DECISIONS OF INSOLVENCY PROFESSIONAL SCOPE OF JUDICIAL REVIEW

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Editor's Note*: In the course of insolvency or bankruptcy proceedings, the insolvency office-holders have to take various decisions – while some of the decisions are taken with the sanction of a body of creditors, and some with prior approval of the judicial authorities, in many other cases, the office-holder has to rely on his own prudence and take decisions, prominently as liquidators.*

In scenarios as liquidation, where there in "insufficiency", decisions taken by the office-holder may be prone to challenges by creditors (secured/unsecured), other stakeholders and even competing buyers for assets. However, the pertinent questions are – What kind of challenges are at all maintainable? Who, at all, can be said to be "aggrieved" by such decision-making? What are the grounds on which this decision-making may be challenged in judicial/quasi-judicial proceedings? When will the courts intervene or not intervene with such decisions? The jurisprudence is rich with rulings from insolvency laws of various countries over the decades, which the author discusses in this Paper.

In course of his conduct of insolvency or bankruptcy proceedings, the insolvency officeholder has to take various decisions. Some of these decisions are taken with the sanction of a creditors' body, such as the Committee of Creditors (CoC). Some are taken with the explicit permission of the judicial or adjudicatory body. However, there are lots of decisions which are taken by the officeholder himself. What are the grounds on which this decision-making may be challenged in judicial/quasi-judicial proceedings? The jurisprudence on this is rich with rulings from insolvency laws of various countries over the decades, as also the general principles of judicial review coming from administrative law.

The relevance of this article, in Indian context, is the fact that the involvement of practising professionals as insolvency officeholders, particularly, liquidators, is quite new, and therefore, decision-making by these professionals may be relatively more aggressive, less inclusive, and therefore, prone to challenges by creditors and other stakeholders. As the actions and decisions of these professionals are taken before legal forums, it may be necessary to see the evolution of the law around this topic from global jurisdictions.

The discussion, therefore, delves on the following –

- An overview of the provisions in India and corresponding/comparable provisions in other jurisdictions talking about the powers/duties of the office-holdersin different roles they might assume under concerned laws.
- Potential situations which generally require/may require exercise of power of decision-making and fetters to such powers, as corollary.
- Right to challenge the decisions – whether such a right exists and if so, who has this right?
- Circumstances when the courts would or would not intervene.

Decision-making powers/duties of office-holders

Decision-making is as much a duty as a power, as envisaged in laws across jurisdictions.

In India, under the Insolvency and Bankruptcy Code, 2016 ("Code"), while during resolution, the board is under animated suspension, liquidation entails statutory discharge of officers of the entity; thereby requiring, in both circumstances, the office-holder to step into the role of decision-making. The office-holder cannot NOT decide. However, such decision-making has been subjected to approval of the CoC during resolution, and to directions of the adjudicating authority ("NCLT") during liquidation.

Note that there is a clear difference between the two phases which the office-holder serves – unlike resolution proceedings where the role of the insolvency professional is mainly that of a facilitator, working under the directions of the CoC, the liquidator is largely on his own and *has to* take several decisions in course of proceedings, thereby functioning in a "quasi-judicial" capacity[56].See, illustratively, sections 20, 23, 25, 28 (in respect of resolution professional), and sections 35, 39, 40, 41 (in respect of liquidators)[57].

Also, there is a noticeable difference between the position of a liquidator under voluntary winding up, and that under winding up by court. In case of voluntary liquidation, the liquidator is appointed by the shareholders. In case of winding up by court, the liquidator is seen as an officer of the court. The liquidator is, therefore, in a more vulnerable position when it comes to challenge to the decisions taken by the office-holder.

Under the UK Insolvency Act, 1986, the powers of the liquidator are enumerated in Schedule 4, read with sections 165-170 – specifically, section 167 provides for powers of liquidators in a winding up by court.Similar powers/duties are seen in laws of other countries too – for example, section 477 of the Corporations Act of Australia, and sections 144-145 of the Insolvency, Restructuring and Dissolution Act, 2018 of Singapore.

Generally speaking, the liquidators have to *decide* in the following illustrative cases –

- day-to-day management of assets of the entity, especially, when the entity is still to be maintained as a "going concern";
- acceptance/rejection of claims;
- whether to bring any action/legal proceeding in the name of the entity;
- whether to settle disputed claims of the entity against third parties, including by way of conciliation, out-of-court settlements, or to continue litigate otherwise;
- whether to assign a cause of action;
- manner of disposal of the assets – whether on slump-sale, piecemeal or in parcels;
- whether to raise money requisite by creating further security on assets;
- whether to hold or to distribute the sums realised;

[56]Hon'ble Supreme Court in *Swiss Ribbons Pvt. Ltd. v. Union of India & Others*, WP (Civil) No. 99 of 2018, paras 60-61.
[57]Interestingly, section 42 uses the expression "appeal" against the decision of liquidator, thereby emphasizing the role of liquidator as a quasi-judicial authority.

- whether to enter into compromise/arrangement with creditors/class of creditors, or members/class of members;
- whether to disclaim certain properties/contracts – this will involve determination of whether the property/contract is onerous;
- whether a certain transaction is vulnerable to be categorised into preferential, undervalued, extortionate, or fraudulent or as wrongful trading or fraudulent trading;

and the list is endless – there are plethora of circumstances where the liquidator is/might be required to take a stand.

Judicial Review of Office-holder's acts or decisions: Provisions of Law

The key questions of law on judicial review of liquidators' actions or decisions may be several:

- Is there a right of challenging liquidator's decisions or actions?
- Who can bring the challenge?
- Under what circumstances will the court usually interfere?

Generally speaking, while granting wide discretionary powers to the office-holders, the law also imposes certain fetters on such powers, thereby modulating their roles, and reducing the chances of conflict between the office-holder and the stakeholders.

Evidently, *refer* section 28 which requires the resolution professional to take prior approval of the CoC before undertaking any of the actions listed thereunder. Similarly, section 35 starts with "*Subject to the directions of the Adjudicating authority* . . ." while laying down general powers and duties of the liquidator. From being subject to "sanction" of the court to being subject to "directions" of the tribunal, the provisions relating to exercise of powers of the liquidator has evolved over time[58].

The second half of section 35 – that is, sub-section (2) – is equally important. It *empowers* the liquidator to consult *any of the stakeholders entitled to distribution* of proceeds under section 53. The proviso clarifies that such consultation is *not binding* on the liquidator.

Besides, section 60 of the Code vests on the NCLT generic powers to determine any question of law/facts, as arising in relation to proceedings of the corporate debtor under the Code.

Similarly, sections 167 and 168 of the UK Insolvency Act, 1986 make provision for judicial intervention. By virtue of sub-section (1) of section 167, in case of a company being wound up by the court, the liquidator may exercise any of the powers specified in Parts 1 to 3 of Schedule 4, which inter-alia include power to being/defend action, to carry on the business for beneficial liquidation, to sell any of the properties of the company by public auction or private contract with power to transfer the whole of it to any person or to sell the same in parcels, to raise security, to distribute, etc. However, at the same time, sub-section (3) of section 167 provides as follows –

[58]Section 35 of the Code is akin to section 290 of the Companies Act, 2013, which in turn, is in contrast to section 457 of the Companies Act, 1956. The latter subjected the powers of the liquidator to "sanction" of the court. Section 458, however, enabled the liquidator to exercise discretion where the court, by order, provides that the powers can be exercised without such sanction. In any case, the exercise of such powers shall be "subject to control" of the court. Besides, *refer* section 460, 463-465 of the Companies Act, 1956.

> "(3)The exercise by the liquidator in a winding up by the court of the powers conferred by this section *is subject to the control of the court*, and *any creditor or contributory may apply* to the court with respect to any exercise or proposed exercise of any of those powers."

Section 168 of the UK Insolvency Act provides supplementary powers to the liquidator. The liquidator *may seek a decision* on any matter from the company's creditors or contributories; and *must seek a decision* on a matter, if requested to do so by 1/10th in value of creditors, or 1/10th in value of the contributories. Sub-section (3) entitles the liquidator to apply to the court in prescribed manner, for directions in relation to any particular matter arising in the winding up. Sub-sections (4) and (5) provide as follows –

> "(4)Subject to the provisions of this Act, the liquidator *shall use his own discretion in the management of the assets and their distribution among the creditors*.
>
> (5)If *any person* is aggrieved by an act or decision of the liquidator, that person may apply to the court; and *the court may confirm, reverse or modify the act or decision* complained of, and make such order in the case as it thinks just."

The fetters, as above, serve two crucial functions – first, these put a control on the use of discretion by the office-holder, and secondly, these spread the responsibility too. However, it must be noted that such intervention or control, as the case may be, has its own limitations. The courts have, time and again, declined to intervene in the acts/decisions of the liquidators unless *the act/decision was something so unreasonable and absurd that no reasonable man would have done it* – see discussions below.

Judicial Review of actions of Office-Holders: Judicial Precedents

In *Re Edennote Ltd; Tottenham Hotspur PLC v. Ryman* [1996] 2 BCLC 389, [1996] EWCA Civ 1349 is a classic case concerning the subject.Certain important aspects as discussed in this ruling are –

(i) The Court, comparing the role of a liquidator to that of a *prudent businessman*, called for inapplicability of commonly referredWednesbury test (see *Associated Provincial Picture Houses Ltd. v. Wednesbury* Corp. [1948] 1 KB 223)while judging the acts/decisions of liquidators, as follows –

> ". . . it is unnecessary, rather it may be confusing, to introduce into the court's control of the acts and decisions of liquidators the language of its control of administrative action. In the latter case the court is usually concerned with the supervision of public servants performing statutory functions; in the former *with the supervision of persons who must, in most of what they do, act as prudent businessmen*. *In general there seems to be something unrealistic in judging the propriety of the acts and decisions of a businessman by asking whether he took into account something he ought not to have taken into account or failed to take into account something he ought to have taken into account.*"

(ii) However, it approved of the test that the court will only interfere with the act of a liquidator if he has done something so utterly unreasonable and absurd that no reasonable man would have done it[59] –

> "it is certainly possible for a liquidator to do something so utterly unreasonable and absurd that no reasonable man would have done it, simply by selling an asset of the company without taking into account the possibility that a third party might well have made a better offer than he to whom it was sold."

(iii) As to "reasonability", the Court emphasised on the importance of being properly advised –

> "A reasonable liquidator must be taken to be one who is properly advised. If support be needed for that proposition, it can be found in Re Hans Place Ltd. [1993] BCLC 768, 778I, where Mr John McDonnell QC is recorded as having submitted that the court can only reverse a decision of a liquidator under section 168(5) *where it is satisfied that it was taken in some way mala fide or "was so perverse as to demonstrate that no liquidator properly advised could have taken it*." . . .*Very often a liquidator will not need advice before he acts.Here he clearly did*."

(iv) Section 167(3) provides, first, that the exercise of the liquidator's powers is subject to the "control" of the court and, secondly, that any creditor or contributory may apply to the court with respect not only to any "proposed exercise" but also to any "exercise" of any of those powers. It is therefore plain that the court can control a past exercise of the powers and can, if appropriate, undo a transaction to which it has led. In any event, the notion that creditors and contributories should be able to seek the directions of the court in an uncontroversial way is a curious one. As to who is a "person aggrieved", the Court remarked, "It is neither necessary nor desirable to attempt a classification of those who may be persons aggrieved by an act or decision of a liquidator in a compulsory winding up. On the footing that the claims of secured creditors have been or will be satisfied, it is perfectly clear that unless and until there proves to be a surplus available for contributories (a most improbable event) "persons aggrieved" must include the company's unsecured creditors. If the liquidator disposes of an asset of the company at an undervalue*, their interests are prejudiced* and each of them can claim to be a person aggrieved by his act." [emphasis ours]

The *Edennote* ruling *(supra)* has been cited and relied upon by an array of rulings, for instance, in *Abbey Forwarding Limited and Hone and others* [2010] EWHC 1644 (Ch), stating that the "test is a high one".

[59]The Court also went into the question of removal of the liquidator. The Court observes, "At [1995] 2 BCLC 268B, Sir John Vinelott said that the decision in *Keypak* was founded on and usefully illustrated the general principle that a liquidator must act in the interests of the general body of creditors and should not continue in office if in the circumstances the creditors no longer had confidence in his ability to realise the assets of the company to their best advantage and to pursue claims with due diligence. Again, I respectfully agree. *But there is an important qualification*, which is indeed accepted by MrHeslop. *The creditors' loss of confidence must be reasonable.* Moreover, the court does not lightly remove its own officer and will, amongst other considerations, pay a due regard to the impact of a removal on his professional standing and reputation." [emphasis ours]

Decisions of Insolvency Professional:
Scope of Judicial Review

In an Australian case, *Wentworth Metals Group Pty Ltd v Leigh and Owen (as liquidators of Bonython Metals Group Pty Ltd): In the matter of Bonython Metals Group Pty Ltd (In liq)* [2013] FCA 349, the Federal Court of Australia discussed relevant legal principles in the context of section 1321 of the Corporations Act, 2001 of Australia. The Federal Court relied on a catena of decisions[60] wherein it has been upheld that "the power of a court under s 1321 and its predecessors to review a discretionary decision of a liquidator has generally been said to be confined to circumstances where the liquidator was *acting unreasonably or in bad faith*", and that "The courts have generally been reluctant to interfere with decisions of liquidators where, as here, *their actions attract the benefit of the business judgment rule* under s 180(2)[61] of the Act."

Commenting upon the limitation of the judicial intervention in the decisions/acts of office-holders, the Federal Court, quoted *ASIC v Forrestview Nominees Pty Ltd (Receivers and Managers Appointed)* [2006] FCA 1530, wherein it was held,

> "Where an appeal is brought against a discretionary or evaluative decision of receivers and managers, and *particular decisions involving qualitative judgment, the scope for curial intervention is necessarily confined*.", as also held in *Duffy v Super Centre Development Corporation Ltd* [1967] 1 NSWR 382 as follows –
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> > "To the extent to which he makes decisions from time to time, they are in effect made under the authority of the Court itself, and they are subject to review and control by the Court should a proper case be made out requiring such intervention. Whilst this Court does, therefore, have an ultimate control over the day-to-day

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[60] *Re Mineral Securities Australia Ltd (in liq)* [1973] 2 NSWLR 207 at 230–231; *UTSA Pty Ltd (in liq) v Ultra Tune Australia Pty Ltd* [1997] 1 VR 667 at 696; (1996) 21 ACSR 251 at 281; *Re Burnells Pty Ltd (In liq)* [1979] Qd R 440 at 441; *Re Tyndall* (1977) 17 ALR 182 at 185; *Re Jay-O-Bees Pty Ltd (in liq)* (2004) 50 ACSR 565 ; [2004] NSWSC 818

[61] The **Business Judgement Rule** is propounded in section 180 (2) of the Corporations Act, 2001, as follows –

"**(2)** A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

(a) make the judgment in good faith for a proper purpose; and
(b) do not have a material personal interest in the subject matter of the judgment; and
(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
(d) rationally believe that the judgment is in the best interests of the corporation.

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

Note: This subsection only operates in relation to duties under this section and their equivalent duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence)—it does not operate in relation to duties under any other provision of this Act or under any other laws.

(3) In this section:

business judgment means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation."

> actions of a receiver and manager, *it is a control which is not in my view to be too freely exercised*. If, of course, there can be shown to be some defect in the manner in which the receiver and manager is conducting his duties – *a defect arising out of some want of good faith or out of some erroneous approach in law or in principle* – then that is clearly a ground on which the Court would entertain an application by one of the interested parties for appropriate directions or some other form of remedial order. Where, however, *the challenge made is that there has been an absence of prudence and wisdom in the receiver's decisions, a far heavier onus rests upon the party who seeks to challenge the decision in question. The Court will not concern itself with minor and ordinary decisions that he may have made: it must be shown that there is a decision of real significance in the affairs of the company and as to which there are real and substantial grounds for questioning its correctness before the Court will embark upon an investigation of what, if any, directions ought to be given.*" [emphasis ours]

The Federal Court also quoted from *Forrestview Nominees(supra)* that, "It is sufficient to say that at the very least the person bringing an appeal under s 1321 in these circumstances *must demonstrate that the decision is informed by some error of law or significant factual error or is otherwise so unreasonable, in the circumstances, that it should not be allowed to stand.* The content of those somewhat ambulatory considerations will be informed by the significance of the decision to the affairs of the company."

The Federal Court of Australia, also noted that *it is important not to lose sight of the standard of conduct expected of liquidators, particularly where matters of commercial or business judgment are involved,* as observed in *In the matter of St Gregory's Armenian School (in liq)* [2012] NSWSC 1215 at [33] –

> "In evaluating the conduct of a liquidator, it is important to remember that *a liquidator is required to make practical commercial judgments*. Much of a liquidator's decision–making involves the application of business acumen. *That a decision is not fully reasoned or supported by the fullest investigation does not mean that it should be second-guessed by the Court*."

Author Remarks

With great powers, comes great responsibility – however, the corollary is also true. It becomes counter-intuitive to expect fulfilment of responsibilities without vesting adequate authority/powers and "freedom to decide".

The office-holders have been vested with powers that ought to be exercised reasonably by following ordinary rules of skill, care, and diligence. The courts do not see such cases with a "keen eye" where the office-holder has acted reasonably and in a manner as a person of ordinary business prudence would act. If each act/decision of the office-holder is questioned on non-serious grounds or grounds not falling in the category of "unreasonableness", the same would cause a serious damage to the professional infrastructure of the concerned laws.