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Proposed Tenet of Legislative Reciprocity under the Draft Indian Cross-Border Insolvency Statute: An Antithesis of Effective Cross-Border Insolvency Resolution

PRANAV M. KHATAVKAR[1]

ABSTRACT

The Insolvency Law Committee ("ILC"), which is a high-level Government-backed committee of insolvency experts, has recommended that India adopt the Model Law on Cross-Border Insolvency, 1997 ("Model Law"), promulgated by the United Nations Commission on International Trade Law ("UNCITRAL").

However, the ILC, while making this welcome recommendation, has also recommended that India temporarily enact the tenet of legislative reciprocity in its version of the Model Law. This article attempts to elucidate why it would be an imprudent idea to enact the tenet of legislative reciprocity in the Indian version of the Model Law, even temporarily.

Structurally, this article (after the preliminaries), first provides miniature knowledge capsules on the basics of cross-border insolvency and the other allied concepts surrounding the principle of legislative reciprocity (the primary assumption being that several readers of this article may not be well-versed with the basics of cross-border insolvency, as it is a fairly tight-knit and an upcoming field). Thereafter, this article highlights as to how the ILC has envisaged the application of the tenet of legislative reciprocity in the draft Indian version of the Model Law. Post-that, we reach the most critical part of this article wherein detailed reasoning is provided as to why enacting the tenet of legislative reciprocity in the Indian version of the Model Law is an imprudent idea. This article then concludes with the reiteration that enacting the tenet of legislative reciprocity in the Indian version of the Model Law is an imprudent idea

I. INTRODUCTION

The Insolvency Law Committee ("**ILC**") (which is a high-level Government-backed committee of insolvency experts), in its report dated October 16, 2018 ("**Report**"), has recommended that India adopt the Model Law on Cross-Border Insolvency ("**Model Law**") prepared by the United Nations Commission on International Trade Law ("**UNCITRAL**").

[1] Author is an Assistant Vice President, Stressed Asset Management, YES Bank Ltd., India.

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Annexed to the Report, is "Draft Part Z," ("**Part Z**") which is essentially the draft Indian version of the Model Law (with suitable modifications), that can be prospectively read into the Insolvency & Bankruptcy Code, 2016 ("**IBC**"), India's flagship insolvency legislation.

In its Report, the ILC has recommended that India enact the tenet of "legislative reciprocity" in its version of the Model Law. This article critically analyzes and reasons as to why it is both legislatively as well as practically, an imprudent idea to do so.

II. CROSS-BORDER INSOLVENCY TERMINOLOGY 101

Before we take a plunge into the contents of this article, we ought to take a few moments and reflect on some of the terms of art defined/referred above, as cross-border insolvency is a fairly tight-knit and an up-coming field.

- **Cross-Border Insolvency**- Cross-border insolvency is a special situation wherein an insolvent/financially-distressed/bankrupt debtor entity has assets and liabilities/creditors in more than one jurisdiction. For instance, an insolvent India-incorporated debtor company with borrowings from banks in the U.S.A., is an example of a cross-border insolvency scenario.
- **UNCITRAL**- UNCITRAL was established as a subsidiary body of the United Nations General Assembly in 1966. Its primary mandate is to facilitate international trade and investment by preparing and promoting legislative as well as non-legislative texts/instruments in multiple areas of commercial law[2].
- **Model Law**- The Model Law is a boilerplate law on cross-border insolvency prepared by the UNCITRAL that countries across the world can prospectively incorporate into their respective domestic insolvency laws, with or without modifications, as they may deem fit. The UNCITRAL, from time-to-time, has also supplemented the Model Law with other non-legislative texts that provide interpretative assistance with respect to the Model Law.

III. PRINCIPLE OF RECOGNITION VIS-À-VIS MODEL LAW

In order to appreciate why embodying the tenet of legislative reciprocity in the Indian version of the Model Law is an imprudent idea, we need to first understand the principle of recognition as envisaged under the Model Law by the UNCITRAL; and we need to do so because the tenet of legislative reciprocity is closely connected with the principle of recognition.

The principle of recognition postulates that insolvency proceedings initiated in one jurisdiction get appropriate recognition in other jurisdiction(s) where the debtor's assets and liabilities are

[2] Source- https://uncitral.un.org/ (last visited on January 14, 2022)

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situated.

One of the principal means of resolution of a cross-border insolvency scenario is one jurisdiction recognizing the insolvency proceedings initiated in another jurisdiction, as if they were local proceedings initiated in that jurisdiction. This is the crux of the principle of recognition.

The primary benefit of recognition of a foreign insolvency proceeding as if it were a local proceeding, is that it helps in saving costs and time, and expedites the process of securing appropriate prayers/reliefs for the parties concerned.

IV. LEGISLATIVE RECIPROCITY

Having now armed ourselves with the basics of cross-border insolvency and the scope of the principle of recognition as envisaged by the UNCITRAL under the Model Law, we can now proceed to understanding the tenet of legislative reciprocity.

Under the tenet of legislative reciprocity, a court in one jurisdiction will only recognize an insolvency proceeding initiated in another jurisdiction, only if the jurisdiction where the insolvency proceedings have been initiated has either adopted the Model Law or has enacted an insolvency legislation along the lines of the Model Law.

(A) Legislative Reciprocity as Envisaged by the ILC

In its Report, the ILC stipulated that the legislative reciprocity requirement be included in the Indian version of the Model Law initially, and that it be diluted eventually, basis India's experience with the application of the Model Law, and basis the subsequent adequate infrastructural development of the Indian insolvency regime.

In support of its aforementioned stipulation, the ILC cited examples of South Africa, Mexico, and Romania as the jurisdictions that have adopted the Model Law with a reciprocity clause. Additionally, the ILC also referred to a finding previously made by the UNCITRAL Working Group on Insolvency Law, that essentially states that jurisdictions that have adopted the Model Law, can include a reciprocity requirement thereunder, if they so desire.

Further, the ILC also clarified in the Report that the legislative reciprocity requirement as contemplated by it, would only apply to Part Z, and not to the rest of the IBC. Accordingly, the ILC expressly clarified that foreign creditors will still be able to initiate and participate in the proceedings under the IBC.

In accordance with its aforementioned stipulation in its Report, the ILC, in Part Z, has expressly stated that the provisions of Part Z shall only apply to those countries that have adopted the

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Model Law and to those countries with whom the Government of India has entered into an agreement in relation to cross-border insolvency.

(B) Issues & Challenges with Legislative Reciprocity as Contemplated by the ILC

- ***Uncertainty Regarding the Duration of Time for the Retention of the Legislative Reciprocity Requirement in Part Z***

The Report does not expressly state the exact duration of time for which the ILC proposes to include the tenet of legislative reciprocity in Part Z. As highlighted above, the Report merely states that the legislative reciprocity requirement will be included in the Indian version of the Model Law **initially** (**emphasis supplied**), and that it will be diluted **eventually** (**emphasis supplied**), basis India's experience with the application of the Model Law, and basis the subsequent adequate infrastructural development of the Indian insolvency regime.

Vagueness and ambiguity in legislative intent has time and again proven to be deleterious. Hence, those stakeholders that will be immediately aggrieved by the legislative reciprocity requirement post-enactment of Part Z, will not have an iota of an idea about the duration of time for which the legislative reciprocity requirement will remain in force under Part Z, which will only lead to further confusion and uncertainty.

- ***Limited Number of Jurisdictions for Prospective Cross-Border Insolvency Liaison***

As of the date of penning of this article[3], only 50 out of 193 member states of the United Nations have adopted the Model Law[4]. Thus, by enacting the tenet of legislative reciprocity, India will effectively be only limiting its prospective cross-border insolvency liaison to these 50 countries.

Additionally, as of the date of penning of this article[5], India hasn't entered into any agreements in relation to cross-border insolvency with any country. Thus, if India were to enforce Part Z today, then it would be able to do so only in relation to the 50 countries that have adopted the Model Law.

Further, there are several jurisdictions with whom India has trade-related and commercial ties such as Nepal, Bangladesh, Germany and Netherlands[6] that are yet to adopt the Model Law. Thus, foreign proceedings, if any, initiated in these jurisdictions, will not be recognized in

[3] January 20, 2022
[4] Source- https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency/status (Last visited on January 20, 2022)
[5] Supra Footnote 2
[6] Source- https://www.worldstopexports.com/indias-top-import-partners/ (Last visited on January 20, 2022)

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India, if it were to enforce legislative reciprocity.

Lastly, it is pertinent to note that in the IBC proceedings of Jet Airways India Ltd. ("**Jet Airways**"), the National Company Law Tribunal ("**NCLT**") (which is the principal judicial authority for adjudicating bankruptcy matters in India), recognized the recovery proceedings initiated against Jet Airways by a Dutch court, and also approved a cross-border insolvency protocol that was in line with the Model Law for co-facilitating the IBC proceedings and the Dutch proceedings. Had the legislative reciprocity mandate been in force in India at the time, the NCLT would have been constrained to deny recognition to the Dutch proceedings because Netherlands is yet to adopt the Model Law.

- ***Administrative and Logistical Hassles for Foreign Creditors while Initiating and Participating in Proceedings under the IBC***

The ILC, in its Report, has categorically clarified that foreign creditors will still be able to initiate and participate in proceedings under the IBC. Further, even the IBC per se does not discriminate in between domestic and foreign creditors. Nonetheless, it is still apprehended that foreign creditors might think twice before exercising the aforementioned options, especially the option of initiating proceedings under the IBC. These apprehensions have been elucidated in greater detail below.

A foreign creditor desirous of initiating proceedings under the IBC, will in all likelihood, seek guidance and representation from an India-qualified counsel. Finding a suitable India-qualified counsel, reviewing the structure and terms of the proposed representation, securing the relevant internal pre-filing approvals, liaising with the India-qualified counsel for sharing of all information and documents, and thereafter closing and filing the draft insolvency petition, is going to entail a significant expenditure of time and funds for the foreign creditor.

Additionally, Alvarez & Marsal, in its report[7] on the performance of the IBC, has highlighted the inordinate time delays in between filing of the insolvency petition and its subsequent admission by the NCLT. Thus, this heavy expenditure of time and funds could make the foreign creditor think twice before they decide to initiate proceedings under the IBC against a debtor.

Further, statistically speaking, only a handful of foreign creditors such as Sunrise 14 AS[8], Mauritius Commercial Bank[9], and China Development Bank have opted the path of initiating proceedings under the IBC against their respective debtors so far; and this is despite the fact

[7] Available at- https://www.alvarezandmarsal.com/sites/default/files/122880_india_remaining_ibc_report_07.pdf (Last visited on January 20, 2022)
[8] *In the Matter of Muskaan Power Infrastructure Ltd.*, CP IB No. 39/CHD/PB/2017
[9] *In the Matter of Varun Corporation Ltd.*, CP No. 725/ I&BP/2017

that IBC will be soon turning 6 this year[10]. Therefore, foreign creditors have not availed of this option in scores anyway.

Lastly, foreign creditors will have the option of participating in ongoing proceedings under the IBC, only if IBC proceedings have already been filed and admitted against their respective debtor. In the event no IBC proceedings have been initiated against their respective debtor, then the foreign creditors will be constrained to consider the aforementioned arduous path of initiating IBC proceedings against their respective debtor.

- ***Issues with Drawing a Parallel from the Legislative Reciprocity Tenets Enacted in Mexico, Romania, and South Africa***

As stated above, the ILC, in support of its stipulation to enact the tenet of legislative reciprocity in Part Z, has cited examples of Mexico, Romania, and South Africa as the jurisdictions that have enacted the tenet of legislative reciprocity in their respective insolvency laws.

Mexico has enacted the tenet of legislative reciprocity in Art. 280 of the *Mexican Commercial Insolvency Law (2000)* ("**Mexican Insolvency Law**"). Romania has enacted the tenet of legislative reciprocity in Art. 18 of the *Cross-Border Insolvency Law (637/2002)* ("**Romanian Insolvency Law**"). Whereas, South Africa has enacted the tenet of legislative reciprocity in §2 of the *Cross-Border Insolvency Act of 2000* ("**South African Insolvency Law**").

Amongst the aforementioned, the South African Insolvency Law is the most rigid and restrictive when it comes to the application of the tenet of legislative reciprocity. Under the South African Insolvency Law, co-operation in cross-border insolvency proceedings can only be extended to certain designated countries. As of the date of writing of this article[11], no countries have been expressly designated for the purposes of extending legislative reciprocity under the South African Insolvency Law. Thus, despite of being one of the first countries to adopt the Model Law[12], South Africa has almost nullified the co-operation tenet envisaged by the UNCITRAL while preparing the Model Law, by introducing a highly restrictive legislative reciprocity clause.

Furthermore, neither of the aforementioned jurisdictions are a match to India in terms of economies of scale and Gross Domestic Product[13]. Thus, simpliciter enforcing legislative

[10] 2022
[11] January 20, 2022
[12] South Africa adopted the Model Law in the year 2000, short 3 years after UNCITRAL promulgated the Model Law.
[13] As per World Bank data, the current GDP of India is USD 2.62 lakh crores; the current GDP of Mexico is USD 1.08 lakh crores; the current GDP of Romania is USD 24,871.56 crores; and the current GDP of South Africa is USD 30,192.36 crores.

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reciprocity in India simply because Mexico, Romania, and South Africa have done so, would be an imprudent exercise.

Lastly, India is currently the 6th largest economy in the world preceded by United States, China, Japan, Germany, and United Kingdom[14]. In fact, United States, United Kingdom, and Japan have adopted the Model Law without any legislative reciprocity requirement; whereas, China and Germany are yet to adopt the Model Law. Thus, purely from a comparative standpoint, India should not enact the legislative reciprocity tenet in its cross-border insolvency law, if it's other significant big-league counterpart economies haven't.

- ***India Prospectively Defaulting to the Already-Existing and Heavily-Criticized Cross-Border Insolvency Provisions under the IBC***

If India were to enforce the second prong of legislative reciprocity as contemplated by the ILC[15], which states that the provisions of Part Z would apply to those countries with whom the Government of India has entered into an agreement in relation to cross-border insolvency, then India would prospectively default to the already-existing and heavily-criticized[16] cross-border insolvency provisions under the IBC (i.e. §§234 and 235).

Under §234, the Government of India can enter into reciprocal bilateral agreements with the governments of other countries for enforcing those provisions of the IBC that deal with corporate debtor(s), and the individual(s) that have personally guaranteed the repayment of the loans extended to the corporate debtor(s) in question (i.e. personal guarantors).

Whereas, under §235, bankruptcy courts in India can approach competent courts in other jurisdictions, where the assets of the corporate debtor(s) and the assets of the personal guarantor(s) that have guaranteed the repayment of the loans extended to the corporate debtor(s) in question are situated.

An action under §235 can be initiated basis an application by the insolvency administrator/liquidator to the concerned bankruptcy court in India. However, an action under §235 can only be initiated if India has entered into a reciprocal bilateral agreement under §234 with the country whose courts are proposed to be approached under §235. This is the scope and extent of §§234 and 235.

Let us also review why §§234 and 235 have attracted so much stakeholder criticism— as of

[14] Source- https://statisticstimes.com/economy/projected-world-gdp-ranking.php (last visited on January 20, 2022)
[15] The first prong of legislative reciprocity as contemplated by the ILC states that Part Z will only apply to those countries that have adopted the Model Law.
[16] See- https://www.scconline.com/blog/?p=247207 (last visited on January 20, 2022)

date[17], the Government of India has not entered into any reciprocal bilateral agreement pursuant to §234. Further, §234 does not provide any guidance/clarity on how the provisions of the IBC will be enforced beyond India's legislative borders. Additionally, execution of reciprocal bilateral agreements often involves time-consuming negotiations, where all the prospective issues/challenges that may arise in cross-border insolvency proceedings might or might not be fully and adequately addressed. NCLTs haven't used §235 as of today either, and that is because an action under §235 can only be initiated, if India has entered into a reciprocal bilateral agreement under §234 with the country whose courts are proposed to be approached under §235.

V. CONCLUSION

Therefore, in light of the aforementioned, India enforcing the second prong of legislative reciprocity as contemplated by the ILC (i.e. executing cross-border insolvency agreements) would prospectively mean India defaulting to its already-existing and heavily-criticized cross-border insolvency provisions

Adopting the Model Law will definitely propel India into the higher orbit in the international business arena, whereas (as elucidated in great detail above), enforcing legislative reciprocity in its version of the Model Law will adversely affect India's economic interests in the long term.

Amongst all the reasons against enforcing legislative reciprocity detailed earlier, the principal reason why India should not enforce legislative reciprocity is because it will greatly limit the number of countries with whom India can prospectively liaise with for resolving cross-border insolvency scenarios.

As stated above, had India enforced legislative reciprocity during the then-on-going IBC proceedings of Jet Airways, the NCLT would have been constrained to deny recognition to the Dutch recovery proceedings initiated against Jet Airways, as Netherlands has not adopted the Model Law, which would have only led to further complications in the matter.

Thus, simply stated, ILC's recommendation of India adopting the Model Law is prudent, whereas, ILC's recommendation that India adopt the Model Law with a tenet of legislative reciprocity isn't.

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