PARADIGM SHIFT IN THE LEGAL REGIME: THE EVOLUTION AND IMPACT OF INSOLVENCY AND BANKRUPTCY LAW IN INDIA

Sukhmani Kaur, LL.B, Campus Law Centre, University of Delhi

ABSTRACT

The Insolvency and Bankruptcy Code, 2016 (IBC) has been a significant development in the insolvency law in India, aiming to provide a transparent, efficient, and effective resolution process for insolvent companies. In India, the Insolvency and Bankruptcy law has undergone a significant transformation with the introduction IBC, resulting in a dynamic legal framework. This has led to the faster resolution of distressed assets and has created opportunities for businesses to be acquired as going concerns. The legal regime has undergone a paradigm shift and is currently exploring new horizons. However, the implementation of the IBC has faced several critiques. This article explores the history and landmark cases of the IBC and provides an analysis of its impact on stakeholders. The article highlights the critiques of the IBC, such as delays in the resolution process, lack of clarity on the rights of stakeholders, impact on small and medium-sized enterprises, lack of infrastructure and capacity, and impact on the banking sector. It concludes that it is crucial to address these critiques to ensure that the IBC continues to evolve and improve over time.

Introduction

An insolvency law impacts both pre-insolvency and post-insolvency actions of the debtors and the creditors and is a critical element of the financial environment of a country[1]. The Insolvency and Bankruptcy Code, 2016 (IBC) is a comprehensive legislation that consolidates and amends the laws relating to reorganization and insolvency of companies, limited liability partnerships (LLPs), and individuals. The IBC has significantly changed the landscape of insolvency law in India and has brought about a paradigm shift in the way insolvency proceedings are conducted in the country. A well-defined insolvency and bankruptcy law can reduce conflicts between creditors and debtors and result in a quicker resolution of financial distress. This enables debtors to re-enter the business arena at a lower cost and in a shorter time, while creditors are encouraged to continue providing credit. The Code is a law for insolvency resolution. Its foundational objectives are to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith and incidental thereto. [2]

History of Insolvency Laws in India

The history of insolvency laws in India can be traced back to the colonial era when the British introduced the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920. These acts were primarily aimed at protecting the interests of individual creditors and did not provide for a comprehensive resolution process for insolvent companies. In 1964, the Law Commission of India recommended[3] combining the two laws to create a common insolvency law that would be applicable to the entire country.

After India gained independence in 1947, the government enacted the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) to address the issue of industrial sickness in the country. SICA provided for a rehabilitation process for sick companies and allowed for the appointment of a government nominee to manage the affairs of such companies. However, the

[1] Sengupta, Rajeswari, Anjali Sharma, and Susan Thomas. "Evolution of the insolvency framework for non-financial firms in India." *Indira Gandhi Institute of Development Research, Mumbai, WP-2016-018, June, http://www. igidr. ac. in/pdf/publication/WP-2016-018. pdf* (2016).
[2] The Insolvency and Bankruptcy Code, 2016
[3] 26th Report of the Law Commission of India

implementation of SICA was marred by delays and inefficiencies, leading to a high number of cases remaining unresolved.

Before IBC came into the picture, the process of winding up of companies was regulated by the Companies Act, 1956. However, there were undue delays in this process. Despite the implementation of several schemes by RBI such as Corporate Debt Restructuring, Joint Lenders Forum, Scheme for Sustainable Structuring of Stressed Assets (S4A), Strategic Debt Restructuring, none of them proved to be successful. The task of resolving insolvency for businesses, addressing defaults in creditor repayments, managing an increase in non-performing assets (NPA), dealing with corporate borrowers and their loans and advances, and allowing creditors to have control over the debtor's assets while addressing any illegalities became a significant challenge for the judiciary.

Thus, in 2015, the government introduced the Bankruptcy Law Reform Committee (BLRC) to recommend changes to the insolvency framework in the country. Based on the BLRC's recommendations, the government enacted the Insolvency and Bankruptcy Code, 2016 (IBC)- the umbrella legislation for insolvency resolution of all entities in India—both corporate and individuals. The aim of codifying insolvency law is to provide for greater coherence in law and facilitate the application of consistent and lucid provisions to different stakeholders affected by business failure or the inability to pay debt. To this end, the Code repealed the Presidency Towns Insolvency Act, 1909, and the Provincial Insolvency Act, 1920, and made amendments to 11 laws, including the Companies Act, 2013, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, to give effect to the newly codified legislation. Section 238 of the IBC provides for overriding nature of the provisions of IBC. Once a corporate entity comes within the process as envisaged under the IBC, all the other applicable provisions of law have to give way to the IBC proceedings.[4] The IBC provides for a comprehensive resolution process for insolvent companies, which includes a time-bound process for resolution, a clear hierarchy of creditors, and a mechanism for the liquidation of the company if a resolution is not possible. The regulator established under the Code, viz. the Insolvency and Bankruptcy Board of India (IBBI), has strived to deliver its mandate in an ever-evolving operating environment.

[4] Dhir & Dhir Associates Advocates & Solicitors, "Insolvency and Bankruptcy Code (IBC) and other Corporate Laws," available at *https://www.icsi.edu/media/portals/2/ppt/Varsha-IBC-230317.pdf.*

Development of the Insolvency and Bankruptcy Code, 2016

The need for a comprehensive insolvency legislation was recognized by the government of India and a committee was formed to examine and recommend changes to the existing framework. The committee, headed by T. K. Viswanathan, submitted its report in 2015, which formed the basis for the Insolvency and Bankruptcy Code, 2016. The IBC was passed by the Parliament of India in May 2016 and received the President's assent on 28 May 2016.

One of the significant changes brought about by the IBC is the introduction of the concept of the Insolvency and Bankruptcy Board of India (IBBI). The IBBI is the regulator for the insolvency professionals, insolvency professional agencies, and information utilities under the IBC. The IBBI was established in October 2016, and it has been instrumental in the implementation of the IBC.

The IBC has been a game-changer in the Indian insolvency law landscape. It has brought about a significant shift in the mindset of creditors, who were earlier reluctant to initiate insolvency proceedings due to the lengthy and complicated procedures. Since its inception, a total of 6199 CIRPs have commenced by the end of December, 2022. Of these, 4199 have been closed. Of the CIRPs closed, 793 have been withdrawn; and 611 cases have ended in approval of resolution plans; while 1901 have ended in orders for liquidation[5]. Responding to market realities, the Code has been amended six times since its enactment, making it one of the most dynamic legislations of recent times.

As noted in *Innoventive Industries Ltd v ICICI Bank and Anr*[6], the scheme of the Code is to ensure that when a default takes place, in the sense that a debt becomes due and is not paid, the insolvency resolution process begins. Default is defined in Section 3(12) in very wide terms as meaning non-payment of a debt once it becomes due and payable, which includes non-payment of even part thereof or an instalment amount. The IBC has also created a level playing field for all stakeholders, including secured and unsecured creditors, employees, and the debtor. The Code has created a cohesive and comprehensive ecosystem that cements the processes and the service providers together towards the achievement of its objectives. With the enactment of the Code, India has witnessed the birth of two professions, namely insolvency profession and

[5] Insolvency and Bankruptcy Board of India (2022). *Annual Report 2021-2022. https://ibbi.gov.in/uploads/publication/7ccd38791123c80bc5d2cf12adfff8c5.pdf*
[6] (2018) 1 SCC 407

valuation profession, that have professionalized insolvency services.[7]

Notable judgments under the Code

Since its inception, the Adjudicating Authority (NCLTs), the Appellate Authority (NCLAT), Honourable High Courts, and the Honourable Supreme Court have all delivered numerous landmark orders and judgments explaining several conceptual issues, settling contentious issues and resolving grey areas. Insolvency as a discipline of knowledge is now getting well established in India. The IBC has been tested in several high-profile cases that have shaped the implementation of the code. Here are a few landmark cases:

Committee of Creditors of Essar Steel India Limited through Authorised Signatory v. Satish Kumar Gupta[8]

This case is a landmark judgment in the Indian insolvency law landscape. The case pertains to the resolution process of Essar Steel India Limited (ESIL), a prominent steel manufacturing company that had become insolvent.

The case was significant because it involved a large number of creditors with conflicting interests, and it tested the effectiveness of the newly introduced Insolvency and Bankruptcy Code, 2016 (IBC). The case was also significant because it involved a number of legal issues that had not been previously addressed in the context of insolvency law.

ESIL had become insolvent, and a resolution process was initiated under the IBC. The Committee of Creditors (CoC), consisting of various financial creditors, was formed to oversee the resolution process. The CoC received various resolution plans from interested bidders, including ArcelorMittal India Private Limited and Numetal Limited.

During the course of the resolution process, it was discovered that both ArcelorMittal India Private Limited and Numetal Limited had violated the eligibility criteria set out under the IBC. The IBC provides that a person shall be ineligible to submit a resolution plan if such person is a promoter or is in the management of a corporate debtor that has defaulted on its debts for over a year.

[7] Sahoo, M & Guru, Anu. (2020). "Indian Insolvency Law". *Vikalpa: The Journal for Decision Makers*.
[8] Company Appeal (AT) (Insolvency) No. 03 of 2019

ArcelorMittal India Private Limited and Numetal Limited were both initially found ineligible to submit resolution plans for Essar Steel India Limited (ESIL) under the Insolvency and Bankruptcy Code (IBC). ArcelorMittal was deemed ineligible due to its association with Uttam Galva Steels Limited, a company that had defaulted on its debts for over a year, and Numetal was held ineligible because one of its shareholders was related to the promoters of ESIL. The National Company Law Appellate Tribunal (NCLAT) upheld this decision, but it was later overturned by the Supreme Court of India. The court held that the IBC's objective is not to disqualify resolution applicants but to ensure the feasibility and viability of the resolution plan. The court clarified the interpretation of the term "related party" under the IBC and held that it should be understood as a person related to the corporate debtor, not to a person related to the corporate debtor. The court also clarified that the IBC disqualifies a resolution applicant only if it is a promoter of a corporate debtor that has defaulted on its debts for over a year. The court directed the CoC to reconsider the resolution plans submitted by both the companies and to approve the most viable and feasible plan. This judgment provides clarity on the interpretation of various provisions of the IBC and highlights the need for greater clarity in the eligibility criteria for resolution applicants under the IBC.

Jet Airways (India) Ltd. v. State Bank of India[9]

The case involves India's first cross-border insolvency and was significant globally due to the involvement of Dutch authorities. Three petitions were filed against Jet Airways for corporate insolvency proceedings due to outstanding debt. The RP and the Dutch Trustee were asked by the NCLAT to explore the possibility of a joint 'Corporate Insolvency Resolution Process,' resulting in an agreement being reached on the proposed model. The parties submitted the final model to NCLAT for approval, which was accepted. Dutch authorities were allowed to participate in the creditors' committee, but they did not have voting rights. As per the cross-border bankruptcy protocol, both the Insolvency Professional and Dutch Trustees could consolidate their claims and review other processes grounded on the information attained. The NCLT Mumbai Bench accepted most of the "windup plan" and gave the consortium 90 days to obtain necessary regulatory approvals.

The NCLT's recent decision in this cross-border insolvency case highlights the need for uniform provisions within the Code for handling such cases involving foreign creditors or debtors. The Code's current provisions necessitate bilateral agreements with individual

[9] 2019 SCC Online NCLAT 1216

countries to enforce the Code's provisions, which can be time-consuming and increase the likelihood of conflicting claims. The final order in the case revealed shortcomings in the Code, particularly in the non-recognition of Dutch Court proceedings, leading to confusion and delays. Therefore, there is a growing demand for more comprehensive provisions to be included in the Code to deal with cross-jurisdictional insolvency cases.

Vidarbha Industries Power Ltd. v. Axis Bank Ltd[10]

The Vidarbha Industries case marked a significant departure from the previously widely understood interpretation of Section 7 of the Code. Prior to this ruling, established legal precedent dictated that the adjudicating authorities had to accept a financial creditor's application for the initiation of the CIRP under Section 7 of the Code only after verifying two conditions: the presence of a financial debt and an acknowledgment of the debt's default. However, the Vidarbha Industries judgment altered this stance by calling on adjudicating authorities to consider factors beyond the mere existence of financial debt and its default.

The Supreme Court, in its ruling, established that the NCLT had discretionary power under Section 7(5)(a) of the Code. It also noted that the mere existence of financial debt and default in payment only entitled a financial creditor to apply for initiation of CIRP, and the NCLT was required to consider other relevant factors before granting admission. These factors included the feasibility of initiating CIRP against an electricity generating company operating under statutory control, the impact of MERC's appeal pending in the Supreme Court, the order of APTEL, and the overall financial health and viability of the corporate debtor under its existing management.

The Court concluded that the use of the word 'may' in Section 7(5)(a) of the Code conveyed the legislature's intent to confer discretionary power to admit applications. In contrast, the word 'shall' imposed a mandatory requirement. The Court applied the principles of literal interpretation and emphasized that the NCLT must not exercise its discretionary power arbitrarily or capriciously. The objective of the Code was not to penalize solvent companies for a single instance of default of financial debt. Therefore, it was essential for the NCLT to investigate relevant factors such as the feasibility of initiating CIRP, the financial health and viability of the corporate debtor, and surrounding circumstances and arguments raised by the corporate debtor.

[10] (2022) 8 SCC 352

Critiques of the Code

IBC has been widely praised for its transparency, efficiency, and effectiveness in resolving insolvency cases. However, the implementation of the IBC has faced several challenges. One of the most significant challenges has been the lack of infrastructure and capacity in the system. The National Company Law Tribunal (NCLT), which is responsible for overseeing the insolvency proceedings under the IBC, has been facing a significant backlog of cases. The lack of sufficient judges and support staff has resulted in delays in the resolution process. In 2019, the government took steps to address this issue by increasing the number of judges and support staff in the NCLT.

Critiques have emerged regarding the implementation and impact of the IBC on various stakeholders. Delays in the resolution process have been a major concern due to the high volume of cases and legal challenges leading to cases being stuck in limbo for extended periods. The lack of clarity on the rights of stakeholders, particularly operational creditors, who may not have a seat at the decision-making table, is another critique. The impact of the IBC on small and medium-sized enterprises has been criticized due to the high threshold for initiating insolvency proceedings. The lack of infrastructure and capacity in the insolvency ecosystem, particularly in relation to adjudicating authorities and insolvency professionals, has been a significant issue. Finally, the IBC's impact on the banking sector, particularly public sector banks with high exposure to stressed assets, has been a concern as significant haircuts may have a long-term impact on their financial health.

The Insolvency Law Committee, in its Fifth Report[11] made recommendations to the Government on issues arising in the implementation of the Code such as mandating reliance on information utilities for initiation of insolvency process, exemptions from the scope of the Moratorium, and amendments to approve or reject a resolution plain within a stipulated time period. It also addressed the standard of conduct to be followed by the Committee of Creditors and conflicts of interest with resolution professionals.

Conclusion

The Code is viewed as an economic law which has brought perceptible behavioural change among debtors and has brought about a cultural shift in the dynamics and balance between

---

[11] Ministry of Corporate Affairs, *Report of the Insolvency Law Committee* (2022) Chapter 2 <https://ibbi.gov.in/uploads/resources/c6cb71c9f69f66858830630da08e45b4.pdf> accessed 4 April 2023

lenders and borrowers, and promoters and creditors. It has a significant impact on various economic factors such as credit growth, job retention, employment opportunities, and entrepreneurial activity, ultimately influencing the overall economic growth. Additionally, it also influences the risk-taking attitude of investors, banks, companies, and entrepreneurs. The current insolvency and bankruptcy law addresses all these crucial economic issues to some extent. Its implementation has already shown progress in these areas, and as the new framework becomes more established, further advancement is expected.