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The Aftermath of India's 2016 Model BIT: Safeguarding Present and Future Investments

—Matthew Hodgson and Saniya Sharma***

This article undertakes a comparative analysis of the restructuring options available to both Indian and non-Indian investors under India's new Model Bilateral Investment Treaty ('BIT'), following the termination of 58 Indian BITs in early-2017. The article analyses the substantive protections afforded to investors under the new Model BIT, its pro-state tilt, and how this endangers foreign investment in India and investment made by Indians abroad. The article then undertakes a critical discussion of potential restructuring options investors can resort to so as to ensure favourable legal protections and some of the challenges of these alternatives, e.g., abuse of process and denial of benefits.

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I. Introduction

The push for foreign investment since liberalisation has seen India become one of the fastest growing economies in the world. Foreign Direct Investment ('**FDI**') "*is considered as a major source of non-debt financial resource for the economic development*"[1] and the Indian Government's stated objective

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1 Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India, 'Consolidated FDI Policy' (15 October 2020) 5 <https://static.investindia.gov.in/2020-10/FDI-PolicyCircular-2020.pdf> accessed 9 October 2021.

is to "*attract and promote FDI in order to supplement domestic capital, technology and skills for accelerated economic growth and development*".[2] Until recently, India also had one of the most extensive bilateral investment treaty ('**BIT**') protection regimes, with over 80 BITs in force.

India's BITs were based on the 1993 India Model BIT and were considered to be "*simplistic in their content and purpose*".[3] Following widespread outcry over the decision in *White Industries*,[4] and the increase in dispute notices that followed,[5] India published the 2016 Model BIT ('**2016 Indian Model BIT**') with the aim of striking a balance between attracting investments and the right to regulate.[6]

The 2016 Indian Model BIT comprises of thirty-eight articles, divided into seven chapters, and is intended to serve as a template for future BIT negotiations. More significantly, pursuant to the issue of the 2016 Indian Model BIT, India terminated the majority of its BITs.

Various authors have commented upon the Model BIT.[7] This article seeks to contribute to the existing literature by discussing the safeguarding options available to investors in light of India's widespread termination of BITs.

Section II briefly summarises the key changes under the 2016 Indian Model BIT with the objective of highlighting concerns that will plague India's re-negotiation of terminated BITs. Section III analyses the latest FDI inflow and outflow in India and brainstorms potential restructuring options for investors. Section IV discuses challenges to restructuring, in particular

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2 ibid.

3 Saurabh Garg, Ishita G Tripathy, and Sudhanshu Roy, 'The Indian Model Bilateral Investment Treaty: Continuity and Change' in Kavaljit Singh and Burghard Ilge (eds), *Rethinking Bilateral Investment Treaties: Critical Issues and Policy Choices* (Both Ends, Madhyam, and SOMO 2016).

4 *White Industries Australia Ltd. v Republic of India* (2010) UNCITRAL, Final Award.

5 At the time of writing, the authors are aware of at leasttwenty-six cases against India under BITs, of which nine are pending, ten have been settled, four have been decided in favour of the investor, one has been decided in favour of the State, and two have been discontinued. *See*, United Nations Conference on Trade and Development ('**UNCTAD**') Investment Policy Hub, 'Investment Dispute Settlement Navigator – India' <https://investmentpolicy.unctad.org/investment-dispute-settlement/country/96/india/investor> accessed 9 October 2021.

6 'Model Text for the Indian Bilateral Investment Treaty' (*Department of Economic Affairs, Government of India*) <https://dea.gov.in/sites/default/files/ModelBIT_Annex_0.pdf> accessed 9 October 2021 ('**2016 Indian Model BIT**').

7 *See*, Lucia Raimanova, 'Indian Model Bilateral Investment Treaty' *(Allen & Overy*, 5 August 2016) <www.allenovery.com/en-gb/global/news-and-insights/publications/indian-model-bilateral-investment-treaty> accessed 9 October 2021; Garg, Tripathy, and Roy (n 3); Prabhash Ranjan and Pushkar Anand, 'The 2016 Model Indian Bilateral Investment Treaty: A Critical Deconstruction' (2017) 38(1) Northwestern Journal of International Law & Business 1.

those that relate to abuse of process and denial of benefits. Finally, Section V sets out the conclusion.

II. The Model BIT Tilts the Balance in Favour of the Host State

Though the 2016 Indian Model BIT is not per se applicable, it forms the basis for India's renegotiation of existing BITs. It is therefore important that investors understand the various provisions of the Model BIT to manage expectations regarding the substance and scope of investment protections that will be available under future BITs to which India will be a party.

The first significant change under the Model BIT is to the definition of 'investment' which has been amended to reflect an 'enterprise-based' approach,[8] as opposed to an 'asset-based' one (as was the case previously). The effect is that: (i) only an enterprise that is legally constituted in India can bring a BIT claim[9]; and (ii) the enterprise must satisfy certain characteristics of investment (such as commitment of capital and other resources, certain duration, expectation of gain and profit, etc.) to avail protection. The new definition is not only narrow[10] but also vague as to the actual meaning of the various "characteristics".[11] This inevitably leaves interpretation open to arbitral discretion, which is bound to create uncertainty at the jurisdictional level, i.e.,on the question of *what* type of investments will receive protection.

The 2016 Indian Model BIT has also reduced the substantive protections for investors. For example, the draft does not make a provision for Most Favoured Nation ('**MFN**'), Fair and Equitable Treatment ('**FET**') or an umbrella clause which are common features of many BITs globally. The

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[8] *See*, 2016 Indian Model BIT, art 1.4: "'Investment' *means an enterprise constituted, organized and operated in good faith by an investor in accordance with the law of the Party in whose territory the investment is made, taken together with the assets of the enterprise, has the characteristics of an investment such as the commitment of capital or other resources, certain duration, the expectation of gain or profit, the assumption of risk and a significance for the development of the Party in whose territory the investment is made….*"

[9] 2016 Indian Model BIT, art 1.3: "Enterprise *means: (i) any legal entity constituted, organized and operated in compliance with the law of a Party, including any company, corporation, limited liability partnership or a joint venture; and (ii) a branch of any such entity established in the territory of a Party in accordance with its law and carrying out business activities there.*"

[10] *See*, Ranjan and Anand (n 7) 20.

[11] For instance, it is not clear as to whether the characteristics of investment are to be satisfied just by the enterprise or its assets. If the former is true, then it may be easier to fall under the definition of investment. Similarly, it is not clear as to how long an enterprise should be in existence to satisfy the "*certain duration*" test.

absence of FET is particularly troubling for investors, since this is the legal standard that is most often invoked by investors asserting investment treaty claims.[12]

A third significant change introduced by the 2016 Indian Model BIT is the requirement that foreign investors pursue local remedies for a period of at least five years before commencing international arbitration.[13] Though not novel, introducing an "exhaustion of local remedies" requirement is highly unusual and is likely to be of particular concern in the context of India, which is ranked number 163 in Ease of Doing Business against the benchmark of "Enforcing Contracts" by World Bank. It currently takes 1,445 days to resolve a contractual dispute in India,[14] with the backlog of cases estimated to increase to around 5 crores by 2022.[15] The requirement to exhaust local remedies can be avoided if an investor can demonstrate that there are "*no available domestic legal remedies capable of reasonably providing any relief in respect of the same measure*".[16] The burden of proof however to demonstrate an absence of legal remedies will likely fall on the investor and may not be easy to satisfy.[17]

A combined and holistic reading of the Model BIT has led various authors and commentators to conclude that the Model BIT offers limited protections to foreign investors, is pro-state and grants significant discretion to arbitral tribunals.[18] This will also be a concern for Indian investors seeking to protect their overseas assets, which will, of course, be similarly limited by the terms of India's new BITs.

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[12] *See*, UNCTAD, *Fair and Equitable Treatment* (UNCTAD Series on Issues in International Investment Agreements II, 2012) 10 <https://unctad.org/system/files/official-document/unctaddiaeia2011d5_en.pdf> accessed 9 October 2021.

[13] 2016 Indian Model BIT, art 15.2.

[14] World Bank, 'Doing Business - Enforcing Contracts' <www.doingbusiness.org/en/data/exploretopics/enforcing-contracts> accessed 9 October 2021. The Index measures "*the time and cost for resolving a commercial dispute through a local first-instance court, and the quality of judicial processes index, evaluating whether each economy has adopted a series of good practices that promote quality and efficiency in the court system*."

[15] Shailesh Gandhi, 'India's huge backlog of court cases is a disgrace – but Covid-19 has provided solutions' (*Scroll.in*, 28 June 2021) <https://scroll.in/article/998458/indias-huge-backlog-of-court-cases-is-a-disgrace-but-covid-19-has-provided-solutions> accessed 9 October 2021.

[16] 2016 Indian Model BIT, art 15.1.

[17] *See*, Ranjan and Anand (n 7) 53:

> "*...barring some of the provisions like FPS and MTPs, the Model BIT has not been able to reconcile the interests of foreign investors with host state's right to regulate. The Model BIT contains a narrow definition of investment, an extremely narrow FET-type provision, excludes MFN clause, and taxation measures from the purview of the BIT. Furthermore, the expropriation provision in the Model BIT blurs the line between lawful and unlawful expropriation, it provides for a NPM provision without a chapeau, and contains a complicated and sequential ISDS.*"

[18] ibid 50-51.

III. The Need to Protect Existing and Future Investments

The Indian Government's pro-investment approach has contributed to increased investments in the country. Covid-19 saw a general decrease in investment in both developed and developing economies.[19] In contrast, India saw an increase in FDI inflow, making it the fifth largest recipient in the world.[20] The trend in FDI outflows do not mimic this trend, but India still ranks among the top twenty economies in the world in terms of the volume of FDI outflow.[21] The figures speak for themselves, as summarised below.[22]

Foreign Direct Investment	2018	2019	2020
FDI Inward Flow (million USD)	42,156	50,558	64,062
FDI Outward Flow (million USD)	11,447	13,144	11,560

Following the adoption of India's 2016 Model BIT, India has terminated the majority of its investment treaties. In fact, only seven BITs and four free trade agreements ('**FTA**') with investment protections are in force today - BITs with the United Arab Emirates ('**UAE**'), Lithuania, Latvia, Bangladesh, Senegal, Libya, and Philippines (discussed further below), and FTAs with Singapore, Malaysia, Korea, and Japan.[23] Of these, only Singapore and the UAE are among the top ten recipients of direct investment from India. The others rank low-starting from 24th (Philippines) to 163rd (Latvia).[24] The below table sets out the top ten countries investing in India, their share of inflow, and the status of the relevant BIT.[25]

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[19] UNCTAD, *World Investment Report 2021* (UNCTAD/WIR/2021) 4-5 <https://unctad.org/system/files/official-document/wir2021_en.pdf> accessed 9 October 2021.

[20] ibid 5.

[21] ibid 7.

[22] UNCTAD, 'General Profile: India' (*UNCTAD Stat*) <https://unctadstat.unctad.org/CountryProfile/GeneralProfile/en-GB/356/index.html> accessed 9 October 2021.

[23] These Free Trade Agreements include the India-Malaysia FTA (2011); India-Japan EPA (2011); India-South Korea CEPA (2009); India-Singapore CECA (2005). *See*, UNCTAD Investment Policy Hub, 'International Investment Agreements Navigator – India' <https://investmentpolicy.unctad.org/international-investment-agreements/countries/96/india> accessed 9 October 2021.

[24] Department of Economic Affairs, Ministry of Finance, Government of India, 'Overseas Direct Investment Data from April 2000 to August 2021' (August 2021) <https://dea.gov.in/sites/default/files/ODI%20factsheet%20August%202021.pdf> accessed 9 October 2021.

[25] Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India, 'Fact Sheet on Foreign Direct Investment (FDI) from April,

Rank	Country	% of total inflows (in terms of USD) (April, 00- June, 21)	Status of Investment Protection Treaty
1	Mauritius	27.71 %	BIT Terminated
2	Singapore	21.64 %	India-Singapore CECA 2005 in force
3	United States	8.32%	-
4	Netherlands	6.90%	BIT Terminated
5	Japan	6.58 %	India-Japan EPA 2011 in force
6	United Kingdom	5.59 %	BIT Terminated
7	Germany	2.41 %	BIT Terminated
8	Cayman Islands	2.13%	-
9	UAE	2.08%	BIT In force
10	Cyprus	2.05%	BIT Terminated

Similarly, the table below sets out the top ten recipients of investments from India, their share of outflow and the status of the relevant BIT.[26]

Rank	Country	% of total outflows (in terms of USD) (April, 00- August, 21)	Status of Investment Protection Treaty
1	Singapore	20%	India-Singapore CECA 2005 in force
2	Mauritius	15.2%	BIT Terminated
3	United States	10.6%	-
4	Netherlands	8.6%	BIT Terminated
5	United Kingdom	6.3%	BIT Terminated
6	UAE	4.4%	BIT in force
7	Channel Island	4.2%	-
8	British Virgin Islands	3.2%	-
9	Russia	3.0%	BIT Terminated
10	Cyprus	2.6%	BIT Terminated

2000 to June, 2021' (June 2021) <https://dpiit.gov.in/sites/default/files/FDI_Factsheet_June2021.pdf> accessed 9 October 2021.

[26] Department of Economic Affairs (n 24).

India never entered into a BIT with the United States ('**US**') and terminated its BITs with Cyprus, Mauritius, Netherlands, Russia and the United Kingdom ('**UK**') after the publication of the 2016 Indian Model BIT. While it was possible to extend the application of the India-UK BIT to the Channel Islands/BVI,[27] it appears that this never took place.[28]

The termination of India's BITs raises two questions: (i) what protections are available to existing investments; and (ii) how do investors protect future investments. We address these questions below.

A. Investments Made Prior to the Termination of BITs

Investments made before the date of termination will generally continue to be protected for a certain period under the 'sunset' provisions of the respective BITs. We have reviewed India's BITs with the UK,[29] Mauritius,[30] Netherlands,[31] and Germany[32]–each of these provide the comfort of sunset provision to investors.

The protections available under the sunset provision varies across BITs, especially in terms of the time, duration and the scope. For instance, the protection afforded under the sunset provision of the India-Mauritius BIT is 10 years from the date of termination or any longer period that is agreed in the relevant investment contract. The protection also extends to investments approved (and not yet made) before the date of termination. On the other hand, India's BITs with the UK, Netherlands, and Germany, extend protection to investments for a period of 15 years from the date of termination.[33]

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[27] The United Kingdom is responsible for the international relations of the Channel Islands and BVI and the India-UK BIT could be extended to these territories through an Exchange of Notes pursuant to Article 13 of the BIT.

[28] Deepa Somasunderam, 'Do companies registered in British Overseas Territories and Crown Dependencies have adequate investment protection?' (*Thomson Reuters Practical Law Arbitration Blog*, 26 July 2018) <http://arbitrationblog.practicallaw.com/do-companies-registered-in-british-overseas-territories-and-crown-dependencies-have-adequate-investment-protection/> accessed 9 October 2021.

[29] Agreement between the Government of the Republic of India and the Government of the United Kingdom of Great Britain and Northern Ireland for the Promotion and Protection of Investments ('**India-United Kingdom BIT**') (14 March 1994), art 15.

[30] Agreement between the Government of the Republic of India and the Government of the Republic of Mauritius for the Promotion and Protection of Investments ('**India-Mauritius BIT**') (4th September 1998),art 13.

[31] Agreement between the Government of the Republic of India and the Government of the Kingdom of the Netherlands for the Promotion and Protection of Investments ('**India-Netherlands BIT**') (6 November 1995),art 16.

[32] Agreement between the Federal Republic of Germany and the Republic of India for the Promotion and Protection of Investments ('**India-Germany BIT**') (10 July 1995), art 15.

[33] India-United Kingdom BIT, art 15; India-Netherlands BIT, art 16; India-Germany BIT, art 15.

Investors must analyse the terms of the applicable BIT to ascertain the precise protection available for past investments.

B. Investments Made After the Termination of BITs

Future investments made in countries/from countries with which India has terminated its BIT will not benefit from the protection under the 'sunset' provisions. If India does not re-negotiate its terminated BITs before the expiry of the protection under sunset provisions, investments made prior to termination will be unprotected.

One way to safeguard investments is to restructure them. Investment protections available under a BIT or FTA are extended on the basis of an investor's nationality.[34] In principle, therefore, Indian investors investing abroad or foreign investors investing in India can alter nationality of their investment through a 'corporate restructuring', i.e., by incorporating companies/subsidiaries/third vehicle in specific jurisdictions to benefit from more favourable conditions (in this case, robust investment protections with the host state).

The first step in such corporate restructuring is to review the existing investment treaties entered into by the host state and select the one that offers the best protection.

From the investor's perspective, the treaty should ideally include: (i) protection against expropriation, including payment of prompt, adequate, and effective compensation (which is found in almost all BITs); (ii) FET provision (which as noted above is the most often invoked and most often successful cause of action); (iii) MFN provision; (iv) full protection and security; (v) umbrella clause; and (vi) right to bring international arbitration proceedings against the host state for the breach of any protections afforded by the BIT and without undue restrictions on such rights (including the requirement to exhaust local remedies or excessive 'cooling off' periods).

We are conscious that each investment is different and that it is not always possible for a specific BIT to contain all the substantive protections listed above. The focus should, therefore, be on identifying a treaty that is most satisfactory when it comes to protecting the investment in question. Of the substantive protections, for example, non-expropriation and FET are key. An investor may be prepared to forego the protections referred to at (iii)-(v) above if the BIT is otherwise strong and depending on the perceived risks

[34] Investment Protections are based on the principle that it extends to investors who are nationals of a contracting state other than the host state in which the investment is made.

associated with the particular investment. For example, if the investor has not entered into a contract with the state, "umbrella clause" protection is unlikely to be important.

Any restructuring will inevitably require consideration of the Indian BITs that are currently in force. This is particularly true for inbound investments, which necessarily rely on India's BITs. To take a simple example, if an investor from the UK seeks to make an investment in India in the year 2022, it has two main options. First, such investor may choose to proceed by investing into India directly. This is a risky approach, because the India-UK BIT was terminated in 2017[35] and so the investment will not benefit from treaty protection. The second option is to route the investment through a country with which India has a BIT in place. The below table summarises the BITs that India currently has in place along with the protections available under each of them.[36]

BIT Party	**Substantive Protections**					**Procedural Rights**		
	FET	**Expropriation**	**FPS**	**MFN**	**Umbrella Clause**	**Cooling-off period**	**Local courts**	**Arbitration**
Bangladesh	Yes	Yes	No	Yes	No	6 months	Yes	Yes
Latvia	Yes	Yes	No	Yes	No	6 months	Yes	Yes
Libya	Yes	Yes	No	Yes	No	6 months	Yes	Yes
Lithuania	Yes	Yes	Yes	Yes	No	6 months	Yes	Yes
Philippines	Yes	Yes	No	Yes	No	6 months	Yes	Yes
Senegal	Yes	Yes	Yes	Yes	No	6 months	Yes	Yes
UAE	Yes	Yes	Yes	Yes	No	6 months	Yes	Yes

[35] Kavaljit Singh and Burghard Ilge, 'India overhauls its investment treaty regime' *Financial Times* (15 July 2016) <www.ft.com/content/53bd355c-8203-34af-9c27-7bf990a447dc> accessed 9 October 2021.

[36] Krystal Lee, Khyati Raniwala, and Shimantika Mandal, 'India' (*GAR Insight*, August 2020) 3 <https://files.lbr.cloud/public/2020-10/ITA_2020_India-Oct_22.pdf?cM6lxfT-kuFc8jsp1r_1LkbPwaqgQ9DRL=> accessed 9 October 2021.

By way of example, to be eligible to claim protection under the BITs with Bangladesh[37] and Lithuania,[38] mere incorporation of a corporate entity will not be sufficient. Such entity must also carry out "*substantial business activities*" in the territory of the contracting party to meet the definition of 'investor'. Under the India-Lithuania BIT, the absence of substantial business activities may be a basis for denying benefits under the Treaty (referred to as a 'denial of benefits' clause).[39] While the India-Bangladesh BIT does not include a denial of benefits clause, it lists minimum characteristics of an investment, which includes the requirement that the investment is of "*significance*" for development of the contracting party receiving the investment.[40] Similarly, the India-Philippines BIT requires a company to be "*actually doing business under the laws…of that Contracting Party.*"[41] Inbound investors

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[37] Joint Interpretative Notes on the Agreement between the Government of the Republic of India and the Government of the People's Republic of Bangladesh for the Promotion and Protection of Investments ('**Joint Interpretative Notes**') <https://dea.gov.in/sites/default/files/Signed%20Copy%20of%20JIN.pdf> accessed 9 October 2021: "*Note on definition of "investor" – Article 1 (c) –*

1. For greater certainty regarding the definition of an "investor":

a) the term "company" referred to in Article 1 (c) of this Agreement means only a company, corporation, firm or association of a Contracting Party that is incorporated or constituted or otherwise duly established pursuant to the laws and regulations of that Contracting Party, and that has its seat in that Contracting Party and is engaged in substantial business activities in the territory of that Contracting Party."

The Joint Interpretative Note further states that:

""Substantial business activities" do not include activities such as (a) strategies/arrangements, the main purpose or one of the main purposes of which is to avoid tax liabilities, (b) the passive holding of stock, securities, land, or other property; or (c) the ownership or leasing of real or personal property used in a trade or business, unless the owner or lessor performs significant services with respect to the operation and management of the property."

[38] Agreement between the Government of the Republic of India and the Government of the Republic of Lithuania for the Promotion and Protection of Investments ('**India-Lithuania BIT**') (31 March 2011), art 2(ii): "*An 'entity' means in particular, though not exclusively, a company, an enterprise, a corporation or association incorporated or constituted in accordance with the laws of that Contracting Party and engaged in substantial business activities in the territory of that Contracting Party*".

[39] India-Lithuania BIT, art 12.

[40] Joint Interpretative Notes (n 37):

"Note on definition of definition of "investment" – Article 1(b) –

In accordance with Article 1 (b), the minimum characteristics of an "investment" are (a) the lasting contribution of capital or other resources; (b) the expectation of gain or profit; (c) the assumption of risk by the investor; and (d) significance for development of the Contracting Party receiving the investment."

See also, Footnote 2:

"Interests or assets that do not typically possess the characteristics of "investments" include portfolio investments, claims to payment resulting from a sale of goods or services by an individual or entity in one Contracting Party to an individual or entity in the other, or an order or judgment sought or entered in a judicial, administrative, or arbitral action."

[41] Agreement between the Government of the Republic of India and the Government of the Republic of the Philippines for the Promotion and Protection of Investment

should, therefore, carefully assess if the commercial realities of the proposed corporate restructuring will satisfy the definitions of "investor" and "investment" under the chosen BIT.

Similarly, an Indian investor seeking to invest in Mauritius in 2022 has atleast two options. It may choose to invest directly into Mauritius, which would leave it without treaty protection given the termination of India-Mauritius BIT. The other option is for an Indian investor to invest in Mauritius via a third country that has a BIT in place with Mauritius. If the client may want make further investments in other jurisdictions, it may be strategically useful to opt for a country that has extensive BITs in place so that those investments are more likely to be protected without the need for the incorporation of further entities. The below table lists the countries with the most BITs.

Serial Number	**Country**	**Number of BITs**
1	Germany	119 (117 in force)
2	Switzerland	112 (111 in force)
3	China	124 (107 in force)
4	United Kingdom	101 (90 in force)
5	Republic of Korea	94 (89 in force)

Most German and Korean BITs define investments broadly to include "*every kind of asset*".[42] A limited number of German BITs also explicitly include assets controlled indirectly, i.e., invested by an investor of one contracting party through a company that is fully or partially owned by the investor and having its seat in the territory of the other contracting party.[43] A majority of German, UK, and South Korean BITs offer high quality of protections including FET, umbrella clause, and MFN.[44] An overwhelming

('**India-Philippines BIT**') (28 January 2000), art 1(3).

[42] Susanne Schwalb, Vincent Voerster, and Vladslav Kury lko, 'Investment Treaty Arbitration: Germany' (*Global Arbitration Review*) <https://globalarbitrationreview.com/insight/know-how/investment-treaty-arbitration/report/germany> accessed 9 October 2021; Hongjoong Kim, Woojae Kim, and Hannah Kim, 'Investment Treaty Arbitration: South Korea' (*Global Arbitration Review*) <https://globalarbitrationreview.com/insight/know-how/investment-treaty-arbitration/report/south-korea> accessed 9 October 2021.

[43] Schwalb, Voerster, and Kurylko (n 42) 8.

[44] ibid; Kim, Kim, and Kim (n 42); Audley Sheppard and Christina Cathey Schuetz, 'Investment Treaty Arbitration: United Kingdom – England &Wales'*(Global Arbitration Review*) <https://globalarbitrationreview.com/insight/know-how/investment-treaty-arbitration/report/united-kingdom> accessed 9 October 2021.

majority of South Korean BITs also include the "full protection and security" standard.

Traditionally, Netherlands has also been a good option as it has BITs in place with a number of countries and most of its BITs offer quality protections. It can also be an advantageous jurisdiction from a tax perspective. However, the status of certain of Netherland's treaties is expected to change in light of the new Dutch Model BIT published in March, 2019 ('**2019 Dutch Model BIT**'), which is more restrictive from an investor's perspective.[45] A further difficulty, as regards investments within the European Union ('**EU**') comes from the decisions of the European Court of Justice in Achmea[46] and Komstroy[47] to the effect that intra-EU investment arbitration under BITs and the Energy Charter Treaty are incompatible with EU law. Indeed, following the Achmea ruling and pursuant to the Agreement for the Termination of the Bilateral Investment Treaties between Member States of the European Union of May 2020 ('**Termination Agreement**'), 23 EU Member-States chose to terminate all intra-EU BITs and sunset clauses in Appendix A of the Termination Agreement.[48] For investments in the EU, Indian investors should therefore ensure that their investment is structured through a non-EU Member-State.

The general discussion above is subject to the proviso that the actual restructuring in most cases will require careful consideration based on the nature of the investment and the text of the available BITs. There are a number of options available to an investor when it comes to restructuring investments. One option is to insert an intermediate company in the ownership structure that is, in turn, eligible for protection under the intended host state's investment treaties (BITs/FTAs/MTAs). This could be a newly incorporated entity or an already existing entity within the ownership structure. Alternatively, investors may assign investments to an entity within the ownership structure that has access to treaty protection.

In all cases, investors will need to be careful that any re-organisation or restructuring meets the threshold jurisdictional requirements under the relevant investment treaty, including any requirement that an investment be held

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[45] Albert Marsman and others, 'Investment Treaty Arbitration: Netherlands' (*Global Arbitration Review*) <https://globalarbitrationreview.com/insight/know-how/investment-treaty-arbitration/report/netherlands> accessed 9 October 2021.

[46] *Slovak Republic v Achmea BV* (6 March 2018) Case C-284/16 (Court of Justice of the European Union – Grand Chamber).

[47] *Republic of Moldova v Komstroy LLC* (2 September 2021) Case C-741/19 (Court of Justice of the European Union – Grand Chamber).

[48] Agreement for the termination of Bilateral Investment Treaties Between the Member States of the European Union.

'directly' by an investor or that it has its main office or substantial activities in the state in which it is incorporated, and is not characterised as "illegitimate". This is discussed in the section below.

IV. Challenges to Restructuring of Investments

As a starting principle, there is an overwhelming consensus that investment structuring is lawful and consistent with the purposes of investment treaties and the ICSID Convention.[49] This extends to restructuring existing investments in order to obtain investment treaty protection in circumstances where the dispute, which may be the subject of a claim, has not yet arisen.[50] However, corporate restructuring to access treaty protection may be subject to challenge in certain circumstances including for alleged abuse of process and under denial of benefits clauses.[51]

A. Abuse of Process

Abuse of process has emerged as a common defence in investor-state disputes where the claimant has undertaken some form of corporate re-organisation or restructuring prior to commencing the claim. At the core of this defence is the principle that "*the purpose of international protection is to protect legal and bona-fide investments*"[52] and to prevent "*abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs*".[53] The threshold for finding abusive initiation of an investment claim is high.[54] However, if successfully established, this defence is

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[49] *See*, for instance, *Aguas del Tunari SA v Republic of Bolivia* (2005), ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, [330(d)]: "*It is not uncommon in practice and—absent a particular limitation—not illegal to locate one's operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability…*"

See also, *Tidewater Inc and others v The Bolivarian Republic of Venezuela* (2013), ICSID Case No. ARB/10/5, Decision on Jurisdiction, [184]: "*It is a perfectly legitimate goal and no abuse of an investment protection treaty regime, for an investor to seek to protect itself from the general risk of future disputes with a host State in this way.*"

[50] *Venezuela Holding BV (case formerly known as Mobil Corporation, Venezuela Holding BV) v Bolivarian Republic of Venezuela* (2021), ICSID Case No. ARB/07/27, Decision on Jurisdiction, [204].

[51] These challenges are not exhaustive.

[52] *Phoenix Action Ltd v The Czech Republic* (2009), ICSID Case No. ARB/06/5, Award, [100].

[53] ibid [144].

[54] *Philip Morris Asia Limited v The Commonwealth of Australia* (2015), UNCITRAL, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility, [539].

sufficient to bar a claim in entirety as it goes to the question of jurisdiction or admissibility of the dispute.

The test to determine abuse has seen varying formulations. An analysis of leading decisions on the issue indicates the importance of purpose[55] and timing[56] of investment in assessment of the legitimacy of the restructuring. In order to determine whether a particular investment deserves protection, the Tribunal will usually take into account the entire series of facts surrounding such investment.

Phoenix v. *Czech Republic* was one of the first awards to dismiss a claim based on abuse of process. In this case, a former Czech national created a company under Israeli law (Phoenix Action) and caused it to acquire interest in two Czech companies that were involved in ongoing disputes in Czech Republic. Two months after the acquisition, Phoenix Action initiated a claim under the Israel-Czech Republic BIT. The Tribunal assessed the timing of the investment, the timing of the claim, the substance of the transaction, and the true nature of operation. Based on the evidence, the Tribunal was convinced that the investment amounted to abuse of process as it was made "*for the sole purpose of bringing international litigation against Czech Republic*".[57]

While the *Phoenix* decision is notable for its emphasis on the motive behind a re-organisation, such determination may not be straightforward. Often restructuring occurs as a part of a broader process with multiple considerations, such as that in *Philip Morris* where the claimant argued that "*one relevant and compelling reason motivating the restructuring was the need to*

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[55] *See*, ibid [536]:

> *"The case law indicates that an abuse of right can be found where a corporate restructuring is motivated wholly or partly by a desire to gain access to treaty protection in order to bring a claim in respect of a specific dispute that, at the time of the restructuring, exists or is foreseeable. In these circumstances, the restructuring is intended to create an unfair advantage for the foreign investor because the investor has no intention of performing any economic activity in the host State."*

[56] *See*, *Tidewater Inc and others v The Bolivarian Republic of Venezuela* (2015), ICSID Case No. ARB/10/5, Decision on Jurisdiction, [145]-[146], [184]:

> *"At the heart, therefore, of this issue is a question of fact as to the nature of the dispute between the parties, and a question of timing as to when the dispute that is the subject of the present proceedings arose or could reasonably have been foreseen. If the Claimants' contentions are found to be correct as a matter of fact, then, in the view of the Tribunal, no question of abuse of treaty can arise. On the other hand, if the Respondent's submissions on the course of events are correct, then there may be a real question of abuse of treaty…But the same is not the case in relation to pre-existing disputes between the specific investor and the State. Thus, the critical issue remains one of fact: was there such a pre-existing dispute?"*

[57] *Phoenix Action Ltd* (n 52) [142], [143]: "*The abuse here could be called a 'détournement de procédure', consisting in the Claimant's creation of a legal fiction in order to gain access to an international arbitration procedure to which it was not entitled…the whole "investment" was an artificial transaction to gain access to ICSID*".

align ownership with the Claimant's pre-existing management control of its subsidiaries, thereby creating a 'better, leaner, clearer structure' and that the 'restructuring helped to minimize tax liabilities'".[58] The Tribunal, however, was not convinced. The lack of contemporaneous evidence explaining the business case for restructuring in detail was considered significant.

Perhaps in order to sidestep the subjectivity and evidential challenges associated with a 'dominant purpose' test, the leading formulation of the abuse of process test has developed to centre on the question of the foreseeability of a dispute. In *Pac Rim*, the Tribunal found that the Claimant had changed its seat of incorporation from Cayman Islands to the US for the principal purpose of gaining access to the investment protections and rights under the Central American Free Trade Agreement ('**CAFTA**').[59] Emphasising the timing of the investment, the Tribunal held that the dividing line is when the relevant party can see an actual dispute or can foresee a specific future dispute as a very high probability and not merely as a possible controversy.[60] A dispute is foreseeable when there is a reasonable prospect that a measure that may give rise to a treaty claim will materialise.[61] This approach also may include significant "grey area".[62] The *Pac Rim* Tribunal eventually dismissed the abuse of process objection on the basis that the restructuring had been undertaken before the dispute had become a "high probability".

Timing of investment was again emphasised in *Mobil* v. *Venezuela*. Mobil was a corporation registered in the US holding investments in Venezuela. Pursuant to a series of tax amendments by the Venezuelan Government, Mobil restructured its investments by inserting a Dutch entity in the ownership structure. Subsequently, the Venezuelan Government nationalised Mobil's investment which led to claims under Venezuelan investment law and the Dutch-Venezuela BIT. The Mobil tribunal held that that restructuring investments to protect against breaches of their rights by the Venezuelan authorities by gaining access to the ICSID convention was a perfectly legitimate goal, as far as it concerned future disputes.[63] However, to accept such restructuring as a way to avoid pre-existing disputes would constitute an abusive manipulation of international law.[64]

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[58] *Philip Morris* (n 54) [574]-[576].
[59] *Pac Rim Cayman LLC v Republic of El Salvador* (2016), ICSID Case No. ARB/09/12, Decision on Respondent's Jurisdictional Objections, [2.41].
[60] ibid [2.99].
[61] *Philip Morris* (n 54) [585].
[62] *Pac Rim Cayman LLC* (n 59) [2.99].
[63] *Venezuela Holding BV* (n 50) [204].
[64] ibid 205.

B. Denial of Benefits

Investors must also evaluate whether the specific BIT under which protection is sought through restructuring has a 'Denial of Benefits' clause.[65] The exact formulation of the clause varies depending on the treaty, but these clauses typically subject the state's right to deny benefits to two conditions: (i) ownership and control of the company to whom the benefits are being denied; (ii) whether the company has substantial business activity.[66] Such provisions can be found, for example, in Article 6.9 of the India-Singapore CECA and Article 10.17 of the India-South Korea Comprehensive Economic Partnership Agreement.[67] The relevant clause in the India-Singapore CECA entitles a party to deny the benefits of investment protection provisions under the treaty to investors if "*the enterprise has no substantial business activities in the territory of the other Party*".

The meaning of "substantial" was considered in *AMTO* v. *Ukraine*, where the Tribunal held that substantial means "*of substance*" and "*not of form*". The substance of a transaction should be determined by reference to the "*materiality not the magnitude of the business activity*".[68] This can work in favour of investors seeking to incorporate enterprises that are lean on resources but high on volume of activity. In *Pac Rim*, the Tribunal further held that the requirement to have substantial business "*relates not to the collective activities of a group of companies, but to activities attributable to the 'enterprise' itself*". In this case, the claimant was "*not a traditional holding company actively holding shares in subsidiaries but more akin to a shell company with no geographical location for its nominal, passive, limited and insubstantial activities*".[69] The change in nationality of the company

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[65] By way of example, *see*, 2016 Indian Model BIT, art 35B:

> *"A Party may at any time, including after the institution of arbitration proceedings in accordance with Chapter IV of this Treaty, deny the benefits of this Treaty to:*
> *(i) an investment or investor owned or controlled, directly or indirectly, by persons of a non-Party or of the denying Party; or*
> *(ii) an investment or investor that has been established or restructured with the primary purpose of gaining access to the dispute resolution mechanisms provided in this Treaty."*

[66] Yas Banifetami, 'Taking into Account Control under Denial of Benefits Clauses' in Yas Banifatemi (ed), *Jurisdiction in Investment Treaty Arbitration* (IAI Series on International Arbitration No 8, IAI 2018).

[67] Comprehensive Economic Partnership Agreement between India and South Korea (India-South Korea) (7 August 2009).

[68] *Limited Liability Company Amto v Ukraine* (2008), SCC Case No. 080/2005, Final Award, [69]. In this case the Tribunal was satisfied that the Claimant had substantial business in Latvia "*on the basis of its investment related activities conducted from premises in Latvia, and involving the employment of a small but permanent staff*".

[69] *Pac Rim* (n 59) [4.75].

therefore did not have any material effect on its business activities, which were insubstantial to begin with.[70]

An enduring issue that plagues the operation of denial of benefit clauses is whether denial of benefits clause should have prospective or retrospective effect. The existing decisions fall under two broad camps.

At one end are cases interpreting the denial of benefits provisions under the Energy Charter Treaty ('**ECT**') which support the position that the host state cannot deny treaty benefits after a claim has been submitted to arbitration, as this would be tantamount to giving the clause retrospective effect.[71] At the other end are cases interpreting denial of benefit provisions under CAFTA-DR and the US BITs that support the position that host state may validly invoke the denial of benefits clause, after a claim has been submitted to arbitration, if this complies with the time limit set forth in the applicable procedural rules.[72] Whilst the reasoning of the Tribunals is not easy to

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[70] ibid [4.73].

[71] *Plama Consortium Ltd v Republic of Bulgaria* (2005), ICSID Case No. ARB/03/24, Decision on Jurisdiction, [162]:

> *"In the Tribunal's view, therefore, the object and purpose of the ECT suggest that the right's exercise should not have retrospective effect. A putative investor, properly informed and advised of the potential effect of Article 17(1), could adjust its plans accordingly prior to making its investment. If, however, the right's exercise had retrospective effect, the consequences for the investor would be serious. The investor could not plan in the "long term" for such an effect (if at all); and indeed, such an unexercised right could lure putative investors with legitimate expectations only to have those expectations made retrospectively false at a much later date. Moreover, in the present case, the Respondent asserts a retrospective effect from a very late date, even after the Claimant's Request for Arbitration and the accrual of the Claimant's causes of action under Part III ECT."*

Masdar Solar & Wind Cooperatief UA v Kingdom of Spain (2018), ICSID Case No. ARB/14/1, Award:

> *"A majority of the Tribunal accepts that submission. It considers that it would contradict the text and the purposes of the ECT to say that a Contracting State may deny benefits retrospectively, after an investment has been made and a dispute has arisen. That would be contrary to the transparency, co-operation and stability objectives of the ECT and it would lead to anomalous results. The majority notes that a majority of tribunals, which has considered this issue, has concluded that before disputes arise, a Contracting State must act, whether by adopting legislation denying benefits generally (or to a specific sector or sectors) or by promulgating measures directed at specific investors. That is both practical and consistent with the object and purpose of the ECT - co-operation, transparency and predictability."*

[72] *Ulysseas Inc v The Republic of Ecuador* (2012), UNCITRAL, Interim Award, [173]:

> *"A further question is whether the denial of advantages should apply only prospectively, as argued by Claimant, or may also have retrospective effects, as contended by Respondent. The Tribunal sees no valid reasons to exclude retrospective effects. In reply to Claimant's argument that this would cause uncertainties as to the legal relations under the BIT, it may be noted that since the possibility for the host State to exercise the right in question is known to the investor from the time when it made its the investment, it may be concluded that the protection afforded by the BIT is subject during the life of the investment to the possibility of a denial of the BIT's advantages by the host State."*

reconcile, the outcome will also depend of course on the language of the relevant treaty.

V. Conclusion

The widespread termination of India's BITs poses a challenge for Indian investors seeking to invest overseas and foreign investors seeking to invest in India from countries with which India has no BIT in force. One way of securing protection is by restructuring investments and obtaining protections under investment treaties of a third state. While corporate restructuring is legitimate, investors must pay close attention to the terms of the relevant treaty, including any requirement for investments to be made directly or for the investor to have significant activities in the state of incorporation (whether pursuant to the definition of 'investor' or by way of denial of benefits clause). Any restructuring needs to be conducted before a dispute becomes foreseeable to avoid the claim being struck out on the basis of abuse of process. Where the restructuring has other motives beyond merely obtaining access to investment treaty protections it would also be prudent to maintain detailed notes outlining the purpose of restructuring.

Guaracachi America Inc and Rurelec PLC v The Plurinational State of Bolivia (2014), UNCITRAL, PCA Case No. 2011-17, [376]:

"The Tribunal cannot agree with the Claimants when they argue that the Respondent is precluded from applying the denial of benefits clause retroactively. The very purpose of the denial of benefits is to give the Respondent the possibility of withdrawing the benefits granted under the BIT to investors who invoke those benefits. As such, it is proper that the denial is "activated" when the benefits are being claimed." At para. 378: "On the contrary, the Tribunal agrees that the denial can and usually will be used whenever an investor decides to invoke one of the benefits of the BIT. It will be on that occasion that the respondent State will analyse whether the objective conditions for the denial are met and, if so, decide on whether to exercise its right to deny the benefits contained in the BIT, up to the submission of its statement of defence."

Permissibility of Anti-Arbitration Injunctions in India and its Impact on commercial Business: A Step Towards Being an Arbitration-Friendly Jurisdiction?

Ravitej Chilumuri and Sameer Bindra***

The concept of 'anti-arbitration injunctions' has always been in muddy waters in India. In this paper, we try to give a complete overview of this concept and its impact on commercial transactions. The paper also aims to cover and address the Indian and English jurisprudence on anti-arbitration injunctions, along with instances of deviation. Finally, we shed light on the compatibility of the judicial approach on this issue with the legislative scheme, and some practical issues that may arise and impact commercial transactions.

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I. Introduction

Since India's first Arbitration Act was enforced in 1899, India has been viewed as having an archaic system of arbitration rules. However, during

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the last few years, a series of court decisions and legislative enactments and amendments have strengthened the country's pro-arbitration policy, bringing it closer to being a hub for both domestic and international arbitration. This article seeks to study and reconcile the emerging phenomenon of Anti-Arbitration Injunctions with the evolving pro-arbitration outlook of Indian policy and its impact on commercial business.

An anti-arbitration injunction ('**AAI**') is essentially an injunction order issued against a party and/or an arbitral tribunal, precluding the initiation or continuation of arbitration.[1] To put it simply, AAIs are passed by a court to stop an entity from arbitrating a dispute or continuing the arbitral proceedings. AAIs increase the risk of judicial intervention by stripping the tribunal of the power to determine its jurisdiction and have historically been used as a delaying and obstructionist tactic.[2] Other jurisdictions have also cautioned against the use of AAIs and allow such a remedy only in exceptional circumstances where the arbitration itself would be vexatious, oppressive, and unconscionable.[3] However, courts in India grant such remedies on a host of other grounds, including invalidity of the arbitration agreement and non-arbitrability of the subject matter.[4]

The phenomenon of AAIs, therefore, presents a conceptual conundrum for arbitration policy. On one hand, AAIs stand in contradiction to the foundational concept of '*kompetenz-kompetenz*'[5] and the legislative intent towards minimising judicial interference.[6] However, on the other hand, various jurisdictions regard the power of tribunals as non-exclusive, giving

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1 Sharad Bansal and Divyanshu Agarwal, 'Are Anti-Arbitration Injunctions A Malaise? An Analysis in the Context of Indian Law' (2015) 31(4) Arbitration International 613; Hakeem Seriki, *Injunctive Relief and International Arbitration* (Informa Law from Routledge 2015); Jennifer L Gorskie, 'US Courts and the Anti-Arbitration Injunction' (2012) 28(2) Arbitration International 295.

2 *See*, Gary Born, *International Commercial Arbitration* (3rdedn, Kluwer Law International 2021) 1349-422.

3 *Excalibur Ventures LLC v Texas Keystone Inc*[2011] 2 Lloyd's Rep 289; Nicholas Poon, 'The Use and Abuse of Anti-Arbitration Injunctions: A Way Forward for Singapore' (2013) 25 Singapore Academy Law Journal 244–95; Sairam Subramanian, 'Anti-arbitration injunctions and their compatibility with the New York convention and the Indian law of arbitration: future directions for Indian law and policy' (2018) 34(2) Arbitration International 185.

4 For instance, *see*, *Bina Modi v Lalit Modi* (2020) SCC Online Del 1678 (Delhi High Court); *Chatterjee Petrochem Co v Haldia Petrochemicals Ltd* (2014) 14 SCC 574 (Supreme Court of India).

5 UNCITRAL Arbitration Rules 2010, art 23; Emmanuel Gaillard, 'Reflections on the Use of Anti-Suit Injunction in International Arbitration' in Loukas Mistelis and Julian Lew (ed), *Pervasive Problems in International Arbitration* (Kluwer Law International 2006) 203–15.

6 As is evident from Arbitration and Conciliation (Amendment Act) 2015 and Arbitration and Conciliation (Amendment Act) 2021.

the courts scope of intervention in certain situations.[7] The issue of AAIs concern essential questions of court interference in arbitration proceedings by way of potentially obstructionist remedies.[8] In the Indian context, the question remains contentious owing to the lack of an authoritative ruling in this regard and the absence of an express provision authorising the grant of AAIs.

Therefore, it is important to study the concept of AAIs in India in juxtaposition to the legislative scheme of the Arbitration and Conciliation Act, 1996 (**'the Act'**). Further, evolving jurisprudence on AAIs must be analysed, with insights from other jurisdictions, to determine whether a harmonious approach to grant of AAIs exists in India. In this connection, this article will examine the current position of law with respect to AAIs in India while analysing the decisions of international arbitral bodies and the domestic practice in common law countries. For the same, Part II of this article shall deal with the common law jurisprudence on anti-arbitration injunctions; Part III shall cover the scheme of remedies and jurisprudence in terms of Indian law; and Part IV shall entail a discussion on the current best practices and improvements that can be brought under Indian law before concluding.

II. COMMON LAW JURISPRUDENCE ON AAIS

Under common law, the courts have adopted a reserved approach in the grant of an AAI. The non-interventionist approach of the courts with ongoing arbitration proceedings appears to be in line with the text of the domestic arbitration acts. For instance, under the English Arbitration Act, there is an express prohibition on judicial intervention, except in circumstances expressly laid down under the Act itself.[9] The limited scope of judicial intervention is visible in three particular instances: *firstly*, when the arbitration agreement is "*invalid, inoperative or incapable of being performed*";[10] *secondly*, a challenge to an award rendered under the English Arbitration Act on certain grounds;[11] and *thirdly*, when relief is sought by a party alleged to be a party but had taken no part in the proceedings.[12]

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7 *Dallah Real Estate and Tourism Holding Co v Ministry of Religious Affairs, Government of Pakistan*, [2010] UKSC 46; *North London Railway Co v Great Northern Railway Co* [1883] 11 QBD 30.

8 n (1).

9 Hakeem Seriki, 'Anti-Arbitration Injunctions and the English Courts: Judicial Intervention or Judicial Protection' (2013) 16(2) International Arbitration Law Review 43.

10 The Arbitration Act 1996, s1 (c) (United Kingdom).

11 The Arbitration Act 1996, s 67 (United Kingdom).

12 The Arbitration Act 1996, s 72 (United Kingdom).

Naturally, given the construct of the English Arbitration Act, the courts have shown a tendency to forbid the grant of injunction, except under exceptional circumstances.[13] The question of granting an injunction on account of concurrent proceedings before different forums has come before the English courts in various instances. They include concurrent proceedings before the court and arbitral tribunal as seen in *J. Jarvis & Sons Pty Ltd.* v. *Blue Circle Datford Estates Ltd*[14] as well as between two separate arbitral tribunals as seen in *Elektrim SA* v. *Vivendi Universal SA*.[15] In all such instances, the Court has taken recourse to the exceptional circumstances test to deny the grant of AAI.

The courts in Hong Kong have also usually refused to grant AAIs in concurrent proceedings before it, in favour of arbitration proceedings.[16] While doing so, the courts have acknowledged that Article 5 of the Model clause does not completely preclude the courts from granting anti-arbitration injunctions. However, in a similar vein to the English authorities, the court has held that the power must be exercised 'sparingly' and in 'exceptional circumstances'.[17] Moreover, AAIs should not be granted in instances where the arbitral tribunal has refused a challenge to its jurisdictions.

As stated, there is no complete restraint on the grant of AAIs; the courts do tend to grant such injunctions when the continuance of the proceedings is evidently *oppressive* and *vexatious*. In the English Court of Appeal decision in *Minister of Finance (Inc) and Malaysian Development Berhad* v. *International Petroleum Investment Coy*,[18] a deed entered into between the parties contained a clause for reference of any dispute between them to arbitration. Accordingly, a London-seated arbitration between the parties culminated in a consent award. The Claimant before the Court sought to set aside this consent award on the ground that the same was obtained by way of fraud or in a way that was contrary to public policy. The Respondent, in response to this challenge, initiated a second arbitration claiming that certain events of defaults had occurred under the settlement deed. This also included the challenge to the consent award by the Claimant as the parties had waived their right to challenge a consent award on grounds of jurisdiction or for any other reason through the settlement deed. The Claimant sought an AAI against the second arbitration proceedings. The Court granted the same on

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[13] Subramanian (n 2) 185 – 217.
[14] [2007] EWHC 1262 (TCC).
[15] [2007] EWHC 571 (Comm).
[16] *SA v KB* [2011] HKCFI 2029 (Hong Kong Court of First Instance); *Lin Ming v Chen Shu Quan* [2012] HKFCI 328 (Hong Kong Court of First Instance).
[17] Subramanian (n 2) 185 – 217.
[18] [2019] EWCA Civ 2080.

the grounds that the Respondent's action to hinder the supervisory jurisdiction of the Court was vexatious.

Notably, the aforementioned decisions were given in domestic arbitrations. Unlike the uniform stance taken for domestic arbitrations, the grant of AAIs in foreign-seated arbitration has seen some variance. The English Court, in *Excalibur Ventures LLC* v. *Texas Keystone Inc*,[19] had to determine a jurisdictional issue in the proceedings initiated before it, being also the subject of proceedings in a New York-seated arbitration. The Court passed an injunction order against the foreign arbitral proceedings with one of the key considerations being the convenience of the parties since the Defendants had no connection with the jurisdiction. Thus, the Court, *inter alia,* applied the doctrine of *forum non-conveniens* to grant an injunction, departing from the limited grounds of 'exceptional circumstances' and continuance of proceedings being 'oppressive and vexatious' as the English courts had previously restricted themselves to in cases of domestic arbitrations. A similar stance was taken by the Court in some other instances.[20]

This trend has however seen a reversal in recent times, with the English courts following the jurisprudence similar to that of domestic arbitration. An instance of it can be seen in *Sabbagh* v. *Khoury*[21] wherein the dispute was between the daughter (Claimant before the English Court) and sons (Claimant before an arbitral tribunal seated in Lebanon) of a deceased businessman. The daughter sought an AAI. The sons argued against it on the ground that the Court could grant the same only if and when England was a natural forum relying on the *Excalibur* case. The Court rejected the argument on the reasoning that the said approach is followed in anti-suit injunctions to prevent any interference with other country's sovereign jurisdiction and the same logic cannot be extended to anti-arbitration injunctions, where no interference with a foreign court is permissible during the continuation of arbitral proceedings.

Even on questions pertaining to validity/non-existence of an arbitration agreement, which have not been subject to prior determination by the Court, the courts should refrain from granting injunctions and defer the matter to the tribunal to decide upon its jurisdictions based upon the principle of *kompetenz-kompetenz*.[22]

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[19] [2011] EWHC 1624 (Comm).

[20] *Internet FZCO v Ansol Ltd* [2007] EWHC 266 (Comm); *Golden Ocean Group Ltd v Humpuss Intermoda Transportasi Tbk Ltd* [2013] EWHC 1240 (Comm).

[21] [2019] EWCA Civ 1219.

[22] ibid 111.

The Canadian Court[23] granted an AAI wherein parallel proceedings were initiated before the local court and a foreign arbitral tribunal upon two primary grounds: (1) the contract contacting the arbitration clause contained an exclusive jurisdiction clause mentioning Ontario; and (2) the parties were participating before the court proceedings in Ontario. The Court considered these factors as amounting to a waiver on part of the parties to conduct arbitration before the foreign forum.

A cumulative reading of the aforementioned authorities leads to a deduction that the courts following common law have largely maintained the least-interventionist approach with respect to ongoing arbitration proceedings, following a similar course in respect of domestic as well as foreign-seated arbitration.

A holistic reading of all the instances cited above show the pro-arbitration stance adopted in most common law precedents. Barring a few exceptions, the courts have always been cautious in granting AAIs given the essence of their arbitration regimes and international obligation, all of which advocate for minimum intervention by the courts in a matter subject to arbitration proceedings. Accordingly, the courts have only granted AAIs in exceptional circumstances namely – the existence of any prior court ruling holding the arbitration agreement/clause as invalid or non-existent; continuance of proceedings being oppressive or vexatious; or waiver of the right to arbitrate by mutual consent or conduct of the parties.

III. Scheme of Remedies under the Act

Through a range of judicial decisions and legislative enactments subsequent to the Law Commission's Report issued in August 2014, Indian arbitration law has undergone numerous pro-arbitration reforms.[24] Modelled on the internationally accepted standards laid down in the UNCITRAL Model Law,[25] the Act stands on the core principle of *'kompetenz-kompetenz'* and grants power to the arbitral tribunal to determine its own jurisdictional competence, including any objections with respect to the existence/validity of the arbitration agreement itself.[26] As it currently stands, the Act not only confers unfettered jurisdiction to the arbitral tribunal to grant interim reliefs

[23] *Dent Wizard International Corp v Brazeau* (1998) 78 OTC 286.

[24] Suvrajyoti Gupta, 'Injunction Raj: Whether Anti-arbitration Injunctions are a Threat to International Arbitrations in India' (2012) International Arbitration Law Review 1.

[25] SR Subramanian, 'BITs and Pieces in International Investment Law: Enforcement of Investment Treaty Awards in the Non-ICSID States: The Case of India' (2013) 14(1) Journal of World Investment & Trade 198.

[26] The Arbitration and Conciliation Act 1996, s 16.

after the commencement of arbitration proceedings,[27] it also minimises the scope of judicial interference at the reference stage to a *prima facie* view.[28] Furthermore, the Specific Relief Act, 1963, which confers upon civil courts' power to grant injunctive remedies, also puts an embargo on such reliefs in cases where equally efficacious relief can be obtained.[29]

In light of this scheme of statutory remedies pertaining to arbitration, the concept of AAIs raises peculiar questions about the efficacy and practical implications of such a remedy and to what extent is it permissible under the law. While courts in India have granted AAIs on primarily *four* grounds analysed herein, it is argued that an "*equally efficacious relief*" can be obtained under provisions of the Act itself, rather than taking recourse to remedies putting a bar to arbitration itself.

IV. Indian Jurisprudence on AAIs and Instances of Deviation

A. Grounds for Granting AAIs

Parties have approached Courts in India to grant AAIs primarily on limited grounds (detailed hereinafter). Out of these four grounds, the Calcutta High Court, in *The Board of Trustees of Port of Kolkata* v. *Louis Dreyfus Armatures SAS*,[30] has recognized the courts to authority grant AAI on three grounds which are as follows:

1. Where an issue is raised as to whether there is any valid arbitration agreement between the parties and the court finds that no agreement exists.
2. Where the arbitration agreement is null and void, inoperative, or incapable of being performed.
3. Where continuation of foreign arbitration proceedings might be oppressive or vexatious or unconscionable.

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[27] The Arbitration and Conciliation Act1996, s 17.
[28] The Arbitration and Conciliation Act 1996, s 11.
[29] The Specific Relief Act 1963, s 41.
[30] (2014) SCC Online Cal 17695 (Calcutta High Court).

1. *Validity of the Arbitration Agreement*

One of the most common grounds on which AAIs have been sought in India is: *firstly,* where the arbitration agreement itself is either invalid[31] or is null and void, inoperative or incapable of being performed, as under Section 45[32] of the Act.

In *Chatterjee Petrochem Co and another v. Haldia Petrochemicals Ltd*,[33] the issue before the Court was whether the agreement between the parties conferred exclusive jurisdiction upon the courts in Calcutta and, consequently, whether an AAI could be granted restraining the arbitration proceedings initiated at ICC, Paris. Relying on the decision in *SBP & Co*,[34] the Court observed that where the subject matter of the claim is covered by an arbitration agreement which is valid and enforceable, then the dispute ought to be resolved by arbitration. However, the Court observed that civil courts in India have the power to grant AAIs in foreign seated arbitrations on the grounds specified under Section 45 of the Act.

In a similar fashion, the Supreme Court, in *World Sport Group (Mauritius) Ltd* v. *MSM Satellite (Singapore) Pte Ltd*,[35] refused to grant AAI on the ground that the applicant did not fulfil the criteria laid down in Section 45. However, it observed that civil courts retained the power to grant AAIs in cases where the arbitration agreement is null and void, inoperative or incapable of being performed.

2. *Arbitrability of the Dispute*

Further, AAIs have been sought by parties and have also been granted where the dispute is not arbitrable. This question however is sometimes controversial as it essentially involves a jurisdictional tussle between the court and tribunal.

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[31] The Arbitration and Conciliation Act 1996, s 8.

[32] The Arbitration and Conciliation Act 1996, s 45:

> *"Power of judicial authority to refer parties to arbitration.—Notwithstanding anything contained in Part I or in the Code of Civil Procedure, 1908 (5 of 1908), a judicial authority, when seized of an action in a matter in respect of which the parties have made an agreement referred to in section 44, shall, at the request of one of the parties or any person claiming through or under him, refer the parties to arbitration, [unless it prima facie finds] that the said agreement is null and void, inoperative or incapable of being performed."*

[33] *Chatterjee Petrochem Co v Haldia Petrochemicals Ltd* (2014) 14 SCC 574 (Supreme Court of India).

[34] *SBP & Co v Patel Engineering Ltd* (2005) 8 SCC 618 (Supreme Court of India).

[35] (2014) 11 SCC 639 (Supreme Court of India).

In 2001, the Supreme Court, in *Kvaerner Cementation India Ltd. v. Bajranglal Agarwal &Anr*,[36] declined to grant an AAI based on the ground that the tribunal has the power to decide on its own jurisdictional competence. However, consequent decisions of the Supreme Court have taken contradictory views. In *SBP & Co* v. *Patel Engineering Limited*,[37] the Court held that an arbitral tribunal does not have an absolute right to decide on its own jurisdiction. Civil courts retain jurisdiction to grant injunctions under Section 9 of the Code of Civil Procedure, 1908 ('**CPC**').

A recent and much-debated decision in this regard was delivered by the Delhi High Court in *Bina Modi & Ors*. v. *Lalit Modi & Ors*.[38] A single-judge bench, relying on the Supreme Court's decision in *Kvaerner*, held that civil courts in India lack the power to grant AAIs when the challenge is primarily on jurisdiction. It held, arguably in consonance with the scheme of the Act, that when the arbitral proceedings have already commenced, the parties have an equal and efficacious remedy under Section 16 of the Act where the arbitral tribunal can adjudicate and rule on its own jurisdiction and validity of the arbitration agreement. In such a scenario, Section 41(h) of the Specific Relief Act, 1963, bars courts from granting injunctions in cases where an equal and efficacious remedy could be obtained. However, the decision was overruled by a Division Bench[39] and an AAI was granted restraining the arbitral proceedings in Singapore. The Division Bench disagreed with the ruling in *Kvaerner* and recognized that certain exceptions are carved out in Section 5 of the Act and that civil courts have the jurisdiction to dwell upon the arbitrability of disputes. Therefore, it is open for a civil court to consider questions of arbitrability in granting AAIs. Upon finding that the dispute itself was in-arbitrable, the Court proceeded to grant an AAI.

The courts in India, in the mentioned authorities, have granted AAIs on reaching a finding of non-arbitrability of the dispute. As mentioned above, under the common law jurisprudence, the ground of arbitrability of a dispute does not find explicit inclusion in the jurisprudence laid down for the grant of AAIs. The question pertaining to the arbitrability of a dispute is essentially a jurisdictional question, which is within the authority of the tribunal to decide based on the principle of *Kompetenz-Kompetenz*, as recognised under the Act.[40] Thus, essentially, the court in granting such injunctions is stepping in a space where the arbitral tribunal as a forum has adequate authority to provide remedial measures under the Act. Moreover, if any party is aggrieved

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[36] (2012) 5 SCC 214 (Supreme Court of India).
[37] *SBP & Co* (n 34).
[38] (2020) SCC Online Del 901 (Delhi High Court).
[39] (2020) SCC Online Del 1678 (Delhi High Court).
[40] The Arbitration and Conciliation Act, s 16.

by the finding reached by the tribunal in this regard, it even has the right to challenge the same before the appropriate forum. Hence, the court in doing so is disregarding its non-interventionist obligation under Section 5 of the Act and the bar on its jurisdiction under Section 41(h) of the Specific Relief Act, 1963 when an "equally efficacious" remedy is available before another forum.

3. *Competence of the Arbitrators*

Next, parties have also sought injunctions on the ground of the incompetence of arbitrators. For instance, in *Ravi Arya v. Palmview Investments Overseas*,[41] the central issue before the Bombay High Court was whether an AAI should be granted when an allegation is made regarding the improper constitution of the arbitral tribunal. The Court rightly found that where a remedy is available under the Act (Section 12), the Court cannot bypass its provisions and grant an AAI. This approach is similar to the common law approach.[42] The rationale was again based on the tribunal's authority to determine its own jurisdiction including ruling upon any challenge to its authority.

Although the Court has opined against the grant of AAI on the grounds of a tribunal's competence, this might not necessarily preclude the parties from bringing such claims before the court. The reason for the same is that post the 2016 amendment to the Arbitration Act; a dichotomy exists under Section 12 between the arbitrators against whose independence and ineligibility there is some justifiable doubt and those who are "ineligible" per se.[43] The decision in *Ravi Arya* falls under the former. In the case of the latter, the grant of AAI is not only a possibility but might happen in all likelihood. Against any person "ineligible" under Section 12(5) read with Schedule VII, the party can directly approach the court under Section 14(2)[44] for terminating the mandate of the arbitrator.

4. *Oppressive, Vexatious and Unconscionable Nature of the Arbitration Proceedings*

The final ground on which Courts have granted AAIs is that the continuance of the arbitration would be oppressive, vexatious, and unconscionable or an abuse of process. This ground is derived from the principles of AAIs in

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41 (2019) SCC Online Bom 251 (Bombay High Court).
42 Arbitration and Conciliation Act, 1996, s 12.
43 Arbitration and Conciliation Act, 1996, s 12(5).
44 Arbitration and Conciliation Act, 1996, s 14(2).

English Law, laid down in the case of *J Jarvis and Sons Ltd* v. *Blue Circle Dartford Estates Ltd*[45] and followed in subsequent decisions.[46] The Court in, *J Jarvis*, held that in order to grant an AAI, the Court must be satisfied that exceptional circumstances exist, where the continuance of the arbitration would be oppressive, vexatious, and unconscionable or there has been an abuse of process. Other English decisions have also discussed the aspect of "exceptional circumstances" while granting an AAI.[47] Courts in Malaysia[48] and Singapore[49] have also granted AAIs on such grounds, however, "very sparingly" and with abundant caution.

Similarly, the Delhi High Court, in *McDonald's India Private Limited* v. *Vikram Bakshi and Ors*[50] and *Himachal Sorang Power Pvt. Limited (HSPL)* v. *NCC Infrastructure Holdings Limited (NCCL)*,[51] recognised the principles laid down in *J Jarvis* and held that an AAI can only be granted in 'exceptional cases' where the holding of arbitration proceedings would be oppressive or unconscionable. For instance, where the issue is whether the parties have consented to the arbitration or where there is an allegation that the arbitration agreement itself is forged. In *McDonald's India*, it was specifically stated that, "*while courts in India may have the power to injunct arbitration proceedings, they must exercise that power rarely and only on principles analogous to those found in sections 8 and 45, as the case may be, of the 1996 Act.*"The principles which the Court was referring to were that the arbitration agreement was null and void on account of it being formed without free consent.

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45 [2007] EWHC 1262 (TCC).

46 *See also*, *Republic of Kazakhstan v Istil Group Inc(No 2)* [2008] 1 Lloyd's Rep 382; *Claxton Engineering Services Ltd v TXM Olaj-Es Gazkutato KFT* [2010] EWHC 2567 (Comm);*Nomihold Securities Inc v Mobile Telesystems Finance SA* [2011] EWHC 337 (Comm); *Golden Ocean Group Ltd v Humpuss Intermoda Transportasi TBK Ltd and Anr* [2013] EWHC 1240 (Comm).

47 Gupta (n 24).

48 The Federal Court of Malaysia decided that the test developed by *J Jarvis* would be applicable where an injunction application is sought by a party to an arbitration agreement. *See*, *Jaya Sudhir A/L Jayaram v Nautical Supreme Sdn Bhd* [2019] 5 MLJ 1 (Federal Court of Malaysia).

49 *See*, *Mitsui Engineering and Shipbuilding Co Ltd v Easton Graham Rush* [2004] SGHC 26 (High Court of Singapore); *Malini Ventura v Knight Capital Pte Ltd and others* [2015] SGHC 225 (High Court of Singapore); The High Court of Singapore refused AAIs on the grounds that for Arbitrations based on UNCITRAL Model Law, and where the Plaintiff sought an injunction on the ground that he did not enter into an arbitration agreement, however, could not prove the same an injunction must not be granted. The Court has thus left the door open for AAIs to be granted under Singapore law under more exceptional circumstances.

50 (2016) SCC Online Del 3949 (Delhi High Court).

51 (2019) SCC Online Del 7575 (Delhi High Court).

While such a position is consistent with wider common law and is cognisant of the exceptional and potentially obstructionist nature of AAIs, in general, Indian courts have gone beyond international principles to grant AAIs on other grounds, including in-arbitrability of the dispute and invalidity of the arbitration agreement. It may be arguable that granting AAI on these grounds is counterproductive because the entire purpose behind AAIs is to streamline the arbitration process and weed out cases which may eventually be set aside at the enforcement stage. However, by injuncting an arbitration proceeding on grounds that the Tribunal itself is competent to hear, the approach runs counter to the legislative intent of promoting arbitration.

B. Consonance of the Judicial Approach with the Legislative Scheme

On the grounds of incompetency of the arbitrator, the Court in *Ravi Arya* was right in holding that the remedies provided for under the Act cannot be by passed by granting an AAI. Similarly, the granting of AAI as an exceptional remedy, where the continuance of arbitration proceedings itself may be vexatious or oppressive, is in line with international precedent. However, granting of AAIs on the grounds on the remaining two grounds is contentious.

It must be observed that the court under Section 9 as well as the tribunal under Section 17 of the Act have been given the authority to grant interim reliefs in respect of an arbitration. This power is inclusive of the power to grant interim injunctions. While the arbitral tribunal can grant such reliefs pertaining to the subject matter of the disputes, the court's powers are not always limited to the subject matter of the dispute. Previously, courts[52] have held that an injunction sought is in the nature of equitable remedy that takes the form of a Court order and requires a party to do or refrain from doing particular activities under Section 151 of the CPC, thereby not limiting them only to the subject matter of the dispute. It is a court order that prohibits one of the parties to a suit in equity from doing or allowing people under his control to act in a manner unjust to the other party. Further, any relief granted by the court/tribunal under these provisions can be challenged before the court under Section 37 of the Act. Additionally, the Act is a self-contained code in relation to the provision of relief of injunction and provides adequate remedial measures to the party aggrieved by the grant or refusal of

[52] 'Inside Arbitration: ASIS to the Rescue Using Anti-Suit Injunctions to Protect an Arbitration Agreement' (*Herbert Smith Freehills*, 25 February 2021) <www.herbertsmithfreehills.com/latest-thinking/inside-arbitration-asis-to-the-rescue-using-anti-suit-injunctions-to-protect-an> accessed 9 September 2022; *GM Telephones, Hyderabad v Jeelal Jaiswal* (1988) 2 LS 46 (SC) (Supreme Court of India).

such injunction. Accordingly, the recourse to courts under the CPC is largely avoidable and unnecessary.

However, a common thread binding most of these decisions is the courts retaining the power to grant AAIs where the arbitration agreement is itself invalid or null and void, or where the dispute is in-arbitrable. However, such cases must be viewed in light of the distinction between pre-commencement and post-commencement stages in the arbitration. It is now a settled position of law that after the commencement of the arbitration proceedings, civil courts ought not to, except in exceptional cases,[53] impinge upon the tribunal's jurisdiction and exercise powers to grant interim measures under Section 9 of the Act. The sole authority to grant such interim relief remains with the tribunal in accordance with Section 17 of the Act. In such a situation, the grant of AAIs in the post-commencement stage not only presents a direct incongruity with the scheme of the Act but also raises questions about the efficacy of AAI.

Further, the decision delivered by the Division Bench in *Bina Modi* raises key issues about its compatibility with the scheme of the Act. It is arguable that the Single Judge, in recognising the presence of equal and efficacious remedy under Section 16 of the Act and the embargo in Section 41(h) of the Specific Relief Act, 1963, rightly reconciled the remedy of AAI with the legislative intent behind the Act. However, the Division Bench, in holding that AAI can be granted on the grounds of in-arbitrability, failed to consider the tribunal's jurisdiction to rule on questions of arbitrability.

C. Issues from a Practical Perspective

Given that anti-arbitration injunctions are court orders that expressly prohibit parties from commencing and/or continuing arbitration proceedings, it tends to elongate the arbitral process and restores parties to a position comparable to that of a suit/court proceeding.

From an international perspective, both the UNCITRAL Model Law 1985 and the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958, which form the basis for the Act, do not provide for an express provision authorising the grant of AAIs by courts.[54]

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[53] A detailed discussion on this aspect was done by the Supreme Court. *See*, *Arcelormittal Nippon Steel (India) Ltd v Essar Bulk Terminal Ltd* (2022) 1 SCC 712 (Supreme Court of India).

[54] Stephen Schwebel, 'Anti-Suit Injunctions in International Arbitration: An Overview' in Emmanuel Gaillard (ed), *Anti-Suit Injunctions in International Arbitration* (JurisNet LLC 2005); Bansal andAgarwal (n 1) 613.

Further, it is important to note that, Section 5 and Section 16 of the Act, indicate the Legislature's intention of upholding the gravitas and sanctity of the arbitral process and minimising the interference of civil courts.

While the grant of AAIs may be justified under certain scenarios as demonstrated in this article, the greater question that remains is whether the remedy in the nature of an AAI can only be granted by courts? There is a tendency amongst the parties to approach the courts for grant of an injunction under the CPC against the arbitration proceedings, with no regard to the seat of arbitration, on the grounds specified in this article above. This is despite the arbitral proceedings being made independent of the provisions under the CPC and the Indian Evidence Act.

The ambiguity, contradictions, and inconsistency in the parameters to be followed when granting or rejecting anti-arbitration injunctions in the Indian arbitral scenario comes in the way while framing a conclusive view.

However, Indian courts appear to agree on one point, i.e., the civil court's power to grant injunctions in anti-arbitration suits should be used sparingly. This is a much-required reprieve granted by Indian courts, tipping the scales in favour of arbitration. Popular opinion holds that a pro-arbitration stance in the Indian legal scenario is necessary, given that the civil and commercial courts of India are overburdened with cases. Prolonged adjudication of such anti-arbitration suits may defeat the purpose of the Act. Narrowing the scope of examination for civil court intervention in anti-arbitration injunction suits would go a long way toward resolving this issue and dilemma.

The article has touched upon the threat of overarching jurisdiction of the courts over the arbitral tribunal in grant of AAIs. The power of the court to grant an injunction under the CPC is much wider compared to the power of injunction provided to the courts under Section 9 of the Act or Section 17 to the arbitral tribunal. The acceptance of such application by the courts thus makes the scope of interfering with the arbitral proceedings much wider, which is not in consonance with the scheme of the Act. The effect of increased court intervention by way of grant of AAIs is also increasingly seen as a commonly used delay tactic. Thus, rethinking the approach to AAIs is imperative.

V. Conclusion

Although AAIs may be used as a weapon to disrupt and stall the Arbitral process, there may be some situations where an AAI may actually be justified.

For instance, the English courts' inculcation of the principles of common law justice and equity have prevented them from completely denouncing AAIs.

Since, the law of injunction in India derives its importance from English equitable principles/jurisprudence,[55] a civil dispute requiring preventative remedies may present itself in any form, and in awarding relief, courts/tribunals are guided by considerations of equity, justice, and good conscience. When equitable consideration demands and justifies it, there should be no hesitancy.[56] The jurisdiction to issue injunctions was thus affirmed and the remedy which is termed as the strong arm of the courts of equity has contributed a lot to consolidate the position of the judiciary in dispensing justice between the litigant parties.[57] The Indian approach to AAIs must be further brought in line with these common law principles. The power to exercise AAIs should be sparingly exercised and be granted only in exceptional circumstances – as specified in this article.

The advantage of using this alternative of giving a restrictive approach to the power of granting injunction has several advantageous effects. The same includes – the maintenance of sanctity of the arbitral process; upholding the authority of the arbitral tribunal; providing an efficacious and timely remedy without any unnecessary delays; and most importantly avoiding unwarranted intervention by the courts, which is what is one of the primary intents of the parties to pick arbitration as the preferred method of dispute resolution.

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[55] RRK Trivedi, 'Law of Injunctions' (1996) Judicial Training & Research Institute Journal 1.
[56] ibid.
[57] ibid.

A Word to the Wise: The Proper Role for the Committee of Creditors in Insolvency Resolution

*Aditya Shiralkar**

The commercial wisdom doctrine, albeit not problematic per se, may stifle the legislative object of the Code in the long run. In time, the doctrine as well as the broader approach to resolution must be consciously evolved to attain the economic object of the Code, to help IBC achieve its full potential, as per design. After tracing the inception and tracking the evolution of the commercial wisdom doctrine in Part I, I proceed to analyse the BLRC Report as well as IBC and the regulatory framework in a new light, in an attempt to ascertain the proper role of the Committee of Creditors in the process of approval of the resolution plan. Part III seeks to draw from the 'feasibility' analysis under the US Bankruptcy Code as a sound example of how deliberative and analytical the resolution process is needed to be. In Part IV, I try to reimagine the resolution process by proposing a more sustainable approach to resolution and a reworking of the 'commercial wisdom' doctrine in its present form.

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I. Introduction

Five years is a short span in the history of a legislation, far from sufficient to evaluate its effect. That the Insolvency and Bankruptcy Code, 2016 ('**IBC**') is a complex economic experiment[1] with diverse, competing objects certainly does not ease the burden.

The heart of this ambitious legislation is the insolvency resolution process, a mandatory, statutorily-guided framework aimed at reviving tottering companies. This process, in its essence, entails inviting bids for plans for resolution from market players and evaluating these plans in a transparent, collective process controlled by the financial creditors of the company. The plans, of course, provide for repayment of the debts consistent with the prescriptions of IBC as well as a roadmap for the future operations of the company.

The Parliament, in its wisdom, has conferred the power and authority of selection of the resolution plan on a Committee of Creditors, comprising of the financial creditors of the corporation ('**Committee**').[2] The approval of the plan by this Committee spells the first stage of a twin-stage approval process.[3] The plan thus approved is then sent to the Adjudicating Authority ('**Tribunal**') for the latter's approval.[4]

The resolution plan is treated as 'approved' only after the Tribunal accords its sanction. This twin approval has far-reaching consequences for those connected with the corporation, for the plan becomes binding on employees, members, creditors, guarantors, government agencies and all the stakeholders.[5]

This binding effect of the plan has received a radical interpretation in the form of the fresh slate doctrine, that states that no claim relating to the

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1. *Swiss Ribbons v Union of India* (2019) 4 SCC 17 [19], [120] (Supreme Court of India).
2. There are some mandatory requirements for effective participation. For instance, financial creditors related to the corporate debtor lack voting rights, but this does not apply to banks and financial institutions that gain related party status through enforcement of their rights: *see*, IBC, provisos to s 21(2).
3. IBC, s 30(4).
4. The Tribunal is empowered to reject the resolution plan too. Section 31(1) of IBC deals with approval; Section 31(2) with rejection.
5. IBC, s 31(1); *Committee of Creditors v Satish Kumar Gupta* (2020) 8 SCC 531 [105] – [107] (Supreme Court of India).

pre-approval phase can survive the resolution process, unless, of course, it is featured in the plan itself.[6] The fresh slate doctrine apart, the resolution plan is a revolutionary document *per se*, for the Committee has wide-ranging powers to interfere with existing contractual and legal rights of the stakeholders under the plan.[7] Even secured creditors and governments are not spared from its writ.

The structure of the legislation makes it apparent that the evaluation of the resolution plan under the twin-stage approval, that marks the culmination of the resolution process, is the key to the assessment of the working of the legislation. To put the point another way, the approval of the *right* resolution plan is a fundamental step to achieve the fundamental objects of IBC — the primary ones including resolution of insolvency of distressed firms and maximisation of asset value for their creditors.

At present, the twin approval process under the Code is regulated by what is known as the commercial wisdom doctrine. The doctrine, in its present manifestation, is a forbidding one. Its plain import is that, the merits of the resolution plan cannot be questioned by the Tribunal. The stated reason is that the Committee's decision is a product of its *commercial wisdom*, the phrase being shorthand for the experience and expertise in the fields of finance, economics, commerce, business administration and such related disciplines, assumed to be the domain of banks and financial institutions that constitute the Committee. The Tribunal simply does not have what it takes to second-guess the product of such wisdom, the doctrine assumes.

Appreciation of the techno-commercial aspects of resolution plans is a *sine qua non* for selecting the best resolution plan. These aspects, besides being inherently complex, require in-depth knowledge and experience in the realms of finance and economics, something that is second nature to financial creditors. Illustratively, revenue estimation, projected costs, debt-equity ratios, asset valuation, means of debt-servicing, are issues that would perplex the layman and the lawyer alike, whereas the commercial man has them for breakfast.

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6 *Ghanashyam Mishra & Sons v Edelweiss ARC* (2021) SCC Online SC 313 [95] (Supreme Court of India); *Jaypee Kensington v NBCC* (2021) SCC Online SC 253 [346], [349] (Supreme Court of India); *Committee of Creditors v Satish Kumar Gupta* (n 5).

7 The potential is apparent from Regulation 37 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ('**CIRP Regulations**'). Regulation 37, directory and open-ended, sets out several potential measures for insolvency resolution and asset value maximisation. One or more of these or such measures are usually adopted in resolution plans.

II. Role of the Committee of Creditors in Resolution and the Commercial Wisdom Doctrine

A. Advent of the Commercial Wisdom Doctrine

The commercial wisdom doctrine was propounded by the Supreme Court more than three years ago, in *K. Sashidhar* v. *Indian Overseas Bank*,[8] and has been since nurtured and elevated to the level of a first principle.

The Supreme Court's formulation of the commercial wisdom doctrine was based on the Bankruptcy Law Reforms Committee ('**BLRC**') Report ('**the Report**'),[9] which has been consistently treated by the Court as the *travaux prépara toires* and the source of guidance for interpreting the Code.[10] The Report restricts the role of the Tribunal to "process" issues, while the business decisions fall in the realm of the Committee of Creditors.[11] The first exposition of the commercial wisdom doctrine in *K. Sashidhar* treated the Committee's assessment of the technical and commercial aspects of the plan as non-justiciable.[12]

This doctrine was affirmed by a larger bench of the Supreme Court in *Committee of Creditors* v. *Satish Kumar Gupta*.[13] While the *K. Sashidhar* exposition could in effect completely foreclose an inquiry into the merits of the resolution plan, the Court's formulation in *Satish Kumar Gupta*[14] permitted a limited inquiry, to the extent of the validity of the decision-making process of the Committee:

> "*Thus, while the Adjudicating Authority cannot interfere on merits with the commercial decision taken by the Committee of Creditors, the limited judicial review available is to see that the Committee of Creditors has taken into account the fact that the corporate debtor needs to keep going as a going concern during the insolvency resolution process; that it needs to maximise the value of its assets; and that*

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8 (2019) 12 SCC 150 (Supreme Court of India).

9 TK Vishwanathan and others, 'Report of the Bankruptcy Law Reforms Committee' (November 2015) ('**BLRC Report**').

10 The BLRC Report has been extensively relied on by the Supreme Court for interpretive guidance in a host of critical rulings on the subject: *Innoventive Industries Ltd v ICICI Bank* (2018) 1 SCC 407 [12], [13] (Supreme Court of India); *K Sashidhar* (n 8)[54], [55], [62]; *Swiss Ribbons* (n 1) [14], [15], [68]; *Arcelormittal India (P) Ltd v Satish Kumar Gupta* (2019) 2 SCC 1 [68]–[70] (Supreme Court of India); *Mobilox Innovations (P) Ltd v Kirusa Software (P) Ltd* (2018) 1 SCC 353 [18]– [21] (Supreme Court of India); *Anuj Jain v Axis Bank* (2020) SCC Online SC 237 [108] (Supreme Court of India).

11 BLRC Report, paras 2, 3.4.2, 3.4.3, 4.2, 5, 5.3.1, 5.3.3, and 5.3.4.

12 *K. Sashidhar* (n 8) [52]–[55].

13 *Committee of Creditors* (n 5).

14 ibid [72], [73].

the interests of all stakeholders including operational creditors has been taken care of."

The commercial wisdom doctrine has been applied in several decisions since by the Supreme Court. In *Maharashtra Seamless Ltd.* v. *Padmanabhan Venkatesh*,[15] the doctrine was applied to uphold the decision of the Committee in approving a plan which released an asset of the company in favour of the resolution applicant at a value 20% less than its liquidation value, *inter alia*, on the ground that the said resolution applicant was infusing more funds to run the company as a going concern, and thus making up for the loss.[16]

Similarly, in *Karad Urban Coop. Bank Ltd.* v. *Swwapnil Bhingardevay*,[17] the Supreme Court refused to second-guess the Committee's evaluation of the feasibility and viability of the resolution plan on the basis that the record revealed that the snag in one aspect of the plan was within the knowledge of the Committee as well as the successful resolution applicant and yet they took a conscious and well-deliberated decision to proceed with the plan.

B. Commercial Wisdom vis-à-vis Legality: Issues under Section 31 of the Code

The nature of the Tribunal's jurisdiction in the second stage approval under Section 31 of the Code has varied with the character of the issue in question. The issues may be broadly classified as matters of *commercial wisdom* and issues relating to the *legality* of the plan.

Commercial wisdom matters are the ones that fall squarely within the technical expertise of the Committee, for example, the feasibility and viability of the resolution plan,[18] the elements of the evaluation matrix,[19] the distribution of amounts between the classes of creditors and the classification/differentiation amongst various creditors, the closing down of certain manufacturing units/undertakings belonging to the corporate debtor,[20] the opting for liquidation where no resolution plan is forthcoming, and the

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15 (2020) 11 SCC 467 [27] – [30] (Supreme Court of India).

16 The Supreme Court found no provision in IBC that would invalidate such a plan, there being no mandate in the IBC that the bid at resolution must match the liquidation value of assets.

17 (2020) 9 SCC 729 [14] – [18] (Supreme Court of India).

18 *Bhaskara Agro v Super Agri Seeds* (2018) SCC Online NCLAT 340 (National Company Law Appellate Tribunal).

19 *IMR Metallurgical Resources AG v Ferro Alloys Corp* (8th June 2020) Company Appeal (AT) (Insolvency) No 272 of 2020 [12] (National Company Law Appellate Tribunal).

20 *Santosh Walokar v Vijay Kumar V Iyer* (24th January 2020) Company Appeal (AT) (Insolvency) No 871-872 of 2019 [26] (National Company Law Appellate Tribunal).

liabilities far outweigh the assets,[21] the question as to whether the stalled operations of a corporate debtor can be successfully revived under the resolution plan.[22] Where commercial wisdom matters are involved, the Tribunal has no authority to re-determine the merits of the issue.

Where issues of legality are involved, for example, violation of the IBC norms and regulations, protection of third-party rights, breach of general law/regulations, the Tribunal exercises jurisdiction akin to a court of first instance, and can undertake a full review of the merits.[23] The prominent rulings on this point are –

1. *MCGM* v. *Abhilash Lal*[24]: under the approved resolution plan, the leasehold lands of the corporate debtor were dealt with and proposed to be commercially exploited without the consent of the landowner. The approval of the plan was held to be illegal and set aside.
2. *Committee of Creditors* v. *Satish Kumar Gupta*[25]:the provision of the resolution plan which sought to effectively extinguish the surety's liability in a unilateral manner, i.e., without the consent of the creditor, was held to be illegal and struck down.
3. *Jaypee Kensington* v. *NBCC*[26]: the Court struck down a term in the resolution plan that purported to extinguish contractual rights of a third party and directed said party to withdraw ongoing legal proceedings for enforcement.

These cases bring out the point that the need for a full review on issues of legality in resolution plans and its rule of law origins. Ensuring that the resolution process stays within the limits of the law is one of the foremost important duties of the Tribunal under Section 31 of IBC and a key justification for the second-stage barrier for approval.

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[21] *Praveen Kumar v. VSL Securities* (9th June 2020) Restoration Application No 01 of 2020 in Company Appeal (AT) (Insolvency) No 308 of 2020 (National Company Law Appellate Tribunal).

[22] *Sreeram E Techno School v. Beans and More Hospitality* (11th September 2019) Company Appeal (AT) (Insolvency) No 936 of 2019 [5] (National Company Law Appellate Tribunal).

[23] The source of this power can be traced to Section 30(2)(e) of IBC read with Section 31(1), which mandates the Tribunal to ensure that the resolution plan does not violate any law in force.

[24] (2019) SCC Online SC 1479 (Supreme Court of India).

[25] *Committee of Creditors* (n 5) [81] – [87].

[26] (2021) SCC Online SC 253 [277] – [279] (Supreme Court of India).

C. Recent Expansion of the Commercial Wisdom Doctrine

Read in this context, the ruling of the Supreme Court, *Kalpraj Dharamshi* v. *Kotak Investment Advisors Ltd*,[27] is unique. Here, the Supreme Court upheld the decision of the Committee in accepting the resolution plan of the successful resolution applicant submitted after the last date, that is, beyond the permissible limit under the applicable CIRP Regulations[28] (albeit before the expiry of timeline in IBC) on the ground, *inter alia,* that the decision was consciously approved by the Committee.

The plausibility of the grievance aside, it pertained to a 'process' issue, and therefore, the matter fell outside the proper scope of the commercial wisdom doctrine, and squarely within the realm of the Tribunal's inquiry into legality. Still, the Court upheld the approval citing the commercial wisdom doctrine. In similar vein, NCLAT upheld the approval of a resolution plan submitted after the deadline in the *Binani Cements* case. Besides the obvious deference to the unanimous approval accorded by the Committee of Creditors, the decision appears to be informed by the by the view that resolution of insolvency is a first order objective.[29]

However, a recent decision of the Apex Court in *Ngaitlang Dhar* v. *Panna Pragati Infrastructure*,[30] does recognise that a challenge to the Committee's approval of the plan, which is based on 'material irregularity' of procedure, may not be saved by an application of the commercial wisdom doctrine.

Close on the heels of the *Kalpraj* ruling[31] is another critical decision — *Jaypee Kensington* v. *NBCC*.[32] Here, the Supreme Court found that one vital aspect of the approved resolution plan had the effect of interfering with the contractual and legal rights of a third party, and was, therefore, contrary to law. Despite being a 'legality' issue the Supreme Court held that the proper course for the Tribunal was to send the plan back to the Committee

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27 (2021) 10 SCC 401 [171], [172] (Supreme Court of India).

28 CIRP Regulations.

29 *Binani Industries v Bank of Baroda* (2018) SCC Online NCLAT 521 (National Company Law Appellate Tribunal); this NCLAT ruling was upheld by the Supreme Court by a non-speaking order in *Rajputana Properties v Ultratech Cement* (2018) SCC Online SC 3596 (Supreme Court of India).

30 (2021) SCC Online SC 1276 [27] – [34] (Supreme Court of India). On facts, the Court found no "material irregularity" in the process and upheld the Committee's approval.

31 *Kalpraj Dharamshi* (n 27).

32 *Jaypee Kensington* (n 26) [143] – [147], [273] – [275].

of Creditors for re-submission after satisfying the parameters delineated by the Code and exposited by this Court.[33]

The recent cases reveal an expansion of the commercial wisdom doctrine in a sense. What were properly issues of 'legality' of the plan or the resolution process were dealt with by the Supreme Court as 'commercial wisdom' matters and the deference accorded by the Court to the Committee evinces a conflation of the issues that are fundamentally distinct by nature.

III. The Proper Role of the Committee of Creditors in the Approval Process: Deciphering the Legislative Intent

A. BLRC Report

The commercial wisdom doctrine precludes an inquiry by the Tribunal into the merits of the Committee's decision on the techno-commercial aspects of the resolution plan.[34] The position, as we have seen, is premised on the BLRC Report,[35] an authentic guide for the construction of the Code. To decipher the internal logic of IBC, it is necessary to appreciate the BLRC Report in a holistic manner, to examine its fundamental assumptions.

The Report has a set of expectations from the participants in the resolution process – the Resolution Professional, who acts as the administrator, coordinating the process, the Committee, which is the primary decision-maker, and the Tribunal, which accords the final approval to the plan, and these expectations are central to the design and working of the Code.

The working of IBC, as envisaged in the Report, carries a promise of intelligent decision-making on the part of all the participants. The primary step in this connection is the analysis of the causes of default. Here, the Report broadly recognises financial failure and business failure as two causes of insolvency. Financial failure is defined as "*a persistent mismatch between payments by the enterprise and receivables into the enterprise, even though*

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[33] This was, of course, not without good reason. The resolution plan of the behemoth was slated to benefit a wide range of interests, including innocent home buyers, and was thus crucial for the economy. The last set of decisions in this line, *viz. India Resurgence v Amit Metaliks* (2021) SCC Online SC 409 [12] – [21] and *Pratap Technocrats v Reliance Infratel Ltd (Monitoring Committee)* (2021) 10 SCC 623 [33] – [48], simply apply the commercial wisdom doctrine to issues such as distribution of payouts to diverse classes of creditors, issues that lie in the proper realm of the doctrine, and thus pose no problem.

[34] This is found in the classic formulation of the Supreme Court in *Committee of Creditors* (n 5).

[35] BLRC Report, paras 2, 3.4.2, 3.4.3, 4.2, 5, 5.3.1, 5.3.3, and 5.3.4.

the business model is generating revenues", while business failure is "*a breakdown in the business model of the enterprise, and it is unable to generate sufficient revenues to meet payments*." There may be a way out in the former case, but the latter is a dead end. A pure financial failure, as opposed to a business failure, may be addressed by debt restructuring and allied measures.

The expectation is that the Committee of Creditors will identify the type of failure during the resolution process -

> "*A sound bankruptcy process is one that helps creditors and debtors realise and agree on whether the entity is facing financial failure and business failure. This is important to allow both parties to realise the maximum value of the business in the insolvency.*"[36]

The problem that the Committee must identify and understand is, at its core, an economic one — whether the company or its business are viable, regard being had to the prevalent market and economic parameters. While acknowledging the difficulties in such assessments, the Report commends:

> "*…In an ideal environment, the assessment will be the outcome of a collective decision. Here, creditors and debtor will negotiate a potential new financial arrangement. Each of them will balance all available information, including all future possibilities of the economic environment under which the enterprise will operate, as well as all alternative investment opportunities available to the creditors as well as the debtor.*"[37]

The Committee is required to bear in mind that their ultimate decision should be one that maximises the economic value of the company in resolution.[38]

A given company may possess 'organisational capital', i.e., an intangible form of capital, measured holistically, which encompasses the business processes and practices that result from the following drivers — human capital, values and norms, and tacit knowledge.[39] The Report recognizes that, "*(A)*

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[36] BLRC Report, para 3.2.
[37] BLRC Report, para 3.2.1.
[38] BLRC Report, para 3.2.2.
[39] *See*, Baruch Lev, Suresh Radhakrishnan, and Peter C Evans, 'Organisational Capital: A CEO's Guide to Measuring and Managing Enterprise Intangibles' (The Center for Global Enterprise, January 2016) <www.thecge.net/app/uploads/2016/02/WEB-Capital-Investment-Feb22.pdf> accessed 28 November 2022; C. Meyer and others, 'Developing and Deploying Organizational Capital in Services vs. Manufacturing' (2014) 26(4) Journal of Managerial Issues 326.

cross a restructuring of liabilities, and in the hands of a new management team and a new set of owners, some of this organisational capital can be protected."[40]

The decision of approval by the Committee must obviously reflect its application of mind to these economic principles. This premise of the Report is reflected even in its choice of the constituents of the Committee, i.e., financial creditors:

> "*...(The Committee reasoned that) members of the creditors committee have to be creditors both with the capability to assess viability, as well as to be willing to modify terms of existing liabilities in negotiations*."[41]

The Report requires the Committee of Creditors to carry out a thorough and deliberative exercise in economic and techno-commercial analysis while approving resolution plans.[42] The Report recognizes that the final decision of the Committee of Creditors would be a "business decision",[43] in that the creditors would protect their self-interest. This position has been recognized by the Supreme Court in *Committee of Creditors* v. *Satish Kumar Gupta,*[44] where the Court expressly held that the Committee of Creditors does not act in a fiduciary capacity but takes a business decision based upon ground realities.

The Supreme Court's analysis on the point in *Anuj Jain* v. *Axis Bank*[45] reveals a different line of thought however. In the *Anuj Jain* ruling, while discussing the choice of financial creditors as Committee of Creditors to the exclusion of other categories, the Court found that in the scheme of IBC, a financial creditor is not expected to act *in terrorem* and ensure repayment, but it is expected to perform the *"unique parenting and nursing role*" as well, given that its stakes are intrinsically interwoven with the well-being of the company in resolution.[46]

In any view of the matter, the ultimate decision ought to be a product of techno-commercial and economic analysis and informed deliberation. Thus, the Committee should prefer a plan that seeks to maximise the economic value of the company for itself as well as for its creditors, and, at the same

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[40] BLRC Report, para 3.2.3.
[41] BLRC Report, para 5.3.1.
[42] BLRC Report, para 5.3.3.
[43] BLRC Report, para 2.
[44] *Committee of Creditors* (n 5) [146].
[45] *Anuj Jain* (n 10).
[46] *Anuj Jain* (n 10) [42.3].

time, gives the company a better chance of survival and success in the long run, other things being equal.

B. IBC and CIRP Regulations

The regulatory framework governing the resolution process — IBC read with the CIRP Regulations — stipulates that a resolution plan must possess the following features:

1. it must contain provisions for the implementation and supervision and adequate means for the same;
2. it must address the cause of default;
3. it must be feasible and viable; and
4. the resolution applicant must have the capability to implement the plan.[47]

These features relate to the economic analysis of the problems and the solutions forming part of the resolution plan, which must be conducted by the Committee at the 'first stage' approval.

The Committee is expected to approve the plan *"after considering its feasibility and viability"*.[48] It is significant that the Committee is required to evaluate the plans as per the evaluation matrix, which gives the allocation of points for both quantitative and qualitative features of the plan; and then *record* its deliberations on the feasibility and viability of each resolution plan during the approval process.[49] As stated above, these technical matters require a significant understanding of business and its processes, which lies beyond the realm of law and the commercial wisdom doctrine is, in part, born out of the necessity to defer to decision-making informed by economic, commercial or financial expertise.

The Supreme Court has recognized the vitality of this deliberative process in *Vijay Kumar Jain* v. *Standard Chartered Bank*.[50] The Court held that each participant who attends the meetings of the Committee of Creditors must be given the necessary information and data to ensure effective participation. The ruling was premised on Regulation 38(3) of the CIRP Regulations. The Court held that even the former management of the company ought to be

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[47] Section 30(2)(d) and (f) read with Section 31(1) and its proviso of IBC read together with Regulation 38(2)(c) and 38(3) of CIRP Regulations.

[48] IBC, s 30(4).

[49] CIRP Regulations, r 39(3) read with IBC, s 30(4).

[50] (2019) 20 SCC 455 [12], [13], [15], [21] – [25] (Supreme Court of India).

given an opportunity of effective participation since,"*(It) is here that the erstwhile Directors can represent to the Committee of Creditors that the cause of default is not due to the erstwhile management, but due to other factors which may be beyond their control, which have led to non-payment of the debt.*"[51] This ruling demonstrates that the deliberative analysis on the techno-commercial aspects of the plan by the Committee must be an inclusive and interactive process.

IV. THE ANALYSIS OF 'FEASIBILITY' OF PLANS UNDER THE U.S. BANKRUPTCY CODE

Similar considerations are found in the reorganisation chapter in the United States Bankruptcy Code ('**Code**').[52] Section 1129 of the Code deals with the confirmation of reorganisation plan by the bankruptcy court confirmation being a mandatory requirement to give effect to the plan, as in the case of IBC. Section 1129(a)(11) of the Code requires the reorganisation plan to be a "feasible" one.[53]

The federal authorities have consistently held that the determination as to feasibility is required to be firmly rooted in predictions based on objective facts, as opposed to speculative or unrealistic projections.[54] An interesting set of rulings handed down by the Third Circuit serve to illustrate the requirement:

1. In *Re: American Capital Equipment LLC*,[55] the court refused confirmation on the 'feasibility' ground, since the only source of finding was proceeds from highly speculative litigation winnings.
2. In *Re: WR Grace & Co.*,[56] the court confirmed the plan, finding it to be 'feasible' on the basis of expert testimony, financial reports, estimates of future earning capacity, current economic conditions, capital structure and earning power. The court additionally found that the amount of USD 1.6 Billion in possible funding was an unrefuted

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[51] ibid [21].
The Court ultimately directed the Committee of Creditors in that case to conduct fresh deliberations after ensuring effective participation of all the stakeholders entitled to attend the meeting as per Section 24 of IBC *inter alia* (*see* Para 25 of the Judgment).

[52] Chapter 11, Title 11 of the Code.

[53] Section 1129(a)(11): "*Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.*"

[54] 9D Am. Jur. 2d Bankruptcy § 2884.

[55] 688 F.3d 145 (3rd Cir. 2012).

[56] 729 F.3d 332 (3rd Cir. 2013).

premise of the plan and there was a reasonable likelihood that the plan would provide for all claims.

3. In contrast, in *Re: Star Ambulance Service,* there were no financial projections given, no disclosure to demonstrate adequacy of capital structure, nothing to show earning power of the business post-reorganization. The bankruptcy court simply refused confirmation of the plan on the 'feasibility' count.[57]

The general factors for gauging 'feasibility' of reorganisation plans have been identified by courts,[58] which are as follows:

1. the sufficiency of the debtor company's capital structure;
2. the earning power of the business;
3. economic conditions;
4. the ability of the debtor company's management;
5. the probability that the same management will continue;
6. the value and marketability of the debtor company's assets;
7. the possible impact of a debtor company's ongoing civil litigation;[59]
8. the prospective availability of credit;
9. the financial ability of the prospective purchaser of the debtor company's asset;[60]
10. the availability of or provision for sufficient cash flows with the plan proponent to fund or maintain the operations and obligations under the plan.[61]

This brief survey of the American experience on feasibility analysis reveals how thorough and analytical a process the approval of resolution

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[57] *Re: Star Ambulance Service*, 540 B.R. 251 (Bankr. S.D. Tex. 2015).

[58] 9D Am. Jur. 2d Bankruptcy § 2885 and 2887. For a detailed analysis, *see*, R Williams (ed), *Confirmation of Plan of Reorganization by Business Entity under Section 1129 of Bankruptcy Code*, 94 Am. Jur. Proof of Facts 3d 1, § 38 (originally published in 2007; updated as on February 2022).

[59] For a particular application, see *Re: Paige*, 685 F.3d 1160 (10th Cir. 2012).

[60] For instance, historical financial projections and guarantees by a company having sound asset base and revenues would help establish feasibility on this count.

See: Re: Waterford Hotel, 497 B.R. 255 (Bankr. E.D. Mich. 2013).

[61] *Re: Settlers Housing Service*, 505 B.R. 483 (Bankr. N.D. Ill. 2014).

The cashflow may be established by showing proposed sales of assets could be accomplished and projections indicated that debtor company would have sufficient, if not excess, net cash to make repayments under the plan.

Re: 20 Bayard Views, 445 B.R. 83 (Bankr. E.D. N.Y. 2011).

plans should be. This is especially necessary at the level of the Committee of Creditors, who are accorded primacy in the decision-making by the Code. Feasibility is, of course, one of the parameters of the resolution plan and the Committee must bestow attention to the diverse commercial aspects before approving the resolution plan.

V. The Case for a Mature and Reimagined Resolution Process

Nascency of the norms, an embattled economic climate, and a propensity to expediency marks the current phase of IBC. The global havoc wreaked by the pandemic has not helped the economy. Given the circumstances, the practice of IBC has shown a leaning towards the quantitative aspects of resolution, the major concerns being maximisation of the number of resolutions, analysis of the quantum of pay-outs and manner of distribution, and of course, managing the timelines. Right from the Committee of Creditors to the Supreme Court of India, at all levels, the discourse on resolution has been largely limited to such issues. This is perfectly understandable and even expected in the first few years of such ambitious legislation.

The Code's tacit promise of intelligent, economic analysis of the insolvency problem, the most brilliant feature of the resolution process, is yet to be delivered. The charm and of course the test of legislation lies in its working. The current experience of the Code seldom focuses on the qualitative aspects of the resolution plan, such as causes of default, market conditions, economic viability, business model and administration issues, and the long-term survival and growth of the entity under resolution.

The study of IBC and CIRP Regulations in the context of the BLRC Report demonstrates that addressing these concerns is a part of the design of IBC. The primacy in decision-making conferred on the Committee is an integral feature of the Code, as interpreted by the Supreme Court in the 'commercial wisdom' doctrine. Sustainable working of this design requires that financial creditors must step up to their role as expert decision-makers, drawing on their knowledge and experience in the fields of finance and economics, commerce, and business administration.

Decisions of Committee in several cases might have been products of rigorous economic analysis, however, this position is tough to determine from the record. The Committees must articulate their reasons for the benefit of others, so that their decisions may be assessed to the extent permissible. The approval process must evolve and mature.

Ideally, the change should stem from within. If that does not transpire, then Tribunals and the Supreme Court must step in as drivers of maturity from without, bearing in mind that resolution imposes great sacrifices on a firm's stakeholders across the board.

The Court's constant refrain on the limits to judicial intervention in the resolution process is well-taken.[62] However, even the classic, oft-cited exposition of the commercial wisdom doctrine in *Committee of Creditors* v. *Satish Kumar Gupta*[63] is accommodative of pointed inquiries into the Committee's ratiocination. After all, the power accorded to the Committee is founded on certain assumptions by the Legislature: assumptions of probity, bonafides, and intelligence. The standard fare of checks and balances may become necessary if these assumptions are belied.

The Supreme Court has placed IBC in the class of experimental economic legislation.[64] The Code, for all its glory, is, at the end of a day, an experiment. It may not do to forget that IBC was preceded by another experiment, the Sick Industrial Companies (Special Provisions) Act, 1985, a legislation that was declared as a failure within eighteen years of its commencement (2003) and was effectively repealed after thirty years (2016) by IBC.[65] That failure is not a new experience in the history of economic laws, especially when it comes to redressing corporate insolvency, should serve as a constant reminder.

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[62] *Arun Kumar Jagatramka v Jindal Steel & Power Ltd* (2021) 7 SCC 474 [95] (Supreme Court of India); reaffirmed in *Vallal RCK v Siva Industries* (2022) SCC Online SC 717 [21], [27] (Supreme Court of India).

[63] *Committee of Creditors* (n 5) [72], [73].

[64] *Swiss Ribbons* (n 1) [17] – [24], [120]: relying on US Supreme Court decisions in *New State Ice Co v Liebmann* (1932) SCC Online US SC 63: 285 US 262 (1932); *Ferguson v C Skrupa* (1963) SCC Online US SC 71: 372 US 726 (1963); and the Supreme Court's own ruling in *RK Garg v Union of India* (1981) 4 SCC 675 (Supreme Court of India).

[65] *Madras Petrochem Ltd v BIFR* (2016) 4 SCC 1 [40] – [45] (Supreme Court of India).

Resolution of Commercial Disputes in India: A Review of the Commercial Courts, 2015

—Dr. Vijay Kumar Singh and Aratrika Deb***

*In the 188th Report on Proposals for Constitution of Hi-Tech Fast–Track Commercial Divisions in High Courts, the Law Commission had expressed concerns over the generalisations made by the courts in the United Kingdom ('U.K.') and the United States ('U.S.') with respect to litigation delays in India. The Commission felt that adequate structural changes needed to be brought to civil courts of the country in a way that they themselves are equipped to solve all high value commercial matters in a timely manner. This led to the very first wave of establishing 'commercial courts' or 'commercial divisions' in 2003, for disposing high value commercial matters on a fast-track basis. It focused on two major notions — definition of 'commercial dispute' and 'specified value' of a commercial dispute — as two prerequisites to developing an appropriate dispute resolution framework. After 2003, almost a decade later the Commercial Courts Act, 2015 ('**CCA 2015**') was enacted where Commercial Courts exclusively equipped to handle complex 'commercial disputes' were created by the government. This was done to tackle the problem of judicial delays in commercial dispute resolution and further to improve India's position on the World Bank's 'enforcement of contracts' indicator. It has been close to seven years since then and in this short span of time, these Commercial Courts have generated and kindled the interest of the Bar and Bench. The volume of cases that we have seen in these last years is a testament to the same. In the aforesaid context, the objective of the paper is to re-evaluate the utility of these commercial courts and commercial divisions and analyse the CCA, 2015. The paper aims to explore whether the 2015 Act has lived up to the intent of the legislation and its stakeholders or has just turned out to be an 'old wine in a new bottle'.*

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I. Introduction

In any modern democracy, establishment of a strong justice mechanism that provides transparent and objective recourse to all is a core value that is held all over the world. Therefore, legal and judicial reforms have been a consistent priority on the agendas of most countries regardless of their state of development. For a developing country like India, especially, having a strong justice system makes it look like an attractive destination for foreign investors who would be willing to access the Indian courts to resolve their disputes.[1]

Since the 1950s, the Law Commission of India has suggested various reforms in the machinery of justice, with a view to removing defects that engulf our justice system.[2] Till date, they have produced more than 256 reports (an average of just over four per year). These reforms were primarily suggested in three spheres — *firstly*, statutory legal reforms that aimed at doing away with the dysfunctional elements of legislation and bringing state intervention to a minimum; *secondly*, administrative law reforms for

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[1] United Nations Office on Drugs and Crime, *Resource Guide on Strengthening Judicial Integrity and Capacity* (2011) <www.unodc.org/documents/treaties/UNCAC/Publications/ResourceGuideonStrengtheningJudicialIntegrityandCapacity/11-85709_ebook.pdf> accessed 9 March 2022.

[2] Expert Committee on Legal Aid, *Processual Justice to the People* (Ministry of Law and Justice, Government of India 1973) <http://reports.mca.gov.in/Reports/15-Iyer%20committee%20report%20of%20the%20expert%20committee%20in%20legal%20aid,%201973.pdf> accessed 22 April 2022.

eliminating constraints to effective decision making, and finally, judicial reforms for faster dispute resolution and easier enforcement of contracts.[3]

In 1991, the economic policy of liberalisation, globalisation and privatisation turned out to be a complete game changer for the Indian economy and by an extension, for the justice system in the country.[4] The new economic policy opened the Indian market to international trade and investment and largely initiated privatisation.[5] Unfortunately, even after the adoption of the new economic policy, investors in the Indian market, particularly foreign investors, faced problems due to the poor state of the country's judicial infrastructure.[6] Our courts were overburdened with cases, lacked adequate number of judges, took a very long time to dispose of cases, and most importantly, judges lacked the expertise required to resolve a complex commercial dispute.[7] Thus, the Indian legal infrastructure needed reforms even before 1991; however, the cycle of reforms that started post 1991 gave it an additional trigger.[8]

About a decade later in 2003, the Law Commission in its 188th Report noted, for the very first time, that the number of disputes arising out of business and commerce have vastly increased post 1991.[9] It stated that these disputes which were mostly 'commercial' in nature needed to be specifically dealt by fast-track courts that are technologically equipped and have professionally competent and trained judges who can hear these commercial matters within designated timelines. In fact, the Law Commission specifically noted that one of the biggest reasons to create commercial courts was to prioritise these high value litigations over other pending matters. Having an effective commercial dispute resolution framework would not only make the Indian litigation environment look good to the world but also cater to

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3 Manoj Mate, 'Globalization, Rights, and Judicial Review in the Supreme Court of India' (2016) 25(3) Washington International Law Journal 643.

4 Bibek Debroy, 'Justice Delivery in India – A Snapshot of Problems and Reforms' (2008) ISAS Working Paper 47 <www.isas.nus.edu.sg/papers/47-justice-delivery-in-india-oco-a-snapshot-of-problems-and-reforms/> accessed 15 April 2022.

5 R Nagaraj, 'What Has Happened since 1991? Assessment of India's Economic Reforms' (1997) 32(44/45) Economic and Political Weekly 2869.

6 Puja Mehra, 'Looking back on the 1991 reforms in 2021' (*Observer Research Foundation*, 24 July 2021) <www.orfonline.org/expert-speak/looking-back-on-the-1991-reforms-in-2021/> accessed 15 April 2022.

7 Pratik Chaudhari and Anay Amin, 'India commercial courts: Saviour of the system' (*World Intellectual Property Review*, 24 September 2019) <www.worldipreview.com/contributed-article/india-commercial-courts-saviour-of-the-system> accessed 6 September 2022.

8 Uday Shankar and Saurabh Bindal, 'Policy Initiatives and the Role of Indian Judiciary' (*SCC Online Blog*, 19 May 2016) <www.scconline.com/blog/post/2016/05/19/policy-initiatives-and-the-role-of-indian-judiciary-initiatives-and-the-role-of-indian-judiciary/> accessed 6 September 2022.

9 ibid.

the needs of domestic businesses that are caught up in litigation for years.[10] If the commercial justice system is one that is fast and efficient, it would automatically create a welcoming business environment and boost the country's international economic relations; which essentially was one of the most important objectives of the 1991 policy.

Following the above line of thought, in the same report, the Law Commission put forward the Commercial Division of High Courts Bill, 2009 ('**the 2009 Bill**').[11] The Bill required State Governments to establish Commercial Divisions in High Courts of their respective states. This was the first legislative attempt to separately identify and categorise 'commercial disputes' and suggest that the country needed specialised courts dedicated to resolve these disputes. Although the 2009 Bill initially received opposition in the Rajya Sabha, a lot of deliberations and discussions led to the final enactment of CCA, 2015. The author has discussed the historical evolution of the same in Part III.

II. Concept of 'Commercial Disputes'

A. Theoretical Framework

The legislative debate on the scope of 'commercial disputes' is often anticipated by the academic debate on the scope of 'commercial law'. Jeremy Bentham had stated that property and state-made law are born and must die together.[12] Once we eliminate law from society, all property and the interests therein cease.[13] Back in those days, there must have been some form of a market system, where the property rights and the rules of exchange (contracts) were protected and enforced.[14] Commerce, as we all know, is an evolving process of interaction and reciprocity which is simultaneously facilitated by and leads to an evolving system of commercial law.[15] Several

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[10] 'New law minister Ashwani Kumar backs new benches for high-value cases' *The Economic Times* (New Delhi, 30 October 2012) <https://economictimes.indiatimes.com/news/politics-and-nation/new-law-minister-ashwani-kumar-backs-new-benches-for-high-value-cases/articleshow/17012614.cms?from=mdr> accessed 9 March 2022.

[11] The Commercial Division of High Courts Bill 2009.

[12] Dean Alfange Jr, 'Jeremy Bentham and the Codification of Law' (1969) 55(1) Cornell Law Review 58.

[13] HLA Hart, 'Bentham and the Demystification of the Law' (1973) 36 Modern Law Review 2.

[14] Jurgen Basedow, 'The State's Private Law and the Economy: Commercial Law as an Amalgam of Public and Private Rule-Making' (2008) 56(3) American Journal of Comparative Law 703.

[15] Bruce L Benson, 'The Spontaneous Evolution of Commercial Law' (1989) 55(3) Southern Economic Journal 644.

economists like Adam Smith and Carl Menger argue that commercial law as a sector developed largely due to the efforts of the merchant community that is entirely capable of creating and enforcing its own law.[16] They were of the view that the market systems have developed through a trial-and-error process, where institutional arrangements that performed more effectively prevailed over ones that were less effective.[17] Thus, customs and practices and traditions in the merchant community always played an important role in developing a legal order.[18] Just like the price system in a market economy, commercial law developed as a product of a deliberate design without the aid and interference of major coercive power of nation states.[19] Economists were of the belief that commercial law itself was analogous to the price system in that it facilitates interaction and makes exchange more efficient.[20]

Much before that, John Locke (1632–1704), while explaining the role of Rule of Law in development and nation–building stated that any modern state requires Rule of Law institutions — effective courts and commercial codes that can secure property rights and enforcement of contracts.[21]

Historically, we are used to looking at the division of law into two major branches — civil and criminal. But towards the nineteenth century, when we look at some of the western countries like Great Britain, Italy, and even some Scandinavian countries, we find that a part of civil law separated itself to grow up independently and form a distinct body of 'commercial law'.[22] In England, 'commercial law' was more popularly called 'lex moratoria' or the 'law of merchants'. It was perceived as an independent system of legal doctrine, akin in status to civil law and a form of immemorial custom which went on to be judicially noticed as a body of rules akin to mercantile

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[16] Bryan Druzin, 'Law Without the State: The Theory of High Engagement and the Emergence of Spontaneous Legal Order within Commercial Systems' (2010) 41(3) Georgetown Journal of International Law 559.

[17] United Nations Commission on International Trade Law ('**UNCITRAL**'), 'Uniform Commercial Law in the 21st Century: Proceedings of the Congress of the United Nations Commission on International Trade Law' (22 May 1992) A/CN.9/SER.D/1 <https://digitallibrary.un.org/record/207822> accessed 6 September 2022.

[18] Emily Kadens, 'The Myth of the Customary Law Merchant' (2012) 90(5) Texas Law Review 1153.

[19] Achim Hurrelmann and others, 'The Golden-Age Nation State and its Transformation: A Framework for Analysis' in Achim Hurrelmann and others (eds), *Transforming the Golden-Age Nation State* (Palgrave Macmillan 2007).

[20] Silvia Fazio, *The Harmonization of International Commercial Law* (Wolters Kluwer 2007).

[21] Lee Ward, 'Locke on Executive Power and Liberal Constitutionalism' (2005) 38(3) Canadian Journal of Political Science 719.

[22] Dennis Patterson, 'Taking Commercial Law Seriously: From Jurisprudence to Pedagogy' (1999) 74(2) Chicago-Kent Law Review 625.

practice.[23] Early modern Italian scholars like Benvenuto Stracca (1509–1578), Sigismundo Scaccia (1564–1634); Tractatus de commerciis et cambio, (1618), and Casaregis (1670–1737) for the first time, presented the body of commercial law and called it the 'law merchant'. Their theories were based on Romanist traditions and legal norms pertaining to commercial relations originating in the Middle Ages and profound knowledge of commercial and court practice. They argued that the subject of autonomy of commercial law is positioned between two extremes — commercial law can either be a 'special law' or 'exceptional law' in contrast to civil law. They chose to position it between these two extremes because 'commercial law' as a discipline did not have any separate jurisprudential foundation; at the same time, it was largely guided by unique practices and rules of the mercantile community that made it distinguishable from 'civil law'. If commercial law is an 'exceptional law' then it must possess an independent system of norms, rules, and endowed with principles that are contrary to or at least different from that of civil law. But, if we look at commercial law as a 'special law', then it means it encompasses within its ambit, provisions that are different from those of civil law but at the same time, integrated into it, the two being bound in their genesis and development to the doctrinal tradition and to the order of principles and norms normally associated with the latter.[24] Commercial law as a discipline did not have a very specific source in jurisprudence, rather it developed as a result of mercantile practice or commercial transactions. Norms and rules followed to swiftly dispose of such mercantile disputes, that suited the mercantile community or litigants slowly gave rise to the body of commercial law. Apart from efficient and timely resolution, commercial law did not possess any special system or principles which were different from those followed in ordinary civil courts at the time. Thus, commercial law can be at best called a special private law that is based on civil law principles and norms and linked to the civil law doctrine.[25]

For example, in the sixteenth century, in England, special courts called the borough and pie powder courts were established that dealt with disputes arising out of mercantile transactions.[26] Blackstone termed these as *"the lowest and at the same time the most expeditious court of justice known to the law of England"*.[27] These courts dealt with mercantile cases that largely

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[23] Enrique Lalaguna Dominguez, 'The Interaction of Civil Law and Commercial Law' (1982) 42(5) Louisiana Law Review 1629.

[24] Murray Raff, 'The importance of reforming civil law in formerly socialist legal systems' (2015) 1(1) International Comparative Jurisprudence 24.

[25] ibid.

[26] Roy Goode, Herbert Kronke, and Ewan McKendrick, *Transnational Commercial Law: Text, Cases, and Materials* (2nd edn, OUP 2015).

[27] 1 Bl Comm 287.

involved mercantile customs, which were questions of fact. In order to introduce rule of law into these mercantile courts, Lord Chief Justice, Lord Mansfield stated, *"In all mercantile transactions, the great object should be certainty: and therefore, it is of more consequence that a rule be certain…"*.[28] He also added that commercial usage needs to essentially be introduced into the main body of English Law without sacrificing its elasticity. Although these specialised courts were popular a little later till 1600s, the procedures followed in these courts weren't that much different from the procedure in other courts.[29] Sir John Baker in his article titled 'Law Merchant and the Common Law before 1700' stated, *"The medieval law merchant was not so much of a corpus of mercantile practice for commercial law as an expeditious procedure especially adapted for the needs of men who could not tarry for the common law"*.[30]

Roy Goode in his treatise on commercial law, examined whether commercial law should be distinguished as a separate discipline from general civil law. He observed that *"in those legal systems that treat commercial law separately from civil law, the character of the transaction may be determined subjectively by the status of the parties as carrying on a business… or objectively by reference to the type of transaction or activity…or by a combination of the two. Whatever the legal system involved, it is clear that commercial law and commercial transactions cannot be isolated as self-contained compartments of contract or of commercial law"*.[31] Goode further observed that historically, it has been very difficult if not impossible, to draft a code that applies exclusively to a civil or commercial transaction, and hence, the hair splitting is best avoided.[32] Even though 'commercial law' cannot be completely isolated from 'civil law', it is self-evident that the former comprises of rules and norms regulating 'commerce', which is why it was ideally called the law of merchants.[33]

Thus, if one wants to understand the scope of 'commercial law' it becomes imperative to define the term 'commerce'. In economics, man's efforts towards the production of wealth are divided into the extractive (which take raw materials from nature), manufacturing (which convert raw materials into objects of use), and distributive industries (which finally sells the product to

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[28] Rex Ahdar, 'Contract Doctrine, Predictability and the Nebulous Exception' (2014) 73(1) Cambridge Law Journal 39.

[29] Patterson (n 22).

[30] Stephen E Sachs, 'From St. Ives to Cyberspace: The Modern Distortion of the Medieval 'Law Merchant'' (2006) 21 American University International Law Review 686.

[31] Roy Goode, 'Rule, Practice, and Pragmatism in Transnational Commercial Law' (2005) 54(3) International and Comparatie Law Quarterly 539.

[32] ibid.

[33] Goode, Kronke, and McKendrick (n 26) 7-8.

the consumer).[34] The legal significance of the word 'commerce' is the comprehension of the last two industries — manufacturing and distributive. It is essentially the approximation of raw material to the consumer for a profit. The principles of law governing individuals engaged in manufacturing and distribution industries and their transactions are what comprise 'commercial law'. The disputes that arise in the sphere of 'commercial law' are 'commercial disputes'.[35]

III. 'Commercial Disputes' in India

India traditionally recognised two types of justice delivery systems — civil courts and criminal courts. The Civil Procedure Code, 1908[36] and the Criminal Procedure Code, 1973[37] clearly lay down the operation and hierarchy of these courts in our judicial system and usher light on the very specific distinction between 'civil' and 'criminal' disputes that our judicial system was designed to resolve. Before the 1991 economic policy that flooded the Indian market with a vast volume of commercial transactions, the need to have a separate forum as part of the country's court system, for handling commercial matters was never felt. Thus prior to 1991, 'commercial disputes' were treated at par with 'civil disputes' and handled by ordinary civil courts that exercised both territorial and pecuniary jurisdiction over them.

In India, the three Chartered High Courts of Bombay, Calcutta, and Madras enjoyed power akin to that of King's Bench in England. Each of these High Courts introduced a 'commercial cause list' under their original side rules, that provided for an expedited resolution procedure for commercial cases. The Delhi High Court Original Side Rules 1967 added a Chapter titled "Appeals from decrees in commercial matters". The Rules defined 'Commercial Causes' as "*causes arising out of ordinary transactions of merchants, bankers arising out of the ordinary transactions of merchants,bankers and traders, such as those relating to the construction of mercantile documents, export or import of merchandize, affreightment, carriage of goods by land, insurance, banking and mercantile documents, mercantile agency,mercantile usage and infringements of trademarks and passing off actions. and traders, such as those relating to the construction of mercantile documents, export or import of merchandize, affreightment,*

[34] Chris Williams, 'The Search for Bases of Decision in Commercial Law: Llewellyn Redux' (1984) 97(6) Harvard Law Review 1495.
[35] Layton Register, 'The Dual System of Civil and Commercial Law' (1913) 61(4) University of Pennsylvania Law Review 240.
[36] The Code of Civil Procedure 1908.
[37] The Code of Criminal Procedure 1973.

carriage of goods by land, insurance, banking and mercantile documents, mercantile agency, mercantile usage and infringements of trademarks and passing off action".[38] Similarly, Calcutta High Court, Bombay High Court, and Madras High Court added the definition of a 'commercial cause' to their respective Original Side Rules.[39] These Rules further stated that all cases arising out Companies Act, 1956 as well as cases affecting the responsibility of a Railway Administration as carriers, will be treated as "Commercial causes".[40]

Section 34 of CPC also states that a transaction is a commercial transaction, if it is connected with the industry, trade or business of the party incurring the liability.[41]

Apart from the above rules, some matters which were 'commercial' in nature went to specialized tribunals like Debt Recovery Tribunal ('**DRT**'), National Company Law Tribunal ('**NCLT**'), the erstwhile Company Law Board, etc.

The Commercial Courts Act, 2015 defines a 'commercial dispute' under Section 2(c) by providing an expansive list of 22 categories of disputes. Out of that list, joint venture agreements and shareholders agreements mentioned in (xi) and (xii) require compliances under the Companies Act, 2013.[42] The adjudicating authority under Companies Act, 2013 is NCLT. Section 241 and 244 gives right to shareholders to go to NCLT if they face any oppression or mismanagement.[43] NCLT also handles matters relating to corporate insolvency under the Insolvency and Bankrupcy Code, 2016 (IBC).[44] However, we need to note that in both cases, NCLT resolves disputes arising out of statutory rights. Even though Companies Act, 2013 and IBC, 2016 are essentially commercial statutes, NCLT only adjudicates upon disputes that violates right in rem and are not contractual in nature. One exception to that was the case of *Tata Consultancy Services v. Vishal Ghisulal Jain, Resolution Professional SK Wheels Pvt. Ltd.*[45] where the Supreme Court held that NCLT has the right to adjudicate contractual disputes that are essential to the success of CIRP. This comes from its residuary jurisdiction under section 60(5)(c) of the IBC, 2016.

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[38] The Delhi High Court (Original Side) Rules 1967, r 1.
[39] The Rules of the High Court at Calcutta (Original Side)1914, rr 3-4.
[40] The Rules of the High Court at Calcutta (Original Side) 1914, rule 2.
[41] The Code of Civil Procedure 1908, s 34.
[42] The Commercial Courts Act 2015.
[43] The Companies Act 2013.
[44] The Insolvency and Bankruptcy Code 2016.
[45] *Tata Consultancy Services Ltd v Vishal Ghisulal Jain, Resolution Professional, SK Wheels Pvt Ltd* (2020) Civil Appeal No 3045 of 2020 (Supreme Court of India). *Also see*, *Gujarat Urja Vikas v Amit Gupta* (2021) 7 SCC 209 (Supreme Court of India).

With respect to intellectual property ('IP') disputes (dealing with registered and unregistered trademarks, copyright, patent, design, domain names, geographical indications, and semiconductor integrated circuits as mentioned in xvii), those that arose from decisions of Controller of Patents, Registrars of Trademark, Design, Copyright Board in relation to registration and revocation of any intellectual property, rectification of register, compulsory licenses etc. went to the Intellectual Property Appellate Board ('IPAB'). The Tribunals Act, 2021 dissolved the IPAB and declared that all appeals will now directly lie to High Courts. With respect to disputes relating to infringement of any IP, an IP holders could pursue a civil action in ordinary civil courts which would grant the plaintiff a range of relief ranging from injunction orders, search and seizure orders, to accounts of profits, damages and costs.[46] After the CCA, 2015 IP disputes have been classified as 'commercial disputes' that go to respective commercial courts.

Of the disputes arising out of ordinary transactions of merchants, bankers, financiers and traders etc. mentioned in (i), with respect to recovery of a trade debt, a creditor (a bank or financial institution) could approach the Debt Recovery Tribunal the Recovery of Debt Due to Banks and Financial Institutions Act, 1993. The RDDBFI Act strictly barred the jurisdiction of ordinary civil courts (except High Courts and Supreme Court) over matters which went to DRT. Other categories of creditors could approach the ordinary civil court to recover their debts. After the enactment of the CCA 2015, creditors can go to a competent Commercial Court, since disputes relating to recover of debts have been classified as a 'commercial dispute'.[47]

Again, under (iv), disputes arising out of aircrafts, aircraft engines etc. have been classified as 'commercial disputes'; however, no mention has been made of disputes arising out of shipbuilding, ships and related transportation contracts. Similarly, disputes arising out of 'subscription and investment' agreements under (xiii) have been classified as commercial disputes however, disputes arising out of private equity and venture capital unless they fall within a specific category would fall out of the definition.

Interestingly, if we look at the plenary clause, (xxii), the definition includes all prescribed commercial disputes that essentially includes the entire gamut

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[46] Mirandah Asia, 'India — The IPAB signs off, as the President signs on the Tribunals Reforms Bill, 2021' (*Lexology*, 10 September 2021) <www.lexology.com/library/detail.aspx?g=2e4286b6-99c4-4dc0-8dbe-6fa9a08e8781> accessed 6 September 2022.

[47] Kunaal Shah, Anirudh Kapoor, and Kartik Adlakha, 'Complex Commercial Litigation in India' (*Lexology*, 12 November 2018) <www.lexology.com/library/detail.aspx?g=4449b31a-ff8d-4dd8-a9bc-a9eadd092b24#:~:text=While%20commercial%20litigation%20involves%20an,dealing%20with%20immoveable%20property%3B%20and> accessed 6 September 2022.

of commercial litigation and leaves out very little; like disputes in public law, writ petitions, family law etc.

CCA, 2015 for the first time attempted to categorise 'commercial disputes' into 22 distinctive categories so that judges of commercial courts can give specific and dedicated attention to each dispute as and when it comes to them. We can give due credit to CCA, 2015 not only if the Commercial Courts deliver fast justice, but also if they produce a rich body of precedents in commercial law. India is a common law country; thus, our legal regime heavily draws from judicial law making. It is believed that through categorising commercial disputes, these courts will be better able to the literature of commercial disputes through its decisions, in order to take this regime forward.[48]

Further, if we closely look at the list of disputes under Section 2(c), they are mostly ones arising out of commercial contracts. A notable feature of any commercial contract is its well drafted dispute resolution clause. Most parties to commercial disputes prefer alternative dispute resolution ('ADR') mechanisms like arbitration and mediation governed by the Arbitration and Conciliation Act, 1996.[49]

This preference towards ADR is primarily because commercial disputes get clogged up in the civil justice system in our country and take an exhausting amount of time to get resolved by civil courts. The intention of the CCA, 2015 was to solve this very problem. Creating commercial courts as part of the civil justice system in the country would give confidence to litigants to resolve their disputes through litigation as well.

IV. Historical Evolution of the Commercial Courts Act, 2015

A. Legislative Attempt to Recognise 'Commercial Disputes'

In 2003, Justice M. Jagannadha Rao, the then Chairman of the Law Commission of India wrote to Mr. Arun Jaitley, the Minister of Law and Justice, expressing concerns over resolution of high value commercial

[48] Sebastian Lewis, 'Precedent and the Rule of Law' (2021) 41(4) Oxford Journal of Legal Studies 873.

[49] Manoj Singh and Nilava Bandhopadhyay, 'The changing paradigm of commercial disputes in India' (*Legal Business*, 27 March 2020) <www.legalbusiness.co.uk/analysis/disputes-yearbook-2020/sponsored-briefing-the-changing-paradigm-of-commercial-disputes-in-india/> accessed 6 September 2022.

disputes in the country. He expressly mentioned that in order to maintain and accelerate the economic growth of the country that got sparked by the 1991 policy, both domestic and foreign investors must be given a clear assurance that they will have access to faster, efficacious forums to resolve any commercial dispute, that they are parties to. He was also of the opinion that our judicial system urgently needed fast-track courts equipped with technological facilities that could resolve high value complex commercial disputes in an expeditious manner and accordingly, the judges of these courts too needed adequate training to address the same.[50]

In the 188th Report titled "Proposals for Constitution of Hi-tech Fast-Track Commercial Divisions in High Courts", the Law Commission studied the establishment and operation of USA, UK, France, Ireland, Singapore, Philippines, Russia etc. — a total of 12 other countries and finally came to the conclusion that High Courts should have a separate bench or 'Commercial Division' dedicated to disposing of high value commercial cases and enforcing decrees relating to the same. The Law Commission seemed convinced that setting up these Benches in High Courts would not only relieve the parties to such disputes from inordinate delays that they face in lower courts, but it would additionally reduce the burden of these lower courts that already have their hands full with other cases.[51] Further, the Law Commission Report mentioned that the overall benefits of setting up these courts that may accrue by way of increased investment in India, both from domestic and foreign investors, will be in hundreds of millions of dollars and the expense in constituting these will only be a very small fraction of it. It was for the first time that the Commission had come up with the term 'commercial disputes' since these disputes were previously heard by ordinary civil courts. In the final chapter of its report, the Law Commission suggested that the very reason of acknowledging 'commercial disputes' as a sub-category of civil disputes is that the former is usually of high pecuniary value involving litigants that are mostly looking for resolving their disputes on a fast-track basis. The Report further goes on to elaborate that giving special attention to this category of disputes will enhance India's global reputation as a country that has expeditious justice delivery systems and improve its image in the 'commercial circles'.[52]

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[50] Sudhir Krishnaswamy, Sindhu Sivakumar, and Shishir Bail, 'Legal and Judicial Reform in India: A Call for Systemic and Empirical Approaches' (2014) 2(1) Journal of National Law University Delhi 1.

[51] Sumeda, 'Explained | The clogged state of the Indian judiciary' *The Hindu* (10 May 2022) <www.thehindu.com/news/national/indian-judiciary-pendency-data-courts-statistics-explain-judges-ramana-chief-justiceundertrials/article65378182.ece> accessed 6 September 2022.

[52] Abhinav Chandrachud, 'Commercial Courts and the Ease of Deciding Cases' (*BQ Prime*, 17 July 2018) <www.bqprime.com/opinion/commercial-courts-and-the-ease-of-deciding-

If one reads the Law Commission's recommendations carefully, it can be seen as an undisputed fact that the former has stressed upon updating the exposure of our courts to the fast-growing changes in commerce occurring globally and increasing their overall capacity to handle cases involving new branches of commercial law. The emphasis on 'fast-track' dispute resolution was also mentioned in an earlier Report of the Law Commission on Amendments to the Indian Arbitration and Conciliation Act, 1996.[53] In spite of such clearly spelled out intention to improve the efficacy of the then judicial system, the recommendations of this Report failed to bring forth any positive development.

The 2009 Bill that established commercial divisions in the High Courts was strongly opposed in the Rajya Sabha. It was specifically pointed that the 2009 Bill solely reflected 'elitist' concerns by 'reserving' a Bench for high value commercial cases and catering to the interests of the corporate sector at the cost of the ordinary litigant. It was further contended that High Courts in our country were already overburdened with pending cases and dealing with absence of adequate judges, creating special commercial divisions would further reduce the number of judges hearing other disputes.[54] Thus, the 2009 Bill did not get the Parliament's assent at this stage. Although it was not rejected in *toto*, substantial amendments were suggested in order to reform the alleged 'poorly drafted and misconceived' provisions of the Bill, which led to the revised Commercial Division of High Courts Bill, 2010. Meanwhile, deliberations continued amongst judges and expert legal professionals on the scope and definition of 'commercial disputes' and since there was no real implementation of the suggestions provided by the Commission and the provisions of the Bill did not get a nod from both houses of the Parliament, commercial disputes continued to get handled by the civil courts on the basis of territorial and pecuniary jurisdiction.[55]

B. Ease of Doing Business in India: A Priority

In 2014, for the first time after the election of the new government, India participated in the World Bank's Ease of Doing Business (EODB) Ranking.

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cases> accessed 6 September 2022.

[53] Law Commission, *Amendments to the Arbitration and Conciliation Act 1996* (Law Comm No 246, 2014) <https://lawcommissionofindia.nic.in/report_twentieth/> accessed 6 September 2022.

[54] 'Report of the Select Committee on the Commercial Division of HighCourts Bill, 2009' (Lok Sabha, 29 July 2010).

[55] Debashree Dutta, 'A Critical Analysis of the Commercial Division of High Courts Bill, 2009' (*AIR Online*, 2010) <www.aironline.in/legal-articles/A+Critical+Analysis+of++the+Commercial+Division+of+High+Courts+Bill%2C+2009> accessed 6 September 2022.

The World Bank's Doing Business project aims at providing objective comparison of business regulations and their implementation in 190 economies across the globe. The parameter for ranking economies on ease of doing business include[56]-

a) Starting a business;

b) Dealing with construction permits;

c) Getting electricity;

d) Registering property;

e) Access to credit;

f) Protecting minority shareholders;

g) Paying tax;

h) Trading across borders;

i) Enforcing Contracts;

j) Resolving Insolvency;

Since the start of the project in November 2001, over 3000 scientific articles have used one or more indicators of the Doing Business Report to arrive at logical conclusions. The study has become one of the World Bank's leading private sector information products and is said to basis of planning and implementing several legislative reforms in developing countries. It is highly influential in business regulations worldwide and it is also the most used set of indicators which is widely analyzed in the academic literature. As noted in the World Bank Independent Evaluation Group study, for national authorities, this report provides a strong and general light on regulatory aspect of business environment. From the point of view of businesses, this report helps promote discussion and dialogue and for World Bank group, this report demonstrates ability to create and utilize world data and freelance resources with an objective to create handy reference material for gauging a country's business environment.[57] The methodology used in World Bank's Doing Business Study clearly specifies that for easy comparability of data collected from all 190 economies, the study is based on standardized case scenarios with specific assumptions. One such assumption is that is the location of

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[56] World Bank, 'Doing Business 2014' <www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB14-Full-Report.pdf>accessed 9 March 2022.

[57] 'Ease of doing business indicators, methodology designed on hard data: WB' *Business Standard* (New Delhi, 15 January 2018) <www.business-standard.com/article/economy-policy/ease-of-doing-business-indicators-methodology-designed-on-hard-data-wb-118011400440_1.html> accessed 6 September 2022.

a standardized business—the subject of the Doing Business case study—in the two largest business cities of the economy. Thus, although the Doing Business study report clearly admits that the biggest limitation of this methodology is that business regulations and their enforcement may differ within a country, particularly in federal states and large economies, the study limits itself to two cities only.[58] Hence, for the purpose of studying India's ease of doing business reforms, only Delhi and Mumbai were selected for collection and examination of data.[59]

One of the most important indicators of the World Bank's EODB rankings is 'Enforcement of Contracts'. This indicator measures the time and cost for resolving a commercial dispute through a local first-instance court, and the quality of judicial processes index, evaluating whether each economy has adopted a series of good practices that promote quality and efficiency in the court system. In other words, it is a direct reflection of the effectiveness of a country's judiciary in handling of and settlement of commercial disputes. To assess the 'Enforcement of Contracts' indicator, the World Bank prepares a questionnaire to assess the quality of judicial processes which focused on four primary areas – Court structure and proceedings, case management, court automation, alternative dispute resolution.[60]

In 2014, the Indian Government had set up a vision of breaking into top 50 countries from the rank of 142 in that year. It was ranked 142nd when the NDA Government took the charge in 2014, this was followed by 130th in 2017,[61] 100th in 2018,[62] 77th in 2019[63] and 63rd in 2020.[64] In its EODB Report, 2020, World Bank complemented the reforms undertaken by the Indian government, given the size and politically diverse nature of its economy. India too made a place for itself in top 10 improvers for the third time in a row. This data clearly shows a forward-looking reform in our business regulations and resultant progress in ease of doing business. It also depicts

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[58] 'Word Bank Ease of Doing Business report limited study in two Indian cities: Chidambaram' *The New Indian Express* (New Delhi, 2 November 2018) <www.newindianexpress.com/business/2018/nov/02/world-bank-ease-of-doing-business-report-limited-study-in-two-indian-cities-chidambaram-1893220.html> accessed 6 September 2022.

[59] Department of Promotion of Industry and Internal Trade, Ministry of Commerce, 'Ease of Doing Business' <https://dpiit.gov.in/sites/default/files/Ease_of_doing_business_Booklet_20210710_08Oct2021.pdf> accessed 9 March 2022.

[60] *ibid*.

[61] World Bank, 'Doing Business 2017'<www.doingbusiness.org/en/reports/global-reports/doing-business-2017> accessed 9 March 2022.

[62] World Bank, 'Doing Business 2018' <www.doingbusiness.org/en/reports/global-reports/doing-business-2018> accessed 9 March 2022.

[63] World Bank, 'Doing Business 2019' <www.doingbusiness.org/en/reports/global-reports/doing-business-2019> accessed 9 March 2022.

[64] World Bank, 'Doing Business 2020' <www.doingbusiness.org/en/reports/global-reports/doing-business-2020> accessed 9March, 2022.

seriousness which the top leadership of the country attaches to our EODB rank for a better global image. Thus, it can be said that a lot of regulatory developments that have taken place post 2014, have been triggered by the ambition to do well in the said ranking.

In 2015, the 253rd Law Commission Report presented the final Commercial Division and Commercial Appellate Division of High Courts and Commercial Courts Bill. After incorporating various suggestions from the Select Committee and Expert Committee, it specifically suggested that establishment of commercial courts exclusively for the efficient resolution of complex business disputes was the key policy measure that needed to be introduced by the government to improve India's position on the enforcement of contracts indicator.[65]

C. Enactment of the Commercial Courts Act, 2015

Accordingly, the Commercial Division and Commercial Appellate Division of High Courts and Commercial Courts Act, 2015 was enacted by both the Houses of Parliament on January 1, 2016 and made effective from October 23, 2015.

Even though it was considered as one of the most significant reforms to better the civil justice system in India, the utility of commercial courts to reach the expectations of solving commercial matters was questioned by the Economic Surveys of India in 2017-2018. The survey highlighted that even though India has made exceptional progress on other indicators of EODB Report like taxation and insolvency reforms, protection of minority investors, ease of obtaining credit etc., it needs to put special emphasis on developing an efficient, effective and expeditious contract enforcement regime.[66] An attractive contract enforcement regime can only be established if commercial disputes are resolved in India on fast-track basis. Following the same line of thought, the Economic Survey of India, 2018-2019 states that India's inability to enforce contracts and resolve legal disputes is the single biggest constraint to ease of doing business in India.[67]

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[65] "Investment', 'ease of doing business' rank high in Jaitleyspeak" *The Hindu* (New Delhi, 28 February 2015) <www.thehindu.com/business/budget/'Investment'-'ease-of-doing-business'-rank-in-high-Jaitleyspeak/article60516752.ece> accessed 9 March 2022.

[66] Sudipto Dey, 'Ease of doing business: Why India is faltering in enforcing contracts' *Business Standard* (New Delhi, 9 January 2020) <www.business-standard.com/article/economy-policy/hamstrung-judiciary-the-reason-why-india-falters-on-enforcing-contracts-119103101234_1.html> accessed 9 March 2022.

[67] Economic Survey 2018-19.

The 2015 Act (before the 2018 Amendment) established Commercial Divisions in High Courts where the later had original civil jurisdictions and Commercial Courts at the district level where High Courts do not have original civil jurisdiction. Appeals from Commercial Courts and Commercial Divisions in High Courts would go to Commercial Appellate Divisions in High Courts. Thus, in Delhi, Bombay, Calcutta, Madras and Himachal Pradesh, Commercial Divisions and Commercial Appellate Divisions in their High Courts were established while in 19 other High Courts, along with Commercial Appellate Divisions, Commercial Courts were established at the district level. The 2015 Act, while defining a 'commercial dispute' set the pecuniary value of the same at 1 crore.

If we look at the recommendations of the Law Commission's 253rd Report, it recognised that it was equally urgent and essential to reform civil litigation in totality, and not just for commercial cases. The Commission stated that in spite of wider changes brought to improve the litigation culture in India through several amendments brought to the Civil Procedure Code in 1976, 2002, amendments made to the Arbitration and Conciliation Act, 1996, the changes in the manner of conducting civil litigation have been minimal and largely cosmetic. The Indian judiciary as a whole will never be able to get rid of inordinate delays and pendency unless these courts start functioning effectively and a distinguished regime of commercial dispute resolution is implemented in spirit in the country.

Unfortunately, for the purposes of World Bank's Doing Business Report, they only reviewed the two largest business cities in the country – Delhi and Mumbai. Their methodology required collection of data for a specific court in each of these cities, that has jurisdiction over disputes worth 200% of income per capita or $5,000; accordingly, only City Civil Courts of Bombay and Delhi came within the purview of the same. The Commercial Courts at the district level in other cities and Commercial Divisions in High Courts of Delhi and Bombay set up by the 2015 Act, did not contribute to any data that the World Bank collected since there were no Commercial Courts in Delhi and Bombay and the Commercial Divisions in High Courts of Delhi and Bombay dealt with disputes of value one crore and above; thus, clearly not coming within the scope of the study. Therefore, India's ranking in the 'enforcement of contracts' parameter continued to be poor till 2018.[68]

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[68] Vaidehi Misra and Ameen Jauhar, 'Commercial Courts Act, 2015: An Empirical Impact Evaluation' (*Vidhi Centre for Legal Policy*, 5 July 2019) <https://vidhilegalpolicy.in/research/commercial-courts-act-2015-an-empirical-impact-evaluation/> accessed 6 September 2022.

When the Bhartiya Janata Party came to power in 2014, one of their key electoral promises was the reinvigoration of the Indian economy and stimulate India's credibility as a lucrative destination for foreign investment. Right from its election manifesto, to its first full-fledged budget in 2015, the new government touted its agenda of improving India's standing in the annually published 'Doing Business' reports of the World Bank. Creating a place for new commercial courts in the Indian judicial system was one such step in that direction.

In the backdrop of this rationale of policy makers, the 2018 Amendment to the Commercial Courts Act, 2015 got triggered. The said Amendment introduced changes to the existing structure of commercial courts in the country – it stated that Commercial Courts shall be established at the district level along with Commercial Divisions of High Courts where the later enjoyed original civil jurisdiction. Appeals from both would lie to Commercial Appellate Divisions of High Courts. However, where the High Courts did not enjoy original civil jurisdictions, Commercial Courts would be set up below the district judge level and appeals from the same would lie to Commercial Appellate Courts; Commercial Courts shall also be set up at the district level. From Commercial Courts at the district level and Commercial Appellate Courts, appeal would lie to Commercial Appellate Division of High Courts. The State government would decide the pecuniary limits of each of these Commercial Courts at the district level and below, which will not exceed pecuniary jurisdiction exercisable by the ordinary District Courts. Another significant change brought by the 2018 Amendment was reduction in the pecuniary value of a commercial dispute.[69] The new Amendment successfully brought the Commercial Courts of Delhi and Mumbai within the scope of World Bank's study; hence we see India's EODB ranking of 186th in the 'enforcement of contracts' indicator in 2015 improve 23 positions to 163rd in 2020.[70]

Aside, from reducing the pecuniary value of a 'commercial dispute', the Amendment Act of 2018 introduced the concept of 'Pre-Institution Mediation' under Section 12A. The provision mandates parties to a commercial dispute to compulsorily go for mediation (except in cases of urgent relief) before they become eligible to be heard by the commercial court. Accordingly, the Commercial Courts (Pre-Institution Mediation and Settlement) Rules, 2018

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[69] The Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts (Amendment) Act 2018.

[70] Prashant Reddy Thikkavarapu, 'How the Government used a Flawed Ordinance to Expedite Cases Dealing with Rs 1 Crore or More While Other Cases Remain Pending' (*The Caravan*, 6 November 2015) <https://caravanmagazine.in/vantage/government-flawed-ordinance-expedite-cases-1-crore> accessed 6 September 2022.

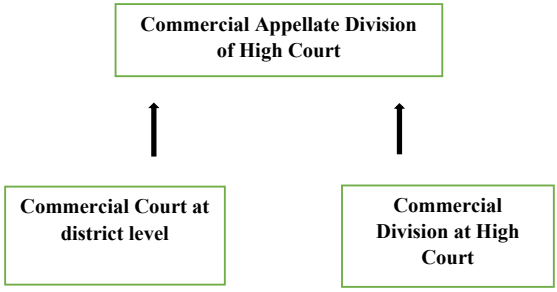
(PIMS Rules) authorize the District and State Legal Services Authorities to conduct these mediations.[71] Commercial Courts were established primarily to solve disputes in a fast and efficient basis. The idea was to promote mediation as a desirable method of resolving commercial disputes; additionally, the Government assumed that even if a small percentage of disputes get solved at this stage, it would somehow reduce the overall litigation burden of these Commercial Courts and Commercial Divisions.

V. Salient Features of the Commercial Courts Act, 2015

A. Model of Commercial Courts

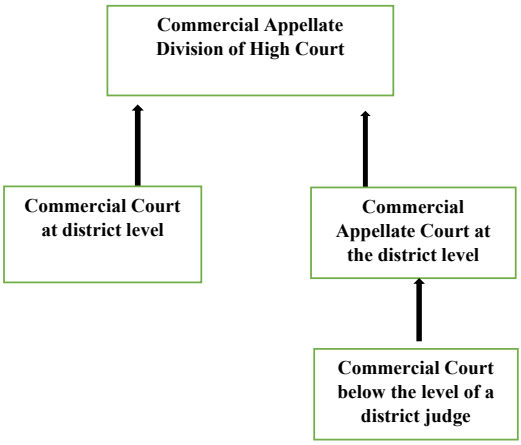
The Act established Commercial Courts at the district level, Commercial Divisions and Commercial Appellate Divisions in High Courts in places where the High Court enjoys original jurisdiction (for example, Delhi, Mumbai, Kolkata, Madras, Himachal Pradesh). In other districts where the High Court does not enjoy original jurisdiction, Commercial Courts are established below the level of a district judge and Commercial Appellate Courts are established at the district level. Other than that, Commercial Courts are also established at the district level. Appeals from the Commercial Courts at the district level as well as Commercial Appellate Courts lie to the Commercial Appellate Divisions of High Courts. The pecuniary jurisdiction of all these Commercial Courts and Commercial Divisions and Appellate Divisions are decided by the state government, with the minimum value of a 'commercial dispute' being three lakhs.

B. High Courts and Original Civil Jurisdiction



[71] The Commercial Courts (Pre-Institution Mediation and Settlement) Rules 2018, r 3.

Where High Courts do not enjoy original civil jurisdiction (19 other High Courts) – fig. ii)



C. Definition of 'Commercial Disputes'

Section 2(1)(c) of the CCA, 2015 defines 'commercial disputes' as disputes arising out of ordinary transactions of merchants, bankers, financiers, and traders etc. It provides an exhaustive list of 22 categories of disputes which can be broadly categorized under three heads –

i) trade/mercantile disputes - those relating to mercantile usage, agency, partnerships, sale, export or import of merchandise or services

ii) infrastructure and construction disputes – including carriage of goods, construction and infrastructure contracts including tenders, agreements relating to immovable property used exclusively in trade or commerce, relating to aircrafts, oil and natural gas,

(iii) business and financial disputes – arrangements including franchising, distribution and licensing, management and consultancy agreements, joint ventures, investment agreements, information technology, financial services, insurance, intellectual property rights etc.

Kindly refer to Part II(B) for a detailed discussion on each of the above categories.

Aside from the above, if the subject matter of an arbitration is a 'commercial dispute', then any application (Section 9, 16, 34) or appeals (Section 37) arising out of Arbitration and Conciliation Act, 1996 would be heard by a

Commercial Court (in case of domestic arbitration) or Commercial Division of a High Court (in case of international commercial arbitration).[72]

D. Case Management Hearings

The Law Commission Reports clearly specified that Commercial Courts were meant to adopt a fast-track procedure in the resolution of commercial disputes. This fast-track procedure would be similar to fast-track arbitration referred to in the 176th Report on 'Arbitration and Conciliation (Amendment) Bill, 2002', subject to suitable modifications for the purpose of fast-track procedure in a civil court.[73] The CCA, 2015 adopted this suggestion and designated strict timelines with respect to filing of pleadings, framing issues and dealing with discovery or document production requests. These courts can further hold case management hearings where at a preliminary stage itself, the court would fix specific dates for the filing of evidence, and date of hearing arguments.[74] Additionally, under Order 57 of the Civil Procedure Code (hereinafter referred to as CPC), Commercial Courts can also order summary judgement at any stage in the litigation process prior to framing of issues.[75]

E. Costs

The Law Commission Reports state that if costs are imposed infrequently any commercial suit that have no actual bearing with the expenses of the case, then litigants may get encouraged to engage in frivolous litigation and delaying tactics.[76] Thus, to fundamentally alter the exhausting litigating culture in India, the CCA, 2015 gives wide powers to Commercial Courts to impose costs on parties who have no reasonable claim, make no reasonable efforts to reach a settlement and delay disposal of matters. The Act further incorporates amendments to the CPC to determine liability to pay costs and sets out the quantum and period by when costs should be paid.[77]

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[72] The Commercial Courts Act 2015, s 10.

[73] Law Commission, *Report on the Arbitration and Conciliation (Amendment) Bill 2002* (Law Comm No 176, 2002).

[74] The Commercial Courts Act 2015, ss 13-14.

[75] The Commercial Courts Act 2015, Schedule.

[76] Law Commission,*Costs in Civil Litigation* (Law Comm No 240, 2012).

[77] The Commercial Courts Act 2015, s 16 read with Schedule; *See also*, Akrati Modi and Harshul Bangia, 'Provision of Cost under Civil Procedure Code: A Need for Change in Today's Time' (*Manupatra*, 4 August 2021) <https://articles.manupatra.com/article-details/Provision-of-Cost-under-Civil-Procedure-Code-A-Need-for-Change-in-Todays-Time> accessed 6 September 2022.

F. Appeals

The CCA, 2015 after the amendment in 2018 provides for two types of appellate mechanisms – in places where High Courts do not enjoy original jurisdiction, appeals from the Commercial Court established below the level of a district judge lies to the Commercial Appellate Court at the district level and from the later to the Commercial Appellate Division in High Courts. In other places where the High Courts enjoy original jurisdiction, appeals from both Commercial Courts at district level and Commercial Divisions of High Courts lie to Commercial Appellate Division in High Courts. These courts would hear appeal under Order 43, CPC, which enumerates a list of orders of the CPC against which appeals can lie. The interesting feature of the CCA, 2015 is that alongside prescribing a period of 6 months for disposal appeals, it also limits the right to appeal for a litigant. Section 8 states that no civil revision application or petition will be entertained against any interlocutory order of a Commercial Court, including an order on the issue of jurisdiction.[78]

G. Pre-institution Mediation

Section 12A of CCA, 2015 makes it mandatory for parties to a commercial dispute to get their dispute resolved through pre-institution mediation. Unless any commercial suit requires urgent relief, parties have to undergo mediation. Commercial Courts (Pre-Institution Mediation and Settlement) Rules, 2018 (hereinafter referred to as the PIMS Rules)[79] authorizes the District and State Legal Services Authorities to conduct these mediations within three months of the date of application. The settlement arrived at by such mediation shall have the status and effect of an arbitral award under section 30(4) of the Arbitration and Conciliation Act, 1996.[80]

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[78] Ajit Warrier and Aditya Nayyar, 'India: Appeals Under the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act, 2015 – A Legal Quagmire' (*Mondaq*, 24 April 2018) <www.mondaq.com/india/contracts-and-commercial-law/694944/appeals-under-the-commercial-courts-commercial-division-and-commercial-appellate-division-of-high-courts-act-2015-a-legal-quagmire> accessed 9 March 2022.

[79] Commercial Courts (Pre-Institution Mediation and Settlement) Rules 2018, Notification No. G.S.R. 606(E); *See also,* the Commercial Courts Act 2015, s 12A.

[80] Aniruddha AS and Akshita Bohra, 'Pre-institution mediation and settlement: Messiah or Chimera?' (*Bar and Bench*, 25 July 2021) <www.barandbench.com/columns/pre-institution-mediation-and-settlement-messiah-or-chimera> accessed 9 September 2022.

VI. ANOMALIES IN THE COMMERCIAL COURTS ACT, 2015

A. Shift in Policy Change and Policy Decision

In 2003, in the 188th Law Commission Report when the establishment of Commercial Divisions of High Courts was discussed for the first time, it related to the perception that Indian judicial system had collapsed due to inordinate delays. Quick disposal of high value commercial matters that go directly to a separate Division Bench of the High Court as opposed to an ordinary civil Court or Single Judge Bench, would not only inspire, and incite confidence in local and foreign investors but also promote India's global image as a desirable business destination. This was in line with numerous economic policies that India had adopted post 1991. Thus, the initial policy objective of setting up Commercial Divisions in High Courts was to develop a fast-track court system that will be equipped with new age technological facilities like online filing, video conferencing etc. This was an extension of the e-Courts Project conceptualized under the National Policy and Action Plan for Implementation of Information and Communication Technology (ICT) in the Indian Judiciary, 2005.[81] The idea was to transform the judicial system of the country by ICT enablement of courts. Thus, if commercial courts were technologically equipped, it would help in the timely disposal of cases and since, a lot of these litigants were foreign entities/individuals, it would make the overall justice delivery system a lot more accessible and cost effective. It was also suggested that fast track courts would be able to solve high value complex commercial matters strictly within the prescribed time, not exceeding a couple of years.[82]

The 2009 Bill which the Law Commission had presented was thoroughly criticised by the Select Committee in Rajya Sabha on accounts of showing unjustifiable preference to commercial disputes over ordinary civil disputes. They also expressed their reservations about the Law Commission copying the entire idea of commercial courts from western countries without properly analysing the actual pendency of commercial matters in various district courts.[83] This idea of fast-track commercial courts, however, continued to morph in the 253rd Law Commission Report as well. Although it states that

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[81] e-Committee, Supreme Court of India, 'Information and Communication Technology in Indian Judiciary' <https://ecommitteesci.gov.in/#:~:text=e%2DCourts%20is%20a%20pan,by%20ICT%20enablement%20of%20courts> accessed 9 March 2022.

[82] Faisal Sherwani and Shubham Saigal, 'Of flawed considerations and failed legislations: Observations from the implementation of the Commercial Courts Act, 2015' (*Bar and Bench*, 16 June 2020) <www.barandbench.com/columns/the-commercial-courts-act-2015-notes-on-considerations-and-observations-from-its-implementation> accessed 6 September 2022.

[83] ibid.

recommendations given by the Select Committee were given due regard, we do not see any change in policy perspective behind the whole scheme of commercial courts.[84]

The Commercial Division and Commercial Appellate Division of High Courts and Commercial Courts Bill, 2015 that got the final nod from both Houses of the Parliament simply changed the structure of Commercial Courts suggested by the 2009 Bill. According to the 2015 Act, both Commercial Courts and Commercial Divisions of High Courts were to be set up. If we look at rationale behind this enactment, it is clearly to set up commercial courts as a forum dedicated to creating a stable, certain and efficient dispute resolution mechanism, essential for India's economic development. The government believed if Commercial Courts can be set up as 'Model Courts' that would establish new norms of practice in commercial litigation and address 'complex facts and question of law', then gradually over time these reforms could be scaled up and extended to all civil litigation in India.[85]

Hence, we can safely say that reforming commercial litigation was essentially the first step to reform the overall civil litigation in the country. However, the 2018 Amendment to the 2015 Act drastically reduced the pecuniary value of a commercial dispute to a mere three lakh from 1 crore and came with the idea that fast commercial dispute resolution needs to happen even at the lowest level of commercial courts. Thus, post 2018, Commercial Courts were set up in every district even below the level of district judge and otherwise. The basic model of commercial courts that was initially introduced as a minor reform by setting up Commercial High Court Divisions transformed into a structural reform of the subordinate court structure on the civil side. Unfortunately, there was no corresponding budgetary allocation for such a radical cultural transformation of these new lower courts. In the absence of these initiatives, it's hard to say that introduction of commercial courts at all seemed to be transformative.[86]

B. Wide Definition of 'Commercial Disputes'

Secondly, it is important to note that the first time the definition of 'commercial disputes' was proposed in the 188th Law Commission Report, it

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[84] V Ramasubramanian, 'Commercial Litigation or Litigation Commercial: Specialised Commercial Courts in India' (2015) 1 NLS Business Law Review 79.

[85] Sudhir Krishnaswamy and Varsha Mahadeva Aithala, 'Commercial Courts in India: Three Puzzles for Legal System Reform' (2020) 11(1) Journal of Indian Law and Society 20.

[86] Prateek Sibal, 'India's Business Policy Needs to Look Beyond World Bank's Doing Business Report' (*The Wire*, 23 February 2017) <https://thewire.in/economy/india-business-policy-beyond-world-bank> accessed 6 September 2022.

envisaged all disputes arising out of banking and insurance transactions, contracts for the sale and supply of goods or services, disputes of building contracts, partnership agreements, business property etc. Therefore, a residuary clause was also added to the definition, enabling High Courts to notify other disputes to be included in the definition. The Report further set out detailed explanations of matters which fall within the meaning of a commercial dispute. The 2009 Bill that followed attempted to provide an exhaustive list of commercial disputes in the definition clause and interestingly, suggested that the necessary determinant to vest the jurisdiction of a Commercial Division over a commercial dispute was the specified pecuniary value of the suit. The 253rd Report further expanded the scope of a 'commercial dispute' and included disputes arising out of 22 categories of documents. This continued in the 2015 Act, completely ignoring the warning given by the Select Committee in Rajya Sabha that a broad definition might lead to extensive litigation. The 2015 Act divided 'commercial disputes' into three broad categories – trade/mercantile disputes, infrastructure/construction disputes and business/financial disputes. The 2018 Amendment to the 2015 Act continued with the same broad definition and reduced the pecuniary value to broaden the scope of jurisdiction of a commercial court.[87]

The author has discussed the status of different categories of commercial disputes and the subsequent challenges in the previous Parts. In the backdrop of the same, we can say that in the event, additional judges are not appointed in these courts, the huge bulk of commercial litigation that were handled by district civil courts across the country are only going to come to a handful of judges sitting at these Commercial Courts and Commercial Divisions; and their pressure will be unbearable.

Thus, in effect, there is a possibility that 'commercial' disputes are being treated as ordinary civil disputes of high pecuniary value. There has not been any legislative debate on how 'commercial' disputes can be separated from civil disputes and the only rationale of drawing a distinction between both has been the pecuniary value, which also has changed over the years. Thus, it is important to note that any broad definition is not only superfluous but also can negate a subject matter assessment while determining whether a dispute is a 'commercial dispute'.[88]

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[87] Essenese Obhan and Shubhangi Agarwal, 'India: Are Disputes Arising Out of Immovable Property Considered as Commercial Disputes?' (*Mondaq*, 7 November 2019) <www.mondaq.com/india/contracts-and-commercial-law/861690/are-disputes-arising-out-of-immovable-property-considered-as-commercial-disputes> accessed 9 March 2022.

[88] Sai Ramani Garimella and MZ Ashraful, 'The Emergence of International Commercial Courts in India: A Narrative for Ease of Doing Business?' (2019) 1 Erasmus Law Review 111.

C. Organisational Structure of Commercial Courts

Let us take the example of West Bengal. The High Court in Kolkata enjoys original civil jurisdiction. Previously under the 2015 Act, Commercial Divisions and Commercial Appellate Divisions were established in the Calcutta High Court. After 2018, Commercial Courts were established in 4 more districts – Asansol, Rajarhat (part of Kolkata), Siliguri and Alipore (part of Kolkata). On 20th March, 2020, the government of West Bengal published a gazette notification declaring the pecuniary jurisdiction of the four Commercial Courts.[89] According to the notification, in case of the Commercial Courts of Asansol, Rajarhat (part of Kolkata), Siliguri and Alipore (part of Kolkata), the pecuniary jurisdiction was 30 lakhs, however for the Commercial Court set in the City Civil Court of Kolkata, the pecuniary jurisdiction was of 3 lakhs to 10 lakhs exclusively and 10 lakhs to 1 crore concurrently with the Commercial Division of High Court. Further, Commercial Division of High Court of Kolkata enjoys a pecuniary jurisdiction of amount 10 lakhs exclusively. The Commercial Court within the territorial jurisdiction of the City Civil Court has still not been established 4 years after the 2018 amendment. Therefore, commercial disputes of value 3 lakhs to 10 lakhs still continue to be heard by and disposed of by the ordinary civil courts. The same needs to be reviewed for other states as well. Hence, it becomes pertinent for us that we do an objective study of the performance of the commercial courts set up under the Commercial Courts Act, 2015 and review their utility in serving effective justice to litigants.[90]

D. Infrastructure and Training of the Judges of 'Commercial Courts'

The Law Commission in their 188th and 253rd Reports stressed upon the requirement of sufficient number of judges with 'adequate' experience in civil and commercial laws in position to man the Commercial Courts. The Select Committee of Rajya Sabha while criticizing the 2009 Bill suggested that the existing vacancies in High Courts need to urgently filled up since these benches would face an increased workload due to the bulk transfer of commercial matters from district courts. The 253rd Report suggested that judges of the commercial court need to have 'demonstrable expertise and experience' in commercial litigation and would be appointed from amongst

[89] 'Gazette Notification regarding the local limits of jurisdiction of Commercial Courts of West Bengal' <https://www.calcuttahighcourt.gov.in/Notice-Files/gazette-notification/2869>accessed 9 March 2022.

[90] Vaidehi Misra and Ameen Jauhar, 'Commercial Courts: A Failure in Implementation' (*BQ Prime*, 21 June 2019) <www.bqprime.com/opinion/commercial-courts-a-failure-in-implementation> accessed 9 March 2022.

the higher judicial service. This new and separate cadre of judges would be selected through a well-defined recruitment process and entitled to a higher pay scale and better perquisites. They would also receive special training for six months at the National Judicial Academy or relevant State Judicial Academy with a view towards their continuous professional education.[91] In spite of such detailed attention, the CCA, 2015 addressed this issue superficially. Although Section 19 and Section 20 provides that it is the State government's responsibility to provide adequate infrastructure and training facilities to the judges of these courts, the lack of legislative mandates on infrastructure and judicial selection has meant that High Courts and the State Governments have essentially renamed existing courts as commercial courts.[92]

E. Concerns Relating to Pre-Institution Mediation

A pre institution mediation is essentially a time bound non adjudicatory process that needs to be completed within three months, post which the parties may or may not arrive at settlement that will have the status of an arbitral award under Section 30 of the Arbitration and Conciliation Act 1996.[93]Under Section 30(4), such an arbitral award has the same effect and status as any other arbitral award on the merits of the dispute. Therefore, whether parties amicably settle their dispute in a non-adjudicatory proceeding such as a pre-institution mediation or in an adjudicatory proceeding such as arbitration, the terms of the settlement in both the cases have the status of an arbitral award. This award qualifies for ground of challenge under Section 34.[94]Such a possibility of challenge detracts from the finality that parties usually desire when they decide to amicably settle their disputes. Any such challenge not only commits the parties to future litigation and uncertainties, but also makes parties skeptical of the efficacy of the mediation process. This is because if a challenge to such an arbitral award were to succeed, the whole pre-institution would be set at naught.[95]

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[91] Report of the Annual National Seminar on Working of the First Level Commercial Courts<https://nja.gov.in/Concluded_Programmes/2016-17/P-992%20ER.pdf> accessed 9 March 2022.

[92] Kruthika Jerome, 'Ease of doing business? High Court of Delhi has no dedicated time for commercial disputes' (*Centre for Civil Society*) <https://ccs.in/ease-doing-business-high-court-delhi-has-no-dedicated-time-commercial-disputes> accessed 6 September 2022.

[93] The Arbitration and Conciliation Act 1996.

[94] The Arbitration and Conciliation Act 1996.

[95] Kritika Sethi, 'Is India ready for 'mandatory mediation'?' *Sunday Guardian* (11 September 2021) <www.sundayguardianlive.com/legally-speaking/india-ready-mandatory-mediation> accessed 9 March 2022.

The main idea behind mandating this mediation was so that parties can completely exhaust the possibility of reaching a cordial solution by themselves before coming to the court. The biggest drawback however, in this situation is where the mediation becomes a 'non-starter'.Under the PIMS Rules, if the opposite party does not participate in the mediation process, does not respond to the notice sent by the Authorities for initiation of mediation or fails to appear on the notified date, the mediation will be treated as a non-starter.[96] Thus, the mandate of pre institution mediation is extremely hard to implement and fails to push both sides to come together to a settlement, since it solely applies to the plaintiff. In effect, pre-institution mediation continues to remain a voluntary process. Only initiation of the process of mediation is mandatory before institution of a suit, and the choice is left with the opposite party to decide whether to participate in such proceedings.[97]

F. Ease of 'Doing Business' Concerns

As the author mentioned earlier, the World Bank's methodology collected data relating to disputes worth 200% of income per capita or $5,000, and did not include within its scope the Commercial Courts and Commercial Divisions established by the 2015 Act. The priority of doing well in the World Bank rankings however continued till 2018 when the first amendment to the 2015 Act was brought. In fact, it was this obsession to score well in the rankings that essentially drove the 2018 Amendment. More number of Commercial Courts were now established in the country after 2018, below the level of a district judge, at the district level, in High Courts (Already in place under the 2015 Act) and their corresponding Appellate Courts and Appellate Divisions. Their pecuniary jurisdiction was also reduced just so they could come within the purview of the World Bank study.[98] Unfortunately, on 16th September, 2021, the World Bank issued an official statement that Ease of Doing Business (or, Doing Business Reports) of 2018 and 2020 were reported to have major data irregularities. Accordingly, they initiated a series of reviews and audits of the reports and its methodology. After reviewing all the information available to date on Doing Business, including the findings of past reviews, audits, they decided to discontinue the Doing

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[96] Avaneesh Satyang and Sohini Mandal, 'India: Mandatory Pre-Institution Mediation: Commercial Courts' (*Mondaq*, 13 August 2018) <www.mondaq.com/india/arbitration-dispute-resolution/727214/mandatory-pre-institution-mediation-commercial-courts> accessed 9 March 2022.

[97] Bhaven Shah, 'Mandatory pre-institution mediation – Purpose v. Procedure' (*SCC Online*, 24 March 2021).

[98] Aparna Gopalan, 'We've Got the Ease of Doing Business – but for whom?' (*The Wire*, 26 October 2019) <https://thewire.in/economy/weve-got-the-ease-of-doing-business-but-for-whom> accessed 9 September 2022.

Business Report.[99] The action came after an external investigation's findings that the rankings could be manipulated. The investigation implicated the then World Bank chief executive Kristalina Georgieva, who is now managing director of the International Monetary Fund, the global lender of last resort, and former World Bank president Jim Yong Kim. However, 3 months after this, on December 16th, 2021, they issued another statement that said that the World Bank has done a systematic review of all data irregularities previously reported and done an independent external verification of their methodology; taking from that, they will be publishing the Ease of Doing Business Rankings and Reports of 2021. These rankings have often set in motion far-reaching economic policies that focus on winding down red tape and easing regulations to facilitate quicker investments, setting off a global competition to reach the top of the rankings. It is also equally critical policy making in many developing nations to push income-generating investment.[100] From the above instances of irregularities, we have to carefully note that any global index, no matter how it improves India's image to the world, cannot be a contributing factor to bring changes to the national legislation or policy.[101] Regulatory and legislative changes in any national civil law reform cannot be proposed, designed and enacted to satisfy an external ranking index targeting the real issue of litigation culture and systemic challenges within the Indian judiciary.

VII. CONCLUSION

As of February, 2022, the total number of cases pending before all the commercial courts in Delhi on the last day of the month is 26,559. Out of 2339 cases instituted that month, 1456 were disposed of. Thus, only 62% were resolved within that very month.[102] From November, 2021 to February 2022, the total number of cases pending have kept on increasing. The picture is quite similar with respect to the four dedicated Commercial Courts of West Bengal. For the Commercial Court at Rajarhat, Alipore, Asansol

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[99] Ian Richards, 'The World Bank's 'Doing Business' report is out of business. Now what next?' (*UNCTAD*, 4 November 2021) <https://unctad.org/news/world-banks-doing-business-report-out-business-so-what-next> accessed 9 September 2022.

[100] Zia Haq, 'Why World Bank junked its ease of doing business rankings' *Hindustan Times* (New Delhi, 18 September 2021) <www.hindustantimes.com/business/why-world-bank-junked-its-ease-of-doing-business-rankings-101631863994289.html>accesse 9 September 2022.

[101] Sonalde Desai, 'Lessons from the death of the ease of doing business index' *The Indian Express* (6 October 2021) <https://indianexpress.com/article/opinion/columns/ease-of-doing-business-index-world-bank-7552199/> accessed 9 September 2022.

[102] 'Summary of Commercial Cases, Consolidated Report' <https://delhicourts.nic.in/commcourt.html#collapse24> accessed 9 March 2022.

and Siliguri, the average number of cases that are disposed of every month is below 10, while pendency of cases is between 100-150.[103] Similarly, for the Commercial Courts in Mumbai, the total number of pending cases have increased from 2685 in December 2021 to 2807 in February.[104] For better implementation of CCA, 2015, particularly Section 17, the Commercial Courts (Statistical Data) Rules 2018[105] was enacted that required the Commercial Courts, Commercial Appellate Courts, Commercial Division or Commercial Appellate Division to release information regarding pendency and status of each commercial suit, time to dispose it etc. by the tenth of every month. In 2020, these rules were amended, these new rules require the courts to publish data on the use of several virtual facilities including the number of e-filed cases, e-payment transactions, and e-processing of summons. Further, details with respect to case management hearings, contested commercial cases also need to be recorded by the High Courts.[106] Of 24 High Courts, only High Courts of Mumbai, Delhi, Karnataka, Rajasthan, Uttarakhand etc. have maintained data up to February 2022, in accordance with the format prescribed by the 2020 Amendment Rules. Rest others have either not been publishing any data at all, or publishing it as per the 2018 rules (High Courts of Calcutta, Hyderabad, Madras, Patna etc.)

While these new rules should ideally create more nuanced data sets and maintain more efficient judicial statistics, these would better the implementation and monitoring of the CCA, 2015 only when the well-intended provisions under the Rules are brought forth in spirit. In United Kingdom, the Commercial Court is a sub-division of the Queen's Bench Division of the High Court of Justice. It comes up with an annual report that not only depicts the performance statistics of the Commercial Court but also provides detailed information about initiatives and projects undertaken to improve its service to the litigants, to make them more familiar with its use.[107] If something as basic as maintaining data is not being implemented and undertaken by courts, a substantive task of depicting performance statistics along with detailed information about initiatives undertaken is probably a farfetched goal for now. However, if India does want to achieve evidence-based law and policy making, then it should be prepared to take similar steps, so that

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[103] 'Statistical Data of 2022 for Commercial Courts of West Bengal' <www.calcuttahighcourt.gov.in/Commercial/>accessed 9 March 2022.

[104] 'Statistical Data of 2022 for Commercial Courts of Maharashtra' <https://bombayhighcourt.nic.in/commercialcourt.php>accessed 9 March 2022.

[105] The Commercial Courts (Statistical Data) Rules 2018, r 3.

[106] The Commercial Courts (Statistical Data) Amendment Rules 2020, r 2.

[107] 'The Commercial Court Report 2020-2021 (Including the Admiralty Court Report)' <www.judiciary.uk/wpcontent/uploads/2022/02/14.50_Commercial_Court_Annual_Report_2020_21_WEB.pdf>accessed 9 March 2022.

CCA Act, 2015 can be implemented in spirit and does not remain a reform on paper.

The primary aim of any civil law reform is speedy justice. Within that sphere, is the need to provide speedy justice of commercial disputes, those with high value litigation because commerce is the life plat of the economy. However, if we want to establish these Commercial Courts and Commercial Divisions as model courts, the government would need to provide additional infrastructure and appoint new judges for the same. The same judges of ordinary civil courts cannot be designated as judges of Commercial Courts and asked to hear matters from all over the district. It would be impossible for them to adhere to the timelines mentioned in the CCA, 2015 which is after all the main intent of the legislation.

Ideally, these commercial courts shall have some technical members to support the judicial members just like the National Company Law Tribunal. If we need to make these Commercial Courts adequately functional, then technology should be mandatorily used to prevent procedural delays. In 2005, the "National Policy and Action Plan for Implementation of Information and Communication Technology (ICT) in the Indian Judiciary - 2005" conceptualized the E-Courts Project. Following that, on 7th August 2013, the Hon'ble the Chief Justice of India launched the e-Courts National portal (ecourts.gov.in). However, more concerted efforts need to be made to implement the judicial management information system. Commercial Courts' judges need to be given proper and regular training so that they build the expertise required to dispose of commercial disputes within prescribed timelines. To make these courts popular, we need to share the best practices that they follow in consonance with other jurisdictions that have established commercial courts. Additionally, the monitoring and supervision of these courts need to be an initiative of the High Courts, rather than the Ministry. Last but not the least, 'ease of doing business' can only be culturally accepted and implemented in India, provided these commercial courts weigh the economic impact of decisions, while deciding cases.

At the valedictory ceremony of the Constitution Day celebrations, Chief Justice of India, CV Ramana stated *"Another issue is that the legislature does not conduct studies or assess the impact of the laws that it passes. Re-branding the existing courts as commercial courts, without creating a special infrastructure, will not have any impact on the pendency"*.[108] The

[108] 'Legislature does not assess impact of laws it passes, leading to big issues, says CJI Ramana' *The Print* (New Delhi, 27 November 2021) <https://theprint.in/judiciary/legislature-does-not-assess-impact-of-laws-it-passes-leading-to-big-issues-says-cji-ramana/772797/> accessed 6 September 2022.

CCA, 2015 was initially designed to handle high value commercial cases in the country, however it progressively enveloped almost all of civil litigation in its scope. A legal reform can only be meaningful if it is supported by huge investment in moulding legal culture - of judges, lawyers and clients - and a corresponding examination of the administrative systems and processes of handling disputes. For a successful legislative reform, there needs to systematic changes both in administrative as well as cultural parameters.[109] Otherwise, the scale and scope of such effort would be simply perceived as an 'old wine in a new bottle'.

[109] Krishnaswamy and others (n 58).

Re-Thinking Liability Frameworks For Shadow Banks

Sayantan Chanda[*]

Shadow Banking via NBFCs has steadily increased in popularity in India over the past decade. Multiple entities offer an array of financial services which provide credit lines for vital projects in infrastructure, housing and other fields. For many start-ups and small businesses across the country, shadow banks are a source of funding. While the growth of the sector is to be appreciated, the potential dangers of this form of capitalism were apparent in 2018 with the collapse of IL&FS. To this end, taking from the lessons learned the hard way from 2018 and the Great Recession of 2007-2009 caused by the meltdown of Wall Street's shadow banks, certain fundamental concepts of company law must be re-examined. It will be argued that further RBI and SEBI Regulations fail to address the issue of banking failures. Rather, the concept of limited liability, long believed as fundamental to the company form, is unsuitable for the NBFC/shadow banking sector and must be diluted to reintroduce a form of multiple liability. This is essential for dissuading the irresponsible and risky strategies employed by management and directors in shadow banks. Such a dilution may also apply to other company forms in the future. Additionally, civil liability, long believed to be the most appropriate way of holding errant bankers liable for their greed and outrageous risk-taking, has turned out to be a disappointment in the United States. The approach of impugning individual directors and managers in civil law will have to be reformed in order to ensure that it is more effective in penalizing their collective negligence.

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I. Introduction

In the modern economy, funding for large-scale ventures and projects does not come exclusively from standard banks. A significant portion of the credit comes from entities which act as 'Shadow Banks'. This phenomenon is particularly pronounced in the United States with multiple shadow banks operating on Wall Street. These banks are essentially companies which mimic the behaviour and provide the same kind of services that standard banks do. This includes accepting deposits, providing loans, and granting insurance, among other functions. However, they exist outside the standard banking regulations and laws.[1] In India, Non-Banking Financial Companies ('**NBFC**' or '**Shadow Banks**') act as the equivalent of the Wall Street shadow banks. Companies such as Bajaj Finserv and Muthoot Finances are entities which provide a large number of financial services that are the same as those provided by standard banks.[2] They are created under and governed by the

[1] Roy Girasa, *Shadow Banking: The Rise, Risks, and Rewards of Non-Bank Financial Services* (Palgrave MacMillan, 2016) 24-25.

[2] 'NBFC Stocks by Net Profit' (*Money Control,* 12 January 2021*)* <https://www.moneycontrol.com/stocks/marketinfo/netprofit/bse/finance-nbfc.html> accessed 12 January 2021.

Companies Act, 2013,[3] and there is no mention of such institutions under the Banking Act, 1949.[4]

Under the Companies Act, shadow banks have the option of choosing limited liability. All major NBFCs are limited liability companies.[5] The obvious reason for this is that shareholders can limit their exposure in case of a default. This liability regime presents an issue that was seen prominently in the 2008 Wall Street crash. The problem, in simple terms, is that limited liability encourages managers and directors to take extremely risky business decisions. If these strategies are fruitful, the profits made are significant. However, if they fail and lead to a default, the directors/managers are secure in the knowledge that their personal liability is limited only to the amount of their shareholding.

The importance of NBFCs in a post-COVID world is likely to increase. In India, multiple sectors of the economy have significant amounts of Shadow Bank money in them, which funds further growth and development.[6] The amount of lending done by Shadow Banks in India is already much greater than in other major economies.[7] Considering the significant contraction in the Indian economy, it is foreseeable that re-starting it will require large amounts of funds. NBFCs will, therefore, play an important role,[8] in providing the necessary loans to stimulate economic activity which had largely stalled during the pandemic.

Recent data has shown a reduction in borrowing costs for a number of Shadow Banks. Considering the ailing condition of several major banks, especially in the public sector, it is likely that businesses will turn to NBFCs for funding.[9] Considering this economic reality, it is necessary to examine

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3 Companies Act 2013.

4 The Banking Regulation Act, 1949, contains no mention of NBFCs. Their activities are hence governed almost entirely by the Companies Act, and RBI regulations/guidelines.

5 Group structure of Bajaj Finserv and its subsidiaries, accessible at: <https://www.bajajfinserv.in/group-structure>; Group Structure of Mahindra Finance, accessible at: <https://mahindrafinance.com/discover-mahindra-finance/subsidiaries>; A survey of the Top 10 NBFCs showed that they were limited liability companies.

6 Suvashree Ghosh & Dhwani Pandya, '$63 billion of zombie buildings sound warning for Indian banks' *The Economic Times* (4 Oct 2019) <https://economictimes.indiatimes.com/industry/banking/finance/63-billion-of-zombie-buildings-sound-warning-for-indian-banks/articleshow/71434585.cms?from=mdr> accessed 12 January 2021.

7 Financial Stability Board, 'Global Shadow Banking Report 2017' (Credit Suisse, 2018).

8 Divya Patil & Anil Poonia, 'Borrowing Costs for India's Shadow Banks Retreat on RBI move' *Bloomberg Quint* (19 Nov 2020) <https://www.bloombergquint.com/economy-finance/borrowing-costs-for-india-s-shadow-banks-retreat-after-rbi-move> accessed 12 January 2021.

9 ibid.

the legal situation regarding these entities. The cause for concern arises largely due to recent high-profile defaults in major Shadow Banks.

A. The Collapse of IL&FS

In 2018, when Infrastructure Leasing & Finance Corporation (**'IL&FS'**) defaulted and sent markets into a spin, many called it a "*mini-Lehman moment*",[10] with all the accompanying financial turmoil that is associated with banking failures on such large scales.[11] Fortunately, the Indian government took steps to correct the crisis which have proved successful.[12] The RBI had to take over IL&FS daily functioning and multiple public sector banks lent it money so that it may begin to re-establish its business.[13]

The pressure on the RBI while dealing with IL&FS default could have been more pronounced. Barely a year later, Dewan Housing Finance Corporation (**'DHFC'**), another Non-Banking Financial Company (**'NBFC'**) similarly defaulted on its debt repayments. This required the RBI to repeat the entire process of removing the Board of Directors and taking over the process of reviving the company.[14] If both these defaults had happened together, it would have doubled the workload for the RBI.[15]

The failure of IL&FS included multiple regulatory failures. There was collusion by multiple IAS officers who were supposed to examine the account books and the functioning of the company.[16] Additionally, credit rating

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[10] Andy Mukherjee, 'India is having its own mini-Lehmann moment on the 10th anniversary of global financial crisis' *The Print* (13 Sept 2018) <https://theprint.in/opinion/india-is-having-its-own-mini-lehman-moment-on-10th-anniversary-of-global-financial-crisis/117042/> accessed 12 December 2020.

[11] Andy Mukherjee, 'India's Shadow-Bank Bust has a Lehman Echo' *Bloomberg* (13 Sept 2018) <https://www.bloomberg.com/opinion/articles/2018-09-13/india-s-il-fs-is-facing-a-lehman-moment> accessed 26 August 2020.

[12] Divya Patil and Anil Poonia, 'Shadow Banks Ride out the Crisis while Virus Ravages India' *Bloomberg Quint* (16 Sept 2020) <https://www.bloombergquint.com/business/shadow-banks-are-riding-out-the-crisis-while-virus-ravages-india> accessed 5 October 2020.

[13] Kavaljit Singh, 'What Explains India's Shadow Banking Crisis, and What Can Be Done Now?' *The Wire* (28 Aug 2019) <https://thewire.in/banking/shadow-banking-crisis-il-fs-dhfl> accessed 28 August 2020.

[14] Shayan Ghosh, 'RBI takes over DHFL board, appoints an administrator' *Livemint* (21 Nov 2019) <https://www.livemint.com/companies/news/rbi-suspersedes-dfhl-board-places-the-company-under-administrator-11574254914817.html> accessed 12 December 2020; Shayan Ghosh, 'Use of insolvency code in Dewan Housing will expedite resolution process' *Livemint* (23 Sep 2019) <https://www.livemint.com/industry/banking/use-of-insolvency-code-in-dewan-housing-will-expedite-resolution-process-1569212343590.html> accessed 12 December 2020.

[15] ibid.

[16] Sucheta Dalal, 'IL&FS: SFIO Investigation Throws up new leads on Insolvent Bank's Dealings' *The Wire* (5 April 2019) <https://thewire.in/banking/ilfs-mess-sfio-investigation-new-dirt> accessed 28 August 2020.

agencies gave the long-term and short-term borrowings by IL&FS an 'AAA' rating. This rating was only amended the day before IL&FS defaulted. The agencies evidently failed to appraise themselves of the crisis that IL&FS was in, and its ratings would have misguided several investors regarding the financial health of the NBFC.[17] Finally, the RBI added IL&FS to its list of 'Systemically Important NBFCs', ostensibly to have greater oversight over it. Despite this, they could not prevent the default and collapse of the Shadow Bank, which brings into question the efficacy of this regulatory oversight.[18]

B. Law and Regulation of Shadow Banks

Financial law and regulation must better address the lacunae that allowed IL&FS and DHFC's failures. As mentioned above, a large amount of funding for projects comes from such NBFCs and this is likely to increase in the aftermath of the COVID-19 pandemic. Financial regulation lays out the guidelines and participatory rules for financial markets, targeting banks, consumers, and other entities.[19] It outlines the rules that must be followed by all participants while carrying out their activities in the financial and banking sphere.

The steps taken following the IL&FS crash to prevent a repeat, have been in the area of regulation.[20] This strategy involves creating further rules and guidelines which allow greater monitoring and oversight by the RBI. However, the wisdom of this approach is questionable. Markets are dynamic and constantly evolving, and usually always outgrow and circumvent regulations, no matter how stringent.[21] Thus, it may be futile to hope that the RBI and other regulators will be better at enforcing new guidelines.

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[17] Anjan Basu, 'IL&FS and the La-La Land that is Indian Credit Rating' *The Wire* (7 Oct 2018) <https://thewire.in/business/ilfs-moodys-fitch-care-icra-rating-companies> accessed 28 August 2020.

[18] Reserve Bank of India, 'List of Non-Deposit taking Systemically Important (NBFC-ND-SI) companies registered with RBI' (As on July 16, 2020) <https://www.rbi.org.in/Scripts/BS_NBFCList.aspx>; Kavaljit Singh, 'How Should India Resolve the fault lines in its Shadow Banking System' *The Wire* (16 June 2019) <https://thewire.in/banking/india-shadow-banking-system-fault-lines> accessed 4 October 2020.

[19] Joanna Benjamin, *Financial Law* (OUP 2007) 6-10.

[20] ET Editorial, 'RBI's welcome steps to reform HFCs' *The Economic Times* (16 July 2020) <https://economictimes.indiatimes.com/blogs/et-editorials/rbis-welcome-steps-to-reform-hfcs/> accessed 28 August 2020.

[21] ibid; Hans-Werner Sinn, 'Risk Taking, Limited Liability and the Competition of Bank Regulators' (2001) National Bureau of Economic Research Working Paper No. 8669 <www.nber.org/system/files/working_papers/w8669/w8669.pdf> accessed 20 November 2021; Lee C Buchheit, 'Did We Make Things Too Complicated?' (2008) 27 International Financial Law Review 24, 26 (noting complexity of financial transactions often obscures their riskiness); Steven L. Schwarcz, 'Disclosure's Failure in the Subprime Mortgage Crisis'

This has been recognized among scholars in the United States.[22] Following the 2008 Wall Street crash, faith in financial regulation being able to prevent financial crises was severely curtailed. American legal scholarship has turned to the larger fields of company and financial Law itself.[23] This is based on the opinion that changing the legal structure of investment banks will be more effective in controlling banking activities. For example, *Lucian and Holger* have identified the 'Moral hazard' inherent in the wage and bonuses structure of managers. This incentivizes them to take great risks in order to increase their profits.[24] Thus, changes in the law must account for such facets of banking.

To this effect, this paper will propose two changes to company law that would be more effective than the new financial regulations. Parts II - IV of the paper will question a fundamental pillar of company law across the world: limited liability. The manner in which limited liability, especially in Shadow Banks, encourages the kind of high-risk strategies as seen in the IL&FS case will be detailed. It will be argued that a return to multiple liability for shadow banks will cause a recalibration of incentive structures within NBFCs and force directors and managers to make decisions which guarantee the sustainability of the Shadow Bank.

Parts V and VI of the paper will then investigate a second limb of managerial control: civil liability for the collapse of NBFCs. It will argue that the Companies Act, 2013 and existing criminal law doctrine is insufficient to deter overt risk-taking in shadow banks. Rather, a mechanism for the personal liability of directors must be instituted. Such a mechanism must focus on how a particular crisis is caused by the way a company operates, as determined by senior management. As an aside, while there are numerous ways in which these two proposals may interact with the Insolvency and Bankruptcy Code, the potential contradictions and how to resolve them will not be comprehensively explored within the scope of this particular paper.

(2008) Utah Law Review 1109, 1110 (pointing out that securities prospectus' are too long for average investors to read).

22 Iman Anabtawi and Steven L. Schwarcz, 'Regulating Systemic Risk: Towards an Analytical Framework'(2011) 86 Notre Dame Law Review 1349, 1382-1383.

23 ibid.

24 Lucian and Holger deal with moral hazard inherent in bankers' pay in 'Regulating Bankers' Pay', (2009) *Harvard Law School John M Olin Center for Law, Economics and Business Discussion Paper Series* Paper 634, 98 Georgetown Law Journal 247.

II. Development and Status of Limited Liability

Limited liability was not always the norm in the common law world. The United Kingdom (**'UK'**) had unlimited liability for banks roughly till 1879 when the law was changed in aftermath of the City of Glasgow Bank collapse.[25] The United States had double liability,[26] and triple liability,[27] till the Great Depression. In both cases, the reason for transitioning away from multiple liabilities was the burden it placed on ordinary shareholders to pay creditors for defaults.[28] This was especially because ordinary shareholders were not involved in the governance of the banks. The trajectory of limited liability in India will now be examined in more detail.

A. Unlimited Liability in Colonial India

The trajectory of company law in India roughly mirrors its corresponding development in Britain. However, the shift away from unlimited liability took place much sooner in the former, motivated in part by the specifics of the colonial economy. The first major banking failure occurred in 1848 with the Union Bank of Calcutta.[29] The Bank's unlimited liability status caused the failure to jolt the entire share market,[30] and led to debate amongst bankers regarding the utility of continuing with this standard of liability.[31]

For the next decade, the Indian legislature showed great deference to the academic and legal opinions back in Britain. When limited liability became an option for banks in 1858 in the latter; it was promptly adopted just two years later,[32] by the colonial administration as well.[33] Importantly, the first

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[25] In the 1850's, the survey - Matthew Willison, 'Were Banks Special? Contrasting Viewpoints in Mid-Nineteenth Century Britain' (2018) Bank of England Staff Working Paper No. 755<https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3249510> accessed 20 September 2020; John Turner, 'The development of English company law before 1900' Queen's University Centre for Economic History (QUCEH) Queen's University Belfast, Working Paper Series No. 2017–01 124 <https://www.econstor.eu/bitstream/10419/149911/1/877815712.pdf> accessed 1 October 2020.

[26] National Banking Act of 1863, ch 58, 12 Stat 665.

[27] Colorado, COLO STAT ANN vol 2, ch 18, § 50 (Mitchie, 1935) (repealed 1935).

[28] Jonathan Macey and Geoffrey Miller, 'Double Liability of Bank Shareholders: History and Implications' (1992) 27 Wake Forest Law Review 31, 37; Graeme G. Acheson, Charles R. Hickson and John D. Turner, 'Does limited liability matter? Evidence from nineteenth-century British banking' (2010) 6 Review of Law and Economics 247.

[29] Charles N. Cooke, *The Rise, Progress, and Present Conditions of Banking in India* (Bengal Print Company, 1863), 141-55, 290-95.

[30] ibid 293-297.

[31] Shyam Rungta, *The Rise of Business Corporations in India, 1851-1900* (CUP 1970) 42-48, 63-65.

[32] Act XIX Joint Stock Companies Act of 1857 (as amended in 1860), s I.

[33] ibid 66-68.

great economic bubble in India coincided with the first five years of limited liability for banks. This was spurred by the rise of the cotton industry in Bombay, which experienced a significant boom due to the supply of cotton from the Southern United States drying up as a result of the American Civil War.[34] During those four years, while the Confederate States of America, initially the primary source of cotton for Britain, was at war, the mills of Bombay experienced an unprecedented level of profitability which fuelled a speculation boom in the financial sector. Predictably, by the time the Confederacy was defeated and the Southern States resumed production, the sudden and drastic drop in demand caused a severe depression in Bombay. The Bank of Bombay, by 1866, was only able to return Rs. 100 on a Rs. 5,000 paid-up shares.[35]

There are several possible explanations for why liability standards were not re-examined following this period. As mentioned before, the Indian administrators had exhibited a lack of independent thinking in simply following the legal direction taken in Britain. Considering the British financial situation had remained stable throughout these years, supplemented at different times by cotton from either Bombay or Southern United States, there was no reason to re-open the discussion. Alternatively, the boom and bust of Bombay was dismissed as a one-off and revitalization of the economy was already put in motion, this time via the tea industry.[36] After all, the Indian economy was merely a proxy for fulfilling the needs of the British, as and when they arose.

What is striking is that this period of debate over the usage of limited liability has largely been forgotten in the modern discourse on law and business. Tripathi described unlimited liability as 'irritating' and opined that the exclusion of limited liability for banks in the 1857 Act was 'strange',[37] without noting the extensive discussions that took place during those times. This approach has led to a dearth of writing which scrutinizes limited liability as it applies to shadow banks and the possibility of altering this facet of law to better regulate the sector. The following sub-section will explore this question, much as colonial lawmakers were doing almost two centuries ago.

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[34] Dinshaw Edulji Wacha, *A Financial Chapter in the History of Bombay City* (Bombay: Commercial Press 1910) 212-15.

[35] Rungta (n 31) 75-85.

[36] ibid 90-100.

[37] Dwijendra Tripathi, *The Oxford History of Indian Business* (OUP 2004) 145.

B. Shadow Banks and Limited Liability: Enabling Overtly Risky Behaviour?

While it may now be clear that limited liability is far from predetermined, the reason why there is a need for India to adopt a stricter liability regime for NBFCs requires a brief overview of the functioning and importance of shadow banks. Taking from Lucien & Holger's earlier observation regarding incentive structures being skewed toward risk-taking, *Hill & Painter* identified how limited liability created a unique situation for bankers, especially for the shadow banks.[38] Not only was management in these firms using others money to make their investments, but limited liability ensured that they could spend much more than the value of their shares, and still have their own money protected.[39]

Thus, it can be said that shadow banks with limited liability give rise to 'moral hazard', whereby irresponsible and dangerous behaviour is encouraged via a corporate structure which unwittingly protects such behaviour.[40] Schwarcz has recognized that the limited liability regime has given rise to three market failures: a) information failure; b) agency failure; c) responsibility failure.[41] For our analysis on whether a different form of liability should be introduced, we will only focus on (c), the Responsibility Failure.

In the context of the Responsibility Failure, there are two salient points: First, shadow banks tend to be decentralized as they grow larger which leads to greater asymmetry in information between different parts of the company. Even in smaller banks, issues arise as power is often centred on primary investors/shareholders. The act of taking risks in their long-term investment strategies can lead to outsized profits.[42] Thus, management often opts to take these risks so as to increase their margins and, should the trades lead to insolvency, limited liability will cap the amount of money they lose. In the IL&FS example, this could explain why multiple high-profile investors such as LIC and HDFC Bank did not intervene prior to the 2018 collapse.

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[38] Claire Hill & Richard Painter, 'Berle's Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability' (2010) 33 Seattle University Law Review 1173, 1177–79.

[39] ibid 1183-84.

[40] Henry Hansmann and Reinier Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100 Yale Law Journal 1879, 1882.

[41] Steven Schwarcz, 'The Governance Structure of Shadow Banking: Rethinking Assumptions About Limited Liability' (2014) 90 Notre Dame Law Review 1 ('Schwarcz').

[42] ibid; Stacy Preston Collins, 'Valuation of Hedge Fund Businesses' (2008) 21 Journal of the American Academy of Matrimonial Lawyers 389, 397.

These shareholders failed to launch investigations despite the deterioration in the financial performance of the NBFC.[43]

Second, the strategy of intermediation,[44] plays a significant role in the problems experienced by Shadow Banks.[45] The act of short-term funding of long-term projects is a common business strategy among Shadow Banks, both in India and the United States. The risk with this approach is that the short-term debt might not be possible to pay back, especially when the long-term projects on which refinancing is dependent are delayed by several years.[46] This perfectly highlights the flawed approach taken by IL&FS.[47] The inability to pay back short-term debt due to massive delays in the projects it was funding, led to IL&FS defaulting and led to insolvency. Of note is that this occurred despite IL&FS being subject to prudential regulations under the RBI's 2016 directions which should have, in theory, allowed for sufficient monitoring.[48]

Why this is particularly dangerous for the larger economy is that the intermediation portfolio of a shadow bank may be in vital sectors.[49] Indeed, this was the logic behind the RBIs designation of IL&FS and other NBFCs as systemically important. The interconnectivity in the banking sector in general makes it likely that a single failure will rapidly lead to contagion and affect the economy and financial market as a whole.[50] While the dissolution of IL&FS dealt a significant blow to the economy,[51] a situation where

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[43] Hemindra Hazari, 'Behind IL&FS Default, A Board that Didn't Bark when it was supposed to' *The Wire* (17 Sep 2018) <https://thewire.in/business/behind-ilfs-default-a-board-that-didnt-bark-when-it-was-supposed-to> accessed 28 August 2020.

[44] Financial intermediation refers to the activities of an institution wherein it voluntarily assumes liabilities in order to acquire financial assets in return and does so through engaging in multiple financial transactions. The ultimate goal is to provide a source of funds, from lenders to borrowers, by acting as the intermediary between the two.

[45] Schwarcz (n 41) 20.

[46] Steven L. Schwarcz, 'Regulating Shadows: Financial Regulation and Responsibility Failure' (2013) 70 Washington & Lee Law Review 1781.

[47] Gurbachan Singh, 'How can we discourage IL&FS and Other Shadow Banks from Relying on Short-Term Funding?' *The Wire* (17 Oct 2018) <https://thewire.in/banking/ilfs-short-term-funding> accessed 14 October 2020; Andrew Crockett & Benjamin H. Cohen, 'Financial Markets and Systemic Risk in an Era of Innovation' (2001) 4(1) International Finance 127.

[48] Master Direction – Non-Banking Financial Company – Systemically Important Non-Deposit taking Company and Deposit Taking Company (Reserve Bank) Directions, 2016 (RBI/DNBR/2016-17/45) as on 16 July 2020.

[49] Anabtawi and Schwarcz (n 22) 1376.

[50] Steven L. Schwarcz, 'Systemic Risk' (2008) 97 Georgetown Law Journal 193, 207, 235 ("Schwarcz II").

[51] PTI, 'IL&FS default impact: NBFCs, HFCs lending to real estate estate almost halved in FY'19 to Rs. 27,000 cr, says report' *Firstpost* (25 July 2019) <https://www.firstpost.com/business/ilandfs-default-impact-nbfcs-hfcs-lending-to-real-estate-almost-halved-in-fy19-to-rs-27000-cr-says-report-7055161.html> accessed 15 October 2020.

some of the larger publicly traded NBFCs were to experience similar troubles would raise an even greater alarm.[52] Both are listed and traded on the National Stock Exchange and Bombay Stock Exchange, meaning a much larger number of ordinary people who trade in their shares would be hard hit by a downturn in their investments. Considering the size of these NBFCs and the greater diversity in their areas of investment in comparison to IL&FS or DHFC, defaults would spread to multiple sectors of the economy.[53] While the RBI has wisely decided to enforce Prudential Regulations on a host of NBFCs[54], IL&FS fate has been evidence that this may be insufficient.

C. Changes to Company Law Instead of Further Regulation

As already alluded to above, financial regulations have been opined as ineffective in preventing shadow bank failures. The RBI had, by virtue of classifying IL&FS as 'Systemically Important', imposed prudential regulations upon it.[55] In principle, this should have been enough to safeguard against banking failure. As the sequence of events shows, this belief was misplaced. Arvind Subramanian, the former Chief Economic Advisor to the Government of India, opines that the issue is not one of regulatory insufficiency, but rather supervisory incompetence.[56] In essence, the problem lies less with the exact parameters of the applicable Regulations and more with the RBI and SEBI's respective abilities to actually supervise compliance.[57]

He notes that IL&FS effectively covered up its bad loans by moving money around across its group of companies, which exceeded 300 entities.[58] He also

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[52] 'Largest NBFCs by Net Profit' *Moneycontrol* (Latest stocks) <https://www.moneycontrol.com/stocks/marketinfo/netprofit/bse/finance-nbfc.html> accessed 25 October 2020

[53] Schwarcz (n 41) 20.

[54] Master Direction – Non-Banking Financial Company – Systemically Important Non-Deposit taking Company and Deposit Taking Company (Reserve Bank) Directions, 2016 (RBI/DNBR/2016-17/45) as on 16 July 2020; Master Direction – Non-Banking Financial Company – Systemically Important Non-Deposit taking Company and Deposit Taking Company (Reserve Bank) Directions, 2015 (RBI/2015-16/23); Master Direction – Non-Banking Financial Company – (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

[55] Reserve Bank of India, 'List of Non-Deposit taking Systemically Important (NBFC-ND-SI) companies registered with RBI (As on July 16, 2020) <https://www.rbi.org.in/Scripts/BS_NBFCList.aspx>; Kavaljit Singh, 'How Should India Resolve the fault lines in its Shadow Banking System' *The Wire* (16 June 2019) <https://thewire.in/banking/india-shadow-banking-system-fault-lines> accessed 4 October 2020.

[56] Arvind Subramanian, *Of Counsel: The Challenges of the Modi-Jaitley Economy* (Penguin Books, 2018) 95-97.

[57] ibid.

[58] ibid; Press Trust of India, 'RBI's Regulatory failure created IL&FS mess, says Arvind Subramanian' *Economic Times* (Nov 29, 2018) <https://economictimes.indiatimes.com/

noted that RBI's Financial Stability Report made no mention of IL&FS, even in its 2018 edition, just before the NBFC collapsed.[59] The RBI in its own report on the failure, published in 2019, admitted that IL&FS had successfully hidden 4 years worth of bad loans from it.[60] What this alludes to is the reality that a majority of scholars,[61] have recognized that a bank which seeks to obfuscate and cover up its activities will always find creative ways to do so. The respective regulatory body, whether in the United States or in India, has always struggled to keep up.

The prevailing wisdom now is that focusing on trying to find ever more stringent RBI or SEBI Regulations is no longer prudent. *Sanyal* has detailed how increasing regulations across sectors merely shifts the systemic risks from one entity to another.[62] Greater regulations on regular banks were what caused businesses to turn to NBFCs to meet their credit needs. Now, trying to crack down on specific NBFCs will merely shift the systemic risk to other Shadow Banks. Like Subramanian, he advises much greater focus be placed on actual supervision and detection of potential issues in these entities.[63]

Thus, any further preoccupation with specific regulatory controls by the RBI and SEBI will risk missing the forest for the trees. Regardless, it seems that the RBI will continue to try and address this issue through regulatory means. Their recent discussion paper on NBFCs has proposed the creation of a 4-tier ranking of NBFCs with different regulatory obligations on each

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news/economy/policy/rbis-regulatory-failure-created-ilfs-mess-says-arvind-subramanian/articleshow/66866097.cms?from=mdr> accessed 24 February, 2021.

[59] Press Trust of India, 'RBI's reports never mentioned possible IL&FS crisis: Arvind Subramanian' *Financial Express* (July 12, 2019) <https://www.financialexpress.com/economy/rbis-reports-never-mentioned-possible-ilfs-crisis-arvind-subramanian/1642510/> accessed 25 February, 2021.

[60] Reuters, 'IL&FS may not have disclosed bad loans for 4 years' *Business Today* (Aug 15, 2019) <https://www.businesstoday.in/current/economy-politics/ilfs-may-not-have-disclosed-bad-loans-for-4-years-rbi-report/story/372754.html> accessed 24 February, 2021.

[61] Lee C. Buchheit, 'Did We Make Things Too Complicated?' (2008) 27 International Financial Law Review 24, 26 (noting complexity of financial transactions often obscures their riskiness); Steven L. Schwarcz, 'Disclosure's Failure in the Subprime Mortgage Crisis' (2008) Utah Law Review 1109, 1110 (pointing out that securities prospectus' are too long for average investors to read); Hans-Werner Sinn, 'Risk Taking, Limited Liability and the Competition of Bank Regulators' (2001) National Bureau of Economic Research Working Paper No. 8669 <www.nber.org/system/files/working_papers/w8669/w8669.pdf> access 20 November 2021; Anabtawi and Schwarcz (n 22).

[62] ENS Economic Bureau, 'Struct bank-type rules on NBFCs may shut off capital or shift systemic risk to another part of the system' *Indian Express* (Feb 21, 2020) <https://indianexpress.com/article/business/banking-and-finance/strict-bank-type-rules-on-nbfcs-may-either-shut-off-capital-or-shift-systemic-risk-to-another-part-of-system-6278741/> accessed 26 February, 2021.

[63] ibid.

tier.[64] What is important to note is that 9,209 out of 9,429 NBFCs will make up the bottom layer and have minimal additional regulatory controls placed upon them. The only major positive is the inclusion of the top 30 NBFCs to the 3rd tier which will mandate exposure, capital and provisioning rules similar to established banks. However, at the same time, cash reserve and liquidity ratios have not been introduced.[65]

The discussion paper seems to be attempting to walk a tightrope between regulation and allowing for economic growth. However, in line with *Sanyal and Subramanian's* views, further nit-picking on the exact ambit of regulations while not doing enough to improve actual supervision will inevitably lead to further banking crises down the road. The preferred and sustainable solution is the alteration of the incentive structure for management personnel in NBFCs. Keeping this in mind, this paper will now elaborate on the potential solutions to this issue under Company Law.

III. Alternatives to the Limited Liability Approach

With the scepticism about limited liability laid out, a possible alternative must be offered. Several have been posited over the past decade in the academic world, especially in the United States, the worst hit by the failure of shadow banks.[66] These alternatives have come from both economists/finance experts and lawyers/regulators. While the former are concerned mostly with methods of capping managerial pay and bonuses and tying them to the performance of the firm, the latter have looked at the possible influence of tort law and altering the corporate structure itself. While both sets of proposals have merit, the legal suggestions have, for the most part, avoided making any significant changes to limited liability beyond suggesting how one could go about it.[67] For this reason, the alternatives, as will be discussed, do not go far enough. The focus will instead be on a more radical and prescient approach, put forward by economists rather than lawyers, which correctly identifies the manner in which to alter the corporate structure while taking into account the past criticisms offered for unlimited liability.

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[64] Publications - Discussion Paper on Revised Regulatory Framework for NBFCs - A Scale-Based Approach, 22 January, 2021.

[65] Editorial, 'Regulating NBFCs' *Business Line* (Jan 27, 2021) <https://www.thehindubusinessline.com/opinion/editorial/regulating-nbfcs/article33677923.ece> accessed 23 February, 2021.

[66] Colin Mayer, *Prosperity. Better Business Makes the Greater Good* (OUP 2018) ('Mayer'); Peter Conti Brown, 'Elective Shareholder Liability' (2012) 64 Stanford Law Review 409.

[67] Schwarcz (n 41) 22-25 [suggesting that a redesign of limited liability will have to take into account two factors: a) reduce systemic risk, and b) avoid discouraging investment. He suggests double liability may be the optimum approach].

A. Legal Solutions to the Problems Caused by Limited Liability

The most popular solution forwarded by legal scholars has been a redefinition of the objectives of the board of directors/senior management of a banking company. Two primary means of effecting this redefinition have been suggested by *Schwarcz* and others.[68] These proposals include: a) Having a social component added to the duties of directors and management; and b) Focusing on torts as a means of checking externalities created by risk taking.[69]

With regard to the first, *Mayer* has opined that directors should be statutorily mandated to keep in mind the larger social and economic consequences of their actions. This will ensure that they will make decisions which guarantee the sustainability of the shadow banks they govern.[70] India has attempted to address this issue from a different perspective through Corporate Social Responsibility. The reception to it has been lukewarm at best. Its effectiveness and overall utility have been questioned often.[71] Additionally, as *Professors Goodhart and Lastra* note, mandating that Directors consider the economic fallout of their strategies can be redundant. It would be difficult to prove that Directors disregarded those larger responsibilities to society, as they can always defend themselves by claiming they acted to the best of their knowledge.[72] Ultimately, refocusing attention on CSR or a social component to Directors' duties may be futile due to the continuing limited liability regime and the incentive structure for directors and managers. Firms will treat the requirement in a formalistic manner, just like they do in India.

The second suggestion involves internalizing the costs of bad business decisions. When a bank fails, multiple outsiders who are involved in business with it or have relied on its representations are affected. These are externalities that tort law attempts to curb. It does so by penalizing the bank and the management personnel who are responsible for making the decisions that led to failure.[73] However, this solution has little utility in a situation where the

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[68] Mayer (n 66); S Schwarcz, 'Misalignment: Corporate Risk-Taking and Public Duty' (2016) 92 Notre Dame Law Review 1.

[69] Schwarcz (n 41) 10-12.

[70] Mayer (n 66).

[71] Pushpa Sundar, 'Five years after CSR became mandatory, what has it really achieved?' *The Wire* (21 Aug 2018) <https://thewire.in/business/five-years-after-csr-became-mandatory-what-has-it-really-achieved> accessed 4 October 2020.

[72] Charles AE Goodhart and Rosa Maria Lastra, 'Equity Finance: Matching Liability to Power' (2020) 6(1) Oxford Journal of Financial Regulation 1.

[73] Schwarcz (n 41).

bank and its shareholders are simply unable to pay up.[74] Additionally, the interconnected nature of the banking system as alluded to above, means the overall effects of a collapse can be wide-ranging to the extent that proving the prerequisites for a tort claim becomes too difficult.[75] From an Indian perspective, the backlog of cases and difficulty in gaining speedy redressal in Indian courts make this a toothless relief, not to mention the non-existent nature of tort litigation in general.

B. Non-Legal Alternatives and the Two-Tier Model of Liability

Most economists and scholars from the financial world have focused on methods of tying the performance of the bank to the remuneration of top management.[76] While this correctly identifies the need to align the interests of management with those of the firm, the more intriguing proposition from a legal perspective is that of *Professors Goodhart & Lastra* (**'the Professors'**). They have suggested creating a two-tier system of liability for shadow banks.[77] While the overall proposal is extensive and includes multiple caveats, they propose, in principle, that the liability regime should separate 'insiders' and 'outsiders' respectively. This is done by identifying those who are closely involved in the management of the company and have significant knowledge about the state of the market and the investment strategy being followed by the firm. These would be the 'insiders' who would be subject to a multiple liability,[78] while 'outsiders' who are not involved in the day-to-day management of the bank and are thus not responsible in case of defaults or failures, would retain limited liability protection.

The core concept of creating layers of liability may still be the correct approach. One of the most important concerns that it successfully addresses is the historical concern which led to unlimited liability and double liability being abandoned in the UK and US respectively: the disproportionate burden on the ordinary shareholder in case of default.[79] These shareholders

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[74] Nina A. Mendelson, 'A Control-Based Approach to Shareholder Liability for Corporate Torts' (2002) 102 Columbia Law Review 1203, 1209–10; Steven L. Schwarcz, 'Marginalizing Risk' (2012) 89 Washington University Law Review 487.

[75] Schwarcz (n 41) 10-12; Schwarcz II (n 50) 207, 235.

[76] Thomas Huertas, 'Rebalance bankers' bonuses: use write-down bonds to satisfy both supervisors and shareholders' (2019), SSRN: <https://ssrn.com/abstract=3336186> accessed 17 September 2020; Patrick Bolton, Hamid Mehran and Joel D. Shapiro, 'Executive Compensation and Risk taking' (2015) 19(6) Review of Finance 2139.

[77] Goodhart and Lastra (n 72).

[78] Multiple liability is seen as being greater than double liability but less than unlimited liability. For an example of where this has been used see Colorado (n 27).

[79] Text to (n 25); Text to (n 28).

would generically qualify as outsiders in this two-tiered model of liability and would, thus, be protected. Simultaneously, it targets the incentive structure of senior management and has more teeth than imposing a formalistic 'social component' to their responsibilities. The potential impact upon their own pockets, should their risky strategies lead to bankruptcy, acts as a natural deterrent through an alteration of the corporate structure.[80]

While this is an intriguing idea, it runs into practical issues. To begin with, as the Professors identify themselves,[81] the distinction between an insider and an outsider is not always clear. A sleeping member on the board would surely be considered an insider in their model, considering their position of seniority and, likely, high wages. However, in terms of actual knowledge of the company's affairs, one of the metrics that is used in the Professors' two-tiered approach, such a board member could very well know so little that he should be an outsider. Regardless, the Professors include such Directors, including external Directors, in the category of 'insiders' as, principally, silent partners or Board members retain the ability to significantly influence the functioning of the bank. This incentivizes these Directors to take a more active role in the running of the bank. Numerous other examples of instances where the two categories blend into each other and become indistinguishable can be listed.[82]

C. Classification and Problems with the Two-Tier Model

At the heart of it, the issue with this approach seems to be the identification of 'insiders'. The issue is not that one must have a precise and formalistic distinction. The Professors acknowledge that it will necessarily be arbitrary to an extent. Rather, the guidelines must be flexible so as to account for different situations across companies.[83] Therefore, what is important is identifying certain principles that can apply across banks, and are indicators of which individuals hold power inside banks. They provide the following principles to determine this demarcation: a) Shareholding Percentage; b) Decision-making power within the bank according to internal documents and Minutes of Meetings; c) Amount of remuneration.

Such usage of principles is preferable to simplistic usage of provisions which are, in no way, meant for this purpose. For example, Section 447 which deals with fraud under the Companies Act, implicitly categorizes

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[80] Steven L. Schwarcz, 'Understanding the Subprime Financial Crisis' (2009) 60 South Carolina Law Review 549, 562–63.
[81] Goodhart and Lastra (n 70).
[82] ibid.
[83] ibid.

Directors as 'insiders'.[84] However, that is incongruous with the purpose of this classification exercise which seeks to identify individuals who would be subject to multiple liability. A fraud provision would be unhelpful in that context. Further, no actual details regarding classification are contained in Section 447. Therefore, it is a manifestly inferior solution to the flexible principles enunciated by the Professors.

While the principles are helpful, the two-tier model arguably defines 'insiders' too broadly and includes too many of the lower-level managers or department heads in the mix.[85] These individuals may have a significant shareholding in the bank, or be paid extremely high wages which put them on a similar level as the board. It is quite possible that heads of risk management teams or chief analysts, for example, would be privy to the meetings and discussions surrounding the soundness of a particular strategy.[86] By several metrics they would be 'insiders'.[87] Armour notes that the most important decisions in implementing policies, actually lie with secondary managers.[88] However, in actuality, their ability to determine the overall direction of the bank is significantly reduced in comparison to the Executive Board and the Directors.[89] *Schwarcz* notes that these details are extremely specific and differ from each bank to the other.[90] As an aside, this is another reason why using proxies such as Section 447 are redundant. A model which would then equate the two groups in assigning greater liability by virtue of them being insiders may seem unfair.

Conversely, these "secondary managers" who are below the top executives and above the rank and file of the bank, often wield significant influence in the actual operation of the firm, if not on the overall policy. *Anabtawi & Schwarcz* have noted how secondary management handle highly technical tasks which are outside the expertise of more senior members who may not have studied or been exposed to such tasks.[91] The two-tier model does not sufficiently recognize these nuances, as such individuals may exert great

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[84] Companies Act 2013, s 447.

[85] Lucian Arye Bebchuk et al., 'Managerial Power and Rent Extraction in the Design of Executive Compensation' (2002) 69 University of ChicagoLaw Review 751, 777 (2002).

[86] Steven L Schwarcz, 'Conflicts and Financial Collapse: The Problem of Secondary-Management Agency Costs' (2009) 26 Yale Journal on Regulation 457, 458 ("Schwarcz III").

[87] Stephen M. Bainbridge, *Corporate Law* (2nd Ed. 2008) ss 5, 9.

[88] In the context of shadow banks, these can include managers in charge of selling, structuring and investing in securities, or overseeing loans and financial transactions. See Schwarcz III (n 86) 459-460.

[89] For the differences between primary and secondary management, see: Anabtawi and Schwarcz (n 22) 1376; Schwarcz III (n 86).

[90] Schwarcz (n 41).

[91] Anabtawi and Schwarcz (n 22) 1376.

influence on the execution of policies and by implication manipulate it if they choose to do so, actually being able to decide what that policy is. Whether they qualify as 'insiders' or 'outsiders' is left unclear and there is little guidance on how to address this confusion.

If we apply the functioning of certain managers, as laid out by Schwarcz & Anabtawi, to the principles laid out by The Professors, the results can be troubling. In terms of Principle (a), such managers could hold significant shares in the bank. In accordance with Principle (c), they may receive high salaries, due to their specific functions, as outlined above. However, as elaborated upon earlier, the reason Shadow Banks fail is often because of the policy. In that sense, Principle (b) plays a significant role and managers may not always be able to determine said policy, even if they are involved in the process in a minor way. They are, often, just executing it.

The Professors actually recognize this as a general problem, though not specifically in the context of secondary managers. They suggest that individuals, who may be concerned with the bank's policy, can confide in the regulatory authorities in order to signal themselves as conscientious objectors.[92] This would shield them from blame, and from the higher standard of liability, in case their fears turn out to be justified. However, the act of informing the regulator regarding potentially risky activities in one's own company carries several risks, discovery being the foremost.[93] This would almost certainly prejudice the individual's position at the firm, if not in the entire market, as the individual would be known as a whistle-blower.[94] However, as recent history shows however, the disaster is often not apparent right up until it is already too late.[95] In fact, having this standard makes it easier for careless individuals to pretend that they had serious doubts about the bank's activities all along. This would be easy to do in the 11th hour when the damage is already done and the disaster is imminent, by which point even the most irresponsible of managers can foresee a default.[96]

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[92] Goodhart and Lastra (n 72).

[93] Alexander Dyck, Adhair Morse & Luigi Zingales, 'Who Blows the Whistle on Corporate Fraud?' (2010) 65(6) The Journal of Finance 2213.

[94] K Giriprakash, 'Why India's Whistleblower Protection Programme is not as effective as that in the US' *The Hindu Business Line* (25 Oct 2019) <https://www.thehindubusinessline.com/companies/why-indias-whistleblower-protection-programme-is-not-as-effective-as-that-in-the-us/article29794564.ece> accessed 5 October 2020; Jayshree P. Upadhyay, 'Just how safe are whistleblowers under Indian law' *Livemint* (22 Oct 2019) <https://www.livemint.com/news/india/just-how-safe-are-whistleblowers-under-indian-law-11571763505941.html> accessed 4 October 2020.

[95] *See*, Steven L. Schwarcz, 'Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown', (2008) 93 Minnesota Law Review 373, 379-80.

[96] Matthew Rabin, 'Inference by Believers in the Law of Small Numbers' (2002) 117 Quarterly Journal of Economics 775, 776, 785-87; Anabtawi and Schwarcz (n 22) 1366-1367.

What this means is that secondary managers may be classified as 'insiders' as they may fulfil either or both of principles (a) and (c). However, as mentioned before, the third principle regarding decision-making power, is what actually leads to bank failure. An individual may be very well-paid, and/or hold many shares. However, they may not have much decision-making power, despite these two factors. In this situation, would it be fair to classify an individual with limited power over the bank's policy, as an 'insider'? This is an issue that must be addressed.

Finally, one further question remains of how to adjudge shareholders who jump ship by selling their shares before a crisis sets in. An individual may instead of raising the alarm, such a shareholder/manager could simply remain long enough to profit off the increase in value in the firm's shares and then liquidate at the appropriate time, before a downward trend sets in. The Professors try to deal with this and argue that if the shareholder/manager exits the company more than three years before a default, then that would be a sufficient buffer time to absolve them of liability.[97]

Once again though, this runs into practical pitfalls. The individual may not exit all at once but do so in a phased manner, especially to avoid suspicion. However, enough shares may be sold whereby he would fall outside the parameters of an insider. He may resign from managerial roles but still retain an informal means of staying updated on the ongoings at the bank. Thereafter, his reduced shareholding would still allow him to profit while simultaneously enjoying the reduced liability associated with an outsider.

These shortfalls do not have an easy fix. However, what the Professors correctly identify, is that the fundamental solution lies in diluting limited liability. In the next section, I will outline my proposal for how the two-tier system of liability can be adjusted in a way that achieves the objective of disincentivizing risk-taking, as well as encouraging whistleblowing on dangerous investment strategies being followed by an NBFC. While the third issue is a stand-alone problem, it is no less pressing and will also be dealt with.

IV. A Three-Tier Approach to Liability

From the discussion above, we have identified three lacunae that have to be addressed in case of any attempt to change the liability regime: a) The classification of individuals within the two-tier model which may lead to overreach; b) The problem of conscientious objectors within management

[97] Goodhart and Lastra (n 72).

who may be left vulnerable if they choose to blow the whistle or be saddled with multiple liability if they decide not to; and c) Identifying and holding liable the shareholders/managers who exit the bank prior to its collapse in order to escape liability. Sub-section A will attempt to address (a) and (b) cumulatively, while B will tackle (c) separately. Drawing from the Professors' implicit assumption, we assume that the upper management and directors are also partial shareholders in the company.

A. The Role of Secondary Management and the Intermediate Tier

To begin with, the two-tier model creates a black and white picture of a bank's corporate hierarchy and functioning and often misses out on the nuances that have been highlighted above. To prevent this, the dilution of limited liability should be more structured by distinguishing between levels of management on the basis of factors that have already been alluded to.[98] Particularly, what I suggest is that we abandon the binary distinction of 'insider' and 'outsider' and add an extra layer of intermediary liability between the senior-most executives/shareholders who are involved in the running of the firm, and the ordinary shareholders who are not involved at all, and who are subject to limited liability. In this intermediary layer, we will include the secondary managers alluded to above. In this manner, proportionate liability will be allotted to each level: triple liability to senior-most managers and directors, double liability to secondary managers and limited liability for ordinary shareholders.

The Professors, in passing, recognize the possibility of including double liability but do not elaborate on the exact category of individuals who would fall under this. The specific situation faced by secondary managers, as elaborated on above, has largely been overlooked. Schwarcz puts this down to the fact that, as secondary managers are subject to control by the top management anyway, there is little utility in looking into the effects of their actions.[99] However, secondary managers such as analysts play a significant role in structuring the securities sold by shadow banks. The Collaterized Debt obligation (CDO) or the mortgage bonds with multiple subprime mortgages were the securities which facilitated the 2008 collapse. Regardless of the highly technical nature of their job, due to the buffer zone they occupy between the senior management and the rest of the shareholders, their

[98] See Lucian A. Bebchuk et al., 'The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008' (2010) 27 Yale Journal of Regulation. 257, 263-64 (discussing the compensation of bank executives).

[99] H.D. Vinod, 'Conflict of Interest Economics and Investment Analyst Biases' 70 (2004) Brooklyn Law Review 53, 69, 72.

peculiar position requires greater scrutiny in order to make clear why they should occupy the middle rung in a triple-tiered liability structure.

The nature of their work makes them important for the three-tier liability model being proposed here. Unlike non-participative shareholders, due to their daily activities and conversations with the top brass, secondary managers are updated on the policy of the bank and the potential dangers associated with it. In some cases, even more so than senior managers, considering they are the ones who actually know the viability of the securities they are buying and selling. In India's case, this may not be that great a concern, considering the small bond market (even though it is likely to continue growing).[100] Regardless of whether the commodity in question is a highly complex financial instrument, the position held by secondary managers in the process of financial transactions and their participation in meetings gives them an insight into the company's direction.[101]

This anomalous position of secondary managers may be utilized to prevent bank failure. Recall earlier, where the difficulty in recognizing that a bank is heading toward a default was mentioned. Thus, what is necessary is to incentivize this class of managers to be vigilant and raise red flags regarding the potential effects of the company's business model. Thus, they must be subjected to a higher level of liability than ordinary shareholders as it would greatly increase their incentive to be cautious. It would also reduce the burden on outside shareholders to conduct due diligence when most of them may not have the resources nor the expertise to do so.[102]

Such managers would be subject to multiple liability under the Professors' model of two-tiered liability. As identified above, this would be a problem as they often lack policy-making ability, which is the primary determinant of whether a bank fails. Thus, they are 'insiders' within the two-tier model, but do not have the ability to prevent banks from taking dangerous policies. Therefore, recognition of this unique situation would require that they not be subject to multiple liability. Instead, double liability would be a better approach. This appropriately recognizes the level of actual power that they hold.

I suggest that double liability for secondary management serves another purpose. Double liability can motivate secondary managers, who are

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[100] Karan Bhasin, 'India's corp bond market is finally drawing interest' *Livemint* (19 Aug 2020) <https://www.livemint.com/mutual-fund/mf-news/india-s-corp-bond-market-is-finally-drawing-interest-11597853629092.html> accessed 4 October 2020.

[101] Dyck, Morse and Zingales (n 83).

[102] Steven L. Schwarcz & Lucy Chang, 'The Custom-to-Failure Cycle' (2012) 62 Duke Law Journal 767, 789; Schwarcz II (n 50) 207.

sceptical of the financial soundness of the intermediation strategy followed by the company, to try and intervene in policy formulation. If they are unsuccessful, their only remaining avenue would be to blow the whistle to regulators regarding the bank's policies. As previously noted, the Professors had suggested whistleblowing as a way of avoiding liability. However, the important drawback in their model was the unlimited liability that individuals would be exposed to in case they were unable to do so. In the three-tier model, they could potentially avoid a comparatively lower double liability standard imposed on them by the company defaulting.

However, in an Indian context, the protections for whistle-blowers and the mechanism for addressing their concerns are weak.[103] Two whistle-blowers from IL&FS had attempted to alert management to the goings on at the company but were turned away.[104] Furthermore, whistle-blowers often face punishment,[105] and threats in terms of their careers and even their lives, for attempting to raise their voices.

Therefore, to get the most out of this opportunity, a revamping of India's whistle-blower laws is necessary.[106]

One could argue that this distinction is unnecessary as the highest level of liability (triple liability in our model) would go to the greatest extent toward encouraging secondary managers to raise red flags. However, this would run into the same issue as with CGB and Depression-era banks i.e., people being disproportionately punished in case of bankruptcy. The history of banking and the consequences of companies failing has shown that the perception of unfairness is a powerful determinant for which policies are acceptable and which are not.[107] Moreover, we would be underestimating the dangers that

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[103] The Whistleblowers Protection Act, 2014 applies only to public servants and is inadequate for dealing with corporate fraud; Section 177(9), Companies Act, 2013 r/w The Companies (Meetings of Board and its Powers) Rules, 2014 requires an audit committee to investigate complaints from whistleblowers. However, there is no external protection for whistleblowers outside of the internal audit committee.

[104] PTI, 'IL&FS fraud: Whistleblower sought to uncover it in 2017, but top-brass covered it up' *The Hindu* (9 June 2019) <https://www.thehindu.com/business/ilfs-fraud-whistleblower-sought-to-uncover-it-in-2017-but-top-brass-covered-it-up/article27703369.ece> accessed 6 October 2020.

[105] The Companies (Meetings of Board and its Powers) Rules, 2014 allow companies to move against employees who make "frivolous complaints".

[106] For a comparative perspective see Sulette Lombard, 'Regulatory Policies and Practices to Optimize Corporate Whistleblowing: A Comparative Perspective' in Sulette Lombard, Vivienne Brand and Jane Austin (eds), *Corporate Whistleblowing Regulation: Theory, Practice and Design* (Springer Link 2020).

[107] Paddy Ireland, 'Limited liability, shareholder rights and the problem of corporate irresponsibility' (2008) 34(5) Cambridge Journal of Economics 837.

accompany raising concerns internally regarding bank investment policies, as discussed briefly already.

To summarize, the basic idea put forward by the Professors is the correct approach. The targeted dilution of limited liability is necessary, but it is only effective if it is flexible and recognizes the difference between groups of shareholders and managers. The three principles do so to a certain extent. However, it is submitted that the intermediate layer of liability that has been proposed goes further toward recognizing that complexity. This three-layered liability regime should ideally be divided into escalating levels with only the ordinary shareholders who are outside the functioning of the company having limited liability. While it is true that limited liability was meant to incentivize economic growth, it is only natural that alterations to this must be made over time, in order to prevent the externalities that have, regrettably, arisen over time.

B. Opportunistic Share Transfers as a Means of Escaping Liability: Lessons from the United States

Having laid out the three-tiered liability regime and discussed the issues pertaining to whistle-blowers, we can now address the remaining issue of opportunistic transfer of shares to consolidate the three-tier model. This problem was not adequately tackled by the Professors. However, as *Macey & Miller* have comprehensively demonstrated, this is not a novel concern. Throughout the history of double liability in the United States, the issue of transfer of shares prior to insolvency, whether opportunistic or otherwise, and complications arising out of such deals, was often faced by courts. Thus, the question of identifying the person who would be liable to pay has an extensive jurisprudence that domestic courts in India may readily draw from.

The jurisprudence on this point is extensive and will not be reproduced entirely here. However, of importance was the way the United States Courts tackled the issue of bank holding companies, which would be relevant in an Indian context given that several of the largest NBFCs are subsidiaries of larger holding companies and form part of a group.[108] The Courts took a significant step in finding the shareholders of the holding company itself liable, rather than the company, even though it was the latter which was recorded

[108] Group structure of Bajaj Finserv and its subsidiaries, accessible at: <https://www.bajajfinserv.in/group-structure>; Group Structure of Mahindra Finance, accessible at: <https://mahindrafinance.com/discover-mahindra-finance/subsidiaries>; A survey of the Top 10 NBFCs showed that all of them were subsidiaries of a holding company and themselves had multiple subsidiaries dealing with different areas of finance.

as the shareholder on the subsidiary banks' books.[109] Even the dissolution of the holding company would not offer any reprieve for the shareholders who would be traced and held personally liable for the debts of their former subsidiary.[110]

The issue that will likely be the most common, is the opportunistic transfers of shares, as already identified by Professors Goodhart & Lastra, and alluded to above. Macey & Muller demonstrate the Courts' deft handling of multiple scenarios. The broad rule, which was highly effective in ensuring that creditors received as much of their money back as possible, was that any transfer made to a person who could not fulfil the liability obligation, would be '*void as to the creditors*.' This meant that creditors would receive their money back from solvent shareholders who had transferred their shares prior to insolvency to individuals who did not have the financial capacity to pay.[111] However, in order to bring some balance to this rule, it was also held that if the transfer was 'final and without recourse', the transferor would be liable for only the debts accumulated prior to the transfer.[112]

In case the transfer was made before any significant troubles were experienced by the bank, the determining factor was whether the transfer was effected for the purpose of avoiding future liability. This would be gleaned from surrounding circumstances and also looking at the nature of the transferee and whether the underlying intention of the agreement was to treat the transferee as a nominee of the transferor.[113] In dealing with this issue, an alternative solution would be for legislative rules to specify a cut-off date beyond which transfers are deemed to be for the purpose of avoiding liability.[114] This would be for the purpose of avoiding judicial discretion over the issue and laying down a definitive rule, if that is deemed a better method.

What this series of cases shows is that practical issues are bound to arise following a dilution of limited liability. However, this should not act as a deterrent, especially when there are past cases to fall back upon and from which to take guidance. The ancillary problems in applying the three-tier

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[109] *Anderson v Abbott*, 321 US 349 (1944); *Fors v Farrell*, 260 NW 886 (Mich. 1935).

[110] *Benton v American Nat'l Bank*, 276 F 386 (5th Cir 1921).

[111] *McDonald v Dewey* 202 US 510, 520 (1906); *Stuart v Hayden* 169 US 1, 8 (1898); *Pauly v State Loan & Trust Co*, 165 US 606, 619 (1897); *Richmond v Irons*, 121 US 27, 58 (1887); *Bowden v Johnson*, 107 US 251, 261 (1882).

[112] *McDonald v Dewey*, 202 US 510.

[113] *Davis v Stevens* 7 F Cas. 177, 178 (SDNY 1879).

[114] For example, the US introduced 38 Stat 273 (1913) for the purpose of preventing "dishonest or cowardly" shareholders from transferring their shares within 60 days of a bank's default to "some dummy" to avoid double liability Changes in the Banking and Currency System of the United States, HR Rep No 69, 63d Cong, 1st Sess 72 (1913). This could potentially be adapted to include a certain number of days prior to default as well.

standard of liability will require a combination of legislative and judicial intervention. I do not contend that the two areas highlighted above are the only potential complications and, undoubtedly, further scholarship on this will be required. This is merely an attempt to pave the way forward by addressing some foreseeable hurdles in giving the layered model of liability its full effect. Taken together, these legal adjustments can assist in preventing banking failures, as well as in fairly allocating responsibility for those that are unavoidable.

C. Can the Three-Tier Model Apply to other Companies?

A question that may arise is whether the proposal outlined above can be extrapolated to companies of all kinds. Corporate insolvency is certainly not restricted merely to shadow banks and occurs across sectors, with several notable examples in the recent past. The Professors and Ireland certainly believe that their own critiques of, and alternatives for, limited liability may be extended to all companies eventually.[115] Simultaneously, the Professors note that it is inadvisable to make this extension in the short-term as further study is required on specific practical concerns in different sectors. To that effect, they identify shadow banks as urgently in need of regulation. On the contrary, Schwarcz believes that shadow banks are special in ways that make a dilution of limited liability an exclusive requirement for them. Thus, there is no need to extend this to other corporations.[116]

Regardless of the disagreement, all agree that shadow banks have exceptional regulatory requirements. Their approach of prioritizing a dilution of limited liability for shadow banks has historical support. In line with the experience in colonial India, 19th-century lawmakers in the UK and US specifically desired that banks mandatorily have unlimited liability, even while limited liability was made an option for all other forms of companies.[117] Many of these reasons reflect modern concerns regarding limited liability for banks. Primary among these issues was the difficulty for creditors and small shareholders to accurately track the financial health of the bank they invested in. As the bank's own investment portfolio can be very diverse and constant monitoring of the status of these loans is difficult, legislators believed there was an exceptional risk associated with banks.[118] As already

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[115] Goodhart and Lastra (n 72) 23; Ireland (n 107) 837, 845-847.
[116] Schwarcz (n 41) 19-22.
[117] Matthew Willison, 'Were Banks Special? Contrasting Viewpoints in Mid-Nineteenth Century Britain' Paper No 755 (2018) Bank of England Staff; Ireland (n 107).
[118] ibid.

outlined above, this is a prominent issue for shareholders in both the two and three-tier models, reflecting the same fears that existed 150 years ago.

A second issue is the position of banks in the economy. As Schwarcz has also outlined in the modern era, shadow banks act as the middle point between multiple sectors and projects. The interwoven network of loans makes any banking failure much more likely to cause contagion across the economy.[119] Additionally, as has been elaborated on extensively above, the investment strategy of an NBFC such as IL&FS increases the actual possibility of a failure. Thus, the higher possibility of such entities actually failing and the consequent possibility of causing systemic harm has led to all these scholars agreeing on an immediate need to regulate them.[120]

Beyond this point, I agree with the Professors' principled position that a solution should be conceived for other corporations as well. However, this does not necessarily mean that it must be a targeted dilution of limited liability, as has been proposed for shadow banks. Ireland notes that it is worth exploring alternative options which principally look to detach governance rights from shareholding,[121] which is an intriguing and far-reaching recommendation in and of itself. Economists have weighed in with proposals outlining different remuneration structures for Directors and senior management.[122] The entire ambit of these different solutions for companies in other sectors of the economy cannot be detailed here and requires a separate and thorough discussion. What is agreed upon by lawyers, academics and economists, is that the specific structure and position of shadow banks means a dilution of limited liability is a practical solution for an urgent problem.

D. Implementing the Three-tier Model

One further point of interest may be the manner in which the IBC would interact with this altered model of liability. Considering the statute was brought about to prevent the winding up of companies in the public interest, the question may arise as to when enforcement of multiple or double liability against management would actually take place. However, this is predicated

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[119] Schwarcz (n 41) 19-22, 25.

[120] Schwarcz (n 41) 19-22; Goodhart and Lastra (n 72).

[121] Ireland (n 107) 837, 856

[122] Thomas Huertas, 'Pay to Play' (17 February 2019) <https://ssrn.com/abstract=3336186> accessed 20 November 2021 (revised May 2019, now entitled 'Rebalance bankers' bonuses: use write-down bonds to satisfy both supervisors and shareholders'); CW Calomiris and RJ Herring, 'How to Design a Contingent Convertible Debt Requirement that Helps Solve Our Too-Big-to-Fail Problem' (2013) 25(2) Journal of Applied Corporate Finance 39; Patrick, Hamid and Joel D, 'Executive Compensation and Risktaking' (2015) 19 Review of Finance 2139.

on the assumption that the liability only comes into effect at the time of insolvency and closure. The Professors consider their model to be applicable even in the occurrence of an actual loss and not merely when the bank has failed entirely.[123] Economists have provided multiple ways in which this may be effectuated.[124]

Another way of looking at the question of applying such unlimited liability would be to make adjustments to the Insolvency and Bankruptcy Code itself. The process of revival of the bank could take into account the assets of the 1st and 2nd tier. Considering that multiple and double liability applies to them respectively, that proportion of value in terms of their personal wealth/assets may be included in the Resolution Plan for repayment of loans to different creditors. Board members of both IL&FS and Yes Bank have been subjected to criminal liability and the addition, in this case would be to also make them liable for repayment of the debts of the bank.

Both of these usages of this altered model of liability can exist simultaneously and it may be unnecessary to restrict it to merely one or the other. However, for the present purposes, a thorough examination of how these two scenarios may play out may require greater elaboration than can be included within this paper. However, the ideal scenario should be to include both these usages in order to take full advantage of this alteration in liability.

V. Civil or Criminal Liability for Senior Management

As mentioned, our discussions above address the senior and secondary managers who are also shareholders, to whatever extent, in the company. While this may be the case for small to medium-sized NBFCs this is not always true for the largest ones, whether private, public or listed. Given this, a further method of controlling the excesses associated with shadow banks is the imposition of sanctions, both civil and criminal. However, the recent track record of utilizing these legal tools has been underwhelming.[125] Even in the United States, the aftermath of the subprime mortgage crisis saw only

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[123] Goodhart & Lastra (n 72) 15.

[124] P Sinclair, 'Advantages and Drawbacks of Bonus Payments in the Financial Sector' in G Caprio, P Bacchetta, J Barth, T Hoshi, P Lane, D Mayes, A Mian and M Taylor (eds), *The Handbook of Safeguarding Global Financial Stability* (Academic Press 2012) 259; John Thanassoulis and Misa Tanaka, 'Optimal pay regulation for too-big-to-fail banks' (2018) 33 Journal of Financial Intermediation 83; Goodhart & Lastra (n 72) 16-17.

[125] In India, cases against directors or management personnel in the aftermath of banking collapses have been primarily criminal charges, brought against a very small group of individuals within the company.

a single arrest of a banker, Kareem Serageldin.[126] Even in that case, he was far from being part of the senior management and would have fallen within the 'secondary management' bracket.[127] The disappointment and outrage of the public in seeing the vast majority of top managers/shareholders get away with nothing more than fines/penalties, and in some cases not even that, was palpable.[128]

In comparison, the Serious Fraud Investigation Office (**'SFIO'**) has investigated IL&FS aggressively, even though the focus has only been on a small group of individuals in the company. Regardless, two arrests of senior management,[129] were made and criminal proceedings against them are ongoing. Despite this, the absence of a clear legal framework for dealing with group liability in India which holds directors personally liable is a cause for concern. Part V of this paper will look at the state of the law regulating liability for directors/managers in India and in other jurisdictions, with emphasis on the United States. In doing so, it will delve into the debate on whether civil or criminal sanctions are most appropriate for addressing corporate misconduct and how the shadow banking sector's peculiarities affect the outcome of the discussion. It will suggest that, instead of focusing on each individual's actions, the law of civil liability should instead look at the group of senior management as a whole where the manner in which a bank functioned or collective negligence regarding the effects of the bank's policies made it more likely to default.

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[126] Peter J. Boyer, 'Why Can't Obama Bring Wall Street to Justice?; Maybe the Banks Are Too Big to Jail. Or Maybe Washington's Revolving Door Is at Work' *Newsweek* (14 May 2012) <https://www.newsweek.com/why-cant-obama-bring-wall-street-justice-65009> accessed 4 October 2020; Marian Wang, 'Why No Financial Crisis Prosecutions? Ex-Justice Official Says It's Just Too Hard', *Propublica* (6 Dec, 2011) <https://www.propublica.org/article/why-no-financial-crisis-prosecutions-official-says-its-just-too-hard> accessed 4 October 2020.

[127] Jesse Eisinger, 'Why only one Top Banker went to Jail for the Financial Crisis' *New York Times* (4 May 2014) <https://www.nytimes.com/2014/05/04/magazine/only-one-top-banker-jail-financial-crisis.html> accessed 10 October, 2020.

[128] Ben Hallman, 'Too Big to Jail: Wall Street Executives Unlikely to Face Criminal Charges, Source Says' *Huffington Post* (8 Sept 2012) <https://www.huffingtonpost.in/entry/criminal-charges-wall-street_n_1857926?ri18n=true> accessed 5 October 2020.

[129] Rashmi Rajput, 'How an IL&FS arm systematically kept lenders in the dark' *The Economic Times* (4 June 2019) <https://economictimes.indiatimes.com/industry/banking/finance/sfio-alleges-ilfss-subsidiary-forged-documents-for-loans/articleshow/69642211.cms> accessed 26 September, 2020; Rashmi Rajput, 'ED arrests two former IL&FS executives in PMLA probe' *The Economic Times* (19 June 2019) <https://economictimes.indiatimes.com/news/politics-and-nation/two-directors-of-ilfs-arrested-by-mumbai-ed-reports/articleshow/69863036.cms?from=mdr> accessed 26 September, 2020 (Rajput ED).

A. Limitations of Civil Law Sanctions

Civil charges can be brought under Section 447 of the Companies Act.[130] While it has been used intermittently since its inception, it has recently been used to pursue charges of fraud in the aftermath of the *Bhushan Steel insolvency*.[131] However, the charges in those cases are criminal in nature. The drawback of these standalone provisions is that there is no mechanism for holding entire groups liable.

There may be a misconception that Indian law allows for the group of directors to be liable. This is an erroneous assumption. The actual difference between group and individual liability has been elaborated upon in American jurisprudence. Group liability connotes liability that is determined at the group level where individual behaviour is irrelevant.[132] This is used in cases where the duty of care and other fiduciary duties have been breached. This is a no-fault liability for the entire board for a particular failure.[133] The reason for this is that determination of which particular director is liable in cases of negligence/failure of due care, is difficult.[134] Thus, when the company suffers due to such negligence, such as when a bank fails due to dangerous policies, the entire Board is liable. Importantly, this is regardless of whether they were directly involved in the decision, or whether they were in charge of implementing that policy.[135] Individual liability for different directors, is for cases of disloyalty or fraud where each director's actions are evaluated.

Fiduciary duties under the Companies Act are provided under Section 166. However, there is no parallel case law in India which applies the group liability principle in the same way as American courts have done. Additionally, Section 166 defines fiduciary duties for each director individually and does not explicitly talk about the Board's liability as a group.[136] Case law does not provide any further assistance on this matter.

Picking individual directors or managers from companies for liability does not address the issue. Directors state that the Managing Director or other specific Directors had greater knowledge than them, and should be the ones held responsible. The claim that decisions were made by the group of

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[130] Companies Act 2013, s 447.

[131] For notable exceptions, see: *Serious Fraud Investigation Office v Neeraj Singhal* (2019) 11 SCC 446 (Supreme Court of India); *Serious Fraud Investigation Office v Nittin Johari* (2019) 9 SCC 165 (Supreme Court of India).

[132] Darian M. Ibrahim, 'Individual or Collective Liability for Corporate Directors?' (2008) William & Mary Law School 1689, 1700-1705.

[133] *Smith v Van Gorkom* 488 A2d 858 (Del 1985).

[134] Ibrahim (n 149).

[135] *Smith v Van Gorkom* 488 A2d 858 (Del 1985).

[136] Companies Act 2013, s166.

Directors can be circumvented by claiming that accurate information was not provided. Moreover, the question of whether a particular policy is the best for the company is not an objective fact. It is a subjective evaluation. Therefore, without having no-fault liability, Directors have several ways to avoid responsibility.

The IL&FS board was criticized for failing to step in when the actions of senior management began showing signs of hurting the company.[137] Negligence-based liability for directors is provided under the Companies Act However, no attempt has been made to enforce it against them thus far.[138] Holding them liable would not be a problem if no-fault group liability was possible. As it stands, only specific directors have been charged with criminal sanctions while the rest of the Board has not been impugned. Further, offences under Section 166 are compoundable, thus making it possible for any individual director to merely plead guilty and pay a fine.

Similar issues exist with the doctrine of piercing the corporate veil. While fraud is one of the grounds which may allow for the doctrine to be utilized for imposing personal liability on a director,[139] the process of enforcing it through courts is tedious enough that, once a default takes place, it becomes essentially redundant to subsequently go through the process. Looking into all the facts behind the functioning of a company is difficult. This is especially so considering the complexity in shadow bank functioning, as already explained.[140] Further, it would only impugn specific directors, which once again fails to address the issue highlighted above. Further, the complexity of NBFC's functioning and difficulty in ascertaining crucial facts in the aftermath of fraud in such large corporations, reduces the doctrine's utility. Narrow exceptions, such as violations under the Prevention of Money Laundering Act, allowed the SFIO and Enforcement Directorate to proceed directly against the IL&FS management.[141]

In adjudging whether civil liability is an adequate approach to the issue of fraud or other violations by directors, most proponents believe that criminal penalties are too harsh.[142] Considering their crimes are primarily in the

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[137] Hazari (n 43).

[138] Companies Act 2013, ss 2(60) and 166(3).

[139] *Estate Officer v Esys Information* (2016) 12 SCC 582 (Supreme Court of India); *S. Sukumar v Institute of Chartered Accountants of India* (2018) 14 SCC 360 (Supreme Court of India).

[140] Mohsen Manesh, 'The Case Against Fiduciary Entity Veil Piercing' (2017) 72(1) The Business Lawyer 61, 63-67; Colin P. Marks, 'Piercing the Fiduciary Veil' (2015) 19(1) Lewis & Clark Law Review, 73

[141] Rajput ED (n 129).

[142] Christine Hurt, 'The Undercivilization of Corporate Law' (2008) 33 Journal of Corporate Law 361, 364.

realm of financial theft, a corresponding financial punishment or penalty would be the proportionate response.[143] In India, the practice of reaching settlements with violators, especially for regulatory violations in listed companies, is common and often precludes further investigation into the matter by SEBI.[144]

Further, the Business Judgment Rule,[145] though not popular in India, protects managers from liability as it provides a significant degree of leeway in the functioning of a company.[146] Unlike in criminal suits where the rule does not apply, civil suits are often dismissed on these grounds in jurisdictions where the rule has seen more substantive litigation.[147] Even apart from this, the aforementioned issues pertaining to difficulty in going through complex internal functioning at a financial institution and pinpointing liability, often eventually leads to settlement. Again, in criminal proceedings, settlement would not be an option.

Further, the legal process of proving civil claims, despite having a lower evidentiary standard than criminal law, remains difficult. Essentially, such claims present a mere theoretical financial risk for an executive or director rather than a certain one.[148] Directors have a large number of defences at their disposal, such as the Business Judgment Rule, proximate cause, lack of causation, remoteness of the specific harm, and so on. In this way risk of being held liable can be significantly diminished during adjudication through the usage of the vast legal and financial resources that these individuals often have at their disposal. A director has every reason to be bullish about his

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[143] ibid.

[144] For example, see: PTI, 'MFL shares case: SEBI settles insider trading matter, receives 15 lakh toward settlement charges', *Moneycontrol* (26 June 2020) <https://www.moneycontrol.com/news/business/mfl-shares-case-sebi-settles-insider-trading-matter-receives-rs-15-lakh-towards-settlement-charges-5465171.html> accessed 3 October 2020; PTI, 'Four individual settle insider trading case with SEBI' *The Economic Times* (26 June 2020) <https://economictimes.indiatimes.com/markets/stocks/news/four-individuals-settle-insider-trading-case-with-sebi/articleshow/76645800.cms?from=mdr> accessed 3 October 2020.

[145] The Business Judgment Rule creates a presumption that the directors are motivated in their actions and decisions by the best interests of the corporation which they are managing. The Rule has used in several common law jurisdictions, but there is little discussion of it in India. See generally *Gimbel v Signal Cos*, 316 A2d 599, 608 (Del Ch 1974); *Dodge v Ford Motor Co*, 204 Mich 459, 170 NW 668 (1919).

[146] Martin Petrin, 'Circumscribing The "Prosecutor's Ticket To Tag the Elite"—A Critique of the Responsible Corporate Officer Doctrine' (2012) 84 Temple Law Review 283, 303.

[147] *ibid; Cede & Co v Technicolor, Inc* 634 A2d 345 (Del. 1994); *Aronson v Lewis*, 473 A2d 805 (1984).

[148] Jennifer G. Chawla, 'Criminal Accountability and Wall Street Executives: Why the Criminal Provisions of the Dodd-Frank Act Fall Short' (2014) Law School Student Scholarship 451; Lisa M. Fairfax, 'On the Sufficiency of Corporate Regulation As an Alternative to Corporate Criminal Liability' (2011) 41 Stetson Law Review 117, 118.

chances of taking extreme risks in investment strategies as it is likely he/she will be able to profit enough that any penalty, if it is awarded at the end of day, will be a small chunk of their newly accumulated wealth. Importantly, this kind of ambitious behaviour cannot amount to fraud. Fraud requires intent, or mens rea, which is obviously missing in these instances. Rather, the breach in such cases is failure to exercise due care or negligence, in terms of the policies of the Shadow Bank. This would not be a problem in India if collective liability was recognized under the Companies Act.

The general belief, echoed in the United States, is that civil charges may punish, but are unlikely to deter.[149] The fact that the penalties or fines can be successfully mitigated through aggressive litigation and in many cases ends in a negotiated settlement with the regulatory authority rather than an outright guilty verdict, reduces the potential of being found guilty of some form of civil violation to a mere 'cost of doing business'.[150] This reality is seen starkly in the periodic struggles that keep plaguing Wall Street every few years. Most prominently, any banker looking at the aftermath of the 2008 crisis would have been reassured that the chances of being imprisoned were essentially non-existent and the defences available to civil actions were robust. In the IL&FS scenario, it has been widely reported that the Board was negligent and several members of management and the board made vast sums of money through bonuses.[151] A similar story can be told for Yes Bank.[152] Yet barely a handful of them have been pulled up for criminal fraud or other violations by SFIO or SEBI. The remainder have not, as of yet, suffered any sanction.

B. Criminal Sanctions: Effective but Inapplicable

Criminal liability is thus of great importance in acting as an efficient deterrent to wrongdoing by management. While there is significant literature on the effects of incarceration and its potential deterrence value,[153] the high

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[149] Lisa L. Casey, 'Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud' (2010) 35 Delaware Journal of Corporate Law 1, 17.

[150] ibid.

[151] Subrata Panda, 'Former IL&FS directors got lucrative paychecks even as firm collapsed' *Business Standard* (21 Dec 2019) <https://www.business-standard.com/article/companies/former-il-fs-directors-got-lucrative-paychecks-even-as-firm-collapsed-119122100018_1.html> accessed 10 October 2020.

[152] Shrimi Choudhary, 'YES Bank loan fraud: CBI charges Rana Kapoor with criminal conspiracy' *Business Standard* (25 June 2020) <https://www.business-standard.com/article/current-affairs/yes-bank-loan-fraud-cbi-charges-rana-kapoor-with-criminal-conspiracy-120062501509_1.html> accessed 16 October 2020.

[153] Paul Robinson, 'Strict Liability's Criminogenic Effect' (2018) 12 Criminal Law and Philosophy 412; Raymond Paternoster and Sally Simpson, 'Sanction Threats and Appeals

standards of criminal law have largely negated its benefits. This is due to the difficulty in proving the necessary elements for a successful prosecution. The laws in India and other jurisdictions are mostly unsuited for the realities of corporate fraud in the context of shadow banks.[154]

The Indian Penal Code has provisions on fraud;[155] however, the high standards of proof required mean their utility is limited. Section 447 of the Companies Act can also be used for the same purpose, but similarly has a high standard of proof.[156] The structure of Indian laws on this point make it necessary for there to be clear evidence of involvement by each individual director along with criminal intent before he/she can be brought to court as an accused individual.[157] This high standard is almost impossible to meet in NBFCs for a number of reasons. The nature of shadow banking operations is such that the claim that defaults were not reasonably foreseeable is not a difficult argument to make. The chances of demonstrating criminal intent would be negligible as managers could merely claim that they acted to the best of their knowledge at the time and as per prevailing market wisdom. In a large and complex organization, this standard is very difficult to effectively implement.[158]

The only other alternative provided under Indian law to this standard is where the relevant statute allows vicarious liability. While the Companies Act under various provisions permits vicarious liability to be assigned to directors and other senior management individuals, this qualifies only for breach of provisions under the Act itself.[159] The act of a shadow bank taking risks which could eventually endanger the firm and creditors, cannot prima

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to Morality: Testing a Rational Choice Model for Corporate Crime' (1996) 30 Law and Society Review 549, 570-572.

[154] For the position in different countries in Europe, see: Katalin Ligeti and Angelo, *Punitive Liability of Heads of Business in the EU: A Comparative Study* in Marletta Katalin Ligeti and Angelo Marletta (eds), (Wolters Kluwer 2019); Goodhart and Lastra (n 72).

[155] Indian Penal Code 1860, ss 421-424.

[156] Bharat Vasani, Molla Hasan and Esha Himadri, 'Corporate Frauds – Emerging Legal Architecture & Judicial Trends' *India Corporate Law* (Oct 13 2020) <https://corporate.cyrilamarchandblogs.com/2020/10/corporate-frauds-emerging-legal-architecture-judicial-trends/ accessed on 10 January 2021> access date needed.

[157] *N.K. Wahi v Shekhar Singh &Ors* (2007) 9 SCC 481 (Supreme Court of India)*; Sunil Bharti Mittal v Central Bureau of Investigation*, (2015) 4 SCC 609 (Supreme Court of India).

[158] See generally for an idea of why bringing charges is difficult, Peter J. Henning, 'Dim Prospects for Financial Crisis Prosecutions' *New York Times – Dealbook Newsletter* (29 May 2012) <https://dealbook.nytimes.com/2012/05/29/dim-prospects-for-financial-crisis-prosecutions/> accessed 7 October 2020; Peter J. Henning, 'How an Inquiry of Goldman Sachs might play out' *New York Times – Dealbook Newsletter* (23 May 2011) <https://dealbook.nytimes.com/2011/05/23/how-an-inquiry-of-goldman-might-play-out/> accessed 7 October 2020.

[159] For example, see Companies Act, 2013 s 128.

facie factor under any of the provisions of the Companies Act. The SEBI Act also empowers the regulator to assign liability to those in charge of the company but once again restricts this to violations under its provisions and also permits a reasonable care and due diligence defence.[160]

The high standards of criminal law have often meant that individuals are able to escape liability or take shelter behind the corporate form. One of the reasons for the aforementioned failure in the United States to prosecute more bankers for criminal wrongdoing was the unhappy experience of their first attempted prosecution of holding senior management in the aftermath of the 2008 financial crisis. The onerous standards led to the highly publicized acquittal of Bear Sterns executives in 2009, which mellowed the Securities and Exchange Commission's appetite for launching similar prosecutions.[161] It reached the point where a conscious decision,[162] was made to not pursue criminal charges against bankers where there was a modicum of doubt that there would be no conviction.[163] Instead, there was a concerted effort to focus primarily on getting civil remedies. Indeed, the *Dodd-Frank Act* was conspicuous in that it did not introduce any new provisions for applying criminal charges.[164]

It is clear that while criminal law has potential, most jurisdictions consider it a step too far to water down the usually stringent standards that must be met by prosecutors.[165] The complexity of the corporate structure and the secrecy with which they often operate, SEBI disclosure requirements

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[160] Securities Exchange Board of India Act 1992, s 27.

[161] Press Release, Dept. of Justice, 'More Than 400 Defendants Charged for Roles in Mortgage Fraud Schemes as Part of Operation "Malicious Mortgage" (19 June 2008) <https://www.justice.gov/archive/opa/pr/2008/June/08-odag-551.html> accessed 4 October 2020; Grant McCool and Michael Erman, 'Ex-Bear Stearns Hedge Fund Managers Acquitted' *Reuters* (10 Nov, 2009).<https://in.reuters.com/article/us-bearstearns-managers/ex-bear-stearns-hedge-fund-managers-acquitted-idUSTRE5A94RW20091110> accessed 4 October 2020.

[162] Reed Albergotti & Elizabeth Rappaport, 'U.S. Not Seeking Goldman Charges', *Wall Street Journal* (9 Aug 2012) <https://www.wsj.com/articles/SB10000872396390443537404577579840698144490> accessed 4 October 2020; Reuters Staff, 'Justice Department Will Not Prosecute Goldman Sachs, Employees for Abacus Deal', *Reuters* (9 Aug, 2012) <https://in.reuters.com/article/us-usa-goldman-no-charges/justice-department-will-not-prosecute-goldman-sachs-employees-for-abacus-deal-idUSBRE8781LA20120809> accessed 4 October 2020.

[163] Government Accountability Institute, 'Justice Inaction: The Department of Justice's Unprecedented Failure to Prosecute Big Finance' (2012) at 16 (quoting Attorney General Eric Holder: "*[W]e found that much of the conduct that led to the financial crisis was unethical and irresponsible . . . we have also discovered that some of this behavior—while morally reprehensible—may not necessarily be criminal*") <https://ritholtz.com/2016/10/justice-inaction-department-justices-unprecedented-failure-prosecute-big-finance/> accessed 5 October 2020.

[164] Chawla (n 148) 27.

[165] All surveyed jurisdictions, including the UK, European countries, the US and Australia, possess a mens rea/intent requirement for criminal liability.

notwithstanding, make any prosecution a difficult one. In this scenario, the choice could simply be to consider whether the strategic decision made by the US Department of Justice to pursue Wall Street bankers for primarily civil claims, thus discarding criminal prosecutions, is the optimum approach.

This seems to present a Hobson's choice, given the drawbacks of purely civil charges, as already discussed. However, when compared to the difficulty of getting a criminal conviction, the approach of the DOJ to follow a purely civil tack makes grudging sense. Considering this, there are a number of adjustments to the law which can be made to bolster its effectiveness in administering justice, even if it is through purely monetary sanctions. This compromise may not possess the same deterrent effect that scholars have posited that criminal sanctions have but it will pave the way forward for a group-based approach to liability in civil liabilities.

VI. Towards a More Effective Civil Remedy for Corporate Misbehaviour

A. Negligence vis-à-vis Business Strategy

The starting point for civil liability for corporate wrongs in shadow banking should be a focus on a negligence standard.[166] This is especially the case considering that most individuals involved in shadow banking often do not foresee the harm their actions may have due to excessive optimism or confidence in their investment strategies.[167] Simply being carried away by large profits during certain periods is also a common fallacy among bankers. Therefore, the appropriate legal way to capture the potential detriments of such behaviour is through focusing on negligence and an emphasis on how ordinary, prudent individuals would have tempered their activities after a certain point or examined the potential consequences of their transactions more thoroughly. *Armour & Gordon* validly note that this will require a dilution of the business judgment rule, where the level of deference to business decisions and strategies is high.[168]

In the United States, a duty of care has been recognized as a responsibility for the board of directors.[169] Despite group liability being recognized, the standard of due care itself has been diluted. Now, directors are required to

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[166] John Armour and Jeffrey N Gordon, 'Systemic Harms and Shareholder Value' (2014) 6 Journal of Legal Analysis 35, 64, 66.
[167] Anabtawi and Schwarcz (n 22) 1366-1367; Rabin (n 86).
[168] Armour and Gordon (n 166).
[169] *In re Caremark Int'l Derivative Litig*, 698 A2d 959 (Del Cg 1996).

only exercise due diligence and ensure that no laws were being broken. In *In Re: Citigroup* in the aftermath of the Wall Street crash of 2008, the Delaware court determined that the responsibilities did not encompass investigating the business strategies of their companies and any negligence in pre-empting such potentially deleterious policies would not be impugned.[170] This standard is both acknowledged but also narrowed down by subsequent decisions which acknowledged a 'duty of care' but confined violations of it to instances where the board 'consciously failed' or 'utterly failed'.[171] While the actions of the board in IL&FS's case may actually fulfil that standard, overall it is unsuitable as it only looks for the most egregious and obvious failures, which are rare and, in any event, can be explained away during adjudication.

Thus, there are two requirements for the negligence-based standard of liability to be effective: a) It must include the requirement for managers and directors to be mindful of the business strategy of an NBFC and not merely the formal requirement of preventing violations of laws. In this respect, the relative lack of usage of the business judgment rule in India is a blessing in disguise and removes a potential mitigating factor; b) As is the case with insider trading laws in India, the standard for violation must on be a '*preponderance of probabilities*'.[172] While this will increase monitoring on the part of the management and board, the second important alteration that must be encouraged is the shift away from looking at actions of each individual director. The evaluation of fault should instead prioritize looking at the way the bank functioned in order to find systemic faults. This second component of the civil liability standard will be the focus of the next section.

B. Collective Over Individual Liability

By emphasising collective liability, the focus must be not on individuals but the corporate system. The emphasis on the systemic functioning of a bank is complementary with the negligence-based approach. When a bank suffers a default, it is not due to a single individual but rather, a systemic failure that takes place where multiple people either participate or become passive enablers. Inbuilt checks and balances fail to pick up on the danger which eventually results in the bank's collapse. Assigning individual blame for such events risks missing the forest for the trees. Thus, there needs to be a legal doctrine developed which can capture mass negligence on the part of senior

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[170] *Re Citigroup Inc Shareholder Derivative Litig* 964 A2d 106 (Del Ch 2009).

[171] *Stone v Ritter* 911 A2d 362, 370 (Del Sup 2006).

[172] *VK Kaul v Adjudicating Officer* (2013) Comp LJ 583 (SAT); for cases where the different burden of proof for criminal and civil cases has been detailed, see *Mousam Singha Roy v State of West Bengal* (2003) 12 SCC 377 (Supreme Court of India); *The Chairman, SEBI v Shriram Mutual Fund* AIR 2006 SC 2287 (Supreme Court of India).

management and the board of directors, as these are the groups who are best placed, usually, to prevent such collapses.

Some countries in Europe have already taken steps toward capturing exactly such excesses committed by senior management within corporations. The UK's *Corporate Manslaughter Act* as well as the notion of '*Senior Management Mens Rea*',[173] focus on the specific way in which a company functioned rather than on individual acts of people within the company. It should be noted that these are clearly linked to criminal law and are meant to assign criminal liability to the company.

However, *Price's* critique of the Corporate Manslaughter Act and suggestion that the focus be on the senior management as a group rather than on individuals leads to some interesting possibilities.[174] Most importantly, he focuses on the role of the corporation, for our purposes an NBFC, as an employer which sets the normative bounds of behaviour.[175] A bank which encourages bad behaviour either outrightly or by repeatedly covering it up is one which makes it far more likely that insolvency will eventually take place. The decision to allow for, or even promote such behaviour is a top-down one i.e., it comes from upper management. The final decision on imposing a specific corporate structure and culture makes the group of senior management a collective that is responsible for whatever the ensuing consequences may be.[176]

There are a number of justifications for this: a) The recognition, as discussed earlier, that large scale failures such as those which lead to manslaughter, while in the course of company activities, usually results from systemic rather than individual failure; b) To prevent upper management shirking responsibility by blaming the secondary management or ordinary employees for specific failures. This is relevant for shadow banks as the upper management aren't usually the ones who directly undertake in securities trading. Thus, they could defend themselves by claiming that they were not the ones designing the securities or directly negotiating the trade; c) No single manager or board member may be culpable enough to impose significant liability at all (an outcome that was common for Wall Street bankers after 2008).

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[173] George R. Skupski, 'The Senior Management Mens Rea: Another Stab at a Workable Integration of Organizational Culpability into Corporate Criminal Liability' (2011) 62 Case Western Reserve Law Review 263.

[174] Luke Price, 'Finding Fault in Organisations – Reconceptualising the Role of Senior Managers in Corporate Manslaughter' (2015) 35(3) Journal of Legal Studies 385.

[175] RH Coase, 'The Nature of the Firm' (1937) 4 Economica 386, 404.

[176] CRP Pouncy, 'Re-evaluating corporate criminal responsibility: it's all about power' (2011) 41 Stetson Law Rev 97, 110.

While statutes such as the Manslaughter Act deal with corporate criminal liability for the company itself, the basic essence of Price's suggestion for how liability should be seen, can be used for personal liability of a civil nature for the senior management and directors of banks. The collective of the senior management would be evaluated on the touchstone of negligence in failing to adequately monitor their risky investment strategies which could lead to ruination for the company. Those knowingly participating in it can be cleaved out of the herd for outright fraud.[177] During trial, those who conscientiously objected to this policy may demonstrate this in order to avoid culpability. Finally, one additional complication may be the exact boundaries or contours of senior management. Section 128(6) could be used as a proxy for this purpose as well. However, it is preferable to avoid such proxies. A regime of designation and certification of all senior management personnel like in the UK is the preferable solution.[178]

The proposal above seeks to find a middle ground between the efficacy and applicability of civil and criminal penalties. Considering that the idea of reducing the standard of criminal law for corporate wrongdoings has not yet taken hold in the vast majority of jurisdictions,[179] and its application throws up several concerns, the most that can be done is to improve and strengthen the regime of civil sanctions. Doing so by looking at the corporate structure and culture in order to implicate the entire class of top managers in NBFCs, and subjecting them to a negligence-based standard which includes the business strategy of the company, would help bring the group to justice, as opposed to hunting for specific individuals.

VII. Conclusion

In recent years, shadow banks have been responsible for fulfilling much of the Indian commercial sector's credit needs following the reluctance of standard banks to shell out loans due to multiple non-performing assets. This has led to NBFCs becoming the foundation blocks of certain segments

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[177] Prosecution for fraud and money laundering are the only cases that have been brought against any director from either IL&FS or Yes Bank. As alluded to above, there appear to be no (word needs clarification) tory claims or claims regarding negligent management of the two companies that are pending.

[178] Senior Managers and Certification Regime, Prudential Regulation Authority; for information generally on this Oonagh McDonald, 'Holding Senior Bankers to Account' in *Holding Bankers to Account* (Manchester University Press 2019).

[179] For a notable exception of innovative usage of criminal law doctrines to prosecute bankers, *see*: Eyvindur G Gunnarsson and Stefan Mar Stefansson, 'Criminal Proceedings in the Wake of the Icelandic Banking Crisis' (2019) 21 European Business Organisation Law Review 415.

of the economy such as real estate, where developers had borrowed around Rs. 2 trillion from such banks by the time IL&FS failed.[180] In fact, this mode of funding is more common in India than it is in several other major economies.[181] Thus, ensuring the health of these entities will be vital for the post-COVID economic recovery, and beyond. Of note, is that the major failures of NBFCs were those in the construction sector.[182] Thus, this particular segment of the economy will require Shadow Banks to be healthy in order to properly recover.[183]

The saving grace, in some ways, of the otherwise devastating IL&FS crisis, was that it was owned entirely by a number of large corporations in the public and private sectors, and it did not accept public deposits. Had IL&FS stocks been traded on the floor of the NSE or BSE and if ordinary business owners and individuals had deposits, there may have been a far greater impact on the general public. Ultimately, that is primarily what mitigated the ripple effects of the 2018 crisis and separates it from the society-wide impacts seen following the subprime mortgage failures of Wall Street.

The cyclical nature in which the financial system runs has been apparent for a long time. Indeed, toward the end of Margin Call, Jeremy Irons's character, John Tuld (a play-off of Lehman Brothers' ex-CEO "Richard Fuld"), recounts every financial bubble and bust since 1637 and remarks, "*We just can't help ourselves*." Whether we can or not is, to borrow from another fictional character in Olenna Tyrell, "*A question for the philosophers*." Our responsibility as lawyers and regulators, however, is to now be the first movers and do our best to pre-empt the potential crises of tomorrow. Doing so will require fundamentally rethinking our position on liability for the individuals who run shadow banks. The history of banking shows us that what we consider fundamental tenets of the law today was far from the norm less than a century ago. In that sense, we may have as much to learn from our past, as we do from our present.

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[180] Tadit Kundu, 'The big challenge of shadow banking in India' *LiveMint* (22 Oct 2018) <https://www.livemint.com/Industry/XbampFSLLmxi1kmE51OlhJ/ILFS-default-NBFCs-NPAs-shadow-banking-in-India.html> accessed 14 December 2020.

[181] ibid; Credit Suisse (n 7).

[182] Saloni Shukla and Saikat Das, 'NBFCs with exposure to housing & construction sector send SOS to RBI' *Economic Times* (April 17 2020) <https://economictimes.indiatimes.com/industry/banking/finance/banking/nbfcs-with-exposure-to-housing-construction-send-sos-to-rbi/articleshow/75192066.cms?from=mdr> accessed 12 January 2021.

[183] Shailja K, 'Last-mile Funding by NBFC to Stressed Real Estate Industry' *Property Advisor* (July 22 2020) <https://propertyadviser.in/news/real-estate/last-mile-funding-by-nbfc-to-stressed-real-estate-industry-754> accessed 12 January 2021.

International Renewable Energy Certificates: An Exercise in Redundancy in the Indian Market?

*—Maathangi Hariharan and Dr. Shouvik Kumar Guha**

Taking long strides, the Indian renewable energy market is a fast-growing compliance mark Recently, India has also agreed to the issuance of international renewable energy certificates and signed agreements with the centralized issuer in this regard. These agreements were signed around the time trading in the power exchanges had been picking up pace. While India has both the domestic and international renewable energy certificate systems in place, numbers indicate that the latter has not gained sufficient traction amongst Indian power generators and users. In light of this, the authors explore the international renewable energy certificate system, and its ability to sit in tandem with the domestic renewable energy certification system. Further, the authors provide an in-depth understanding of the domestic renewable energy certificate trading system. Finally, they explore the success (or lack thereof) of the international renewable energy certification specifically in the Indian market.

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I. Introduction

Energy attribute certificates, which enable a consumer to identify and track the source of generation independent of the underlying electricity generated, are one of the many market-based solutions introduced to move further towards clean energy. For electricity generated from renewable resources, energy attribute certificates take the shape of a renewable energy certificate (**'REC'** or **'RECs'**), which certifies that each MWh of energy generated is from a renewable source. Originally introduced as a means of satisfying the purchaser's renewable purchase obligations i.e., the obligation to ensure that a certain percentage of the gross total energy portfolio is derived from renewable energy sources, RECs can now either be purchased to fulfil the mandatory renewable purchase obligations (**'RPOs'**) or can be purchased voluntarily by any end consumer to increase consumption of electricity from renewable sources.[1]

Globally, while there exists a very underdeveloped and fragmented framework to regulate renewable energy,[2] it appears that there are three energy attribute certification systems and their applicable regulatory frameworks (collectively, **'EAC systems'** and individually, an **'EAC System'**) that are widely understood as being consistent and reliable. These are the REC system of the United States of America (**'USA'**),[3] the Guarantees of Origin scheme formulated by the European Union (**'EU'**),[4] and the International REC system formulated by the International REC

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1 *See generally:* Leslie Parker, 'International Law and the Renewable Energy Sector' in Kevin R. Gray, et. al. (eds), *The Oxford Handbook of International Climate Change Law* (OUP2016).

2 *ibid*.

3 The United States of America has in place the REC scheme, regulated both at the State and federal levels. The RECs issued are money market instruments that can be traded. Around thirty States have mandated that suppliers ensure a portion of the total electricity supplied to the end-consumer is generated from renewable resources, seven States have maintained the requirement to supply electricity generated from renewable resources to be a voluntary requirement, and the remaining thirteen States have not regulated the consumption of renewable power in any manner whatsoever. *See:* I-REC Standard, 'Understanding EAC Schemes and Roadmaps for Their Development' (*International REC Standard*, September 2020) <https://www.irecstandard.org/what-are-recs/> accessed 10 September 2020.

4 The energy attribute certification system adopted by the European Union, known as 'guarantees of origin' or GOI, is in essence electronic certification that guarantees the purchaser of electricity that electricity has been generated from a renewable source, enables trading in the electricity generated, and increases transparency for the end-use-purchaser to know whether the electricity purchased has been produced from a renewable or non-renewable source of energy. *See*: Directive 2009/28/EC of the European Parliament and of the Council on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC [2009] OJ L 140.

Foundation. Other nations, such as Australia, South Africa, and India have functional national renewable energy certification systems backed by a regulatory framework. The variation in EAC systems has resulted in a plethora of bilateral contractual arrangements, rather than a unified regulatory framework that is sufficiently flexible to accommodate unique features of national systems.[5] This complete lack of uniformity, apart from those in the USA and EU and their questionable reliability,[6] led to the introduction of the International REC (collectively '**IRECs**' and individually an '**IREC**') system, to facilitate global trading in IRECs.[7]

The IREC Foundation has opined that the similarities in national systems are more often than not limited to the terminologies used, and substantive differences may deter multinational corporations ('**MNCs**') with a presence in more than one geographic market and/or jurisdiction from transitioning to clean energy.[8] It has also opined that in the absence of a uniform and familiar system to purchase RECs, the time and monetary investment to shift to clean energy increases substantially for MNCs, thereby deterring them from transitioning to clean energy.[9] While the IREC Foundation argues that RECs (USA) and GOIs (EU) represent best practices, particularly with respect to reliability and consistency, it has also admitted that RECs (USA) have displayed substantial variations and lack of standardization.[10] Therefore, one ponders whether the key drivers of the IREC i.e., reliability and uniformity are actually reflections of a myopic view of EAC systems across the world. Along with an overview of the IREC, its functionality, trading, and redemption mechanisms, we assess its ability to facilitate the move to clean energy in Part II of this paper.

While India has in place its own REC System, it has also adopted the IREC, with the Green Certificate Company ('**GCC**') as its issuer of IRECs. The Indian REC System is a compliance market i.e., where the supplier is required to ensure that a portion of the electricity supplied is generated from renewable sources. We delve into the nuances of the Indian REC System, recent developments, and trading on the Indian power exchanges in Part III of this paper. The IREC is only slowly gaining recognition in India. However, whether this slow recognition is sufficient to establish a notable presence in India in the near future is questionable, thus leading us to consider in Part IV

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5 I-REC Standard (n 3).

6 I-REC Standard, 'I-REC Guide – How I-REC Works' (*International REC Standard*, February 2015) <https://www.irecstandard.org/about-us/> accessed 10 September 2020.

7 I-REC Standard (n 3).

8 ibid.

9 ibid

10 ibid.

of this paper whether the IREC is actually an exercise in redundancy in the Indian market. Our concluding remarks are provided in Part V of this paper.

II. International Renewable Energy Certificates: Facilitating an International Market

The IREC is very simply, an 'attribute tracking system' designed to track the quantum of renewable energy consumption for markets outside the EU and USA, and draws from the best practices of both of these jurisdictions.[11] It is a certificate issued for every 1 MWh of electricity produced from a renewable energy source. It is unique and can be obtained in addition to carbon offsets or emission reduction certificates issued for the same 1 MWh of energy for which an IREC is to be issued.[12] It facilitates a market for energy attribute certificates,[13] in a manner such that they can be redeemed in any country, subject to compliance with laws applicable in the country of redemption.[14] For instance, IRECs issued in India (a registered issuer nation) can be redeemed by the purchaser of IRECs in Singapore, Dubai, Egypt, Australia, or Mexico. One of the key drivers behind the IREC was to enable MNCs to meet their renewable energy consumption quotas across nations with reduced barriers.[15] Tetra Pak's purchase of IRECs in China, for instance, has resulted in a 13% increase in total renewable energy consumption across its global operation levels.[16]

However, unlike a GOI that has to be necessarily cancelled by the end of 18 months by the member nation issuing the GOI, an IREC is an everlasting certificate until redeemed by an end consumer or withdrawn due to an error in certification. Interestingly, a proposal was submitted before the IREC Foundation in December 2019 to introduce an annulment process,

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[11] Bioenergy International, 'I-REC Documented Renewable Power Now Available in West Africa' (*Bioenergy International*, 5 February 2020) <https://bioenergyinternational.com/markets-finance/companies-can-now-buy-renewable-power-in-west-africa> accessed 20 September 2020.

[12] International REC Standard, 'The I-REC Code' (International REC Foundation, NP) <https://gcc.re/documents/The_I-REC_Code_v1.8.pdf> accessed 25 August 2020.

[13] International REC Standard, 'View on Prices' (International REC Foundation, 20 August 2020) <https://www.irecstandard.org/vision-for-market-development/> accessed 25 September 2020.

[14] International REC Standard, 'View on Market Boundaries' (International REC Foundation, February 2020) <https://www.irecstandard.org/vision-for-market-development/> accessed 25 September 2020.

[15] Bioenergy International (n 11).

[16] South Pole, 'Case Study: Tetra Pak Reduces Climate Impact by Sourcing 100% Renewable Electricity in China' (South Pole, NP) <https://www.southpole.com/clients/tetra-pak-renewable-electricity-china> accessed 25 September 2020.

which allowed the issued IRECs to be cancelled and placed in an annulment account.[17] The attributes of the cancelled IRECs could be claimed by the last owner of the IREC in a different accounting standard. However, on annulment, the underlying attributes and rights of the IREC stand released cannot be claimed by a beneficiary.[18] Apart from the consideration that annulment and redemption could be used for the same 1 MWh of energy for which an IREC was granted, members did not find any significant risks associated with introducing an annulment system and did not find the perpetual validity of the IRECs to be an issue that merits an overhaul of the existing IREC Code.[19] This proposal was ultimately rejected by the board of the International REC Standard Foundation. Therefore, it appears that the current system whereby an IREC remains valid in perpetuity until withdrawn or redeemed will continue to remain the *status quo*.

A. Issuing and trading IRECs

Issuing an IREC follows certain simple steps. First, the electricity generating device ('**EGD**') must be registered with the IREC and detailed information on the EGD must be provided either by the 'production device'[20] or 'production group'[21] or a registrant working on behalf of the EGD for registration purposes. The information provided will be verified by an independent third party. Once the issuer organization is satisfied with the evidence provided, the registrant is recorded as a participant on the IREC registry.[22]

The registrant then makes a request to the issuer to issue IRECs. Pricing an IREC is not a function of the IREC Foundation, but rather a factor of various attributes of the IREC such as "*location, age, device, technology, size,*

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[17] International REC Standard, 'Overview Complete Annulment Consultation' (International REC Foundation, August 2020) <https://www.irecstandard.org/documents/> accessed 10 October 2020.

[18] ibid.

[19] ibid.

[20] The I-REC Code defines a Production Device to mean 'One or more related generation units of substantially the same technology capable of producing electricity delivered through an identifiable measurement point.'*See:* International REC Standard (n 13).

[21] The I-REC Code defines a 'Production Group' to mean 'A group of generation installations (a single metering point that is a source of generation within a production group) of substantially the same technology capable of producing electricity delivered through a number of identifiable measurement points. Installations constituting a group can be geographically dispersed, but must all exist within a single Issuer's country of service.' *See:* International REC Standard (n 13).

[22] International REC Standard, 'The I-REC Code Subsidiary Document 04: Issuing I-RECs' (International REC Standard, NP) <https://gcc.re/documents/I-REC_CSD04_Issuing_IRECs_v1.7.pdf> accessed 7 October 2020.

subsidy support, sustainability labels and others".[23] The IREC Foundation has amply clarified that it merely "*facilitates a market for Energy Attribute Certificates ('EACs') in many countries around the world*".[24] It appears that pricing is an unregulated market exercise. A nation may either establish an issuer organization of its own such as Singapore (issuer is the SP Group), or Dubai (issuer is the Dubai Carbon Centre of Excellence), or Russia (issuer is Goal Number Seven). Alternatively, nations can have IRECs issued by the GCC, which is the central issuer, or the Rest of the World issuer recognized by the IREC Foundation.[25] A producer in India can sign an agreement and register themselves as a registrant with the GCC ('**GCC Agreement**'). The GCC Agreement shall be valid at least for a period of 12 months from the date of signing.[26] A key feature is that a producer has to represent and warrant to the GCC that the energy units for which an IREC application is made has not and will not be sold unless the IREC granted accompanies such sale of energy units (including in the case of self-consumption), and such energy units have not been produced under any national renewable purchase obligation or similar arrangement whereby the consumers can purchase attributes.[27] The concerns that the warranties raises are further detailed in Part IV of this paper.

An IREC issued can either be traded by placing it in the trading account or redeemed by placing it in the redemption account, and cannot simultaneously exist in both accounts.[28] Once an IREC is placed in the redemption account, no action other than redemption can be undertaken by the IREC owner.[29] Similar to any other EAC system, the 'green' or 'environmental' attributes of the IREC can be claimed by the certificate owner only at the time of redemption (more commonly known as cancellation in any EAC system).

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[23] International REC Standard, 'I-REC Prices' (International REC Foundation, August 2020) <https://www.irecstandard.org/documents/?wpdmc=market-information> accessed 7 October 2020.

[24] International REC Standard (n 14).

[25] GCC is the issuer organization for the following nations: India, China, Costa Rica, Egypt, El Salvador, Guatemala, Honduras, Indonesia, Malaysia, Mexico, Nigeria, Philippines, Panama, Peru, Sri Lanka, South Africa, Vietnam, Taiwan, Turkey, and Uganda. *See:* International REC Standard, 'Authorized issuance countries' (International REC Foundation, September 2020) <https://www.irecstandard.org/documents/> accessed 15 November 2020.

[26] International REC Standard, 'Standard Terms and Conditions for Registration and Issuing' (International REC Standard, NP) <https://gcc.re/> accessed 21 September 2020.

[27] ibid.

[28] I-REC Standard (n 7).

[29] ibid.

B. IRECs and National RE Systems

In issuing an IREC, once the registrant of the EGD represents and warrants to the registrar that it is not a recipient of any energy production certificates (including IRECs), or is a part of a similar 'attribute tracking system,' then the registrant will be recorded as a participant on the IREC registry.[30] However, the IREC Code clarifies that a user that registers itself with a similar energy attribute tracking system, is not prohibited from registering with the IREC, provided that a declaration to such effect is made. At this juncture, one can observe a peculiar inconsistency in the IREC Code. While on the one hand, the Code permits an IREC to co-exist with another energy attribute tracking system on the condition that such registration is sequential, on the other hand, registration itself is contingent on the issuer being satisfied that the registrant is not a part of an attribute tracking system that is similar to the IREC, or has declared its registration with another similar energy tracking system. Given that the underlying principles of any energy attribute system are common across different jurisdictions despite any difference in legalities,[31] the Code appears to give the issuer complete discretion in deciding whether or not registration with an existing national level energy attribute tracking system will result in rejection of the application to register with the IREC. One may, therefore, argue that this inconsistency supports the claim that the IREC is most definitely, a redundant exercise where a robust national RE System is already in effect.

IREC is in essence a voluntary energy attribute certification system. The IREC Foundation has clarified that an IREC is strictly a 'voluntary disclosure' and cannot replace any existing certificate system used to meet renewable purchase obligations (individually a **'RPO'** and collectively **'RPOs'**) unless the law specifically recognizes IRECs as instruments that can be used for such purpose.[32] Undoubtedly, one can conclude that the IREC can co-exist with a national RE System. Owing to the lack of sufficient data in this domain, the reliability of the IREC as a mechanism to transition to clean energy remains to be seen.

India, as earlier mentioned, has a national RE System, which also facilitates trading in the national power stock exchanges viz. Indian Energy Exchange Limited (**'IEX'**) and Power Exchange of India Limited (**'PXIL'**)

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[30] International REC Standard and GCC,'Standard Terms and Conditions for Registration and Issuing' (International REC Foundation, August 2020) <https://www.irecstandard.org/registrants/>accessed 30 September 2020.

[31] International REC Standard,'Understanding EAC Schemes and Roadmaps for Their Development' (International REC Foundation, September 2020) <https://www.irecstandard.org/what-are-recs/> accessed 7 October 2020.

[32] International REC Standard (n 15).

(collectively, the '**Indian Power Exchanges**'). In the following section, we look at the renewable energy market in India and outline the regulatory regime that governs REC sand the Indian Power Exchanges.

III. Renewable Energy: The Indian Market

To test the viability of IREC in the Indian market, it is important to understand the current regulatory framework that governs RECs. Particularly, the Electricity Act, the National Tariff Policy and the role of Electricity Regulatory Commissions merit attention. This analysis provides a foundation for our assessment of the viability of IRECs in the Indian market.

A. Understanding the regulatory framework

1. *The Electricity Act and the National Tariff Policy*

The National Tariff Policy, 2006 ('**NTP**') favours the twin mechanism of RPOs and RECs. The rationale for at win mechanism appears to stem from the realization that any entity generating RE can trade in both the generated power as well as the evidence of contributing to the environment via the RECs, as RE production has resulted in a reduction in environmental harm caused by lower production of green house gases and emissions. For every Mega Watt hour worth of electricity generated and added to the grid by the entity, it can be issued one REC, and it can subsequently sell to the obligated entities (via inter-state and intra-state transfers) both this power as well as the corresponding REC, the latter being used by the obligated entity to fulfill its RPO in turn in any state in India. In this way, even if a particular state does not have sufficient RE production capacity, the RPO of entities operating in that state can be duly satisfied.[33] The latest target set by the Central Government of increasing the national RE capacity to 175 GW by 2022 (comprising 100 GW from solar sources, 10 GW from bio-resource based sources, 60 GW from wind sources, and the remaining 5 GW from hydro-electricity of small capacity) appears to be indicative of the increasing stress that the production and use of RE is currently being subjected to, although based on available official data provided by the Power Ministry of

[33] Swati Paliwal, Vikas Singh Bhadoria and Piyush Sharma, *Renewable Energy Potential Assessment in Indian Perspective*, 6(6) (2013) International Journal of Engineering Research and Technology 801.

the RPO trajectory, the total RE generation remains considerably behind the estimated target till date. [34]

The concept of a RPO in the Indian context has been referred to in Section 86(1)(e) of the Electricity Act, 2003[35] (**'the Act'**), as well as in the NTP. In essence, it mandates that certain specified entities (referred to in the Act and the NTP as 'obligated entities') would have to purchase electricity up to a specific percentage of their total electricity consumption from renewable energy sources only. The aforesaid obligation is further classified into that pertaining to solar[36] and non-solar renewable energy sources. The NTP makes multiple references to compulsory renewable energy (**'RE'**) purchases –*inter alia*, the appropriate Commission has been entrusted with the determination of a certain percentage of the total power consumption in the area of a distributor licensee to be purchased from renewable sources. While fixing this amount, the Commission ought to take into consideration the extent of availability of such RE within that area concerned. Simultaneously, the total cost incurred by the said licensee to meet such RPOs should be considered by

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[34] *See* Ministry of Power, Government of India, 'Order No. 23/03/2016 – R&R', available at <https://powermin.gov.in/sites/default/files/webform/notices/RPO_trajectory_2019-22_Order_dated_14_June_2018.pdf> accessed 20 December 2020, and Annual Generation Reports issued by the Central Electricity Authority for years 2011-2020 available at <https://cea.nic.in/annual-generation-report/?lang=en> accessed 20 December 2020.

[35] According to this section, "*The State Commission shall discharge the following functions, namely…(e) promote co-generation and generation of electricity from renewable sources of energy by providing suitable measures for connectivity with the grid and sale of electricity to any person, and also specify, for purchase of electricity from such sources, a percentage of the total consumption of electricity in the area of a distribution licensee.*" Failure to adhere to such provision would attract penalties under Section 142 of the Act of up to INR100,000 (Indian Rupees one hundred thousand) for each instance of failure, and an additional penalty of up to INR 6,000 (Indian Rupees six thousand) per day for a continuing failure. Some of the other salient provisions of the Act that facilitate the promotion of renewable energy in India include the Preamble itself (referring to the need for promoting efficient policies benign to the environment), Sections 3(1) and 3(3) (empowering the Central Government to frame and revise in consultation with the States the National Electricity Policy and the National Tariff Policy to develop power systems reliant on *inter alia* renewable energy), Section 61(h) referring to the appropriate Commission keeping in mind generation and co-generation of power from renewable energy sources while determining tariff, Section 66 talking about the need to promote a market for activities such as trading in renewable energy, and Sections 86(1)(b) and 86(1) I empowering the State Commissions to regulate electricity purchase and procurement related conditions (including but not limited to pricing issues) and also transactions via power purchase agreements, as well as to provide for the necessary grid connectivity and sale conditions, besides determining the equisite proportion of total power generation and consumption that power generated from RE sources must comprise. Further, related references to RE generation, cogeneration, procurement, transactions, trading, and the need to facilitate the same may also be found in the National Electricity Policy, 2005, specifically in paragraphs 5.12.1-5.12.3 thereof.

[36] In particular, the State Commission is required under the NTP to affix a percentage of solar power purchase obligations in a manner such that it reaches 8% of the total energy consumption by 2022.

the relevant Commission while determining the appropriate tariff. Instead of buying electricity from specified RE sources, the obligated entities may also fulfil their RPO by purchasing RECs from the market. With regard to any RE-based intermittent power not obtained via competitive bidding, the price for such procurement would depend upon the ceiling prescribed by the Central Electricity Regulatory Commission ('**CERC**'). Further, any RE-based power purchased by an obligated entity in bulk package bundled with thermal power produced by a generating company (companies intending to set up coal/lignite-based thermal power stations are also required to develop a specified capacity to produce such RE) would be considered as part of the entity's efforts to meet its RPO; this essentially bolsters the policy attempt to bring cogeneration from sources other than purely RE sources within the ambit of the RPO. In an additional attempt to encourage RE generation, the NTP also prescribes inter-state transmission of solar and wind-based power for sale purposes to be exempted from levies or charges.[37]

2. *Role of the Electricity Regulatory Commissions*

The CERC REC Regulations and the CERC (Power Market) Regulations[38] are some of the most important instruments when it comes to the governance of the entire REC market segment. The auctions (with uniform pricing policy) and bidding that take place are usually anonymous in nature and subject to voluntary participation. The CERC has issued several orders over the past years modifying the design of the REC market,[39] methodologies of

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[37] Paliwal, Bhadoria and Sharma (n 33).

[38] The Draft Power Market Regulations issued in July 2020 proposes to apply to the Power Exchanges, other market participants as well as the Over the Counter Market, besides seeking to regulate contracts traded on the Exchanges, contracts relating to RECs and Energy Saving Certificates, OTC market contracts and all other contracts approved by the regulatory authorities concerned. The Regulations also address conditions of eligibility for an entity to start a Power Exchange (demutualized company registered under the Companies Act, 2013, and having a net worth of atleast INR 50 crores and allowed by its MoA to start such an Exchange), the permissible ownership structure and share holding patterns of such Exchanges (shareholding of individual members and clients together with persons acting in concert limited to 5%, shareholding of other individuals limited to 25% total shareholding by members and clients limited to 49%), exit schemes for said Exchanges, management of risk by the Exchanges, clearing and settlement concerns, transaction fee, contracts dealt with, the applicability of the CERC (Open Access in inter-State Transmission) Regulations, 2008 to OTC markets, concepts such as market coupling, market oversight mechanism, regulatory intervention under specific circumstances and the ambit of regulatory power, to name a few. For further discussions about the Draft Regulations, *see* Kush Saggi and Aastha Bajaj, 'India: Highlights of the Proposed Power Market Regulations, 2020' (*Mondaq*, 17 August 2020) <https://www.mondaq.com/india/contracts-and-commercial-law/976634/highlights-of-the-proposed-power-market-regulations-2020> accessed 30 December 2020.

[39] *See* Petition for modification of matching rules in REC (2012) Central Electricity Regulatory Commission Petition No. 231/MP/2012, wherein the price-time priority

discovering equilibrium prices,[40] etc. based on stakeholder feedback received. Studies have revealed that since 2015-16, the number of RECs being issued have decreased owing to the changes made in the eligibility conditions (of captive power plants in particular) referred to above, while the redemption of RECs has increased.[41] A few years back, in 2017-18, RECs from non-solar energy sources had displayed a spike in their purchase, which corresponded to an initiative undertaken by multiple state commissions to enforce the RPOs in their jurisdictions.[42] Overall, a sizable portion of the RECs (solar and non-solar) keep being retained by the respective generating entities for their RPOs.

The bulk of the purchase has been made by the distributor licensees, while the captive power plants and the open-access consumers usually account for the rest. According to a study conducted back in 2018, the states from where obligated entities of all categories have bought RECs the most since the launch of the scheme in 2011 would be Maharashtra, Gujarat, Delhi, Rajasthan, and Odisha respectively, where as the states having bought the least would include Tripura, Manipur, Mizoram, Meghalaya, and Haryana.[43] In an interesting development, quite a few purchases have been known to have been made by entities as part of their respective corporate social responsibility mandates.[44]

Apart from the CERC REC Regulations, the State Commissions also have got their own regulations mandating the obligated entities to buy specific percentages of RE power as part of their RPO (REC usually being considered as one of the avenues of discharging such obligations, as mentioned earlier). The various entities also have to pay periodical fees and charges for application processing, accreditation, revalidation, REC issuance, and

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methodology (ensuring that the supplier placing orders early can sell all its RECs successfully) was changed to accommodate the price pro-rata methodology whereby the participants quoting a price higher than the market price would be allotted RECs first and in pro-rata proportion thereon. The excess supply conditions prevailing in the market might have resulted in this stance.

40 *See* Modification in price discovery methodology and matching rules in Term Ahead Market and Renewable Energy Certificate Market (2012) Central Electricity Regulatory Petition No. 147/MP/2012 in *Indian Energy Exchange Ltd, In re* 2012 SCC OnLine CERC 9, where in the methodology accepted consisted of averaging the buyer's and seller's prices provided the supply and demand graphs end up overlapping each other, so as to provide a more equitable solution.

41 *See* Central Agency, National Load Despatch Centre, Power System Operation Corporation Limited, 'Renewable Energy Certificate Mechanism in India: Key Learnings, Data Analysis and Way Forward' (2018) <https://posoco.in/wp-content/uploads/2018/08/REC_REPORT_17082018_fPRINT.pdf> accessed 31 December 2020.

42 ibid.

43 ibid.

44 ibid.

annual charges to both the Central and State agencies concerned – this has been provided for by way of separate orders issued by the CERC in September 2010,[45] February 2014,[46] and December 2016,[47] intended to support capacity building of said agencies with the proceeds.

B. Trading in RECs

Back in 2010, the Central Electricity Authority ('**CEA**') had been authorized by the CERCREC Regulations to register any entity eligible to trade in RECs, issue RECs, and exercise power to make all account-related settlements for such trade, while maintaining a transactional repository of all such trade and associated activities.[48] The CERCREC Regulations also require a RE producer expecting to get registered for issuing and trading in RECs to first obtain accreditation from the concerned State Electricity Authority ('**SEA**'), not enter into any CERC approved power purchase agreement ('**PPA**') involving selling power at a preferential tariff, and to sell the power produced by it to the concerned local distributor licensee of the area with prescribed price ceilings, or to any other licensee or open access consumer at market-driven prices. The CERC being empowered with the ability to periodically determine floor price[49] for the Indian Power Exchanges where trading in REC can take place is also a product of the CERC REC Regulations, as is the requirement of having compliance directors to report to the CERC about the degree of adherence by the entities generating RE and trading in RECs.[50] While originally, the RECs were supposed to have a validity period of a year

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[45] *See Determination of Fee and Charges payable under Regulation 11 of the Central Electricity Regulatory Commission (Terms and Conditions for Recognition and Issuance of Renewable Energy Certificate for Renewable Energy Generation) Regulations, 2010* (Suo Moto) (2010) Central Electricity Regulatory Commission Petition No. 230/2010.

[46] *See CERC, Determination of Fee and Charges payable under Regulation 11 of the Central Electricity Regulatory Commission (Terms and Conditions for Recognition and Issuance of Renewable Energy Certificate for Renewable Energy Generation) Regulations, 2010 Central Electricity Regulatory Commission, In re* 2014 SCC OnLine CERC 289.

[47] *See CERC, Determination of Fee and Charges payable under Regulation 11 of the Central Electricity Regulatory Commission (Terms and Conditions for Recognition and Issuance of Renewable Energy Certificate for Renewable Energy Generation) Regulations, 2010* (Suo Moto) (2016) Central Electricity Regulatory Commission Petition No. 230/2010.

[48] *See* ABPS Infrastructure Advisory Private Limited, *Report On Development of Conceptual Framework for Renewable Energy Certificate Mechanism for India,* (2009) <https://mnre.gov.in/img/documents/uploads/3538e292967048c8b78f6db30bc2720e.pdf> accessed 20 December 2020.

[49] Floor price is determined by the difference between the viability requirement of the project and the average cost for purchasing power at a given location and forbearance price i.e., maximum price for which REC scan be traded.

[50] For further details, one may refer to the provisions of the Central Electricity Regulatory Commission (Terms and Conditions for recognition and issuance of Renewable Energy Certificate for Renewable Energy Generation) Regulations, 2010 ('**CERC REC Regulations**').

as per the CERC REC Regulations, the same has at present been extended to1095 days.[51]

The first amendment to the Regulations in 2010[52] kept RE generating entities that are existing parties to a PPA (a three-year cooling-off period was prescribed in case the agreement was brought to an end before the scheduled expiry date) at preferential prices outside the ambit of eligibility for registering and issuing RECs. Similarly, captive power plants focusing on RE sources were allowed to participate in the RE framework so long as such plants choose not to avail any concessional or wheeling charge, benefits of banking facility, charge for promotional transmission, or exemptions from electricity duty.

The next amendment in 2014[53] introduced changes such as keeping RE obtained through a competitive bidding process and RE generating entities selling power to obligated entities as part of RPO fulfillment, out of the REC issue and trading scheme, but including co-generation plants to the extent of the capacity of their connected load as well as captive generation plants availing electricity duty benefit. Provisions for self-retaining RECs (*inter alia* for setting off against RPO) and revoking/recovering money paid for RECs issued/sold by entities registered under false information, and prescribing eligibility threshold for the distributor licensees to be come part of the REC Scheme, were some of the other changes brought forth by this amendment.

The next amendment, given effect in 2015,[54] further extended the REC validity to the present 1095 days and also introduced the concept of new vintage REC multipliers. Subsequently, the 2016 amendment[55] sought to restrict REC supply conditions by removing RE generating entities choosing self-consumption from with the ambit of the REC scheme provided they did not get their plants commissioned before September 2010 or after March 2016 or not registered by April 2016 and if the plant was already changing any concessional or wheeling charge, benefits banking facility, charge

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[51] As per the 2015 Amendment brought to the 2010 Regulations.

[52] For further details, one may refer to the provisions of the Central Election Regulatory Commission (Terms and Conditions for recognition and issuance of Renewable Energy Certificate for Renewable Energy Generation) (First Amendment) Regulations, 2010.

[53] For further details, one may refer to the provisions of the Central Electricity Regulatory Commission (Terms and Conditions for Tariff determination from Renewable Energy Sources) (Second Amendment) Regulations, 2014.

[54] For further details, one may refer to the provisions of the Central Electricity Regulatory Commission (Terms and Conditions for recognition and issuance of Renewable Energy Certificate for Renewable Energy Generation) (Third Amendment) Regulations, 2014.

[55] For further details, one may refer to the provisions of the Central Electricity Regulatory Commission (Terms and Conditions for recognition and issuance of Renewable Energy Certificate for Renewable Energy Generation) (Fourth Amendment) Regulations, 2016.

for promotional transmission. Similarly, entities disposing power produced in open access form that were also levying similar charges had also been excluded.

One of the most significant contributions of the CERC in the trading of RECs in Indian Power Exchanges has been the orders passed by it determining the applicable floor and forbearance prices separately for RECs from solar and non-solar sources for such trading. From July 2020 onwards, the CERC has removed the floor prices for both solar and non-solar RECs completely, while the forbearance prices have been kept at INR 1000 (Indian Rupees one thousand) per Mega Watt hour.[56] While the removal of the floor price might have been in response to the dwindling trade volume in RECs that has been witnessed for over some time,[57] such a step is not going to be without ramifications of its own. For instance, the price reduction may *prima facie* encourage entities to compensate for their unfulfilled RPO by purchasing more RECs instead of actively buying green energy;[58] however, at the same time, given the absence of a strong enforcement mechanism and deterrent effect via the imposition of stiff monetary penalties, the entities might opt to wait instead, hoping for a further reduction in price that would not always result into the increase in trade volume of the RECs that a price reduction measure might have originally intended to produce.[59]

While the REC framework in India is an operational reality as on date based on the discussions above, yet there are several obstacles[60] in its path that it must overcome to reach its true potential for facilitating environmental

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[56] *See* Team RE Connect 'CERC announces new Forbearance and Floor Price for REC Framework, 2020' (*Reconnect Energy*, 2020) <https://reconnectenergy.com/blog/2020/06/cerc-announces-new-forbearance-floor-price-for-rec-framework-2020/> accessed 30 December 2020. This drastic reduction in floor price was opposed by many stakeholders, but the CERC chose to take this decision nonetheless without conducting any hearing. However, it has chosen to initiate a review mechanism for affixation of floor and forbearance prices keeping in mind market conditions and also possibilities and modalities of introducing suitable vintage and technology multipliers. Following this order, in response to appeals filed by the GEA, IWPA and TEECL, APTEL put a temporary stop to trading in such Power Exchanges under the revised pricing norms.

[57] *See for instance* Anand Gupta, 'REC Trade Results – April 2020' (EQ International, 30 April 2020) <https://www.eqmagpro.com/rec-trade-result-april-2020/> accessed 30 December 2020.

[58] This might actually disincentivize the entities that had to fulfil the irrespective RPOs by buying green energy straight from the source at a higher price earlier.

[59] Another factor that might compromise the significance of this move with regard to demand for RECs would be the capping of RPOs for captive power plants based on their commissioning date. This would lead to demand for RECs being restricted regardless of the drop in price. Therefore, the combination of seeking to rely on market forces, while at the same time trying to stage regulatory intervention by way of prescribing such caps might end up being counter-productive.

[60] *See* Central Agency, National Load Despatch Centre, Power System Operation Corporation Limited (n 41).

sustainability and green energy usage. Some of these tests that it must face in the days to come include developing a stringent enforcement mechanism (with increasing level of participation and initiatives from the state commissions) for RPO compliance,[61] together with substantial financial penalties for deterrent effect, bridging the chasm between demand and supply insofar as RECs are concerned,[62] developing a robust market voluntary purchase of RECs,[63] increasing efforts towards capacity building,[64] phased reduction of floor and forbearance prices in the Power Exchanges,[65] and modifying the REC market design to reflect changing attitude towards RE in general[66] and specific energy sources and availability and affordability there of in particular.

1. *The Indian Power Exchanges*

The actual trading in RECs that can take place in the Indian Power Exchanges mentioned above, however, remains to be the culmination of a long process that starts with the concerned SEA providing accreditation to the project in question. The generating entity would register itself with the CEA (the SEA might provide recommendation in this regard) and then become eligible forgetting RECs issued to it (either from the date of registration or from the date of commencing operations commercially, whichever is later) that should match with the quantum of energy that it contributes to the grid.[67] The entity

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[61] The RPO Compliance Cell created by the Ministry of New and Renewable Energy, dedicated towards coordinating efforts towards ensuring RPO adherence between central and State agencies and private entities is a good step towards this end.

[62] A strong and effective price discovery mechanism needs to be put in to use in all the approved Power Exchanges for this purpose; this would also ensure an increase in the over all volume of efficient trade in the long run.

[63] The Corporate Social Responsibility policies and norms should be redesigned to such end, bringing the purchase of RECs within their ambit and also make it an attractive option for Indian companies. In particular, directives to such effect can be made at the soonest with regard to all public sector undertakings.

[64] While Central and State agencies already conduct workshops for advocacy and dissemination of information, further sensitization about RPOs and the role of RECs is definitely necessary especially on the level of the open-access consumers and voluntary buyers.

[65] While the latest CERC directive has brought about a drastic change in the floor price and also a substantial reduction in the forbearance price, it still remains to be seen how the market reacts to such a sudden change and the outcome of there late pending litigation before the Appellate Tribunal for Electricity.

[66] The reduced cost of direct procurement, supply level excess, and regulatory intervention on pricing level have caused the generating entities' enthusiasm for the REC Scheme to dwindle over the years, to counter which, new policy level instruments, multipliers, and incentives to trade need to be introduced to modify the market design from the original one created a decade back.

[67] The matching is done on the basis of the Energy Injection Report prepared by the concerned State Load Dispatch Centre. See S.K. Soonee, et al., Renewable Energy Certificate Mechanism in India (16th National Power Systems Conference, December 2010) <https://www.recregistryindia.nic.in/pdf/Others/Renewable_Energy_Certificate_

may trade these RECs either on the IEX and/or PXIL (bidding might take place on a monthly basis by eligible obligated entities in this regard), where upon the CEA would redeem said RECs (on receipt of confirmation of the transaction from the concerned Indian Power Exchange) from and to the respective accounts of the seller and the buyer, by extinguishing the RECs on a first-in-first-out mode.[68] Of course, any generating entity may also choose to retain its RECs towards fulfillment of its own RPO. In case any generating entity end supplacing more bids for sale than the RECs that are there in its account, then it might be considered as a defaulter (and included in the list dedicated to such category) and its bids would not be considered as part of the transaction by the concerned Indian Power Exchange.[69] The entire process is supported by the online portal established centrally including an online payment mechanism.

IV. IRECs: An Indian Perspective

While India has enabled purchase and redemption of IRECs, it is pertinent to note that there are certain conditions to be followed by the GCC while issuing an IREC to a producer – first, the attributes should not have been used already to satisfy any RPOs; secondly, no power should have been supplied under a long-term PPA towards any RPOs at the time the IRECs are claimed; thirdly, for the duration IRECs are claimed for a particular project, the same project cannot claim RECs as per the CERC REC Regulations; fourth, availing concessional open access benefits that render the project ineligible for RPOs is not permitted for the period in which the IRECs are claimed; and finally, if the project seeks issuance of IRECs for a specific time period of the total project duration, then such project can claim the renewable energy generation under IREC for such limited time period.[70]

While these conditions are *prima facie* not onerous, they indeed give room to question the success of the IREC system in India. Given that India is an energy compliance market, the tendency of power generators to actually prefer the issuance of IRECs in addition to the CERC REC Regulations is unknown. However, a useful starting point to assess the extent of usage, and arguably, the popularity of IRECs, is the information provided by the

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Mechanism_in_India,_16th_NATIONAL_POWER_SYSTEMS_CONFERENCE.pdf> accessed 20 December2020.

68 ibid.

69 ibid.

70 International REC Standard, 'Authorised Issuance Country List' (International REC Standard, 31 May 2021) <https://www.irecstandard.org/download/authorized-issuing-countries/> accessed 7 July 2021.

IREC registry. A quick perusal reveals that India has progressively displayed enthusiasm towards IRECs, meriting a spot amongst the top five nations to use IRECs. In 2019, India was identified as one of the most active nations accounting for 25% of the total registrations with the GCC.[71] Between June 2019 and May 2020, India saw a cumulative issuance of 1,075,842 IRECs.[72] Statistically, 91 wind, solar, thermal, and hydel electricity projects have been registered as devices with the IREC registry. Data from the IREC shows that as of June 2021, India has recorded a registered capacity of 2,328.459 MW, with approximately 47% of the total capacity marked by registration for solar energy certificates. Despite having the highest registered capacity, solar devices have not been issued more than approximately 8% of the total IRECs issued. Hydel devices, on the other hand, have, despite the lower registered capacity, been issued around 76.59% of the total IREC certificates.

The following table provides a brief overview of the number of devices, total registered capacity, and certificates issued to RE generators in India, across different RE sources.

Parameter	Hydro	Solar	Thermal	Wind	Total
Registered Capacity (MW)	939.6	1,086.109	17.95	294.7	2,338.359
Devices	15	33	3	43	94
Certifi cates issued	4,087,746	434,350	44,207	778,840	5,345,143

Table (i) –IREC issuance in India[73]

Amongst developing nations, however, India trails behind China and Brazil not only in terms of registered capacity, but also in the number of devices registered, and certificates issued. Tables (ii) and (iii) present an overview of the number of devices, total registered capacity, and certificates issued to RE generators, across different sources of RE, in China and Brazil respectively.

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[71] GCC, 'Annual Review 2019' (*GCC*, NP) <http://review.gcc.re/2019> accessed 5 February 2021.

[72] International REC Standard, 'Market Statistics June 2019 – May 2020' (International REC Standard, August 2020) <https://www.irecstandard.org/wp-content/uploads/2020/08/StatsReport-2020-05-EE.pdf> accessed 15 June 2021.

[73] The columns broadly indicate the source of renewable energy. Specific aspects of each renewable source of energy, such as whether it is onshore or offshore wind energy, the solar panels are ground or roof mounted, or if hydro-electricity is generated from a dam, run of river or pumped hydro storage have been clubbed under the respective head of energy. Data provided herein is as on 12 July 2021. *See:* Evident, 'Evident Device Register' (*Evident*, NP) <https://evident.services/device-register> accessed 30 June 2021.

Parameter	Hydro	Solar	Thermal	Wind	Total
Registered Capacity (MW)	2,708.3	433.382	90	8,329.35	11,561.032
No. of devices	43	11	3	95	152
Certificates issued	8,759,155	667,830	1,654,611	29,815,698	40,703,427

Table (ii) –IREC consumption in China[74]

Parameter	Hydro	Solar	Thermal	Wind	Total
Registered Capacity (MW)	8,842.787	420.367	1,223.709	3,283.445	13,770.308
No. of devices	35	27	18	127	207
Certificates issued	3,149,634	262,628	553,051	8,585,116	12,550,429

Table (iii)–IREC consumption in Brazil[75]

It is to be noted that no correlation can be established between the number of registered devices and certificates issued. While certain devices have been registered, they are yet to be issued any IRECs, be it in India, China or Brazil. The data from the IREC registry fails to throw any light on the reasons for such non-issuance. Given that the IRECs are attributes that promote a voluntary RE market, one can only hypothesize the reasons for the non-issuance of IRECs. A variety of reasons may be attributed, ranging from a voluntary decision not to apply for the issuance of IRECs, to the lack of legislative clarity in the harmonious existence of IRECs and the national RE system. The CERC REC Regulations for instance, solely focus on the domestic RE system and do not expressly or implicitly address IRECs. The only source of clarity on the conditions for issuance of IRECs is as per the authorized issuer information issued by the IREC Foundation.[76]

Typically, as a dualist nation, any international agreements ratified by India, are implemented by way of local or national law.[77] Legal compliance would necessitate the passage of a national legislation. However, with India's decision to accept the GCC as the issuer for IRECs, a unique situation has been created. No law formally backs this voluntary attribute tracking system. At the same time, it is an international RE instrument that is increasingly

[74] ibid.
[75] ibid.
[76] International REC Standard (n 72).
[77] Constitution of India 1950, art 246.

gaining recognition in India, which in turn is resulting in India becoming both compliance and voluntary RE market. One could argue that since the IREC is only an attribute tracking system, there is no requirement for the Ministry of New and Renewable Energy to issue any policy guidelines or prepare a draft legislation on the same. Both stakeholders viz. RE generators and purchasers stand to benefit from this line of thought. This can facilitate easy registration, issuance, and trading of IRECs for RE generators. For RE purchasers such as MNCs, the absence of any legislative guidance or obligations translates to increased speed, efficiency and possibly, reduced transaction costs. However, the need for legislative clarity out weighs the ease of issuing and trading IRECs for two reasons. *First*, an IREC can be issued and redeemed anywhere, subject to compliance with local laws. While there is no data available on whether IRECs have been redeemed in India, there is a clear absence of the compliance requirements to be satisfied with, before redeeming IRECs. *Second*, and more importantly, there is no clarity on whether or not it is a financial asset. It is possible to argue that the IREC is in essence only a manner of accounting for green electricity, and thus, eliminating the need for intervention from the Reserve Bank of India. However, given that the IREC is inherently structured as an instrument akin to any other capital market instrument, it may fall short of being determined as relevant only for the purposes of accounting. It remains to be seen whether the Reserve Bank of India will intervene to determine asset classification of the IREC, and if doing so will turn the tables for IRECs in India.

V. Conclusion

With the slow move towards a dual electricity market viz. voluntary and compliance, it is imperative that the Indian government undertakes certain legislative measures to facilitate deeper integration of the IREC model with the existing Indian RE framework. Energies of the present government are strongly directed towards domestic RE policies, national schemes, and enhancing trading on the Indian Power Exchanges. While these policies address a wider target audience, promoting IRECs could also motivate MNCs, with a large Indian presence, to make a complete shift towards clean energy. As India slowly recovers from the woes of the COVID pandemic, and inches back towards normalcy, it is imperative to ensure that energy consumption, especially by corporate houses, is solely from RE sources. Much needed clarity on the use of IRECs, in the form of policy guidelines or a legislative framework can go a long way in preventing the IREC exercise from being rendered redundant in the Indian market.

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