CORPORATE INSOLVENCY RESOLUTION IN INDIA

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ABSTRACT

Legislation on insolvency resolution has been a very significant area of law making for ages; this significance has increased over time with the increasing preponderance of credit and security and non-performing assets (NPAs) especially in the corporate world. The non-performing assets in India are clear by-product of the liberalized and globalized financial system. To deal with the NPA issue, several efforts have been made in the past but to our disappointment none have been successful. This article aims at throwing light on the evolution of corporate insolvency and bankruptcy laws in India.

Below is a brief discussion of the developments that took place in order to improve the corporate insolvency resolution system, the working of the present insolvency resolution mechanism and the way forward.

Keywords: Insolvency, Corporate Insolvency, Debts, NPAs, Sick Companies, IB Code, 2016

Historical Backdrop

The Companies Act was enacted in 1956 in independent India which was in force until recently when the entire law was overhauled to introduce the 2013 Act bringing about major changes. But the 1956 Act did not have any provision for the corporates to provide for a mechanism of insolvency resolution. It was in 1985 that for the first time the Congress Government brought about a dedicated legislation for the revival and rehabilitation of sick as well as potentially sick companies in India by the enactment of 'Sick Industrial Companies (Special Provisions) Act (SICA), 1985'. But the Act turned out to be a complete failure. One major loophole of the Act was its applicability only in cases of sick 'industrial' companies.[1] It also provided for the establishment of 'Board for Industrial and Financial Reconstruction (BIFR)' and 'Appellate Authority for Industrial and Financial Reconstruction (AAIFR)'. Section 22 of the SICA stipulated for the stay of proceedings against a corporate debtor if it has been registered as a sick company with BIFR. The companies used this as a shield to protect themselves from winding up petitions. This led to unnecessary delay in the resolution process resulting in over heaping of non-performing assets and their non-utilisation for any other purpose. For the recovery of debts and resolution of NPAs issue another legislation 'the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI)' was introduced and two quasi-judicial bodies were constituted to recover debts namely, the Debt Recovery Tribunal (DRT) and the Debt Recovery Appellate Tribunal (DRAT). Quite clearly the law was not meant for the resolution of NPAs as only banks and financial institutions could file cases before DRT and those too only related to recovery of debts. This mechanism did not prove to be as efficient as was required and expected.

The ever increasing NPA problem forced the NDA Government to introduce the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) and several amendments were also proposed under the then in force company law. The amendment inserted a new Chapter VI-A to provide for rehabilitation of Sick Industrial Companies (SIC). The SIC (Special Provisions) Act, 1985 was to be repealed and the functions of BIFR were to be performed by the National Company Law Tribunal (NCLT); Since the 2002 amendment to Companies Act also provided for the replacement of the Company Law Board

[1] Industrial companies under SICA included only those companies that are industrial undertakings within the meaning of first schedule attached to the Industries (Development and Regulation) Act, 1951 subject to the exceptions specified in the Act.

with National Company Law Tribunal and also created an Appellate Tribunal (NCLAT). But this amendment was never enforced. The challenges in implementation of this amendment were: first, regarding the establishment of NCLT and its constitutional validity and second doing away with SICA without bringing about any proper replacement for that. We had to continue with SICA even after acknowledging its flaws in 2002 till 2016. The obsolete company law (1956 Act) continued for about half a century. In 2005 a Committee headed by Dr. J.J. Irani thoroughly revised the company law and on the basis of the report submitted by the committee an entirely new legislation was brought about in 2013. The new Act had a chapter devoted to the revival and rehabilitation of sick companies.[2] It was difficult to enforce most of the provisions of the Companies Act, 2013 at once. The Ministry of Corporate Affairs notified the provisions in bits and pieces but Chapter XIX on sick companies could not be notified. There was no single legislation that dealt with insolvency and bankruptcy. Provisions relating to it could be found under SICA, 1985 the RDDBFI, 1993 SARFAESI, 2002 and the Companies Act, 2013. Each of these statutes provided for separate mechanisms and authorities for dealing with sickness of companies: BIFR, DRT and NCLT and their respective appellate tribunals including jurisdiction of Company Law Board and High Courts. The concurrent existence and jurisdiction of these authorities made the situation chaotic.

The work on insolvency laws was going on in parallel as the need for it was felt way back in 2002. The Bankruptcy Law Reforms Committee headed by T.K. Viswanathan consolidated and amended myriad laws under a unified Code that was long awaited to find a solution around debt laden sick companies. The Insolvency and Bankruptcy Code, 2016 (IB Code) promised to usher sweeping changes in the financial system.

The working of IBC for resolving corporate insolvency: Is it inerrant?

Law is a reflection of the state of mind of any society; a confused law is, therefore, a bad reflection of our state of thinking and resolution. (Kothari 2013) The statement is apt for the legislative history of insolvency laws in India in the recent past as has already been discussed above.

The codification of scattered laws under IBC came as a relief especially for the creditors. Under the previous laws, the debtors were in dominant position but now the creditors no longer chase

[2] Chapter XIX of the Companies Act, 2013 that has now been repealed.

the corporate debtors, it is vice-versa. Section 6 of the IB Code allows filing of insolvency resolution petitions by corporate debtor itself, financial creditors (covering both secured and unsecured creditors) as well as operational creditors.

On the lines of Bankruptcy Code of the United States, India also aimed to introduce an integrated legislation on insolvency and repealed and amended eleven legislations.

Table 1: List of amended and repealed acts through IB Code, 2016

Section of IB Code 2016	Amended Act	Schedule of IB Code 2016
245	Indian Partnership Act 1932	I
246	Central Excise Act 1944	II
247	Income- tax Act 1961	III
248	Customs Act 1962	IV
249	Recovery of Debts due to Banks and Financial Institutions Act 1993	V
250	Finance Act 1994	VI
251	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002	VII
252	Sick Industrial Companies (Special Provisions) Repeal Act 2003	VIII

253	Payment and Settlement Systems Act 2007	IX
254	Limited Liability Partnership Act 2008	X
255	Companies Act 2013	XI

Key Highlights

- Single adjudicating authority: The Code has designated NCLT (also DRT) as the only adjudicating authorities to resolve corporate insolvency.

- Two-stage processes: The first stage is insolvency resolution followed by initiation of liquidation process if the resolution plan fails.

- Institutional framework: It provides for appointment of insolvency resolution professionals registered with insolvency professional agencies. It also provides information utilities for maintenance and distribution of data relating to debtors. A new market regulator to regulate the functioning of the insolvency intermediaries is also constituted- the Insolvency & Bankruptcy Board of India (IBBI).

- Time bound speedy resolution processes: The insolvency resolution period has been fixed to 180 days with a maximum of 90 days extension. This time bound resolution process discourages the callous approach of the corporate debtors towards the creditors and in repayment of debts.

- Declaration of moratorium: Under section 14 of the IB Code provision for moratorium ensures that an uninterrupted time is given to the corporate debtor as an opportunity to revive and rehabilitate for the preparation of resolution plan. It is similar to section 22 of SICA that stipulated for stay of proceedings against the debtor after its admission under IB Code.

The World Bank releases its 'Ease of doing of business' report every year that determines the ease of doing business in countries on the basis of ten sub-indices insolvency resolution being one of them. After the introduction of IB Code in 2016 India's ranking has improved from 136 out of 190 countries in 2017 to 100 in 2018 and then 77th in 2019. India is the only country that

has shown such promising improvement in just three years after the implementation of a new insolvency resolution regime. India's position, however, worsened a bit in the latest ranking on 'paying taxes' and 'resolving insolvency' — two parameters where improvement was expected following the roll-out of GST and the insolvency and bankruptcy code.[3]

There have been allegations on the World Bank regarding repeatedly changing the methodology of its ease of doing business report over several years, which the World Bank has also accepted to be unfair and misleading.[4] Chile has also accused the World Bank for being biased in its competitiveness ranking and discriminating against South-American Countries.[5] Moreover, the Report is the result of a survey conducted in only select metropolitan cities of the country.[6]

Looking at the implementation of the Code in India separately it can be said that apparently the new regime has been introduced as a savior. It helps in insolvency resolution and expedites the debt recovery process but right from its enforcement there has been more emphasis on operationalizing it rather than properly implementing it.

There is ample scope for wide interpretation of its several provisions, one such provision being the scope of the terms 'financial creditors' and operational creditors'.[7] The definitions of each of these terms do not indicate the coverage. There was confusion regarding the applicability of the Code and status of homebuyers and corporate guarantors that was subsequently clarified. As per section 128 of the Indian Contract Act, the liability of guarantors is coextensive with that of the principal debtor. In fact it is not only coextensive but also distinctive from the

[3] FE Bureau, "Ease of Doing Business ranking 2019: Know what worked for India and what didn't in its 23 notch leap to 77th slot", *Financial Express*, November 1, 2018 *available at* https://www.financialexpress.com/economy/ease-of-doing-business-ranking-2019-know-what-worked-for-india-and-what-didnt-in-23-notch-leap-to-77th-slot/1368596/ (last visited on Apr 2, 2023)

[4] Zumbrun, Josh and Talley, Ian "World Bank Unfairly Influenced Its Own Competitiveness Rankings", *The Wall Street Journal*, January 12, 2018 *available at* https://www.wsj.com/articles/world-bank-unfairly-influenced-its-own-competitiveness-rankings-1515797620 (last visited on Apr 2, 2023).

[5] Reuters, "Chile slams World Bank for bias in competitiveness rankings", January 14, 2018 *available at* https://www.reuters.com/article/us-chile-worldbank/chile-slams-world-bank-for-bias-in-competitiveness-rankings-idUSKBN1F20SN?il=0
(last visited on Mar 23, 2023).

[6] Doing Business, World Bank available at https://www.doingbusiness.org/en/rankings/india; The methodology is subject to several limitations.

[7] For details see sections 5(7) and 5(8) for the definitions of financial creditor and financial debt respectively. Sections 5(20) and 5(21) provide for definitions of operational creditor and operational debt.

liability of the principal corporate debtor under the Code. Accordingly, both the principal corporate debtor and the guarantor can be proceeded against under the Code now.[8]

Whereas, even after the 2018 amendment to the IB Code, the status of homebuyers even though clarified remains unexamined. Homebuyers after the Jaypee Real Estates dispute were rejected as operational creditors by NCLT but were included as financial creditors by the 2018 amendment. Lately, there were delays in giving possession to homebuyers who had booked houses for themselves from the real estate giants. The builders borrowed money from the homebuyers and then defaulted at the time of giving possession.

To improve the status of homebuyers an amendment in section 3 of IB Code was made including 'money borrowed' from 'allottees' of houses of real estate projects within the meaning of 'financial debt' and therefore they are now to be treated a financial creditors allowing them to become a part of 'Committee of Creditors' (CoC). The CoC plays a crucial role in preparing the resolution plan and its approval. CoC determines the fate of the corporate defaulter. The question is that can these 'allottees' be treated as secured creditors? When it comes to giving priority during payment of proceeds it is unclear whether they be given preference while making payments when the company gets into liquidation. Under the Real Estate (Regulation and Development) Act, 2016 the homebuyers have similar rights as that of a secured creditor. It is pertinent to note here that treating homebuyers as secured creditors may pose practical difficulties at different levels for example at the stage of construction, agreement to sell or at the time when only allotment letters are given. Similarly including them in the CoC at any of these stages may not be appropriate as CoC is vested with many powers. The ambiguity regarding the scope of these two terms i.e. financial and operational creditors has made it difficult to determine who all can proceed against the corporate debt defaulter under IB Code and approach the National Company Law Tribunal (NCLT). So far SEBI has been entrusted with the task of protecting the interest of investors. This confusion therefore further leads to institutional conflict between NCLT and other regulators in the market.

Though it is expected that the Supreme Court will clarify this institutional conflict in the recent case pertaining to New Delhi based HBN Dairies that is accused of operating an illegal

[8] As per section 5(22) of the IB Code personal guarantor is the means of an individual who is the surety in the contract of guarantee to a corporate debtor.

Collective Investment Scheme. There is a dispute regarding the categorization of contributors in fraudulent schemes as financial creditors.[9]

The Way Forward

Undoubtedly, the corporate insolvency resolution reforms in India have come a long way to deal with the insolvency resolution problem. But the Code does not cater for unforeseeable situations that may come up in future. The approach so far has been to deal with the situation as it comes.

The Code has empowered creditors but more clarity is required with respect to the scope of the term creditor since the definition is not inclusive. The intention of the framers of the Code for not providing an inclusive definition may be to not limit its scope but a definition in an abstract form is defeating the very purpose of the Code.

The provisions in the present regime are mainly creditor driven and not debtor-motivated. Revival of sick companies is more like a survival instinct, which has to come from the debtor itself and not from the creditors. When it comes to creditor driven enforcement the social cost involved is a lot. There is a need to strike a balance between the needs of creditors and concerns of debtors at the same time. Currently this balance is missing.

[9] Modak, Samie, "SC verdict in Sebi-NCLT legal tussle will set a precedent", *Business Standard,* June 25, 2019.

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