PERSPECTIVES

presents emerging issues and ideas that call for action or rethinking by managers, administrators, and policy makers in organizations

Indian Insolvency Law

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> The failure of some business plans is integral to the process of the market economy. When business failure takes place, the best outcome for society is to have a rapid renegotiation between the financiers, to finance the going concern using a new arrangement of liabilities and with a new management team. If this cannot be done, the best outcome for society is a rapid liquidation. When such arrangements can be put into place, the market process of creative destruction will work smoothly, with greater competitive vigour and greater competition.
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> —Report of Bankruptcy Law Reforms Commission

Every economy aspires to grow fast. Every government strives to maximize economic welfare of its citizens. However, some countries perform well, while some others lag behind. Several factors determine their performance. Some of the necessary conditions for an economy to do well are: a well-developed, large credit market to fund businesses; a structured mechanism to facilitate entry and exit of businesses as well as entrepreneurs; a competitive marketplace to ensure optimum utilization of resources; and a well-greased process to rescue firms from premature death. All of these are founded on economic freedom. Let us touch upon each of these aspects in terms of the role of the state in ensuring that these necessary conditions are met for an economy to prosper.

CREDIT AVAILABILITY

Every supplier of funds wishes to invest in a balanced portfolio while every firm wishes to build a balanced capital structure in sync with their objective functions. A market economy makes it possible, where the portfolio and the capital structure have a balanced combination of debt and equity as well as of different variants of debt and equity. The state intervention generally strengthens the rights of suppliers of funds and thereby reduces risks for them, leading to a higher supply of capital at a lower cost. This promotes capital formation. If, however, the interven-

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tion strengthens rights of one set of suppliers of funds vis-à-vis those of others, the supply of funds from one source may increase, while supply from other sources, as well as overall supply, may reduce. Where creditors have relatively weaker rights as compared to equity suppliers, market hesitates to supply credit. This limits supply of credit, and consequently, the firm and the economy forego the benefits of capital gearing. State intervention should balance the rights and powers of the suppliers of different types of funds, yielding a balanced capital structure for firms.

RESOURCE UTILIZATION

Mainstream economic thought believes that at any point in time, human wants are unlimited while the resources to satisfy them are limited. The central economic problem, therefore, is the inadequacy of resources vis-à-vis ever-increasing, unlimited wants. Mainstream legal thought believes that as a person moves from a natural state to an economic state, it loses some degree of freedom. The central legal problem, therefore, is the lack of freedom to pursue economic interests meaningfully. Thus, there are twin inadequacies of limited resources and freedom. Resources have alternative uses, and firms pursue self-interests. An economy thrives when the self-interested firms have the maximum possible freedom to shift resources to more efficient uses continuously and seamlessly. There are occasions when the resources at the disposal of a firm are underutilized, as compared to other firms in the industry. The state intervention should facilitate optimum utilization of resources at all times by preventing the use of resources below the optimum potential, ensuring efficient use of resources within the firm or releasing unutilized or underutilized resources for other uses, through the closure of the firm.

ENTREPRENEURSHIP

A company has indefinite life by law. There is, however, a continuous threat to its life from the 'market'. It experiences financial stress to start with, which, if not addressed in time, converts to economic stress, eventually leading to its death. The average life of S&P 500 companies has reportedly reduced from 90 years to 18 years over the last century. While the state intervention should facilitate the death of an unviable company, it must rescue a viable company well in time. Death of a viable company would mean loss of organizational value, and the creation of a similar company would take considerable time.

A business should continue as long as it is efficient and exit otherwise. The state intervention should facilitate the exit of an inefficient business to enable the larger economic ecosystem to reallocate resources seamlessly from such businesses to efficient ones. The cost of impeded exit, that is, the cost to keep failing business alive, is prohibitive (GOI, 2016). The process of creative destruction should drive out failing, unviable businesses continuously. This is a sine qua non of an efficient, effective and efficacious market economy. Joseph Schumpeter described this market process as *creative destruction.* He suggested: *Capitalist reality is first and last a process of change.* It is sometimes the case that a business, which is not efficient, can be made efficient with a change of the entrepreneur or persons in charge of the business. For this change, entrepreneurs need to be provided with easy entry and exit opportunities from the markets (Schumpeter, 2003). If it is onerous for an entrepreneur to exit a business, he would not be starting it. The state intervention should enable entrepreneurs to get in and get out of business with ease and release them form genuine business failures. The greatest successes come from having the freedom to fail (YouTube, 2017). In Silicon Valley, touted as the global centre of entrepreneurialism, the notion of 'failing is succeeding' has ingrained itself such that entrepreneurs, who may have gone through one or more business bankruptcies, are looked up to with honour.

IMPORTANCE OF INSOLVENCY LAW

Given the above set of central issues facing an economy, we proceed to present the role of insolvency and bankruptcy law, in the form of effective state intervention, in the larger milieu of economic legislation to serve as a forerunner for enhanced economic growth.

Exit barriers may be economic, strategic or emotional, which keep firms in the business even when they are not in the best of financial health. Such exit barriers do not allow distressed firms to exit impeding efficient allocation of limited resources of an economy. This also hinders technological progress precluding new technologies to replace the old. Easy exit procedures are imperative to encourage entrepreneurship. Laws which trap businesses in lengthy court proceedings or impose penal provisions on bankruptcy muzzle risk-taking entrepreneurship (Porter, 1976).

One of the considerations for an exit by a corporate is also the availability of an efficient insolvency regime in a country. Effective insolvency regimes, while coming into play at the end of the business life cycle, have an overwhelming impact on the commencement of the cycle, ensuring the willingness of banks and investors to lend and that of entrepreneurs to enter the market, taking some amount of risk. An effective insolvency law can provide a much-needed orderly process for the reorganization or liquidation of insolvent entities. It provides comfort in the form of a safety net for business activity by offering mechanisms for rescue or value, maximizing exit from the business. An effective system for insolvency and business exit must be able to timely distinguish between those firms that can be saved and those that must exit fast.

A good insolvency regime should inhibit the premature liquidation of sustainable businesses. It should also discourage lenders from issuing high-risk loans, and managers and shareholders from taking imprudent loans and making other reckless financial decisions (Djankov et al., 2008). A firm suffering from poor management choices or a temporary economic downturn can still be turned around. When this happens, all stakeholders benefit. Creditors can recover a larger part of their investment; more employees keep their jobs, and the network of suppliers and customers is preserved. Studies show that effective reforms of creditor rights are associated with lower costs of credit, increased access to credit, improved creditor recovery and strengthened job preservation (Klapper & Clasessens et al., 2002; Neira, 2019). If at the end of insolvency proceedings, creditors can recover most of their investments, they can continue reinvesting in firms and improving companies' access to credit. Similarly, if a bankruptcy regime respects the absolute priority of claims, secured creditors can continue lending and confidence in the bankruptcy system is maintained (Armour et al., 2015; Djankov, 2009).

While the importance of a well-functioning insolvency resolution framework is well recognized, different countries have approached it differently, such that there is no single, internationally accepted regulatory framework for organizing an efficient insolvency resolution process. These differences stem from differences in the underlying economic context, legal traditions, institutional structures and political economy of a nation. Furthermore, insolvency laws have witnessed evolution over long times based on the changing needs of the stakeholders (Sharma & Sengupta, 2015).

INSOLVENCY AND BANKRUPTCY LAW IN INDIA

The reforms in India, in the 1990s, focused on freedom of entry. It ushered in liberalization, privatization and globalization. It dismantled the *license-permit-quota Raj*[1] when discretionary license gave way to an entitlement of registration. It allowed firms meeting the eligibility requirements to raise resources, without requiring any specific approval from the state, to facilitate freedom of entry. The reforms in the 2000s focused on creating a free and fair market competition. It moved away from the control of monopoly of firms to promote competition among firms at the marketplace. Size or dominance, per se, was no longer considered bad, but its abuse was. The reforms provided a level playing field and competitive neutrality and prohibited firms from restricting the freedom of other firms to do business.

The index of economic freedom, which measures the degree to which the policies and institutions of an economy are supportive of economic freedom, has substantially improved for India since the 1990s. The outcome has been astounding. The average growth rate in the post-reforms period since 1992 has been more than double than that in the pre-reforms period. Today, India is the fastest growing, trillion dollar economy and the sixth largest in the world. The Indian economy moved from socialism with limited entry to *marketism* without exit, leading to substantial cost of impended exit (GOI, 2016).

Given that the resources are scarce, and failures are not unusual in a dynamic market economy, India needed a codified and structured market mechanism to put the underutilized resources to more efficient uses continuously and free entrepreneurs from failure. The significance of this mechanism can be gauged from the fact that it was the absence of the same which led to some sick private sector enterprises to be taken over the government and nationalized sectors in the1960s and the 1970s.

Several attempts were made to provide legal and institutional machinery for dealing with a debt default. However, these had not kept pace with the changes in the Indian economy. While provisions for recovery action by creditors were available through the Indian Contract Act, 1872, special laws such as the Recovery of Debts and Bankruptcy Act, 1993 and the Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002, they did not yield desired outcomes. Further, action through the Sick Industrial Companies (Special Provisions) Act, 1985 and the winding-up provisions under the Companies Act, 1956 were not proving to be very helpful for either recovery by lenders or restructuring of firms. The laws dealing with individual insolvency, namely the Presidential Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 were also archaic and not suitable to the changing needs of the time. This hampered confidence of lenders and consequently, the debt market. While secured credit from banks was a predominant form of credit, the corporate debt market was yet to develop (GOI, 2016).

ENACTMENT OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016

In the backdrop of these rather unsuccessful experiments, the stressed assets in the banking system reached unacceptably high levels by the end of 2015. By September 2016, it reached about 9 per cent of gross loans of all banks and 12 per cent of gross loans of public sector banks, which accounted for more than 80 per cent of total non-performing assets (NPA). On the corporate side, major companies were operating with an interest coverage ratio of less than 1, implying an inability to service debt obligations. Thus, what emerged is popularly referred to as the *Twin Balance Sheet* problem where both the banks and the corporates were reeling under the stress of bad loans.

It was amidst this state in 2016 that the Insolvency and Bankruptcy Code, 2016 (Code) was enacted on 28 May 2016, which reformed the existing institutional structure for insolvency and bankruptcy resolution and replaced the erstwhile regime with a modern and well-structured law. The objective of the Code is 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. The Code consolidates laws on insolvency and applies to companies, limited liability partnership firms, other body corporates, personal guarantors, partnership firms, proprietorship firms and individuals.[2] It establishes a linear, collective process which is binding on the debtor, creditor and all other stakeholders. In the case of corporate insolvency, it provides creditors with a chance to assess the viability of the corporate debtor (CD). A corporate insolvency resolution process (CIRP) under the Code ends up with a resolution plan rehabilitating the failing CD or commencement of liquidation of the CD. Individual insolvency proceedings can proceed either through a fresh start process that results in the write-off of qualifying debts or through the insolvency resolution process, which would provide debtors with a chance to negotiate payments. A bankruptcy process, entailing sale of the assets of the debtor, can arise on failure of the insolvency resolution process.[3]

India did not have any prior experience of a law for insolvency resolution that was proactive, incentive-compliant, market-led and time-bound. Many institutions required for the implementation of a modern and robust insolvency regime did not exist. The Code and the reform envisaged under the Code was, in many ways, an experiment in economic legislation. The swiftness of the enactment and implementation of the code probably has no parallel inside or outside the country.

The Code addresses four fundamental concerns of the erstwhile corporate insolvency regime:

1. The enterprise value of the firm reduces exponentially with time, as prolonged uncertainty about its ownership and control and general apprehension surrounding insolvency may make the possibility of resolution remote. The Code mandates closure of resolution process in a time-bound manner to preserve the value.

2. Resolution entails commercial as well as adjudicatory decisions. The Code empowers and facilitates the stakeholders of the firm and the Adjudicating Authority (AA) to decide on matters within their respective ambit expeditiously. The Code empowers the Committee of Creditors (CoC) to take all commercial decisions.

3. A firm is financed through equity and debt. If debt is serviced, equity has complete control of the firm. When the firm fails to service the debt, the Code shifts control of the firm to the creditors for resolving insolvency. The Code moved from 'debtor-in-possession' model to 'creditor-in-control' model.

4. The earlier regime allowed creditors to work out resolution or settlement with the existing promoters. The Code now enables them to bring in any resolution applicant for insolvency resolution. Further, it prohibits anyone, including promoters, who suffers

from any of the specified disabilities, from submitting a resolution plan. There is a credible threat if a firm undergoes CIRP, the control and management of the firm may move away from existing promoters and managers, most probably, forever.

A key innovation of the Code is the four pillars of institutional infrastructure that it establishes. First of these pillars is a class of regulated persons, that is, Insolvency Professionals (IPs). They play a key role in the efficient working of the insolvency, liquidation and bankruptcy processes. The second pillar is a new industry of the Information Utilities (IUs). These store facts about lenders and terms of lending in electronic databases and eliminate delays and disputes about facts when default does take place. The third is the AA, namely the National Company Law Tribunal (NCLT) acting as the forum where corporate insolvency is heard and Debt Recovery Appellate Tribunal where individual insolvencies are heard. The fourth pillar is the regulator, namely the Insolvency and Bankruptcy Board of India (IBBI) which has regulatory oversight over the processes and professionals under the Code.

PROGRESS SO FAR

The entire regulatory framework and ecosystem for corporate insolvency resolution was put in place by the end of 2016, and debtors and creditors started using the Code for resolution. The Code added resolution to the choice set of banks to tackle the menace of NPAs. A bank can choose between resolution and recovery, and it has many options for resolution as well as recovery. Resolution under the Code is not an addition to its recovery menu.

The Code has created a cohesive and comprehensive ecosystem that cements the processes and the service providers together towards the achievement of its objectives. With the enactment of the Code, India has witnessed the birth of two professions, namely insolvency profession and valuation profession, that have professionalized insolvency services. The Code has opened unlimited possibilities of resolution, including merger, amalgamation and restructuring of any kind, which often requires professional help. This has created markets for services of IPs, IPAs, registered valuers (RVs), registered valuers organisations (RVOs), insolvency professional entities (IPEs) and IUs and expanded the scope of services of advocates, accountants and other professionals. There are presently around 3,000 IPs, 3 IPAs, 69 IPEs, 3,030 RVs and 12 RVOs. The Code has also created markets for education and capacity building of these professionals.

Debtors and creditors alike are utilizing the provisions of the Code. Till March 2020, about 3,700 corporates, including some with very large NPAs, have been admitted into CIRP. About 1,135 CIRPs have completed the process either by yielding resolution plans or by ending up with orders for liquidation. A total of 312 processes have been closed on appeal or review or settled, and 157 have been withdrawn. Another 669 firms have commenced voluntary liquidation. Rich jurisprudence has developed. The government has been proactively addressing the issues that come up in the implementation of the reform. Since its enactment in 2016, the Code has been amended four times, within a short period, mainly to streamline the processes and address any emerging deficiencies.

KEY OUTCOMES

An assessment of the design of an insolvency regime can be guided by a measurement of the effectiveness, efficiency and efficacy of the insolvency procedures (Garrido et al., 2019). Effectiveness of an insolvency regime can be ascertained by measuring the extent to which an insolvency system achieves its intended objectives. Looking at this measure about the objectives of the Code, the results are quite visible. One of the key goals of the Code is the maximization of value of assets of the CD in financial distress while it is undergoing a CIRP. The Code enables this by requiring the creditors to make a collective endeavour to revive the failing CD and improve utilization of the resources at its disposal. If revival is not possible, the Code releases resources for other efficient uses. In either case, the value of the assets of the CD improves. It prevents depletion of value by enabling early initiation of the process for revival and expeditious conclusion of the process. In fact, the CD would be tempted to initiate process early to minimize potential loss to creditors. The Code mandates the Resolution Professional (RP) and the liquidator to determine if the CD has been subject to irregular transactions, such as preferential, or fraudulent, or undervalued, or extortionate transactions in the past, and if so, he is obliged to file an application with the AA for appropriate directions. This exercise not only helps recover lost value for the stakeholders but also deters the management from indulging in such transactions. This will cleanse the corporate governance and improve the confidence of stakeholders.

The Code attempts to meet its other objective of promoting entrepreneurship by reducing the incidence of failure, by incentivizing prevention of failure, rescuing failing businesses, wherever possible and releasing resources from failed businesses wherever required. It enables an honest entrepreneur to make an orderly exit if his enterprise fails despite his best of intentions and efforts. Thus, the possibility of failure does not hold up an entrepreneur from commencing a business or implementing a new idea.

Efficiency parameter measures the extent to which the insolvency system achieves its objectives with the minimum use of resources. It measures the relationship between inputs and outputs. In effect, an efficient system would translate into a quick resolution of financial distress with maximum recovery and minimum costs. The recovery rate under an insolvency procedure is a function of time, cost and outcome. The Code provides a timeline of 330 days to conclude a CIRP. Probably, no other regime in the world mandates a time-bound resolution. This push has meant that proceedings under the Code take on average about 350 days, including time spent on litigation, in contrast with the previous regime where processes took about 4.3 years. The insolvency resolution process cost has been reduced immensely from the levels of about 9 per cent of the estate value under the previous insolvency framework.

In a matter of over 3 years, approximately 25,000 cases have been filed under the Code, of which around 3,000 cases have been admitted. A total of 221 cases have yielded resolutions, and 914 resulted in liquidation. About 2,170 cases were undergoing CIRP as on 31 March 2020.

Efficacy is the measure of the extent to which there exists a connection or contribution of the insolvency system (sub-system) with higher-level systems like legal, economic and financial systems. The efficacy of the Code can be evaluated on the basis of the positive spillover effects of the Code on the stakeholders and various units of the economy in general. In this regard, the Code has had an impact on the credit market. The Code is also helping in resolving the NPA problem of the banking system. Some of the large cases of NPAs, such as Bhushan Steel, Electrosteel Steels, Alok Industries, Jyoti Structures Ltd and Monnet Ispat & Energy Ltd have been resolved, and financial creditors have realized their dues.

According to RBI's Financial Stability Report (FSR) (RBI, 2019), the increased pace at which NPAs were recognized led to the NPA cycle peaking in March 2018. With most of the NPAs already recognized, the NPA cycle turned around with GNPA ratio declining to 9.3 per cent in September 2019.

Beyond realization for creditors and revival of firms, the Code has ushered in significant behavioural changes resulting in substantial recoveries for creditors outside the Code and improving the performance of firms. The credible threat of a resolution process that may shift the control and management of the firm away from existing promoters and managers, most probably, forever, is acting as a deterrent for the management and promoters of the firm from operating below the optimum level of efficiency. It is further motivating them to make the best efforts to avoid default. Further, it encourages the debtor to settle default with the creditor(s) at the earliest, preferably outside the Code. There have been several instances where debtors have settled their debts voluntarily or have settled debts after filing an application for CIRP with the AA, but before the application is admitted. There are also cases of settlements after an application is admitted. The Code has thus brought in significant behavioural changes and thereby redefined the debtor–creditor relationship. With the Code in place, non-repayment of loan is no more an option, and ownership of the firm is no more a divine right and equity is no more the only route to own a firm.

The Code is also instilling confidence among the stakeholders with respect to the financial system in general. As per the Systematic Risk Survey reported in the FSR of June 2019, about 50 per cent of the respondents felt that the prospects of the Indian banking sector are going to improve marginally in the next 1 year aided by the stabilization of the process under the Code which will also play a key role in enhancing the confidence in the domestic financial system. As the implementation of Code strengthens going forward, and framework for individual insolvency is also in place, it is expected that it would contribute immensely to government's start-up initiatives.

RECOGNITIONS

Swift implementation of the Code got reflected in Ease of Doing Business. The World Bank's Ease of Doing Business Report (DBR) has recognized India's efforts at resolving insolvency easier. India's ranking in resolving insolvency improved from 136 in the DBR for 2017 to 103 in the DBR for 2018. India further recorded a remarkable improvement in its ranking in the 'resolving insolvency' parameter, being placed at the 52nd position in the report released in October, 2019. India is now, by far, the best performer in South Asia in this parameter and does better than the average for Organisation for Economic Co-operation and Development (OECD) high-income economies,

MYTHS SURROUNDING THE CODE

When new legislation is enacted, the market hinges all its hope on the new law, hoping that it would resolve all market failures at the very first instance. As the new law is enforced, its intended outcomes take time to materialize on the ground. In the meanwhile, the market draws certain conclusions about the outcomes of the law based on a few initial results, which quickly metamorphose into popular myths. Three years into operation, while the Code has brought about several changes and its outcomes are quite discernible, there a few misconceptions about this new law which stem largely from the lack of complete understanding of the intent of the law and the processes involved. Some of these myths are attempted to be dispelled here.

Myth 1: The Code is for Recovery of Debts Due

The Code is not a recovery tool for creditors but a resolution mechanism to breathe life into a stressed CD. It envisages resolution of a failing yet viable firm. It bifurcates the interests of the company from that of its promoters/management, with a primary focus to ensure revival and continuation of the company by protecting it from its own management and from death by liquidation. It is a beneficial legislation which puts the company back on its feet, not being mere recovery legislation for creditors (e.g., *Swiss Ribbons Pvt. Ltd. & Anr. vs. Union of India & Ors.*, (2019) 4 SCC 17). If there is a resolution applicant, who can continue to run the firm as a going concern, every effort must be made to try and see that this is made possible (e.g., *Arcelor Mittal India Private Limited vs. Satish Kumar Gupta and Ors.*, (2019) 2 SCC 1). The National Company Law Appellate Tribunal (NCLAT) reiterated that the Code is not a recovery law (e.g., *Binani Industries Limited vs. Bank of Baroda & Anr.*, CA (AT) No. 82,123,188,216 & 234-2018). While recovery bleeds the CD to death, resolution endeavours to keep the CD alive. The Code prohibits and discourages recovery in several ways. The NCLAT further stated that the first-order objective is resolution. The second-order objective is the maximization of value of assets of the firm, and the third-order objective is promoting entrepreneurship, availability of credit and balancing the interests. This order of objectives is sacrosanct.[4]

Myth 2: Stakeholders Are Not Treated Equally

The distribution of realization under resolution plans has been a bone of contention in several CIRPs and caused prolonged litigation and undue delay in completion of the process, occasionally disturbing pre-insolvency entitlements of creditors. The myth that operational creditor (OCs) are at a lower pedestal when compared to other creditors of the CD was dispelled when the Code was amended by the Insolvency and Bankruptcy Code (Amendment) Act, 2019 to provide that OCs shall be paid not less than the amount payable to them in the event of liquidation of the CD or the amount payable to them if realizations under the resolution plan were distributed in accordance with the priority in the liquidation waterfall, whichever is higher. This means the OCs should not be paid less than the amount they would have received in the event of a liquidation of the CD. In the matter of *Committee of Creditors of Essar Steel India Limited vs. Satish Kumar Gupta & Ors* (Civil Appeal Nos. 8766-67/2019 and other petitions) the Hon'ble Supreme Court emphasized that protecting creditors in general is, no doubt, an important objective. Protecting creditors from each other is also important. If an 'equality for all' approach recognizing the rights of different classes of creditors, as part of an insolvency resolution process is adopted, secured FCs will, in many cases, be incentivized to vote for liquidation rather than resolution, as they would have better rights if the CD is liquidated. This would defeat the objective of the Code, which is the resolution of distressed assets and only if the same is not possible, should liquidation follow. Equitable treatment is to be accorded to each creditor depending upon the class to which it belongs: secured or unsecured, financial or operational.

Myth 3: Many Companies Are Getting Liquidated

The success of the Code is often adjudged by the number of CIRPs ending with resolution plans versus CIRPs ending up with liquidation. As at the end of March 2020, 57 per cent of the CIRPs, which were closed, ended in liquidation, as compared to 14 per cent ending with a resolution plan. While these statistics paint a picture of the Code falling short of achieving its intended objective of resolution of the CD, it is, however, important to note the companies rescued had assets valued as about ₹900 billion, while the companies referred for liquidation had assets valued at ₹200 billion when they entered the IBC process. Thus, in value terms, assets that have been rescued are more than four times those sent for liquidation. Further, 72.46 per cent of the CIRPs ending in liquidation were earlier with the Board for Industrial and Financial Reconstruction and or were defunct. The economic value in most of these CDs had already eroded before they were admitted into CIRP due to poor economic value. As the Code deals with certain legacy issues passed on by erstwhile legislations, it is envisaged that a higher percentage of CIRPs will yield resolution of the CD in the future. Further, the Code promotes resolution over liquidation.[5] Once a CIRP is initiated and the market discovers, if the market discovers that the process should not have been initiated, the Code allows termination of process with the approval of the CoC by 90 per cent of voting power before the constitution of CoC, after the constitution of CoC but before the invitation of Expression of Interest, or after the invitation of Expression of Interest in exceptional cases, on an application made by the applicant. During the process, the stakeholders endeavour to rescue the firm through a resolution plan. However, if the CoC is of the view that running the entire CIRP would be an empty formality and that liquidation would maximize value, it may opt for liquidating the CD. Liquidation process commences only on the failure of the resolution process to revive the firm.

Myth4: Creditors Are Taking Huge Haircuts

The Code's focus on resolution of the CD is to maximize the value of assets of the CD. When a resolution plan is approved by the CoC, which comprises of the FCs, it reflects the value that the CoC attaches to the CD if it is resolved as opposed to being liquidated. While such a resolution plan may entail a haircut for the FCs as compared to the total amount due to them from the debtor, it is, however, a bonus as compared to liquidation value of the CD. The FCs stand to gain more value if the CD is resolved than if the CD is liquidated. As of March 2020, 221 companies have been rescued through resolution plans. They owed approximately ₹4,000 billion to creditors. However, the realizable value of the assets available with them, when they entered the CIRP, was only ₹900 billion. The Code maximizes the value of the existing assets, not of the assets which do not exist. Under the Code, the creditors recovered ₹1,800 billion, about 183 per cent of the realizable value of these companies. Hypothetically, any other option of recovery or liquidation would have recovered, at best, ₹100 minus the cost of recovery/liquidation, while the creditors recovered ₹180 under the Code. The excess recovery of ₹80 is a bonus from the use of the processes under the Code. Despite this recovery, the FCs had to take a haircut of 54 per cent as compared to their claims. This only reflects the extent of value erosion that had taken place when the companies entered the IBC process.

Further, it also needs to be appreciated that under the Code, the creditors can take or cause a haircut of any amount to any or all stakeholders. Further, they seek the best resolution from the market, through a professional, unlike the earlier mechanisms which allowed them to find a resolution only from the existing promoters. This aids in getting the best possible resolution plan.

Myth 5: Resolution Plan Is Not Binding on the Government

The Code provides that a resolution plan approved by the AA is binding on the CD, its members, creditors and other stakeholders. In the case of *Pr. Director General of Income Tax vs. M/s. Synergies Dooray Automotive Ltd. & Ors.*, the NCLAT settled that tax dues being operational debt,[6] the government is an OC. A resolution plan, which settles dues of the creditors, should be binding on the government. There have been instances where government followed up for the balance dues after approval of the resolution plan. This was creating uncertainty and discouraging potential resolution applicants. Under the Code, once a resolution plan is approved, it is binding on all stakeholders. The Insolvency and Bankruptcy Code (Amendment) Act, 2019 aimed to capture this spirit by specifically providing that a resolution plan will also be binding on the Central government, state governments or any local authority to whom a debt in respect of payment of dues is owed. The objective of this amendment was to reduce delays caused by the government or any local authority raising demands after approval of a resolution plan and making it clear that once a resolution plan is approved, it is binding on them as well.

Myth 6: Direct Liquidation Is Not Allowed

The Code does not permit a stakeholder to initiate liquidation directly. It, however, empowers the CoC to decide to liquidate a CD at any time during the CIRP. The CoC may vote for liquidation in their very first meeting or even before the preparation of the information memorandum. Further, an option is available whereby at any time during CIRP, but before confirmation of resolution plan, the CD may be liquidated. However, there have been a few instances like in the matter of *Punjab National Bank vs. Siddhi Vinayak Logistic Limited* where the NCLT insisted that a liquidation order may be passed only after failure of the CIRP to yield a resolution plan.[7] There are instances where early liquidation would maximize the value, while running the entire CIRP would be futile. Thus, the law enables initiation of CIRP which could end in a resolution plan or liquidation as decided by the stakeholders. In addition, the Code provides that a corporate person, who intends to liquidate itself voluntarily and has not committed any default, may initiate voluntary liquidation proceedings. Thus, where liquidating the CD is a more economically viable option, the stakeholders, including the CD itself, may choose to do so.

CONCLUSION

The legal framework of insolvency and bankruptcy impacts a number of economic indicators such as credit growth, job preservation, employment creation and entrepreneurship and in turn, overall economic growth. It also causes behavioural changes in terms of affecting the willingness of investors, banks, companies and entrepreneurs to take risks. Each of the central economic issues pointed out at the outset of this article, can be said to be, in some form, addressed by the modern, comprehensive insolvency and bankruptcy law in the form of the Code. The implementation of Code has started demonstrating its results on each of these fronts, and as the new regime matures, further progress is likely to be visible.

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Notes

1. A term coined by C. Rajagopalachari for bureaucratic system of granting licences and permits for new commercial ventures.
2. The Code is not applicable to financial service providers, except those that are specifically notified as being covered by the processes.
3. The provisions relating to individual insolvency, as laid out in Part III of the Code, have not been notified yet except for the purpose of individual who are personal guarantors to CD.
4. Preamble to the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018.
5. Preamble to the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018.
6. CA(AT)(Insolvency) 205-2017 & 309,559,671& 759-2018.
7. Inv. P.5-2018 IN IA No. 27-2018 IN CP (IB) No. 89-7-NCLT-AHM-2017.

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