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Bankruptcy practice in India

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ABSTRACT

The bankruptcy framework prevailing in India, traces its roots back to colonial rule. That framework has undergone a number of amendments over the past 200 years, creating a plethora of overlapping and sometimes conflicting articles. The latest attempt at reconciliation of these various Acts was made under the Companies Act, 2013. This paper drives through the land mark amendments in the history of India, leading to the current bankruptcy framework. Each Act is discussed based on the requirements, procedures and outcomes post enactment. Also, the major pros and cons of the different Acts are identified, and a critical analysis is presented of the latest Act, Companies Act, 2013. Moreover, the provisions of Chapter 7 and Chapter 11 of the U.S Bankruptcy Framework are compared against the provisions of these Acts. The paper then presents a diluted, easy to understand, step by step procedure of the current bankruptcy framework. Followed by a case analysis of a recent prominent Bankruptcy, to elicit the issues in the current framework. In conclusion, a list of recommendations is presented, to improve the Bankruptcy Framework in India.

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1. Introduction

As of July 1st 2014, India accounted for 17.5% of world population, with a UN estimated head count of over 1.26 billion. Measured in terms of purchasing power parity, India's GDP of $7.376 trillion (compared with $1.877 trillion by standard counting) ranks it the third largest economy in the world. Clearly India bulks large in the global scene.

With its wealth and resources, India has always been a fertile ground for entrepreneurial inceptions and foreign establishments. As of July 2013, India had over 1.3 million registered companies. Of these, 0.26 million companies have been closed for various reasons such as bankruptcies and liquidations. According to the Department of Industrial Policy and Promotion (DIPP), the total foreign investment inflows soared by 24.5% to $ 44.9 billion during FY2015, from $ 36.0 billion in FY2014.

The above noted massive corporate and financial services with comparably large dissolutions, call for a commensurate bankruptcy framework. The current Indian bankruptcy framework is, however, arrantly disorganized. In a recent statement, the finance minister, Arun Jaitley has identified the reformation of the current bankruptcy system as a key priority for the overall development of the country.

2. Overview

The Indian bankruptcy procedures are extremely time consuming and resource intensive. Their inefficiencies, resulting from excessive regulation of economic activity, have accumulated ever since India's independence. Indian post-independence industrial policies, such as limited private ownership, industrial licensing and import substitution led many financially unviable firms to consider exit or restructuring options. However, the existing social, political, and legal system did not contain an appropriate framework for fair and systematic resolution of insolvency cases. This has substantially slowed the pace of the much needed industrial restructuring.[1]

Over the years, several changes have been made to the bankruptcy system and its underlying procedures. Nonetheless, no single comprehensive and integrated policy on corporate bankruptcy in India compares to the Chapter 11 (reorganization) or Chapter 7 (liquidation) bankruptcy code in the US. Four separate agencies, the High Courts, the Company Law Board, the Board for Industrial and Financial Reconstruction (BIFR), and the Debt Recovery Tribunals (DRTs), have overlapping authorities, which creates systemic delays and complexities in the process.[2] Three important legislative acts and a number of special provisions lay out procedural guidelines for the liquidation or reorganization process.

Formal insolvency laws in India can be traced to “The Presidency Towns Insolvency Act 1909” and “Provincial Insolvency Act, 1920”. These Acts dealt with non-trader insolvency/consumer insolvency. Corporate/Trader insolvency is dealt with under the Companies Act, 1956, which is a landmark in Indian Insolvency Law system. After a series of amendments and transitions of different laws dating back to the

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[1] Nimrit Kang and Nitin Nayar, The evolution of corporate bankruptcy law in India, March 2004.

[2] Omkar Goswami, Corporate Bankruptcy in India—A comparative perspective, January 1996.

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Government of India Act 1800, the numerous fragments of Corporate Insolvency laws converged into the Companies Act, 1956. The intent of this law was to consolidate the various laws for the "new" post-independence India of 1947. The Companies Act, 1956 saw major amendments in 1988 on recommendations of the Sachar Committee, followed by amendments in 2002 based on recommendations of Eradi committee report. Finally the companies Bill 2009 set out a list of amendments to the Companies Act, 1956 with the intent to recreate a leaner version of the original Companies Act, 1956.

Herein, we shall discuss the implications of various bankruptcy reforms that have been implemented in India. We will observe how these reforms molded the Indian bankruptcy system into its current, far from ideal form. We conclude with a detailed review of a prominent recent bankruptcy case.

3. Indian Insolvency Laws

3.1. Companies Act, 1956

The Companies Act of 1956 is a detailed piece of legislation modelled after the British Companies Law. It grants a variety of monitoring and regulatory powers to the federal/union government and the High Courts. According to the guidelines laid out under this Act, liquidation of a company facing financial distress can be accomplished in two ways: voluntary liquidation by creditors or involuntary liquidation by the court.

The former, voluntary liquidation, is a more efficient process that proceeds after shareholders vote for liquidation. Control of the liquidation process is handed over to secured creditors. These secured creditors, then, appoint either a private or official liquidator who oversees the sale of assets and distribution of proceeds. The latter, involuntary liquidation, is a less efficient and a more time consuming process. Any creditor with a minimum of INR 500 unpaid and undisputed debt (US $8), upon giving three weeks' notice to the company, can petition the court for involuntary liquidation. The court, then, validates the claims and the fairness of the petition before ordering liquidation. The court, acting with pure discretion, has the authority to decline the petitioners claim to hold the company insolvent on "considerations including that of public interest".[3]

The debtor remains in possession of the assets while the court decides the case. However, as soon as the winding-up is ordered by the court, an official liquidator (appointed by the court, usually a government employee) takes control of the process, which includes claiming and selling assets, recovering preferential payments made, and settling the company's liabilities. During settlement of claims, highest priority is given to secured creditors and workers'/employees' back wages, followed by government and administrative claims like severance pay of employees and pension benefits. The residual is used to settle claims of unsecured creditors and equity holders. Unlike the US bankruptcy code, no provision exists for an automatic stay[*] in the period between filing of the petition and ruling by the court. This period, which can last up to a year, is characterized by a delirium of lawsuits by all types of borrowers. In fact, in some cases, creditors even resort to sale of those debtor's assets which they hold in their possession. The result of this chaos is a further wastage of time, as the courts have to deal with these actions before giving an equitable judgement in the overall case. The fraudulent transfers and preferential payments made within the six month period, spanning from the time when the liquidation petition was filed, are dealt in the same manner as in the US bankruptcy code. In addition, a provision for restructuring limited to either a merger and acquisition strategy or a voluntary compromise arrangement between the company and the creditors may be used in order to change the capital structure, if authorized as part of a compromise. The proposal for compromise can be made by one or more of the involved parties, which include creditors, management, government and the official liquidator. Such a complaint must be approved by the court, as the court supervises the implementation of the compromise. Note that unlike the "cramdown" concept adopted as part of the US Chapter 11 reorganization plan, the compromise here is not enforced by the court, and is actually carried out only when approved by the creditors.

Though it has been amended a number of times over the years, the Companies Act, 1956 holds a major share of active judicial clauses. The Ministry of Corporate Affairs annual report as shown below, released the count of petitions received, disposed and pending over the year 2010–2011. The Companies Act, 1956 performs fairly impressively by disposing 10,798 cases in 2010, but it still ended with a pending balance of 2853 cases.

Consolidated Statement of Petitions/Applications Received, Disposed of and Pending for the period 01.04.2010 to 31.12.2010 under Companies Act, 1956.

	Previous balance	Receipts	Disposal	Pending
Filed Under Companies Act, 1956	4549	9102	10,798	2853

Calculated on data retrieved from "Ministry of Corporate Affairs, Annual Report, 2010–2011".

3.2. Sick Industrial Companies Act (SICA), 1985

This Act establishes a comprehensive legal framework for reorganizing the activities of a sick industrial organization. As defined under SICA,[4] a company is considered "sick" if it: a) has been registered for at least seven years, b) has incurred cash losses for two consecutive years, including the current year, c) has cumulative losses that amount to more than its net worth. However, through an amendment to SICA, passed in 1993, condition a) was revised to reduce the limitation of registered duration to 5 years, and condition b) was eliminated.

Under this Act, in order to ensure timely detection of "sick" industrial organizations and provide the required intervention, a quasi-judicial body—the Board for Financial and Industrial Reconstruction—was constituted. The application for intervention must be filed by the Board of Directors within 60 days "from the finalization of audited accounts of the year in which the company has fallen sick".[5] Once the application has been filed, the BIFR exercises one of three options: a) approve a management/creditor sponsored plan without concessional financing, b) determine unviability of the business and recommend liquidation to the court or c) claim that the firm must be reconditioned in the public interest, and approve a plan requiring major concessions and sacrifices from various parties including subsidies from the government. In options b) and c), to determine the viability of the company and propose a turnaround plan, the BIFR appoints the largest secured lender as the operating agency (OA).

Concomitantly, an automatic stay is granted against all claims, suits and legal proceedings against the "sick company", but the debtor remains in possession of the assets. The management or the creditors can challenge in the court, any action prescribed by the BIFR. The courts often refer the case back to the BIFR for further review, which leads the case into a vicious circle.[6]

[3] Mitra, N. L., 2001, "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.

[*] In United States bankruptcy law, an ***automatic stay*** is an automatic injunction that halts actions by creditors, with certain exceptions, from collecting debts from a debtor who has declared bankruptcy. Under section 362 of the United States Bankruptcy Code, the stay begins at the moment the bankruptcy petition is filed. Secured creditors may, however, petition the bankruptcy court for relief from the automatic stay upon a showing of cause.

[4] SICA 1985, "Regulatory Requirements: SICA", June 2000, available from http://business.gov.in/closing_business/sica.php.

[5] Mitra, N. L., 2001, "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.

[6] Nimrit Kang and Nitin Nayar, The evolution of corporate bankruptcy law in India, March 2004.

The table below charts the yearly performance of BIFR in handling cases. Of the 5687 cases registered for revival/winding up over the years, 2327 cases were dismissed. That more than 40% of cases have been dismissed, clearly indicates the need to create a better and faster methodology for dealing with petitions where revival or winding up are not required. With a multitude of cases being filed every year, the wasted judicial resources could be leveraged towards a faster and more productive progress on the "genuine" cases.

Board for Industrial & Financial Reconstruction As on 30.09.2010.

Year	Total cases regd. during the year	Cases disposed off during the year			
		Cases under revival	Cases revived	Winding up recommended	Dismissed
1	***2***	***3a***	***3b***	***3c***	***3d***
1987	**311**	**0**	**0**	**0**	**8**
1988	**298**	**0**	**1**	**12**	**29**
1989	**202**	**0**	**1**	**31**	**77**
1990	**151**	**1**	**3**	**42**	**45**
1991	**155**	**1**	**5**	**47**	**27**
1992	**177**	**3**	**7**	**30**	**43**
1993	**152**	**3**	**13**	**63**	**59**
1994	**193**	**2**	**38**	**77**	**48**
1995	**115**	**6**	**25**	**61**	**29**
1996	**97**	**6**	**92**	**83**	**25**
1997	**233**	**2**	**34**	**81**	**21**
1998	**370**	**5**	**21**	**49**	**36**
1999	**413**	**4**	**11**	**61**	**72**
2000	**429**	**8**	**37**	**142**	**156**
2001	**463**	**10**	**47**	**113**	**126**
2002	**559**	**21**	**34**	**107**	**212**
2003	**430**	**08**	**42**	**99**	**190**
2004	**399**	**06**	**29**	**50**	**70**
2005	**180**	**17**	**71**	**19**	**180**
2006	**118**	**63**	**91**	**22**	**296**
2007	**78**	**66**	**81**	**19**	**205**
2008	**57**	**80**	**64**	**13**	**130**
2009	**64**	**192**	**82**	**19**	**125**
2010	**43**	**690**	**70**	**22**	**118**
TOTAL	**5687**	**1199**	**899**	**1262**	**2327**

Sourced: Board of Industrial and Financial Reconstruction (http://bifr.nic.in/geninfo.htm).

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

This piece of legislation was created in order to decentralize the judicial work, which was then concentrated in India's Civil Courts. It allows banks and other financial institutions to pursue recovery of outstanding debts greater than One million Rupees (US $ 15,300) by filing a petition before a Debt Recovery Tribunal (DRT). The Deb Recovery Tribunal is a court that has been set up, under the Section 3 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993. According to the Section, the Tribunal shall consist of one person, appointed by the notification of the Federal/Central government, who is the Presiding Officer, and he/she is the only one with the authority to exercise the powers vested in the tribunal. The Presiding Officer's role is to issue a necessary recovery certificate, which is forwarded to the Recovery Officer.[7]

Recovery of debts due to banks and other financial institutions is not given priority by Civil Courts, which forces them, like any other litigant, to go through the unduly time consuming process of the Civil Courts. Thus, this Act, while overriding the other two jurisdictions, provides banks and financial institutions a relatively swift process to get their claims appraised and validated.

- Post enactment of SARFAESIA Act, the DRT was made responsible for handling recovery cases for both financial institutions and individual lenders. Previously, only financial institutions had access to DRT.

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

Unlike the previous acts, SARFAESIA is applicable to the whole of India. This act came as a relief to financial institutions and secured creditors, providing a clear debt recovery system. Herein, steps and limitations in recovery of non-performing assets (NPA) without court intervention are laid out. Assets are categorized as non-performing assets or NPAs when interests or installments of principal due remain unpaid for more than 180 days. This act is limited to secure creditors only, unsecured creditors have no right under this act.

This Act deals with three major aspects:

1. Enforcement of security interest
2. Handling of NPAs
3. Framework for asset securitization

Pre requisites for SARFAESIA applicability:

I. The debt should be secured.
II. The debt should be classified as NPA
III. More than INR 1, 00,000 (One Lakh rupees)(US $1500) and above and more than 20% of the principal loan amount and interest are outstanding.
IV. The security is not agricultural land.

The Indian financial sector was impacted by the economic crisis of 2008 in similar ways to the American banking sector. As a result some of the supposedly most "secure" and "stable" banks closed as listed below:

- District Cooperative Bank Ltd. of Gonda in UP.
- The Maratha Co-operative Bank of Karnataka
- Parivartan Co-operative Bank of Maharashtra
- Ravi Co-operative Bank
- Indira Priyadarshini Mahila Nagrik Sahakari Bank of Chhattishgarh
- Varda Co-operative Bank
- Harugeri Urban Co-operative Bank
- Kittur Rani Channamma Mahila Pattana Sahakari Bank
- Challakere Urban Co-operative Bank
- Basavakalyan Pattana Sahakari Bank
- Vasantdada Shetkari of Sangli
- Shri PK Anna Patil Janata Bank
- South Indian Co-operative Bank Ltd.
- Rohe Ashtami Sahakari Bank Ltd.
- Ajit Sahkari Bank
- Bhavnagar Mercantile Co-operative Bank
- Chalisgaoan Cooperative Bank
- Hirekerur Bank

A majority of the above banks' closures were a result of misuse of their assets. The SARFAESIA act was designed to deal with such bad debts.

The Act provides three ways of recovering NPAs:

I. Securitization:

This area of the act provides for issuance of receipts from Qualified Institutional Buyers. These receipts represent ownership of a securitization or reconstruction of the financial assets. It directs the lenders to

[7] G.S. Dubey, "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.

maintain a separate account for each security. The assets are applied towards redemption of investments on the specific security.

II. Asset Reconstruction: For the purpose of reconstruction of the assets of the borrower, one of the following steps is to be taken by the securitization or reconstruction company:

- Proper management of the business of the borrower.
- Sale or lease of a part or whole of the borrower's business.
- Rescheduling of payments of the debt.
- Security enforcement.

III. Enforcement of security:

The lender may issue notice to the borrower and guarantor to pay the amount due within 60 days from the notification date. Failure to comply with the notice, permits the bank/financial institution to take any of the below steps without intervention of the court:

1. Take possession of the security.
2. Sale or lease or assign the right to the security.
3. Manage the same or appoint another person to manage the same.

The Act also empowers the bank/financial institution to:

1. Issue notice to borrowers to surrender secured assets.
2. Demand debtors pay any sum due of the borrowed amount.
3. When proceeds are to be undertaken, in addition to personal property of guarantor, agricultural land is excluded in the event of security interest created on it.
4. In event of a demand notice, the borrower can make a representation or raise objection. An authorized officer shall review the same within 15 days and determine whether the demand notice stands or the objection is acceptable.

3.5. Insolvency Framework

In addition to the Companies Act, 1956, the "Sick Industrial Companies Act, 1985", "the Recovery of Debts due to Banks and Financial Institutions Act, 1993" and "the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)" plays various roles in the formulation of the insolvency law framework of modern India.

In India, based on the plethora of Acts enacted over the years, numerous forum have been set up for the type of organization under 'rescue'. Industrial companies file under the Board for Industrial and financial reconstruction (BIFR) under the SICA as discussed. Other companies file with the Company law board and liquidation authority at the high court of the state where the company is located. The high court ruling is overshadowed by the BIFR recommendation when a liquidation is recommended by BIFR. In such a situation, the high court enjoins a liquidation because the BIFR is a panel of experts.

Akin to the above, when a financial institution is recommended to undergo a dissolution by the reserve bank of India (RBI), the high court enjoins a dissolution. The forums available to financial institutions under RDDB and SARFAESI Act are the debt recovery tribunals (DRT).

3.6. The Companies (Second Amendment) Act, 2002

In an effort to have a single source of resolution, for all the forums discussed above, the setup of "The National company law tribunal (NCLT)" and its related appellate tribunals have been prescribed under The Companies (Second Amendment) Act (2002). These tribunals would play three major roles. First, they would plan and overlook a revival and rehabilitation order from BIFR. Second, they manage high court jurisdiction for winding up of companies. Last, they would take over the role played by Company law board (CLB).

Under the companies Act, the winding up of a company is due to either:

1. Compulsory Winding
2. Voluntary Winding

Compulsory Winding: This winding is by the tribunal. The Tribunal shall order for winding up in case a petition is filed by a shareholder of a company. This is done only when assets are available for distribution among the shareholders.

Voluntary Winding: This is independent of the tribunal and can be further classified into members and creditors. Members winding up occurs when the company is solvent, whereas creditor voluntary winding occurs when the company is insolvent.

*A comprehensive discussion on the winding up procedures of Industrial companies can be accessed at "*Elements of Bankruptcy Law and Business Rescue in India—Vaneeta Patnaik*".

The table below reports the speed with which liquidation petitions are being handled with the current judicial mechanism. Of the 7018 cases in the year 2010–2011, only 794 (11.3%) of cases were resolved or completed. This points up the need for a more comprehensive and resource intensive framework.

Distribution of the companies in liquidation by their mode of winding up during 1.4.2010 to 31.12.2010.

S. no.	Subject	No. of cos under liquidation as on 31.03.2010	Received during the period 01.04.2010 to 31.12.2010	Total (Col. 3 + 4)	Disposed during the period 01.04.2010 to 31.12.2010	No. of companies under liquidation as on 31.12.2010
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1	Members voluntary winding up	1357	46	1403	177	1226
2	Creditors voluntary winding up	100	1	101	0	101
3	Winding up by court	5297				
4	Winding up subject to supervision of court	3	0	3	2	1
	Total	**6757**	**261**	**7018**	**794**	**6224**

Sourced: Ministry of Corporate Affairs, Annual Report, 2010–2011.

The latest Act (Companies Act, 2013) sought to upgrade further the Insolvency framework in India. Below are few eminent specs of this long awaited facelift of the Bankruptcy framework of India.

3.7. Companies Act, 2013 **(EFFECTIVE APRIL 1ST 2014)**

The Companies Act, 2013 replaced the landmark Companies Act, 1956. It is believed to be the culmination of the approximately 25 amendments to the Companies Act, 1956 over the last few decades. Currently, only about 1/5 of the sections, ones which required very little change in old rules, of the Act are in effect. Other sections of the Act are slowly being implemented. This has resulted in confusion and unclear understanding about the exact rules, among the practitioners and others alike. A quasi-judicial body has been established under the Companies Act, 2013 which replaces and has similar powers to the Company Law Board, known as National Company Law Tribunal (NCLT).

The key modifications and ideas presented in Companies Act, 2013 are:

- The companies are directed to form a rehabilitation fund or an insolvency fund. This fund will be contributed to by the company itself, the government and interests/income from investment on the

fund. The fund would be used in case of proceedings initiated to make payments and protect the assets of the company. This is a continuation of the rehabilitation fund of Companies Act 2002, wherein 0.1% of the revenues were taxed to create a rehabilitation account. This is an important provision which has been highly anticipated to act as a driving force in efficiently resolving insolvency situations for companies and creditors. (Article 269)

- This Act also directs companies to assign a liquidator on behalf of the company (Article 310).
- A company liquidator as decided by the company initially or a provisional liquidator appointed by the tribunal will be responsible for carrying out winding up of orders. He/She would have the power to approach the tribunal in case of any lack of independence within the company. This is to ensure a fair, fast, transparent and a hassle free realization of orders (Article 275). Additionally it assigns the appointed liquidator to act in the best interest of the company, otherwise he/she can be replaced (Article 276). Also all company personnel are obligated to cooperate with the liquidator (Article 284). Additionally, (Article 290, 291, 292, 293 and 314 of the Companies Act, 2013) gives specifics of the powers and duties of the liquidator to ensure efficiency and a mellifluous process.
- The company liquidator seeks a tribunal for a committee to be set up to assist/monitor the liquidation process. All meetings shall be convened by the company liquidator, and meeting minutes shall be shared with tribunal on a monthly basis. Also, a report shall be given to all members and creditors on a quarterly basis (Article 316). Additionally, within 7 days from the point when the winding up order is given, the registrar shall endorse in the gazette and stock market (if applicable) of the proceedings (Article 277).
- Once this stage is reached, the main enhancement to the current Indian corporate insolvency system is made evident, the Companies Act, 2013 mandates the liquidator to file a detailed report with the tribunal within 60 days containing key characteristics and parameters (Article 281); and based on the review of this report, the Tribunal shall set a time frame by when the proceedings should be completed (Article 282), though this time frame can be revised, it can be a great indicator/enforcer to have a smooth winding up process. This particular article also gives leverage to the Tribunal to issue directives in a completely different direction as long as it can serve to protect/ preserve/enhance the value of the company assets. Also, to ensure progress and honesty, the Tribunal shall audit the company liquidator's accounts regularly (Article 294).
- During the liquidation process, if the company liquidator is of the opinion that a scam/fraud has been committed in the process i.e. if the declaration of insolvency were to prevaricate the creditors or if the reported assets or financial statements are not accurate, the liquidator shall report to the tribunal immediately and the Tribunal shall order an investigation under section 210.
- This act also grants special permissions to the liquidator to modify the process of liquidation by providing special permissions or directives such as pay to creditors in full, make compromise calls with creditors etcetera.
- In addition to the process of winding up, the liquidator is also responsible for handling unpaid dividends and undistributed assets, either into a Company liquidation dividend and Undistributed Assets Account or indicate these amounts in case of a voluntary windup.
- In place of Tribunal liquidators, the central government can intervene, to appoint "official" liquidators (more than one if need be) on behalf of the central government who shall carry out the liquidation tasks (Article 359, 360 and 363)

3.8. Framework in action

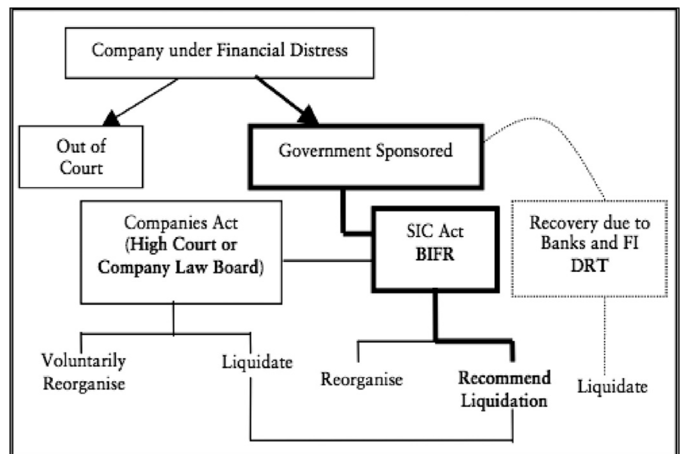
With all the above Acts enacted over the last few decades, the procedure to file bankruptcy and the avenues available to bankrupt corporations or financial institutions can be a daunting task to discern. We attempt to elucidate below a simple guide of the steps to be undertaken for a distressed corporation or financial institution:

At the onset of distress and the days leading up to it, the company/financial institution should attempt to garner both financial support and support from its shareholders and lenders in order to avert the need for a bankruptcy filing. This is to avoid the conglomerate of paralegal expenses, distortion of the image of the organization and time consuming procedures. In other words, avoiding the costs of the bankruptcy process can be a win win for all of the company's stakeholders.

4. Overall process

If the efforts to avoid a distressed situation fail, the company may attempt to exercise a "compromise" with its creditors and workers outside the premises of court. Inside the paralegal framework, a corporation is classified as distressed based on the litmus test of SICA Act. Banks and financial institutions approach the Debt Recovery Tribunals seeking the same.

The Indian Bankruptcy Process



Source: Nimrit Kang and Nitin Nayar, The evolution of corporate bankruptcy law in India, March 2004

The DRT helps the financial institutions and guides towards a Liquidation and manages it if there are no avenues for recovery of debts.

The SICA Act was defined and handles only industrial corporations. But, Companies Act, 2013 differs from SICA by including all types of corporations under it. Consequently, all the distress companies are handled under the Companies Act, 2013 post enactment of the same. Moreover, the Companies Act, 2013 does not categorize a company as sick based on the comparison of accumulated debt against net worth as was the case with SICA. Rather, it shifts the control to the secured creditors who own more than 50% of the outstanding debt.

When the secured creditors approach tribunal based on either of the two conditions enlisted below, the tribunal exercises a demand for revival/rehabilitation or liquidation:

1) The company has not paid satisfactorily to the debtors
2) The company has failed to pay the debt within 30 days of notice of demand.

Once the tribunal establishes the sickness of the company, the secured creditors or the company itself may make an application for the measures to be undertaken for rehabilitation or revival. The tribunal analyzes the application which includes financial statements, and appoints an interim administrator. The interim administrator convenes meetings with company management and secured creditors and prepares a report of the best possible measures for a mellifluous revival of the company. This report should be approved by the creditors (secured and unsecured) before being sought for approval by the tribunal. The tribunal

then sanctions the report which is then implemented for the revival of the organization.

If the report prepared by the interim administrator is not approved by the creditors, the administrator shall inform the tribunal along with a report of the measures proposed, in which case, it culminates with the tribunal ordering for the liquidation of the organization.

5. Case study

As the framework of bankruptcy is fairly unclear, and provisions among the various Act counter each other to a large extent, a case study can further elucidate the nature and weaknesses of the current system:

In a landmark case between two prominent nationalized banks, Allahabad bank v/s Canara Bank exposes the contradicting impacts of provisions in RDB act, 1993 on the provisions of Companies Act, 1956.

Herein, the two nationalized banks go head on over sales of properties to recover debts from a debtor company. Allahabad bank, having obtained a simple money decree was proceeding with the appropriation of property and sales of the same in order to recover debts as provisioned under Recovery of Debts Act. Canara bank on the other hand, was a secured creditor against the same debtor company whose case was still pending in the court of law (Tribunal). In view of the parallel pending judgement, an order was passed staying the sales under sections 432 and 537 of companies Act. This stay order was being challenged by Allahabad bank. The initial amount filed for recovery by Allahabad bank was a gargantuan Rs. 24,49,29,520 (US $3,768,608) with 18% interest and interest tax of 0.75% p.a from the debtor. Allahabad bank contended that according to RDB, the tribunal had complete authority over the appropriation and sale of property to recover debts. On the other hand, Canara bank contended that Allahabad bank was liable to seek leave of the company court before such proceedings were undertaken.

A few of issues with the framework exposed in this case were:

- In any act, the jurisdiction of the tribunal and Recovery officer were unclear.
- The requirement of companies to seek leave of Company court was unclear.
- The power of Company court on mediating or staying proceedings under the Act were unclear.
- The ownership of sales on appropriation proceedings for recovery needs to be determined.
- Position of secured creditors in winding up proceedings who choose to participate v/s those who stand outside during the proceedings.

This case, exposed one of the many impasses in the Indian bankruptcy judicial framework which is being revised as this is written. The framework is inundated with overlapping sections of Acts and more importantly, conflicts among the Acts for a similar situation.

5.1. Upcoming considerations

The recent Doing Business, 2015 Report, ranked India 137th for resolving insolvencies. The interim report of Bankruptcy Law reform Committee looks into the bankruptcy framework on a periodic basis in order to identify loopholes and improvement opportunities.

The latest update on the bankruptcy judicial framework has identified a list of issues and proposed recommendations for the same. This is a good vantage point to understand the latest issues under consideration. The interim report of the Bankruptcy Law reform committee, 2015 has listed an exhaustive set of changes to be implemented to the current system. Below is a list of few major changes: (The complete report can be accessed through the link given in the references section)

- Need for early recognition of distress and intervention to rescue.
- Allowance to secured creditors to file rescue applications at an earlier stage as opposed to current requirement of a default on a minimum of 50% of outstanding debts.
- To gain better clarity on the viability and expedited time lines of rescue or liquidation procedures
- Provision to secured creditors to be allowed direct appointment of a company administrator when a company is determined to be "SICK".
- Provision to take over the management and assets by the administrator on own motion or by vote of secured creditors.
- Revision of the powers and functions of the company administrator.
- Empowering unsecured creditors representing 25% of the value of the debt owed by the company to all its unsecured creditors to initiate rescue proceedings if the debtor company fails to pay a single undisputed debt owed to any unsecured creditor exceeding a prescribed value within 30 days of the service of the notice of demand or fails to secure or compound it to the reasonable satisfaction of such unsecured creditor.
- Consideration of the viability of the company while determining its sickness.

6. Conclusion

Though the current Bankruptcy system has undergone numerous changes, especially in the last three decades, the process remains overly complicated and extremely time consuming. The roots of the Indian bankruptcy system, stem from the British regime, and the contemporary framework is bereft of standard, cohesive and fair steps for handling bankruptcies. The framework is complicated and though it encompasses numerous statutes, enforcement of them is exiguous. The current framework is still far behind in having a cogent and comprehensive structure like those available in countries such as United States. The panoply of Acts are extant and expound on sunder issues, but when practically implemented, are fairly dilating besides contradicting one another in various ways. The latest Act, Companies Act, 2013, has been designed to overcome these shortcomings. This inconsequential and dilating process impediments are recognized distinctly by the current government and conscious efforts are being made to improve the system.

The recent press release of Oct 18th 2015 conveys the proclivity of the government, being led by prime minister Narendra Modi, to improve the century old system. Its major focus would be on consolidating the different laws and reducing the delays in the process. Bloomberg business reported that only 25.7 cents per dollar is being recovered by the current system, in contrast to 80.4 cents per dollar in U.S in half the time. The new recommendations and ameliorations are geared towards building a more creditor friendly system, and alongside provide legal indemnifications to unsecured creditors to instill more confidence in them to lend to long-term projects.

Going forward, it would be intriguing to analyze the effects of Companies Act, 2013, and its contributions towards resolving the inherent and conspicuous glitches of the current framework, and the aftermath of the numerous transmutations of the current system proposed by the government.

References

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