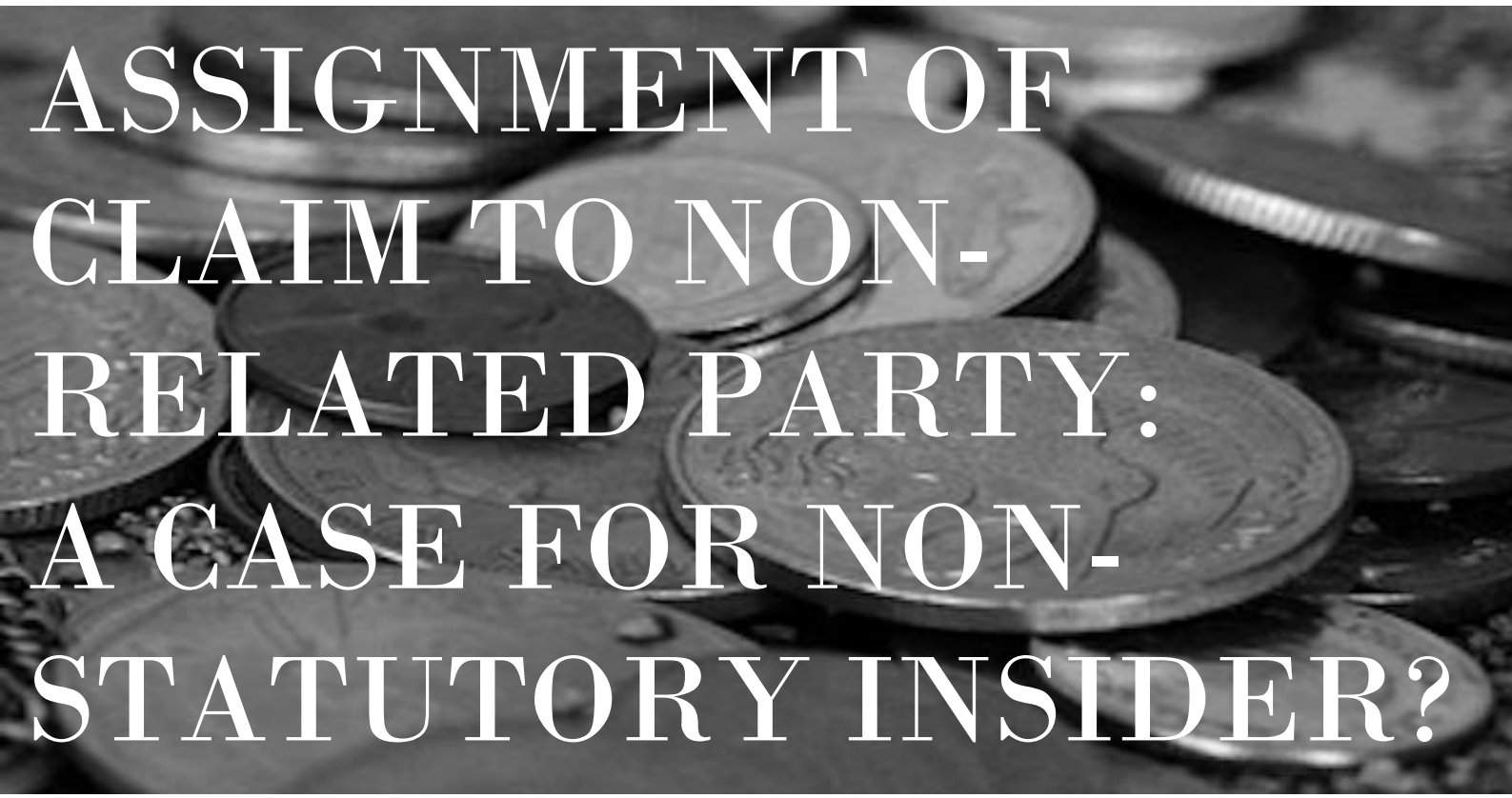

ASSIGNMENT OF CLAIM TO NON-RELATED PARTY: A CASE FOR NON-STATUTORY INSIDER?

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Background

Recently, vide its order dated December 14, 2018 in the case of Company Appeal (AT) (Insolvency) No. 169 of 2017 ("**Synergies Dooray order**"), the National Company Law Appellate Tribunal ("**NCLAT**") has rejected the appeal filed by Edelweiss Asset Reconstruction Company Limited ("**EARC**"), one of the financial creditors of Synergies Dooray Automotive Limited ("**Synergies Dooray")**, challenging the order dated August 2, 2017 of the Hyderabad bench of National Company Law Tribunal ("**NCLT**"), approving the resolution plan pertaining to Synergies Dooray. Whilst rejecting the challenge, which was based on the fundamental premise that a 'non-related party' assignee of a related party financial creditors cannot be inducted in the committee of creditors ("**CoC**") of a corporate debtor undergoing corporate insolvency resolution process ("**CIRP**") under the provisions of Insolvency and Bankruptcy Code, 2016 ("**IBC**"), NCLAT seemed to have taken view different from its own earlier decision rendered in the case of *Pankaj Yadav v. State Bank of India* [Company Appeal (AT) (Insolvency) No. 28 of 2018], on August 7, 2018 ("**Fortune Pharma order**"). The different views taken by NCLAT, which may be justified basis the specific facts of the cases, points to a more fundamental question- can there be a straight-jacket formula which can be applied to ascertain whether an assignee of a debt owed to a related party financial creditor of the corporate debtor be subject to same disqualifications that the related party assignor would be subject to, or would it require a more case-by-case basis analysis, based more on the factual aspect.

It is in light of the above background that, we wish to analyse in this thought paper, whether a non-related assignee of a debt owed to a 'related party' would retain its 'related party' character and the yardsticks that may be applied to ascertain the same.

Legislative Framework

The CoC occupies an important and probably the most critical position during the CIRP of a corporate debtor. Be it the decision to allow withdrawal of CIRP once the same has been admitted[1], or extending the period of the CIRP beyond the initial period of one hundred eighty days[2], or appointment[3] or replacement of the resolution professional[4], all of the aforesaid is dependent upon the relevant majority of members constituting the CoC approving such decision. Approval of a resolution plan is also such an item, which is dependent upon the CoC approving the same with at least sixty six percent of the voting shares of the financial creditors[5]. Accordingly, in the context of approval of the resolution plan at least, the constituents and voting powers of the creditors forming the CoC assumes huge significance.

The constitution of a CoC is governed under sub-section (2) of Section 21 of IBC, which reads as follows:

> *"21. (2) The committee of creditors shall comprise all financial creditors of the corporate debtor:*
>
> *Provided that a related party to whom a corporate debtor owes a financial debt shall not have any right of representation, participation or voting in a meeting of the committee of creditors.* (emphasis supplied)

[1] See, Section 12A of IBC.
[2] See, Section 12(2) of IBC.
[3] See, Section 22(2) of IBC.
[4] See, Section 27(1) of IBC.
[5] See, Section 30(4) of IBC.

Thus, whilst section 21(2) postulates that the CoC will be formed by all the financial creditors of the corporate debtor, if a related party (as defined under section 5(24) of the IBC[6]) is also a financial creditor of the corporate debtor ("**Related Party Creditor**"), such related party does not have any right of representation, participation or voting in a meeting of the CoC[7].

As we have also noted earlier, approval of a resolution plan is dependent upon the approval of requisite majority of members of the CoC. It is in this context of having the right to approve (or reject) a resolution plan, the issue of assignability of debts due to Related Party Creditors, assumes significance, as, in terms of Rule 28 of *Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016*, a creditor is allowed to *assign or transfers the debt* due to such creditor to *any person* even during the CIRP period and thus, opening up the possibility of potential avoidance of the restriction in influencing the decision making powers of the CoC by assigning/ transferring the debt to associate but 'non-related parties'. To understand how such assignment can potentially affect the decision-making powers of CoC, let us turn our interest to two of the cases referred to in the background to understand the role that related parties played in influencing the resolution plan.

NCLT Decision in the CIRP Involving Synergies Dooray

The Hyderabad Bench of NCLT, *vide* its order dated January 23, 2017 had admitted the petition filed by the corporate debtor i.e. Synergies Dooray, a sick company under the aegis of erstwhile

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[6] **Section 5(24):** "*related party*", *in relation to a corporate debtor, means –*
(a) a director or partner of the corporate debtor or a relative of a director or partner of the corporate debtor;
(b) a key managerial personnel of the corporate debtor or a relative of a key managerial personnel of the corporate debtor;
(c) a limited liability partnership or a partnership firm in which a director,
partner, or manager of the corporate debtor or his relative is a partner;
(d) a private company in which a director, partner or manager of the corporate debtor is a director and holds along with his relatives, more than two per cent. of its share capital;
(e) a public company in which a director, partner or manager of the corporate debtor is a director and holds along with relatives, more than two per cent. of its paid-up share capital;
(f) anybody corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;
(g) any limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;
(h) any person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;
(i) a body corporate which is a holding, subsidiary or an associate company of the corporate debtor, or a subsidiary of a holding company to which the corporate debtor is a subsidiary;
(j) any person who controls more than twenty per cent. of voting rights in the corporate debtor on account of ownership or a voting agreement;
(k) any person in whom the corporate debtor controls more than twenty per cent. of voting rights on account of ownership or a voting agreement;
(l) any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor;
(m) any person who is associated with the corporate debtor on account
of –
(i) participation in policy making processes of the corporate debtor; or
(ii) having more than two directors in common between the corporate debtor and such person; or
(iii) interchange of managerial personnel between the corporate debtor and such person; or
(iv) provision of essential technical information to, or from, the corporate debtor;

[7] The composition of CoC, where the corporate debtor has no financial creditor or if all the financial creditors of the corporate debtor are related parties, has been stipulated under Rule 16 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 which allows the CoC to be constituted of only operational creditors.

Sick Industrial Companies (Special Provisions) Act, 1985, seeking initiation of the CIRP under section 10 of the IBC.

The financial creditors of Synergies Dooray were (i) Alchemist Asset Reconstruction Company Limited, with amount of claim admitted amounting to INR 122,06,00,000 (Indian Rupees one hundred and twenty two crores six lakhs) and percentage share in voting in the CoC being 13.83% (thirteen decimal eight three percent); (ii) EARC, with amount of claim admitted amounting to INR 86,92,00,000 (Indian Rupees eighty six crores ninety two lakhs) and percentage share in voting in the CoC being 9.84% (nine decimal eight four percent); (iii) Millenium Finance Limited ("**MFL**") with amount of claim admitted amounting to INR 673,91,00,000 (Indian Rupees six hundred seventy three crores ninety one lakhs) and percentage share in voting in the CoC being 76.33% (seventy six decimal three three percent) and (iv) Synergies Castings Limited ("**SCL**") with amount of claim admitted amounting to INR 89,26,00,000 (Indian Rupees eighty nine crores twenty six lakhs) and percentage share in voting in the CoC being 0% (zero percent), because SCL was a related party and hence not a part of the CoC as per section 21(2) of the IBC.

Resolution plans were submitted by three entities i.e. SCL, SMB Ashes Industries, Suiyas Industries Private Limited out of which the resolution plan submitted by SCL was approved by a majority vote of 90.16% (ninety decimal one six percent) with certain modifications. It is pertinent to note that EARC had abstained from voting.

An application bearing C.A. No 123/2017 in CP(IB)No.01/HDB/2017 was moved before the NCLT, Hyderabad for submission of the resolution plan under section 30(6)[8] of the IBC and for approval under section 31(1)[9] of the IBC, against which, objections were raised by EARC alleging that MFL was a related party under section 5(24) of the IBC and hence should not have been allowed to be a part of the CoC and vote on the resolution plan.

EARC filed C.A. Nos 43, 56, 57 and 124 of 2017 by questioning the constitution of the CoC and the related party issues. EARC's main contention was that *vide* an assignment agreement dated November 24, 2016 which was executed between MFL and SCL, SCL had assigned a significant portion of its debts to MFL which gave MFL more than 75% (seventy five percent) voting power in the CoC and thus MFL could approve any resolution plan all by itself. Since SCL was a related party of Synergies Dooray within section 5(24) of the IBC, by the said assignment agreement, MFL would also become a related party and hence should not have been allowed to be a part of the CoC.

Regarding the issue of the status of MFL as a "related party" as defined, under section 5(24) of the IBC, in CA No. 43 of 2017 in CP No. 01/IBC/HDB/2017, the resolution professional had submitted the following:

> "*14) With regard to issue of related party, it is stated that related party has been defined under section 5(24) of the IBC by a plain reading of the provisions of section 5(24), it is evident that MFL does not fall into any one of the conditions that may trigger the applicability of section 5(24) so as to establish a related party relationship between SCL and MFL. SCL (Respondent No.4) in the instant case, had assigned its debts to MFL on 24.11.2016, which is even prior to coming into force of the SICA Repeal Act, which came in force on 01.12.2016. In the said background, it is evident that SCL as a part of its commercial decision assigned its dues to MFL and MFL also as a part of its business decision as a Non-Banking Financing Company*

[8] **Section 30(6):** *The resolution professional shall submit the resolution plan as approved by the committee of creditors to the Adjudicating Authority.*

[9] **Section 31(1):** *If the Adjudicating Authority is satisfied that the resolution plan as approved by the committee of creditors under sub-section (4) of section 30 meets the requirements as referred to in sub-section (2) of section 30, it shall by order approve the resolution plan which shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.*

(NBFC) acquired the debts from SCL. Pursuant to the assignment of the dues of SCL in favour of MFL, the charge of MFL on the assets of the Corporate Debtor has been duly registered and the same forms a part of the application as filed with Tribunal. So the contention of applicant that MFL can fall within the definition of related party qua the Corporate Debtor is not at all tenable and liable to be rejected. Both EARC and MFL are Financial Creditors of the Corporate Debtor who have taken over the loans of the Corporate Debtor from the original lenders." (emphasis supplied)

Accepting the argument of the resolution professional, the NCLT Hyderabad, observed the following:

"*8. So far as the issue relating to allegation of related party, it is to be mentioned here that the applicant like that of MFL got subsequently assigned debt of original lenders. The litigation started by the applicant right from initiation of case before BIFR and EXIM Bank, its original assignee, which is one of seven creditors of corporate debtor. As rightly pointed out by the Learned Resolution professional, MFL cannot be termed as related party and the applicant has no locus standi to question various rights obtained by MFL from SCL by Assignment Agreement Deeds in question. The applicant is making everything a serious issue right from stage of BIFR till date. We have examined the legality of Assignment deeds in question in detail in subsequent CA No. 57 of 2017, wherein we have passed a detailed order by rejecting all the contentions of the applicant. Since initiation of CIRP proceedings only the applicant amongst various financial creditors raised various issues, viz, incorrect admission of claims, constitution of invalid CoC, initial IM, malafide ulterior motive of reducing the voting right of the applicant which is questionable and suspicious, apprehensions, etc. All the other concerns of the Applicant are dealt with above suitably. Therefore, we are of the prima facie opinion that the applicant's action throughout the entire CIRP proceedings which is not acceptable considering the preamble of the Code. After perusing various records, the Bench is of the opinion that there is no relationship between SCL and MFL. The Applicant's submission that the agenda of the meeting of CoC would have far reaching effect which is prejudicial to the interest of the Financial Creditors including the Applicant is factually not correct, since none of the other financial creditors objected to it. With regard to the intentions of the Corporate Debtor as well as its related party SCL, we would like to add that the proceedings before the Adjudicating Authority under the IBC is summary proceedings. Therefore, mensrea cannot be raised before the Adjudicating Authority under the IBC proceedings."* (emphasis supplied)

NCLT Decision in the CIRP Involving Fortune Pharma

CIRP was initiated against Fortune Pharma Private Limited on August 28, 2017 by the Mumbai bench of the NCLT, pursuant to a Section 10 application moved by the corporate debtor on June 29, 2017.

An application was filed by State Bank of India ("**SBI**") alleging that, during the period between the date of filing the Section 10 application (being June 29, 2017) and the date of admission (being August 28, 2017), the related parties of the corporate debtor had executed several assignment deeds, whereby the voting power of SBI in the CoC came down from 100% to 55%. SBI contended that the act of assignment of the debt owed by the related parties to a 'non-related' party financial creditor, post filing of the Section 10 application was a malicious act, with the ulterior motive of reducing the voting power of SBI.

The arguments advanced by SBI found favour with NCLT, with both the judicial members penning their concurrent, but separate decisions. Relevant paragraphs in this regard are as follows:

Per Mr. B P Mohan (Member Judicial):

> "*9. As regards the disqualification, it is clear that the Mr. Sudhakar H Mulay and Mulay Constructions Private Limited are not entitled to vote in the Committee of Creditors as they are "related parties". In view of the aforementioned peculiar circumstances of this case, and the meticulous planning on the part of the promoter/directors of the Corporate Debtor to execute Assignment Deeds with the sole intention of bringing down the voting power of the Applicant cannot be regarded as a natural business decision. Hence, a related party cannot suddenly become a non-related party just because he washes off his hands and hands over the papers to other party who have no valid reason for taking up assignment of a debt which may not be recoverable. We don't see any business prudence on the part of Brainer Impex Limited and Mr. Pankaj Radhakrishna Yadav in stepping into the shoes of the Assignors. Since the whole transaction is controversial, the disqualification cannot be removed and it follows till the end. The point (b) and (c) are decided in favour of the Applicants and accordingly the voting power of the Applicant is restored back to 100%.*" (emphasis supplied)

Per Mr. M K Shrawat (Member Judicial):

> "*13. The summum bonum of the above decision is that by an assignment the assignee does not get the right to change its status. If the Assignor is a 'related party' then the assignee shall also be treated in the same status as 'related party' vis-à-vis to the impugned debt. Yet another example is that if the assignor is an 'operational creditor' then as a result of assignment the assignees shall be treated as 'operational creditor' and its status must not for a moment be considered as 'financial creditor'.*" (emphasis supplied)

NCLAT's Decisions upon Appeal

As would be apparent from the aforesaid discussion, the Mumbai and Hyderabad benches of the NCLT had taken diametrically opposite views in the context of whether a non-related party assignee of debts of a related party would be treated differently for the purpose of participation in the CoC. When appealed against the respective orders, NCLAT rejected both the appeals preferred against the decisions, albeit on different grounds.

The reason given by NCLAT in the *Fortune Pharma order* (*supra)* to reject the appeal was as under:

> "*7. It is not in dispute that the assignor Mr. Sudhakar Mulay was the Director/promoter of the 'Corporate Debtor'. Therefore, he is 'related party' within the meaning of Section 5(24). A legal transfer of 'debt' account from a 'creditor' (assignor) to a third party (assignee) provides the rightful ownership to the assignee. The 'debt assignment' is a transfer of debt with all the rights and obligations associated with it from a creditor to a third party, who is' assignee'. The 'debt' is in the form of loan from a 'financial institution', the debtor is referred as a 'borrower' and if the debt is in the form of securities, such as bonds, the debtor is referred to as an 'issuer'. Undisputedly, the assignment is the transfer of one's right to recover the debt of another person as a contractual right. Rights of an 'assignee' are no better than those of the 'assignor'. It can be, therefore, held that 'assignor' assigns its debt in favour of the 'assignee' and 'assignee' steps in the shoes of the 'assignor'.*

> *The 'assignee' thereby takes over the right as it actually did and also takes over all the disadvantages by virtue of such assignment*." (emphasis supplied).

The same may be contrasted with the following observation of NCLAT rendered in the *Synergies Dooray order* (*supra*):

> "*In the result, we hereby declare that both 'Synergies Castings Limited' and 'Millennium Finance Limited' were eligible to execute the assignment agreements in question and all rights flow those agreements to 'Millennium Finance Limited'. After getting assignment of rights, the 'Millennium Finance Limited' is fully competent to participate in 'Committee of Creditors' in question and it cannot be called a related party as explained*." (emphasis supplied)

As is apparent from the aforesaid, whilst in the *Fortune Pharma order*, NCLAT held that the assignee would be subject to the same rights *and disadvantages*, the issue of *disadvantage attaching to the assignee* was did not get any mention in the *Synergies Dooray order*.

Whilst in the ultimate analysis, it could be well argued that the difference in the outcome from the NCLAT decisions was based on the specific factual circumstances[10], the decisions probably highlight the importance of undertaking a deeper scrutiny of factual elements for determination of restrictions on participation by an assignee of Related Party Creditors in the CoC. In the subsequent paragraphs, it would be our endeavor to ascertain the relevant principles through judicial precedents developed in other bankruptcy-mature jurisdictions and examine whether the same principles would hold good under the IBC or not. In the absence of direct judicial precedents in India, we will also refer to certain foreign judicial developments on the evolution of the jurisprudence on this issue and examine whether the same principles would hold good under the IBC or not.

Discussion

The rationale behind a creditor assigning its claims against a corporate debtor undergoing insolvency resolution process was discussed by United States Court of Appeals, Third Circuit ("**Third Circuit**") in the case of *In re KB Toys*[11], in the following terms:

> "*Creditors holding claims against an entity who has filed a Chapter 11 petition sometimes face a risky and lengthy bankruptcy process. To avoid this risk and expense, a creditor may look to sell its claim, a practice permitted under the bankruptcy rules. In re Kreisler, 546 F.3d 863, 864 (7th Cir.2008) (citing Fed. R. Bankr. P. 3001(e)). By selling its claim, a risk averse creditor can opt out of the bankruptcy process and obtain an immediate, albeit discounted, payment on the debt it is owed. See id. Claim purchasers buy these claims and hope to receive a distribution from the debtor's estate in excess of the price paid. See Tally M. Wiener & Nicholas B. Malito, On the Nature of the Transferred Bankruptcy Claim, 12 U. Pa. J. Bus. L. 35, 36 (2009) ("Some purchasers are simply ... investing with an eye towards receiving a distribution on claims in cash or readily liquidated property in excess of the purchase price.")*" (emphasis supplied)

[10] In so far as Synergies Dooray case, whilst, without having all the relevant facts, it would be unfair for us to impute any allegation of ulterior motive behind such assignment of debt by SCL to MFL, a few facts which were of particular interest are (a) the date of assignment of debt being November 26, 2016, by which period, a few of the sections of the IBC were already notified and implying the impending notification of the rest of the provisions; and (b) initiation of resolution process by the corporate debtor itself on January 23, 2017, implying a certain amount of preparedness on part of the promoters of Synergies Dooray.

[11] *In re KB Toys* 736F.3d 247 (3d Cir. 2013).

Where the purpose behind acquisition of the claim is to derive distribution on claims from the liquidated property of the corporate debtor, it can be prima facie assumed that, the creditor would be governed by the intention to derive the best possible distribution and not by any other extraneous considerations. It is only where, the decision-making power is influenced by other extraneous considerations, the question of bias and impropriety may arise.

If one wishes to analyse IBC to ascertain whether under IBC, such assignment of claims on preferential terms (or on a non-arm's length basis) can be avoided, he may be directed to Section 43, which deals with preferential transactions and avoidance of such preferential transactions. The relevant part of the section has been reproduced below:

> *"43. (1) Where the liquidator or the resolution professional, as the case may be, is of the opinion that the corporate debtor has at a relevant time given a preference in such transactions and in such manner as laid down in sub-section (2) to any persons as referred to in sub-section (4), he shall apply to the Adjudicating Authority for avoidance of preferential transactions and for, one or more of the orders referred to in section 44.*
>
> *(2) A corporate debtor shall be deemed to have given a preference, if—*
>
> *(a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor and*
> *(b) the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position than it would have been in the event of a distribution of assets being made in accordance with section 53."* (emphasis applied)

As Section 43(2) of the IBC deals with avoidance of preference given in the context of *transfer of property or an interest* thereof, reference may also be made to section 3(27) of the IBC, which defines the expression '*property*' as follows:

> *"(27) "property" includes money, goods, actionable claims, land and every description of property situated in India or outside India and every description of interest including present or future or vested or contingent interest arising out of, or incidental to, property".* (emphasis supplied)

The question, however, would be, whether assignment of a claim, owed by the corporate debtor to its creditor, can be challenged under Section 43 of IBC. This in turn begs the question, as to whether, such a claim can at all be classified as *property* of the corporate debtor. In the context of US Bankruptcy code, the answer would be no, especially in view of the following observation of the Third Circuit in the *KB Toys* case:

> "*ASM did not purchase property of the estate. ASM purchased claims against the Debtors' estates. A claim against an estate is not property of that estate. Enron I, 340 B.R. at 206 ("[A] claim as defined under [§] 101(5),is not ,and has never been, considered property of the estate (it is being asserted against) under [§] 541 of the Bankruptcy Code."). Thus, on its face, § 550(b) is inapplicable to ASM*." (emphasis supplied)

Closer home, our own Supreme Court has also, in the case of *ICICI Bank Limited v. APS Star Industries Limited*[12], acknowledged the aforesaid principle by noting as follows:

[12] *ICICI Bank Limited v. APS Star Industries Limited* Civil Appeal No.8393 OF 2010, decided on September 30, 2010.

> "*46. As stated above, an outstanding in the account of a borrower(s) (customer) is a debt due and payable by the borrower(s) to the bank. Secondly, the bank is the owner of such debt. Such debt is an asset in the hands of the bank as a secured creditor or mortgagee or hypothecate. The bank can always transfer its asset. Such transfer in no manner affects any right or interest of the borrower(s) (customer)….. At this stage, we wish to once again emphasize that debts are assets of the assignor bank. The High Court(s) has erred in not appreciating that the assignor bank is only transferring its rights under a contract and its own asset, namely, the debt as also the mortgagee's rights in the mortgaged properties without in any manner affecting the rights of the borrower(s)/mortgagor(s) in the contract or in the assets.*" (emphasis added)

In substance, if the claim owed by corporate debtor to its creditors cannot be considered as a *property* of the corporate debtor, assignment or transfer of such claim even at non-arm's length basis, would not be subject to anti avoidance rule specified under Section 43 of the IBC. This may pose a critical threat for the success of a genuine attempt being made to revive or liquidate the corporate debtor in a manner which addresses the concerns of all stakeholders, and not only of a few.

The broader question, however, would be, whether the judiciary would be permitted to disregard the voting by an assignee of Related Party Creditor, by virtue of the claim being assigned by the Related Party Creditor.

In this context, it would be interesting to trace the development of the concept of 'insider' under the US Bankruptcy Code, which is analogous to the '*related party*' concept under IBC. The expression 'insider' finds enumeration under section 101(31)[13] of the US Bankruptcy Code and people or entities that fall strictly within the definition of 'insider' are called 'statutory insiders'. However, the US bankruptcy courts have also recognised a class of insiders who are called 'non-statutory insiders' and refers to a person, who is not explicitly listed in section 101(31) of the US Bankruptcy Code, but who has a sufficiently close relationship with the debtor to fall within the definition[14]. It is important to make this distinction because it is on the basis of this that the US Bankruptcy courts

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[13] **Section 101(31)**: *The term "insider" includes –*
(A) if the debtor is an individual –
(i) relative of the debtor or of a general partner of the debtor;
(ii) partnership in which the debtor is a general partner;
(iii) general partner of the debtor; or
(iv) corporation of which the debtor is a director, officer, or person in control;
(B) if the debtor is a corporation –
(i) director of the debtor;
(ii) officer of the debtor;
(iii) person in control of the debtor;
(iv) partnership in which the debtor is a general partner;
(v) general partner of the debtor; or
(vi) relative of a general partner, director, officer, or person in control of the debtor;
(C) if the debtor is a partnership –
(i) general partner in the debtor;
(ii) relative of a general partner in, general partner of, or person in control of the debtor;
(iii) partnership in which the debtor is a general partner;
(iv) general partner of the debtor; or
(v) person in control of the debtor;
(D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;
(E) affiliate, or insider of an affiliate as if such affiliate were the debtor; and
(F) managing agent of the debtor.

[14] See *Schubert v. Lucent Techs. Inc. (In re Winstar Commc'ns, Inc.)*, 554F.3d 382, 395 (3d Cir.2009).

have proceeded to decide on the nature of a transferred claim in a bankruptcy case from a statutory insider to a non-insider.

Prior to 2016, there are a plethora of judicial precedents on the moot point as to who is to be considered a non-statutory insider. There are certain judgments which have taken a limited approach[15] in defining non-statutory insiders and there are certain judgments which have taken an expansive approach[16] towards defining non-statutory insiders.

However, an important case on this moot point is *US Bank N.A., Trustee, et al., by an through CW Capital Asset Management LLC, solely in its capacity as Special Servicer, Appellant v. The Village at Lakeridge, LLC, Appelee, Rovert Alan Rabkin, Real Party in Interest* (*"***In Re The Village at Lakeridge, LLC***"*)[17] decided by the United States Court of Appeals, Ninth Circuit ("**Ninth Circuit**") in February 2016, which addressed the issue that whether a transferred claim retained its insider status for the purpose of voting on the resolution plan. The debtor, Village at Lakeridge, LLC had filed for a Chapter 11[18] bankruptcy. There were two creditors holding claims against the debtor's assets. One was MBP Equity Partners 1, LLC ("**MBP**") who held an unsecured claim in the amount of $2.76 million (US Dollars two million seven hundred and sixty thousand) and the other was U.S. Bank National Association ("**USBNA**") which held a secured claim in the amount of $10 million (US Dollars ten million). MBP, sold its claim against the debtor to Dr. Robert Rabkin ("**Rabkin**"), who had a business and personal relationship with one of MBP's board members, but otherwise, had no connection to MBP or the debtor prior to purchasing the claim. The debtor's plan for reorganization could only be confirmed under section 1129(a)(10) of the US Bankruptcy Code if at least one class of impaired claims had voted to accept the plan. Section 1129(a)(10) of the US Bankruptcy Code reads as follows:

> *"(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider."* (emphasis supplied)

USBNA had opposed the plan however, Rabkin had approved the plan. Since, the claims of both the creditors were impaired, the plan had to be approved.

USBNA argued that Rabkin had become a non-statutory insider because of his close relationship with one of the board members of MBPA and hence was not entitled to vote on the plan. The bankruptcy court had granted USBNA's motion and disallowed Rabkin from voting on the reorganization plan as he had become a non-statutory insider. The bankruptcy court's order was reversed by the United States Bankruptcy Appellate Panel for the Ninth Circuit ("**BAP**") and it held that:

> *"insider status cannot be assigned and must be determined for each individual ''on a case-by-case" basis, after the consideration of various factors."*

Thus, Rabkin was not a non-statutory insider and was allowed to vote on the reorganization plan.

The Ninth Circuit, in a split verdict, affirmed the BAP's ruling and held the following:

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[15] *Butler v. David Shaw, Inc*, 72 F.3d 437 (4th Cir. 1996) decided on January 3, 1996; *In Re Boston Pub. Co., Inc.,* 209 B.R. 157 (Bankr.d.Mass. 1997), decided on May 2, 1997; *In Re Gilbert,* 104 B.R. 206 (Bankr. W.D. Mo. 1989) decided on August 3, 1989.

[16] *Three Flint Hill Ltd. P'ship v. Prudential Ins. Co. (In re Three Flint Hill Ltd P'ship)*, 213 B.R. 292, 299 (D. Md. 1997); *In re Applegate Property, Ltd*., 133 B.R. 827, 833 (Bankr. W.D.Tex.1991); *In re Holly Knoll P'ship*, 167 B.R. 381, 385 (Bankr. E.D. Pa.1994).

[17] *US Bank N.A., Trustee, et al., by an through CW Capital Asset Management LLC, solely in its capacity as Special Servicer, Appellant v. The Village at Lakeridge, LLC, Appelee, Rovert Alan Rabkin, Real Party in Interest* 814 F.3d 993 (9th Cir. 2016).

[18] Chapter 11 under the United States Bankruptcy Code permits reorganization under bankruptcy laws of the United States.

> *"[11 – 13] … A person does not become a statutory insider solely by acquiring a claim from a statutory insider for two reasons. First, bankruptcy law distinguishes between the status of a claim and that of a claimant. Insider status pertains only to the claimant; it is not a property of a claim. Because insider status is not a property of a claim, general assignment law - in which an assignee takes a claim subject to any benefits and defects of the claim does not apply. Second, a person's insider status is a question of fact that must be determined after the claim transfer occurs."*
>
> *…*
>
> *"[14] … Further, if a third party could become an insider as a matter of law by acquiring a claim from an insider, bankruptcy law would contain a procedural inconsistency wherein a claim would retain its insider status when assigned from an insider to a non-insider, but would drop its non-insider status when assigned from a non-insider to an insider."* (emphasis supplied)

However, in the decision rendered in *In re The Village at Lakeridge, LLC*, there was an interesting precedent which was cited by USBNA, but the Ninth Circuit had conveniently rejected it on technical grounds. USBNA had made reference to a judgment delivered by the Ninth Circuit itself in *Wake Fores, Inc. v Transamerica Title Ins.*[19] which held that *insider status does transfer with a claim under the general law of assignment.* However, the Ninth Circuit rejected USBNA's contention by referring to a Ninth Circuit procedural rule stating that unpublished cases issued prior to 2007 could not be cited to courts in the Ninth Circuit.

The ruling by the Ninth Circuit was referred to by the Court of Appeal of the Republic of Singapore in the matter of *SK Engineering & Construction Co Ltd v Conchubar Aromatics Ltd and another*[20] while determining who is to be treated as a related creditor for the purposes of confirming a scheme of arrangement. It held the following:

> *"52 The reasoning in this case is persuasive even though it relates to the interpretation of the United States Bankruptcy Code. It would be absurd if a creditor which acquires its claim against a scheme company from a related creditor were to find that the votes attached to the claim are automatically discounted because of the status of the assignor-creditor, regardless of the present assignee-creditor's status and relationship with the scheme company. The purpose of discounting related creditors' votes is to remove or negate the influence of any bias which such creditors might have towards a certain voting outcome. That concern is not attached to the claim, but rather, is attached to the individual creditor in question. Such concerns would not be present if a creditor which acquires its claim against a scheme company from a related creditor has no demonstrable reason for bias towards any particular voting outcome beyond its own interests as a creditor"* (emphasis supplied)

The aforesaid approach, in our view, reflects the correct approach in determining whether the assignee of a Related Party Creditor would be subject to the same disqualifications. In fact, it appears to us that, the rationale provided by Mr. B P Mohan (NCLT Member Judicial) in the Fortune Pharma matter followed the same approach in the sense, the decision was not *based on whether the assignee is a non-Related Party Creditor* (the approach followed by Hyderabad Bench of NCLT in Synergies Dooray case and upheld by NCLAT), or *that an assignee automatically becomes disqualified on the basis that the disadvantages applicable to a Related Party*) *are also transferred to the assignee* (an approach followed by the other judicial member of the Mumbai bench in

[19] See, *In re Greer West Inv. Ltd. P'ship),* No. 94–15670, 1996 WL 134293 (9th Cir. Mar. 25, 1996) (unpublished) cited in *In re The Village at Lakeridge, LLC* at page number 1001 at footnote 10.
[20] *Wake Fores, Inc. v Transamerica Title Ins.*[2017 SGCA 51 (Singapore)].

Fortune Pharma case and which found favour with NCLAT), but on whether the circumstances promoting such assignment was based on non-commercial ulterior motives.

Final Thoughts

It would be interesting to follow the development of jurisprudence in this regard and to examine, if the NCLTs choose to look beyond the apparent status of the assignee, and rather place emphasis on the identification of the assignee-creditor's status vis-à-vis the corporate debtor/ Related Party Creditor to ascertain the intent behind the assignment. Consequently, it would be interesting to consider whether the concept of 'non-statutory insider' can be introduced even in the Indian context, to mitigate the potential abuse of the spirit behind debarment of Related Party Creditors.

This note has been written by Arka Majumdar (Partner).

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