The new Indian insolvency regime: Effective, or is the jury still out?

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The corporate insolvency landscape in India has been refocused with the Insolvency and Bankruptcy Code 2016 (IBC) in the spotlight. Enacted in May 2016, the IBC has been regarded as a game-changing legislation for insolvency resolution.[1] With the shift to a creditor-centric approach from a debtor-in-possession model which seemingly had failed, the IBC strives to conclude a corporate insolvency resolution process (CIRP) with a resolution plan considered viable by its creditors, failing which the corporate entity faces liquidation. Six years down the line, its performance invites the question: is the IBC living up to what it set out to achieve?

Multitude of mechanisms prior to the IBC

There was a prevalence of legislation and judicial mechanisms prior to the IBC regime to deal with stressed companies, including:

- The Board for Industrial and Financial Reconstruction (BIFR) set up under the Sick Industrial Companies (Special Provisions) Act 1985 (SICA) for the detection of sickness of industrial companies and assisting in the revival or closure of sick companies;
- Debt Recovery Tribunals (DRTs) set up under the Recovery of Debts and Bankruptcy Act 1993[2] (RDB Act) for speedy recovery and redress for banks and a specified set of financial institutions; and
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI) enacted for expeditious enforcement of security interest without the intervention of courts.

At the onset, the SICA and RDB Acts were regarded as a step in the right direction but were gradually consumed by the vortex of deferrals. According to data available on the World Bank website, previously, the average time taken to resolve insolvency in India was 4.3 years.[3] Borrowers relied on the SICA provisions that prohibited legal action against companies referred to BIFR, which delayed and stalled lenders. DRTs grappled with an overwhelming number of cases and an underwhelming bench capacity. As of April 2016, more than 70,000 cases were pending before 33 DRTs in the country and as of the end of February 2022, over 1,60,000 cases were pending; indicating that the DRTs are struggling with case load even with the shift of insolvency matters to a new tribunal system.

Under the aforementioned legislation, the existing ownership and management retained control over the debtor company. The dawn of the IBC brought with it a paradigm shift, from this "debtor-in-possession" model by putting creditors in control and doing away with the seemingly "divine right of promoters" to retain control of the corporate debtor.

Settling the law

In June 2017, at the behest of the Reserve Bank of India, banks initiated proceedings against 12 large debtors with an aggregate outstanding claim of INR 3.45 lakh crores (25 per cent of total non-performing assets). Protracted litigation ensued in respect of many of these companies as the promoters of this "dirty dozen" spared no expense in contesting the new legislation to keep CIRP at bay. These cases witnessed questions being asked and answered, provisions being challenged and explained – all contributing greatly to the IBC regime as it is today. However, the timelines that were expected for resolution were easily stretched, and in fact, it took more than three times the time that was statutorily expected.

Settling of law is a process and may take years, if not decades. As per the Bankruptcy Law Reforms Committee (BLRC) report,[4] laws relating to bankruptcy witness substantial changes that could span two decades or more. The frameworks for insolvency resolution in the UK and US comprised legislation passed around the 1980s, with modifications as recently as the early 2000s. In the UK, an act was introduced in June 2020 containing some temporary and permanent measures for companies affected by the pandemic.[5] Title 11 of the US Code codified the Bankruptcy Reform Act of 1978 in the US.[6] Even after decades, when the law finally seems to be in place, it must constantly evolve to keep with an ever-changing world.

The courts have been instrumental in interpreting legislative intent and pronouncing precedent. While settling the law, however, it is possible that courts deviate from a previous stance. A recent example of this is the ruling of the Hon'ble Supreme Court of India in the case of *Vidarbha Industries Power Ltd v Axis Bank Ltd*,[7] where the court significantly diluted its stance in *Innoventive Industries Ltd v ICICI Bank and Another*[8] five years down the line.[9]

Following the *Vidarbha* judgment, every defaulting corporate debtor is likely to use extraneous factors as a defence and thereby further delaying the process envisaged under the IBC. Precedent under the IBC comes with its fair share of calm and chaos: on one hand, it strives to uphold creditors' interests, while on the other hand, debtors have a new defence up their sleeve.

Double distress due to debt and delay

Distressed debtors are not just faced with the consequences of default but are also subject to delayed resolution. Pendency of legal proceedings in India continues to cause a strain on the already-overwhelmed judicial infrastructure. BIFR and DRTs were unable to resolve cases in a timely fashion and were naturally not ready to take up additional proceedings under a new law and

regime. Thus came about the need for a new structure of courts under the new IBC. Insolvency jurisdiction for corporate persons under the IBC is vested in the newly formed National Company Law Tribunal (NCLT). However, given the formative years of a new law and the heavily contested first cases, it comes as no surprise that the NCLT has also not been immune to the prolongation of proceedings and fast-accumulating backlog. Until the end of June 2022, the IBC rescued 1,934 corporate debtors, of which 517 CIRPs concluded with resolution plans after an average of 460 days (after excluding the time excluded by the adjudicating authority). There were 1,703 CIRPs ending with liquidation orders, taking an average of 428 days.[10] The IBC initially prescribed a timeline of 180 days (extendable by 90 days) for CIRP, which saw a statutory increase to 330 days (including time taken in legal proceedings). Despite this, as of June 2022, 61 per cent of CIRPs have been ongoing for over 270 days.[11]

As per the data available on the NCLT website, there are presently 16 benches (including one principal bench in New Delhi) and over 30 members (including the president).[12] There is no doubt that best efforts are being made to increase the capacity of these tribunals, but until then, the current capacity would weigh them down. The commercial nature of the IBC and the requirement for business expertise while deciding corporate insolvency matters bring about a need for technical members and industry-specific experts to be on the NCLT. Eliciting such technical experts to be appointed on a judicial bench is also a challenge.

Oddly enough, while the NCLT is credited with delay, it is the applicants who file for extensions that lead to adjournments. The blame game of delaying should also account for the time lost in contending the existence of debt. The management of corporate debtors, possibly reluctant to face CIRP, leave no stone unturned when it comes to objecting to debt, default or the transaction.[13] When faced with default, company management entertain activities that benefit them to the extent of retaining control over the company, at the creditors' detriment.

Overwhelmingly, the NCLT has also been attributed to creditors filing frivolous cases, resolution applicants not being provided with complete information and contradictory verdicts being pronounced at different levels. Further, promoters of the corporate debtor or frustrated creditors may even hold up proceedings, defeating the IBC's purpose.[14] The NCLT is already faced with a high volume of pending cases without accounting for the time squandered over vexatious proceedings. The situation is almost comparable to the onset of the monsoon season where flooding is always going to result in damage even in an arid area.

Dynamic(s) change

The previous regime of debtor-in-possession did not bring about any substantial improvements in terms of credit discipline in the country.[15] The balance of convenience now rests in favour of creditors who have a vested interest in keeping the debtor as a going concern. Under the IBC, the committee of creditors, whose commercial wisdom has been upheld time and again by the courts, makes CIRP-related decisions. Promoter participation is limited to cooperation with the resolution professional.

Default is a risk that most lenders undertake as an occupational hazard. Although early detection and timely resolution of stressed assets are always recommended[16] – as they say, prevention is better than cure – determination of default may not always be possible until it occurs. By this time, the borrower's assets invariably diminish in value, making repayment more challenging. A time-bound resolution can curb further value destruction and ensure availability of credit. In an ideal scenario, all creditors work collectively to find a viable resolution to the debtor's insolvency. The maximisation of value, as contemplated by the IBC, requires a collaborative effort from the creditors to aid the revival of a debtor.[17]

The IBC regime has witnessed a change in how promoters of debtor companies regard debt. The possibility of losing their assets in case of failure of resolution has made debtors more serious about defaults.[18] Defaulter's paradise no longer prevails,[19] following significant reform from debtors and creditors alike. While shifting the balance in favour of creditors, the IBC did not intend to play bargaining tool to arm-twist borrowers. The creditor-centric approach is meant to increase the chances of resolution, as opposed to using the threat of insolvency against borrowers. Naturally, when faced with the consequences of the CIRP, debtors would opt to avoid defaults where there is a clear case of viability in the enterprise. Debts have been settled on numerous occasions voluntarily or around the time of filing an application for CIRP.[20]

Conclusion

Initial recoveries under the IBC could seemingly spell a success story, although it may still be too early to judge. Of the CIRPs which yielded resolution plans by the end of June 2022 (175 out of 514 for which data are available), 34 per cent were earlier with BIFR and/or defunct.[21] The sheer volume of cases that have spilled over from the previous regime could redirect the NCLT's focus from fresh cases, and the snowball effect could just as easily end with history repeating itself.

For a favourable verdict on the IBC, all stakeholders need to work constructively together while bearing in mind the objectives of the IBC. For example, preserving the commercial value of a corporate debtor as intended by the IBC would require stricter adherence to time frames, as opposed to viewing them as suggestions. It is our collective responsibility as a society to ensure collaborative action in furtherance of the legislative intent of the IBC, and not just in furtherance of debt recovery at the cost of yet another legislative attempt at debt resolution. Lenders have been seen to use the IBC as a last resort, possibly owing to the haircuts they are subject to. However,

delaying the insolvency resolution process only leads to value deterioration, and consequently larger haircuts. The endless cycle of delay and debt can only be broken with increasing accountability of all stakeholders involved.

There is no doubt that the IBC has resulted in good corporate governance and made lenders more vigilant by emphasising their role as stakeholders. At the same time, there is no denying the scope for further improvement. Collective responsibility, judicial certainty and efficient implementation of suggested reforms will only assist in accomplishing what the IBC set out to achieve. With proposed reforms, including for cross-border insolvency in the pipeline, this modern legislation deserves a little more patience for it to flower, and given the hope provided from its initial blossoms, is certainly worth waiting for.

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Endnotes

1. Report of the Insolvency Low Committee (Moy 2022), p17.
2. Nomenclature amended by the IBC; previously, "The Recovery of Debts Due to Bonks and Financial Institutions Act, 1993".
3. *Time to resolve insolvency (years)*, World Bonk, https://doto.worldbonk.org/indicotor/IC.ISV.DURS.
4. The report of the BLRC Volume I: Rationale and Design (November 2015), p26.
5. Corporate Insolvency and Governance Act 2020 – Interim report Morch 2022 (21 June 2022), https://www.gov.uk/government/publicotions/corporate-insolvency-ond-governonce-oct-2020-interim-report-morch-2022/corporote-insolvency-ond-governonce-act-2020-interim-report-morch-2022.
6. M/S Innoventive *Industries Ltd ICICI Bank and Another*.
7. Civil Appeal No 4633 of 2021.
8. (2018) 1 SCC 407.
9. In *Innoventive Industries*, the Supreme Court hod held that an opplicotion by a financial creditor for initiation of CIRP would hove to be admitted by the tribunal if there was on occurrence of default. This was also upheld in several later judgments, setting this as established precedent for almost five years. However, in the Vidorbho judgment, the Supreme Court hos now held that the tribunals would hove discretion in admitting o CIRP application upon being satisfied that debt and default exist and may toke into account "relevant factors" as well.
10. The quarterly newsletter of the IBBI (April–June 2022, Vol 23), pp20 and 21.
11. Ibid, p17.
12. NCLT website, https://nclt.gov.in/.
13. IBBI consultation paper on issues related to reducing delays in the corporate insolvency resolution process (13 April 2022), p1.
14. Mohonty, P, "Reality check: Challenges notwithstanding, IBC promises positive changes in bankruptcy low of Indio", *Business Today*, https://www.businesstodoy.in/latest/economy-politics/story/ibc-insolvency-and-bonkruptcy-code-indio-promises-positive-chonges-credit-defoult-resolution-professionols-nclt-coses-corporotes-liquidation-process-241066-2019-12-11.
15. *Resolution of stressed assets and IBC* (Address delivered by Shri M Rojeshwor Rao, deputy governor, Reserve Bonk of Indio – 30 April 2022 – in the International Research Conference on Insolvency and Bankruptcy held at IIM Ahmedobod).
16. Report of the Working Group on Tracking Outcomes under the Insolvency and Bankruptcy Code, 2016 (10 November 2021), p3.
17. Report of the Working Group on Tracking Outcomes under the Insolvency and Bankruptcy Code, 2016 (10 November 2021), p5.
18. "In three years of IBC, more hits than misses", CRISIL, https://www.crisil.com/en/home/newsroom/press-releoses/2019/05/in-three-yeors-of-ibc-more-hits-thon-misses.html.
19. *Swiss Ribbons Pvt Ltd and Another v Union of India and Others*.
20. Report of the Working Group on Tracking Outcomes under the Insolvency and Bankruptcy Code, 2016 (10 November 2021), p3.
21. The quarterly newsletter of the IBBI (April–June 2022, Vol 23), p16.