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[2018] 1 IBJ (Art.) 33

European Best Practices for Monitoring Insolvency Practitioners

In this article, the author provides insights on the monitoring best practices of Insolvency Practitioners in European Union.

Introduction

In the light of the enormous changes in Indian law relating to bankruptcy, the editorship of this Journal asked me whether it would be possible to provide some insights on the monitoring system of insolvency practitioners (IPs) in Europe. I am grateful for this opportunity as it allows me also to present some personal views on the subject.

Let me first explain what I mean with Europe. That is what is known as the European Union (EU), a political and economic union of 28 Member States, with a population of over 500 million inhabitants. The EU has developed over the last decades an internal (single) market, using a standardised system of laws that apply in all its Member States. The internal market is based on four central EU principles, ensuring free movement of people, goods, services and capital within this market. The EU enacts legislation in justice and home affairs and maintains common policies in such areas as trade and agriculture. Within it, a monetary union has been established, which came into full force in 2002. Its main goal is the introduction of the euro as a currency. This union is composed of 19 Member States. In the area of securing an area of 'Freedom, Security and Justice', the EU has developed, since 2002, a system of cross-border recognition of insolvency judgments and some matters closely related to it. As of 26 June 2017 a recast version of this system, a regulation, which binds all EU Member States automatically, came into force.[1] The EU covers nearly all countries in Europe, excluding Switzerland and Norway, and, in the foreseeable future, the UK ('Brexit').

Preventive Restructuring Frameworks

An important legislative development in Europe dates from the end of 2016. In November 2016, the European Commission presented its 'Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the

1. *Regulation (EU) 2015/848 of the European Parliament and the Council of 20th May 2015 on insolvency proceedings (recast), see O.J. L 141/19 of 5 June 2015. See http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2015:141:FULL&from=RO.*

efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU' ['Proposal Restructuring Directive (2016)'].[2] Recital 1 of the Proposal Restructuring Directive (2016) sets out its goal: 'The objective of this Directive is to remove obstacles to the exercise of fundamental freedoms, such as the free movement of capital and freedom of establishment, which result from differences between national laws and procedures on preventive restructuring, insolvency and second chance. This Directive aims at removing such obstacles by ensuring that viable enterprises in financial difficulties have access to effective national preventive restructuring frameworks which enable them to continue operating; that honest over indebted entrepreneurs have a second chance after a full discharge of debt after a reasonable period of time; and that the effectiveness of restructuring, insolvency and discharge procedures is improved, in particular with a view to shortening their length.' The Proposal Restructuring Directive (2016) contains an Explanatory Memorandum (23 pages) and the text with 47 recitals and 36 Articles.

The proposal is based on seven '... key principles to ensure insolvency and restructuring frameworks are consistent and efficient throughout the EU: (*i*) companies in financial difficulties, especially SMEs, will have access to early warning tools to detect a deteriorating business situation and ensure restructuring at an early stage, (*ii*) flexible preventive restructuring frameworks will simplify lengthy, complex and costly court proceedings. Where necessary, national courts must be involved to safeguard the interests of stakeholders, (*iii*) the debtor will benefit from a time-limited 'breathing space' (or: stay) of a maximum of four months from enforcement action in order to facilitate negotiations and successful restructuring, (*iv*) dissenting minority creditors and shareholders will not be able to block restructuring plans but their legitimate interests will be safeguarded, (*v*) new financing will be specifically protected increasing the chances of a successful restructuring, (*vi*) throughout the preventive restructuring procedures, workers will enjoy full labour law protection in accordance with the existing EU legislation, and (*vii*) training, specialisation of practitioners and courts, and the use of technology (*e.g.* online filing of claims, notifications to creditors) will improve the efficiency and length of insolvency, restructuring and second chance procedures.

2. *See (COM)(2016) 723 final ('Restructuring Directive). See for all related documents http://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=50043.*

Presently, with the European Union and the Council of EU Member States, the text is being discussed and negotiated in detail. It may last another year before a final text of a Directive will be ready. Contrary to a 'regulation', which binds the member States directly, the text of a Directive has to be implemented by the legislators of all the individual Member States.

European-wide Research

In the meanwhile, under the auspices of the European Law Institute (ELI) I have conducted, together with Professor Dr Stephan Madaus (University of Halle-Wittenberg, Germany) research on the topic of Business Rescue in Insolvency Law.[3] Early 2014 we started a two-stage project. The first stage comprised the drafting of National Inventory and Normative reports by National Correspondents (NCs) from 13 EU countries, based on detailed questionnaires. In addition, an Inventory report on international recommendations from standard-setting organisations, such as UNCITRAL and World Bank, was prepared. Based primarily on these detailed reports, the second stage consisted of drafting the ELI Instrument on Business Rescue with recommendations for a legal framework enabling the further development of coherent and functional rules for business rescue in Europe. After the Project Team finalised the draft Instrument in early 2017, ELI Fellows and Members of the ELI Council voted to approve the 'ELI Business Rescue Report' at the ELI General Assembly, representing around 1400 ELI Members, and Annual Conference in Vienna (Austria) on 6 September 2017. It consists of 115

3. *ELI is an independent non-profit organisation established in 2011 to initiate, conduct and facilitate research, make recommendations and provide practical guidance in the field of European legal development.*

recommendations which are developed on more than 375 pages.[4]

The Report contains recommendations on a variety of themes affected by the rescue of financially distressed businesses. The Report's ten chapters cover: (*i*) Actors and procedural design, (*ii*) Financing a rescue, (*iii*) Executory contracts, (*iv*) Ranking of creditor claims; governance role of creditors, (*v*) Labour, benefit and pension issues, (*vi*) Avoidance transactions in out-of-court workouts and pre-insolvency procedures and possible safe harbours, (*vii*) Sales on a going-concern basis, (*viii*) Rescue plan issues: procedure and structure; distributional issues, (*ix*) Corporate group issues, and (*x*) Special arrangements for small and medium-sized enterprises (SMEs) including natural persons (but not consumers). The Report also includes a glossary of terms and expressions commonly used in restructuring and insolvency matters.

Actors

From our National Correspondents it is noticeable that inefficiencies or problems in the handling of restructuring or insolvency cases often stem from the way people understand (or not) and use (or misuse) the law rather than from the legal framework itself. The law in the books is only one aspect of a functioning legal system, with the law in practice being the more important other one. In matters of restructuring and insolvency it is many times the actors (*e.g.* insolvency practitioners, turnaround managers, courts) and their behaviour that shape the outcome of a legal framework which is why we looked at actors first. The way people act can, of course, be influenced by legal rules. Here, duties to act in a specific way are important, professional and ethical standards in particular. But even more important is a legal framework that includes the right incentives for all stakeholders which means that lawmakers should also consider factors like conflicts of interest, remuneration, reputation, integrity, developing and maintaining skills and experience. In the report a group of actors is distinguished (courts, mediators, supervisors or debtors in possession), but in the context of this contribution I focus on insolvency practitioners.

Insolvency Practitioners

In the EU, for matters of restructuring and insolvency the most important actors in nearly any insolvency proceeding are the courts and the respective insolvency practitioners. Their authorities and roles are based on or limited to the provisions of domestic law. In cases where a role of an actor extends beyond the implementation of mandatory rules of insolvency law, it will be determined – generally – by contract, for instance the services of a turnaround advisor. The status, power and supervision of such an advisor will be regulated by contract and, as the case may be, by applicable professional or ethical rules which apply to the actors concerned.

A limited set of questions concerning an insolvency practitioner has been posed to the National Correspondents. The responses to these questions are being ordered in a general way below. It should be stressed that this ordering does not assess matters that are of indirect or direct influence on the performance of insolvency practitioners, such as the strength or the weakness of a national insolvency system, the openness towards (or the reluctance to) changes in insolvency legislation or the overall professionality of an association of insolvency practitioners, whilst also no research has been done to the efficiency and effectiveness of the functioning of IPs in their day-to-day work. The responses serve to demonstrate the heterogeneity of the manner in which principle and practical issues concerning IPs have been worked into a national legal framework.

These questions posed were the following.

Who may be appointed to act as an insolvency practitioner?

In the 13 countries reviewed, an IP could be :

(*i*) a (bar-registered) lawyer (in Belgium in bankruptcy cases; Greece; in Italy the commissari giudiziali; common practice in the Netherlands),

4. *The full report will be published by Oxford University Press soon. The source of the report and the suggested citation is: Wessels, Bob and Madaus, Stephan, Business Rescue in Insolvency Law - an Instrument of the European Law Institute (September 6, 2017). Available at SSRN: https://ssrn.com/abstract=3032309, or alternatively: Wessels, Bob and Madaus, Stephan, Business Rescue in Insolvency Law - an Instrument of the European Law Institute (September 2017). Available at http://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf.*

(*ii*) a specifically designated professional (in England and Wales: a licenced insolvency officeholder, licence to be provided by one of seven professional bodies, including accountancy and law; in France: a mandataire judiciare; Latvia; in Greece: a licensed statutory auditor or A' class accountant/tax consultant) or

(*iii*) an expert with business knowledge of experience (with a variety of requirements: Austria, in Belgium in a non-bankruptcy case, Germany; Sweden).

In all these cases, national specific eligibility criteria apply, such as age, level of knowledge, reputation, certain amount of years of experience, independence, impartiality, mandatory training, a 'clean slate' (no criminal convictions, not having been declared bankrupt, no outstanding debts etc.). Only individuals can be appointed (Germany, England and Wales, Sweden), not companies (as is however the requirement in Hungary). In Spain a company can be appointed, when at least one of its members is a registered lawyer and another of its members is an economist or an auditor.

How are they appointed?

The results of our survey generally lead to five models:

(*i*) IP selection and appointment by the court, e.g. France, Germany (unless preliminary creditors' committee is established), Greece, Netherlands, Poland, Spain, Sweden),

(*ii*) creditors' influence on the selection of the IP (Belgium, Bulgaria, England, Estonia, Romania),

(*iii*) debtor's influence or debtor itself (Belgium),

(*iv*) selection without involvement of a court or of creditors (*e.g.* via drawing by lot or an electronic system) (Hungary, Lithuania, Slovak Republic, Slovenia), or

(*v*) selection and appointment by a state agency (Latvia, in case the debtor and the creditors cannot agree on a particular candidate). In Latvia, the insolvency administrator is supervised by government agency and the court. The agency supervises the performance of the insolvency administrator and is entitled to issue binding resolutions (for instance to oblige the administrator to request the termination of particular procedure because the debtor does not comply with the plan).

What powers do they have in each relevant procedure?

As the National Reports indicate, in nearly all laws the insolvency practitioner's powers flow directly from the applicable law. National law allows an insolvency practitioner to take measures or intervene in legal positions that he would not be allowed to without such laws. Across countries the powers of an IP are tailored to specific proceedings, but in as far as they relate to the debtors' assets they are generally broad, *e.g.* to manage the debtor's business, enter into new contracts on its behalf, sell its assets, decide on the executory contracts, collect outstanding claims of the debtor, preserve all rights and claims of the debtor, decide on pending law suits or payment of creditors. There are differences across countries as to how certain important actions the IP wishes to take are regulated, such as whether the IP needs prior approval of a supervisory judge, the court or a creditors' committee for *e.g.* the continuation of the business activities, the immediate sale of perishable goods, the continuation of pending proceedings, concluding a settlement with creditors, an interim payment to creditors, the initiation of liability proceedings against management, payment of the secured creditor against release of the collateral or a private (non-auction) sale of certain property. Certain powers of an IP directly relate to or flow from the execution of the powers mentioned, such as (again differently ordered depending on the country and specific proceeding in issue) (*a*) gathering of the estate and its assets, among which also actions to 'reconstruct' the estate, for example via an action of setting a previous transaction aside, (*b*) drawing up an inventory list of the assets and the preservation of the estate and ensure that there are no assets being dissipated, (*c*) describing the estate, as well as valuate its components and (*d*) drawing up a statement of assets and liabilities, showing the nature and amount of the assets and the debts of the estate show, and the identity of the creditors and the amount of their claim (including, where relevant, a verification of claims process).

What duties do they owe, and to whom? What sanctions apply for breach of duty, and do they include any risk of personal liability?

The variety of responses in this section continue. In nearly all countries where it applies a distinction is made between formal proceedings and actions of practitioners outside a formal scope. Duties of a practitioner exist based on a general norm (*e.g.* to supervise the business, Austria in URG proceedings; duty is to ensure a fair balance between the interests of the company, the creditors and any other parties involve, in an English CVA), with a general content (*e.g.* the diligence required by a 'good' office holder; the professional standards and conduct expected from an authorised insolvency officeholder; he must act as is reasonably expected of an administrator with due understanding and experience, who fulfils his task with punctiliousness and commitment), sometimes reflecting a light benchmark (light negligence), either to specific persons or towards all persons within the realm of the interests the IOH is to protect. In Sweden the Company Reorganisation Act does not include any provisions regarding liability to pay for damages for the administrator, but in literature it is submitted that the same liability as under the Bankruptcy Act shall apply also to administrators in a company reorganization, but this is still an open question. Specific duties may exist based on specific norms (*e.g.* to report, to convene a meeting) and the French report also mentions a criminal liability for the office holder. In matters of civil liability either specific rules apply or often general principles of a countries' civil law. In Greece for instance, the insolvency administrators (syndicos), the special administrator of L. 4307/2014 and the special agent are liable towards the debtor and the creditors for any fault, whereas towards any third party they are liable for malice or gross negligence.

Liability itself can be attached to the function of an IOH (in its quality as IOH) as well as personal, e.g. for the total amount of losses and has to be established within the formal insolvency proceeding or in general civil proceedings. In Poland for instance the receiver, court supervisor and administrator appointed in the respective proceedings act in their own name but on account of the bankrupt debtor; they are not liable for obligations contracted in matters concerning the bankruptcy estate, but can be liable for any damage resulting from improper performance of their duties. In nearly all countries, in formal proceedings, an IOH can be dismissed or replaced, either at the request of all parties, of a specific party, at its own request of by the court ex officio. In some a court can order that the administrator carries out a specific act or does not carry out a specific act or that the administrator call a creditors' meeting to consider a specific resolution.

Some countries possess a disciplinary process when violating general norms (*e.g.* any violation of professional ethics, and any failure of integrity or honor, even relating to facts unconnected with professional practice), can be sanctioned (*e.g.* in France, England, Hungary).The Spanish report notes that there are no specific duties set forth for the insolvency mediator apart of the general powers he has, whilst there is no sanction regime for the insolvency mediators, as opposed to what happens with insolvency administrators.

What reporting obligations do they come under?

A great variety of matters are published or notified in several ways (internet, official gazette, general notices) towards a variety of addressees: the general public (available information of any practitioner making his potential services known), all creditors or to specific addressees, such as a registration of companies (in Hungary online submission), shareholders, an employees' representative or a public prosecutor (Belgium, France). In Germany the creditors' meeting (which is bound by confidentiality) may require the insolvency practitioner to give specific information. In case of notices certain forms are prescribed and certain periods should be obeyed, *e.g.* the fact of being appointed, the date certain proceedings have started, the aim of the proceedings, notifications for creditors' meetings, whether the proceeding involves creditors from other countries. A central duty in nearly all countries is the requirement to notify all (known) creditors to submit their claims for verification purposes. Reporting duties may be related to the specific goal of the involved expert (an opinion of a third person to the court, filing of certain documents), regarding specific matters of the estate or the intention to initiate certain proceedings (in case of transaction avoidance or directors' liability), regarding certain transactions (*e.g.* exceeding a certain amount). Information or reporting duties also may relate to the continued performance of the business after a restructuring process has started or related to the mandatory involvement of a creditors' committee. Many times interim or progress reports to a court, a company registration (Italy) or a creditors' committee are mandatory, as is full and detailed reporting (on managing the affairs of the debtor, including financial accountability, the causes of the company's troubles) may be related to the finalization of a restructuring process or the termination or conversion of certain proceedings. In Poland periodically and yearly reporting duties exit to tax and social security authorities. Many times (interim) reports are accessible by the general public, but in some countries access is limited to certain persons in interest, such as the creditors, in some cases access is possible only after the approval of the (supervisory) judge. Availability may differ (and overlap): the office of the IOH or a bailiff's office (in Germany reports are part of the court's files and may be inspected by creditors without further prerequisites) or a website. In France progress reports shall not become public. In Greece the insolvency administrator (syndicos) is obliged to submit to the creditors' meeting a report on the financial situation of the debtor and the causes that led to bankruptcy, the prospects of preserving the business as a whole or in part, its potential viability and the possibility of the debtor's entering into a reorganization plan, as well as the projected consequences regarding the satisfaction of creditors. Also, the insolvency administrator is obliged to submit a report describing his work progress to the supervisory judge every six months. In special administration procedure, the administrator is responsible for all publications relating to the public auction (publication of invitation to potential investors, publication of the court decision that accepts the selection of the highest bidder, etc.), and for the publications relating to the distribution of the auction proceeds. Moreover, the administrator is responsible to notify all the auction's participants on the selection of the highest bidder. In Spain, for the insolvency mediator there is no particular information obligation.

How are they remunerated?

In theory, the remuneration of an insolvency office holders could be arranged in several ways. It could be a 'salary' in these instances in which an IOH is a public official, employee of the State or a state's agency. In the countries in our survey no examples have been mentioned. The remuneration could be based on an hourly rate (in the Netherlands calculated per six minutes time units; in Belgium the system mandates a fee quote to the court's approval; in England and Wales since 1 October 2015 administrators, liquidators and trustees in bankruptcy also have the duty to provide fee estimates to creditors), a fixed rate, a percentage of realisations from the debtor's estate, a combination of the foregoing or (as in Latvia) an agreement with the debtor (in case there is no agreement the remuneration is one minimal wage per month). The sum received may include certain costs, including costs for third party advice. Such a general rate is related to a described basis (value of the assets; results achieved during trading of business) and could be adjusted by a regressive percentage calculated by referring to the value of the assets or progressively based on, for example, the experience of the insolvency practitioner and the complexity of the case. Another model – in some countries supplying the basic remuneration system – is that remuneration is affected by the outcome of the procedure (for example, through payment of a 'bonus' for the realisation and distribution or maximisation of recoveries or rescue of the debtor's business).

In all models it might be possible that any outcome is limited to a maximum amount of remuneration that can be charged by an insolvency practitioner. In many models the final determination – in formal proceedings – is in the hands of a court, sometimes pre-advised by the supervisory judge. In France a creditor's representative is entitled to a fixed fee per case and a fixed right on the basis of a certain action (*e.g.* realisation of assets). In pre-insolvency proceedings, not surprisingly, fees are the result of the agreement concluded between the debtor and the practitioner.

The National Reports describe national remuneration systems in quite some detail. Nearly all national systems are characterised by meticulous regulation, in the primary law and in secondary law. No mention is made of the fact that certain remuneration schemes could be an obstacle in true cross-border cooperation, *e.g.* in the case that remuneration in country A is based on value of sales of assets, whilst it would objectively be more efficient to include these assets in a sale of all the assets, initiated out of country B. In nearly all remuneration systems fees and costs are borne by the debtor. As a consequence, problems arise in cases where an estate has hardly any assets or even is asset-less.

Significant International Tendencies

As of 26 June 2017 the role of an insolvency practitioner (and of a court) in cross-border insolvency cases is notably increased. The Recast of the EU Insolvency provides in Articles 41 – 44 for cooperation and communication where there are multiple insolvency proceedings relating to a single debtor. The existing mutual duty to cooperate has been extended in several ways. Articles 41 – 44 EIR (2015) also imposes duties of cooperation and communication as between courts (Article 42), and between insolvency practitioners and courts (Article 43 EIR (2015)), as well as between insolvency practitioners (Article 41 EIR (2015). These provisions not only extend the number of parties subject to the Regulation's duties of cooperation and communication, but also provide more detail as to the content of these duties, and (in the case of Article 43) provide a rule to regulate the costs of such cooperation and communication (Article 44).[5] Parallel provisions to Articles 41 – 44 EIR (2015) can be found in Chapter V of the Regulation, which governs cooperation, communication and coordination in corporate group insolvencies. In cross-border insolvency instances quality, professionality and integrity will be of uppermost importance.

In our Report we have taken into account four sets of (non-binding) international norms which are relevant for the organisation of the insolvency profession, namely those of the World Bank, the United Nations Commission on International Trade Law (UNCITRAL) and those of the European Bank for Reconstruction and Development (EBRD).[6] The last source to use has its limits to a large part of Northern Europe, the Nordic-Baltic Recommendations on Insolvency Law (December 2015).[7]

Impetus for Recommendations

We adhere to the views that have been developed for over thirty years: 'The success of any insolvency system ... is very largely dependent upon those who administer it. If they do not have the confidence and respect, not only of the courts and of the creditors and debtors, but also of the general public, then complaints will multiply and, if remedial action is not taken, the system will fall into disrepute and disuse'. Fletcher and I, fully accepting this view, have in addition stressed '... that it is not only the creditors' confidence, but the trust the market puts in the insolvency office holders' actions, which may translate in her/his ability to exercise a transparent process, *e.g.* for unsecured creditors to be informed in a clear way about any process and to be able to influence any administration, to understand the way the profession is regulated, which would include a mechanism to maintain trust in any regulatory regime, such as a post-action review or a complaints procedure'.[8]

It is clear that the organisation of the profession on insolvency practitioner is organised in a variety of ways in all EU Member States. On all aspects of the insolvency practitioners' professions' deontology there are some similarities, but many times there are differences and diversities in a large proportion of its details. These aspects concern what EBRD in its 2014 report has called '... seven core elements (benchmarks) for the development and performance of the IOH profession', these being (*i*) licensing and registration, (*ii*) regulation, supervision and discipline, (*iii*) qualification and training, (*iv*) appointment

5. *For its increase with the effect that duties to cooperate and communicate cross-border to courts too, see para. For a discussion see Bob Wessels, 'Commentary on Articles 41-44 EU Insolvency Regulation (Recast)', in Reinhard Bork and Kristin van Zwieten (eds.), Commentary on The European Insolvency Regulation, (Oxford University Press 2016), p. 457-506.*

6. *For seven other sets of recommendations, see Ian F. Fletcher en Bob Wessels, Harmonisation of Insolvency Law in Europe, Preadvies uitgebracht voor de Vereniging voor Burgerlijk Recht (Deventer: Kluwer 2012), p. 32 et seq.*

7. *I refer for the analysis of these international non-binding rules to our report.*

8. *Ian F. Fletcher and Bob Wessels, o.c., 82.*

system, (*v*) work standards and ethics, (*vi*) legal powers and duties, and (*vii*) remuneration.[9]

Following my earlier observations, it is an essential element in an insolvency framework that there should be no doubt whatsoever about an insolvency practitioner's inherent professional and personal qualities, both in a national as well as in an international context.[10] With the automatic recognition of an opening judgment, the powers of any appointed IP can be exercised – within the rules set by Article 21 EIR (2015) – in 26 other Member States. The specific way of coordinating cross-border insolvency proceedings, including communication with (foreign) courts requires certain specific qualities and skills.

Insolvency law can only function with the assistance of experienced and knowledgeable actors, such as the insolvency office holder. Where he or she has a crucial role in the efficient administration of insolvency proceedings to which the European Insolvency Regulation (2015) is applicable, it is evident that IPs should have the appropriate know how to play that role. From the sources mentioned above, it follows that a variety of solutions is found on basic matters such as appointment, supervision, education or remuneration. Of utmost importance is that IOHs work on the basis of trust, which is not so much the believe that a professional may have in its own ethical behaviour, integrity and know how, but how third parties in the market see IOHs, or better: the perception of these third parties in the market.[11]

9. *EBRD, 'Assessment of the insolvency office holder, Review of the profession in the EBRD region' 2014, available at http://assessment.ebrd.com/insolvency-office-holders/2014/report.html. See para. 5.*
10. *Uncertainty regarding how to ascertain whether a person from abroad is indeed a qualified and professionally regulated IOH was expressed as one of the four concerns, flowing from a self-assessment of 66 judges from 22 EU Member States, see Gert-Jan Boon et al., Grensoverschrijdende rechterlijke samenwerking in insolventies, Nederlands Juristenblad 2016/199.*
11. *I note, with appreciation, Recital 40 of the Proposal Restructuring Directive (2016): Member States should also ensure that the practitioners in the field of restructuring, insolvency and second chance which are appointed by judicial or administrative authorities are properly trained and supervised in the carrying out of their tasks, that they are appointed in a transparent manner with due regard to the need to ensure efficient procedures and that they perform their tasks with integrity. Practitioners should also adhere to voluntary codes of conduct aiming at ensuring an appropriate level of qualification and training, transparency of the duties of such practitioners and the rules for determining their remuneration, the taking up of professional indemnity insurance cover and the establishment of oversight and regulatory mechanisms which should include an appropriate and effective regime for sanctioning those who have failed in their duties. Such standards may be attained without the need in principle to create new professions or qualifications.' See Articles 25 – 27 of the Proposal Restructuring Directive (2016).*

As set out, in the EU attempts are made to harmonise key topics of insolvency laws. Our ELI report contains another hundred or so recommendation to support national legislators. Where rules are changing, the profession will change too, and practitioners are well advised to participate in the determination of the rules which apply to their future work.

Below follow the recommendations made. I hope they can be of any use in the new insolvency environment of India.

Recommendations

Recommendation 1.11: Member States should lay down expressively in their laws that the professional performing restructuring and insolvency tasks is impartial, independent and competent. Being regulated as a lawyer or an accountant does in itself not sufficiently guarantee the standards of performance necessary for the proper exercise of the restructuring and insolvency tasks.

Recommendation 1.12: The European and national legislators should set professional and ethical standards for insolvency practitioners and ensure that the relevant professional bodies are consulted and involved in the creation of such standards and that they take into account best practices for appropriately regulated professional parties as set out in principles and guidelines on regulation of the restructuring and insolvency profession developed or adopted by European and international non-governmental organisations active in the area of restructuring and insolvency. Such standards should at least contain rules on licensing and registration, supervision and discipline, qualification and training, an appointment system, work standards during administration, legal powers and duties, remuneration, reporting and communication and ethical working standards (including rules on conflict of interests and a complaint procedure).

Recommendation 1.13: Member States should safeguard the independence and competence of insolvency practitioners by providing for a transparent and predictable process of appointment and resignation/removal as well as adequate means of supervision and an appropriate, timely remuneration in each individual case.

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Suspension of Board's Powers Under the Insolvency and Bankruptcy Code, 2016

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This article attempts to dwell on some of the contentious issues which crop up in the course of the corporate insolvency resolution process.

Introduction

On the enactment of the Insolvency and Bankruptcy Code, 2016 ('Code') and its Regulations, several issues have cropped up demanding professional expertise for demystifying and proper interpretation of some of the provisions of this Code and its Regulations in letter and spirit. One of the issues which has been hotly debated by the stakeholders is how the Code has had its ramifications on the position of the Board of directors of the Corporate Debtor (which is in the centre stage of the whole process of the Corporate Insolvency Resolution Process), once an application for the insolvency process is admitted by the National Company Law Tribunal.

The Code has cast heavy responsibilities, duties and obligations on the Interim Resolution Professional ('IRP'), the resolution professional ('RP') and the liquidator (collectively referred to hereinafter as the "service providers"). It has also vested with them substantial powers, virtually dislodging the board of directors of the corporate debtor from a position of strength and power in managing the affairs of the company to a mere onlooker. This abrupt change has not been looked at kindly by the promoters, Board of directors and its management team. Understandably so, since all the powers and privileges thus far has been stripped off all of a sudden so much so that there is a tendency on the part of the directors to interfere, genuinely or clandestinely, in the functions of the service providers. There is a silent tug-of-war going on between the directors and the service providers. The stronger the service provider is, more bellicose is the attitude of the Board of directors. In the melee, the committee of creditors whose members may not be fully equipped to interpret legally the actions taken by the service providers, often find themselves in dilemma while interpreting certain provisions of the Code and its Regulations in relation to other laws, necessitating reference to their respective legal departments or to take recourse to outside help in the form of inviting opinions by practicing legal experts resulting in valuable loss of time though providing professional opportunity to legal experts.

Board's Powers, Authority, Rights, Responsibilities, Duties and Obligations

Before we go into some of the common specific issues that we encounter in the Code and its Regulations, particularly in relation to the Board's powers, and of course their rights, duties and obligations while the resolution process is on, let us understand the meanings of these words from the Companies Act which is directly related to actions of the corporate debtor. The understanding of the meaning of terms "*Board's power*", "*Board's authority*", "*Board's rights*" and "*Board's duties and obligations*" is essential since clause (b) of sub-section (1) of section 17 of the Code inter-alia states that ''*from the date of appointment of the interim resolution professional the powers of the board of directors or the partners of the Corporate Debtor, as the case may be, shall stand suspended and be exercised by the interim resolution professional*"

Board's Power

The word "*power*" or the term "*Board's power*" are not defined under the definition clause either in the Companies Act, 2013 ('the 2013 Act'), or even in the Companies Act, 1956 ('the 1956 Act'). However, the term "*Board of directors*" and the word "*Board*" are defined in both the Acts. There is small difference in the definition of "*Board of directors*" or "*Board*" in the respective Acts. While the 1956 Act, had defined these terms as: *"Board of directors" or "Board", in relation to a company, means the Board of directors of the company,* the 2013 Act defines these terms to mean *"the collective body of directors of the company".*

The Code, nor any of its Regulations define the above terms except that the word "*Board*" has been defined to mean the Insolvency and Bankruptcy Board of India ('IBBI') and not the board of directors which is irrelevant for our discussions here. Reading of section 180 of the Companies Act, 2013, in line with section 293 of the 1956 Act, gives a perspective on the 'Restrictions on powers of board' as under:

> 180. (1) The Board of directors of a company shall exercise the following powers only with the consent of the company by a special resolution, namely : -
>
> (a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings....
>
> (b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;
>
> (c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business ;

Board's Authority

The word "*authority*" is also not defined under any of the Companies Acts or the Code or its Regulations. Authority stems from power. "Power" is a broader term. Delegation of power for rightful purposes is "authority". To illustrate, a king has power to be cruel. But he has no authority to be so. Similarly, the Board has power to delegate authority to a director to sign cheques on behalf of the company to meet its objectives say, for expenses other than for capital expenditure. If the director uses this authority for capital expenditure, then we can say he has exceeded his authority. If he siphons off the money and credits the company's money to his personal account then he has misused his authority. Narrowing this to our discussion, the Board which has powers, is authorized to approve the accounts in a rightful manner. If it approves false accounts, it has misused its authority and not exceeded. Similarly, sub-section (3) of section 179 of the 2013 Act vests a power on the Board to approve the financial statement and Board's Report at its meeting and not by circulation. If it does by circulation it has exceeded its authority laid down by law. Power has no boundaries whereas authority has boundaries.

Board's Rights

The respective definition clauses of the 2013 Act, the 1956 Act, or the Code or its regulations do not define the term "*Board's rights*" or "r*ights of directors*". However, the Companies Act has showered lot of rights to the directors individually and collectively in various sections of the Acts. Individual rights are such as right to inspect accounts, right to receive notices of Board meetings, right to participate in Board's proceedings, right to vote at these meetings, right to inspect Board minutes, etc. Collective rights are such as right to refuse transfer of shares, right to elect a chairperson of the Board meetings, right to appoint managing director, right to recommend dividend, etc. But there is a subtle difference between *a power* and *a right*. *Power* is authoritative whereas a *right* is an entitlement to be claimed. Otherwise power and right are almost synonymous. Removal of a director is more of a power than a right.

Board's Duties, Responsibilities and Obligations

Again there are collective duties and obligations and individual duties and obligations cast upon the directors by the 2013 Act. A director as an individual has a duty to attend Board meetings and contribute to the deliberations of the Board. Directors are under individual obligations to disclose their interests, whether directly or indirectly, in contracts or arrangements with the company. They are also individually duty bound to disclose their directorship in other companies or their shareholding in other companies and other plethora of duties. The aforesaid duties are only illustrative. Collectively, the Board has a duty to approve the annual accounts, authenticate the same, get the accounts audited and place the same before the shareholders alongwith their report. They have a collective duty of appointing the auditors, convene and conduct shareholders' meetings etc. Directors have a duty to issue its responsibility statement as part of its report. Similarly there are enough obligations and liabilities cast upon the directors individually and collectively as a Board.

Differences in the Functions

There is a distinct distinction between the powers and rights of the Board vis-a-vis the duties, responsibilities and obligations of the directors. Some of them are targeted at individuals while some others are targeted on a collective body of directors. The powers and rights are conferred whereas duties, responsibilities and obligations and liabilities are imposed. Failure to comply with the duties or obligations may result in penalties and fines not only on the company but also on the directors, company secretary and the other key managerial personnel ('KMPs'), like the CFO and the CEO. Exercising a power or a right is a choice but there is no choice in complying with the duties or the obligations. Powers of the board are collective and is drawn from the Act, memorandum and articles of association and cannot in the normal course be delegated but can be delegated if such delegation is authorized by the articles or by means of Board resolution or a general body resolution to a committee or to individual directors. Rights, duties and obligations cannot be delegated.

Some Specific Issues

The stakeholders often encounter the following issues while a company is undergoing a Corporate Insolvency Resolution Process under the code.

Approval of Financial Statements and Board's Report

In some of the meetings of the committee of creditors constituted under the IBC, 2016, questions are being raised by the members as to how the Board can approve the financial statements and the Board's Report which fall due for approval during Corporate Insolvency Resolution Process when the board is "suspended" under clause (b) of sub-section (1) of section 17 of the Code and even go to the extent of stating that the RP managing the affairs of the company and being a *defacto* MD has to approve and authenticate the accounts on behalf of the company. It gives rise to a question as to whether the IRP or RP becomes a director in the Board automatically to exercise these responsibilities of the board? The answer is 'no'. There is a misconception in the minds of some of the stakeholders that the board itself is suspended. Clause (b) of sub-section (1) of section 17 is very clear that the "powers of the Board" are suspended. That means the duties and obligations on the part of the directors still remain intact since the corporate debtor against whom the process is targeted is a "going concern" till it is liquidated, if at all. Therefore, all the provisions of the 2013 Act, are still applicable to the company. Section 238 of the Code states as under:

"The provisions of this code shall have effect, nothwithstanding anything inconsistent therewith contained in any other law for time being in force or any instrument having effect by virtue of any such law". The above arguments have no element of inconsistency with the Code.

Section 179 of the 2013 Act, has explicitly stated, *inter alia,* that the Board of directors shall exercise certain powers on behalf of the Company by means of resolutions passed at meetings of the Board and the relevant extract is reproduced hereunder for the sake of convenience:

"179(3). The Board of directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board, namely:—

(a) to (f)

(g) to approve financial statement and the Board's report;

(h) to (j)

(k) any other matter which may be prescribed...."

The Companies (Meetings of Board and its Powers) Rules, 2014 has added certain additional powers pursuant to clause (k) of sub-section (3) of section 179 of the 2013 Act by means of a notification dated 18th March, 2015 which is not relevant for our discussions now.

The argument that the power to approve financial statements and the Board's report lies with the board as per clause (g) of sub-section (3) of section 179 of the 2013 Act, and since the Board's powers are suspended as per clause (b) of sub-section (1) of Section 17 of the Code during Corporate Insolvency Resolution Process, the board has no authority to approve the financial statement or the Board's report will not hold water due to the following reasons. Sub-section (1) of section 179 states as under:

"(1) The Board of directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do :

Provided that in exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting":

The above proviso makes section subservient to section 134 of the 2013 Act, which is reproduced hereunder:

"(1) The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board at least by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director and the chief executive officer, if he is a director in the company, the chief financial officer and the company secretary of the company, wherever they are appointed, or....

(3) There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include....

(5) The Directors' Responsibility Statement referred to in clause (c) of sub-section (3) shall state that –

(a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(d) the directors had prepared the annual accounts on a going concern basis; and

(e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Explanation.— For the purposes of this clause, the term "internal financial controls" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

(f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

(6) The Board's report and any annexures thereto under sub-section (3) shall be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.

(7) A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of –

(a) any notes annexed to or forming part of such financial statement;

(b) the auditor's report; and

(c) the Board's report referred to in sub-section (3).

(8) If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both."

The above are some of the important duties of directors, failure of which results in penalty and fine.

Appointment of Independent Directors

The 2013 Act, for the first time, defines an '*Independent director*' and the definition in clause (47) of section 2 is identical to the one provided in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, a regulation applicable only to listed companies. Clause (47) of section 2 says that an 'independent director' means an independent director referred to in sub-section (6) of section 149.

Who has to appoint the Independent Director, the Board or the Shareholders?

It is the primary responsibility of the Board to appoint an independent director and the shareholders are the approving authority only. In fact, clause (a) of sub-section (6) of section 149 of the 2013 Act, stipulates that the Board has to form an opinion on the integrity and expertise and experience of the proposed candidate before his or her appointment. It is not the shareholders who form an opinion on the proposed independent director. The proviso to sub-section (5) of section 152 of the 2013 Act states that in case of appointment of independent director in the general meeting, an explanatory statement for such appointment, annexed to the notice for the general meeting, shall include a statement that in the opinion of the Board, he fulfills the conditions specified in the Act for such appointment. The shareholders, therefore, cannot appoint an independent director *suomoto*. The modalities of appointing an independent director are generally described in the articles of association of the company. Therefore, suspension of Board's power to appoint independent director under clause

(b) of sub-section (1) of section 17 of the Code is not what is contemplated since the appointment of an independent director is a duty of the Board and not a power under the 2013 Act as well as under SEBI Regulations. Therefore, the Board can appoint an independent director during the course of the Corporate Insolvency Resolution Process.

Appointment of Nominee Directors

The definition clause in the 2013 Act (section 2) does not define the term, "*nominee director*". However, *Explanation* to section 149 defines *"nominee director"* as a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests. Sub-section (3) of section 161 of the 2013 Act empowers the Board of directors to appoint a nominee director. But as per this section this power can be exercised only subject to the articles of association of the company. Articles of companies invariably provide that a financial institution or a collaborator or the holding company has a right to nominate persons on the Board as long as their interest in the company is subsisting because of a contract or arrangement. It is their right to nominate and the Board cannot refuse to appoint the recommended person as nominee unless there are valid grounds which can only be technical in nature, *e.g.*, the nominee suffers from disqualification under section 164 of the 2013 Act or the nominee is already a director in more than 20 companies, etc. Therefore, what appears to be a power of the Board gets transformed into a duty and obligation under the articles of association and can be considered to be outside the ambit of clause (b) of sub-section (1) of section 17 of the Code.

Powers Which are Suspended

Clause (a) of sub-section (1) of section 17 of the Code explicitly states that from the date of appointment of the IRP the "management of the affairs" of the Corporate Debtor shall vest in the IRP and clause (b) of sub-section (1) of section 17 states that the powers enjoyed hitherto by the Board shall be exercised by the interim resolution professional. In view of what has been discussed in the above paragraphs on sieving the duty from the powers, clarity has to be brought in as to what is left of the Board's suspended powers called "management of affairs" that cannot be exercised by the Board but has to be exercised by the IRP. The Code does not envisage a situation in which the moment an IRP is appointed, it would be expected that the Board will abandon the affairs of the company and leave it entirely to the IRP. From what has been seen in practical terms, the members of the Board who have been running the company along with its management team do cherry picking and when it is convenient to them, they deflect the responsibility to the IRP merrily. Examples of such situations are when a supplier claims his money, or a worker demands bonus that is due, or a statutory authority wants matters to be resolved by meeting the statutory dues etc. The same section 17 expects that the officers and managers who were reporting hitherto to the Board and KMPs will have to report to the IRP. To that extent the Board's powers in demanding loyalty from its officers and managers will get suspended though in practical terms it rarely happens. The IRP has to immediately wrest financial control in the company from the Board hitherto enjoyed by the Board by giving suitable instructions in writing to all the banks and financial institutions to ensure that the erstwhile signatories of cheques be revoked. That itself will be a big dent in the Board's powers. The Board's powers to make structural changes in the capital of the company or in the constitutional documents would stand withdrawn during the resolution process. The board will have no power to dispose off any of the fixed assets of the company. In short, the Board's power in managing the day to day affairs of the company will be drastically curtailed except to help the IRP in running the company as a going concern which becomes its duty.

Supreme Court's Judgment

In the case of *Innoventive Industries Ltd.* v. *ICICI Bank* [2017] 1 IBJ (JP) 31, the Supreme Court has passed a comprehensive judgment which attempts to settle some nagging issues in the Code. In my humble opinion and with due respect to the Supreme Court, in view of what has been discussed above on powers, rights and duties of the Board, it appears that there is a need to revisit the opinion of the Court in para 11 reproduced hereunder:

> "11. Having heard learned counsel for both the parties, we find substance in the plea taken by Shri Salve that the present appeal at the behest of the erstwhile directors of the appellant is not maintainable. Dr. Singhvi stated that this is a technical point and he could move an application to amend the cause title stating that the erstwhile directors do not represent the company, but are filing the appeal as persons aggrieved by the impugned order as their management right of the company has been taken away and as they are otherwise affected as shareholders of the company. According to us, *once an insolvency professional is appointed to manage the company, the erstwhile directors who are no longer in management, obviously cannot maintain an appeal on behalf of the company.* (Emphasis added) In the present case, the company is the sole appellant. This being the case, the present appeal is obviously not maintainable. However, we are not inclined to dismiss the appeal on this score alone. Having heard both the learned counsel at some length, and because this is the very first application that has been moved under the Code, we thought it necessary to deliver a detailed judgment so that all Courts and Tribunals may take notice of a paradigm shift in the law. Entrenched managements are no longer allowed to continue in management if they can't pay their debts."

Whether suspension of powers means and includes right to carry on the business of the company, to represent the company before courts and tribunals other than powers to make investment, borrow, grant loans as mentioned in section 179 of the 2013 Act? Since the Code is just at its infancy and an evolving statute, it remains to be seen how the Supreme Court will deal with this subject in future.

Conclusion

The above arguments have been fortified by the Circular No. IP/002/2018 dated 03rd January, 2018 issued by the IBBI under section 196 read with section 208 of the Code, wherein it has been very clearly stated that the corporate person needs to comply with applicable laws and SEBI requirements, if applicable, during Corporate Insolvency Resolution Process and has cast a heavy responsibility on the Insolvency Professionals for such compliances. The provisions of clause (b) of sub-section (1) of section 17 should be looked at in a limited sense. The objective of the Code is not to derail the management of the company as a going concern. Suspension of the board instead of suspension of the "Powers of Board" as inadvertently mentioned and used as an adjective, *i.e.*, "Suspended Board" in clause (b) of sub-section (3) of section 24 of the Code, will lead to a ridiculous situation of a company becoming defunct even before the resolution process starts. This is not the intention of the Code. Also, sub-section (1) of section 28 of the Code clearly states that the RP during Corporate Insolvency Resolution Process shall not take certain actions as spelt out under clauses (a) to (m) of that section without the prior approval of the Committee of Creditors (CoC). It is therefore, clear that some of the Board's powers are now enjoyed by CoC whereas the responsibilities of the board continue as ever before.

■■■