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The 'bankruptcy code' would enhance the ease of doing business in India

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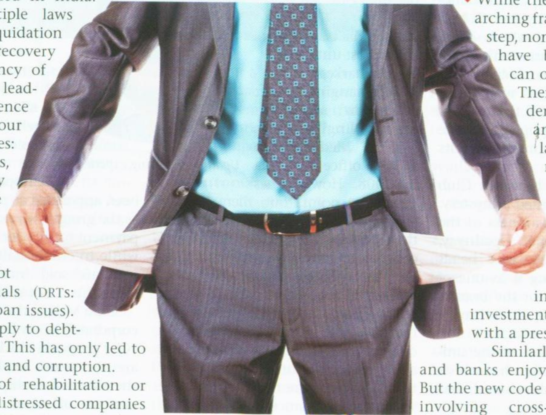
Introducing the Insolvency and Bankruptcy Code and getting it approved by both Houses of Parliament is perhaps the high point of the first two years of the Modi government. The prime minister has, time and again, emphasised the need to enhance the 'ease of doing business' in India. The Bankruptcy Code is a very progressive step taken in that direction.

After 1991, as the economy liberalised, many financial sector laws have evolved, keeping pace with the emerging global needs. But the insolvency law, an essential part of any country's financial architecture, remained outdated and almost unreformed in India. India has multiple laws dealing with liquidation of companies, recovery of debt, insolvency of individuals, etc, leading to the existence of as many as four different agencies: the high courts, the Company Law Board, the Board for Industrial & Financial Reconstruction (BIFR) and the Debt Recovery Tribunals (DRTs: engaged in bad loan issues). Different laws apply to debtors and creditors. This has only led to delays, confusion and corruption.



The process of rehabilitation or winding up of distressed companies has also remained long-drawn, leading to immense value erosion. India had no single law dealing with insolvency. Thus, the idea of bringing all insolvency issues under an overarching common law is indeed an action, which was long overdue and the present government needs to be complimented for this.

An efficient mechanism to address insolvency issues encourages entrepreneurship, job & wealth creation and overall economic growth. It enables market participants to more accurately price, manage and control risks and corporate failure. The new code attempts to lay out a framework that is in tune with the modern needs and also tries to align India with developed world in creating a better legal framework for doing business. The code has many positives. A bigger say by the creditors in shaping any restructuring initiative, a time bound resolution, emphasis on asset recovery, allowing employees to initiate bankruptcy process, and a defined waterfall mechanism, where government claims are to be settled last among all creditors are some of the highlights of this code. All these indicate that much thought has gone into the drafting of the code.

However, despite its noble intent and many of its positives, the code seems to have inadvertently missed out on addressing certain crucial aspects:

- While the creation of an overarching framework is a welcome step, none of the existing laws have been repealed. This can only create confusion. There has to be a clear demarcation as to when and where the existing laws apply *vis-à-vis* the new Code.
- We are living in a globalised world, where global companies have subsidiaries and joint ventures operating in India, riding on investments; also, global banks with a presence in India.

Similarly, Indian companies and banks enjoy a presence abroad. But the new code cannot address issues involving cross-border insolvency. There is no effective mechanism for co-operation between the courts of India and other countries, or for administration of cross-border insolvencies and treatment of stakeholders in case of any insolvency proceedings started in a foreign jurisdiction while involving assets or creditors in India. We have seen how the Dabhol Power Co, set up by Enron, owed thousands of crores of rupees to IDBI and ICICI and what happened to it, when Enron declared bankruptcy in the US.

Such incidents can happen again. Many previous committees on insolvency law reform have recommended the adoption of the UNCITRAL Model Law on Cross-Border Insolvency to provide an effective mechanism to deal with

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such cases. But the government of India prefers to handle such cases by signing bilateral agreements with other countries. Apart from being time-consuming, this will also run the risk of conflicting rules being framed for different jurisdictions, which can act as a major dampener in attracting foreign investments.

The code speaks of creating a new cadre of insolvency professionals. In fact, the quality of such professionals will be a determining factor in the successful implementation of the code. However, the code envisages the government will play an active role in the creation of this cadre – in the appointment, removal and oversight of conduct of insolvency practitioners. Such active government involvement and intervention may actually end up deterring experienced professionals from joining this cadre. The new cadre of insolvency practitioners should ideally be created from chartered accountants, cost accountants, company secretaries, corporate lawyers and professionals from merchant banking, investment banking, NBFCs (especially the infrastructure finance companies), credit rating agencies, etc, who fulfil certain eligibility criteria.

To make that happen, there should ideally be a panel of experts primarily from the finance and legal professions with representations from various industries (especially sectors which account for the maximum stressed loans), which should conduct the recruitment process. There may, at the most, be a token representation from the government on this panel. Apart from recruitment and appointment of insolvency practitioners, this panel should also be given the additional responsibility to licence and de-licence insolvency practitioners, and if need be, also take disciplinary action against them.

Alternatively, the UK model may be followed. There, insolvency practitioners are monitored by their individual 'recognised professional bodies' (RPBs), each one of them with dedicated committees to deal with insolvency licensing, complaints and disciplinary matters. Insolvency practitioners need to comply with 'statements of insolvency practice' (SIP), which essentially constitute a model code of conduct. Since India has dedicated professional institutions for CA, CS, cost accountants, etc, the UK practice could be emulated here as well, thereby relieving the government from getting into the nitty-gritties of creation of this new professional cadre.

Putting the onus of dealing with personal insolvency resolutions on the DRTs is a sub-optimal approach. DRTs are already overburdened with work and suffering from a huge backlog of cases. The additional burden of personal insolvency resolutions can adversely impact the quality of DRTs' core function of debt recovery.

The code requires the establishment of an Insolvency & Bankruptcy Board of India, a quasi-judicial body, which will review the applications received to verify insolvency of the concerned companies. This board will also register professionals. With the code outlining a big role for the government in registration of professionals and the creation of the board, the government will, quite invariably, have some direct or indirect influence on insolvency proceedings. This can result in conflict of interest because the board, which has government representation in it, may have to conduct proceedings where one of the disputed parties is a government entity. The role of the government, therefore, should ideally be restricted to that of an overall supervisor of the board, with the task of undertaking regular audit and oversight to ensure that the best practices are being adhered to.

While under the existing laws, it was the debtors who enjoyed an unfair advantage, the code tilts the scale heavily in favour of creditors. Under the code, the committee of creditors has been made the sole, all-powerful authority that can either accept or reject the revival plan of the debtor entity. The code does not even provide the debtor an opportunity to be heard before ordering the commencement of proceedings and before insolvency professionals take over the management. This approach may not be conducive to the business environment of the Indian economy. Active participation of all stakeholders is necessary for the ultimate revival of a company.

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For ages, different governments have kept on debating and discussing the need for a Bankruptcy code. This government, by introducing this code, has made a positive beginning and demonstrated clearly its intent to break the status quo. Now is the time to consult all the stakeholders and take their feedback in ironing out the glitches that this code can throw up. For a crucial piece of legislation like this one, the government should aim for nothing less than 'perfection'. ♦

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