VOLUME 4 | ISSUE 3

INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH

UNVEILING MALPRACTICES: THE DARK SIDE OF RESOLUTION AND LIQUIDATION UNDER IBC, 2016

- Mulanshu D. Vora & Shloak S. Sanghvi[1]

ABSTRACT

The Insolvency and Bankruptcy Code (IBC) was enacted to provide a comprehensive framework for resolving insolvency and bankruptcy issues in India. It aimed to rescue failing companies, individuals, and partnerships while expediting the recovery of debts owed to creditors. However, despite its noble intentions, the IBC is susceptible to various malpractices during the liquidation and resolution processes. With the help of this article, we delve deeper into the numerous malpractices involved during the insolvency proceedings, highlighting the necessity for a robust and stringent framework to maintain the integrity of the Act, further emphasising the importance of ensuring fair and transparent insolvency proceedings for all the stakeholder involved.

Keywords: *Insolvency, Bankruptcy, Malpractices, Auctions, Insolvency & Bankruptcy.*

INTRODUCTION

Insolvency & Bankruptcy Code, 2016 was propounded to save dying companies, insolvent individuals and partnerships, and if there was no hope of saving them, then to facilitate & expedite the process of recovery of monies lent to debtors by Banks, Financial Institutions and Creditors through liquidation. Materializing IBC took a lot of trial and error. IBC has tried to be as foolproof as possible, but it is still a victim of malpractices carried out by corporate debtors, directors of dying companies, liquidators, and so on. Before the government introduced the Insolvency & Bankruptcy Code, 2016 the framework and laws relating to insolvency and bankruptcy were fragmented; no solid code was found to remedy

[1] Students at KC Law College, Churchgate

the loss-taking creditors; this was a significant issue to corporate creditors, and they found themselves with no ironclad answer to their problems. Their NPAs kept piling up, and they did not see a way out; the government tried to fill the lacunas of this problem by introducing the Recovery of Debts and Bankruptcy Act, 1993 and SARFAESI Act, 2002, although the situation changed by 2016 the NPAs accumulated over all these years amounted to the tune ofINR 6,119.5 billion.Even though IBC is not a perfect code, it has still heralded a paradigm shift in debt recovery. IBC has resolved 891 cases till 2023 involving bank loans worth 10 lakh crore while facilitating recovery of up to 3.2 lakh crore[i]. IBC's first & foremost goal was to help recover money from creditors by rejuvenating the company. Still, according to the data provided by IBBI, out of the 3400 plus cases admitted under IBC, more than 50% of cases have resulted in liquidation, and only 14% of cases have accomplished resolution. Identifying the malpractices that impede the purpose of IBC is crucial to safeguarding the interests of all the stakeholders involved.

Let's understand what Resolution and Liquidation mean.

RESOLUTION

Resolution under the IBC begins with the appointment of a Corporate Insolvency Resolution Professional (CIRP) upon admission of an insolvency application by the NCLT. The CIRP takes charge of the company's operations and works towards formulating and implementing a resolution plan. The resolution process involves inviting prospective resolution applicants to submit plans for restructuring the company's debts and operations. These plans are evaluated by the Committee of Creditors (CoC), and if a viable plan is agreed upon, it is submitted to the NCLT for approval. The NCLT assesses the resolution plan to ensure it complies with the requirements of the IBC and is in the best interests of creditors and stakeholders. Once approved, the resolution plan becomes binding on all stakeholders, and the resolution applicant takes over the company's management to implement the plan. The objective of the resolution is to revive the company as a going concern, preserve its value, and maximise the recovery for creditors. It may involve debt restructuring, asset monetisation, infusion of funds, or management changes. Overall, the resolution process aims to balance the interests of creditors and stakeholders while preserving the company's economic value and promoting sustainable growth.

LIQUIDATION

Liquidation is initiated when a company fails to resolve its financial distress through a resolution plan or other means. Once it is determined that liquidation is necessary, the company's affairs are wound up under the supervision of a liquidator appointed by the National Company Law Tribunal (NCLT). The liquidator takes control of the company's assets, sells them off, and distributes the proceeds among creditors and shareholders according to the waterfall mechanism prescribed in the IBC. Secured creditors are typically paid first, followed by unsecured creditors, and finally, shareholders. The liquidation process aims to maximise the recovery of funds for creditors while ensuring a fair and orderly distribution of assets. It involves conducting investigations, realising assets, settling claims, and ultimately dissolving the company. Under liquidation, the powers of the company's board of directors cease, and the liquidator assumes responsibility for managing and administering the company's affairs until its dissolution. The process is governed by strict timelines and procedures outlined in the IBC to ensure transparency and accountability.

TYPES OF MALPRACTICES

1. **Violation of sanctity of auction by liquidators**:

a. Many times, there have been instances where liquidators have convened the corporate debtor's sale process unlawfully, i.e., unlawfully evading a public auction or improperly and unfairly conducting a private sale to benefit another party. In ***Hira International Ltd. vs. Girdharilal Allied Sugar Industries Ltd.*** [ii], NCLT Indore has held that ***"The private sale as a mode of sale is meant for a situation when the auction gets failed, and not for the situation when the Liquidator by its illicit actions didn't let the auction to take place at all, like the present case."***

b. Another instance is where the liquidator cancelled a valid sale through a public auction. The liquidator had confirmed the sale via email. After confirming the sale, the liquidator feared he could fetch a higher price if he held another auction in***Eva Agro Feeds Private Limited V. Punjab National Bank &Anr.*** [iii]the Supreme Court held that "***mere expectation of the Liquidator that a still higher price may be obtained can be no good ground to cancel an otherwise valid auction and go for another round. Such a cause of action would lead to the incurring of avoidable expenses and erode the credibility of the auction process. Apart from post-auction, it is not open to the Liquidator to act on third-party communication and cancel an***

auction unless it is found that fraud or collusion had vitiated the auction. The necessary resultfrom that place is that there can be no absolute or unfettered discretion on the Liquidator's part to cancel an otherwise valid auction."

2. **Leaking valuation reports of the company undergoing liquidation:**

a. When the valuation report of a company undergoing liquidation is leaked, the sanctity of the liquidation process is violated, and such a leak goes against the letter and spirit of the Code. Recently, the NCLAT in ***M/s. Kineta Global Limited vs. M/s. IDBI Bank Ltd***[iv]has emphasised the confidentiality of such reports:***"One cannot remain in oblivion of a prime fact that the aforesaid 'Regulations' read in conjunction with Regulation 21 of the Insolvency & Bankruptcy Board of India (Insolvency Professionals Regulations, 2016) unerringly points out that an Insolvency Professional is to ensure that information to be of confidentiality in character about the Insolvency Resolution Process, liquidation or bankruptcy process and the same is to be maintained at all points of time."***

3. **Malicious and fraudulent initiation of CIRP:**

a. It is intriguing to know how far the corporate debtor may fall to avoid paying their dues by circumventing the provisions of IBC and using them for their gain. ***Wave Megacity Centre Private Limited v. Rakesh Taneja***[v] is an example. Here, the appellant applied Section 10 of the Code, praying for the initiation of CIRP on the grounds of default on the part of the corporate debtor. The respondents then filed an application under section 65 seeking rejection of the application filed by the appellant under section 10. The Hon'ble NCLT rejected the application under section 10. Aggrieved by this order, the appellant approached NCLAT. The Hon'ble NCLAT noted that one of the directors, the director of the appellant company right from the company's genesis, had resigned and had transposed himself as a financial creditor before applying section 10. While rejecting the appeal, the Tribunal held that ***"When finding recorded by the Adjudicating Authority is that Section 10 Application has been initiated fraudulently and maliciously, even if there is debt and default, the Adjudicating Authority is not obliged to admit Section 10 Application. Sections 10 and 65, which are part of the same statutory scheme, need to be read together to give effect to the legislative scheme of the Code. If CIRP is initiated by a corporate***

applicant fraudulently with malicious intent for any purpose other than insolvency resolution, holding it that the Adjudicating Authority must admit Section 10 Application will be contrary to the statutory scheme under Section 65. If conditions under Section 65 are fulfilled, the Section 10 Application can be rejected, even if debt and default are proved. Thus, Section 65 has to be read as enabling a provision to reject an application even on proving of debt and default Section 10 Application is not to be obligatorily admitted. In the present case, ithas been held that the Application under Section 10 has been maliciously and fraudulently initiated for a purpose other than resolving insolvency."

4. **Violation of Duties by Resolution Professionals or Insolvency Professionals**

The Insolvency and Bankruptcy Board of India's Disciplinary Committee has taken action against several resolution professionals for breaching rules and regulations. ***In the Disciplinary Proceedingsconducted by the Disciplinary Committee of IBBI of Mr Mukesh Mohan[vi], an Insolvency Professional, the committee had his license cancelled,*** and he was debarred from taking on new assignments for a decade due to severe breaches of duty. This included misleading the NCLT during four different Corporate Insolvency Resolution Process (CIRP) proceedings. Similarly, ***in the Disciplinary Proceedings[vii] conducted by the Disciplinary Committee of IBBI of Mr Rajiv Chakraborty, an Insolvency Professional***, the resolution professional was suspended for employing both an accounting firm and a law firm, resulting in overlapping services that exacerbated the burden on the distressed corporate debtor. This disregard for established rules highlights these resolution professionals' significant duty violations.

5. **Unfair tactics adopted by secured creditors**

In a troubling case underscoring the prevalence of malpractices within resolution and liquidation processes, the actions surrounding ***Mercator Petroleum Limited (MPL) and UTI Capital[viii]*** came to light. The Resolution Professional (RP), Mr Gupta, has brought forth allegations, including the inflation of dues through dubious means and the imposition of exorbitant interest rates. These allegations point to potential breaches of regulatory frameworks and raise concerns regarding UTI Capital's dual role as both a creditor and a prospective resolution applicant, suggesting a significant conflict of interest. Moreover, discrepancies in disclosed amounts and questionable practices, such as charging interest

during a COVID-19 lockdown period in defiance of Supreme Court rulings, further highlight the need for vigilance and accountability in such proceedings.

6. **Committee of Creditors (CoC) attempting to prioritise its debts over statutory dues:**

In a troubling trend observed in insolvency proceedings, the Committee of Creditors (CoC) has been seen attempting to prioritise its dues over statutory obligations, thereby neglecting the repayment of government dues. This practice raises significant concerns regarding fairness and adherence to legal principles within the insolvency framework. The judgment of the Supreme Court in the case of ***State Tax Officer v. Rainbow Papers Ltd***[ix]**.**Underscores the importance of prioritising statutory dues over other debts in insolvency proceedings. The Court emphasised that government dues, such as taxes and other statutory obligations, are considered secured debt under the Insolvency and Bankruptcy Code (IBC). Thus, attempts by the CoC to prioritise its dues at the expense of statutory dues constitute a malpractice or unfair practice. Such actions undermine the integrity of the resolution process and deprive government authorities of crucial revenue, impacting public services and governance. Furthermore, the Supreme Court upheld the priority in repaying government dues in insolvency proceedings in a recent judgement delivered in the case of ***Sanjay Agarwal v State Tax Officer*** [x]

7. **Misuse of Moratorium Period provided to the Corporate Debtor:**

The process of CIRP is accompanied by a moratorium period. The so-called moratorium period is imposed so that the assets of the CD do not vaporise quickly and can run as a going concern,ensuring maximum value for the company's stakeholders. During the moratorium period, the creditors are legally barred from recovering their monies from the CD. This shield provided to the CD is often misused by them and used to justify not fulfilling their non-monetary obligations, judgments, or decrees for specific performance. There was a void in the Code around this topic due to a lack of judicial decisions on this subject matter. This void was filled by the Hon'ble Madras High Court when a division bench heard a writ petition filed by a law student against MCA & IBBI and passed a crystal clear judgment. In the view of the Court, the execution of decrees obtained before the initiation of CIRP would remain unaffected by the imposition of a moratorium. In ***V.R. Swetha Naidu v. The Secretary to Government***[xi]**,**the MHC held that ***"a third party does not fall in the definition of "creditor"***

and would be treated differently for subsisting contractual obligation to make the payment to the corporate debtor, which may be under a decree for specific performance, as a party therein does not fall within the definition of "creditor" and thereby it will not come within the sweep of Section 14 of the Code." With this judgment, the proposition of law regarding the fulfilment of the non-monetary obligation of CD during the moratorium period is well settled.

8.Corporate Debtors/Financial Creditors indulging in Forum Shopping:

Corporate debtors and creditors may engage in forum shopping during insolvency proceedings as a strategic manoeuvre to secure a favourable outcome. Forum shopping involves seeking relief from different courts or tribunals until a desired judgment or resolution is obtained. By exploiting variations in legal interpretation or procedural differences between jurisdictions, debtors and creditors may attempt to manipulate the insolvency process to their advantage, undermining the fairness and integrity of the resolution proceedings. In the case of ***SRV Techno Engineering Pvt. Ltd. v Purvanchal Vidyut Vitran Nigam Ltd,***[xii] the NCLT, Allahabad held that ***"after the Operational Creditor has approached the grievances committee of MSME tribunal resulting into referring the dispute to the Arbitrator as per the scheme envisaged under the MSME Act/ Rules, and the arbitrator thus has finally decided the dues of the Operational Creditor as against the Corporate Debtor, the process of determination of the dues has thus already gone into. Once the Arbitrator and the award have been adjudicated, the dispute has been passed in favour of the Operational Creditor to the extent of the amount mentioned in the award itself. The Operational Creditor cannot be allowed to go for forum shopping and rake up the issue to make a case for an alleged default against the Corporate Debtor U/s 9 of the Code for the remaining amount,if any."***

CONCLUSION

The Insolvency and Bankruptcy Code, 2016, introduced to rescue failing companies and expedite debt recovery, has faced a myriad of malpractices, threatening its efficacy. From corporate debtors misusing moratorium periods to stakeholders manipulating resolution and liquidation processes, these practices challenge the integrity of the insolvency framework. While the Code has made significant strides in resolving cases and facilitating recovery, the prevalence of malpractices necessitates robust regulatory oversight. Addressing these issues

promptly is crucial for ensuring fair and transparent insolvency proceedings. Judicial vigilance is also essential to uphold legal principles and maintain trust in the system. However, the persistence of malpractices highlights the Code's ongoing evolution. Many cases remain unresolved, reflecting the complexity of the process. Additionally, creditors are often forced to accept significant loan haircuts, revealing the system's limitations. A comprehensive regulatory framework and stringent oversight are necessary to address these challenges. Furthermore, enhancing the competence and integrity of Resolution Professionals through training and filtering mechanisms is vital. Only through these efforts can the Insolvency and Bankruptcy Code evolve into a more effective tool for corporate restructuring and debt resolution in India.

BIBLIOGRAPHY

i. **https://www.newindianexpress.com/business/2024/Feb/20/ibc-resolves-891-cases-involving-rs-10-lakh-crore-loan-defaults-till-dec-23**
ii. TP 182 of 2019 [CP(IB) 591 of 2019]
iii. 2023 10 SCC 189
iv. 2024 SCC OnLine NCLAT 73
v. 2023 SCC OnLine NCLAT 50
vi. IBBI/DC/07/2018
vii. IBBI/DC/85/2022
viii. IA. No. 1124/2023 In CP(IB)No. 3434/MB/C-V/2019
ix. 2023 9 SCC 545
x. 2023 INSC 963
xi. W.P.No.21277 of 2022
xii. CP (IB) No.486/ALD/2019