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Insolvency Reforms in India: History, Growth and Cross Border Issues

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ABSTRACT

This paper examines the impact of the new insolvency code that is Insolvency and Bankruptcy code of India, 2016. With fast changing economy and ways of doing business there was a need for a new law as previously governing act failed to solve the insolvency issues effectively. In this paper the issues and loopholes in SICA etc are properly discussed and how IBC has made the insolvency proceedings simpler and time effective as compared to the previous Acts where there was no time limit. Appointment of an Resolution Professional (RP) by the National Company Law Tribunal on recommendation from the Insolvency and Bankruptcy Board has made this process transparent as RP takes over the management of the company and committee of creditors are formed whose votes are taken in all important matter.

This code has no doubt improved the insolvency process in India but issues with cross border insolvency still exist. According to IBC for cross border issue bilateral arrangements need to be made with the respective country where lies the assets of the corporate debtor but till now India has not formed such bilateral arrangement with any country. Many progressive countries have adopted the UNCITRAL model that has lead to uniformity in the cross border insolvency laws and has increased the ease of doing business there. This paper properly describes the issues faced by the companies in case of cross border insolvency, as India has yet not adopted the UNCITRAL model.

I. INTRODUCTION

The phenomenal growth in trade and commerce globally has increased the incidence of corporate entities having business, debtors, creditors and assets throughout the world². Many financial institutions, banks and other individual creditors have come forth to lend the money

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² Example, to various initiatives to remove trade barriers and the increasing number of financial conglomerates and multinational enterprises. This has also been partly attributed to the relaxation in exchange controls laws and other foreign investment regulations: R.W.Harmer, "The UNCITRAL Model Law on Cross-Border Insolvency", (1997) 6 International Insolvency Review 145 at 146. Businesses may fail due to a variety of reasons including poor management and inefficient production of goods and services or changes in laws and regulations : Rosalind Mason, "Cross-Border Insolvency Law : Where Private International Law and Insolvency Law Meet", in Paul J Omar (ed), International Insolvency Law (Ashgate Publishing 2008) 28.

to the companies for their business but in this era of high competition there lies a possibility where the company may fail to earn profits and is unable to return the money borrowed by it from the financial creditor. In such situation there lies two options either to initiate an insolvency or liquidation proceedings. In insolvency proceeding there is hope for the survival of the company, as the company will be aided so that it can restore its resources and rehabilitate in order to pay back its debt. On the contrary in liquidation procedure the company's asset are used to pay back the creditor. This process leads to loss in the economy of the country as the share holders loose their money and the creditors get only that much return that is possible to receive from the assets of the company, whereas insolvency proceeding are positive for an economy as it rehabilitate the sick company and for this purpose Insolvency and Bankruptcy Code, 2016 (IBC) was introduced in India. This code makes the insolvency proceedings far easier, transparent and time bound. Bankruptcy Law Reforms Committee (BLRC) was formed that was chaired by **Dr TK Vishwanathan** drafted this bill and the draft bill was introduced in the parliament on December 2015. The bill finally got the presidential assent on 28 May, 2016.³ Before the introduction of the code there were acts like Sick Industrial Companies Act (1987) that determined the insolvency proceedings but due to the Insolvency and Bankruptcy Code (IBC), 2016 acts like SICA and schemes of RBI (Reserve Bank of India) were scrapped.⁴ According to research India has high number of bad debts record that is around 11% of the money lending and this rate is increasing with time and duration to recover these bad debt is too long and hence India ranked 63rd in World in ease of doing business.⁵ 50 % of these bad debts are Corporate debts that are very difficult to recover because of multiple reason like cross boundaries etc.⁶ Corporates borrow huge some of money from the nationalized banks and fail to return one such example is Vijay Mallya. Hence there was a need for such a law that will strictly regulate the insolvency proceedings in India.

II. NEED FOR INSOLVENCY AND BANKRUPTCY CODE

A board was formed under SICA, Board for Industrial and Financial Reconstruction (BIFR) that determined the sickness of the company. The board measured the sickness of that particular

³ History of insolvency and Bankruptcy code in www.wikipedia.org.

⁴ Article: Insolvency and Bankruptcy code challenges and shortcomings article by Anubhav Pandey: on ipleaders blog <https://blog.ipleaders.in/insolvency-and-bankruptcy/>.

⁵ Economic Times article link: <https://economictimes.indiatimes.com/news/economy/indicators/india-jumps-to-63rd-position-in-world-banks-doing-business-2020-report/articleshow/71731589.cms>.

⁶ Neil Cooper and Rebecca Jarvis, "Recognition and Enforcement of Cross-Border Insolvency", (John Wiley & Sons 1996). A "truism of a free market economy is that there will be insolvencies"; Kent Anderson, "The Cross-border Insolvency Paradigm : A Defense of the Modified Universal Approach Considering the Japanese Experience", (2000) 21 U. Pa. J. Int'l Econ. L. 679.

company on the basis of a certain financial criteria that is calculating the losses of the company in a particular financial year and if the losses are more than the net worth of the company is considered sick but according to IBC if an organization has an overdue debt of more than Rs 1,00,00,000 in that case the organization can proceed with an insolvency proceeding.⁷

Additionally, according to SICA once the company is referred to BIRF the creditors cannot proceed against the company but there is no time bound in SICA even years could pass and the lender cannot take any action but this issue was considered in Insolvency and Bankruptcy Code of India and it limited the time insolvency resolution to 180 days that can be extended to 270 days only. In SICA it is to the discretion of the Board for Financial Reconstruction to appoint an operating agency to the sick company that at times take wrong decision which makes it difficult for the company to rehabilitate and the situation of the creditors worsen but according to this code an Insolvency Professional (IP) will be appointed in the sick company who will take over the company's management and make major decisions with the approval of the creditors.

The rehabilitation scheme according to SICA can violates any preexisting law as mentioned in section 32 thus if the sick company violates any law it could be given clean chit as it could be considered as a rehabilitation process. In contrast according to Section 30 of IBC any resolution can pass only if it does not violate any preexisting laws.

RBI came up with some statutory scheme for restructuring the debt such corporate debt restructuring, joint lenders forums etc. Its scheme were followed by the bank only if there is sufficient proof for the revival of the company but according to this code the petition is reject only if its fraudulent or it fails to certain provisions. Secondly restructuring schemes of RBI are very rigid and the banks cannot use the same scheme in every situation like for example changing the management even though the loss suffered was not due to managerial errors hence the situation differs from case to case and hence it is impossible to use the scheme repeatedly.

Incase of individual bankruptcy the case is still governed under the provisions of Provincial Insolvency Act, 1920.

III. MECHANISM UNDER INSOLVENCY AND BANKRUPTCY CODE

The contents of this code are borrowed from various jurisdictions and have been drafted in a way that it fulfills the loopholes that were present in the process of revival and rehabilitation of the company. The code is drafted in a way that it makes sure the participation of the lenders

⁷ Article published in ipleaders blog link: <https://blog.ipleaders.in/sica-to-ibc-historical-analysis/> .

in taking important decisions unlike in SICA. Such involvement of the creditors makes the process easier. Voting by the committee of creditors makes sure that the commercial interest prevails. The resolution professional takes over the company and normal the normal business is continued by the resolution professional⁸ with the prior approval from the committee of creditors. The creditors cannot take action against the defaulters during the insolvency process that is strictly a time bound process of 180 days that could extend maximum to 270 days. This process demands high amount of accountability from all the members involved in this process from insolvency professionals to committee of creditors, everyone need to keep a check on the working of each other.⁹

Insolvency process is not a debt recovery process and should not be confused with the debt recovery process. The mechanism can be further explained as :

RDBA: The Recovery of Debts due to Banks and financial institution Act, 1993 (RDBA) was enacted in the country so that the banks and the financial institution can have early and faster recovery of the debts (money) and hence to further facilitate the recovery of the debt a tribunal was set up that is Debt Recovery Tribunal (DRT) under this act. There is no such procedure of minimum amount of debt, the banks and other financial institution can file in this tribunal with no restriction on the amount. Only banks and financial institution can file an application in DRT none other individual or institution can file.¹⁰

SARFAESI: The Securitization and Reconstruction of Financial Assets and

Enforcement of Securities Interest Act, 2002 was constituted so that the financial organizations and the banks could recover and settle the loans they have granted to the debtor by selling off the asset that was kept as a security for the money. The banks and institutions can proceed with such an act without even going to the court if the debtor fails to return the due amount on time. To recover their loans and advances, by simply selling off the secured property, without approaching a court for the same.

IBC: Insolvency and Bankruptcy Code is mechanism in which the sick company is rehabilitated. Unlike above in this code there is a criterion of minimum amount. The company should have the debt of minimum 1 lakh and no bank or financial institution can file an application for initiation of insolvency process.¹¹

⁸ Section 18 of IBC describes the duties of the resolution professional.

⁹ Short note on IBC laws link: <https://ibclaw.in/short-note-on-insolvency-and-bankruptcy-code-2016/> .

¹⁰ Debt Recovery Laws link: <https://financialservices.gov.in/debt-recovery-laws> .

¹¹ Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 link: https://en.wikipedia.org/wiki/Securitisation_and_Reconstruction_of_Financial_Assets_and_Enforcement_of_Security_Interest_Act,_2002 .

IV. INITIATION OF THE INSOLVENCY PROCEDURE

The financial creditor can initiate insolvency procedure. A financial creditor is a person, bank or any financial institution that has lent the money to the company. He can file an application against the corporate debtor in NCLT along with proof of default alone or jointly with other creditors. NCLT has to look into the application within 14 days of filing and can reject the application if it doesn't find any or if there is any proceeding pending against the resolution professional. The operational creditor can also initiate insolvency proceedings.¹² Operational creditor is like a supplier or someone who has extended its payment for the business. He first has to give prior notice to the debtor for the payment of the dues and if within 10 days the debtor fails to payback or fails to bring into notice any dispute against business or any record for the unpaid money, the operational can file for an insolvency resolution process. Even Corporate debtor, the person or company who has borrowed the money can file for insolvency along with the books accounts and other financial documents. Before initiating an insolvency procedure the creditors have to analyze whether the inability of the corporate debtor to repay the loan is because of financial crisis or business crisis and only if it is because of the business crisis insolvency procedure can be initiated.¹³

According to section 12 of IBC this process should be completed within 180 days that can be extended further by 90 days that is insolvency procedure should be completed within 270 days maximum and according to section 16 of IBC NCLT should appoint an interim insolvency professional after taking the assent from the Insolvency and Bankruptcy Board of India within 14 days of admitting the application. The interim insolvency professional will be appointed for the tenure of 30 days and have the power like the Board of directors of the company that belongs to the corporate debtor and the power of the Board of Directors will be suspended during the insolvency proceedings. The insolvency professional shall have the access over the assets, books of accounts and other documents of the company. He will manage all the corporate affairs and will act as an supervisor over all the staff of the company. The insolvency professional on verification of the claim made by both the parties that is corporate debtor and creditor can accept or reject it. He will have access over all the necessary information of the company as and when required during the process.

¹² The Insolvency and Bankruptcy Code, 2016, <http://www.prsindia.org/administrator/uploads/media/Bankruptcy/Bankruptcy%20Code%20as%20passed%20by%20LS.pdf>.

¹³ Initiation of Insolvency in Insolvency and Bankruptcy Code of India : lawsikho.com .

V. FINANCIAL CREDITORS

Section 5(7) of the Code states that the person to whom a financial debt is owed is known as a financial creditor. It is important to mention that the debt should be a 'financial debt' otherwise the creditor will not be considered as financial creditor. The financial debt is not the amount lent by the financial creditor but it also includes the interest upon it due to time or due to non-payment of the debt. The debt is further divided into secure and unsecure debt, they are equal in case of insolvency proceedings but the difference of preference exist in liquidation process. The amendment that was made in the code in 2018 allowed the homebuyers and allottees under RERA (Real Estate Act, 2016) to initiate insolvency resolution proceedings.

Financial creditor can initiate the financial proceeding according to Section 7 of this code alone or jointly with creditors¹⁴ if the corporate debtor is at default. According to Section 3(12)¹⁵ of this code default is the amount or the part of amount that the corporate debtor fails to repay or the amount due to be paid to the creditor.

VI. RELEVANT CASES REGARDING SECTION 7 OF IBC

One of the important mechanisms of IBC is initiation of the insolvency proceedings. Some of the important judgments related to this section are as follows-

Sree Metaliks Limited and Anr. vs. Union of India:

A writ petition was in the Calcutta High court challenging constitutional validity of section 7 of IBC on the ground that it is against the principles of natural justice and insolvency proceeding can be initiated without even hearing the side and will of the corporate debtor. Calcutta High court rejected the writ and stated that National Company law Tribunal is formed by proper procedures under the Companies Act, 2013 and section 424 of this act makes it compulsory and essential to follow the principles of natural justice and therefore section 7 of IBC is not unconstitutional.¹⁶

Innoventive Industries Limited vs. ICICI Bank:

In this case National Company Law Appellate Tribunal (NCLAT) was questioned about the validity of a section 7 applications as it was filed without taking the prior permission from the debtor. Joint Lenders Forum (JLF) mandates that permission of the corporate debtor is essential

¹⁴ Substituted for "other financial creditors" by IBC (second amendment) Act, 2018, w.r.e.f. 6.6.2018

¹⁵ Enforced with effect from 1.11.2016 .

¹⁶ Case in indiankanon.org W.P.7144 (W) OF 2017 IN THE HIGH COURT AT CALCUTTA (Constitutional Writ Jurisdiction).

before initiating insolvency proceedings. NCLAT held that lack of consent from the Joint Lenders Forum does not vitiate an insolvency application.¹⁷

State Bank of India vs. Radheshyam Fibres Pvt. Ltd.,:

In this case NCLT examined whether pendency of proceedings in Debt Recovery Tribunal is a proof of default. NCLT held that as the petition to recover money the financial creditor has filed DRT but the tribunal has not taken any action and an order declaring default was passed by it. Hence if the financial creditor has filled an application in DRT doesn't mean that the financial debtor has not committed any default.¹⁸

M/s. Starlog Enterprises Limited Vs. ICICI Bank Limited:

The section 7 of IBC application filed by ICICI bank was rejected by NCLAT on the ground that it is fraudulent. NCLAT held that the claim submitted by ICICI bank is incorrect and very hastily moved the application in order to get an ex-parte order from the authority. NCLAT further held that the bank couldn't disapprove its fraudulent intention by claiming the correct amount thereafter.¹⁹

VII. CROSS BORDER INSOLVENCY

Section 234 and 235 of the Insolvency and Bankruptcy Code of India deals with cross border insolvency related issues, though proper laws has yet not been enforced by India. According to these sections India will get into a bilateral agreement with the country under whose jurisdiction lays the assets of the assets of the corporate debtor. In this case the National Company Law Tribunal has to make arrangements with the respective court or tribunal. So far India has not entered into such bilateral agreement with any country. In case if a foreign proceeding is to be recognized in India the procedure set out in Civil Procedure Code, 1908 along with the principles of English Common Law is applicable, though these are not enough for insolvency related proceedings. In same manner if the Indian proceedings are to be recognized abroad the rules and law of that particular jurisdiction will apply and to cope up with issue there is the need for a uniform law in issues related to cross border insolvency is required.²⁰

¹⁷ Case in indiankanoon.org link : <https://indiankanoon.org/doc/181931435/> .

¹⁸ Case in legitquest.com link: <https://www.legitquest.com/case/state-bank-of-india-v-radheshyam-fibres-pvt-ltd/195274>.

¹⁹ CIVIL APPEAL NOs. 8337-8338 OF 2017 link: http://ibbi.gov.in/webadmin/pdf/order/2017/Sep/31%20Aug%202017%20in%20the%20matter%20of%20Innoventive%20Industries%20Ltd.%20Vs.%20ICICI%20Bank%20%26%20Anr.%20Civil%20Appeal%20Nos.8337-8338%20of%202017_2017-09-01%2009:56:52.pdf .

²⁰ International Bar Association Cross Border Insolvency Concordat, 1995, being an early attempt to develop a

Countries have accepted United Nations Commission on International Trade Law (UNCITRAL) ²¹model so that there is uniformity. The investors are facing several problems because of the jurisdiction issues and hence there a need for a common law for cross border Insolvency issues.

Progressive countries like Australia, United States of America and United Kingdom etc have already adopted these UNICITRAL ²²insolvency laws on June 2018 and hence making it easier to do business there. India has yet not adopted this method, thigh the code allows that India can get into treaties with the country following UNICITRAL model but it would be a better and simpler solution for the country to sign UNICITRAL model.

United Nations Commission on International Trade model has made an attempt to reduce the complexities that are face due to cross borders. It provides a framework for the insolvency professionals of the other jurisdiction to participate or initiate the insolvency proceedings in that particular jurisdiction. UNCITRAL model set out certain principles to identify the correct jurisdiction for the insolvency proceedings though in India the foreign insolvency professional need to appoint Indian insolvency professional who can represent him in the India courts.

Jet Airways Case:

In this case one of the corporate creditor of Netherland filed an insolvency proceeding against Jet Airways; the Dutch court passed the orders for insolvency. An airplane of Jet Airways that was parked in the Amsterdam airport was seized by the insolvency professional appointed by the Dutch court and request was sent to other creditors and Ministry of Corporate affairs of India to corporate while assessing the assets of Jet Airways. ²³

Further in this case the other consortium banks, which were led by an India bank that is State Bank of India, filed an insolvency proceeding against the corporate debtor in National

framework for harmonizing cross-border insolvency proceedings. Available online at 1995 IBA_Resolutions_Cross_Border_Insolvency_Concordat_1995.pdf; Bob Wessels, Cross-Border Insolvency Law: International also a comment by Elizabeth k Somers, "The Model International Insolvency Cooperation Act : An International Proposal for Domestic Legislation", (1991) 6 Am.J.Int'l & Pol'y 677 .

²¹ UNCITRAL was established by General Assembly Resolution in 1966 and consists of 36 member states. In addition a number of observer states and governmental and private international bodies were present at its meetings.

²² Bob Wessels, Bruce A Markell and Jason J. Kilborn, International Cooperation in Bankruptcy and Insolvency Matters (Oxford University Press 2009) 202, citing Pottow, (n 8). According to Professor Fletcher, however, the fact that a Model Law is only a legislative guide enabling a State to decide how much or how little of the Model Law it wishes to accept "is likely to be viewed by some as the Achilles' heel of this form of international harmonization".

²³ Bob Wessels, et al., (n 24) 199; Jenny Clift, "The UNCITRAL Model Law on Cross-Border Insolvency – A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency", (2004) 12 Tul. J. Int'l & Comp. L.398. A list of the colloquia is also available at http://www.uncitral.org/uncitral/en/commision/colloquia_insolvency.html (accessed on 3 September 2012).

Company Law Tribunal, Mumbai. It was held in NCLT that the proceeding as *nullity ab initio* and held that according to Section 13, 14, 44A of Civil Procedure Code, 1908 the judgment from the foreign court will not be recognized here. The Indian creditors initiated an insolvency proceeding here and due to non-uniformity the Jet Airways suffered difficulty.²⁴

VIII. CONCLUSION

Insolvency And Bankruptcy Code no doubt brought great reformation in the preexisting insolvency laws in India. The code brought transparency in the insolvency proceedings and made the proceeding simpler according to the procedure established by the code. The completion of these insolvency proceedings within 180 days that could stretch maximum to 270 days has actually speedup the insolvency process as compared to past like in SICA there was no time bound and the financial creditor cannot even start with other proceedings against the company. Code brought transparency by appointing a resolution professional that will take over the company's management. He will act like a Board of director of the company and will make major decisions. A committee of creditors will be formed who will have the right to vote in all-important decisions of the company during the process.

This code though has lead to considerable amount of positive reformation with regard insolvency proceeding within the country but a lot of work need to be done incase of cross border insolvency. The UNCITRAL model that is adopted by the major countries should be adopted rather than doctrine of reciprocity²⁵ where lies the issue of jurisdiction. Positive amendments are being made in this code time to time and the code has majorly proved to be a boon in Indian legal system.

²⁴ Para 86, *ibid*. Para 87 of the Guide gives a more detailed explanation : "In some States the expression "public policy" may be given a broad meaning in that it might relate in principle to any mandatory rule of national law. In many States, however, the public policy exception is construed as being restricted to fundamental principles of law, in particular constitutional guarantees; in those States, public policy would only be used to refuse the application of foreign law, or the recognition of a foreign judicial decision or arbitral award, when that would contravene those fundamental principles.

²⁵ Section 2 of the Cross-Border Insolvency Act of 2000, brought into force on 28 November 2003, which enacted the Model Law, however, restricts the application to only states designated by the Minister of Justice in the Government Gazette. Section 2(2) (b) of the Act further makes it clear that the Minister may only do so if he is satisfied "that the recognition accorded by law of such a State ... justifies the application of this act to a foreign proceeding in such a State".