Insolvency and Bankruptcy Code, 2016: The Journey and The Destination

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It was at the time when the financial status of the banks had hit rock-bottom with the bad-debts accruing to a level from which revival was difficult, that the country drafted the new Insolvency and Bankruptcy Code, 2016. It was considered to be more comprehensive legislation that consolidated the provisions of the myriad statutes that were relevant in the field. The paper examines the birth and the journey of the Code, by touching upon different aspects, from the backdrop of its advent to the aims and objectives it seeks to achieve and finally giving way to a critical analysis of the legislation. The author has tried to compile the various phases that have been undergone by the said legislation and give a holistic and unbiased view on its level of efficacy.

Introduction

Drafted by the Bankruptcy Law Reforms Committee, the Insolvency and Bankruptcy Code, 2016 came as a harbinger of big news to the corporate world. The Code with its advent went on to repeal nearly 12 archaic legislations and thereby becoming a true game changer in the corporate and economic arena.

The Code was put forth at a point when the financial status of the banks had hit rock-bottom with the bad-debts accruing to a level from which revival was difficult. Going by the data shared by Assocham (Associated Chambers of Commerce of India)[1] the stressed assets of the banks stood at Rs.10 trillion at the end of the 2015-2016 fiscal year. Stressed assets comprise NPA, restructured loans and written off assets. Of this, the non-performing loans alone stood at Rs.6.3 trillion.[2] Thus, not just the banking sector but the financial infrastructure of the country as a whole, as well as it's business environment had been in a trench. Therefore a reform in the field of legislation, by doing away with the several overlapping and obsolete legislation, proved essential to uplift them.

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1 Wharton University, Pennsylvania, 'Is India's New Bankruptcy Law a Game-changer?', *23* May 2016, *Knowledge Wharton Official Website* available at http://knowledge.wharton.upenn.edu/article/indias-new-bankruptcy-law-game-changer/, accessed on 23 January 2018.

2 Dev Chatterjee & Avishek Rakshit, 'Banks' finance to improve this year-end', 19 October 2016, Business Standard Official Website available at http://www.business-standard.com/article/finance/banks-finances-to-improve-by-this-year-end-116101900007_1.html, accessed on 23 January 2018.

Technically, the factors that push for the need for new legislation in this field, move in a perpetuate circle. To begin with, it is interesting to note that, these concepts find themselves falling under the ambit of several jurisdictions and the laws relating to the same were not in a consolidated form. Starting from the Presidency Towns Insolvency Act, 1909 to the latest Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002 and the Companies Act, 2013, they find mention in several legislations and regulations. Due to this overlap, several institutions also had jurisdiction in the insolvency and bankruptcy process. The Company Law Board, the High Courts, the Debt Recovery Tribunals and the Board of Industrial and Financial Reconstruction dealt with the insolvency of entities they govern, which led to the problem of concurrent jurisdiction, systemic delays, and other related complexities.[3]

Ineffective Laws and their Replacement

Kristin van Zwieten, in her work "Corporate Rescue in India – The Influence of the Courts"[4] talks about the inherent flaws in our previous legislation that governed issues of insolvency and bankruptcy. She points out that implementation of statutes like the Sick Industrial Companies Act (SICA), 1985 and the judicial and legislative innovations in the same, were key players in the delay in the winding up process. Most of these legislations were highly in favor of the debtors and hence resist the easy liquidation of even those businesses that prove extremely unviable. This was mainly seen from the title and provisions of SICA, which dealt with damage by the company (debtor or defaulter) only at its terminal stage. To be more precise, repair work was undertaken only when the defaulter qualified itself as a sick company. Also if we have a thorough analysis, we find that before the Code, different actors were governed by different statutes regarding the same matter. That further complicates, with the multi-layered legal procedures that had to be undertaken.[5]

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3 ENS Economic Bureau, 'Insolvency and Bankruptcy Code: A legislation to promote investments, develop credit markets', 22 December 2015, *Indian Express Official Website* available at http://indianexpress.com/article/india/india-news-india/insolvency-and-bankruptcy-code-a-legislation-to-promote-investments-develop-credit-markets/#sthash.782eZ4x4.dpuf, accessed on 23 January 2018; Ran Chakrabarti & Nandita Bose, 'India: Insolvency and Bankruptcy Code, 2016: A Critical Analysis', 23 November 2016, *Mondaq Official Website* available at http://www.mondaq.com/india/x/546802/Insolvency+Bankruptcy/Insolvency+And+Bankruptcy+Code+2016+A+Critical+Analysis, accessed on 23 January 2018.

4 Kristin van Zwieten, 'Corporate Rescue in India: The Influence of the Courts', vol. 15, no. 1, *Journal of Corporate Law Studies p. 1,* 2015.

5 Aparna Ravi, 'The Indian Insolvency Regime in Practice-An Analysis of Insolvency and Debt Recovery Proceedings', working paper, Indira Gandhi Institute of Development Research, Mumbai, 2015, available at http://www.igidr.ac.in/pdf/publication/WP-2015-027.pdf, accessed on 23 January 2018.

For example, SICA, 1985 applies only to companies. There is the Recovery of Debt Due to Banks and Financial Institutions (RDDBFI) Act, 1993 which led to the establishment of the Debt Recovery Tribunal that made debt recovery easier, but only for banks and other financial institutions, regardless of whether they are secured or unsecured creditors. Similarly, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 enabled merely the secured creditors for a speedy recovery of their debts by seizing and selling off the securities of their debtors. This meant that the secured creditors were given the leeway to recover their debts without actually approaching the adjudicatory authorities and this was challenged in *Mardia Chemicals Ltd. v. Union of India*[6]. Also, when some legislations are tilted to the interests of the debtors, some like the SARFAESI are in favor of the creditors. The hiatus created by the conflicting rights of the parties, also provided loopholes for either of the parties to take undue advantage of the situations in their favor. *BHEL v. Arunachalam Sugar Mills ("ASM")*[7] was one such case that saw the High Court working upon the conflicts of rights of the parties, due to the plethora of insolvency laws involved. [8]

Interestingly, there also persisted a trend whereby, the delay time was made use of by the debtors to start a new company in the name of their near or dear ones and use it to siphon out the assets or money from their collapsed ventures. [9]

Many laws including SICA, 1985 currently stand repealed and the Board for Industrial and Financial Reconstruction (BIFR) and the Appellate Authority for Industrial and Financial Reconstruction (AAIFR), that fall under the said Act, have been dissolved.[10] The SARFAESI Act, 2002 has also been amended to act as facilitating legislation for the Code.

Aim and Purpose

The new legislation seeks to alleviate all the associated disadvantages by amalgamating the relevant provisions of all the legislation into one Code, which would now be the sole piece of regulation with regard to matters of insolvency

6 *Mardia Chemicals Ltd. v. Union of India*, SCC, 2004, SC, p.311.

7 *BHEL v. Arunachalam Sugar Mills,* O.S.A.Nos.58 and 59, 2011, *Indian Kanoon Official Website* available at https://indiankanoon.org/doc/1815311/, accessed on 23 January 2018.

8 Aparna Ravi (n 5).

9 The Economist, 'Bankruptcy in India: The Business of Going Bust', 19 November 2015, *The Economist Official Website* available at http://www.economist.com/news/business/21678773-long-awaited-bankruptcy-code-should-help-owners-and-lenders-business-going-bust, accessed on 23 January 2018.

10 Mani Gupta, 'Repeal of SICA', 29 November 2016, *India Corp Law Official Website* available at http://indiacorplaw.blogspot.in/2016/11/repeal-of-sica.html, accessed on 26 January 2018.

and bankruptcy. The obsolete statutes like the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 were repealed and the National Company Law Tribunal (NCLT) and the Debt Recovery Tribunal (DRT) are now vested with the exclusive authority and jurisdiction. Furthermore, the Code has in its proposal, an Insolvency and Bankruptcy Fund of India and the government has, in addition, proposed[11] for a separate framework for bankruptcy resolution for the heavily stricken banks and financial entities. This is because these companies will find hard to survive until the Insolvency Resolution Process has been completed when there is no guarantee of being fully revived.

"A time-bound manner of 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 or incidental thereto"[12], reflects the objective of the Code.

The Code has brought under its umbrella all companies, partnerships and individuals, other than the financial firms and creates an institutional framework comprising a Regulator, Insolvency Professionals (IP), Information Utilities (IU) and the adjudicatory mechanisms (primarily the National Company Law Tribunal (NCLT) and the Debt Recovery Tribunal (DRT).Essentially, within a well-structured institutional framework and a holistic law, the drafters can be seen to have had fast track redressal of creditor concerns, as the key objective. This is further evidenced by the provisions in the Code, which set a time frame of 90 days, for the settlement of matters brought before the Adjudicating Authorities (NCLT and DRT). The proceedings may extend to a maximum of 180 days, with an extension of 90 days being given, if need be, depending on the facts and circumstances of the matter before the court.

Expectations

The Code, thus, might go ahead to start a whole new wave in the credit scenario of the country, by encouraging more cross-border financing and unsecured lending to local borrowers, as the Code is expected to create a level playing field to both the domestic and foreign creditors and thereby ensuring more certainty around the bankruptcy process.[13] Going by a World Bank study, India has the

11 'India: The Insolvency and Bankruptcy Code, 2016 - Key Highlights', TRILEGAL, 16 May 2016, *Mondaq Official Website* available at http://www.mondaq.com/india/x/492318/Insolvency+Bankruptcy/The+Insolvency+And+Bankruptcy+Code+2016+Key+Highlights, accessed on 26 January 2018.

12 Bankruptcy Law Reforms Committee Report, Volume 1, 16 November 2015.

13 Shishir Mehta et al, 'India: The Insolvency and Bankruptcy Code, 2016 - New Road and New Challenges', 26 May 2016 *Mondaq Official Website* available at http://

lowest recovery potential, which levitates around 25%, due to the protracted delays of up to four years (nearly twice more than the time taken by China), in winding up sick companies.[14]

The case of Kingfisher is a fine example to prove these statistics. When the company, which was once India's second-biggest airlines, stooped down to an estimated debt of more than Rs. 1.5 billion in 2012, it was only in 2015 that the creditor banks managed to annex control over its Mumbai headquarters.[15] The procedural hindrance is the only viable reason one can think of, that caused the delay. However, with the enforcement of the Code, the extensive dawdles and the resultant incapacity for recovery, are anticipated to reduce considerably.

The Code: Salient Features in a Nutshell

The novice strategy brought forth by the Code with regard to the procedural aspects is the highlight of the legislation. As we know, the key focus of the code is to expedite the winding up and recovery mechanism. With this objective, it has designed a system for initiating proceedings, by involving two independent stages in the process. The first stage is the Insolvency Resolution Process (IRP), followed by the traditional process of liquidation, which forms the second stage.

The first stage assesses as to whether the debtor's business is viable to continue and also looks into the options for its rescue and survival. This is a collective mechanism for the creditors. IRP stands different from the previous mode of the reorganization process that was initiated by the debtors and lenders, with them pursuing distinct methods of recovery.[16]

However section 4 of the Insolvency and Bankruptcy Code, 2016, clearly lays down that, in order to initiate such proceedings, the default should be at least for an amount of Rs. 1 lakh (which may be increased to up to Rs. 1 crore by the Central Government) for companies and Rs. 1000 for individuals and unlimited partnerships.

It has even gone ahead to set an order of priority with regard to the distribution of

www.mondaq.com/india/x/495202/Insolvency+Bankruptcy/The+Insolvency+And+Bankruptcy+Code+2016+New+Road+And+New+Challenges, accessed on 25 January 2018.

14 Wharton University (n 1).

15 The Economist (n 9).

16 Ran Chakrabarti & Nandita Bose, 'India: Insolvency and Bankruptcy Code, 2016: A Critical Analysis', 23 November 2016, *Mondaq Official Website* available at http://www.mondaq.com/india/x/546802/Insolvency+Bankruptcy/Insolvency+And+Bankruptcy+Code+2016+A+Critical+Analysis>, accessed on 23 January 2018.

the proceeds from the liquidation process[17] where the costs incurred for the IRP and the liquidation process are placed higher than the dues owed to the secured debtors and the unpaid employees and the workers. The terms of punishment have also been prescribed by the Code, for acts of defrauding creditors, making false representations, proven misconduct during the IRP, concealment of property, so on and so forth. (s.68 to s.77)

All the matters are to be directed to the National Company Law Tribunal (NCLT), in the case of companies and the Debt Recovery Tribunal (DRT), in the case of individuals and unlimited partnerships. Thereby, all the other judicial institutions are kept outside the scope of the entire procedure, except the Supreme Court, in case of appeals from the appellate authorities in each of the above instances.

A Comparison

The Code is seen to have been highly influenced by the bankruptcy laws of the United States, except for the slight differences in the way, both have been executed. For instance, chapter 7 and chapter 11 of the US Bankruptcy Code, speak about the two different bankruptcy procedures for corporations. When the former talks about a liquidation process being initiated against the debt defaulters, the latter refers to a situation where the debtor company gets to continue its operation till the creditors have actually formulated a plan for reorganization. With regard to the liquidation process, a trustee is generally appointed to invigilate the entire procedure and the company would remain non-functional before the sale of the business and the auction of its assets. While in India, the Code insists on the identification of its status of revival, prior to officially declaring the company as an insolvent and initiating liquidation.

Similarly, if in the US, the Code grants the company the power to manage its affairs till the completion of the proceedings, in India, the power of administration shifts to the resolution professionals and the creditors, who further regulate and manage the affairs of the company, during the course of the IRP. Whatsoever, we find that the pulp and essence of both laws are essentially the same.

Adjudication: Procedural Mechanism

The procedural mechanism envisaged by the Code is very simple and finite. The creditor can initiate the Insolvency Resolution Process (IRP) in the National Company Law Tribunal (NCLT) or the Debt Recovery Tribunal (DRT), or the same can be done by the other stakeholders like the shareholders, employees

[17] The Insolvency and Bankruptcy Code, 2016, s.53.

and even the debtors as voluntary insolvency proceedings, subject to certain exceptions and provisos. This would be followed by a moratorium ordered by the NCLT on the debtor's operation for the period (called "Calm Period") of the IRP during which no judicial proceedings can be initiated against the said debtor.[18] It further appoints an Insolvency/Resolution Professional (RP), whose primary function is to run the borrower's business for the creditors as their agent. RP constitutes a Creditor's Committee, with only the financial creditors. Operational creditors with certain threshold attend the meeting without voting powers. All the decisions are taken based on a minimum of 75% majority and all such decisions are binding on all the creditors and debtors. [19]

Flaws and Changes: Probable Difficulties

The Code, admittedly, is only at its premature stage that, it has started encountering practical difficulties in its operation. Some are blatantly seen on the face of it, while some happen to be the remote repercussions that could arise in all probability if its enforcement follows the same pattern as is being followed at present.

We know as a matter of fact that, when there is a failure on the part of the corporate debtor to pay the debt due by him to the operational creditor, the latter can send a demand notice to the former asking for payment. This sets the beginning of the ten day period during which, the debtor has to either make the payment or dispute such demand, failing which the creditor can apply to the adjudicating authority to initiate an insolvency resolution process against the unpaid debtor. Now here begins the primary hassle. The dispute mentioned in the context, refers to, both a suit filed, as well as arbitration proceedings. Therefore, since filing a suit is generally an expensive process, the debtor might file for an arbitral reference to dispute the debt, without actually having the intention to move in for arbitration. The problem lies in the fact that the adjudicating authority does not really have the powers to examine as to whether the dispute is bonafide or otherwise. And also, since it is a mere question of fact, there does not stand any chance for the creditors to go in for appeal.[20] Even if the dispute is resolved in the arbitration, the debtor can always go in for an appeal at the High Court to set aside the arbitral award.

Secondly, once the application is accepted, the management of the debtor's business passes on to the hands of the Resolution Professional (RP). This may

18 Ibid, ss.13-14.

19 The Insolvency and Bankruptcy Code (n 17).

20 L.V.V Iyer, 'Is the Bankruptcy Law Flawed?', *The Hindu* (28 May 2016) available at http://www.thehindu.com/business/Industry/Is-Bankruptcy-Code-flawed/article14344304.ece, accessed on 18 October 2016.

prove detrimental to the company, mainly due to two reasons; one, that the RP is not fluent with the health of the debtor company. Moreover, a mere replacement of the sorts alone won't prove to be motivating to the creditors, on whose behalf the professional functions.[21]

Thirdly, the creditors' committee on whose instructions the RP works, is dominantly run by the financial creditors, since they have the voting rights. The operational creditors, whose entry into the committee is carefully restricted, are also denied of any voting right. This involves an element of arbitrariness since the operational debtors are also parties who have vested interests in the company.

Finally, the Code stands unclear as to whether the management would be restored to the debtor on the completion of the resolution process and recovery of debts. Thus, it leaves scope for further disputes to arise in this regard. Also, the legislation is silent about the alternative reliefs available to the debtor, other than liquidation, if his enterprise cannot be revived after the 180 or 270 days period expires. This quite blatantly defies the basic aims of the Code, which was to better the ease of doing business in the country.[22]

Owing to all these flaws, the constitutionality of the Insolvency and Bankruptcy Code, 2016 was challenged in the Bombay High Court, in furtherance to the first case that was admitted under the same jurisdiction, under the Code (*ICICI Bank v. Innoventive Industries Limited*).

Bereft of the difficulties in the field of litigation, the fact that the dues to the government qualifies to be least in the priority hierarchy in the waterfall system, seemed quite surprising and unlikely.[23]

Challenges in Implementation

The actual menace begins on the pragmatic levels. As has already been discussed, the jurisdictional powers are concentrated in the hands of the NCLT (and the DRT, in the case of individuals and unlimited partnerships). The Companies Act, 2013 had already passed on to the hands of the NCLT all the pending, as well as the forthcoming matters under the Company Law Board. The matter gains depth, as we realize that there were nearly 4200 pending cases as on March 2015, in the Company Law Board, where the estimated number of fresh cases filed comes to around 4000.[24] All these have now been passed on to the NCLT, along with the

21 Ibid.

22 Ibid.

23 The Insolvency and Bankruptcy Code (n 17), s. 53.

24 Rajeswari Sengupta & Anjali Sharma, 'Challenges in the Transition to the New Insolvency and Bankruptcy Code', *The Wire* (15 December 2016) available at https://thewire.in/86871/insolvency-and-bankruptcy-code/, accessed on 28 January 2018.

matters (both new and pending) dealt by the BIFR and the AAIFR. The immense caseload on the institution, would either coax it to flout on the face of it, the aim of the code to expedite the proceedings or hurriedly decide on the matters disregarding the norm for delivering justice.

The quick development of the infrastructure for information utilities is also going to be a major hurdle in the course of implementation.

Conclusion

In the author's opinion, the Code is definitely, landmark legislation as far as the country's economy and the investment field is concerned. But before a hasty implementation, slight amendments in the literature and infrastructural developments, with an amount of far-sight, would be desirable, for the statute to see the effects that it had originally envisioned.