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DILEMMA OF ENVIRONMENTAL CLAIMS: AN ANALYSIS OF THE SUSTAINABLE PRACTICES UNDER INSOLVENCY FRAMEWORK

- Shweta Jugran¹

ABSTRACT

With the world moving towards sustainable practices, the idea of restructuring business while taking care of the environment is also gaining significant momentum. In today's global sphere, the corporate world is developing very fast. Since there is steady growth in business, there is pressure to address the growing environmental concerns. With power comes responsibility; hence, there is an urge to address the environmental claims that are arising with the rise of competitive business practices.

This article revolves around the issue of sustainable business restructuring. The author tries to address the gap in the business practices and claims of environmental creditors when any business comes to the stage of being insolvent. The author tries to explain the waterfall mechanism under the Insolvency and Bankruptcy Code 2016 and the existing legal framework for insolvency. Further, the author tries to explain green insolvency and sustainable business and their challenges. Further, the author deals with green charges and how environmental claims are addressed in insolvency. The author also explains the moratorium period and the legal challenges concerning it. Finally, the author presents the need for an environment insurance scheme and also provides the way forward in the direction of environmental claims and insolvency and the need to address the same.

Keywords: Green Insolvency, Restructuring, Environmental Creditors, Moratorium Period, Sustainable

¹ 3rd year student, School of Law, Forensic Justice and Policy Studies, National Forensic Sciences University, Gandhinagar, Gujarat.

INTRODUCTION

The concept of green insolvency has gained significant momentum in recent years, emphasizing sustainable restructuring and giving weight to environmental claims. As our country moves towards a highly globalized economy, businesses face increasing pressure to address both economic and ecological challenges. It is essential to integrate the best environmental practices into the insolvency process. The Insolvency and Bankruptcy Code was introduced into the corporate framework to establish a proper structure for the insolvency process. This code streamlines the insolvency process and provides a business-friendly mechanism. It addresses the claims of all stakeholders in a company. Through the committee of creditors, the claims of all creditors are managed fairly and without any malpractices. It is crucial to consider environmental claims within this framework, given the depletion of natural resources and our reliance on the environment.

UNDERSTANDING THE LEGAL FRAMEWORK AND GREEN INSOLVENCY

WATERFALL MECHANISM

A proper way of insolvency leads to development and prevents economic crisis; hence, it becomes imperative for the insolvency managers and committee of creditors to make sound decisions.

In the waterfall mechanism, when the insolvency proceedings take place, the claims of different stakeholders are taken care of according to preference. To understand the waterfall mechanism, we have to imagine a waterfall. The point from where the water falls, that place accumulates heavy water, and then the water flows downward speedily and widely. In the same way, the claims of the closely connected persons who are workers and then the creditors who have invested a huge amount of money are resolved first, and then all the other creditors receive their share.

In the waterfall mechanism, firstly, the workers and employees whose salary has not been given for more than 24 months are fixed, and then the claims of secured creditors are addressed. Subsequently, the claims of unsecured creditors are addressed, the government due are considered, and other creditors are addressed. Section 53 of IBC provides the mechanism for the distribution of assets.²

² Insolvency and Bankruptcy Code, No. 31 of 2016, § 53 (India).

Now, the question is where the claims of environmental creditors stand. In one of its judgements, the Tripura High Court places environmental claimants as unsecured creditors on the 'other debt and dues' list under section 53(1)(f) of IBC.³

UNDERSTANDING THE ASPECT OF GREEN INSOLVENCY

Before moving forward with the claims of other creditors, it is vital to understand what green insolvency. Most companies rely on the environment and natural resources for their business. If they are not taking the resources directly, they affect the environment with their activities. A coal factory is polluting the environment, depleting the resources, and harming the ecology. A business working in the field of petroleum is damaging the environment. With the increase in demand, these companies are expanding their business while exploiting the natural resources. If these companies become insolvent, they have a sufficient share of exploitation, but even after harming nature, they are not liable for their practices. Since sustainable solutions need to play a more prominent role in insolvency and restructuring processes, we have to find ways of incorporating them.⁴

It needs better access to environmental risk and its mitigation, leading up to eco-friendly approaches as per sustainability principles. As a result, IBC adheres to the conventional practices of insolvency in putting financial creditors at a top tier compared to any other stakeholder. It leaves the most exploited part, the environment, out of the claims, neglecting the ecological responsibility during corporate distress.⁵

SUSTAINABLE AT THE RISK OF BEING INSOLVENT

The world has become a global landscape where boundaries are tarnished, and people are working together for the greater good. The companies are establishing their ideas, and some are going toward becoming green economy. The best practices are applied by the companies in order to levy heavy taxes and respect the environment. The task of going green and following sustainable practices is very easy to identify but very tough to implement. The supportive framework that is created by some companies is sometimes unable to get praise from people, and the dilemma of getting insolvent looms over them.

³ Bhowmik v. Union of India, WP(C)(PIL) No. 04/2022, Tripura High Court, March 14, 2022.

⁴ M. P. Ram Mohan & Sriram Prasad, *Environmental Claims under Indian Insolvency Law: Concepts and Challenges*, W.P. No. 2023-02-01 (Indian Institute of Management Ahmedabad, February 2023).

⁵ Aditi & Pratishtha, *Redefining Insolvency: A Case for Prioritizing Ecological Concerns*, (2024), available at <https://www.ircl.in/post/redefining-insolvency-a-case-for-prioritizing-ecological-concerns>.

It becomes essential to prevent them from becoming insolvent. Many companies are following green practices; the legal framework is needed to make flexible laws for them to grow. The National Guidelines on Responsible Business Conduct directs to follow sustainable business practices. It is applicable to every business irrespective of their size. It recognises the endeavour to ensure resource-efficient and low-carbon processes and technologies. The companies following these practices are better positioned and get preference in market opportunities. For example, companies investing in renewable energy areas can take advantage of an Investment Tax Credit (ITC). This scheme allows them to get benefits in installation costs and reduce their overall trade burden.⁶ The Green Credit Program launched by the Ministry of Environment, Forest and Climate Change allowed green credit for implementing environment-friendly activities. This program incentivises sustainable practices across industries and local bodies.⁷ The government has also encouraged the use of biomass energy by implementing the Biomass Utilization Scheme. Companies investing in this field are eligible for tax deduction under section 80-IA of the Income Tax Act. With that, the government provides for renewable energy subsidies and tax benefits for Green Certification.⁸

With these schemes, the government has tried to incentivise green practices, but when it comes to insolvency, no schemes protect such businesses. There is a need for such rules or guidelines where the insolvency procedure is relaxed for the company, and while entertaining the claims, the relaxed guidelines should be made. CSR is the corporate social responsibility of a company, but claims that are raised after insolvency are completely different from CSR; hence, the rules should not be stringent.

CSR AND INSOLVENCY

GREEN CHARGES

Environmental obligations are one of the most neglected but important duties. When a committee of creditors is formed for the insolvency process and how the debt will be paid off, they generally prioritise the financial creditors. When a company like steel manufacturing and coal company becomes insolvent, they leave a lot of carbon footprint behind them, which leads to the

⁶ Ministry of Corporate Affairs, Nat'l Guidelines on Responsible Bus. Conduct (2019) (India).

⁷ Ministry of Env't, Forest & Climate Change, Green Credit Programme (2023) (India).

⁸ Income Tax Act, No. 43 of 1961, § 80-IA (India).

degradation of the environment. Hence, it is very important to recognise the green charges and environmental protection.⁹

Many companies are mandated to perform corporate social responsibilities, which are sometimes equated with green charges. But both things are different. CSR is done by the company during its continuance, but the environmental harm done by the company after being insolvent leaves its carbon footprint; this factor is uncovered under CSR. Hence, it is very important to differentiate between CSR and green charges. A company, after becoming insolvent, cannot negate its obligations towards the environment. There should be some insurance that is dedicated to the environment in the company's memorandum.

In *Orphan Well Association v. Grant Thornton Ltd.* The Supreme Court of Canada has stated that after going bankrupt, an oil and gas company has to fulfil provincial environmental obligations before paying anyone it owes money to. The Supreme Court stated that the Redwater Estate could not avoid its environmental obligations. These costs were not debts requiring payments. They were duties to the public and nearby landowners.¹⁰

ENVIRONMENTAL CLAIMS

The environmental protection issues are increasing with the increase in global warming, and there is a leading increase in severe cases that harm the environment. There are three types of companies that claim damages related to the environment under insolvency in the CIRP process. The first is the company that deals with hazardous chemicals. It damages the environment, causes an accident, becomes insolvent, and then claims for the CIRP process.

The second type is the company that deals with hazardous chemicals and becomes insolvent not because it has affected the environment and caused an accident but because it cannot pay the debt.

The third type is the company that applies best practices and works for the environment.

Let us assume that after causing an accident, the first company becomes insolvent and thus goes for CIRP. The moratorium period begins, and the environmental claims are placed on the lower list. According to section 53 of the IBC act, under the waterfall mechanism, the financial creditors are first paid, then the secured and subsequently the unsecured creditors. Now, the dilemma is for the environment claimant. What remedies are available since they are placed on other creditors' lists?

⁹ Linna, T 2019, 'Insolvency proceedings from a sustainability perspective', INSOL International Insolvency Review, vol. 28, no. 2, pp. 210-232.

¹⁰ Orphan Well Association v. Grant Thornton Ltd. (31.01.2019 - SCCN) : MANU/SCCN/0009/2019.

The dilemma in the second scenario is that a company, after applying for the CIRP process, is placed into a moratorium period. Since it has caused harm to the environment as it deals with hazardous substances, should some environmental claims be raised? Should the company deposit some amount to harm the environment?

In the third scenario, where the company is dealing with good practices and becomes insolvent, should there be any relaxation given to it?

Until now, the purpose of IBC has been to regulate the insolvency procedure and ease the company's insolvency process. This process does not involve social causes.

MORATORIUM PERIOD AND LEGAL DILEMMA

When a case is applied for the insolvency proceedings, all the other claims remain halted till the decision is made. No other claims are entertained. Now, the environmental claims are put at non-secured creditors. Their claims are treated secondary by the law. If a company has degraded the environment and now files for Insolvency, then the existing tortious liability will not be entertained, which sometimes gives an escape from ecological liability.

Treating environmental claims under the IBC is a tedious and not-so-fruitful process since the objective of the IBC is to remove legal conundrums in corporate restructuring and insolvency procedures. It formulates the guidelines for the same, whereby it is essential to prioritize the financial creditor's claims over others. If environmental claims are put inside the financial creditor's list, it will complicate the already complicated procedure. Hence, it is essential to have a separate structure to address the environmental claims rather than amalgamating it with IBC.¹¹

Several stakeholders' rights are hinged due to Insolvency, including those of farmers who are unsecured creditors. We cannot give priority to their claims. So, it becomes imperative for the legislature to create an appropriately structured framework dedicated solely to environmental claims.¹²

EXISTING LEGAL FRAMEWORK

The judiciary has time and again refused to interfere in the decision of the committee of creditors. Since IBC is solely to ease the practice of insolvency, more changes and interference by the court will make the insolvency process more intricate, which is already a complex process. However,

¹¹ Ram Mohan & Prasad, *supra* note 2, at 3.

¹² Casey Watters, *Empowering States to Set the Priority Of Environmental Claims In Bankruptcy*, 31 J. Land Use & Envtl. L. 55 (Fall 2015).

there is a need to recognise environmental claims since they involve basic fundamental rights, including the right to life. However, the Court has emphasised the issue of fair treatment of financial and operational creditors.

In *the Committee of Creditors of Essar Steel India Limited vs Satish Kumar Gupta & Ors*, the Supreme Court of India specified integrating environmental claims over corporate insolvency processes. It is one of the significant decisions that paved the way towards recognising green insolvency. In this case, the court has emphasised the company's compliance with environmental regulations, as steel production has a significant environmental impact. This judgement indirectly supports the green insolvency process by emphasising financial recovery and operational sustainability. The court has stated that the different classes of creditors should be treated equitably, and all stakeholders, including the concerned environmental stakeholders, should be treated fairly.¹³

There is a need to develop a legislative framework that has environmental insurance where every claim is fulfilled. Adding environmental claims with financial creditors will complicate the process of insolvency. It is essential to provide special status to environmental claims. When a company is dealing with hazardous substances and procedures that are affecting the environment, there should be a mandate to create an insurance policy. While doing CSR, there is a limit under section 135 of the Companies Act, which provides that companies must meet either of these criteria that are:

- i. Net worth of more than 500 crore rupees, or
- ii. Turnover of more than 1000 crore rupees, or
- iii. Net profit of more than 5 crore rupees

If a company meet any of these criteria, then they are required to spend a minimum of 2% of its average net profit from the preceding 3 financial years on CSR activities.¹⁴

Similarly, there should be different criteria for the insurance scheme. When this criterion is met, the company should have a certain level of environmental insurance, which should increase with an increment in the profit of the company and the level of harm it is doing to the environment.

NEED FOR AN ENVIRONMENT INSURANCE SCHEME

The present insolvency framework has been made to simplify the insolvency and bankruptcy procedure. Making environmental claims a part of such a complex procedure will further hamper the rights of all the creditors, and not enough remedy will be available for the environmental

¹³ Committee of Creditors of Essar Steel India Limited vs. Satish Kumar Gupta and Ors. (15.11.2019 - SC) : MANU/SC/1577/2019

¹⁴ Companies Act, No. 18 of 2013, § 135 (India).

damages. Hence, it is suggested that an environmental insurance scheme be included, where a company is liable to insure the environmental claims so that there is no need to hamper the insolvency process after it goes insolvent. All the claims can be entertained through the insurance.¹⁵

The Public Liability Insurance Act of 1991 is one of the most prominent legal frameworks that intends to provide immediate relief to persons affected by accidents caused by hazardous industries. It emphasised upon public liability insurance for the victims. This act works on the principle of absolute liability, where the owner has to compensate the victims without needing to prove the fault.¹⁶ The owners are obliged to obtain public liability insurance to cover such claims mandatorily.¹⁷ The act also focuses on creating an Environment Relief Fund under section 7A in order to manage the claims efficiently and to provide immediate relief to the victims.¹⁸ This act aims to provide several avenues to ensure relief to the victim and to provide adequate compensation.

This act can pave the way for establishing environmental claims without hampering the insolvency process. There is a need to change the criteria in the act. Since it covers only compensation to the victims involved in hazardous chemical accidents, the ambit of the act can be widened to cover the environmental claims under the insurance fund. The fund should already be created to ensure that at the time of insolvency, all the environmental claims are compensated before the claims of creditors.

This act can smooth the process of compensation without going through lengthy legal battles. It will prioritise the environmental claim under the public liability insurance scheme before the actual liquidation process starts.¹⁹

The Polluter Pay Principal is well established under this scheme since it is crucial under environmental law. This principle makes the company financially liable for environmental damages. This principle helps an environmental creditor to assert his claim in the insolvency process against the company and other creditors. The claimants can directly apply for an insurance policy, which enhances their chances of getting compensated for the loss that is not counted under the simple insolvency procedure.²⁰

¹⁵ M.P. Ram Mohan & Sriram Prasad, Is Insurance a Solution to Address Environmental Considerations in Insolvency? A Conceptual Exploration, *INSOL Europe Yearbook* 2023, 93 (2023).

¹⁶ Public Liability Insurance Act, No. 6 of 1991, § 3 (India).

¹⁷ Public Liability Insurance Act, No. 6 of 1991, § 4 (India).

¹⁸ Public Liability Insurance Act, No. 6 of 1991, § 7A (India).

¹⁹ Ram Mohan & Prasad, *supra* note 5, at 7.

²⁰ Muhammad Munir, *History and Development of the Polluter Pays Principle: An Overview* (2023).

While under the IBC, the financial creditors have a higher say than all other creditors, this insurance act provides adequate relief and primacy to environmental claims, thereby maintaining the accountability of the companies involved in damaging the environment.

WAY FORWARD

We are entering an era where industries are running at an incredible pace. So many companies are getting established, and there is a great revolution in industrialisation. The environment is getting exploited each day, which makes the state come up with a policy that prioritises the process where a company becomes insolvent, and it has exploited the environment heavily. The process of managing insolvency with environmental claims is a very complex procedure; the legislature has to come up with a highly motivated structure to support the much-needed environmental claims. There is a need to re-evaluate the legal framework. The Public Liability Insurance Act is one of the impactful laws that can aid in the process, but its integration with the insolvency process is a complex task. Looking at the current situation, we need to prioritise our approach to such claims. We have to create a more just, equitable and fair process that covers the environmental claim, which will lead to our promise of sustainability and public duty.²¹

CONCLUSION

Moving forward with the green claims, it is crucial to involve the stakeholders in this process. There is a need to make stringent procedures to deal with such claims. All the resources are taken from the environment, which exploits the environment, leading to degradation in the lifestyle of people. There is a need to create accountability for such stakeholders. It becomes imperative to harmonise the insolvency process with environmental laws to pave the way for a sustainable and green future, where economic activities do not hamper the idea of a greener future.²² There is a need to create a balanced approach without further complexing the insolvency process. Hence, it is upon the legislature and stakeholders to develop a policy that is suitable for both the environment and the creditors. There is a need to check existing laws and develop a framework crucial to economic and environmental development.

²¹ Ram Mohan & Prasad, *supra* note 5, at 7.

²² Saqib Aziz, Mahabubur Rahman, Dildar Hussain & Duc K. Nguyen, *Does Corporate Environmentalism Affect Corporate Insolvency Risk? The Role of Market Power and Competitive Intensity*, 2021. Available at: <https://www.sciencedirect.com/science/article/pii/S0921800921002408>.