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# **DRAWBACKS AS TO INSOLVENCY AND BANKRUPTCY CODE 2016**

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## **ABSTRACT**

India's legislation has come up with a compact law which is a compilation of several previous laws having failed to perform. This code is the code of insolvency and bankruptcy code which was initiated in 2016. India even though had thought that this code would overcome all the difficulties of sick companies and would carve the way of the corporate creditors and debtors, the code too had some drawbacks of its own which is properly prescribed in this article. This paper also provided the effects caused by the code in the corporate world of India. The current condition of the world is very deteriorating due to the pandemic of coronavirus, which in turn is harming the code in many manners than understood. This paper provides a brief outlook towards the problems faced by the code during the tenure of the coronavirus. The major goal of the code was to treat both the creditors and debtors equally but how this goal was turned in a drawback is one of the major aspects of this paper.

## **INTRODUCTION**

Insolvency is a financial condition for an individual, partnership firm or company in which they are unable to pay of its debt to a creditor. In this condition, one's liability exceeds one's realizable assets. A solution to this problem is either by modification of repayment method by debtors or creditors or by writing the loan due off. If even after this stage the debt is not resolved then in such situation the insolvents assets are liquidated through a process prescribed under insolvency and bankruptcy code,2016 to recover the outstanding loan. This process given is rather a legal action in liquidating the assets of an insolvent in the court of law. The court appoints a person known as the liquidator to liquidate such assets of the insolvent person and distribute such shares to the creditors as per the list which the insolvency resolution professional makes according to the code.

On the other hand, there is bankruptcy which is a different topic. Bankruptcy is a more like a voluntary surrender by debtor concept. Bankruptcy involves the debtor to himself approach the court to hereby declare him insolvent as it is not able to pay back its debt. In bankruptcy, the court acts as a liquidator and liquidates the assets of the debtor and distributes it among the creditors. The primary difference between an insolvent and a bankrupt is that, bankruptcy is a permanent stage whereas insolvency is a temporary stage.

## **BACKGROUND**

Insolvency and bankruptcy are not new concepts to India, there had been enacted various laws that have been governing them since a long time. Basing in the history of insolvency and bankruptcy there had been twelve laws governing them until now, but all of them in particular have failed. Due to which defaulter from India and other countries had started to consider India as a proper place for enacting their act of considering bad loans as there was no institution nor any legal setup to tackle such nuisance done by the defaulters, thus showing to the other countries in the global market the incapacity on behalf of India to handle the defaulters.

Even though India had many acts and enactments to punish defaulters like the recovery of debts due to banks and financial institution act (1993), the sick industrial act (1985), the Indian contract act (1872), the sarfaesi act (2002), etc. they all failed to recover the bad debts in complete or within stipulated time as there were many loopholes to these acts.

In relation to the above issues placed, the government decided to take certain steps to overcome the problems, which was done by the government by replacing the flawed acts of insolvency and bankruptcy with new stringent laws which emphasises to take care of defaulters in a time bound manner and prescribed procedure where the creditors would be equal to the defaulters. It was on 11th of May, 2016, when the Insolvency and Bankruptcy Code, 2016 was passed by both the houses of the Parliament and received the assent of the President on 28th of May, 2016.

### **SUMMARY OF THE INSOLVENCY AND BANKRUPTCY ACT 2016**

The main motive of the government to enact insolvency and bankruptcy act,2016, was to remove the piling up of various laws into one law or act to facilitate the process of insolvency and bankruptcy. The primary feature of this code is to resolve matters in a time bound manner thus maximizing the defaulter's assets value. This law provides to aid sick or insolvent companies to either wind up their business or make a plan to revive their businesses. The code equally helps the creditors and investors to get back the amount they have put in a company in the form of loans. In this code, even the creditors (financial or operational) or its workmen can initiate the insolvency proceedings, if defaults take place.

The code considers no difference between the rights of domestic and international creditors. The Code has also taken steps to balance the interest of involved stakeholders even if it involved modification as to the payments of Government dues. The law has been made by keeping in mind the international standards i.e. to conduct the insolvency proceedings commercially and professionally rather than dragging the courts into it. The code also provided immunity to debtors from claims arising from creditors during resolution, to maintain an uninterrupted resolution period(moratorium)

## **DRAWBACKS OF THE CODE**

In the last nine quarters — between January 2017 and March 2019 — 1,858 companies have been admitted to the corporate insolvency resolution process. Of this, 715 have exited the process — 378 of them have been liquidated and 337 have either withdrawn or accepted the resolution plans. Many from the latter group have also moved the appellate authority, the National Company Law Appellate Tribunal, or the Supreme Court.

### **1. APPEALS AND PRECEDENTS**

The government by enacting the law of insolvency and bankruptcy code made a major drawback by implementing its poor track records on implementation of the law as it clearly states the non-compliance of precedents as the tribunals works on its own evidences and circumstances of the cases. As the law had enacted tribunals to regulate the legal proceedings to rely on the courts are new to the litigation process and do not have much precedents. Even though the further appeals and Article 136 of Special leave petition can include Supreme Court in the insolvency proceedings by appealing further in the NCLAT, the main motive of the code is disturbed as its main aim is to finish the proceedings within the time period stipulated by the code, that is 180 days which can be extended for 90 days. Involvement of further appeals and litigation completely defeats the aim of the code of completing the insolvency proceedings within a time bound perimeter. It is clearly given in one of the leading cases L. Chandra Kumar v. Union of India [ A.I.R 1997 SC 1125]<sup>1</sup> that the writ can even be filed under a High Court where the insolvency proceedings were taking place

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<sup>1</sup> L. Chandra Kumar v. Union of India [ A.I.R 1997 SC 1125]

as the tribunal is answerable to the High court, this presents that the delay would be further extended as an appeal through writ can be filed even under the concerned High Court.

The whole concept of the appeals of the courts can be defeated if there would be a prescribed date of completion of the whole proceedings involving the appeals related to the proceedings, which is definitely not seen in the Essar Steel Ltd. Case which lasted for 900 days exceeding a lot beyond the prescribed time, this drawback be overcome by including the precedents given by courts in the previous laws which piled up to become insolvency and bankruptcy code,2016 like sick industries act 1985, contract act 1872, presidency towns insolvency act 1909, etc. and making provisions in the code to not extend the appeal period in litigation beyond a prescribed time.

## **2. CREDITOR COMMITTEES**

The insolvency and bankruptcy code,2016 states that the insolvency can be done only by going through a process i.e. the insolvency resolution process. The insolvency resolution process involves appointment of a resolution or insolvency professional to conduct or regulate the proceedings related to insolvency, one of the major functions of the professional is to list out a number of creditors whose money or debts has been defaulted by the debtor and make committee out of it to facilitate the process.

This involves a major drawback to the code, as a company would always take debts from various types and institutions of creditors, thus to have the committee of creditors in large number would disrupt the proceedings of insolvency as different types of creditors comes in different class and would like to have debt recovered in different manner or modes.

Many jurisdictions in the world have different committees for different classes of creditors to facilitate the process e.g. USA so that less time is spent in clarifying the debts owned by debtors to different classes of creditors, thus even the insolvency and bankruptcy code needs a similar provision in the code to simplify the proceedings of insolvency

## **3. VOTING RIGHTS AS TO CREDITORS**

The creditor committee constituted by the insolvency professional has the function to analyse the proposals laid down by the professional about different methods or modes to recover the debt and decide whether to revive the business of the debtor or liquidate it by going to the next stage. This proposal can be approved by voting with an approval percentage of 75%. The voting system is a drawback to certain creditors i.e. even if there is an acceptance of 74% for a proposal the process has to wait for the remaining 1% to vote, so that the method of recovery can be implemented. A similar provision for better decision-making should be considered. The code must prescribe methods to recover debts for creditors who does not want to indulge in the proceedings or who do not accept the proposal made by the committee.

The lower scale creditors tend to not accept the proposals made by bigger scale creditors but the voting for proposal most of the times exceed 75% thus making the lower scale creditors to be at loss. (creditors must be allowed to consider their path of recovery of debt or to have their ideas implemented at the process of liquidation or revival of the business of the debtor)

#### **4. INFORMATION MEMORANDUM**

Information memorandum is a note for policy briefing, it is a document used for transmitting policy analysis into the political analysis sphere i.e. to provide information to the creditors about the resolution plan. Information memorandum is defined under section 5(10) and section 29 of the insolvency and bankruptcy code, the information in this document relates to information which the resolution professional provides to the creditors during the resolution process. It contains the manner and information which the creditors could not know or would not be able to discover if it were not because of the help of the resolution professionals. This information helps he creditors come up with a better proposal for the recovery of money from the debtors.

The problem with the memorandum is that it has a clause to disclose the liquidation value beforehand. The code uses the information memorandum to plan the resolution, thus after knowing the value related to liquidation the creditors do not try to plan any other mode of recovery of debt, if the liquidation value is good and vice versa and it is also causing the prospective bidders to thrust deeper problems for the creditors. Thus, to overcome this drawback the code must defer the information requirement to a later stage or provide the information only in the creditors committee.

## **5. TIME PERIOD**

Ranging from interests that are protracted to litigation to reinterpretation periodically of the law, the insolvency and bankruptcy code has been time consuming and slow in projects that have not been working successfully, the best example for this drawback has been the major case of Essar steel ltd. Which has exceeded the period of 270 days (now 330 days after amendment) and had been under litigation for 500 days.

The insolvency and bankruptcy code has mentioned that the application must be admitted by the resolution professional within 14 days, this clause was introduced to improve the time quality of the process. The major drawback being in this clause is that the direction given by the code is merely directory rather than mandatory, thus there are many cases that have come up which have not been admitted by the professional since a year e.g. Bhushan Power &Steel was admitted far beyond the 14day period and was under litigation for 520 days.

Another problem causing the delay in time is the low numbers of courts/tribunals and judges with knowledge (or professionals) of the code which is leading to piling up of the cases

## **6. LOW NUMBER OF COURTS OR TRIBUNALS**

The cases which arises out of the insolvency and bankruptcy code are taken by the national company law tribunals(NCLT) which until now are sixteen in number and has one national company appellat law tribunal(NCLAT). This is a very low number compared to the number of pending cases that is an astonishing number of 19,771 as NCLT had taken over the cases arising from different law enactments as sarfaesi act (2002), contract act (1872), etc. which was given in a data presented by the national company law tribunal as given by Minister of State for Finance and Corporate Affairs Anurag Singh Thakur in a written reply to the Rajya Sabha. To complete the goal set up by the code, the legislation must enact more tribunal and appoint more judges with knowledge correlating to the code.

## **7. HANDING OF MANAGEMENT TO RESOLUTION PROFESSIONALS**

The code involves resolution professional to be appointed to regulate the proceeding and during the resolution process the company is handed over to these professionals (management and functioning). This creates a drawback because most of the professionals include chartered accountants which are often experienced in advising a company rather than actually running it. Thus, the company is always at stake on the verge of management and regulation. This means that the resolution professionals must learn the practical problem falling on the company in a very short span of time. This drawback can be defeated by either keeping the company in the hands of the company itself or by the professional who had been in a post that directly correlates the company's management.

The resolution professionals according to the code are given a time period to resolve their disputes this is a hindrance in working of the professionals as it makes the professionals work hastily. Because of this the professionals have less time to coup up with the management and problems of the company. To defeat this there must be time period which could be extended on favour of the professional (valid reason to be listed for delay).

## **CONCLUSION AND THE IMPACT OF CORONAVIRUS**

Coronavirus have been one of the most dangerous pandemic spreading around the world. It had already since January have closed all the major economies like China, Italy, Spain, etc. not leaving behind India, India had been in lockdown since the mid of march, the lockdown has not only effected the economies or financial status of the country but also its legislative functions. In accordance to insolvency and bankruptcy code, 2016 due to the lockdown the cases pending are not going further in resolution as only two benches of supreme court have been permitted to be open for urgent cases and all other courts in India have been closed. As the financial condition of India have gone down the average assets value of the companies would fall down thus minimizing the value of assets for liquidation of the debtors, harming both the debtors and creditors. The companies in the resolution process would also be affected as the management of the company would be in the hands of the resolution professionals who are not trained to handle a company in such a bane. The creditors would ask for a higher asset rebound as during this period their companies would have also faced losses and would try to make up the losses. The pandemic has been very bad for both international and national ventures for all countries but can be resolved if every country tries to work with mutual understanding.

The insolvency and bankruptcy code, 2016 had been enacted by the legislation after reviewing and overcoming the drawbacks faced by the previous enactment dealing with the same, its main goal was to reduce the time used in the litigation, provide maximum liquidation value for debtors and put the creditors and debtors on a same scale panel treating them equally. The code had been performing better than the previous enactments in mostly all aspects as per the reserve bank of India as well as reports from the economic times. But everything in the world have pros and cons and the code has its own. Since the coming years the results of the code have been improving but there are some drawbacks which is pulling back the code. If the legislation works to overcome the drawbacks presented by the code the code would work more fluently to achieve its goals.