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Evolving Landscape of Commercial Wisdom: Analysing Judicial Interpretations in IBC Cases

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ABSTRACT

The evolving commercial wisdom within the context of the Insolvency and Bankruptcy Code (IBC) has been the subject of much attention. This article examines judicial interpretations surrounding the Committee of Creditors (CoC) and their exercise of commercial wisdom during insolvency proceedings. Analyzing key legal precedents, we explore the delicate balance between creditor interests, business viability, and judicial review. The recent Supreme Court ruling in MK Rajagopalan v Dr Periasamy Palani Gounder has implications for the CoC's decision-making authority. We also recommend the implementation of a Code of Conduct to govern CoC actions. The concept of commercial wisdom must be scrutinized prudently to strike the right balance between liquidation and reorganization .

***Keywords**: Evolving Landscape, Commercial Wisdom, Insolvency and Bankruptcy Code (IBC), Committee of Creditors (CoC), Judicial Interpretations, Decision-Making Authority, Code of Conduct, Business Viability, Liquidation, Reorganization.*

I. INTRODUCTION

In the dynamic arena of commercial transactions, the Insolvency and Bankruptcy Code (IBC) stands as a cornerstone, guiding the resolution of financial distress and the preservation of economic vitality. Within this framework, the notion of commercial wisdom has emerged as a pivotal concept, encapsulating the nuanced decision-making processes of stakeholders navigating insolvency proceedings. This paper delves into the evolving landscape of commercial wisdom as elucidated through judicial interpretations within the realm of the IBC.

The Committee of Creditors (CoC), entrusted with the task of safeguarding creditor interests and steering the course of insolvency proceedings, occupies a central role in the manifestation of commercial wisdom. Their deliberations and actions bear significant consequences for businesses under financial strain, determining the paths of liquidation or reorganization. Against this backdrop, the judiciary plays a crucial role in interpreting the scope and boundaries of the

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CoC's authority, often scrutinizing their decisions through the lens of commercial prudence.

Drawing insights from key legal precedents and recent developments, this article navigates through the intricate interplay between creditor interests, business viability, and judicial oversight. Notably, the Supreme Court's landmark ruling in MK Rajagopalan v Dr Periasamy Palani Gounder[3] reverberates through the landscape, reshaping perceptions of the CoC's decision-making authority and judicial review mechanisms. As such, the implications of judicial interpretations extend far beyond the confines of individual cases, shaping the contours of commercial wisdom within the IBC framework.

In light of these developments, there arises a pressing need for a structured framework to govern the actions of the CoC, ensuring transparency, accountability, and adherence to principles of fairness. This paper advocates for the implementation of a Code of Conduct tailored to the specific dynamics of insolvency proceedings, guiding ethical conduct, procedural norms, and the exercise of commercial judgment. By fostering a culture of responsible decision-making, such measures can contribute to the harmonious balance between the imperatives of liquidation and the prospects of business rehabilitation.

II. The Role of the Committee of Creditors (CoC)

The Committee of Creditors (CoC) constitutes a pivotal entity within the framework of corporate bankruptcy resolution under the Insolvency and Bankruptcy Code (IBC). Tasked with representing the diverse interests of stakeholders involved in the insolvency process, the CoC shoulders crucial responsibilities. Its formation occurs after the compilation of proofs of claims by the Interim Resolution Professional (IRP), as stipulated by Sections 18 and 21 of the IBC. Comprising solely of financial creditors of the corporate debtor, the CoC excludes operational creditors, as delineated by the IBC's distinction between the two creditor categories.

The CoC wields considerable authority in insolvency proceedings, exercising decision-making powers that significantly influence the fate of the corporate debtor. One of its primary functions is the evaluation of resolution plans presented by the IRP or other relevant parties. Through voting, the CoC determines the approval or rejection of these plans, thereby charting the course of action for the corporate debtor, whether it be resolution or liquidation. In instances where a feasible resolution plan is unattainable, the CoC deliberates on the necessity of liquidation.

Additionally, the CoC assumes a supervisory role over the actions of the IRP throughout the insolvency process, ensuring adherence to the provisions of the IBC and safeguarding creditor

[3] https://www.livelaw.in/tags/mk-rajagopalan-v-dr-periasamy-palani-gounder.

interests. Operating within the framework of a "creditor-in-control" model, the CoC facilitates effective decision-making by empowering creditors to assume management control post-default, thereby fostering corporate rehabilitation and efficient debt settlement.

Legal precedent, as exemplified by cases like ***Innovative Industries v. Union of India***[4], underscores the alignment of judicial interpretations with the objectives of the IBC. The courts have consistently upheld the principle of creditor management control following a debt default, emphasizing the necessity of empowering creditors in insolvency proceedings.

The Committee of Creditors (CoC) is a crucial component in the insolvency resolution process. Its role is to facilitate speedy debt settlement, maximize the value of assets, and enable the rehabilitation of the corporate debtor. The CoC's decisions carry significant weight and can greatly impact the outcome of insolvency proceedings. As such, it is a pivotal decision-making body in the realm of corporate bankruptcy resolution.

III. Commercial wisdom and judicial review

The enactment of the Insolvency and Bankruptcy Code (IBC) heralded a significant shift in India's insolvency landscape, prioritizing corporate revival over liquidation. Central to this framework is the Committee of Creditors (CoC), which assumes a pivotal role in the Corporate Insolvency Resolution Process (CIRP). An essential guiding principle shaping the CoC's decision-making is the notion of **"commercial wisdom."** This principle, while rooted in financial considerations, grants the CoC a degree of discretion to consider broader factors crucial for corporate revival.

In the legal matter of ***Sunil S. Kakkad v. Atrium Infocom Private Limited***[5] the National Company Law Appellate Tribunal (NCLAT) scrutinized the notion of commercial wisdom within the context of the Insolvency and Bankruptcy Code (IBC). The case pertained to the Corporate Insolvency Resolution Process (CIRP) of a dormant corporate debtor, wherein the Committee of Creditors (CoC) had opted for liquidation without soliciting expressions of interest (EoI) for resolution plans. Despite objections, the NCLAT upheld the CoC’s decision, highlighting that the exercise of commercial wisdom by the CoC is not subject to judicial review, as protected under Section 33(2)[6] of the IBC. The tribunal refrained from delving into

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[4] L. Viswanathan, I.D. (2022) *Innoventive Industries Limited v. ICICI Bank Limited: Paradigm Shift in insolvency law in India, India Corporate Law*. Available at: https://corporate.cyrilamarchandblogs.com/2017/09/innoventive-industries-limited-v-icici-bank-limited-paradigm-shift-insolvency-law-india/ (Accessed: 04 May 2024).

[5] Sunil S. Kakkad (S) v. Atrium Infocom Pvt. Ltd. And Others (S). | Supreme Court Of India | Judgment | Law | CaseMine

[6] jain, A. (2020) *Concept of commercial wisdom and its legal implications, Live Law*. Available at: https://www.livelaw.in/law-firms/articles/concept-of-commercial-wisdom-and-its-legal-implications-162125 (Accessed: 04 May 2024).

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alternative insolvency resolution avenues, citing deference to the commercial judgment of the CoC and adherence to the statutory framework outlined in the IBC.

Within the ambit of the IBC, the CoC, predominantly comprising financial creditors, holds considerable power in the CIRP. Its responsibilities range from evaluating resolution plans to ultimately determining the fate of the corporate debtor through approval or rejection. Notably, these decisions extend beyond mere creditor recovery, impacting various stakeholders like employees and shareholders. The principle of commercial wisdom allows the CoC to assess factors such as the potential for revival as a going concern, stakeholder interests, and the exercise of commercial prudence, even if it diverges from strict maximization of creditor recovery.

Legal precedents further delineate the contours of commercial wisdom. Judicial decisions like ***Vallal RCK v. M/s Siva Industries***[7] and ***K Shashidhar v. Indian Overseas Bank***[8] affirm the autonomy of the CoC in business decisions, shielding them from extensive judicial scrutiny. However, recent rulings, exemplified ***by MK Rajagopalan v. Dr. Periasamy Palani Gounder***[9], caution against overextension of this principle, emphasizing the need for accountability and transparency within the CoC's functioning.

The delicate balance between CoC autonomy and judicial review is crucial for effective insolvency proceedings. While ensuring creditor interests are safeguarded, excessive litigation risks deviating from the legislative intent of the IBC. One potential avenue to strike a harmonious balance could be the establishment of a Code of Conduct for CoC members. Such a framework could provide guidelines for decision-making while ensuring alignment with the overarching objectives of the IBC.

Thus the principle of commercial wisdom empowers the CoC, its boundaries are subject to evolving jurisprudence. As courts navigate this intricate terrain, they must strike a balance that safeguards both creditor interests and the prospects for corporate debtor revival, thus ensuring the efficacy of the insolvency resolution process in India.

IV. Key judicial precedents

The Principle of Commercial Wisdom is a cornerstone within the framework of the Committee

[7] Cbclseconduser (2022) *Vallal RCK v. Siva Industries: Decision in the right direction?*, *CBCL*. Available at: https://cbcl.nliu.ac.in/insolvency-law/vallal-rck-v-siva-industries-decision-in-the-right-direction/ (Accessed: 04 May 2024).

[8] *K. Sashidhar V. Indian Overseas Bank & Ors.* (no date) *Responsive Slide Menus*. Available at: https://www.argus-p.com/updates/updates/k-sashidhar-v-indian-overseas-bank-ors/ (Accessed: 04 May 2024).

[9] Supra 7

of Creditors (CoC) under the Insolvency and Bankruptcy Code (IBC), embodying its authority to make informed business decisions collectively. This principle recognizes the expertise inherent within the CoC to navigate the complexities of insolvency proceedings. However, it prompts the question of whether the CoC's discretion is absolute or open to judicial scrutiny.

Examining legal precedence sheds light on the boundaries and extent of the CoC's commercial wisdom:

In ***Vallal RCK v M/s Siva Industries***[10]**,** the Supreme Court affirmed that the adjudicatory authority should not interfere with the CoC's decisions regarding settlement plans under Section 12A of the IBC, acknowledging their expertise in assessing feasibility and viability.

Similarly, in ***Ashish Saraf v Bhuvan Madan***[11], the Court reiterated the CoC's responsibility in making business decisions, emphasizing that these decisions are beyond judicial review.

The case of ***K Shashidhar v Indian Overseas Bank***[12] reinforced the autonomy of the CoC, limiting judicial review to the grounds specified in the IBC.

In the Committee of Creditors of ***Essar Steel India Ltd v Satish Kumar Gupta***[13] and Ors, the Court emphasized adherence to the guidelines outlined in the IBC, particularly regarding the exercise of judicial review power.

However, recent rulings, such as in ***MK Rajagopalan v Dr Periasamy Palani Gounder***[14], have clarified that the principle of commercial wisdom does not grant absolute discretion to the CoC. Judicial review may intervene in cases of manifest arbitrariness or demonstrably perverse decisions.

In response to these developments, there's merit in proposing a Code of Conduct for CoC members to ensure transparency, fairness, and accountability in their actions.

While the CoC's commercial wisdom is vital, it must operate within reasonable bounds. Achieving a balance between autonomy and accountability is essential, with judicial oversight playing a crucial role in maintaining this equilibrium and upholding the integrity of insolvency proceedings under the IBC.

V. THE NEED FOR A CODE OF CONDUCT

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[10] Supra 7

[11] (2021) *Ashish Saraf vs. Bhuvan Madan & Ors. – Supreme Court, IBC Laws*. Available at: https://ibclaw.in/ashish-saraf-vs-bhuvan-madan-ors-supreme-court/ (Accessed: 04 May 2024).

[12] Supra 8

[13] https://www.snrlaw.in/wp-content/uploads/2021/04/SR-Insights-Case-Note-Judgement-of-the-Supreme-Court-in-the-Essar-Steel-Case.pdf

[14] Supra 6

The Committee of Creditors (CoC) plays a pivotal role in insolvency resolution proceedings, tasked with making critical decisions that can determine the fate of financially distressed companies. While the CoC holds significant power, concerns have arisen due to the absence of a standardized Code of Conduct (CoC) governing its actions. This paper advocates for the implementation of a comprehensive CoC to ensure fairness, transparency, and accountability in decision-making processes during Corporate Insolvency Resolution Processes (CIRP).

(A) The Role and Responsibilities of the CoC:

The CoC is envisioned as the supreme decision-making body during CIRP, comprising a diverse group of financial creditors (FCs) with varied interests. Its responsibilities include appointing and supervising the Resolution Professional (RP), assessing the viability of the debtor's business, approving resolution plans, and potentially deciding on liquidation. The CoC wields considerable power, with decisions impacting stakeholders' interests, including operational creditors.

(B) Judicial Oversight and Legal Precedents:

Legal precedents emphasize the limited judicial review available for CoC decisions, stressing the importance of adhering to the principles of the Insolvency and Bankruptcy Code (IBC). The courts have upheld the autonomy of CoCs in making commercial decisions, provided they consider factors such as asset maximization, maintaining the debtor as a going concern, and safeguarding stakeholders' interests.

(C) Proposal for a Comprehensive Code of Conduct:

To enhance the effectiveness and integrity of CoC proceedings, a proposed Code of Conduct is outlined. The code aims to establish guiding principles for CoC conduct, ensuring adherence to ethical standards and promoting informed decision-making. Key components of the proposed code include:

- **Transparency and Conflict-of-Interest Mitigation:** Mandating transparent conduct and disclosure of conflicts of interest to prevent biased decision-making.
- **Reasoned Decision-Making:** Requiring all CoC decisions to be backed by fair reasoning and documented for accountability.
- **Maintaining Arm's Length with Resolution Professionals:** Ensuring independence in dealings with Resolution Professionals to avoid conflicts of interest and maintain impartiality.
- **Enhanced Due Diligence:** Emphasizing thorough due diligence of Resolution

Applicants and corporate debtors to facilitate informed decision-making.

- **Deadlock Resolution Mechanism:** Establishing protocols for resolving deadlocks within the CoC to prevent impasses in decision-making processes.
- **Information Disclosure**: Mandating the disclosure of all relevant information to Resolution Professionals to facilitate effective business management during CIRP.
- **Enforcement Measures:** Implementing penalties or disciplinary actions for CoC members engaging in misconduct, with safeguards for decisions made in good faith.
- **Timeliness and Data-backed Decision-Making:** Ensuring adherence to statutory timelines and requiring CoC decisions to be supported by relevant data and information.
- **Professional Competency Requirements:** Setting minimum competency standards for CoC members to promote effective representation and decision-making.
- **Diverse Expert Involvement:** Encouraging diverse representation within the CoC, including experts from various fields to facilitate comprehensive discussions and decision-making.

A comprehensive Code of Conduct for Committees of Creditors is essential to instil confidence in the insolvency resolution process and uphold the principles of fairness, transparency, and accountability. By adhering to ethical standards and promoting informed decision-making, the proposed code can strengthen commercial prudence and contribute to the successful resolution of financially distressed companies.

VI. BALANCING LIQUIDATION AND REORGANIZATION

Insolvency and Bankruptcy Code (IBC), aims to streamline insolvency resolution in India by providing a uniform, transparent, and predictable procedure. Within this framework, the concept of balancing liquidation and reorganization plays a pivotal role.

(A) Distribution Waterfall in Liquidation:

The IBC introduces a unique distribution waterfall for the event of liquidation. This order of priority determines how the dues owed to various stakeholders are settled.

Under **Section 53** of the IBC, the following priorities are established:

- Insolvency resolution process costs and liquidation costs are paid first.
- workmen’s dues for the 24 months preceding the liquidation commencement date and debts owed to a secured creditor (if the creditor has relinquished security) are addressed.

- Wages and unpaid dues owed to employees (other than workmen) for the 12 months preceding the liquidation commencement date follow.
- Financial debts owed to unsecured creditors come next.
- Then, any amount due to the central government and state government, along with debts owed to a secured creditor for any unpaid amount after enforcing security interest, are settled.
- Remaining debts and dues, preference shareholders, and equity shareholders or partners are considered in that order.

(B) Government Debts and Operational Creditors:

The IBC prioritizes the interests of unsecured financial creditors over government debts and operational creditors. The rationale behind this prioritization is that government dues are unlikely to significantly impact total government receipts, whereas non-payment could severely affect commercial creditors' ability to sustain themselves. Operational creditors and government authorities have raised concerns about this distribution waterfall, advocating for a more equitable treatment.

(C) Maximization of Value and Stakeholder Interests:

The preamble of the IBC emphasizes the importance of maximizing asset value, promoting entrepreneurship, and balancing stakeholder interests. The key challenge lies in determining whether reorganization efforts can revive the corporate debtor as a viable business entity or if liquidation would yield better returns. In making this decision, the CoC considers various factors such as the industry outlook, the debtor's potential, and the feasibility of proposed resolution plans. Ultimately, the CoC's decision-making process involves navigating this delicate balance between liquidation and reorganization, taking into account both short-term gains and long-term viability.

VII. Conclusion

The landscape of commercial wisdom within the framework of the Insolvency and Bankruptcy Code (IBC) reflects a dynamic interplay of judicial interpretations, creditor interests, and the imperative of corporate revival. Through an analysis of key legal precedents and recent developments, it is evident that the Committee of Creditors (CoC) occupies a central role in shaping the outcome of insolvency proceedings. The principle of commercial wisdom grants the CoC considerable discretion in decision-making, yet recent judicial interventions have underscored the need for accountability and transparency within their actions.

The evolving jurisprudence surrounding the CoC's authority highlights the delicate balance between autonomy and oversight. While courts have recognized the expertise inherent within the CoC, recent rulings have cautioned against unchecked discretion, emphasizing the need for adherence to statutory guidelines and principles of fairness. The proposal for a Code of Conduct tailored to govern CoC actions emerges as a pragmatic response to these developments, offering a structured framework to ensure ethical conduct, procedural adherence, and informed decision-making.

Moreover, the overarching goal of the IBC—to strike a balance between liquidation and reorganization—remains paramount. The distribution waterfall in liquidation, prioritization of stakeholder interests, and the maximization of asset value underscore the complex considerations involved in insolvency resolution. The CoC's role in navigating this balance, while safeguarding creditor interests and fostering corporate rehabilitation, underscores the critical importance of effective decision-making within the insolvency framework.

In essence, the evolving landscape of commercial wisdom within the IBC necessitates a nuanced approach that reconciles creditor interests, judicial oversight, and the imperatives of corporate revival. By embracing transparency, accountability, and adherence to guiding principles, stakeholders can contribute to the efficacy and integrity of insolvency resolution in India, thereby fostering a robust ecosystem for economic vitality and corporate governance.

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