INSOLVENCY LAWS: A WALL OF CONTROL OVER CORPORATE WORLD

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"Insolvency can also be termed as the procedure of financial death and rebirth" (Pahwa, 2018)

This paper examines the current Insolvency Regime of the country and is based upon the pitfalls and inadequacy of insolvency legislations hegemonizing corporate sector in India.

Debt Financing: A fundamental activity by Corporate Persons

"The Pecking Order theory says that the firm will borrow, rather than issuing equity, when internal cash flow is not sufficient to fund capital expenditure" (Myers, 2001)[1]. In the process of financing a new venture the directors of a corporate firm estimate two major outcomes- whether the venture will maximize profit, or it will increase overall valuation of the firm. While the former outcome is limited to increase in wealth of shareholders, later increases market share, market value and overall income power of the corporation. Debt financing is a process which undertakes less cost of raising capital compared with equity issue, but it undermines the objective of profit because interest on liability is an expense, however, the corporation benefits in long run. Issuing equity to dilute current share of stakeholders is an indication to overvalued stock and on the other hand utilizing debt to fund a project is a sign of capability.

Owing to the Great Financial Crisis, the Government of India in the period 2008-2014 enabled corporations to indulge in debt financing by lowering interest rates, resultant to which many companies incurred huge debts. Opportunistic opposition after gaining ruling power implemented stricter regulations and formulated a law to re-distribute resources of a highly indebted company to set of industrialists that support them. Such actions develop a fear among corporations to opt for debt financing which is crucial for growth and instead choosing capital issue which dilutes the power and costs more. It not only discourages them to take loans, but it also limits the organization's operations by providing ultimate remedy to credit suppliers. The financial creditors have gotten a tremendous mightiness, they can force corporations into liquidity, they can take over the management or to reduce taxable income they can simply write

[1] Journal of Economics Perspectives- vol.15.

off loans. In the time frame of 2014-2021 10 Lakh Crore amount written off by banks (Newslaundry, 2021)[2].

Evolution of Insolvency Reforms & IBC,2016 as Principal Law

"The earliest rudiments of insolvency legislation can be traced to section 23 and 24 of the Government of India Act, 1800, which conferred insolvency jurisdiction on the Supreme Court at Fort William and Madras and the Recorder's Court at Bombay" (India, 1964)[3].

[Table 3.1: Government committees on bankruptcy reforms

Year Committee Outcome
Amendments to the Provincial Insolvency Act,1920 (1964 24th Law commission).

SICA, 1985. (1981 Department of Company Affairs).

RDDBFI Act, 1993.(1991 RBI)
SARFAESI Act, 2002.(1998 RBI)

Companies (Amendment) Act, 2002, Proposed repeal of SICA.(1999 GOI)
Proposed a comprehensive bankruptcy code. (2001 RBI)

Enforcement of Securities Interest and Recovery Debts Bill, 2011. (With amendments to RDDBFI and SARFAESI).(2005RBI)Proposed improvements to credit infrastructure.(2008 Planning Commission) Draft Indian Financial Code which includes a Resolution Corporation for resolving distressed financial firms. (2013 Ministry Of finance)] (Committee, 2015)[4]

Afterwards, the Insolvency And Bankruptcy Code, 2016 emerged as the principal legislation for the matters of Insolvency.

Central Government is the ultimate soloist that foremost conducts enactment and formulation of Insolvency laws, that's why it is the guiding force towards this huge evolution from a legislation that was restricted to reconstruction and preservation of Industrial units to a legislation that constitutes ability in the creditors to throw away management and eliminate

[2] An Article by Vivek Kaul on Newslaundry.com.
[3] 26th Law Commission Report on Insolvency Laws.
[4] Prior to enactment of IBC,2016 and The Committee that Proposed Final Draft of IBC.

mechanisms set up by original promoters of a corporate debtor. RBI works corresponding to the left wing ruling period invented insolvency laws which were neither disputed at large, nor argued to be unconstitutional. "Banks should be encouraged to adopt statistical risk management techniques like Value-at-Risk in respect of balance sheet items which are susceptible to market price fluctuations, forex rate volatility and interest rate changes, the Committee recommends that an asset be classified as doubtful if it is in the substandard category for 18 months in the first instance and eventually for 12 months and loss if it has been so identified but not written off " (II, 1998)5. This was the stand of makers of SARFAESI, 2002 and it delivers support to debtors who are inspired to build businesses and look forward to include debt in capital. "The Code will facilitate the assessment of viability of the enterprise at a very early stage" (Committee, 2015)[6]. Legislature for IBC was adamant to provide remedies to creditors even at the instance of new born entity.

"The Code will enable symmetry of information between creditors and debtors" (Committee, 2015). Individual Identity principle was granted for the purpose of protecting entity's secured information, treating debtors equal to creditors is mistaken at the very premise of Company law, one runs the business the other provides funds or goods and services in exchange of returns from the business. Right wing government when first came into power proposed to abolish SICA, and have a unified Insolvency code, second time coming in power it disregarded IFC. IBC holds glorified combination of all the functions of past insolvency laws as it provides take-over of particular asset by liquidation process to the corresponding lender (RDB), it provides a third party interference in form of resolution professional consistent with creditors who took support of Asset Restructuring Company under SARFAESI and it also deals in matters of industrial insolvency. Nonetheless, it distinguishes from them in broad identification and supremacy of Committee of Creditors which holds power of appointing Resolution professional, control over decision making and management function of the entity, CoC has unchallenging right to adopt or reject a resolution plan and above all it can pass a decision for liquidating, it enjoys a permitted license to kill the corporation. On one hand in 2013 GOI took responsibility of regulating financial sector to ensure no risky credit to be granted, in 2016 opposition yielded extreme advantageous position to lenders who failed to intake due diligence prior to furnishing funds or committing contracts. IBC confirms the absolute adjudication role to NCLTs but the authority has no control over resolution plan because it can only approve an

[5] Narasimham II Committee set up by RBI in 1998.
[6] The Report of the Bankruptcy Law Reforms Committee vol.1.

already approved plan by CoC, meaning it cannot uphold a rejected plan by CoC as binding. "The primacy given to the Committee of Creditors under the IB code, without being diluted, may take into its compass consultation/concurrence of the equity shareholders of the company" (Pahwa, 2018)[7]. This was the decent way of highlighting that actual owners of the organisation infer no rights or say in the current highly treasured and appreciated legislation on crucial aspect of insolvency.

Debarring any political agendas, evolving insolvency laws in India have only empowered the country, as validated by World Bank ratings which shows upgradation from 134th position in 2014 to 63rd position in 2019 in the scenario of ease of doing business (Tradingeconomics, 2021)[8]. However, not so much economically, Global Investment Growth in 2005 stood at whooping 18% and it has seen sluggish growth since 2014 and resultant to which in 2019 it declined to -4% (RBI, 2021)[9].

"It argues that past practices of banks and term lending institutions - economically unsound project appraisal, inappropriate discounting at opportunity costs, poor identification and inadequate provisioning of tainted portfolios, and insufficient capital adequacy not only prevented early detection and cure or unhealthy companies, but also induced the secured creditors to Increase their exposure in palpably sick companies" (Committee T. , 1993)[10]. These were the parameters which SICA proposed to resolve and implement a better environment for industrial lending and debt financing. However, SICA lacked efficient disposal of cases, it provided huge delayed process under BLRC for revival of a struggling company. It involved dependence on high courts for decision making and it was confined only to companies which have two or more subsidies in an industry.

"The report of the BLRC, speaks of the criticality of speed for the working of the bankruptcy code, specifying two reasons- inability to make significant decisions without full clarity of ownership and control, and, the longer the delay, the more likely that the entity in question would move towards liquidation rather than resolution, and that too a low value liquidation due to a high economic rate of depreciation"[11] (Sekhri, 2020). Insolvency legislations until IBC were abiding by the principle of debtor-in possession, IBC revolutionised to ensure corporate

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[7] A paper by Navin k. Pahwa in the Journal NLS of Indian Review vol.30, No.2.
[8] An economic Survey by World Bank in 2021.
[9] World Bank Statistics used by RBI.
[10] Report of The Committee on Industry Sickness and Corporate Restructuring.
[11] A Publication Of Articles by Insolvency and Bankruptcy Board of India.

debtors are unable to escape liabilities and also the personal guarantors must be chargeable during liquidation process. It establishes an exit which is a unique dimension for directors of a failed company, the company itself and dissolvement of shareholders when company cannot revive. NCLT and NCLAT adjudicate and eliminate burden on courts and provisions for fast and pre-packaged resolutions were discovered. IBC does not differentiate while recovering debts between operational creditors who supply goods or services (including employees and workmen) to the corporation and financial creditors with the role consisting funds supply for capital expenditure.

Corporate world is a source of employment, resources and lifestyle to the entire population. Hence, provisions of any insolvency law will affect directly to corporations, their members and also to the public at large. Being insolvent is an act of not being able to pay one's liability due to shortfalls in income generation which can be due to natural circumstances or even at times due to government's restriction policies on doing business, hence, terming it as pure consequence of mis-management (IBC) cannot be a valid conclusion. After the regulation of IBC, corporate lending through banks has seen its worst, capital expenditure stands at all time low and investments by foreign corporations is in negative percentile (RBI, 2021)[12].

Nature of Lenders & Associated Remedies

"If a debtor defaulted to an unsecured creditor, the creditor had three remedies to recover its claim civil suit, arbitration or petition the High court for winding up if the debtor is a company" (Sreyan Chatterjee, 2018)[13]. Understanding this, a creditor if unsecured had to either face the over-delaying adjudicating process of courts or convince the debtor into opting for arbitration where he would obviously had to settle for the disputed amount, prior to IBC, 2016. An unsecured creditor is someone who relies on basic feeling of trust and provides the debt without being able to fall back on any collateral if debtor defaults. Considering the era of 21st century and evolving nature of humans to lie fearlessly, nowadays unsecured creditors to a corporation mostly consists of operational creditors such as, who participate in supplying goods to corporate debtor on credit, provides services to corporation on credit like employment or workmen services and government bodies enabling corporate debtor to undertake a project on credit. IBC liquidation and distribution of revenue from assets of a corporate debtor process ranks on priority basis- workmen's dues just after clearing costs of liquidation, ranks next the

[12] Data Published by RBI in 2021.
[13] A Research Paper in the Journal NLS of Indian Review vol.30, No.2.

employees' unpaid dues, after that persons who may have supplied goods or any other unsecured financial services and for operational creditors government stands at bottom. Due to provisions like these IBC is distinct to be an enormous economic reform and principal insolvency dispute resolving law. Previous legislations inherited no regards to operational debt, RDB, 1993 and SARFAESI, 2002 only allowed rights of financial creditor to recover debt and SICA however considered an operational debt, the process was related to reconstruction of the debtor rather than disposal of assets to creditor. This is one of the reasons why economy prevailed during SICA and declined after enactment of IBC, as creditor-in possession principle only benefits the financial sector which is only a part of corporate world.

Secured creditors are first and foremost party that gets access to their secured rights or collaterals in question even before the liquidation or asset distribution process starts in current insolvency regime, it is the duty of resolution professional to compensate secured creditors with priority basis and with full amount, if a corporate debtor has limited resources to pay dues and can only satisfy secured liabilities, rest of the claims would not be repaid. Consequently, providing secured creditors indefinite right will diminish entrepreneurship and business element of the largest tax payers and revenue generators to the economy. "The primacy of the powers with the Committee of Creditors, which is controlled by major secured creditors, is resulting in decisions which are against the basic concept of 'going concern'" (Pahwa, 2018).

Other than asset distribution and compensation remedy, IBC allows creditors to form a creditors committee and also provides right for initiating insolvency resolution process against the corporate debtor. One assumes that involvement of operational creditor in creditor's committee is a major economic revolution but on analysing entire code, the purpose was to grant more functionary control and increment in liable amount. SARFAESI and RDB excluded operational debt or operational creditors because of valid reasoning, financial creditors can force insolvency as their function is to enable capital infusion against valuation of a promised collateral and is confined to dealing of funds, therefore, insolvency proceedings initiated by such creditors makes sense.

Benchmark Judgements

a) **Performance of NCLT**

13. The Ministry during the course of evidence have provided the following information regarding the performance of NCLT:

Total cases dealt from 01.06.2016 to 31.05.2021

Category	Total Cases dealt	Total Cases disposed	Total Cases pending
IBC	32,547	19,377	13,170
Merger & Acquisition	12,490	11,318	1,172
Other cases under Companies Act	31,814	25,193	6,621
Total	76,851	55,888	20,963

14. Regarding the amount involved in the cases pending with the NCLT, the Secretary, Ministry of Corporate Affairs during the course of evidence on 12 January, 2021 stated that:

> "The amount involved is Rs. 9,20,000 crore. What is triggered under Section 7, which is the financial creditor is 4,365 cases. That translates to Rs. 6,77,000 crore. Financial creditors have triggered that process. Section 9 that is triggered by the Operational Creditor is 8,331 cases. That is only Rs. 78,000 crore compared to Rs. 6,77,000 of 4,365 cases. Here, the number is almost double. But the claims is only 10 or 15 per cent of that amount. Section 10, which is the Corporate debtor himself, it is 266 cases with a claim amount of Rs. 52,000 crore. There is one that is 253 with the claim amount of Rs. 1,11,000 crore."

15. The age-wise pending cases in NCLT under IBC as on 31 May, 2021 are as under:

IBC Sec	0-90 days	91-120 days	121-180 days	180+ days	Total
Sec 7	155	147	306	2,177	2,785
Sec 9	279	401	1091	4,202	5,973
Sec 10	85	17	51	455	608
Others	111	60	121	193	485
Total	630	625	1,569	7,027	9,851
Percentage	6.39%	6.34%	15.92%	71.33%	

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(Finance, 2021)[14]

- Swiss Ribbons Pvt. Ltd. & Ors. V. Union Of India & Ors.(2019) 4 SCC 17

  This was the first case that challenged constitutional validity of the entire code, petitioners were however unsuccessful, they raised questions over operational creditors being treated equally as financial creditors, members of adjudicating authority not being fundamentally appointed, powers of resolution professional are against concept of justice and exclusion of promoters in the process is harming the objectives of the code. The court took reliance on "primary focus of the legislation is to ensure revival and continuation of the corporate debtor by protecting corporate debtor from its own management and from a corporate death by liquidation" (ArcelorMittal Ltd. v. Satish Kumar Gupta , 2019), and also mentioned " States have 'power to legislate against what are found to be injurious practices in their internal commercial and business affairs, so long as their laws do not run afoul of some specific federal constitutional prohibition, or of some valid federal law' (LincoIn Federal Labor Union v. Northwestern Iron & Metal Co. , 1949), hence arguments raised were held to be invalid. (2019)[15]

[14] Standing Committee on Finance 2020-2021, Implementation Of IBC- Pitfalls & Solutions.

[15] Judgement by R.F. Nariman, J.

- Encore Asset Reconstruction Company Pvt. Ltd. V. Charu Sandeep Desai (2019) NCLAT 284

  This case established that any other legislation whether existing or non-existing has no ruling power and IBC, 2016 prevails over SARFAESI, 2002 if it is inconsistent with provisions of the former.

- Essar Steel Asia Holding Ltd. V. Satish Kumar Gupta (2019) NCLAT 644

  For deciding the future of one of the biggest Steel company and leader of the industry, Hon'ble NCLT refused to entertain an application by shareholders to not to initiate insolvency proceedings as they were willing to pay back their dues and ever a larger sum than what was decided by resolution professional. Adjudication authority even took into consideration a case of Supreme Court where resolution applicants were allowed to dispose off their dues before submitting a resolution plan in order to abide by section 29A of the code (Arcelor Mittal India Pvt. Ltd. v. Satish Kumar Gupta and Ors., 2018)[16]. Nonetheless, NCLT disregarded the application by shareholders for settlement rather than insolvency proceedings and held insolvency resolution process to be initiated.

- Committee of Creditors of Essar Steel India Ltd. V. Satish Kumar Gupta (2020) 8 SCC 531

  Through 2019 amendment of the section 30(2)(b)code, the state took an advantageous position for recovering debt owed to Essar Steel as the amended section highlighted the amount to be paid to a creditor who are not in favour of the resolution plan will be decided by the Board of Insolvency and bankruptcy of India and will be equal to amount which would have been paid in case of liquidation. Consequently the total amount to be received by Standard Chartered Bank and other private banks reduced from 2100 crore to 61 crore. "It was contended that legislature has, therefore, overstepped the separation of powers boundaries"[17]. The court held that "The argument, though attractive at the first blush, but if accepted, would require us to rewrite the provisions of the I&B code. It would also result in doing violence to the legislative intent"[18], therefore petition not admissible. (Committe of Creditors of Essar Steel India Ltd. v.

[16] A case with reference to Art. 142 of The Constitution by Supreme Court.
[17] Argument by Senior Advocate Shri Kapil Sabil representing Standard Chartered Bank.
[18] Judgement by R.F .Nariman J.

Satish Kumar Gupta & Ors., 2020). Consequently, Standard Chartered Bank which was the highest lender to infrastructure sector closed maximum of its branches in India and Essar Steel was acquired by Mittal Group.

- Lalit Kumar Jain v. Union Of India & Ors. (2021) 9 SCC 321
  "Amount claimed should be against the corporate person only" (Mr. Ishwar Khadelwal v. Amrapali Infrastructure Pvt. Ltd. , 2017), this was the decision of the tribunal when petitioner was enforcing amount due to him on subsidies of Amrapali Group[19]. In 2019 GOI issued a notification through ministry of Corporate Affairs involving personal guarantors of a corporate debtor into insolvency and liquidation process, meaning personal assets of a guarantor will be liquidated if needed. The petitioners argued that role of the government being the executive is to 'bring a law into operation' not to exercise powers conferred with legislator which are an abuse of delegated power principle and outside of its scope of functions[20]. The court highlighted that this is an example of conditional legislation which is a broader concept allowing executive to frame rules and guidelines and flesh out gaps within the broad legislative policy (Lalit Kumar Jain v. Union of India & Ors., 2021).

The Legislations seem to come into phased manner and executive has gained a complete authorized stand granted by the Apex Court. However, the economic outcomes of such financial and insolvency regime need some attention as we have witnessed maximum take overs of insolvent companies by only few and ultra-rich industrialists, competition is being erased from the economy and companies are hesitant to raise debts. Moreover, known promoter groups like JAYPEE, RIL led by Anil Ambani, ESSAR Steel and VIDEOCON have lost their founders and force which guided them to rule the business world once, additionally, Future Group is at a stage when it could be held insolvent any moment and handed over to creditors. Debt incurred by Financial firms is at its peak as it is left unregulated (MoneyControl, 2022)[21].

[19] NCLT Principal Bench referred to Section 3(7).
[20] Arguments by one of the most prominent learned counsel Mr. Harish Salve.
[21] Top 100 Companies in debt amount out of which top 10 are Financial Firms with average debt over 85% of Capital.

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