

# INSIGHTS

## RESTRUCTURING & INSOLVENCY



### Group Insolvency Regime in India

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The increased consolidation in India Inc over the last few years has led to numerous instances of situations wherein the group holding company lands into indebtedness and is on the verge of being insolvent, thereby impacting all its subsidiary companies, or vice-versa, wherein indebtedness of a subsidiary creates risk for the larger group. Such instances are categorized as 'group insolvency', which refers to the process of clubbing together the assets and liabilities of individual companies and undertaking the insolvency proceedings as one substantive consolidation of the holding company, its associates, and its subsidiaries.

On one hand, group insolvency seeks to balance the doctrine of separate legal entity as laid down in *Salomon v. Salomon & Co Ltd*<sup>1</sup> while recognizing the practical reality that a consolidated insolvency process is advantageous for all stakeholders, as their resolution(s) can be consolidated before one court of law and combined assets can be utilized to the greatest advantage for the entire group.

#### Judicial pronouncements

The Insolvency and Bankruptcy Code, 2016 (IBC) does not accommodate and provide for specific arrangements or contain any provision for group insolvency as the legislation, in its present form, is designed for a single economic entity and envisages a framework to deal with the insolvency and liquidation of corporates on a standalone basis. However, the Courts seem to have taken cognizance of this gap and have started the process of addressing the same.

- In the landmark case of *State Bank of India & Anr v. Videocon Industries Ltd & Ors*<sup>2</sup>, a consortium of banks led by State Bank of India, being the common creditor, filed an application before the National Company Law Tribunal (NCLT), Mumbai Bench seeking substantive consolidation of fifteen Videocon companies into single proceedings for the purpose of CIRP to form the common debtor. The NCLT allowed substantive consolidation of thirteen of the fifteen Videocon companies on the grounds of common control, common directors, common assets and liabilities, amongst others. The decision was arrived at by referring to several US and UK case laws where it was held that bankruptcy courts may order for consolidation while exercising their equitable powers. This ruling, in essence, laid the building blocks for the introduction of the single economic entity principle in the IBC, and for initiation of group insolvency regime in India. Recently, an interesting development has taken place in this matter where NCLT, Mumbai bench has approved the resolution plan of Twin Star Technologies Ltd., marking it as the first major group resolution plan in India<sup>3</sup>.
- Group insolvency has also been initiated to give relief to homebuyers. In the case of *Edelweiss Asset Reconstruction Co Ltd v. Sachet Infrastructure Pvt Ltd & Ors*<sup>4</sup>, the National Company Law Appellate Tribunal (NCLAT) ordered for a simultaneous CIRP to be initiated against a group of five companies through a common RP in order to develop a residential real estate project and complete it in one go.

<sup>1</sup> (1897) AC 22

<sup>2</sup> 2019 SCC OnLine NCLT 745

<sup>3</sup> Order dated June 08, 2021 in IA 196 of 2021 in CP (IB) 02/MB/C-II/2018 and other company petitions

<sup>4</sup> 2019 SCC OnLine NCLAT 592

- Similarly, in the matter of *Chitra Sharma v. Union of India*<sup>5</sup>, the Supreme Court (SC) directed the parent company (Jaypee Group) to deposit a substantial amount in lieu of the insolvency proceedings initiated against its group companies.
- Going one step further, albeit exercising its powers under Article 32 of the Constitution, the SC in *Bikram Chatterji & Ors. v. Union of India*<sup>6</sup>, came to the aid of the aggrieved homebuyers by ordering attachment of properties of all forty group companies in the Amrapali group and freezing of bank accounts of all companies and their directors.
- In another instance, while dealing with the insolvency process in the case of *Axis Bank Ltd & Ors v. Lavasa Corp Ltd*<sup>7</sup>, NCLT consolidated the Lavasa group insolvencies in order to avoid potential losses likely to be caused by fractured insolvencies while noting that the insolvency of the subsidiaries largely depended on the outcome of their parent's insolvency.
- The recent downfall of IL&FS group comprising of 348 companies also brought the need to regulate the group insolvency framework under IBC. As recently as on June 22, 2021, the NCLAT, while dealing with IL&FS cases specifically, held that by virtue of various settled cases, the law has developed where group insolvency is also permissible.

### Report of the Working Group on group insolvency

Recognizing the growing need for a holistic framework for group insolvency, the Insolvency and Bankruptcy Board of India (IBBI) constituted a Working Group which submitted its recommendations on September 23, 2019<sup>8</sup>. The Working Group primarily considered three elements – procedural coordination mechanisms, substantive consolidation mechanisms and rules for perverse behavior of companies in a corporate group – and addressed key aspects pertaining to identification of a group, the extent of grouping and the mechanics involved. Among several recommendations, it recommended the implementation of the group insolvency framework in a phased manner.

- **Phase 1:** The first phase should initially be applied only to companies in a domestic group with adoption of procedural coordination mechanisms as a trial mechanism. Procedural coordination mechanisms are rules which coordinate the different insolvency processes of various group companies, without disturbing the division of assets and substantive claims of creditors of each of the group companies. This mechanism lowers costs and reduces the time associated with different insolvency processes. It consists of the following elements:
  - Joint application process for insolvency of multiple companies
  - Communication, cooperation and information sharing between different insolvency professionals, NCLTs and CoCs under IBC
  - Single Adjudicating Authority to administer insolvency proceedings
  - Single insolvency professional for companies in a corporate group
  - Creation of a group creditors' committee
  - Enabling of group coordination proceedings
  - Extension of overall time frame for conclusion of CIRP of group entities to 420 days
- **Phase 2:** The second phase should introduce mechanisms of group insolvency in cross-border group insolvencies and substantive consolidation, depending upon the implementation of first phase of framework. The concept of substantive consolidation seeks to consolidate the assets and liabilities of group companies so that they are considered as a single economic unit for the insolvency process.

In drafting the framework, the Working Group has taken into consideration the UNCITRAL Legislative Guide on Insolvency Law on 'Treatment of enterprise groups in insolvency'<sup>9</sup>, the 'World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes, 2016'<sup>10</sup> and has extensively drawn references from western legislation in European countries and United States, with the aim of designing a comprehensive and practical framework to facilitate insolvency resolution and liquidation of companies in a group. However, upon analyzing the recommendations of the Working Group, there are a few grappling concerns that need to be addressed:

<sup>5</sup> (2018) 18 SCC 575

<sup>6</sup> 2019 SCC OnLine SC 901

<sup>7</sup> Order dated February 26, 2020 in MA 3664/2019 in C.P.(IB)-1765, 1757 & 574/MB/2018

<sup>8</sup> <https://www.ibbi.gov.in/uploads/whatsnew/2019-10-12-004043-ep0vq-d2b41342411e65d9558a8c0d8bb6c666.pdf>

<sup>9</sup> <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/leg-guide-insol-part3-ebook-e.pdf>

<sup>10</sup> <https://documents1.worldbank.org/curated/en/518861467086038847/pdf/106399-WP-REVISED-PUBLIC-ICR-Principle-Final-Hyperlinks-revised-Latest.pdf>

- Definition of the term 'corporate group' provided by the Working Group for the purpose of this framework so as to include holding, subsidiary and associate companies, is vague and fails to be inclusive
- Inherent ambiguity between jurisdictional issues arising due to the recommendation of a single Adjudicating Authority to mandatorily monitor the group insolvency process and the liberties provided to stakeholders to have different Adjudicating Authorities during the process of transfer of their applications
- Applicability of cross-border insolvency provisions with relation to group insolvency since the development of provisions related to cross-border insolvency is itself at a nascent stage
- Non-settlement of the application of the principle of extension of liability as far as the Indian jurisprudence related to group insolvency proceedings is concerned
- Lack of consideration of issues relating to provisions for dealing with multiple tax jurisdictions, the concept of group moratorium, the procedure to move out from group insolvency proceedings in case of settlement between creditors and corporate debtors, the feasibility of insolvency proceedings of a corporate debtor having cross investments and backward or forward linkages with other group entities without consolidation, alignment of management of multiple group companies by single RP, etc.

## **Conclusion**

A large percentage of companies in our country are part of a group structure, as a result which they are interconnected and structurally, financially, and operationally interdependent. This necessitates an integrated view of their business while aiming to achieve value maximization in the process of restructuring and revival or liquidation.

Introduction of group insolvency law will not only make the resolution process expeditious and cost-effective for the group companies, it will also allow the Adjudicating Authority to pierce the corporate veil and hold these group companies working as a single-economic unit, accountable. While the IBC is silent in this regard, positive steps are being taken by the courts to fill in the lacunae through judicial pronouncements. Given the large number of benefits offered by the concept of group insolvency process, it is imperative in the long run for the Parliament to give legislative recognition to this by way of introducing the necessary provisions under the IBC, being mindful of the inherent challenges and issues that arise from the Working Group's report. Since the recent amendments to the IBC in 2021 have not dealt with group insolvency at all, it will be noteworthy to see how the Parliament implements these suggestions in the future.

