
THE POSSIBLE CONFLICTS IN INSOLVENCY AND BANKRUPTCY CODE, 2016 IN ESTABLISHMENT OF TRIBUNALS

Shivam Srivastava,

B.A.LL.B., Indore Institute of Law, Indore

ABSTRACT

The practice of lending and borrowing is millenniums old. The concept of banking was on track from the existence of human beings. The economic transactions evolving lead India to compete at Global Market. In our country now, we have great reputable banks now in the 21st century-with massive collection of more than \$2 trillion. This banking system with the regular flow of credit-system facility is considered as backbone of country. The banking (or credit) sector is one that holds the significant position of every country in the world economy. Without the presence of a well-established credit-system facility, one cannot expect the economy to roll on. Banking sector plays a vital role in booming or flourishing the economy. With growing economy it needs to maintain its credit facility. Banking in India is at its worst condition and more is yet to come if preventive measures are not taken at right time. Rising Non-Performing Assets (NPA), Slow Recovery Rate, Doing Business, Time taken for Liquidation Process are the factors which needs to be trigger and bring the banks and business back on track. Many times banks failed to recover the amount or have had to wait for very long time for the decision of Civil Courts for the debt-recovery. This led the Civil Courts with a havoc and trapping of crores of rupees in litigation proceedings, which the bank could not re-advance, forcing the Government to establish a Debt Recovery Tribunal (DRT) and National Company Law Tribunal to make the proceedings of debt recovery fast and lowering the litigation cost. This essay aims to explain the loopholes and shortcomings in the Insolvency and Bankruptcy Code, 2016 on technical and legal basis.

Keywords: Insolvency, Bankruptcy, NCLT, DRT, Insolvency Professionals, Liquidation

INTRODUCTION

With the intense and constantly emergent competition in the businesses of various economic sectors. India is also a fastest growing economy¹ in the world. It stands 2nd in Asia and 7th in the world. After Independence India continues to target on its economy. With growing economy it needs to maintain its credit facility. In past few decades Indian Banks failed to maintain this credit ratio facility in the country. This is not the only hurdle in the economic growth of India, there are many more. To overcome these hurdles various laws are being made. One of them is "The Insolvency and Bankruptcy Code, 2016²". It was introduced by the Minister of Finance, Mr. Arun Jaitley, in Lok Sabha on December 21, 2015, and subsequently referred to a Joint Committee of Parliament. The Committee submitted its recommendations and a modified Code based on its suggestions on April, 28 2016. The modified Code was passed by Lok Sabha on May 6, 2016. The Code creates a foundation for resolving insolvency and bankruptcy in India and tries to bring both corporate insolvency and personal insolvency both under one umbrella.

This Code will apply to all kinds of:

- Corporate Enterprises
- Limited Liability Partnerships
- Partnership Firms; and
- Individuals

Insolvency is a situation where a company is unable to repay their outstanding debt and is not able to run company with its current pace while bankruptcy is when a person is legally declared as incapable of paying dues and obligations.

In this essay, I will first address the amended or repealed legislature in context of this Code. Thereafter, I would attempt to provide why this Code required or is in existence. In that section, I will also address the data provided by Reserve Bank of India surrounding the concept of Non-Performing Assets (NPA), time taken in Liquidation process and its application. Further, I will review the legal systems of the

¹ GDP (current US\$)" (PDF). *World Development Indicators*. World Bank. **Retrieved 18 April 2017**.

² 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.

Code on technical points, ecosystem of the Code with regard to their points of divergence in the application of conflict rules. At last, I will sum up the topic with possible solutions.

Such an integrated code is vital because earlier the matter was diagnosed under at least 13 different laws and codes which was very multifaceted and lengthy process. This code repeals the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920. In addition, it also amends 11 laws, including the Companies Act, 2013; Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and Sick Industrial Companies (Special Provisions) Repeal Act, 2003, among others. The Code repeals and amends few laws in addition to this new Code. They are-

Amending Schedule	Existing Legislature	Impact of the Code, 2016
XI	Chapter XIX and Chapter XX of Companies Act, 2013	Amended
V	Recovery of Debts Due to Banks and Financial Institutions, 1993	Amended
VII	Sarfessi Act, 2002	Amended
X	Chapter XIII, LLP Act, 2008	Amended
VIII	SICA Act, 1985	Amended
N.A.	The Presidency Towns Insolvency Act, 1909	Repealed
N.A.	The Provincial Insolvency Act, 1920	Repealed

WHY THIS CODE WAS NEEDED?

- Lowering the NPA's-** Till 2008, Private Banks performed very bad having most of the NPA's. It means a non performing asset (NPA)³ is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days. Post 2008, this scenario completely changed and as of now Public Sector Banks are in huge NPA's. In the FY 2016-17⁴ (till March) total NPA is about Rs.6120 Billion. Gross bad loans of public sector banks increased to Rs 6.07 Lakhs Crore in December from Rs. 5.02 Lakhs Crore at the end of March 2016, according to government data⁵. As a result of increasing NPA's, money being paid becomes fruitless and decreased profit lead to shortage of enough cash at hand which indirectly leads to increase in interest rate for the other customers who have borrowed money for shortest period of time. The shortage of money hampers the functions of the banks like routine payments and dues which makes banks difficult to perform their necessary tasks.
- Ease of doing business-** Ease of doing business is an index published by the World Bank. It is a cumulative assessment that requires different sources (construction permits, registration, getting credit, tax payment mechanism etc) which define the ease of doing business in a country. Business and economy of a country go hand in hand. They are complementary to each other. In the year 2015, India was ranked⁶ 142nd in the ease of doing business but within a year India showed improvement of 12 (twelve) positions and is now ranked at 130th in the latest report by World Bank.
- Increasing Recovery Rate-** Banks in India has a sudden powerful forward or upward movement in recovery rate of bad debts. The recovery rate of banks in the FY 2015- 16 was 10.3 percent i.e. only Rs 22,800 Crore recovered from Total of Rs 2,21,400 Crore⁷. For increasing recovery rates Government is all geared up to amend Banking Regulation Act and already made many

³ Study on Non-performing Assets, (March30th 2017),

https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7357#def **visited on 15th May 2017 at 5:20 P.M.**

⁴ Study on Non-performing Assets, (March30th 2017), <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4> **visited on 15th May 2017 at 5:32 P.M.**

⁵ Dheeraj Tiwari, *IMF alerts on NPA's*, The Economic Times, May 16th, 2017 at pg 15

⁶ Anonymous post/article, *Initiatives on Improving 'Ease of Doing Business' in India*, (Dec, 11th 2015),

<https://mail.google.com/mail/u/0/?tab=wm#inbox/15c0c0508c89cd9d?projector=1> **visited on 17th May 2017 at 4:34 PM**

⁷ George Mathew, *Non-performing assets: Bad loan recovery by banks only gets worse in four years*,

<http://indianexpress.com/article/business/banking-and-finance/non-performing-assets-bad-loan-recovery-by-banks-only-gets-worse-in-four-years-4456317/>, (Published: January 3, 2017 1:38 am) **Visited on 19th May, 2017 at 10:48 PM**

amendments. This amendment in Banking Regulation Act will keep a watchful eye on companies those have been the biggest loan defaulters.

- **Reducing Time Taken:** Time taken to resolve insolvency in India puts a huge pressure on companies and was a very complicated task. In India it takes 4.3 years⁸ to resolve insolvency as per World Bank. Insolvency activates the procedure that needs to be result in to liquidation⁹. Earlier the process of liquidation was carried out by Official Liquidator but now the appointment of Insolvency Resolution Professionals will be acting same as Liquidator.

ECOSYSTEM OF INSOLVENCY AND BANKRUPTCY CODE

Insolvency and Bankruptcy Board of India¹⁰: This is a Board established under the code. This apex body will be governing and working for promoting transparency & governance in the administration of the Insolvency and Bankruptcy Code; will be involved in setting up the infrastructure and accrediting Insolvency Professionals & Insolvency Utilities. A body corporate, having perpetual succession and a common seal, with power, to acquire, hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or be sued. The Board¹¹ comprises of:

- a. One Chairperson;
 - b. Three members from Central Government officers not below the rank of Joint Secretary or equivalent.
 - c. One nominated member from the RBI; and
 - d. Five members nominated by the Central Government; of these, three shall be whole-time members.
- **Insolvency Professional Agency:** It is the agency authorized by the Insolvency and Bankruptcy Board of India. This agency shall enroll the Insolvency Professionals and

⁸ World Bank, Doing Business Report, <http://data.worldbank.org/indicator/IC.ISV.DURS?view=map> visited on **19th May, 2017 at 12:28 PM**

⁹ **Liquidation** is the winding up of a corporation or incorporated entity under the supervision of a person or "liquidator", empowered under law for such operation and for distribution of proceeds to the various creditors as per an agreed formula.

¹⁰ The insolvency and bankruptcy code, 2016, no. 31 of 2016, §§ 188 & 196 (2016).

¹¹ The insolvency and bankruptcy code, 2016, no. 31 of 2016, § 189 (2016)

promote the professional development¹². These agencies will issue guidelines and direct the IPs time to time. The agency¹³ shall:

- a. Ensure conformity with the Code and rules, regulations and guidelines;
- b. Set the solid standards of professional conduct for its members;
- c. Monitor performance of its members; and
- d. Suspend or terminate the membership of insolvency professionals who are registered, on the grounds set out in its bye-laws.

At present there are three Insolvency Professional Agencies registered namely;

1. Institute of Insolvency Professional Of ICAI
2. ICSI Insolvency Professional Agency
3. Insolvency Professional Agency of Institute of Cost of Accountants of India

- **Insolvency Professionals:** Persons enrolled and registered under Insolvency Professional Agency to act as insolvency professionals. They will be appointed by creditors and will perform resolution process same function as Liquidator and Bankruptcy Trustee. They will abrogate the powers of Board of Directors¹⁴.
- **Information Utilities¹⁵:** Person shall carry on its business as information utility with a certificate of registration issued by the Board. It will act as centralized data storage entity getting financial information from debtors or creditors.

The two critical points regarding Information Utilities are:

1. At the time of trigger of the resolution process. The Insolvency and Bankruptcy Code envisages that the occurrence of default will be recorded at an Insolvency Utility, and this evidence will be used by the Adjudicating Authority (AA) to trigger the resolution process.

¹² The Insolvency and bankruptcy code, 2016, no. 31 of 2016, § 199 (2016).

¹³ The Insolvency and bankruptcy code, 2016, no. 31 of 2016, § 204 (2016).

¹⁴ The insolvency and bankruptcy code, 2016, no. 31 of 2016, §§ 206-208 (2016).

¹⁵ The insolvency and bankruptcy code, 2016, no. 31 of 2016, §§ 209-216 (2016).

2. At the time of forming the creditors committee. The information from the IUs will be used to determine all the creditors to the debtor so as to form the creditors committee.
- **Adjudicating Authority:** There will be two adjudicating authority. One for the corporate enterprises i.e. National Company Law Tribunals (NCLT) and the second is Debt Recovery Tribunals (DRT) for individuals and Partnership firms. The appellate tribunals for both are National Company Law Appellate Tribunals (NCLAT) and Debt Recovery Appellate Tribunals (DRT) respectively. They will entertain and dispose the applications related to resolution plans¹⁶. At present, there are total 38 DRTs functioning at various parts of the country. The latest being established at Siliguri. At present, there are 5 DRATs functioning at Allahabad, Chennai, Delhi, Kolkata and Mumbai. At present there are there are total 11 (eleven) benches National Company Law Tribunal including a principle bench at New Delhi. The Central Government has constituted National Company Law Tribunal (NCLT) under section 408 of the Companies Act, 2013.

Civil Courts^{17 18} will not have any jurisdiction to entertain any matter regarding NCLT, NCLAT, DRT or DRAT. However, further appeal may be filed in Supreme Court^{19 20} challenging the decision of NCLAT or DRAT.

¹⁶ The insolvency and bankruptcy code, 2016, no. 31 of 2016, §§ 60, 79, 79 (2016).

¹⁷ The insolvency and bankruptcy code, 2016, no. 31 of 2016, § 180 (2016).

¹⁸ The insolvency and bankruptcy code, 2016, no. 31 of 2016, § 63 (2016).

¹⁹ The insolvency and bankruptcy code, 2016, no. 31 of 2016, § 182 (2016).

²⁰ The insolvency and bankruptcy code, 2016, no. 31 of 2016, § 62 (2016).

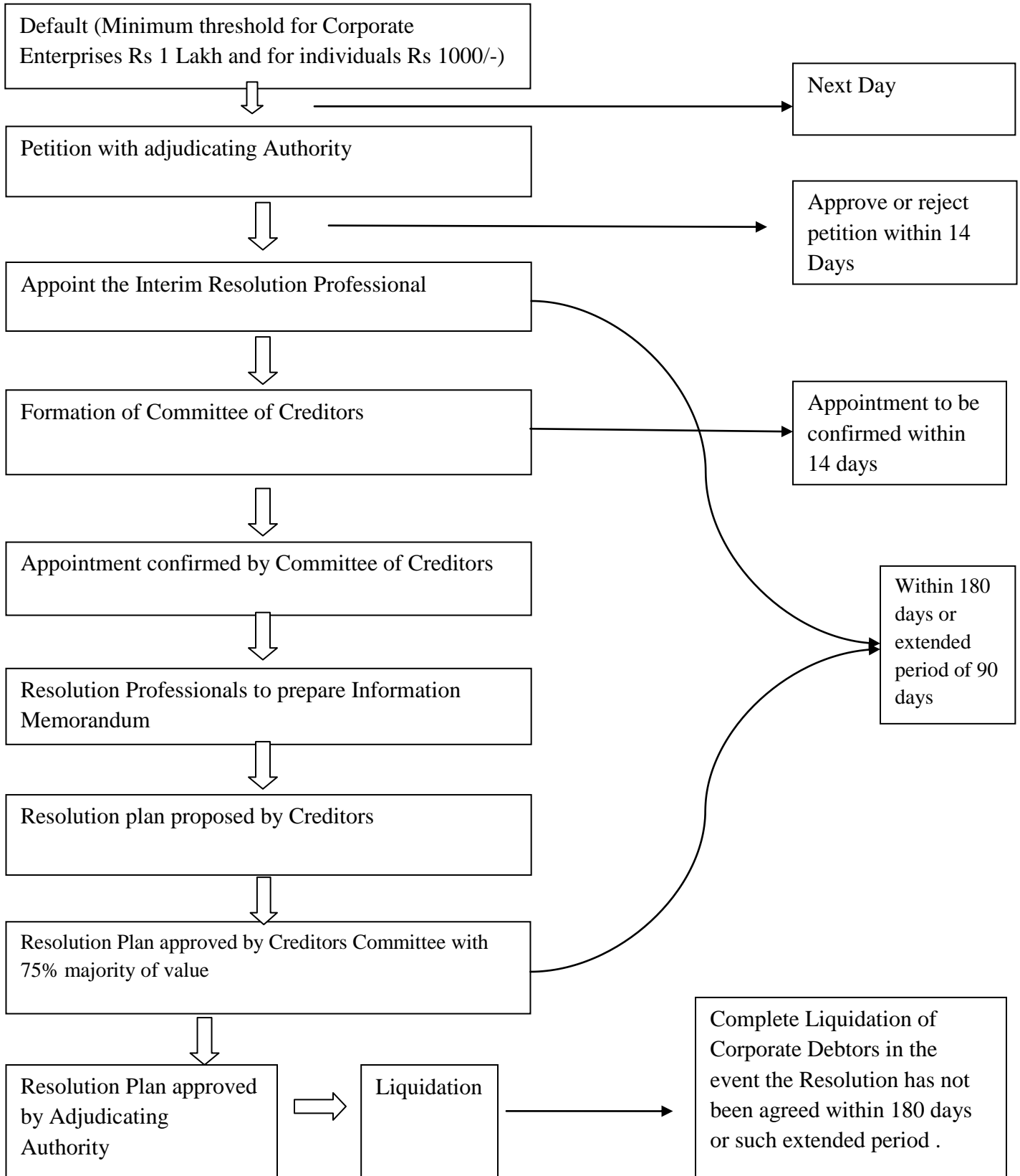
WHO CAN INITIATE INSOLVENCY RESOLUTION PROCESS?

1. **Financial Creditors**- Any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned for or transferred to. Examples Organizations like Banks or Financial Institutions.
2. **Operational Creditors**- A person to whom operational debt is owed. Operational Debt means claim in respect of goods and services including employment or any dues to government.
3. **Corporate Creditor**- A corporate creditor is a party that has a claim on the services of a company or large organizations.

WHAT ACTS CAN BE RESULTED IN LIQUIDATION?

1. A 75% of Creditor's Committee does not approve the Resolution Plan.
2. If the NCLT rejects the submitted Resolution Plan on the technical grounds.
3. The debtor contravenes the agreed Resolution Plan & an affected person makes an application to the NCLT to Liquidate the Corporate Debtor.
4. The Corporate Committee does not approve the Resolution Plan within 180 days or such extended 90 days.

Corporate insolvency resolution- steps



LOOPHOLES AND SHORTCOMINGS

- ***Provision of Moratorium***²¹: This provision under section 13 & 14 of Insolvency and Bankruptcy Code will bring the provision of Section 22 of SICA all over again. Section 22 of SICA was intended to be moratorium so at the stay of that company can be rehabilitated in a mean time people do not keep on pressing upon the company while they are trying to recover the health of the company. Hence, no suit or other legal proceedings can be filed by or against debtor.
- ***Insolvency Professionals***: This is the very critical position in the whole procedure. Earlier the whole corporate debt situation was handled in the enactment like Sarfessi Act. The debtors were in full control of the business and often can transfers money from one account to another. They continue to default on payments and deceive the creditors for significant period of times. That was a major concern. Now the entire control goes to creditors.
- ***Information Utilities***: Insolvency and Bankruptcy Code, 2016 mandates the Insolvency Resolution Process in time bound manner. This can only be done only if the electronic records contained in the Information Utility are considered as conclusive evidence in respect of this The Information and Technology Act, 2000 (Information and Technology Act) amended definitions in the Indian Evidence Act, 1872 (Indian Evidence Act) to include electronic records as "evidence". Definition of "documents" and "admission" was also amended to include electronic records.

However, the Code does not specify any penalty for not submitting this data. So it appears that if a creditor does not submit this information, the 'penalty' is that in case of default, the creditor cannot take advantage of the fast and easy processes enabled by the Insolvency Utility mechanism.

²¹ The insolvency and bankruptcy code, 2016, no. 31 of 2016, §§ 13 & 14 (2016).

- **Minimum Threshold:** The Default minimum threshold is not very high. Now this creates a huge problem. Suppose, in case of rent of large business organizations or outlets in places like Mumbai, Delhi, Bangalore. If a tenant did not pay a rent for once or twice. Then the landlord will file the claim to Adjudicating Authority. For Corporate Enterprises the default minimum threshold is Rs 1 Lakh.

If we take this example in small or medium enterprises the scenario becomes worse, the default minimum threshold is Rs 1000 only. Just imagine if a person owes someone Rs 2000/- and lives in a remote area and creditor files a complaint in Debt Recovery Tribunal which are situated only at capitals and that person comes from the remote area to appear before DRT. It seems again not in the spirit of ease of doing in business. Often times more than 75% of credit would be from an individual or one bank. And if there interest militates with the interest of some customers of businesses and they suggest a resolution plan which is not in the interest of promoters, investors or customers of business. Even than the resolution plan will be followed till the end.

- **Situation in Tribunals:** As the default threshold very low as 1 Lakh can open the door for this whole process that has been set down. Suddenly, in some period of time if 100 such petitions filed with adjudicating authority. Even assuming what can be lodged as a part of this petition-

1. Original Contract between parties
2. Invoices
3. Bank History
4. Emails
5. Physical Letters

Anything from the above mentioned can be lodged as a part of petition which could be from 50 to 100 pages. If Adjudicating Authority has 50 such matters in front of them every week and if they have only two weeks to approve or reject the petition after reading 100 pages or more pages. The fact is without increasing of such benches across countries will eventually choke the system completely. There are no provisions what will happen if there is no decision being taken by Adjudicating Authority within 14 days.

In the case of National Company Law Tribunal the question arises *how much work NCLT can handle?* They are going to take operation mismanagement, winding and many more. Any order passed by NCLT shall subject matter will lie appeal in NCLAT. There is only one bench at NCLAT. There will be huge backlog of cases again at NCLAT completely clogged at the appellate stage.

Earlier the equivalent proceedings had also given rise to frequent instances of divergence between the laws. Four different institutions -

- a. The High Courts;
- b. The Company Law Board;
- c. The Board for Industrial and Financial Reconstruction (BIFR); and
- d. The Debt Recovery Tribunals (DRTs)

These all institutions have common characteristics over jurisdiction, generating mount to the probable of systematic and technical delays and complexities in the whole judiciary process. Though, the new bill removes all this technical and overlapping jurisdictions

- ***Insolvency Resolution Process:*** In the whole process let's assume for time being Insolvency Professional act as CEO of company and takes operational control of company. Now the question is *does India have such a large number of trained professional currently?* Insolvency Resolution Professional without the knowledge of that company how will they make the business survive. Now under the same process the Insolvency Resolution Professional will either be approved or rejected by committee of creditors. By this 21 (twenty one) days are already gone out of 180/270 days. All over again a new Insolvency Resolution Professional comes.

At the end of 180/270 days, resolution plan of 75% needs to be approved from creditors. And if not 75% the whole process by default to Liquidation. There is no power to Adjudicate Authority to look at Resolution plan and suggest any change except if there is technical error.

POSSIBLE SOLUTIONS

1. There is no managerial jurisdiction as such over DRT and NCLT by High Court or any other. Though there are Disciplinary provision for Insolvency Professionals, Insolvency Professionals

Agency and Information Utilities²². However a writ petition can be filed in the High Court against an order/decreed of the DRT or NCLT. So, as a result DRT and NCLT do not have any accountability towards any of the authority. There is no such set criteria or process to check and balance DRT and NCLT. As a matter of fact, there is an added need for ensuring accountability for the Tribunal.

2. The law or rules shall be made which bars the banks to extend further loans to a defaulting company which failed to repay the loans. The recovery rate of banks needs to be monitored and as soon as any company makes defaults, the notice in the form of warning of red-flagging shall be issued. The bank's one of its most important pursuits is to advance loans to the needy but this is also the right of the banks to get their advances back by those needy customers. Extension of credit is also a major product of banks and financial institutions. But if this credit extended by banks is not recovered then the cycle of lending and borrowing gets disturbed and it results in the increase in the Non Performing Assets.
3. The judicial responsibility can be maintained by publishing day to day cause lists of particular information, and then by comparing that cause list with other courts. This will inculcate a competition and motivate them to work. This may also assist courts to improve the efficiency of their own management and their internal planning²³.
4. There should be a system of reviewing the DRT and NCLT done by DRAT and NCLAT respectively. DRAT and NCLAT has been acknowledged as a competent body to analyze the efficiency of the Debt Recovery Tribunal and National Company Law Tribunal. The DRAT and NCLAT should look into the reason for the backlog of cases and see to it that the speedy recovery is assured²⁴.
5. The duty to appoint working staff under the Tribunal will be a big task. Appointments made need to be fair and transparent within a stipulated period of time. If appointments are not done within a

²² The Insolvency and bankruptcy code, 2016, no. 31 of 2016, § 220 (2016).

²³ *Mukund P Unny*, "A Study on the Effectiveness of Remedies Available For Banks in a Debt Recovery Tribunal", Centre for Public Policy Research, page no. 24

²⁴ *Mukund P Unny*, "A Study on the Effectiveness of Remedies Available For Banks in a Debt Recovery Tribunal", Centre for Public Policy Research, page no. 25

time there will be shortage of staff. As a matter of fact, there will be huge backlog of cases again and it will choke the system completely.

6. Stay Petitions have to be analyzed carefully before being accepted or rejected. Now rejecting Stay Petitions will not hamper the system but allowing large number of stay petition will again pile up the files of cases in the DRT and NCLT. The rejection not hampering the Adjournment should also be strictly regulated. If the DRT and NCLT were to grant adjournments in the same manner as the Civil Courts, then the very purpose of setting up of the DRT and NCLT would be defeated.

CONCLUSION

On a contrary, the efforts to cut down NPAs of Banks and Financial Institutions in India, this code is not going to help alone. As an Apex Body Reserve Bank of India has to be more watchful and will have to fight to overcome this problem. Though Reserve Bank India and Finance Ministry of India are doing their best to recover NPAs. But on the other hand they need to take preventive measures to reduce the future NPAs. If no steps taken to put a stop to future NPAs, the very purpose of this code will be defeated and there will be again a huge stock of NPAs standing on the door. However, this code will generate lot of employment resulting in the form of Insolvency Professionals, Insolvency Utility Technicians and management professionals in Insolvency Professional Agencies etc.

The worst about this is that RBI has definition and norms for "Willful Defaulters", which, together with implementation of the code, will fasten the recovery from borrowers and maintain the discipline in overall credit. But the problem with RBI is that they have not given any definition other than this, most importantly for "Constrained Defaulters" which literally means to compel or force someone who fails to fulfill a duty, obligation, or undertaking. The RBI needs to determine that why that particular person was forced for not paying the debts. They need to ascertain on one or more points and fill this gap. Though this will require RBI to come and work at grass root level. The main definition should focus on what was the reason that forced a person to become defaulter.

BIBLIOGRAPHY

Books

1. Bare Act, Universal Law Publications, Insolvency and Bankruptcy Code, 2016
2. *Unny M. P.*, " A Study on the Effectiveness of Remedies Available For Banks in a Debt Recovery Tribunal", Centre for Public Policy Research

Magazines and Newspaper articles

Tiwari D., May (16th 2017). *IMF alerts on NPA's*, The Economic Times, at pg 15

Website or Webpage

1. Anonymous post/article (March30th 2017). *Study on Non-performing Assets*, , <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4>
2. Anonymous post/article, (Dec, 11th 2015). *Initiatives on Improving 'Ease of Doing Business' in India*, <https://mail.google.com/mail/u/0/?tab=wm#inbox/15c0c0508c89cd9d?projector=1>
3. Mathew G., (January 3rd, 2017 1:38 am). *Non-performing assets: Bad loan recovery by banks only gets worse in four years*, <http://indianexpress.com/article/business/banking-and-finance/non-performing-assets-bad-loan-recovery-by-banks-only-gets-worse-in-four-years-4456317/>
4. Mishra A. R., (December 20th 2016). *World Bank Business Ranking*, , Live Mint, <http://www.livemint.com/Politics/mEsOQJt9O23uIKNXVtHhMK/World-Bank-business-rankings-Govt-plots-8point-strategy-to.html>
5. *RBI circulars*, (March30th 2017). *Study on Non-performing Assets*, , https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7357#def
6. World Bank, *Doing Business Report*, <http://data.worldbank.org/indicator/IC.ISV.DURS?view=map>
7. Mishra A. R., (December 20th 2016). *World Bank Business Ranking*, , Live Mint, <http://www.livemint.com/Politics/mEsOQJt9O23uIKNXVtHhMK/World-Bank-business-rankings-Govt-plots-8point-strategy-to.html>