact that India requires a proper code on cross-border insolvency. However, there is also a pressing need to develop aircraft leasing industry in India. In light of that, the Ministry of Civil Aviation constituted a Working Group on Development of Avenues for Aircraft Financing and Leasing Activities, known as 'Project Rupee Raftar.' This Report proposes to set up aircraft leasing companies in India s in the International Financial Services Centre ("**IFSC**") notified by the Government of India under the Special Economic Zone Act, 2005.[43] In line with this, IFSC Authority exercising its powers under section 3 of the International Financial Services Centres Authority Act, 2019 notified aircraft leasing as a financial product.[44] The capital requirement threshold of USD 200,000 or its equivalent in freely convertible foreign currency is to be maintained by the entity at all times which reflects prudence.[45]

Apart from this, akin to BASEL norms that supervise the banking sector and set certain standards with respect to capital adequacy and internal assessment process *inter alia*, norms can be set for the aviation sector as well. The Framework for aircraft leasing in India has certain capital requirement thresholds for the lessors. Similarly, airlines must also at a global level have certain capital

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[42] Anwesha Mitra, *India Placed on Watchlist with Negative Outlook amid Go First Insolvency Row*, LIVE MINT (May 12, 2022)https://www.livemint.com/news/india/india-placed-on-watchlist-with-negative-outlook-amid-go-first-insolvency-row-nclt-hearing-to-resume-on-monday-11683888927855.html.

[43] InCorp Advisory, *Project Rupee Raftaar: Development of Aircraft Leasing and Financing in India*, (Mar. 8, 2023) https://incorpadvisory.in/blog/gift-city-the-new-hub-for-indian-aircraft-leasing-and-financing/.

[44] International Financial Services Centres Authority, Circular no. F. No. 172/IFSCA/Finance Company Regulations/2022-23/01 (May 18, 2022).

[45] Framework for Aircraft Lease, 2022, Part I, Clause F(i).

requirements based on their expenses. The airlines can be mandated to maintain expense ratios, assets ratios and liability ratios. Deviation from such maintenance must be notified publicly so the stakeholders can streamline their supply or renegotiate their terms pre-emptively. There is also discourse on deploying AI in insolvency detection. Insolvency and restructuring are based on certain sets of data which makes it ideal for utilizing AI.[46] AI can be used to pre-emptively understand when a company is inching towards insolvency and strategically plan accordingly. Therefore, while framework is required to deal with insolvency, steps must be taken to avoid it.

Lastly, as discussed, moratorium clause requires a re-look and must be made at par with global standards. The CTC Bill must be implemented, however, not in its current form. The current form, under its repossession clause, completely dismantles the chance of revival of an airline. Therefore, a balanced and a tailored legislation is the need of the hour.

[46] Joanna Goodman, *Artificial Intelligence in Insolvency work*, 8-9, INSOL EUROPE (2018).

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