

# Insolvency and Bankruptcy Hotline

March 17, 2022

## TREATMENT OF CONTINGENT CLAIMS UNDER IBC: ISSUES AND SOLUTIONS

Pre-mature extinguishment of arbitration proceedings or a summary dismissal of a creditor's claims pending adjudication may appear to be ominous. Such was the position with respect to treatment of contingent claims under the Insolvency and Bankruptcy Code, 2016 ("IBC"). There has been a recent pronouncement which apparently turns around the position. We discuss this development as well as the way forward for contingent claims under the IBC.

The IBC imposes a moratorium on the initiation or continuation of legal proceedings against the corporate debtor ("CD") for the entire duration of the corporate insolvency resolution process ("CIRP"). Hence, any adjudication of disputed claims that are pending as on the date of initiation of CIRP get stalled. All categories of creditors are invited to submit their claims during the CIRP in order to prepare a consolidated liability statement for the CD. As a part of this process of consolidation, claims pending adjudication are also submitted by the respective claimants ("Contingent Claims").

The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process of Corporate Persons) Regulations, 2016 ("CIRP Regulations") allow a resolution professional ("RP") to estimate the claim amount in cases where the final crystallization of claims is indeterminate, like Contingent Claims [Regulation 14(1), CIRP Regulations].

The Supreme Court of India ("Supreme Court"), in *Fourth Dimension Solutions Ltd. v. Ricoh India Ltd. & Ors.* ("Fourth Dimension") has provided a contrasting perspective with past judicial discourse, in relation to treatment of Contingent Claims under the IBC.

Previously, the Supreme Court in *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta*, ('Essar Steel') observed that once the CIRP ends, the CD, starts afresh on a 'clean slate'. Further, the SC observed that adjudication of Contingent Claims cannot be allowed to continue post successful completion of a CIRP. However, the SC in *Fourth Dimension*, has allowed an arbitration proceeding to continue post completion of the CIRP. This contrasts with the 'clean slate' doctrine propounded by the Supreme Court in *Essar Steel*.

## APPROACH BY INDIAN COURTS

Indian Courts have adopted two distinct approaches while treating Contingent Claims.

In 2019, the SC in *Essar Steel*, upheld the decision of the RP, in attributing a notional value of INR 1 to Contingent Claims therein. The sole reason being that the Contingent Claims were pending adjudication as on the date of initiation of the CIRP. The Supreme Court observed that a prospective resolution applicant should be aware of the exact extent of liabilities attached to a CD. This would enable a resolution applicant to attribute an acquisition value to the CD. Post completion of the CIRP, if Contingent Claims are determined to the detriment of the CD then that would effectively cause an inflation of the acquisition value for the resolution applicant. The implication being that Contingent Claims, by virtue of their uncertain nature, cannot be admitted and nor can they be determined post completion of the CIRP.

In *Fourth Dimension*, the Supreme Court was faced a similar situation. Fourth Dimension ("FDSL") had initiated an arbitration proceeding against Ricoh India, the CD, which was pending on the date of commencement of the CIRP. FDSL's claim was provided a notional value of INR 1 by the RP. Thereafter, the successful resolution plan sought to extinguish all pending litigations including the one initiated by FDSL. The Supreme Court disallowed extinguishment of the pending arbitration proceedings, thereby paving the way for FDSL to continue the stalled arbitration proceedings against the CD post completion of the CIRP.

## OUTLINING THE PROBLEM

One of the primary objectives of the IBC is to revive and revitalize stressed companies while keeping them as a going concern. The approach taken in *Fourth Dimension* might be detrimental to this objective. Permitting all legal proceedings to continue post completion of CIRP can disincentivise an acquirer from bidding for a CD, due to the possible inflation of acquisition value post completion of the CIRP. Further, the acquirer would want to get control of a clean entity without legacy liabilities which require management bandwidth. This would enable the acquirer to focus on issues like business synergies and growth of the CD. Even so, the other approach of effectively extinguishing a claim on the ground that it had not crystallised prior to the commencement of the CIRP cannot be adopted either. If a creditor with an uncrystallised Contingent Claim is neither given a chance to pursue the claim after completion of the CIRP, nor attributed any value during the CIRP, then such creditors would be left remediless.

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The following suggestion can be considered while treating Contingent Claims under the IBC.

The Insolvency and Bankruptcy Board of India ("IBBI") had released a discussion paper on August 26, 2020 on assignment of contingent claims ("**Discussion Paper**"). The Discussion Paper identified (a) that there is an inherent value to all contingent claims, (b) that occurrence of future uncertain events have an impact on the value of contingent claims, and (c) a methodology to account for such uncertainties and ascertain the value of such claims. Thereafter, the IBBI amended the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 ("**Liquidation Regulations**") to allow assignment of actionable claims, disputed claims, cause of action and contingent claims ("**2018 Amendment**").

Therefore, all Contingent Claims are capable of being estimated and an RP should be barred from rejecting them merely because they have not been crystallised.

As discussed in this paper, the primary reason cited by RPs to attribute nil value to Contingent Claims is their inability to estimate the value of contingent claims. However, the 2018 Amendment has made it mandatory for liquidators to estimate the value of contingent claims. Therefore, an RP by using the assistance of valuers, can follow the same methodology to estimate the value of contingent claims.

All valuations computed under the IBC like fair value and liquidation value, are binding on all stakeholders. Similarly, the valuation of contingent claims, as computed under the aforementioned mechanism, should also be binding on the respective creditor/claimant.

This process will ensure that (a) Contingent Claim is not attributed *nil* value by default, (b) a successful resolution applicant has certainty and finality on the acquisition value of the CD upon approval of its resolution plan.

– Adimesh Lochan, Arjun Gupta & Vyapak Desai

You can direct your queries or comments to the authors

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