

Reforms in Insolvency Resolution of Corporate Persons - Glimpses and thoughts

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Reforms in Insolvency Resolution regime have been long overdue. Time taken in completion of insolvency and bankruptcy proceedings has been a matter of concern to the financial sector. In matters of recovery of dues, banks and financial institutions have recourse to laws¹ aimed at speeding up recovery. However, if insolvency proceedings are initiated against their borrowers by creditors or the borrowers themselves, there would be delays in recovery of the dues of banks and financial institutions also. Therefore, an efficient insolvency resolution regime benefits the financial sector also.

The experience with respect to resolution of sick industries under the existing set up² has been far from satisfactory. The existing framework for insolvency and bankruptcy is inadequate, ineffective and results in undue delays in resolution, therefore, the proposed legislation (IBC)³. Winding up and liquidation of companies, which form a very big chunk of the corporate sector, is governed by Company Law⁴. The insolvency of individuals is dealt with separately under other laws⁵.

The difficulty in the current insolvency mechanism is the inordinate delay that takes place in liquidation process. Further, processes under SICA under BIFR take a lot of time which effectively dissipate the assets, bring down the value of realisable assets and eventually adversely affect the recovery of loans extended by the banks. The major difficulty in the current system is that High Courts do not have sufficient liquidators. Too many pending cases and too few Official Liquidators have been causing huge amount of backlog of cases. Cases have been piling up in the HCs for a number of years all over the country.

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¹ Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI).

² Board of Industrial and Financial Reconstruction (BIFR) constituted by the Sick Industrial Companies (Special Provisions) Act, 1985, Board of Industrial and Financial Reconstruction

³ Statement of Objects and Reasons attached to Bill No. 349 of 2015 introduced in the Loksabha which ultimately became the Insolvency and Bankruptcy Code, 2016.

<<http://www.prsindia.org/uploads/media/Bankruptcy/Insolvency%20and%20Bankruptcy%20code.%202015.pdf>> accessed on October 15, 2016.

⁴ Companies Act, 1956 and Companies Act, 2013, some portions of which are yet to be brought into force.

⁵ Provincial Insolvency Act, 1920 or Presidency Towns Insolvency Act, 1909

The crux of the problem, apart from the availability of the liquidators, is the stringent and elaborate procedures to be followed in the case of liquidation through Official Liquidators under the supervision of the High Courts. These procedures were meant to be strict so that maximum recovery is made without any leakage from the system and to ensure justice to all the stakeholders. These procedures also contribute to inordinate delay.

The objective of IBC has been clearly stated in the Statement of Objects and Reasons as under.

“The objective of the Insolvency and Bankruptcy Code, 2015 is to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders *including alteration in the priority of payment of government dues* and to establish an Insolvency and Bankruptcy Fund, and matters connected therewith or incidental thereto. An effective legal framework for timely resolution of insolvency and bankruptcy would support development of credit markets and encourage entrepreneurship. It would also improve Ease of Doing Business, and facilitate more investments leading to higher economic growth and development.”⁶ (Emphasis added)

IBC has been passed by both Houses of the Parliament and it has received the assent of the President⁷. A few sections of IBC relating to setting up of the Insolvency and Bankruptcy Board⁸ have been brought into force⁹ so that IBC can start functioning shortly. Insolvency and Bankruptcy Board has been formed. A Legal Adviser of RBI is an ex officio member on the Board.

Besides all these, one of the biggest issues is the priority in payments out of the amounts realised. Even if banks realised the dues by using the SAFAESI Act or DRT Act, sovereign dues had priority in insolvency proceedings. In *Central Bank of India v. State of Kerala*¹⁰, the Supreme Court ruled that the State law which required sales tax dues to be paid before other dues was valid. As a result, the efforts put in by banks for recovery went in vain. IBC has given priority to the secured creditors over State dues¹¹.

The other salient features of IBC are:

⁶<<http://www.prsindia.org/uploads/media/Bankruptcy/Insolvency%20and%20Bankruptcy%20code.%202015.pdf>> accessed on October 15, 2016.

⁷ 28th May 2016

⁸ sections 188 to 194 < [http://egazette.nic.in/\(S\(fck1gnccyqywvqjphj3jwtd\)\)/Search1.aspx](http://egazette.nic.in/(S(fck1gnccyqywvqjphj3jwtd))/Search1.aspx)>

⁹ W.e.f 5th August 2016

¹⁰ (2009) 4 SCC 94

¹¹ Sections 53 and 178 of IBC.

- a. Bringing resolution and insolvency process under one law under NCLT for corporate persons (Financial Service Providers not included). Similar process for individuals and other associations under DRT.
- b. Resolution and insolvency to be handled by regulated professionals
- c. Strict timelines at every stage.
- d. Committee of creditors to decide on resolution or winding up.
- e. Commencement of insolvency proceedings if resolution fails.
- f. Fast track insolvency resolution for certain corporate persons¹².
- g. Enabling Central Government to enter into an agreement with the Government of any country outside India for enforcing the provisions of IBC¹³.

Under IBC, either the defaulter or the creditor can apply for the insolvency resolution of a corporate person to the National Company Law Tribunal (NCLT) and propose the name of the resolution professional¹⁴. A moratorium would be issued by the NCLT¹⁵. The moratorium period would act as a cooling period during which no legal action can be taken against the defaulter as revival/resolution mechanism would be initiated. This would insulate the resolution efforts from being delayed or interfered with by parallel legal proceedings.

The NCLT would appoint 'Resolution Professional' or 'Insolvency Professional' to administer the revival/resolution process or liquidation process as the case may be. The Resolution Professional would manage the affairs of the defaulter and operate its business as a going concern in accordance with the resolution plan. A committee of creditors would be created as a Resolution Committee, comprising of the creditors¹⁶, which would approve the resolution plan which when approved by NCLT will be binding on the corporate person¹⁷. Thus, the thrust of the Code is to shift the control from the defaulting debtor's management to its creditors, where the creditors' committee runs the enterprise of the debtor with the Resolution Professional acting as authorized official.

The timeline to decide and execute the revival plan is 180 days, with a maximum one-time extension of 90 days¹⁸. In case the revival is not workable and the Committee of creditors decides that the liquidation process should commence, NCLT is required to pass an order of

¹² Sections 55 *et seq*

¹³ Section 234

¹⁴ Section 16 of IBC.

¹⁵ Section 14.

¹⁶ All financial creditors will be in the Committee of creditors, section 21 IBC.

¹⁷ Section 31 IBC.

¹⁸ Section 12

liquidation¹⁹. Then, the resolution professional shall act as the Liquidator²⁰. The moratorium passed under section 14 will cease to have effect²¹. The liquidator shall hold the liquidation estate as a fiduciary for the benefit of all the creditors²². Resolution Professional can take control and custody of any asset over which the corporate debtor has ownership rights including assets which may be located in a foreign country²³.

The Resolution Professionals and insolvency professionals work under the code prescribed by the Bankruptcy Board²⁴. A new regulator is being constituted with legal provisions. It has to be seen how this unfolds and how effective it can become against the current gloomy background of liquidation and recovery process.

The financial sector may not be happy with making DRT²⁵ as the adjudicatory authority in the case of insolvency of individuals and partnership firms and thereby overburdening of DRTs as it could impact their recovery process outside insolvency. However, financial sector is expecting IBC to provide a long awaited respite from insolvency resolution regime which has been an epitome of delays.

The proof of the pudding is in the eating. The success of IBC depends on the maintenance of the timelines specified in IBC at each step. That depends heavily on the performance of the new breed of professionals, namely, Resolution Professional or Insolvency Professional. Regulation of this new profession is vested in a Board. If the Board is able to ensure that these professionals act effectively, IBC will be successful. It remains to be seen whether the new Code and the new Regulator would be the bellwether in this troubled times of liquidation and recovery process.

¹⁹ Section 33(2) Ibid

²⁰ Section 34(1)

²¹ Section 31(3)(a)

²² Section 36(2)

²³ Section 18.

²⁴ Section 196(d)

²⁵ Section 79