CORPORATE INSOLVENCY

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By the raising of the global economy, there is also increasing the problems with corporate insolvency. The issues about corporate insolvency has big significance, and lot of people think that this law needs reforms.

The Indian economy is making investments in lot of outside companies but it is also opened for foreign investments.

High Level Committee headed by Justice V.B. Balakrishna Eradi[1], has been set up by the India government in the 1999.

The Department of Company Affairs had given a mandate to the Committee to examine and make recommendations with regard to desirable changes in existing law on winding up of companies so as to achieve more transparency and avoid delays in final liquidation of companies.

Recommendations of the Committee

The Committee had to examine and make recommendations regardless of:

A self-contained law on winding up of companies having regard to the Sick Industrial Companies (Special Provisions) Act, 1985 and the Securities Contracts (Regulation) Act, 1956 with a view to creating confidence in the minds of investors, creditors, labor and shareholders.

The manner in which the assets of the companies are brought to sale and the proceeds are distributed efficiently;

[1] superannuated Judge of Supreme Court of India

the rules of winding up and adjudication of insolvency of companies;

The mechanism through which the management of companies will be conducted after the winding up order is issued and the authority which will supervise timely completion of proceedings;

The desirability of changes in existing law relating to winding up of companies so as to achieve more transparency and avoid delays in the final liquidation of the companies.

- The jurisdiction, power and authority relating to winding up of companies should be vested in a National Company Law Tribunal which should be vested with the functions and power with regard to rehabilitation and revival of sick industrial companies, a mandate presently entrusted with BIFR under SICA.
- To take the power from High Court and the transfer of the pending winding up proceedings to the Tribunal, the act from 1956 should be changed appropriately.
- The adoption of the international trend in law relating to corporate bankruptcy, firstly sell the valuable things as soon as possible and secondly adjudication of claims and distribution of proceeds
- An in-depth assessment of the office of Official Liquidators, in view of inadequate and incompetent manpower and absence of latest office equipment and technologies.
- A liquidation Committee consisting of creditors of the company on the lines of Section 141 of the Insolvency Act, 1986 of UK be set up to assist the Liquidator.
- The repeal of SICA and recommended the ameliorative, revival and reconstructionist procedures obtaining under it to be reintegrated in a suitably amended form in the structure of the 1956 Act except that there is no stand still provision like Section 22 of SICA.
- Part VII of the Companies Act, 1956 should incorporate a new substantive provision to adopt the UNCITRAL Model Law as approved by the United Nations and the Model Law itself may be incorporated as a Schedule to the Companies Act, 1956, which shall apply to all cases of Cross-Border insolvency.

- Adopt the necessary principles enunciated under the heading "Legal Framework", "Orderly and Effective Insolvency Procedures - Key issues", to bring the provisions of the Companies Act, 1956 in line with international practices.

The report from the committee has been finished and submitted in 2000 to the Central Government, in August 2001 some companies had been introduced to the Parliament of India. The Bills, if passed in their present form will bring the curtains down on the Sick Industrial Companies (Special Provisions) Act, 1985 and will restructure the Companies Act, 1956 in a big way leading to the new regime of tackling corporate rescue and insolvency procedures in India with a view to creating confidence in the minds of investors, creditors, labor and shareholders.

Scheme of Insolvency Laws

The need for an insolvency law in India was first articulated in the three Presidency-towns of Calcutta, Bombay and Madras. The earliest rudiments of insolvency legislation can be traced to sections 23 and 24 of the Government of India Act, 1800, which conferred insolvency jurisdiction on the Supreme Court at Fort William and Madras and the Recorder's Court at Bombay. These Courts were empowered to make rules and order for granting reliefs to insolvent debtors on the lines intended by the Act of the British Parliament called the Lord's Act passed in 1759.

The stream of insolvency laws can be separated under two parts:

A personal insolvency agreement (PIA) is one of two agreement options available. A PIA, also known as a Part 10, is a legally binding agreement between you and your creditors governed by Provisional Insolvency Act, 1920 and Presidency Towns Insolvency Act, 1908

Corporate Insolvency, whose consequence is winding up of the company under the Companies Act, 1956.

In the liberalization, deregulation and adopting market economy, India is has increasing growth of retail loans to individuals, housing loans and credit card users. On account of phenomenal rise in retail lending it will be necessary in the near future to give a re-look at the personal insolvency laws to ensure that any insolvency proceedings against individuals are also expeditiously decided.

Corporate law (also known as business law or enterprise law or company law) is the body of law that applies to the rights, relations, and conduct of persons, companies, organizations and businesses.

It studies how corporations, investors, shareholders, directors, employees, creditors, and other stakeholders such as consumers, the community, and the environment interact with one another.

Corporate law is a part of a broader companies' law (or law of business associations). It is often considered to be a branch of civil law and deals with issues of both private law and public law.

Sick companies

The Sick Industrial Companies Act (SICA) was a key piece of legislation dealing with the issue of rampant industrial sickness in India. The Sick Industrial Companies (Special Provisions) Act (SICA) of 1985 was enacted in India to determine the extent of sickness in industrial units, expedite the revival of potentially viable companies and close unviable units to release investment locked up in them for productive use elsewhere. SICA defined a sick industrial unit as one that had existed for at least five years and had incurred accumulated losses equal to or exceeding its entire net worth at the end of any financial year.

Industrial sickness has long been a chronic problem in in the Indian economy.

SICA identified a number of internal and external factors responsible for this epidemic. Internal factors within the organizations included mismanagement, overestimation of demand, wrong location, poor project implementation, unwarranted expansion, personal extravagance, failure to modernize and poor labor-management relationships. External factors included an energy crisis, raw materials shortage, infrastructure bottlenecks, inadequate credit facilities, technological changes and global market forces.

Widespread industrial sickness affects the economy in a number of ways, such as loss of government revenue, tying up scarce resources in sick units, increasing non-performing assets held by banks and financial institutions, increasing unemployment, loss of production and poor productivity. SICA was implemented to rectify these adverse socio-economic consequences.

An important SICA provision was establishing two quasi-judicial bodies – the Board for Industrial and Financial Reconstruction (BIFR), and the Appellate Authority for Industrial and Financial Reconstruction (AAIFR). BIFR was set up as an apex board to spearhead handling the industrial sickness issue, including reviving and rehabilitating potentially sick units and liquidating non-viable companies. AAIFR was set up to hear appeals against BIFR orders.

SICA was repealed and replaced by the Sick Industrial Companies (Special Provisions) Repeal Act of 2003, which diluted some SICA provisions and plugged certain loopholes. A key change in the new act was that apart from combating industrial sickness, it aimed to reduce its growing incidence by ensuring that companies did not resort to a sickness declaration merely to escape legal obligations and gain access to concessions from financial institutions.

When an industrial company has become a sick industrial company, the board of directors of the said company are required to make a reference to BIFR for determination of the measures which shall be adopted with respect to the company.

A regulation that stipulates that individual health insurance policies must contain certain provisions before being valid. The Uniform Individual Accident and Sickness Policy Provisions Act was created by the National Association of Insurance Commissioners (NAIC) and is required by each individual state. This act was created to establish a standard of quality and ensure health insurance policies have an adequate level of coverage by requiring that certain provisions be written into every policy.

Uniform Individual Accident And Sickness Policy Provisions Act

The insurance industry is state-regulated and overseen by the NAIC. The NAIC is made up of elected representatives from each state to ensure that insurance companies are conducting business in a fair and ethical manner. Their goals are to protect the public, promote competition, ensure consumers are being treated fairly, ensure the insurance company is functioning properly, and support and improve regulations. The Uniform Individual Accident and Sickness Policy Provisions Act is just one of many ways the NAIC actions have improved the insurance market as a whole.

Pursuit of Individual Claims

In the insolvency laws in India, where all the suits are stayed on making of the winding up order, parties may pursue individual claims in certain circumstances.

- Winding up procedure implies all personal rights be converted into right to prove debt in winding up.
- Under section 446, stay on all suits and the winding up Court to decide all suits by or against the company.
- A secured creditor may enforce security interest without a suit and therefore, real rights of secured creditors are protected.
- Criminal proceedings or proceedings against directors or officers are not stayed.
- Income tax proceedings will continue against the liquidator.

The Stacking Order of Priorities

The debts due as workmen's dues and the claims of the secured creditors sacrificed to workmen have an overriding preferential claim or priority to all debts. The debts payable shall be paid in full unless the assets are insufficient to meet them in which case they shall abate in equal proportions.

Compromises and Arrangements

Apart, from the lengthy and time-consuming winding up procedure, all the companies liable to be wound up under the Companies Act may resort to the alternative of compromise or arrangement. The Court may make orders to enforce these remedies and where a meeting of creditors or class of creditors or members or any class of members is called upon, certain disclosures shall be made. The orders passed by the Courts include transfer of property to another company and to facilitate amalgamation, merger and demergers. Even reduction of capital to the extent that the capital is lost, or capital is in surplus is permitted.

An Analysis

The institution of BIFR has hardly satisfied the call for revival and rehabilitation of sick industrial undertakings and SICA has proved to be a complete failure. The lenders i.e. the banks and financial institutions, find SICA to be the biggest obstacle on their road map to recovery of dues. The existing legal framework of corporate insolvency faces several follies, which may be rectified once the proposed amendments are notified in the Official Gazette.

Procedural delays

There are inherent defects both, procedural and legal in proceedings before BIFR. The BIFR takes nearly one year to determine whether a company is sick. Thereafter, it takes around one year to formulate revival strategy. Consideration of the same also takes substantial time since banks and financial institutions have their own hierarchy in decision making, leading to avoidable delays. The decisions by the banks are also neither transparent, nor subject to judicial review. By the time decisions are taken and communicated, the plan, which had been conceived, has lost its viability resulting in failure of revival schemes even after sanction.

Lack of timely commencement of proceedings

Under the existing law, a company can approach the BIFR for adopting steps for its revival, on erosion of its entire net worth. The erosion of entire net worth is too late a stage to attempt restructuring as by the time the net worth is eroded the company is too sick to be revived and has lost its resilience to restructure and revive itself.

Poor enforcement mechanism

The mechanism for its implementation is so poor that violations take place fearlessly leaving no fear for law. The misuse of the said forum in making an entry by manipulating must be curbed by strict penal consequences for such misuse, which should be demonstrably used to ensure that no entity attempts to misuse these provisions. However, this aspect and solution to this problem has to be found out in the proposed legislation.

Lack of extra territorial jurisdiction

Indian insolvency laws do not have any extra-territorial jurisdiction, nor do they recognize the jurisdiction of foreign courts in respect of branches of foreign banks operating in India. Therefore, if a foreign company is taken into liquidation outside India, its Indian business will be treated as a separate matter and will not be automatically affected unless an application is filed before an insolvency Court for winding up of its branches in India.

Conclusion

when the deregulation and liberalization are taking place, number of restrictions on undertaking industrial activities has been withdrawn and relaxed. There is a need to take the process of liberalization a step further and recognize that so long as a company is acting in the interest of shareholders and otherwise observing the law of the land it should have the freedom to manage its affairs, merge, amalgamate, restructure and reorganize or otherwise plan its affairs as it considers best in the interest of the stakeholders. Interference by the Government or court or any tribunal should only be in the event of any detriment to the shareholders or under the Competition Act to prevent monopolies or restrictive trade practices. While undertaking reforms in the Insolvency Laws there is a need to change the focus from strict regulation of the activities of companies to granting freedom to the industry in conducting its business activities and lay down norms for protection of interest of stakeholders.