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Revival and Restructuring of Sick Companies

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ABSTRACT

"Business failures, including the corporate bankruptcy phenomenon, are sobering economic realities reflecting the uniqueness of corporate death." It is the harsh reality that in the competitive market, some enterprises will fail to survive. In India, industrial disease has increased in both the large and small industries. Reassuring oneself that this is, in part, a byproduct of industrial expansion, does not lessen the gravity of the issue. However, there are measures which can be helpful for an enterprise to take its own stand in today's economy. Corporate restructuring is a way to revive sick organizations. Due to its numerous benefits, such as enhanced corporate performance and stronger corporate governance, it has long- lasting impacts on the company. The paper highlights the historical background of corporate restructuring. The aim of this paper is to understand the legislations governing the revival of enterprises in India.

***Keywords**: Corporate Restructuring, company, market, economy, bankruptcy.*

I. INTRODUCTION

Industrial sickness, particularly in smaller settings industry has always been detrimental to the Indian economy as it is affecting a growing number of sectors, such minor steel, engineering, cotton, jute, sugar, and textiles. The industrial economy is collapsing due in part to loss-making industries in both the public and private sectors. In India, industrial disease has increased in both the large and small industries. Reassuring oneself that this is, in part, a byproduct of industrial expansion, does not lessen the gravity of the issue. In addition to having an impact on creditors, owners, and workers, industrial illness also wastes resources and fuels societal unrest. Therefore, it is seen to be crucial to develop appropriate protocols for handling sick units and to set up appropriate systems for early detection of industrial illness signs to take preventative action.

(A) Corporate Restructuring

Corporate restructuring is the process of altering a company's organizational structure. Corporate restructuring can entail drastically altering a company by merging or eliminating

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units. It entails reorganizing the company to boost productivity and profitability. It is a thorough procedure that enables a corporation to streamline processes, fortify its position in the market, achieve corporate goals, create synergies, and maintain its status as a successful, competitive enterprise. Corporate restructuring's scope includes increasing profitability and economy through cost reduction and efficiency improvements. A corporation must rebuild itself and concentrate on its competitive advantage if it is to expand or endure in a cutthroat market.

II. Historical background of corporate restructuring

Debtors who were unable to pay their debts in Ancient Greece were treated as slaves by their creditors, who also gained authority over all of their personal belongings. Even though some jurisdictions provided protection from physical abuse of debt slaves for a maximum of five years, this did not ensure that repressive behaviour towards creditors or their slaves would be regulated.[2] Manu, in ancient India, stipulates that the creditor has every right to reclaim the assets he lent to the debtor. During those days, fasting or sitting on 'a dharna' was also common practice. In Rome, the old proverb, "He who cannot pay with his purse pays with his skin," was literally applied. The creditor may arrest the debtor and turn him into a slave, execute him, or sell him to foreigners after three demands for payment and sixty days to make the payment.

The term 'bankruptcy' comes from the old Italian phrase "banca rotta," which meant that a trader's bench was broken when he could not pay his creditors. "This is the most frequently accepted explanation for the genesis of bankruptcy in both France and Italy."[3]

The first bankruptcy law was passed in England in 1542, during Henry VII's reign. A bankrupt person was then regarded as a criminal and was punishable by law, which might include anything from a lengthy stay in debtors' jail to the death penalty. He enacted legislation that nullified the practice of his forebears sending them to special debtor's jails, which quickly reached capacity. In 1570, Queen Elizabeth I developed a complex bankruptcy law in England that became the model for several colonies implementing similar laws in their own jurisdictions.

"The legislative branch's Article I grants the United States the authority to make "uniform laws about bankruptcy" following its independence."[4] The United States initially changed its bankruptcy laws in 1800, essentially copying an English statute that would later become the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCA), which was passed in 2005. It has now become one of the world's most sophisticated bankruptcy legal systems.

[2] A Brief History of Bankruptcy, available at http://www.bankruptcydata.com/Ch11History.html (April 14, 2024)
[3] Heather Whipps, The History of Bankruptcy: Dungeons, Slavery and Executions, available at http://www.livescience.com/3629-history-bankruptcy-dungeons-slavery-executions.html (April 14, 2024).
[4] US CONSTI. Art. I, δ 8. cl. 4.

India’s bankruptcy rules, like most of the other legislation, are a British legacy. “Prior to the arrival of the British, there was no native law.”[5] The Government of India Act, 1800, as well as a number of other enactments, established the framework for Indian bankruptcy law. But it took us almost 70 years to recognize that we needed a thorough bankruptcy code.

Corporate restructuring operations are anticipated to take place on a far larger scale than in the past due to the economy's trend towards globalization and growing competitiveness. Corporate restructuring is essential for businesses to attain economies of scale, worldwide competitiveness, appropriate size, as well as several additional advantages, such as lower operating and administrative costs.

(A) Symptoms of Sickness in Companies

Identification of illness requires prompt response. To do this, we must examine the symptoms, which will enable us to determine the unit's illness. The signals that the sick units display can be used to track this. Financial distress can manifest as a variety of symptoms, such as short-term liquidity issues, revenue losses, operating losses, and an excessive reliance on external credit until the company reaches a point where it is overextended in debt and unable to raise the necessary capital to pay its debts. When dividends are ignored and the share price falls precipitously, it is considered an illness signal for large units whose shares are traded on stock markets. Thus, this metric will need to be applied extremely carefully in conjunction with other distinguishable symptoms to determine whether missing dividends is a sign of illness or merely a brief decline in financial performance.[6] These indicators and symptoms give rise to suspicions that the involved industrial unit is prone to illness.

III. Laws governing the Revival of Sick Companies

1. Sick Industrial Companies Act, 1985
2. The Companies, Act, 2013
3. The Insolvency and Bankruptcy Code

1. Sick Industrial Companies Act, 1985

The Industrial Reconstruction Corporation of India (IRCI) was established by the Indian government in the 1980s to give sick units financial support so they might resurrect under their pre-existing framework. Later, to perform the same role in a different capacity, it was renamed

[5] MULLA LAW ON INSOLVENCY LAW IN INDIA (1958), pp. 1-2.
[6] Dholakia H Bakul, Industrial Sickness in India: Weed for Comprehensive Identification Criteria. Available at: http://www.vikalpa.com/pdf/articles/1989/1989_apr_jun_19_24.pdf, (April 20, 2024)

The Industrial Reconstruction Bank of India (IRBI). After more transformation, this is now known as The Industrial Investment Bank of India (IIBI), and it is no longer obligated to provide funding for the struggling industries. Following the outbreak of illness in the nation's industrial climate throughout the 1980s, the Indian government established a Committee of Experts in 1981, chaired by Shri T. Tiwari, to investigate the issue and suggest appropriate solutions. In accordance with the Committee's recommendations, the Government of India passed the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986), also referred to as the SICA, as special law.

Supreme court in *Namit R Kamani v. R.R. Kamani (1988)*[7] had explained the object of SICA as "(a) affording maximum protection to employment (b) optimising the use of funds and available production assets (c) realising amounts due to banks, institutions, creditors and (d) providing efficient authority consisting of experts for expeditious determination of measures to avoid time consuming procedures".[8]

a) **Board of Industrial and Financial Reconstruction (Section 15)**

When an industrial company becomes ill, its Board of Directors must refer the matter to the Board (BIFR) for guidance on the appropriate course of action within 60 days of the completion of the properly audited financial statements for the fiscal year in question adopted considering the business. If the Board of Directors had sufficient grounds, even prior to such finalization, to believe that the company had turned into a sick unit, the Board of Directors shall, within sixty days of such belief, refer the matter to the Board for decision-making regarding the appropriate course of action for the company.

Moreover, if an industrial company has a valid reason for becoming ill, the Central Government, Reserve Bank, State Government, public financial institution, State level institution, or scheduled bank may refer the matter to the Board for the purpose of determining what steps should be taken shall be enacted regarding the business. Nonetheless, any industrial project located alone in such a state may be mentioned by the State Government. In a similar vein, a public financial institution, a state-level institution, or a scheduled bank may only provide a reference if it has given financial assistance, fulfilled an obligation, or taken an undertaking about the referenced company.

When financial assets are bought by any securitization business or after the Securitization and

[7] Namit R Kamani v. R.R. Kamani (1988) 4 SCC 387 (1989) 2 Comp LJ 391/AIR 1989 SC 9/(1989) 66 Comp Cas 132(SC)
[8] *Ibd.*

Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, no reference to the Board for Industrial and Financial Reconstruction shall be made rebuilding business in accordance with that Act's section 5 subclause (1).

"With effect from December 1, 2016, the SICA has been repealed by the Sick Industrial Companies (Special Provisions) Repeal Act, 2003 ("Repeal Act"). This has resulted in the dissolution of the BIFR and other bodies formed under the SICA."[9]

2. The Companies Act, 2013

The Ministry of Corporate Affairs, Government of India, constituted the 'J J Irani Committee' to draft amendments to the company law framework. It put up ambitious plans to change the winding up and liquidation process, enhancing shareholder rights, and creditors, etc. It went undiscovered until after the Satyam Scam in 2009, at which point the government became aware of it and drafted the new Companies Bill, 2009. The Companies Act, 2013 provided a concrete legal framework for these recommendations in 2013.

Chapter XX (Sections 270 to) of the 2013 Act lays down the provisions for the revival and rehabilitation of sick companies.

a) Winding Up:

The process of concluding a company's existence and allocating its assets to its creditors and members is known as winding up. After being appointed, an administrator known as a "liquidator" seizes control of the business, gathers its assets, settles its bills and then allots any remaining funds to each member in line with their individual entitlements.

Winding up is the process of dissolving a corporation by paying off all of its debts and liabilities, collecting its assets, returning any significant goods to the creditors, and returning any contributions made by the members. Thus, we might define winding up as the process of ending a company's existence. The remaining surplus of the business is then divided among the members in line with their rights. Another name for it is liquidation.

b) Modes of Winding Up:

The Companies Act of 2013 can only be used to wind up a corporation by the Tribunal as of the enactment of the Insolvency and Bankruptcy Code, 2016. The old definition of voluntarily winding up has been eliminated. The term "winding up" refers to winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable, as defined by

[9] Ministry of Finance, Notification No. S.O. 3568(E), dated November 25, 2016, available at http://www.egazette.nic.in/WriteReadData/2016/172799.pdf

Section 2(94A), as amended by the Insolvency and Bankruptcy Code. The Act's Chapter XX has measures for winding up businesses.

Tribunal winding up may be mandated in situations covered by section 271. Should any of the individuals specified in section 272 submit an application, the Tribunal will issue an order for winding up.

Section 271 provides for circumstances in which a company may be wound up by Tribunal. The section reads:

"A company may be wound up by the Tribunal—

(a) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(b) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

(c) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

(d) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

(e) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up."

Two of the grounds for winding up by the Tribunal - Inability to pay debt and winding up under Chapter XIX of the Act - have been deleted with the passing of Insolvency and Bankruptcy Code.

The corporation may decide by special resolution that the Tribunal may wind it up under section 271 (a). There could be any reason whatever may lead to the resolution's passage. "The Tribunal must, however, ensure that the winding up does not conflict with the public interest or the overall company's interest."[10] "When a firm experiences loss that prompt it to approve a special resolution for winding up, the court Tribunal must also consider the likelihood or

[10] B. Viswanathan v. Seshasayee Paper and Boards Ltd. [1992] 73 Comp. Cas. 136 (Mad.).

potential for the company to experience a financial revival."[11] This clause is predicated on the idea that, absent unusual circumstances, the shareholders are the best arbiters of whether the company ought to cease operations. The shareholders have the authority to dissolve the corporation as they are the ones who created it. A winding up petition cannot be filed by the directors without the general meeting's approval. The directors may, of course, submit such a petition, provided that the general assembly approves of their decision.

It is noteworthy that the Tribunal, has discretion over the situation and is not required to order winding up just because the corporation has decided to do so. In Section 271, the word "may" indicate that Tribunal has the authority to make decisions on their own discretion. Furthermore, it should be noted that the company's ability to file the winding up petition is based on more than only the basis specified in section 271(b)— namely, the adopting of a special resolution. Without requiring a special resolution, a company may submit such petition on further grounds listed in Section 271.

As per section **271(c)** of the Companies Act, 2013, "The Registrar or any other person authorized by the Central Government may make application to the Tribunal for winding up. On such an application, the Tribunal may order winding up on the following grounds:

(*i*) The affairs of the company are being conducted in a fraudulent manner; or

(*ii*) The company was formed for **fraudulent or unlawful purpose**; or

(*iii*) The persons concerned in the formation of the company or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith.

It should be noted that the Tribunal may only take action under subclause (e) upon request from the Registrar or another person designated by the Central Government for the purposes listed in that subclause. Noteworthy is the fact that under section 213(b). The Tribunal has the authority to order an investigation into a company's operations for the reasons listed above, which are comparable to the previously stated subclause (e). The Central Government may petition the Tribunal under section 224(2)(a) to wound up the corporation on the grounds specified under.

A ground of **winding up for failing to file financial statements or annual returns is provided by Section 271(d).** It is a positive aspect that there is indiscipline and lack of accountability in managing the company is pervasive and long-standing, and government enterprises are not an exception. It is unclear, though, how much the threat of being wound up will deter corporate management from acting wildly irresponsibly in this area. In particular, the five years in a row

[11] Advance Television Network Ltd. v. ROC [2011] 108 SCL 702 (Delhi)

is too long to really jeopardize the company's capacity to remain viable.

Under **section 271(e), if the Tribunal determines that it is fair and reasonable for the firm to be wound up, it may also issue an order** for its winding up. This is a distinct and independent basis for a winding up order and the establishment of a case under. Therefore, it is not required that the conditions be the same as those that support an order based on one of the other six particular grounds.

3. The Insolvency and Bankruptcy Code, 2019

There was no unified law in the nation that addressed insolvency and bankruptcy prior to the passage of the Insolvency and Bankruptcy Code. In India, there were several laws that overlapped and several adjudicating bodies that dealt with the financial failure and insolvency of both individuals and organizations. The bankruptcy and insolvency framework were insufficient, ineffectual, and caused unjustified delays in the resolution process. The Indian credit system is being unduly burdened by the legislative and institutional framework, which failed to assist lenders in efficiently and promptly recovering or restructuring defaulted assets. The Insolvency and Bankruptcy Code aims to expeditiously consolidate and modify the legislation concerning the reorganization and insolvency resolution of individuals, partnership partnerships, and corporate entities. The Supreme Court upheld the constitutionality of the IBC and observed that "the foremost and primary objective of the IBC is the reorganization and insolvency resolution of the CD in a timebound manner."[12]

In addition to promoting entrepreneurship, an efficient legal framework for the prompt settlement of insolvency and bankruptcy will also make doing business easier, attract more investment, and promote economic growth and development. The Insolvency and Bankruptcy Code of 2016 establishes a single bankruptcy and insolvency law, thereby unifying the previous framework. Companies, partnerships, limited liability partnerships, individuals, and any other body that the central government may designate are all covered by the Code.

The NCLAT observed that "the first order objective of the IBC is resolution, the second order objective is maximization of the value of assets of the firm, and the third order objectives are promoting entrepreneurship, availability of credit, and balancing the interests of stakeholders. This order of objectives is sacrosanct."[13]

The Insolvency and Bankruptcy Code (IBC) offers the Corporate Insolvency Resolution Process (CIRP) procedure as a means of resolving a Corporate Debtor's (CD) insolvency. Aside

[12] Swiss Ribbons Private Limited and Another Vs. Union of India and Others [(2019) 4 SCC 17]
[13] Binani Industries Ltd Vs. Bank of Baroda & Another (CA (AT) (Ins) 82/2018 & Others)

from voluntary liquidations, which are only applicable in the absence of a default in direct CD liquidation is prohibited under the IBC from occurring in the event of any debt being paid by the CD. This is not the case with the old system of winding up under the Companies Act, 1956, or the amended Companies Act, 2013, which did not provide a resolution procedure prior to a company's winding up. According to the IBC framework, a creditor of the CD or the CD itself may apply to the jurisdictional authority to start a CIRP in the event that the CD defaults on an obligation.

Part II of the Insolvency and Bankruptcy Code, 2016 lays down the following two stages:

1. Corporate Insolvency Resolution Process [Sections 6 to 32] and
2. Liquidation [Sections 33 to 54 and Section 59]

1. Initiation of CIRP

Sections 12 to 32 of the Insolvency and Bankruptcy Code, 2016 outline the steps involved in the Corporate Insolvency Resolution Process after it is started. It is a time-bound procedure designed to enable an expedient resolution of insolvency, either by liquidation or by bringing the company back to life.

A uniform framework for insolvency resolution and bankruptcy proceedings of partnerships, corporations, and individuals is offered by the code. The primary goal of the Code is to balance the interests of stakeholders by promoting entrepreneurship and facilitating loan accessibility. The clause of the code stipulates that an operational creditor, the corporate debtor itself, or a financial creditor may commence legal action in circumstances such as default in debt payments.

When the Interim Resolution Professional assumes command of the corporate debtor management, the directors' authority is suspended. The Interim Resolution Professional invites claims from creditors and conducts a comprehensive inquiry into the corporate debtor's financial problems. The committee established by the creditors, often referred to as the Committee of Creditors (CoC), is in charge of making decisions regarding the resolution process. In the event that a viable resolution plan cannot be identified, the CoC may choose to liquidate the corporate debtor or adopt a resolution plan put forth by a resolution applicant.

The CIRP procedure has a **330-day** maximum deadline for completion, including any NCLT-granted extensions. According to a predetermined priority sequence, the creditors will get a portion of the revenues from the sale of the corporate debtor's assets, according to the Code. In general, the CIRP procedure offers a clear and effective method for resolving corporate

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insolvency in India, which is advantageous to all parties involved, including shareholders, creditors, and staff.

2. Liquidation Process

The liquidation procedure will begin if creditors or NCLT reject a company that is undergoing CIRP and its resolution plan. In such a scenario, the business is liquidated and the proceeds from the sale of its assets are used to pay off the creditors' outstanding debt.

The Insolvency and Bankruptcy Code of 2016 and its implementing rules and regulations regulate the CIRP liquidation process.[14] The steps in the liquidation procedure are as follows:

- Appointment of Liquidator: The NCLT selects a liquidator to manage the company's affairs during the liquidation procedure. The company's assets are taken over by the liquidator, who also starts the process of selling them to pay off the creditors.
- Asset List Preparation: The liquidator compiles a list of the company's assets and sends it to the NCLT. All of the company's mobile and immovable assets, such as buildings, machinery, inventory, and land, are listed on the asset list.
- Sale of Assets: In order to pay off the outstanding debt owing to the creditors, the liquidator starts the process of selling the company's assets. Either a private sale or a public auction is used to sell the assets.
- Distribution of Sale Proceeds: Following the sale of the assets, the proceeds are divided among the creditors in line with the 2016 Code's established order of precedence. Priority over the proceeds goes to secured creditors, then workmen's compensation and unpaid employee debt.
- Closure of the Liquidation procedure: The liquidator notifies the NCLT that the liquidation procedure is over after all of the company's assets have been sold and the proceeds have been divided among the creditors. After then, the NCLT gives an order to end the liquidation procedure.

Financial creditors evaluate the feasibility of the debtor’s business and the possibilities for its resuscitation and rehabilitation throughout the corporate bankruptcy resolution procedure. The debtor's business goes through the liquidation procedure if the corporate insolvency resolution process is unsuccessful or if the financial creditors determine that the debtor’s firm should be wound up because it cannot be operated profitably.

[14] Insolvency and Bankruptcy Code, 2016 (IBC), ss 33-54; Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, reg 3.

During the liquidation process, the liquidator realizes and distributes the debtor's assets in compliance with the 2016 Insolvency and Bankruptcy Code.

IV. CONCLUSION

A great number of businesses involved in a variety of economic activities make up an economy. Depending on the nature of their business, every company aspires to compete with other companies in the same industry. To make money, they employ product improvements or marketing techniques a competitive benefit. A well-functioning market will naturally push out participants who are unable to uphold industry norms. "The rule that governs the market domain is "survival of the fittest," which states that only those who can effectively compete will survive."[15]

Industrial disease is an issue that affects all economies, regardless of size. The development of an appropriate institutional and regulatory framework to address the problem is crucial. The new strategy should include a proper exit process for the non-viable units in addition to a mechanism to protect workers' interests. Additionally, a strict procedure should be developed to prevent the company's directors from deceiving the unit in order to classify it as sick. The primary goal is to avoid issues with creditor cooperation. Additionally, it must foster efficiency in the debtor-creditor relationship both ex-antes, or when the debtor is solvent, and ex-post, or after the debtor has already become bankrupt. The laws governing such corporate reorganization should not be burdensome and bogged down in red tape and bureaucratic red tape, but rather simple and helpful.

(A) Recommendation

1. The main tool available to policymakers for bringing about social change in a peaceful manner is legal reform. Similar to how a functional judiciary is essential to the long-term health of an economy, the government should pledge to uphold private property rights in order to attract investors.
2. While reminding the proverb "look before you leap", multinational mangers participating in an overseas acquisition process should gain better information relating to host country institutional environment, local political party influence, government administration, and economic and financial markets policies and performance. Further recommended that collaboration, networking, and alliances with project consultants typically aid in gaining a deeper comprehension of the business climate in the nation of

[15] M. White, The Corporate Bankruptcy Decision, 3 Journal of Economic Perspectives, (1983), 129.

host. Stated differently, the legal framework of a nation plays a critical role in the operations of its businesses, and managers must devote a great deal of time to overseeing it.

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