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Harmonisation and other Challenges for the Insolvency Profession in 2023

INSOL Europe
Yearbook 2023

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ISBN: 978-1-7393683-1-9

Published by INSOL Europe
PO Box 7149, Clifton
Nottingham NG11 6WD UK

https://www.insol-europe.org/

Chapter 8

Is Insurance a Solution to Address Environmental Considerations in Insolvency? A Conceptual Exploration

M P Ram Mohan
Professor and Member, Misra Centre for Financial Markets and Economy, Indian Institute of Management, Ahmedabad, India

Sriram Prasad
Research Associate in Strategy, Indian Institute of Management Ahmedabad, India

1. Introduction

Insolvency law tries to make the best of a bad bargain—that is, it tries to maximise the value of a failing firm. In doing so, insolvency regimes prioritise some interests over others, referred to as "conscious prioritizations".[1] Conscious prioritizations are based on factors ranging from economic and social interests to appeasing interest groups. In India, the Insolvency and Bankruptcy Code 2016 (IBC) consciously prioritises secured over unsecured debt, and private debt over government debts and dues.[2]

Such prioritisation allows for extinguishing or only paying out a small percentage of unsecured debt.[3] While there have been no environmental claims under the IBC so far,[4] environmental claimants would likely be treated as unsecured contingent claimants.[5] As environmental claims generally arise from tortious actions (which are also litigable under the statutory framework in India),[6] they are given low priority under the IBC. Such prioritisation of secured debt over environmental debt likely has an adverse effect on environmental policy in India.

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1 See, generally, Carlos Cuevas, 'The Rehnquist Court, Strict Statutory Construction and the Bankruptcy Code' (1994) 42 *Clev St Rev* 435, where Cuevas provides instances of the US Congress consciously prioritising one interest over the other for the purposes of bankruptcy.

2 Section 53, Insolvency and Bankruptcy Code 2016 ("IBC").

3 There are many cases where under the IBC, the resolution plan prioritises repayment of secured debt. The Insolvency Regulator's data shows that financial creditors (who generally are secured creditors) recovered 34.2% of their claims compared to operational creditors (generally are unsecured creditors), who recovered 17.6% of their claims. See *IBBI Quarterly Newsletter Data Jan – March 2023* (IBBI, 2023), available at: <https://ibbi.gov.in/uploads/publication/51cd3268be50c04f9745bb3959b09a89.pdf>.

4 Namrata Nair and Medha Shekar, 'Green Insolvency: Perspective and Policy Prescription', in IBBI, *Exploring New Perspectives on Insolvency* (IBBI, 2002), 351.

5 A contingent claim is a claim whose exact value depends on a contingency, such as the outcome of arbitration or a trial, and is assigned a nominal value (INR 1) during insolvency resolution.

6 See Environment (Protection) Act 1986, Water (Prevention and Control) Act 1974 and Air (Prevention and Control of Pollution) Act 1981.

There are instances in jurisdictions such as United States[7] and United Kingdom,[8] where an application of insolvency law has adversely affected the goals environmental policy seeks to achieve. In Europe, the interaction between environmental considerations and insolvency is unclear. Emmanuelle Inacio observes, "the question of the insolvent polluter is not covered by the European law".[9] In India, where environmental claimants are unsecured creditors, a seemingly apparent solution would be treating environmental claimants as secured creditors. However, that is not the case and it is pertinent to understand the logic and limits of insolvency law. Insolvency law is seemingly agnostic to social issues

Treating claims arising from tortuous liability or statutory considerations on par with secured debt would challenge one of the core principles of insolvency law, which is respecting the nature of debt as according to the principles of contract, as reflected in the priority a creditor receives. On this, Emmanuelle Inacio remarks that:

> "(p)rotecting the environment when a company is insolvent is extremely costly and prevention appears to be key."[10]

In our paper, we explore a different solution. As adequately addressing environmental considerations during insolvency seems impractical, we explore if environmental considerations under insolvency be addressed through insurance.

In this paper, the first part details treatment of environmental claims under IBC and explores why treating environmental claims on par with secured claimants may not be the most efficient solution to address environmental claims. The second part of the paper discusses if environmental claimants can be brought under the Public Liability Insurance Act 1991 and the limitations of such an approach. The third part looks at whether insurance can be a better and more efficient solution in guarding environmental considerations during insolvency.

2. The treatment of environmental claims under the IBC

Environmental claims can broadly be defined as any claim caused due to environmental harm or liability.[11] Environmental harm or liability caused would also likely incur government fines and a clean-up cost to be paid according to the polluter pays principle. Such a policy furthers the goal of environmental protection. The IBC lacks any specific provision for the treatment of environmental claims. Therefore, environmental claims would have to be classified within the existing framework.

Under the IBC, environmental claims would be of two types—claims arising out of decrees obtained and claims arising out of on-going litigation. These claims would be classified as contingent claims and claims by decree holders, both of which have lower priority in the dispersal of money compared to secured claims. Even government fines classified under

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7 See Joshua Macey and Jackson Salovaara, 'Bankruptcy as bailout: coal company insolvency and the erosion of federal law' (2019) 71 *Stan L Rev* 879, where the authors examine how coal companies have used bankruptcy to evade environmental and labour laws.

8 See Carolyn Shelbourn, 'Can the Insolvent Polluter Pay? Environmental Licences and the Insolvent Company' (2000) 12 *Journal of Environmental Law* 207, where the author analysed two insolvency cases which externalised the cost of environmental protections during insolvency on the government.

9 Emmanuelle Inacio, 'When environment meets insolvency' (2019/20) *Eurofenix* (Winter issue) 14.

10 Ibid., 15.

11 Deborah Parker, 'Environmental Claims in Bankruptcy: It's a Question of Priorities' (1995) 32 *San Diego L. Rev.* 221 ('Environmental Claims In Bankruptcy').

"Government debts and dues" are provided lower priority compared to secured creditors. Under the IBC, many resolution plans have done away with government debts and dues.[12] Therefore, in all probability, environmental fines and clean-up costs may also be extinguished under the IBC.

In this manner, IBC, either consciously or unconsciously, impedes goals set forth by environmental policy. In understanding the interaction between insolvency and environmental law, merely viewing insolvency as overriding another law may be short-sighted.[13] Insolvency is a symptom and not a cause. Insolvency law attempts to address this symptom. If insolvency occurs due to mismanagement, fraud or criminal activity, the company is restructured or wound up, as guided under insolvency law. Insolvency laws also have look-back periods to recover monies lost to fraudulent and related party transactions. Other laws address the criminality behind insolvency, and as the case may be, any money recovered is to be reimbursed.[14] It is difficult to envisage an adequate solution for environmental considerations within the scope of insolvency, where a company causes environmental harm, incurs liability, and subsequently seeks recourse under insolvency. Cases involving economic fraud can often be reversed, unlike cases concerning environmental harms, which are often irreversible and may require long-term efforts to remedy.

2.1. Is providing higher priority to environmental claims a possible solution?

As briefly touched upon in the introduction, a seemingly apparent solution is treating environmental claims as secured debt within insolvency, or providing environmental claims a higher priority in insolvency, as has been advocated by some commentators in the past.[15] Let us examine how this fares under IBC, which reflects many standard features observed in insolvency regimes across jurisdictions.

A moratorium is imposed on all ongoing litigation against the company (termed the Corporate Debtor under the IBC) as soon as a case is admitted to insolvency. This would also mean that if cases are ongoing against the Corporate Debtor (CD), the claim's value would be uncertain. Claims which are uncertain are called contingent claims and pose a dilemma of

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12 See cases such as *Ghanashyam Mishra & Sons (P) Ltd. v. Edelweiss Asset Reconstruction Co. Ltd.,* (2021) 9 SCC 657 (India); *Punjab National Bank v. Bhushan Power & Steel Limited*, 2019 SCC OnLine NCLT 18702 (India); *Shaji Purushothaman v. S. Rajendran*, 2020 SCC OnLine NCLAT 651 (India), among others.

13 See, generally, Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard, 2001), where Jackson cautions scholars against "viewing bankruptcy law as somehow conflicting with and perhaps overriding some other urgent social or economic goal" and implores them to examine bankruptcy in the context of what it is. However, such an approach has been critiqued by other scholars for ignoring social and economic goals. See David Carlson, 'Philosophy in Bankruptcy' (1987) 85 *Michigan Law Review* 1341; HongYin Teo, 'Bankruptcy Law: Is It Really Only about Debt-collection?', in *The True Function of Bankruptcy Law (Cross-sections Vol V)* (2009).

14 Preferential, Undervalued, Fraudulent and Extortionate transactions can also be recovered under the IBC by the Insolvency Professional. Currently, the value of the claims filed by Insolvency Professionals to recover such transactions is INR 285368.39 crore (around EUR 32 billion). See Table 15, *IBBI Quarterly Newsletter Data Jan – March 2023* (IBBI, 2003), available at: <https://ibbi.gov.in/uploads/publication/51cd3268be50c04f9745bb3959b09a89.pdf>.

15 See Christopher Symes, 'Environmental protection orders and insolvency: It is onerous to disclaim, or to prioritise or to resolve the conflict of two public interests' (2018) 37 *Australian Resources and Energy Law Journal* 29; see also Parker (above note 11).

determination.[16] The issue particularly takes precedence in environmental claims, where the impact of the environmental harm often takes time to materialise—and some claims may also arise after the process of resolution. In cases where the claim arises after the process of resolution, the claimants may have no recourse as the company would be provided a fresh start. Similarly, in case of liquidation, the claimants may have no party to pursue their claim against.[17]

If the courts determine a tortious environmental claim in favour of the claimant, they would provide the claimant a decree awarding compensation. Treating such decrees as secured would challenge one core principle associated with insolvency. The principle under challenge would be that the nature of debt and the priority afforded to the debt is determined on basis of pre-existing contractual rights. The classification of creditors based on the pre-existing contractual relationship is one of the core principles the IBC is based on and seems unlikely to be done away with or changed.

Further, if environmental claims are treated alongside secured debt, the special treatment afforded to environmental claims under insolvency would spur other special interest groups to seek higher priority for their claims. For instance, in India, farmers having unsecured claims may seek higher priority. These are the predominant concerns in treating environmental debt as secured debt. Regardless, even if the environmental debt were to be treated as secured debt, it would be subject to the same challenges secured creditors face, such as the time taken and the figure of compensation received.

Environmental claimants would often require immediate assistance and relief, which would not be possible under either insolvency resolution or litigation. Even in the unlikely event of environmental claims being treated as secured debt, under the IBC, secured debtors only recover around one-third of their admitted claim.[18] Therefore, a solution outside the scope of insolvency seems better suited to address environmental claimants and liability. The Public Liability Insurance Act 1991 (PLI Act) with adequate tweaking provides an avenue to consider.

3. The Public Liability Insurance Act

In December 1984, a gas leak at a chemical plant in Bhopal, located in Madya Pradesh, claimed thousands of lives, commonly known as the Bhopal gas tragedy.[19] In this case, the compensation the victims received was astonishingly low, with there being numerous attempts to increase the compensation. Recently, in 2023, the Supreme Court rejected an

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16 The practice currently is to assign contingent claims a nominal value and set aside a fund for them, where they may be litigated upon after the moratorium ends due to a successful resolution. For instance, in *Punjab National Bank v. Bhushan Power & Steel Limited*, 2019 SCC OnLine NCLT 18702 (India), the contingent claimants were allowed to proceed with their claims as a fund of INR 35 crores had been set aside for contingent claims. However, their claims were capped at 10% and had to be filed within a two year period from the date of approval of the resolution plan.

17 The claim can be filed against the Directors or Promoters of the company in their personal capacity but is unlikely to be successful due to the high burden of proof placed on the claimants.

18 Above note 3, as seen in the data provided by the Insolvency Regulator, financial creditors (who are generally secured creditors) receive 34.2% of their claims.

19 Danish Siddiqui and Nita Bhalla, 'Bhopal's toxic legacy lives on, 30 years after industrial disaster' (*Reuters*, 28 November 2014), available at: <https://www.reuters.com/article/us-india-bhopal-widerimage-idUSKCN0JC0WD20141128>.

appeal to reopen the case and increase the compensation observing the case to be settled once and for all.[20]

In light of the Bhopal gas tragedy, the government enacted and notified the PLI Act in 1991. The PLI Act mandated companies handling hazardous substances (as notified by the government) to compulsorily purchase insurance policies guarding against accidents.[21] The PLI Act defines accident as "a fortuitous or sudden or unintended occurrence while handling any hazardous substance resulting in continuous or intermittent or repeated exposure to death of, or injury to, any person or damage to any property"[22] and omits accidents caused due to war or radioactivity.[23] Under Section 6(1) of the PLI Act, "the person who has sustained the injury" and "the owner of the property to which the damage has been caused" can file an application of relief. Where the accident has resulted in death, the legal representatives and agents of the deceased can file a claim.[24]

In case of an accident, the insurance policy would ensure compensation was provided to the victims. In this regard, if environmental harm were to occur due to the accidental discharge of hazardous substances, the environmental claimants would have an avenue to claim compensation under the PLI Act. As discussed earlier, environmental claims can broadly be defined as any claim caused due to environmental harm or liability. If a company pollutes a river and causes damage to a drinking water source, farmlands or personal injury—the company has caused environmental harm and any claims arising from such would be "environmental claims".

The determination of compensation under the PLI Act is comparatively straightforward. The concerned Collector, a quasi-executive and quasi-judicial authority present in each district, makes the determination based on the principle of no-fault liability.[25] The Collector can then pass an order for compensation on determining if the case involved hazardous substances and was an accident.

However, the compensation under the PLI Act has not been updated since 1991 and is outdated. In case of a medical injury, compensation is capped at INR 12,500 (EUR 141.08) and INR 25,000 (EUR 282.16) in case of death. For permanent disablement, the compensation is capped at INR 25,000 (EUR 282.16) in addition to an INR 12,500 (EUR 141.08) cap for medical expenses.[26] People with partial disability are to be paid INR 1,000 (EUR 11.29) per month for three months. In case of damaged property, compensation is capped at INR 6,000 (EUR 67.72).[27]

It is also to be noted that the compensation under the PLI Act does not prohibit civil actions or civil courts from providing additional compensation.[28] Efforts are also underway to try and

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20 Arpan Chaturvedi, 'India's top court rejects govt plea seeking more compensation for Bhopal gas disaster victims' (*Reuters*, 14 March 2023), available at: <https://www.reuters.com/world/india/indias-top-court-rejects-govt-plea-seeking-more-compensation-bhopal-gas-disaster-2023-03-14/>).

21 Section 4, The Public Liability Insurance Act, 1991 ("PLI Act").

22 Section 2(a), PLI Act.

23 The Civil Liability for Nuclear Damage Act, 2010 addresses nuclear pollution.

24 Section 6(1), PLI Act.

25 Section 3, PLI Act.

26 The conversion rate is as of 26 May 2023 and amounts to EUR 1 = INR 88.60.

27 Schedule, PLI Act.

28 Section 8, PLI Act.

amend the PLI Act, towards updating the compensation.[29] Apart from the compensation, another limitation under the PLI Act is that there should be an "accident" involving a "hazardous substance". This would exclude many instances of environmental pollution caused due to negligence, intentional tort, among others. For instance, in the case of *M. C. Mehta v Union of India* (1988),[30] many tanneries knowingly discharged untreated wastewater across the river Ganges. M. C. Mehta, an environmental lawyer, secured the order to prevent the tanneries from doing so. In such a case where there is intentional tort, claims arising from the pollution caused by the tanneries would not be covered under the PLI Act as the wastewater discharge was intentional and not accidental. This is a limitation of insurance in general, which will not protect against acts of wilful pollution.

The insurance schemes under the PLI Act also have general caveats which exempt the insurance policy from covering government fines and court-mandated clean-up costs. Overall, the PLI Act is limited in its current scope,[31] possibly more so when interacting with insolvency law.

3.1. The Public Liability Insurance Act and Insolvency

In India, there have been no environmental claims under the IBC as of today. Consequently, the IBC and the PLI Act have not interacted so far, leading to certain grey areas which may complicate claiming insurance under the PLI Act if the company is admitted to insolvency.

Once a company is admitted to insolvency, a moratorium on all ongoing cases against the company is enforced. The logic behind a moratorium is to protect the value of the company's estate from the stresses of litigation and aid smooth resolution. Quasi-judicial proceedings are also prohibited during a moratorium. However, the Court allowed a claim to be determined under the Customs Act (which is a quasi-judicial proceeding) but not the enforcement of the claim. The determined claim had to be filed with the insolvency professional. Therefore, while the Collector's proceeding under the PLI Act is a quasi-judicial proceeding, there is scope that it may be allowed to proceed. Furthermore, there are two arguments against applying the moratorium to such proceedings. One, in insurance policies, insurance companies have a general clause which allows them to defend the case. Two, as the Collector has to determine the case on the principle of no-fault liability and verify the facts of the accident, the determination is straightforward and does not require complex legal work. Legal costs are also generally covered under the insurance policies and would not diminish the value of the insolvent company's estate.

Another issue that may arise is, what if the insolvency results in a resolution of the stressed company, leading to a fresh start under the IBC.[32] Then, the company is only bound by the liabilities agreed to in the resolution plan. All remaining liabilities, which may include

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29 Ministry of Environment, Forest and Climate Change, *Note for consultation on the proposal to make amendments in the "Public Liability Insurance (PLI) Act, 1991"* (F. No. 12/96/2020-HSM), which introduces the amendments and proposes that the compensation provided would be prescribed in the Rules which can be decided by the Ministry and not be present in the Act, This would enable the Ministry to keep updating the Rules (through Executive orders) as and when required compared to amending the Act each time they would want to update the figures for compensation.

30 *M. C. Mehta v. Union of India* AIR 1988 SC 1037 (India).

31 According to some reports, lack of compliance with the PLI Act is an issue as well, where many companies handling hazardous substances have not brought any insurance as mandated under the PLI Act.

32 Sections 31, 32A of the IBC.

environmental claims and government dues, are extinguished. The resolution plan has to be approved by the courts, which in the past have approved resolutions that extinguish contingent claims (the category environmental claims will most likely fall under) and government dues, as allowed under the IBC.[33]

A question that follows is, if a company limits or does away with its contingent liability, would the insurer still be liable to pay compensation for the environmental harm the company caused? The answer is unclear. Public liability insurance policies use language which indemnifies the insured on suffering any loss caused by the accident. This means the insurer's liability arises out of the insured's liability. Where some environmental liability has been extinguished during insolvency, the insurer may refuse to indemnify such loss—as no loss can arise from the extinguished environmental liability. A similar situation may arise where the company is liquidated, where the insurer may deny claims as the company no longer exists.

3.2. Harmonising Public Liability Insurance with Insolvency

A moratorium and a fresh start provided under insolvency may hinder claims under the PLI Act, as seen in the previous part. The uncertainty regarding how insolvency would interact with insurance, as seen in its possible conflicts with the PLI Act, highlights the necessity to harmonise insurance and insolvency law. Such harmonisation would guarantee the ability to pursue insurance claims even in cases of insolvency. There should also be a provision to ensure the continuing of the insurance policy during insolvency where the payment of premiums should be counted as insolvency costs.

One way to harmonise insurance with insolvency is allowing claimants to sue the insurer directly. This would ensure that no proceedings are halted due to the insolvency of the insured company. A similar approach exists in New South Wales, Australia, through the Civil Liability (Third Party Claims Against Insurers) Act 2017.[34] Such a law allows third parties who had a claim against the insolvent insured to sue the insurer directly.[35] Similarly, clarifying that the insurer's liability would not end if the insured company is liquidated or receives a fresh start addresses the possibility of denying claims due to a fresh start. Here, the insurer's liability exists regardless of a fresh start or liquidation, but it does not mean the insurer's liability exists for eternity. Limitation periods, as applicable under insurance law, apply.

In such a manner, PLI Act can be harmonised with IBC, where there is no substantial change to how the IBC operates or any of the core principles insolvency law is based upon. While currently limited in its scope, the PLI Act provides insurance as an alternate avenue to address environmental concerns. In the next part, we explore whether insurance would provide a better avenue than insolvency to address environmental claims.

4. Insurance or insolvency: which better addresses environmental considerations?

Before delving into what better addresses environmental considerations, we need to understand how environmental considerations manifest in insolvency. Environmental liability

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33 See *sub nom. Ghanashyam Mishra & Sons (P) Ltd. v. Edelweiss Asset Reconstruction Co. Ltd.*, (2021) 9 SCC 657 (India).

34 Civil Liability (Third Party Claims Against Insurers) Act 2017 (NSW).

35 Ibid., s 4.

can either cause insolvency or be a cause of insolvency. For instance, an accident causes a chemical spill and incurs environmental liability—due to which the company faces much litigation and has to declare insolvency. This is a case of environmental liability causing insolvency. In another instance, a company facing financial stress may cut corners and accrue environmental liability due to negligence. In this situation, an adverse financial situation is the cause of insolvency and the corresponding environmental harm.

Companies in either situation can seek recourse under insolvency law. Insolvency law, as observed earlier, is agnostic to the cause of insolvency and instead tries to remedy the situation of insolvency. The cause of insolvency, if malicious or criminal, is to be addressed through other laws. Insolvency law merely focuses on trying to maximise the value of the company. The IBC has adopted the approach of keeping the company a going concern to protect and maximise its value.[36]

To maximise value and keep the company a going concern, insolvency law consciously prioritises the company's immediate interests over other interests. This is seen in the implementation of a moratorium. The principle of fresh start is also reflective of value maximisation. These principles and application of insolvency law denote the limited yet crucial purpose insolvency law serves, which is maximising the value of a stressed company. It also clarifies how insolvency law tries to save as much value as possible for the claimants (although the distribution of value among the claimants is based on pre-insolvency contractual rights) and is not responsible for environmental claimants not receiving adequate compensation. While some may argue, in prioritising secured creditors over environmental claimants, insolvency law is unfair in distributing value, as previously discussed, there are many challenges in the treatment of environmental claimants as secured creditors. Also, fair treatment on par with secured creditors under insolvency does not guarantee adequate compensation, as in insolvency, there is almost always a haircut taken by the creditors.

Rather than trying to accommodate environmental considerations within insolvency, where it is impractical to expect complete compensation, alternate avenues to address environmental considerations should be explored. Insurance may provide such an alternative solution to efficiently address environmental concerns in ways insolvency would never be able to address. The scope of providing compensation through insurance is far greater than compared to insolvency.

This is partly exemplified by the PLI Act, under which claiming compensation is comparatively straightforward. Insurance is also mandatory under the PLI Act if a company handles hazardous substances. The PLI Act is although limited in its current iteration where the amount for compensation is low. Also, the interaction between insurance and insolvency is uncertain, where clarifications with how a moratorium and a fresh start affect the insurer's liability are needed. Solutions to harmonise the uncertain interaction between insurance and insolvency are straightforward, as are reflected in Part 3.2 and briefly discussed further as well. Also, if a company already has an insurance policy similar to PLI to address environmental risks, the interaction of insurance and insolvency would still need harmonisation.

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[36] See Report of the Bankruptcy Law Reforms Committee, November 2015, available at: <https://ibbi.gov.in/BLRCReportVol1_04112015.pdf>.

Allowing claimants to directly sue the insurer if the insured company is under insolvency would address the problems moratoriums pose. Another feature that may be needed to harmonise insurance law with insolvency would be ensuring that the insurer's liability continues to exist, regardless of the insured company being liquidated or receiving a fresh start, according to the relevant limitation period. Such a provision is needed to ensure insurers do not refuse claims on grounds that the insured's liability has ceased to exist. These are some ways to harmonise insurance law with insolvency, enabling insurance to protect environmental considerations during insolvency.

Also, if one were to design an insurance scheme to protect environmental considerations during insolvency in India, some key factors, as indicated in the paper, would need to be explored. One, the insurance would have to be mandatory and paying the premiums would have to continue during insolvency. However, it is important to safeguard against creating a barrier to trade and entry. The criteria for companies covered under such an insurance scheme must be explored and studied in great detail. Two, the scope of the law would have to extend beyond the current scope of the PLI Act, which limits itself to hazardous industries. The scope and definition of "accident" may also need to be broadly classified.

5. Conclusion

A prima facie exploration of insurance as an avenue to address environmental concerns in insolvency seems promising and should be studied further. There have been cases in the past where the use of insolvency has resulted in undermining environmental policy. However, it is not appropriate to understand insolvency as the cause leading to the effect of undermining environmental policy. It is rather instructive to understand insolvency as an effect of a cause that also leads to environmental policy being undone.

It is not the case that insolvency law cannot be misused or abused, although using law to gain an advantage is not endemic to merely insolvency law. Insolvency law, when misused, evolves with stricter anti-abuse provisions to prevent future misuse. In this regard, we need to find a solution for environmental considerations being left unaddressed during insolvency. Insolvency laws predominantly address financial distress. Similarly, insurance can be used to address environmental considerations which are not prioritised during insolvency and should be developed as a solution, given the growing importance of the need to protect the environment.