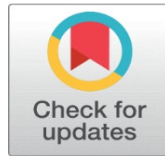
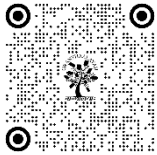


# CRITICAL STUDY OF THE COMMERCIAL WISDOM OF COMMITTEE OF CREDITORS UNDER IBC

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## ABSTRACT

The Insolvency and Bankruptcy Code (IBC) of 2016, shaped by the Bankruptcy Law Reforms Committee, aims to create a structured, time-bound resolution framework for corporate insolvency in India. A key principle of the code is the role of the Committee of Creditors (CoC), empowered to make decisions based on commercial wisdom, which courts typically refrain from interfering with unless the decisions are irrational or unlawful. The CoC's primary function is to protect creditors' interests and maximize asset recovery, while balancing the rights of various stakeholders, including operational creditors. Judicial scrutiny of commercial wisdom has evolved through landmark judgments, emphasizing minimal intervention unless legal violations or bad faith are evident. Despite the code's successes, challenges such as delays, recovery rates, and the exclusion of non-CoC creditors remain. The study suggests that while the CoC's role is vital, there is a need to ensure inclusive decision-making and focus on corporate revival rather than liquidation. Ultimately, the IBC seeks to create an ecosystem that fosters business revival and value preservation, but its success depends on efficient, stakeholder-aligned practices.

**Keywords:** Insolvency and Bankruptcy Code (IBC), Committee of Creditors (CoC), Commercial Wisdom.

## 1. INTRODUCTION

The present insolvency and bankruptcy regime in India was the outcome of the suggestions made by the Bankruptcy Law Reforms Committee headed by Dr. T K Viswanathan. The Committee's recommendations for the new insolvency and bankruptcy resolution system were based on a few core principles namely (i) facilitating the assessment of viability of the enterprise at an early stage; (ii) enabling symmetry of information between creditors and debtors; (iii) ensuring a time-bound process to better preserve economic value; (iv) respecting the rights of all creditors, with clarity on priority; and (v) ensuring finality of outcomes<sup>1</sup>.

The outcome of the action on these recommendations was the Insolvency and Bankruptcy Code (IBC) of 2016<sup>2</sup>. The code and its related ecosystem have continued to evolve since then, effectively advancing the principles mentioned above. However, its implementation being a function of the broader ecosystem in which it operates, the code has faced various criticisms in its relatively short existence, particularly regarding delays in meeting timelines and unsatisfactory recovery

<sup>1</sup> Dr T K Viswanathan is the Key architect of the Insolvency and Bankruptcy Code

<sup>2</sup> The Report of Bankruptcy Law Reforms Committee dated 04-11-2015

rates, partly due to the misaligned incentives amongst the stakeholders. While several amendments have been made to the IBC since its introduction to address some of these concerns, challenges still persist. It can be seen that laws of Bankruptcy and Insolvency has implications on various sectors – banking, employment, company laws, eventually impacting the economy. The (then) Union Finance Minister Arun Jaitley while presenting the budget on July 10, 2014 stated in his speech that an entrepreneur friendly legal bankruptcy framework will be developed.

All stake holders need to adopt such practices which are in alignment with the objectives of the code so as to ensure efficient mechanism of insolvency regime. In this study a humble attempt is made to understand the role of Committee of Creditors and their commercial wisdom and how the same is interpreted by the Adjudicating authorities.

## **2. COMMERCIAL WISDOM – MEANING**

The principle of Commercial wisdom is a recognised concept in Indian Jurisprudence. It essentially envisages that courts should not interfere with the business decisions of Companies or their management unless those decisions are so unreasonable that no man with ordinary prudence would not have made them. The concept of commercial wisdom pertains to the capacity to make prudent and logical choices that prioritise the welfare of the various parties engaged in a commercial transaction. Resultantly, the principle helps in minimising unnecessary judicial intervention in business matters.

In the context of IBC the principle assumes importance, when the CoC, typically composed of financial creditors takes over the decision making authority from the Company Board of Directors, once the Corporate Insolvency Resolution process (CIRP) initiates. The CoC primary responsibility is to protect and advance the interest of Creditors. This includes safeguarding their right to recover the amounts owed to them to the greatest extent possible. The CoC has the power to approve or reject the resolution plans submitted. The CoC is an entity tasked with the representation of all financial creditors of the corporate debtor, who possess a legitimate claim on its debt or assets. The authority to grant or deny approval of a resolution plan, which entails a proposal for the revival or liquidation of the corporate debtor lies with the CoC.

## **3. COMMERCIAL WISDOM – VIEW OF THE COURTS**

The aspect of Commercial wisdom was interpreted and discussed in various judgments by the Courts including the Apex Court. The interpretation was getting developed by passage of time since the implementation of IBC in the year 2016. The Courts typical keep distance from the decisions of the CoC since they are commercial decisions outside the scope of judicial interpretation. The Courts used to respect the autonomy and expertise of the CoC members with respect to the commercial decisions. The Courts have abstained from intervening in the merits or practicability of a settlement plan, unless it contravenes any legal requirement or is capricious or unjust.

It is observed that even with the overall umbrella of Commercial wisdom the courts was very careful in acknowledging certain restrictions and exemptions to the business prudence of the Code of Conduct particularly when it impacts the concerns of other parties involved, such as operational creditors, dissenting financial creditors, employees or the public welfare. The Courts have clearly interfered in those cases when the Code of conduct of CoC demonstrated bad faith, collusion or discrimination.

## **4. JUDICIAL SCRUTINY OF COMMERCIAL WISDOM – JUDGMENTS**

In the matter of *Essar Steel India Ltd (CoC) v Satish Kumar Gupta (2020) 8 SCC 531*<sup>3</sup> the Apex Court upheld the importance of CoC in determining how the proceeds should be distributed among different groups of Creditors in a resolution plan. However it also stressed the need for the CoC to consider the interests of all parties involved and guarantee that operational creditors receive at least their liquidation value. The Supreme Court invalidated specific parts of Regulation 38 of the IBC (Insolvency Resolution Process for Corporate Persons) Regulation 2016 which granted preference to secured financial creditor over unsecured financial creditors in the event of disagreement.

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<sup>3</sup> (2020) 8 SCC 531

In the case of *K Sasidhar V Indian Overseas Bank (2019) 12 SCC 150*<sup>4</sup> the Supreme Court of India made a significant ruling regarding the authority of CoC in the approval of resolution plans under the IBC. The Court emphasised that if a decision made by the CoC is purely commercial or business oriented, it falls outside the scope of justiciability. In other words, the court cannot review or interfere with such commercial decisions.

The Honble Supreme Court in *Kalparaj Dharamshi Vs Kotak Investment Advisors Ltd., (2021) 10 SCC 401*<sup>5</sup> the court made note of the fact that IBC itself stipulates a few grounds for contesting a resolution plan. These grounds which are listed in section 30 and 61 of the IBC, cover things like contravention of the law, failing to adhere to the rules established by the Insolvency and Bankruptcy Board of India, material irregularities in the resolution professional use of their authority among other elements. It reaffirmed the primacy of the CoC in evaluating and approving resolution plans. The court emphasised that the CoC, given its composition of financial creditors and its commercial expertise, is often best positioned to assess the feasibility and merits of a resolution plan.

Similarly while delivering the judgment in *Arcellor Mittal India Pvt Ltd v Satish Kumar Gupta*<sup>6</sup> & ors & *Swiss Ribbons Pvt Ltd & Anr vs Union of India*<sup>7</sup> the Honble Supreme Court observed that the CoC role is multi-faceted from the determination of viability of Corporate debtor to ensuring that the plan balances the rights of other creditors such as operational creditors.

In the matter *Arun Kumar J Vs Jindal Steel & Power Ltd*<sup>8</sup> the SC observed that the law makers were careful and hard working to ensure that the potency of the code remains strong. The Court has stated that innovation from the Adjudicating authority or the Appellate authority should be minimal and it should not disturb the fundamental principles of the Code. From all the judgments it is very clear that as long as there is no ambiguity or abdication of provisions of the code & Regulations the Committee of Creditors cannot be enquired with matters relating to the commercial wisdom during CIRP. It can be presumed to a greater extent that there is an absolute protection of commercial wisdom from the judicial review of the Tribunal/ Appellate tribunal.

## 5. INSTANCES WHERE COMMERCIAL WISDOM BECOMES DISADVANTAGE FOR OTHER STAKE HOLDERS

- The lack of clear limitation on the CoC powers may act as disadvantage to those creditors not included in the CoC.
- The rising percentage of hair cut will definitely act as challenge to the operational creditor. To cite an example during the insolvency process of *Videocon Industries Ltd*<sup>9</sup> secured financial creditors faced a hair cut of about 96% while operational creditors experiences a haircut of nearly 99%.
- The commercial wisdom can be questioned in terms of section 30 and section 61 of the Code.
- In *Rajagopalan Case*<sup>10</sup>, the Apex court interfered with the Commercial wisdom of the CoC and stated that the Commercial wisdom should not be overextended to overlook a major flaw in its decision making when it failed to consider the application of any existing law particularly since the resolution plan violated section 88 of the Indian Trust Act.
- In the classic case of *Swiss Ribbons Pvt Ltd v Union of India* (noted supra) the Honble Apex Court has noted the unique role that operational creditors play in the business, given their direct involvement in the company's day -to - day operations.

<sup>4</sup> (2019) 12 SCC 150

<sup>5</sup> (2021) 10 SCC 401

<sup>6</sup> (2019) 2 SCC 1

<sup>7</sup> (2019) 4 SCC 17

<sup>8</sup> AIR 2021 SC 1563

<sup>9</sup> 2018 SCC Online NCLT 13182

<sup>10</sup> NCLAT Chennai judgment dated 17-03-2023

- In the famous case of *Siva Industries and Holdings*<sup>11</sup> the Supreme Court upheld the CoC decision even though it meant the lenders would have to take a hair-cut of 93.5 %. Similarly in *Jaypee Kensington Case*<sup>12</sup> the apex court noted that the legislature has not endowed the adjudicating authority (NCLT) with the jurisdiction or authority to analyse or evaluate the commercial decision of CoC, much less to enquire into the justness of the rejection of the resolution plan by the dissenting financial creditors.

## 6. CONCLUSION

The commercial wisdom of CoC is a paramount function enabling them to exercise their powers which goes in line with the preamble and sacrosanct order of the objectives therein. It is to be noted that the CoC while exercising the commercial wisdom needs to have an all-inclusive approach by taking into account the interest of all the stake holders. To conclude, the Tribunals under IBC has been in excess of its jurisdiction in certain cases whereas the Apex Court efficiently driven the decision towards the vision of legislature. The orders going in conflict with the procedure and requirements can be called into question, but not the commercial wisdom. This is because the committee of creditors are considered as the determinant factors with the duty of maximization of assets as well as ensuring balance between the rights of stake holders. If the time and situation demands more stringent practices can take place against to ensure that the mechanism is run efficiently. In this connection it is possible that bankruptcy or liquidation proceedings may be the only way for the company to revive and start afresh. We should, however, look to restructuring and revival of units as the first option and enable it in a quick and time bound manner. There are valuable assets vesting within an enterprise that we as a nation can ill afford to run doing even though as creditors the liquidation process appears as the safer and risk free option. For this it may be necessary to create an ecosystem that encourages revival of the enterprises. While IBC 2016 remains a landmark legislation, that has fundamentally altered the landscape of corporate practices in the country, the onus is on us to ensure that collectively, we harness the potential of the code to create a thriving ecosystem which enables value preservation.

## CONFLICT OF INTERESTS

None.

## ACKNOWLEDGMENTS

None.

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<sup>11</sup> Supreme Court decision dated 03-06-2022 in Civil Appeal no 18111812 of 2022

<sup>12</sup> (2021) 12 SCR 603

Siva Industries & Holdings Case – Supreme Court Civil Appeal No 18111812 of 2022

Jaypee Kensington Case (2021) 12 SCR 603