Insolvency Proceedings, Recent Judgments and Way Forward

Over the time, the IBC, 2016 has undergone many changes, overcome barriers while adapting to the growing corporate and economic needs of the country, providing for reorganisation to rescue a distressed company if its business is viable or close it if it is unviable, through a market driven process. While the IBC has certainly helped in resolving companies with larger financial value, it has faced limitations in addressing distress situations for smaller enterprises. The PPIRP for MSMEs has made sincere effort to provide a legal framework to rescue small businesses out of the court settlement. However, some recent judgements by the Supreme Court, though related to individual cases, seem to have derailed the entire process of the Code. ***Read on to know more…***

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The enactment of Insolvency and Bankruptcy Code (IBC) in May 2016 was a watershed moment in India's resolution to embrace a pragmatic, business conducive environment aligned with the globalised economy. Built on the fallen ramparts and edifices of Presidential Towns Insolvency Act (1909), Provincial Insolvency Act (1920), Sick Industrial Companies (Special Provisions) Act 1985, Recovery of Debts due to Banks and Financial Institutions Act (1993) as also the SARFAESI Act of 2002 which individually, and in conjoined way did not yield desired results, the IBC act was instrumental in improving India's ranking in ease of resolving insolvency indicators internationally. India's rank moved up to 52 from 136 in terms of 'resolving insolvency' in three years in the World Bank's Doing Business reports (overall rank now 63 from 142 in 2014) as IBC framework has been compared to those prevailing in better rated Organisation for Economic Co-operation and Development (OECD) countries. In the Global Innovation Index, India's rank improved from 111 in 2017 to 47 in 2020 in 'Ease of Resolving Insolvency'.

The history of evolution of insolvency laws globally shows how public perception of insolvency of businesses has changed from time to time. Overtime, insolvencies

came to be decoupled from moral failure and got allied more to economic reasons for failure. It became easier for entrepreneurs to exit in case of non-wilful/honest business failure and come up with a new business wherever feasible.

Experiences demonstrate the extent to which the absence of orderly and effective insolvency procedure mechanisms can exacerbate economic and financial crises. Without effective procedures that are applied in a predictable manner, creditors may be unable to collect on their claims, which will adversely affect the future availability of credit. Without orderly procedures, the rights of debtors (and their employees) may not be adequately protected, and different classes of creditors may not be treated equitably. In contrast, the consistent application of orderly and effective insolvency procedures plays a critical role in fostering growth and competitiveness and also assists in the prevention and resolution of financial crises, such procedures induce greater caution in the incurrence of liabilities by debtors and greater confidence in creditors when extending credit or rescheduling their claims.

Some excerpts from the Bankruptcy Law Reforms Committee (BLRC) of November 2015, providing insight into why the IBC Code was enacted and the purpose for which it was enacted, give a peep into the requirements that stressed upon preambles woven around low time to resolution, low loss in recovery and higher levels of debt financing across a wide variety of debt instruments:

(i) India is one of the youngest republics in the world, with a high concentration of the most dynamic entrepreneurs. Yet these game changers and growth drivers are crippled by an environment that takes some of the longest times and highest costs by world standards to resolve any problems that arise while repaying dues on debt.

(ii) the recovery rates obtained in India are among the lowest in the world. When default takes place, broadly speaking, lenders seem to recover about 20% of the value of debt, on an NPV basis.

When creditors know that they have weak rights resulting in a low recovery rate, lesser inclination to lend is not uncommon.

The key economic question in the bankruptcy process is that when a firm (referred to as the corporate debtor in the IBC act) defaults, the question arises about what is to be done. Many possibilities can be envisioned. One possibility is to take the firm into liquidation (hitherto, done by High Courts). Another possibility is to negotiate a debt restructuring, where the creditors accept a reduction of debt on an NPV basis and expect that the negotiated value exceeds the liquidation value. Another possibility is to sell the firm as a going concern and use the proceeds to pay creditors. Many hybrid structures of these broad categories can be envisioned.

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Under IBC mechanism, the trigger for a financial creditor's application is non-payment of dues when they arise under existing loan agreements. It is for this reason that Section 433(e) of the Companies Act, 1956 (If the company is unable to pay its debts) has been repealed by the Code, bringing a change in approach. Legislative policy now is to move away from the concept of "inability to pay debts" to "determination of default". The cited shift enabled the financial creditor to prove, based upon documentary evidence, that there was an obligation to pay the debt and that the debtor has failed in discharge of such obligation.

Over the time, the Code has undergone many changes, overcome barriers while adapting to the growing corporate and economic needs of the country, providing for reorganisation to rescue a distressed company if its business is viable or close it if it is unviable, through a market driven process. Progress made under the Code and problems encountered have now opened up avenues for further refinements in the resolution processes. The code has been instrumental in getting rid of the 'negative sum game' where all the creditors would rush to stake claims and recover thereupon individual priority basis, triggering a run on the assets of the company in insolvency thereby jeopardising the economic interests without recourse for other concerns in stress and the business environment.

While the IBC has certainly helped in resolving companies with larger financial value, it has faced limitations in addressing distress situations for smaller enterprises. The IBC (Amendment) Ordinance, 2021 was promulgated with a focused agenda for the corporate micro, small and medium enterprises (MSMEs) in the form of the pre-packaged insolvency resolution process (PPIRP/ pre-pack) that involves very limited role of courts and thus aims to provide a faster and efficient corporate

rescue plan, broadening the scope and capacity of the IBC. It is a major advancement towards adopting out of court workouts as the way forward for achieving faster resolution and minimum distortion of value of assets. This not just impacts the corporate health of the country but translates into the overall growth prospects. Such provisions will act as incentives for greater investments and improve India's position on several global indices.

The objective of the code has three underlying elements that benefit the entire ecosystem as it gears towards better efficiency and transparency viz.:

Prevention: The Code resolves financial stress where it could not be prevented. The enactment of the Code and its rulings have created a conducive environment where management and promoters of the company are motivated to make their best efforts to avoid default, thereby avoiding ceding control of their enterprise. It also encourages them to settle default with the creditor(s) at the earliest, preferably outside the Code. Also, the CIRP undoes avoidance transactions, and necessitates the beneficiary of such transactions to disgorge the value, thus taking away the incentive to indulge in vulnerable transactions.

Time value of Money: The Code necessitates resolution in a time bound manner as excessive delay is most likely to diminish the organisational capital of the company. When the company is not in the best of its health, protracted uncertainty about its ownership and control makes the prospects of resolution remote, thereby impinging on economic growth. The Code requires that a CIRP shall mandatorily be completed within a timeline. Timeline is, in essence, the USP of the Code.

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Freeing up economic resources for a circular economy: The Code provides a mechanism for a company, where resolution is neither possible nor desirable, to exit with the least disruption and cost and release idle resources in an orderly manner for fresh allocation to efficient uses since for a market economy to function efficiently, the process of creative annihilation should be adapted to weed out failing, unviable companies in a continual manner.

In its about six years existence, the IBC has walked a chequered path, meeting a formidable nemesis in the form

of Covid, delays and procrastination tactics through 'looking for loopholes' mentality and seeking multi-tiered legal recourses by certain promoters. Despite dwindling recovery for certain classes of creditors, it would be imprudent to deny its towering presence and overarching impact on creating a conducive environment, within the ambits of laid down rules, that fosters efficiency, innovation and competitive ecosystem, quintessential ingredients for success of businesses in a globalised world.

Going forward, a slew of reforms like mandating reliance on information utilities (IUs) for establishing default, bringing enhanced clarity on continuation of proceedings for avoidable transactions and improper trading after CIRP, change in threshold date for look-back period of avoidable transactions aligning it with date of filing of application for initiation of CIRP instead of the date of commencement, timeline for approval or rejection of resolution plan, guidelines for standard of conduct of the Committee of Creditors (CoC), mandatory consultation by liquidator with the Stakeholders Consultation Committee (SCC), amending secured creditor's contribution (of those who step out of the liquidation process) in workmen's dues or liquidator expenses in preserving assets, amending mechanism for terminating a voluntary liquidation process, amendment of Sec 224 of IBC to empower the Central government towards prescribing a detailed framework for contributions to and utilisation of the IBC funds and separate appellate mechanism for orders issued under Section 20 by the IBBI and its disciplinary committee should revive and reinvigorate this all-encompassing law. Also, the IBC provisions relating to individual insolvency dealing with fresh start process, proprietorship, and partnership firms and other individuals through DRT are yet to come into force.

The transformational law, in a short lifetime, has seen volleys of rulings and judgements, alongside some

conflicting ones that seemingly question the very essence of the purpose behind the enactment of the law. The most recently apex court judgement in the *Vidarbha Ind. Power Vs. Axis Bank* (12 July 2022) wherein the binding conditionality of NCLT admitting the CIRP moved by a Financial Creditor was set aside by the Hon. Bench, siding with the arguments that Section 7(5) (a) of the IBC enables NCLT to reject an application, even if there is existence of debt, for any reason that the NCLT may deem fit, for meeting the ends of justice and to achieve the overall objective of the IBC, which is revival of the company and value maximization. In the cited order, the court held that NCLT can not admit an insolvency application filed by a FC merely due to the fact that a financial debt exists, and the CD has defaulted in its repayment. Instead, the bench opined that the NCLT must consider additional grounds that the CD may raise against such admission by default. The interpretation (with the word 'may' instead of 'shall' in IBC act towards admission of CIRP initiated by FCs paving the way for the order) could fundamentally impact the IBC framework at the crucial admission stage itself. There are apprehensions that many Corporate Debtors may use the recent judgement to shield themselves from the IBC proceedings. This in fact can take the IBC to the road traversed by earlier legislations and their catastrophic consequences on the economic vigour and lending and borrowing discipline.

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Some other important IBC related judgements having wide ramifications in recent times are *Asset Reconstruction Company (India) Ltd. Vs. Tulip Star Hotels Ltd. & Ors.* 2022 (Provisions of IBC and rules & regulations framed thereunder be construed liberally, in a purposive manner to further the objects of enactment of the statute), *Kotak Mahindra Bank Vs. A Balakrishnan* 2022 (a liability in respect of a claim arising out of a recovery certificate would be a financial debt within Sec 5(8) of IBC and a limitation period of three years starts from the date of the issuance of the recovery certificate), *NOIDA authority Vs. Anand Sonbhadra* in Supreme Court 2022 (Lease of land by NOIDA to Builders does not fall within the ambit of Financial Debt, to be treated as an Operational Debt) and the most quoted case of Swiss Ribbons wherein the apex court affirmed the IBC's constitutional validity.

Acts like IBC have ensured enactment of speedy laws and bodies like NCLT/NCLAT which are, in a sense, Governments within a Government, imperium in imperio, carrying out governance on behalf of Government in a defined framework. Let's hope the spirit of the Code is not diluted.