LIQUIDATION OF THE COMPANIES UNDER THE BANKRUPTCY AND INSOLVENCY

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ABSTRACT

The term Insolvency is not defined in the Insolvency and Bankruptcy Code, 2016 (IBC), but UNCITRAL Legislative Guide on Insolvency law defines the term. Insolvency occurs 'when a debtor is unable to pay its debts as they mature or when its liabilities exceed the value of Assets.' Bankruptcy is a legal status. Insolvency is a financial condition. An insolvent company or a debtor is unable to meet its obligations as they become due or its liabilities exceed the value of its assets. When a debtor is unable to pay its debts and other liabilities as they become due, legal system is required to provide a legal mechanism to address the collective satisfaction of the outstanding claims from assets of the debtor. A range of interests are required to be addressed and accommodated by such legal mechanism. There may be many parties affected by the proceedings, including the debtor, the secured creditors, unsecured creditors, employees, guarantors, suppliers of goods and services etc. The mechanism that is required to be adopted should not only strike a balance between aforesaid stakeholders, but also be relevant to social, political and other policy considerations that may have an impact on the economic and legal goals of the insolvency proceedings.

Key words: Insolvency, Bankruptcy, Liqidity etc

INTRODUCTION

The current Indian Insolvency and bankruptcy regime is highly fragmented, with multiple judicial forums and lacking clarity in terms of jurisdiction and certainty of decisions. Further, decisions are appealed, cross appealed and stayed by courts having

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concurrent and overlapping jurisdictions. It may lead to delay in closure of unviable business. Secured creditors, unsecured creditors, employees and others may have different and competing rights with no common regulatory process in place to determine the priority of claims. Lack of data and information in respect of indebtedness, assets and security situations of companies further aggravates the problems. Therefore, average time to resolve the insolvency in India used to take minimum 4 to 5 years which is very high in comparison to that in other advanced countries in the world. In UK and USA, it takes hardly one to one and half years respectively. It is a known fact that India has a very low rate of recovery in the world. Large amount of NPAs and stressed assets coupled with low rate of recovery has made the situation worse. To resolve the financial difficulties of the debtors, various types of proceedings in terms of restructuring may be followed including the Insolvency proceeding which is most formal in nature. Unfortunately, as mentioned above, in India laws pertaining to the Insolvency proceedings and its resolutions were fragmented and covered in many legislations. None of the legislations has been equipped enough to cover the specialized insolvency and bankruptcy proceedings.[3]

1.1 RELEVANT LAWS PRIOR TO INSOLVENCY AND BANKRUPTCY CODE

Prior to enactment of the Insolvency and Bankruptcy Code, 2016 (IBC), the structure of Bankruptcy and Insolvency process in India has been multi-layered. The legislative process was covered under multiple laws and the process consisted of multiple forums with overlapping jurisdictions. Two legislations viz. the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 covered Individual Insolvency and bankruptcy proceedings. The Presidency Towns Insolvency Act, 1909 covered three erstwhile presidency towns of Mumbai, Kolkata and Chennai, while the Provincial insolvency Act, 1920covered the rest of the country. In case of corporate entity, many laws applied with varied and overlapping jurisdictions. The Companies Act, 1956 contained provisions for rehabilitation and winding up of all registered companies. Laws pertaining to rehabilitation of sick industrial companies were covered under the Sick Industrial Companies (Special provisions) Act,1985(SICA) which exclusively

[3] The High Level Committee on Law relating to Insolvency and Winding up of the Companies (2000).

applied to an industrial company (undertaking) in distress. A specialized Board viz. Board for Industrial and Financial Reconstruction (BIFR) assessed the viability of the industrial company. The Sick Industrial Companies (Special Provisions) Repeal Act, 2003, which was though enacted in the year 2003, came into force only on 1st December, 2016. Further, an out of court mechanism was set up after 2000 for Banks to restructure loan contracts with debtors which provided for Corporate Debts Restructuring (CDR) and in the year 2015 under the Ministry of Finance, a joint lending forum viz. Strategic Debt Restructuring (i.e. SDR) Forum was set up. Certain laws are also in force in respect recovery of debts under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI Act) and enforcement of security interest under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). The adjudication authority for deciding the matters under RDDBFI Act, 1993 and the SARFAESI Act, 2002 is Debts Recovery Tribunal (DRT) with Debts Recovery Appellate Tribunal (DRAT) as appellate authority. In the matter of winding of the company, the company court of the respective High court exercised jurisdiction and the winding up of the corporate entity took place through the respective company courts of the High Courts with the help of the Official liquidator, attached with the High Court, under the provisions of the Companies Act[4].

1.2 LIQUIDATION OF COMPANIES ON THE GROUND OF INSOLVENCY

During the initial period following the commencement of the Companies Act, 1956, the application of law on liquidation was guided by governmental policy on the resolution of industrial sickness. It was perceived that the healthy functioning of the industrial sector was vital to the economic growth of the country. Thus, this period was characterized by government interventions in cases of industrial indebtedness, such as management takeovers and provision of rescue finance by the financial sector. In this framework, liquidation of an insolvent company was only seen as a measure of last resort. Consequently, this is likely to have diminished creditor recourse to liquidation as a mechanism for enforcement of debt. Following economic liberalization and the concomitant reform of the banking sector in the 1990s, the

[4] Statement of Objects and Reasons of Insolvency and Bankruptcy Code, 2016

interventionist policy of the government underwent a change. This ought to have increased creditor recourse to liquidation and winding up proceedings against insolvent companies. However, the liquidation provisions under the 1956 Act, have been widely seen as being ineffective in protecting stakeholder interests and facilitating an easy exit for companies in financial trouble. Various committee reports and studies have analysed the limitations of India's liquidation law and proposed substantive changes to the provisions in the Companies Act, 1956[5].

The Eradi Committee Report , submitted to the Central Government in 2000, drew attention to the administrative aspects of the liquidation regime as being responsible for delays in the winding up proceedings, particularly after the making of the winding up order. The Report echoed the findings of the Goswami Committee Report regarding the vulnerability of the official liquidator to delays at various stages. Additionally, it pointed out that further delays were caused due to the requirement of court approvals at several stages of the liquidation process. The Eradi Committee noted that the liquidators also faced significant resource constraints- there was a lack of well-trained staff to assist the liquidator, and often enough, the liquidator did not have enough funds to cover the expenses of liquidation, costs of litigation etc. The Eradi committee Report also noted that there were constraints in court capacity due to a dearth of judges dealing with company matters at the High Courts. Very significantly, it also pointed towards the involvement of courts in the failure of the law on liquidation; it noted that in some cases, delays were caused by the courts which insisted on pursuing recovery proceedings even for very small claims or on carrying on the business of the company for many years or delayed the making of a winding up order against the company.

1.3 VISWANATHAN'S COMMITTEE

It is against the above ground that a committee i.e., The Bankruptcy Law Reform Committee‖ under the Chairmanship of Dr.T.K.Viswanathan was set up by the Central Government in August, 2014, (Viswanathan's Committee)to study the Corporate

[5] Section 235 of the Insolvency and Bankruptcy Code,2016

bankruptcy legal frame work in India. The objectives of the Committee were to resolve insolvency with[6]

(i) lesser time involved,

(ii) lesser loss in recovery, and

(iii) higher levels of debt financing across a wide variety of debt instruments. The focus of the committee was on the problems of insolvency and bankruptcy under the Companies Act, 2013.According to the Viswanathan's Committee, the limited liability company is a contract between equity and debt. As long as debt obligations are met, equity owners have complete control, and creditors have no say in how the business is run. When default takes place, control is supposed to transfer to the creditors; equity owners have no say. This is not how companies in India work today. For many decades, creditors have had low power when faced with default. Promoters stay in control of the company even after default. Only one element of a bankruptcy framework has been put into place: to a limited extent, banks are able to repossess fixed assets which were pledged with them. While the existing framework for secured credit has given rights to banks, some of the most important lenders in society are not banks. They are the dispersed mass of households and financial firms who buy corporate bonds. The lack of power in the hands of a bondholder has been one (though not the only) reason why the corporate bond market has not worked. This, in turn, has far reaching ramifications such as the difficulties of infrastructure financing. Under these conditions, the recovery rates obtained in India are among the lowest in the world. When default takes place, broadly speaking, lenders seem to recover 20% of the value of debt. While lending to limited liability companies is particularly important, lending also takes place to individuals, sole proprietorships, partnerships, limited liability partnerships, etc. A comprehensive and consistent treatment of bankruptcy and insolvency for all these is an essential ingredient of India's rise into a mature market

[6] Supra note 10.

economy. Therefore, the Committee felt that there should be a single unified framework which deals with bankruptcy and insolvency of persons other than financial firms.

1.4 RECOMMENDATIONS OF VISWANATHAN'S COMMITTEE

On the basis of the above analysis, the Viswanathan's Committee concluded that the failure of some business plans is integral to the process of the market economy. When business failure takes place, the best outcome for society is to have a rapid re-negotiation between the financiers, to finance the going concern using a new arrangement of liabilities and with a new management team. If this cannot be done, the best outcome for society is a rapid liquidation. When such arrangements can be put into place, the market process of creative destruction will work smoothly, with greater competitive vigor and greater competition. India is in the process of laying the foundations of a mature market economy. This involves well drafted modern laws that replace the laws of the preceding 100 years, and high performance organizations which enforce these new laws. Keeping the above objectives in view, the Viswanathan's Committee in their Report submitted in November,2015, recommended for[7]

(i) consolidation of all the existing laws relating to insolvency of companies, limited liability entities, partnership firms and individuals which are scattered in a number of legislations into a single legislation,

(ii) creation of an environment to improve the handling of conflicts between creditors and debtors, avoid destruction of value and distinguish malfeasance is-a-vis business failure and (iii) creation of a platform to provide greater clarity in the law, to facilitate the application of consistent and contract provisions to different stakeholders affected by business failure or inability to pay debt and to provide for swift and effective bankruptcy resolution. Based on the recommendations of the Viswanathan's Committee, the Insolvency and Bankruptcy Code,2016 has been enacted by the Parliament .The provisions of the Code have come in

[7] Section 7 of the Insolvency and Bankruptcy Code,2016 as by the Insolvency and Bankruptcy Code(Amendment) Ordinance, 2018 w.e.f. 06-06-2018.

to force on different dates. The Insolvency and Bankruptcy Code, 2016 (the Code) has been enacted 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 priority of payment of government dues and to establish an Insolvency and Bankruptcy Fund, and matters connected therewith and incidental thereto. An effective legal framework for timely resolution of insolvency and bankruptcy would support development of credit markets and encourage entrepreneurship. It would also improve Ease of Doing Business, and facilitate more investments leading to higher economic growth and development.[8]

1.5 CORPORATE INSOLVENCY RESOLUTION PROCESS

It applies to matters relating to insolvency and liquidation of corporate debtors where the minimum amount of default is one lakh rupees. The Central Government may, by notification, specify the minimum amount of default of higher value which shall not be more than one crore rupees. Where a corporate debtor has defaulted in paying a debt that has become due and payable but not repaid, the corporate insolvency resolution process may be initiated in the manner provided in the Code in respect of such corporate debtor by a financial creditor, an operational creditor or the corporate debtor itself. Early recognition of financial distress is very important for timely resolution of insolvency. Any financial creditor can initiate the corporate insolvency resolution process where the corporate debtor has defaulted in paying a debt that has become due and payable but not repaid. Financial creditors are those creditors to whom a financial debt is owed. Operational creditors are those creditors to whom an operational debt is owed. The corporate debtor itself may initiate the insolvency resolution process once it has defaulted on a debt. Operational creditors are also permitted to initiate the insolvency resolution process. This will bring the law in line

[8] Sangeetha Vivek, Voluntary Winding up Under Insolvency Bankruptcy Code‖, Corporate Law Reporter, 2017. (Visited on 22nd July, 2017).

with international practices, which permit unsecured creditors to file for the initiation of insolvency resolution proceedings.

1.6 INITIATION OF CORPORATE INSOLVENCY RESOLUTION PROCESS BY FINANCIAL CREDITOR

The Code lays down the procedure for the initiation of the corporate insolvency resolution process by a financial creditor or jointly with other financial creditors or any other person on behalf of the financial creditor as may be notified by the Central Government when a default has occurred. The financial creditor can file an application before the National Company Law Tribunal (NCLT/Tribunal) along with proof of default and the name of a resolution professional proposed to act as the interim resolution professional in respect of the corporate debtor. The requirement to provide proof of default ensures that financial creditors do not file frivolous applications or applications which prematurely put the corporate debtor into insolvency resolution proceedings for extraneous considerations. The adjudicating authority/Tribunal can, within fourteen days from the date of receipt of the application, ascertain the existence of a default from the records of a regulated information utility. A default may also be proved in such manner as may be specified by the Insolvency and Bankruptcy Board of India(Board).Once the adjudicating authority/Tribunal is satisfied as to the existence of the default and has ensured that the application is complete and no disciplinary proceedings are pending against the proposed resolution professional, it shall admit the application. The adjudicating authority / Tribunal are not required to look into any other criteria for admission of the application. It is important that parties are not allowed to abuse the legal process by using delaying tactics at the admissions stage.[9]

1.7 INITIATION OF CORPORATE INSOLVENCY RESOLUTION PROCESS BY OPERATIONAL CREDITOR

The Code also sets out the procedure for the initiation of the corporate insolvency resolution process by an operational creditor. This procedure differs from the procedure applicable to financial creditors as operational debts (such as trade debts,

[9] Chapter V of Part II of the code consisting of Section 59

salary or wage claims) tend to be small amounts (in comparison to financial debts) or are recurring in nature and may not be accurately reflected on the records of information utilities at all times. The possibility of disputed debts in relation to operational creditors is also higher in comparison to financial creditors such as banks and financial institutions. Accordingly, the process for initiation of the insolvency resolution process differs for an operational creditor. Once a default has occurred, the operational creditor has to deliver a demand notice or a copy of an invoice demanding payment of the debt in default to the corporate debtor. The corporate debtor has a period of ten days from the receipt of the demand notice or invoice to inform the operational creditor of the existence of a dispute regarding the debt claim or of the repayment of the debt. This ensures that operational creditors, whose debt claims are usually smaller, are not able to put the corporate debtor into the insolvency resolution process prematurely or initiate the process for extraneous onsiderations. It may also facilitate informal negotiations between such creditors and the corporate debtor, which may result in a restructuring of the debt outside the formal proceedings. On the expiry of the period of ten days from the date of receipt of the invoice or demand notice, if the operational creditor does not receive either the payment of the debt or a notice of existence of dispute in relation to the debt claim from the corporate debtor, he can file an application with the adjudicating authority for initiating the insolvency resolution process in respect of such debtor. He also has to furnish proof of default and proof of non-payment of the debt along with an affidavit verifying that there has been no notice regarding the existence of a dispute in relation to the debt claim. Within fourteen days from the receipt of the application, if the adjudicating authority/Tribunal is satisfied as to[10]

(a) the existence of a default, and

(b) the other criteria specified in the Code being met, it shall admit the application.

1.8 INITIATION OF CORPORATE INSOLVENCY RESOLUTION PROCESS BY CORPORATE APPLICANT

[10] Saket Shukla, Akshay Sachthey and Debottam Chattopadhyay, The Insolvency and Bankruptcy Code 2016: Time to Wind Up the Winding-up Regime?‖, Mondaq (upadated 27 June, 2018)

A corporate debtor itself may initiate corporate insolvency resolution process under the Code. A corporate applicant (defined as a specific set of persons linked to the corporate debtor) may make an application to the adjudicating authority along with the corporate debtor's books of accounts and other specified documents, the name of a person proposed to be appointed as the interim resolution professional and the special resolution passed by the shareholders of the corporate debtor. The adjudicating authority shall admit the application within fourteen days from the date of receipt of the application, if it is complete and no disciplinary proceeding is pending against the proposed resolution professional. Since the corporate applicant can only initiate the corporate insolvency resolution process upon the occurrence of a default and not on mere likelihood of inability to pay debts, the corporate applicant cannot trigger the corporate insolvency resolution process prematurely to abuse the moratorium provisions.[11]

CONCLUSION

The term „company" has strictly no technical or legal meaning. In terms of the Companies Act, "company" means a company incorporated under that Act or under any previous company law. Under common law, a company is a "legal person"" or „legal entity" separate from and capable of surviving beyond the lives of its members. Like any juristic person, a company is legally an entity apart from its members, capable of rights and duties of its own, and endowed with potential of perpetual succession. It is an association of persons formed for the purpose of some business or undertaking carried on in the name of association, each member having the right of assigning his share to any other person(s), subject to the regulations of the company. The company is the most important institution in the commercial world having is tremendous impact on the social and political frontiers as well. A company has to be registered under the companies Act after complying with the various requirements laid down in the Act. Company Law in India is the cherished child of the English parents. Our various Companies Acts have been modelled on the English Acts.1 Following the enactment of the Joint Stock Companies Act, 1844 in England, the first

[11] rancis Beaufort Palmer and Geoffrey Morse, "Company Law Annotated Guide to the Companies Act, 2006", Thomson by Sweet & Max Well, 2012 and Palmer"s Company Law, 20th edn. 56

Companies Act was passed in India in 1850.It provided for the registration of the companies and transferability of shares. The Amending Act of 1857 conferred the right of registration with or without limited liability. Subsequently, this right was granted to banking and insurance companies by an Act of 1860 following the similar principle in Britain. The Companies Act of 1856 repealed all the previous Acts. That Act provided inter alia for incorporation, regulations and winding up of companies and other associations. This Act was recast in 1882 embodying the amendments which were made in the Company Law in England up to that time. In 1913, a consolidating Act was passed in India and major amendments were made to the consolidated Act in 1936.In the meantime, England passed a comprehensive Companies Act in 1948.In 1951, the Indian Government promulgated the Indian Companies (Amendment) Ordinance, under which the Central Government and the Court assumed extensive powers to intervene directly in the affairs of the company and to take necessary action in the interest of the company. The ordinance was replaced by an Amending Act of 1951.

The Companies Act, 1956 was enacted repealing the 1913 Act with a view to consolidate and amend the earlier laws relating to companies and certain other associations. The Companies Act, 1956 was based largely on the recommendations of the Company Law Committee (Bhabha Committee).This Act was the longest piece of the legislation ever passed by the Parliament in India

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