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"Reverting Back: A Critical Analysis of the Insolvency and Bankruptcy Code"

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Abstract:

The Insolvency and Bankruptcy Code was enacted in 2016 with an intention to consolidate the existing framework by creating a single law for insolvency and bankruptcy. It may be noted that one if the major objectives of the Code is to protect the interests of the creditors. The Code sought to remedy the various 'illnesses' suffered by the insolvency laws in the previous regime by shifting away from the debtor-in-possession model, prevalent in the previous regime, to the one where both the creditors and the debtors operate within a framework of equity and fairness to all stakeholders to preserve the value of the Company. However, the Code was not perfect by all means, it is still a work under progress. Furthermore, in light of the Covid-19 pandemic, the government has shifted its focus to protecting the interests of the businesses. Although, *the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020* seems have promulgated with the intention of protecting companies and promoters from *no fault liability* due to the Covid-19 pandemic, the ambiguities in the legislation seem to raise more questions than answers. In fact, the recent ordinance seems to indicate a transition to the earlier model which was detrimental to the interests of the creditors. Therefore, this essay seeks to address analyze the issues and ambiguities with specific reference to the 2020 Ordinance.

Introduction:

According to the Black's law dictionary, the term Insolvency refers to the inability to pay one's debt. The modern business environment is heavily dependent on use of credit by the companies.[1] However, in this process, there is a high degree of risk incurred by the creditors. In fact, the entire economy may come to a standstill if this credit cycle is stopped. Therefore, insolvency law seeks to protect the interests of the creditors in the event of default by the Corporate debtors ("Company"). In fact, one of the major aims of the insolvency law is to replace this free-for-all regime with one in which creditors' rights and remedies are suspended and a process established for the orderly collection and realization of the debtor's assets and the fair distribution of these according to creditor's claims.[2]

[1] Id. at 9
[2] *supra*

Insolvency laws do not give a free-leeway for corporate failures.[3] Business life involves taking risks and dealing with crises on a regular basis, hence, only those able to compete successfully with each other will survive.[4] In fact, many sick companies may. The presence of an efficient competition in the market would no doubt drive some companies to the wall (applying the neo-capitalist theory). It may be inferred that the companies in the current day and age more or less run on the principle of the '*Survival of the fittest*'. Some of the reasons for a corporate failure are poor financial controls, mismanagement and market conditions. Hence, the insolvency laws seek to remedy a corporate failure by restructuring the corporate entity to rework those issues.[5]

Evolution of the Code

The Insolvency and Bankruptcy Code ("Code") was enacted in 2016 to consolidate and amend the laws relating to the reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of the value of assets of the company which is facing the threat of bankruptcy ("Corporate Debtor"). One of the major aims for the enactment of the Code was increase the ease of doing business in India. Prior to the enactment of the Code, the legal regime governing the winding up process was, to put it brusquely, as sick as the companies.[6] For, the previous regime was more of an adversarial which was tilted in favor of the debtors. The reason for this perception is the fact that under the previous regime, the debtor retained control over the Company's management during the insolvency proceedings. The Code tries to remedy this issue by passing over the management of the Company to the resolution professional. In fact, the insolvency proceedings were highly fragmented due to the multiplicity of legislations in the previous regime. There were also a lot of ambiguity with regard to the powers of the creditors and the debtors, during the insolvency proceedings, due to this multiplicity of laws, as the powers were provided under various different legislations. The Code consolidated and codified various legislations dealing with the insolvency process in the previous regime such as the Sick Industrial Companies Act, 1985 ("SICA") ; the Recovery of Debt Due to Banks and Financial Institutions, 1993 ("RDDBFI"); the Companies Act, 2013, and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("SARFAESI") when it came into force. Hence, the Code sought to consolidate all these various legislations into one consolidated code in an effort to resolve the issue of the multiplicity of laws on the subject.

[3] *supra*.
[4] Id. at 145.
[5] *supra*.
[6] Bharat Chugh & Avaya Hari Singh, A to Z of the Insolvency and Bankruptcy Code, https://www.livelaw.in/columns/a-to-z-of-the-insolvency-and-bankruptcy-code-a-beginners-guide-157569 (last visited 11 June 2020)

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In essence, the Code shifts away from the debtor-in-possession model to the one where both the creditors and the debtors operate within a framework of equity and fairness to all stakeholders to preserve the value of the Company.[7] In the Swiss Ribbons Case[8], the Supreme court of India summing up its observation of the Code held that :

> *"The Insolvency Code is a legislation which deals with economic matters and, in the larger sense, deals with the economy of the country as a whole. Earlier experiments, as we have seen, in terms of legislations having failed, 'trial' having led to repeated errors, ultimately led to the enactment of the Code. The experiment contained in the Code, judged by the generality of its provisions and not by so-called crudities and inequities that have been pointed out by the petitioners, passes constitutional muster."*[9]

Therefore, it may be observed in the words of Justice Norman that the 'debtor's paradise' is lost, with the enactment of the Code and all the decisions relating to a company facing insolvency proceedings now falls under the Insolvency Resolution Professionals ("IRP") and the Committee of Creditors ("CoC").[10] Despite inheriting some very sick 'zombie' firms from the previous regime, the IBC in a very short time formats enactment has shown great results.[11]

Objectives of the Code:

It is a truth universally acknowledged that the society in the current era facilitates the use of credit by the companies. In fact many businesses cannot function with taking any debt as it fulfills the need to fund investments and expenses.[12] Going into debt is fine so long as it can be serviced and repaid, and is within the means of the corporate debtor to do so.[13] However there is a high chance that the creditors would greatly suffer if the corporate debtor becomes unable to repay the debt by the due date.[14] Furthermore, the Code also empowers the creditor wherein he/she can get back the dues either through the Corporate Insolvency Resolution Process ("CIRP") or through the liquidation of defaulting debtor.

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[7] Sameer Sharma, How Do We Ensure India's Insolvency and Bankruptcy Code Keeps Working Well?, https://thewire.in/banking/india-ibc-solvency-bankruptcy, (last visited assessed 15 June 2020).
[8] Swiss Ribbons Pvt. Ltd. V. Union of India (2019) SCC OnLine SC 73 (India).
[9] *supra.*
[10] *supra.*
[11] FINCH, *supra* note 1, at 9.
[12] Rao Pramod, Critique of the insolvency & Bankruptcy Code, 2016, http://www.insolindia.com/uploads_insol/resources/files/critique-of-ibc-by-pramod-rao-1040.pdf (last visited 10 May 2020).
[13] supra.
[14] FINCH, *supra* note 1, at 9.

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The IBC came into being with a wider scope and aiming to resolve the issues via more effective provisions and implementation. It is an act to consolidate and amend the laws having reorganization and insolvency resolution issues as the subject-matter. It is was applicable to Companies, Partnership firms, Limited Liability Partnerships, Corporate Persons and Individuals in the case of any insolvency, liquidation, voluntary liquidation or bankruptcy proceedings. The objective of the code is as follows:-

> *"An Act to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto"* [15]

Hence, it may be observed that the primary focus of the IBC is not only to recover the monies to the creditor but also to ensure the revival and the continuation of the corporate debtor by protecting him from its own management from a *'Corporate death'* through liquidation.[16]

Speedy Resolution Process:-

The Code aims to consolidate and amend the existing insolvency laws in addition to simplifying and expediting the process of insolvency proceedings. Prior to the enactment of the IBC, there were various scattered laws relating to insolvency and bankruptcy which resulted in inadequate and ineffective results with undue delays. In fact, prior to the enactment of the IBC, Insolvency resolution in India took 4.3 years (as of 2015) on an average against 1 year in the United Kingdom and 1.5 years in the United States of America.[17] Therefore, the legislature tried to remedy these mistakes with the enactment of the IBC by simplifying and speeding up the winding up/liquidation process. Timely resolution and the preservation of the value in underlying assets is one of the major objectives of the IBC.[18] The Code has always been marketed as a law which seeks to complete the insolvency process in a timely manner. This objective of a speedy resolution process is rejected under the provisions of section 12 of the Code which envisages the completion of the insolvency process within 180+90 days. The Bankruptcy Law Reforms Committee provides the rationale for this objective of speedy resolution as:

[15] *The report of the Bankruptcy Law Reforms Committee, 2015,* https://ibbi.gov.in/BLRCReportVol1_04112015.pdf (last visited 15 May 2020).
[16] Swiss Ribbons Pvt. Ltd. V. Union of India (2019) SCC OnLine SC 73 (India).
[17] FINCH, *supra* note 1, at 9.
[18] *supra*.

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> *"Speed is of essence for the working of the bankruptcy code, for two reasons. First, while the 'calm period' can help keep an organization afloat, without the full clarity of ownership and control, significant decisions cannot be made. Without effective leadership, the firm will tend to atrophy and fail. The longer the delay, the more likely it is that liquidation will be the only answer. Second, the liquidation value tends to go down with time as many assets suffer from a high economic rate of depreciation. From the viewpoint of creditors, a good realization can generally be obtained if the firm is sold as a going concern. Hence, when delays induce liquidation, there is value destruction. Further, even in liquidation, the realization is lower when there are delays. Hence, delays cause value destruction. Thus, achieving a high recovery rate is primarily about identifying and combating the sources of delay."*[19]

Despite the efforts taken for the implementation of the IBC, it is not without faults. Prior to the 2019 amendment, the earlier time period of 180+90 days for the insolvency process despite seeming to be an effective remedy prima facie, was not practical in India, given the slow regulatory process in by various government agencies such as the approval required by the Competition Commission of India (CCI). This resulted raised questions on the effectiveness of the IBC proceedings such as (1) whether the rescue operations envisioned under the IBC is used to avoid the CCI regulations and (2) whether the corporate debtor can use the loopholes in the law to prevent the CoC from taking the restructuring decisions. These questions may be analyzed through a brief case-study of the acquisitions of UltraTech Cements.

An analysis of the Code through the case-study of the rescue acquisitions of UltraTech cements

It may be noted that the heavy debts and the '*Zombie*' Companies has resulted in the enactment of the Code. However, it may interesting to note that despite the enactment of the Code, many promoters strived to solve their financial problems out of the scope of the Code in an effort to maximize their value, which is ironically one of the major objectives of the code. Furthermore, the recovery rates under the Code is also surprisingly on the lower end. In fact, as of 30 June 2019, only 120 of the 2,162 cases under Insolvency and Bankruptcy Code were closed by resolution. Similarly, of the ₹2.53 trillion claims admitted under the IBC process, only 42.8% of claims worth ₹1.08 trillion were recovered.[20] However, between January 2015 and April 2019,

[19] Chugh & Singh, *supra* note 5.

[20] Vivek Kaul, Why IBC success in recovering bad loans is middling, https://www.livemint.com/industry/banking/why-ibc-success-in-recovering-bad-loans-is-middling-1565551101789.html, (last visited 16 June 2020).

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there were seven large distressed asset acquisitions amounting to a total of $23 billion.[21] A lot of companies also went through slump sales, sale of assets, mergers, its to avoid going into insolvency. The regulatory body surprisingly seemed to have cast a blind eye on these practices. These practices were problematic as it raised a lot of competition issues. An analysis of the Cement Industry in India would throw a better light on these practices.

Consolidation has become the order of the day in the Indian Cement Industry which was expected to change the industry pecking order in the sector with the enactment of the Insolvency and Bankruptcy Code. Although the pace of this consolidation has accelerated in the recent years, it was not due to operational reasons but because of heavy debts built up by some players.[22] Although, many of the players realized that high debt is counter-productive in 2015 itself, the pace of consolidation accelerated only in the last couple of years when they were brought under the purview of the IBC. The Aditya Birla group owned UltraTech Cements made headlines in 2017 when it announced its acquisition of JCCL's cement plants for Rs. 16,189 crores. As a part of the deal, loans worth around Rs.12,000 crores on the books of JCCL moved to UltraTech. This acquisition was a win-win situation for both the parties as it gave UltraTech entry into Gujarat and it helped JCCL cut a portion of its Rs. 55,000 crores debt.[23]

The Binani Case

However, Binani Cements case which had taken a lot of twists and turns proved to be a test case for implementation of the Code. In this case, Dalmia Bharat bid was approved by the IRP based on the primary bids, hence UltraTech Cement, which has been vying for an acquisition gave a letter of comfort to Binani with a promise to acquire the assets at much higher amount, prompting the promoters of Binani Cement, to seek an out of court settlement from NCLT, which was not an option available at the given time[24]. It is interesting to note that, this out of court settlement did not face much backlash from the Adjudicating authorities. In a landmark decision, the adjudicating body as it approved UltraTech's bid to acquire Binani cements ruled that insolvency resolution process should aim to extract the maximum value from the auction of stressed assets.[25] This decision opened the floodgates to litigation by permitting UltraTech's bid thereby opening up new avenues to the defaulting companies to find new and better ways out of an otherwise hitherto stringent process. Furthermore, the acquisition of Binani cements by

[21] Ridhima Saxena, Distressed asset acquisitions, consolidation behind large M&A transactions, https://www.livemint.com/companies/news/distressed-deals-consolidation-driving-large-m-a-deals-in-india-bain-co-1569482593936.html (last visited 11 June 2020).
[22] *Bankruptcy Law - A game changer*, https://indiancementreview.com/special-report/Bankruptcy-Law---A-game-changer/111698 (last visited 11 June 2020).
[23] *supra*.
[24] *supra*.
[25] Binani Industries Ltd. v. Bank of Baroda (2018) SCC OnLine NCLAT 521 (India).

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UltraTech, gave the later, in addition to its earlier acquisitions, a large market share and competitive advantage in western India.[26] This kind of acquisition by UltraTech would have attracted the notice of the Competition Commission of India in the pre-IBC era. However, this transaction more less went scot-free due to the 180+90 time limit (pre-2019 amendment case).

The 2019 Amendment

The Insolvency and Bankruptcy Code (Amendment) Act, 2019 (Amendment Act), inserted two provisos to section 12(3) of the Code to increase the time limit for resolution process to 330 days. This period of 330 days includes (a) normal CIRP period of 180 days, (b) one-time extension, if any, up to 90 days of such CIRP period granted by the Adjudicating Authority, and (c) the time taken in legal proceedings in relation to the CIRP of the Corporate Debtor.[27] This 330 day time period would be inclusive of both the time taken in legal proceedings any extensions granted by the adjudication authority.[28] Upon the failure to complete the CIRP process within this time period would attract liquidation, which would be an unfeasible option for stakeholders involved.[29] This amendment sought fill in the gaps of the regulatory time frame, especially with reference to the Competition Commission of India, as the 330 day time limit was in compliance with the Competition Commission's timeframe for the investigation process.

Although, the government sought to protect the value of assets, which would go down if the CIRP process goes on for a long period of time, by laying down this non derivable time limit, they had clearly disregarded the fact that the non-compliance of this deadline, would forcefully push the Corporate Debtor into liquidation, which could be equally detrimental to his interests. This issue was raised in the case of *Essar Steels.*[30] In this case, it was held that the CIRP is to be concluded within 330 days, but this time period may be extended by the adjudicating authority where the short period of time left for the completion of the CIRP is attributable to the pendency of the action before or the inefficiency of the adjudicating authority.[31] Although the *Essar Steels* decision introduced some flexibility in the time period, it still failed to address two key issues which are as follows : (1) The standard that has to be satisfied in convincing the tribunal that they themselves have caused the delay in the CIRP process; and (2) whether they can be a limit

[26] Thomas & Vyas, NCLAT nod to UltraTech's Binani Cement bid sets precedent, https://www.livemint.com/Companies/3jejXNs2MOCmiailsJDtsL/NCLAT-approves-UltraTechs-Rs-7900-crore-offer-for-Binani-Ce.html> (last visited 11 June 2020).
[27] Insolvency and Bankruptcy Board of India Notification CIRP-13011/1/2019-IBBI dated 11 November 2019 <https://ibbi.gov.in/uploads/whatsnew/1f4d5f48bbc0d66b4b53ce6cb8220d08.pdf> assessed on 11 June 2020.
[28] Id. at 9.
[29] *supra*.
[30] Committee of Creditors of Essar Steel India Limited Through Authorized Signatory v. Satish Kumar Gupta (2019) SCC OnLine SC 1478 (India).
[31] *supra*.

to the extensions which can be granted beyond the 330 days limit.[32] In the absence of a limitation, the objective of the 2019 amendment may not be fulfilled.

Hence, it may be observed through various landmark IBC cases like Swiss Ribbon, Essar Steel, Binani Cements, etc., that one of the main intentions behind the implementation of the IBC is to protect the interests of the creditors. However, it may be interesting to note that during the current Covid-19 pandemic, the Insolvency law seems to have taken 180 degrees turn.

Suspension of the IBC Proceedings:

In the current backdrop of Covid-19, new issues and challenges emerged on the Indian insolvency laws, some of which are unlikely to be solved by the courts. In June 2020, section 10A and section 66(3) has been inserted in the Code trough the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020.[33] This 2020 ordinance is more of a Covid-19 relief package. It primarily seeks to provide relief to the corporate debtor directly affected by the Covid-19 pandemic, which has disrupted business operations across the countries. It strives to prevent the companies which are experiencing distress on account of this unprecedented situation, from being pushed into insolvency proceedings under the IBC, 2016 thereby giving them a breather in which to recoup and resuscitate their business. [34]

Section 10A makes it clear that creditors cannot drag any company to courts/insolvency proceedings, which will be in effect for the next six months and can be extended by up to one year. This clause overrides sections 7, 9 and 10 of the Code. Section 7 deals with financial creditors initiating insolvency action, Section 9 deals with operational creditors initiating action.[35] Section 10 allows a defaulting company to approach the National Company Law Tribunal (NCLT) to declare it insolvent. Therefore, fresh insolvency proceedings under the code would be suspended for and would exclude all Covid-19 related debts from the definition of 'default'. It is also a matter of concern that the 2020 ordinance also provides a relaxation to the corporate debtor from the wrongful trading provisions. As per the new section 66(3) of the Code

[32] Id. at 9.
[33] Anant Merathia & Poornima Devi, IBC Amendment Ordinance 2020: No fresh insolvency for default after lockdown declaration, https://www.newindianexpress.com/business/2020/jun/08/ibc-amendment-ordinance-2020-no-fresh-insolvency-for-default-after-lockdown-declaration-2153907.html (last visited Jun 10, 2020).
[34] Srivastava, Khare & Kishore, Insolvency And Bankruptcy Amendment Ordinance: June 2020, https://www.mondaq.com/india/insolvencybankruptcy/952306/insolvency-and-bankruptcy-amendment-ordinance-june-2020 (last visited 11 June 2020).
[35] Merathia & Devi, *supra* note 32.

the resolution professionals will be barred from initiating wrongful trading applications against directors of companies where the IBC process is suspended.[36]

Earlier, the minimum threshold for initiation of the insolvency proceedings was raised from the earlier one lakh rupees to one crore rupees. These measures clearly reflect the current need of the hour to prioritize the continuity of businesses over resolution under the Code, which is already in damp market conditions.[37] However, these measures inevitably place the creditors under a precarious situation. The combined effect of this measures and the ordinances foreclose the opportunity of the creditors to seek resolution under the Code for a significant period of time. Furthermore, these measures may also serve as an easy escape route for some corporate debtors who may have had impending insolvency proceedings even before the Covid-19 situation.[38] Additionally, these measure could also negatively effect the interests of the companies as they would drastically reduce the possibilities of a company receiving any loans in this period. Furthermore, the Reserve Bank of India has already provided a moratorium for a period of six months which has already provided some relief to the corporate debtors.[39]

Frivolous Suits:

Prior to the 2020 Ordinance, either a financial creditor or an operational creditor may trigger insolvency proceedings against the Company for a minimum default of only rupees one lakh. A brief glance at the current state of the Indian economy would suggest that this amount is too low for being the minimum threshold for triggering the Insolvency proceedings. Having such low thresholds is detrimental to the interests of the company itself as, any company may in the ordinary course of business experience bad years, having the minimum threshold this low high result in frivolous litigations which may be detrimental to the interests of the company. This problem may be more profound in Start-ups and MSMEs in India which currently emerging in a rapid scale. The burden of firmly distinguishing the vexatious claims from the legitimate claims of creditors ought to fall on the adjudicating authority.[40] The rationale behind this low threshold may be attributed to the belief of the legislative wing that there could possibly be no chance of recovery for a company which cannot pay for an invoice less than 1 lakh rupees.[41] It is

[36] G.P. Madaan & Aditya Madaan, IBC Amendment Ordinance 2020 : Ambiguities leave more questions than answers, https://www.livelaw.in/columns/ibc-amendment-ordinance-2020-ambiguities-leave-more-questions-than-answers-157916 (last visited assessed 11 June 2020).
[37] Merathia & Devi, *supra* note 32.
[38] *supra.*
[39] RBI Circular dated 27 March 2020, https://m.rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=11835 (last visited 16 June 2020).
[40] FINCH, *supra* note 1, at 243.
[41] *The report of the Bankruptcy Law Reforms Committee, 2020,* http://www.mca.gov.in/Ministry/pdf/ICLReport_05032020.pdf (last visited 15 May 2020).

interesting to note that the Government of India, in an effort to provide relief to the Companies as a part of the *'Atmanirbhar Bharat Abhiyan'* package, increased the minimum threshold for the initiation of the insolvency proceedings from 1 lakh rupees to 1 crore rupees. [42]It may be noted that increasing the minimum threshold, in fact has an adverse effect on the Operational creditors who are in most of the cases are small scale vendors, individuals and Micro, Small, and Medium Enterprises. This increment has the potential to give license to large companies to delay the bills of small companies whose supply is valued at less than 1 crore.[43] This is quite ironic as the notification was made to help the MSMEs avoid insolvency in the first place.Thus the instant ordinance coupled along with the amendment increasing the minimum threshold of default could be a double-edged sword for MSME's. [44]

Conclusion:

At the first glance, it may be observed that the Code strives to remedy the issues, such as the prevalence of the debtor-in-possession model which was predominant in the previous regime. However, in light of the recent trends in the law, one may infer that the law seems to go back to the earlier model. The main intention of the Code, which was to protect the interests of the creditors is currently being neglected in an effort to *'protect the interests of the company'*. Although, the 2020 Ordinance seems have promulgated with the intention of protecting companies and promoters from *no fault liability* due to the Covid-19 pandemic, the ambiguities in the legislation seem to raise more questions than answers. The Ordinance must ensure not become a double-edge sword which has the potential to defraud/affect the interests of the small scale vendors, MSMEs and individual creditors who more often than not fall into the category of operational creditors, especially those whose credit falls below 1 crore rupees. The legislative wing must ensure that Section 10A does not become a tool for regaining the defaulter's paradise, which the enactment Code sought to achieve in the first place. The legislature and adjudicating authority also needs to be mindful of the implementation of the Ordinance, which may possibility open a lot of floodgates to litigation on account of provisions introduced in the ordinance providing an exemption period for defaults and the restriction on filing of fraudulent/wrongful trading applications by resolution professionals among other things.

[42] Sanjay Vijaykumar, MSMEs not keen on proposed amendments to Insolvency and Bankruptcy Code, https://www.thehindu.com/news/national/tamil-nadu/msmes-not-keen-on-proposed-amendments-to-insolvency-and-bankruptcy-code/article31621263.ece (last visited Jun 11, 2020).
[43] *supra*.
[44] *supra*.