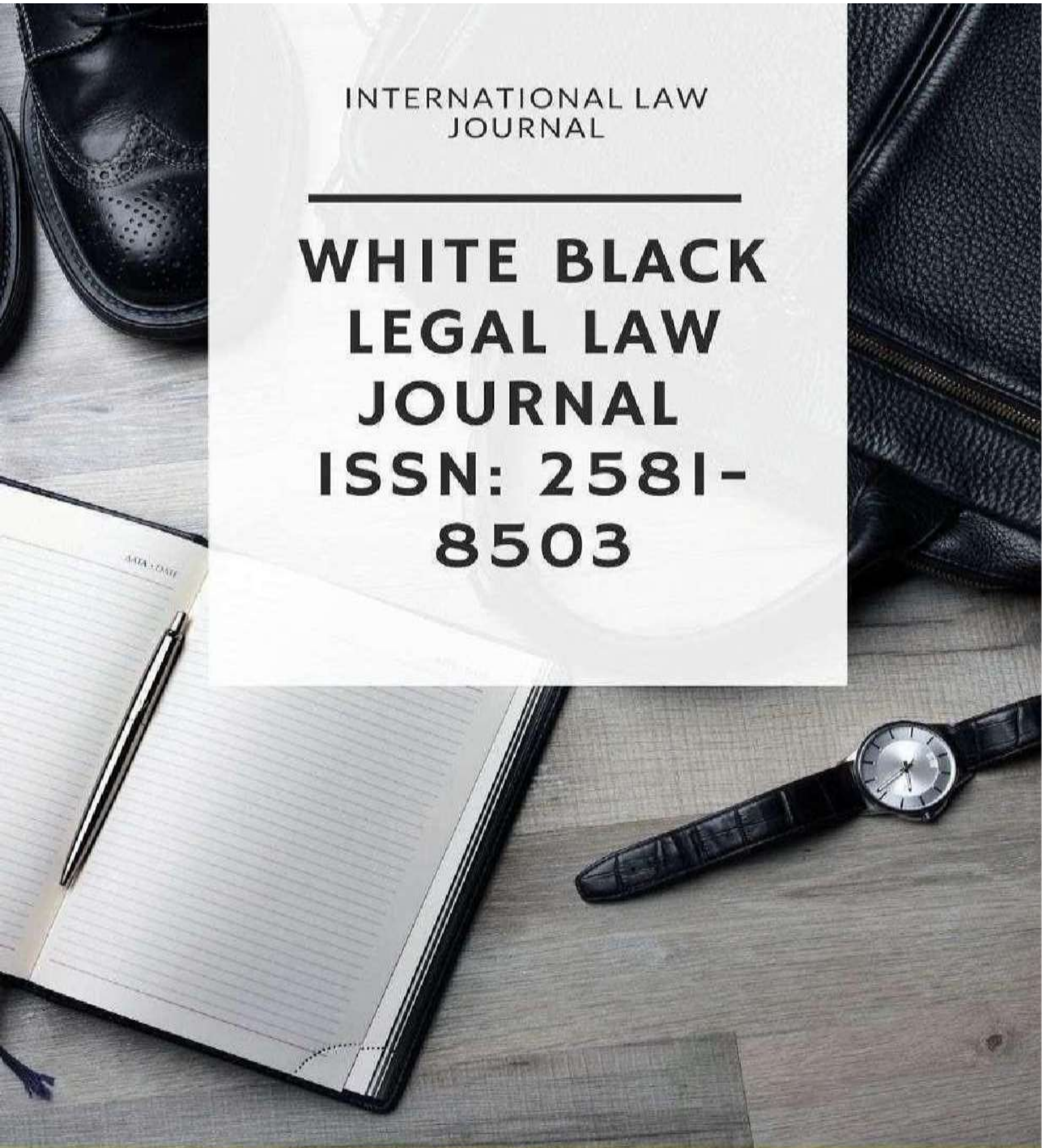

INTERNATIONAL LAW JOURNAL

WHITE BLACK LEGAL LAW JOURNAL

ISSN: 2581-8503

Peer - Reviewed & Refereed Journal

The Law Journal strives to provide a platform for discussion of International as well as National Developments in the Field of Law.

EDITORIAL TEAM

Raju Narayana Swamy (IAS) Indian Administrative Service officer

Dr. Raju Narayana Swamy popularly known as Kerala's Anti Corruption Crusader is the All India Topper of the 1991 batch of the IAS and is currently posted as Principal Secretary to the Government of Kerala . He has earned many accolades as he hit against the political-bureaucrat corruption nexus in India. Dr Swamy holds a B.Tech in Computer Science and Engineering from the IIT Madras and a Ph. D. in Cyber Law from Gujarat National Law University . He also has an LLM (Pro) (with specialization in IPR) as well as three PG Diplomas from the National Law University, Delhi- one in Urban Environmental Management and Law, another in Environmental Law and Policy and a third one in Tourism and Environmental Law. He also holds a post-graduate diploma in IPR from the National Law School, Bengaluru and a professional diploma in Public Procurement from the World Bank.

Dr. R. K. Upadhyay

Dr. R. K. Upadhyay is Registrar, University of Kota (Raj.), Dr Upadhyay obtained LLB , LLM degrees from Banaras Hindu University & Phd from university of Kota.He has succesfully completed UGC sponsored M.R.P for the work in the ares of the various prisoners reforms in the state of the Rajasthan.

Senior Editor

Dr. Neha Mishra

Dr. Neha Mishra is Associate Professor & Associate Dean (Scholarships) in Jindal Global Law School, OP Jindal Global University. She was awarded both her PhD degree and Associate Professor & Associate Dean M.A.; LL.B. (University of Delhi); LL.M.; Ph.D. (NLSIU, Bangalore) LLM from National Law School of India University, Bengaluru; she did her LL.B. from Faculty of Law, Delhi University as well as M.A. and B.A. from Hindu College and DCAC from DU respectively. Neha has been a Visiting Fellow, School of Social Work, Michigan State University, 2016 and invited speaker Panelist at Global Conference, Whitney R. Harris World Law Institute, Washington University in St.Louis, 2015.

Ms. Sumiti Ahuja

Ms. Sumiti Ahuja, Assistant Professor, Faculty of Law, University of Delhi, Ms. Sumiti Ahuja completed her LL.M. from the Indian Law Institute with specialization in Criminal Law and Corporate Law, and has over nine years of teaching experience. She has done her LL.B. from the Faculty of Law, University of Delhi. She is currently pursuing Ph.D. in the area of Forensics and Law. Prior to joining the teaching profession, she has worked as Research Assistant for projects funded by different agencies of Govt. of India. She has developed various audio-video teaching modules under UGC e-PG Pathshala programme in the area of Criminology, under the aegis of an MHRD Project. Her areas of interest are Criminal Law, Law of Evidence, Interpretation of Statutes, and Clinical Legal Education.

Dr. Navtika Singh Nautiyal

Dr. Navtika Singh Nautiyal presently working as an Assistant Professor in School of law, Forensic Justice and Policy studies at National Forensic Sciences University, Gandhinagar, Gujarat. She has 9 years of Teaching and Research Experience. She has completed her Philosophy of Doctorate in 'Intercountry adoption laws from Uttranchal University, Dehradun' and LLM from Indian Law Institute, New Delhi.

Dr. Rinu Saraswat

Associate Professor at School of Law, Apex University, Jaipur,
M.A, LL.M, Ph.D,

Dr. Rinu have 5 yrs of teaching experience in renowned institutions like Jagannath University and Apex University. Participated in more than 20 national and international seminars and conferences and 5 workshops and training programmes.

Dr. Nitesh Saraswat

E.MBA, LL.M, Ph.D, PGDSAPM
Currently working as Assistant Professor at Law Centre II, Faculty of Law, University of Delhi. Dr. Nitesh have 14 years of Teaching, Administrative and research experience in Renowned Institutions like Amity University, Tata Institute of Social Sciences, Jai Narain Vyas University Jodhpur, Jagannath University and Nirma University.
More than 25 Publications in renowned National and International Journals and has authored a Text book on Cr.P.C and Juvenile Delinquency law.

Subhrajit Chanda

BBA. LL.B. (Hons.) (Amity University, Rajasthan); LL. M. (UPES, Dehradun) (Nottingham Trent University, UK); Ph.D. Candidate (G.D. Goenka University)

Subhrajit did his LL.M. in Sports Law, from Nottingham Trent University of United Kingdoms, with international scholarship provided by university; he has also completed another LL.M. in Energy Law from University of Petroleum and Energy Studies, India. He did his B.B.A.LL.B. (Hons.) focussing on International Trade Law.

ABOUT US

WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

<u>EXTORTIONATE TRANSACTIONS IN INSOLVENCY – EVALUATING THE EFFECTIVENESS OF THE IBC 2016</u>

AUTHORED BY - DEEPANSH BHATI,
Law Student, Law Centre II, University of Delhi

Abstract

This research paper explores the regulatory framework of extortionate transactions under the Insolvency and Bankruptcy Code (IBC), 2016 in India. Extortionate transactions, defined as credit terms exploiting financial distress with excessively burdensome conditions, pose significant challenges to creditor rights and insolvency proceedings. The study examines the legal and economic implications of such transactions, emphasizing their detrimental impact on creditor recovery and the broader financial system. Central to the analysis is a critical review of Section 50 of the IBC, which governs the distribution of assets during insolvency. The paper evaluates how Section 50 addresses extortionate transactions, highlighting its effectiveness in preventing asset stripping and ensuring equitable creditor treatment. Through comparative insights with international insolvency regimes, particularly the Creditor in Control (CIC) model in India and the Debtor in Possession (DIP) model in the United States, the research assesses best practices for safeguarding creditor interests. It explores legal principles such as the anti-deprivation rule and pari passu distribution, essential for mitigating the adverse effects of extortionate transactions. The study underscores the necessity for legislative reforms to strengthen Section 50 and enhance its applicability in mitigating the risks associated with extortionate transactions. It proposes recommendations for legislative clarity and procedural improvements, aiming to foster creditor confidence, uphold fair treatment, and bolster economic resilience within India's insolvency framework.

Keywords – IBC, Extortionate Transactions, Credit Transactions, Avoidable Transactions, Insolvency, Bankruptcy

The extension of credit to corporate debtors inevitably entails the risks of insolvency and bankruptcy. Although often used interchangeably, insolvency and bankruptcy denote distinct financial states and legal processes. Insolvency denotes a financial condition where an individual or company is unable to meet their debt obligations as they become due, indicating financial distress without necessarily initiating formal legal proceedings[1]. On the other hand, bankruptcy constitutes a formal legal process pursued by an insolvent individual or entity to seek relief from all or some of their debts. Bankruptcy proceedings typically involve either asset liquidation or the formulation of a reorganization plan aimed at repaying creditors, overseen by a bankruptcy court[2].

In the broader economic context, creditor entities typically anticipate potential gains when extending credit transactions. However, the presence of Non-Performing Assets (hereinafter referred as "NPA") often contradicts this economic presumption, leading entities into unfavourable circumstances. NPAs commonly arise from several underlying causes, including balance sheet insolvency, where total liabilities exceed the measurable value of assets; cash flow insolvency, where inadequate liquidity prevents timely debt servicing; or deliberate non-compliance with debt obligations due to fraudulent intentions. These factors collectively contribute to the challenging environment surrounding NPAs.

The contradiction of this fundamental economic presumption often stems from the information asymmetry between corporate debtors and creditors. In credit markets characterized by imperfect information, lenders encounter challenges in accurately assessing the creditworthiness of borrowers due to this asymmetry. Borrowers typically possess more detailed information about their financial health and future prospects compared to lenders, which gives rise to issues of adverse selection and moral hazard in the allocation of credit[3]. This phenomenon is widely recognized as contributing to the escalation of NPAs within banking systems globally[4], India being no exception.

Prior to the enactment of the Insolvency Bankruptcy Code, 2016 (hereinafter referred as "IBC" or the "Code"), resolution of insolvencies of corporations as well as bankruptcies of individuals was an uphill task given the scattered nature of multiple legislations[5] which offered inconsistent and

---

[1] Mokal, R. J. (2001). "The Value of Rescue: A Critical Analysis of the London Approach to the Resolution of Financial Distress." *Journal of Corporate Law Studies*, 1(1), 136-178.
[2] Altman, E. I., & Hotchkiss, E. (2005). Corporate Financial Distress and Bankruptcy: Predict and Avoid Bankruptcy, Analyze and Invest in Distressed Debt. John Wiley & Sons.
[3] Stiglitz, J. E., & Weiss, A. (1981). "Credit Rationing in Markets with Imperfect Information." American Economic Review, 71(3), 393-410.
[4] Berger, A. N., & Udell, G. F. (2002). "Small Business Credit Availability and Relationship Lending: The Importance of Bank Organizational Structure." Economic Journal, 112(477), F32-F53.
[5] See The Sick Industrial Companies (Special Provisions) Act, 1985; The Recovery of Debts Due to Banks and Financial

inefficient resolution procedures. Inadequate and inefficient laws to address insolvency can significantly undermine economic stability and growth. Poorly functioning insolvency frameworks create uncertainty for creditors and investors, diminish recovery rates for creditors, and ultimately deter entrepreneurship and economic development[6]. Thus, in response to contemporary requirements, IBC was enacted to consolidate and revise the fragmented and ineffective laws governing insolvency and bankruptcy resolution.

The IBC is a comprehensive statute that addresses the reorganization and insolvency resolution of corporate debtors, partnership firms, and individuals in a time-bound manner[7]. The primary legislative intent behind the Corporate Insolvency Resolution Process (hereinafter referred as "CIRP") under the Code is to resolve the debt and insolvency status of the company, as opposed to dissolving or shutting down the company through winding-up proceedings under the Companies Act, 2013. The foundational objectives of the IBC are threefold: first, to resolve the debt of the corporate debtor; second, to maximize the value of the corporate debtor's assets; and third, to promote entrepreneurship, enhance the availability of credit, and balance the interests of all stakeholders[8].

The Code plays a pivotal role at a juncture where the financial interests of creditors are jeopardized due to information asymmetry favouring corporate debtors. When a debtor entity or individual faces significant financial challenges leading to balance sheet or cash flow distress, the directors and promoters of the entity are typically the first to recognize the threat, placing creditors at a disadvantage. In such a scenario, there is a high likelihood that the corporate debtor may attempt to alienate the entity's assets to the detriment of the creditors, which grossly violates the 'anti-deprivation rule.' The anti-deprivation rule is a common law principle which stipulates that parties cannot contract out of the statutory insolvency regime by agreeing that, on the insolvency of one of them, property will be removed from the insolvent's estate to the detriment of its creditors. This rule aims to prevent a reduction in the pool of assets available for distribution among creditors by prohibiting contractual provisions that would have such an effect[9].

Institutions Act, 1993; The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002; Companies Act, 2013

[6] World Bank. (2019). "Doing Business 2020: Comparing Business Regulation in 190 Economies." World Bank Group.

[7] Insolvency and Bankruptcy Board of India (IBBI). (2016). "Insolvency and Bankruptcy Code, 2016: A Reform to Promote Resolution, Maximize Value of Assets, and Balance Interests of All Stakeholders."

[8] The Insolvency and Bankruptcy Code, 2016, Preamble

[9] Goode, R. M. (2011). Principles of Corporate Insolvency Law (4th ed.). Sweet & Maxwell.

Apart from the anti-deprivation rule, the pari passu distribution principle is another fundamental premise of English Insolvency Law. The pari passu principle mandates that all unsecured creditors share equally in the distribution of the assets of the insolvent estate. This principle precludes any contractual arrangement that seeks to provide one creditor with a greater share of the estate than others in the same class[10]. Juxtaposing both premises, it can be concluded that while the anti-deprivation rule targets attempts to withdraw assets upon bankruptcy, thereby reducing the value of the insolvent estate to the detriment of creditors, the pari passu principle ensures that statutory provisions for pro-rata distribution cannot be overridden by a contract granting one creditor more than their equitable share[11].

A similar position is adopted by the IBC under Section 49, which addresses undervalued transactions deliberately entered into by the corporate debtor to defraud creditors by keeping assets beyond their reach[12]. The rationale behind including this provision in the Code aligns with the anti-deprivation rule in the United Kingdom[13].

The rationale behind corporate debtors entering into undervalued or extortionate credit transactions can be elucidated through the framework of the IBC. The legislative intent of the Parliament advocated for the 'Creditor in Control' (hereinafter referred as "CIC") model tailored for the Indian market, diverging from the 'Debtor in Possession' model observed in the United States. Under the Creditor in Control model, creditors assume a pivotal role in decision-making during insolvency proceedings, prioritizing the management and maximization of their claims. This model underscores creditors' rights and interests in overseeing the preservation and equitable distribution of the debtor's assets[14]. The rationale behind this approach is rooted in the belief that creditors possess a vested interest in safeguarding asset values and ensuring fair distribution of proceeds[15].

Conversely, the Debtor in Possession (hereinafter referred as "DIP") model prevalent in U.S. bankruptcy law[16] empowers the debtor to retain control over its assets and operations throughout the

---

[10] Fletcher, I. F. (2009). The Law of Insolvency (4th ed.). Sweet & Maxwell.
[11] Belmont Park Investments Pty. Ltd. v. BNY Corporate Trustee Services Ltd & Anr., 38 UKSC [2011]
[12] The Insolvency and Bankruptcy Code, 2016, Section 49
[13] Bankruptcy Law Reform Committee, Interim Report of the Bankruptcy Law Reform Committee (Feb. 2015) 98-99
[14] Armour, J., Hsu, A., & Walters, A. (2006). The Creditors' Bargain and Option-Preservation in Restructuring Law. European Business Organization Law Review (EBOR), 7(1), 1-34.
[15] Jackson, T. (2012). Principles of Corporate Insolvency Law. Oxford University Press.
[16] United States Bankruptcy Code, 1978

restructuring process, under the supervision of the bankruptcy court. This framework enables the debtor's management to continue business operations, negotiate restructuring plans with creditors, and potentially emerge from bankruptcy as a viable entity[17]. The court oversees major decisions to safeguard creditors' interests and asset values, aiming to facilitate a balanced and equitable resolution for all stakeholders involved in the restructuring process[18].

A fundamental distinction between these two insolvency regimes lies in the eligibility to initiate the resolution process. Under the DIP approach, only the corporate debtor can propose a plan within 120 days following the relief order. In contrast, the IBC expressly prohibits a corporate debtor from initiating the corporate insolvency resolution process[19] and categorically disqualifies them from acting as a resolution applicant[20].

The CIC approach exposes creditors to the risk of entering into extortionate transactions with corporate debtors. In this framework, creditors may extend credit without adequate due diligence, often charging exorbitant interest rates to secure their positions when a corporate debtor anticipates insolvency. Corporate debtors, facing imminent insolvency, may feel compelled to accept such credit terms to stave off financial collapse. Under the CIC approach as envisioned by the Insolvency and Bankruptcy Code (IBC), corporate debtors face the prospect of losing control over their operations to the Committee of Creditors and Resolution Professionals. This outcome underscores the vulnerability of corporate debtors in the credit market, where their options are constrained by the decisions of creditors and insolvency resolution processes governed by the IBC. Section 50[21] empowers the adjudicating authority to avoid such extortionate transactions however, it is fraught with a plethora of challenges and legal issues.

TRANSACTION AVOIDANCE AND EXTROTIONATE TRANSACTIONS

Avoidable transactions in insolvency law refer to those transactions that a liquidator or trustee can challenge if they unfairly prejudice creditors. These transactions encompass preferences given to specific creditors, transactions conducted at undervalued prices, or those executed with the intent to

[17] Baird, D. G., & Rasmussen, R. K. (2002). The End of Bankruptcy. Yale Law Journal, 111(3), 357-384.
[18] Skeel, D. A. (2014). Debt's Dominion: A History of Bankruptcy Law in America. Princeton University Press.
[19] The Insolvency and Bankruptcy Code, 2016, Section 11
[20] The Insolvency and Bankruptcy Code, 2016, Section 29A
[21] The Insolvency and Bankruptcy Code, 2016, Section 50

defraud creditors. The primary objective is to uphold fairness and equality among creditors by reclaiming assets improperly disposed of prior to the initiation of insolvency proceedings.[22]

Derived from principles of insolvency, transaction avoidance has broadened its application, often manifesting in the annulment of unconscionable contracts.[23] Sections 43 – 51 of the Insolvency and Bankruptcy Code (IBC) delineate four main categories of avoidable transactions: Preferential Transactions, Undervalued Transactions, Fraudulent Transactions, and Extortionate Transactions.

Extortionate transactions in insolvency law refer to credit transactions where terms are so harsh or burdensome that they are considered excessive or oppressive. These transactions typically involve exorbitant interest rates, fees, or terms that exploit the debtor's financial distress, often to the detriment of creditors. The aim is to protect the fairness and integrity of the insolvency process by scrutinizing and potentially setting aside such transactions to prevent undue advantage taken of the corporate debtor's vulnerable financial position.[24] The predecessor laws[25] to IBC had no specific provision relating to extortionate transactions in credit market.

Such transactions in most of the cases, are manifested when either of the parties possesses unequally higher bargaining power than its counterparts. For instance, when the entities anticipate insolvency, the prospective creditors sense a position of dominance and higher bargaining power, a position apt for exploitation of corporate debtors through exploitative transactions.[26] Any transaction resulting from the abuse of such dominant power shall lack true freedom of contract[27], an idea highly signified under the law, as it ensures that economic interests of the community are secured[28].

Even if it is well established that an extortionate transaction was entered into by the consent of the parties without the abuse of dominant position, then too freedom of contract is a contextual necessity, not an absolute requirement.[29] Extortionate transactions do not require qualifier of abuse of dominant

---

22 Kenneth Kettering, "Principles of Corporate Insolvency Law" (Oxford University Press, 2019), p. 145.
23 Jason Harris, "Australian Insolvency Law: Cases and Materials" (Cambridge University Press, 2020), p. 212.
24 Paul Omar, "Principles of Insolvency Law" (Oxford University Press, 2020), p. 212.
25 See Supra note 5
26 Rebecca Parry, ‘Extortionate Credit Transactions (Insolvency Act 1986, Sections 244 and 343),’ in Transaction Avoidance in Insolvencies (Rebecca Parry et al. eds., 3rd ed. 2018) 197
27 LIC of India v. Consumer Education and Research Centre, (1995) 5 SCC 482, Pg. 32, 37
28 Anson’s Law of Contracts (J. Beatson et. al eds., 30th ed. 2016) 4
29 G.H.L Fridman, ‘Freedom of Contract’ 2 Ottawa L. Rev. 1 (1967)

position in order to be set aside, they are illegitimate independently.[30] The prescriptions of law, such as the Insolvency and Bankruptcy Code (IBC) in the present context, should not validate such transactions in light of broader public interest and economic concerns. Extortionate transactions, whether or not involving abuse of dominant position, unfairly disadvantage other creditors who extended credit on fair terms. Courts, when identifying such transactions detrimental to other creditors of the corporate debtor, should employ transaction avoidance mechanisms to strike a fair balance among creditors. Allowing extortionate transactions under the guise of the abuse of dominant position qualifier would breach the pari passu distribution principle, as it could lead to certain creditors unjustly receiving preferential treatment over others by exploiting the debtor's vulnerability.

An opposing perspective on the legal issue asserts that the provision for setting aside extortionate credit transactions could potentially restrict credit availability, thereby diminishing overall market liquidity.[31] Higher interest rates are often justified by the concept of a risk premium, reflecting the increased likelihood of default due to the precarious financial condition of corporate debtors.[32] This viewpoint emphasizes that only transactions which a corporate debtor would not ordinarily undertake, but for the expectation of insolvency and urgent credit needs, should be categorized as extortionate.[33]

SECTION 50, INSOLVENCY AND BANKRUPTCY CODE, 2016

While the Insolvency and Bankruptcy Code (IBC) does not explicitly define the term 'extortionate transactions,' it empowers the liquidator or resolution professional to seek avoidance of transactions involving the receipt of financial or operational debt entered into within two years preceding the insolvency commencement date through application to the adjudicating authority.[34] The Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 (hereinafter referred as "IBBI Regulations"), provide necessary guidance with respect to the scope of the provision, and it states that a transaction shall be considered as an extortionate transaction where its terms:

"*(1) require the corporate debtor to make exorbitant payments in respect of the credit provided; or*

[30] Lord Denning, The Due Process of Law (London: Butterworths, 1980), p. 112.
[31] Robert E. Scott and Alan Schwartz, Contract Theory and the Limits of Contract Law (Harvard University Press, 2008), p. 142.
[32] William A. Klein, John C. Coffee Jr., and Frank Partnoy, Business Organization and Finance: Legal and Economic Principles (Foundation Press, 2018), p. 455.
[33] Report of Review Committee, Insolvency Law and Practice (Cmnd 8558, June 1982, United Kingdom), Pg 1481 – 1484
[34] The Insolvency and Bankruptcy Code, 2016, Section 50

(2) are unconscionable under the principles of law relating to contracts"[35]

In cases where a corporate debtor is subjected to unfairly high interest rates or severe default provisions, such terms could be deemed extortionate under Section 50 of the IBC.[36] Upon the discovery of extortionate transactions, the adjudicating authority is empowered under Section 51[37] to undertake various actions. These actions may extend to third parties receiving interests through the concerned transaction. Thus, it can be concluded that the IBC provisions do not outright invalidate extortionate transactions but rather seek their modification or avoidance.

At first glance, it may appear that extortionate transactions are adequately addressed by the Insolvency and Bankruptcy Code (IBC). However, in essence, the IBC merely codifies existing contractual remedies aimed at nullifying unconscionable agreements. In fact, these contractual remedies often impose more stringent thresholds to be met. Section 23 of the Indian Contract Act, 1872 (hereinafter referred to as the 'Contract Act'), stipulates that an agreement shall be deemed void if the court finds its consideration or object to be opposed to public policy. In the case of Central Inland Water Transport Corporation Limited and Another v. Brojo Nath Ganguly and Another[38], the terms in the contract of employment and service rules, which allowed for the termination of permanent employees without assigning any reason on three months' notice or pay in lieu thereof on either side, were challenged. Recognizing the unequal bargaining power between the employer and the employee, the court held these terms to be unconscionable, unfair, unreasonable, and against public policy. Consequently, the termination was struck down as void. The Hon'ble Supreme Court reiterated this legal position in Mary v. State of Kerala[39]. Thus the present position of law under section 23 of Contract Act stipulates that the unconscionable agreements are against public policy. Therefore, it is deduced that the extortionate transactions are void under section 23 of the Contract Act on grounds of being unconscionable and thus opposed to public policy.

The legal issue surrounding Regulation 11(1) is procedural rather than substantive. While the Limitation Act grants the corporate debtor a three-year period to file a suit under Section 23 of the Indian Contract Act, the liquidator or resolution professional is permitted to approach the adjudicating

[35] The Insolvency and Bankruptcy Board of India (Liquidation Process) Rules, 2016, Regulation 11
[36] Ashish Makhija, Insolvency and Bankruptcy Code of India (2018) 992.
[37] The Insolvency and Bankruptcy Code, 2016, Section 51
[38] Central Inland Water Transport Corporation Limited and Another v. Brojo Nath Ganguly and Another etc. (1986) 3 SCC 156.
[39] Mary vs State Of Kerala & Ors 2014 (14) SCC 272

authority regarding transactions only within the two years preceding the insolvency commencement date. This discrepancy highlights a lack of harmony between existing legislation and the new insolvency framework.

The Indian Contract Act lacks a dedicated provision specifically addressing the unconscionability of contracts. Consequently, the primary legal remedy is found under Section 16, which defines undue influence. This section allows the affected party to render the contract voidable at their option under Section 19A. To invoke this remedy, the undue influence in question must be such that it overpowers the volition of the affected party[40], thereby securing an unfair advantage[41]. However, hon'ble Supreme Court has noted that if the parties have wilfully entered into an unconscionable bargain, law cannot come to their rescue later on.[42]

If a creditor incorporates unconscionable terms into an agreement—terms that are not necessarily exorbitant interest rates—the adjudicating authority is unable to set these terms aside unless undue influence by the creditor is established. This legal stance is highly questionable and undermines the fundamental objective of Section 50 of the Insolvency and Bankruptcy Code (IBC). The primary aim of Section 50 is to ensure equal treatment for all creditors. Therefore, any form of unconscionability that grants undue advantage to a particular creditor or group of creditors should be subject to nullification. Under Section 16 of the Indian Contract Act, undue influence is recognized only when one party has real or apparent authority over the other, stands in a fiduciary relationship with the other, or contracts with a person whose mental capacity is impaired. In the context of credit transactions, these conditions are typically not met, making the presumption of unconscionability a legal fiction. Consequently, Regulation 11(2) of the Insolvency and Bankruptcy Board of India (IBBI) regulations does not align with the objective of Section 50 of the IBC.

WAY FORWARD

The provisions of the Insolvency and Bankruptcy Code (IBC) should be suitably amended to align them with the overarching objectives of the Code. Section 50 was enacted to ensure a level playing field for all creditors, ensuring that no creditor is placed at an advantageous or disadvantageous

[40] P Saraswathi Ammal v. Lakshmi Ammal, AIR 1978 Mad 361
[41] Ladli Prasad Jaiswal v. Karnal Distillery Co. Ltd., 1964 1 SCR 270
[42] S.K. Jain v. State of Haryana, (2009) 4 SCC 357

position. The primary objective of this section is to prevent extortionate transactions. Achieving this goal necessitates targeted legislative interventions to reinforce the intent and efficacy of Section 50.

The Limitation Act, 1963, grants a statutory period of three years for a prospective plaintiff to file a suit to set aside a contract and seek remedies in matters concerning loans. The Insolvency and Bankruptcy Code (IBC), however, prescribes a shorter statutory period of two years for similar remedies. This discrepancy can have significant practical implications for insolvency resolution. If a suit is filed before the adjudicating authority after two years but within the three-year period, the liquidator assumes control of all contracts entered into by the corporate debtor. Nonetheless, the liquidator would be precluded from seeking any remedy from the adjudicating authority to set aside extortionate transactions under the IBC. Concurrently, due to the principles of privity of contract and lack of locus standi, the liquidator would be barred from approaching a civil court under Section 19A or Section 23 of the Indian Contract Act, 1872. This legal gap effectively shields extortionate transactions from any form of judicial scrutiny, thereby undermining the protective intent of the IBC.

Regulation 11(2) of the IBBI Regulations directs us to interpret unconscionability through the lens of the Indian Contract Act, 1872, where the remedy necessitates proving both substantial and procedural unconscionability to obtain relief. However, the objectives and purpose of the Insolvency and Bankruptcy Code (IBC) require only evidence of substantial unconscionability. This implies that even consensual extortionate transactions, entered into with genuine freedom of contract, should be set aside to ensure true equality among creditors.

An amendment to the Contract Act should align with recommendations from the Law Commission of India, aiming to empower courts to declare contracts unenforceable based solely on substantial unconscionability. The Commission's 103rd Report proposed the inclusion of draft Section 67A in the Contract Act, which would read as follows:

> *"(1) Where the Court, on terms of the contract or on the evidence adduced by the parties, comes to the conclusion that the contract or any part of it is unconscionable, it may refuse to enforce the contract or the part that it holds to be unconscionable.*
>
> *(2) Without prejudice to the generality of the provisions of this Section, a contract or part of it is deemed to be unconscionable if it exempts any party thereto from – (a) the liability for*

wilful breach of the contract or (b) the consequence of negligence"[43]

The inclusion of this provision would empower courts to declare contracts unconscionable and unenforceable based solely on substantive unconscionability. This amendment aims to alleviate the potential hardship faced by liquidators or resolution professionals in meeting the stringent requirements of Section 16 of the Contract Act.

The explanation to section 50 of the Code clarifies that any debt extended by a person providing financial services, which complies with prevailing laws concerning such debts, cannot be categorized as an extortionate credit transaction. However, financial services regulators typically do not govern specific credit transaction rules; rather, it is the Reserve Bank of India that sets guidelines on fair lending practices for institutions[44]. Consequently, lenders have considerable freedom to set interest rates based on their policies, risk assessments, and borrower categorizations. This latitude in drafting loan terms and conditions underscores the importance of clear and equitable practices in credit transactions.

CONCLUSION

The Insolvency and Bankruptcy Code (IBC) is a dynamic legislation undergoing continuous changes and refinements to achieve optimal effectiveness. India has made significant strides in the 'Resolving Insolvency' category of the Ease of Doing Business Index, improving from the 134th rank in 2018 to 63rd in 2020. Recognizing these advancements, India received the Global Restructuring Review award for the most improved jurisdiction in 2018. However, as with any nascent law, the IBC continues to evolve through judicial interpretation and iterative amendments, underscoring the judiciary's pivotal role in refining and enhancing its application.

[43] Law Commission of India, Report No. 103, Unfair Terms in Contract (July 28th, 1984), Pg. 2.6
[44] Reserve Bank of India, Guidelines on Fair Practices Code for Lenders (May 5, 2003)