



An Evolutionary Assessment of India's Bankruptcy and Insolvency Laws

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ABSTRACT

In 2016, following the recommendations of the "Bankruptcy Laws Reforms Committee constituted by Ministry of Corporate Affairs," India enacted a standardized and cohesive legislative framework to resolve the insolvency and bankruptcy issues in an effort to address the rising Non-Performing Assets and to rectify the bankruptcy demands and claims, all while introducing reform measures in the entrepreneurial dynamism of the Indian economy. Distressed businesses can use the Code's spelled-out mechanisms, the "Corporate Insolvency and Resolution Process" and "Liquidation", to resolve insolvency in an orderly and time-bound fashion. These tools provided by the Code are used as recovery mechanisms for corporate debtors, helping them to avoid the closure of viable businesses while maximizing the value of their assets for creditors. Studying and analyzing the creation of a strong law to comprehensively regulate insolvency, and locating the practical problems attached to its implementation, will be the focus of the research. This paper will compare and contrast the current legislative framework with the past insolvency and bankruptcy legislative framework and discuss their implications. There will also be a brief discussion of the existing international guidelines that regulate this field as part of the article.

KEY WORDS

**Corporate, Bankruptcy, Law, MCA, NPA,
Liquidation.**

INTRODUCTION

In 2016, following the recommendations of the “Bankruptcy Laws Reforms Committee constituted by Ministry of Corporate Affairs,” India enacted a standardised and cohesive legislative framework to resolve the insolvency and bankruptcy issues in an effort to address the rising Non-Performing Assets and to rectify the bankruptcy demands and claims, all while introducing reform measures in the entrepreneurial dynamism of the Indian economy. Distressed businesses can use the Code’s spelled-out mechanisms, the “Corporate Insolvency and Resolution Process” and “Liquidation”, to resolve insolvency in an orderly and time-bound fashion. These tools provided by the Code are used as recovery mechanisms for corporate debtors, helping them to avoid the closure of viable businesses while maximising the value of their assets for creditors. Studying and analysing the creation of a strong law to comprehensively regulate insolvency, and locating the practical problems attached to its implementation, will be the focus of the research. This paper will compare and contrast the current legislative framework with the past insolvency and bankruptcy legislative framework and discuss their implications. There will also be a brief discussion of the existing international guidelines that regulate this field as part of the article.

With emergence of “open- market economy” as a consequence of westernization, liberalisation privatisation, globalisation and industrialisation, it became India’s endeavour to continuously promote and improve their economic activity at an accelerated rate. The Indian Government, thereby, formulated liberalised and progressive economic policies for promoting trade, commerce and industrialisation in the country. This resulted into prompt establishment and expansion of corporate entities on a large scale.

A company is generally described as a cumulation of interests of stakeholders. A company is, thereby, expected to make utmost use of its existing assets’ value and thereby serve the legitimate expectations of its stakeholders. There is a risk that those who are owed money by a company (creditors) will suffer if the company (corporate debtor) fails to pay its debt on the due date in a society where companies, in the light of progressive economic policies, are leveraged to utilise easy credit and banking facilities to the fullest. The debtor is regarded as insolvent when such a default in payments takes place on their end, whether as a result of monetary failure, business failure, or blatant fraud. This scenario is referred as insolvency. It was recently on June 13, 2022, held in the case of *Rathi Graphic Technologies Limited v. Rajkumar Rathi and Other*¹ that, “we have departed from socialistic approach to capitalistic approach. Even the judiciary has adopted a hands-off approach based upon foreign jurisprudence qua economic legislation. In our view, there is urgent need to adopt a middle path, that is, somewhere between the creditors driven process and debtors in control process to really take care of interests of all stake holders which include society at large.”²

Background of IBC Laws

Insolvency and Bankruptcy are the two words often used interchangeably. However, a thin line difference lies between the two terminologies. According to Black Law’s dictionary, where on one hand insolvency means a situation where the debtor fails to repay its outstanding debts on due date whereas bankruptcy is a legal proceeding which is initiated due to the debtor’s inability to pay its outstanding debts. The English word “bankruptcy” comes from the Italian phrase “banca rotta,” which means “to break the bench.” During the medieval period in Europe there was a practice “to break the bench or counter” of the businessmen when they failed to repay its debt. In Europe and England (under ‘the Statute of Maribridge 1267’) the defaulters were held criminally liable. However, the Roman and the Indian legal regime tackled with such default in the civil law. Moreover, in the Hindu law in India the legal heirs of the deceased are held liable to pay his debt from the inherited estate of the deceased.³

Prior to 2016 in India, the interest of aggrieved creditors and debtors were protected under various laws which regulated “insolvency and bankruptcy. They are “the Presidency Towns Insolvency Act, 1909,” “the Presidency Insolvency Act, 1920,” “the Companies Act, 1956,” “Sick Industrial Companies Act, 1985”

and the “Companies Act, 2013”. Key objective of “insolvency and bankruptcy laws” must be to provide a systematic and effective process for reorganisation or liquidation insolvent entities.⁴ Before making of “Insolvency and Bankruptcy Code, 2016” (here in after referred as “the Code”), we had no comprehensive, uniform and coherent legislation related to the insolvency and bankruptcy. The multiple legislations prior to Code governing insolvency often resulted in preventing creditors from recovering their legitimate dues and restricting debtors from exiting or discontinuing their business freely in a proper and time bound manner due to an inadequacy of a proper resolution mechanism resulting in grave consequences. “To this end, the” enactment of the Code repealed “Presidency Towns Insolvency Act”, 1909, the “Presidency Insolvency Act”, 1920 and made amendment to eleven 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 enforce the newly enacted legislative framework, thereby, giving an overriding effect to the Code.⁵

Freedom of entry, ease of doing business and freedom to exit are significant features of conducting business in an economy. Therefore, an effective and efficient insolvency regime is essential to rescue sound businesses and foster liquidation and lead to market exist of distressed or unviable business. A weak insolvency legal regime is likely to push a viable business to become unviable. The “World Bank Group”, which is globally recognised as a “Financial Stability Board”, is said to be the one who sets standard in the field of “insolvency” and recognizes the “creditors’ rights” alongside the “United Nations Commission of International Trade Law” (UNCITRAL).⁶ In wake of the financial crisis of late 1990s, “the World Bank” along with “the UNCITRAL”, along the “International Monetary Fund”, created “the Insolvency and Creditor Rights Standard” (ICR Standard), and “the Legislative Guide on Insolvency Law” (Legislative Guide) to serve as a representative of the global agreement on the best methods for assessing and improving national insolvency and creditor rights systems.⁷ The combination these stands as a guiding light for India and other countries to create a robust insolvency regime in their respective territory. Moreover, the International Financial Corporation, a member of the “World Bank Group”, assists in creating a stable and efficient insolvency professional. Insolvency and bankruptcy” laws in India has witnessed a drastic evolution. “A reform had been recommended several times to insolvency regime by several commissions. To name a few, “J.J. Irani Committee”, “Tiwari Committee Report” of 1984, “Narasimham Committee” report of 1991, “Sachar Committee Report” of 1978, the “Eradi Committee” report of 2002”. It was on the stipulated suggestion of the “Eradi committee” “to open a private market of liquidators for compulsory liquidation” for which the “Bankruptcy Law Reform Committee in 2015 (BLRC)” was constituted. “BLRC” was headed by Shri. T.K. Vishwanathan. It was for this committee which proposed for enacting the Code”. This consequently resulted in creation of “Insolvency and Bankruptcy Code, 2016”. The Code is based on the “UNCITRAL Legislative Guide.”

Enactment of IBC

Given the young emerging Indian economy, its limited resources and routine market failures of corporate person with the ever evolving entrepreneurial dynamism during 2000s, India faced an urgency to have “an adequate and prominent market mechanism” in order to put to use the under-utilised assets of such corporate persons to more efficient usage and reduce business failures while restoring the Indian market equilibrium.⁸ In light of this, the Code was enacted as an economic legislation on May 28, 2016 on the recommendation of “BLRC”. The Code is an improved unified version of the fragmented insolvency laws with reforms and additional legal changes to address the escalating Non- Performing Assets and to resolve the insolvency and bankruptcy related challenges faced by corporate person in the Indian economy. The idea behind the legislation of the Code was to effectively tackle the business failures.

The Code brings uniformity to the insolvency laws dealing corporate persons, personal guarantors, individuals as well as partnership firms within a particular stipulated timeframe⁹ to attain maximum value of existing assets of above mentioned persons vis-à-vis “promote entrepreneurship”, ensure availability of “credit”

whilst balancing “the interests of the stakeholders including Government dues”.¹⁰ The order of objective stated is sacrosanct.¹¹ “If we let these insolvency proceedings under the Code go on for as long as you want, you will be going against what the Code is trying to do.”¹² The goal of the Code is to protect the creditors and rescue the debt ridden corporate persons. Moreover, the Code does not aim to shut down the corporate debtors rather to it aims revive it by ousting the defaulters and bringing in insolvency professions in the management of the corporate debtors.¹³ As a going concern, the proposes for the revival of corporate debtor whilst stating liquidation as last resort for such debtors.¹⁴ The Code envisages to facilitate reforms to emerging entrepreneurial dynamism in the Indian economy. It has replaced the prior fragmented legal regime of insolvency with a market driven, incentive pro, predictable and time restricted insolvency regime.¹⁵ Accordingly, the Code has positively ushered its way to bring out successful outcomes of its policies, guarantees expansion of cost and profit for all its stakeholders within a particular timeframe.¹⁶

The regulations concerning corporate insolvency and liquidation went into effect on December 1, 2016, while the provisions concerning personal guarantors of corporate debtors (CDs) insolvency resolution and bankruptcy went into effect on December 1, 2019.¹⁷ The most significant object of the Code is a to have time restrictive resolution. It prescribes a periodic framework for the establishing “Corporate Insolvency Resolution Process” (‘mechanism to “freedom to exit”’), starting from the initiation of the said process till its closure. “The Code facilitates, incentivises and empowers the ecosystem to close the process expeditiously to avoid any grave consequences.”¹⁸ However, an early resolution application and a time bound resolution process has the potential to bring back the corporate person back into business resulting into its revival rather than winding up. Moreover, it puts the underutilised assets of the company to a productive use in no time. Time is the essence of the Code¹⁹; indefinite delay defeats its object²⁰ and the prescribed time for CIRP is mandatory.²¹ With the creation of the Code, a robust legal regime has been established for the distressed corporate persons.

The Code envisages its concern foremost about the resolution of the corporate and then recovery of the money for the creditors. In this context, the Code provides for two most important concept and their framework. Firstly, CIRP for restructuring and revival of distressed businesses in time stringent and systematic way. Secondly, liquidation process for the corporate persons who wants to exit the market. To facilitate a smooth operation of the insolvency regime, in the Code underlies four very important supporting pillars forming the institutional framework, namely, “Insolvency and Bankruptcy Board of India” (‘IBBI’), the legal regulator; “Insolvency Professionals” (‘IPs’), enrolled plus regulated by the “Insolvency and Bankruptcy Agencies”; Information Utilities (‘IUs’), the information repositories and Adjudicating Authorities, which comprises of the Supreme Court, the National Company law Appellate Tribunal and the National Company Law Tribunal. They are conferred with their respective powers and duties to perform in the context of CIRP.

The CIRP is constituted for the resolution of the viable entities and liquidation of the unviable entities. The proceedings under the Code initiates with a default of payment of certain amount, specified by the Central Government of India, made on the part of the corporate debtor. The process starts when a “Financial Creditor,” a “Operational Creditor,” or a “Corporate Applicant” files an application with the NCLT against a “Corporate Debtor””. One the application is approved, qualified regulated IPs (who are then substituted with Resolution Professionals) are appointed who take the charge of the management of the corporate debtor. Moreover, a moratorium is imposed, as soon as CIRP initiates, upon the debtor whereby no legal suits or proceeding could be instituted against a debtor until end of process, providing a corporate debtor umbrella protection to revive. This is also referred as “calm period” which aims to preserve the existing resources of the debtor for the collective benefit of the aggrieved stakeholders.²² Moving on, a “Committee of Creditors” is constituted to approve the Resolution Plan, consisting mainly of financial creditors, in order to have directive process. All these procedures have their own time limitation stipulated under various provisions in the Code, which make the CIRP a unique and expeditious process. If the CIRP is conducted properly and completed successfully, the corporate debtor revives. But if the CIRP once fails, the corporate debtor consequently enters into the

liquidation phase. Thereby, “the liquidation proposal is to be approved by the Adjudication Authority and then a liquidator is to be appointed to further perform the liquidation proceedings”. However, a corporation can also voluntarily opt to undergo liquidation even in case of no default. This scenario is referred as “solvent liquidation”. The Code is an umbrella legislation which gives the interested stakeholder a prominent solution.²³ “Some significant characteristics of the Code are time restrictive resolution mechanism, timely recognition of default, regulatory framework, dedicated adjudicatory body, moratorium, and liquidation”.²⁴

Decoding the IBC

Before the establishment of the Code, the insolvency laws were neither comprehensive nor accommodating to the needs of time. Laws were fragmented and multi-layered and the resolution processes were lengthy and not proper resulting in grave consequences for the parties involved. When it comes to an individual’s insolvency, it is the pre-independence legislations of 1909 and 1920 which still applies. The pre-independence legislation continues to apply even today as we have been notified about the same under the Code yet, even though we have the provisions for same. But we do anticipate for it soon. Likewise, the Companies Act, 1956 governed liquidation of the companies” and the rehabilitation of the distressed firms were dealt under the SICA, up till the enactment of the Code. Failure to re-pay the debt was the trigger point to operationalize winding up proceeding under the 1956 Act which used to be followed by mandatory liquidation process which took years to complete. Similarly, under SICA, “the erosion of the net worth of the company” resulted in the initiation of the rehabilitation and rescue process. But the SICA failed to achieve the desired results in the insolvency regime mainly due to never-ending application of the moratorium and absence of a time frame for resolution process. The 1956 Act did not provide for revival and rehabilitation of a company in duress. However, with the enforcement of the Code in 2016, “the insolvency legal regime” became much convenient and effective. The Code not only has a two-level process. They are resolution proceeding and liquidation proceeding. The Code requires the defaulter to undergo these processes under the guidance of a regulated and qualified professionals within the stipulated period of time in order to prevent any adverse consequences. Moreover, the Code envisages the principle of “Freedom-to-Exist” and also “Solvent Liquidation” for corporate persons. The Reserve Bank of India had also formulated legislative mechanism for debt and security enforcement²⁵ for the purpose of debt restructuring in form of rules, instructions, circulars and schemes. However, after the enactment of the Code, RBI withdrew all alternative mechanism stipulated by it for the resolution on February 12, 2018 as it was declared to be ultra vires²⁶ certain provision of the “Banking Regulation Act, 1949”.²⁷

Conclusive Remarks

The Code has established a systematic and strong ecosystem for the creditors as well as debtors to make maximum utilisation of assets in times of distressed assets in consultation with qualified professionals. Even though the Code is still in its infancy, it has been amended several times to be in line with the line of the dynamic Indian economic market scenarios. The Code has evolved as a uniform and coherent economic legislation and it requires to be examined and analysed along with the regulations, circulars, rules, orders and guidelines laid down by the insolvency regulator IBBI and the Central Government in order to foster effective outcomes. Prior to the Code, the Indian economy neither had a proper exit mechanism nor an efficient rescue mechanism. The Code emerged as a key reform in the Indian economy which has addressed both the above stated issues along with several other issues related to a distressed company. It is comprehensive, unique, systematic, time stringent, dynamic, effective, market-driven and binding legislation which deals not just with corporate persons but also with partnership firms, associations, personal guarantors and even individuals under the CIRP. It also deals with MSME corporate debtors under the “Pre-packaged Insolvency Resolution Process” (PPIRP), which has been incorporated in the Code with an amendment to pace up with the emerging start-ups in the Indian economy. It is a significant economic change that aids “distressed enterprises, recognises market flaws, and eliminates information manipulation”.²⁸ The Code propagates the importance of an expeditious

resolution and recovery process. It has thereby provided for establishment a strong and efficient institutional framework to achieve its objectives set forth successfully. India's ranking on "Ease of Doing Business" survey conducted by World Bank got improved from 140th in 2015 to 108th in 2018 to 63rd in 2022.²⁹ Henceforth, the Code is often referred as a "game changer" legislation.³⁰ The Code has shifted from "Debtors Paradise" approach to follow a "Creditor in Control" approach to deal with the insolvency issues which allows the creditors to have faith in the procedure to avail, if not anything at least something, out of their invested assets. The Code narrates transparency and accountability. In this context, the moratorium period is imposed upon the corporate to facilitate collective benefit of the creditors. The Code professes to incentivise the creditors by preventing the disposal of the existing "assets of the corporate debtor" through the moratorium. In terms of defaulter, the Code under its provisions has allowed them to file for initiating the CIRP, as no one else stands in a better position to know that if their business is failing or not. This not only allows the corporate to resolve and restructure the existing issues with the help of the insolvency resolution professionals but also to revive and rehabilitate. Also, the Code in light of the principle of "freedom to exit" allows the corporate debtor to file for liquidation proceeding. This helps the solvent corporate person to exist the market willingly while availing the most of their existing assets. The insolvency process under the Code has proved to be a success for both the corporate debtor and creditor and has improved the overall investment market.

CONCLUSION

Even after having such an efficient and coherent legislation, the Code has attracted a huge number of litigations. This has created a challenge for the resolution process of viable corporate persons to be completed within the stipulated time frame resulting in the failure of the Code's objective. Moreover, the limited knowledge of insolvency laws with the judicial authorities makes it difficult for them to settle the litigation expeditiously. The judicial authorities, therefore, heavily rely on the "commercial wisdom" of Committee of Creditors. This prevents the said authorities to decide the case on its merits. In this view, the transparency of the Code stands in conflicting position. This issue could be resolved by spreading awareness about the aims and objectives of the Code amongst the judicial authorities, thereby, consequently with a proper implementation of the Code provisions by them. Also, in this regard enactment of proper amendments and having judicial precedents will be of great help.

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