CORPORATE RESTRUCTURING AND INSOLVENCY: CRITICAL ANALYSIS OF LAWS IN INDIA

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ABSTRACT

In India, numerous overlapping legislations come into play while conducting the insolvency resolution proceedings. The procedure laid down in each of the statutes for realisation of assets, seizure and fulfilling the debt obligations vary from one another. As a result, the overlapping statutes cause unnecessary confusion during the insolvency and liquidation proceedings. This problem necessitated the formulation of a consolidated insolvency regulatory framework.

Additionally, an insolvency regime in a country is required to be strong for the reason that when companies fail to restructure in order to rehabilitate themselves, the outcome often results in liquidation of such companies. Therefore, the purpose of the study is to provide an overview of the concepts of corporate restructuring, revival of sick companies, insolvency and bankruptcy from an Indian legal perspective. The scope of the study encompasses the existing legislative measures and practices regarding the areas in India by conducting an examination of the provisions of Insolvency and Bankruptcy Code, 2016, Companies Act, 2013, SARFAESI Act, 2002 and SICA, 1985 in consonance with relevant judicial pronouncements. Additionally, the focus of the study is to analyse and explore the effectiveness of these legislations, the issues and gaps in the current legislative framework will be identified along with a study on the impact of the insolvency laws on the Indian economy to provide a critique on the lacuna in the Indian insolvency laws. After identifying the issues in the existing legislative framework, the study aims to derive suitable suggestions regarding necessary reforms required in laws relating to corporate restructuring and Insolvency to mitigate the issues at hand.

Keywords- Bankruptcy, Corporate Restructuring, Insolvency, Rehabilitation, Revival, Sick Companies.

INTRODUCTION

Prior to the liberalization of the Indian economy by the industrial policy of 1991, the economy was strictly regulated by government policies and regulations that were restrictive and inflexible in allowing corporate restructuring. However, the growing trend of hostile takeovers and presence of affluent industrialists, was of prominence in encouraging corporate restructuring in India. Further, the Industrial Policy of 1991 was crucial in relaxing the rigid governmental policies and opening the economy to fulfil the restructuring requirements in terms of opportunities and competition.

The flexibility in the restructuring opportunities due to absence of stringent policies has given the opportunity to business communities to opt for different business strategies in terms of redesigning the organizational structure. Therefore, Corporate Restructuring helps in improving efficiency, effective management of competition, increasing corporate growth, judicial utilization of resources as well as in meeting stakeholders' expectations. It serves different purposes for different companies at different points of time and may take up various forms. [i] To adjust assets and liabilities in an organisation, restructuring may take place in the form of mergers, amalgamations, acquisitions, compromises, arrangement, etc.

Restructuring techniques are used to prevent business failure which can be attributed to numerous economic and financial reasons. If restructuring and revival activities are not undertaken, the business failure often results in insolvency and bankruptcy proceedings.

The inability of a legal person to meet their debt obligations when they become due can be referred to as insolvency. Such a situation occurs where the liabilities exceed the total assets available to repay such debts, attributed to drop in cash flows, inflation in expenses and mismanagement of cash. The negative returns tend to result in fall of market shares and subsequently lead to closure due to consistent losses. The concept of bankruptcy slightly differs from insolvency. In case, a court of law determines the status of insolvency as well as provides directives to resolve the insolvency matter, it is termed as bankruptcy.[ii]

Some of the reasons causing insolvency are unforeseen market changes, incompetence of management, lack of business experience, improper business practices, lack of financial resources, excessive expenditure, competition, poor financial management, etc. Therefore,

economically, insolvency and bankruptcy laws are essential to ensure proper re-allocation of assets that are locked in businesses that have failed.

In India, various overlapping laws administer Corporate Restructuring, Insolvency and Bankruptcy, such as[iii] Companies Act 2013, Sick Industrial Companies Act, 1985, SARFAESI Act, 2002, Insolvency and Bankruptcy Code, 2016, etc.

Therefore, the Insolvency and Bankruptcy Code, 2016 aims at consolidating the scattered Insolvency resolution and debt recovery laws for corporates and individuals under one umbrella, to make the recovery process more simplified, less rigid, effective and prompt, while maximizing the value of assets, ensuring the interest of all stakeholders' and promoting entrepreneurship without adversely affecting the rights of creditors. Consequentially, the Code must be analysed for a better understanding the position of the insolvency legislations in India.

RESEARCH PROBLEM

In India, numerous overlapping legislations come into play while conducting the insolvency resolution proceedings. The procedure laid down in each of the statutes for realisation of assets, seizure and fulfilling the debt obligations vary from one another. As a result, the overlapping statutes cause unnecessary confusion during the insolvency and liquidation proceedings. This problem necessitated the formulation of a consolidated insolvency regulatory framework.

Varying avenues to redress issues under different statues has not only led to a tremendous number of Non-Performing Assets to pile on but also resulted in delayed recovery of dues by the creditors from their defaulters. Therefore, to resolve the issues caused by a disintegrated framework, the Insolvency and Bankruptcy Code provides a plausible solution.

However, legislations are not the sole basis on which an insolvency regime can be successful. A strong institutional structure is imperative to provide a backing to these statutes. Therefore, even though the insolvency laws in India resemble those of international countries, the Indian laws lack effectiveness. This indicates that different authorities like Courts, Adjudicatory Authorities, Liquidators and other professional need to support the system to prevent failure.

It is also necessary that the insolvency laws are in consonance debt recovery laws, tax laws and labour law.[iv] Therefore, the paper aims to provide an overview of the legislations that regulate insolvency proceedings in India.

Several recent reforms in the insolvency laws, like the establishment of National Company Law Tribunal, enactment of Companies Act, 2013 and Insolvency and Bankruptcy Code 2016; have changed the liquidation process and resolution for sick companies. These reforms have transformed the corporate landscape of India. The new laws have witnessed several changes and are in a position of evolution with a lot left to be addressed. The current insolvency regime lacks in catering to the interest of stakeholders other than creditors while also failing to adequately protect unsecured creditors who are in the majority. Additionally, the lack of clarity between the jurisdiction of different courts and tribunals has forced the Supreme Court to interpret these statuses and the conflict of jurisdiction between the varying statues. Furthermore, several challenges have been identified since the enactment of IBC, like the constitutionality of the Act, numerous infrastructural issues attributed to inadequacies in Benches, large number of cases pending before the tribunals.
consequentially, the problems in the current insolvency regime increase the need to educate various stakeholders of the resolution mechanism under IBC and Companies Act, 2013, for appropriate use of these legislations. Additionally, the judiciary has had to clarify the intent and provisions of the code, due to its constant evolution, lack of clarify on certain aspects and possibility of multiple interpretations.[v]

Therefore, the paper further aims to analyse the lacuna in the insolvency laws in India and subsequently provide suitable suggestions to address these issues.

HYPOTHESIS

Based on the research questions, the following hypothesis is formulated:

H1- Deficiencies in the regime of corporate restructuring and rehabilitation is positively associated with the need for strong insolvency legislation.

H2- issues in the current insolvency laws in India is negatively associated with the existence of strong legislative framework.

H3- the need for a strong insolvency regime is positively associated with the need for reforms in the current insolvency legislative framework.

RESEARCH QUESTION

The following research questions arise due to the legal problem:

I. Whether the regime of corporate restructuring and rehabilitation is viable and adequate under the Indian Legislative framework?

II. Whether the implementation of the current insolvency laws in India have achieved the intended purpose of the legislation?

III. What reforms can be made to the existing insolvency laws to address the issues and gaps in the legislations?

RESEARCH OBJECTIVES

The following research questions arise due to the legal problem:

I. To explore and understand the regime of corporate restructuring and rehabilitation to determine the viability and adequacies of the aforementioned legislations.

II. To analyse the implementation of the current insolvency laws in India along with judicial pronouncements to scrutinize if the legislations has achieved their intended purpose.

III. To examine and determine the need for reforms to the existing insolvency laws based on the issues and gaps identified in the legislations.

RESEARCH METHODOLOGY

Nature

The nature of the current research is going to be qualitative and will be approached in a doctrinal method. The nature is going to be qualitative as rather than numerical data, concepts and principles are going to be studied to prove or disprove the hypothesis of the study. Firstly, the researcher will rely on the explanatory and analytical approach to study the standpoint of India Laws in terms of corporate restructuring and rehabilitation as well as insolvency proceedings under Chapter II and III. Furthermore, critical and interpretive approach of research shall be used to scrutinise the legislations to understand the issues and gaps in the laws as well as their impact on the Indian Economy under Chapters IV and V. Lastly, applied approach of research will be used derive the degree of success and viability of the insolvency laws in India to make conclusions and suggestions in the need for reforms in the current insolvency regime.

Doctrinal Research

The researcher will use **doctrinal legal methodology** to critically analyse the existing legislative framework governing Corporate Restructuring and Insolvency laws in India. Primary Data like the central legislation of the Companies Act, 2013; SICA, 1985; SARFAESI Act, 2002; and Insolvency and Bankruptcy Code, 2016 will be used along with various authorities and judicial pronouncements on it. Additionally, the research will also be relied on secondary data sources such published government reports, books and research work by scholars and articles on websites. To synthesise the literature used in the research, reliance has been placed on databases and other online resources to access relevant publications of research papers and journals.

LIMITATIONS OF THE STUDY

The study will be limited to analysing the laws and judicial pronouncements solely within India. The study will not provide a comparative analysis of the Indian laws with international

laws in matters relating to corporate restructuring and insolvency while evaluating the effectiveness of the Indian legislative framework. Additionally, the study will not get into the extensive details of old regime set out in SARFAESI Act, 2002 and SICA, 1985 though judicial pronouncements as the main focus of the study is to deal with the effectiveness of the current corporate restructuring and insolvency regime. The study will be limited to detailed evaluation of the insolvency and Bankruptcy Code, 2016 based on judicial pronouncements NCLT, NCLAT and the Supreme Court of India. Furthermore, the research lacks in providing a discussion on the ancillary concepts associated with corporate restructuring and insolvency such as mergers, acquisitions and takeovers and areas other than corporate debt restructuring, cross-border insolvency and the international scenario of insolvency laws. The study being doctrinal in nature suffers from the vices of perception regarding findings and conclusion like any other doctrinal research.

CORPORATE RESTRUCTURING AND REVIVAL OF SICK COMPANIES

Post-independence the aim of the makers of the constitution was to ensure that India became a socialist welfare state. For which, the preamble and the Directive Principles of State Policy encouraged the Indian government to move towards industrialisation to transform India from an agrarian to an industrial country. The government revolutionised the Indian Economy with large-scale industrialisation.[vi] However, numerous industries failed to sustain themselves and were turning sick, being prone to irradiation.

The government to cope with this problem, used to take over the sick companies to prevent them from closing down, and thereby impacting the production of goods and services. The sick industries used to be nationalised, which turned out to be a huge burden in terms of obsolete technologies being used, increasing liabilities towards employees, financial institutions and creditors. To an extent the Indian government was successful in reviving these companies, which were subsequently handed over to the proprietors. However, the government was finding this method to be uneconomical and rather ineffective in controlling industries from turning sick.

Rehabilitation of Sick Companies:

Enactment Of SICA, 1985.

The growing number of sick companies was concerning for the Reserve bank of India, as it was a keen indication of loss of production, employment, governmental revenue and unpaid debts with banks and financial institutions. To deal with this, in 1981, Tiwari Committee was formed under Shri T. Tiwari to identify the cause of industrial sickness and to make recommendations that would mitigate the issue.[vii]
The Tiwari Committee identified the need for a special statue to address the issue of industrial sickness. They also suggested the setting-up of a quasi-judicial body for the same. After consultation with those affected by industrial sickness and based on the recommendations of Tiwari committee, Sick Industrial Companies (Special Provisions) Act, 1985 was enacted.
SICA was mainly a remedial law[viii], since it gave power to the Board of Industrial and Financial Reconstruction (BIFR), which was a quasi-judicial body to take up any legal or financial decisions to ensure the revival and rehabilitation of sick industrial companies or liquidation it could no longer be revived[ix].

Deficiencies Of SICA, 1985

SICA was not a very effective piece of legislation and failed to achieve its intended purpose. Numerous shortcomings were witnessed in its functioning. One of the main issues with the legislation was the it permitted the old management of a defaulting company to retain control even during the rehabilitation process.[x] SICA was also ineffective in timely rescuing sick industries. This was mainly due to delay in the proceedings before BIFR. Rehabilitation proceedings generally took approximately five to seven years through BIFR and subsequent appeals elongated the process further.

Even though SICA was intended to reduce judicial intervention, the involvement of courts in the rehabilitation was excessive. Additionally, BIFR was also not very efficient in determining whether a sick company was eligible for revival or liquidation. The statute was in favour of debtors over creditors in the rehabilitation proceedings and provided for automatic moratorium on recovery proceedings.

Due to these drawbacks amongst many, SICA was repealed in 2003 and BIFR and AAIFR were dissolved.

Rehabilitation under Companies Act, 2013

Chapter XIX of Companies Act, 2013 regulates the revival of all companies and not just special industrial companies like under SICA.
The rehabilitation process is carried out by NCLT, which is a quasi-judicial body. The Companies Act, 2013 is relatively efficient by provisions requiring higher creditor involvement in the revival process; a set criterion to determine liquidity test; moratorium only on application to NCLT, creditor committee to determine if company is to be liquidated or revived, approval of creditors in rescue scheme, etc. Even though the provisions under Companies Act, 2013 has improved substantially from the old regime, there are still certain challenges that need to be addressed for effective functioning of the legal framework.[xi]

Rehabilitation under Insolvency and Bankruptcy Code, 2016

The code consolidates the insolvency process along with the restructuring and rehabilitation process within a single legislation. The corporate insolvency resolution process under the Code, is creditor oriented and can be initiated even by financial creditors[xii] or the debtor company being the insolvency applicants[xiii].

When a debt is owed by a corporate debtor, towards which it defaults, corporate insolvency proceedings can be initiated. Instead of relying on the "sickness test" as prescribed bunder SICA and Companies Act, 2013, the Code focuses on "cash flow test", which is better at determining extent of default and plausibility of revival[xiv]. After a fair assessment, the insolvency applicant may proceed to apply to the National Company Law Tribunal and initiate the insolvency proceedings after complying with the required procedure. If the NCLT is satisfied with the application, it may be admitted and the process against the corporate debtor, commences. Upon admitting the application, the NCLT has to declare moratorium[xv], wherein no legal proceedings can be undertaken against the corporate debtor to slow the insolvency proceedings. The information that corporate insolvency proceedings have been initiated against a corporate debtor is given through a public announcement and an "interim resolution

professional"[xvi] who is registered with the Insolvency and Bankruptcy Board of India is appointed.

The Code has changed the regime from a debtor-friendly process to a creditor-friendly process. This substitution is seen considering that a committee of creditors is formed along with the insolvency professional taking charge replacing the old management of the company.

In the corporate insolvency resolution proceedings, revival and rehabilitation is witnessed by formulating a resolution plan. Rehabilitation takes place if the resolution plan is accepted by the Committee of creditors and the NCLT and implemented after the approvals[xvii]. The Code prescribes a detailed process for the same. If no resolution plan is approved by the NCLT or agreed upon by the committee of creditors within 180 days, then the company is liquidated.

CORPORATE DEBT RESTRUCTURING

Corporate debt restructuring is the process in which an entity's outstanding liabilities are reorganised to reduce the debt a company has to pay at a lower rate or deferring the date on which the payment will be due or providing the company with more financial assistance to carry-on operations with higher efficiency. Through this mechanism, a company is less likely to default and the potential of repayment becomes high. Sometimes, creditors choose to forgo collection of debt for holding equity in the company.[xviii]

The requirement of developing an adequate system for the process of corporate debt restructuring tends to arise when an entity and its creditors come to the realisation that the company is likely to survive and be feasible in the future, however, is currently undergoing monetary instability and is facing hardship in meeting its debt obligations.

A time-bound and transparent process will ensure effective restructuring of the debts of a viable company facing financial turmoil. Corporate restructuring prevents the possibility of a company to undergo liquidation and provides the company an opportunity to negotiate with

the creditors regarding reduction of the debt obligation and providing an opportunity to ensure survival.

SARFAESI Act, 2002

The SARFAESI Act, 2002 aimed at monitoring "securitization and reconstruction of financial assets and enforcement of security interest" and other incidental matters.[xix] The provisions of the Act apply to Non-Performing Assets (NPAs). A bank or a financial institution can only avail the remedy available through the SARFAESI Act, 2002, in case a debtor owes a debt to a secured creditor by way of a security agreement, and thereby defaults in payment towards the secured debt, the debtors account in such a case is classified as an NPA by the secured creditor[xx]. Therefore, to undertake a recovery process under SARFAESI Act, classification of an account as an NPA is essential. Before declaration of an account as NPA, a notice must be given by the secured creditor to the debtor to fulfil the debt obligation within 60 days from the notice and the notice must prescribe details of the amount playable and the security intended to be enforced by the secured creditor upon default.[xxi]

However, during this process, before classifying any account as NPA, Banks and financial institutions need to strictly adhere to the guidelines, as any irregularity can be detrimental and vitiate the proceedings commended under SARFAESI Act. Generally, banks in such a case, given ample of opportunity and time for following up and also, assess whether a restructuring option would be feasible in case any segment of the bank wishes to voluntary undertake the process of saving the NPA. Therefore, the entire process approximately takes 6-9 months. It is only after all options are exhausted in trying to save the NPA and attempts are made to retain the economic value of assets, that the creditor opts the recovery channel though SARFAESI Action.

The Act provides a secured creditor with numerous courses of remedies, to recover the debt owed, namely, by taking absolute possession of the secured assets of the defaulter; change in the management of the debtor company; appointment of an individual to control the secured asset the possession of which is taken by the secured creditor; requiring the person who is liable to repay the debtor a debt, to pay the secured creditor enough to recover the secured debt.

Therefore, SARFAESI Act has been an effective tool in the management of NPAs. The Act has been a resourceful means to recover debts from NPAs for the Indian Banking Industry. Considering that, comparing the situation before and after enactment, the number of non-performing loans have significantly reduced. For resolutions of NPAs, SARFAESI Act, DRTs and Lok Adalats are available changes of which, SARFAESI is seen as the most effective method.

INSOLVENCY LAWS IN INDIA

The Indian insolvency regime in the past has been such that numerous overlapping statutes operated simultaneously. These laws prescribed different means to undertake debt restructuring, seizure or realisation of assets to satisfy outstanding debts. All of these overlapping statutes caused unnecessary confusion while dealing with the insolvency and liquidation process in India and piling up of NPAs. Therefore, the Insolvency and Bankruptcy code, 2016 consolidated the insolvency framework to protect the interest of investors and facilitate credit flow in India by speedy redressal of claims.

The Code allows a creditor to initiate insolvency proceedings of a debtor cannot pay its debts. The Code has differentiated between Financial and operational creditors. Wherein a financial creditor is owed by a debtor a financial debt against "consideration of time value of money"[xxii], whereas, an operational creditor provides goods and services to the debtor.

The debtor also has a resource under the Code to opt for revival mechanism or liquidation. If the debtor is aware of the inability to repay the debt obligation, a company may opt for voluntary insolvency resolution proceedings by approaching the NCLT.

The institutional framework under the Code, provides for the Insolvency and Bankruptcy Board of India which is a supervisory and regulatory body that ensures education and implementation of the Code. The Code also provides for a new cadre of insolvency professionals known as the resolution professional who overlook the resolution proceedings. The Code also establishes an Insolvency Professional Agency to regulate the practice of these professionals.

The Code also deals with the formation of Information Utilities[xxiii] that collect, maintain and provide financial information to financial institutions, investors, adjudicating authorities,

insolvency professionals, and other stakeholders regarding a corporate debtor. The information is about the liabilities, default, outstanding debt and other such information provided by the creditors. The records from these utilities serve as evidence during insolvency resolution proceedings.

The adjudicating authority that undertakes insolvency proceedings is the NCLT, which is eligible to handle all issues relating to insolvency resolution. No other tribunal or civil court can interfere with the NCLT's jurisdiction[xxiv]. An NCLT decision can be appealed in the NCLAT[xxv] and then subsequently in the Supreme Court.[xxvi] Additionally, Limitation Act, 1963 applies to the proceedings under the Code[xxvii]. The Supreme Court said that the Section must be made applicable retrospectively, "*otherwise, applications seeking to resurrect time-barred claims would have to be allowed, not being governed by the law of limitation.*"[xxviii] Therefore, claims that are time-barred cannot be proceeded against under the Code. The aim of the Code is revival though Corporate Insolvency Resolution Process (CIRP) and when the debt cannot be resolved, liquidation.

CORPORATE INSOLVENCY RESOLUTION PROCESS

Initiation Of CIRP

A financial creditor individually or jointly or any person for the financial creditor may apply to the NCLT for initiation of Insolvency resolution proceedings once default occurs. However, under the Code there is no requirement to send a notice to the debtor. Due to this the Supreme Court in ***Innoventive Industries v IDBI Bank***[xxix] mandated service of notice to the debtor and the right of the debtor to be heard aligned with principles of natural justice.

The Code requires that within 14 days of application the NCLT must ascertain the existence of default to accept or reject the application. The 14-day period is not mandatory but merely a directive[xxx]. However, no standard or degree of proof has been prescribed to ascertain the exitance of default. Therefore, the Supreme Court clarified that mere existence of an outstanding debt which has been defaulted, needs to be enquired[xxxi].

An operational creditor can also apply to the NCLT to initiate the insolvency process. However, before that, the operational creditor has to make demand for repayment of the outstanding debt

and in case the debt isn't paid, the operational creditor can apply to the NCLT.[xxxii] Within 10 days of the demand, the debtor has an option to dispute the debt by showing that the dispute was in existence. In one of the landmark judgments, ***K. Kishan v. Vijay Nirman Company Pvt. Ltd.***[xxxiii]***,*** the Supreme Court stated that, proceedings under IBC cannot be initiated unless all other available mechanism has been utilized. Therefore, operational creditors could not prematurely use IBC for debt enforcement.

A corporate debtor can initiate insolvency proceedings, wherein a special resolution by the shareholder of the corporate debtor needs to be passed or three-forth of the total partners should assent to filing for insolvency and by furnishing books of accounts to the resolution professional.[xxxiv]

Existence of a "Dispute"

The Concept of a dispute has been envisaged in section 5(6) of the IBC, wherein a dispute must be such that it *"includes a suit or arbitration proceedings"*. Such a dispute must be regarding *"the existence of the amount of debt"* or *"quality of goods or service"* or *"breach of a representation or warranty"*. For the "existence of the dispute", no notice of dispute should have been received by the operational creditor or there must be no record of dispute in the information utility for the application to be accepted. Per contra, if the operational creditor has notice of dispute in the aforementioned manner, the application can be rejected under Section 9(5)(ii)(d) of IBC. A corporate debtor can prove the existence of a dispute by showing the records of dispute in a pending suit or arbitration, if the dispute relates to the conditions prescribed under section 5(6) by giving notice of such a dispute to the operational creditor.

The Apex Court in the case of ***Mobilox Innovations Pvt. Ltd. v. Kirusa Software (P) Ltd***[xxxv], answered a material question regarding the existence of a dispute between the parties before the demand notice of the unpaid operational debt was received by the Corporate Debtor. Additionally, the adjudicating authority must determine if the dispute was brought to the notice of the operational creditor before service of the demand notice. The Supreme Court went on to interpret the words of section 8(2)(a) which state, *"Existence of a dispute, if any,* ***and*** *record of the pendency of the suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to such dispute."*

While giving its interpretation that the term ‘and’ in section 8(2) (a) should be construed as ‘or’, the Supreme Court highlighted the intention of the legislature, stating that, *“Otherwise, only a dispute pending before a court or arbitral tribunal can stop insolvency proceedings and not any other type of dispute.”*

Insolvency Resolution Process.

Once the application is accepted, a moratorium is declared for initiating any legal proceedings against the debtor[xxxvi] till the insolvency process is complete, to keep the debtor’s assets intact from being attached in any other legal proceedings. Only with the approval of the committee of creditors can the asset be alienated or encumbered. The NCLT within 14 days appoints an interim resolution professional. The professional takes over the management and control of the company and the Board of Directors stand suspended. The IRP assesses the current financial position of the corporate debtor and collect the claims of all creditors. The duration of the process is prescribed to be complete within 180 days, extendable by 90 days[xxxvii].

To improve the process of valuation of assets and increase transparency, the Code along with the IBBI regulations for Corporate insolvency resolution proceedings were amended in 2018. Earlier it was only necessary to determine liquidation value, which was replaced with the additional requirement of fair value, to ensure the bid submitted by resolution applicants is not below market value.[xxxviii] Therefore, the value of assets is maximised to meet maximum debt obligations.

Earlier the position was that post-admission, application for CIRP could not be withdrawn, however the same has been allowed *“with the approval of 90% of voting share of Committee of creditors”* in the NCLAT judgment ***Lokhandwala Kataria Construction v. Nisus Finance and Investment Managers***,[xxxix] which also led to the insertion of Section 12A to the Code. In ***Swiss Ribbons Pvt. Ltd. v. Union of India,***[xl] the Supreme Court held that, in case a committee of creditors has not been formed *“a party can approach the NCLT directly, which Tribunal may, in exercise of its inherent powers under Rule 11 of the NCLT Rules, 2016, allow or disallow an application for withdrawal or settlement...”*

Committee Of Creditors

The resolution professional establishes the committee of creditors which include all the financial creditors.[xli] This addition was brought to the insolvency regime to transform the process to a creditor driven approach, where the committee takes major decisions like approving the resolution plan, appointment of the resolution professional, etc.

Since operational creditors cannot be a part of the committee of creditors, preferential treatment is given to financial creditors. In the case ***Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta***[xlii] the Apex Court recognised the need for "equitable recognition" and not "equal recognition" for different categories of creditors must be considered by the Committee of Creditors during a resolution process. The primacy and "commercial wisdom" of the CoC was resisted by the Apex Court as long as the interest of all creditors is taken into account.

The CoC holds enormous powers such as they can replace the resolution professional at any point, the resolution professional has to take approval of the CoC for gathering initial finances, creating security interest, amend creditor's rights, etc. additionally, a resolution plan requires the approval of the Committee of creditors and they oversee the resolution process, making sure that the asset value is maximised, the interests of all the stakeholders are considered and the corporate debtor remains a going concern.[xliii]

Resolution Plan

The main aim of the Code was to ensure that a debtors insolvency issue is resolved by finalising the resolution plan, without liquidation.[xliv] In the best-case scenario, the resolution plan provides a technique to allow the corporate debtor to repay the whole debt owed and allows the debtor to survive as a going concern. Without being able to pay the entire debt amount owed, the debtor would be liquidated. Additionally, all the costs relating to insolvency resolution process, implementation of plan and compliance of law, must be paid. If the resolution plan is approved by the committee od creditors and then by NCLT, the plan is implemented and the corporate debtor has a fresh chance of survival.

Before an amendment to the Code in 2017, resolution plans could be presented to the CoC by any person. However, the insertion of Section 29A to Code, now puts forth certain restrictions

on who can be a resolution applicant. Person's insolvent, wilful defaulters, convicted for an offence, etc. have been disqualified. Additionally, persons who manage the account of the Corporate debtor, person who has executed a guarantee for the debtor or person who was a promoter when a fraudulent transition took place, have also been excluded. In ***Chitra Sharma v. Union of India***[xlv]***,*** the Apex Court clarified the intention of section 29A of the Code, stating that it was *"to ensure that the persons responsible for insolvency of the corporate debtor do not participate in the corporate insolvency resolution process by means of a backdoor entry, effectuate public interest and ensure effective corporate governance."*

Once all eligibility requirements and the resolution plan are submitted, if the committee of creditors or the NCLT does not approve it or even if approval have been received by there is irregularity in the implementation, the debtor is liquidated.[xlvi]

A viable resolution plan, to be implementable, must be accepted by 66% of the members of the committee of creditors. If no plan is accepted by the CoC within 270-330 days, the corporate debtor is liquidated. However, the Supreme Court found this time period to be directory and not mandatory.[xlvii]

However, if resolution fails, a liquidation order is passed by the NCLT and the committee of creditors ceases to exist. A liquidator is appointed who verifies the claims of creditors, prepares a memorandum of assets, and takes into custody the assets of the corporate debtor to ensure proper liquidation. A stakeholder's consultation committee is constituted. The assets of the company are sold off by the liquidator by an auction and the process takes up to one year.

ISSUES FOR CONSIDERATION UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

The Code is still in its initial stages of implementation and therefore, with it, arise certain challenges and ambiguity regarding unclear provisions. No law can be without flaws from its inception. Therefore, with amendments and judicial interpretation, the issues in the Code can be resolved.

Directory Timelines

The objective of the Code was to provide timely resolution which previous statutes like SICA, 1985 failed to provide. An amendment to the Code in 2019 on the same lines made the timeline under section 12 of the Code, "mandatorily" requiring the completion of the insolvency process in a maximum time frame of 330 days. However, the Supreme Court has not stuck with this amendment in the ***Essar Steels case***[xlviii]***,*** wherein it interpreted, the term as directory and the time could be extended in case certain conditions were met. The decision has caused backlog of cases in the NCLT and NCLAT for the insolvency proceedings.

Differential Treatment for Different Classes of Creditors.

The committee of creditors for the purpose of the insolvency resolution process only comprises of financial creditors leaving aside operation creditors. This has created numerous issues with operational creditors who believe the organisation is able to survive because of their credit and by ignoring their involvement in the process, their interests are severely hampered. A similar issue was raised in ***Binani Industries Ltd. V. Bank of Baroda***[xlix]***,*** where the Supreme Court decided that the claims of operational creditors should be recorded and they should be given a seat at the table. The committee of creditors was required to submit a written report to ensure the rights of all creditors is ensured.

Excessive Power with the Committee of Creditors.

Excessive power is available with the committee of creditors who decide the fate of the corporate debtor as to whether it will be allowed to function as a going concern or it will be liquidated. Substantial amounts of power with the creditors does not ensure public interest. There have been numerous instances where the intention of the committee of creditors has been questioned. However, the court have time and again decided that the "commercial wisdom" of the committee should not be questioned.[l]

Misconduct by Insolvency Professional.

Insolvency professional have a big responsibility in the insolvency process, to run the business of the Corporate Debtor. However, the Code is largely silent on the qualification requirements of an insolvency professional, even though they are responsible for running the entire business

in place of the old management. Even though the professional only undertakes an administrative role, lack of essential qualifications can lead to irreparable damage to the debtor's company. In one case where, Mukesh Mohan, an insolvency professional, manipulated the entire committee of creditor towards a resolution plan, was found to be detrimental to the corporate debtor[li]. However, even though the insolvency professional was liable for misconduct, he escaped liability having the defence of undertaking activities in good faith. Therefore, regulations are needed to be put in place to regulate such behaviour.

Third-Party Security Transactions

In case a corporate debtor goes into an insolvency process, a person who has entered into a third-party security transaction with the corporate debtor will not be able to enforce such a security due to the moratorium being imposed. Neither will such a person be included as a financial creditor. Such a person will therefore, not be eligible for seat in the committee of creditors and their rights can be unilaterally modified during the resolution process. Even while deciding the priority of distribution under section 53 of the Code, not qualifying as financial creditors, they can merely be seen as indirect secured creditors, for whom no reference has been made under the Code. The position of the Supreme Court is clear through the decision in ***Anuj Jain v. Axis Bank Limited***[lii] and ***Phoenix Arc Pvt. Ltd. v. Ketulbhai Ramubhai Patel***[liii]**,** where it has been laid down with sufficient clarity that third party security holder's interest could not be considered as "financial debt" and therefore, are not financial creditors.

Cross-Border Insolvency.

In India, cross-border insolvency is regulated under Sections 234 and 235 of the Code, which require bilateral agreements between India and another country to initiate cross-border insolvency proceedings. However, the present framework is not well equipped to deal with cross-border insolvency in the absence of a bilateral treaty. The intention of cross-border insolvency is to be able to protect the interests of foreign creditors who are owed by the corporate debtor, in different jurisdictions, therefore the right to initiate insolvency resolution proceedings also lies in different jurisdictions. The insolvency law in India needs to be amended in this aspect to ensure better administration of assets in the cross-border insolvency process.

Pre-Packaged Insolvency Resolution Plans

In USA and UK, the arrangement of "pre-packaged insolvency process" is allowed where in the entire or part of the corporate debtor's business is negotiated with potential applicants before the insolvency proceedings commence. In India, still the bidding system is followed to get a resolution plan approved. Allowing pre-packaged plans will not only ensure an extremely quick resolution process, but it also ensure maximisation of the asset value. However, allowing such a process would require implementation of necessary safeguards. This from of resolution can be seen to benefit the Indian economy to recover from the large number of NPAs.

Consolidated Insolvency

The insolvency law committee in 2018 recommended that group insolvency should be made a part of the Code. In a group insolvency resolution proceeding, if many entities belonging to one group become insolvent, then the entire group can be reorganised and restructured together as a single entity. Clubbing the assets and liabilities of these entities as a group will allow better utilization of the asset through maximisation in its value. In India, the NCLT in the past has allowed group insolvency for Videocon Industries Limited[liv]. However, there is no law governing the same, and was only allowed in the instant case due to common management, assets and liabilities.

Reluctant to Accept Large Haircuts

Secured creditors are often reluctant to accept large haircuts. Since the committee of creditors under the Code is required to decide on the extent to which they are ready to allow waiver and concession to the debts of the corporate debtor. It is often seen that such a decision falls at the back of selected members of the organisation, who are apprehensive about accepting larger haircuts and thereby, driving the corporate debtor to liquidation. Therefore, officials refusing to accept offers under resolution plans should be questioned, if realisation under liquidation is actually lower than after accepting large haircuts in resolution plans. Secured creditors need to be educated by insolvency professionals at the time of security enforcement.

IMPACT OF INSOLVENCY AND BANKRUPTCY CODE, 2016 ON THE INDIAN ECONOMY

The limited years of implementing the Code has not been sufficient in determining the true impact of the legislation on various parts of the economy. Major changes in the behaviour of corporate entities regarding corporate governance practices, investors regarding their lending practices, capital markets and the economy as a whole is impacted by the implementation of the Code. The impact of the code on various elements of the economy needs to be identified.

Impact on Corporate Governance.

A company and its management are intertwined in India regardless of the company being a separate entity. Therefore, to keep a check, certain mandatory provisions have been included in the Companies Act, 2013 and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. These regulations deal with provisions for independent directors, disclosure requirements, related party transactions, preparation of financial statements and organisational reporting, etc. therefore, it is the duty of directors to work in the best interest of the company, its stakeholders, and the community.[lv] A director is required to exercise independent judgment in matters where there is possibility of direct or indirect conflict of interest. The directors have to ensure, there is correctness and fairness in the financial reporting with adequate system of control. However, the implementation of the Code has increased the involvement of creditors in the corporate governance role.

It is often the directors who are responsible for the management, that realise the stressed position of a company and therefore aim to resolve it by taking loans or alienating assets of the company. Additionally, indulging in fraudulent activities is often caused by improper monitoring of loans by banks. Therefore, the Code has been effective in placing deterrence measure to prevent such acts. The Code also provides a period to look back into the actions of the director of a corporate debtor to hold them liable for the insolvency process, considering they ought to have known the possibility of a corporate insolvency resolution proceeding and made no attempt to minimise the losses.[lvi] The liquidator is empowered to reproach the NCLT if they find any transaction undervalued or aimed to defraud creditors[lvii], and if the transaction is found to be malafide, the NCLT may impose penalty under the Code.[lviii] For the directors who have erred, the Code provides civil and criminal liabilities. The promotors are at the

potential risk of losing control of their company under the Code and if the company is undergoing insolvency for turning into an NPA, the promotors are also barred from bidding their company.

Impact on Business Practices

The balance of power through the Code has now been transferred from the promotors to the creditors. Therefore, there is increasing discipline in borrowing behaviour of corporate debtors. The threat of potentially losing their company, has increased the amount of responsibility among the company's promotors and management.[lix] The creditors have also started practicing stricter evaluation criteria for loans. The Corporates are being asked for higher equity and are required to show the source, therefore increasing the leverage monitoring. Additionally, the end-use of the loan is being strictly monitored and the corporate debtors are under threat of consequences of not adhering to the purpose of the loan. The bankers are also under the check of the RBI to make sure the funds are not diverted, wherein any diversion can be considered as wilful defaulting. This could be a serious predicament for the promotors from accessing loans in the future. Similarly, SEBI has strictly restricted raising money from capital markets for wilful defaulters or even becoming directors of companies. The auditing committee and the board of directors are responsible to track the use of funds raised by issuing securities. Therefore, the increasing pressure on the promotors, is forcing them to resolve their dues by selling off shares or assets. Corporate debtors are also trying to pay off their debts during the pre-admission stage, before being declared as insolvent by NCLT. Therefore, data by IBBI show that numerous cases are being disposed off due to recovery in the pre-admission stage.[lx] Therefore, the Code has impacted the behaviour of both the lenders and the creditors.

In 2019 RBI released guidelines for stressed assets, requiring lenders to identify initial signs of a stressed loan account and classifying it as special mention accounts.[lxi] If the borrower defaults, the lender reviews the borrowers account for 30 days, and if the threshold is met, the resolution plan has to be implemented in 180 days. Given the strict timelines under the Code, the borrows closely monitor loan proposals and performance of the company during the tenure of the loan.

Impact on Capital Markets

According to world Bank[lxii], the recovery rate has increased from 26 percent to 72 percent under the Code. This has improved the confidence of the investors in the capital market. Considering that the government and market regulators, are attempting to grow the culture of corporate-bond market in India, non-bank source of credit is increasing compared to the share of bank loans. Therefore, the standards of credit rating agencies for monitoring the quality of bonds have also been enhanced. The impact of the Code on the Indian bond market is yet to be analysed. However, the growing confidence of the investors, has resulted in increasing investment in stressed assets due to the Code. In 2018, India witnessed an increase in M&A deals, attributed to the enactment of the Code.[lxiii]

Impact on NPAs

The growing number of gross non-performing assets was turning hazardous for the Indian banking system, due to aggressive lending by bank and wilful defaulting by debtors. If resolution of stressed assets was not plausible, the Code provided for quick liquidation for stressed corporate debtors. The time-bound resolution under the Code, has proven to be a robust system for resolution and liquidation, which has resulted in a decrease of gross NPAs with scheduled commercial banks. High rate of resolution and realisation is seen under the Code compared to the old regime. Therefore, the Code has been instrumental in recovery of NPAs. However, numerous resolution plans have proven to be unsuccessful, resulting in frequent liquidation. Additionally, often the whole NPA is not resolved as resolution plans are accepted with heavy haircuts.

CONCLUSION

Noteworthy efforts have been taken by the enactment of the Insolvency and Bankruptcy Code to update the whole system of credit in India by way of amendments and by repealing the old insolvency regime. The code has promised to reform the insolvency system in a creditor driven manner, which is proving to be successful. The focus of the Code is on identification of a company’s financial distress at an early stage and subsequently maximising the value of the corporate debtor’s assets. The uniform regime provides for a sequential and time-bound

mechanism for resolving insolvency or proceeding to liquidation. This efficient process under the Code, can be seen as a mechanism to improve debt recovery rate in India and strengthen the corporate bond market in India that has taken a back step.

The enactment of the Code and its proper implementation is likely to enhance the Indian position in ease of doing business, along with improving the gross domestic product, credit flow, foreign direct investment and the complete economic environment. Nevertheless, the entire burden of the success of the Code is reliant on the way in which the provisions of the Code are implemented by the adjudicating authorities and resolution professionals. With the high number of resolutions in the last few years, it is evident that the Code is proceeding on the path to success. However, this is precisely the time when those responsible for implementation of the Code, should not become complacent of the issues that remain unaddressed. The legal and procedural barriers need to be addressed by the adjudicating authorities and the legislature with minimum changes in the existing legislation. Regardless of the challenges, it is evident that the Code has significantly improved the old and complicated insolvency regime by consolidating all the aspects of resolution and liquidation under the same Code. The legislature and judiciary along with RBI and SEBI have played an imperative role by coordinating their efforts towards developing a strong legislative framework for revival and rehabilitation of stressed assets as well as expeditious resolution and liquidation process. India is growing in terms of its position as a developed country capable of a strong position in retail investment and insolvency resolution, worldwide. Additionally, the measures under the Code are an effective way of reducing the burden of stressed assets on the Indian Banking system.

SUGGESTIONS

In the light of the aforementioned analysis and conclusion, it can be suggested that:

- For maximum recovery from a corporate debtor, the process of sale and auction done by the liquidator should be more transparent, so as to fetch a fair market value for the assets of the company to repay the amount owed to the creditors.
- The management responsible for not taking effective action and pushing the company towards insolvency, thereby going against the interest of the creditors, should be made accountable for mismanagement.

- Even though the laws in place are effective, their implementation by the adjudicating authority at times fails to meet the mark of successful implementation. Along with the judicial acumen, attention must also be paid to practical and business approach while rehabilitating a company. The judiciary need to work with other disciplines to ensure effective revival of companies.
- The issues of pendency of cases, judicial incapability, inconsistency in procedure, lack of proper administration, as was faced in the DRT and BIFR can be avoided with the NCLT only as long as the strict-timelines prescribed under the Code is actually followed. Tribunals such as the NCLT have an opportunity to of not getting trapped into procedural intricacies and therefore have the option of ensuring timebound proceedings.
- Adequate compensation and infrastructural system will ensure the retention of the greatest minds towards the judicial and administrative staff in the tribunals.
- Additionally, establishing more NCLT benches will ensure speedy disposal of cases.
- For the insolvency resolution proceedings to be successful under the Code, the government, banks and RBI need to determine a common objective. The government's primary objective is public interest, the banks focus on early recovery and resolution, while the RBI aims to ensure stability in the economy. These diverse objectives have been seen to limit the effectiveness of the Code; therefore, they must identify common objectives.
- There is a requirement for empowering the recovery mechanism, to effectively identify the real stressed assets from those who are wilfully defaulting. Where wilful defaulters are discouraged by deterrence and the genuinely stressed accounts have the opportunity of restructuring and reorganising. This is likely to cause a positive shift by way of banks not being risk evasive.
- Adequate infrastructure can be a key by way of establishing a well-equipped information dissemination system and skilled personnel. The growing number of cases before the NCLT due to the Code, will require an extension of infrastructure. This will prevent the NCLT from suffering the fact similar to DRT.
- Even though the Code in itself resolves several problems of the previous regime, ineffective implementation by the adjudicating authorities will defeat the purpose of this key legislation. Therefore, the focus must not be on expeditiousness in implementation, but towards meticulous transition and sticking to the objectives of the enactment.

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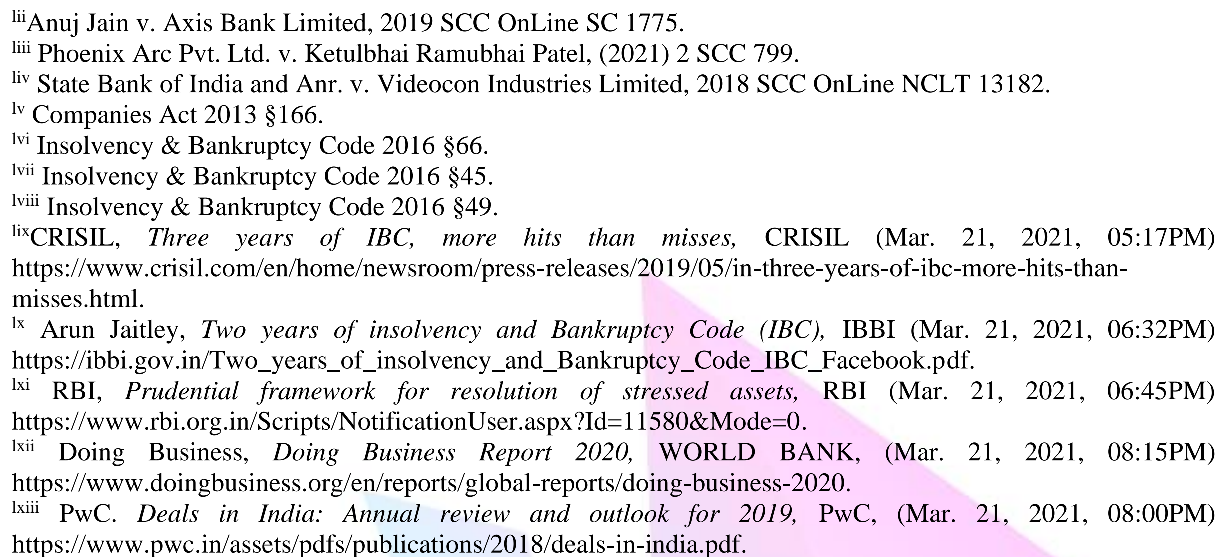

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