

Classifying Government Debt in Going Concern Resolutions

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ABSTRACT

The liquidation regime in India provided a super-priority to government dues and employee dues from 1956 to 2016 followed by payouts to any other types of creditors (banks, financial institutions or trade creditors). In 2016, a going concern model of resolution prior to liquidation was introduced under a new insolvency regime repealing the previous liquidation regime. The priority of claims under the Insolvency and Bankruptcy Code, 2016 provides that all government dues (that are central (federal) government or state government) would be ranked much lower and *pari passu* with secured creditors who had not enforced their security interest. This was done as a measure of a government bailout model and to offer priority to banks, in particular public sector (central government owned) banks who were in distress owing to their high-risk exposures. Further, under the new Indian insolvency model, certain categories of creditors such as trade creditors are to be paid above the liquidation value and in priority. The new insolvency regime, further introduces an automatic moratorium at insolvency commencement. This moratorium disallows any pending litigation and individual enforcement actions to be pursued against the insolvent corporate debtors, including government litigation.

In the above context, the going concern insolvency resolution process in India, requires municipal and state government authorities that are owned and governed by state governments to offer 'critical services' such as electricity and water typically supplied in contract with state governments or extend leases based on whether it is 'essential' to the business of the insolvent corporate debtor. In other recoveries by government authorities such as central or state tax authorities, the amounts received from insolvency resolution are relatively lower than the amount claimed. This has resulted in several parallel litigation often in violation of moratorium. A recent case initiated by a state electricity board, where state /municipal law allowed for seizure of fixed assets for payment of dues raised the question of whether a state government

stakeholder can be classified in a separate category of debt. The Supreme Court of India has upheld the specific instance of the state government secured creditor, resulting a review in other ongoing resolutions and government debt. Another instance, where owing to past dues, the water pollution board – a municipal authority, ordered a factory closure on non-payment of dues during going concern resolutions resulting in lower asset value.

In the above background, this paper, in its first part, seeks to address the issue of whether state governments should be addressed as separate stakeholders in a priority of claims, in going concern resolutions. Based on the data of the resolutions available in the public domain, distress of the state governments in going concern resolutions is often higher than that of the central government but the law envisages a bailout that leaves them with very limited recoveries. Most state government incomes are subject to distressed recoveries that are high value, which needs separate deliberation since not all states have the same revenue streams and certain states have demonstrable distress. In the second part, the paper delves into issues of violation of moratorium provisions and other going concern issues that are owed to the repurposing of the insolvency regime to focus on protections to a 'financial creditor' (public sector banks and other financial institutions) in insolvency.

At this stage, the paper looks at the Indian regime and will consider moving to draw illustrations from regimes that may offer a suitable comparative.