

## Insolvency in India during Ancient Times



*The concept of insolvency in Hindu literature can be traced back to the ancient texts of the Vedas, which speak of a man's duty to pay back 'Deva-Rina', where Hindu Literature gets its idea of insolvency. The term 'Deva-Rina' describes the obligation that a person owes to the Almighty or Deities for the blessings and advantages they have experienced in life. Besides, there is the concept of 'Rishi-Rina', which refers to the debt owed to the sages or wise men who have passed down the knowledge and wisdom of the Vedas to future generations. A description of the cosmic wheel of life can be found in Chapter 3 of Shrimad Bhagavad Gita. This article explores the evolution of insolvency laws in India from ancient Hindu Literature to the contemporary. **Read on to know more...***



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### 1. Introduction

Insolvency and Bankruptcy Code, 2016 (IBC) aims to consolidate the existing legal framework and establish a single law for insolvency and bankruptcy. The objective of the IBC is to streamline the existing framework by repealing the Presidency Towns Insolvency Act of 1909, Provincial Insolvency Act of 1920, and the Sick Industrial Companies Act of 1985 (SICA) and also amending other laws, including the Companies Act of 2013, Recovery of Debt Due to Banks and Financial Institutions Act of 1993, and Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002.

Under the IBC regime in India, cases go through a specific legal process, which involves several stages and legal forums such as:

- (a) National Company Law Tribunal (NCLT): where a creditor files a petition for initiating insolvency proceedings against a debtor.
- (b) National Company Law Appellate Tribunal (NCLAT): a higher forum where parties can appeal against orders passed by the NCLT.

(c) Supreme Court (SC): Any person aggrieved by any order of the NCLAT may file an appeal to the Supreme Court.

Insolvency laws were introduced in India during the British colonial period, as there was a need to regulate trade-related operations in the Presidency States of Bombay, Madras, and Calcutta. The Indian Insolvency Act of 1848 was introduced, but with changing times, the insolvency laws were needed to be updated. Thus, the Presidency Towns Insolvency Act of 1909 and the Provincial Insolvency Act of 1920 were enacted to ensure that both the Presidency Towns and Non-Presidency Towns were included under the ambit of insolvency laws in India.

The modern insolvency law has evolved over the centuries and has been influenced by English laws. However, a startling fact is that insolvency laws have been in place since ancient times, even in our own history.

## 2. The evolution of the Insolvency & Bankruptcy Laws in India: A Historical Perspective

Insolvency and Bankruptcy are two related but distinct concepts. While insolvency refers to the inability to pay debts as they become due, bankruptcy is the legal process that results from insolvency. In other words, insolvency is a state of financial distress that may lead to bankruptcy.

According to the *Dharmashastras*, failure to repay debts can have severe consequences, one is loss of reputation. Therefore, it is considered a moral duty to repay one's debts, and various remedies and penalties were prescribed for those who default on their financial obligations. The *Dharmashastras* are a collection of *Smriti* texts that were authored by the sages in ancient times to provide guidance on ethical and legal principles in Hindu society i.e., *Sanatan Dharma*. The *Dharmashastras* state that if a person dies without repaying his/her debts, the unpaid debt will have to be paid in the next life by serving the creditor as a slave. This cycle of servitude will continue until the debt is fully discharged, and the person will not be able to attain salvation until the debt is paid off.

In the ancient Hindu legal system, the concept of '*Kusidin*' was used to refer a creditor or a person who lends money. In ancient Hindu society, money lending was a common practice and *Kusidin* played an important role in the economy. However, the charging of high-interest rates by

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*Kusidin* was also a cause of concern, and Hindu law provided for regulations to ensure fair practices in lending and borrowing. To determine the extent of the borrower's assets and liabilities and for their settlement, a person known as the "*Vyavaharik*" was appointed to investigate the matter. The same matter would then be taken up to the king for resolution. In the modern context, the role of the "*Vyavaharik*" has been replaced with the "Resolution Professional (RP)". The RP is appointed to spearhead the Corporate Insolvency Resolution Process (CIRP) by the Adjudicating Authority (AA). The RP plays a crucial role in managing the affairs of the Corporate Debtor (CD) during the insolvency process and facilitating the resolution of its debts. The *Manusmriti*, for instance, regarded *Kusidin* as an acceptable means of accumulating wealth.

Kautilya's writings from the Mauryan era are one of the known references to a structured system of lending. Within these texts, there are mentions of various types of loan deeds such as *RNapatra*, *RNapanna*, and *RNalekhaya* that were commonly used and recognized during the Maurya empire's reign from 321 to 185 BCE. In the Maurya Era, a financial instrument called "*Adesha*" emerged. This instrument was a directive given to an indigenous banker, instructing them to transfer the specified amount on the note to a third party. This bears resemblance to the concept of a contemporary Bill of Exchange. Loan instruments were widely utilized in big cities, and merchants exchanged Letters of Credit. During the Mughal period, loan agreements called '*Dastawez*' were prevalent, with two variations: '*Dastawez-e-Indultalab*', which was payable immediately, and '*Dastawez-e-Miadi*', which was payable after a specified period. These are identical of DP (Documents against Payment)-LC (Letter of Credit) and DA (Documents against Acceptance) -LC (Letter of Credit) of modern Banking system.

Another concept was '*Arthashastra*' which comes from ancient Indian texts that were written around 300 BCE by

the Indian philosopher, economist, political scientist Chanakya (also known as Kautilya). The term "*Arthashastra*" means "the science of wealth" and it contains a detailed account of everything a king should have the understanding to become a good ruler such as economics, public policy, politics, diplomacy, logic, administration, management, defence sciences etc. One of the mechanisms suggested in the *Arthashastra* to deal with insolvency and debt was the idea that if a debtor was unable to pay their debts, they could be forced to work for their creditors until the debts were paid off. This was seen as a way to ensure that the creditor was not left with unpaid debts, while also giving the debtor an opportunity to work off their debts. Another suggestion made in the *Arthashastra* is the establishment of a debt relief fund, which is akin to nowadays Interim Finance. This fund would provide financial assistance to insolvent debtors who were unable to pay off their debts. The idea was that this fund would help to alleviate the burden on debtors who were struggling financially, while also ensuring that creditors were not left with unpaid debts.

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In the *Arthashastra* (Book 3 Chapter 13), insolvency is discussed as a possible scenario for a trader or merchant who is unable to pay off their debts. The Chapter outlines the consequences of insolvency and the steps that can be taken by creditors to recover their money. Example of insolvency given in the Chapter is that of a trader who has borrowed money to finance a business venture and not able to repay the loan due to losses incurred in the venture. The trader's assets are then seized by their creditors, who may sell them off to recover their money. The Chapter also lays out the procedure for dealing with insolvency. If a trader is unable to pay the debts, the creditors could approach the king's court to initiate insolvency proceedings. The court would appoint a receiver to take charge of the trader's assets and distribute them among the creditors.

Another concept has been '*Sreni System*' which was an important economic and social institution in ancient India. This guild-based system was made up of various occupational groups or guilds, each with its own chief who

was responsible for the economic well-being of its members. The *Sreni System* is believed to have existed in India since the Maurya period or before and continued to play an important role in Indian society and economy for centuries. One of the unique features of the '*Sreni System*' was the provision of '*Dharma-Saukshmya*' which allowed for the discharge of debts in cases of insolvency. This provision was based on the principle of *Dharma* (*Science of Righteousness*), or righteous behaviour, and recognized that economic setbacks and misfortunes could happen to anyone. The provision of '*Dharma-Saukshmya*' ensured that debtors who were unable to repay their debts due to unforeseen circumstances could be given relief and not be punished unjustly.

During the medieval period, insolvency became a common problem, especially in the mercantile communities. To address this issue, various provisions were made under the Islamic law, which was prevalent in many parts of medieval India. Islamic law allowed for the appointment of a *Nazir* (trustee) to manage the affairs of an insolvent person or entity. The *Nazir* was responsible for liquidating the assets and distributing the proceeds among the creditors. The process was overseen by a *Qazi* (Islamic Judge), who was responsible for ensuring that the distribution was fair and equitable as per the Islamic Laws. Another notable development in insolvency and bankruptcy during the medieval period was the emergence of *Hundis* or Bills of Exchange. *Hundis* were widely used in the mercantile communities as a means of credit and payment. They were issued by merchants and bankers and could be endorsed and traded like modern-day cheques. In case of default, the creditor could initiate legal proceedings against the debtor.

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In Sultanate period, the *Qazi-ul-Qazat*, also known as the *Chief Qazi*, was the highest judicial authority of the Islamic legal system. This position was responsible for hearing civil and criminal cases and ensuring that justice was served according to Islamic law. In the case of insolvency, the *Qazi-ul-Qazat* would act as an arbitrator between the debtor and the creditor to negotiate a payment

plan that would settle the debt. If negotiations were unsuccessful, the debtor would be declared insolvent, and his assets would be sold off to repay the creditor. This was done to prevent the debtor from running away or hiding his assets to avoid paying back the debt. The *Qazi-ul-Qazat* was responsible to ensure that the sale of assets was done in a fair and transparent manner and that the proceeds were distributed among the creditors according to the amount owed to each of them. This can be well equated with the IBC where in the present days RPs are appointed to work out a Resolution Plan and if it could not materialise, they are allowed to proceed for the Liquidation of the CD.

### 3. Development of Insolvency & Bankruptcy in Different Yugas

In Hindu Literature, it is believed that the world undergoes a cycle of four Ages or Yugas. Each Yuga is said to have its own distinct characteristics and spiritual significance.

- (a) In Hindu Literature, '*Satyuga*' is considered to be the golden age, where people lived a virtuous life and followed the path of truth and righteousness. As per the ancient texts, insolvency cases were not prevalent during *Satyuga* because people lived in a harmonious and cooperative society where everyone had enough resources to meet their needs. They lived a simple life and were content with what they had. They did not accumulate wealth or possessions beyond their needs, which helped in preventing insolvency cases. Moreover, the economy in the *Satyuga* was largely based on the barter system, where people exchanged goods and services, which reduced the chances of financial disputes and insolvency cases. Therefore, insolvency cases were not a common phenomenon in the *Satyuga*.
- (b) *Tretayuga* is a period in Hindu Literature, which is believed to have occurred millions of years ago. There are a few instances mentioned in Hindu Literature where characters faced financial difficulties or debts. The story of the great king Raja Harishchandra is a popular legend that illustrates the significance of virtue and sacrifice. Harishchandra, known for his virtuous and righteous conduct, encountered various obstacles in his life. His encounter with *Vighnaraja*, the deity of obstacles, is one of them. *Vighnaraja* possessed the king's body and destroyed the Sage Vishwamitra's holy *tapasya*, leading to the sage losing all the learning that

he gained through his *tapasya*. To make amends for King's mistake, Vishwamitra asked for *Dakshina* for his '*Rajasuya Yajna*'.

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The king, without any hesitation, donated everything he had except for his body, his wife, and their only son. On further insistence of Sage Vishwamitra, the king faced various challenges in fulfilling his promise and had to sell his wife and son to an old man as a maid servant. The king then worked as a slave at a cremation ground under the instructions of '*Chandala*' (Chief of the Crematorium in Kashi i.e., Varanasi). He had to collect fees for every cremation that took place there. When Harishchandra's own son died due to a snake bite his wife didn't have money to pay fee for his cremation. He continued with his righteousness and honesty and did not allow the funeral of his son to take place without cremation fee. As it was the height of Harishchandra's test, the God Vishnu exonerated him for all his hardships with the consent of Sage Vishwamitra and revived his family and kingdom back to him. As there were no corporates at that time and the wealth used to held by Kingdoms, this story provides a clear case of corporate insolvency of the contemporary and also presents a unique example of Personal Insolvency.

- (c) In Hindu Literature, the *Dwaparyuga* is believed to be the third of the four cosmic ages, characterized by a decline in moral and spiritual values. Many stories from this period relate to insolvency, which is the state of being unable to pay one's debts. One such story is about the '*Pandavas*'. In the game of '*Chausar*', they lost their Kingdom to *Kauravas*. They had to go exile into forest for many years. The story serves as a cautionary tale about the consequences of poor financial decision-making and the importance of responsible financial management.

- (d) *Kaliyuga* is considered the last and fourth *yuga*, known for its moral decay, corruption, and chaos. The historical records reveal several instances of insolvency and bankruptcy during this period. The medieval period in India witnessed a significant rise in insolvency cases due to the increasing commercialization and trade activities. The Mughal

Emperor Akbar, as per the suggestions of his finance minister Todarmal, took various measures to address this issue, such as appointing officials to supervise financial transactions, establishing courts to settle disputes, and imposing penalties for fraud and other financial crimes.

**Akbar, as per the suggestions of his finance minister Todarmal, took various measures to address the issue of insolvency such as appointing officials to supervise financial transactions, establishing courts to settle disputes, and imposing penalties for fraud etc.**

In present times, the legal framework in India has a comprehensive mechanism for dealing with insolvency cases, along with the introduction of various measures. In the 19<sup>th</sup> century, British colonial rule saw a further increase in insolvency cases in India due to the introduction of highly discriminatory commercial laws and the growth of new industries. The Indian Insolvency Act of 1848 was the first law that dealt with insolvency in India during British colonial rule. This law provided for the appointment of a court-appointed trustee who would take control of the insolvent's assets and distribute them to the creditors. In modern times, the Indian government has introduced the IBC to address insolvency cases. The IBC provides for a time-bound process for resolving insolvency and aims to maximize the value of the assets of the insolvent company, protect the interests of creditors and other stakeholders, and promote entrepreneurship and investment. Overall, while insolvency cases have been prevalent throughout history, the *Kaliyuga* period saw a significant rise in insolvency cases due to the increasing commercialization and trade activities on one side and moral deterioration on

the other. Various measures have been introduced to address insolvency, and the current legal framework in India provides for a comprehensive mechanism for dealing with insolvency cases.

#### 4. Conclusion

Insolvency, or the inability to pay one's debts, has been a problem for individuals and societies throughout the history. In ancient times, insolvency was often viewed as a moral failing, and debtors were sometimes punished severely, including being sold into slavery. However, ancient societies also developed various forms of debt relief, such as debt forgiveness and debt restructuring, to help debtors get back on their feet.

In modern times, insolvency is typically handled through legal processes such as insolvency proceedings. These processes aim to provide debt relief while also protecting the rights of creditors. In many countries, bankruptcy laws have been established to provide a framework for insolvency proceedings, including the discharge of debts, the sale of assets, and the distribution of proceeds to creditors.

One key difference between ancient and modern insolvency is the role of the State. In ancient times, debt relief was often provided by religious or community institutions. In modern times, the State has taken up a larger role in providing debt relief and regulating insolvency proceedings.

Overall, while the specifics of insolvency have evolved over time, the basic problem of debt and the need for debt relief remain constant. Both ancient and modern societies have developed systems and processes to address this issue, with varying degrees of success.

