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Insolvency Bankruptcy Code with Reference to Medical Insolvency - A Regime

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Abstract
The Insolvency and Bankruptcy Code (IBC), introduced in 2016, was designed to unify and streamline the existing insolvency and bankruptcy laws into a single comprehensive framework. One of the primary goals of the IBC is to safeguard creditors' interests. The Code aimed to address the shortcomings of previous insolvency laws by moving away from the debtor-in-possession model, which was common in the earlier regime. Instead, the IBC established a framework where both creditors and debtors could operate within a structure of equity and fairness, ultimately working to preserve the value of the company. However, the IBC is still evolving and is not without its flaws.

In response to the challenges posed by the Covid-19 pandemic, the government has shifted its focus towards protecting businesses. Although the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, appears to have been enacted with the intention of shielding companies and promoters from liabilities arising through no fault of their own during the pandemic, the ambiguities within the legislation raise more questions than answers. In fact, this recent ordinance seems to suggest a return to the earlier model, which was detrimental to creditors' interests. This essay seeks to analyze the issues and ambiguities associated with the 2020 Ordinance, with particular attention to its implications for the IBC.

Keywords: Insolvency, Legal, Amendment, Insolvency and Bankruptcy Code.

Introduction
Insolvency, as defined by Black's Law Dictionary, refers to the inability to pay one's debts. In today's business environment, companies heavily rely on credit, making the role of creditors vital to the functioning of the economy. If the credit cycle were to be disrupted, it could potentially bring the entire economy to a halt. Insolvency law exists to protect creditors' interests when a corporate debtor (i.e., a company) defaults on its obligations. One of the primary objectives of insolvency law is to replace the chaotic, "free-for-all" approach with a structured process that suspends creditors' rights and remedies, allowing for the orderly collection, realization, and fair distribution of the debtor's assets based on creditor claims.

However, insolvency laws do not offer a free pass for corporate failures. Business inherently involves risk and crisis management, and only those companies that can successfully navigate these challenges will survive. An efficient market, driven by competition, inevitably leads to the failure of some businesses, reflecting the "survival of the fittest" principle. Corporate failures can result from various factors, including poor financial controls, mismanagement, and unfavorable market conditions. Insolvency laws aim to address these failures by restructuring the corporate entity and resolving the underlying issues.

Evolution of the Code
The Insolvency and Bankruptcy Code (IBC), enacted in 2016, was introduced to consolidate and amend the laws governing the reorganization and insolvency resolution of corporate entities, partnerships, and individuals. The Code aims to maximize the value of assets of companies facing bankruptcy threats (known as "Corporate Debtors") and to facilitate a time-bound resolution process. One of the key motivations behind the enactment of the IBC was to improve the ease of doing business in India.

Before the IBC, the legal framework for winding up companies was as troubled as the companies themselves. The previous system was adversarial and skewed in favor of debtors, allowing them to retain control over their company's management during insolvency proceedings. The IBC addressed this issue by transferring management control to a resolution professional. The old regime was also plagued by fragmentation, with multiple laws governing insolvency, creating ambiguity around the powers of creditors and debtors. The IBC sought to resolve this by consolidating and codifying various existing laws, such as the Sick Industrial Companies Act, 1985 (SICA); the Recovery of Debt Due to Banks and Financial Institutions Act, 1993 (RDDBFI); the Companies Act, 2013; and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI).

In the landmark Swiss Ribbons case, the Supreme Court of India observed that:

"The Insolvency Code is a legislation that deals with economic matters and, in a broader sense, with the economy of the country as a whole. Earlier experiments, as we have seen, in terms of legislations having failed, 'trial' having led to repeated errors, ultimately led to the enactment of the Code. The experiment contained in the Code, judged by the

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generality of its provisions and not by so-called crudities and inequities that have been pointed out by the petitioners, passes constitutional muster."
Thus, as Justice Norman aptly noted, with the enactment of the IBC, the "debtor's paradise" has been dismantled. Decisions concerning companies undergoing insolvency proceedings now rest with the Insolvency Resolution Professionals (IRPs) and the Committee of Creditors (CoC). Despite inheriting some severely distressed "zombie" firms from the previous regime, the IBC has demonstrated significant success in a relatively short time since its enactment.

Objectives of the Code

In the modern era, it is universally recognized that credit is a fundamental component of the business environment, enabling companies to finance their investments and cover operating expenses. For many businesses, taking on debt is a necessity. Debt is manageable as long as the corporate debtor can service and repay it within their means. However, the potential risk to creditors is significant if the corporate debtor fails to repay the debt when due. The Insolvency and Bankruptcy Code (IBC) addresses this concern by empowering creditors to recover their dues either through the Corporate Insolvency Resolution Process (CIRP) or by liquidating the defaulting debtor's assets.
The IBC was introduced with the broader objective of addressing and resolving issues related to insolvency and bankruptcy in a more effective manner. It seeks to consolidate and amend the existing laws governing reorganization and insolvency resolution, making it applicable to companies, partnership firms, limited liability partnerships, corporate persons, and individuals in cases of insolvency, liquidation, voluntary liquidation, or bankruptcy proceedings.
The primary focus of the IBC is not only to recover funds owed to creditors but also to ensure the revival and continuation of the corporate debtor. The Code aims to protect the corporate debtor from its own mismanagement and prevent a 'corporate death' through liquidation. By doing so, it balances the interests of both creditors and debtors, ensuring that businesses can be rescued and continue to operate whenever possible.

Speedy Resolution Process

One of the key objectives of the IBC is to simplify and expedite the insolvency process, addressing the inadequacies and inefficiencies of the previous legal framework. Before the enactment of the IBC, India's insolvency resolution process was notoriously slow, taking an average of 4.3 years (as of 2015) compared to one year in the United Kingdom and 1.5 years in the United States. This slow process often led to value erosion and inefficiency, prompting the need for a more streamlined and timely resolution mechanism.
The IBC was designed to remedy these shortcomings by setting clear timelines for the completion of the insolvency process. The Code aims to resolve insolvency cases within 180 days, with a possible extension of up to 90 days. The rationale behind this emphasis on speed is twofold. First, a swift resolution is crucial because, during the insolvency process, significant decisions cannot be made without full clarity of ownership and control. Without effective leadership, the firm risks atrophy and failure, increasing the likelihood of liquidation. Second, the value of assets tends to decline over time due to economic depreciation, and delays in the resolution process can lead to value destruction. Therefore, achieving a high recovery rate depends on identifying and addressing the sources of delay.
Despite the efforts to implement the IBC effectively, it is not without its challenges. Prior to the 2019 amendment, the 180+90 day timeline, though seemingly effective in theory, proved impractical in India due to the slow regulatory processes of various government agencies, such as the Competition Commission of India (CCI). This raised concerns about the effectiveness of the IBC, including whether the rescue operations envisioned under the Code were being used to circumvent CCI regulations and whether corporate debtors could exploit legal loopholes to prevent the Committee of Creditors (CoC) from making restructuring decisions.

Case Study: UltraTech Cements

The enactment of the IBC was driven in part by the heavy debts and 'zombie' companies that plagued the Indian economy. However, it is noteworthy that, despite the Code's implementation, many promoters sought to resolve their financial issues outside its scope to maximize value—a goal ironically aligned with one of the IBC's primary objectives. Surprisingly, the recovery rates under the Code have been on the lower end. As of June 30, 2019, only 120 of the 2,162 cases under the IBC had been resolved, and only 42.8% of the ₹2.53 trillion in claims admitted under the IBC process were recovered.
Interestingly, between January 2015 and April 2019, seven large distressed asset acquisitions amounting to $23 billion occurred in India. Many companies also engaged in slump sales, asset sales, and mergers to avoid insolvency. These practices, largely overlooked by the regulatory body, raised significant competition issues.
The Indian cement industry serves as a compelling example of these practices. Consolidation has become the norm, driven not by operational efficiencies but by the heavy debts accumulated by some players. The pace of consolidation accelerated significantly in recent years, particularly when companies were brought under the purview of the IBC. A notable example is the 2017 acquisition by UltraTech Cements of JCCL's cement plants for ₹16,189 crores. As part of the deal, loans worth around ₹12,000 crores on JCCL's books were transferred to UltraTech. This acquisition was

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mutually beneficial, providing UltraTech entry into the Gujarat market while helping JCCL reduce its ₹55,000 crore debt.

The 2019 Amendment

The Insolvency and Bankruptcy Code (Amendment) Act, 2019, introduced significant changes, including the insertion of two provisos to Section 12(3) of the Code, extending the time limit for the resolution process to 330 days. This period includes the standard 180 days, a one-time extension of up to 90 days granted by the Adjudicating Authority, and the time taken in legal proceedings related to the CIRP. The 330-day limit is intended to align with the CCI's timeframe for investigation and protect the value of assets, which could diminish if the CIRP process drags on.

However, this strict time limit also presents challenges. Failure to complete the CIRP within 330 days could result in the forced liquidation of the corporate debtor, a scenario that could be equally detrimental to all stakeholders involved. This issue was highlighted in the Essar Steel case, where the Supreme Court of India held that the CIRP should be concluded within 330 days, but allowed for flexibility if delays were due to pending actions before or inefficiencies of the adjudicating authority.

While the Essar Steel decision introduced some flexibility, it left unresolved two critical issues: the standard required to convince the tribunal that delays were caused by the adjudicating authority and whether there should be a limit to extensions beyond the 330-day deadline. Without clear guidelines, the objectives of the 2019 amendment may not be fully realized.

Suspension of the IBC Proceedings

In the wake of the COVID-19 pandemic, the Indian insolvency framework faced unprecedented challenges, necessitating swift and decisive legislative action. Recognizing the economic disruption caused by the pandemic, the government introduced the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, which incorporated sections 10A and 66(3) into the Code. This ordinance served as a relief package aimed at protecting corporate debtors significantly impacted by the pandemic, offering them a respite from the threat of insolvency proceedings under the IBC, 2016 .

Key Provisions and Implications:

1. **Section 10A:**
   - This section temporarily suspends the initiation of insolvency proceedings by creditors for defaults arising on or after March 25, 2020, the date of the nationwide lockdown in India. The suspension is effective for six months and may be extended up to one year. This provision overrides sections 7, 9, and 10 of the Code, which pertain to the initiation of insolvency proceedings by financial creditors, operational creditors, and the corporate debtor itself, respectively .
   - The inclusion of Section 10A ensures that companies facing financial distress due to the pandemic are not pushed into insolvency. By excluding COVID-19-related debts from the definition of 'default,' the provision aims to offer a breathing space for businesses to recover and resume normal operations without the looming threat of insolvency .
2. **Section 66(3):**
   - This section provides relief to directors of companies by barring resolution professionals from initiating wrongful trading applications during the suspension period. This protection prevents directors from being held personally liable for decisions made during the pandemic, recognizing the extraordinary circumstances businesses are facing .
3. **Increase in the Minimum Threshold:**
   - In a move to further protect businesses, the minimum threshold for initiating insolvency proceedings was raised from ₹1 lakh to ₹1 crore. This measure is particularly beneficial for small and medium-sized enterprises (SMEs), which are often more vulnerable to financial distress during economic downturns .

Challenges and Concerns:

While these measures provide much-needed relief to corporate debtors, they also raise significant concerns for creditors. The suspension of insolvency proceedings and the increase in the minimum threshold effectively deprive creditors of a vital tool for debt recovery. This situation could lead to a precarious financial environment for creditors, particularly operational creditors, who are often smaller businesses themselves.

Moreover, there is a risk that these measures could be exploited by companies that were already on the brink of insolvency before the pandemic, allowing them to delay or avoid repayment obligations. The suspension period could also deter potential lenders from providing financial support during this time, further exacerbating liquidity issues for struggling businesses.

The Reserve Bank of India (RBI) had already introduced a moratorium on loan repayments, offering temporary relief to corporate debtors. However, the combination of the RBI's moratorium and the suspension of IBC proceedings could lead to a significant reduction in recoveries for creditors, undermining the very purpose of the Code.

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Conclusion

At its core, the Insolvency and Bankruptcy Code was designed to address the inefficiencies of the previous debtor-in-possession model, prioritizing the protection of creditors' interests. However, the recent legislative changes introduced in response to the COVID-19 pandemic suggest a shift back towards safeguarding corporate debtors, potentially at the expense of creditors.

While the 2020 Ordinance was enacted with the noble intention of shielding companies from the adverse effects of the pandemic, its ambiguous provisions may lead to unintended consequences. There is a real risk that Section 10A could be misused, allowing defaulters to evade their obligations under the guise of pandemic-related distress. Additionally, the exclusion of fraudulent and wrongful trading applications during the suspension period could open floodgates to litigation, further complicating the insolvency landscape.

The government and judiciary must exercise caution in implementing these provisions to ensure they do not inadvertently restore the "defaulter's paradise" that the IBC sought to eliminate. In particular, the interests of small-scale vendors, MSMEs, and individual creditors—who often fall into the category of operational creditors—must be carefully considered. As the pandemic continues to evolve, the legislative and adjudicative bodies must remain vigilant in balancing the interests of all stakeholders in the insolvency process.

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