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ANALYSING THE LAW OF INSOLVENCY AND BANKRUPTCY IN INDIA

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Abstract

This research paper looks at the evolution and efficacy of bankruptcy and insolvency laws in India, with a particular emphasis on the change from fragmented laws to the comprehensive Insolvency and Bankruptcy Code (IBC) of 2016. The Insolvency and Bankruptcy Code (IBC) was enacted to bring together disparate insolvency laws and create a structured, time-bound process for handling bankruptcy matters. The Companies Act of 1956, the Sick Industrial Companies Act of 1985 (SICA), the SARFAESI Act of 2002, and the RDDBFI Act of 1993 were among the several acts that made up India's legal framework for insolvency prior to its enactment. This led to lengthy court proceedings, inefficiencies, and financial hardship for creditors. The paper examines how the IBC changed the way insolvency was handled, putting more emphasis on distressed enterprises' rehabilitation than on liquidation. Additionally, the paper offers an analysis of the current regime with pre-IBC frameworks, focusing on the effects of the IBC on investor confidence and economic recovery as well as procedural reforms and creditor-debtor dynamics. In conclusion, the research highlights ongoing issues such as ambiguity in the requirements for filing for insolvency and constraints in institutional structures, suggesting areas for future reform

Introduction

Insolvency refers to the state of an individual or entity whose assets are insufficient to pay off his debts. Insolvency is expressly used to denote the inadequacy of a party to pay his debts due during the course of business[1]. On the other hand, bankruptcy refers to the legal status of an individual or entity unable to pay his debts to creditors[2]. The bankruptcy process begins when a petition is admitted in a court or appropriate authority and the assets of the debtor are evaluated to pay the creditors. Bankruptcy is merely the formal declaration of insolvency under law. The purpose of the formal process of insolvency and bankruptcy is to ensure that creditors

[1] Section 2(8) of the Sale of Goods Act, 1930 (30 of 1930)
[2] Wharton's Concise Law Dictionary, Universal Law Publishing Co., Sixteenth Edition, p.109

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are safely paid their dues and are reimbursed for the money they put into the company, at the same time provide the debtor an opportunity to revive their company and continue their course of business. Liquidation is only considered when a resolution cannot be settled. A systematic procedure of resolution and rehabilitation for struggling companies is to be accounted for in a legal system, in order to effectively disburse the parties concerned, whereas an uncodified and fragmented system will only create confusion and hardship for parties. This research paper seeks to identify the effectiveness and problems of insolvency and bankruptcy laws in the Indian legal system, whilst analysing the defects of the old regime prior to the implementation of the Insolvency and Bankruptcy Code, 2016[3].

The IBC

The Insolvency and Bankruptcy Code, 2016 (IBC) is the law that governs insolvency and bankruptcy procedures in India, for both individual and corporate entities, coming into force on December 1st, 2016. The act had consolidated a previously scattered and unorganised body of laws, spread across several legislations, where provisions from these acts were indiscriminately put together to form a loose framework neither clearly outlining a systemic structure of procedure nor providing a formulaic approach for courts to interpret the law effectively. With multiple laws overlapping and numerous adjudicatory authorities, the need for a comprehensive framework often entered into discourse when problems arose due to the lack of the same. 'Bankruptcy and Insolvency' is mentioned in the Concurrent List under Entry 9[4], allowing both central and state governments to legislate on it. The Bankruptcy Law Reforms Committee[5] presented its report to the Ministry of Finance on November 4, 2015, with the objectives of the committee being resolved to consolidate insolvency laws with; lesser time involved in the process, lesser loss in recovery, and higher levels in debt financing. The N L Mitra Committee[6] in 2001 also suggested the implementation of a comprehensive insolvency code, as well as a time-bound process for insolvency proceedings. The purpose of codifying insolvency laws was to place emphasis on coherence, predictability and to provide for a sound mechanism for different stakeholders in the event of a business failure or the inadequacy in the payment of debts, with the focus of the new regime shifting to rehabilitation of distressed companies as opposed to liquidation. One of the defining features of the Code is the time-bound

[3] The Insolvency and Bankruptcy Code, 2016 (31 of 2016)
[4] The Constitution of India, Sch. VII, List III, Entry 9
[5] Bankruptcy Law Reforms Committee Report, November 2015
[6] The Report of the Expert Committee on Legal Aspects of Bank Frauds, 2001

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procedure of the Corporate Insolvency Resolution Process (CIRP) which mandates the insolvency proceeding to be completed in 180 days extendable upto 270 days, a 2019 amendment to the act further increased the timeline to 330 days. For start-ups and small companies the timeline is 90 days extendable by 45 days. A far cry from the old regime's unwavering and uncertain timelines drawn out for years on end, weighed down by vexatious litigation and unfulfilling outcomes. The Code also established the Insolvency and Bankruptcy Board of India (IBBI), which oversees all insolvency proceedings as well as participating in the regulation of entities registered under it. The IBBI consists of 10 members with representatives from the Ministry of Finance and the RBI. The National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT) have been granted jurisdiction over all insolvency petitions in the country, with the Supreme Court entertaining Special Leave Petitions under Art 136[7] as well. The decision of the Court in **Jotun India Private Limited v PSL Limited Company[8]**, effectuated the transfer of numerous cases against companies whose winding up petitions remained pending in High Courts, subsequently transferring them to the NCLT after the implementation of the IBC.

Background

Prior to the IBC, the banking sector was afflicted by financial distress caused by rising non-performing assets, stressed assets and burdensome litigation; relief for creditors was provided in the Companies Act, 1956[9] and the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA)[10], however, these two acts focused on the revitalisation of ailing companies, rather than the payment of creditors. The Other remedies provided to secured creditors was to enforce their securities by excluding themselves from the winding up process under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)[11]. This paper seeks to analyse the efficacy of the IBC, 2016 and to determine the extent of improvements in the sphere of insolvency and bankruptcy, unto which the IBC has sought to provide. The IBC, 2016 has endeavoured to restructure the entire process that would ensue in the event of a company failing to make its dues with creditors, focusing on a more market-led and predictable framework in a time-bound process. Seeking to maximise the

[7] The Constitution of India, Art 136
[8] Jotun India Private Limited v PSL Limited Company, High Court of Bombay, Company Application No. 572 of 2017
[9] The Companies Act, 1956 (1 of 1956)
[10] Sick Industrial Companies (Special Provisions) Act, 1985
[11] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002)

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value of assets, providing a greater freedom to exit and addressing information asymmetries. The Code has allowed for the shift in importance from the debtor to the creditor, making markets safer for investors in case of default.

Procedure under the IBC

An insolvency proceeding under the IBC can be initiated by the financial creditors, operational creditors or the corporate debtor (the company itself), following which a Corporate Insolvency Resolution Process (CIRP) can be brought against the defaulting company, upon application to the National Company Law Tribunal (NCLT). In usual cases, the RBI issues a direction to financial creditors, typically banks who have claims against the company, ushered by the lead bank in the joint lender forum with the largest claim. To initiate such a process, the minimum default amount that has to be proven is 1 crore, after which the NCLT has 14 days to admit the application, for such cases directed by the RBI, the case has to be admitted as the default is already proven. After this, a moratorium is to be declared which is essentially a freeze on all legal proceedings and sale or transfer of a company's assets. The moratorium period provides a safeguard to the corporate debtor, allowing for a smooth and hassle-free resolution process. An Interim Resolution Professional (IRP) is to be appointed by the NCLT, in which the affairs of the company are entrusted with, following the suspension of the powers of the Board of Directors and remains such till the case is completed. The IRP identifies the potential creditors of the company and their claims, establishing the Committee of Creditors (CoC) constituting primarily the financial creditors, although operational creditors can participate albeit without voting powers. The CoC then appoints the Resolution Professional who formulates a Resolution Plan detailing the procedure to revive the company and settle the claims of the creditors. The Resolution Plan on approval from the CoC is submitted to the NCLT for further approval, after which the company is handed to a Resolution Applicant following a successful bid, and the plan is executed in the hopes of reviving the company. If no Resolution Plan is approved within the maximum 270 stipulated by the Code, the company undergoes liquidation. A liquidator is appointed to sell off the company's assets to pay off the creditors in a hierarchical order of priority, with financial creditors given precedence followed by operational creditors, unsecured creditors and workmen. Once all the assets are liquidated and creditors satisfied the liquidator submits its report to the NCLT, an order of dissolution of the company is finally issued.

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Overview of the procedure under the previous framework

The process of insolvency under the old regime was fragmented and unorganised. Insolvency and bankruptcy for individuals was covered under the Presidency Towns Insolvency Act, 1909[12], and the Provincial Insolvency Act, 1920[13], both of these acts were applicable to small companies. The IBC ecosystem has since absorbed the purview of individual insolvency under itself. The Companies Act, 1956 contained provisions for the winding up of companies which were to be admitted in the High Courts. Part VII of the act contained provisions for winding up. Secured creditors especially, were required to undergo a long and arduous process under the Companies Act, through winding up petitions that would often result in the winding up of borrowing companies. Leading to the liquidation of the company's assets, where such creditors pinned their hopes on the courts admitting the petitions to receive their dues under the liquidation process. The Companies Act, 2013[14] also contained provisions for winding up, but were subsequently repealed 3 years later by the IBC.

The Sick Industrial Companies (Special Provisions) Act, 1985 was the first major attempt by the Government of India to revive ailing companies especially in the industrial sector during the 1980s. The Act defined a 'sick company' as one whose net worth has completely eroded, and which has existed for more than five years, suffering complete losses exceeding their net worth. With the Adjudicating Authorities under the SICA being the Board for Industrial And Financial Reconstruction (BIFR) and the Appellate Authority for Industrial and Financial Reconstruction (AAIFR) as defined under Section 3(b) and 3(a) of the Act, respectively. Under Sec 15, the company was required to make a reference to the BIFR within 60 days from the date of finalisation of its duly audited accounts. The failure of the SICA was largely attributed to its approach in looking at sick companies, which determined them by prioritising the balance sheet of the company rather than cash flow statements, which could indicate the company's immediate ability in meeting its obligations. Since the SICA considered ailing companies on the basis of the erosion of their net worth, the company's liquidity would have been depleted much faster at the same time, making it a monumental task for the company to be salvaged effectively[15]. Another major constraint of the SICA was that it excluded companies engaging in trading or providing other services, this severely limited the purview under which companies

[12] Presidency Towns Insolvency Act, 1909
[13] Provincial Insolvency Act, 1920
[14] The Companies Act, 2013 (18 of 2013)
[15] Roy, D. (2019) Insolvency: Before and after the insolvency and bankruptcy code, iPleaders. Available at: https://blog.ipleaders.in/laws-on-insolvency-before-and-after-the-ibc/

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and their creditors can seek relief under this act. An amendment to the act in 1991, allowed for government companies to be adjudged under it. SICA was effectively repealed after the Parliament passed the Sick Industrial Companies (Special provisions) Repeal Act of 2003, dissolving the BIFR and the AAIFR, however, the act wasn't notified as they were delays in the setting up of the NCLT, which was set to replace the aforementioned Adjudicating Authorities in the Companies (Second Amendment), Act 2002. The act was finally repealed upon the commencement of the IBC.

The Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDBFI Act)[16], the Tiwari Committee was constituted with the objective of solving the problem of the recovery of dues of banks and financial institutions, proposed establishment of the specialised Tribunals, the Debt Recovery Tribunals and the Debt Recovery Appellate Tribunals who would aid in alleviating the rising amount of default money in the public sector and would utilise the recovered amount for funding the development of the country. Sec 19(9) of the act allowed for tribunals to issue certificates of recovery against all companies registered under the Companies Act of 1956, with recovery officers playing a central role in the disbursement of debt. The RDDBFI did not apply to banks and financial institutions whose amount due is less than 10 lakh rupees. Sec 25 provided for various modes of recovery which included the arrest of the defendant, the attachment and sale of movable and immovable property, and the appointment of a receiver to manage the properties of the defendant.

Secured creditors also had the option of seizing their assets and recovering their dues without having to go to court under the SARFAESI Act, 2002. It was enacted with a view of enforcing the interests of secured creditors by allowing them to auction commercial or residential assets of defaulters to recover loans, the RBI having the power to determine and manage these assets under the act. Sec 13 of the act empowers secured creditors to issue a demand notice to the defaulter, after which if the loan is not repaid within sixty days of issue of the notice, the creditors can take physical possession of the asset allowing them to auction or sell the assets to reimburse themselves. Sec 30 of the Act established Asset Reconstruction Companies (ARC), providing struggling banks and financial institutions an opportunity to clean up their balance sheet by isolating non-performing loans, allowing them to focus on other activities. In **Mardia Chemicals Ltd. v. ICICI Bank**[17], the Supreme Court struck down Sec 17(2) of the act as

[16] Recovery of Debts due to Banks and Financial Institutions Act, 1993
[17] Mardia Chemicals Ltd. v. ICICI Bank AIRONLINE 2004 SC 948

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unconstitutional, as the provision mandated borrowers to deposit 75% of the disputed amount claimed by the creditors to the Debt Recovery Tribunal, only then a petition could be admitted to stay a proceeding under the Act. The Court struck down Sec 17(2) as it felt that such a deposit of 75% would be unreasonable against debtors, as it is based on a unilateral claim and it may not be possible for the borrower to raise such an amount as his secured assets may already have been taken by the creditors or sold[18].

Other non-statutory frameworks and systems relating to the recovery of debts included the CDR and SDR, which were attempts by financial organisations led by the RBI to alleviate the dire situation of a credit crisis by providing a voluntary system for the parties to adjudge among themselves. Corporate Debt Restructuring (CDR) Mechanism was a non-statutory and voluntary agreement entered into by creditors and debtors for restructuring of debt, introduced for the first time in 2001, and largely implemented by banks and financial institutions. The CDR was only limited to banks and the financial institutions that had an aggregate exposure not exceeding 10 crore rupees. Strategic Debt Restructuring (SDR) was introduced by the RBI on June 8, 2015, with the main purpose of the scheme dealing with the exercise of stressed assets in a fulfilling way, by changing the management of the company to effectively deal with these assets. However, the scheme turned out to be largely ineffective, as there was an inadequacy in the number of cases admitted and an even lower number being resolved. The old regime, before the IBC can be seen as an incoherent amalgamation of various provisions

Comparative analysis of insolvency laws before and after the IBC

1. Objective:
    - SICA - Rehabilitation and revival of sick industrial units
    - RDDBFI - Recovery of debts due to banks and financial institutions through the Debt Recovery Tribunals
    - SARFAESI - Enforcement of security interests over defaulter's properties, establishment of Asset Reconstruction Companies
    - CDR and SDR - Change in existing terms and conditions of debt
    - IBC - Maximisation in asset value, resolution in a time-bound process
2. Trigger amount:

[18] Securitisation Law — Scrutinized by Shantimal Jain (2004) JULY PL (Jour) 22

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- SICA - Company must exist for 5 or more years, accumulated losses should exceed the net worth in a financial year
- RDDBFI - Default amount more than 10 lakh
- SARFAESI - Default amount owed to a secured creditor
- CDR and SDR - Aggregate exposure not exceeding 10 crores
- IBC - Default amount more than 1 crore

3. Time-line:
    - SICA - 1 year to determine if a company is sick
    - RDDBFI - Typically more than 2 years
    - SARFAESI - 1 to 2 years
    - CDR and SDR - No fixed time-line, it's an ongoing process
    - IBC - 180 days to maximum 330 days for CIRP, 135 days maximum for start-ups and small companies

4. Types of creditors:
    - SICA - Secured and unsecured
    - RDDBFI - Secured and unsecured
    - SARFAESI - Secured
    - CDR and SDR - Secured
    - IBC - Financial and operational creditors, including both secured and unsecured

5. Adjudicating Authorities:
    - SICA - BIFR and AAIFR
    - RDDBFI - Debt Recovery Tribunal and Debt Recovery Appellate Tribunal
    - SARFAESI - Assistance from Chief District Magistrate and appeal to the Debt Recovery Tribunal
    - CDR and SDR - RBI regulations and voluntary agreements between creditors and debtors
    - IBC - NCLT and NCLAT

6. Pillars of legal regime:
    - SICA - BIFR and AAIFR
    - RDDBFI - Debt Recovery Tribunal and Debt Recovery Appellate Tribunal

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- SARFAESI - Public auctions
- CDR and SDR - RBI regulations
- IBC - Insolvency and Bankruptcy Board of India, NCLT, and Insolvency Professionals.[19]

Securing investments

The growth of credit is deemed to be one of the major drivers of the economy, while non-performing assets are considered to be a detriment in the face of development of the financial sector. The overall health of a financial system is determined by the quality of assets held by banks and other financial institutions[20]. Credit worthiness is one of the key factors measured by moneylenders to determine the efficiency of their investments. A financial system cannot sustain itself without a reliable mechanism for investors to safely finance their operations, a key component of this being the guarantee or assurance that they will be paid back for the money they put in. Strong insolvency and bankruptcy laws provide a framework under which distressed creditors can seek relief through legal routes in ensuring that the money they have invested in failed ventures would be reimbursed. This instils a sense of confidence and sustainability in their undertakings by providing a safety net unto which they can rely upon in case things take a turn for the worse, the IBC has sought to ensure precisely this resolve. Sec 7 of the IBC empowers the Financial Creditors to initiate the CIRP, allowing for a greater culture of cautious lending and prudent borrowing. Sec 7 assures the interests of creditors' by providing them the option of directly addressing defaults. Challenges however, arise from the lack of precise description of what constitutes a legitimate default, resulting in disputes over the eligibility criteria. This ambiguity could possibly result in the burdening of the judicial system with insolvency proceedings that lack merit. In **Swiss Ribbons Pvt. Ltd. v. Union of India[21]**, the Court determined the constitutional validity of Sec 53 of the Code, differentiating between the financial creditor and the operational creditor. In which the Supreme Court recognised that there is an intelligible differentia between financial debts and operational debts, resulting in no obstruction of Art 14. The Code recognizes various kinds of secured debts and guarantees protection of legitimate interests of financial creditors over operational creditors, and seeks to prioritise the interests of the former over the latter, reinforcing the object of the Code. The

[19] Ibid, 15
[20] Bharati V. Pathak. The Indian Financial System. Markets, Institutions and Services. Second Edition. pg no. 576
[21] Swiss Ribbons Pvt. Ltd. v. Union of India AIR 2019 SUPREME COURT 739

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'resolving insolvency index' given by the World Bank's Doing Business Report of 2020, observed that India rose up the ranks from 136th to 52nd position since the enactment of the IBC[22].

Conclusion

The IBC, since coming into force, has been resolute in reforming the financial sector, overhauling outdated regulations characteristic of a socialist system, and misaligned with private interests therefore stunting economic growth in a globalised and privatised economy. It has had a significant impact over the economy of the country, such as increasing recoveries in defaults, boosting investor confidence and reducing the burden of non-performing assets affecting banks and financial institutions. The Insolvency and Bankruptcy Code has played a significant role in expediting insolvency procedures in India. This is demonstrated by the fact that the NCLT accepted 269 resolution plans in FY24, a 42% increase from the previous year. This increase demonstrates how well the code works to help struggling companies get back on their feet. Even with this achievement, the average time to resolution is still 679 days, which is much longer than the 330-day statutory limit. This is mostly because of stakeholder litigations that reduce the value of recovery. Nonetheless, the IBBI initiatives to improve resolution process strength, cut down on delays, and increase transparency have shown promise. 32% of the admitted claims through the CIRP were realised in FY23, with financial service providers yielding a 41% recovery. Furthermore, the decrease in the resolution to liquidation case ratio from 0.46 to 0.61 indicates a move in the direction of more successful insolvency outcomes. This trend has also been facilitated by prepackaged insolvency, which has allowed for a 25% claim realisation rate. Notwithstanding persistent difficulties, especially with regard to accelerating procedures, the IBC is still vital to the transformation of India's insolvency scene[23].

[22] Resolving insolvency - doing Business - World Bank Group. Available at: https://archive.doingbusiness.org/en/data/exploretopics/resolving-insolvency
[23] Standard, B. (2024) At 269, NCLT approves record resolutions under IBC in FY24: Ibbi Data, Business Standard. Available at: https://www.business-standard.com/economy/news/nclt-approves-record-resolutions-under-ibc-in-fy24-shows-ibbi-data-124051601194_1.html