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The 'Opt-out' & 'Opt-in' options: Probing into the Report of the Working Group on Group Insolvency

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Since the advent of the Insolvency & Bankruptcy Code in 2016, a need for transmuting from standalone insolvency to group insolvency was considered in the backdrop of rising cases involving the insolvency of companies within groups. The Working Group on Group Insolvency submitted its report, rendering an elaborative framework to be followed in cases when entities within a group become insolvent. One such attribute was the option to 'opt-out' and 'opt-in' by the group entities from and to the group insolvency proceedings respectively. However, the Working Group has failed to comprehend the impending irregularities and difficulties if these options, without any alterations, are availed. This piece aims at answering the aforementioned anomalies in order to make the report of the Working Group full-proof. Since the report and the jurisprudence of group insolvency in India are in its nascent stage, any alterations made at the moment would be more feasible as compared to when the same has become part of the Code.

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In the world of globalization and extensive conglomerates, it has become imperative to develop a framework which deals with financially distressed entities within a group in a coordinated fashion. However, the extant mechanism for the resolution process and the liquidation of these entities offered under the Insolvency & Bankruptcy Code of 2016 ("**Code**") is restricted to only single entities, which fall within the boundaries of India. The absence of such a holistic framework was sensed when entities within the group of *Videocon*[1] and *IL&FS*[2] among many others were brought before the Adjudicating Authority ("**NCLT"**). This eventually led to the fruition of certain group insolvency principles, which were non-uniform and varied from case to case. To counter the same and to shed light on the emerging group insolvency practice in India, the Working Group on Group Insolvency ("**WG"**) submitted its Report on 23rd September 2019 to provide a standard approach to be undertaken in group insolvencies.[3] It endorsed a structure that would smoothen the process of corporate restructuring and liquidation for the debt-ridden entities of a group but is confined to only domestic entities in the absence of cross-border regulations. The WG left it to the discretion of the individual entities whether to be a part of the group insolvency or conduct it on a stand-alone basis. In the backdrop of the same, options for opting-out & opting-in have been inscribed to allow the parties to switch from group proceedings to a stand-alone proceeding and vice-versa.

This paper is broadly divided into two parts – 'Opt out' option and 'Opt in' option. The author will aim to highlight certain anomalies that may arise in the implementation of these two options that were left unattended by the WG. The writing will also stress on answering these inconsistencies alongside, and succinctly explaining the framework bolstered by the WG. This paper is based on the assertion that the following inconsistencies and their solutions will be plausible in cases where group companies are highly operationally dependent on each other.

[1] State Bank of India & Anr. v. Videocon Industries Ltd. & Ors., (2019) MA 1306/2018 in C.P. No. 02/2018.
[2] Union of India v. Infrastructure Leasing & Financial Services Ltd. & Ors., Company Appeal (AT) No. 346 of 2018.
[3] Insolvency and Bankruptcy Board of India, *The Report of the Working Group on Group Insolvency 2019,* (Dec. 24, 2020, 7:00 PM), https://www.ibbi.gov.in/uploads/whatsnew/2019-10-12-004043-ep0vq-d2b41342411e65d9558a8c0d8bb6c666.pdf.

A. 'OPT-OUT': MATTERS CONSIDERED & ISSUES LEFT IN THE LURCH –

The WG laid down the implementation of the entire framework into two phases. The first phase will include procedural coordination mechanisms ("**PCM"**) and rules against perverse behaviour. It works on the rationale of reducing the costs of the formal insolvency process by avoiding duplication of efforts and ultimately leading to maximization of assets of the group entities. The second phase, which relates to substantive consolidation and cross-border insolvency, will be implemented at a later stage, depending on evaluation of its necessity and from the experience of executing the first phase. Another reason why the substantive consolidation is not recommended at present is that it does not adhere to the principles of asset partitioning and separate legal entity which are respected by PCM.

PCM consists of the following parts – a joint application, a group Committee of Creditors, a single NCLT & Insolvency professional ("**IP**"), communication & information sharing, and group coordination proceedings. Moreover, the group coordination proceedings will be governed by a framework and will be permitted at the discretion of the Committee of Creditors ("**CoC"**) of the entities undergoing Corporate Insolvency Resolution Process ("**CIRP**"). This framework may include how a group coordinator will be appointed, tactics for requesting a common resolution plan, opt-out and opt-in options, *et cetera.* Ergo, opt-out and opt-in options are a part of the PCM. Moreover, only communication and information sharing will be mandatory and the rest of the PCM will be enabling.

The following paragraphs will deal with inconsistencies arising out of the 'opt-out' options:

i. The half-explained rationale

The WG stated that the commercial wisdom of the CoC of the specific entity will be paramount in considering whether being a part of the group insolvency will be value augmenting for that individual entity or not. The CoC can avail the same by vote of a majority. In the absence of any specified threshold, it will be safe to presume that the same will be 66% of the majority.[4]

[4] Insolvency and Bankruptcy Code, 2016, §§12(2), 22(2), 27(2), 30(4), No. 31, Acts of Parliament, 2016.

However, the WG has not taken into consideration the outlook of resolution applicants. In a group company where the entities are operationally dependent on each other, the resolution applicants may devise a common resolution plan that will include all the entities of the group. Since the functioning of the group as a whole is dependent on the synergies of the entities, any entity opting-out of the group will be a major setback for the applicants as it will shrink the overall functional value of the group. The same has been discussed in detail under the next head.

However, the commercial wisdom of the CoC has been accorded a higher pedestal by the Supreme Court[5] and hence, forced consolidation in the group proceedings was never an option by the WG. To harmonize between the twin-objectives of championing the commercial wisdom of the CoC and rendering maximum value for the applicant, the 'opt-out' option is etched. However, the entire objective would be fruitless if there is any ambiguity in the time when this 'opt-out' option has to be availed by the individual entities.

ii. Setting the cut-off date for the 'Opt-Out' option

To uphold the commercial wisdom of the CoC, WG has given the CoC's of individual entities the first-hand opportunity to decide whether to opt-out or not. A cut-off date will help in order to avoid the group companies to leave the group insolvency at the advanced stages of the resolution process which may disrupt the value of the overall group and may even send the group into liquidation. However, a deadline must be set for this, after which the CoC of that individual entity cannot conduct standalone insolvency but only has to be a part of the group insolvency; the WG has not marked any deadline/cut-off date for the same. Nonetheless, only those companies can avail the opt-out option that are signatories in the group coordination proceedings.

The WG rightly stated the ideal time to decide whether to avail the opt-out option would be the first meeting of the CoC which is conducted within 30 (Thirty) days of the initiation of the CIRP or 7 (Seven) days within the constitution of the CoC as per regulation 40A of IBBI Regulations.[6] Till then, the entity may draw a comparative analysis of the value that will be assigned to it in group insolvency and stand-alone insolvency, ascertain whether the

[5] Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta & Ors., (2019) SCC Online SC 1478; K. Sashidhar v. Indian Overseas Bank & Ors., (2019) SCC Online SC 257.
[6] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg 40A, Gazette of India, pt. III sec. 4 (Dec. 1, 2016); Insolvency and Bankruptcy Code, 2016, § 22(1), No. 31, Acts of Parliament, 2016.

advantages of group insolvency outweigh the costs entailed, *et cetera*. However, such a task may-be time consuming as CoC has to ascertain not only the value of its assets & liabilities but that of the entire group along, with various other internal and external factors. Hence, imposing an obligation on the entities to hastily decide whether to avail the 'opt-out' option or not without considering the above factors would be unjustified.

Alternatively, submission of Information Memorandum ("**IM"**) by the Group Coordinator ("**GC"**) to the Group CoC[7] should be considered the cut-off date. The reason for this is that until the making of IM, the GC is conducting various tasks like public announcement, verifying claims, *et cetera,* but all of these are being conducted separately for all the group entities. However, at the time of making IM in order to solicit a common resolution plan and to make the most out of the synergies of the highly dependent group entities, there is a need to prepare a consolidated IM rather than standalone IM's. Ergo, prior to composing the consolidated IM, all the group entities should contemplate whether to opt-out or not. Moreover, the GC should be an insolvency professional registered under the Code.[8]

Subsequently, the GC cumulatively arranges the assets, liabilities along with other vital information of all the group companies. Such an IM will be sent to the Group CoC which can then assess the overall viability of the group. For instance, a group 'X' includes entities X_A, X_B, X_C, X_D and X_E which are highly operationally dependent on each other and with a cumulative value of INR 1,300 cr. The resolution applicants, who, after receiving a 'request for resolution plan'[9], which includes the consolidated IM along with the evaluation matrix and others, will proceed to devise a resolution plan accordingly.

However, if any entity opts-out after the 'request for resolution plan', it will fail the entire purpose of those resolution plans as each of these plans would have been crafted based on the synergies of group entities. From the above instance, if X_C of the group 'X' decides to opt-out, not only its overall value

[7] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg 36(1), Gazette of India, pt. III sec. 4 (Dec. 1, 2016).
[8] Insolvency and Bankruptcy Board of India, *The Report of the Working Group on Group Insolvency 2019,* at p 1.3.2.6 (Dec. 26, 2020, 4:34 PM), https://www.ibbi.gov.in/uploads/whatsnew/2019-10-12-004043-ep0vq-d2b41342411e65d9558a8c0d8bb6c666.pdf.
[9] Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Reg 36B, Gazette of India, pt. III sec. 4 (Dec. 1, 2016).

will decline from INR 1,300 cr. but it would also be difficult for the new acquirer to continue the group 'X' as a going concern due to a high operational dependence on each other. The successful resolution applicant would be left with no option but to either trim down the value of the plan or withdraw it. If the latter ensues, the entire group may be liquidated due to little / no time left for the CIRP or due to the paucity of other feasible resolution plans.

Hence, setting the cut-off date as 'submission of IM to Group CoC' be considered as a pre-emptive step. However, even if an entity decides to opt-out after the submission of the IM but before the request for resolution plan as u/r 36B, it should acquire the approval of the NCLT. Based on various parameters like time left for the CIRP, revised valuation of the group, extra costs to be entailed in producing the revised IM and other factors may hand down its decision. Even if NCLT allows the entity to opt-out, it must not let it slip away without imposing the resolution process costs accrued to its proportion. The author strongly advocates that even in the worst-case scenario, the NCLT should not allow any entity to opt-out after 'request for resolution plan' has been issued.

iii. Restaging the Dissenting Entities

Elaborating the above-stated example of group 'X', let us assume that all the entities of group 'X' except X_A approved the common resolution plan. In such a set-up, WG states that X_A may not be permitted to extend extra time unless there is ample time in their CIRP to conduct standalone insolvency.[10] The WG has adhered to the notion of conducting a time-bound resolution which is one of the pillars on which the Code is structured. However, such a step framed by the WG would almost in every case lead to the liquidation of those group companies that are involved in different stages of supply chain from the rest of the group.

To emphasize, consider that X_B, X_C, X_D and X_E are involved in the manufacturing of final goods while X_A is involved in transporting the final products. Any resolution applicant may generally contrive a common resolution plan that will be more manufacturing-oriented as the group's primary operation is of manufacturing while the transporting the same can be considered as secondary. Since there are 5 entities, every CoC will be

[10] Insolvency and Bankruptcy Board of India, *The Report of the Working Group on Group Insolvency 2019,* at p 1.3.2.6 (Dec. 26, 2020, 5:49 PM), https://www.ibbi.gov.in/uploads/whatsnew/2019-10-12-004043-ep0vq-d2b41342411e65d9558a8c0d8bb6c666.pdf.

conferred a lesser share of the Group CoC (this value is inversely proportional to the number of entities in the group if the financial creditors of those entities are different subject to the composition and constitution of the group CoC decided in the framework agreement) and the likelihoods are high that X_A will reject the common plan presented. Eventually, X_A will succumb to liquidation if there is insufficient time left for completion of CIRP.

To forestall the impending liquidation and to conduct the process in a time-bound manner for such dissenting entities, a structure similar to fast-track insolvency may be explored. Unlike fast-track CIRP envisaged under chapter IV of the Code, the CIRP for such dissenting entities should be for a period of 60 (Sixty) days and should commence from the date when the dissenting entity rejected the common resolution plan. Such a short period is being prescribed because all the major functions that are undertaken in a standard CIRP like public announcement, verification of claims, constitution of CoC, appointment of registered valuers, *et cetera* have already been accomplished. The dissenting entity simply has to re-valuate its IM, frame an evaluation matrix and issue 'request for resolution plan'. Moreover, the request for extension of time as u/s 56(2) should not be at the discretion of the individual CoC but with the NCLT.

Such a structure may be increasing the time-frame by 60 (Sixty) days but it is providing the dissenting CoC the complete autonomy to not only exercise its commercial wisdom in crafting a suitable evaluation matrix, but also approving a potentially beneficial resolution plan which can keep the entity as a going concern.

B. 'OPT-IN': TIP OF THE UNRESOLVED ICEBERG

The WG has not comprehensively highlighted the 'opt-in' options apart from only stating that the same can be availed by the group companies at a later stage if the framework agreement provides for such an option. However, certain questions relating to opt-out options like deciding the cut-off date can be posed here too. The response to this question would be the same as discussed above i.e. 'submission of IM to the Group CoC'; the same rationale being applicable in this case.

Nonetheless, the procedure to avail an opt-in option and the impediment it entails has been overlooked by the WG.

There may be two reasons why a group entity would attempt to opt-in. First, the attempting entity became insolvent after the group insolvency was already initiated. Second, at the time of signing the framework agreement, there were objections to the addition of that entity by other group companies.

To facilitate the procedure, it should be the GC's role to assess whether the attempting entity is included or not, as he has been entrusted with the task of evaluating the group assets together with the discrete share of each entity, settlement of intra-group debts, *et cetera*.[11] However, other entities may object to the inclusion of the attempting entity leaving the group coordinator in a catch-22 situation. Thus, to circumvent such a situation, the group coordinator should predominantly consider whether the inclusion of the entity would result in augmenting the overall value of the group without hampering the value of the entity being included along with other parameters. The rationale is being drawn from the case of *Binani Industries*[12] where the National Company Law Appellate Tribunal ("**NCLAT**") held that –

"The first order objective is "resolution". The second order objective is "maximisation of value of assets of the 'Corporate Debtor" and the third order objective is "promoting entrepreneurship, availability of credit and balancing the interests of all stakeholders". This order is sacrosanct."

Since maximisation of value of the assets has been accorded a higher pedestal, turning down the 'opt-in' option for the entities by the GC would be considered an infraction of the aforementioned principle. Even if the proposal to 'opt-in' is rejected by the group coordinator, the attempting entity should always have a provision to approach the NCLT.

C. Conclusion

The scrutable procedure submitted by the WG to be used in group insolvencies is not cabined to the unheeded implications of availing the 'opt-out' and 'opt-in' options. The blanket cover provided to directors of the holding entity in group CIRP, which can be scrapped only in exceptional situations, has also raised many questions.[13] The report of the WG can prove to be the

[11] *Id.*
[12] Binani Industries Ltd. v. Bank of Baroda, Company Appeal (AT) (Insolvency) No. 82 of 2018.
[13] Ananya HS, *Extension of Liability in Group Insolvency Proceedings, CBCL Blog* (Dec. 27, 2020, 9:30 PM), https://cbcl.nliu.ac.in/insolvency-law/extension-of-liability-in-group-insolvency-proceedings/.

new Pandora's box for the Code, as there could be many aspects of the report, which when applied in practical situations may create procedural and, at times, substantive obstacles to the group insolvency proceedings.

However, the non-deliberation of the WG on the aforementioned issues is not enough to declare that the report of the WG is purposeless. There are many suitable add-ons to make the entire procedure in consonance with the principles of limited liability and asset partitioning, which can be inferred from the report. First, the decision to avail the PCM is left at the behest of the CoC of each group company. Second, if the entire group succumbs to liquidation, a fresh filing has to ensue. This entails that CoC of each entity is again allowed to decide whether to conduct stand-alone liquidation or be part of the group liquidation. Third, the assets of any entity will be put in the service of the creditors of that specific entity only. Fourth, to conduct such a vast and intrigued procedure, the timeline for group CIRP will be 420 (Four Hundred and Twenty) days.

The report which is a first-hand attempt to morph from single entity insolvency to group insolvency has been proposed at an appropriate time when the concept of group insolvency is gathering momentum in other mature jurisdictions. When the recommendations of the report are espoused by the legislature, it will reduce the gap between India and developed jurisdictions on corporate insolvency. However, to maximize the potential of the recommendations of the WG, there is a need to re-examine the report especially the 'opt-out' & 'opt-in' options, for the least.