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CORPORATE INSOLVENCY REGIME IN INDIA

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In India, before the advent of the IBC the insolvency regime didn't exist in any uniform or structured manner, instead there were multiple legislations which overlapped and covered the field. The IBC regime in direct contrast presents a unified regime. The development in our country is traced in the subsequent sub-sections.[2]

PRE-IBC REGIME (1951-2016)

Before the IBC, the term 'insolvency' was not defined under Indian law, and neither was the term 'bankruptcy'. 'Bankruptcy & Insolvency' is Entry 9 in List III of the VII Schedule under Article 246 of the Constitution of India. The process of winding up of companies was regulated by the Companies Act 2013, and was done under the supervision of the NCLT. The Tribunal was mandated by certain conditions under Section 27 under which it should direct for the winding up of the company. The first of these conditions is the situation where the company is 'unable to pay its debts'. Which used to be the sub provision under which companies near to insolvency could be wound up. There were two sets of separate laws in India with respect to Insolvency in terms of individuals, partnership firms and unincorporated entities, and corporations. The Presidency Towns Insolvency Act, 1909 and Provisional Insolvency Act, 1920 were the two laws that had jurisdiction over personal Insolvency and have almost the same provisions, but they had different territorial jurisdictions.[3]

While Presidency Towns Insolvency Act, 1909 applied in the previous presidency towns, namely, Kolkata, Mumbai and Chennai, Provincial Insolvency Act, 1920 applied to the

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[2] 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).

[3]Aghion, P., Hart, O., & Moore, "Time to resolve Insolvency", J. (1992). *The economics of bankruptcy reform* (No. w4097). National Bureau of Economic Research

rest of India. It is important to mention that though the IBC has provisions for personal insolvency as well, they are still not notified and are not in force. Therefore, these previous laws continue to function till the time the relevant provisions of the IBC are not notified, even though technically they don't exist today. As per these archaic laws, Insolvency was treated as a crime and not as a normal business situation which may arise in the usual course of business. A debtor could commit an act of Insolvency, as if it were a crime.5 As mentioned above, the IBC is the first law to include every aspect of insolvency in a single legislation. Before its enactment the judicial process of resolution and liquidation was complicated, time-consuming and ineffective.

The previous legal and procedural framework relating to corporate Insolvency, is laid out by four major legal instruments, which are as follows:

• Companies Act 2013

• Sick Industrial Companies (Special Provisions) Act, 1985 [SICA]

• Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) Act, 2002, also popularly known as the Securitization Act

• Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDB Act) [Debt Recovery Tribunals are set up under this Act] As a result of the above, four different agencies, the High Courts, the Company Law Board/Tribunal, the Board for Industrial and Financial Reconstruction (BIFR), and the Debt Recovery Tribunals (DRTs), had overlapping jurisdictions, which created systemic delays and complexities in the process.

The decision to restructure the organisation or ultimately close it is taken by an entrepreneur only when a business doesn't grow profitably. Thus, the entrepreneur can either decide to wind up the company and release the investment, whatever is retrievable, or otherwise may also try to revive the company if the viability of such an enterprise is still feasible. The industries which "make losses that are more or less permanent and are not likely to be eliminated easily" are referred to as sick industries. Under usual circumstances, such units undertake widespread restructuring or are closed down to pinpoint and eliminate the activities or operations that are unprofitable in particular. To

resolve such situations, SICA was enacted.

Speedy remedial measures and the detection of industrial sickness were the priority of this enactment. Hence, it provided for setting up of a quasi-judicial body called Board for Industrial and Financial Reconstruction (BIFR), the purpose of which was to expedite the process of revival of units that are potentially viable units or else their closure. SICA was applicable to the industries specified in the First Schedule7 to the Industries (Development and Regulation) Act, 1951 (IDR Act).

The basic motivation of enacting a law like SICA was to adjudge sickness in the industrial units and to release locked up investment in sick industries. The objectives of SICA, as mentioned in the legislation are:

• To detect sick and potentially sick companies within time

• Speedy adjudication of the state of the company so that further action can be taken in respect of that company.

• The measure which has been so arrived above should be expeditiously enforced.8 SICA also provided for the constitution of another quasi-judicial body.[4]

BIFR was instituted as an adjudicating authority that was held responsible for taking appropriate measures for revival and rehabilitation of potentially sick undertakings and for liquidation of non-viable companies. At the same time, AAIFR was constituted for hearing the appeals against the orders of the BIFR. SICA, after being amended twice - first in 1991and later in 1998, was repealed and replaced by Sick Industrial Companies (Special Provisions) Repeal Act, 2003. The new Companies Act, 2013 attempted to reconcile SICA with the old Companies Ac, 1956 by repealing SICA and incorporating the repealed provisions into the Companies Act itself. This effort failed because the law, although passed, was never notified, and SICA continues to be operational. As per the SICA repeal Act of 2003, BIFR and AAIFR were dissolved and replaced by National Company Law Tribunal (NCLT) and National Law Appellate Tribunal (NCLAT) respectively. The NCLT subsequently could only be constituted by the Companies Act

[4] Aghion, P., Hart, O., & Moore, J. (1992). The economics of bankruptcy reform (No. w4097). National Bureau of Economic Research

2013, which came into effect from 1st June 2016.[5]

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFESI Act), was enacted with a purpose to provide more teeth to the recovery process in cases where the debtor has defaulted against a secured creditor. This is one of the pre-IBC laws which still remains functional today, due to separate fields of operation.

Rights like the seizure of the secured asset and, subsequently, sale of the same were conferred upon a secured creditor. This process under SARFESI served as an efficient proxy to the time consuming and costly judicial process. The banks under SARFAESI were vested with wide powers and they can:

• Take possession of the secured assets of the borrower. This includes the right to transfer by way of lease, assignment or sale of the same for realization of the secured debt.

• Take over the management of the secured asset including the right to transfer by way of lease, assignment or sale of the same for realization of the secured debt.[6]

• Appoint any person to manage the secured asset.

Under the SARFESI Act, a Securitisation Company (SCO) and a Reconstruction Company (RCO) are constituted as special purpose vehicles. These are registered companies under the Companies Act, whose main objectives are securitization and asset reconstruction. The SARFESI Act deals with three aspects broadly:

1. Enforcement of Security Interest by secured creditor (Banks/Financial Institutions)

2. Transfer of NPAs to RCO, which will then liquidate them and realize the proceeds.

3. To enact a legal framework for securitization of assets.

Under Section 13 (1) of the SARFESI Act, "security interest created in favour of any

[5] Joseph, A. L., &Prakash, M. (2014). “A study on analyzing the trend of NPA level inprivate sector banks and public sector banks. International Journal of Scientific and ResearchPublications”.

[6] Bakshi, P.M. and Kashyap, S.C., 2012. The constitution of India. Universal Law Publishing.

secured creditor may be enforced, without the intervention of court or tribunal, by such creditor in accordance with the provision of this Act." This is one of the most important provisions of the Act, where the jurisdiction of the court has been cut out. Due to this provision, the law came under heavy criticism as a draconian law

LIMITATIONS OF PRE-IBC REGIME AND THE NEED FOR REFORM

Delays in insolvency resolution were put on record by The Bankruptcy Law Reforms Committee in 2015. The primary reason for such delays is the multiplicity of jurisdictions of different authorities and laws and the lack of clarity in the overall law for Insolvency. A comparative perspective on this issue sheds the light on the gravity of the situation. If we compare the average time taken for an insolvency resolution to conclude, in India, it takes 4.3 years on an average, whereas, in the United Kingdom, it takes one year, in the United States of America its 1.5 years, and in South Africa, it stands at two years.

Further, the courts are also impaired in terms of their capacity, and even more time is taken by them to deliver the judgements by the courts and tribunals. For instance, the number of cases pending before the Debt Recovery Tribunals are 62,000 as on December 2014, and ironically the number of cases that were disposed of were just 10,000, i.e., just about 16.1 per cent of the pending cases. The whole purpose of the IBC is to consolidate the existing law of Insolvency in India. The first step to accomplish this would be to notify the repeal of the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 2017. [7]

IBC 2016

The IBC brought about major structural changes with itself. It can be better understood through an example of amendment which it made in the Companies Act, 2013. We have seen above that under the Companies Act, the British position had been followed. A company could be wound up if there is no ability left in it to pay off its debt. As was mentioned earlier, this places the courts in a complicated position. There are now two questions of facts that the court needs to ascertain. First, it is the existence of the debt. The court must find out whether or not there exists a debt. This is a question that can be

[7] Joseph, A. L., &Prakash, M. (2014). “A study on analyzing the trend of NPA level inprivate sector banks and public sector banks. International Journal of Scientific and ResearchPublications”.

easily settled through regular documentation, with which the judicial process is usually accustomed. The problem rests with the second question, which is finding out the 'ability' to pay off the debt that exists.

It is not a simple question of finding an occasion on which the company didn't pay what was due, but whether it has the financial capacity to pay or not becomes the question. The company might have defaulted on a particular payment, but the court cannot order any winding up unless and until it makes sure that the company has also lost its financial capacity to pay. This is an uncalled-for task for the courts. As discussed earlier, in order to find this ability, mere legal knowledge is not sufficient, but knowledge of finance and economics is also required. Hence, the framing of law in this style became an impediment to the effective functioning of the courts. This was remedied in the IBC. Through the operation of Section 255 of the IBC, Section 271 of the Companies Act was amended, and the above-reproduced provision was deleted. The process of dealing with corporations that are not in a position to repay their debt was entirely shifted to the IBC. It is now pertinent that relevant provisions of the IBC are also examined.

The entire law of Insolvency in a given jurisdiction very intrinsically depends upon how Insolvency and bankruptcy are defined, understood and how its procedures are framed. The IBC also amends multiple laws, including and more importantly, the Companies Act, 2013, DRT Act, 1993 and SARFAESI Act, 2002. The Act provides a framework for the time-bound insolvency resolution process. It enunciates two separate but similar processes for (i) companies and limited liability partnerships; and (ii) for individuals and partnership firms. The IBC has also created the following new institutions for an effective administration of the framework:

Insolvency Professionals - A particular cadre of certified professionals recognized as insolvency professionals (IPs) are fashioned to handle the process of insolvency resolution. These I.P.s are supposed to execute the insolvency resolution process by taking over the management of the debtor company and also by assisting the creditors in collating the relevant information and the management of the process of liquidation. The IBC has created a model of insolvency regime where the promoters of a company are ousted during the resolution process, and the powers of management are vested into a

neutral third party, which the I.P.s are supposed to become. Insolvency Professional Agencies (IPAs)–IPAs are independent bodies that enrol the I.P.s.

The IPAs are supposed to follow an enrolment process like conducting examinations, certifying I.P.s, and enforcing an Act of conduct for the functioning of I.P.s. Moreover, an IPA is supposed to furnish a performance bond to the regulator, which is the Insolvency and Bankruptcy Board of India (IBBI), as soon as the insolvency resolution commences through a member I.P. This bond will serve as a surety against any misconduct by the I.P. for the duration of the resolution process. A guarantee against the misconduct is necessary because the I.P. is supposed to perform a very critical job in the resolution process[8]

Information Utilities–The primary function of Information utilities will be to collect, collate and disseminate financial information related to debtors. This information will serve as evidence for initiating insolvency proceedings. This information can be collected from creditors through records of debt, liabilities etc.

Insolvency and Bankruptcy Board of India - The IBC has established an Insolvency and Bankruptcy Board of India which serves as a regulator to supervise the functioning of the insolvency regime, which includes IPs, IPAs and individual resolution processes. Also, as per the provisions of the IBC, the interim functions of the Board can be discharged by a financial sector regulator (such as RBI, SEBI etc.). Adjudicating Authorities – Under the scheme of the IBC, two judicial authorities are envisioned for the following purposes: (i) To assess the applications which are put forward for initiating insolvency proceedings (ii) for the approval of appointments of the I.P.s, and (iii) for the approval of resolution plans. National Company Law Tribunal (NCLT) is the authority that is vested with the power to adjudicate cases for companies and limited liability partnerships and is the Adjudicating Authority for them. National Company Law Appellate Tribunal (NCLAT) is the authority that will hear appeals from the NCLT and is thus referred to as the Appellate Authority. Debt Recovery Tribunal (DRT) is the authority, which is vested with the responsibility to adjudicate cases for individuals and partnership firms, that is, personal Insolvency. Debt Recovery Appellate Tribunal (DRAT) will hear appeals against the orders of DRT.

[8] Aghion, P., Hart, O., & Moore, J. (1992). The economics of bankruptcy reform (No. w4097). National Bureau of Economic Research

INSOLVENCY RESOLUTION PROCESS

The insolvency resolution process envisaged by the IBC for corporates has four stages. A brief overview of the order is as follows:[9]

i. Initiation: The resolution process is initiated on an application by the creditors or the debtors to the Tribunal. The process is to be mandatorily completed within a period of 180 days from the day of the approval of the application. The limitation period may be extended by the Tribunal for an additional 90 days. During the proceedings, the creditors will have no claim upon the Debtor, and no lawsuits will be valid.

ii. Appointment of R.P.: As soon as the resolution process starts, the creditors or the Tribunal appoint an I.P. for the discharge of the following functions: (i) the management of the affairs of the corporate Debtor, (ii) the powers of the Board of directors or the partners of the corporate Debtor, as the case may be, and (iii) constitute the committee of creditors.[10]

iii. Creditors committee: A committee consisting of financial creditors will be constituted for taking decisions regarding insolvency resolution. Financial creditors may either be: (i) secured creditors, whose loans are backed by collateral (security), or (ii) unsecured creditors whose loans are not backed by any collateral. The creditors committee will take decisions by a 75% majority. It will oversee the management of the Debtor's assets and appoint a permanent I.P. to conduct the resolution process.

iv. Resolution: The creditors committee will decide to (i) restructure the Debtor's debt by preparing a resolution plan or (ii) liquidation of the assets of the Debtor to repay the loans. If no such decision can be concluded through the resolution process, the assets of the debtor assets will be liquidated to repay the debt.[11]

v. Approval of plan: The I.P. is supposed to submit the resolution plan to the Tribunal after it has been approved by the committee of creditors. The plan will be approved by the

[9] Joseph, A. L., &Prakash, M. (2014). "A study on analyzing the trend of NPA level inprivate sector banks and public sector banks. International Journal of Scientific and ResearchPublications".
[10] Bakshi, P.M. and Kashyap, S.C., 2012. The constitution of India. Universal Law Publishing.
[11]Fooladi, M., & Nikzad Chaleshtori, G. (2011, June). Corporate governance and firm performance. In International Conference on Sociality and Economics Development (ICSED 2011), Kuala Lumpur, Malaysia, June (pp. 17-19)

after satisfaction of certain criteria which include, the certainty that the operational creditors have received as much as they were entitled to. The resolution is supposed to be subsequently implemented. For the companies where the resolution is successful, the insolvency process concludes. But for the companies where there was no successful resolution plan, the corporation is put through the liquidation process.

vi. Liquidation: During the liquidation process as well, an effort is made to salvage a corporation as a going concern. If a sale cannot happen at this stage, too, then the corporation is subjected to dissolution. The amount so realized will be used to repay outstanding dues, whatever possible. The order of the discharge of the financial obligations of the Debtor will be:

(i) The costs incurred by the resolution process and the fees of the I.P.,

(ii) secured creditors (usually banks) and up to 12 months of worker dues,

(iii) employee wages (up to 12 months),

(iv) unsecured creditors,

(iv) dues to government and remaining debt owed to secured creditors (residual amount if the creditor enforces his security),

(v) any remaining debt, and

(vii) shareholders.

EFFECTIVENESS OF INOSLVENCY LAWS

The IBC has been enacted relatively very recently in the year 2016. Thus, there is no literature present directly or indirectly present which concerns around the issues which are investigated in this thesis. As has been mentioned earlier, IBC is a law which has certain underlying economic objectives, and is consequently based on those economic principles. Thus, IBC is considered to be a legal reform from the point of view of the economy. Accordingly, literature is firstly available from other countries wherein a similar reform has been carried and the consequences that followed after the introduction of such a reform. Herein, literature from similarly placed developing countries to India,

where comparison makes more sense, like Columbia and Thailand has been referred.[12]

Secondly, literature is also available on the general notion of relationship between legal and regulatory framework and the performance of the financial sector and the economy. The concerned legal and regulatory framework in these studies is not always the legislative framework concerning insolvency or bankruptcy, instead the general legal framework dealing with corporate behaviour and governance.

Thirdly, literature is also available with respect to the regime in India which existed before the enactment of the IBC, which explores the problems with the previous regime and takes us to the logic of implementation of IBC. The series of studies which have been referred here first explore and establish a strong relationship between the legal and regulatory framework and the performance of the financial sector. Subsequently, other studies explore the relationship between the legal framework and the commercial contractual terms which are granted and argue that a better legal framework leads to better commercial terms in a contract.[13]

On Insolvency law and value realisation, literature proves that a positive relationship exists between the two. The same has been proven by other studies which have studied the impact in developing countries like Thailand and Columbia as well as developed countries like Belgium. The case for reform in pre-IBC insolvency regime in India has been made out by literature which has dealt with the problems in the previous regime like of pendency in courts and no time bound process for disposal of cases. One study has categorically found out that the attitude of the judges was critically responsible for the pre-IBC regime.

Having established that the insolvency law reform is critical for the performance of the financial sector and the growth of economy, a prima facie case for insolvency law reform is made out as it is. The same is substantiated further by studies relating to comparable countries. However, it is also proven by literature that the legal reform can be undone by

[12] Core, John E., Wayne R. Guay, and Tjomme O. Rusticus. "Does weak governance cause weak stock returns? An examination of firm operating performance and investors' expectations." the Journal of Finance 61, no. 2 (2006): 655-687.

[13]Fooladi, M., & Nikzad Chaleshtori, G. (2011, June). Corporate governance and firm performance. In International Conference on Sociality and Economics Development (ICSED 2011), Kuala Lumpur, Malaysia, June (pp. 17-19)

the interpretations of the law by the judges. Accordingly, the concern of the present thesis is given validity which deals with the interpretations which the judges have given to the provisions of the IBC.

PERFORMANCE OF IBC

The performance of the resolution process under the IBC process is analysed through the status of the cases that have been filed before the NCLT and the outcomes in such cases. There are broadly two outcomes that are possible in any case; (i) The debt is either resolved by all the stakeholders, and such resolution is approved by the NCLT. If this is the outcome, then it can be regarded as a successful resolution process; (ii) there may be liquidation of the company, where the company may be dissolved34, and its assets are sold to provide its creditors whatever capital is recoverable in the situation. Liquidation can be regarded as an undesirable outcome because if the company is not saved, employees lose their jobs. However, another measure of performance is the capital which is recovered from the operation of law. It may be possible that even in the case of Liquidation, if all the claims of the creditors are met with, it is relative success of the procedure. On the basis of these factors, the following analysis has been done. The Corporate Insolvency Resolution Process (CIRP) as enumerated under the IBC starts with the filing of an application. It concludes with either a resolution plan being passed or an order of liquidation. The Insolvency and Bankruptcy Board of India (IBBI) releases data on the number of applications being filed, the nature of applicants, the status of the cases, the outcome of in these cases etc. This data is analysed in the following sub-sections as it relates to the various stages of the CIRP

ADMISSION AND ADJUDICATION

The first section deals with the filing of application for the initiation of the insolvency process. The primary issues dealt in this section are the differential treatment of the FCs and the OCs, the adjudication on what is financial debt and how it is related to time value of money, with respect to OCs what's the meaning of a pre-existing dispute and whether it will impair the application. Second section deals with withdrawal of the application, if and when should a withdrawal be allowed. The most prominent issue being dealt with in this section is whether there should be any withdrawal in the first place, because the process once started by one creditor makes every creditor a stakeholder.

Originally the IBC didn't allow any withdrawal, but it was later amended to allow the same. This section examines how have the courts approached this issue. Third section deals with the issues arising due to statutory prescription of a time limit for the completion of the process. The judiciary has found it problematic to adhere to the time limit because of the pendency of so many cases. The courts have tried to exempt themselves whereas amendments in the law have emphasized on the sanctity of the time limit. The fourth section deals with one of the most important parts of the IBC which is the moratorium and how the courts have approached when it comes in conflict with other laws. The IBC envisages that during the resolution process no litigation should be carried on or instituted against the company, instead, all proceedings should be consolidated in the form of claims under the insolvency process. This has been implemented through a provision of moratorium which grants a blanket stay. For this very reason it has frequently come in conflict with other laws, especially where the government agencies are entitled to recover dues like taxes from the company.[14]

ADMINISTRATION UNDER THE IBC.

The organisation is divided into six parts. The first part deals with the role of interim resolution professional in the resolution process. The IRP is appointed by the NCLT the moment it admits the application against the company. The IRP replaced the management of the company and takes control of the day to day affairs of the company. Thus, there has been substantial litigation on what all the IRP is authorised to do and what remains outside scope of its powers. The same is covered in the first part. The second part deals with the claims. Since a company undergoing insolvency resolution process usually has many claimants, it is a very complex job to compile all the claims. This is an important function for two reasons.

First, because this gives an idea of the total amount of the liability of the company and second, since only when a person's claim is accepted they are recognised as a creditor, and accordingly given powers in the process. Therefore, many cases have come up before the courts which have dealt with the question on when a claim may or may not be accepted. The third part deals with the duties and functions of the Resolution Professional

[14] "Time to resolve Insolvency", World Bank, Aghion, P., Hart, O., & Moore, J. (1992). The economics of bankruptcy reform (No. w4097). National Bureau of Economic Research

(RP). The IRP no longer remains an 'interim' RP if it is confirmed by the CoC. This issue itself has seen a number of cases which deal with under what conditions the IRP should be or should not be confirmed as the RP, along with other issues like what actions of RP require CoC authorisation etc. The fourth part covers the powers and functions of the CoC. The Indian insolvency law model is creditor in control and hence, CoC is vested with the final authority on taking commercial decisions relating to the corporate debtor's day to day business as well as the final fate of the corporate debtor. The primary issues which has been litigated are the disputes among the various members of the CoC, on what decision to take.[15]

The creditors with a minority voting share have often approached the NCLT about this. The fifth part of this chapter deals with Section 29A, which provides for persons who are ineligible to introduce a resolution plan. This provision has become very contentious because it was inserted through an amendment and debars persons who are related or connected to the corporate debtor. This has entailed substantial litigation on the point whether a person is connected to the corporate debtor or not and what is the test for determining the connection. The sixth part of the chapter deals with Resolution Plan. These provisions of the IBC have been litigated intensely because persons whose resolution plans have failed have challenged the decisions of the CoC in front of the NCLT. The Courts have developed complicated jurisprudence on how they would be hearing challenges to the CoC decisions in such cases.[16]

[15] Core, John E., Wayne R. Guay, and Tjomme O. Rusticus. "Does weak governance cause weak stock returns? An examination of firm operating performance and investors' expectations." the Journal of Finance 61, no. 2 (2006): 655-687.

[16] Bakshi, P.M. and Kashyap, S.C., 2012. The constitution of India. Universal Law Publishing.