

Indian Insolvency Regime in Practice

An Analysis of Insolvency and Debt Recovery Proceedings

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While there is much anecdotal evidence on the abysmal track record of courts and tribunals in resolving insolvency proceedings, there have to date been few empirical studies of how the Indian insolvency regime functions in practice. This paper is based on an analysis of select high court and tribunal judgments with the aim of gaining a better understanding of the existing insolvency resolution process for companies and to identify where the delays and bottlenecks lie. Three themes that emerged from this exploratory study are: (i) the significant inefficiencies and conflicts that have resulted from having a number of different laws and legal forums to govern companies in distress, (ii) various judicial innovations and weak institutions that have contributed to enormous delays in insolvency proceedings, and (iii) misinterpretations of the law by debt recovery tribunals when considering cases of debt enforcement under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act. As India moves towards enacting a new insolvency and bankruptcy legislation, it is hoped that this study will be helpful in understanding the urgent need for reform and in providing initial insights on the direction the new law should take.

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Introduction

On 4 November 2015, the Bankruptcy Law Reforms Committee, a committee constituted by the Ministry of Finance, submitted its report and a draft for a new insolvency and bankruptcy legislation. The committee's report and draft bill envisage far-reaching reforms, including an overhaul of India's existing legal framework for dealing with debtors in distress and the creation of new institutional infrastructure for resolving insolvency and bankruptcy of both firms and individuals. These reforms were a response to advocacy from several quarters, which identified India's weak insolvency regime, on paper and in practice, as one of the reasons for the malfunctioning of the country's credit markets (Bannerjee et al 2012; Sane and Thomas 2012; Rajan 2008). The World Bank's Ease of Doing Business Index 2015 ranked India 137 out of 189 countries on the ease of resolving insolvencies based on various indicators such as time, costs, recovery rate for creditors, the management of a debtor's assets during the insolvency proceedings, creditor participation and the strength of the insolvency law framework.

These concerns are not new. Almost since its enactment, the operation of the Sick Industrial Companies (Special Provisions) Act (SICA), 1985 has attracted scathing criticism for its lengthy delays in determining the viability of sick enterprises and for lending itself to significant abuse by debtor companies looking to siphon off their assets from creditors. Another commonly heard complaint was the implementation of liquidation proceedings in the high courts, which could take years or decades to be completed. However, while the Indian insolvency law regime has been subject to universal condemnation, there has to date been little systematic study of how insolvency and insolvency-related laws have been implemented in practice. In this paper, I have attempted to piece together the process that a company in distress goes through upon entering the legal system through an analysis of the judgments of the high courts and debt recovery tribunals in insolvency and debt enforcement proceedings. The goal of my analysis is to gain a better understanding of the implementation of the Indian insolvency regime and to identify where the delays, inefficiencies and bottlenecks in the process lie. As India sets on the path towards enacting a new insolvency and bankruptcy code, I hope that this analysis provides some insights for the structure and direction that the code must take to avoid the pitfalls of the current regime.

A recent exception to the lack of literature on insolvency proceedings in India is a study by Kristin van Zwieten (2015).

Based on an extensive study of high court judgments relating to liquidation proceedings and the implementation of sICA, van Zwieten points to certain judicial innovations that contributed to the delays and ineffective resolution of corporate insolvencies in India. These innovations relate in large part to the pro-debtor stance of the high courts and their reluctance to liquidate even unviable businesses. My analysis of the case law confirms some of her findings and provides additional insights on the functioning of insolvency and debt recovery proceedings by looking beyond sICA into the interactions among the patchwork of different laws in India that together govern companies in distress.

Section 1 provides an overview of the existing legislation and the legal forums that deal with companies in distress in India. Section 2 describes the scope and methodology of the study and, in particular, the methodology used for selecting and analysing the cases reviewed. In Section 3, I present my findings from the case law review that focus largely on three themes: (i) the significant inefficiencies, confusion and conflicts that have resulted from having multiple forums and laws to govern companies in distress, (ii) the reasons for enormous delays in insolvency-related proceedings, in particular liquidation, and (iii) issues that have arisen in the context of the implementation of debt recovery proceedings under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act. I conclude by briefly considering the implications of these findings for structuring and implementing a new insolvency and bankruptcy code.

1 Existing Legal Framework

When a company defaults on a debt payment, there are three kinds of legal procedures available to creditors and debtors that are common to all jurisdictions: (i) foreclosure or enforcement of the debt by a creditor or group of creditors, (ii) liquidation of the debtor and a distribution of its remaining assets to creditors, and (iii) a reorganisation or revival of the business, which results in a continuation of the business in some form or in the sale of the business as a going concern. (Djankov et al 2008). The first of these options is a debt recovery procedure, while the latter two fall into the camp of corporate insolvency procedures. Though closely related, debt enforcement and corporate insolvency are distinct concepts. Debt enforcement refers to a mechanism by which individual creditors attempt to recover the debt due to them upon a default by the borrower, typically by enforcing the collateral securing the debt. By contrast, corporate insolvency procedures provide a collective mechanism to deal with a distressed company's overall position and affect the rights of all stakeholders.

In India, the legal framework that deals with companies in distress is multilayered, involving a combination of collective insolvency and debt enforcement laws. Further, each of these types of legal proceedings are often applicable to specific stakeholders (for example, only secured creditors or only banks and financial institutions) and are dealt with in different legal forums. Below is a brief description of the main pieces of legislation that affect debtors in default and their creditors.

Collective Insolvency Laws: In the area of collective insolvency proceedings, India has separate laws to deal with rescue and rehabilitation, on the one hand, and liquidation, on the other. The only law currently in force that provides for the rescue and rehabilitation of distressed companies is sICA, which applies exclusively to industrial companies. Under sICA, industrial companies in distress (based on a test involving an erosion of their net worth by 100%) make a reference to the Board for Industrial and Financial Reconstruction (BIFR), which, after considering the viability of the debtor company, either sanctions a rehabilitation scheme or refers the company to the high court for winding up. However, it did not take long for sICA to acquire a reputation for delays and for lending itself to significant abuse by debtors who often used the BIFR as a "safe haven" to siphon off assets from creditors (van Zwieten 2015). In fact, sICA had been universally condemned from so many different quarters that an act was passed for its repeal in 2002.¹ However, the repeal legislation could not be notified as accompanying amendments to the older Companies Act 1956 (CA 1956) could not be operationalised.² More recently, Chapters xxx and xx of the Companies Act 2013, which provide for rescue and liquidation frameworks, respectively, for all companies and take into account some of the criticisms of sICA, have been introduced, but these provisions too are not yet operational. As a consequence, sICA remains the only statutory mechanism for the rehabilitation of distressed companies, though it only covers a subset of companies.

The governing legislation for liquidation proceedings continues to be the CA 1956 as the new provisions in the Companies Act 2013 have not yet been notified. Under the CA 1956, winding up could be voluntary at the request of the debtor (an option for solvent debtors) or compulsory upon a winding up order passed by the high court. Compulsory liquidation proceedings upon an insolvency of the debtor may either reach the high courts upon a winding up petition filed by the debtor or creditors or through a reference from the BIFR.

Debt Recovery Laws: The most basic mechanism for debt recovery that is available for all types of creditors involves filing a petition in a civil court of competent jurisdiction and this mechanism remains available today. However, a series of laws were enacted in the 1990s and 2000s to facilitate debt recovery for certain classes of creditors given the high pendency of cases in the civil courts and experience of abuse with laws such as sICA. The Recovery of Debt Due to Banks and Financial Institutions Act (RDDBFI Act) was enacted in 1993 to make it easier for banks and financial institutions to recover debt. The RDDBFI Act is available to both secured and unsecured creditors, but they need to be banks or notified financial institutions. This act provided for the establishment of debt recovery tribunals (DRTs) and debt recovery appellate tribunals (DRATs) and any cases pending before the civil courts that involved debt of over Rs 10 lakh were automatically transferred to the DRTs.

Another act passed nearly 10 years after the RDDBFI Act was the SARFAESI Act 2002. This act provides a mechanism for secured creditors to take possession of the securities and sell

them to recover debts due. The most interesting feature of SARFAESI is that its enforcement does not require the involvement of a court or tribunal. Section 13 of the SARFAESI Act allows secured creditors to take steps to enforce their security interest in respect of any debt of a borrower that is classified as a non-performing asset without the intervention of a court or tribunal if certain conditions specified in the act are met. Any debtor who then wants to contest the action taken by a creditor under the SARFAESI Act may do so through an appeal to the DRT within 45 days of the enforcement action being taken.³

The enactment of the SARFAESI Act involved an accompanying amendment to SICA to provide that (i) a reference to the BIFR could not be made once an enforcement action under the SARFAESI Act had commenced, and (ii) to the extent that a reference to the BIFR had already been made and was pending, such a reference would abate if secured creditors holding at least three-fourths in value of the outstanding debt of the borrower commenced proceedings under SARFAESI.⁴ Thus, SARFAESI intended to protect secured creditors by ensuring that their enforcement under the act would take precedence over any reference by a debtor to the BIFR. It appears that SARFAESI has been at least partially effective since its enactment in terms of debt enforcement, though as described below there still remains much confusion over the interpretation of SARFAESI by courts and tribunals.

2 Analytical Framework, Scope and Methodology

In this paper, I attempt to understand how the legal framework described above works in practice through an analysis of selected court and tribunal judgments. In analysing what these judgments tell us about the efficacy of the Indian insolvency regime, I have broadly relied on the benchmarks provided by the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency that lists nine general objectives of any insolvency law regime (UNCITRAL 2015):

(1) Provision of certainty in the market to promote efficiency and growth, (2) maximisation of value of assets, (3) striking a balance between liquidation and reorganisation, (4) ensuring equitable treatment of similarly situated creditors, (5) provision of timely, efficient and impartial resolution of insolvency, (6) preservation of the insolvency estate to allow equitable distribution to creditors, (7) ensuring a transparent and predictable insolvency law that contains incentives for gathering and dispensing information, (8) recognition of existing creditor rights and establishment of clear rules for ranking priority of claims, and (9) establishment of a framework for cross-border insolvency.

The objectives outlined above are interrelated and rest on three fundamental characteristics that are shared by most well-developed insolvency law regimes either in the law or through practice (Mukherjee, Thyagarajan and Anchayil 2015; Sengupta and Sharma 2015): (i) a linear step-by-step process for a debtor and creditors to follow when insolvency is triggered, which allows for predictability and certainty in terms of process and outcomes, (ii) a collective mechanism for

resolving insolvency (as opposed to individual debt enforcement actions) that helps preserve value and also serves to advance principles of equity and fairness by involving all stakeholders in the process, and (iii) a time-bound process for resolving insolvency that either ends in a rescue and restructuring of the debtor's business or a liquidation and distribution of the debtor's assets to various stakeholders. The purpose of reviewing these judgments is to gather insights into the functioning of the corporate insolvency resolution process in India and, in particular, on the efficacy of the insolvency regime in providing for these three features.

Case Selection: My analysis is based on a detailed review of 45 judgments of the high courts and 15 judgments from the DRTs and DRATs, as well as a review of important judgments of the Supreme Court that have had a significant impact on the interpretation of existing insolvency legislation. The BIFR's orders do not include the details of its reasoning as they are in the form of Summary of Proceedings (sops) and are, therefore, not a part of this analysis. However, because the high courts consider references from the BIFR for liquidation as well as appeals from the BIFR, it has been possible to gain an insight into the BIFR's adjudicatory processes as well as interpretive issues with SICA from high court judgments. All of the judgments reviewed are from the period after June 2002, the year when the SARFAESI Act came into effect, and are intended to provide a picture of how a debtor in distress or a creditor seeking recovery goes through the legal system as it exists today.

The judgments selected for the detailed review were chosen from a much larger group of high court and tribunal judgments with the goal of obtaining judgments that covered the various types of insolvency-related matters that were heard by the courts and tribunals. For the high courts, the types of cases can be broadly classified into four categories. For each of the categories, I have reviewed at least 10 judgments and have tried to choose cases that involve a range of common fact patterns and stakeholders: these include cases with a single secured creditor, multiple secured creditors and those that involved other complicating factors, such as the presence of labour or workmen whose claims had to be adjudicated by the courts. In addition, I have chosen these judgments from different high courts across the country. The four categories are as follows:

(i) *References from the BIFR for liquidation:* Under SICA, if the BIFR determines that the rescue of a sick company is not feasible, it may make a reference to the high court for liquidation of the debtor. The role of the high court in such instances is to implement the liquidation decision of the BIFR by passing a winding up order.

(ii) *Winding up petitions in the high courts:* These cases involve winding up petitions filed by creditors under the CA 1956.

(iii) *Appeals from the BIFR or the BIFR's appellate tribunal:* The decisions of the BIFR and AIFR may be appealed to the high courts. These cases typically involved the interpretation

of specific provisions of SICA and other laws and play an important role in the development of jurisprudence in this area.

(iv) *Appeals from the DRT/DRAT and the interaction between debt enforcement and collective insolvency laws*: The decisions of the DRATs are also appealable to the high courts and typically involve the interpretation of the RDDBFI Act or the SARFAESI Act and, very often, the interaction between these two laws. Many of these cases also involved conflicts between the RDDBFI Act or SARFAESI Act, on the one hand, and collective insolvency laws, such as SICA or the CA 1956, on the other.

The judgments of the DRTs and DRATs that were selected involved enforcement proceedings under the RDDBFI Act or an appeal by a debtor from enforcement action taken under SARFAESI. Most of these judgments centred on the interpretation of particular provisions of these acts or the interaction between the two acts and I have selected judgments that involved different questions of law and a mix of issues under both the RDDBFI Act and SARFAESI Act.

The methodology and case selection described above has its limitations and is not intended to be an exhaustive review of all insolvency or insolvency-related proceedings in these forums. I also do not claim that the specific cases reviewed provide a representative sample of insolvency-related proceedings before the high courts and tribunals. However, I believe that the selected cases do capture the range of the categories of cases heard by the high courts and tribunals on the subject and are, therefore, a useful starting point for insights into the resolution of insolvency cases in the legal system.

Unlike other reviews of insolvency proceedings, this review includes both collective insolvency and debt recovery proceedings. I have chosen this approach because these two types of proceedings are closely related and often interact with each other. On the one hand, secured creditors tend to use security enforcement tools such as the SARFAESI Act even after collective insolvency proceedings have commenced and, often with a view to superseding the collective insolvency proceeding. Conversely, winding up petitions are often filed in high courts as a tool to aid debt recovery, that is, situations where creditors use the possibility of a winding up order being passed to induce repayment by the debtor. I believe that understanding this interaction between collective insolvency and debt recovery proceedings is a key to understanding how the insolvency legal framework works in practice.

3 Findings

Two major themes emerged from my case review that point to the current system being unable to achieve two fundamental principles of any insolvency law regime—certainty in the law and, consequently, a certain degree of predictability in outcomes, and the timely resolution of insolvency. These are, first, the existence of a multilayered insolvency law framework with multiple forums for hearing different types of proceedings and, second, various judicial innovations and weak institutions that have contributed to significant delays,

particularly in liquidation. Finally, I look briefly at one other theme that was reflected in my case review on the enforcement of SARFAESI.

3.1 Problem of Multiple Fora, Parallel Proceedings and Conflicts

A very large majority of cases reviewed did not involve a single legal proceeding in one forum, but multiple proceedings across different forums. Each proceeding was typically initiated by a different party and the high courts were left with having to decide which proceeding was to take precedence over the others and how conflicts among the different laws were to be resolved. The case of *BHEL vs Arunachalam Sugar Mills (ASM)* that was decided by the Madras High Court in 2011⁵ provides a good illustration of such a pattern. ASM and its sister concern defaulted on their credit facilities which gave rise to numerous proceedings by secured and unsecured creditors alike:

- A bank, the main secured creditor, filed an application in the DRT for debt recovery.
- Another creditor of ASM, filed a company petition for the winding up of ASM.
- Another secured creditor that had lent funds to ASM through a credit facility, entered into a memorandum of undertaking with the bank for the bank to sell the debtor's properties and pay the secured creditor its due from the proceeds.
- A company that had leased machinery to ASM, initiated proceedings invoking the arbitration clause in the agreement and filed an application in the high court restraining ASM from transferring/selling its assets.
- A secured creditor of ASM's sister concern initiated proceedings under the SARFAESI Act, took possession of its assets and sold the same by auction.
- An unsecured creditor, which had supplied a boiler to ASM, filed a civil suit against ASM for recovery of money due to it by sale of immovable properties of ASM.

While this might be at the extreme end of the spectrum in terms of the number of parallel proceedings, almost all the cases reviewed involved proceedings in at least two forums and more often than not proceedings going on in parallel. There were situations where the debtor company had made a reference to the BIFR under SICA while a secured creditor had filed a winding up petition in the high court⁶ or initiated enforcement action under the SARFAESI Act⁷ and other cases where creditors had each initiated proceedings in different forum or under different statutes.⁸ In all of these situations, the task before the high courts was to resolve the conflicting rights of these different parties arising from different statutory provisions. *Oswal Foods Limited*,⁹ for example, involved a situation where the debtor company had made two references to the BIFR, while a creditor filed a winding up petition in the high court. In *BST and PSP Workers Union vs Union of India*,¹⁰ secured creditors sought to enforce under the SARFAESI Act while the BIFR was considering the sickness of the debtor company and made a reference to the high court for liquidation. In *Jeevan Diesels and Electricals vs HSBC*,¹¹ the Calcutta High Court had to consider whether a creditor could file a winding up petition in the high court

while another creditor had initiated enforcement action in the DRT under the RDDBFI Act.

Apart from the obvious delays and inefficiencies that arise from having to traverse multiple legal forums, the piecemeal structure of insolvency proceedings in India has had at least two major consequences. First, having a combination of winding up petitions and debt recovery proceedings run in parallel means there is little clarity for creditors (or debtors) on the overall position of the insolvent debtor or even on the actions of other creditors. This goes against the very grain of the one of principal objectives of insolvency law of having a linear and orderly process to preserve value, provide certainty and maximise recovery for creditors.

For example, in *Kritika Rubber Industries vs Canara Bank*,¹² one group of secured creditors had initiated an action in the DRT, while another group subsequently filed a winding up petition in the Karnataka High Court. The DRT decided in favour of the creditors and a recovery officer at the DRT ordered the attachment of the property securing the debt, which was subsequently sold in an auction. In the meantime, the high court had ordered the winding up of the debtor and appointed an official liquidator (OL) to oversee its liquidation. The OL, upon learning of the DRT's actions, sought an order to set aside the sale by auction, which the high court allowed. An interesting fact in this case is that it appears that the parties to the DRT proceedings were unaware of the winding up petition in the high court. Indeed, one of the secured creditors claimed to have had no knowledge of the winding up petition (that was filed in 1999) until it received notice of the OL's action to set aside the sale authorised by the DRT (which occurred in 2008).¹³ Such cases reveal the complete lack of clarity that creditors have about their recovery under the existing legal framework.

Second, the existence of multiple laws and forums brought to light numerous conflicts among the legal provisions and the rights of various stakeholders under different statutes. The courts have also had to deal with conflicts over jurisdiction and, in particular, on the extent of the DRT's jurisdiction. Some illustrative examples below show that the high courts across the country did not always resolve these conflicts in a consistent manner.

Conflicts between SICA and Debt Enforcement Laws: Many of the cases that involved conflicts between the SARFAESI Act and SICA were relatively straightforward as they often involved a factual question of whether 75% of creditors had indeed sought enforcement action under the SARFAESI Act in which case the BIFR proceedings would need to abate.¹⁴ However, there were still nuances that required the courts to use their interpretive powers. For example, in *BST and PSP Workers Union vs Union of India*,¹⁵ the BIFR had made a reference for liquidation in the high court while secured creditors had sought enforcement action under the SARFAESI Act. The Kerala High Court held that as the secured creditors had not notified the BIFR of the SARFAESI enforcement action, the BIFR retained jurisdiction and the winding up order passed by the high court was valid. In another case that proceeded along similar lines,¹⁶ the BIFR had made a reference to the high court for liquidation but the high

court was yet to pass a winding up order. In such a situation, the Orissa High Court held that the proceedings in the DRT could not proceed ignoring the recommendations from the BIFR for winding up. These cases suggest that despite the SARFAESI Act's attempts to override SICA, this has not always worked in practice.

The most recent decision of the Supreme Court that dealt with the conflict between rescue and rehabilitation and debt enforcement laws was in *KSL Industries vs Arihant Threads Ltd.*¹⁷ In this case, the conflict was between SICA and the RDDBFI Act. The provisions in conflict were Section 22 of SICA that provides for a stay of all proceedings against the debtor and Section 34 of the RDDBFI Act that provides that the act has overriding effect. The Supreme Court considered the objects of both laws in detail and decided that SICA took precedence over the RDDBFI Act. The Court gave a lot of weight to one clause in the RDDBFI Act that stated that the act was in addition to and not in derogation of, other statutes, including SICA.¹⁸ This has been considered a regressive judgment and goes against the grain of standard statutory interpretation. Typically, as both SICA and the RDDBFI Act are special legislations, the later enactment being the RDDBFI Act would prevail.¹⁹ Further, it is curious that the Court placed much emphasis on the context of SICA's enactment but failed to consider the current status of SICA and that an act had even been passed for its repeal!

Conflicts between Winding up Proceedings and the SARFAESI Act: The SARFAESI Act also often clashed with winding up proceedings that had been commenced pursuant to the CA 1956. The primary question in most of these cases was whether enforcement action could proceed under SARFAESI in situations where a winding up petition had been filed in the high court. Unlike in the case of the conflict between SICA and the SARFAESI Act, the interaction between SARFAESI and the CA 1956 is not spelled out as clearly in the legislation and it was not surprising that the high courts and the DRTs resolved this conflict in different ways. In *Indian Bank vs Sub-Registrar*,²⁰ the high court of Telangana and Andhra Pradesh held that the debtor's assets could be sold in an auction pursuant to a SARFAESI Act enforcement action without the leave of the Company Court where a petition had been filed for winding up. By contrast, in cases involving very similar fact patterns, both the Madras and Karnataka high courts ruled that the consent of the OL was required for such a sale.²¹ The Supreme Court came to quite a different conclusion in *Official Liquidator, UP and Uttarakhand vs Allahabad Bank*²² which involved the role of the Company Court and the OL where the company subject to winding up proceedings was also subject to recovery proceedings under the RDDBFI Act. The Supreme Court upheld the precedence of the RDDBFI Act and held that the Company Court did not have jurisdiction over matters that were pending before the DRT.

Conflicts between SARFAESI and RDDBFI Act: Courts have also had to grapple with the interaction among different debt enforcement laws. Enforcement proceedings under the RDDBFI Act and the SARFAESI Act involve different mechanisms for debt enforcement (with SARFAESI not requiring the intervention of

a court or tribunal). An issue that has often arisen is whether creditors may institute parallel proceedings under these two laws. In *Bank of India vs Ajay Finsec Pvt Ltd and Ors*,²³ the DRT ruled that banks and financial institutions may simultaneously pursue proceedings under the SARFAESI Act and RDDBFI Act. This view was also upheld by the Supreme Court in *M/s Transcore vs Union of India*,²⁴ where the Court stated that the two acts were complementary to each other. However, despite both these rulings, nearly two years after *Bank of India vs Ajay Finsec Pvt Ltd*, the Patna High Court held that the proceedings under the RDDBFI Act could not be initiated if SARFAESI Act enforcement action had begun.²⁵

My analysis of the case law reveals that the multilayered framework for insolvency and debt recovery has been ineffective in ensuring an orderly process for winding up or for recovery by creditors. First, the prevalence of numerous parallel proceedings and the lack of a coordinated insolvency process, means that in a majority of cases most stakeholders have no clarity of their position vis-à-vis the debtor or other creditors. Even where a creditor is successful in debt enforcement or in having its petition disposed in one forum, there is nothing to prevent its recovery from being impacted by another parallel proceeding initiated by a different stakeholder. Second, as the numerous cases involving conflicts between different statutes reveal, there are several issues on which the interaction among the different laws is unclear and the inconsistent interpretation of these conflicts by the courts has only muddied the waters further. In some situations, these conflicts are a result of unclear laws or the failure to consider the collective impact of different statutes while in others it appears to be innovative interpretations of relatively clear laws by the courts.

3.2 Causes of Delay

In assessing the effectiveness of insolvency regimes, the efficiency and timeliness of the process are emphasised as delays go against the grain of preserving and maximising the value of the debtor's assets. Tables (1a) and (1b) provide the time taken between the

Table 1a: Time Taken for High Court Cases (Time period known for 42 of 45 cases)

Time Period	Number of Cases	Comments/Breakdown
0–2 years	8	<ul style="list-style-type: none"> • Winding up petitions – 4 • SARFAESI/RDDBFI Act – 4
2–5 years	10	<ul style="list-style-type: none"> • Appeals from BIFR/AIFR – 5 • SARFAESI/RDDBFI – 5
5–10 years	7	<ul style="list-style-type: none"> • References from BIFR – 2 • Winding up petition – 1 • Appeal from BIFR – 1 • SARFAESI/RDDBFI – 3
10+ years	17	<ul style="list-style-type: none"> • References from BIFR – 8 • Winding up petitions – 3 • Appeals from BIFR – 3 • SARFAESI/RDDBFI – 3

Table 1b: Time Taken for DRT/DRAT Cases (Time period known for 13 of 15 cases)

Time Period	Number of Cases	Comments/Breakdown
0–2 years	5	
2–5 years	1	
5–10 years	5	One of these cases took six years in DRT, but 17 years in total
10+ years	2	

commencement of the first legal action (such as the making of a reference to the BIFR, initiating enforcement action under SARFAESI or filing a winding up petition in the high courts) and the date of the judgment. These time periods are likely to be an underestimate as the disposal of a case did not mean that the resolution of the insolvency process has been completed.

Though the samples are too small to provide statistical or average data on the time periods for resolution, they do suggest that resolution is extremely slow in the high courts with 17 of the 42 cases taking over 10 years for resolution. While cases in the DRT/DRAT were disposed more quickly, even these tribunals do not have a track record for particularly speedy disposal. Below are some reasons for these delays that I could glean from my review of the judgments.

Existence of Multiple Forums: The existence of multiple forums described in Section 3.1 is at least one of the causes for delays as parties move back and forth between these different forums. In several cases, there was typically at least a few years of time lost between the BIFR providing a liquidation opinion and the high court issuing a winding up order. In *Re: Consolidated Steel and Alloys*,²⁶ the Delhi High Court actually failed to issue a winding up order following the BIFR's reference and creditors subsequently had to file a separate winding up petition in the court. In that case, the BIFR made a reference for liquidation in 1998, but the high court issued a winding up order only in 2005 in response to a winding up petition filed by a creditor in 2002. The reason for the high court's failure to act in this case is unclear, but such delays only lead to further depletion in the value of the debtor's assets and dilute any recovery that creditors might otherwise have been able to obtain.

Pro-debtor Stance and Deference to the BIFR: As has been observed by other commentators, the high courts and Supreme Court have typically adopted a pro-rehabilitation stance and been reluctant to order winding up proceedings. There is a whole line of Supreme Court precedent, for example, which suggests that a winding up order does not signal the closure of the process. In *Rishabh Agro Industries Ltd*,²⁷ a division bench of the Supreme Court held that it was open to the directors of the company to explore the possibility of rehabilitation even after the winding up order had been passed. This judgment has since been cited in several later cases when former management of a debtor attempt to revive a company in the final stages of being wound up.²⁸

Passing a Winding Up Order Does Not Signal the End of the Matter: In many of the liquidation cases reviewed, the issuance of a winding up order did not necessarily signal the close of the insolvency process. There were numerous instances of liquidators struggling over the priority of claims and payments many years after the winding up order had been passed. Often these related to issues with workmen's compensation. For example, in *Mining & Allied Machinery Corp'n vs The Official Liquidator*,²⁹ nearly 10 years after the winding up order was passed, the Calcutta High Court was asked to consider whether contract labourers could be treated as workmen and, therefore,

be entitled to proceeds from liquidation as secured creditors. Interestingly, the high court did not provide an opinion on this issue, but instead directed the official liquidator to make a decision within 12 weeks. In *Official Liquidator, Suganti Alloys Castings Ltd vs Edupuganti Subba Rao*,³⁰ while the Andhra Pradesh High Court passed the winding up order in 1990, the OL was struggling to complete the liquidation process as late as 2006. The OL finally filed a petition in the high court alleging that the ex-managing director of the debtor had not been cooperative in providing information required for liquidation and distribution of assets, which the court allowed, holding the ex-managing director guilty of negligence and breach of trust.

As one of the goals of the insolvency regime is to preserve value, delays in proceedings that lead to further erosion of value are particularly important to guard against. My case review suggests that a combination of factors to do with the law and its interpretation by the courts have contributed to these delays. The courts have often been reluctant to issue winding up orders and appear willing to allow the ex-management of the debtor to explore rehabilitation options during all stages of the process. Further, my case review shows that many of the delays also occur after a winding up order has been passed. This process is often invisible from public scrutiny as the court no longer has a role to play. Yet, it would be a mistake to assume from this that the issuance of a winding up order implies that the insolvency has been resolved and the liquidation completed.

3.3 Challenges to SARFAESI

Fourteen of the 45 cases from the high courts and five of the 15 cases from the DRTs/DRATs involved applications by debtors to stay enforcement action under the SARFAESI Act. In a majority of these cases (12 of 19), the court allowed SARFAESI action to continue, but these judgments are nevertheless worth examining further as they reflect situations where SARFAESI enforcement was not as smooth as the statute intended it to be. These judgments also reveal instances of courts either misinterpreting the act or significantly expanding the scope of their review powers in adjudicating challenges to SARFAESI enforcement action.

First, there were instances of applications to stay SARFAESI enforcement actions being filed in civil courts and instances of civil courts adjudicating such challenges despite the explicit provision in the act that the DRT ousts the jurisdiction of the civil court in SARFAESI actions. In *Bank of India vs Natarajan and Ors*,³¹ the civil court issued an interim stay on the enforcement of SARFAESI proceedings, which it continued to extend over a one-year period. The secured creditor ultimately appealed the decision to the high court which ruled that the civil court had no jurisdiction over SARFAESI actions, let alone the power to issue an interim stay. While this was the correct result, much time was lost as a result of a completely contrary understanding of the SARFAESI Act by a civil court judge.

Second, there were situations where the DRTs went beyond the scope of their permitted review when dealing with challenges to SARFAESI. Under the SARFAESI Act, the role of the DRT when considering a challenge to enforcement action is to examine whether the secured creditor's action was taken in

accordance with the provisions of the SARFAESI Act and related rules.³² In practice, however, the DRTs and DRATs often overstepped this line to go on to adjudicate the substance of the claim itself. For example, in *Lakshmi Sankar Mills vs Indian Bank and Ors*,³³ the DRT did not allow the debtor's application to stay SARFAESI enforcement, but imposed a condition. The DRT held that the asset sale under SARFAESI could proceed only if the debtor did not deposit a fixed amount by a specified date. The debtor appealed this condition to the DRAT which went on to lower the amount of the deposit. Ultimately, the Madras High Court remanded the decision back to the DRT to consider only the narrow question of whether the secured creditors had complied with the provisions of SARFAESI, but this was three years after the banks had initiated enforcement action. In another similar case,³⁴ the DRT granted the debtor additional time to pay the deposit before the bank could initiate the sale, while the narrow question it was supposed to consider was whether the bank had adhered to the enforcement of security rules under SARFAESI.

The purpose of the SARFAESI Act was to provide a relatively quick mechanism for secured creditors to enforce their security interests without court intervention. To the extent that the debtor has the ability to challenge the enforcement action in court, Section 17 of the act requires the debtor to bring such an application within 45 days and also makes clear that the review by the DRT should be limited to whether the secured creditor has complied with the provisions of SARFAESI. These and other provisions of SARFAESI are all aimed at enabling the efficient and timely enforcement of security without much scope for delays. My review of cases, however, suggests that the enforcement of security pursuant to SARFAESI has, in practice, not been immune from the judicial delays and uncertainties that arise in other insolvency proceedings. It is, of course, difficult to ascertain the proportion of cases in which SARFAESI enforcement has been allowed to go unchallenged as opposed to those occasions on which it has been challenged in court. However, where a debtor does challenge SARFAESI enforcement, creditors have experienced long-drawn-out struggles in the courts.

Conclusions: Implications for a New Insolvency and Bankruptcy Code

The case review in this paper suggests that a significant problem with the insolvency regime in India is its multilayered structure. India's patchwork of insolvency laws that each applies to a different class of stakeholders or processes has resulted in parallel proceedings, conflicts between different statutes and uncertainty for creditors over their recovery. I have also argued that, apart from the multilayered legal framework, various factors to do with the law and its implementation have caused major delays in insolvency proceedings, particularly when it comes to winding up and liquidation. These include the reluctance of courts to issue winding up orders and their willingness to allow debtors to explore rescue and rehabilitation even when such an approach may no longer be feasible. Further, there is a need to have an effective legal framework to control the liquidation process post-issuance of the winding up order which is when the greatest delays often occur.

I believe that the conflicts and multiple proceedings that have arisen from the multilayered insolvency law framework point to a strong need for a unified law that applies to all aspects of a company in distress and for all stakeholders. While different stakeholders in an insolvency process do (and should) have different rights and interests, setting these out in a single code, as the draft insolvency and bankruptcy bill does, provides a framework for balancing the competing interests of debtors, secured creditors and other stakeholders. Such an approach would also minimise the possibility of conflicts between the different rights and priorities of various stakeholders as well as the instances of parallel proceedings.

Another critical issue to consider is the relationship between insolvency resolution and debt recovery proceedings. Insolvency law has often been described as a mechanism to provide sufficient incentives for creditors to enter into the collective insolvency process rather than pressing ahead with individual recovery (Jackson 1982; Jackson and Scott 1989). By contrast, the focus of reforms in India has until now been on facilitating speedy recovery by banks and other classes of secured creditors. These initiatives are understandable and necessary in light of delays in court proceedings and the significant abuse of SICA by debtors. However, this focus on the interests of only banks and secured creditors has come at the cost of an organised insolvency

process that preserves value and benefits all stakeholders. The draft insolvency and bankruptcy bill seeks to restore the balance in favour of collective insolvency proceedings by not allowing SARFAESI enforcement action during the 180-day moratorium that comes into place upon commencement of the collective insolvency resolution process.

This is not to suggest that the current problems with the Indian insolvency regime will disappear if we were to have a unified insolvency and bankruptcy law. As my case review suggests, the insolvency regime has to date been characterised by weak institutions, whether it is the high courts, the BIFR or the official liquidators, and a new law alone cannot fix these issues. The institutional infrastructure proposed in the draft bill—a regulator, insolvency professionals and a tribunal, among others—need precise mandates, sufficient resources and training to ensure that the proposed law is effectively implemented and the timelines provided in it are followed. Equally important is the need for a careful review of the draft bill to analyse how it interacts with existing laws and to repeal or amend overlapping or conflicting laws. Yet, by providing for a linear, time-bound and collective insolvency resolution process, the draft bill is certainly a step in the right direction towards minimising delays and providing greater predictability for debtors and creditors in both process and outcomes.

NOTES

- 1 Sick Industrial Companies (Special Provisions) Repeal Act, 2002.
- 2 The changes made in the older companies act legislation, the CA 1956, have not entered into force as Chapter VIA of the CA 1956 which provided for the National Company Law Tribunal (NCLT) to exercise powers in relation to sick industrial companies could not be notified as the NCLT was subject to a long-drawn-out litigation. The Supreme Court on 14 May 2015 delivered its judgment on the constitutionality of the NCLT. A few amendments to the operation of the NCLT are required before these provisions can be notified.
- 3 SARFAESI Act, Section 17.
- 4 SICA 1985, Section 15(1).
- 5 *BHEL vs Arunachalam Sugar Mills Ltd*, (High Court of Madras), OSA Nos 58, 59, 63, 64 and 81 of 2011, decided on 12 April 2011.
- 6 See, for example, *In re: Oswal Foods Limited*, [2008]145CompCas259(All), decided on 16 November 2006; *In Re: Consolidated Steel and Alloys*, CA Nos. 165, 385, 706 and 992/07 and 1031/08 in CP No 428 of 2002, decided on 7 November 2008.
- 7 *Asset Reconstruction Co India P Ltd vs Shamken Spinners Ltd*, AIR 2011 Del 17, decided on 22 November 2010; *M/S Digivision Electronics Ltd vs Indian Bank*, WP 13056/2005 and others, decided on 7 July 2005.
- 8 *Kritika Rubber Industries vs Canara Bank* (Karnataka High Court), CA No 190/2008 in Co P No 167/1999, decided on 13 June 2013.
- 9 *In re: Oswal Foods Limited*, (2008) 145Comp Cas259 (All), decided on 16 November 2006.
- 10 CP 23 of 2006, decided on 3 August 2009.
- 11 APO 254 of 2014 and CP 845 of 2013, decided on 2 December 2014.
- 12 *Kritika Rubber Industries vs Canara Bank* (Karnataka High Court), CA No 190/2008 in Co P No 167/1999, decided on: 13 June 2013.
- 13 *Kritika Rubber Industries vs Canara Bank* (Karnataka High Court), CA No 190/2008 in Co P No 167/1999, decided on: 13 June 2013, para 3.3 and para 32.

- 14 See, for example, *Triveni Alloys Ltd vs Board for Industrial and Financial Reconstruction and Ors*, WP No 4481 of 2005 and 32594 of 2003, decided on 19 July 2005.
- 15 CP 23 of 2006, decided on 03 August 2009.
- 16 *Sri Bireswar Das Mohapatra and Anr vs State Bank of India*, WP (C) No 8567 of 2006, decided on 17 August 2006.
- 17 Supreme Court, Civil Appeal No 5225 of 2008, decided on 27 October 2014.
- 18 RDBFI Act, Section 34(2).
- 19 This was indeed the view of two-judge bench of the Supreme Court from which this decision was appealed.
- 20 *Indian Bank vs Sub-Registrar*, Writ Appeal Nos 1420 and 1424 of 2013 and OSA Nos 34 and 35 of 2013, decided on 11 November 2014.
- 21 *BHEL vs Arunachalam Sugar Mills Ltd*, OSA Nos 58, 59, 63, 64 and 81 of 2011, decided on 12 April 2011; *Kritika Rubber Industries vs Canara Bank*, CA No 190/2008 in Co P No 167/1999 decided on 13 June 2013.
- 22 AIR 2013 SC 1823.
- 23 Original Application No 167 of 2001, decided on 28 November 2003.
- 24 AIR 2007 SC 712.
- 25 *M/S Pune Cold Storage vs State Bank of India*, (AIR 2013 Part I; II (2013) BC 501 Patna HC).
- 26 CA Nos 165, 385, 706 and 992/07 and 1031/08 in CP No 428 of 2002, decided on 7 November 2008.
- 27 MANU/SC/0381/2000: (2000), 5 SCC 515.
- 28 See, for example, *In re: Oswal Foods Limited*, [2008]145CompCas259(All), decided on 16 November 2006.
- 29 CA Nos 115, 426, 797/2012 and 1126/2011 and BIFR 510/1992, decided on 2 December 2014.
- 30 CA 160 of 1995, decided on 19 April 2006.
- 31 *Bank of India vs N Natarajan and R Sakadevan*, (High Court of Madras), CRP (PD) No 829 of 2007 and MP No 2 of 2007, decided on 4 July 2007.
- 32 SARFAESI Act, Sections 17(2) and (3).
- 33 *Lakshmi Sankar Mills vs Indian Bank and Ors*, WP Nos 37148 and 37534 of 2007, decided on 15 April 2008 (Madras High Court).

- 34 *Satwanti Automobiles vs State Bank of India*, WP (C) No 4252 of 2014, decided on 17 September 2014.

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