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COMPARATIVE STUDY OF CIRP UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016 WITH OTHER CORPORATE INSOLVENCY LAWS

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ABSTRACT

This comparative study delves into the evolution and differences between the Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code (IBC) and earlier Indian laws like the Sick Industrial Companies Act (SICA), revealing critical shifts in the approach to resolving corporate insolvency. SICA, introduced in the 1980s, aimed to identify and revive sick or potentially sick companies, facilitated by bodies like BIFR and AAIFR, whereas the IBC emphasizes efficient insolvency resolution, asset value maximization, and stakeholder balance. Unlike SICA, which required formal references from specified entities, the IBC allows any interested party to initiate CIRP upon a default threshold of Rs. 1 Crore. Notably, the IBC introduces a moratorium period post-application admission, unlike SICA. The call for claims, resolution professional appointment, and focus on proactive resolution distinguish the IBC from earlier frameworks, fostering a more agile and value-driven approach to corporate insolvency resolution, underscoring the importance of this evolving legislation amidst global insights from UK and US insolvency laws.

INTRODUCTION

Corporate Insolvency resolution process under IBC is the talk of the town. The governance of the corporate insolvency prior to the introduction of this Code was under multiple legislations and RBI Schemes namely, Corporate Debt Restructuring (CDR) and Strategic Debt Restructuring (SDR). The failure of these legislations and schemes in resolving the complex insolvency and bankruptcy issues and the resultant inordinate delays led to the dire need of enactment of an effective and efficient insolvency and bankruptcy regime in the form of the Code. The institutional machineries were unable to serve the expected purpose. The process tends to differ under the earlier laws and the IBC, due to the introduction of new authorities and the organization of new adjudication setup and authorities that were not provided under the earlier laws. It is appreciable that the IBBI has played a proactive role in dealing with every emergent situation via, rules and regulations.

For the economic development of a country, a sound, healthy and protected banking system is crucial. Banks and Financial Institutions are the backbone of a nation. Through this sound banking system, an economy will develop swiftly. The Indian banking system is regulated by the Reserve Bank of India (RBI), which is the Central Bank and regulates all banks, financial institutions and non-banking financial institutions. We have witnessed a number of frauds in which many banks and money of public are cheated. Consequently, there are large numbers of NPAs on the Balance Sheet of banks which are non-recoverable. The rate of NPAs was on a rise since, 2008 and was 2.2% of the Gross Advances in 2007-08. This rate reached 9.3% in 2016-17 to 11.2% in 2017-18 and started declining thereafter from 2018. The rate of NPAs in the Indian Economy fell to 9.1% in 2018-19 that is, within 1.5 years of the implementation of the Code although recovery of bad debts is a herculean task.¹

The researcher believes that a separate discussion on the Insolvency and Bankruptcy Code, 2016 is necessary. Hence, in this chapter the researcher has made comparison of the Corporate Insolvency Resolution Process (CIRP) under the Code with the earlier laws (SICA, RDDBFI, SARFAESI and Companies Act, 2013). Insolvency and bankruptcy laws were in place in other countries since a long time and comparatively the Code is still a young evolving

legislation. Corporate insolvency laws differ from nation to nation in various aspects due to different economic and political conditions, institutional structures, etc. Therefore, there is no sole earmarked globally accepted corporate insolvency regime with well-defined laws for an efficient insolvency resolution process. These international insolvency laws give us more insight as they have dealt with innumerable cases. The importance of insolvency laws is well-known and there was no such efficient framework in India having standard rules and regulations. Due to the absenteeism of universal corporate insolvency resolution framework the researcher has compared the corporate insolvency resolution regimes of United Kingdom (UK) and United States of America (US) alongside that of India. The prime objective of this comparison is that India will learn crucial lessons from the insolvency laws of other nations through this differentiation and the lacunae in the IBC can also be filled by the legislative reform process of the nations.

1.COMPARATIVE STUDY OF IBC WITH THE EARLIER INDIAN CORPORATE INSOLVENCY LAWS

1.1 REHABILITATION PROCEEDINGS UNDER SICA, 1985

In the 1980s, there was rampant ³³Industrial Sickness in India and to combat this issue the Government of India came up with the crucial legislation – SICA. This Act was brought to spot the sick or potentially sick companies and for taking faster remedial measures to revive these companies and to close the units when their revival is not possible, which was an action to release the locked up investment. As per Section 3(1)(o) of SICA, when there was complete net worth erosion of a Company

³³ Reserve Bank of India, Various Reports.

(the company should have existed for at least five years) and its accumulated losses exceeded or equaled 'its entire net worth of any financial year', then it was termed as Sick Company. The concept of "Potentially Sick Companies" was perceived and recognized to make sure that the steps for resolution and revival could be taken up at an early stage. An industrial unit which existed for at least five years, 'at the end of any financial year' had accumulated losses of 50% of its average net worth in 'the immediately preceding four financial years' and had failed to repay its debts to its creditors in three consecutive quarters on demand made was called as Potentially Sick Company.

The Quasi-Judicial bodies under SICA were BIFR (Board of Industrial and Financial Reconstruction) and AAIFR (Appellate Authority for Industrial and Financial Reconstruction). BIFR was an apex board for discharging the functions and duties conferred and imposed by SICA. AAIFR was an appellate body constituted to hear appeals against the orders of BIFR. Reference of the sick company had to be made to the BIFR (under Section 15 of SICA) for determining the remedial measures with respect to the sick company by the Board of Directors of the company itself or the Central Government or Reserve Bank of India or Public Financial Institution or State Government or a Scheduled Bank. Suo Moto enquiry could be made by the BIFR, without any reference, for determining the financial state of the company. The reference was required to be made within sixty days from the date of finalization of the duly audited accounts of the company for the financial year 'at the end of which the company had become sick'.

Consequently, BIFR had to make an enquiry into the sick company within sixty days of the reference made to it under Section 16 of SICA. BIFR was left with two options, one was passing an order to give time to the company to escape insolvency and other was passing an order for revival of the company. Generally, it took the help of an operating agency. The BIFR could direct the agency to prepare a scheme for revival or BIFR could also pass the order of giving time to the company to make its net worth exceed the accumulated losses or to prepare a scheme for financial reconstruction of the company or to change the management of the sick unit. When after making due enquiry BIFR was of the opinion that it was just and equitable to wind up the company then it could forward its opinion to the High Court. The High Court ordered Winding up of such sick company and the

proceedings of winding up were taken up in accordance with the Companies Act, 1956. *On the other hand the IBC has provided very simple process to resolve insolvency of sick companies.*

KEY DIFFERENCES BETWEEN SICA AND THE CODE :

- i. Objective of legislations** - The objective of SICA is to timely detect the sick and potentially sick companies and their revival whereas the objective of IBC is to resolve the insolvency of companies through restructuring tools, maximize the value of assets, promote entrepreneurship, availability of credit and balance the interests of all stakeholders.
- ii. Who triggers the process** - There is no requirement of determination of sickness of a company under the Code and upon default any FC or OC or the CD itself can file the application with the NCLT for initiating a CIRP but under SICA the reference of sick company is made to the BIFR by the BoD of the company itself or the Central Government or RBI or State Government or Public Financial Institution or State Level Institution or Scheduled Bank.
- iii. Amount of default** - The minimum amount of default threshold is set at Rs. 1 Crore (this limit is enhanced from Rs. 1 Lakh by Amendment Act of 2020) for triggering the insolvency proceedings under the Code but the SICA is triggered when there is a loss of 50% of the net worth of a company. Hence, it is already too late to trigger a process under SICA because by the time BIFR decides revival or liquidation of a company, half of the company's net worth already gets eroded. So, IBC provides a safe route of triggering a corporate insolvency resolution process and quickly revives the company before its net worth starts getting eroded.
- iv. Moratorium Period** - Under the IBC proceedings A Moratorium period is declared by the NCLT after admission of the application on the contrary there is no provision of moratorium period under the SICA proceedings.
- v. Call for claims** - The NCLT calls for claims in the insolvency proceedings and no such call is made under SICA.
- vi. Resolution Professional** - An insolvency resolution professional termed as IRP is appointed by the NCLT under the IBC who takes over the company whereas no IRP is appointed during the revival proceedings under SICA.

vii. CoC - A CoC is formed under the IBC proceedings which takes all the decisions and the IRP or the RP acts on the decisions of the CoC. On the other hand no such committee of creditors is formed under SICA. That is why the Code is creditor-in-possession regime while SICA was not so.

viii. Time-bound process - A time-bound resolution process is provided by the Code whereas there is no time-bound revival process under SICA and it takes around one to two years for a company to get admitted for further investigation.

ix. Misuse by Debtor companies - SICA was misused by the debtor companies to stall the proceedings and to save themselves from the claims of creditors and therefore, creditors had to suffer but under the IBC proceedings there is no such possibility because all the decisions are taken by the creditors and the resolution plan is also approved by the CoC and then approved by the NCLT.

x. Waterfall mechanism - There is no provision of waterfall mechanism for the distribution of assets under SICA in the event of liquidation. On the contrary the Code provides a waterfall mechanism for the distribution of assets in the event of liquidation and this waterfall mechanism enhances the rights of creditors. The priority of payment starts from securing the rights of secured creditors to workmen and then to the payment of equity

In a nutshell the decision of closing down the sick company was taken in a court of law in SICA proceedings. This procedure took a long period of time and the sickness took even longer period to get cured. Time happens to be money in business and a collapsing business sees erosion of Capital on a daily basis. Consequently, SICA failed due to its procedure and approach in dealing with these issues.

FLAWS IN SICA :

The glitches found in the functioning of SICA are mentioned as under-

I. Extremely difficult to rehabilitate the company- It was highly difficult to rehabilitate the sick company because the detection of sickness was made at a stage when the accumulated losses of the company grew large enough to wipe out the equity reserves and base. By the time BIFR could decide to revive or liquidate a company, half of the company's worth was already eroded.

II. Section 22 of SICA was misused by the Promoters of the company-Section 22 of SICA allowed the debtor companies to seek bar on legal proceedings for

arbitration, execution, enforcement of security interest, recovery suits, etc and hence was misused by unscrupulous promoters. The Section dealt with Moratorium and was rampantly misapplied by the promoters for deferring action by the creditors.

III. Inordinate delay- The proceedings under SICA faced undue delays in the completion of the inquiry and sanctioning of the scheme. There was absence of definite timelines in SICA.

IV. Reluctance in Liquidating a Sick Company – The High Courts and the BIFR followed Socialist mindset and were reluctant in liquidating a Sick company. This was due to the fear of unemployment, labour unrest, etc.

1.2. RECOVERY PROCEEDINGS UNDER RDDBFI ACT, 1993

Narasimham Committee I, 1991 endorsed the view of Tiwari Committee, 1981 for establishing a Quasi-Judicial set up exclusively for banks and financial institutions which can quickly dispose off the recovery cases by adopting a summary procedure. Pursuant to these recommendations, the Government of India enacted the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI Act) under which Quasi-Judicial Authorities were constituted. RDDBFI Act was renamed as “Recovery of Debts due to Banks and Financial Institutions and Bankruptcy Act, 1993” by the amended in 2016. Section 1(4) of the RDDBFI Act says that the provisions of this Act are applicable where the amount of debt due to a bank or financial institutions or consortium of banks/financial institutions is not less than Rs. 10 Lakh and also empowers the Central Government to specify (by notification) a minimum debt of not less than Rs. 1 Lakh.

The Debt Recovery Tribunals (DRTs) have the jurisdiction, power and authority for entertaining and deciding applications from banks and financial institutions to recover the debts due.² The Debt Recovery Appellate Tribunal (DRAT) is conferred the Appellate jurisdiction and the power of general superintendence and control over DRT.

An application has to be filed before the DRT of relevant jurisdiction along with the certified true copies of the documents in support of the claim and if another bank/financial institution has to recover its debt from³⁴ the same person then the other bank/financial institution can join the applicant bank/financial institution by making an application to the DRT at any stage of the proceedings but before the

³⁴ The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (Act 51 of 1993), s. 17



final order is passed. The Registrar of the DRT or any other Presiding Officer authorized in this behalf shall issue Summon/Notice which will be served by the applicant to the defendant.

The Defendant is required to file the reply/Written Statement within one month from the date of service of the Summon/Notice. With the permission of the DRT the defendant can seek extension of the time for filing reply and if the defendant fails to file his reply within the time or the extended time, then the DRT may proceed ex-parte. At the first hearing,³⁵ the defendant can file claim for set-off/counter claim. If the defendant admits his liability, then the presiding officer will pass an order directing the defendant to pay off the admitted³⁶ amount within 30 days of the date of order of the DRT. On the failure of the defendant in paying the admitted claim within the period, the presiding officer may issue a certificate of debt due in terms of Section 19 of the Act. After giving opportunity of hearing to both the parties and hearing their submissions, the DRT shall pass its interim or final order. The DRT will issue a Recovery Certificate (RC) within 15 days of the order and forward it to the Recovery Officer. The RC has the same effect as the decree of the civil court. Any aggrieved party may file an appeal against the order of the DRT to the DRAT within 30 days from the date of receipt of the order. No appeal lies against the order of the DRT which was passed with the consent of the parties. The DRAT shall endeavor to dispose off the appeal within the period of six months.

KEY DIFFERENCES BETWEEN THE CODE AND RDDBFI ACT:

i. Objectives of legislations - The objective of RDDBFI Act is debt recovery through establishment of Tribunals (DRTs and DRATs) for speedy adjudication whereas the objective of the IBC is reorganizing and insolvency resolution within the timeframe for maximizing the value of the assets. So, the purpose of the Code is not just recovery of debts rather it tries to restructure the debtor companies which are sick yet viable.

ii. Applicability of legislations – The Code applies to companies, individuals, partnership firms, limited liability partnership firms and other notified bodies but the

³⁵ The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (Act 51 of 1993), s. 19(1).

³⁶ The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (Act 51 of 1993), s. 17A

RDDDBFI Act is applicable on Banks, Financial Institutions, Asset Reconstruction Companies and other as specified by the Government.

iii. Initiation of proceedings – Only the Banks and Financial Institutions can initiate recovery proceedings under the RDDDBFI Act while any of the creditors or the debtor can itself make an application for initiation of IBC proceedings before the NCLT. That is, anyone is authorized to initiate insolvency proceedings.

iv. Default limit – The default threshold for initiation of IBC proceedings is Rs. One Crore whereas the under the RDDDBFI Act the default threshold is the debt of not less than Rs. Ten Lakh but the Central Government is empowered to notify this limit to not less than Rs. 1 Lakh.

v. Value of Assets – The assets are blocked under the RDDDBFI Act for a considerable period of time and this renders the assets unproductive. But under the IBC the assets are efficiently managed by the insolvency professional and the business of the company keeps on going well as per the decisions of the CoC. Therefore maximum value of the assets is realized via, the Code but there is either reduction or complete erosion in the value of assets.

vi. Judicial Intervention – There is judicial intervention during the RDDDBFI Act proceedings because for stalling the proceedings, the borrowers raised claims against lenders in the civil courts. For ensuring smooth proceedings under the IBC, section 238 of the Code provides that the IBC shall prevail over any other provision or law contrary or inconsistent with any of the provisions of the IBC. Also no claims can be raised during the IBC proceedings by the creditors under any other forum or court.

vii. Easy proceedings – The IBC provides an easy and simple proceeding with the specified timelines but no timelines are fixed under the RDDDBFI Act and its proceedings are unclear and complex. Moratorium period is also fixed under the IBC while no such moratorium period is provided under the RDDDBFI Act.

FLAWS IN RDDDBFI ACT :

I. Judicial intervention in the recovery proceedings – The DRTs were established for helping the banks and financial institutions in recovering their dues speedily without being subject to the lengthy procedures of Civil Courts. The cases were

delayed because the High Courts were not using statutory remedies available to them under the DRT Act. They exercise their jurisdiction under Article 226 for passing the orders and this had serious adverse impact on the rights of banks and financial institutions. In order to stall the proceedings, the borrowers raised claims against lenders in the civil courts.

II. DRT being headed by One Presiding Officer – There is only one presiding Officer appointed for each DRT. On comparison of the cases and appeals being filed with the DRT headed by one Presiding Officer, does not suffice imparting judgment judiciously. The main objective of RDDBFI is speedy disposal of cases which cannot be achieved with one presiding officer in comparison to the pending sea of cases awaiting trial and decision. One Presiding Officer may not have good legal acumen.

III. Applies only to the Banks and Financial Institutions – The provisions of the RDDBFI Act apply only to the banks and financial institutions. The other creditors, equity investors or the suppliers of goods and services are not given legal remedy under the Act.

IV. Assets are blocked for considerable time – The assets are blocked for a considerable period of time under the DRT and this renders the asset unproductive. The value of the asset gets eroded with the passage of time and then in the end either no value or a very small value is realized.

V. DRTs were over burdened with the cases – The DRTs were to reduce the burden of the judiciary. As per the Deshpande Committee Report, the problem has been transferred to the DRTs, as the ideal number of cases to be handled by the DRT at any given point of time was supposed to be 30, but this number in the inception was around 4000 in major cities.⁵ The success rate of the DRTs was pegged below 25 per cent, which is of serious concern.

VI. Limited Powers of DRT – The DRTs have summary proceedings and hence they are not equipped for addressing the complex questions of fraud and misrepresentation and questions of law and the DRTs across India are ill-equipped to handle the huge number of cases. The RDDBFI Act was the first creditor friendly legislation enacted and a mechanism put in place in India. Despite the constitution of the DRTs, banks were not powerful in the recovery process and hence, they could not achieve the desired extent of recovering capability. The amount of NPAs kept on increasing and accumulating in the country.

1.2.1. RECOVERY PROCEEDINGS UNDER SARFAESI ACT, 2002

The Narasimham Committee II, 1998 on Banking Sector Reforms raised concern around the rising NPAs of the Indian Banking Sector. The recommendations of the Committee led to the enactment of the **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002** (SARFAESI Act), to protect the financial creditors, who are mostly the banks and other financial institutions. The Act allowed them to recover NPAs and enforce their security interests without the intervention of the court. There are two methods provided under the SARFAESI Act for the recovery of NPAs and are:

a. Taking possession of the secured assets of the debtor (with the right to assign, lease and sell the secured assets) and

b. Taking over the business or management of the debtor company until the NPA is recovered. The banks and financial institutions are also empowered under the SARFAESI Act to sell the financial assets to Asset Reconstruction Companies (ARCs). The sale of assets to ARCs should be in accordance with the guidelines issued by the RBI in this behalf. The account of the debtor or the borrower should be classified as an NPA by the secured creditor and must be of the outstanding balance of Rs. 1,00,000 or above. A 60 days Demand Notice should be served by the secured creditor on the debtor company demanding repayment of the due amount and should also specify the assets over which he proposes to enforce its security interest. The debtor retains the right to representation/objection within the 60 days notice period. The secured creditor should consider this representation/objection and communicate the acceptance or non acceptance of the representation/objection to the debtor within 15 days with the written reasons for non acceptance.

On the expiry of notice period of 60 days, if the debtor fails to discharge its liability then the secured creditor can enforce its security interest over the secured assets by, (a.) taking possession of the secured assets, (b.) taking over the management of the secured assets (along with the right to transfer by way of lease, assignment or sale of the assets), (c.) appointing a person to manage the secured assets, and (d.)

requiring any person who has acquired the assets from the debtor to pay the amount necessary for satisfying the debt. When the secured creditor is unable to recover his entire dues, then he may approach the DRT or other court for the recovery. He is allowed to simultaneously pursue its remedies both under the DRT as well as the SARFAESI Act.

The SARFAESI Act was enacted with the intention of faster recovery of dues and reducing NPAs. It is said that the banks misused the SARFAESI Act at times. This issue went to the Supreme Court and the constitutional validity of the Act was upheld. The Judiciary was very much aware and cautious of the interests of the borrowers and since then every effort is made by the judiciary to ensure that the object of SARFAESI Act is not diluted.

When the debt burden is high then SARFAESI Act is not much effective because there is little scope of revival as the Public Auction kills the business whereas the Code is focused to ensure the securing the interests of all stakeholders and is directed towards reviving the business and that is why the IBC is highly effective in the large cases.

THE OTHER POINTS OF KEY DIFFERENCES BETWEEN THE IBC AND THE SARFAESI ACT :

i. Objectives of legislations - The objectives of the SARFAESI Act are Enforcement of Security Interest over the property of the debtor and establishment of ARCs whereas the objective of the IBC is Revival and Rehabilitation of companies and Maximisation of the value of the assets.

ii. Trigger Amount – The triggering amount for initiating the proceedings under the SARFAESI Act is the amount owed to a Secured Creditor but the default threshold under the IBC is minimum amount of Rs. 1 Crore (prior to the 2020 Amendment Act, it was Rs. 1 Lakh). This means that there is no limit set for default under the SARFAESI Act.

iii. Adjudicating Authorities – The adjudicating authorities under the SARFAESI Act are the Chief Metropolitan Magistrate and Chief District Magistrate for assisting in recovery of the dues and DRAT is the appellate authority while NCLT and NCLAT are the adjudicating authorities under the IBC.

iv. Creditors Covered – The Secured creditors are covered under the SARFAESI Act that is the secured creditors are protected and can initiate SARFAESI proceedings. These secured creditors are mostly the Banks and other Financial Institutions on the other hand the IBC covers all types of creditors such as, secured and unsecured creditors and financial and operational creditors.

v. Nature of proceedings – The nature of proceedings under the SARFAESI Act is recovery, the proceedings are not for the revival and rehabilitation of sick companies but the nature of proceedings under the IBC is both recovery and revival. The prime objective of the Code is revival of companies.

vi. Sale of Assets – The prime focus is not to sell the assets under the Code but is to revive the company via, restructuring and maximizing the value of assets. On the contrary the assets are quickly sold by the banks under the SARFAESI proceedings via, Public Auction.

FLAWS IN SARFAESI ACT :

I.NPA classification and Settlement of issues at an early stage – In some cases it is seen that the banks act unreasonably and invoke the provisions of SARFAESI Act by classifying the account as NPA even when there is possibility that the borrowers are willing to correct the same and honour the commitments as agreed upon. There is possibility of regularizing the account by the borrowers. The guidelines issued by the RBI in this behalf are not followed by the banks properly.

II. Not applicable to Unsecured Creditors – One of the major flaws in SARFAESI Act is that it is not applicable to the unsecured creditors. The equity investors, depositors, homebuyers and other service providers are the key stakeholders of the borrower companies and they are not given the chance to recover their investments. The Act has provided sweeping powers to the banks and financial institutions only.

III. Sale of Assets under the SARFAESI Act – The provision of sale of assets under the SARFAESI Act is highly criticized by the borrowers. The auction process for the sale of assets is hurriedly completed and hence it becomes extremely difficult for the debtors in getting the transaction set aside. The banks always try to get maximum possible price for the property through public auction because they are the trustees of the property and the balance sale consideration goes to the borrower after adjustments. But in reality it is not so easy for the borrowers to get the balance

consideration. They have to at times fight with the bank and this is due to the lack of proper procedures under the SARFAESI Act.

1.2.2. PROCEEDINGS UNDER THE COMPANIES ACT, 2013

Before the enactment of the IBC, Winding up of Companies was completely under the purview of the Companies Act, 1956 and later under the Companies Act, 2013. Now a company can be wound up either under the Companies Act, 2013 or under the IBC depending upon the facts and circumstances of each case. Sections 33-54 and Section 59 of the IBC and Sections 230-231 and Sections 270-365 of the Companies Act, 2013 deal with the provisions of the Winding up of Companies. There were two modes of Winding up under the Companies Act, 2013:

a. Winding up by the Tribunal, and

b. Voluntary Winding up.

a. ***WINDING UP BY THE TRIBUNAL*** – Winding ³⁷up of a Company is initiated by filing a Petition only in the NCLT. There are some grounds³⁸ under which a company can be wound up by the Tribunal and they are as follows:

i. When the company is unable to pay its debts,

ii. When the company by Special Resolution resolves that the company be wound up by the tribunal,

iii. When the company has acted against the interests of sovereignty and integrity of India, the security of the state, friendly relations with foreign state, public order,

iv. When the Tribunal has ordered winding up of the company under Chapter XIX,

v. When on the application made by the Registrar or by any other person authorized by the Central Government, the Tribunal is of the opinion that the affairs of the company are conducted in a fraudulent manner or the company was formed with a fraudulent or an unlawful purpose or the persons concerned in the formation or management of its affairs have been found guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up,

³⁷Winding up is a process where all the assets of the Company are sold, liabilities are paid off and surplus left if any, is distributed.

³⁸ The Companies Act, 2013 (Act 18 of 2013), s. 271.



- vi. *When the company has defaulted in filing with the registrar its financial statements or annual returns for immediately preceding five consecutive financial years, or*
- vii. *When the tribunal is of the opinion that it is just and equitable that the company should be wound up.*

The petition for winding up can be given by those enumerated under Section 272 of the Companies Act, 2013, which are:

- i. *The Company,*
- ii. *Creditor (including any contingent or prospective creditor/creditors),*
- iii. *Any Contributory,*
- iv. *All or any of the above three mentioned parties,*
- v. *The Registrar,*
- vi. *Any person authorized by the Central Government in this behalf,*
- i. *The Central or the State Government in case of a company against the sovereignty and integrity of India.*

A person other than the company is also authorized to file winding up petition and if the Court deems fit then it can give a notice of 30 days to the company and this time period can be extendable for 30 more days under special circumstances.

b. VOLUNTARY WINDING UP – In the case of voluntary winding up the company does not go to the Court and the matter is solved between the shareholders of the company and the company in a General Meeting. The process of winding up starts from the date of passing of the resolution in the General Meeting. The company appoints the Official Liquidator who handles the affairs. Section 304 lists out the circumstances under which the company could be wound up voluntarily and these are as follows:

- i. If in the General Meeting the company passes a resolution requiring the voluntary winding up of the company as a result of the expiry of the time period for its duration, if any fixed by the articles or upon the occurrence of any event for which the articles provide that the company should be dissolved;
- ii. If Special Resolution is passed by the company to wind itself voluntarily.

KEY DIFFERENCES BETWEEN THE CODE AND THE COMPANIES ACT :



i. Objectives of legislations – Objective of the Companies Act is to wind up the company whereas the IBC primarily seeks to revive the company and if the revival fails then the option of liquidation is resorted to.

ii. Ease in Procedures – The procedures under the IBC for insolvency resolution and liquidation is simple and clear but the procedures laid down under both the Companies Act are unclear and complex.

iii. Different modes of winding up within the legislations – the Companies³⁹ Act provide for voluntary winding up and winding up by the tribunal (Companies Act, 1956 provided for the modes of members' and creditors' winding up too) but there are no different modes given under the IBC. Anyone amongst the creditors and the corporate debtor itself can initiate CIRP under the Code.

iv. Sequence of Payments - The costs of Winding up and Liquidator's Fees were

kept at the bottom of sequence of payments under the Companies Act, 2013⁹ and the Waterfall Mechanism under the Code deviates from this sequence of payments, Secondly, the Companies Act gave top position to the payment of Government dues but now under the IBC Government dues are paid after the payment of the unsecured creditors. Lastly under the IBC, dues of workmen for 24 months are considered from the date of commencement of liquidation but the Companies Act accounts the date of winding up order for computing 2 years.

v. Time consumption - Processes under the Code are less time consuming on the other hand processes under both the Companies Acts are time consuming. The Code provides for timelines to be followed in every step and hence, the cases are tried to be resolved within a short timeframe of 330 days.

FLAWS IN COMPANIES ACT, 2013 :

I. Creditors used the provision of “Inability to pay debts” for recovery of their debts – The creditors of the company pressed the button of “Inability to pay debts” for the recovery of their debts under summary procedure and as a Fast Track Solution. Through this issue if the company failed to pay its debts even after the 21 days statutory notice timeline, then the company was deemed to be insolvent and the winding up proceedings commenced upon the company. It is improper to use winding up provisions for the seeking enforcement of the payment of the debt which is

³⁹The Companies Act, 2013 (Act 18 of 2013), s. 274.



bonafide disputed by the company and a court cannot be treated as a debt collecting agency or cannot be used as a means of creating pressure on the company in paying a bonafide disputed debt.

II. There is a lot of intervention of the Tribunal under the Act – The NCLT intervenes a lot during the Compulsory Winding up process⁴⁰ of the company. The Tribunal supervises the winding up proceedings under the Companies Act, 2013. Now after the amendment under the Companies Act, 2013, Winding up can only be done by the NCLT alone. The procedure is set out in Part I of Chapter 20 and Sections 270-274 set out the procedures largely. The provisions of Voluntary Liquidation of Companies (Sections 304-323) have been removed from the Companies Act, 2013 and are now governed under the Insolvency and Bankruptcy Code, 2016. The two grounds (of ‘Inability to pay debts’ and ‘Chapter XIX – Revival and Rehabilitation of Sick Companies provisions’) for winding up by the Tribunal have been deleted with the passage of the IBC.

1.3. COMPARATIVE STUDY OF IBC WITH THE INSOLVENCY LAWS OF UK AND US

The Indian legal and constitutional machinery for dealing with insolvency and bankruptcy was not in line with the international standards. The erring promoters and the management used to retain control over the company. *The demons in the Indian economic system were the ‘wilful defaulters’*. India was ranked 136th while UK stood at 13th position, Singapore stood at 27th position and US was ranked 5th on the Insolvency⁴¹ Index of the EoDB, 2016.¹⁰ The facts that Insolvency resolution time in India was 4.3 years on an average and creditors recovered 25.7 cents per dollar are self-explanatory of the worst conditions encountered by the creditors. Hence, reformation in the Indian insolvency and bankruptcy regime was of the essence. Repairing the unsuccessful and broken Indian insolvency regime was a big challenge for the BLRC. Though the 2016 Code is comparatively an evolving law yet it has fitted itself into the Indian economy and has shown miraculous results within a short span of its implementation.

⁴⁰ The Companies Act, 2013 (Act 18 of 2013), ss. 325, 326 and 327

⁴¹ World Bank “Doing Business 2016 – Measuring Regulatory Quality and Efficiency”, 13th ed.

World Bank group Flagship Report.



1.3.1. COMPARISON OF THE IBC WITH THE INSOLVENCY LAW OF UK

Globally insolvency and bankruptcy legislations were in place for a long time, the BLRC referred to the United Kingdom's insolvency laws because as per the World Bank's 2016 EoDB index recovery in UK took 1 year on an average and creditors realized 88.6 cents on the dollar. UK was ranked 6th on the EoDB index

*and stood on 13th position on the Ease of Resolving Insolvency index.*¹¹ The framework of IBC is based on the UK's insolvency law with certain modifications, as the BLRC spotted out and customized some of the key aspects of the UK's insolvency regime which may not fit into the Indian system. The IBC is a progressive legislation and the main objective of the Code is Resolution rather than Liquidation. It is already discussed in Section 2.1 of Chapter 2 that there was no Insolvency law in India before the Britishers came to India. For the first time the need of insolvency law was felt in the presidency towns where Britishers carried out trade (that is in Bombay, Calcutta and Madras). Insolvency legislation started in India with the passage of Statute 9 in 1828 and this lasted till 1848. The insolvency court sat when the need arose.

Thereafter in following years different provisions were made in various acts to deal with insolvency cases and finally the first insolvency law was brought in India in the form of the Companies Act, 1956. But this act it referred to only 'inability to pay' and did not refer to insolvency or bankruptcy of companies. Later even the passage of RDDBFI Act or SARAFESI Act or the Companies Act, 2013 did not provide solution to the problem. The detailed explanation of the history of insolvency legislation in India is provided under Section 2.1 of Chapter 2 and the CIRP contemplated under the code is also discussed earlier in Section 2.2 of Chapter 2.

Two rounds of crucial reforms (in 1986 and in 2002) have been undertaken in the UK's corporate insolvency resolution framework. The 1982 Cork Committee Report also known as the Insolvency Law Review Committee chaired by Sir Kenneth Cork, advocate the adoption of a comprehensive insolvency legislation in UK and ultimately Insolvency Act, 1986 was enacted. The Insolvency Act, 1986 consolidated all the insolvency provisions of the companies and individuals and repealed the

insolvency provisions in the Companies Act. The Corporate insolvency is dealt in First Part of the Act and provisions for Individual insolvency are contained in Second Part. As per this law the ailing companies are either liquidated or rescued as going concern through the insolvency process. The Act was amended in 2000 which added new provisions of 'company voluntary arrangements' (CVAs) of companies and of Moratorium. The CVA is a tool to rescue falling businesses and provides that a formal binding agreement can be made by the company in financial difficulty with its creditors. The debts are settled by the company by negotiating with the creditors along with the minimal court involvement.

The Enterprise Act 2002, attempted to enhance efficiency and accountability in insolvency proceedings by abolishing administrative receivership and replacing it with administration.¹² It provided entry route into administration without a court order. The principal responsibility of administrators was to rescue the company as a going concern. The procedures available under the UK's insolvency regime are:

i. Voluntary Restructuring – Under this scheme the Board of Directors of the company retain control over the company and negotiations are made to restructure the company as a going concern.

ii. Administration – The company is held together under this procedure and plans are made for its sale, rescue or liquidation. There is a moratorium period during which the creditors are prevented from taking action against the company and the administrator is appointed by the Directors of the company without the court's involvement⁴² but subject to certain conditions.

iii. Liquidation – The company is liquidated if the liquidation order is obtained from the court by the shareholder, creditor or the directors. The company or its assets are sold in the liquidation process. Even the company can pass resolution to liquidate itself on obtaining the creditors approval for winding up the company. No attempts are made to rescue the company as a going concern.

1. Receivership – The creditors (the secured creditors) appoint the receiver for the sale of assets of the company, so that the creditors get their repayment of secured debts.

⁴² Vernon Dennis, Alexander Fox, "The Law of Insolvency: Insolvency Act 1986 to Enterprise Act 2002" *The Law Society* (Feb 20, 2003).

MAJOR SIMILARITIES BETWEEN THE CODE AND THE UK'S INSOLVENCY LAW ARE :

1 Focus on re-organization – Both the insolvency laws lay major emphasis on re- organization of the business as a going concern over liquidation.

2 Initiation of the insolvency process – Anyone amongst the debtor or creditor can initiate the insolvency process upon default by the debtor.

3 Recommendation of appointment of IP – Under both the insolvency laws creditor, debtor or the court can recommend the appointment of IP.

4 Creditor driven process – Creditors manage the affairs of the company and decide future course of action for the company. Under the UK's insolvency law management control passes to the appointed administrator (or the insolvency practitioner) and IP is appointed under the IBC.

2 Moratorium Period – After the filing of insolvency petition moratorium period is given under both the laws, during the continuance of which no recovery action or suits can be initiated against the company.

3 Priorities of payment – Clear waterfall of payments is provided under both the legislations which lists out the priority of payments to secured and preferential creditors.

4 Multiple IPAs – There are many self regulating bodies under both the laws, and any professional can become an IP after clearing the exam and registering with such body. In UK there are self regulating bodies like, ICAEW, ICAS and ACCA.

KEY DIFFERENCES BETWEEN THE CODE AND UK'S INSOLVENCY REGIME :

1. Role of Insolvency Professional (IP) – Under the insolvency law of UK, after the appointment and remuneration of the IP are approved by the creditors there is no obligation for an IP to take further approvals from the creditors for the management of the CD during the insolvency process, since in UK an IP is considered to be an officer of the court. But under the IBC, an IP is required to take approvals from the CoC for many acts for the management of the CD. The IBC has assured greater involvement of creditors in the insolvency process and that is why it is called as creditor-in-possession regime.

2. Voting Power of Creditors and Approval of Resolution Plan – Under the Code only the financial creditors are given right to vote in a creditors’ committee for various decisions to be taken by the IP for the management of the company and for the approval of a resolution plan 66% majority votes of the creditors’ committee is required. These financial creditors include both the secured and unsecured creditors. While under the insolvency law of UK all the creditors (excepting the secured creditors to the extent of their security) including the operational creditors are given voting right in the creditors’ committee in the ratio of their outstanding dues, for the approval of the resolution plan and a simple majority is required for approval of the resolution plan.

4 Who can be an IP? – In the insolvency law of UK only an individual can be an IP but under the IBC an individual and a partnership firm (with unlimited liability) can be appointed as an IP.

5 Requirement of providing Bond by the IP – An IP under the insolvency law of UK is required to submit a general and a specific bond for covering any fraudulent act which can be committed by the IP and this bond is based on the value of assets in the insolvency case.

6 CIRP completion deadline – Under the Code, the insolvency resolution process has to be completed within the time line of 330 days failing which the liquidation process is automatically triggered on the other hand under the insolvency law of UK there is no such deadline.

1.3.2. COMPARISON OF THE IBC WITH THE INSOLVENCY LAW OF US–

Early US bankruptcy laws were not uniform and this hindered business amongst states. In 1800 (that is, eleven years after the US was ratified) the first bankruptcy law in US was enacted and was repealed in three years. Later other bankruptcy laws were enacted in 1841, 1867 and 1898. Commission on the bankruptcy laws of the United States was constituted in 1970 which studied the bankruptcy law and recommended reforms. On the recommendations of this committee, US Bankruptcy Reform Act of 1978 was enacted which is a federal law which is applicable in all states of US. The 1978 Act (is amended several times) brought sweeping changes in the US bankruptcy system, also enhanced the scope of bankruptcy judges.

US was ranked 5th in the Resolving Insolvency Index of World Bank's EoDB Report, 2016 with the recovery rate of 81.5 cents on the dollar. The reason behind this achievement is the well developed and organized bankruptcy law. This legislation also focuses on the re-organization over liquidation. Restructuring of companies is dealt under Chapter 11 of the Bankruptcy Code. This Code is similar in many respects to the UK's Insolvency Act 1986, except that the US Bankruptcy law has a Debtor-in-possession regime which implies that the management remains in its place of controlling the company during the re-organization and bankruptcy process and the corporate debtor is given the opportunity of reorganizing. As per the World Bank data the insolvency proceedings in US take approximately a year on an average. The Moratorium period under the US Bankruptcy Code automatically applies to all legal proceedings against the distressed company. Exclusive period of 120 days is given to the debtors (after entering restructuring proceedings under Chapter 11 of the Code) for filing reorganization plans with the court and the creditors can propose their plan on the expiry of 180 days if the debtors plan do not receive approval.

There is no condition of 'insolvency' under the Chapter 11. Insolvency case commences with the voluntary filing of a petition by the debtor company and the petition must be accompanied by- (a). A list of creditors and (b). A summary of Assets and Liabilities. The basis behind this provision is that a debtor company may initiate the process for obtaining bankruptcy relief in some cases (such as, massive tort liabilities, adverse outcome in litigation, etc). But the petition should be made in 'Good Faith' (that is, the intention behind the petition must be re-organization or liquidation or sale of the company) and the creditors can file for getting the petition dismissed when this is not the case. Also the secured creditors may threaten the company to enforce their liens so that the debtor company is forced for filing relief under chapter 11 (bankruptcy proceedings). In another situation an involuntary petition can be filed against a large debtor company for commencing bankruptcy proceedings by three creditors where the debtor has more than 12 creditors- who hold unsecured non-contingent undisputed claims of more than \$16,750 in aggregate and the company is generally unable to pay the debts as they become due.¹³ In case the company has less than 12 creditors then a Solitary Creditor qualifies to file an involuntary petition if he has debts of \$16,750 in aggregate against the debtor. The debtor company may contest the petition filed by such creditors if the criteria is not met and file suit

against those creditors for costs, attorney fees and even for damages if such petition is filed in bad faith.

Under the US bankruptcy code an 'automatic stay' period called moratorium starts which stays all continuing litigations against the company, enforcement of judgments are prevented and bars filing of fresh suits against the company. The moratorium⁴³ period is effective during the entire pendency of the case. The debtor company⁴⁴ is given a period of 120 days for exclusively formulating a re-organization plan and this period can be extended on giving sufficient reasons. But the extension will not be granted beyond 18 months of filing the bankruptcy petition. The 18 months 'drop- dead date' was inserted by the US bankruptcy code amendment in 2005 so that the debtor company cannot use extension provision as a delay tactics (in dealing with creditors and opponents in litigation) for formulating a re-organization plan. Ultimately the relatively short period of extension mollifies creditor concerns and benefits all stakeholders because a speedy process is an essential component of a successful re- organization.

The Debtor-in-possession feature in Chapter 11 of the US Bankruptcy Code has its own merits in contrast with the Creditor-in-possession regime of the UK Insolvency Act and the IBC. The present management retains the controlling power over the company and this management tries to look out for multiple re-organization plans so that the company can continue as a going concern in the long run whereas in the Indian and UK's Insolvency regime an Insolvency Professional (IP) is appointed to manage the affairs of the company with the consent of the Committee of Creditors. The IP is a third party who is unaware with the affairs of the company and hence, it takes time for him to get acquainted with the affairs. Appointing an IP is a costly affair, as he will be remunerated from the bankruptcy estate. Another advantage of the Debtor-in-possession is that the management comes up with the most economical and efficient means of re-organizing under the supervision of the court.

KEY DIFFERENCES BETWEEN THE CODE AND CHAPTER 11 OF US BANKRUPTCY CODE :

⁴³ The US Bankruptcy Code, s. 362(a).

⁴⁴ The US Bankruptcy Code, s. 1121



6 Initiation of the Resolution Process – The resolution plan under the IBC can be initiated by anyone amongst the FCs or the OCs or by the CD itself but the under the US Bankruptcy Code the petition for initiation of the insolvency process is voluntarily submitted by the CD or it may be involuntarily filed by the creditors (after meeting certain requirements).

7 Control and Management of the corporate debtor – The control and management of the corporate debtor remains with the present management of the company under Chapter 11 of US Bankruptcy Code whereas under the IBC the control and management is transferred to the IP appointed. The CD continues to enjoy the same control over the company as before as per the US Bankruptcy Code.

8 Powers of the Debtor Company and the IP – The debtor company under the US Bankruptcy Code has the same powers as before of adopting, disclaiming or assigning any old or new contract but under the IBC, the IP has no powers to do so without the prior permission of the Creditors' Committee.

9 Creditors' Approval – The IP appointed under the IBC in many cases takes actions after obtaining approval from the CoC and the resolution plan is approved by 66% majority votes of the CoC. On the contrary in the US Bankruptcy Code, the reorganization plan is generally proposed by the debtor company itself and the creditors whose rights are effected may vote on the resolution plan. If the resolution plan gets required votes then it may be confirmed by the court.

10 Who can file a Resolution Plan – Under the US Bankruptcy Code the Debtor (except a small business debtor) is given exclusive right of filing a resolution plan within 120 days and if the CD fails to file a plan within 120 days then the period is extended but not beyond 18 months in any case, after the expiry of this exclusive period a creditor or the case trustee may file a competing plan. Under the IBC, any resolution applicant (which consists of primarily the market at large, the creditors and the promoters who submit affidavit of their eligibility under Section 29A of the IBC) can file a resolution plan.

11 Resolution process Costs – The resolution process under the US Bankruptcy Code is a cheaper process as the same management controls the whole process on the other hand IBC is a costlier process as it involves appointing a third person called IP who manages the entire resolution process and charges his fees.

1.4. CONCLUSION

The IBC was introduced with the aim of resolving debts of insolvent companies which was earlier a long process that did not offer any resolution and the cases kept on lingering in courts for years where the value of assets eroded with the passage of time. The cases from the earlier forums yielded hardly 10-20% of the value of assets and the position of unsecured creditors was dismal. Entire process in these courts was like a contest between the prosecution and defence and the courts played the role of referee. Now the trial procedure in the NCLTs is determined by the judges. They play an active role in hearing and questioning the parties directly and are assisted by the IPs and IPAs. Therefore, their contribution is extremely important for disposing a case speedily.

It is deduced from the comparison made above in this chapter that the IBC has certainly answered the issue of piling bad loans affecting the banking and corporate sectors in the Indian Economy. The IBC has swapped the positions of debtor and creditor and changed their relationship. All the stakeholders- creditors, debtors, employees, workmen, etc are benefitted from the resolution process because every last ditch attempt is made to revive the company and keep it running as a going concern. Option of Liquidation is resorted to only when there is no possibility of reviving the business and is not prudent to keep the business running since the company will always remain in losses.

Insolvency laws of UK and US were there in place, well settled and mature ones. The insolvency regime of UK is a creditor-in-possession regime, one of the most established and acknowledged worldwide. That is why the BLRC based the IBC on UK's insolvency regime. The earlier Indian insolvency procedures were debtor driven processes and the debtors played the role of a dictator. So the IBC is not based on Bankruptcy Code of US although some of its features such as Moratorium period are present in the IBC. The present Indian insolvency reform has adopted the best features of both the insolvency legislations of the US and UK and is tailored to suit the Indian economy and other conditions.