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A Comprehensive Analysis of India's Insolvency and Bankruptcy Laws

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ABSTRACT

The introduction of India's Insolvency and Bankruptcy Code (IBC) in 2016 indeed represented a significant departure from the traditional insolvency regime in the country. It aimed to revolutionize the resolution process, strengthen creditor rights, and promote a more dynamic entrepreneurial culture. However, the journey of implementing the IBC has not been without its hurdles, prompting a thorough examination of its efficacy and broader impact on the economy. This dissertation embarks on a meticulous exploration of India's insolvency and bankruptcy laws.

It delves into various aspects, including their historical evolution, the underlying legal framework, practical challenges in implementation, and the socio-economic ramifications. By adopting a mixed-method approach, incorporating legal analysis, empirical research, and comparative perspectives, the dissertation aims to offer a holistic understanding of the strengths, weaknesses, and potential avenues for reform within India's insolvency regime. Through legal analysis, the dissertation scrutinizes the intricacies of the IBC, assessing its compatibility with existing laws and international best practices. It examines key provisions, procedural intricacies, and judicial interpretations to gauge the law's effectiveness in achieving its stated objectives. Incorporating empirical research, the dissertation ventures into the real-world implications of the IBC. It investigates case studies, examines data on resolution outcomes, and evaluates the impact on stakeholders, including creditors, debtors, and investors.

I. INTRODUCTION

While every entrepreneur wants to run a successful business and earn big profits, not every entrepreneur is successful in their endeavours. The failure of a business affects not only the business entity, but also its creditors who have done business with the debtor and are now faced with the prospect of collecting the receivables owed to them from the bankrupt business entity. Business failure can be caused by actual circumstances beyond the control of the entrepreneur or business entity, such as the occurrence of a natural disaster, the spread of a pandemic, or unpredictable market forces. However, it can also arise as a result of negligence or fraudulent behavior on behalf of a business entity.[2] Regardless of the reasons, in the end, creditors try to

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[2] M. S. Sahoo, ―Freedom to Exit Code builds the third pillar of economic freedom‖, 1 The Quarterly Newsletter

recover their debts. In such a scenario, insolvency and bankruptcy laws come into play. Insolvency and bankruptcy law balances two priorities, firstly to pay the bankrupt's creditors as much as possible and secondly to ensure that the bankrupt gets back on his feet and can continue to do business as much as possible. . While the first priority is important, there is also growing recognition of the second priority. If apparently harsh insolvency and bankruptcy laws lead to the legal death of a bankrupt entity, the economy will not only be deprived of a productive producer of goods or services and the employees of such bankrupt entity will be out of work, but such liquidation will also discourage entrepreneurs from attempting to start businesses, which will reduce the economic situation productivity. Insolvency and bankruptcy law must therefore balance the interests of creditors and debtors from the point of view of the social and economic situation. Before proceeding further, it is important to have a basic understanding of the concepts as well as legal theories related to insolvency and bankruptcy.

II. CONCEPTS OF INSOLVENCY AND BANKRUPTCY

Insolvency can be defined as a condition where a person, corporate or otherwise, is unable to pay its obligations as they become due, or where the person's assets are less than its liabilities. Whereas bankruptcy is a legal status determined by courts/tribunals based on a person's insolvency. Statutes are issued on the basis of a bankruptcy order to deal with the issue of insolvency.

So even though a person may be insolvent, they will not be declared bankrupt until a court/tribunal decision is made. However, a person who has fallen into bankruptcy will most certainly be insolvent.

Depending on the laws in force in the country, a person may be declared bankrupt on a petition filed in the courts/tribunals by the person himself or by a creditor whose debt has not been repaid.

The terms 'bankrupt' and 'bankruptcy' have been defined under the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as the Code), in part III under Section 79 (3) and (4) as follows: —

(3) bankrupt means,

(a) a debtor who has been adjudged as bankrupt by a bankruptcy order under Section 126;

(b) each of the partners of a firm, where a bankruptcy order under Section 126 has been made

of IBBI, 2016.

against a firm;

or (c) any person adjudged as an undischarged insolvent.

(4) bankruptcy means the state of being bankrupt.

III. Theory of insolvency

Various theories have been developed regarding the aims and ultimate purpose of insolvency law. These theories assume a wide range of goals and objectives for the insolvency process. For the purposes of this study, it is essential to understand the purpose of insolvency proceedings. The various theories dealing with insolvency are discussed as follows.

Jackson proposed the theory of bargaining with creditors, which became one of the most influential theories regarding corporate insolvency. Jackson assumes that if the debtor and his creditors were rational, they would negotiate ex ante and limit their individual claims in favor of a collective debt collection mechanism. Bankruptcy as a collective mechanism would reduce costs and maximize value. According to Jackson, bankruptcy proceedings should focus on increasing the efficiency of the debt collection process, increasing the value of the debtor and reducing the strategic costs of the debt collection process. The aim of bankruptcy proceedings should not be to protect the rights of non-investors, i.e. persons whose claims will be damaged by the debtor's insolvency, but who do not have a legal right to the debtor's property.[3] Thus, larger interests, such as those of the community, may not be protected by insolvency law from a creditor bargaining theory perspective.

However, while the legal framework may favor creditors, the ultimate objectives of the legislation are multiple, including ensuring that the debtor continues in business and rescuing the debtor, in the case of legal entities such as companies and limited liability companies, from legal death by winding up in liquidation, facilitating the granting of loans, as well as the support of free enterprise. The chairman of the Bankruptcy Board of India explains the evolution of insolvency laws in the country

(A) Research Objective

The research objective for analyzing insolvency and bankruptcy laws in India can vary depending on the specific focus and scope of the study. However, here are some common objectives that researchers might pursue:

Evaluate the effectiveness of existing insolvency and bankruptcy laws in India in achieving

[3] Thomas H. Jackson, The Logic and Limits of Bankruptcy Law (2001).

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their intended goals, such as promoting timely resolution of distressed assets, maximizing asset value, and protecting the interests of creditors and stakeholders.

Compare India's insolvency and bankruptcy laws with those of other jurisdictions, identifying similarities, differences, and best practices. This can help in identifying areas for improvement and international benchmarking.

Investigate the impact of insolvency and bankruptcy laws on the overall economic growth and investment climate in India. This might involve analyzing how these laws influence lending behavior, entrepreneurship, and the efficiency of capital allocation.

(B) Evolution of Insolvency Laws in India

For the stated purpose it is not necessary to examine in detail all the literature relating to the subject and only briefly refer to the German literature as follows:

Mulla and Ravi (2017)[4] provide a detailed history of the insolvency laws existing prior to the passage of the Code.

Datey (2019)[5] states that the code was introduced to overhaul all insolvency legal processes in India.

As mentioned earlier, the Banking Law Reforms Committee (BLRC) has proposed an overhaul of the entire system and the introduction of various new elements such as a new regulator, involvement of insolvency practitioners, etc.

Wahi (2017)[6] explains the insolvency process under the code with respect to legal entities. A petition for declaration of insolvency of a company can be filed only in the National Company Law Tribunal (NCLT).

Three categories of persons can submit such a request:

Operating creditors, i.e. those who have debts for goods sold or services rendered,

Financial creditors, i.e. those who have debts for money provided for the time value of money,

as well as a Corporate Person itself if it finds that it is unable to pay its creditors.

If the application is complete and there is default on the debt, the NCLT will declare the legal entity insolvent. There is an additional requirement for operational creditors that there is no pre-existing dispute regarding the provision of goods or services. The appellate authority for NCLT decisions is the National Company Law Appellate Tribunal (NCLAT) and NCLAT decisions

[4] Sir Dinshah Fardunji Mulla & Aparna Ravi, Mulla on the Law of Insolvency in India (2017
[5] V. S. DATEY, GUIDE TO INSOLVENCY AND BANKRUPTCY CODE (7th Edition 2019 edition ed. 2018)
[6] AJAY KUMAR, CORPORATE INSOLVENCY BEFORE NCLT & NCLAT (2017).

can be challenged in the Supreme Court.

Singh and Shriram (2017)[7] explain that once the NCLT renders a corporate entity insolvent, it issues a moratorium order to stay all further legal action against the insolvent company. Appoints a professional to manage the debtor's company. A professional posts a notice asking for people

who have debts to apply. A Committee of Creditors (COC) is appointed to make major decisions regarding an insolvent entity. Calls are published to resolve plans to repay the debts of the insolvent entity in exchange for the transfer of the insolvent entity to the resolution applicant.

Kumar (2017) further states that if all resolution plans are rejected, the legal entity will be liquidated. The existence of a legal entity ends with the alienation of the legal entity's assets in order to pay off its debts to the maximum extent possible.

When enumerating the principles of the insolvency process, Kolichala (2019) called the above legislation one of the biggest reforms in banking. Mishra and Das (2020) argue that the provisions of the code remove the stigma of personal insolvency and enable the individual debtor to exit a failing business with dignity.

Handa (2020) writes that the acquisition of debt companies under the Code may be more beneficial to investors than through the normal route and may result in greater benefits for investors.

Sukumuran (2021) states that the code established insolvency proceedings that are time-bound and market-linked.

IV. Background of previous legal framework existing in India

Prior to the enactment of the Code, debt recovery and bankruptcy, as well as the initiation of insolvency, were governed by a web of laws in India.[8]

For corporations, the conditions were governed by the Companies Act, 1956. For people living in the territory of the erstwhile Presidency of Calcutta, Bombay and Madras, the governing law was the Presidency Insolvency Act, 1909, while the Interim Insolvency Act, 1920 applied to all others.

In addition to the above, the Sick Industrial Companies (Special Provisions) Act, 1985‖ also applied to industrial companies with 60 months history, whose net worth was nil or negative

[7] Ram Singh & Hiteshkumar Thakkar, Settlements and Resolutions Under the Insolvency and Bankruptcy Code: Assessing the Impact of Covid-19, The Indian Economic Journal 00194662211013218 (2021)

[8] IBBI, Handbook on ―Understanding the IBC: Key Jurisprudence and Practical Considerations‘‘ (2020).

and having 50 or more employees, while provisions for proposing debt restructuring were provided to companies suffering from debt.

The Banks and Financial Institutions Debt Recovery Act of 1993 was also enacted to make it easier to get loans.

The Securitization and Reconstruction of Financial Assets and Recovery of Security Interests Act of 2002 also provided an opportunity for debtors to quickly recover secured assets without court intervention.

In addition to these laws, the Reserve Bank of India also introduced the Corporate Debt Restructuring Scheme (CDR Scheme) which provided guidelines for banks to undertake debt restructuring. Due to the existence of many laws, there were contradictions and overlaps between these laws.

In addition, concurrent proceedings have resulted in conflicting orders and decisions between different authorities in those proceedings. This led to confusion not only for IBBI but also for delays in the proceedings. The average time for debt restructuring and liquidation in India was almost 4.3 years.[9] The old insolvency regime was argued to be ineffective and fraught with delays.[10] The ineffectiveness of previous laws contributed to the increase in market uncertainty.[11]

In 2014, the Banking Law Reform Committee was established to propose improvements to the legislative framework governing bankruptcy. In 2016, the Committee presented a report in which it proposed the overhaul of the entire system and the introduction of various new elements, such as a new regulator, the involvement of insolvency experts, etc.[12]

These recommendations were implemented in the form of a code that entered into force in 2016. The new code introduces a completely new legal structure. It is rightly said to be one of the biggest economic reforms in India.[13]

It establishes the Insolvency and Bankruptcy Board of India (IBBI/Board) as a supervisory body, provides timelines for the process, etc. The main objective of the legislation has been set to rescue the debtor and resolve his debt in a manner that enables it to run as a going concern

[9] WORLD BANK, Doing Business 2016 Measuring Regulatory Quality And Efficiency (2016), available at: http://www.doingbusiness.org/content/dam/doingBusiness/media/ Annual Reports/English/DB16-Full-Report.pdf
[10] JOINT COMMITTEE ON THE INSOLVENCY AND BANKRUPTCY CODE, 2015, Report of the Joint Committee on the Insolvency and Bankruptcy Code, 2015 (2016)
[11] M. S. Sahoo & Anuradha Guru, Indian Insolvency Law, 45 Vikalpa 69–78 (2020).
[12] BANKRUPTCY LAW REFORMS COMMITTEE, The Report of The Bankruptcy Law Reforms Committee (2015)
[13] Datey, Guide to Insolvency and Bankruptcy Code - As amended by Insolvency & Bankruptcy Code (8th Edition August 2019 ed. 2019)

and WORLD BANK, Doing Business 2016 Measuring Regulatory Quality And Efficiency (2016), to prevent the legal death of the debtor. The code has even been compared to a Swachhata drive aimed at eradicating bad debts. However, information disclosed by IBBI shows that only a few cases of corporate debtor debt resolution occur, while in a surprisingly large percentage of cases, the debtor faces dissolution.

It is in this context of the objective of the Code that this study aims to examine and analyze the Code, identify gaps, suggest improvements and compare the laws in India with those existing in foreign countries as specified in terms of suggesting changes to strengthen the Code.

V. CORPORATE INSOLVENCY RESOLUTION PROCESS

The Corporate Insolvency Resolution Process (CIRP) is a key mechanism under the Insolvency and Bankruptcy Code (IBC) in India for resolving insolvency and bankruptcy of corporate entities. Here's an overview of the CIRP:

1. Initiation:

The CIRP is initiated when a corporate debtor defaults on its debt obligations, and a financial creditor, operational creditor, or the corporate debtor itself files an application for insolvency resolution with the National Company Law Tribunal (NCLT).

The NCLT examines the application and, if satisfied, admits it to initiate the CIRP. The admission triggers a moratorium period during which no legal action can be taken against the corporate debtor.

2. Appointment of Interim Resolution Professional (IRP):

Upon admission of the application, the NCLT appoints an Interim Resolution Professional (IRP) to manage the affairs of the corporate debtor during the CIRP.

The IRP takes control of the corporate debtor's assets, constitutes a Committee of Creditors (CoC), and oversees the preparation of a resolution plan for the revival of the company.

3. Moratorium Period:

The CIRP imposes a moratorium period during which creditors are prohibited from initiating or continuing any legal proceedings against the corporate debtor.

The moratorium period aims to provide a conducive environment for negotiating and implementing a resolution plan without external disruptions.

4. Formation of Committee of Creditors (CoC):

The CoC comprises financial creditors of the corporate debtor, who have voting rights

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proportional to their debt claims.

The CoC plays a central role in the CIRP by evaluating resolution plans submitted by prospective resolution applicants and approving a viable plan for implementation.

5. Resolution Plan:

Resolution applicants interested in acquiring the corporate debtor submit resolution plans to the CoC within a specified timeframe.

The resolution plan outlines the proposed restructuring or revival strategy for the corporate debtor, including details of the proposed financial restructuring, operational changes, and management arrangements.

The CoC evaluates the resolution plans based on viability, feasibility, and maximization of value for creditors and selects a preferred plan for implementation.

6. Approval and Implementation:

The CoC votes on the resolution plan, and if approved by a requisite majority (usually 66% of voting share), it is submitted to the NCLT for final approval.

Once approved by the NCLT, the resolution plan becomes binding on all stakeholders, and the corporate debtor's management is transferred to the successful resolution applicant.

The resolution plan is implemented under the supervision of the IRP or a resolution professional appointed by the NCLT to ensure compliance with the approved terms.

7. Liquidation:

If a viable resolution plan cannot be approved within the specified timeframe or if the CoC rejects all submitted plans, the corporate debtor may be subjected to liquidation.

In liquidation, the corporate debtor's assets are sold off, and proceeds are distributed among creditors in accordance with the priority of claims specified under the IBC.

VI. Conclusion

It is clear enough from the above discussion that the introduction of the code has brought about a fundamental change in the relationship of creditor and debtor and the defaulter's paradise has been lost. However, as effective as the Code has been, more work needs to be done to ensure that the interests of all stakeholders are met and that the objectives of the Code are met. The Code classified creditors into different classes and provided for different treatment of different categories of creditors. Although such differential treatment is to some extent justified in view of the different nature of creditors, there is not sufficient protection in the Code to guarantee the

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interests of all creditors. and excessive power has been given to certain categories of creditors, ie financial creditors, as compared to other categories of creditors. This led to the marginalization of the representation of other types of creditors and affected their rights.

It can also be seen that although the law promises better enforcement upon successful resolution, only a small portion of debtors' debts are resolved. This problem is further compounded by non-compliance with deadlines. Therefore, even the rights of the bankrupt entity are not fully protected, because with a large number of debtor corporations that are forced into liquidation, the debtor corporation is at risk of liquidation, in which case their business will cease to operate and, as a result, the employees of the debtor's business will be negatively affected and the economy as a whole.

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