Journal of Banking and Insurance Law
Volume 1, Issue 2
www.stmjournals.com

Plethora of Acts which Led to the Development and Formation of Insolvency and Bankruptcy Code 2016

*Vijaya Lakshmi Raju**
Student, Dr. Ambedkar Global Law Institute, Tirupati, Andhra Pradesh, India

Abstract

The Insolvency and Bankruptcy framework is not a novel concept. It traces its history back from the British regime when Provincial and Presidency Act used to determine and control the insolvency procedures. Subsequently, with the passage of time, many regulations came up on the subject matter but since no specific regulatory authority was there to deal with such anomalies, which later resulted in the overlapping of certain existing laws, as different acts infer diverse judicial authority ensuing in dearth of lucidity and certainty. Furthermore, no precise or concrete data was present, which could state the ground reality of the company's indebtedness and their bad loans. Hence, there was a dire need for a uniform and unvarying law to avoid the multiplicity of the cases of same nature, and in that sense IBC could be the fitting solution to this haziness. Consequently, this article has dealt with before and after independence laws with respect to Insolvency and Bankruptcy.

Keywords: *Insolvency, Bankruptcy, Authority, Indebtedness, Haziness*

***Author for Correspondence** E-mail: rajuvijayalakshmi2@gmail.com

BEFORE-INDEPENDENCE

Provincial and Presidency Acts

In India, the insolvency law was based on the Roman principle *cession bonarum* which dwells about the condition where the debtors voluntarily surrender their goods or estate to the creditors. It was not that the debtors got an easy way out, but the good thing was they got protection from personal arrest. However, if debt was not paid in full, then creditors could sell off their mortgaged property and make up for their losses. The initial fundamentals of insolvency laws can be limited to Sections 23 and 24 of the Government of India Act, 1800, where the courts had the power to make rules and grant relief on the guidelines of the Lord's Act, 1759. Afterwards, the insolvency law with various amendments and seeing the need, the framers went one step ahead and passed a law in 1889, where difference was made between traders and non-traders, when adjudicating the cases related to bankruptcy. This act continued till the implementation of Presidency Towns Insolvency Act, 1909. Thus, we can safely say from there India got its first insolvency laws. It could be divided into two: The Presidency-Towns Insolvency Act of 1909 and the Provincial Insolvency Act of 1920, wherein the former Act was applied to the presidency towns only which were Calcutta, Madras, and Bombay which were directly under British regime and the later Act was relevant to the rest of India. Far ahead, even the presidency-towns insolvency act of 1909 was repealed by the Provincial Insolvency Act, 1920, which was followed till IBC came into force. Here, both the above-mentioned Acts dealt with only the consumer insolvency exempted corporations and firms within its realm. For dealing with corporate insolvency, Companies Act, 1956, was enacted, on the recommendations of the Homi Bhabha Committee in 1950, whereby the erstwhile Companies Act 1913 was revoked.

AFTER INDEPENDENCE

Companies Act 1956

Liquidation of the company facing financial crisis can be done through two ways:
1) Voluntary liquidation by creditors
2) Involuntary liquidation by the court

In voluntary liquidation, the liquidation was more proficiently managed as they were more reliant on the pronouncements taken by the shareholders in the annual general meeting as what should be done. The secured creditors took care of all the process related to liquidation, as they could select or appoint official or private liquidator to allot the sale and purchase of the assets in question [1]. In involuntary liquidation, it was an onerous procedure and not as efficient as voluntary liquidation, as here the creditor who had an unpaid debt for more than Rs.500 had to give a notice to the company for its recompense. If company did nothing fruitful in relation to the certain grievances, he could file a petition in the court for involuntary liquidation only after the completion of three weeks of the notice given. The court had full discretion to resolve in favor of the company by cataloging it as an insolvent entity [2]. Further till the case was not decided the property remained with the debtor only. If an official liquidator had been appointed, then he had all the discretion as how the assets, payments and claims will be settled. Secured creditors were always given first preference when liquidation of the companies took place. One of the major loopholes or the glitches in this legislation was that there was no rule of injunction during the pendency of the suit or till the ruling took place; so eventually creditors used to sell off their assets and make merry [3], ultimately causing more ruckus in the whole procedure of liquidation. Therefore, we can very well say after being amended and modified a number of times, still some of the pertinent questions were not answered. Several judicial pronouncements were taken into consideration which recognized numerous landmark precedents but eventually it couldn't accomplish the requirement which was desirable for an effective insolvency regulation [4].

Sick Industrial Companies Act (SICA), 1985

A company which can be termed as a "sick" company [5]:

a) Which has been registered for at least five years,

b) Which has cumulative losses that amount to more than its net worth [6].

Formerly, the company's registration obligation was seven years instead of five years and similarly the company should be making losses for two consecutive years to qualify as a sick company. These two provisions were there in the original Act [7] but later it withered off by the 1993 Amendment [8], seeing and following the trend all over the world. In order to get the appropriate finding and to deliver mandatory intervention, a quasi-judicial body, namely, the Board for Financial and Industrial Reconstruction (BIFR) was instituted, where the applications can only be filled by the Board of Directors within sixty days, where its audit report should state, that the said company comes under the ambit of Sick Company [9]. Once the application was filed to the BIFR, they had three options, out of which they could use only one; such options were:

a) Take support of management/creditor-supported plan without any relaxations in financing.

b) Determine unviability of the corporate and endorse winding up to the preferred court.

c) An entitlement that the company must be serviced in the public interest, and accept a plan needing some vital relaxations from several parties which may also include grants or aids from the government. Here, unlike Companies Act, 1956, an automatic decree of stay was granted against all legal proceedings, suits and claims made against the "sick company", but the debtor had the control over the assets till the final ruling. Nonetheless, the major shortcoming of this act could be if the creditors were not satisfied with the verdict then they could go and appeal in the court, wherein the courts would again refer the case back to the BIFR, thus a vicious circle was formed as the whole point of establishing such quasi-judicial body was weakened. Thus, in the end, the creditors or the people connected directly were the sufferers [10].

Recovery of Debts due to Banks and Financial Institutions Act, 1993

It was formed in order to distribute and organize the judicial labor, which was rigorous to the civil courts as they were dealing with every issue whether the matter was of divorce or of a contractual nature, as no such scrutiny was done whatsoever it was. Debt Recovery Tribunal was set up under Section 3 of the above-mentioned Act. It permitted banks and other financial institutions to hunt the retrieval of unsettled debts greater than ten lakh rupees by filing an application to Debt Recovery Tribunal (DRT). This Act offered banks and financial establishments a comparatively speedier procedure to get their prerogatives assessed and authenticated [11]. It reduced the backlog of the cases to some extent. Hitherto, DRT was managing all the cases whether it was concerned with companies or individuals [12], but now after the enactment of Insolvency and Bankruptcy Code 2016, it only deals with the individuals and the partnership firms [13].

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (SARFAESIA)

This Act is concerned only with the non-performing assets or in layman words you say bad loans. So, in simple terms, NPAs are the assets where the interest or the part of the principal amount remains unpaid even after the passage of 180 days. There is no need of the court intervention; it's on the banks discretion to go forward and sell those securities which were kept as a security against which the loan was given in the first place.

This Act applies when the debt is classified as an NPA, i.e., 180 days have passed. It shouldn't be an agricultural land. The debt should be secured, i.e., it is applicable only to the secured creditors. The outstanding loan is more than one lakh rupees and more than 20% of the principal amount. Likewise, the Act talks about three ways of recovering debts:

1. Securitization: It is pooling and repacking the financial assets into marketable securities that could be sold to investors, it could be by buying the financial assets or raising capitals from the QIB by issuing the security receipts. It is a situation when banks certify certain loans as bad loans or NPA (non-performing assets), as they have tried every measure to get it back but they didn't succeed, so they give all the documents or the securities of the defaulters to QIB (Qualified Institutional Buyers) to sell them, so that they can get something out of nothing. Moreover, QIB sells out those securities to numerous investors and earn money, and return the bank's share as decided earlier after withholding their profits.

2. Asset Reconstruction: It is a phenomenon where a non-performing asset is converted into a performing asset under the purview of RBI regulations and SARFAESI Act. It could be done by taking over or changing the management of the company in issue, lease or sale of the company, whether whole or any substantial part, rearrangement of the payment of arrears, i.e., altering interest rates, and lastly settling the dues according to the laws prescribed. For instance, whenever a person defaults in the payment of the loan, or couldn't pay the installments or interests which were duly required for the payment, meanwhile even the creditors think that the property kept as a security would not give him much revenue. Consequently, what the creditor does is, he changes the whole contract, he changes the interest rate and gives more time to the debtor to clear his dues. The same procedure is carried out by the big banks or companies, when someone defaults in payment.

3.Enforcement of the Security Act : It comes under chapter 3 of the SARFAESI Act, where any default of the payment has been done by the borrower, whether the collateral is movable or immovable (by giving advertisement in a national daily and an English newspaper), bank would give sixty days of time period, after issuing the statutory notice under section 13(1) of the said Act , in which the borrower has to reply within 15 days, and stating reason for such default if he doesn't comply then the bank could move ahead by selling off the security. Earlier this procedure was enshrined in CPC, but now SARFESI Act deals with it.

The Companies (Second Amendment) Act, 2002

This was the first Act which asked to setup a separate body to deal with corporate matters only which led to the enactment of The National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT). These would deal with all the matters pertaining to BIFR. Secondly, they would manage winding up proceedings which previously was done by the High Courts. Furthermore, they define winding up in two:

voluntary winding up – winding up done by the members and the creditors. The former could go for the process when the company was solvent whereas the latter can go when the company was insolvent; and compulsory winding up which is done by the tribunal. It is done when the shareholders file a petition for the distribution of the available assets to them.

Companies Act, 2013

Key aspects which came in this Act: The companies were asked to establish the rehabilitation or insolvency fund in case of the proceedings introduced to make payments and defend the assets of the company. The fund would be contributed by the company, government, and the interest earned by the investments. This Act gave power to the companies to employ a liquidator who would have the power of winding up, or could approach tribunal whenever deemed necessary.

Also, this Act provided the liquidator special permissions and power to pay the creditors in full or make compromise with them, when they had an opinion that their interests were jeopardized. During the liquidation process if the liquidator was of the opinion that a scam had been committed, he could personally go before the tribunal and ask for investigation. Further, instead of the tribunal liquidators, the central government had authority to employ official liquidators on behalf of them, when they thought liquidation was mandatory and no alternative option was left [14].

CRITICAL ANALYSIS OF THE RECOMMENDATIONS OF THE BANKRUPTCY LAW REFORMS COMMITTEE (BLRC)

It was set up by the Ministry of Finance and Economic Affairs order dated August 2014 under the Chairmanship of TK Viswanathan to study the "Corporate Bankruptcy Legal Outline in India" and the committee submitted a well-researched description to the government for ameliorating the existing system [15]. Subsequently, they issued two reports namely, Interim Report which came in February 2015 and the Final Report which came out in November 2015, where the former called as "Approach Paper" or a comprehensive document for the anticipated new code and other noteworthy reforms which can improve the insolvency laws in India and can be beneficial in the near future.

Likewise, the Bankruptcy Law Reforms Committee recommended bringing together the prevailing legal framework at that time, by annulling two laws and amending other six. It has proposed to revoke the Presidency Towns Insolvency Act, 1909, and the Provincial Insolvency Act, 1920, as they were too old to be used as an active legislation when seen in the future prospects.
In furtherance, the committee asked to revise certain Acts, namely:

- Indian Partnership Act, 1932
- Recovery of Debts Due to Banks and Financial Institutions Act, 1993
- Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- Limited Liability Partnership Act, 2008
- Sick Industrial Companies (Special Provisions) Repeal Act,1985, and 2013
- Companies Act, 2013 [16]

The prime recommendations of the final report were as follows:

Insolvency Bankruptcy Board of India: The said Bill proposed to establish Insolvency Bankruptcy Board of India (IBBI), an insolvency regulator to regulate, control, and supervise the proper functioning of the insolvency professional agencies, insolvency professionals, and informational utilities.

Insolvency Adjudicating Authority: It would comprise of the Debt Recovery Tribunal (DRT) which will have jurisdiction over individuals and unlimited liability partnership firms only and its appeal shall lie to the Debt Recovery Appellate Tribunal (DRAT), whereas for companies and limited liability entities National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) shall be the adjudicating authority.

Informational Utilities: It would encompass all the important data and the vital information for the companies to provide better understanding of the insolvency status of the persons involved or a part of the companies. Their function would be to gather, organize, and validate the financial information of the companies and the creditors of the given companies and how to deal with them accordingly.

Insolvency Professionals: The new terminology has been created where the regulator would look after the professional conduct, ethics standard and disciplinary functions for the development of insolvency professionals. And these professionals would collectively work for the insolvency professional agencies.

Bankruptcy and Insolvency Procedures for Limited Liability Entities and Companies

(i) The said Bill intended to have a strong, comprehensible and prompt method for identification of financial distress if any company is experiencing and how the revival process can be carried out if the firm can be found workable and viable. For such process, period of one eighty days has been given for carrying out the insolvency resolution, which can be further extended to ninety days only under exceptional circumstances. Throughout the insolvency process the administration and management of the debtor is looked after by the insolvency professionals who work for the insolvency professional agencies [17].

(ii) Further, if seventy five percent of the financial creditors agree for such insolvency resolution, then it should be certified and sanctioned by the adjudicating authority (DRT or NCLT). If disallowed, the adjudicating authority could ask for liquidation.

(iii) Likewise, a concept of fast track insolvency resolution process has to be developed, wherein the insolvency resolution process must be completed within a period of ninety days from the trigger date. Nevertheless, a leeway of forty-five days could be provided by the adjudicating authority, if required.

(iv) Bankruptcy and Insolvency Processes for Individuals and Unlimited Liability Partnerships: Two separate processes are there firstly, the Fresh Start Process and secondly, the Insolvency Resolution.

(a) Fresh Start Process: Here the person whose income does not surpass Rs.60,000 and the cumulative value of assets are less than Rs.20,000, then they an option to liberalize their “qualifying debts” [18]. Here the concerned professionals would consider the matter, examine and explore all possible outcomes and formulate a concluding list within one eighty days for all the mentioned qualifying debts. If approved, the debtor could be given the chance of starting with the clean slate.

(b) The Insolvency Resolution Process: The debtors and the creditors would involve and participate in discussions and dialogue to reach at a certain conclusion for the configuration of the debts and activities of the debtor, administered by the insolvency professional.

(c) The bankruptcy of a person or an entity can only be introduced when the resolution process fails. The trustee is accountable for management of the property of the bankrupt and for the circulation of the earnings on the urgency basis.

- Transfer of proceedings: Any proceeding undecided before the BIFR or AAIFR under Sick Industrial Companies Act (SICA), 1985, before would be declined. Nevertheless, the effected company might approach adjudicating authority in one eighty days from the beginning of this regulation.
- Transition Provision: Until the regulator was established and goes down well with its working activities, the central government would come down and carry out functions of the regulator which were deemed to be necessary. Consequently, the act shouldn’t be facing complications due to the lack of structural developments [19].

SUGGESTIONS AND CONCLUSION

Broadly, we can say that this new legislation is a welcome step for our economy and it may bring huge business and develop our markets to another level, but still it has shortcomings as well. Firstly NCLT will be dealing with all the matters related to insolvency, which may cause a lot of burden, as for their effective functioning the whole process must be carried out within one hundred eighty days. Secondly, the whole system would be controlled by the government and its officials, so somewhere down the line we can again be stuck to the same vicious circle.

The bankruptcy and insolvency laws have gone through umpteen changes, some have been productive, but still some lacunas remained unfulfilled which led to the enactment of the Insolvency Bankruptcy Code, 2016. The New Act is still in the nascent stage, but only a couple of years have passed, when it came into force. It has intended to overcome the inadequacies which were there by the virtue of previous acts [20]. This insignificant and enlarging process impairment is encouraged particularly by the think tanks and the present government and their constant and relentless efforts made to improve the system must not go into vain.

REFERENCES

1. Companies Act (1956). http://www.mca.gov.in/Ministry/pdf/Companies_Act_1956_ 13jun2011.pdf assessed on 26/02/18.
2. Patnaik V. Elements of Bankruptcy Law and Business Rescue in India. Accessed on 24/02/18.
3. Mitra NL. Report of The Advisory Group on Bankruptcy Laws. May 9, 2001. Available from the Reserve Bank of India, http://www.rbi.org.in/ s/20, 811.pdf. Accessed on 25/02/18.
4. Branch B, Khizer A. Bankruptcy practice in India. Isenberg School of Management, University of Massachusetts, Amherst, MA, United States. Available online 16 June 2016. Accessed on 26/02/18.
5. SICA 1985. Regulatory Requirements: SICA. June 2000, available from http:// business.gov.in/closing_business/sica.php. Accessed on 22/02/18.
6. Sick Industrial Companies (Special Provisions) Amendment Act, 1993.
7. Sick Industrial Companies Act (SICA), 1985.
8. Supra note 2.
9. Supra note 1.
10. Kang N, Nayar N. The Evolution of Corporate Bankruptcy Law in India. March 2004. Accessed on 25/02/18.
11. Dubey GS. An introduction to the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, 30 September 2013. http://www.manupatra.co.in/newsline/articles/ Upload/80938A41-3558-4A9F-BB18-FD5C6192CA00.pdf. assessed on 26/02/18.
12. After the enactment of the SARFAESI Act.
13. Supra note 7.
14. Companies Act 2013. http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf assessed on 25/02/18.
15. BLRC Interim Report https://www.finmin.nic.in/sites/default/files/Interim_Report_BLRC_0.pdf assessed on 26/02/18.
16. Bankruptcy Law Reforms Committee. Report Summary. http://www.prsindia.org/administrator/uploads/general/1448943398_Report%20Summary%20-%20BLRC.pdf
17. Thapar S. A Modern Insolvency and Bankruptcy Law for India. http://www.shilpithapar.com/a-modern-insolvency-and-bankruptcy-law-for-india/# assessed on 25/02/18.
18. The debts which are liquidated, unsecured and not excluded debts and up to Rs.35,000.
19. Press Information Bureau. Summary of the Recommendations of the Bankruptcy Law Reforms Committee (BLRC), dated 04 November 2015; 17:23 IST, http://pib.nic.in/newsite/PrintRelease.aspx?relid=130208, assessed on 26/02/18.
20. Singh & Associates. India: Development of Insolvency Law – A Different Law Every Day! http://www.mondaq.com/india/x/641822/Insolvency+Bankruptcy/Development+Of+Insolvency+Law+A+Different+Law+Every+Day assessed on 26/02/18.

Cite this Article

Vijaya Lakshmi Raju. Plethora of Acts which Led to the Development and Formation of Insolvency and Bankruptcy Code 2016. *Journal of Banking and Insurance Law.* 2018; 1(2): 31–36p.