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Stigma, Corporate Insolvency, and Law: International Practices and Lessons for India

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M P Ram Mohan* & Muskaan Wadhwa^Ψ

Abstract

Insolvency and bankruptcy have always attracted a measure of stigma. The negative attitude towards insolvency emerged due to the historically harsh treatment of bankrupts and the perception of bankruptcy as a breach of a sacred relationship between the debtor and creditor. Majority of the existing legal scholarship studying the bankruptcy stigma focuses on personal insolvencies, while its influence on corporate insolvencies has largely been neglected. This paper attempts to fill this gap by examining the impact and manifestations of stigma in the context of corporate insolvency. The paper does so by contrasting the corporate insolvency schemes of the United States and the United Kingdom. It argues that while both jurisdictions prioritise the rehabilitation of corporate debtors, there is a divergence in the methodologies across the Atlantic due to the varied historical, cultural, and economic attitudes towards business failures. With this background, the paper explores bankruptcy stigma in the Indian context and shows how certain provisions of the Insolvency and Bankruptcy Code, 2016 seem to reinforce and perpetuate the stigma against incumbent management and promoters of corporate debtors. The paper argues that there is a need to ameliorate the stigma associated with corporate insolvency for the successful rescue and rehabilitation of distressed corporations and for promoting entrepreneurship, innovation, and economic growth in the country.

Keywords: Stigma; Bankruptcy and Insolvency; IBC; Section 29A of IBC

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I. INTRODUCTION

Much ink has been spilt on the social stigma attached to personal bankruptcies.[1] Most of the existing legal literature focuses on the plausible causes of stigma and attempts to ascertain whether the stigma surrounding personal bankruptcy still exists or has declined over time.[2] The negative perception attached to personal bankruptcies has both historical and sociological roots. Historically, debtors were treated as quasi-criminals and were subjected to harsh punishments, including death.[3] This was because bankruptcy was viewed as the debtor's own fault; rather than a consequence of external factors.[4] From a sociological lens, bankrupts were stigmatised because bankruptcy filings were considered a serious moral indiscretion.[5] By declaring bankruptcy, the debtor deviated from his ethical obligation to repay incurred debts and recklessly disregarded the trust that the creditors had reposed in him.[6] Thus, perceiving bankruptcy as a breach of a trust relationship and the imposition of draconian punishments played a key role in reinforcing the stigma surrounding personal bankruptcy.

Over the past several decades, the social condemnation of bankrupts has been argued to have declined.[7] Various causes, such as industrialisation and the expansion of consumer credit, are attributed to have caused the shift in public opinion of personal bankruptcy.[8] Other factors that have enabled the softening of bankruptcy stigma include a growing recognition that financial failure may result from extraneous events such as unemployment, inflation, medical bills rather than fraudulent conduct of the debtor and the rise of liberal bankruptcy laws.[9] Simultaneously, however, other scholars argue that bankruptcy stigma still exists and has, in fact, become more

[1] The terms 'insolvency' and 'bankruptcy' are used interchangeably throughout this paper. These terms attract divergent meanings in the Unites States (US) and the United Kingdom (UK). While under the US law, the term bankruptcy applies to individuals and corporations alike, within the UK, bankruptcy is limited to the legal process through which only private individuals can be discharged of their debt. Historically, two separate expressions existed because the term bankruptcy was confined to traders who experienced bankruptcy due to accident or misfortune such as loss of ship, while the term insolvency was applicable to non-traders or private individuals who experienced insolvency invariably due to their own profligacy.

[2] *See e.g.*, Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Less Stigma or More Financial Distress: An Empirical Analysis of the Extraordinary Increase in Bankruptcy Filings*, 59 STANFORD LAW REVIEW 213 (2006); Rafael Efrat, *The Evolution of Bankruptcy Stigma*, 7 THEORETICAL INQUIRIES IN LAW 365 (2006) [hereinafter *Efrat, Evolution of Bankruptcy Stigma*]; Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1 BYU LAW REVIEW 177 (1999).

[3] Louis Edward Levinthal, *The Early History of Bankruptcy Law*, 66 THE UNIVERSITY OF PENNSYLVANIA LAW REVIEW 223, 228-231 (1918).

[4] Rafael Efrat, *Bankruptcy Stigma: Plausible Causes for Shifting Norms*, 22 EMORY BANKRUPTCY DEVELOPMENTS JOURNAL 481, 489 (2006) [hereinafter *Efrat, Plausible Causes for Shifting Norms*].

[5] Lisa J. McIntyre, *A Sociological Perspective on Bankruptcy*, 65 INDIANA LAW JOURNAL 123, 131 (1989).

[6] *Id.*

[7] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 392.

[8] Michael D. Sousa, Bankruptcy Stigma: A Socio-Legal Study, 1, 61 (Thesis, University of Denver).

[9] *Id.* at 59-60; *See* discussion *infra* pp. 10-11.

potent as a result of the widely publicised information about individual bankruptcy filings available on the Internet.[10] The ease of access to information adds on to the bankruptcy stigma and works as a substantial deterrent for some persons considering filing for bankruptcy.[11]

Notwithstanding the lack of consensus on the matter of decline, it is generally accepted that bankruptcy still carries a measure of stigma that affects the functioning of bankruptcy systems, be it personal or corporate bankruptcies.[12] Most legal studies focus on the stigma attached to personal insolvency due to its pronounced nature, while the same has been relatively underexplored as far as corporate insolvency is concerned.[13] This paper attempts to study the bankruptcy-stigma interface in the context of corporate insolvency. This study assumes importance because the impact and manifestations of stigma and the questions it raises are to an extent distinct from personal bankruptcy.[14] Although there is some overlap between the two in that both personal and corporate insolvency affect entrepreneurs; nevertheless, differences exist as while personal insolvency influences a broad range of entrepreneurs, corporate insolvency only impacts high growth entrepreneurs who incorporate a limited liability corporation.[15]

Moreover, the nature and the objective of personal and corporate insolvency vary significantly,[16] and thus, the manifestation of stigma and the corollary problems are also distinct. The objective of most corporate insolvency legislations today is to domesticate the rescue culture as opposed to liquidation.[17] In other words, there is an emphasis on the rescue and rehabilitation of distressed corporations, while liquidation is envisioned only as a matter of last resort. However, the ubiquity of stigma acts as an obstacle in the successful materialisation of the rescue culture.[18] Due to the stigma, fear, and guilt associated with bankruptcy, the management and promoters of the corporate debtor are hesitant to initiate the

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[10] *See* Sullivan et al., *supra* note 2, at 242-243.
[11] Sullivan et al., *supra* note 2, at 243.
[12] Tibor Tajti, *Bankruptcy Stigma and Second Chance Policy*, 6 CHINA-EU LAW JOURNAL 1, 3 (2017); Nicola Howell & Rosalind Mason, *Reinforcing Stigma or Delivering a Fresh Start: Bankruptcy and Future Engagement in the Workforce*, 38 UNSW LAW JOURNAL 1529, 1531 (2015).
[13] *See* Tajti, at 2.
[14] Tajti, *supra* note 12, at 5.
[15] Saul Estrin et al., *Prospect Theory and the Effects of Bankruptcy Laws on Entrepreneurial Aspirations,* 48 SMALL BUSINESS ECONOMICS 977 (2017).
[16] *See* Hamish Anderson, *Corporate Insolvency After the Insolvency Act 1986*, 20 B.L.J. 49 (1988) (noting that while personal insolvency is concerned with providing a fresh start to individual debtors, corporate insolvency aims at rehabilitation of the company).
[17] Tajti, *supra* note 12, at 6.
[18] Tajti, *supra* note 12, at 6.

corporate insolvency resolution process.[19] This reluctance of the corporate officers delays the early identification of financial distress and exhausts potential for reorganisation, tilting the bankruptcy regime in favour of liquidation.[20] The stigma surrounding corporate insolvencies also has the spillover effect of disincentivising the management from taking risks, thus deterring entrepreneurial activities and innovation levels in the country.[21]

The negative perception surrounding corporate insolvency may also result in a host of adverse consequences. Once a company is declared insolvent and enters the resolution process, key stakeholders may begin to disassociate themselves with the firm.[22] Suppliers may refuse to supply goods or services or do so at unfavourable terms; customers may disengage with the company by shifting their demand to alternative competitors,[23] and the employee morale may plummet due to the fear of retrenchment, which in turn would lead to lower productivity.[24] The high intensity of bankruptcy stigma may also lead to unfavourable *ex-ante* consequences; for example, companies may shift their businesses to jurisdictions with a more conducive restructuring environment.[25] Furthermore, the reputational damage that ensues from the commencement of insolvency may also make it harder for the distressed company to raise finances, thus dampening the chances for its revival.[26]

Agreed, a healthy dose of bankruptcy stigma is a beneficial tool in prompting entrepreneurs to make better financial decisions. However, in cases where the debtors are facing uncontrollable financial distress, the stigma does not deliver any societal benefit. Conversely, in such situations, the stigma exacerbates the difficulties faced by the corporate debtors and acts as a hurdle in their effective reorganisation. In this instance, only if the intensity of bankruptcy stigma is low and if there are sustained changes in the attitude towards business failures can the rescue and rehabilitation of corporate debtors be successful.[27] This, in essence, is the central

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[19] Tajti, *supra* note 12, at 7; Andrew Spring, *Now is the Time to Shatter the Insolvency Stigma*, ACCOUNTS DAILY (Sept. 11, 2020) https://www.accountantsdaily.com.au/columns/14822-now-is-the-time-to-shatter-the-insolvency-stigma.

[20] Tajti, *supra* note 12, at 7.

[21] Sharon A Simmons et al., *Stigma and Business Failure: Implications for Entrepreneurs Career Choices*, 42 SMALL BUSINESS ECONOMICS 485, 502 (2014).

[22] Wesley Rosslyn-Smith et al., *Exploring the Indirect Costs of a Firm in Business Rescue*, 34 SOUTH AFRICAN JOURNAL OF ACCOUNTING RESEARCH 24 (2020).

[23] *But see* discussion on the invalidity of ipso facto clauses in the US, UK, and India *infra* pp. 14-16, 24.

[24] Rosslyn-Smith et al., *supra* note 22, at 24; Robert I. Sutton & Anita L. Callahan, *The Stigma of Bankruptcy: Spoiled Organisational Image and its Management*, 30 ACADEMY OF MANAGEMENT JOURNAL 405, 416 (1987).

[25] *See* Tajti, *supra* note 12, at 3 (citing German *Schefenacker* forum shopping case).

[26] Rosslyn-Smith et al., *supra* note 22, at 25; Sutton & Callahan, *supra* note 24, at 420.

[27] Tajti, *supra* note 12, at 6; Gerard McCormack, *Apples and Oranges? Corporate Rescue and Functional Convergence in the US and UK*, 18 INT. INSOLV. REV. 109, 114 (2009) [hereinafter *McCormack, Apples and Oranges*].

claim of this paper. Hence, studying stigma in the context of corporate insolvencies is critical for obtaining a comprehensive understanding of the impact and manifestations of stigma and for forging a bankruptcy legislation that fosters the restructuring of distressed businesses.

This paper is structured as follows: Section I explores how stigma came to be associated with personal insolvency and whether bankruptcy stigma has declined or not over the past several decades. Section II contrasts the corporate insolvency scheme of the US and the UK. The Section describes how even though both the US and UK are committed to the rescue culture, there is a divergence in their insolvency apparatus; that is, the US has adopted the debtor-in-possession model, while the UK has resorted to the creditor-in-possession model due to the historical, cultural and economic differences and varying intensity of bankruptcy stigma. Section III analyses bankruptcy stigma in the Indian context. For this purpose, this Section looks at the shift from the debtor-in-possession to the creditor-in-possession model in India and thereafter examines the provisions of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) that seem to perpetuate stigma in the insolvency process. Section IV maps the decisions of the judiciary to gauge the judicial attitude towards corporate debtors and understand their role in reinforcing the bankruptcy stigma. Finally, Section V and Section VI conclude the paper by suggesting a few means by which the stigma associated with corporate insolvency can be mitigated.

II. STIGMA AND BANKRUPTCY LAW

There is no universally accepted definition of bankruptcy stigma. As a broad term, 'stigma' has been defined by social psychologists to mean a deeply discrediting attribute and a deviation from the expected social norm.[28] Professor Ervin Goffman, in his seminal work, *Stigma: Notes on the Management of Spoiled Identity,* contends that the society categorises individuals based on their personal attributes.[29] Individuals with favourable personal characteristics acquire a normal social status, while those with a stigmatised condition receive a '*discredited*' or a '*discreditable*' status in society depending upon whether the stigmatised condition is apparent or latent.[30]

[28] ERVING GOFFMAN, STIGMA: NOTES ON THE MANAGEMENT OF SPOILED IDENTITY 9 (Penguin, 1990); Howell & Mason, *supra* note 12, at 1534.
[29] *See* Goffman, at 9.
[30] Arthur Kleinman & Rachel Hall-Clifford, *Stigma: A Social, Cultural and Moral Process,* 63 J EPIDEMIOL COMMUNITY HEALTH 418 (2009).

According to Goffman, people with stigmatised conditions that are overt and can easily be perceived on encounter, for instance, obesity or a particular race, attain a discredited status. On the other hand, a stigmatised condition that is latent and cannot be easily noticed, for example, mental illness or drug addiction, attracts a discreditable social status. Goffman further argues that for those individuals with a discreditable social status "*the issue is not that of managing tension generated during social contacts but rather that of managing information about his failing.*"[31] Thus, for these persons, the choice then maybe whether or not to reveal the stigmatised condition to other members of the society, and how, when and where should such revelation take place. Since bankruptcy is a condition that cannot be readily discerned by others, it is considered a discreditable status that people may attempt to hide from others as far as possible.[32]

From a legal and economic lens, bankruptcy stigma can be understood to mean "*a cost associated with filing for bankruptcy based on injury to reputation or violation of moral standards*."[33] In other words, bankruptcy stigma can be referred to as an indirect cost of financial stress that may result in immense emotional turmoil in case of personal insolvency or impede the success of a rescue attempt of an insolvent firm in case of corporate insolvency.[34] The legislation on personal insolvency[35] and stigma as bankruptcy's by-product predates the legal framework on corporate insolvency, which was introduced with the passage of the UK Companies Act in 1862.[36] Hence, the reasons for the development of bankruptcy stigma associated with personal insolvency are worth investigating in order to understand stigma in the context of corporate insolvency.

A. Potential Causes of Stigma Surrounding Personal Insolvency

One of the causes for the emergence of stigma surrounding personal insolvency is the historically harsh treatment of debtors.[37] In primitive societies, bankrupts were considered as thieves who stole money from their creditors and, more significantly, who robbed the

[31] Goffman, *supra* note 28, at 57.
[32] Howell & Mason, *supra* note 12, at 1535; Sousa, *supra* note 8, at 31.
[33] Sullivan et al., *supra* note 2, at 233.
[34] Rosslyn-Smith et al., *supra* note 22, at 25.
[35] *See* discussion *infra* p. 9.
[36] Hamish Anderson, *An Introduction to Corporate Insolvency Law*, 8 PLYMOUTH LAW & CRIMINAL JUSTICE REVIEW 16 (2016).
[37] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 392; Sousa, *supra* note 8, at 52.

confidence that the creditors had trustingly reposed in them.[38] As a result, the early debt recovery system was marked with derogatory and humiliating practices targeting the debtors.[39] In particular, the execution of the outstanding debt amount was directed against the debtor's person instead of his or her property.[40] Thus, it was common as per the ancient Roman and Greek laws for the creditors to condemn the debtors and their family to slavery, cut the debtors' body parts, or even kill them as a means of executing the debt.[41] In Roman law, when there were several unpaid creditors, the debtor's body would be dismembered, and the pieces would be distributed among the creditors in proportion to their debt.[42]

The concept of debt and its repayment also occupied a significant area in the ancient Hindu law, as reflected from the writings in the *Dharamashastras*.[43] The *Dharamashastras* are a collection of important *Smiriti* texts, written by sages in ancient times that served as a repository of a body of rules and code of conduct.[44] Non-payment of debt was considered a sin by the *Dharamashastras*, which stated that if a person died without discharging the outstanding debt, then all of the debtor's good deeds would transfer to the creditor.[45] Further, the debtor had to discharge the unpaid amount by serving as a slave or a beast to the creditor in the next life.[46] The *Smiritis* also allowed for infliction of draconian punishments. In particular, the *Manusmiriti* permitted the creditors to recover the debt amount by seizing the body of the debtors and forcing them to perform labour.[47] Violence could also be meted out by the creditor, who could kill or maim the debtor, or confine the debtor's wife, sons or cattle until the outstanding amount was repaid.[48] Thus, these harsh and derogatory practices played an important role in manifesting and reinforcing acute social stigma surrounding bankruptcy.

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[38] Emily Kadens, *The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law*, 59 DUKE L.J. 1229, 1238 (2010).
[39] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 370.
[40] Levinthal, *supra* note 3, at 232; Pihu Mishra & Sushanta Kumar Das, *Social Ramifications of Bankruptcy Law, in* QUINQUENNIAL OF INSOLVENCY AND BANKRUPTCY CODE, 2016, 1, 84 (2021).
[41] Levinthal, *supra* note 3, at 228-231.
[42] Catarina Frade, *Bankruptcy, Stigma and Rehabilitation*, 13 ERA FORUM: JOURNAL OF THE ACADEMY OF EUROPEAN LAW 45, 46 (2012).
[43] Rajiv Mani, *Debts in Ancient India, in* INSOLVENCY AND BANKRUPTCY CODE A MISCELLANY OF PERSPECTIVES, 1, 263 (2019).
[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] Levinthal, *supra* note 3, at 230 (citing Manu which provided that "*by whatever means a creditor may be able to obtain possession of his property, even by those means may he force the debtor and make him pay*"); *See* Bibek Debroy, Address on From No Exit to Easy Exit: A Case Study of IBC, IBBI's Fifth Annual Day Lecture 8 (Oct. 1, 2021) (stating that Manu allowed recovery of dues by the creditors through force, without recourse to a court of law).
[48] Levinthal, *supra* note 3, at 230.

To escape these barbarous punishments, the debtors would often flee from their creditors, which was possible due to lack of communication and political barriers restricting movement.[49] As a result, the '*act of flight*' became associated with bankruptcy, which directly influenced the first insolvency law passed in England in 1542, called the Act Against Such Persons As Do Make Bankrupt.[50] The English legislators borrowed the term bankrupt from the French law, wherein it was used to denote only fraudulent or criminal insolvents.[51] Not surprisingly, the 1542 statute, consistent with the etymological roots of the term bankruptcy, covered only those individuals who sought to defraud their creditors. Honest but unfortunate insolvents whose losses were brought on by forces outside their control fell outside the purview of this legislation.[52] Interestingly, however, the 1542 statute used the term bankrupt only once in the title, while the remaining legislation referred to the bankrupt as the '*offender.*'[53] Such negative verbiage employed by the 1542 statute to label debtors served to perpetuate the stigma surrounding bankruptcy.[54]

Another peculiarity that marked the 1542 statute was that it viewed bankruptcy as a positive '*act*' committed by the debtor. Therefore, a person did not unintentionally '*become'* bankrupt (such as by reasons beyond the debtor's control) but was actively '*made'* so by his fraudulent and reckless conduct.[55] Once this fraudulent conduct, such as that of fleeing away from the creditors, was committed, the solvency of the debtor was irrelevant. Later, in the seventeenth century, there was a growing realisation that there may be cases wherein the defaulting debtor had committed no positive or intentional act.[56] Instead of enacting a new legislation to cover such unintentional instances of insolvency, the legislators in the subsequent statutes stretched the meaning of the term bankrupt to cover even honest insolvents.[57]

While doing so, the legislators, however, did not discard the need for an act to be established, as was required under the erstwhile 1542 statute; rather, a legal fiction was created wherein the non-action of the debtor was regarded as the action.[58] For example, the bankruptcy statute

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[49] Israel Treiman, *Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law*, 52 HARVARD LAW REVIEW 189, 193 (1938).
[50] W.J. Jones, *The Foundations of English Bankruptcy: Statutes and Commissions in the Early Modern Period*, 69 TRANSACTIONS OF THE AMERICAN PHILOSOPHICAL SOCIETY 1, 12 (1979).
[51] Kadens, *supra* note 38, at 1240.
[52] Kadens, *supra* note 38, at 1240.
[53] Kadens, *supra* note 38, at 1240.
[54] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 371.
[55] Treiman, *supra* note 49, at 192; Jones, *supra* note 53, at 24.
[56] Treiman, *supra* note 49, at 192.
[57] Treiman, *supra* note 49, at 196.
[58] Treiman, *supra* note 49, at 196; Jones, *supra* note 50, at 12.

enacted in England in 1604 assumed a purely passive and involuntary instance of being arrested for unpaid debt and imprisoned for six months as an '*act of bankruptcy*.'[59] There was nothing voluntary or fraudulent about this new '*act*' of being arrested. Yet, the legislators considered being detained for six months to be a '*conduc*t' on the part of the debtor, which rendered him officially bankrupt.[60] This emphasis of the earlier legislations on the debtor's fraudulent or passive conduct and not his financial condition as forming the basis for bankruptcy contributed to the perpetuating of bankruptcy stigma.[61]

From a social perspective, debtors were stigmatised because bankruptcy filings were considered a serious moral indiscretion; that is, the debtor had deviated from his ethical obligation to repay incurred debts and recklessly disregarded the trust that the creditors had reposed in him.[62] The debtor's breach of trust was viewed as a betrayal of a sacred relationship that warranted outrage and stigma.[63] Another reason for the social condemnation of bankruptcy filings is related to borrowings.[64] Availing of personal credit attracted social disdain because it was perceived to deviate from the cherished ideals of thriftiness and self-sufficiency.[65] While self-restraint garnered admiration, bankruptcy was condemned and scorned because the debtor had chosen to consume loans instead of living within his means.[66] Thus, by taking loans, an individual failed to meet the societal standards of sufficiency, individualism, and autonomy and therefore was subjected to stigmatisation and received societal disrespect.[67]

B. Changing Perception of Social Stigma

With the rise of consumer credit in the 1920s, the social censure of bankrupts began to decline. The rampant growth in consumerism and increase in production of goods led to debt accumulation being viewed favourably for consumption purposes.[68] Soon, in some societies, such as the US, indebtedness became associated with a higher standard of living and a sign of one's social status.[69] There was also a shift in society's perception of the causes of bankruptcy.

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[59] Treiman, *supra* note 49, at 196.
[60] Treiman, *supra* note 49, at 196.
[61] Treiman, *supra* note 49, at 198.
[62] McIntyre, *supra* note 5, at 131.
[63] McIntyre, *supra* note 5, at 131.
[64] Frade, *supra* note 42, at 49.
[65] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 369.
[66] Frade, *supra* note 42, at 49.
[67] Sousa, *supra* note 8, at 45.
[68] Efrat, Plausible Causes for Shifting Norms, *supra* note 4, at 490.
[69] Paul Ali et al., *Short a Few Quid: Bankruptcy Stigma in Contemporary Australia*, 38 UNSW LAW JOURNAL 1575, 1586 (2015).

Beginning in the 1960s in the US, people began to increasingly attribute financial failure to events beyond the debtor's control. Thus, economic and personal conditions such as inflation, unemployment, stock market losses, medical bills were blamed for an individual's financial distress.[70]

Additionally, newer bankruptcy and pro-industry legislations played an important role in reducing the negative connotation surrounding bankruptcy. Historically, legislations had referred to bankrupts as '*deceivers, frauds, cheaters, and offenders*.'[71] Such negative labelling reinforced and perpetuated society's contempt towards insolvents. However, post-1970s, new bankruptcy legislations were introduced, which served to soften bankruptcy stigma. For example, the US Bankruptcy Code, 1978, replaced the term '*bankrupt*" with '*debtor*' to mitigate the stigma surrounding bankruptcy.[72] This change in terminology played a crucial role in signalling the desire of the legislators and society to view bankrupts as any other individual owing a debt.

Lastly, media and attorney advertisements contributed to the decline in the deviance associated with bankruptcy. The widespread media coverage of bankruptcy filings by politicians and celebrities generated acceptance of bankruptcy as a legitimate response to financial distress.[73] Moreover, to remain competitive, many attorneys started advertising their services to the public. These advertisements reduced the search costs for the debtors by providing them accessible information about bankruptcy and reduced the costs of legal representation.[74] Hence, both media and attorney advertisements played a crucial role in increasing the number of bankruptcy filings and softening the stigma attached to personal insolvency.

A few empirical legal studies have been undertaken to test whether there has been a decline in the stigma associated with bankruptcy. In general, the legal literature on bankruptcy stigma can be divided into two camps – with Professors Teresa Sullivan, Elizabeth Warren, and Jay Westbrook arguing that bankruptcy stigma still exists and has, in fact, increased over time, while Professor Rafael Efrat, on the other hand, suggests that bankruptcy stigma has faded

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[70] Efrat, Plausible Causes for Shifting Norms, *supra* note 4, at 492.
[71] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 392.
[72] Sousa, *supra* note 8, at 59; Frade, *supra* note 42, at 50; Nathalie Martin, *The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation*, 28 B.C. INT'L & COMP. L. REV. 1, 39 (2005) [hereinafter *Martin, Role of History and Culture*]; Karen Gross, *Preserving a Fresh Start for the Individual Debtor: The Case for Narrow Construction of the Consumer Credit Amendments*, 135 U. PA. L. REV. 59, 110 (1986); *See* In Re Waldrep, 20 B.R. 248 (1982); In Re Cummings, 84 F. Supp. 65 (S.D. Cal. 1949).
[73] Jones & Zywicki, *supra* note 2, at 212.
[74] Sousa, *supra* note 8, at 59.

considerably.[75] In the study conducted by Efrat,[76] he supports the hypothesis that there has been a significant decline in the stigma surrounding personal insolvency. He examined 176 newspaper articles on bankruptcy published by the New York Times between 1864 and 2002 to assess the evolving public sentiment.[77] He observed that there was a dramatic shift in the discourse regarding personal insolvency in the US. Earlier, insolvents were referred to as cheaters, crooks, or evildoers.[78] However, beginning in the 1960s, the articles published by New York Times started addressing the insolvent debtors with sympathetic undertones as someone needing help and began attributing bankruptcy to exogenous events.[79] Notably, these newspaper articles also began referring to personal insolvency as a matter of fundamental civil liberties and consumer rights instead of something to be scorned upon.[80] Professor Efrat concluded that the potency of bankruptcy stigma had diminished during the last 150 years.

However, Sullivan, Warren, and Westbrook,[81] in their empirical study, refute the claim that there has been a decline in the stigma surrounding personal insolvency. The authors, in their study, analyse the debt-to-income ratio of a group of debtors to test whether the increase in bankruptcy filings was due to the fading bankruptcy stigma. The authors argued that if the stigma had indeed declined, then there should have been a decrease in the median debt-to-income ratio of the debtors, as debtors with a lighter burden would be willing to undergo the bankruptcy process.[82] However, this was not the case, with the debtors being worse off in 2001 than in 1981. Hence, they argued that the rise in bankruptcy filings during this period could not be attributed to the weakening stigma associated with bankruptcy; rather, they suggested that the increase in the filings was a symptom of greater financial distress being faced by American families.[83]

Hence, as Sousa points out, there is no unanimity within the legal literature about whether the stigma attached to personal insolvency has declined or not.[84] Notwithstanding the lack of consensus among legal scholars, it is generally accepted that bankruptcy, including corporate

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[75] Sousa, *supra* note 8, at 5.
[76] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2.
[77] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 386-392.
[78] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 389.
[79] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 390.
[80] Efrat, Evolution of Bankruptcy Stigma, *supra* note 2, at 390.
[81] Sullivan et al., *supra* note 2.
[82] Sullivan et al., *supra* note 2, at 237-238.
[83] Sullivan et al., *supra* note 2, at 247.
[84] Sousa, *supra* note 8, at 5.

insolvency, still retains a measure of stigma,[85] making its study relevant. As stated earlier, to date, the research on bankruptcy stigma has overwhelmingly focused on personal insolvency; however, the same hasn't received much attention as far as corporate insolvency is concerned. Therefore, this paper will hereinafter limit its focus to the stigma attached to corporate insolvency, beginning by studying how stigma has influenced the bankruptcy scheme of the UK and US in the following Section, and thereafter the bankruptcy scheme of India in Section IV of the paper.

III. CORPORATE INSOLVENCY AND STIGMA IN THE US AND UK

The corporate insolvency regime of the US and UK has influenced the insolvency apparatus of countries across the globe,[86] including India, warranting their examination. The insolvency laws of both jurisdictions (that of the US and UK) are committed to the rescue culture and are geared towards rehabilitating failing business enterprises as a going concern rather than liquidating them on a piecemeal basis.[87] While the objective of both systems is identical, there is divergence across the Atlantic in the modality through which this goal is achieved.[88] The following section will contrast the corporate insolvency scheme of the US and the UK and subsequently explore the difference in their approach from a legal and cultural lens.

A. Contrasting the Corporate Insolvency Scheme of the US and UK

Chapter 11 of the Bankruptcy Code, 1978, governs the restructuring proceedings in the US. The proceedings are generally initiated with the debtor filing a voluntary petition before the bankruptcy court accompanied with a disclosure statement.[89] The insolvency of the corporate debtor is irrelevant in filing a Chapter 11 petition; however, the petition must necessarily be made in good faith and have an underlying '*reorganisation purpose*.'[90] Once the petition is filed, an automatic stay comes into effect, during which all litigations, collection, and

[85] Tajti, *supra* note 12, at 3; Howell & Mason, *supra* note 12, at 1531; GERARD MCCORMACK, CORPORATE RESCUE LAW – AN ANGLO-AMERICAN PERSPECTIVE 127 (Edward Elgar, 2008) [hereinafter *McCormack, Corporate Rescue Law*].
[86] Ian Wallace & Adhuv Prinja, *Transatlantic Court-ing Behaviour: The US v. The UK*, WHITE & CASE, 1 (2018), https://www.whitecase.com/sites/whitecase/files/files/download/publications/transatlantic-court-ing-behaviour.pdf.
[87] McCormack, Apples and Oranges? *supra* note 27, at 112.
[88] *See* Nathalie Martin, *Common-Law Bankruptcy Systems: Similarities and Differences*, 11 AM. BANKR. INST. L. REV. 367, 394 (2003) [hereinafter *Martin, Common-Law Bankruptcy Systems*] (explaining why despite having similar goals and economic systems the UK, Canada and Australia have adopted a bankruptcy system different from the US).
[89] Title 11 U.S.C. §§ 301, 1121, 1125.
[90] SGL Carbon Corporation Case, 200 F.3d 154 (3d Cir. 1999).

foreclosure activities are suspended.[91] This ensures a breathing space for the debtor to put together a rescue plan without any pressure from the creditors.[92]

A peculiarity that marks the scheme in the US is concerning the exercise of control by the management during the restructuring period. Unlike the UK and India, the incumbent management continues to run the company's ordinary business, and no insolvency practitioner is appointed.[93] This is known as the debtor-in-possession model and is based on the premise that the management of the company is best suited to spearhead the reorganisation due to their familiarity with the business operations.[94] Although the legislation does provide for the appointment of a trustee, such displacement of the management in favour of the trustee is limited to exceptional cases wherein there is a suspicion of fraud, misfeasance, or risk to the company's assets.[95]

The debtor has the exclusive right to propose a reorganisation plan for the first 120 days after the Chapter 11 petition is filed.[96] This period can be further extended by a maximum of 18 months from the date of filing, provided that sufficient reasons are established.[97] The Chapter 11 scheme also deals with contracts containing '*ipso facto*' clauses.[98] An ipso facto clause is a contractual provision specifying that the supplier is permitted to terminate or modify long-term supply arrangements in the instance that the counter party enters into formal insolvency process.[99] The US Bankruptcy Code renders these clauses as unenforceable when they are presented in an executory contract[100] or an unexpired lease, thereby restricting the ability of the creditors to terminate contracts on the basis of the insolvency of the debtor.[101] This curtailment of ipso facto clauses by Chapter 11 is significant from a stigma perspective because

[91] Title 11 U.S.C. § 362(a).
[92] *Chapter 11 Bankruptcy Basics*, US COURTS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (last visited Mar. 16, 2022).
[93] Martin, Role of History and Culture, *supra* note 72, at 30.
[94] McCormack, Apples and Oranges? *supra* note 27, at 113; *See* Commodity Futures Trading Commission v. Weintraub, 471 U.S. 343, 355 (1985) (stating that the willingness of courts to leave the debtors in possession is based on the assurance that the officers and managing employees can be dependent upon to carry out their functions with the same fiduciary responsibility as a trustee).
[95] Title 11 U.S.C. § 1104; Re Marvel Entertainment Group, 140 F.3d 463, 471 (3d Cir. 1998).
[96] Title 11 U.S.C. § 1121(c)(2).
[97] Title 11 U.S.C. § 1121.
[98] Title 11 U.S.C. §§ 365(e), 541(c).
[99] Andrea Coles-Bjerre, *Ipso Facto: The Pattern of Assumable Contracts in Bankruptcy*, 40 N.M.L. REV. 77 (2010).
[100] *See Id.* (stating that executory contracts are those wherein material obligations on the debtor and the other party to the contract are wholly or substantially unperformed).
[101] *But see* Riggs National Bank of Washington v. John Gillis, 729 F.2d 982 (4th Cir. 1984) (where the ipso facto clause in the contract other than executory contract or unexpired lease was terminated on the basis of broad considerations relating to the purpose of the US Bankruptcy Code).

it effectively prevents situations wherein the suppliers may attempt to disengage with the bankrupt firm by stopping the supply of essential goods or services or changing the terms of the contract such as by increasing the prices of the goods to the detriment of the corporate debtor. Absent such a provision in the insolvency law, the success of the reorganisation proceedings maybe impeded due to the unilateral termination of contracts by the creditors.[102]

Once the reorganisation plan is proposed, the creditors can vote to either proceed with or reject the plan, file a competing one, or opt for liquidating the debtor's business.[103] Every class of creditors whose rights are impaired/modified by the scheme is required to vote. In cases where there are dissenting creditors, and at least one class of impaired creditors have approved the plan, then the bankruptcy court would confirm the plan despite the objections through a cramdown, as long as the plan is fair and equitable.[104] Chapter 11, thus, allows the management to remain in control, confers upon them the exclusive right to propose a plan, and protects the company from the creditors' claims during the restructuring process.[105] Hence, many perceive the US bankruptcy scheme to be 'pro-debtor.'[106]

The UK insolvency law is contained in the Insolvency Act, 1986, which has recently been amended by the Corporate Insolvency and Governance Act, 2020 (CIGA). Prior to the 1986 statute, the corporate bankruptcy regime of the UK was purposed towards achieving liquidation of failing enterprises instead of rehabilitation.[107] Influenced by the insolvency model followed in the US[108] and the economic crisis prevailing in the UK, the 1986 statute marked a shift in the corporate bankruptcy regime towards the rescue culture.[109] Despite the shared goal, there

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[102] *But see* UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, LEGISLATIVE GUIDE ON INSOLVENCY LAW 122 (2005) (stating that controlling the ambit of ipso facto clauses infringes upon the parties' freedom to enter into and enforce their contracts and thus, a balance must be struck between the debtor's survival which may require the preservation of contracts and interfering into the contractual rules).
[103] Martin, Role of History and Culture, *supra* note 72, at 33.
[104] Title 11 U.S.C. § 1129(a).
[105] Adam Plainer & Carinne Ball, *Comparison of Chapter 11 of the United States Bankruptcy Code with the System of Administration in the United Kingdom*, JONES DAY, 8, https://www.jonesday.com/files/Publication/b0c886bd-6721-4c66-9213-db7f01ddb55f/Presentation/PublicationAttachment/96b1ebf1-2203-4577-bff4-8baf89f4e0d1/Comparison%20of%20Chapter%2011.pdf
[106] Philippe Froute, *Theoretical Foundations of a Debtor Friendly Bankruptcy Law in Favor of Creditors*, 24 EUR J LAW ECON 201, 205 (2007); *But see* McCormack, Apples and Oranges? *supra* note 27 (arguing that the standard characterisation of US law as pro-debtor and UK law as pro-creditor is a potentially misleading oversimplification. Moreover, there has been a functional convergence due to the changes brought in the UK by the Enterprises Act, 2002 and the emergence of debtor-in-possession financing agreements in the US).
[107] Alyssa S. Nishimoto, *Shifting Paradigms within Corporate Bankruptcy Law: The History and Future of Chapter 11 and Its Global Effects on Business Restructurings*, 5 CREIGHTON INT'L & COMP. L.J. 102, 106 (2013).
[108] McCormack, Corporate Rescue Law, *supra* note 85, at 45.
[109] Nishimoto, *supra* note 107.

are critical differences between the Chapter 11 model of reorganisation and the one envisioned by the UK's 1986 statute.

In contrast to the US, the UK insolvency law follows the creditor-in-possession model. Under this model, a licensed insolvency practitioner, known as the administrator, is appointed who displaces the incumbent management during the restructuring process.[110] The day-to-day affairs of the distressed company are carried out by the administrator, who is also responsible for putting forth a debt reorganisation proposal to the meeting of the creditors.[111] This proposal may either be accepted, rejected, or accepted with modifications by the creditors;[112] however, if unaccepted, a traditional liquidation occurs.[113] The UK insolvency law, thus, has a 'pro-creditor' orientation due to the management's displacement during the administration proceedings[114] and greater decision-making power being conferred to the creditors.[115]

Significantly, however, the changes brought in by CIGA increases the relevance of the debtor-in-possession model in the UK. The CIGA has introduced Part AI to the 1986 statute which provides for a standalone restructuring moratorium.[116] As a result of this development, a moratorium can be obtained by the directors of the company upon filing an application to the court along with a statement stating that the company is or is likely to be unable to pay its debts and the moratorium would aid in the rescue of the company as a going concern.[117] Thus, the restructuring moratorium under CIGA can be granted without the initiation of a formal insolvency process. This is in contrast to the moratorium in case of the administration, as the restructuring moratorium is issued not only as a precursor to the insolvency process, but also allows the management to continue to retain control of the company, subject to the appointment of a licensed insolvency practitioner (known as the monitor), thereby marking a shift to the debtor-in-possession model.[118] The CIGA has also introduced Section 233B to the 1986 statute that invalidates ipso facto clauses.[119] However, unlike the Chapter 11 regime, the ipso facto

[110] HAMISH ANDERSON, AN INTRODUCTION TO CORPORATE INSOLVENCY LAW 33 (Oxford University Press, 2017); McCormack, Apples and Oranges? *supra* note 27, at 113.
[111] Martin, Common-Law Bankruptcy Systems, *supra* note 88, at 394.
[112] Insolvency Act, 1986, c. 45, § 5(2) (UK).
[113] Martin, Common-Law Bankruptcy Systems, *supra* note 88, at 394.
[114] Froute, *supra* note 106, at 205.
[115] Nishimoto, *supra* note 107, at 107.
[116] Jennifer Payne, *An Assessment of the UK Restructuring Moratorium*, SSRN 1, 8 (2021).
[117] Insolvency Act, 1986, c. 45, § A6.
[118] Payne, *supra* note 116.
[119] *See* Belmont Park Investments Pty Ltd. and Ors. v. BNY Corporate Trustee Services Ltd. and Anr., [2011] 3 W.L.R. 521 and Fibria Celulose S/A v. Pan Ocean Co Ltd, [2014] Bus. L.R. 1041 (outlining the position prior to CIGA where ipso facto clauses in contracts were generally found to be valid under English Law if they were a part of a bona fide commercial transaction).

provision under CIGA is narrower in that it only applies to contracts for supply of goods and services, and not all executory contracts.[120]

B. Cultural Attitude, Bankruptcy and Law: Experience of the US and UK

The divergence in the historical, cultural, and economic attitude toward debt forgiveness, risk-taking, and entrepreneurship has shaped the insolvency laws of the US and UK.[121] Generally, corporate insolvencies attract a lesser degree of stigma than personal insolvencies; nevertheless, both are viewed far more negatively in the UK.[122] Such negative perception has grown out of UK's cultural and historical attitude towards financial failure, which was regarded as a result of a wrongdoing rather than misfortune.[123] The prevailing sentiment was that "*once a bankrupt, always a bankrupt*."[124]

This belief influenced the UK's insolvency law, which is highly sceptical of the debtor-in-possession model and considers it akin to "*leaving an alcoholic in control of a pub.*"[125] Hence, there is a presumption favouring the creditor-in-possession model, with the administrator being considered best equipped to rescue the business. Moss argues that this scepticism towards debtors is also reflected in the judicial attitude in England, which tends to favour the financiers and bankers who occupy a respectable position in the society, while the debtors are perceived as excessive risk-takers.[126] Further, the judiciary is inclined to be sympathetic towards the insolvency practitioners who are professionals and are acquainted with the court, as opposed to the debtors whose descent into insolvency is treated with suspicion.[127]

Even today, the negative perception of corporate debtors subsists in the UK, with insolvency been considered a "major embarrassment."[128] The incompetence of the company executives is blamed for the company's financial plight, who face difficulty in finding another job and are

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[120] Payne, *supra* note 116, at 12.
[121] Martin, Role of History and Culture, *supra* note 72, at 4.
[122] Martin, Common-Law Bankruptcy Systems, *supra* note 82, at 368.
[123] Martin, Role of History and Culture, *supra* note 73, at 38; Jay Westbrook, *A Comparison of Bankruptcy Reorganisation in the US with the Administrative Procedure in the UK*, 6 INSOLVENCY LAW AND PRACTICE 86, 88 (1990).
[124] Martin, Role of History and Culture, *supra* note 73, at 38.
[125] Gabriel Moss, *Chapter 11: An English Lawyer's Critique*, 11 INSOLVENCY INTELLIGENCE 17, 18–19 (1998).
[126] Gabriel Moss, *Comparative Bankruptcy Cultures: Rescue or Liquidation? Comparisons of Trends in National Law – England*, 23 BROOKLYN JOURNAL OF INTERNATIONAL LAW 115, 121 (1997).
[127] *Id.*
[128] Martin, Role of History and Culture, *supra* note 72, at 38; Press Release, IP Survey Changing Attitudes: It's Time to Admit British Business Has a Problem, ICAEW, (Sept. 7, 2017) https://www.icaew.com/-/media/corporate/files/technical/insolvency/publications/ip-survey-changing-attitudes-release.ashx [hereinafter *ICAEW Press Release*].

shunned socially.[129] In a 2017 survey of 146 insolvency practitioners in the UK, it was found that the three primary factors that prevent businesspersons from initiating the insolvency process are that: (i) they are apprehensive of the eventual loss of control over the company due to management displacing regime; (ii) they lack knowledge of the options available to them; and (iii) they fear the impact of insolvency on their family and lifestyle.[130] Thus, the survey suggests that even though bankruptcy stigma has diminished to a certain extent, it continues to plague the business decisions of the management. The survey also calls for a change in the culture of fear and embarrassment in the UK for the successful restructuring of businesses.[131]

In contrast, the US adopts a favourable attitude towards risk-taking and considers insolvency a natural consequence of the market economy.[132] The forgiving nature of the US insolvency model is influenced by its unique capitalist system that encourages entrepreneurialism and greater consumer spending.[133] This is reflected in Chapter 11,[134] which recognises the need for the management to continue in control of the company during the restructuring process. Instead of being penalised, the company's directors are considered best suited to manage the business operations. In fact, investors in the US prefer to financially back businessmen and women who have had some experience with financial failure.[135] As such, companies like Radio Shack, American Apparel, and Hostess Brands in the US have undergone multiple bankruptcies coining the terms 'Chapter 22' and 'Chapter 33' as companies repeat the Chapter 11 process.[136]

Even the judiciary in the US has adopted a lenient stance towards bankruptcies, with the courts notably observing that "*filing of a bankruptcy petition is no more misconduct than the filing of a suit for breach of contract or an adoption petition, unless filed fraudulently. Even though bankruptcy imparts certain social stigma, it is not evidence of bad character*."[137] Thus, the forgiving design of the US bankruptcy law with its leanings toward the debtor-in-possession

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[129] Alexandra Rhim, *Reorganisation Schemes under U.K. Insolvency Act of 1986: Chapter 11 as a Springboard for Discussion*, 16 L.A. INT'L & COMP. L. REV. 985, 1012 (1994); ROY GOODE, PRINCIPLES OF CORPORATE INSOLVENCY LAW 62 (Sweet and Maxwell, 4th ed. 2011).
[130] ICAEW Press Release, *supra* note 128.
[131] ICAEW Press Release, *supra* note 128.
[132] Frade, *supra* note 42, at 53.
[133] Martin, Role of History and Culture, *supra* note 72, at 3.
[134] Martin, Role of History and Culture, *supra* note 72, at 7, 35.
[135] Gerard McCormack, *Control and Corporate Rescue – An Anglo American Evaluation*, 56 ICLQ 515, 524 (2007) [*McCormack, Anglo American Evaluation*].
[136] Eliza Ronalds-Hannon, *Filing Chapter 11 Becomes Enticing Option for Ailing Retailers*, BLOOMBERG (Sept. 18, 2017) https://www.bloomberg.com/news/articles/2017-09-18/filing-chapter-22-becomes-enticing-option-for-ailing-retailers; Helena Vieira, *Does Flopping Have an Upside? Business Rethinks the Meaning of Failure*, LSE BLOG (June 27, 2016) https://blogs.lse.ac.uk/businessreview/2016/06/27/does-flopping-have-an-upside-business-rethinks-the-meaning-of-failure/.
[137] Merrit v. State, 683 S.E.2d 855 (Ga. 2009).

model, automatic stay on secured assets, and the exclusive right of the debtors to propose a resolution plan[138] has to an extent been shaped by the favourable economic and cultural attitude towards debt and entrepreneurship prevalent in the US and the lower intensity of bankruptcy stigma.[139]

Despite the positive outlook towards insolvency in the US, empirical research suggests that some degree of bankruptcy stigma continues to persist. Professor Robert Sutton and Anita Callahan, in their study of four computer firms who had filed for bankruptcy, argued that seeking protection under Chapter 11 taints the image of the top management and, thereby, that of the firm.[140] The directors are blamed for the poor performance of the company, who find it challenging to find new jobs and thus face a blow to their individual careers.[141] Suppliers and customers also begin disengaging with the distressed company by refusing to supply or purchase goods.[142] Furthermore, the negative reaction by the audience towards bankruptcy makes it harder for the corporate debtor to enter into new relationships for its revival.[143] The US Court of Appeals has also recognised the adverse consequences of corporate insolvency stating that "*often, once a petition for bankruptcy is filed, keeping the bankrupt in operation is difficult. Suppliers and customers, fearing interruption of service, may shy away and creditors be reluctant to advance fresh credit, even though such credit carries a high priority in bankruptcy. The bankrupt may be shunned like a leper.*"[144] Thus, even though Chapter 11 endeavours to rescue the insolvent company, the underlying stigma acts as an impediment by dampening the chances of survival in some cases.

This shows that while the intensity of stigma is less '*biting*'[145] in the US than in the UK, it is still a factor to be reckoned with. The above discussion demonstrates how bankruptcy stigma, to an extent, has not only influenced the insolvency model adopted by different jurisdictions

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[138] *See* discussion *supra* p. 14.
[139] *See* Yvana L.B.H. Mols, *Bankruptcy Stigma and Vulnerability: Questioning Autonomy and Structuring Resilience*, 29 EMORY BANKRUPTCY DEVELOPMENTS JOURNAL 289, 303 (2012) (stating that "*lawmakers and public perception of stigma's effect on debtors in bankruptcy have both been major driving forces for bankruptcy legislation throughout American History*"); *But see* Tajti, *supra* note 12, at 18 (stating that while Mols' statement may be an exaggeration, it cannot go uncontested that the perception of stigma has played an important role in shaping the bankruptcy legislation of the US, although it may not be the only factor).
[140] Sutton & Callahan, *supra* note 24, at 413.
[141] Sutton & Callahan, *supra* note 24, at 413.
[142] Sutton & Callahan, *supra* note 24, at 416; *See* Rosslyn-Smith et al., *supra* note 22, at 25; Tajti, *supra* note 12, at 10; *But see* Title 11 U.S.C. § 365(e) (addressing this situation by invalidating ipso facto clauses in contracts).
[143] Sutton & Callahan, *supra* note 24, at 420; *See* In Re Mid-Valley Aggregates, 49 B.R. 498 (1985) (where the debtor argued that the stigma of bankruptcy proceeding made it difficult for it to obtain financing for its continued operations).
[144] In re Met-L-Wood Corp., 861 F.2d 1012 (7th Cir. 1988).
[145] Tajti, *supra* note 12, at 1.

but also how the stigma affects the operation of the bankruptcy process by acting as an obstacle to effective restructuring. Hence, developing measures to reduce the bankruptcy stigma is essential to provide a real second chance to insolvent companies. However, the US experience indicates that the reforms in the legal system alone will not be enough to alleviate the stigma. There must also be sustained changes in the attitude towards business failures. The next section will look at the stigma associated with corporate bankruptcy in India.

IV. BANKRUPTCY STIGMA IN THE INDIAN CONTEXT

The function of any legal system is to act as an arbiter of stigma:[146] it should seek to ameliorate the stigma by attaching importance to the dignity of individuals; however, the legal system may sometimes reinforce and, in fact, perpetuates the stigma. In the following section, we shall examine the historical evolution of insolvency, outlining the shift from the debtor-in-possession to the creditor-in-possession model through the IBC in India. It shall also give a brief overview of the IBC and examine the provisions that seem to perpetuate stigma in the insolvency process.

A. Evolution of Bankruptcy/Insolvency: Shift from Debtor-in-Possession to Creditor-in-Possession Regime

Prior to the liberalisation of the Indian economy in 1991, the need for a comprehensive corporate insolvency and bankruptcy law was not urgently felt. Since the protectionist policies of the Indian government excluded most trading risks, insolvency did not receive much attention.[147] During this time, corporate insolvency was dealt with by the Companies Act, 1956, which provided for the liquidation and winding-up of companies,[148] with the High Court being the adjudicating authority. However, the procedure under this statute was plagued with inordinate delays, a lack of trained official liquidators, and inadequate disclosure of information about the organisation or its business by the insolvent company's management.[149]

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[146] MARTHA NUSSBAUM, HIDING FROM HUMANITY: DISGUST, SHAME AND THE LAW 223, 289 (Princeton University Press, 2004).

[147] Saket Hishikar, *A Concise History of Bankruptcy, Insolvency, and Debt Restructuring Laws in India*, 45 VIKALPA 115, 116 (2020).

[148] The Companies Act, 1956, Act No. 1 of 1956 § 425–560 (India).

[149] Kristin van Zwieten, The Demise of Corporate Insolvency Law in India: The Role of the Courts, 1, 112 (Thesis, University of Oxford, 2012); Report of the High Level Committee on Law Relating to Insolvency and Winding Up of Companies 10-16 (July 2000) http://reports.mca.gov.in/Reports/24-Eradi%20committee%20report%20of%20the%20high%20level%20committee%20on%20law%20relating%20to%20insolvency%20&%20winding%20up%20of%20Companies,%202000.pdf [hereinafter *Eradi Committee Report*].

By the 1980s, the problem of industrial sickness became widespread, necessitating urgent bankruptcy and insolvency reform. As a result, the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) was enacted to expedite the identification of sickness in industrial companies and rehabilitate them. SICA also provided for the establishment of a new legal forum known as the Board for Industrial Finance Reconstruction (BIFR). Unlike the current procedure under IBC, SICA had adopted the debtor-in-possession model (analogous to the one prevalent in the US). Hence, the incumbent management was not divested of the control when the BIFR considered rehabilitating or liquidating the sick industrial company. Notably, unlike Chapter 11, there was no provision under SICA for an exclusive period wherein only the debtor could put forth a resolution plan.[150] Instead, if the BIFR determined the revival of the company as possible or in the public interest, then an operating agency (bank or financial institution in most cases) was appointed by the BIFR to propose the reorganisation scheme.[151]

The SICA failed on multiple counts. The system was marked by prolonged delays, revival plans in most cases were not sustainable, and BIFR lacked professional expertise.[152] Notably, the Report of the Committee on Industrial Sickness and Corporate Restructuring chaired by Omkar Goswami suggested that the failure of SICA could be attributed to the debtor-in-possession model.[153] He argued that this model created information asymmetry[154] since the creditors lacked adequate information about the company's financial position, which was in possession of the management. Because of this, the creditors became vulnerable to strategic delays and the infeasible schemes sanctioned under the legislation.[155] Thus, the failure of SICA led the legislators to view the debtor-in-possession model with much scepticism, which since then has been understandably eschewed by the IBC.

However, India's scepticism of the debtor-in-possession model, based on SICA's failure, should be viewed with caution. This is because the design of the debtor-in-possession under SICA had crucial distinctions from the one prevalent under Chapter 11. While under the extant

[150] Akshaya Kamalnath, *Corporate Insolvency Resolution in India – A Proposal to Overcome the Initiation Problem*, 88 UMKC L. REV. 631, 634 (2020).
[151] The Sick Industrial Companies (Special Provisions) Act, 1985, Act No. 1 of 1986 § 18(1).
[152] Shakti Deb & Indrajit Dube, *Insolvency and Bankruptcy Code 2016: Revisiting with Market Reality*, 63 INTERNATIONAL JOURNAL OF LAW AND MANAGEMENT 125 (2020).
[153] Report of The Committee on Industrial Sickness and Corporate Restructuring 22 (July 1993), http://reports.mca.gov.in/Reports/31-Goswami%20committee%20of%20the%20industriai%20sickness%20and%20corporate%20restructuring,%201993.pdf.
[154] Kristin van Zwieten, *Corporate Rescue in India: The Influence of the Courts*, 15 J. CORP. L STUD. 1, 13 (2015) [hereinafter *Zwieten, Corporate Rescue in India*].
[155] *Id.*

scheme of Chapter 11, the debtor possesses the exclusive right to propose a plan for the revival of the company within the first 120 days, SICA allowed only an operating agency identified by the BIFR to file the resolution plan. Additionally, the failure of SICA was a cumulative result of the rehabilitation bias of the courts, lack of expertise of BIFR, and problems in the implementation of the legislation and not the debtor-in-possession model alone.

Post SICA's failure, several committees were appointed to study India's corporate bankruptcy and insolvency framework and to suggest measures for reforming the same,[156] including the Banking Law Reform Committee (BLRC) in 2014.[157] The BLRC proposed a paradigm shift to India's corporate bankruptcy scheme. Unlike the past regimes in which the creditors had little say, the BLRC noted that the question of whether the corporate debtor must be liquidated, restructured or sold as a going concern must be free of government intervention and should vest with the creditors alone.[158] In fact, the BLRC emphasised that "*the appropriate disposition of a defaulting firm is a business decision, and <u>only the creditors</u> should make it"*[159] when responding to the topic of how the insolvent debtor's assets should be deployed. This was a striking departure from SICA, with the BLRC endorsing the management displacing insolvency regime.[160] Hence, the committee proposed a creditor-centric insolvency framework which is now reflected in the IBC.

B. A Brief Overview of the IBC

The IBC marks an important milestone in the evolution of economic reforms in India. It covers the insolvency resolution of corporate debtors, partnership firms, and individuals. The provisions of the IBC dealing with the insolvency and liquidation of corporate persons came

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[156] The Report of the Committee on the Financial System (1991) (Narasimhan Committee I) https://ibbi.gov.in/uploads/resources/Narasimham%20Committee%20I-min.pdf; Committee on Banking Sector Reforms (1998) (Narasimhan Committee II) https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?ID=251; Eradi Committee Report, *supra* note 153; The Report of the Expert Committee on Legal Aspects of Bank Frauds (2001) (L.N. Mitra Committee) https://ibbi.gov.in/August%202001,%20Dr.%20N.L.%20Mitra%20Committe%20Report%20on%20Legal%20 Aspects%20of%20Bank%20Frauds.pdf; Report of the Expert Committee on Company Law (2005) (Irani Committee) https://www.ibbi.gov.in/uploads/resources/May%202005,%20J.%20J.%20Irani%20Report%20of%20the%20Expert%20Committee%20on%20Company%20Law.pdf; Report of the Committee on Financial Sector Reforms (2008) (Raghuram Rajan Committee) https://faculty.iima.ac.in/~jrvarma/reports/Raghuram-Rajan/cfsr_all.pdf.

[157] Rajeswari Sengupta et al., *Evolution of the Insolvency Framework for Non-Financial Firms in India* 8 (Indira Gandhi Institute of Development Research, Working Paper No. 18, 2016).

[158] The Report of the Bankruptcy Law Reforms Committee—Volume I: Rationale and Design 12 (2015) https://ibbi.gov.in/BLRCReportVol1_04112015.pdf [hereinafter *BLRC Report*].

[159] Kristin van Zwieten, Keynote Address on Insolvency and Bankruptcy Code 2016: Impact on Markets and the Economy 2 (Dec. 16, 2019) [hereinafter *Zwieten, Keynote Address*]; *See* BLRC Report, at 12.

[160] *See* Zwieten, Keynote Address.

into effect on 1st December, 2016.[161] Except for the provisions dealing with personal guarantors to the corporate debtor, which came into effect on 1st December, 2019, Part III of the IBC dealing with insolvency and bankruptcy of individuals and partnership firms has not come into force yet.[162]

Like the corporate insolvency regime of the US and UK, the IBC is committed to the rescue culture. Thus, the first-order objective of the IBC is to seek resolution of the distressed entity, the second objective is to achieve value maximisation of the assets of the distressed firm, and the third is to promote entrepreneurship, availability of credit, and to balance the interests of various stakeholders.[163] This order of objectives, as observed by the National Company Law Appellate Tribunal (NCLAT), is sacrosanct.[164] The Corporate Insolvency Resolution Process (CIRP) is the procedure envisioned by the Code for the resolution of insolvency of the corporate debtor. The CIRP can be triggered by three means: by the corporate debtor itself,[165] the financial creditor,[166] or the operational creditor[167] who can file an application to the National Company Law Tribunal (NCLT) (also known as the Adjudicating Authority) on the occurrence of a default[168] of an amount not less than INR. 1,00,00,000.[169]

The distinction between an operational creditor and a financial creditor is a significant one. It is premised on the purpose of the transaction between the creditor and the corporation that resulted in the debt.[170] In cases where a financial debt[171] is owed, *i.e.*, a debt availed for financial purposes such as a loan from a bank, then the person to whom the debt is owed is known as a financial creditor.[172] Whereas an operational creditor is one to whom an operational

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[161] Understanding the IBC: Key Jurisprudential and Practical Considerations, INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, 18 https://www.ibbi.gov.in/uploads/publication/e42fddce80e99d28b683a7e21c81110e.pdf [hereinafter *IBC Handbook*].
[162] *Id.* at 58.
[163] Binani Industries Ltd. v. Bank of Baroda & Anr., 2018 SCC OnLine NCLAT 521 ¶ 17.
[164] *Id.*
[165] The Insolvency and Bankruptcy Code, 2016, Act No. 31 of 2016 § 10 [hereinafter *IBC*].
[166] IBC § 7.
[167] IBC § 9.
[168] IBC § 6.
[169] IBC § 4; Ministry of Corporate Affairs, S.O. 1205(E) (Notified on March 24, 2020).
[170] MP Ram Mohan & Vishakha Raj, *Section 29A of India's Insolvency and Bankruptcy Code: An Instance of Hard Cases Making Bad Law?* 5 (Indian Institute of Management Ahmedabad, Working Paper No. 2021-07-01) [hereinafter *Mohan & Raj, Section 29A IBC*].
[171] IBC § 5(8).
[172] IBC § 5(7).

debt is owed,[173] *i.e.* debt in respect of the supply of goods or services or salaries to employees.[174]

Once the NCLT accepts the application to initiate the CIRP, a moratorium comes into effect, which bars the continuation and initiation of legal proceedings against the corporate debtor.[175] Notably, unlike the US (and, more recently, the UK), the IBC does not per se prohibit the operation of ipso facto clauses.[176] However, section 14 that deals with moratorium carves out a limited exception whereby contracts where the counter party supplies essential[177] or critical[178] goods and services to the corporate debtor or those contracts dealing with government licenses, grants, and permits required for the conduct of the corporate debtor's business cannot be terminated upon the commencement of the CIRP.[179] This is only a narrow provision and no clear position emerges under the IBC in relation to the validity of ipso facto clauses in other contracts,[180] such as contracts for loans, guarantees and other types of financing agreements, and contracts with the corporate debtor's customers for supply of good or services who may be incentivised to terminate contracts due to the stigma of insolvency.[181]

Along with the imposition of a moratorium, the NCLT also appoints an Interim Resolution Professional (IRP) who takes over the management of the corporate debtor, thereby displacing the board of directors.[182] Thus, the IBC has shifted from the erstwhile debtor-in-possession regime under SICA to the creditor-in-possession model. Upon appointment, the IRP collates the claims submitted by the creditors and thereafter constitutes the Committee of Creditors (CoC) comprising all financial creditors (whether secured or unsecured). The objective of forming a CoC is to adopt a collective approach towards insolvency resolution as opposed to dealing with claims individually.[183]

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[173] IBC § 5(20).
[174] IBC § 5(21).
[175] IBC § 14.
[176] Vidhi Centre for Legal Policy, Insolvency and Bankruptcy Code: The Journey So Far and the Road Ahead 34-35 (Dec. 2018) https://vidhilegalpolicy.in/wp-content/uploads/2019/05/IBC_Thejourneysofarandtheroadahead_Dec18.pdf.
[177] IBC § 14(2); Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg. 32.
[178] IBC § 14(2A).
[179] IBC § Explanation to 14(1).
[180] Gujarat Urja Vikas Nigam Ltd. v. Amit Gupta and Ors, (2021) 7 SCC 209 ¶ 135.
[181] Aparna Ravi, *Ipso Facto Clauses and the IBC*, NATIONAL LAW SCHOOL BUSINESS LAW REVIEW (May 23, 2021) https://www.nlsblr.com/post/ipso-facto-clauses-and-the-ibc.
[182] IBC §§ 16, 17.
[183] Municipal Corporation of Greater Mumbai v. Abhilash Lal & Ors., (2020) 13 SCC 234 ¶ 27.

At its first meeting, the CoC appoints a resolution professional, and subsequently, the process of inviting resolution plans begins. Members of the CoC deliberate on the feasibility of the plans proposed by resolution applicants and approve the same by a vote of not less than 66 percent of the voting shares of the financial creditors.[184] At this juncture, section 29A becomes significant, which, *inter alia*, restricts the promoters and the management of the corporate debtor with Non-Performing Assets (NPAs) accounts from putting forth a resolution plan.[185] This provision, in particular section 29A(c), seeks to exclude 'unscrupulous promoters' who caused the company's financial distress from regaining control of it;[186] a provision illustrative of the social stigma against former management, which will be further delved into in the following section of the paper.

C. Evidence of Stigma under the IBC and its Implications

The IBC has undoubtedly made the process of entering and exiting from the market much simpler. However, some aspects of the Code require reappraisal due to their tendency to reinforce and perpetuate the stigma against corporate debtors. These include section 29A(c) of the IBC, which bars the promoters and incumbent management from submitting a resolution plan and the creditor-in-possession model that reinforces the bias against the debtors. The following section of the paper will examine the stigma underlying these features and their impact on the functioning of the insolvency process and the economic growth of the country.

(i) Stigma and section 29A

Section 29A was introduced through an Ordinance promulgated on 23rd November, 2017,[187] and was ultimately enacted as the Insolvency and Bankruptcy (Amendment) Act, 2018.[188] This provision incapacitates/excludes a list of persons[189] from submitting a resolution plan, with the

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184 IBC § 30(4).
185 Mohan & Raj, Section 29A IBC, *supra* note 170, at 1.
186 The Insolvency and Bankruptcy Code (Amendment) Bill, 2017, Bill No. 280 of 2017 ¶ 5 (Dec. 26, 2017) [hereinafter *2017 Amendment Bill*].
187 The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, § 29A (Nov. 23, 2017) https://ibbi.gov.in//webadmin/pdf/legalframwork/2017/Nov/180404_2017-11-24%2007:16:09.pdf.
188 The Insolvency and Bankruptcy Code (Amendment) Act, 2017, § 29A (Jan. 19, 2018) https://ibbi.gov.in//webadmin/pdf/legalframwork/2018/Jan/182066_2018-01-20%2023:35:29.pdf
189 IBC § 29A (includes undischarged insolvent; willful defaulter; an individual who has control over an account that has been classified as an NPA for over a year; convicted offender; individual disqualified to act as a director under the Companies Act, 2013; person prohibited by Securities and Exchange Board of India from trading in the securities market; promoter or management personnel in the corporate debtor involved in preferential, undervalued, extortionate or fraudulent transaction; guarantor for a debtor against whom the proceedings under IBC have commenced and connected parties to these persons).

ineligibility stipulated under section 29A(c) being of particular relevance to this paper. Section 29A(c) disqualifies a person who has an account or is a promoter, person in management, or control of the corporate debtor, with an account that has been classified as an NPA by the Reserve Bank of India for at least one year from bidding for the assets of the corporate debtor.[190] With this amendment, the IBC now not only displaces the management in favour of the IRP during the insolvency process but goes a step ahead to bar the promoters and the former management from bidding for the rehabilitation of their own company.[191] Notably, this automatic disqualification under section 29A is unique to India and marks a significant departure from most mature jurisdictions, including the US and UK's insolvency law.[192]

Section 29A was introduced in a climate of much scepticism against the management of insolvent companies.[193] High profile cases of promoters, and their related parties, regaining control of the corporate debtor at a fraction of their outstanding dues, prompted the introduction of this provision with grave urgency a year and a half after IBC came into force.[194] It was perceived to be inherently unfair for the promoters who, through their misconduct, had contributed to the company's downfall to regain control on a clean slate at the expense of the creditors.[195] This is best exemplified by the remarks made by Late Mr. Jaitley, the then Finance Minister, in the Parliament who said that "*in the case of resolution, all type of creditors may take some haircut, and the <u>man who created the insolvency</u> pays a fraction of the amount and comes back into management…that is something which besides being commercially imprudent would also be <u>morally unacceptable</u>.*"[196] The rationale behind section 29A can also be discerned through the statement of object and reasons of the Insolvency and Bankruptcy Code (Amendment) Bill, 2017 (2017 Amendment Bill), which sought to prevent "*unscrupulous*" and "*undesirable*" persons from benefitting from the insolvency process.[197]

It is, therefore, clear from the statement of object and reasons and the remarks made in the Parliament that the central concern of the amendment was to bar those persons whose

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190 IBC § 29A(c).
191 Mohan & Raj, Section 29A IBC, *supra* note 170, at 3.
192 Injeti Srinivas, *The Story Behind Section 29A of IBC Page*, *in* INSOLVENCY AND BANKRUPTCY REGIME IN INDIA: A NARRATIVE 97, 100 (2020).
193 Aparna Ravi, *A Rocky Road to Resolution: Achievements and Struggle of India's Insolvency Code*, THE INDIA FORUM (Oct. 12, 2021) https://www.theindiaforum.in/article/rocky-road-resolution.
194 Edelweiss Asset Reconstruction Company Ltd. v. Synergies Dooray Automotive Ltd. & Ors., 2018 SCC OnLine NCLAT 845 [hereinafter *Synergies Dooray*]; Srinivas, *supra* note 192, at 97-98.
195 IBC Handbook, *supra* note 161 at 143; Ravi, *supra* note 193.
196 Srinivas, *supra* note 192, at 102.
197 2017 Amendment Bill, *supra* note 186, ¶ 2.

misconduct caused the company's financial distress from regaining control of it. However, in the absence of any explicit reference to the term '*misconduct*' in section 29A(c), the provision seems to sweep across the board, bringing cases of malfeasance and honest business failure under the same camp.[198] In doing so, section 29A(c) assumes that the corporate debtor's financial distress is a consequence of the '*actions*' of those in control:[199] an assumption echoing early bankruptcy legislations that viewed default as a fraudulent '*act*' of individuals.[200] This goes against the very design of the IBC, which recognises that business failures are inevitable in a dynamic market economy, and all failures are not a fraud.[201] Admittedly, there may be cases wherein the promoters orchestrate transactions to push the company into insolvency; however, the IBC contains provisions to meet such situations.[202] Section 29A(c), in contrast, by bringing honest promoters under the same umbrella as wilful and unscrupulous defaulters, seems to perpetuate and reinforce the stigma against failed entrepreneurs and deny them a second chance.[203]

The strong and prejudicial language of the 2017 Amendment Bill and the parliamentary debates has found its way into judicial decisions justifying section 29A.[204] As will be discussed later, the Supreme Court, in a series of decisions,[205] has resorted to a purposive interpretation of section 29A, *i.e.* interpreting the provision in light of its object and legislative history to prevent the backdoor entry of the management. The purposive interpretation, along with the negative rhetoric of the 2017 Amendment Bill employed by the judiciary, has also played a crucial role in entrenching the already embedded stigma against failed businesses.

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198 AKAANT KUMAR MITTAL, INSOLVENCY AND BANKRUPTCY CODE: LAW AND PRACTICE (Eastern Book Company, 2021) (ebook).

199 Mohan & Raj, Section 29A IBC, *supra* note 170, at 17.

200 *See* discussion *supra* pp. 9.

201 Rajeswari Sengupta & Anjali Sharma, *Understanding the Recent Ordinance Amending the Insolvency and Bankruptcy Code*, IDEAS FOR INDIA (Mar. 28, 2018) https://www.ideasforindia.in/topics/money-finance/understanding-the-recent-ordinance-amending-the-insolvency-and-bankruptcy-code.html.

202 Ravi, *supra* note 193; *See* IBC §§ 43-51, 66(1), 66(2) (dealing with preferential, undervalued, fraudulent and extortionate transactions, fraudulent and wrongful trading).

203 MP Ram Mohan & Vishakha Raj, *Entrepreneurship and Insolvency: Why Rules of Exit Matter*, *in* QUINQUENNIAL OF INSOLVENCY AND BANKRUPTCY CODE, 2016, *supra* note 40, at 131, 138 [hereinafter *Mohan & Raj, Entrepreneurship and Insolvency*].

204 *Id.*

205 ArcelorMittal Indian Pvt. Ltd. v. Satish Kumar Gupta, (2019) 2 SCC 1 ¶ 27 [hereinafter *ArcelorMittal*]; Swiss Ribbons Pvt. Ltd. v. Union of India, (2019) 4 SCC 17 ¶ 62 [hereinafter *Swiss Ribbons*]; Phoenix ARC Pvt. Ltd. v. Spade Financial Service, (2021) 3 SCC 475 ¶¶ 89, 90; Arun Kumar Jagatramka v. Jindal Steel and Power Ltd., 2019 SCC OnLine NCLAT 759 ¶¶ 40, 49-52 [hereinafter *Arun Kumar Jagatramka*].

(ii) Tilt towards liquidation

The social stigma against failed businesses and the incumbent management, embedded under section 29A as seen above, has the potential of diminishing chances of the successful revival of the corporate debtor by tilting the insolvency regime towards liquidation.[206] It is pertinent to note that the salutary objective of IBC is to achieve the reorganisation and rehabilitation of the corporate debtor in a time-bound manner,[207] while liquidation is envisioned as only a matter of last resort.[208] The rationale behind the preference of the rescue culture over liquidation is the recognition that the going concern value of the assets of the corporate debtor is greater than the value of the assets if liquidated on a piecemeal basis.[209] Although the rescue of distressed corporations is the foremost goal of IBC, statistics indicate that more companies are being liquidated than successfully rehabilitated. Up until March 2022, a total of 5258 CIRPs were admitted before various benches of NCLT, out of which 3406 have been closed. Of the CIRPs closed, 731 CIRPs were closed on appeal, reviewed or settled, and 586 were withdrawn. Significantly, while 480 CIRPs ended with a resolution plan, an overwhelming majority of 1609 resulted in liquidation.[210]

By shrinking the pool of prospective resolution applications,[211] the rigours of section 29A(c), and the stigma against failed promoters and management underlying it, may compromise the goal of resolving insolvency by pushing the corporate debtor towards liquidation.[212] This can be observed from the case of *Sunrise 14/AS Denmark v. Muskaan Power Infrastructure*,[213] wherein the order for the company's liquidation was passed as only a member of the Board of Directors had submitted a resolution plan, who was disqualified under section 29A(c).

[206] Ministry of Corporate Affairs, Report of the Sub-Committee of the Insolvency Committee on Pre-packaged Insolvency Resolution Process ¶ 3.66 (Oct. 31, 2020) https://www.ibbi.gov.in/uploads/whatsnew/34f5c5b6fb00a97dc4ab752a798d9ce3.pdf [hereinafter *MCI Pre-pack Report*] (stating that when a corporate debtor is facing financial distress, the incumbent management is often the only one willing to purchase the business and thus, sales to connected parties is often the only option to preserve the business of the company); Ministry of Corporate Affairs, Report of the Insolvency Law Committee ¶ 14.3 (Mar. 2018) https://ibbi.gov.in/uploads/resources/ILRReport2603_03042018.pdf [hereinafter *ILC Committee Report*] (stating that the broad disqualifications under Section 29A shrinks the pool of resolution applicants).
[207] IBC Handbook, *supra* note 161, at 58; Swiss Ribbons, *supra* note 205, ¶ 27.
[208] Arun Kumar Jagatramka, *supra* note 205, ¶ 40.
[209] McCormack, Apples and Oranges? *supra* note 27, at 112.
[210] *The Quarterly Newsletter of the Insolvency and Bankruptcy Board of India*, IBBI, Jan. – Mar. 2022, at 12 [hereinafter *IBBI Newsletter*].
[211] Mittal, *supra* note 198; ILC Committee Report, *supra* note 206.
[212] Mittal, *supra* note 198; Nirmal Gangwal, *IBC is Tilted Against Business Recovery*, BW DISRUPT (Aug. 30, 2021), http://bwdisrupt.businessworld.in/article/IBC-Is-Tilted-Against-Business-Recovery/30-08-2021-402348/.
[213] 2018 SCC OnLine NCLT 4331.

Likewise, in the case of *R. Vijay Kumar v. Kasi Viswanathan*,[214] the liquidation value of the corporate debtor was INR. 3,00,00,000, whereas the promoters of the corporate debtor were willing to pay a sum of INR. 30,00,00,000. Despite the presence of a favourable resolution plan, the company was ordered to be liquidated due to the embargo under section 29A(c). In *C. Mahendra International Ltd. v. Naren Sheth*,[215] one of the resolution applicants had submitted a resolution plan for INR. 6,14,00,000, which was not accepted, while the promoter of the corporate debtor offered INR. 6,50,00,000. The plan proposed by the promoter was also rejected on account of section 29A(c), and the liquidation of the corporate debtor was ordered.

These cases demonstrate how due to the widened pool of ineligible resolution applicants, the corporate debtor has to either settle for non-competitive bids or be liquidated, even though the company's assets may have been more valuable if kept together as a functioning unit. This illustrates how the restrictions under section 29A, particularly section 29A(c), which embodies the social stigma against the promoters and erstwhile management by prohibiting them from bidding for their own company may diminish the chances of successful actualisation of the rescue culture by forcing companies that can be revived into liquidation.

(iii) Initiation problem

A laudatory aim of the IBC is to maximise the value of the distressed corporation's assets through the early identification of financial distress and initiation of restructuring proceedings. The earlier the resolution proceedings are initiated, the greater are the chances of preservation and maximisation of the value of the corporate debtor's assets.[216] Delay in beginning the insolvency resolution process can further depress the value of the firm's assets to the extent that there is not much left to rescue once the restructuring proceedings commence. Empirical studies on bankruptcy initiation indicate that the harsher the bankruptcy apparatus is for the managers and promoters, the more likely it is for them to postpone the onset of insolvency resolution proceedings even at the cost of inefficient continuation.[217] In the case of a creditor-in-possession regime, for instance, the managers do not have enough *ex-ante* incentives to promptly resolve financial distress because of their inevitable displacement in favour of the

[214] 2019 SCC OnLine NCLAT 227.
[215] 2019 SCC OnLine NCLAT 332.
[216] Pratik Datta, *Value Destruction and Wealth Transfer under the Insolvency and Bankruptcy Code, 2016*, 15 (National Institute of Public Finance and Policy, Working Paper No. 247, 2018).
[217] Barry E. Adler et al., *Theory and Evidence on the Bankruptcy Initiation Problem* 2 (American Law & Economics Association Annual Meetings, Working Paper No. 53, 2006).

administrator.[218] Hence, in such cases, the managers end up filing for bankruptcy only after the financial trouble becomes acute, with the ultimate outcome of the process being liquidation.[219]

Within the Indian context, the IBC marks a departure from the debtor-in-possession model under the erstwhile SICA by transitioning to the creditor-in-possession model. As discussed earlier, this transition was brought about due to the heightened scepticism against corporate debtors generated as an aftermath of SICA's failure.[220] A combined application of the creditor-in-possession model and section 29A(c), that not only displaces the incumbent management in favour of the IRP but also prevents them from bidding for their own company, arguably contributes to the bankruptcy initiation problem.[221] The company directors are generally reluctant to initiate the insolvency resolution process because of their inevitable displacement and their ineligibility to submit a resolution plan under section 29A(c). This is illustrated by the fact that since IBC's inception, only 6.14 percent of the insolvency proceedings have been commenced by the corporate debtor.[222] One could argue that section 29A(c), which prohibits the promoters and the management from submitting a resolution plan who hold an NPA for at least one year encourages the early initiation of resolution proceedings, *i.e.* within one year of the account under their control being declared as an NPA. While this may be true, commencing the bankruptcy process within one year may in some cases be premature, and once this short period lapses, the management would be reticent to initiate the proceedings due to their disqualification from submitting a resolution plan.[223]

(iv) Creditor-in-possession model and value destruction

Besides the delay in initiating the insolvency proceedings, recent studies suggest that the architectural design of the IBC that favours a creditor-in-possession model may also lead to the value destruction problem.[224] Due to the scepticism towards the incumbent management, the IBC provides for their replacement with a resolution professional. Unlike the UK, however, the resolution professional primarily acts as a facilitator who invites feasible resolution plans without deciding itself whether the corporate debtor must be liquidated, restructured or sold as

[218] *Id.* at 28; Douglas G. Baird, *The Initiation Problem in Bankruptcy*, 11 INTERNATIONAL REVIEW OF LAW AND ECONOMICS 223, 232 (1991).
[219] *See* Adler et al., *supra* note 217, at 28.
[220] *See* discussion *supra* pp. 21-22.
[221] Kamalnath, *supra* note 150, at 656.
[222] IBBI Newsletter, *supra* note 210, at 13.
[223] Mohan & Raj, Entrepreneurship and Insolvency, *supra* note 203, at 136.
[224] Datta, *supra* note 216, at 17.

a going concern.[225] The ultimate authority to approve or reject these proposals lies with the CoC comprising of the financial creditors. The IBC's preference of the CoC as the decision-making body has logistical reasons: at the time of its enactment, the market for insolvency professionals was not yet in existence.[226] Hence, conferring them with the power equivalent to that of an administrator in the UK would have had a draconian effect.

However, the direct creditor decision-making model pursued by the IBC suffers from various defects. First, this model augments the costs associated with the CIRP due to the increased bargaining between the creditors.[227] Second, if 66% or more of the financial debt is owed to the secured creditors, then the decision regarding the future of the company would be in effect made by them.[228] These secured creditors, in most cases, do not have the right incentive to maximise the value of the company and recover more than the face value of their debt.[229] Rather, these secured creditors would prefer the immediate liquidation of the corporate debtor to realise the company's liquidation value and make good on the outstanding debt owed to them.[230] Hence, the creditor-friendly approach adopted by the IBC may push the financial creditors to liquidate the company in haste, thereby causing value destruction.[231]

(v) Impact of stigma on entrepreneurship, risk-taking and innovation

The design of an insolvency law has a significant effect on the entrepreneurial ecosystem and the economic performance of a country.[232] Research shows that stringent bankruptcy laws based on strong creditor rights are associated with lower levels of entrepreneurial activities.[233]

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[225] IBC Handbook, *supra* note 161, at 122; Swiss Ribbons, *supra* note 205, ¶ 61.
[226] Zwieten, Keynote Address, *supra* note 159, at 9.
[227] Zwieten, Keynote Address, *supra* note 159, at 11.
[228] Datta, *supra* note 216, at 18.
[229] *But see* Datta, *supra* note 216, at 17 (arguing that this is not always true as there could be countervailing factors like reputational costs in repeat lending which may incentivise secured creditors not to automatically liquidate firms on payment default).
[230] Datta, *supra* note 216, at 19; See Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta, (2020) 8 SCC 531 ¶¶ 85, 146 (wherein it was argued that disregarding the security interests of the secured creditors and treating them equally to the unsecured financial creditors would incentivise them to vote for liquidation rather than resolution. While considering this argument, the Supreme Court upheld the supremacy of creditors and noted that the CoC does not owe a fiduciary duty to any group of creditors but is required to take a business decision with the requisite majority, which binds all stakeholders, including any dissenting creditors. While doing so, the interests of the operational creditors, however, must be protected. Arguably, the board powers of the CoC comprised of a majority of the secured financial creditors, as recognised by the Apex Court, may create a conflict of interest wherein they would be incentivised to maximise recovery for themselves while exercising their wisdom and the check imposed in the form of protection of operational creditors may not be enough).
[231] Datta, *supra* note 216, at 21.
[232] Froute, *supra* note 106, at 202.
[233] Naga Lakshmi Damaraju et al., *Do Stringent Bankruptcy Laws Always Deter Entrepreneurial Activities? A Study of Cultural Influences*, 45 ENTREPRENEURSHIP THEORY AND PRACTICE 418 (2021); John Armour & Douglas Cumming, *Bankruptcy law and Entrepreneurship*, 10 AMERICAN LAW AND ECONOMICS REVIEW 303, 304 (2008).

This is because, in a creditor-friendly insolvency regime, there is an increased fear of failure, which acts as an *ex-ante* barrier for engaging in risk-taking.[234] For instance, in England during the sixteenth century, when death was an acceptable punishment for default, it is unlikely that entrepreneurs borrowed money to engage in exploratory projects because the cost of failure was just too high.[235] Although the borrowers are treated less severely today, the stigma persists, impacting the rate of entrepreneurship and risk-taking. In a survey conducted in Europe and the US, people were asked whether "*one should not start a business if there is a risk it might fail*."[236] While 50 percent of the Europeans agreed with this statement, only 33 percent of Americans responded affirmatively, highlighting the impact of cultural influences and stigma on risk-taking and entrepreneurship.

However, Saul Estrin, Tomasz Mickiewicz, and Anna Rebmann in their study suggest that the harshness of corporate bankruptcy law does not affect all entrepreneurs alike, but only the highly ambitious entrepreneurs who are likely to incorporate a limited liability company and thus be impacted by corporate bankruptcy law.[237] Their study further reveals that entrepreneurs do not attach the same level of significance to all elements of insolvency law; rather, there are some aspects of debtor-friendly insolvency legislations that matter more to the entrepreneurs and encourages higher aspiration entrepreneurship. These aspects are the removal of the incumbent management during the restructuring proceedings (creditor-in-possession) and no automatic stay on secured assets, since these features significantly impact the extent to which the entrepreneur can remain in control once the firm enters the reorganisation proceedings.[238]

The authors argue that jurisdictions where the insolvency regime mandates the removal of the incumbent management during the reorganisation process, and there is no automatic stay on secured assets, have a lower likelihood of an individual becoming a high-growth and ambitious entrepreneur and as such, these provisions should be avoided.[239] At the same time, some aspects of creditor-friendly corporate insolvency legislations, such as imposing restrictions on reorganisation by requiring creditor consent to initiate the resolution process, have a positive impact on high growth entrepreneurship because they strengthen the creditors' position and

[234] Florian Ederer & Gustavo Manso, *Incentives for Innovation: Bankruptcy, Corporate Governance and Compensation Systems, in* HANDBOOK OF LAW, INNOVATION, AND ECONOMIC GROWTH 1, 6 (2011).
[235] *Id.*
[236] European Commission, Flash Eurobarometer 160: Entrepreneurship (June 2005).
[237] Estrin et al., *supra* note 15, at 983.
[238] Estrin et al., *supra* note 15, at 984.
[239] Estrin at al., *supra* note 15, at 995.

lowers the cost of credit available in the market.[240] As a result, the authors propose that an optimal insolvency legislation that encourages high growth entrepreneurship would be one that safeguards the entrepreneurs from downside risk of failure and allows them to retain control during the resolution process while still favouring the creditors.[241]

Apart from giving an impetus to entrepreneurship and risk-taking, insolvency laws also spur the level of innovation in the market. This is supported by a study conducted by Viral Acharya and Krishnamurthy Subramanian, who, by using patent filings in the US as proxies for innovation, found that a creditor-friendly insolvency regime is marked with higher liquidation rates which cause firms to shun innovation.[242] In contrast, a debtor-friendly insolvency regime spurs greater innovation by encouraging entrepreneurs to start a new venture if the first has failed and allows them to apply the learnings from their prior failure.[243]

In the Indian insolvency scenario as well, one of the primary goals of the IBC is the promotion of entrepreneurship in the country. The IBC seeks to operationalise this goal by easing entry into and exit from the market. Significantly, the BLRC, in its report, had recognised the role insolvency law plays in facilitating risk-taking and entrepreneurship, which in turn accelerates the country's economic growth.[244] It had noted that in a vibrant market economy, some degree of failure is inevitable. In fact, this failure is a natural corollary of limited liability corporations that were created with the objective of taking risk. Seen in this light, bankruptcy law must normalise business failure and encourage entrepreneurs to shut shop if they do not succeed and start a new venture. However, in reality, the IBC treats failed businesses and entrepreneurs quite strictly.[245] As seen from our discussion on section 29A(c), the promoters and management are blamed for the financial distress of the corporate debtor. The corporate officers are seen as unscrupulous persons who ran the company aground through their misconduct and, thus, are prevented from participating in the future of their company. Such a negative and stringent attitude towards business failure runs the risk of deterring individuals from engaging in high-

[240] *See* Estrin et al., *supra* note 15, at 984, 994 (arguing that creditor's position is strengthened if restrictions are imposed on the initiation of reorganisation because the secured creditors can choose to go for liquidation and recover their dues rather than going through uncertain and lengthy reorganisation process).
[241] Estrin et al., *supra* note 15, at 995.
[242] Viral V. Acharya & Krishnamurthy V. Subramanian, *Bankruptcy Codes and Innovation*, 22 THE REVIEW OF FINANCIAL STUDIES 4949, 4950 (2009).
[243] Brendan Burchell & Alan Hughes, *The Stigma of Failure: An International Comparison of Failure Tolerance and Second Chancing* 1 (Centre for Business Research, University of Cambridge, Working Paper No. 334, 2016).
[244] BLRC Report, *supra* note 158, at 23.
[245] Mohan & Raj, Entrepreneurship and Insolvency, *supra* note 203, at 136.

growth entrepreneurship, innovative projects, and impacts the overall level of the country's economic growth.

V. INFLUENCE OF THE INDIAN COURTS

The judiciary has played a pivotal role in influencing and modelling the insolvency law in India. Hence, the purpose of the following section is to review the judgments passed by the Courts under the erstwhile SICA and the IBC to gauge the judiciary's attitude towards debtors and understand their role (if any) in reinforcing the social stigma surrounding corporate insolvency.

A. Judicial Attitude Towards Corporate Debtors under SICA

As discussed earlier,[246] SICA provided for the establishment of a quasi-judicial body known as BIFR, which after considering the viability of the distressed industrial company, either sanctioned a rehabilitation scheme or referred the company to the High Court for winding-up. In the interest of finality and speed, SICA sought to insulate the decisions of BIFR from undue interference of the courts. As a result, the High Courts' power was limited to (i) exercising judicial review of the decisions of the BIFR and (ii) passing a formal winding-up order of unviable firms referred by BIFR.

Practically, however, the courts often deviated from the narrow confines of judicial review by reconsidering the merits of the case. Extensive studies have been undertaken by Kristin van Zwieten[247] and Aparna Ravi[248] on the High Court decisions under the erstwhile SICA. Zwieten, in her study, analyses why SICA came to operate as it did, a legislation marked with inordinate delays[249] and associated harm to the creditors who relied on SICA to recover their dues.[250] She locates the cause for the failure of SICA to not only the structural deficiencies in the law, but how the law operated in action – particularly, how SICA was interpreted and applied by judges.[251]

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[246] *See* discussion *supra* pp. 20-21.
[247] Zwieten, Corporate Rescue in India, *supra* note 154.
[248] Aparna Ravi, *The Indian Insolvency Regime in Practice – An Analysis of Insolvency and Debt Recovery Proceedings* (Indira Gandhi Institute of Development Research, Working No. 27, 2015).
[249] *See* Zwieten, Corporate Rescue in India, *supra* note 154, at 12 (stating that it took five to seven years for a company to be revived under SICA).
[250] Zwieten, Corporate Rescue in India, *supra* note 154, at 4.
[251] Zwieten, Corporate Rescue in India, *supra* note 154, at 4.

To study the practical operation of SICA, Zwieten collated a dataset of 1066 judgments from a range of courts and tribunals other than BIFR.[252] These cases reveal various judicial innovations developed by the courts that significantly impacted how SICA operated, particularly contributing to the prolonged delays and ineffective resolution of sick companies. One such innovation revealed by the judicial decisions was the High Courts' imperative to explore rehabilitation even after the BIFR had passed an order of liquidation.[253] This approach arguably emerged due to the pro-debtor stance of the High Courts and their unwillingness to liquidate even unviable debtors.

The rehabilitative thrust of the courts, as argued by Zwieten, can be observed from the case of *Kanoria Jute Industries Ltd. v. Appellate Authority for Industrial and Financial Reconstruction*,[254] wherein the proceedings under SICA were registered in 1987, and a liquidation order was passed by BIFR in 2002. The appellate authority confirmed the order for liquidation in 2005, stating that there was no scope for framing and approving a revival scheme. When the order was challenged in a writ petition before the Calcutta High Court by the employees, the Court noted that "*effort should always be to achieve the goal of revival of the sick company concerned. Even if an approved revival scheme is likely to take quite a long time to ensure a real turnaround in the company concerned, it should not be considered as a negative aspect, although in the process, of course, the creditors may at times have to accept a longer time for recovery of their dues.*"[255] Further, the High Court noted that remanding the case back to BIFR for reconsideration "*will greatly serve the cause of the workers and employees of the company, though it may not serve the cause of creditors to the extent of their respective expectations*."[256] This shows that, at times, courts were willing to completely sideline the interests of the creditors while giving multiple chances for revival to the corporate debtor.

Another such instance of creative judicial practice favouring the debtor can be seen in *Board Opinion v. Hathisingh Manufacturing Company Ltd.*[257] In this case, despite multiple opportunities, no workable scheme for revival of the petitioner company was developed over the long span of 12 years. The Gujarat High Court, while considering whether the company

[252] *See* Zwieten, Corporate Rescue in India, *supra* note 154, at 15-16 (stating that the reason why BIFR's decisions were excluded from research is because the BIFR's orders are not readily available in the public domain).
[253] Zwieten, Corporate Rescue in India, *supra* note 154, at 16.
[254] (2009) 149 CompCas 555.
[255] *Id.* ¶ 12.
[256] *Id.*
[257] (2004) 119 CompCas 25.

should be wound up, noted that there was no possibility for reviving the company as dues of the secured creditors were mounting and the net worth of the company had been completely eroded.[258] The Court nevertheless declined to pass an order for liquidation stating that "*since the company is working and workmen are being paid their wages regularly, the court thinks it fit and proper to impose the conditions on the company to pay equivalent amount to the secured creditors in their respective proportion which the company is paying to the workmen every month. This arrangement is not only for a period of one month, but till the dues of the secured creditors are paid*."[259] With this, the High Court ordered the continuance of the company's operation to safeguard the interests of the workers, while the claims of creditors were reduced to receiving only payments in the form of instalments.[260]

In other cases, the courts passed lengthy stay orders on the BIFR's proceedings[261] and liquidation orders,[262] granted adjournments to enable the pursuit of rehabilitation[263] and allowed the parties to propose scheme of arrangements even after a formal winding-up order was passed.[264] These cases indicate the judiciary's disposition in encouraging multiple attempts at rehabilitating the company, even when the prospects seemed quite bleak. As argued by Zwieten, the courts often adopted such a pro-revival approach to protect the interests of the workers and other employees who were perceived as vulnerable, even after the economic liberalisation of 1999, when there was increasing pressure on these obsolete companies from competitive market forces to close down.[265] While no firm conclusion can be drawn by the authors in the absence of an empirical analysis, Zwieten's study suggests that the courts under the erstwhile SICA viewed debtors far more favourably, often going to great lengths to offer them a second chance, even at terrible costs for the creditors and financial institutions.

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[258] *Id.* ¶ 23.
[259] *Id.* ¶ 25.
[260] Zwieten, Corporate Rescue in India, *supra* note 154, at 19.
[261] Modi Industries Ltd. v. Nagar Palika, Modinagar, AIR 2000 All 271.
[262] Narmada Aluminium Industries Ltd. v. Appellate Authority for Industrial and Financial Reconstruction, (2005) 3 GLR 2296; Re JK Satoh Agricultural Machines Ltd, (2007) 138 CompCas 955; Akshaya Textiles Ltd. v. The Tabsildar, (2008) 143 CompCas 66.
[263] Re Varsha Spinning Mills Ltd., (1999) 82 DLT 828; Kamdar Ladat Simiti of Nanikram Shobraj Mills Ltd. v. Nanikam Shobraj Mills Ltd., (2005) 125 Comp Cas 740.
[264] Prestige Garden Estates Pot Ltd. v. State of Karnataka, (2007) 139 CompCas 372; Kumardhubi Metal Casting and Engineeting Ltd. v. Kumardhubi Karamchari Congress, (2006) II BC 134.
[265] Zwieten, Corporate Rescue in India, *supra* note 154, at 28.

B. Judicial Attitude Towards Corporate Debtors under IBC

The IBC marks a paradigm shift from the erstwhile legal regime. Under the IBC, the Adjudicating Authority is the NCLT which accepts the applications for initiating the CIRP, confirms resolution plans agreed by the CoC, and passes orders for liquidation of the corporate debtor. Appeals against the orders of the NCLT lie to the NCLAT and, further, to the Supreme Court of India. Together, the NCLT, NCLAT, and Supreme Court have played a pivotal role in interpreting the provisions of the IBC and paving the way for evolving insolvency jurisprudence. There has also been a gradual shift away from the favourable attitude of the judiciary towards the corporate debtor and the incumbent management. Such a shift in the judicial attitude can be gauged from the language and approach employed by the courts in the judicial pronouncements justifying the applicability and constitutionality of section 29A of the IBC.

Section 29A was introduced by the legislature after the decision of the NCLAT in the *Synergies Dooray* case.[266] In this case, a resolution plan for the corporate debtor was proposed by its related party[267] and was approved by the CoC. The resolution plan, which the NCLT further confirmed, resulted in a haircut of 94% for the financial creditors, while the promoters who were exercising control over the CoC through their related party were able to wrestle back control of the corporate debtor.[268] This anomaly urged the need for a legislative reform to prevent the promoters from regaining control of the company at the expense of the creditors. As a result, section 29A was introduced through an Ordinance which was ultimately enacted as the 2018 Amendment Act.[269]

One of the first cases in which the Supreme Court applied section 29A was *Chitra Sharma v. Union of India,*[270] wherein a resolution plan proposed by Jaiprakash Associated Ltd., the holding company of the corporate debtor, was rejected due to the statutory bar under section 29A. In arriving at this conclusion, the Supreme Court relied upon the statement of objects and reasons appended to the 2017 Amendment Bill. The Court observed that the purpose for introducing section 29A was to ensure that those persons who, through their "*misconduct*" had

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[266] Synergies Dooray, *supra* 194.
[267] IBC § 5(24).
[268] Veena Mani & Ishan Bakshi, *The Curious Case of Synergies Dooray & Its Implications on the Insolvency Code*, BUSINESS STANDARD (Sept. 20, 2017) https://www.business-standard.com/article/companies/flaws-in-the-insolvency-code-117091900999_1.html.
[269] *See* discussion *supra* pp. 25-26.
[270] (2018) 18 SCC 575.

caused the insolvency of the corporate debtor, do not participate in the resolution process.[271] With this, the words of the 2017 Amendment Bill that cast a stigma on the incumbent management crept their way into the language of the courts.

Soon after, the Supreme Court passed its decision in *ArcelorMittal* that authoritatively explained the contours of section 29A. In this case, two resolution plans were proposed, one by ArcelorMittal India Pvt. Ltd. (AMIPL) and the other by Numetal Ltd. (Numetal) for the corporate debtor – Essar Steel India Ltd. (ESIL); however, both the resolution applicants were found to be ineligible under section 29A. AMIPL was disqualified because its connected party,[272] ArcelorMittal Netherlands, was found to be the promoter of Uttam Galva Steels Ltd., whose account had been classified as an NPA. While Numetal was found to be ineligible because one of its shareholders was held entirely by the son of Mr. Ravi Ruja, the promoter of ESIL whose account had also been declared as an NPA. One might argue that both the resolution applicants were rightly ineligible under section 29A from a plain reading of the text of the provision, which includes persons "*acting jointly or in concert*" with the resolution applicant. However, instead of relying merely on the text, the Supreme Court resorted to a purposive and rather expansive interpretation of section 29A.[273] In doing so, the Court held that section 29A must be interpreted in light of its purpose and legislative history. This purposive interpretation has enabled the judiciary to expansively interpret section 29A to encompass even those situations that do not strictly fall within the purview of the IBC.

The need for a purposive interpretation of section 29A was once again reiterated by the Supreme Court in *Swiss Ribbons*, wherein the constitutionality of several provisions of the IBC, including section 29A(c), was challenged. One of the grounds for the challenge was that this provision treats "*unequals as equals*." In other words, the clubbing of unscrupulous promoters and those guilty of malfeasance with the sincere and honest promoters under section 29A(c) was argued to be manifestly arbitrary.[274] However, the Supreme Court did not find any merit to this argument stating that malfeasance is not the only criteria for disqualification under section 29A, which also includes persons who have fallen foul of the law and persons who are unable to pay their debts for a period of one year after their account is declared as an NPA.

[271] *Id.* ¶ 31.
[272] IBC § Explanation I to 29A.
[273] Umakanth Varottil, *Essar Steel Case: Supreme Decodes Section 29A of the IBC*, INDIACORPLAW (Oct. 7, 2018) https://indiacorplaw.in/2018/10/essar-steel-case-supreme-decodes-section-29a-ibc.html.
[274] Swiss Ribbons, *supra* note 205, ¶ 66.

Thus, the provision was found to be constitutionally valid.[275] While concluding the judgment, the Court noted that the earlier legislative experiments to tackle insolvency and bankruptcies had been a glaring failure.[276] In contrast, the IBC has largely proven to be successful in so far as it has increased recovery for the financial creditors, and as such the court asserted that "*the defaulter's paradise* [under the IBC] *is lost and in its place, the economy's rightful position has been regained*."[277]

An important precedent that stretched the applicability of section 29A by relying on the purposive interpretation is the NCLAT's decision in *Jindal Steel & Power Ltd. v. Arun Kumar Jagatramka*,[278] which the Supreme Court later upheld.[279] The NCLAT, in this case, had to decide whether the ineligibility under section 29A was also applicable to persons submitting a scheme of compromise and arrangement under section 230 of the Companies Act, 2013, while the corporate debtor was undergoing liquidation under the IBC. It was argued that the reading-in of the disqualification under section 29A into section 230 of the Companies Act was not permissible because it was a different section in a different enactment and that it would be tantamount to the judicial reframing of the legislation.

To answer this, the NCLAT relied upon section 35(1)(f) of the IBC, which prohibits the liquidator from selling the movable and immovable properties of the corporate debtor in liquidation to a person who is ineligible under section 29A. Significantly, prior to this decision, section 35(1)(f) was not considered a bar on the schemes of compromise and arrangements under the Companies Act; nevertheless, NCLAT relied on section 35(1)(f) to state that even during liquidation, the corporate debtor "*had to be saved from its own management*."[280] Thus, the NCLAT found the disqualification under section 29A to be also applicable to compromise and arrangement under section 230 of the Companies Act. This was upheld by the Supreme Court, which relied on its earlier decisions in *Chitra Sharma*, *ArcelorMittal,* and *Swiss Ribbons* to underscore the importance of a purposive interpretation of section 29A. It held that section 29A must be construed in such a manner so as to ensure that "*the object of the IBC is not defeated by ineligible persons, including but not limited to the management who have run the company aground, to return in the new avatar of resolution applicants*."[281] Therefore, with the

[275] Swiss Ribbons, *supra* note 205, ¶ 69.
[276] Swiss Ribbons, *supra* note 205, ¶ 86.
[277] Swiss Ribbons, *supra* note 205, ¶ 86.
[278] 2019 SCC OnLine NCLAT 759.
[279] Arun Kumar Jagatramka, *supra* note 205.
[280] *Supra* note 278, ¶ 11.
[281]Arun Kumar Jagatramka, *supra* note 205, ¶ 52.

aid of purposive interpretation, the judiciary was able to stretch the applicability of section 29A to schemes of compromise and arrangement under the Companies Act.

What is evident from the aforementioned decisions on section 29A is the judiciary's disposition to keep the incumbent management from regaining control of the corporate debtor. This judicial attitude is based on the broader scepticism against the management and the promoters who are considered responsible for the company's financial demise. By picking up the strong rhetoric of the 2017 Amendment Bill that referred to the promoters as "unscrupulous persons" and expansively interpreting section 29A in these cases, the judiciary has played a role in reinforcing and perpetuating the stigma against failed businesses.

Recently, the Single Judge Bench of the Calcutta High Court in the case of *Univalue Projects Pvt. Ltd. v. Union of India*[282] struck down the order passed by the NCLT imposing a mandatory prescription on all financial creditors to submit certain financial information as a record of default before the information utility as a condition precedent for filing an application under section 7. While the facts and the reasoning of the decision are not relevant to the central theme of this paper, what is strange is the "afterword" that the Court appended to the judgment. In the afterword, the Single Judge traced the legislative history of the Code and concluded by stating, *"let the <u>unscrupulous corporate debtor</u> continue to exist under the foreboding threat of the Damocles' sword of comprehensive action under the IBC, 2016 that hangs over its head!"*[283] Completely unconnected to the dispute, it was unnecessary for the Court to use such strong language. The judiciary must choose their words carefully, which must be rinsed free of stigma and bias, for they send powerful signals to the public. The signal that seems to be sent through such strong and negative verbiage is the refusal of the Courts to see the incumbent management and promoters of distressed businesses as anything other than incompetent and unscrupulous persons, thus denying them a second chance.

VI. WINDS OF CHANGE

The above discussion demonstrates the role of bankruptcy stigma in impeding the successful rehabilitation of corporate debtors and affecting the overall level of a country's entrepreneurial initiatives, innovation, and economic growth. Hence, effective tools need to be designed to combat the same. One recent innovation that has the potential to aid in the reduction of the

[282] (2020) 222 CompCas 288.
[283] *Id.* ¶ 86.

stigma is the introduction of the Pre-Packaged Insolvency Resolution Process (PPIRP). Notably, the PPIRP framework has only been rolled out for the Micro, Small, and Medium Enterprises (MSMEs) in India through the insertion of Chapter III-A of the IBC and is yet to be introduced for larger firms.[284]

Although in its nascent stages in India, PPIRP has proven to be successful in the US and UK.[285] As the term suggests, pre-pack is a process wherein the corporate debtor, its creditors, and important stakeholders negotiate on the resolution of the debt before the company goes for the formal insolvency process. The PPIRP framework functions as a hybrid model amalgamating both informal (out-of-court) and formal (court supervised) insolvency proceedings.[286] The process is initiated by the corporate debtor, who, on approval from 66 percent of the financial creditors, files an application to the NCLT.[287] Once approved by the NCLT, the pre-pack insolvency process commences, which has to be completed within a period of 120 days. A key distinguishing feature between the PPIRP and CIRP is that the incumbent management continues to remain in control of the corporate debtor during the pre-pack process:[288] marking a shift towards the debtor-in-possession model from its previous creditor-centric approach.

The pre-pack process offers several unique features that make it attractive to corporate debtors. The process involves minimal compliance and filing requirements, thus significantly cutting short the time associated with formal insolvency proceedings. Speedy disposal of the cases also helps in mitigating the costs involved in the process, allowing value maximisation of the corporate debtor.[289] Significantly, since the negotiations occur informally, the process affords the parties a degree of privacy and confidentiality. This enables them to freely negotiate the resolution terms without attracting the stigma related to the formal insolvency process.[290] Hence, pre-pack has the potential for diluting the stigma by shielding the corporate debtor from public scrutiny, at least during the initial informal stages of the process.

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[284] The Insolvency and Bankruptcy Code (Amendment) Act, 2021, Act No. 26 of 2021 (Aug. 11, 2021) https://ibbi.gov.in//uploads/legalframwork/0150ec26cf05f06e66bd82b2ec4f6296.pdf.

[285] R.P. Vats & Srijal Sinha, *Pre-Packaged Insolvency Resolution Process under the Insolvency and Bankruptcy Code*, MONDAQ (May 12, 2021) https://www.mondaq.com/india/insolvencybankruptcy/1067642/pre-packaged-insolvency-resolution-process-under-the-insolvency-and-bankruptcy-code.

[286] MCI Pre-pack Report, *supra* note 206, ¶ 1.36.

[287] Sanjeev Jalan, *Pushing Pre-pack Insolvency Resolution*, BUSINESS LINE (May 21, 2021) https://www.thehindubusinessline.com/opinion/pushing-pre-packed-insolvency-resolution-ep/article34616672.ece.

[288] MCI Pre-pack Report, *supra* note 206, ¶ 2.26(b).

[289] Vidhi Centre for Legal Policy, Designing a Framework for Pre-Packaged Insolvency Resolution in India 13 (Feb. 2020) https://vidhilegalpolicy.in/wp-content/uploads/2020/07/Report-on-Pre-Packaged-Insolvency-Resolution.pdf.

[290] *Id.* at 10.

Another legislative reform that can aid in the reduction of the stigma of insolvency proceedings is positive labelling. For example, as seen earlier,[291] the US Bankruptcy Code relabelled the term bankrupt, with the debtor to soften the stigma traditionally attached to the bankruptcy process. More recently, efforts of such nature have been made by Chile, whose institution, which is in charge of overseeing the insolvency proceedings, was labelled as "Superintendence of Insolvency and *Re-entrepreneurship*" in an attempt to mitigate the bankruptcy stigma.[292]

However, it is pertinent to note that the reduction in the intensity of stigma cannot be achieved by legislative innovations alone, as is evident from the US experience. These legislative reforms need to be accompanied by sustained changes in the attitude towards business failure. Businesses fail due to a host of reasons such as the ongoing pandemic, changes in the regulatory framework, shift in consumer behaviour and preferences and not always due to the incompetence or malfeasance of the company management. Hence, there needs to be a shift in the manner in which business failure is perceived to ameliorate the bankruptcy stigma. To bring about such a shift in the attitude towards business failure, there is a need to change the manner in which insolvency law is understood and taught.[293] It is important to understand that the insolvency and bankruptcy framework of a country does not only have ramifications for those facing financial distress but also the market economy as a whole. From an *ex-ante* perspective, the insolvency framework has significant implications for the availability and the cost of credit in the market, the business decisions of the creditors and debtors, and the rate of entrepreneurship and innovation. Therefore, disseminating information and raising awareness about the insolvency law's role in promoting economic growth may also help reduce the bankruptcy stigma.

VII. CONCLUSION

Most corporate insolvency legislations today are intentionally transitioning from the liquidation culture to the corporate rescue culture. This stands true for the IBC, which recognises the rehabilitation and reorganisation of the corporate debtor as its foremost objective. However, an impediment to the successful materialisation of the rescue culture is the ubiquity of stigma in the insolvency process. While the IBC has undoubtedly brought about a much needed structural change in the insolvency framework of India, there are certain

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[291] *See* discussion *supra* p. 11.
[292] Aurelio Gurrea Martinez, *Implementing an Efficient Insolvency Framework for Micro and Small Firms,* 30 INT. INSOLV. REV. 46, 59 (2021).
[293] *Id.*

elements of the Code that have strengthened and, in fact, perpetuated the stigma against failed businesses. This includes section 29A(c) and the creditor-centric design of the IBC. As seen in the paper, section 29A(c) views the promoters and the erstwhile management of the corporate debtors as unscrupulous persons who caused the company's downfall through their misconduct. Thus, the management is not only displaced during the insolvency process due to the creditor-in-possession model but they are also barred from putting forth a resolution plan. This sceptical attitude towards the management and business failure has been further reinforced by judicial pronouncements, which have picked up the language of the 2017 Amendment Bill on section 29A and have resorted to a purposive interpretation to stretch the applicability of the ineligibilities under this provision. Such an attitude underlying the legislative framework and judicial decisions is problematic because it tilts the balance of the insolvency framework in favour of liquidation. Due to the social stigma associated with insolvency, the corporate officers are reticent to initiate the insolvency process, delaying the early identification of financial distress and causing value destruction. The negative perception of insolvency also affects the way in which businessmen and women make their decisions from an *ex-ante* perspective. Hence, there is a need to reduce the intensity of stigma to a tolerable level for the efficient rehabilitation of distressed corporations. One recent legislative development that seems promising as far as stigma is concerned is PPIRP which shields the corporate debtor from public scrutiny, and thus the accompanying stigma, due to the informal nature of the negotiations. However, this paper concludes by noting that such legislative innovations alone will not stem bankruptcy stigma without sustained changes in the manner in which business failures and insolvency laws are understood.