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# **INDIA'S INSOLVENCY AND BANKRUPTCY CODE, 2016: A COMPREHENSIVE ANALYSIS**

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## **ABSTRACT**

*India's banking system faces significant challenges, with gross non-performing assets (GNPA) reaching an all-time high. Non-Performing Assets (NPAs) are assets that no longer generate income for banks. As of March 2021, the gross non-performing asset ratio stood at 7.48%, and it is projected to increase to 9.8% by March 2022 according to the RBI's financial stability report. To address these issues, India has implemented various debt resolution mechanisms, including the Insolvency and Bankruptcy Code (IBC) enacted in May 2016. The IBC aims to provide an efficient and time-bound solution for distressed companies, allowing a total of 270 days for resolution or liquidation. Following the passage of the Insolvency and Bankruptcy Code (IBC) in Parliament in May 2016, the National Company Law Tribunal (NCLT) was established on June 1, 2016. Since then, the NCLT has been handling insolvency and bankruptcy cases, operating with 11 benches. Both the IBC and NCLT fall under the purview of the Insolvency and Bankruptcy Board of India (IBBI), which was set up on October 1, 2016. The IBBI oversees and regulates insolvency professionals, agencies, businesses, and information utilities. It also has the authority to enforce rules related to corporate insolvency, corporate liquidation, individual bankruptcy, and individual insolvency. The IBC has played a crucial role in reforming credit control for borrowers, aiming for timely resolution and faster loan recovery. As of December 2020, a total default of Rs. 105570.01 billion had been admitted under the IBC 2016.*

*Keywords: National Company Law Tribunal, Insolvency and Bankruptcy Code, 2016, Non-performing assets, Liquidation, Iron and steel sector.*

## INTRODUCTION

Empirical research demonstrates that sophisticated financial institutions play a crucial role in accelerating economic growth and reducing income inequality. By proportionately boosting the wages of lower-income households, they contribute to growth with equity, which is essential for our country's prosperity. However, the foundation of a well-developed financial system lies in robust legislative structures. Effective laws must be clear, unambiguous, and adaptable to address existing challenges while remaining flexible in response to changing environments. Strong legal systems stimulate the growth of refined financial markets and intermediaries, enhancing the economy's risk management capabilities and ultimately leading to economic progress. Key factors include robust contract enforcement and transparent disclosure practices. Every piece of legislation has a timeline associated with it, and its significance should be evaluated within that context. Regular legislative reviews are essential, especially in dynamic fields like finance. As Aristotle wisely noted, even written laws should not remain unaltered forever. India, often considered one of the most over-legislated countries, should prioritize updating outdated Acts and regulations to align with the evolving financial landscape. Financial sector policies comprise a set of policies, such as: – Prudential policies to ensure safety and soundness of the financial system (financial stability) – Regulatory and Supervisory policies – Depositor and Consumer protection policies – Financial Inclusion policies – Other policies for sufficient supply of credit to economically crucial sectors i.e. manufacturing, Parliament has passed —Insolvency and Bankruptcy Code, 2016<sup>1</sup> to resolve all the insolvency issues and to curb the menace of high NPAs in the country. According to "World Bank" report in 2011 the percentage of NPAS was 2.5%. This increased to 9.1% in 2016, which is a threefold increase. Further, prior to the enactment of IBC the time required for insolvency resolution was very high and the recovery rates very low (25.7 cents to Dollar)<sup>1</sup> “Among the BRICS economies, India faces one of the lowest recovery rates. The prevalence of Non-Performing Assets (NPAs) has several detrimental effects, including elevated interest rates, disruptions in investment and credit cycles, diminished investor confidence, and overall constraints on economic growth. Fortunately, with the implementation of the Insolvency and Bankruptcy Code (IBC), NPAs are expected to be resolved within 180 days, potentially leading to improved recovery rates.”

Assets can have several negative consequences on an economy. These include high interest rates, disruptions to investment and credit cycles, diminished investor confidence, and overall

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<sup>1</sup> World Bank Report, 2011 (May, 20, 2021) <https://openknowledge.worldbank.org/handle/10986/4389>.

constraints on economic growth. However, with the implementation of the Insolvency and Bankruptcy Code (IBC), non-performing assets (NPAs) are expected to be resolved within 180 days, potentially leading to improved recovery rates. The Insolvency and Bankruptcy Code (IBC) introduced several significant changes, including the establishment of the “Insolvency and Bankruptcy Board of India,” the role of “Insolvency Resolution Professionals,” and the formation of the “Committee of Creditors.” India’s position in the “Ease of Doing Business Report 2020” by the World Bank improved by 14 places, reaching 63rd out of 190 nations. This progress was driven by various economic reforms, with one key parameter being the ease of resolving insolvency<sup>2</sup>

Despite being in effect for over a year, the IBC remains a work in progress. It is crucial to assess its functioning and identify any issues hindering the efficiency of the resolution and liquidation framework. The legal framework should address the resolution mechanism from a practical standpoint, emphasizing the following characteristics:

- Early Intervention Before Insolvency: Timely measures to prevent insolvency.
- Speed of Intervention/Resolution: Swift action to resolve distressed situations.
- Ability to Transfer or Merge Operations: Facilitating business continuity.
- Effective Write-Down of Shareholders’ Rights: Ensuring fairness in the process.
- Protection of Ongoing Business: Safeguarding operational continuity.
- Furthermore, the resolution mechanism should extend beyond banks and also address the resolution of other Systemically Important Financial Institutions (SIFIs).

## **STATEMENT OF PROBLEMS**

The **Insolvency and Bankruptcy Code (IBC)** has been a focal point in India’s efforts to address insolvency challenges. As non-performing assets (NPAs) burgeon due to corporate defaults, the government recognizes the threat posed to the banking industry—the backbone of the economy. In response, the IBC was enacted to streamline insolvency resolution, aiming to maximize asset value within a defined timeframe.

This study delves into the features of insolvency and bankruptcy legislation across various nations, including India. It seeks to assess whether these legal frameworks act as a boon or a bane for the

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<sup>2</sup> Ease of Doing Business 2020: India ascended 17 notches, ranked at 63rd position by The World Bank (jagranjosh.com)

Indian banking sector. By examining academic research on the Indian IBC, we aim to evaluate its relevance and effectiveness in revitalizing the banking industry<sup>3</sup>

## AIMS

Comprehend the Concept of the Bankruptcy and Insolvency Code: Understand how the Bankruptcy and Insolvency Code functions as a corrective tool within the banking industry.

Review and Evaluate Research Studies on the Insolvency and Bankruptcy Code: Analyze existing academic research related to the Insolvency and Bankruptcy Code.

Identify Flaws in the Current Legislation: Examine the shortcomings and limitations present in the current text of the legislation.

## OBJECTIVES OF THE STUDY

The **literature review** serves as a foundation for justifying the observed problem and shaping the research objectives. Here are the primary and secondary objectives derived from the identified issues:

### **Primary Objectives:**

- **Highlight Issues in Earlier Regimes:** Shed light on various issues related to **Insolvency and Bankruptcy laws** in previous regimes.
- **Emphasize Government-Initiated Changes:** Explore major changes introduced by the **Government of India in Insolvency and Bankruptcy laws**, particularly those impacting the Indian banking sector.
- **Uncover Implementation Challenges:** Investigate challenges faced during the implementation of **Insolvency and Bankruptcy Laws** in India.
- **Analyze Outcomes for the Banking Industry:** Illuminate the outcomes for the banking industry following the enactment of the **IBC, 2016**.

### **Secondary Objectives:**

- **Identify Factors Affecting Bankruptcy:** Examine major factors—both within India (including market and economic factors) and outside India—that influence bankruptcy.
- **Study Demographic Factors and Risk Perception:** Evaluate how certain demographic factors within banks influence their perception of risk and return in loans provided to different borrower segments (e.g., big corporates, MSMEs, individuals, retail businesses,

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<sup>3</sup> [Explained | The Insolvency and Bankruptcy Code \(IBC\)- where does it stand today? - The Hindu](#)

farmers).

- **Explore Factors Responsible for Insolvency:** Investigate factors contributing to insolvency and bankruptcy in borrowing recoveries by banks, including adverse market conditions, fraud, domestic issues (for individuals), and weather/geographical challenges (for loans to farmers in India).

## **LIMITATIONS OF RESEARCH**

The limited availability of research articles and books on this topic poses a challenge. Additionally, the Insolvency and Bankruptcy Code (IBC) being relatively new has resulted in a scarcity of studies analyzing its impact on the economy, especially within the banking sector.

## **LITERATURE REVIEW**

1. **Deepak Tandon, Neelam Tandon (2019):** According to the researcher, India's banking industry is plagued with asset quality degradation difficulties, resulting in significant losses due to insufficient provisioning for non-performing assets. As a result, the financial system's long-term viability has grown increasingly problematic. NPAs and bad loans have accumulated over time, according to the academics, adding to the spiralling effect of the same. The researchers went on to say that lapses in banking operations, particularly non-compliance with procedures, were the main cause of a number of bank frauds. They also determined that, despite the fact that the RBI has been adopting preventative steps for the treatment of stressed assets, as well as fast corrective efforts to improve asset quality, the results have been mixed, and progress has been gradual. They believe that in order to improve the banking system's conditions in the future, it is critical to have a strong and sustainable credit growth.
2. **Srijan Anant, Aayushi Mishra (2019):** According to the study, the IBC is one of the most significant legislative reforms in India. According to the author, the IBC not only strengthens India's legal system, but also provides a new identity and recognition for India on a global scale. According to the author, the legislation consolidates the previous various bankruptcy laws into a single law. The author has examined the code's essential elements as well as its legal foundation. The author has also attempted to assess the influence of the Insolvency and Bankruptcy Code on India's macroeconomic climate.

3. **Renuka Sane (2019):** When the IBC was passed in 2016, the researcher believed that the government only reported corporate insolvency and not personal insolvency. According to the author, the current state of the Indian credit industry necessitates the creation of a personal insolvency law. The document gave a quick overview of the IBC's provisions on personal insolvency. The author offers policy recommendations that must be addressed prior to the effective implementation of law in order to ensure proper design of subordinate legislation and the growth of institutional infrastructure. In comparison to other emerging or developed economies, the author believes that India's debt to GDP ratio is substantially lower. Despite the fact that NPAs on personal loans from the banking sector are fewer than those on industrial loans, the author believes that their rising nature necessitates the resolution of personal insolvency difficulties. The author expresses grave worries about agricultural loans, as well as the fact that the impact of informal lending is unknown. Only institutional credit has legal redress, leaving other types of lenders without a legal avenue for recovery. In her study, the researcher gives a quick outline of the legal provisions. According to the study, the primary purpose for creating the law was its possible influence on India's loan sector. A brief discussion of the unique processes for dealing with default was conducted, which included the "Fresh Start" process, which provides debt-waiver to debtors who meet certain eligibility conditions in terms of income, assets, and debts; and the "Debt Recovery Tribunals" (DRTs), which are the adjudicating authority for corporate insolvency. The success of the IBC, according to the study, is determined by the design of subordinate legislation as well as the evolution of institutional infrastructure.
4. **Nishith Desai Associates (2019):** The influence of IBC on the Indian debt market in its early phases was examined by the researcher. The numerous hurdles in the proper execution of the Code, according to the academics. According to the researcher, constructive judicial interpretation, as well as successful Code modifications, have aided in the resolution of many difficult cases. The regulatory and supervisory authority, the Insolvency and Bankruptcy Board of India ("IBBI"), according to the researcher, has been doing a commendable job in proactively raising knowledge. The researcher has examined the major decisions made throughout the year and concludes that corporate India's aim to turn around loss-making enterprises is incredibly optimistic for the economy and the banking system, which is beset by rising NPAs.

The researcher has concentrated on three areas: the Impact of the IBC on Creditors and Investors, Statutory and Regulatory Developments, and Finally, Recent Judicial Developments.

5. *Manoranjan Ayilyath (2019)*: The Bankruptcy and Bankruptcy Code, according to the researcher, prevents the erosion of company value and makes it simple to find a solution for time-bound insolvency resolution for the purpose of growing the firm. Because the Code relating to the Insolvency Resolution and Bankruptcy of Individuals and Partnership Firms has not yet been made properly operational, the present IBC is unable to meet the financial market and resolution process. This research investigates the different variables and problems that stymie growth in the system, which must be addressed as a continuous process.
6. *Akshaya Kamalnath(2019)*: The Insolvency and Bankruptcy Code (“IBC”) was implemented in 2016 with the primary goal of being a tool for effective restructuring and rescue, according to the study. The IBC model was built on a solid foundation of infrastructure, including dedicated company law tribunals, a dedicated regulator, and stringent deadlines. It has uncovered a few concerns throughout its two-year operation, such as directors' resistance to initiating the IBC procedure and losing control of the company. The ‘Modified Revlon Duty’ was created to encourage the promoter to assess the firm rather than retain control of the board of directors during liquidation.
7. *Adam Feibelman & Renuka Sane (2018)*: The **Insolvency and Bankruptcy Board of India (IBBI)** bears the legal responsibility for gathering and disseminating critical information related to the new insolvency and bankruptcy system. Given that the system is still in its early stages, the IBBI plays a crucial role in establishing a robust data collection and sharing mechanism. Notably, empirical research conducted in the United States has underscored the significance of data in ensuring the efficient functioning of insolvency systems across any country. The researcher emphasizes that insolvency data serves as a valuable resource, providing insights into broader macroeconomic risks and business failures. Consequently, both the IBBI and adjudicating authorities should prioritize comprehensive data collection. However, it's essential to acknowledge the challenges associated with acquiring and analyzing

data effectively.

8. *Dr. P.N.Harikumar & Dr. Susha D,(2017):* According to the study, non-performing assets are a key source of concern for India's scheduled commercial banks, and they have had a significant impact on the banks' profitability and liquidity. The purpose of this article is to explain the notion of a nonperforming asset (NPA), the status of NPAs in Indian Scheduled Commercial Banks, and the recovery of NPAs through multiple primary channels. The author strongly believes that in order to improve the financial health of the banking system, it is vital to reduce nonperforming assets (NPAs).
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10. *Nakul Sharma, Dr. Rahul Vyas(2017):* The purpose of this study is to examine the Insolvency Professional Agency structure in terms of its role and scope, as it is the IBC's bulwark in terms of procedural and regulatory breadth. The IBC 2016 is a watershed moment in our country's legal history since it provides timely settlement, encourages entrepreneurship, which improves credit availability, and balances the interests of all stakeholders.

## **HYPOTHESIS**

**Hypothesis (HO):** The Insolvency and Bankruptcy Code, 2016 **adequately serves as a comprehensive legislative framework for recovery within the banking industry.**

**Alternative Hypothesis (HA):** The Insolvency and Bankruptcy Code, 2016 **falls short of being a comprehensive legislative framework for recovery within the banking industry.**

## **RESEARCH METHODOLOGY**

This research relies on **secondary information**. It draws upon assessments issued by reputable Indian corporate agencies to examine the **Insolvency and Bankruptcy Code (IBC)** from various angles. The data was manually collected from orders related to insolvency petitions involving banks, which were published on both the **National Company Law Tribunal (NCLT)** and the **National Company Law Appellate Tribunal (NCLAT)** websites. The objective is to comprehensively address various aspects of the IBC for successful implementation in India. The following **research methodology** was employed to achieve the stated goals.

### **Type of Research Design**

In my study, I employed a **Descriptive Research design**. Through this approach, I analyzed various facts based on both primary and secondary data.

- **Primary Data:** I collected opinions from bankers.
- **Secondary Data:** I gathered information on different banks' **Non-Performing Assets (NPAs)** and their recovery patterns from various published reports and indices.

For this research, the **population** for secondary data includes all the different banks' NPAs and their recovery trends. Specifically, I focused on data from selected **Reserve Bank of India (RBI) reports** during the period from **January 1, 2017, to October 31, 2020**—which served as my sample frame. This period represents a subset of the overall observed timeframe (from January 1, 2017, to October 31, 2020) and was chosen for detailed analysis. Additionally, the primary data was collected from experienced and well-positioned individuals within the banking sector.

### **Scope of Study**

The **scope of my secondary data** is confined to the period from **January 1, 2017, to October 31, 2020**. As for the **primary data**, it is limited to the following banks:

1. State Bank of India
2. Bank of India
3. Punjab National Bank
4. Bank of Baroda
5. Canara Bank
6. HDFC Bank
7. ICICI Bank

These institutions serve as the focal points for my research.

### **Source of Data**

Gathering secondary data on the quarterly values of Non-Performing Assets (NPAs) is facilitated by their availability in various newspapers and reports published by the **Reserve Bank of India (RBI)**. This source is highly efficient and reliable, as the RBI directly collects records from various banks<sup>4</sup>.

## **PAST LEGAL REFORMS BROUGHT IN THE INSOLVENCY**

### **REGIME OF INDIA**

The legal environment of any country significantly influences its economic development. A robust legal framework is essential for establishing a strong global presence. Within this context, the banking sector assumes a pivotal role in driving economic growth. The level of **Non-Performing Assets (NPAs)** serves as a critical indicator of a banking industry's health in any economy. The NPA problem directly impacts the sector's performance and can lead banks to be cautious about risk capital when extending new loans. In situations where NPAs or other factors threaten a bank's viability, or when economic conditions give rise to systemic crises, insolvency systems become particularly crucial. These creditor/debtor regimes enable prompt responses from countries and stakeholders, ensuring stability and effective resolution.

**Non-Performing Assets (NPAs)** have a direct impact on bank profitability, leading to rising capital costs and heightened risk perception. When banks are unable to recover debts, they resort to legal proceedings, which can be time-consuming. As a result, funds become tied up in litigation, and the value of assets pledged to banks deteriorates. Despite various reforms in the banking sector, the NPA problem persists due to several factors, including the absence of a robust insolvency framework.

Financial creditors employ various recovery mechanisms to mitigate non-performing assets. However, previous measures, such as those under the Contract Act or specialized acts like the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, and the Securitization and Reconstruction of Financial Assets Enforcement of Security Interest Act, 2002, have not yielded desired outcomes. Additionally, provisions related to winding up companies and the Sick

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<sup>4</sup> [Reserve Bank of India - Reports \(rbi.org.in\)](https://www.rbi.org.in)

Industrial Companies (Special Provisions) Act, 1985, offer limited assistance in recovering overdue amounts from borrowers.

Furthermore, individual insolvency laws, such as the Presidential Towns Insolvency Act, 1909, and the Provincial Insolvency Act, 1920, are outdated and pose challenges to an effective recovery mechanism.<sup>5</sup>

Over time, the Non-Performing Asset (NPA) problem in India escalated into a crisis. Initially, private sector banks led the list of banks with the highest NPAs. However, the situation worsened, and eventually, 8 out of 10 public sector banks dominated the list. Interestingly, the slow legal process had an unintended consequence: banks became risk-averse and disproportionately invested their assets in sovereign debt paper.

Unfortunately, the insolvency process remained highly ineffective, failing to adequately address non-performing loans. To tackle this crisis and enhance the ease of doing business in India, the government established the **Bankruptcy Law Reform Committee** in 2014, with the aim of expediting the enactment of new insolvency laws.

#### **Challenges with “Out-of-Court” Restructuring Framework:**

- The **Corporate Debt Restructuring Scheme (CDR)** was introduced by the Reserve Bank of India (RBI) in 2001 as an out-of-court restructuring mechanism for corporate loans. Inspired by the London Approach and INSOL Principles, CDR aimed to address financial distress without court intervention.
- While CDR has benefited stakeholders, it has limitations. Notably, it is available only for cases involving **multi-creditor financing**. Additionally, lenders often prioritize **recovery of money** over comprehensive business restructuring.

#### **Concerns Regarding One-Time Settlement:**

- The RBI periodically issued one-time settlement schemes to facilitate dues settlement between lenders and borrowers. However, some of these schemes did not yield desired results.
- Lenders were apprehensive about writing off loans, fearing potential investigations by

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<sup>5</sup> [Personal Bankruptcy or Insolvency laws in India - iPleaders](#)

regulatory bodies. They questioned the merits of each waiver granted.

#### **Issues with Filing Civil Suits:**

- Banks faced challenges due to the **lengthy and cumbersome procedure** for debt recovery in overburdened civil courts.
- Insufficient commercial capacity and infrastructure in civil courts contributed to delays, resulting in significant funds being tied up for years.

### **ISSUES WITH SARFAESI**

**Non-Performing Assets (NPAs)** persistently rise in banks and financial institutions due to the absence of an effective insolvency law. Neither the Debt Recovery Tribunal (DRT) nor other mechanisms yielded substantial recoveries. To address this, the **T.R. Andhyarujina Committee** proposed a special enactment—the **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act)** in 2002. Although some amounts were recovered, challenges arose during asset sales. Few buyers participated in auctions, and issues like high stamp duty, valuation disagreements, and banks' reluctance to take over management complicated the process.

### **WINDING UP OF COMPANY**

Winding up of companies takes a long time in India. Till recently application for winding up on any ground including pursuant to recommendation made under SICA was required to be filed under Companies Act 2013. But after enactment of IBC default in payment of debt can be ordered only by NCLT, earlier this power was with the High Court. As on 31 October 2015 only about 955 out of 4636 cases of court were resolved in 5 years. Even some of the cases are pending in court for more than 20 years<sup>6</sup>. Due to the lengthy process kept substantial corporate assets unrealized and undistributed. The inordinate delay in liquidation proceedings marred the possibilities of rapid use of productive assets lying dormant in these proceedings throughout the country.

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<sup>6</sup> Report of the Joint Parliamentary Committee on Insolvency Code, Department of Financial Services , pg76-77,2016

## **MULTIPLICITY OF LEGISLATIONS:**

### **1. Corporate and Firm Insolvency:**

- Prior to the introduction of the **Insolvency and Bankruptcy Code (IBC) 2016**, India had multiple and overlapping laws governing insolvency proceedings. These included provisions from the **Partnership Act, 1932**, the **Companies Act**, the **Sick Industrial Companies (Special Provisions) Act, 1985 (SICA)**, the **Recovery of Debt Due to Banks and Financial Institutions Act, 1993**, and the **Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)**.
- Unfortunately, these laws were not particularly helpful for financial creditors, especially banks, due to various loopholes and contradictory provisions.
- Consequently, there arose a need for a unified and streamlined insolvency and bankruptcy recovery mechanism.

### **2. Individual Insolvency:**

Individual insolvency proceedings were governed by century-old laws—the **Presidency Towns Insolvency Act, 1909 (PTIA)** for residents of Mumbai, Kolkata, and Chennai, and the **Insolvency Act, 1920 (PIA)** for other residents. However, these laws have become outdated and lost their relevance in the present era.

## **LOW RECOVERY RATE**

Over the years it was observed that the public sector banks faces the problem of rising NPAs more in comparison to private sector banks and foreign banks. In the year 2013-14 total number of cases filed are 10,44,636, out of which most of the cases (8,40,691) are filed through Lok Adalats but the recovery was only 6.1 per cent, cases which are filed through SARFAESI Act was (190537) but recovered 27.2 percent of amount. Whereas in the year 2016-17 total cases were 22,61,873, but most of the amount was recovered through DRTs. It is observed that year by year NPA cases are increasing i.e 46.18 percent during this five years and recovery through Lok Adalats is very less though most of the cases dealt by this channel. It is also found that most of the amount recovered through SARFAESI Act and DRTs only. Hence, the government and RBI has to take measures to recover through the SARFAESI Act and DRTs which will maximize the recovery of NPAs, which enables stability of bank performance and contributes for the growth and development of economy.

## RISE OF NPA

3. **Non-Performing Assets (NPAs)** can significantly impact an economy in various ways. Here are some key points:
  4. **Earning Assets Decline:** As NPAs increase, the earning potential of assets declines. Operating expenses rise due to provisioning for bad loans, affecting overall profitability.
  5. **Risk Aversion in Lending:** Banks become risk-averse when dealing with NPAs. They hesitate to provide new loans, which can hinder economic growth.
  6. **Viability of Banks:** NPAs can jeopardize the viability of banks. If a bank's financial health is compromised, it affects its ability to support economic activities.
  7. **Systemic Crises:** In times of economic downturn or systemic crises, an effective creditor/debtor insolvency system becomes crucial. It allows prompt responses to stabilize the financial system.
  8. **Legal Challenges and Asset Disposal:** The legal process for asset disposal is time-consuming. Banks often need to approach courts for debt recovery, leading to blocked funds and deteriorating asset values.
  9. **Reforms and Insolvency Framework:** While reforms have resolved some bad loans, the absence of a robust insolvency framework continues to be a challenge for banks

### **Impact of NPAs on banks:**

The rising Non-Performing Assets (NPAs) have significant implications for the banking sector, directly impacting their profitability. Here are the various effects of NPAs on banks:

1. **Liquidity Position:** High NPAs create a gap between assets and liabilities, compelling banks to raise funds from the market at higher costs. This affects the liquidity of the bank.
2. **Undermining Bank Image:** Elevated NPAs tarnish a bank's image both domestically and globally, leading to reduced profitability.
3. **Impact on Funding:** In an economy with high NPAs, there is a scarcity of funds. Consequently, only a few banks can afford to lend money.
4. **Higher Cost of Capital:** To ensure smooth day-to-day operations, banks must set aside more capital.
5. **Increased Risk:** High NPAs reduce a bank's risk-taking capacity.
6. **Effect on Income:** NPAs, being unproductive, reduce a bank's income.
7. **Profitability and Interest Rates:** NPAs negatively impact profitability and influence interest rates.

## **Reasons for Insolvency, Bankruptcy & Indebtness**

India has grappled with an inefficient insolvency resolution framework for quite some time. The previous regimes suffered from overlapping laws, including the Presidency Towns Insolvency Act, 1909, the Sick Industrial Companies Act, 1985, the Limited Liability Partnership Act, 2008, and the Companies Act, 2013. These complexities led to undue delays in resolving insolvency cases. Additionally, cases could be prosecuted in multiple jurisdictions simultaneously. To address these shortcomings, then-Finance Minister Arun Jaitley introduced the **Insolvency and Bankruptcy Bill** in the Lok Sabha in December 2015. It was subsequently passed by the Lok Sabha on May 5, 2016, and the Rajya Sabha on May 11, 2016. The President signed the code on May 28, 2016, and it has been in effect since December 2016<sup>7</sup>

## **THE COMPANIES ACT 2013'S NEW PROVISIONS FOR PROTECTING SECURED CREDITORS' RIGHTS**

The Companies Act of 2013 has introduced several measures to prevent companies from facing insolvency and financial distress. These provisions aim to enhance transparency, accountability, and corporate governance. Let's delve into some key aspects:

### **1. Corporate Criminal Liability:**

- The Companies Act, 2013 includes provisions related to the criminal liability of companies.
- It outlines circumstances under which a company can be held liable for offenses, and it provides for penalties, fines, and even imprisonment of officers in certain cases.

### **2. Class Action Suit:**

- The concept of class action suits is relatively new in India but has statutory recognition under the Companies Act, 2013.
- Class action suits allow a large number of people with a common interest to sue or be sued as a group.
- These suits provide a procedural device for plaintiffs to file and prosecute litigation on behalf of a larger group or class that shares common rights and grievances.

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<sup>7</sup> Critical analysis of insolvency law in India - iPleaders

### 3. Serious Fraud Investigation Office (SFIO):

- SFIO investigates serious cases of fraud and white-collar crimes under the company's law.
- It is a multi-disciplinary organization with experts from various fields.
- SFIO's role is crucial in maintaining investor confidence and protecting their interests.

### 4. National Company Law Tribunal (NCLT):

- The establishment of NCLT aims to expedite the liquidation process, making it more efficient and less rigid.
- NCLT plays a vital role in resolving insolvency cases and ensuring fair proceedings.
- These provisions collectively contribute to a healthier corporate ecosystem and safeguard the interests of stakeholders.

The concept of the corporate veil, which separates the corporate identity from its promoters and shareholders, has its origins in the landmark case of *Salomon v. Salomon & Co. Ltd.* In this case, the court established that a company is distinct from the individuals who manage it. However, the misuse of this principle led to the concept of "Lifting of the Corporate Veil." Under this doctrine, investors or creditors can seek protection if the company engages in fraudulent practices or other criminal activities.

In the context of criminal law, the term "individual" typically refers to a natural person who has committed an act prohibited by law. However, various statutes, including Section 3(42) of the General Clauses Act, 1897, define "person" to include any company, association, or body of individuals, whether incorporated or not<sup>8</sup>. While a company can sue and be sued in its own name, prosecuting a corporate entity in criminal cases is challenging. Unlike individuals, a company cannot be imprisoned or sentenced to death. The primary form of punishment for a corporate entity is fines, which are often relatively insignificant. The question remains: Can a corporate entity ever face prosecution for criminal offenses beyond mere financial penalties?

The debate surrounding the attribution of criminal liability to companies in India remains ongoing. Opinions are divided, with both proponents and opponents of corporate criminal liability expressing their views.

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<sup>8</sup> [Section 177 of Companies act 2013: Whistle blower policy \(caclubindia.com\)](#)

### Arguments Against Corporate Criminal Liability:

1. **Lack of Individual Mind:** Critics argue that a corporate entity lacks an independent mind and cannot exhibit the moral turpitude or negative intent required for criminal guilt. Treating a company as if it possesses a blameworthy state of mind is futile, as it inherently cannot have such intent.
2. **Incarceration Impossibility:** Since sending an organization behind bars is impossible, achieving the objectives of deterrence, punishment, and rehabilitation through penal sanctions becomes challenging.

### Arguments in Favor of Corporate Criminal Liability:

1. **Corporate Existence:** Advocates assert that corporate entities are not mere fictions. They exist tangibly within society and have the capacity to cause harm, similar to human beings.
2. **Responsibility for Crimes:** Treating corporations like natural persons and holding them accountable for their committed crimes is just and reasonable.
3. **Upholding Fundamental Values:** Corporations with societal influence must respect fundamental values. Criminal law upholds these values, making it appropriate to hold corporate entities criminally liable.

In recent times, wrongdoing has evolved from individual acts to white-collar crimes with far-reaching consequences. The question remains: Can corporate persons be held criminally liable?

### Theories of Corporate Liability:

There are two theories commonly used to hold corporations criminally liable for offenses:

#### **Vicarious Liability** and the **Identification Theory**.

1. **Vicarious Liability:**
  - Under this traditional theory, the master (corporation) is held liable for the acts of its servant (employee) performed within the scope of the master's business.
  - Importantly, no personal fault on the part of the master is required to establish liability.
2. **Identification Theory:**
  - This theory recognizes that certain senior officers within a corporation act as the directing force of the organization.
  - Their acts and intent are attributed to the corporate entity itself.
  - Instead of vicarious liability, the corporate entity is directly held liable for its actions.

These theories shape the legal framework for determining corporate criminal liability.

**Statutory Inadequacy Regarding Corporate Criminal Liability:** Indian statutes still primarily hold company officials criminally liable, rather than the corporate entity itself.

Instances of this include:

**1. Indian Companies Act:**

- Sections 63, 68, 203, and others within the Indian Companies Act impose liability on company officials, but not on the company itself.
- Similar provisions exist in various other Indian statutes and norms.

**2. Limitations on Sanctions Against Corporations:**

- Sanctions such as incarceration cannot be applied directly to corporations.
- Consequently, these sanctions are not included in the different provisions of the Indian Penal Code that deal with mandatory imprisonment.

While certain legal improvements are gradually being introduced, there remain other Indian statutes with similar limitations.

## **EVOLUTION OF CORPORATE CRIMINAL LIABILITY IN INDIA**

In *Oswal Vanaspati & Allied Industries v. State of U.P.*<sup>9</sup>, The Full Bench of the Allahabad High Court ruled that a corporation, as a juristic person, cannot be sentenced to imprisonment. The dispute arises over whether a fine alone can be imposed on a corporation under Section 16 of the Act, or if such a sentence would be unconstitutional and therefore invalid. It is well-established that a conviction must be followed by a sentence or punishment. If only corporal punishment (imprisonment) is specified, a legal entity like a firm cannot be prosecuted or punished in that manner. However, in such circumstances, the entire sentence stipulated can be granted to the firm as a component of the sentence, specifically in the form of a fine. Legally, a sentence imposed by the law is valid. While a sentence longer than the stipulated term is always illegal, a shorter sentence may not always be considered criminal.

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<sup>9</sup> 1993 1 Comp LJ 172

In the case of *Standard Chartered Bank & Others v. Directorate of Enforcement & Others*<sup>10</sup>, The Supreme Court examined whether a corporation, as a juristic person, could be prosecuted for an offense punishable by mandatory imprisonment and a fine. The Court clarified that corporations can indeed be tried and punished for criminal offenses. While there are precedents suggesting that corporations cannot commit crimes, the prevailing modern norm is that corporations, except in cases where their corporate nature precludes certain offenses, can indeed be held criminally liable. The Court emphasized that a corporation can face indictment or other criminal proceedings even if the criminal act was committed by its agents. However, the question of whether a company can be held accountable for crimes requiring mens rea (criminal intent) remains unanswered.

## CLASS ACTION SUIT

The origin of Class Action Suits is one of the significant changes introduced by the **Companies Act, 2013** through **Section 245**. While the concept of a class action lawsuit is not new, its statutory recognition and enforceability in the Indian context emerged only with the Companies Act of 2013. Let's delve into the details:

### 1. What Is a Class Action Suit?

A class action suit refers to a legal proceeding where a **group of individuals** affected by the same or similar injury collectively file a lawsuit against a common defendant.

It allows people with shared interests or grievances to seek a joint remedy against unlawful activities that have caused them financial or legal harm.

### 2. The Satyam Scam and Class Action Suits:

- The **Satyam Computers Services Ltd. scandal** in 2009 brought class action suits into the spotlight in India.
- Satyam was accused of **misrepresenting its financial accounts**, deceiving board members, stakeholders, and investors.
- Around **three lakh Indian investors** were unable to seek redressal due to the absence of provisions for class action suits under the **Companies Act, 1956**.
- In contrast, American investors successfully obtained damages by filing a class-action suit in the **US courts**.

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<sup>10</sup> (2005) 4 SCC 530

### 3. Provisions in the Companies Act, 2013:

- Post the Satyam scandal, India recognized the need for class action suits.
- The **Companies Bill, 2009** introduced the concept, and the Companies Act of 2013 incorporated provisions for class action suits under **Sections 245 and 246**.
- These provisions enable affected shareholders to seek relief when the management's conduct harms the company's interests.

### 4. Why Class Action Suits Matter:

- **Securing Minority Shareholders:** Class action suits protect minority shareholders from abusive or arbitrary management behavior.
- **Combining Claims:** By summing up individual claims, group actions streamline litigation processes.
- **Resource Depletion and Low Voter Turnout:** Social dilemmas, such as resource depletion or low voter participation, can be addressed through class action suits.

## **THE SERIOUS FRAUD INVESTIGATION OFFICE (SFIO)<sup>11</sup>**

The Serious Fraud Investigation Office (SFIO) is a fraud investigating bureau in our country. The SFIO is a multi-disciplinary association and was set up by Govt. of India under Ministry of Corporate Affairs, comprising of specialists in the diverse fields for identifying and prosecuting crimes/frauds pursuant to Government of India by methods of a resolution dated 2nd July 2003 (Resolution No. 45011/16/2003-Adm-I) and was later given formal lawful status vide Section 211 of the Companies Act, 2013. SFIO is an organisation formed on the recommendations of Naresh Chandra committee which was approved in January 2003. At first SFIO did not enjoy a formal lawful status. It completed examinations in the suspected cheats and fraud within the current legal system under Section 235 to 247 of the past Companies Act, 1956 - as an executive agency on behalf of the Central Government or a Court of competent jurisdiction. There is no reference of SFIO in the Companies Act, 1956, however different officers of SFIO have been approved under Section 621 of the Companies Act, 1956 (as individual approved by Central Government) to record complaints against defaulting organizations. SFIO got statutory acknowledgment once the new Companies Act, 2013 was formulated. In the new Companies Act, 2013, powers, for example, treating the examination reports which is filed by SFIO officers as a report recorded by a Police

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<sup>11</sup> INSPECTION, INQUIRY AND INVESTIGATION, The Institute of Company Secretary of India; available at: <<https://www.icsi.edu/portals/0/INSPECTION,%20INQUIRY%20AND%20INVESTIGATION.pdf>> accessed on 28th June, 2021

Officer, power to capture the suspected, power to issue letter of request in cases including corporate entity having business/interests outside the nation and so forth are allowed. (The Companies Act 1956 did not have any arrangement for examination/gathering of proof on account of transactions and people based outside India. Other investigating offices like CBI and Enforcement Directorate have these powers. (Wherever required, the matters of international ramifications were referred to CBI and / or Enforcement Directorate and both these agencies were looking into the issue of defaulting companies abroad.)

### **Investigation Procedure of SFIO<sup>12</sup>**

- i. According to Section 212 (1) of the Companies Act, 2013, —the Central Govt. may assign the investigation into the affairs of a company to the Serious Fraud Investigation Office –
  - a) On receipt of report of the Registrar or Inspector under section 208;
  - b) On intimation of a special resolution passed by a company requesting an investigation into its affairs;
  - c) In public interest;
  - d) On the request of any Department of Central Government or State Governmentll. When such an order from the Government is received, Director, SFIO might select such number of Inspectors as he may deem proper for the reason of making such investigation and examination.
- ii. According to sub-section (3) of section 212 of Companies Act, 2013, —the investigation into the affairs of a company shall be conducted in the manner and by following the procedure specified in Chapter XIV of Companies Act, 2013. The SFIO shall submit its report to the Central Government within the period specified in the order.
- iii. According to sub-section (4) of section 212 of Companies Act, 2013, —the Director SFIO shall cause the affairs of the company to be investigated by an investigating officer, who shall have the powers of the Inspector under section 217 of the Companies Act, 2013.
- iv. According to sub-section (5) of section 212 of Companies Act, 2013, — it shall be the responsibility of the company, its officers and employees, who are or have been in the employment of the company to provide all information, explanation, documents and assistance to the investigating officer as he may require for conduct of business.
- v. According to sub-section (11) of section 212 of Companies Act, 2013, —the Serious Fraud Investigation shall submit an interim report, if so directed by the Central Governmentll.

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<sup>12</sup> Investigation Procedure of SFIO; available at:< [http://www.s fio.nic.in/inves\\_proc.aspx](http://www.s fio.nic.in/inves_proc.aspx).> accessed on 24thMay, 2021.

- vi. According to sub-section (12) of section 212 of Companies Act, 2013, —on completion of investigation, the SFIO shall submit the Investigation Report to the Central Government. SFIO gets into the investigation only upon receiving an order from the central government in this regard. In other words, it cannot take up cases on its own. In addition to this, if any case has been given by the Central Government of India to the SFIO for carrying out investigation under Companies Act, 2013 no other investigating agency of the Union Government or any State Government can proceed with the investigation in such cases and in the event any such investigation has already been started, it can't continue further, and the related agency will have to transfer the relevant records as well as the documents with regard to such offences to Serious Fraud Investigation Office.

The **Saradha Group financial scandal stands** as a significant case that brought the **Serious Fraud Investigation Office (SFIO)** into action. Let's delve into the details:

#### **Saradha Group Scam Overview:**

The Saradha Group, a consortium of over **200 private companies**, orchestrated a **Ponzi scheme** in Eastern India.

Despite being popularly but incorrectly referred to as **chit funds**, these companies were actually running **collective investment schemes**.

The group managed to collect a staggering amount of ₹200 to 300 billion (US\$4–6 billion) from over 1.7 million depositors before its collapse in April 2013<sup>1</sup>.

The scheme promised high returns and operated through a vast network of agents who received hefty commissions.

#### **Aftermath and Investigations:**

In the wake of the scandal, the **State Government of West Bengal** (where most investors were based) instituted an inquiry commission to investigate the collapse.

To safeguard low-income investors, the state government set up a fund of **₹5 billion (US\$63 million)**

The **Central Government**, through the **Income Tax Department** and **Enforcement Directorate**, launched a **multi-agency probe** to investigate the Saradha scam and similar Ponzi schemes.

In May 2014, the Supreme Court of India transferred all investigations related to the Saradha scam and other Ponzi schemes to the Central Bureau of Investigation (CBI) due to inter-state

ramifications, potential international money laundering, regulatory failures, and alleged political connections.

Several prominent personalities, including **Members of Parliament**, were arrested for their alleged involvement in the scam.

#### 1. Comparison to Past Scams:

- The Saradha scam has often been likened to the **Sanchayita investment scam**, which occurred in West Bengal during the 1970s.
- The Sanchayita scam led to the formation of the **Prize Chits and Money Circulation Schemes (Banning) Act of 1978**.

#### 2. Satyam Case:

##### Background:

- **Satyam Computer Services**, a prominent Indian IT company, faced a massive financial scandal in **2009**.
- The company's founder, **B. Ramalinga Raju**, confessed to **cooking the company's books** for several years.
- The fraud amounted to a staggering **₹7,000 crore** (approximately **US\$1 billion**).

##### SFIO Investigation:

- The SFIO was tasked with investigating all aspects of the Satyam case.
- It probed the **money trail** and other related matters within India.
- The investigation report, spanning **12,000 pages in 30 volumes**, was submitted to the government within the stipulated three months.
- The SFIO also referred matters related to **fund transfers outside India** to the **Enforcement Directorate**.

##### Findings:

- Independent directors were found to be **unaware** of the fraud in the company's accounts.
- The SFIO recommended prosecution against those responsible, including the company's founder.
- The CBI filed a chargesheet against **nine accused**, including B. Ramalinga Raju, for various breaches of the Indian Penal Code and violations of company law.

### 3. Deccan Chronicle Holdings Ltd. (DCHL) Case:

#### Overview:

- DCHL, the owner of English dailies **Deccan Chronicle** and **Asian Age**, faced allegations of **monetary irregularities**.
- The company failed to repay loans to its money lenders.

#### SFIO Investigation:

- The SFIO examined DCHL's affairs and found violations of about **20 sections** of the **Companies Act, 1956**.
- These violations included offenses that could lead to **imprisonment**.
- DCHL had raised funds by selling **non-convertible debentures** and faced financial distress.
- Lenders took action against DCHL under the **Securitization Act**.

#### Companies Act 2013 and SFIO:

- The Companies Act 2013 aimed to **strengthen the SFIO**.
- In its new form, the SFIO became a **statutory body** empowered to initiate prosecution as directed by the **Central government**.
- In summary, the SFIO plays a crucial role in investigating and addressing complex financial frauds, ensuring transparency, and safeguarding corporate interests.

## **NATIONAL COMPANY LAW TRIBUNAL (NCLT)**

There is a noticeable fashion around the globe towards rationalization of business activities and simplification of statutes for its proper governance. This trend is being driven to a certain extent, by the utilization of electronic communication and information technology that has speeded up business transactions as well as making them global. Time is, along this line, ready to guarantee ripe that dispensation of justice and disposing of business matters by the court and authorities ought to be tuned in to the speed with which business is being carried out. In addition to this certain business matters require specific domain knowledge in order to deal with the issues reasonably. Keeping in mind the backlog of legal cases and the requirement for specialized knowledge of the persons discharging the duty of adjudicating the issues involving intricate issues relating to the subjects, the process of setting up of specialized tribunals has gained momentum over a period of time. The birth of setting up of specialized tribunals can be traced in the Apex

court judgement in *Sampath Kumar case*<sup>13</sup>. In this case while adopting the theory of alternative institutional mechanism the Supreme Court stated that —since independence, the population explosion and the increase in litigation had greatly increased the burden of pendency in the High Courts. The Supreme Court further mentioned the studies conducted towards relieving the High Courts of their ever increasing case load, the recommendations of the Shah Committee for setting up independent Tribunals and likewise suggestion of the Administrative Reforms Commission for setting up of Civil Service Tribunals.

In *R. Gandhi, President, Madras Bar Association v. Union of India*<sup>14</sup>, the petitioner challenged the constitutionality for creation of NCLT and NCLAT on the ground that —Provisions regarding formation of NCLT and NCLAT are ultra vires of Article 14 of the constitution. The Supreme Court held that the Parliament's power to create National Company Law Tribunal and National Company Law Appellate Tribunal is clearly traceable to Entries 43 and 44 of List I. The Court also viewed that Parliament is thus competent to enact law with regard to the incorporation, regulation and winding up of Companies. The power of regulation would include the power to set up adjudicatory machinery for resolving the matters litigated upon, and which concern the working of the companies in all their facets. It may be pointed out that the Law Commission, as referred to by the Supreme Court in the case of *L Chandra Kumar*<sup>15</sup>, had also recommended the creation of specialist Tribunals in place of generalist Courts. Along these lines, the formation of National Company Law Tribunal and Appellate Tribunal and vesting in them the powers exercised by the High Court with respect to matters cannot be said to be unconstitutional. With respect to the challenge of the provisions contained in the new Act relating to the qualifications of technical members of NCLT/NCLAT, the Apex Court held that only officers who are holding the position of Secretaries or Additional Secretaries alone are to be considered for appointment as technical Members of NCLT.

## **A HISTORICAL ECONOMIC REFORM IN INDIA: THE INSOLVENCY AND BANKRUPTCY CODE, 2016**

The Insolvency and Bankruptcy Code, 2016 (IBC) stands as a pivotal milestone in India's economic reforms. It addresses corporate insolvency and liquidation, providing a structured framework for resolution and recovery. Under this code, the **National Company Law Tribunal**

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<sup>13</sup> S P Sampath Kumar v. Union of India, 1985 (4) SCC 458.

<sup>14</sup> (2010)11 SCC 1

<sup>15</sup> L Chandra Kumar v. Union of India (1997) 3SCC, 261.

(NCLT) plays a crucial role in adjudicating insolvency cases, while **Insolvency Resolution Professionals (IRPs)** manage the corporate insolvency resolution process. Whether it's restructuring or voluntary liquidation, the IBC has transformed the landscape of corporate debt management, fostering transparency and efficiency in India's business ecosystem.

The Insolvency and Bankruptcy Code, 2016, provides for consistent and extensive provisions on the insolvency of corporate persons, partnership firms and individuals. The creditors retrieve the information regarding the possibility of growth of the debtors and agree to make up a plan for their improvement and speedy liquidation. It provides a systematic framework for speedy and formal "insolvency resolution process and liquidation process"<sup>16</sup>. It was amended in 2019 under "Insolvency and Bankruptcy (Amendment) Code". The goals of the Code are as follows:

- a) Harmonizing "the relationship between the creditors and the debtors" and negotiation among them.
- b) "Consolidating and amending laws of reorganization" and "insolvency resolution process and liquidation process" of "corporate persons, partnership firms and individuals".
- c) Fixing time duration that is "180 days" for insolvency settlement.
- d) "Insolvency and Bankruptcy Board of India" establishment and more.

It applies to "company and Banking companies" under "the Companies Act, 2013" or under any previous company law to their "insolvency, liquidation, voluntary liquidation or bankruptcy"<sup>17</sup>.

## **INTERNATIONAL SCENARIO ON LAWS OF INSOLVENCY**

In various legal systems, corporate insolvency rules can be broadly categorized as either **debtor-friendly** or **creditor-friendly**. Here's a breakdown:

### **Debtor-Friendly Regimes:**

- In countries like the **United States, France, and Italy**, debtors tend to benefit more from insolvency proceedings.
- Reorganization or rescue measures are often designed to support the debtor, allowing them to continue operations and repay debts.

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<sup>16</sup> Ishrat Siddiqui, "Synopsis on SARFAESI Act v. IBC, 2016", TAXGURU, <https://taxguru.in/corporate-law/synopsis-sarfaesi-act-insolvency-bankruptcy-code-2016>.

<sup>17</sup> THE INSOLVENCY AND BANKRUPTCY CODE, 2016, Sec 2

Liquidation is seen as a last resort, primarily safeguarding the interests of creditors.

### **Creditor-Friendly Regimes:**

- In contrast, countries like the **United Kingdom, Sweden, and Germany** prioritize creditor rights.
- Insolvency proceedings focus on maximizing creditor recovery.
- Liquidation is considered a more straightforward procedure for realizing assets and repaying debts.

However, it's essential to recognize that the success or failure of an insolvency regime isn't solely determined by its friendliness toward debtors or creditors. Other factors come into play:

- **Legal Institutions:** The effectiveness of insolvency laws depends on the quality and efficiency of the legal institutions overseeing the process.
- **Nature of Firms:** Different types of firms (small, large, complex, etc.) have varying needs during insolvency.
- **Capital Structure:** The financial structure of firms influences the feasibility of reorganization or liquidation.

**In India**, the Insolvency and Bankruptcy Code, 2016 (IBC) emphasizes prioritizing creditors' interests over shareholders and other stakeholders. While the law aims to strike a balance, its practical implementation remains critical.

**In the United States**, no proof of insolvency is required for a firm to be rescued under Chapter 11 of the Bankruptcy Code. The UK, on the other hand, uses a company's insolvency or likelihood of insolvency as a trigger to put it into administration (the formal process for revival and rehabilitation of companies under financial distress). Because questionable solvency is frequently an indicator of potential financial difficulties, such a test is best suited for deciding whether or not the company should be rehabilitated<sup>18</sup>.

**In the United Kingdom**, a court will only issue an administration order if it is satisfied that the firm (a) is unable to pay its debts or is likely to become unable to pay its debts, and (b) that the

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<sup>18</sup> Interim Report of The Bankruptcy Law Reform Committee (February 2015); available at: <[http://www.finmin.nic.in/sites/default/files/Interim\\_Report\\_BLR\\_0.pdf](http://www.finmin.nic.in/sites/default/files/Interim_Report_BLR_0.pdf)> accessed on 24th June 2021

administration order is fairly likely to fulfil the administration order's purpose<sup>19</sup>

In the case of In the matter of *Highberry Limited v Colt Telecom Group plc*<sup>20</sup>, the analysis of this phrase in the context of the first ground was directly at question. Colt Telecom (Colt) is or is soon to become insolvent, according to a petition for administration order filed by Highberry, due to a drastic drop in its share price since 2000, as well as substantial operating losses and negative cash-flows, as well as an auditing firm's report. Highberry noteholders who wanted Colt to go into administration contended that while there was no risk of cash flow insolvency until 2006, after that year, Colt would be unable to repay a significant portion of the capital due on the notes when it became due. (which was four years after the petition was filed) since it was unclear if it would be able to generate adequate cash flow from its assets or whether anyone would be prepared to re-finance the firm in 2006. The question was whether a petitioner must prove that the company is "likely to be unable to pay its debts on a balance of probabilities" or whether it is sufficient to prove that there is a "real prospect" of that happening, and Jacob J. felt it was necessary to look into the definition of "likely" as it appeared in the IA 1986.

*Re Primlaks (UK) Ltd*<sup>21</sup> In a notable case, it was discussed that the plain grammatical meaning of the word "likely" does not always align with the speaker's belief that something will most likely happen. Specifically, this interpretation does not necessarily apply to the term "likely" as used in the Insolvency Act 1986 (IA 1986).

#### **Administration Proceedings:**

- Putting a corporation into administration is a significant step.
- Both creditors and the company itself have the right to apply for administration.
- However, initiating administration exposes the company to various costs, risks, and challenges associated with the process.
- The question arises: Did Parliament intend for this severe step to be taken merely when insolvency was a serious possibility, or only when it was more likely than not?

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<sup>19</sup> Schedule B1, para 11, IA 1986 - Conditions for making order - The court may make an administration order in relation to a company only if satisfied— (a) that the company is or is likely to become unable to pay its debts, and (b) that the administration order is reasonably likely to achieve the purpose of administration.

<sup>20</sup> [2002] EWHC 2815 (Ch).

<sup>21</sup> (1989) 5 B.C.C. 710.

**Interpretation of “Likely”:**

- The case experience suggests that demonstrating a “serious potential” of insolvency (rather than insolvency being more likely than not) may be insufficient.
- The court grappled with whether businesses should face hostile proceedings when it is highly probable that they are not insolvent.

In summary, the interpretation of “likely” in insolvency cases involves balancing the severity of the situation against the practical implications of initiating proceedings. The legislative intent remains a critical consideration.

## **PERMITTING UNSECURED CREDITORS TO START RESCUE ACTIONS**

Currently, the Companies Act 2013 permits the following parties to file an application before the NCLT for a declaration that the company is sick- (a) the company, (b) any secured creditor, (c) the Central Government, (d) the Reserve Bank of India, (e) State Government, (f) public financial institution, (g) a State level institution, (h) a scheduled bank. Unsecured creditors are not permitted to initiate rescue proceedings under the Companies Act 2013. This may reduce the incentives of unsecured creditors to provide credit. The recent global financial crisis has shown that a market for bank loans may not be available at all times and alternative sources of finance need to be put in place to prevent widespread liquidity crunch when the banks are under distress. A right to initiate rescue proceedings is particularly important for unsecured bond investors, who expose themselves to a high risk in such investments<sup>22</sup>

### **MORATORIUM**

Let’s discuss the flaws associated with the moratorium provisions under the Companies Act, 2013 (CA 2013) and explore how other jurisdictions handle similar situations.

#### **1. Broad Discretion of NCLT:**

- The National Company Law Tribunal (NCLT) has significant discretion in deciding whether to grant a moratorium.
- This lack of specific guidelines can lead to inconsistent outcomes and uncertainty for stakeholders.

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<sup>22</sup> Interim Report of The Bankruptcy Law Reform Committee (February 2015); available at: <[http://www.finmin.nic.in/sites/default/files/Interim\\_Report\\_BLRC\\_0.pdf](http://www.finmin.nic.in/sites/default/files/Interim_Report_BLRC_0.pdf)> accessed on 24th June 2021.

## 2. **No Provision for Modification:**

- Once a moratorium is granted, there is no provision for lifting or modifying its terms.
- This rigidity may not account for changing circumstances during the insolvency process.

## 3. **Lack of Explicit Creditor Consideration:**

- The CA 2013 does not expressly require the NCLT to consider creditor interests when granting a moratorium.
- This omission may impact the fairness of the process.

## 4. **Absence of Interim Moratorium:**

While the NCLT is hearing an application, there is no provision for an interim moratorium. This gap could expose the debtor company to potential abuse during the proceedings.

## 5. **Automatic Moratorium in Other Jurisdictions:**

In some countries, insolvency proceedings trigger an automatic moratorium on all other legal actions. Safeguards are incorporated to prevent debtor companies from exploiting the moratorium.

For instance, in the United States, Chapter 11 bankruptcy filings automatically impose a stay on enforcing claims against the firm and its assets. This ensures a balanced approach while protecting both creditors and debtors during insolvency proceedings.

Secured creditors, on the other hand, can ask the court to lift the stay in specific circumstances. The moratorium may be removed for good reason, such as if the court finds that the debtor corporation failed to sufficiently preserve the creditor's property interests during the moratorium period. Similarly, if the debtor has no equity in the property and it is not required for the debtor's efficient reorganisation, the moratorium may be waived with respect to an action against property of the debtor's estate.

An interim moratorium applies between the filing of an application to appoint an administrator or the giving of notice of intention to appoint an administrator and the actual appointment of such administrator under Schedule B1 of the IA 1986 (UK). In addition, the Insolvency Act of 1986 imposes an automatic moratorium on insolvency proceedings. The insolvency proceedings

moratorium is extensive in scope. There is also an automatic moratorium on enforcing security over the company's property, repossession of goods in the company's possession under a hire-purchase agreement (defined to include retention of title arrangements), exercise of a landlord's right of forfeiture by peaceful re-entry, and the filing of legal proceedings against the company.<sup>23</sup>

## **THE MORATORIUM'S PRINCIPLES**

As mentioned earlier, **initiating a Chapter 11 bankruptcy** in the United States results in an automatic halt on pursuing claims against the corporation and its assets. According to **Section 362(a) of the US Bankruptcy Code**, the court has the authority to lift this moratorium by terminating, annulling, modifying, or imposing conditions on it. Such relief may be granted for specific reasons, such as when the debtor has not adequately safeguarded the rights of a secured creditor with regard to the property.

In the UK, case law related to the **moratorium provisions** under the **Insolvency Act 1986 (IA 1986)** offers valuable insights into how administrators and courts should exercise their discretion when considering lifting the moratorium. Let's delve into the key principles established by the court in the case of **Re Atlantic Computer Systems plc**:

### **1. Purpose of the Administration Order:**

- When a company enters administration, the primary purpose is to achieve specific goals, such as rescuing the company as a going concern or maximizing creditor returns.
- The court must assess whether granting leave to exercise proprietary rights (including security rights) would hinder the achievement of this purpose.

### **2. Balancing Interests:**

- In cases where a creditor seeks leave to enforce its proprietary rights, the court must strike a balance.
- On one hand, the court considers the **legitimate interests of the creditor** seeking enforcement.
- On the other hand, it weighs these interests against the **legitimate interests of other creditors** and the overall administration process.

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<sup>23</sup> T. H Jackson, THE LOGIC AND LIMITS OF BANKRUPTCY LAW, pg. 35, (1st ed., 1986).

### 3. Creditor's Proprietary Interests:

- The court recognizes that **creditors with proprietary interests** (such as secured creditors) have a significant stake.
- It emphasizes that an administration should not unduly prejudice these creditors' rights unless it is absolutely necessary.
- Even when it becomes inevitable to limit proprietary rights, the court does so only to a **reasonable extent**.

As a result, the court will have to assess the loss (whether financial or non-financial, direct or indirect) caused to the creditor as a result of the refusal of leave against the loss given to others as a result of the grant of leave. The court will have to consider factors such as the company's financial situation, its ability to pay rental arrears as well as ongoing rentals, the administrator's proposals, the length of time the administration order has been in effect, and the length of time it will remain in effect when conducting this exercise, the effect of the court granting leave on the administration, the effect of the court refusing leave on the creditor seeking for leave, the final result to be attained by the administration, the chances of such a result being obtained, and the administration's history to date. Other factors should be considered as well, depending on the circumstances of each instance. Thus, in *Bristol Airport v Powdrill*, the court considered the parties' conduct as a major reason in denying leave-the creditors having benefited from the administrator's acts for the most of the administration term and were now attempting to exercise their securitization rights.

## **FINANCIAL SUPPORT FOR RESCUE AND SUPER-PRIORITY GRANTS**

If a financially troubled firm is to emerge from rescue proceedings successfully, it must be possible for it to continue trading at that time. For this aim, a financially struggling firm will often need outside funding. But once a business starts the rescue process, it gets quite hard to get financing because not many lenders are willing to give money to a struggling business. Lenders must therefore be encouraged to lend by policies that prioritize this kind of funding, grant them more rights in governance, and provide protections for the interests of creditors, among other things.

The CA 2013 contains no clauses that incentivize lenders to extend credit to a company that is

experiencing financial difficulties. The Committee on Financial Sector Reforms took a close look at a proposal to give rescue financing super-priority, but in the end, the Committee favored a scenario where the debtor would try to reach an amicable agreement with its biggest secured creditor, meaning that creditor would typically be the one providing additional financing in restructuring. Based on the experience of other jurisdictions, it is recommended that super-priority rescue finance be granted, either by means of legislative measures or through judicial interpretation. For instance, in the United States, bankruptcy courts place a high premium on a lender who consents to extend credit to a company going through reorganization a process known as debtor-in-possession financing.

## **CONCLUSIONS & SUGGESTIONS**

**Efficiently resolving insolvency** is crucial for maintaining a healthy and robust economic system in any country. India's **Insolvency and Bankruptcy Code, 2016 (IBC)** represents a significant milestone in addressing insolvency and bankruptcy issues. Let's explore its key features, challenges, and impact:

### **Time-Bound Resolution:**

The IBC emphasizes resolving insolvency cases within predefined timeframes. This focus ensures quicker outcomes and minimizes economic disruptions.

### **Unified Framework:**

The IBC consolidates various laws into a single code. It streamlines the resolution process for distressed companies and individuals.

### **Creditor Rights and Balance:**

The IBC aims to strike a balance between debtor and creditor interests. It provides a clear hierarchy for debt repayment, promoting transparency.

### **Business Rescue and Asset Realization:**

By establishing a well-defined legal infrastructure, the IBC facilitates business rescue. It enables efficient asset realization, benefiting both creditors and the economy.

An important legal milestone in India was the introduction of the IBC, which marked the transition from debtor-in-possession to creditor-in-control. Every time a paradigm shift is put into effect by

law, there are a few hitches. Consider the Goods and Services Tax (GST) as an example. In March 2021, GST receipts came to a total of Rs 1.24 lakh crore. When it was initially made available in July 2017, it received negative reviews for not providing the promised advantages. The GST has, nevertheless, performed better over time. Every law has teething issues, and an infrastructure needs to be built around a law in order to realize its full potential. In September 2020, the Corporate Insolvency Resolution Procedure (CIRP), which results in resolutions, took an average of 433 days, according to the Reserve Bank of India's (RBI) most current Financial Stability Report. Even while this is more than the allotted 330 days, it is still far less than the previous regime, in which the settlement of insolvencies took an average of four years.

According to the **Insolvency and Bankruptcy Board of India (IBBI)** newsletter, **49.61 percent** of **Corporate Insolvency Resolution Processes (CIRPs)** that concluded resulted in **liquidation orders**, while **13.41 percent** led to a **resolution plan**. Notably, the **Board for Industrial and Financial Reconstruction (BIFR)** was responsible for **73.48 percent** of the CIRPs that ended in liquidation. However, it's essential to recognize that the number of entities liquidated alone does not define the success of an insolvency regime. **Companies admitted to insolvency** are akin to patients on their deathbeds, and a law that can save even **10 percent** of such companies is beneficial. The **13.4 percent survival rate** among these admittedly distressed enterprises signifies a glimmer of hope. **Challenges persist**, particularly concerning the expertise of **insolvency professionals (IPs)** who oversee these processes. IPs face both an **expertise deficit** and a **trust deficit**. Unlike the rigorous process in the UK, becoming an IP in India has been relatively straightforward.

As we progress, it becomes crucial to **shift the mindset of creditors** regarding the **Insolvency and Bankruptcy Code (IBC)**. Rather than viewing it solely as a recovery mechanism, we should recognize its broader purpose. Additionally, expediting the **judicial infrastructure** is essential to overcome implementation challenges. We must move forward with a **leap of faith**, acknowledging that significant changes take time after all; **Rome was not built in a day**.

Regarding the cases referred to the **National Company Law Tribunal (NCLT)** under the IBC, the journey has been marked by twists and turns, leading to several amendments. Despite these changes, unanswered questions persist. Approximately **18 months** after the IBC's enactment, the government introduced an ordinance in **November 2017**. This ordinance aimed to prevent defaulting promoters and related parties from bidding for their companies without first settling

their outstanding payments. While subsequent adjustments have been made to the clauses, critical unresolved issues are now coming into focus.

Let's explore the threshold for initiating insolvency proceedings in India and the United States.

#### **India:**

- The Insolvency and Bankruptcy Code, 2016 (IBC) governs insolvency proceedings in India.
- A single default of Rs. 100,000/- is sufficient to trigger insolvency procedures.
- This seemingly low threshold can pose challenges, especially in a corporate context.
- For instance, an employee experiencing non-payment or delayed salary due to temporary cash-flow issues could inadvertently initiate insolvency proceedings.
- Similarly, even a small vendor facing unexpected non-payment of dues may set the process in motion.

#### **United States:**

- In the US, the threshold for bankruptcy filings is different.
- If a firm owes three or more creditors an aggregate amount exceeding USD 12,300 (approximately Rs. 800,000/- at the current exchange rate), it can file for bankruptcy.
- This higher threshold aims to strike a balance between addressing financial distress and preventing unnecessary insolvency proceedings.

The **2016 Insolvency and Bankruptcy Code** applies to both corporations and non-corporate entities. When a corporate debtor defaults, a financial creditor, an operational creditor, or the corporate debtor itself can initiate the “corporate insolvency resolution process” under Section 6 of the Code. Any creditor, whether financial or operational, can trigger the insolvency resolution procedure by providing evidence of default. The entity is then taken over by the **Committee of Creditors** and **Insolvency Professionals** if the adjudicating agency (such as the National Company Law Tribunal or the Debt Recovery Tribunal) issues a clean signal. An applicant creditor prepares a resolution plan and submits it to the **Insolvency Resolution Professional**. However, there is no guarantee that the resolution plan will be approved by 75% of the creditors. Operational creditors, who are not part of the committee, face challenges in getting their interests represented. The NCLT must ensure equitable treatment for operational creditors during the examination of the resolution plan.

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