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## OVERVIEW OF INSOLVENCY LAWS IN INDIA INCLUDING CORPORATE INSOLVENCY



### **CA Rajkumar S. Adukia**

B. Com (Hons.), FCA, ACS, ACMA, LL.B,  
M.B.A, Dip IFRS (UK), Dip LL & LW,  
DIPR, Dip in Criminology  
Mob: 9820061049  
Email: [rajkumarradukia@caaa.in](mailto:rajkumarradukia@caaa.in)

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## 1. INTRODUCTION

Insolvency is when an individual, corporation, or other organization cannot meet its financial obligations for paying debts as they are due. Insolvency can occur when certain things happen, some of which may include: poor cash management, increase in cash expenses, or decrease in cash flow.

A finding of insolvency is important, as specific rights are enabled for the creditor to exercise against the insolvent individual or organization. For example, outstanding debts may be paid off by liquidating assets of the insolvent party. Prior to proceedings, it is common for the insolvent entity to meet with the creditor in order to attempt to arrange an alternative payment method.

It is possible that a business may be "insolvent" in cash flow, yet still solvent on the balance sheet. These cases may involve illiquid assets, which help the balance sheet's solvency but not the cash flows. This can also work the other way around with negative net assets (balance sheet insolvency), yet a positive cash flow. In this case, the flow of cash is simply enough to pay off debts, despite the fact that the business has more liabilities than assets.

Bankruptcy is not exactly the same as insolvency. Technically, bankruptcy occurs when a court has determined insolvency, and given legal orders for it to be resolved. Bankruptcy is a determination of insolvency made by a court of law with resulting legal orders intended to resolve the insolvency.

Insolvency describes a situation where the debtor is unable to meet his/her obligations. Bankruptcy is a legal maneuver in which an insolvent debtor seeks relief.

The main reasons behind insolvency are primarily poor management and financial constraints. This is much more prevalent in smaller companies. Specifically, the reasons are:

- Market – Company did not recognize the need for change
- Bad debts – obviously money owed by customers
- Management – failure to acquire adequate skills, imprudent accounting, lack of information systems
- Finance – loss of long term finance, over gearing or lack of cash flow
- Knock on effect – i.e. from other insolvencies
- Other – for example excessive overheads etc.

## Overview of Insolvency Laws in India by Rajkumar S. Adukia

It is however observed that the larger the company, the better the chance of survival and of receiving remedial treatment and of paying creditors.

## **2. ORIGIN AND NEED OF INSOLVENCY LAWS**

The principal focus of modern insolvency legislation and business debt restructuring practices is not the liquidation and elimination of insolvent entities but on the remodeling of the financial and organizational structure of debtors experiencing financial distress so as to permit the rehabilitation and continuation of their business. In some jurisdictions, it is an offence under the insolvency laws for a corporation to continue in business while insolvent. In others (like the United States with its Chapter 11 provisions), the business may continue under a declared protective arrangement while alternative options to achieve recovery are worked out.

Ultimately the basic objective of insolvency laws is the distribution of the effects of a debtor in the most expeditious, equal and economical mode and liberation of his person from the demands of his creditors when he has made a full surrender of his property.

### **Origin of concept of bankruptcy**

The Ponte Vecchio, literally *Old Bridge*, is a famous medieval bridge over the Arno, in Florence, Italy, noted for having shops (mainly jewelers) built along it. Presumably first erected in Roman times, it was originally made of wood. After being destroyed by a flood in 1333 it was rebuilt in 1345, this time in stone. It always hosted shops and merchants (legend says this was originally due to a tax exemption), which displayed their goods on a table after authorisation of the Bargello (a sort of a lord mayor, a magistrate and a police authority). It is said that the economic concept of bankruptcy originated here: when a merchant could not pay his debts, the table on which he exposed (the "banca") was physically broken ("rotta") by soldiers, and this practice was called "bancarotta" (broken table). Not having a table anymore, the merchant was not able to sell anything more to anyone.

Philip II of Spain had to declare four state bankruptcies in 1557, 1560, 1575 and 1596. Spain became the first sovereign nation in history to declare bankruptcy.

The characteristic discharge of debts was introduced to Anglo-American bankruptcy with the statute of 4 Anne ch. 17 in 1705, where the discharge of unpayable debts was offered as a reward to bankrupts who cooperated in the gathering of assets to pay what could be paid.

Bankruptcy is also documented in the Far East. According to al-Maqrizi, the Yassa of Genghis Khan contained a provision that mandated the death penalty for anyone who became bankrupt three times.

### **Object of insolvency law**

The law of insolvency is a social legislation which has been enacted to provide respite and relief to the honest debtors who due to any unfortunate or unforeseen circumstances become incapable of paying back their debts. Its object is also of securing distribution of a debtor's estate among his creditors equitably and thereafter to release him under certain conditions from liability in respect of his debts and obligations.

In the case of *Yenamulla Malludora vs P.Seetharatnam* (AIR 1966 SC 918), Supreme Court of India observed, 'The object of the law of insolvency is to seize the property of an insolvent before he can squander it and to distribute it amongst his creditors. It is however not every debtor who has borrowed beyond his assets or even one whose property is attached in execution of his debts, who can be subjected to such control. The jurisdiction of the Court commences when certain acts take place which are known as acts of insolvency and which give a right to his creditor to apply to the Court for his adjudication as an investment.'

### **Significance of Law of Insolvency**

The law of insolvency has always been neglected. If a person is declared insolvent, he is not looked upon with respect. But actually the law of insolvency protects the debtor from humiliation and oppression of his creditors.

When a person is declared insolvent, his creditors are barred from initiation any suit or legal proceedings against him and they cannot seek any remedy against his property in respect of their debts provable under the insolvency law. On adjudication of a debtor as insolvent his whole property vests in official receiver.

His creditors are more interested in the recovery of their debts than in person of debtors. So after vesting the property in official receiver, they are relieved of the fear of being defrauded by the debtor or of the apprehension of the debtor running away with his property. The insolvent, if by any chance, escapes the jurisdiction of the Insolvency Court, it does not much bother them as the official receiver is the person in whom the property of the insolvent vests. And their debts are to be realized from the proceeds collected by the receiver in the official discharge of his functions under the Insolvency law.

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In course of time, more so because of the process of economic liberalization, individuals are facing competition in all aspects. In this era of survival of the fittest, those who are unable to adjust to this new economic situation may fall in trap of indebttness. In such a situation, the law of insolvency can in fact help them in emerging out of the state of indebttness while retaining their liberty and freedom.

### 3. INSOLVENCY LAWS IN INDIA

Under the Constitution of India 'Bankruptcy & Insolvency' is Entry 9 in List III - Concurrent List, (Article 246 –Seventh Schedule to the Constitution) i.e. both Center and State Governments can make laws relating to this subject. Entry 43 of List I deals with 'incorporation, *regulation and winding up* of trading corporations, including banking, insurance and financial corporations, but *not including co-operative societies*' whereas Entry 44 of List I deals with 'incorporation, *regulation and winding up* of corporations, whether trading or not, with objects not confined to one State, but not including universities.' Further, Entry 32 of List II deals with 'incorporation, *regulation and winding up* of corporations, other than those specified in List I...'

In India the process of winding up of companies is regulated by the Companies Act and is under the supervision of the court. Although article 19 (1)(g) of the Constitution of India gives freedom to practice any profession or to carry on any occupation, trade or business to the citizens of India, there are restrictions on closure of any industrial undertaking. Such restriction is justified on the ground that it is in public interest to prevent unemployment. As a result of such policy there is a freedom to undertake any industrial activity, but there is no freedom to exit.

In the process of deregulation and liberalization number of restrictions on undertaking industrial activity has been withdrawn and relaxed. There is a need to take the process of liberalization a step further and recognize that so long as a company is acting in the interest of shareholders and otherwise observing the law of the land it should have the freedom to manage its affairs, merge, amalgamate, restructure and reorganize or otherwise plan its affairs as it considers best in the interest of the stakeholders. Interference by the Government or court or any tribunal should only be in the event of any detriment to the shareholders or under the Competition Act to prevent monopolies or restrictive trade practices. While undertaking reforms in the Insolvency Laws there is a need to change the focus from strict regulation of the activities of companies to granting freedom to the industry in conducting its business activities and lay down norms for protection of interest of stakeholders.

#### **Insolvency Laws for Individuals and Corporates**

In India the term insolvency has not been defined anywhere, but still the word is commonly used to describe the process of insolvency. The stream of insolvency laws governing insolvency & bankruptcy are as follows –

- i. Transfer of Property Act, 1882
- i. The Code of Civil Procedure, 1908



- ii. The Presidency Towns Insolvency Act, 1909 (Applicable to Mumbai, Kolkatta & Chennai)
- v. The Provincial Insolvency Act, 1920 (Applicable to Rest of India)
- v. Companies Act, 2013
- ii. Sick Industrial Companies Act, 1985
- v. The Recovery of Dues to Banks and Financial Institutions Act, 1993
- v. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFEASI Act)
- x. Rules, Policies made by Reserve Bank of India from time to time

### **Present nature of Insolvency Process in India**

1. Insolvency/ Liquidation process essentially encompasses aspects of recovery, revival, reconstruction and winding up and therefore the process has to be seen in a holistic manner with all such aspects in sight.
2. No Separate Unified Insolvency Code covering all the above aspects in one place is present. Therefore the process is complicated, time consuming and ineffective.
3. The present Legal and procedural framework relating to Corporate Insolvency apart from several other special provisions like debt recovery laws, is laid out by 4 major legislations, namely:
  - o Companies Act, 2013
  - o Sick Industrial Companies (Special Provisions) Act, 1985 [SICA]
  - o Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) Act, 2002 also known as the Securitization Act
  - o Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDB Act) [Debt Recovery Tribunals are set up under this Act]

#### **4. COMMITTEES ON INSOLVENCY**

##### **1) Shri. T. Tiwari Committee**

In the year 1981, the Reserve Bank of India, deeply concerned over the issue of alarming increase in the incidence of industrial sickness which was resulting in loss of production, loss of employment, loss of government revenue and unnecessary blocking of huge funds advanced by the banks and financial institutions to the industrial undertakings, constituted a committee under the chairmanship of Shri. T. Tiwari, Chairman, Industrial Reconstruction Corporation of India to look into the causes of industrial sickness, to assess the depth of the problem and to suggest remedial measures. Following the recommendations of the Tiwari Committee, the Government of India enacted the Sick Industrial Companies (Special Provisions) Act, 1985, (SICA) in order to provide for timely detection of sickness in industrial companies and for expeditious determination of the preventive, ameliorative, remedial and other measures and for enforcement of the measures. Although, the object of the Act was laudable, the Act was factually misused by the erring promoters' to defeat the object of the Act. Due to such inherent defects of SICA and again, for some unexplained reasons, BIFR failed to fulfill the purpose and mandate as envisaged therein.

##### **2) Justice V.B. Balakrishna Eradi Committee**

Then came the Justice V.B. Balakrishna Eradi Committee Report in 1999 recommending, inter alia, setting up of a National Company Law Tribunal (NCLT in short) to be vested with the functions and power with regard to rehabilitation and revival of sick industrial companies, a mandate presently entrusted with BIFR under SICA and forming of a liquidation committee consisting of creditors of the company in the lines of Section 141 of the Insolvency Act, 1986 of UK to assist the Liquidator and by adopting the necessary principles enunciated under International Monetary Fund's propagated norms for 'Orderly and Effective' insolvency procedures. The statement (financial) of affair, which took the most time, is now to be filed, in case of voluntary winding up, along with the winding up application, and in case of an involuntary proceeding, at the time of the first defense. The liquidation program is bound to be time bound. Other recommendations were adoption of UNCITRAL Model Law for Cross Border Insolvency; need to encourage voluntary winding up of companies and criteria of sickness of companies to include inability to pay debts.

3) **N L Mitra Committee**

In 2001 came the Report of the Advisory Group on Bankruptcy Laws, called the N L Mitra Committee appointed by the RBI which made several recommendations on bankruptcy law reforms, the first among which was consolidation of bankruptcy laws into a separate code. However, no legislative steps have still been taken in this regard.

4) **JJ Irani Committee**

Then the JJ Irani Committee Report in 2005 was formulated to review the laws concerning liquidation and restructuring of the companies recommended several revisions to the Companies Act, more particularly for a transparent and globally acceptable insolvency and restructuring procedures, in short. The Committee has proposed significant changes in the law to make the restructuring and liquidation process speedy, efficient and effective. Recommendations are directed at restoring the eroded confidence of key stakeholders in the insolvency system while balancing their interest. According to the report, “it is important that the basic principles guiding the operation of corporate entities from registration to winding up or liquidation should be available in a single, comprehensive, centrally administered framework”.

5) **Bankruptcy Law Reforms Committee**

The Union Finance Minister Shri.Arun Jaitley during his Budget Speech of 2014-15 announced that an entrepreneur friendly legal bankruptcy framework would be developed for SMEs to enable easy exit. Pursuant to the above announcement, a Committee was set-up by the Department of Economic Affairs, Ministry of Finance, under the Chairmanship of Mr.T.K.Viswanathan, former Secretary General, Lok Sabha and former Union Law Secretary, on 22.8.2014 to study the corporate bankruptcy legal framework in India and submit a report. Dr. Viswanathan submitted the Report of the Committee on November 4, 2015. The Report is in two parts: Volume I – titled “Rationale and Design” and Volume II – titled “Draft Insolvency and Bankruptcy Bill”.

## 5. INTERNATIONAL SCENARIO OF LAWS ON INSOLVENCY

### United States of America

The United States has established insolvency regimes which aim to protect the insolvent individual or company from the creditors, and balance their respective interests. The largest bankruptcy in U.S. history occurred on September 15, 2008, when Lehman Brothers Holdings Inc. filed for Chapter 11 protection with more than USD\$639 billion in assets.

Bankruptcy in the United States is permitted by the United States Constitution (Article 1, Section 8, Clause 4) which authorizes Congress to enact "uniform Laws on the subject of Bankruptcies throughout the United States." Congress has exercised this authority several times since 1801, most recently by adopting the Bankruptcy Reform Act of 1978, codified in Title 11 of the United States Code, commonly referred to as the Bankruptcy Code ("Code"). The Code has been amended several times since 1978, most recently in 2005 through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 or BAPCPA. Some law relevant to bankruptcy is found in other parts of the United States Code. For example, bankruptcy crimes are found in Title 18 of the United States Code (Crimes), tax implications of bankruptcy are found in Title 26 of the United States Code (Internal Revenue Code), and the creation and jurisdiction of bankruptcy courts are found in Title 28 of the United States Code (Judiciary and Judicial procedure).

While bankruptcy cases are filed in United States Bankruptcy Court (units of the United States District Courts), and federal law governs procedure in bankruptcy cases, state laws are often applied when determining property rights.

Entities seeking relief under the Bankruptcy Code may file a petition for relief under a number of different chapters of the Code, depending on circumstances. Title 11 contains nine chapters, six of which provide for the filing of a petition whereas the other three chapters provide rules to govern those petitions.

Chapter 7 of the Title 11 of the United States Code (Bankruptcy Code) governs the process of liquidation under the bankruptcy laws of the United States. (In contrast, Chapters 11 and 13 govern the process of *reorganization* of a debtor in bankruptcy). Chapter 7 is the most common form of bankruptcy in the United States.

When a troubled business is badly in debt and unable to service that debt or pay its creditors, it may file (or be forced by its creditors to file) for bankruptcy in a federal court under Chapter 7. A Chapter 7 filing means that the business ceases operations unless continued by the Chapter 7 Trustee. A Chapter 7 Trustee is appointed almost immediately. The Trustee generally sells all the assets and distributes the proceeds to the creditors.

This may or may not mean that all employees will lose their jobs. When a very large company enters Chapter 7 bankruptcy, entire divisions of the company may be sold intact to other companies during the liquidation.

Fully-secured creditors, such as collateralized bondholders or mortgage lenders, have a legally-enforceable right to the collateral securing their loans or to the equivalent value, a right which cannot be defeated by bankruptcy. A creditor is fully secured if the value of the collateral for its loan to the debtor equals or exceeds the amount of the debt. For this reason, however, fully-secured creditors are not entitled to participate in any distribution of liquidated assets that the bankruptcy trustee might make.

In a Chapter 7 case, a corporation or partnership does not receive a bankruptcy discharge—instead, the entity is dissolved. Only an individual can receive a Chapter 7 discharge (see 11 U.S.C. § 727(a)(1)). Once all assets of the corporate or partnership debtor have been fully administered, the case is closed. The debts of the corporation or partnership theoretically continue to exist until applicable statutory periods of limitations expire.

Individuals who reside, have a place of business, or own property in the United States may file for bankruptcy in a federal court under Chapter 7 ("straight bankruptcy", or liquidation). Chapter 7, as with other bankruptcy chapters, is not available to individuals who have had bankruptcy cases dismissed within the prior 180 days under specified circumstances. In a Chapter 7 bankruptcy, the individual is allowed to keep certain exempt property. Most liens, however (such as real estate mortgages and security interests for car loans), survive. The value of property that can be claimed as exempt varies from state to state. Other assets, if any, are sold (*liquidated*) by the interim trustee to repay creditors. Many types of unsecured debt are legally discharged by the bankruptcy proceeding, but there are various types of debt that are not discharged in a Chapter 7. Common exceptions to discharge include child support, income taxes less than 3 years old and property taxes, student loans (unless the debtor prevails in a difficult-to-win adversary proceeding brought to determine the dischargeability of the student loan), and fines and restitution imposed by a court for any crimes committed by the debtor. Spousal support and property settlements through divorce are likewise not covered by a bankruptcy filing. Despite their potential non-dischargeability, all debts must be listed on bankruptcy schedules.

Bankruptcy discharge stays on the individual's credit report for up to 10 years for most purposes. This may make credit less available and/or terms less favorable, although high debt can have the same effect. That must be balanced against the removal of actual debt from the filer's record by the bankruptcy, which tends to

improve creditworthiness. Consumer credit and creditworthiness is a complex subject, however. Future ability to obtain credit is dependent on multiple factors and difficult to predict.

Chapter 9, Title 11 of the United States Code is a chapter of the United States Bankruptcy Code, available exclusively to municipalities and assists them in the restructuring of debts. Most famously, Chapter 9 was used by Orange County, California in 1994 to adjust its debts. Previous to the creation of Chapter 9 bankruptcy the only remedy when a municipality was unable to pay its creditors was for the creditors to pursue an action of mandamus, and compel the municipality to raise taxes. During the Great Depression this approach proved impossible so in 1934 the Bankruptcy Act was amended to extend to municipalities. The 1934 Amendment was declared unconstitutional in *Ashton v. Cameron County Water District*, however a similar act was passed again by Congress in 1937 and codified as Chapter X of the Bankruptcy Act (later re-designated as Chapter IX). Chapter IX was largely unchanged until it was amended in 1976 in response to New York City's financial crisis. The changes made in 1976 were adopted nearly identically in the modern 1978 Bankruptcy Code as Chapter 9.

While in many ways similar to other forms of bankruptcy reorganization (Chapters 11, 12, and 13), Chapter 9 has some unique characteristics. Because municipalities are entities of State governments, the power of Congress to adjust their debts through bankruptcy is limited considerably by the 10th Amendment. Municipalities' ability to re-write collective bargaining agreements are much easier than in a corporate Chapter 11 bankruptcy and can trump state labor protections allowing cities to renegotiate unsustainable pension or other benefits packages negotiated in flush times.

### **United Kingdom**

United Kingdom insolvency law regulates companies in the United Kingdom which are unable to repay their debts. While UK bankruptcy law concerns the rules for natural persons, the term insolvency is generally used for companies formed under the Companies Act 2006. "Insolvency" means being unable to pay debts. Since the Cork Report of 1982, the modern policy of UK insolvency law has been to attempt to rescue a company that is in difficulty, to minimise losses and fairly distribute the burdens between the community, employees, creditors and other stakeholders that result from enterprise failure. If a company cannot be saved it is "liquidated", so that the assets are sold off to repay creditors according to their priority.

## Overview of Insolvency Laws in India by Rajkumar S. Adukia

The main sources of law include the Insolvency Act 1986, the Insolvency Rules 1986, the Company Director Disqualification Act 1986, the Employment Rights Act 1996 Part XII, the Insolvency Regulation (EC) 1346/2000 and case law. Numerous other Acts, statutory instruments and cases relating to labour, banking, property and conflicts of laws also shape the subject.

UK law grants the greatest protection to banks or other parties that contract for a security interest. If a security is "fixed" over a particular asset, this gives priority in being paid over other creditors, including employees and most small businesses that have traded with the insolvent company.

The Insolvency Act 1986 essentially governs issues relating to personal bankruptcy and Individual Voluntary Arrangements and all administrative orders relating to company insolvency.

### Australia

Australian insolvency law regulates the position of companies which are in financial distress and are unable to pay or provide for all of their debts or other obligations, and matters ancillary to and arising from financial distress. The law in this area is principally governed by the Corporations Act 2001. Under Australian law, the term insolvency is usually used with reference to companies, and bankruptcy is used in relation to individuals.

Insolvency law in Australia tries to seek an equitable balance between the competing interests of debtors, creditors and the wider community when debtors are unable to meet their financial obligations. The aim of the legislative provisions is to provide:

- an orderly and fair procedure to handle the affairs of insolvent companies;
- to ensure a *pari passu* equal distribution of the assets amongst creditors;
- to ensure claims against the insolvent company are resolved with the minimum of delay and expense;
- to rehabilitate financially distressed companies and businesses where viable;
- to engage with key stakeholders in the resolution of insolvency issues; and
- providing for the examination of insolvent companies and their representatives, and the reasons for their failure.

## **China**

The Enterprise Bankruptcy Law of the People's Republic of China was first passed in 1986. On 1 June 2007, the new Enterprise Bankruptcy Law of the PRC came into force. It contains 136 articles, almost 100 more than the 1986 law it replaced, and consequently it is thought to be more complete legally. The Enterprise Bankruptcy Law of the PRC was adopted in August 27, 2006, and became effective since June 1, 2007.

China's new bankruptcy law mirrors the modern bankruptcy laws of other countries, particularly the United States. The new law applies to all legal entities, including foreign invested enterprises (FIEs), such as WFOEs and Joint Ventures, though it does not apply to individuals.

The law utilizes an administrator who will act much like bankruptcy trustees do in U.S. bankruptcy proceedings. The administrator's role is to help the creditors and to assist in assuring the bankruptcy runs smoothly. The law provides who may serve as an administrator and it is expected most administrators will come from the ranks of China lawyers and China accountants.

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The most important difference between China's new and old bankruptcy laws is that the new law gives secured claims priority over employee, tax, and general claims, unlike the old law which gave workers (it was communism, remember) first claim to the debtor's assets. The new law is more in line with most developed commercial countries in that employee claims now take precedence only over unsecured creditors.

The new law applies to Chinese companies operating overseas and it applies to foreign companies operating in China. It also accounts for the extraterritorial effect of Chinese bankruptcy judgments and it permits enforcement of foreign judgments from countries that act reciprocally towards Chinese judgments. In other words, debtors with foreign judgments against a bankrupt Chinese company may be able to collect on that judgment in the Chinese bankruptcy.



## **Canada**

The key Legislations that regulate matters relating to bankruptcy and insolvency in Canada are -

- Bankruptcy and Insolvency Act (BIA)
- Companies' Creditors Arrangement Act (CCAA)
- Winding-up and Restructuring Act (WURA)
- Bankruptcy and Insolvency General rules
- Orderly Payment of Debts Regulations

### **Insolvency Procedures**

The Bankruptcy and Insolvency Act (BIA) provides a legislative framework for the liquidation of the assets of an insolvent individual, corporation or partnership, and the distribution of the proceeds in a fair and orderly way among the creditors. It provides for the appointment of a trustee to take charge of the assets, sell them and distribute the proceeds. Alternatively, the Act provides ways for insolvent businesses or consumer debtors to avoid bankruptcy by negotiation arrangements with their creditors for the compromise of their debts and the reorganization of their financial affairs.

The Companies' Creditors Arrangement Act (CCAA) provides a legislative framework for the reorganization of insolvent corporate debtors. It enables an insolvent company to seek a court order staying its creditors from taking action against it while it negotiates an arrangement with them for the rescheduling or compromise of its debts.

The Winding-up and Restructuring Act (WURA), provides an alternative framework to the BIA for the liquidation and distribution of an insolvent corporation's assets among its creditors. It is the only legislative vehicle available for the liquidation of major financial institutions, including banks, insurance companies and trust and loan companies, none of which can be liquidated under the BIA.

## **Singapore**

Singapore's bankruptcy law and corporate insolvency law are governed by the Bankruptcy Act (Chapter 20) and the Companies Act (Chapter 50) respectively.

The Bankruptcy Act, which came into force on 15 July 1995, aims to reduce the instances where parties resort to bankruptcy proceedings and encourage the settlement of claims through voluntary arrangements.

Bankruptcy is commenced only at the instigation of creditors. It is costly and can only apply when the debt owed is in excess of \$10 000.

Alternatives to bankruptcy:

- Private Arrangements
- The debtor may apply to the court to make a proposal for voluntary arrangements
- A creditor can seek recovery of a debt through a court order or judgement
- Alternative dispute resolution in court

There are three types of corporate insolvency proceedings under Singapore company law. They are:

- (a) a scheme of arrangement under section 210 of the Companies Act;

A scheme of arrangement may be proposed between the company and its creditors or any class of them or between the company or its members or any class of them. This is usually done where it is desired to adjust members' or creditors' rights inter se, or to reorganize the share capital of the company, or in the case of a group its reconstruction or merger. The Companies Act provides for schemes of arrangement to be binding on creditors and members after approval by the requisite majority of creditors present and voting, and upon approval by the court. This obviates the need for a unwieldy and complicated series of negotiations with a view to obtaining the unanimous approval of the members or creditors to a novation or assignment or other variation of their rights.

- (b) appointment of receiver or a receiver and manager out of court under Part VIII of the Companies Act;

This is technically not an insolvency procedure since: (a) it is not dependent on proof of insolvency but arises from private agreement between the debtor and the creditor; (b) it is not a proceeding for the collective benefit of the creditors but for the benefit of a single secured creditor; and (c) the receiver's function is not to rehabilitate the company but to realise the secured creditors' security;

However, receivership is regulated by Part VIII of the Companies Act which: (a) imposes on receivers some of the obligations of other insolvency administrators; (b) applies the priority rules for preferential creditors applicable in a liquidation to a receivership under a floating charge. Furthermore, a receiver is in fact appointed when a company is insolvent or near insolvency and he is usually given extremely wide powers of management by the debenture under which he is appointed. As such, a receiver usually takes control over the whole or substantially the whole of a company undertaking. Therefore, receivership has aspects of an insolvency proceeding.

- (c) a petition for the liquidation of the company under Part X of the Act; and
- (d) a petition for judicial management under Part VIII A of the Act.

Part VIII A of the Companies Act provides for the appointment of a judicial manager by the court upon a petition presented by the company, its directors, or a creditor if the Court is satisfied that the company is unable to pay its debts and that the appointment would be likely to achieve: (a) the survival of the company or the whole or part of its undertaking as a going concern; (b) the approval of a compromise or arrangement between the company and its creditors; or (c) a more advantageous realization of the company's assets than could be effected on a winding up. There is no provision for a petitioner to annex an independent report assessing the petitioner's proposals as in England; and this is normally not done.

The presentation of a petition for the appointment of a judicial manager gives the company a respite from the attentions of its creditors. While such a petition is pending, the company has extensive immunity from liquidation and legal proceedings. A petition for judicial management may therefore be used to stave off a compulsory winding up or to prevent execution being levied against the company's property.

The Official Receiver is responsible for the overall regulation and supervision of bankruptcy and corporate insolvency law, and administers the vast majority of bankruptcy cases and corporate insolvency in Singapore. The Official Receiver heads the Insolvency and Public Trustee's Office within the Ministry of Law.

The High Court of Singapore has the power to make a bankruptcy order/winding up order after considering whether the debtor/company is in a position to pay the debt. The High Court also annuls bankruptcy orders and issues warrants of arrest against bankrupts. The Subordinate courts hear prosecution proceedings for alleged bankruptcy offences such as the non-filing of Statement of Affairs.

## 6. UNCITRAL LAWS ON INSOLVENCY

The United Nations Commission on International Trade Law (UNCITRAL) (established in 1966) is a subsidiary body of the General Assembly of the United Nations with the general mandate to further the progressive harmonization and unification of the law of international trade. UNCITRAL has since prepared a wide range of conventions, model laws and other instruments dealing with the substantive law that governs trade transactions or other aspects of business law which have an impact on international trade. UNCITRAL meets once a year, typically in summer, alternatively in New York and in Vienna.

### **UNCITRAL Model Law on Cross-Border Insolvency**

Adopted by UNCITRAL on 30 May 1997, the Model Law is designed to assist States to equip their insolvency laws with a modern, harmonized and fair framework to address more effectively instances of cross-border insolvency. Those instances include cases where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place. The Model Law respects the differences among national procedural laws and does not attempt a substantive unification of insolvency law. It offers solutions that help in several significant ways, including: foreign assistance for an insolvency proceeding taking place in the enacting State; foreign representative's access to courts of the enacting State; recognition of foreign proceedings; cross-border cooperation; and coordination of concurrent proceedings.

Scope of the Model Law –

It applies to foreign proceedings “relating to insolvency” where:

- the purpose of the proceedings is the reorganization or liquidation of the debtor
- the proceedings are collective
- assets and affairs of the debtor are subject to court control or supervision (art. 2)
- certain entities can be excluded (Art. 1)

Examples of entities excluded are generally those subject to specialized regulatory regimes:

- Banking and insurance institutions
- Financial and investment institutions
- Commodity exchange members
- Brokerage companies and traders
- Consumers

### **UNCITRAL Legislative Guide on Insolvency Law**

Adopted by UNCITRAL on 25 June 2004, the purpose of the Legislative Guide is to assist the establishment of an efficient and effective legal framework to address the financial difficulty of debtors. It is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations. The advice provided in the Legislative Guide aims at achieving a balance between the need to address the debtor's financial difficulty as quickly and efficiently as possible and the interests of the various parties directly concerned with that financial difficulty, principally creditors and other parties with a stake in the debtor's business, as well as public policy concerns. The Legislative Guide addresses the issues central to an effective and efficient insolvency law and assists the reader to evaluate different approaches available and to choose the one most suitable in the national or local context.

### **UNCITRAL Practice Guide on Cross Border Insolvency Cooperation**

Adopted by UNCITRAL on 1 July 2009, the Practice Guide provides information for insolvency practitioners and judges on practical aspects of cooperation and communication in cross-border insolvency cases. The information is based upon a description of collected experience and practice, focusing on the use and negotiation of cross-border agreements. It provides an analysis of more than 39 agreements, ranging from written agreements approved by courts to oral arrangement between parties to the proceedings that have been entered into over the last decade or so. The Practice Guide is not intended to be prescriptive, but rather to illustrate how the resolution of issues and conflicts that might arise in cross-border insolvency cases could be facilitated by cross-border cooperation, in particular the use of such agreements, tailored to meet the specific needs of each case and the particular requirements of applicable law. The Practice Guide includes a number of sample clauses to illustrate how different issues have been, or might be, addressed - they are not intended to serve as model provisions for direct incorporation into a cross-border agreement. It also includes summaries of the cases in which the cross-border agreements that form the basis of the analysis were used.

## **7. INSOLVENCY OF INDIVIDUALS AND UNINCORPORATED ENTITIES**

Law of insolvency is basically a social legislation that has been enacted to provide respite and relief to the honest debtors who due to any unfortunate or unforeseen circumstances become incapable of paying back their debts. Its object is also of securing distribution of a debtor's estate among his creditors equitably and thereafter to release him under certain conditions from liability in respect of his debts and obligations.

The Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920 are two major enactments that deal with personal insolvency and have parallel provisions and their substantial content is also similar but the two differ in respect of their territorial jurisdiction. While Presidency Towns Insolvency Act, 1909 applies in Presidency towns namely, Kolkata, Mumbai and Chennai, Provincial Insolvency Act, 1920 applies to all provinces of India. These two Acts are applicable to individuals as well as to sole proprietorships and partnership firms and are not applicable to corporations or against any association or company registered under any enactment. Section 107 of The Presidency Towns Insolvency Act, 1909 and Section 8 of The Provincial Insolvency act, 1920 specifically prohibits any insolvency petition against any against any corporation or against any association or company registered under any enactment for the time being in force.

The Presidency Towns Insolvency Act, 1909 consists of 127 sections and 2 schedules.

The Provincial Insolvency Act, 1920 consists of 83 sections and 2 schedules.

### **Persons who can be adjudged insolvent**

The law has prescribed the category of persons who can be declared insolvent by court.

- Any person who is capable of entering into a contract (i.e., who has attained the age of majority and is of sound mind and is not disqualified from contracting by any law) can be adjudged insolvent provided he is a debtor and he has committed an act of insolvency. Since a minor is not competent to contract, he cannot therefore, be adjudged insolvent under any circumstances.
- If the debtor is a lunatic, he can be adjudged insolvent for the debts contracted by him when he was sane.
- A minor partner in a firm cannot be adjudged an insolvent but his share in the property of the firm is, however, liable for the debts of the firm.

- A partnership firm may be adjudged insolvent in the name of the firm when each of the partners has committed an act of insolvency or a joint act of insolvency.
- A deceased person cannot be adjudged an insolvent on any proceedings initiated after his death.
- A foreigner in India may be adjudged insolvent if he is a debtor and has committed an act of insolvency.
- In case of a Hindu joint family, when all the members are personally liable on a joint debt and have committed a joint act of insolvency, the members of the Hindu joint family can be adjudged insolvent.

### **Background of insolvency law in India**

Before the British came to India, there was no insolvency law in India. The Indian regulation that dealt with insolvency law was initially found in Government of India Act, 1800.

In 1828, a statute was passed which marked the beginning of special insolvency legislation in India and the statute applied to Presidency towns namely Bombay, Madras and Calcutta. It was originally meant to be in force for a period of four years but was extended till 1843. In 1848 another statute of insolvency law namely the Indian Insolvency Act, 1848 was passed which made a distinction between traders and non-traders. Insolvency jurisdiction under the statute was transferred to High Courts. Its jurisdiction was also limited to presidency towns. In 1909 the present Presidency Towns Insolvency Act, 1909 was passed.

Insolvency law in mofussil/districts was made in 1877 by incorporating the rules of insolvency in Chapter 20 of the Code of Civil Procedure, 1877. Jurisdiction in relation to insolvency matters was given to District Courts. These rules were modified by Chapter 20 of the Code of Civil Procedure, 1882. Later on the Provincial Insolvency Act, 1907 was passed which was repealed by present Provincial Insolvency Act, 1920.

### **Insolvency of sole proprietorship**

The owner of a sole proprietorship is not a separate legal entity from the business of the sole proprietorship. So the laws governing bankrupt individuals also govern insolvent sole proprietorships. Individuals can file a petition for their own bankruptcy or a court may declare them bankrupt if they are unable to pay their debts.

### **Insolvency of Partnership firm**

Each of the partners is jointly and severally liable for the debts of the partnership. On dissolution of a partnership, the assets of the partnership have to be first applied towards the repayment of debts of the partnership to third parties. If the assets are not sufficient to repay the debts, the creditors may take

proceedings against the partners. According to Section 41 of the Indian Partnership Act, 1932 a partnership will be dissolved if all but one of the partners becomes insolvent.

### **Insolvency proceedings**

A person does not become insolvent just by the fact that he is a debtor and is unable to pay his debts. He also does not become insolvent just because his liabilities are more than his assets. It is necessary to initiate insolvency proceedings against him and get an adjudication order against him under the law of insolvency.

Insolvency proceedings can only be initiated against a person who is a debtor under the provisions of the Act of 1920 or who is a debtor under the provisions of the Act of 1909. According to Section 2(b) of Act of 1909 and Section 2(a) of Act of 1920, debtor includes a judgment-debtor. Judgment debtor is a person who has suffered a decree against him that is against whom a decree has been passed.

The debt to be recovered from the debtor has to be a provable debt which includes all debts and liabilities, whether present or future, certain or contingent provided the obligation for which they became due was incurred before the date of adjudication. The claims which are not capable of being fairly estimated or demands in the nature of unliquidated damages are not provable debts. However demands in the nature of unliquidated damages arising by reason of a contract or breach of trust are provable. (Sec.46 of Act of 1909 and Sec.34 of Act of 1920)

The commission of an act of insolvency by the debtor is a pre-condition for filing insolvency petition. There are 8 acts of insolvency out of which six are voluntary and two are involuntary. (Sec.9 of the Act of 1909 and Sec.6 of Act of 1920). By an amendment in 1978, non-compliance to an insolvency notice given by a creditor has also been added as an act of insolvency. A debtor is supposed to have committed an act of insolvency in the following cases:

- (a) If, in the States or elsewhere, he makes a transfer of all or substantially all his property to a third person for the benefit of his creditors generally;
- (b) If, in the States or elsewhere, he makes a transfer of his property or of any part thereof with intent to defeat or delay his creditors;
- (c) If, in the States or elsewhere, he makes any transfer of his property or of any part thereof, which would, under this or any other enactment for the time being in force, be void as a fraudulent preference if he were adjudged an insolvent;
- (d) If, with intent to defeat or delay his creditors,--
  - (i) he departs or remains out of the States,



- (ii) he departs from his dwelling-house or usual place of business or otherwise absents himself,
- (iii) he secludes himself so as to deprive his creditors of the means of communicating with him;
- (e) If any of his property has been sold or attached for a period of not less than twenty-one days in execution of the decree of any Court for the payment of money;
- (f) If he petitions to be adjudged an insolvent;
- (g) If he gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debts;
- (h) If he is imprisoned in execution of the decree of any Court for the payment of money

### **Filing of Insolvency Petition**

After the commission of an act of insolvency, insolvency proceedings can be initiated by filing an insolvency petition either by a creditor or by the debtor.

If the creditor wants to file a petition against his debtor, he has to prove that an act of insolvency has been committed and also that the amount of debt due from the debtor is five hundred rupees or more. He can file it only within three months of commission of the act of insolvency. (Sec.12 of Act of 1909 and Sec.9 of Act of 1920)

Even a debtor can present an insolvency petition against himself. Filing of such a petition by the debtor is one of the enumerated acts of insolvency and the creditors also can file an insolvency petition against him on the basis of a debtor's petition. For filing an insolvency petition against himself, the debtor has to prove any of these three conditions, namely his debts amount to five hundred rupees or he has been arrested and imprisoned in execution of the decree of any court for the payment of money or an order of attachment in execution of such a decree has been made and is subsisting against his property. (Sec.14 of Act of 1909 and Sec.10 of Act of 1920)

No petition, whether presented by a debtor or by a creditor, should be withdrawn without the leave of the Court.

When two or more insolvency petitions are presented against the same debtor or where separate petitions are presented against joint debtors, the Court may consolidate the proceedings of any of them, on such terms as the Court may think fit.

### **Jurisdiction for filing Insolvency Petition**

Insolvency jurisdiction under Section 3 of the Presidency Towns Insolvency Act, 1909 vests in the High Courts at Kolkata, Madras and Bombay.

Insolvency jurisdiction under Section 3 of the Provincial Insolvency Act, 1920 vests in District Courts but the State Government may, by notification in the Official Gazette, invest any Court subordinate to a District Court with jurisdiction in any class of cases, and any Court so invested shall within the local limits of its jurisdiction have concurrent jurisdiction with the District Court.

### **Powers of the Insolvency Court**

Section 4 of the Act of 1920 confers complete and full powers on the insolvency court to decide all questions of title or priority or of any nature, whatsoever, which may arise in any case of insolvency.

Section 7 of the Act of 1909 also invests Insolvency Courts with the same power as are given under the Act of 1920 but the questions of title are not mentioned in Section 7 but the Court has power to decide all questions whether of law or fact. Under Section 8, the Court has the power to rescind, review or vary any of its own orders.

### **Contents of Insolvency Petition**

Section 13 of the Act of 1920 deals with the particulars to be mentioned in the insolvency petition. Every insolvency petition presented by a debtor should contain the following particulars, namely:--

- (a) a statement that the debtor is unable to pay his debts;
- (b) the place where he ordinarily resides or carries on business or personally works for gain, or, if he has been arrested or imprisoned, the place where he is in custody;
- (c) the Court (if any) by whose order he has been arrested or imprisoned, or by which an order has been made for the attachment of his property, together with particulars of the decree in respect of which any such order has been made;
- (d) the amount and particulars of all pecuniary claims against him, together with the names and residences of his creditors so far as they are known to, or can by the exercise of reasonable care and diligence be ascertained by, him;

(e) the amount and particulars of all his property, together with-- (i) a specification of the value of all such property not consisting of money; (ii) the place or places at which any such property is to be found; and (iii) a declaration of his willingness to place at the disposal of the Court all such property save in so far as it includes such particulars (not being his books of account) as are exempted by the Code of Civil Procedure, 1908, (5 of 1908), or by any other enactment for the time being in force from liability to attachment and sale in execution of a decree;

(f) a statement whether the debtor has on any previous occasion filed a petition to be adjudged an insolvent, and (where such a petition has been filed)-- (i) if such petition has been dismissed, the reasons for such dismissal, or 77 (ii) if the debtor has been adjudged an insolvent, concise particulars of the insolvency, including a statement whether any previous adjudication has been annulled and, if so, the grounds therefor.

Every insolvency petition presented by a creditor or creditors should set forth the particulars mentioned above and should also specify (a) the act of insolvency committed by such debtor, together with the date of its commission; and (b) the amount and particulars of his or their pecuniary claim or claims against such debtor.

#### **Proceedings on admission of Insolvency Petition**

According to Sec.20 of the Act of 1920, when the Court makes an order of admission of the creditor's petition, it may and in the case of admitting the debtor's petition, the Court shall appoint an interim receiver of the debtor's property and direct him to take immediate possession.

Section 16 of the Act of 1909 contains similar provisions, only difference being that there is no distinction between creditor's petition and debtor's petition and it is at the Court's discretion to appoint an interim receiver at the time of admission of petition or at any subsequent stage before adjudication.

#### **Dismissal of Debtor's / Creditor's petition**

Under Sec.25 of the Act of 1920, the Court may dismiss the creditor's petition for insolvency if it is not satisfied with the proof of his right to present the petition or of the service on the debtor of notice of the order admitting the petition, or of the alleged act of insolvency, or is satisfied by the debtor that he is able to pay his debts, or for any other sufficient cause. In case of a petition presented by a debtor, the Court may dismiss the petition if it is not satisfied of his right to present the petition. Similar procedure is prescribed under Sec.13 & 15 of the Act of 1909.

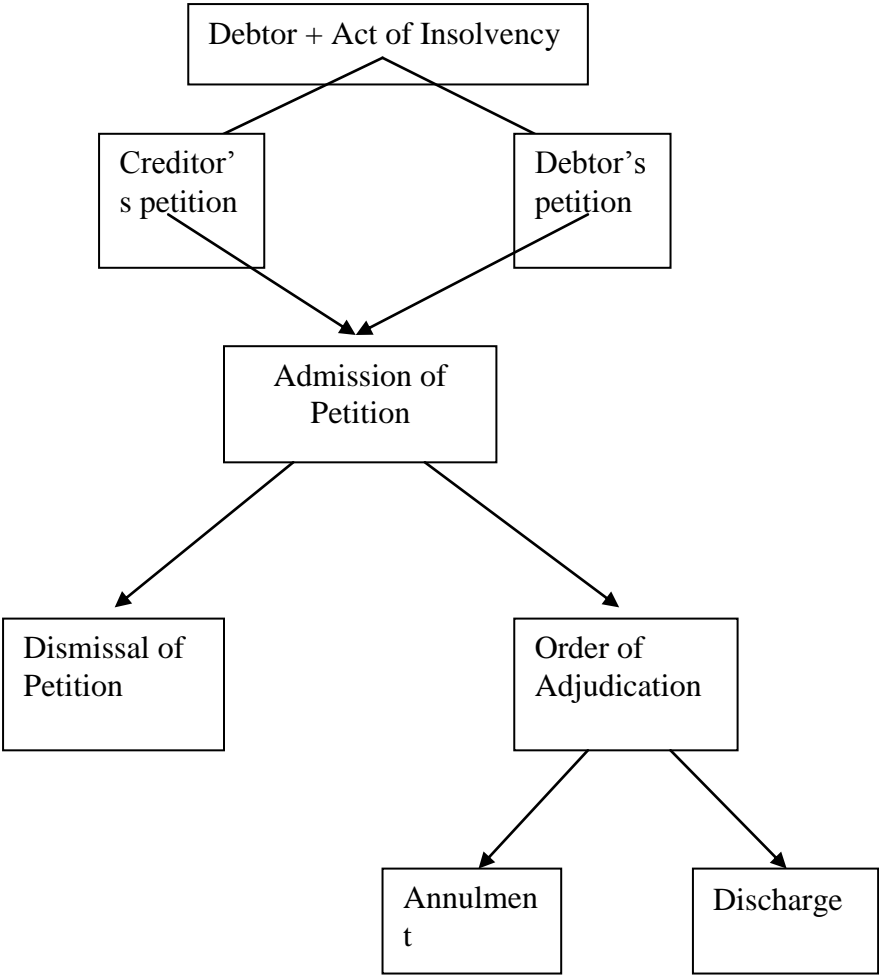
### **Order of Adjudication**

If the Court does not dismiss the petition, it should make an order of adjudication and specify in that order, the period within which the debtor should apply for discharge. The order of adjudication is passed under Sec.13 & 15 of the Act of 1909 and under Sec.27 of the Act of 1920. The order of adjudication should be published in the Official Gazette as per Sec.20 of the Act of 1909 and Sec.30 of the Act of 1920.

### **Proceedings subsequent to the Order of Adjudication**

The effects of an order of adjudication are enumerated under Sec.17 of the Act of 1909 and Sec.28 of the Act of 1920. The effects are that the property of the insolvent vests in the Court or official receiver / assignee and will become divisible among his creditors. There are certain classes of properties that shall not be vested. The order of adjudication also places an embargo on the creditors that they shall not have any remedy against the property of the insolvent in respect of the debt provable in insolvency. They are also not permitted to commence any suit or other legal proceeding except with the leave of Court and on such terms as the Court may impose. This bar does not apply to criminal proceedings. Under Sec.18 of the Act of 1909, the Court is authorized to stay any suit or other proceedings pending against the debtor before any Judge or Judges of the Court or in any other Court subject to the superintendence of the Court. The court is also authorized to stay any insolvency proceedings pending against the debtor in any court subject to the superintendence of the Court. On an application by the insolvent, the Court can make an order for protection of the insolvent from arrest or detention for any debt to which the order of adjudication applies.

**Solvency Proceedings from Commencement to Termination**



## 8. CORPORATE INSOLVENCY

The issue of corporate insolvency has attained great significance with the globalization of economy. A need has been felt for bringing about reforms in the sphere of law of insolvency. The basic objectives of corporate insolvency are:

- to restore the debtor company to profitable trading where it is practicable;
- to maximize the return to creditors as a whole where the company itself cannot be saved;
- to establish a fair and equitable system for the ranking of claims and the distribution of assets among creditors, involving a redistribution of rights;
- to provide a mechanism by which the causes of failure can be identified and those guilty of mismanagement brought to book;
- placement of the assets of the company under external control;
- substitution of collective action for individual pursuits;
- avoidance of certain transactions and fraudulent conveyances, dissolution and winding up etc.

There is no single comprehensive and integrated policy on corporate insolvency in India comparable with the Chapter 11 or Chapter 7 bankruptcy code in the US. There are three major legislative Acts namely the Companies Act, 1956/2013 Sick Industrial Companies (Special Provisions) Act, 1985 (SICA in short) and The Securitisation, Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI in short) and several special provisions, which provide procedural guidance on the liquidation or reorganization process. As a result, four different agencies, the High Courts, the Company Law Board, the Board for Industrial and Financial Reconstruction (BIFR), and the Debt Recovery Tribunals (DRTs), have overlapping jurisdiction, which creates systemic delays and complexities in the process.

The Presidency Towns Insolvency Act, 1909 and The Provincial Insolvency act, 1920 is applicable only to individuals, sole proprietorships and partnership firms. Section 107 of The Presidency Towns Insolvency Act, 1909 and Section 8 of The Provincial Insolvency act, 1920 specifically prohibits any insolvency petition against any against any corporation or against any association or company registered under any enactment for the time being in force.

### **Companies Act, 1956**

Chapter V of the Companies Act, 1956 provides for a mechanism by which corporate revival and rehabilitation may be undertaken. Section 391 of the Act provides for a court-supervised process by which a company can enter into a scheme of arrangement or a compromise with its creditors and/or members. The nature of the scheme or compromise that can be proposed under this provision is very wide: it includes schemes or compromises that may be proposed to restore the company to profitability. Further, such a scheme may be proposed at any stage, including during the pendency of insolvency proceedings against the company. There is no requirement of proof of insolvency or impending insolvency. Thus, the company's management can act at the early signs of financial distress and collaborate with the creditors to rescue the company. Further, unlike the SICA, all companies, and not just industrial companies, are covered within the ambit of Section 391. However, unlike SICA, provisions for debt restructuring under Chapter V of the Act do not provide for an automatic moratorium.

Chapter V of the Companies Act, 1956 provides for a mechanism by which corporate revival and rehabilitation may be undertaken. Section 391 of the Act provides for a court-supervised process by which a company can enter into a scheme of arrangement or a compromise with its creditors and members. The broad procedure under Section 391 is this: a scheme of arrangement or a compromise may be proposed between the company and its creditors or a class of creditors. Once the scheme is proposed, the company or any creditor or the liquidator of a company being wound up has to make an application to the court for holding a meeting of the creditors or a class of creditors. The scheme/compromise shall be binding on the company and all its creditors, and in the case of a company being wound up, on its liquidator and all contributories if: (i) it gains the approval of a majority in number, representing three-fourths in value of the creditors or class of creditors, present and voting at the meeting; (ii) it is sanctioned by the court; (iii) a certified copy of such order of sanction has been filed with the Registrar of Companies. When separate meetings are held for the approval of a single composite scheme, the approval of three-fourths majority in value of each meeting of creditors / class of creditors is required for the scheme to have been considered approved for the purposes of Section 391. The company can apply to the court for a stay on the initiation or continuation of any suit or proceedings against the company, so as to prevent enforcement action by creditors while the scheme is being finalised.

The current legal framework governing the winding-up of companies is contained in the Companies Act, 1956. The provisions contained in Chapter XX of the Companies Act, 2013 relating to winding up of

companies have not been notified yet. The winding up proceedings under the 1956 Act are carried out voluntarily (members' voluntary liquidation, which is a liquidation procedure for solvent companies, and creditors' voluntary liquidation), or compulsorily by the High Court. It may be noted that insolvency of a company is only one of the grounds for compulsory winding up a company.

### **Companies Act, 2013**

The Companies Act, 2013 provides for a new comprehensive regime for revival and rehabilitation of companies under Chapter XIX and Liquidation in Chapter XX. The procedure under the Act in relation to corporate rescue shall be administered by the NCLT (National Company Law Tribunal), a quasi-judicial body. However, these provisions have not been notified.

The current legal framework for bankruptcy resolution (winding up of a company on inability to pay debt) continues to be the Companies Act 1956, pending provisions in Companies Act 2013 which are yet to be notified.

Chapter XIX (Secs. 253 to 269) contains the following provisions for rehabilitation or liquidation of sick companies –

- i. Provisions of revival and rehabilitation of sick companies will apply to all companies and not only to an industrial company.
- ii. Inability to pay debts is considered as criteria for determining a sick company. If a company fails to pay debts due to its secured creditor representing 50% or more of outstanding amount of debt within 30 days of demand, any secured creditor may file an application to National Company Law Tribunal (the tribunal) to declare such company as a "sick company". The company may also file an application to the tribunal to declare it as a sick company on above ground.
- iii. Where the Tribunal is satisfied that a company has become sick company, it shall after considering all the relevant facts and circumstances of the case, decide, as soon as may be, by an order in writing, whether it is practicable for the company to make the repayment of its debts within a reasonable time.
- iv. On the determination of sickness by the tribunal, the applicant shall make an application within 60 days of determination, for measures to be adopted for revival or rehabilitation.



- v. Where the Tribunal determines the Company as Sick and where the company has no draft scheme for its revival and rehabilitation, the Tribunal may direct the Interim administrator who shall be appointed by Tribunal from a panel maintained by the Central Govt.
- vi. When the interim administrator submits his report about the possibility of revival, then company administrator is appointed who undertakes the approval process by creditors and submits the same to the tribunal who would sanction the scheme within 60 days of approval by creditors.
- vii. Then, the determination of sickness.

Chapter XX (Secs. 270 to 365 deals with winding up of companies. The company may be wound up in any of the following modes –

- i. By National Company Law Tribunal
- ii. Voluntary winding up

According to Sec.271(1) may be wound up by the Tribunal if –

- (a) if the company is unable to pay its debts;
- (b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
- (c) 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;
- (d) if the Tribunal has ordered the winding up of the company under Chapter XIX(i.e. Revival and Rehabilitation of Sick Companies);
- (e) 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;
- (f) 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
- (g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

A company will be deemed to be unable to pay its debts –

- (a) if a creditor, by assignment or otherwise, to whom the company is indebted for an amount exceeding one lakh rupees then due, has served on the company, by causing it to be delivered at its registered office, by registered post or otherwise, a demand requiring the company to pay the amount so due and the company has failed to pay the sum within twenty one days after the receipt of such demand or to provide adequate security or re-structure or compound the debt to the reasonable satisfaction of the creditor;
- (b) if any execution or other process issued on a decree or order of any court or tribunal in favour of a creditor of the company is returned unsatisfied in whole or in part; or
- (c) if it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the company.

A petition for Winding Up may be presented under Section 272 by any of the following persons:

- (a) the company; or
- (b) any creditor or creditors, including any contingent or prospective creditor or creditors;
- (c) any contributory or contributories;
- (d) all or any of the parties specified above in clauses (a), (b), (c) together
- (e) the Registrar;
- (f) any person authorised by the Central Government in that behalf;
- (g) by the Central Government or State Government in case falling under clause (c) of Section 271(1) i.e. Company acting against the interest of the sovereignty and integrity of India.

### **SICA**

When an entrepreneur is unable to grow profitably and expand the business on a sustained basis, he may have to take a decision of either restructuring its organization or closing it. Thus, he may either revive the company if it is potentially viable or ensure the closure of an unviable unit so as to release the investments locked up in such units for productive use elsewhere.

Sick industries are those industries which make losses that are more or less permanent and are not likely to be eliminated easily. In the normal course, such units would close down or would undergo extensive restructuring to eliminate the operations or activities that are particularly unprofitable. To deal with such a problem, Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) was enacted. It aimed to detect

industrial sickness and provide for speedy remedial measures. Hence, a quasi-judicial body called Board for Industrial and Financial Reconstruction (BIFR) was set up which expedited the process of revival of potentially viable units or closure of unviable units.

The Sick Industrial Companies (Special Provisions) Act, 1985 pertains to the industries specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, (IDR Act) subject to the exceptions specified in the Act.

The basic rationale of enacting The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) was to determine sickness in the industrial units. It also aimed at expediting the revival of potentially viable units so as to make the investments in such units profitable. At the same time, to ensure the closure of unviable units so as to release the investments locked up in such units for productive use elsewhere.

Sec.3(1)(o) of the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) defines sick industrial company as an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.

Section 3 (1) (ga) of Act defines 'Net worth' as the sum of the paid-up capital and free reserves, while the term 'free reserves' means all reserves credited out of the profits and share premium account, but does not include reserve out of re-valuation of assets, write back of depreciation provisions and amalgamation.

Government companies having State or Central Government share holdings of 51% or more are kept outside the purview of the Act. Also small scale industrial units and Ancillary units are kept outside the purview of the Act.

### **1) Constitution of BIFR and AAIFR**

The Sick Industrial Companies (Special Provisions) Act, 1985 provides for the constitution of two quasi-judicial bodies, that is, Board for Industrial and Financial Reconstruction (BIFR) and Appellate Authority for Industrial and Financial Reconstruction (AAIFR). BIFR has been set up as an apex board to tackle industrial sickness and is entrusted with the work of taking appropriate measures for revival and rehabilitation of potentially sick undertakings and for liquidation of non-viable companies, while, AAIFR has been constituted for hearing the appeals against the orders of the BIFR.

## **2) Reference to BIFR**

The Board of Directors of a sick industrial company is required under Sec.15 of the Sick Industrial Companies (Special Provisions) Act, 1985 to report the sickness to the BIFR within 60 days of finalization of audited accounts, for the financial year at the end of which the company has become sick. BIFR has prescribed a format for this report. While reporting by a company of its sickness to the BIFR is mandatory as per the provisions of law, any other interested person/party can also report the fact of sickness of a company to the BIFR. Such interested parties may be the financial institution/bank that has lent loan to the company, the RBI, the Central/State Governments. The BIFR has prescribed a different format for the report to be submitted by such interested parties. When a company has been financed by a consortium of banks, it is the Lead Bank that should report to the BIFR about the sickness under advice to other participating banks in the consortium.

## **3) Inquiry by BIFR**

When a case is referred to the BIFR, it is verified by the Registrar of the BIFR as to whether the facts of the case fall within the provisions of the Sick Industrial (Special provisions) Act, 1985. If so, the BIFR accepts the case and notifies a date for hearing the case. For rehabilitating a sick unit, cooperation of various connected agencies is a must. This co-ordination is achieved by the BIFR. The BIFR invites the representatives of the informant sick company, the representatives of concerned financial institutions and commercial banks, representatives of the Central/State Governments, trade union representatives etc., to the hearing and inquiry is made under section 16 of the Act.

After the hearing, the BIFR itself may conduct a study or entrust the work to an 'operating agency' appointed by it to determine whether the company is in fact sick. According to Sec.3(1)(i) of SICA, "operating agency" means any public financial institution, state level institution, scheduled bank or any other person as may be specified by general or special order as its agency by the Board. Normally, the lead financial institution or the lead public sector bank that has financed the company is nominated as the operating agency. Lead institution is one that has major financial stake in the sick company. The enquiry should be completed within 60 days. On completion of the enquiry, the BIFR will declare whether the company is sick or not.

4) **Revival package –**

Once a company has been found sick, the BIFR may grant time to the sick company to enable it to make its net worth positive and bring the company out of sickness, without any external financial assistance. If it is found infeasible for company to make its net worth positive without any external financial assistance, or if the BIFR decides that the company cannot make its net worth positive within a reasonable time, the BIFR will direct the operating agency to prepare a suitable revival package for the restoration of the health of the company.

The operating agency will then prepare a suitable revival package. The revival package may vary from case to case depending on the nature of the problem and may include additional financial assistance, postponement of recovery of loan already lent by banks and financial institutions, change in management, amalgamation, sale of redundant assets, lease of assets or any other suitable measure. The revival package should be submitted to the BIFR within a time limit of 90 days or such extended period as may be granted by the BIFR.

On submission of the revival package by the operating agency, the BIFR should send the revival package in a draft form to all the interested parties (*i.e.*, the sick industrial company, the banks/financial institutions who have given financial assistance to the sick company, the operating agency, the transferee company (if there is a recommendation in the revival package for amalgamation) etc., eliciting their views/suggestions on the revival package. The BIFR should also publish particulars of the draft revival package in newspapers inviting suggestions/objections, if any, from the shareholders of the sick company, creditors and employees of the sick company, transferee company and any other interested party. On receipt of views/suggestions/objections on the draft revival scheme, the BIFR may, if deemed fit; afford an opportunity to the interested parties to be heard. After careful examination of all the aspects, the BIFR will sanction the revival scheme with or without any modifications. The scheme, as sanctioned, will come into force from the specified date and all the concerned parties are required to abide by the provisions of the revival scheme. The BIFR may also order the operating agency to implement the sanctioned revival scheme.

When the revival package as finalized by the BIFR contains further financial assistance or relief, concessions, sacrifices etc. (for example, sanctioning of additional financial assistance for the purchase of certain balancing equipments, waiving of penal interest/compound interest charged, waiving of interest in part or full, waiver from sales tax etc.) then the scheme will be circulated to the concerned agencies for their consent to be received within a period of 60 days. Once the various agencies involved in the revival scheme give their consent to the scheme, it will become binding on the consenting parties to implement the recommendations

contained in the revival scheme. However, when any of the involved agencies does not give its consent to the scheme, the BIFR has no powers to force the agency to accord its consent. If in the opinion of the BIFR, the revival package cannot be successful without the consent from one or more of the agencies involved, the BIFR has no other option but to recommend for winding up of the company. In fact, the threat of actual winding up of the company is the only weapon in the hands of the BIFR to make the various agencies to extend suitable relief and concessions as may be deemed necessary by the BIFR. BIFR itself cannot initiate the winding up proceedings. It can only forward its opinion to the concerned High Court and the High Court will initiate the winding up proceedings under the Companies Act, 1956 on the basis of the opinion of the Court.

**5) Other provisions –**

Where in respect of an industrial company, an inquiry is pending, or any scheme referred is under preparation or consideration or a sanctioned scheme is under implementation, then no proceedings for the winding-up of the industrial company or for execution, distress or the like against any of the properties of the industrial company shall be made. Also, no suit for the recovery of money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans, or advance granted to the industrial company shall lie or be proceeded with further, except with the consent of the Board or, as the case may be, the Appellate Authority.

Also with respect to the above conditions, the Board may by order declare with respect to the sick industrial company concerned that the operation of all or any of the contracts, assurances of property, agreements, settlements, awards, standing orders or other instruments in force, to which such sick industrial company is a party or which may be applicable to such sick industrial company immediately before the date of such order, shall remain suspended or that all or any of the rights, privileges, obligations and liabilities accruing or arising there under before the said date, shall remain suspended or shall be enforceable with such adaptations and in such manner as may be specified by the Board. However, such declaration should not be made for a period exceeding two years, which may be extended by one year at a time so that the total period shall not exceed seven years in the aggregate.

Any person who violates the provisions of the Act or any scheme or any order of the Board or of the Appellate Authority will be punishable with imprisonment for a term which may extend to three years and

also be liable to a fine. No court shall take cognizance of any offence mentioned except on a complaint in writing of the secretary or any such other officer of the Board or the Appellate Authority or any such officer of an operating agency as may be authorized in this behalf by the Board or the Appellate Authority.

## 9. INSOLVENCY AND SARFAESI

### **Introduction**

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (The Securitisation Act) has been enacted with an intention to strengthen the creditors rights through foreclosure and enforcement of securities by the banks and financial institutions by conferring on the creditors the right to seize the secured asset and sell of the same in order to recover dues promptly bypassing the costly and very time consuming legal process through courts.

The Securitisation Act empowers the banks and Financial Institutions to move on its own against a borrower whose assets are secured, and who has made some kind of default in repayment of the same. The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law. Thus after complying with the statutory provisions in the said act the banks can:

- Take possession of the secured assets of the borrower. This includes the right to transfer by way of lease, assignment or sale of the same for realization of the secured debt.
- Take over the management of the secured asset including the right to transfer by way of lease, assignment or sale of the same for realization of the secured debt.
- Appoint any person to manage the secured asset.

The Securitisation Act contains 41 sections in 6 Chapters and a Schedule. Chapter 1 contains 2 sections dealing with the applicability of the Securitisation Act and definitions of various terms. Chapter 2 contains 10 sections providing for regulation of securitisation and reconstruction of financial assets of banks and financial institutions, setting up of securitisation and reconstruction companies and matters related thereto. Chapter 3 contains 9 sections providing for the enforcement of security interest and allied and incidental matters. Chapter 4 contains 7 sections providing for the establishment of a Central Registry, registration of securitisation, reconstruction and security interest transactions and matters related thereto. Chapter 5 contains 4 sections providing for offences, penalties and punishments. Chapter 6 contains 10 sections providing for routine legal issues.



The Reserve Bank of India has issued guidelines and directions relating to registration, measures of ARCs, functions of the company, prudential norms, acquisition of financial assets and related matters under the powers conferred by the SARFAESI Act, 2002.

### **Incorporation and registration of Special Purpose Companies**

The Securitisation Act proposes to securitise and reconstruct the financial assets through two special purpose vehicles viz. 'Securitisation Company ('SCO')' and 'Reconstruction Company (RCO)'. SCO and RCO ought to be a company incorporated under the Companies Act, 1956 having securitisation and asset reconstruction respectively as main object. The Securitisation Act requires compulsory registration of SCO and RCO under the Securitisation Act before commencing its business. Further a minimum financial stability requirement is also provided by requiring SCO and RCO to possess owned fund of Rs.2 crore or up to 15% of the total financial assets acquired or to be acquired. The RBI has the power to specify the rate of owned fund from time to time. Different rates can be prescribed for different classes of SCO and RCO.

The Act deals with three aspects.

1. Enforcement of Security Interest by secured creditor (Banks/Financial Institutions)
2. Transfer of non- performing assets to Asset Reconstruction Company, which will then dispose of those assets and realize the proceeds.
3. To provide a legal framework for securitisation of assets.

### **Enforcement of Security Interest -**

Under the Act security interest created in favour of any secured creditor may be enforced, without the intervention of court or tribunal, by such creditor in accordance with the provision of this Act.

*(Notwithstanding anything contained in section 69 or section 69(A) of the Transfer of Property Act, 1882)*

#### Section 13(2)

Where any borrower, who is under a liability to a secured creditor under a security under a security agreement, makes any default in repayment of secured debt or any installment thereof , and his account in respect of such debt is classified by the secured creditor as non-performing asset, then the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4)

(4). In case the borrower fails to discharge his liability in full within the period specified in sub-section(2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:-

(a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for releasing the secured asset.

(b).take over the management of the assets of the borrower including the right to transfer by way of lease, assignment or sale for releasing the secured asset.

(c). appoint any person to manage the secured assets the possession of which has been taken over by the secured creditor.

(d). require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money any money is due or may become due to the borrower, to pay the secured creditor so much of the money as is sufficient to pay the secured debt.

Under section 69 of Transfer of Property Act, mortgagee can take possession of mortgaged property and sale the same without intervention of Court only in case of English mortgage. In addition mortgagee can take possession of mortgaged property where there is a specific provision in mortgage deed and the mortgaged property is situated in towns of Kolkata, Chennai or Mumbai. In other cases possession can be taken only with the intervention of court. Therefore till now Banks/Financial Institutions had to enforce their security through court. This was a very slow and time-consuming process.

(English Mortgage is where mortgagor binds himself to repay the mortgaged money on a certain date, and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will retransfer the property to the mortgagor upon payment of the mortgage money as agreed.)

Under the SARFAESI Act, if a loan becomes a non-performing asset (“NPA”) i.e. if a borrower is in default in respect of payment of interest or any instalment of the principal, beyond a period of 90 days of such amount becoming due then secured creditors are entitled to enforce the security interest created in their favour in accordance with the provisions of the SARFAESI Act. The secured creditors are required to give the borrower a notice of 60 days describing the default and the measures proposed to be taken. The borrower is given an opportunity to make representations to the secured creditors and the secured creditor may, after giving reasons for rejecting the representations of the borrower, take measures referred to in Section 13(4) of the SARFAESI Act, such as taking over possession of the secured assets or taking over the management of the business of the borrower etc., without the intervention of courts to enforce its security interest.

According to Section 2 (o) of the Act, Non Performing Asset means an asset or account of a borrower which has been classified by the bank or financial institution as sub-standard doubtful or loss asset.-

- a) In case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to the asset classifications issued by such authority or body;
- b) In any other case, in accordance with the directions or guidelines relating to assets classifications issued by the reserve bank.

### **Methods for recovery of Non-performing assets**

The SARFAESI Act, 2002 provides three alternative methods for recovery of NPAs, namely:

- **Securitisation:** It means issue of security by raising of receipts or funds by Securitisation Company (SC) /Asset Reconstruction Companies (ARC). A securitisation company or reconstruction company may raise funds from the qualified institutional buyers by forming schemes for acquiring financial assets. The SC/ARC shall keep and maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired, out of investments made by a qualified institutional buyer and ensure that realizations of such financial asset is held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.
- **Asset Reconstruction:** The SCs/ARCs for the purpose of asset reconstruction should provide for any one or more of the following measures:
  - the proper management of the business of the borrower, by change in, or takeover of, the management of the business of the borrower
  - the sale or lease of a part or whole of the business of the borrower
  - rescheduling of payment of debts payable by the borrower
  - enforcement of security interest in accordance with the provisions of this Act
  - settlement of dues payable by the borrower

- taking possession of secured assets in accordance with the provisions of this Act.
- Exemption from registration of security receipt: The Act also provides, notwithstanding anything contained in the Registration Act, 1908, for enforcement of security without Court intervention: (a) any security receipt issued by the SC or ARC, as the case may be, under section 7 of the Act, and not creating, declaring, assigning, limiting or extinguishing any right, title or interest to or in immovable property except in so far as it entitles the holder of the security receipt to an undivided interest afforded by a registered instrument; or (b) any transfer of security receipts, shall not require compulsory registration.

**Exception to the Securitisation Act (Sec.31)**

The provisions of this Act will not apply to--

- (a) a lien on any goods, money or security given by or under the Indian Contract Act, 1872 (9 of 1872; or the Sale of Goods Act, 1930 (3 of 1930) or any other law for the time being in force;
- (b) a pledge of movables within the meaning of section 172 of the Indian Contract Act, 1872 (9 of 1872);
- (c) creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934 (24 of 1934);
- (d) creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958);
- (e) any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created;
- (f) any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930 (3 of 1930);
- (g) any properties not liable to attachment (excluding the properties specifically charged with the debt recoverable under this Act) or sale under the first proviso to sub-section (1) of section 60 of the Code of Civil Procedure, 1908 (5 of 1908);
- (h) any security interest for securing repayment of any financial asset not exceeding one lakh rupees;
- (i) any security interest created in agricultural land;
- (j) any case in which the amount due is less than twenty per cent of the principal amount and interest thereon.

## **10. INSOLVENCY AND RECOVERY OF DEBT DUE TO BANKS**

Soon after the independence of the country it was found that the Indian economy was lying in a shattered condition with no productivity at every stage, no per capita income, a poor standard of living, dependence on agriculture and that the economy of the country was still in a primitive stage. Finance is the life blood of business and economic activities, the government was fully alive to the question that in case financial resources were not made and it was also realized that the entire banking system of the country was to be remodeled and reshaped and new financial institutions were to be established. In many cases the units, which had borrowed money from, state financial Corporation and the Industrial Finance Corporation at the center and the state level misappropriated the huge amounts which were loaned to them and when the question of recovery of came it was found that nothing was available. Under these circumstances it was considered that a special procedure should be adopted for the recovery of the various debts, which were due to banks and financial institutions.

In 1981, a Committee under the Chairmanship of Shri T. Tiwari had examined the legal and other difficulties faced by banks and financial institutions and suggested remedial measures including changes in law. The Tiwari Committee had also suggested setting up of Special Tribunals for recovery of dues of the banks and financial institutions by following a summary procedure. The setting up of Special Tribunals was done to not only fulfill a long-felt need, but also was an important step in the implementation of the Report of Narasimham Committee.

During this time (September, 1990) more than fifteen lakhs of cases filed were by the public sector banks and about 304 cases filed by the financial institutions were pending in various courts, recovery of debts involved more than Rs.5622 crores in dues of Public Sector Banks and about Rs.391 crores of dues of the financial institutions.

The locking up of such huge amount of public money in litigation prevented proper utilisation and recycling of the funds for the development of the country. The Committee on the Financial System headed by Shri M. Narasimham considered the setting up of Special Tribunals with special powers for adjudication of such matters and speedy recovery as critical to the successful implementation of the financial sector reforms. An urgent need was, therefore, felt to work out a suitable mechanism through which the dues to the banks and financial institutions could be realized without delay.

### **The Recovery of Debts Due to Banks and Financial Institutions Act, 1993**

The Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBI Act) was passed by the Parliament of India to provide for the speedy adjudication of matters relating to recovery of debts due to banks and financial institutions. This Act provided a procedure that was distinct from the existing Code of Civil Procedure in order to ensure such a speedy adjudication. This Act also provided for setting up of a separate set of tribunals to hear such matters and these tribunals are termed as Debt Recovery Tribunals (DRTs). The Government has set up such DRTs in many states in the country. Presently there are thirty three Debt Recovery Tribunals and five Debt Recovery Appellate Tribunals across the country.

The provisions of RDDBI Act, 1993 will not apply where the amount of debt due to any bank or financial institution or to a consortium of banks or financial institutions is less than ten lakh rupees or such other amount, being not less than one lakh rupees.

The RDDBI Act, 1993 provides Banks and Financial Institutions to approach the Debt Recovery Tribunal by filing an application for recovering its due. Only when the amount of due qualifies under the Act, the Banks and Financial Institutions could approach the Debt Recovery Tribunals under RDDBI Act, 1993. When the Bank approaches the Tribunal for recovery, then, the Tribunal will look into the claim made by the Bank in accordance with the procedure prescribed under RDDBI Act, 1993 and finally pass an award. The award can be executed by the Bank.

The procedures adopted in DRTs are very simple and uncomplicated. Unlike higher costs in civil courts, the DRT proceedings are cheaper. Within 30 days of filing DRT application, summons are sent to the defendants, who have to immediately submit their reply statements. Evidences are admitted in the form of sworn affidavit. Defendants are given the opportunity to cross examine bank's witness. As per the Act, the Tribunal has to decide the case within six months from the filing of case.

Any person aggrieved by any measure taken by secured creditor or his authorized officer may file an appeal to Debts Recovery Tribunal, within 45 days from date on which such measure was taken i.e. action of taking possession of asset, takeover of management of business of borrower, appointing person to manage secured asset etc. is taken by the creditor.

When a borrower files an appeal, the appeal cannot be entertained unless; the borrower deposits 75% of the amount claimed in the notice by secured creditor. The DRT can waive or reduce the amount required to be deposited. The amount is not required to be deposited at the time of filing appeal, but appeal will not be heard

till the amount is deposited. The borrower while filing the appeal should also file an application requesting the Debt Recovery Tribunal to admit the appeal without deposit of any amount. If the DRT orders partial deposit of the amount and the same is not deposited, appeal can be dismissed.

The 75% deposit is only required if the appeal is filed by the borrower. If some other aggrieved person (e.g. guarantor, shareholder) files it the deposit is not required.

If a person is aggrieved by the order of the DRT, it can file an appeal to the Appellate Tribunal within 30 days from date of receipt of the DRT order.

If the DRT or Appellate Tribunal holds that possession of assets by the secured creditor was wrongful and directs the secured creditor to return asset to concerned borrower, the borrower shall be entitled to compensation and costs as may be determined by DRT or Appellate tribunal.

The Tribunal can also direct return of asset, if the secured creditor had already sold or transferred the asset to a third party.

The tribunal can also make an interim order (injunction or stay or attachment) against the defendant to debar him from transferring, alienating or disposing of any property and assets belonging to him. In the case of disobedience of an order made by the Tribunal, or breach of any of the terms on which the order was made the Tribunal may order the properties of the person guilty of such disobedience or breach, to be attached and may also order such person to be detained in the civil prison.

The Tribunal has the power to appoint a receiver of any property, to remove any person from the possession or custody of the property and commit the same to the possession, custody or management of the receiver for the realization, management, protection, preservation and improvement of the property, the collection of the rents and profits thereof, the application and disposal of such rents and profits and the execution of documents as the owner himself has, or can appoint a Commissioner for preparation of an inventory of the properties of the defendant or for the sale thereof.

Where a certificate of recovery is issued against a company registered company, the Tribunal may order the sale proceeds of such a company to be distributed among its secured creditors in accordance with the provisions of Sec. 529A of the Companies Act, 1956.

## Overview of Insolvency Laws in India by Rajkumar S. Adukia

Wide residuary powers are given to DRT so that the Tribunal may make such orders and give such directions as may be necessary or expedient to give effect to its orders or to prevent abuse of its process or to secure the ends of justice.



## **11. CORPORATE DEBT RESTRUCTURING MECHANISM (CDR)**

Debt restructuring is a significant modification made to the debt, operations or structure of a company. This type of corporate action is usually made when there are significant problems in a company, which are causing some form of financial harm and putting the overall business in jeopardy. The hope is that through restructuring, a company can eliminate financial harm and improve the business.

Guidelines issued by the Reserve Bank of India on restructuring of advances (other than those restructured under a separate set of guidelines issued by the Rural Planning and Credit Department (RPCD) of the RBI on restructuring of advances on account of natural calamities) are divided into the following four categories:

- (i) Guidelines on restructuring of advances extended to industrial units.
- (ii) Guidelines on restructuring of advances extended to industrial units under the Corporate Debt Restructuring (CDR) Mechanism
- (iii) Guidelines on restructuring of advances extended to Small and Medium Enterprises (SME)
- (iv) Guidelines on restructuring of all other advances.

### **Corporate Debt Restructuring Mechanism (CDR)**

There are occasions when corporates find themselves in financial difficulties because of factors beyond their control and also due to certain internal reasons. For the revival of such corporates as well as for the safety of the money lent by the banks and financial institutions, timely support through restructuring of genuine cases is called for. However, delay in agreement amongst different lending institutions often comes in the way of such endeavors. Based on the experience in countries like the UK, Thailand, Korea, Malaysia, etc. of putting in place an institutional mechanism for restructuring of corporate debt and need for a similar mechanism in India, a Corporate Debt Restructuring System was evolved and detailed guidelines were issued by Reserve bank of India on August 23, 2001 for implementation by financial institutions and banks.

The Corporate Debt Restructuring (CDR) Mechanism is a voluntary non-statutory system based on Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA) and the principle of approvals by super-majority of 75% creditors (by value) which makes it binding on the remaining 25% to fall in line with the majority decision. The CDR Mechanism covers only multiple banking accounts, syndication/consortium accounts, where all banks and institutions together have an outstanding aggregate exposure of Rs.100 million and above. It covers all categories of assets in the books of member-creditors classified in terms of RBI's prudential asset classification standards. Even cases filed in Debt Recovery Tribunals/Bureau of Industrial and

Financial Reconstruction/and other suit-filed cases are eligible for restructuring under CDR. The cases of restructuring of standard and sub-standard class of assets are covered in Category-I, while cases of doubtful assets are covered under Category-II.

Reference to CDR Mechanism may be triggered by:

- Any or more of the creditors having minimum 20% share in either working capital or term finance, or
- By the concerned corporate, if supported by a bank/FI having minimum 20% share as above.

It may be emphasized here that, in no case, the requests of any corporate indulging in fraud or misfeasance, even in a single bank, can be considered for restructuring under CDR System. However, Core Group, after reviewing the reasons for classification of the borrower as wilful defaulter, may consider admission of exceptional cases for restructuring after satisfying itself that the borrower would be in a position to rectify the wilful default provided he is granted an opportunity under CDR mechanism.

The legal basis to the CDR System is provided by the Debtor-Creditor Agreement (DCA) and the Inter-Creditor Agreement (ICA). All banks /financial institutions in the CDR System are required to enter into the legally binding ICA with necessary enforcement and penal provisions. The most important part of the CDR Mechanism which is the critical element of ICA is the provision that if 75% of creditors (by value) agree to a debt restructuring package, the same would be binding on the remaining creditors.

Similarly, debtors are required to execute the DCA, either at the time of reference to CDR Cell or at the time of original loan documentation (for future cases). The DCA has a legally binding 'stand still' agreement binding for 90/180 days whereby both the debtor and creditor(s) agree to 'stand still' and commit themselves not to take recourse to any legal action during the period. 'Stand Still' is necessary for enabling the CDR System to undertake the necessary debt restructuring exercise without any outside intervention, judicial or otherwise. However, the 'stand still' is applicable only to any civil action, either by the borrower or any lender against the other party, and does not cover any criminal action.

Besides, the borrower needs to undertake that during the 'stand still' period the documents will stand extended for the purpose of limitation and that he would not approach any other authority for any relief and the directors of the company will not resign from the Board of Directors during the 'stand still' period.

## **12. DRAFT INSOLVENCY & BANKRUPTCY BILL, 2015**

### **Interim Report of Bankruptcy Law Reforms Committee**

The Union Finance Minister Shri.Arun Jaitley during his Budget Speech of 2014-15 announced that an entrepreneur friendly legal bankruptcy framework would be developed for SMEs to enable easy exit.

Pursuant to the above announcement, a Committee was set-up by the Department of Economic Affairs, Ministry of Finance, under the Chairmanship of Mr.T.K.Viswanathan, former Secretary General, Lok Sabha and former Union Law Secretary, on 22.8.2014 to study the corporate bankruptcy legal framework in India and submit a report.

The Committee will examine the whole gamut of issues relating to bankruptcy including the following specific areas:

- i. Why bankruptcy matters?
- ii. Early detection and resolution of financial distress
- iii. Protection of interest of stakeholders
- iv. Study the rescue mechanism and suggest ways of improving it
- v. Examine the role of the institutions engaged in the process of rescue and liquidation
- vi. Liquidation procedure for smaller companies
- vii. Any other aspect relevant to the subject

The Committee submitted an Interim Report on 10<sup>th</sup> February 2015, which was placed on the website of the Ministry of Finance.

### **Interim Report**

The Committee decided to divide the project into two parts:

- (i) to examine the present legal framework for corporate insolvency and suggest immediate reforms, and
  - (ii) to develop an 'Insolvency Code' for India covering all aspects of personal and business insolvency.
- BLRC was of the opinion that developing an Insolvency Code and its operationalisation would require more time.

- Main purpose of the interim report was to suggest certain immediate reforms for improving the corporate insolvency regime in India, given that the provisions of the new Companies Act, 2013 on rescue and liquidation of companies may be subsumed into the Insolvency Code with suitable modifications.
- This Report does not address issues relating to insolvency resolution of banks and other financial institutions. (This has been addressed by the Financial Sector Legislative Reforms Commission (“FSLRC”).)
- The BLRC is of the opinion that further thought and consideration is required before implementing the UNCITRAL Model Law on Cross-Border Insolvency. Such adoption should ideally take place only after the adoption of the Insolvency Code. The issues relating to cross-border insolvency will be addressed as part of the final report of the BLRC.
- The Interim Report does not cover issues relating to debt recovery legislations.

#### **Summary of Issues in the Interim Report**

- 1) Revival & rehabilitation of sick companies - As of today, all aspects of rehabilitation of sick/potentially sick industrial companies continue to be governed by SICA.
- 2) Debt restructuring under Schemes of Arrangement - Chapter V of the CA 1956 (or Chapter XV of CA 2013) provides for a mechanism by which corporate revival and rehabilitation may be undertaken (at least in theory). Section 391 of CA 1956 provides for a court-supervised process by which a company can enter into a scheme of arrangement or a compromise with its creditors and/or members.
- 3) Liquidation / winding up of companies - The current legal framework governing the winding-up of companies is contained in the Companies Act, 1956. The provisions contained in Chapter XX of the Companies Act, 2013 relating to winding up of companies have not been notified yet.
- 4) Insolvency resolution of individuals and partnerships - (i) Personal insolvency is primarily governed under two Acts in India: the Presidency Towns Insolvency Act, 1909 (for the erstwhile Presidency towns, i.e. Kolkata, Mumbai and Chennai) and the Provincial Insolvency Act, 1920 (for the rest of India). Though these are central laws, it should be noted that both these Acts have a number of state specific amendments. The substantive provisions under the two Acts are largely similar. There have not been any substantial changes to this regime over the years and it has proved to be largely ineffective in practice.

Unlike the CA 2013, there are no provisions for the rehabilitation or revival of sick LLPs.

- 5) Insolvency resolution of Co-operative Societies – Co-operative Societies Act, 1912 and the Multi-State Co-operative Societies Act, 2002 do not provide for the rehabilitation or revival of sick co-operative societies.
- 6) Asset reconstruction under the SARFAESI Act – The mechanism under the Act is largely seen as a debt recovery tool and not an insolvency resolution tool (i.e., it does not facilitate rescue in practice).
- 7) Debt enforcement / Recovery - DRTs fall within the purview of the Ministry of Finance, unlike civil courts, which are part of the judicial hierarchy under the supervision of the respective High Court.
- 8) Non-statutory framework prescribed by the RBI - The Corporate Debt Restructuring mechanism, as envisaged in the RBI circulars on the subject, aims to provide a forum for corporate debt restructuring for viable businesses in financial distress outside the court/tribunal driven legal processes. The RBI has recently laid down guidelines for early recognition of financial distress, taking prompt steps for resolution, and ensuring fair recovery for lending institutions. The RBI issued new Guidelines for Rehabilitation of Sick Micro and Small Enterprises in 2012, which provides for the process of identification of a sick unit, early detection of incipient sickness, and lays down a procedure to be adopted by banks for resolution of distress.
- 9) Several State governments have their own Relief Undertaking legislations that seek to provide for rehabilitation of sick undertakings established or funded by the government. Many such legislations were specifically enacted for the purpose of preventing unemployment.
- 10) The Central Government is authorised to take-over the management of a scheduled industrial company under the Industries Development and Regulation Act, 1951 several grounds and provide relief similar to those available under insolvency laws (suspension of claims etc.)

The Interim Report focuses on suggesting immediate reforms to the legal regimes with regard to Revival & rehabilitation of sick companies; Debt restructuring under Schemes of Arrangement and Liquidation / winding up of companies.

#### **Summary of recommendations (Interim Report)**

- Section 253(1) of CA 2013 should be amended to specify that any secured creditor may initiate rescue proceedings if the debtor company fails to pay a single undisputed debt owed to such secured creditor exceeding a prescribed value within thirty days of the service of the notice of demand or fails to secure or compound such debt to the reasonable satisfaction of such creditor.

- The NCLT should be empowered to impose sanctions/costs/damages on a petitioner and disallow re-applications on the same grounds if it finds that a petition has been filed to abuse the process of law.
- Section 253 of CA 2013 should be amended to allow unsecured creditors representing 25% of the value of the debt owed by the debtor company to all its unsecured creditors to initiate rescue proceedings if the debtor company fails to pay a single undisputed debt owed to any such unsecured creditor exceeding a prescribed value within 30 days of the service of the notice of demand or fails to secure or compound it to the reasonable satisfaction of such unsecured creditor. (Unsecured creditors are not permitted to initiate rescue proceedings under the CA 2013. This may reduce their incentives to provide credit.)
- Sections 253 to 258 of CA 2013 should be redrafted to ensure that the viability of a company is taken into account while determining its sickness and enabling the creditors to have a say in such determination. (The CA 2013 uses 'sickness' as the preliminary criterion for determining whether a company should be rescued or not. However, it does not prescribe any statutory test for determining 'sickness' and leaves much to the discretion of the NCLT.)
- The NCLT's discretion to grant, refuse or lift a moratorium under Section 253 (2) should be guided by a non-exhaustive list of grounds specified in a separate statutory provision.
- 75% of the secured creditors in value (or 75% of all creditors by value, if there is no secured debt in the company) should be able to appoint a company administrator directly (after a company has been declared sick) and determine the terms and conditions for such appointment (including the fee), subject to *post facto* confirmation by the NCLT.
- One of the main drawbacks of the SICA regime was that it allowed the existing management of the debtor company to remain in control of the company during the course of rescue proceedings (which facilitated practices involving siphoning of assets, etc.). In order to address this concern, the CA 2013 provides that an interim administrator or the company administrator can take-over the management of the debtor company, but only on being directed to do so by the NCLT. Once again, it leaves too much to the discretion of the NCLT without providing any criteria to guide the exercise of such discretion.
- Chapter XIX of CA 2013 envisages an important role for the company administrator (who can be selected from a panel of specified professionals) in the revival and rehabilitation of financially distressed

companies. However, despite having such a prominent role in the rescue proceedings, the CA 2013 does not specifically set out the powers and functions of the administrator in detail.

- Section 262 should be amended to provide for the following principles to be applicable at the time of sanctioning a scheme of revival: (i) the creditors within the same class should be treated equally; (ii) dissenting creditors should get as much in scheme as they would in liquidation; (iii) consent of creditors who are not affected by a scheme should not be required (for instance, secured creditors who have realised their security interests outside the rescue proceedings); (iv) related parties should be excluded from the unsecured creditors entitled to vote on a scheme.
- Section 261 should be amended to include ‘raising secured and unsecured loans from any creditor (whether existing or external) as part of a scheme of revival’. The scheme may also provide for ‘super priority’ being granted to creditors who provide such finance – i.e., the rescue finance providers will rank ahead of all existing creditors subject to such safeguards for the existing creditors as may be provided in the scheme.
- Schemes of arrangement can become a very effective tool for debt restructuring, acknowledging however that such restructurings can also be achieved less formally (and often less expensively) through a workout outside the court.
- In order to re-instate the debt enforcement function of the statutory demand test for winding up, if a company fails to pay an undisputed debt of a prescribed value as per Section 271(2) (a), the creditor should be entitled to a winding up order irrespective of whether it is insolvent (in commercial or balance sheet terms) or not.
- There should be a separate declaratory provision that upholds the priority rights of secured creditors on their security interests notwithstanding anything to the contrary contained in any state or central law that imposes a tax or revenue payable to the Government by virtue of a specific statutory provision made.
- The avoidance provisions under the CA 2013 (Sections 328 and 329) should be strengthened by providing for a longer vulnerability period (up to two years) for avoiding transactions entered into with related parties of the company.

- All efforts must be made to ensure that the liquidators and their counsels are sufficiently equipped and have all necessary resources to: (a) discharge their duties efficiently; (b) bring cases against the management for committing offences contemplated in the law during the course of liquidation; and (c) effectively manage the costs associated with achieving these functions.
- Although the RBI has also issued separate instructions to banks for revival of sick *micro and small enterprises* or MSEs, the said guidelines do not apply to medium enterprises. In order to effectively address issues relating to insolvency of all MSMEs, the personal insolvency regime needs be substantively reformed. The proposed Insolvency Code will be a comprehensive law that will not only cover companies and other forms of business enterprises, but also provide a detailed and modern framework (and institutions) for resolution of personal insolvencies.

#### **Summary of the Recommendations of the Bankruptcy Law Reforms Committee (BLRC)**

The Report of the BLRC is in two parts:

- Rationale and Design/Recommendations;
- A comprehensive draft Insolvency and Bankruptcy Bill covering all entities.

The draft Bill i.e. The Insolvency and Bankruptcy Code, 2015 has consolidated the existing laws relating to insolvency of companies, limited liability entities (including limited liability partnerships and other entities with limited liability), unlimited liability partnerships and individuals which are presently scattered in a number of legislations, into a single legislation. The committee has observed that the enactment of the proposed Bill will provide greater clarity in the law and facilitate the application of consistent and coherent provisions to different stakeholders affected by business failure or inability to pay debt and will address the challenges being faced at present for swift and effective bankruptcy resolution. The Bill seeks to improve the handling of conflicts between creditors and debtors, avoid destruction of value, distinguish malfeasance vis-a-vis business failure and clearly allocate losses in macroeconomic downturns.

The **major recommendations** of the Report are as follows:

- i. **Insolvency Regulator:** The Bill proposes to establish an Insolvency Regulator to exercise regulatory oversight over insolvency professionals, insolvency professional agencies and informational utilities.



- i. **Insolvency Adjudicating Authority:** The Adjudicating Authority will have the jurisdiction to hear and dispose of cases by or against the debtor.
  - a. The Debt Recovery Tribunal (“DRT”) shall be the Adjudicating Authority with jurisdiction over individuals and unlimited liability partnership firms. Appeals from the order of DRT shall lie to the Debt Recovery Appellate Tribunal (“DRAT”).
  - b. The National Company Law Tribunal (“NCLT”) shall be the Adjudicating Authority with jurisdiction over companies, limited liability entities. Appeals from the order of NCLT shall lie to the National Company Law Appellate Tribunal (“NCLAT”).
  - c. NCLAT shall be the appellate authority to hear appeals arising out of the orders passed by the Regulator in respect of insolvency professionals or information utilities.
- ii. **Insolvency Professionals:** The draft Bill proposes to regulate insolvency professionals and insolvency professional agencies. Under Regulator’s oversight, these agencies will develop professional standards, codes of ethics and exercise a disciplinary role over errant members leading to the development of a competitive industry for insolvency professionals.
- v. **Insolvency Information Utilities:** The draft Bill proposes for information utilities which would collect, collate, authenticate and disseminate financial information from listed companies and financial and operational creditors of companies. An individual insolvency database is also proposed to be set up with the goal of providing information on insolvency status of individuals.
- v. **Bankruptcy and Insolvency Processes for Companies and Limited Liability Entities:** The draft Bill proposes to revamp the revival/re-organisation regime applicable to financially distressed companies and limited liability entities; and the insolvency related liquidation regime applicable to companies and limited liability entities.
  - a. The draft Bill lays down a clear, coherent and speedy process for early identification of financial distress and revival of the companies and limited liability entities if the underlying business is found to be viable.
  - b. The draft Bill prescribes a swift process and timeline of 180 days for dealing with applications for insolvency resolution. This can be extended for 90 days by the Adjudicating Authority only in exceptional cases. During insolvency resolution period (of 180/270 days), the management of the debtor is placed in the hands of an interim resolution professional/resolution professional.
  - c. An insolvency resolution plan prepared by the resolution professional has to be approved by a majority of 75% of voting share of the financial creditors. Once the plan is approved, it would require sanction of the

Adjudicating Authority. If an insolvency resolution plan is rejected, the Adjudicating Authority will make an order for the liquidation.

d. The draft Bill also provides for a fast track insolvency resolution process which may be applicable to certain categories of entities. In such a case, the insolvency resolution process has to be completed within a period of 90 days from the trigger date. However, on request from the resolution professional based on the resolution passed by the committee of creditors, a one-time extension of 45 days can be granted by the Adjudicating Authority. The order of priorities [waterfall] in which the proceeds from the realisation of the assets of the entity are to be distributed to its creditors is also provided for.

vi. **Bankruptcy and Insolvency Processes for Individuals and Unlimited Liability Partnerships:** The draft Bill also proposes an insolvency regime for individuals and unlimited liability partnerships also. As a precursor to a bankruptcy process, the draft Bill envisages two distinct processes under this Part, namely, Fresh Start and Insolvency Resolution.

a. **In the Fresh Start process**, indigent individuals with income and assets lesser than specified thresholds (annual gross income does not exceed Rs. 60,000 and aggregate value of assets does not exceed Rs.20,000) shall be eligible to apply for a discharge from their “qualifying debts” (i.e. debts which are liquidated, unsecured and not excluded debts and up to Rs.35,000). The resolution professional will investigate and prepare a final list of all qualifying debts within 180 days from the date of application. On the expiry of this period, the Adjudicating Authority will pass an order on discharging of the debtor from the qualifying debts and accord an opportunity to the debtor to start afresh, financially.

b. **In the Insolvency Resolution Process**, the creditors and the debtor will engage in negotiations to arrive at an agreeable repayment plan for composition of the debts and affairs of the debtor, supervised by a resolution professional.

c. The bankruptcy of an individual can be initiated only after the failure of the resolution process. The bankruptcy trustee is responsible for administration of the estate of the bankrupt and for distribution of the proceeds on the basis of the priority.

vii. **Transition Provision:** The draft Bill lays down a transition provision during which the Central Government shall exercise all the powers of the Regulator till the time the Regulator is established. This transition provision will enable quick starting of the process on the ground without waiting for the proposed institutional structure to develop.

viii. **Transfer of proceedings:** Any proceeding pending before the AAIFR or the BIFR under the SICA, 1985, immediately before the commencement of this law shall stand abated. However, a company in respect

of which such proceeding stands abated may make a reference to Adjudicating Authority within 180 days from the commencement of this law

### **The Draft Insolvency and Bankruptcy Bill, 2015**

The Bill is divided into 5 parts. It consists of 238 clauses and 1 schedule.

Part I – Preliminary

Part II – Insolvency Resolution and Liquidation for Corporate Persons

Part III – Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms

Part IV – Regulation of Insolvency Professionals, Agencies and Information Utilities

Part V – Miscellaneous

Code extends to the whole of India, but Part III i.e. insolvency Resolution and Bankruptcy for individuals and Partnership Firms will not extend to Jammu & Kashmir.

Code is applicable to –

- Companies incorporated under the Companies Act
- any other company governed by any special Act
- LLPs
- such body corporate, incorporated by any Act for the time being in force,
- partnership firms and individuals

Types of debtors -

- financial creditor
- operational creditor
- corporate debtor

The Bill seeks to promote entrepreneurship, availability of credit, and balance the interests of all the stakeholders by consolidating and amending the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner and for maximization of value of the assets of such persons and matters connected therewith or incidental thereto.

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The Bill was introduced in the Lok Sabha on December 21, 2015. It was then referred to the Joint Committee of Parliament on December 23, 2015. The Panel is expected to submit its report in the beginning of the Budget session, so that it could be passed in the second half of the session.

### **13. PROCESS OF RECOVERY OF DEBTS IN INDIA**

Indian legal system encompasses varied legal provisions for recovery of debts by the banks and financial institutions as follows:

- Summary Suits Order XXXVII of the Code of Civil Procedure
- Ordinary Suits for Recovery
- Debt Recovery Tribunal recovery applications filed by banks and financial institutions for debt not less than Rs.10 lakhs.
- Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Securitization Act). In case any bank has charge over specific movable / immovable properties, not being exempt properties under Section 31 of the Act, and where the amount to be recovered is not less Rs.1,00,000/-, the Secured Creditor can enforce the security without intervention of Court. The most expeditious and effective mode of recovery for a Secured Creditor in India.
- Arbitration proceedings for recovery of outstanding amount as under the Arbitration agreement/ clause in the loan documents, in cases where the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (DRT Act) is not applicable.
- Criminal action may also be initiated for prosecution and punishment as per the Indian Penal Code and other laws where debt is also tainted with fraud, cheating, misfeasance etc. in addition to civil proceedings
- Filing of criminal complaint under Section 138 of the Negotiable Instruments Act, 1881 (NI Act) for dishonour of any cheque issued by borrower to the bank in discharge of legally enforceable liability can also be considered to pressurize the borrowers / guarantors to pay the dues of the bank.
- Section 391 of the Companies Act allows a company and its creditors or members, or any class of them, to enter into a 'compromise' or a scheme of arrangement under the direction of the courts. Such a compromise or arrangement requires sanction of the court, which directs holding of meeting of creditors or members or class of creditors or members, as the case may be. On agreement of creditors or members present

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in majority representing three-fourth in value (both the conditions are concurrent and cumulative) of creditors or members, the court may sanction any such compromise or arrangement.

### Broad classification of the Debt Work Out Process in India

Amount to be recovered	Procedure
Does not exceed Rs.1,00,000/-	I) Filing simple suit for recovery before Civil Court; II) Filing of summary suit under Order XXXVII of CPC, 1908 III) Filing mortgage suit for foreclosure of mortgage; & IV) Arbitration proceedings if Arbitration Agreement exists.
Exceeds Rs.1,00,000 but does not exceed Rs.10,00,000	In addition to above, in case the security interest has been created in specific movable / immovable property provisions of the Securitization Act may be invoked to repossess the mortgaged property, without intervention of the Court, and sell the same.
Exceeds Rs.10,00,000	Original Application is to be filed before the DRT for recovery of dues. Civil Court / Arbitrator will not have jurisdiction to entertain such claim.

#### **14. INSTITUTIONAL MACHINERY**

Insolvency jurisdiction is a special jurisdiction. It is essentially civil in nature and there are separate insolvency courts. The District Courts under the Provincial Insolvency Act have jurisdiction to hear insolvency petitions. The High Court where the High Court has original jurisdiction has got insolvency jurisdiction. The High Court in certain presidency towns like Bombay, Calcutta and Chennai has got the insolvency jurisdiction under the Presidency Towns Insolvency Act. The High Courts of Bombay, Calcutta and Chennai under its original side jurisdiction have specific rules made for determining insolvency matters. The District Court Rules under the Provincial Insolvency Act, therefore, stipulate the rules to be adopted for insolvency proceedings. There are no pecuniary jurisdiction limitations on the District Court under the Provincial Insolvency Acts or on the High Courts of Mumbai, Calcutta and Chennai under the Presidency Town Insolvency Act.

The administrative and judicial machinery with regard to Corporate Insolvency and Restructuring are the High Courts, Ministry of Corporate Affairs, Registrar of Companies, Official Liquidators, Company Law Board, Debt Recovery Tribunal (DRT) and Board for Industrial and Financial Reconstruction (BIFR).

##### **1) Ministry of Corporate Affairs**

The Ministry is primarily concerned with administration of the Companies Act, other allied Acts and rules & regulations framed there-under mainly for regulating the functioning of the corporate sector in accordance with law. The Ministry is also responsible for administering the Competition Act, 2002 which will eventually replace the Monopolies and Restrictive Trade Practices Act, 1969 under which the Monopolies and Restrictive Trade Practices Commission (MRTPC) is functioning. Besides, it exercises supervision over the three professional bodies, namely, Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries of India (ICSI) and the Institute of Cost and Works Accountants of India (ICWAI) which are constituted under three separate Acts of the Parliament for proper and orderly growth of the professions concerned. The Ministry also has the responsibility of carrying out the functions of the Central Government relating to administration of Partnership Act, 1932, the Companies (Donations to National Funds) Act, 1951 and Societies Registration Act, 1980.

## **2) High Court**

High Court is the Court of jurisdiction for handling winding up proceedings under the Companies Act, 1956. The winding up proceedings is administered by the Official liquidator under the supervision of the respective High Court.

## **3) Official Liquidator**

The Official Liquidator is the officer appointed by the Central Government under section 448 of the Companies Act, 1956 for the purpose of administering the winding up proceedings. Sections 448 to 463 of the Companies act, 1956 deals with the overall role of official liquidators in winding up proceedings.

Functionally the Official Liquidator is under the supervision and control of the High Court but administratively is under the control of the Central Government through the Regional Director, Ministry of Company Affairs.

The liquidation proceedings are carried on as per the provisions of Companies Act, 1956 and Companies (Court) Rules, 1959, Companies (Official Liquidator's Accounts) Rules, 1965 and other applicable enactments under the overall supervision, direction, orders and control of the Honorable High Courts.

## **4) Registrar of Companies**

Registrar of Companies (ROC) appointed under the Companies Act covering the various States and Union Territories are vested with the primary duty of registering companies floated in the respective states and the Union Territories and ensuring that such companies comply with statutory requirements under the Act. These offices function as registry of records, relating to the companies registered with them, which are available for inspection by members of public on payment of the prescribed fee. The Central Government exercises administrative control over these offices through the respective Regional Directors.

## **5) Debt Recovery Tribunal (DRT)**

The Debts Recovery Tribunals have been established by the Government of India under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 for expeditious adjudication and recovery of debts due to banks and financial institutions. The Debts Recovery Tribunal is also the appellate authority for appeals filed against the proceedings initiated by secured creditors under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.



To keep in line with the international trends on helping financial institutions recover their bad Debts quickly and efficiently, the Government of India has constituted thirty three Debt Recovery Tribunals and five Debt Recovery Appellate Tribunals across the country.

The Debt Recovery Tribunals are governed by provisions of the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, also known as the RDB Act. The Debts Recovery Tribunals (DRT) can hear claims of Banks only if the amount claimed is Rupees Ten lakhs and above.

Each Debt Recovery Tribunal is presided over by a Presiding Officer. The Presiding Officer is generally a judge of the rank of Dist. & Sessions Judge. A Presiding Officer of a Debt Recovery Tribunal is assisted by a number of officers of other ranks, but none of them need necessarily have a judicial back ground. Therefore, the Presiding Officer of a Debt Recovery Tribunal is the sole judicial authority to hear and pass any judicial order.

Each Debt Recovery Tribunal has two Recovery Officers. The work amongst the Recovery Officers is allocated by the Presiding Officer. Though a Recovery Officer need not be a judicial Officer, but the orders passed by a Recovery Officer are judicial in nature, and are appealable before the Presiding Officer of the Tribunal.

The Debt Recovery Tribunal can appoint Receivers, Commissioners, pass ex-parte orders, ad-interim orders, interim orders apart from powers to Review its own decision and hear appeals against orders passed by the Recovery Officers of the Tribunal.

#### **6) Board for Industrial and Financial Reconstruction (BIFR)**

The Government of India, in order to tackle the problem of industrial sickness, has set up a Board for Industrial and Financial Reconstruction (BIFR), under the purview of Sick Industrial Companies (Special Provisions) Act, 1985 (SICA). It has been established as a quasi-judicial body in the Department of Economic Affairs, Ministry of Finance, for revival and rehabilitation of potentially sick undertakings and for closure/liquidation of non-viable and sick industrial companies. This Body was set up in January 1987 and became functional with effect from 15<sup>th</sup> May 1987.

The appellate authority to hear appeals against the orders of the BIFR is the Appellate Authority for Industrial and Financial Reconstruction (AAIFR). This authority was constituted in April 1987.

## **15. OPPORTUNITIES IN CORPORATE INSOLVENCY AND RESTRUCTURING**

Just like a person requires treatment to treat his disease, a sick company also requires some form of treatment to overcome its problem of debts. This treatment may be in the form of restructuring of a company.

Restructuring is the corporate management term for the act of reorganizing the legal, ownership, operational, or other structures of a company for the purpose of making it more profitable, or better organized for its present needs. Alternate reasons for restructuring include a change of ownership or ownership structure, demerger, or a response to a crisis or major change in the business such as bankruptcy, repositioning, or buyout. Restructuring may also be described as corporate restructuring, debt restructuring and financial restructuring.

There are a broad range of opportunities that arise from corporate insolvency and financial restructurings.

1. Spotting and evaluating distressed companies for restructuring and rescue planning.
2. Reviewing the various risks involved in restructuring.
3. Developing risk mitigation strategies.
4. Working out a detailed bankable financial structure of the business.
5. Working out a detailed plan for restructuring the business from all angles.
6. Assessment of distressed assets, cash position, due diligence and turnaround feasibility.
7. Advice on optimum utilization of resources.
8. Drafting insolvency petitions.
9. Representation and registration of sick companies with BIFR.
10. Representation before the Debt Recovery Tribunals.
11. Representation before the NCLT or NCLAT
12. Negotiating settlements.
13. Identifying Areas of Opportunity for the company.
14. Advisory in relation to a merger or acquisition or takeover.
15. Advisory services to management on an ongoing basis.

## **16. INSOLVENCY REGULATORS AND ASSOCIATIONS**

### **International Association of Insolvency Regulators (IAIR)**

The International Association of Insolvency Regulators (IAIR) is an international body that brings together the collective experiences and expertise of government insolvency regulators from jurisdictions around the world.

Members recognise that effective and efficient procedures for dealing with financial failure are essential for maintaining confidence in financial markets, encouraging enterprise, underpinning investment and economic growth and supporting business and consumer credit; and that, increasingly, insolvencies extend beyond national jurisdictions through the continuing development of international trade and finance. IAIR aims to promote liaison and co-operation and provides a forum for discussion amongst insolvency regulators. The Association thereby contributes to a wider understanding of insolvency issues, procedures and practices and the development of approaches that reflect the different legal, socio-economic, historical, cultural and institutional frameworks of the countries from which members come.

Members of the IAIR are:

- Government Departments/Ministries
- Agencies and Public Authorities

which have responsibility in their country for one or more of:

- Insolvency Policy and Legislation
- Insolvency Practice and Administration
- Insolvency Regulation

As such membership is generally restricted to organisations that provide the regulatory function in their country's insolvency regime and hence IAIR members are normally government officials or representatives of the court.

IAIR members meet annually at a combined Conference and Annual General Meeting (AGM). At these meetings, members:

- Exchange information;
- Report on recent developments in their jurisdiction;
- Consider topics for detailed study and approve study reports.
- Engage in discussion, at both a national and international level, about current thinking in relation to:
  - Insolvency policy and legislation
  - Practice and administration
  - Regulatory issues

Conferences usually run for three days and include social events arranged by host countries. These events provide excellent networking opportunities and assist with the development of bilateral and multilateral relationships.

**INSOL International - International Association of Restructuring, Insolvency & Bankruptcy Professionals**

INSOL International is a world-wide federation of national associations of accountants and lawyers who specialise in turnaround and insolvency. There are currently over 44 Member Associations with over 10,000 professionals participating as members of INSOL International. Individuals who are not members of a member association join as individual members.

INSOL also has ancillary groups that represent the judiciary, regulators, lenders and academics. These groups play an invaluable role within INSOL and provide valuable forums for discussions of mutual problems.

INSOL was formed in 1982 and has grown in stature to become the leading insolvency association in the world. It is a valuable source of professional knowledge, which is being put to use around the world on diverse projects to the benefit of the business and financial communities.

**INSOL India**

INSOL India is an association of the members of the legal fraternity, chartered accountants, company secretaries and other persons, bodies and institutions, desirous of the development, diffusion and advancement of law relating to insolvency and related laws and to provide a forum for national and international participation, debate and awareness in the field of law and policy. INSOL India conducts research, holds

seminars, conferences, workshops and discussions for development and growth of the law relating to insolvency and related laws in India and undertakes comparative studies of legal developments in other countries in cooperation with persons, bodies and institutions in different parts of the world.

The Association was formed on September, 27, 1997 under the guidance of Mr. Justice D. P. Wadhwa, then sitting Judge, Supreme Court of India with Mr. Justice Manmohan Sarin elected as first President of the Executive Committee of INSOL India.

The main objects of the Association which is a non-political, non-trading and non-governmental association are:

1. To bring together the members of the legal fraternity in various disciplines of law in India and outside India for closer co-operation, development, understanding and promotion of law, more particularly, law relating to insolvency and related laws;
2. To promote studies, diffusion and advancement of international and comparative law.
3. To act as a forum for the promotion of national participation, debate and awareness in the field of law and policy.
4. To conduct research, hold seminars and discussions, develop and maintain a library, collect documents relating to the growth and development of laws in India and to undertake comparative studies of legal developments in other countries of the world.
5. To hold workshops, seminars, conferences, discussion and meetings on the subjects relating to jurisprudence and legal practice.
6. To develop contacts and cooperate with various other institutions in different parts of the world.
7. To develop, promote and assist professional bodies and groups involved in the practice of law, administration of Justice and legal education.
8. To undertake any work and to engage in any activity as may be necessary for the purpose of implementation of the objects hereinabove and any other objects that INSOL India may adopt.
9. To use and develop law as a source and an instrument towards social change for development as well as building co-operation among the people.

## **Global Insolvency**

Global Insolvency is a joint project of the American Bankruptcy Institute and INSOL International. It serves as a comprehensive source of information both on current issues in international insolvency and restructuring law and on the legal framework for insolvency and restructuring around the world. The site features daily news headlines on insolvency developments around the globe. From current commentary and recent filings to international protocols and bankruptcy statutes to advice on cross-border lending, the GLOBAL Insolvency site offers a range of information for insolvency practitioners, judges, accountants, trustees and others.

With over 13,000 members, the American Bankruptcy Institute is the largest American multi-disciplinary, non-partisan organization dedicated to research and education on matters related to insolvency. It is also the leading American provider of bankruptcy educational programs, produces numerous publications and testifies before Congress.

## **Global Insolvency Law Database**

The GILD is the World Bank's legal portal for insolvency and creditor rights (ICR) matters and is maintained by the World Bank's Legal Vice-Presidency. In a world driven by credit, developing the means to effectively respond to default conditions is essential to foster commercial confidence and predictability. If properly designed, insolvency and creditor rights laws can contribute to the economic health of countries by providing a safety valve in the event of financial distress, reducing asset deterioration, and restoring balance to commercial relationships.

The World Bank contributes to the stabilization of the global financial architecture in the area of insolvency and creditor rights through an integrated program. This program includes the promulgation of principles on insolvency and creditor rights, assessment and technical assistance to clients, and capacity building events.

The World Bank developed the Principles and Guidelines for Effective Insolvency and Creditor Rights Systems (Principles) in conjunction with partner organizations, international experts, and the international community. The *Principles* represent an international consensus on best practices in insolvency and creditor rights (ICR) and constitute the standard for benchmarking the effectiveness of ICR systems. In addition, they offer guidance to policymakers who want to establish a functional system for healthy debtor-creditor relations.

**17. USEFUL WEBSITES**

<http://www.finmin.nic.in/> - Ministry of Finance, Government of India

<https://www.insolvencyreg.org/members-websites> - International Association of Insolvency Regulators

<https://www.insol.org/> - International Association of Restructuring, Insolvency & Bankruptcy Professionals

<http://www.insolindia.com/intlmem.htm> - INSOL India

<http://globalinsolvency.com/> - Global Insolvency

<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/LAWANDJUSTICE/GILD/0,,pagePK:181022~theSitePK:215006,00.html> – Global Insolvency Law Database