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Bankruptcy Regime: Understanding the Concept and Analyzing the Problems Through History

NEETI GOYAL[1]

ABSTRACT

Bankruptcy Laws in India are in very novice stage. The laws have been enacted but has not been implemented so far. Insolvency and bankruptcy code has been a game changer in terms of stressed corporates while the stressed partnership firms or the individuals who have in extraordinary circumstances lost their businesses had been struggling from the harshness of organized or unorganized financial sector. This article will through some light on the historical legal regime of bankruptcy and the need for a change of law in changing times. The article will give a referring point to the reader in the context of the evolution of the legal regime in India.

Keywords: *Bankruptcy laws, Individual bankruptcy, stressed partnership firms.*

I. INTRODUCTION

For a country to develop there must be good flow of money in every sector. The flow of credit in a economy is equally important. There can be big scale credit generally in corporate sector, which is also the organized sector in terms of recovery of credit. On the other hand there can also be small scale credits, which is less organized in terms of credit.[2] Credit is taken by big cooperate companies and by small households as well. Even the Government supports the system of credit. generally for establishing small scale industries, partnership firms and so on.[3] As no one not even big cooperate or even the State can proceed with huge projects with limited financially resources. Therefore the system of credits helps in achieving the desired project.[4] However the question here arises, "What happens if the party fails to return the credit?" In other

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[1] Author is an Assistant Professor at University of Petroleum and Energy Studies, School of Law, Knowledge Acres, Kandoli, Dehradun, Uttarakhand, India.

[2] By Julia Kagan April 19, 2021 at Investopedia web https://www.investopedia.com/terms/l/loan.asp Last seen at 31 August,2022

[3] loans and advances definition web https://www.lawinsider.com/dictionary/loans-and-advances Last seen at 31 August,2022.

[3] Ibid

[4] *A Concise History of Bankruptcy, Insolvency, and Debt Restructuring Laws in India* Saket Hishikar, Insolvency and Bankruptcy Reforms: The Way Forward, October 15, 2020, Ihttps://doi.org/10.1177/0256090920953988, Volume 45, Issue 2

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words " What happens incase of defaults in credits?

Bankruptcy laws play an vital role. Not only in prescribing the manner in which the credits must be returned but also in economic perspective as well. Bankruptcy laws are the basis of proper dissolution or reshaping a company or any small firm to the limited liability. Moreover it deals with balancing the interest between the two parties (creditor and debtor) and the economy. As it has to balance the interest of the economy as well it includes the Government as well. Making Bankruptcy laws a very sensitive topic.

Failure to pay to pay back credit is not only an issue of the cooperate. Like the most recent on in which Spartech has declared itself insolvent in the court of law.[5] Insolvency has a major impact on the economy. However personal loan has been rising and so the number of defaulters has also been rising. For instance: the Reserve Bank of India (RBI) in its report 'Sectoral Deployment of Bank Credit 2021 to 2022' has declared that the demand for personal loan has grown to an approximate 12.4 per-cent which was only about 10 percent in 2021. [6] However, it is also important to keep in mind that, due to the pandemic the number off unemployment and cut in salary has also forced a large number of people to take up credit in the view to satisfy basic needs.[7] Therefore the research see the above data as not a good sign for the economy but rather a aftermath of the pandemic.

Loan and default in paying back are two issues of the same coin. Personal loan defaulters are rising, there are a number of factors. What happens if a credit become default? Insolvency is the best feasible and effective method of recovery of debts due. The advantage of debtor filing insolvency is, that the debtor is in a position of control in the process of resolution. Moreover it is manner in which the recovery is made in a structured and statutory means during such crises.[8]

There are two types of insolvency:

1. Personal insolvency: Generally personal credit are picked up by smaller scale business, partnership, smaller vendor, agriculture sector and individuals. However, due to various factors, such as unemployment, failure in business an so on, they become defaulter's.[9] In the entire researcher is bringing a light on personal insolvency,

[5] Supertech stares at insolvency amid heat of twin-tower demolition, Business Standards, Last Updated at April 23, 2022.

[6] Struggling with debt? Here is how individual insolvency works in India,The Economic Times, May 23, 2022,

[7] Ibid 6

[8] Ibid6

[9] Individual insolvency for the poor on the back burner, focus now on toxic asset resolution, Banikinkar Pattanayak April 18, 2022, https://www.financialexpress.com/industry/individual-insolvency-for-the-poor-on-the-back-burner/2494283/, **last visted on September 25,2022.**

2. Cooperate insolvency: As it is stated " bigger the profit bigger the risk" this phrase would be suitable for big cooperate companies.[10] Cooperate companies take up big credit from Banks and try to run a business but many a time they also become bankrupt and declare insolvency. Cooperate insolvency is one of the most organcsed sector under Bankruptcy laws. [11]

From the above one can understand that. In terms of legal and economic term "Bankruptcy" can be understood as *"a cost associated with filing for bankruptcy based on injury to reputation or violation of moral standards."*[12] From the above line ne can understand that, Bankruptcy is equivalent to financial stress which can either be used as an attempt to rescue an insolvent company in case of corporate insolvency or it can lead to complete monetary break down as in case of personal insolvency. Such the Farmer Suicide.[13]Therefore laws on insolvency and bankruptcy is not only economical sensitive but political as well as emotional sensitive.[14]

II. SOME IMPORTANT TERMINOLOGY

Some important terms that will be used in the entire research work:

I. *Creditor:* A creditor is the institution such as bank, which gives money to the party in need. Is called a creditor.[15] According to the Section 10 of the Act the term "creditor" means "any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor and a decree holder "[16]

II. *Debtor:* The party that receives the amount of money from the creditor. Is called Debtor.[17]

III. *Principle amount:* The Amount of money that agreed by the creditor to give to debtor.[18]

IV. *Interest:* The fixed amount of money that is added to the Principle amount. Which the Lending institution receives is called Interest.[19]

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[10] Ketan Gaur and Anirudh Krishnaa, India: Personal Guarantors Under The Insolvency And Bankruptcy Code, 2016 – The Road Ahead, MONDAQ, https://www.mondaq.com/india/insolvencybankruptcy/1077658/personal-guarantors-under-the-insolvency-and-bankruptcy-code-2016-the-road-ahead last visted on September 25,2022.
[11] Hamish Anderson, An Introduction to Corporate Insolvency Law, 8 PLYMOUTH LAW & CRIMINAL JUSTICE REVIEW 16 (2016)
[12] Rafael Efrat, The Evolution of Bankruptcy Stigma, 7 THEORETICAL INQUIRIES IN LAW 365 (2006)
[13] Robert I. Sutton & Anita L. Callahan, The Stigma of Bankruptcy: Spoiled Organisational Image and its Management, 30 ACADEMY OF MANAGEMENT JOURNAL 405, 416 (1987).
[14] Ibid 11
[15] *SupraNote at* 2
[16] THE INSOLVENCY AND BANKRUPTCY CODE, 2016 NO. 31 OF 2016
[17] *Ibid* 6
[18] *Ibid* 6
[19] *Ibid* 6

V. *Tenure:* The time period within which the Debtor has to pay back the borrowed amount of money to the creditor.[20]

VI. *Insolvency:* Insolvency means, when the debtor is in a sate of financial crises. In which the debtor is unable to pay back their loans. This leads to insolvent proceedings. In which legal action is taken against the debtor and the asset of that person entity may be liquated in order to pay of the outstanding amount.[21]

III. Bankruptcy laws in India during British rule

Bankruptcy laws haven't evolved during the British era. There are many arguments that laws on bankruptcy and insolvency are more than 2000 years old. They lay their argument that the modern concept of Bankruptcy and insolvency principles can be found in various *Smriti.* [22]

However, during the British rule laws on Bankruptcy and insolvency, become more a byproduct of common law traditions.[23] During the British rule, a creditor could only recover dues of personal loan, by filing recovery suit in the court of law under the following two laws:[24]

1. Presidency Towns Insolvency Act, 1909: it is only applicable to the Presidency Town i.e Calcutta, Bombay and Madras.[25]
2. The Provincial Insolvency Act, 1920: However, the Provincial Insolvency Act, 1920 is applicable to whole of India accept the towns mentioned under Preidency Town Act 1909 . [26]

The above two Acts are similar in their body. They are only split by geographical landmass.[27]

IV. Bankruptcy laws after Independence of India

In 1947, when the British left. India was like a newborn baby. It had to either adopt the old laws made during the British era or enact new laws. In the same way it had to constitute its own constitution, and unlike insolvency there were a number of other important topics to be enacted and discussed upon. However, the founders of the constitution were aware of the importance of "Insolvency and Bankruptcy laws." Therefore, they covered insolvency and Bankruptcy in the

[20] *Ibid* 6
[21] Ibid6
[22] Supra 1 Note@ 3
[23] Ibid22
[24] Ibid 22
[25] The Individual Insolvency Framework of India by Darshana Rajendran, June 3, 2012 https://www.dvara.com/research/blog/2012/06/03/the-individual-insolvency-framework-in-india/ last visited on September 25,2022
[26] Ibid25
[27] Ibid 25

schedule 7 of the constitution. The 7th Schedule is the related to the matters of the concurrent list. In it both the State Government and the Central Government are allowed to develop laws.[28]

Before we go through the legal developments in the laws of Insolvency and bankruptcy. It is important to understand. That during the first few years of independence the government of India, was had a very different vision and different problems to tackle first. For example one such issue was *"How to make India a self-efficient country."* Therefore, the researcher would like to this period as the development of a newborn Country.[29]

During the period of 1947 to 1980, the Government of the country was more focused on reducing of disparity among different section of the society. this can be analyzed from its policies. Therefore, a was adopted. For instance, it was more concerned on labor-intensive industrialization sponsored by the public sector enterprises. Foreign capital investment was discouraged and government's control on the key sectors was considered essential. During that period the control was so strong that with the help of Industries Development and Regulation Act, 1951, the Government was the sole who could decide *'who can produce what'*.[30] As a result, any one who wanted to start an industrial production, would had to first obtain license from the state. The free economy market was restricted and only a limited numbers of private players enjoyed monopoly.[31] As a result this lead to imbalance in distribution of resources and most importantly these units were making losses and their net worth eroded eventually. By 1960, an alternative economic policy began to become visible. However, this lingered on till 1990, when India was hit with crises. As the 'Balance of Payment' was heavily impacted. Due to the environment of monopoly and favoritism by the Government.[32]

The researcher would like to divide the developments in the regulatory and legal framework for dealing with personnel insolvency and bankruptcy into the following parts:

i. *Between the year 1947 and 1990:*

There was no major change till 1985, in dealing the personal bankruptcy. In other words, Personal bankruptcy were governed by the same two laws like they did during the British rule.[33] Which are as follow:

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[28] Constitution of India
[29] *Ibid28*
[30] Mehta, V. (1964). Economic implications of democratic socialism some reflections on the Indian economic conference, The Economic Weekly, (January 25, 1964). Patwari, S. (2014). Voluntary winding up in India - A comparative analysis, available at SSRN: http:// ssrn.com/abstract=2377165.
[31] *Ibid 30*
[32] *Ibid 30*
[33] The Indian Insolvency and Bankruptcy Bill: Sixty Years in the Making, https://www.iimidr.ac.in/wp-content/uploads/Vol8-1-TIIBB.pdf, last visited on October 12, 2022.

a. The Presidency Towns Insolvency Act, 1909.[34]

b. The Provisional Insolvency Act, 1920.[35]

ii. From 1990 till 2010

The Government enacted a new law *' Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) in 2002.'*[36] The Act provides a legal mechanism for expedited recovery of secured assets through, Banks and Financial Institutions. In order to recover their non-performing assets without intervention of the court. Though SARFAESI did expedite the recovery process to some extent. However, it lacked in powers for considering restructuring and reorganization.[37]

iii. After 2010:

By 2010, it had become clear to the government that, a single, comprehensive framework is needed to effectively tackle delay in bankruptcy proceedings. This reform was initiated by setting up a *' Financial Sector Legislative Reforms Commission.'* This commission was led by Justice Sri Krishna in 2011.[38] However, by 2014 the Ministry of Finance constituted,' *the Bankruptcy Legislative Reforms Committee,'* led by T. K. Viswanathan. This committee submitted a report of two volume in 2015. In the first volume the "The economic rationale and design features of a new legislative framework" was covered [39] and in the second volume it was discussed about " the draft of the bill."[40]

Note: the researcher only covered the development of the individual bankruptcy laws. It did not mention any thing about the cooperate insolvency law. Yet the researcher would like to comment that, the government from 1947 till yet was only concerned with the development of Bankruptcy laws for the cooperate framework. However, it somewhere completely ignored the development of bankruptcy laws at individual level.[41]

V. THE CURRENT LAW ON BANKRUPTCY AND INSOLVENCY

The Parliament in 2016 passed the Insolvency and Bankruptcy Code (IBC). The purpose of the code is to have a comprehensive law on bankruptcy. It would cover both provisions of

[34] *Ibid 33.*
[35] *Ibid 33.*
[36] *Ibid 33.*
[37] *Ibid 33.*
[38] Ravi, A. (2015). The Indian insolvency regime in practice: An analysis of insolvency and debt recovery proceedings, IGIDR (WP-2015-027).
[39] *Ibid 38.*
[40] *Ibid38.*
[41] Supra 3 Note@ 25

insolvency i.e., corporate, and personal insolvency. As we are aware from the above developments. That India never had a modern insolvency regime. Which would cover incentive complaints being led by market-led, and time-bound.[42] The new law laid down the following basic requirement:

a) Infrastructure had to be created.[43]

b) Capacity had to be built.[44]

c) Professions had to be developed[45].

d) Markets and practices had to develop.[46]

e) Stakeholders had to be aware of the Code.[47]

the IBC is the onset of a new start; therefore, it plays a vital role in the evolution of economic reform in India. As it not only covers laws for corporate debtors but also partnership firms, and individuals. [48] However, the provision in in the code were enacted in different times. For instance, according to the code the provision in relation to cooperate insolvency became effective from 1st December, 2016. Whereas the provision dealing with personal guarantors to the corporate debtor came into effect from 1st December 2019. [49] Both problems with cooperate insolvency and personal insolvency are equally important. However provisions which deal with insolvency and bankruptcy of individuals and partnership firms has not come into force yet.[50]

From the enactment of this code till 2020, it has already rescued about 250 such firms through resolution plans, one third of which were in deep distress. However, it has referred 955 firms for liquidation.[51] From the above data it is clear that the main objective of the Code is to safe firms from complete distress and bring new life to them. The researcher is of the opinion that a lot have been development in the field of bankruptcy in cooperate sector. however, it is high time for the government to lay eyes on bankruptcy in personal sector as well. As it is mentioned in the Code that it covers both path of bankruptcy. The researcher question, where is the part

[42] The Insolvency and Bankruptcy Code, 2016 NO. 31 OF 2016

[43] Understanding the IBC: Key Jurisprudential and Practical Considerations, INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, 18 https://www.ibbi.gov.in/uploads/publication/e42fddce80e99d28b683a7e21c81110e.pdf.

[44] *Ibid 43.*

[45] *Ibid 43.*

[46] *Ibid 43.*

[47] *Ibid 43.*

[48] *Ibid 43.*

[49] *Ibid 42.*

[50] *Ibid 43*

[51] Insolvency and Bankruptcy Regime in India A Narrative, 2020 Insolvency and Bankruptcy Board of India 7th Floor, Mayur Bhawan, Connaught Circus, New Delhi.

for Personal Insolvency? As the pressure is rising with time in the credit market. [52] For instance, personal guarantors for companies, which fall under cooperate bankruptcy. Become pray for creditor to act against them. The distress in the agriculture sector also indicates a serious concern. Moreover, in the sector small scale in Industries and medium, small and micro enterprises, which are a part of the economic development are also facing distress. Therefore it is important that laws on individual bankruptcy should also be upheld. [53]

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[52]Anagol, Santosh, Shawn Cole, and Shayak Sarkar (2017). "Understanding the advice of commissions-motivated agents: Evidence from the Indian life insurance market". In: Review of Economics and Statistics 9
[53] Banerjee, Abhijeet and Esther Duflo (2014). "Do Firms Want to Borrow More? Testing Credit Constraints Using a Directed Lending Program". In: Review of Economic Studies

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