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Integrating ESG into India's Insolvency and Restructuring Framework

Introduction

Environmental - impact on the planet, **Social** - interaction with employees, customers, partners and the overall community, and **Governance** - corporate leadership standards (ESG) criteria have emerged at the forefront of corporate considerations globally, offering a robust framework to recalibrate business operations and investments. These collectively measure the sustainability and societal impact of an enterprise. These criteria are instrumental in *discerning the future financial performance*, encompassing both returns and risks, of companies.

The Global Sustainability Standards Board's GRI Sustainability Reporting Standards says that organisations, through their activities and business relationships, exert significant influence on the economy, environment, and people, thereby making either positive or negative contributions to sustainable development. This notion of sustainable development, famously defined as 'development which meets the needs of the present without compromising the ability of future generations to meet their own needs', serves as the bedrock for integrating ESG into corporate strategy.

Companies are increasingly recognising that their long-term operational purview extends

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beyond mere profit maximisation, encompassing contributions to broader societal and environmental welfare. Entities with strong ESG profiles are often associated with diminished risk and enhanced long-term profitability. Investors, in particular, leverage ESG information to evaluate an organisation's impacts, its integration of sustainable development into its business strategy, and to identify associated financial risks and opportunities, ultimately assessing its long-term viability.

Concurrently, insolvency and restructuring laws, traditionally narrow in their focus on creditor interests, are undergoing a transformative shift towards accommodating broader stakeholder interests. This evolution signifies an acknowledgement of the expansive societal role and responsibilities of corporations. The nexus of ESG and insolvency thus represents the burgeoning integration of sustainability considerations into corporate rescue mechanisms. In the multifaceted Indian context, characterised by a vast economic landscape, diverse corporate entities, and intricate societal challenges, this intersection holds particular salience. This article aims to illuminate the profound importance of ESG considerations in corporate restructuring in India and delineate potential avenues for their efficacious integration into the existing insolvency framework.

ESG Considerations in Corporate Insolvency

The fundamental principle of responsible business posits that enterprises bear a duty of accountability to all involved parties. In India, this principle was initially codified in the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVGs), launched in 2011. As per the new reporting requirements, with effect from financial year 2022-2023, filing of Business Responsibility and Sustainability Reporting (BRSR) shall be mandatory for the top 1000 listed companies (by market capitalization) and shall replace the existing BRR[1].

Globally, there is a heightened recognition of the imperative to integrate ESG considerations into corporate insolvency laws. This development stems from the realisation that companies function within a wider societal context and must therefore be accountable to a more expansive array of stakeholders beyond just their creditors and shareholders. These stakeholders comprise individuals or groups whose interests are or could be impacted by the activities of corporate debtors.

In the Indian legal landscape, IBC[2] stands as the principal legislation governing insolvency and restructuring. However, the IBC, in its current form, does not explicitly incorporate ESG considerations, maintaining a primary focus on maximisation of asset value. The restructuring process, inherently, offers a crucial window for corporations to redefine their strategic priorities and reorient their business models. Integrating ESG considerations can significantly

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facilitate long-term sustainability and competitiveness. The inclusion of ESG factors in the restructuring process also resonates with the broader objective of insolvency laws – to preserve the economic value of companies and ensure their continuity as a going concern, a principle frequently underscored by judicial pronouncements.

The World Bank's new corporate flagship initiative, Business Ready (B-READY)[3], which replaces the 'Doing Business' Report, will annually assess the global business and investment environment. This new benchmarking exercise will also address environmental obligations in bankruptcy and review sound environmental regulatory practices within insolvency proceedings. Significantly, the Business Insolvency indicators will account for elements of social significance pertinent to insolvency, such as environmental and labour claims, or any other related social policy interests arising by operation of law.

Incorporating ESG factors during a corporate insolvency process in India can yield manifold benefits, mirroring those observed in a general restructuring process. Firstly, ESG factors enable the identification of latent risks often not discernible through conventional financial analysis. For instance, a company with deficient environmental practices may confront regulatory penalties or reputational damage that could adversely affect its financial performance. This is particularly pertinent in India, where environmental regulations are progressively becoming more stringent. Early identification of such risks can profoundly shape the insolvency process, paving the way for a more streamlined resolution. While environmental liabilities like fines and penalties would typically rank low as operational dues in a liquidation waterfall, "absolute liability" or "polluter pays" principles might place certain harms outside this framework, though this remains largely untested.

Secondly, enhanced investor appeal is a significant benefit. ESG factors are gaining paramount importance for investors. Companies demonstrating robust ESG performance are increasingly attractive to socially responsible funds and other investors who integrate ESG considerations into their investment decisions. India has seen a substantial increase in ESG-related investments, with ESG mutual funds reaching approximately US $1.5 billion by August 2022, a five-fold increase from March 2019. India also emerged as the second-largest green bond issuer among emerging markets and developing economies in 2021. This growing interest highlights the financial incentive for businesses, even those in distress, to prioritize ESG.[4]

Thirdly, improved stakeholder relationships arise from the consideration of ESG factors, which can significantly bolster relationships with various stakeholders, including employees, customers, and the local community. This, in turn, can augment a company's reputation and brand value, which is particularly advantageous during an insolvency process.

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Pathways for ESG Integration under IBC

The IBC could be suitably amended to explicitly mandate the consideration of ESG factors during the insolvency and restructuring process. This would necessitate revisions to the relevant provisions of the Code. For instance, Section 30(2) of the Code could be modified to stipulate the incorporation of ESG factors in the evaluation of resolution plans. Such a revision would align with the overarching goals of preserving economic value, fostering sustainable business practices, and accommodating the interests of a broader spectrum of stakeholders. Along with this, the role of the Resolution Professional could be augmented to explicitly include a duty to consider and address ESG risks and opportunities. This would empower RPs to conduct due diligence on ESG aspects and ensure that resolution plans address these critical elements.

Introducing financial or regulatory incentives for resolution plans that prioritise ESG adherence could significantly catalyse adoption. This could include reduced regulatory scrutiny, tax benefits, or preferential lending rates from financial institutions for ESG-compliant businesses. Strong mechanisms for monitoring ESG compliance post-resolution are crucial to ensure adherence to commitments. Regular audits and public disclosure of ESG performance can reinforce accountability. Leveraging advanced technologies like blockchain can facilitate the creation of transparent and immutable records of ESG performance, streamlining monitoring and reporting processes.

Conclusion

The integration of ESG principles into resolution plans under the IBC represents a significant opportunity to align India's insolvency framework with Sustainable Development Goals.[5] By embedding sustainability at the core of corporate restructuring, India can ensure that distressed businesses emerge stronger, making positive and lasting contributions to the economy, society, and the environment.

Citations

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