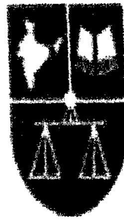

"CORPORATE BANKRUPTCY LAWS: WHERE STANDS INDIA?"

(A study of the Existing Legal Regime on Corporate Bankruptcy in India with the Specific Emphasis on Status of India in comparison to development of other Jurisdiction)

DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF LL.M. (BUSINESS LAWS)

UNDER THE GUIDANCE OF DR. N.L.MITRA, FORMER DIRECTOR, NLSIU, BANGALORE

SUBMITTED BY:
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I.D. No. 330

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DECLARATION

I hereby declare that this dissertation **"Corporate Bankruptcy Laws: Where stands India?"** is the outcome of research conducted by me under the guidance of **Dr. N. L. Mitra**, Former Director, National Law School of India University, Bangalore.

I also declare that this work is original except for such help taken from such authorities as has been acknowledged at the appropriate places.

I further declare that this work has not been submitted in part or in whole for any degree at any other university.

Bangalore

Date 31/05/2010

Ranjan Kumar Singh

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CERTIFICATE

This is to certify that this Dissertation "Corporate Bankruptcy Laws; Where Stands India?" submitted by Mr. Ranjan kumar Singh (ID. No. 330) for the Degree of LLM (Business Law) of the National Law School of India University is the product of bona fide research carried out under my guidance and supervision. This Dissertation or any part thereof has not been submitted elsewhere for any other degree.

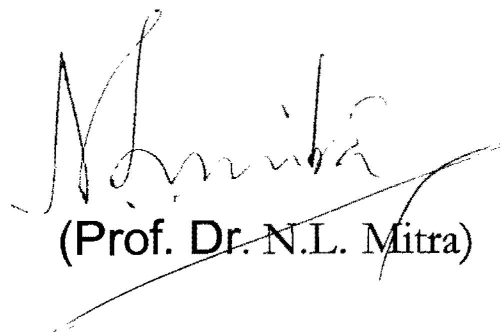

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TABLE OF CONTENTS

TABLE OF CONTENTS...

TABLE OF ABBREVIATION...01

LIST OF CASES...02

INTRODUCTION...03-04

Significant Of Bankruptcy...04

RESEARCH METHODOLOGY...04-06

Aims And Objectives...04

Scope And Limitation...05

Hypothesis...05

Research Questions...05

Data Collection... 06

Method Of Analysis...06

Mode Of Citation...06

CHAPTER 1...07-13

INSOVENCY: IMPORT, CONCEPT AND HISTORICAL DEVELOPMENT

1.1 Bankruptcy And Insolvency...07-08

1.2 Concept Of Bankruptcy...08-09

1.3 Historical Background...09-11

1.4 Modern Developments...11-12

1.5 India's Position On Corporate Insolvency...................................12-13

CHAPTER 2...14-18

CORPORATE BORROWING AND CAUSES OF CORPORATE FAILUIRE

2.1 Corporate Debt And Insolvency...14

2.2 Debt And Credit...14-15

2.3 Equity And Debt...15-16

2.4 Model Of Corporate Debt-Equity Relations.....................................16-17

2.5 Debt...17-18

2.6 Corporate Failure: Causes...

CHAPTER 3...19-21

CORPORATE BANKRUPTCY: FUNCTIONS, AIMS and OBJECTIVES

3.1 Function Of Corporate Bankruptcy...19

3.2 Objective And Visions...20-21

CHAPTER 4...22-25

BANKRPTCY: LEGAL THEORY NAD POLCIY CONCERN

4.1 Legal Theories In Bankruptcy...22

4.1.1 Bankruptcy Claims And Non-Bankrupcy Entitlements.........................22

4.1.2 Collective Liquidation...22-23

TABLE OF CONTENTS

4.2 Policy Issues........23
4.2.1 Defaults........23
4.2.2 Priority Principles........23-24
4.2.3 The Pari Passu Principle........24
4.2.4 Preferences........25
4.2.5 Creditors' Co-Ordination........25

CHAPTER 5........26-35
CORPORATE BANKRUPTCY: COMPARATIVE TREND (WITH SPECIAL REFERENCE TO US AND UK)
5.1 Bankruptcy Jurisdictions........26
5.2 Criteria For Judging The Efficiency Of A Bankruptcy Code........26-27
5.2.1 The First Criterion........27
5.2.2 The Second Criterion........27
5.2.3 The Third Criterion........28
5.2.4 The Fourth Criterion........28
5.2.5 The Fifth Criterion........28
5.3 The United States Bankruptcy Code........29-30
5.3.3.1 Procedure In Chapter 11........30
5.3.3.2 Workouts........31
5.3.3.3 Workouts V. Chapter 11........31
5.3.3.4 Reasons Why Workouts Fail........31-32
5.3.4 The United Kingdome Bankruptcy Code........32
5.3.4.1 Liquidator........32
5.3.4.2 Receivership........32-33
5.3.4.3 The Administrator........33
5.3.4.4 Workouts........33
5.3.4.5 Reorganisation........33-34
5.4 France........34-35
5.5 Germany........35

CHAPTER 6........36-59
INDIA: CORPORATE BANKRUPTCY LAWS
6.1 Restructuring........36-37
6.1.1 Reduction Of Share Capital........37-38
6.1.2 Compromise Or Arrangement With The Creditors........38
6.1.3 The Sick Industrial Companies (Special Provisions) Act........38-39
6.1.3.1 Restructuring Under SICA........39-40
6.1.3.2 Working Of SICA........40-42

TABLE OF CONTENTS

6.1.4 Winding Up........45
6.1.4.1 Unability To Pay "Debt"........45-46
6.1.4.1.1 Statutory Notice........46
6.1.4.1.2 Decreed Debt........47
6.1.4.1.2 Commercial Insolvency........47
6.1.4.1.4 Members' Voluntary Winding Up........47
6.1.4.1.5 Creditors' Voluntary Winding Up........48
6.1.5 Striking The Name Off The Register........48-49
6.1.6 Winding Up By The Tribunal........49
6.1.6.1 Conduct Of Winding Up Proceedings........49
6.1.6.2 Liability Of Contributors Under List A........50-51
6.1.6.3 Liability Of Past Members........51
6.1.6.4 Unlimited Liability Of Some Officers........51
6.1.6.5 Payment Of Liabilities By Liquidator........52
6.1.6.6 Preferential Payments........52-53
6.1.6.7 Insolvency Laws And Preferential Payments........53-54
6.1.6.8 Fraudulent Preference........54-55
6.1.6.9 Voluntary Transfer........55
6.1.6.10 Transfer Of Shares........55-56
6.1.4.11 Proceedings against Delinquent Officers........56
6.1.6.12 Workmen's Rights and Dues........56-57
6.1.6.13 Official Liquidator........57-58
6.2 Comparative Note........58-59

CHAPTER 7........60-70
SUGGESTIONS AND CONCLUSION
7.1 Suggestion........60
7.1.1 Bankruptcy: A Separate Branch Of Law........60-61
7.2 Other Suggestions........61-67
7.3 Conclusion........67-68
Endnotes........69-70

Bibliography........71-73

Annexure A........74-76

Annexure B........77-79

Table A........41

TABLE OF ABBREVIATION

AAIFR	-	Appellate Authority for Industrial and Financial Reconstruction
AIR	-	All India Reporter
Am. Bankr. L.J	-	American Bankruptcy Law Journal
AOLs	-	Assistant Official Liquidators
BIFR	-	Board for Industrial Finance and Reconstruction
Com Cases	-	Company Cases
Comp LJ	-	Company Law Journal
Cornell L. Rev	-	Cornell Law Review
Cap. U. L. Rev.	-	Capital University Law Review
Col. L. Rev.	-	Columbia Law Review
Duke L.J.	-	Duke Law Journal
Dy. OLs	-	Deputy Official Liquidator
Int'l Law	-	International Law
ITR	-	Indian Tax Review
Mich. L. Rev.	-	Michigan Law Review
NW. U. L. Rev	-	Northwestern University Law Review
OL	-	Official Liquidator
SICA	-	Sick Industrial Companies Act
Va. L. Rev.	-	Vanderbilt Law Review
U Chic. L Rev	-	University of Chicago Law Review
Wash. ULQ	-	Washington University Law Quarterly

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In re, Vasant Investment Corporation Ltd. (1982) 52 Com Cases 139 (Bom.)
Katha Factory Mazdoor Sangh V. Laxmi Industrial & Trading Co. P. Ltd., (1988) 2 Comp LJ 67(All);
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National Textile Workers' Union v. Ramakrishnan (1983) 53 Com Cases 184
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Rishab Agro Industries vs. PNB Capital Services Limited reported in [2000] 25 SCL 461.
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S. Foundary Equipment Ltd. V. Gopi Ram Goyal, (1981) Tax L R 92 (Cal)
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INTRODUCTION

The Corporate Bankruptcy Laws in India is not the less discussed area. But it has to be seen that whether there has been merely discussion or there has been also any positive and effective respond to these discussions. What else needs to be done to make the Indian Legal system on Corporate Bankruptcy Law efficient enough to compete with other already developed or emerging system on the same? The concern on the lagging behind in the Bankruptcy laws has been well expressed by Vanessa Finch in the following words; "Insolvency[1] is an area of law of increasing importance not merely in its own right but because it impinges on a host of other sectors such as company, employment, tort, environmental, pension and banking law. It is essential, therefore, that the development of insolvency law proceeds with sense. If this is lacking, this area of law is liable to be marked by inconsistencies of reasoning and failures of policy, with the result that related legal sectors will also be affected.[i] These laws are perceived as parameters and important indicia of the economic health of a country.

SIGNIFICANT OF BANKRUPTCY

"Insolvency law is the root of commercial and financial law because it obliges the law to choose".[ii]

This statement shows the gravity of the subject. The whole economics is for the income, the income the considerable part of which comes from the trade. Trade happens by virtue of establishing business relation between two entities or persons. One important feature, an entity or a person should have for entering into this business relation is 'to remain solvent'. Thus, commercial and financial law of a country has the objective to secure solvency for the purpose of smoothly raising the real income of country.

Corporate Bankruptcy as a subject is not only of great theoretical importance but also is of practical importance, considering the large number of bankruptcies of major business firms in recent years. The mystery of corporate debt and the intricacies in costs, benefits, consequences and alternatives of corporate insolvency have attracted the time and effort of many lawyers and economists. Reorganisation has emerged as an interesting facet of

[1] It is admitted that there is difference between the term 'bankruptcy' and 'insolvency'. The difference between these terms will be discussed in the forthcoming chapters.

bankruptcy, more importantly in the United States where corporations and creditors have started using chapter 11, as a strategy.[iii]

The subject of corporate Bankruptcy lies at the intersection of price theory and game theory and of economic theory and finance theory and a subject moreover of great practical important. The world is opening up at unprecedented pace. The new business ventures are emerging so fast. Business transactions are taking place at rapid rate and quantum. In this situation, chances of failing these businesses are also increasing. This leads to instability of economy of country as well, along with other various legal issues.

In this scenario, there are other emerging concerns also; Indian legal regime has not taken care of, by far. The possibility of goods and services to cross borders is becoming a cardinal facet of business which can no longer be ignored. In today's' world, corporations operate in different countries at the same time through various outlets. The inability of the domestic laws of various countries to address the issues of cross-border transactions has many grave situations. Meaning thereby, corporate bankruptcy is now more than a matter of exclusive domestic concern. Industrial sickness is also an accepted part of Corporate bankruptcy Laws. In India, the problem of the industrial sickness has been a long standing one and the sizable magnitude and incidence of sickness has been a serious concern for the government.

RESEARCH METHODOLOGY

AIMS AND OBJECTIVES

Aim of this research paper to find out whether Indian Legal Framework on the corporate insolvency laws meets the challenges faced in the changed circumstances. Where, Corporate Insolvency Laws has seen revamp in all the other jurisdiction of the world, where stands India? India has choice of selecting from a variety of Bankruptcy laws of various countries. On one hand, we have Chapter 7 (Liquidation) and Chapter 11 (Reorganisation) of the US Bankruptcy Code and on the other hand, the receivership/administrative receivership of UK Insolvency Act, 1986. Again, How India responds the policy issues involved in the Corporate Bankruptcy cases. Whether existing legal structure is efficient to answer the questions posed by recent 2008/2009 global recession? The aim of this research paper is to find out the answer of all these queries.

SCOPE AND LIMITATION

The scope of this research is to determine adequate legal framework exists to regulate the corporate bankruptcy situation. This work is restricted to evaluate the legal framework of India on corporate insolvency law keeping in view the development of these laws in other jurisdiction.

HYPOTHESIS

1. Whether Indian bankruptcy laws failed to keep pace with the domestic and international developments.
2. With the eyes of the international investment community increasingly focused on India, certain reforms of the country's exiting bankruptcy law are important.

RESEARCH QUESTIONS

In order to test these hypotheses, the researcher will attempt to find out the following questions;

a. What are the policy issues in bankruptcy?
b. What are the elements of a good bankruptcy laws?
c. What are the developments in Bankruptcy laws of other important jurisdiction of the world?
d. What are the main features which make corporate bankruptcy laws of international standard?
e. Does present status of the Indian bankruptcy laws of India subscribe international standards?
f. What is the current policy in Corporate Bankruptcy Laws in India?
g. If India needs a comprehensive bankruptcy code, what are the issues it must address in Indian situation?
h. What are the other emerging issues and principles which India needs to incorporate in existing corporate bankruptcy laws.
i. What are the factors need to be considered in order to evolve the best practices of regarding corporate bankruptcy laws to the Indian requirements.

DATA COLLECTION

For my research, I have relied on both primary sources and secondary sources. The Primary source of data includes Legislation on Corporate Bankruptcy, International Treaties and Conventions on Corporate Bankruptcy Laws. The secondary source of data include the reports of various Committee that have worked towards reforming the corporate bankruptcy laws, survey reports on the working of authorities constituted by the Companies Act and SICA, reports and documents of the United Nations, International Monetary Fund, World Bank, International Bar Association, European Union etc., in so far as they deal with corporate bankruptcy. Monographs, books and journal articles on the relevant topic have also been used and acknowledged. Views expressed and interviews published in the Newspaper have also been used.

METHOD OF ANALYSIS

The present work has used descriptive and analytical method of analysis for its research. This work is a qualitative research. This involves a comparative study with the bankruptcy laws in other countries. The proposed study aims at identifying good principles of bankruptcy suitable to the Indian conditions. The comparative studies will be made is made keeping in view the special political and economic milieu of India.

MODE OF CITATION

In the present work, researcher is using uniform method of citation i.e. Harvard Blue Book method of citation.

CHAPTER 1

INSOVENCY: IMPORT, CONCEPT AND HISTORICAL DEVELOPMENT

1.1 BANKRUPTCY AND INSOLVENCY

Most of us tend to get confused, thinking that whether insolvency and bankruptcy are two words with the same meaning or they have entirely different meaning. "Insolvency" means inability to pay debts as they fall due – from Latin "*solver*", to pay. Bankruptcy comes from the Italian "*banca rotta*", broken bench, after Italian money changers or banks whose bench in the market square would be broken if they did not pay their debts.

The distinction between 'insolvency' and 'bankruptcy' was a result of the unco-ordinanted, and indeed illogical, condition of the laws relating to debt and bankruptcy that the distinction arose historically between insolvency, as a factual condition, and bankruptcy as a legal condition or status. This antithesis, between the factual and technical meaning of the terms most often employed, has tended to become obscured by popular usage, whereby the adjectives "bankrupt" and "insolvent: are treated virtually as synonyms for each other.[iv]

However, there is a thin line of difference between the meanings of these two terms. Bankruptcy is a way of dealing with any debts that you may have if you are unable to pay them back. It is generally seen as the last resort as it will mean selling off any assets that you have and does come with a number of possible consequences to your career and your credit rating. Bankruptcy stems from the word bankrupt which signifies a situation where a firm cannot meet its current debt obligations. Insolvency is the condition of being unable to pay one's debt as they fall due or in the usual course of trade and business. While the word 'bankruptcy' originates from the French word "*bancus or banque*" and the Latin word 'ruptus', the term 'insolvency' means the position of not being a solvent which is derived from the root word 'solve' meaning 'clear up'.[v]

Again, The Encyclopaedia Britannica draws a distinction between the two concepts[2]. It refers to bankruptcy as the status of a debtor who has been declared by judicial process to be unable to pay his debts. Bankruptcy is defined in terms of a legal status to be determined and declared by judicial decree. Conversely, insolvency is defined as the inability to meet debts as they mature. There are certain other conditions that have to be met before a person can be

[2] The New Encyclopaedia Britannica (15th Ed, vol. 6, Encyclopaedia Britannica Inc: Chicago, 1991) at 332

declared bankrupt, like committing of an act of bankruptcy. Hence, there is an important difference between declaring bankruptcy and insolvency. Declaring bankruptcy occurs when a debtor voluntarily or involuntarily goes through the legal process of bankruptcy. Insolvency is a financial state that can be defined in one of two ways: As the inability to pay debts as they come due or having liabilities in excess of assets. A state of insolvency might cause a debtor to eventually file bankruptcy.

The Indian constitution talks about both bankruptcy and insolvency. These words have been mentioned under Entry 9 of List III of Schedule VII of the Constitution. However, this provision was adopted into the Constitution without any debate or explanation on the two concepts.[3]

It is to note that all standard text books treat the two terms as one and the same. Thus, the words 'bankruptcy' and 'insolvency' are often interchangeably used.

1.2 CONCEPT OF BANKRUPTCY

Why it is important to determine whether a company is or is not insolvent? Insolvency in one form or another is a prerequisite to the initiation of formal insolvency proceedings. Whether a company is solvent or not will determine whether a voluntary liquidation is controlled by creditors or members. Once a company becomes insolvent, members lose their right to petition for a winding-up because they will cease to have a tangible interest in assets.[vi]

The essence of the concept of insolvency consists in a debtor's ultimate inability tommet his or her financial commitments. The traditional way of identifying this state of affairs is by the so-called "balance-sheet" test of insolvency: upon a balance of the debtor's liabilities and assets, the former exceed the latter with the consequence that it is impossible for all the liabilities to be discharged in full. A different – but commercially more useful – indicator of financial distress is known as the "cash-flow" test, which is based on objective demonstration of the debtor's inability to meet obligations at the time of falling due. [vii]

The traditional view prior to 1985 was that the crucial method for determining solvency was the "cash flow test". [viii] Thus, a company that could pay its debts as they fell due was deemed solvent, no matter what the state of its balance sheet was. The source of the funding used to settle debts was largely irrelevant. After 1985, this test was supplemented by the "balance

[3] See, Constituent Assembly Debates, Official Report, Volume IX (New Delhi:Lok Sabha Secretariat, 1999) pp. 937

sheet test"[4]. A company that could manage to pay its debts as they fell due was nevertheless deemed insolvent if, according to this balance sheet, liabilities exceeded assets. Contingent liabilities were brought into the equation for these purposes. As a result of these changes many more companies came within the purview of the corporate insolvency laws.

Thus, there are two alternative tests to determine whether a company is or is not insolvent. It is clear that a company with a healthy balance sheet can still be the subject of a winding-up petition if it is unable to pay its debts within the extended meaning given to it in the statutory provisions.

The principle of bankruptcy laws is to prevent persons craftily obtaining into their hands great substance of other men's goods, and at their own wills and pleasures consuming the substance obtained by credit of other men, and it is always to be remembered that it is the protection of persons who have so given credit which is the professed object of bankruptcy laws.[ix]

1.3 HISTORICAL BACKGROUND

The origin of all modern European insolvency laws – and many American, Asian and African laws – may be traced to ancient Rome. Until the Twelve Tables of circa 450 BC[5], the debtor secured what he owed absolutely with life and limb. The Twelve Tables introduced a procedure by which the creditor had to call three times publicly on the debtor to pay, presumably so that a friend or relative could cover for the insolvent. If no benefactor came forward or the debtor did not himself make good, then the spendthrift could be sold into slavery or killed.

During the reign of Augustus (63 BC to 14 AD), the *venditio bonorum*[6] evolved. The bankrupt's goods were transferred to a successor empowered to sell them, retain a share of the proceeds as commission, and distribute the rest among the creditors. The procedure did

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[4] Section 123 of the UK Insolvency Act 1986 has introduced this test. S. 123(2): "A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the
company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.
[5] Table III of Laws of TWELVE TABLE speaks "One who has confessed a debt, or against whom judgment has been pronounced, shall have thirty days to pay it in. After that forcible seizure of his person is allowed. The creditor shall bring him before the magistrate. Unless he pays the amount of the judgment or some one in the presence of the magistrate interferes in his behalf as protector the creditor so shall take him home and fasten him in stocks or fetters. He shall fasten him with not less than fifteen pounds of weight or, if he choose, with more. If the prisoner choose, he may furnish his own food. If he does not, the creditor must give him a pound of meal daily; if he choose he may give him more."
[6] The term '*venditio bonorum*' is the Roman word which means 'the formal process of taking all property from a bankrupt or insolvent person and managing that estate to sell as soon as possible and at the highest available price, with the proceed to satisfy as they can, the debts owed to the bankrupt's creditors.'

not result automatically in a discharge of the debts. In limited circumstances, as assignment of the creditor's rights, the *cession bonorum*[7], could achieve a discharge where *venditio* would not. With time, other forms emerged, such as the *pignus in causa iudicati*[8] for solvent debtors and the *mission in bono* for insolvent debtors.[x]

The early history of insolvency law in England and Wales is concerned purely with individual insolvency (bankruptcy). Statutes dealing with the bankruptcy of individual debtors were enacted at intervals from the mid-sixteenth century onwards.[xi] As the concepts of the modern limited liability company emerged during the first half of the nineteenth century it began to be possible for the members of incorporated companies to limit their personal liability, and thus to create a distinction between corporate and individual insolvency. The authoritative confirmation of this vital aspect of commercial law came with the decision of the House of Lords in *Salomon* V. *Saloman & Co* ,.[9] which was a case involving the liquidation of what was, in substance, a one-man company.

The first known bankruptcy law was passed in England in 1542 to give creditors remedies (other than imprisonment) against debtors who did not pay their bills. Under this law, debtors were considered quasi-criminals. The English Parliament first passed bankruptcy acts for the benefit of creditors, not for the protection of debtors.[xii] In 1570, England passed its second bankruptcy law. This time, only a creditor could commence a bankruptcy case, i.e., bankruptcy was involuntary for the debtor. Only a merchant could be a debtor. It also contained the principle that during the bankruptcy case, a bankruptcy commissioner seized the bankrupt's assets, sold them and distributed them pro rata to the creditors. Over the next 100 or so years, Parliament made a few changes to this bankruptcy law, primarily to let the commissioner take more of the bankrupt's assets and to increase penalties for non-compliance. A 1604 amendment permitted the debtor's ear to be cut off. In 1705, Parliament made sweeping changes. By these changes, a co-operative bankrupt could receive a discharge of the unpaid balance of his debts. A co-operative bankrupt would also be entitled to keep certain property – the first exemptions – based on the total value of his assets. An uncooperative bankrupt who was defrauding his creditors could be put to death, although

[7] The *'cessio bonorum'* is a latin work. In Roman Law, it means "voluntary surrender of goods by a debtor to his creditors. It did not amount to a discharge of the debt unless the property ceded was sufficient for the purpose, but it secured the debtor from personal arrest.

[8] Under this form, portions of debtor's property were seized by way of pledge – a procedure which was resorted to in certain cases on the postulation of the plaintiff according as the praetor, acting extra ordinem, judged fit.

[9] [1897] A.C. 22.

records indicate that only five debtors were put to death, although records indicate that only five debtors were put to death during the 115 years this provision existed.

Modern American bankruptcy has its beginning in the Bankruptcy Act of 1898. This law allowed both voluntary and involuntary cases, permitted debtors to claim exemptions and removed most barriers for discharging virtually all debts. During the 1920s, the Act was amended to add grounds for denial of discharge and debts excepted from the discharge. In 1938, Congress overhauled American bankruptcy law. Although most changes affected business bankruptcies, this law also created Chapter XIII, the wage earners' repayment plan.

The next major change came with the enactment of the Bankruptcy Act of 1978, the law that exists today. It was amended in 1984 to add several new categories of nondischargeable debts. Originally in the United States Constitution Convention of 1787 it was discussed that the only objection for giving Congress the power to pass uniform laws on the subject of bankruptcy was that bankrupts were occasionally put to death in England and that should not happen in United States. Two centuries of working has shown that there is little danger of such abuse.

1.4 MODERN DEVELOPMENTS

The first approach towards developing a bankruptcy law was to reduce rigour of practices against the failing but honest debtor. This is quite evident from the development of bankruptcy law in the earlier days during Romano-Germanic and Anglo-Saxon legal system. Once the rigour of legal and social practice was moderated, fraudulent practices started to defraud the creditors. Naturally, the second objective of bankruptcy law that developed in the next period of the history was predominantly focussed on the protection of the creditors against all fraudulent practices of the debtor.

In recent times a third movement in the policy direction of bankruptcy law is quite visible. The objective is to provide a facility of 'exit', so that an insolvent person can quickly get out of the circuit of insolvency and reappear in the economic activities at the quickest possible time. It is now understood that insolvency may be primarily due to two reasons: Firstly, non-viability of the project or the economic activity where the substratum of the project or the economic activity is lost due to any reason, including change of technology, customer behaviour and demand pattern And secondly, inefficiency and/or deliberate malpractices and mismanagement. In the first case, the objective of the bankruptcy law is,

world over, to facilitate the insolvent person to get a quick exit and restart. In the second case, the law's role is to deal very firmly with an erring debtor for operational mismanagement and malpractices, but at the same time, to protect an innocent debtor who by sheer misfortune falls into the abyss of insolvency.

Consequently, in recent times, great efforts have been made to remove the disgrace attached to bankruptcy.

Further, 'insolvency' has become move international in dimension. The reasons include: greater freedom of capital flows; the sheer size and speed of movement of capital flows; the integration of payment and securities clearing systems and their concentration in volume terms in few large financial centres; the growth of interlinked world trade; and the formation of large groups of companies with branches and subsidiaries in a multitude of jurisdictions. The approach is to develop principles of comity which would recognise the effects of foreign insolvency proceedings at the debtor's main centre of operations, sometimes without local court order, as in England, sometimes with a court order subject to conditions, as in most countries based on the civil tradition. [xiii]

1.5 INDIA'S POSITION ON CORPORATE INSOLVENCY

India's underlying bankruptcy system is in the traditional English mould, that is, there are bankruptcy laws for individuals and a company winding-up under the Companies Act 1956 which imported the individual bankruptcy rules into corporate liquidations such as proof by secured creditors, insolvency set-off, debts and liabilities provable, interest on debts and debts ranking pari passu.

Corporate insolvency laws in India are not consolidated. Thus Corporate Insolvency Laws in India are fragmented in different legislation still not complete and perfect in dealing with the real issue of corporate insolvency. Following are the legislations which, in some or other way, deal with the corporate insolvency;

- **Companies Act 1956**
- **Sick Industrial Companies (Special Provisions Act) 1985 ,**
- **Recovery of Debts due to Banks and Financial Institutions Act, 1993**

- **The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (S.13)**
- **State Financial Corporations Act, 1951 (S. 29)**

The Indian insolvency law is still embedded in the United Kingdom (UK) tradition under which the insolvency laws as such pertain to individual insolvencies, and insolvencies of artificial legal entities are pursued under the respective laws under which they are incorporated. While the UK has moved to a consolidated insolvency law, the same has not been done in India. Corporate insolvency law is an integral part of the system of facilitating and governing business in any economy. Insolvency is a possible outcome of an enterprise, and it is impossible to conceive of a business that is completely insolvency remote. Enterprise involves risk-taking, and risks may overwhelm the capital of an enterprise and take it to bankruptcy. In the case of individuals there are two Insolvency Acts, one for the presidency towns and other for the rest of the country, the former is The presidency-Towns Insolvency Act, 1909 and the later is The Provincial Insolvency Act, 1920. The first as mentioned above is the "Indian Insolvency Act" which was promulgated in 1848. It was formulated on the same lines as the contemporary British Act. Thereafter, there were several attempts to amend or replace the Act but nothing happened before the Provincial Act was passed in 1907 followed by the Presidency-Town Act in 1909. The 1907 Act was replaced in 1920. Provisions of both the statutes are similar, though the Presidency-Towns Act contains provision for official assignee, procedure of the court in details and limitation provisions. Both these statutes exclude corporations from insolvency proceedings to be conducted under these statutes (Sec.8 of the Provincial Act and Sec.107 of the Presidency-Towns Act).

CHAPTER 2

CORPORATE BORROWING AND CAUSES OF CORPORATE FAILUIRE

2.1 CORPORATE DEBT AND INSOLVENCY

It is necessary to understand corporate debt because without the concept of debt and the institution of credit, corporations would not face risk of bankruptcy. Without debt there would be no threat of destructive collection and no firm would need the protection offered by bankruptcy law. In the United States, it is believed that the inherent advantages of fixed obligations to a firm go beyond any benefits that result from income tax law.[xiv] The issues attending corporate insolvency law are closely linked to those surrounding corporate borrowing. Bankruptcy is a collective procedure for the recovery of debts by creditors.

All corporations finance their operations by issuing a combination of equity and credit. Both equity holders and creditors have a right on the firm. The equity holders are compensated with dividends apart from the proceeds of the firm on liquidation. The right of the equity holder is, however, a residual right and is secondary to the rights of the creditors. In contrast, the creditor's right to payment is non-contingent and in the event of default by the firm the creditor has the right to proceed under the non-bankruptcy law.

2.2 DEBT AND CREDIT

It is the creation of credit that gives rise to the debtor-creditor relationship and makes insolvency possible in the first place.[xv] To ask whether the legal framework of corporate insolvency law is acceptable involves, accordingly, some examination of the arrangements that the law recognises for obtaining credit and for raising corporate capital. If corporation or creditors in an insolvency face problems that arise from the multiplicity and complexity of arrangements for obtaining credit and ensuing difficulty of resolving the respective claims of different types of creditor, the best way to reform insolvency arrangements might well be to rationalise the legal methods available for raising capital and obtaining credit rather than to tinker with the insolvency rules that apply to the various credit devices.[xvi]

Creditors may be of different class. There are institutional lenders, trade creditor[10], venture capitalist, government agencies. Other type of creditor is the holder of a document issued by the company which acknowledges indebtedness and which usually (but not necessarily) involves a charge on the assets of the company. Another major category of corporate creditor is the employee. In so far as employees have carried out work and are entitled contractually to wages and other benefits as yet unpaid, they constitute creditors of the firm. There are other kinds of creditors e.g. consumers and other corporate customers who might have paid in advance for goods and services, sometimes shareholders who owed money in their capacity as shareholders (such as dividends) and involuntary creditors who may be entitled to payment from the company in accordance with a court order.

Credit can be obtained in four main ways: by offering security; by seeking an unsecured loan; by using a sale as a *de facto* security arrangement; and by resort to third party guarantee. Security can arise either consensually or through operation of the law. There are four forms of consensual security in English law: the pledge; the contractual lien; the mortgage; and the equitable charge. Security arising through operation of the law may be anticipated by the potential corporate debtor and used as a way of establishing a credit arrangement. The normal rule in a corporate insolvency is supposedly that all unsecured creditors are treated on an equal footing – *pari passu* – and share in insolvency assets pro rata according to their pre-insolvency entitlements or sums they are owed.

2.3 EQUITY AND DEBT

There are mainly two ways available to the company to raise capital. One is raising capital by issuing shares and other is by taking loan. Firms do have a justified bias towards debt not only because the interest payments are tax deductible but also because debt responds to certain asymmetric information problems better than equity.[xvii] The justification flows from the following two reasons. Firstly, debt responds to the problem of underreporting as the debt contract provides that the lender can liquidate the firm unless the borrower makes a minimum payment. Secondly, debt is less subject to information asymmetry as its value is more a function of factors that outsiders can assess. Equity, on the other hand, may be overvalued and there is no means of finding it out without assessing private information. Thus, the

[10] Trade creditor is the individual or firm who supplies goods or services to the company but who does not require immediate payment. Though It is to note that sale credit does not in law constitute a loan. For details, see, Vanessa Finch, Corporate Insolvency Law: Perspective and Principles, Cambridge University Press,pp. 59 -119

market is more likely to value debt accurately. As debt enables the firm owners to finance a project at the correct price, it is more preferred that equity.

Debt financing plays a crucial role in reorganisation. Bankruptcy institutions in the developed countries have so far not invoked an absolute rule of no debt. Some reorganised firms have emerged with a seemingly high debt level, and others emerged with an all-common-equity capital structure. There can be a two-fold explanation for these conditions. Bankruptcy institutions may be uncertain as to whether the purpose of the reorganisation mechanism is to ensure the viability of firms, to allow creditors quickly to collect as much as possible during reorganisation, or to strike some balance between the two. Bankruptcy institutions may also be uncertain as to whether they should impose a uniform, highly predictable capital structure, or whether they should allow the capital structure to be established through case-by-case bargaining by the parties and case-by-case review by the courts.[xviii] However, the exponents of debt-equity relational theory asserts that corporate debt relationship do not have clearly defined meanings.[xix]

2.4 MODEL OF CORPORATE DEBT-EQUITY RELATIONS

There are three conceptions of corporate debt-equity relations which compete with each other in the realm of corporate financing. They have been explained below.

1. THE TRADITIONAL CONCEPTION

The traditional conception has the simple model which has roots in pre-industrial era. Debt is treated as an exchange between flesh-and-blood individuals.[11] In this idea, debtor and creditor are known to each other and personally involved in the debt relationship. In adversity, the banker will not hesitate to foreclose. Upon a debtor's insolvency, the creditors' interest prevail and the law imposes creditor-protective duties. The insolvent debtor's estate is administered for the creditors' benefit.[xx] The law intervenes to prevent violence and to protect the mode of exchange from the participants' self-protective instincts. Legal rules that evolved in response to this conception have shaped debtor-creditor doctrine to culminate in what it is actually today.[xxi]

2. THE INVESTMENT CONCEPTION

The investment conception approaches debt in a different way. The underlying transaction involves a publicly offered corporate bond issue on a long-term basis. Here, there is no

[11] In this model the creditor resembles Shylock, the quintessential merciless moneylender popularized by Shakespearean play. William Shakespeare, The Merchant of Venice, The Complete Works, Act I, Sc. 3, II. 140-50, act IV, sc. 1, II. 184-310(Peter Alexander ed., London: Collins, 1964).

persons-to-person interaction as the transactions take place through corporate bonds. The debtor is a management corporation that issues a security, not an individual who signs a note. The creditor, an institution or an individual, is more a security holder than an adverse lender. Relationships between issuers and security holders are depersonalised and objectified. Managerial theories of the corporation influence the investment conception.[xxii] The investment conception emphasises the shared characteristics of debt and equity-debt and equity investments differ only in degree; they are not fundamentally different forms of participation. Like equity investors, debt investors have their funds tied up in the fortunes of the company. Like equity, debt holders are considered as outsiders dependent on effective performance by corporate managers, a separate interest group without substantial security holdings. The creditor or debt holder is viewed as bondholder, a single investor holding a piece of paper that gives no practical means of achieving corporate power. Thus, creditor protection in law follows a practical possibility and a policy priority.

3. THE AGENCY CONCEPTION

The 'agency' conception of corporate debtors and creditors originates from financial economics.[xxiii] Under the agency conception, the neo-classical microeconomic model of production by firms determines the interpretive gloss applied to loan transactions. Ratinal, profit-maximising microeconomic actors populate this model. There is a presumption of conflicts of interest and self-protection by contract. Like investment conception, debt resembles stock, and the lender holds a depersonalised security. But here the lender can trade that security in a perfect trading market. There is a transformation of the investment conception's long-term, co-operative loan into a fully objectified investment in diversified portfolio of securities. Upon such securitisation, the possibility for investor self-protection expands. The experience in various developed countries has shown that the increased corporate debt in relation to equity, assets or cash flow is likely to lead to a greater probability of bankruptcy.

2.5 DEBT

Debt forms the central issue in corporate bankruptcy, for without debt there would be not bankruptcy situations. Hence, it is essential to define the term 'debt' clearly in unambiguous terms. In defining it, which figures in clause (e) of section 433, the Indian Courts have, from time to time, attempted to give an explanation in consonance with the spirit of the above

section. In *Kesoram Industries and Cotton Mills Ltd. v. CWT*[12], the court defined debt as "a sum of money which is now payable or will be payable in future by reason of a present obligation *debitum in praesenti solvendum in future.* The liability of a carrier for short delivery is ' a debt' even though the quantum of liability has yet to be ascertained.[13] In *Newfinds (India) v. Vorion Chemicals & Distilleries,*[14] the court held that the term debt would refer to a definite sum and would not include any claim for un-liquidated damages or a sum of money which is capable of being ascertained. A debt must be a determined or definite sum of money payable immediately or at a future date. A contingent or conditional liability is not a debt, unless the contingency or condition has already happened.[15] It was also held that a petition filed on default of payment of price of goods supplied would not be an abuse of process and the petition would be fit for admission.[16] The importance of debt in bankruptcy denotes that debt is a condition precedent for bankruptcy to occur.

2.6 CORPORATE FAILURE: CAUSES

Companies routinely encounter difficult times and survive them. Some firms, however, undergo formal or informal rescue procedures before regaining health and others may end up in liquidation. Companies can be said in the main to fail through either internal deficiencies or pressure exerted by external factors.[xxiv] Internal factors include 'poor financial controls', 'mismanagement' etc. Misfortune is outside the control of the bankrupt company. There can be factors like e.g. increased interest rates, currency depreciations, unforeseeable economic slumps, natural disasters and the like. Some of these spring from government incompetence or from the weakness of societies which maintain incompetent governments? Misfortune also includes reasonable risk-taking where optimism proves not to be justified. All business involves an element of risk.

Some bankruptcies are caused by fraud of management or senior officials in the form of embezzlement or looting the company or financial non-disclosure or overstatement or invention of non-existent assets. Many insolvencies are caused by the unexpected failure of a major debtor, leading to collapsing dominoes knocking each other over – the cascade ripple or systemic insolvency. This is a particular risk for banks but affects all companies.[xxv]

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[12] (1966) 59 ITR 767 (SC)
[13] Also, *Kudremukh Iron Ore Co. v. Kooky Roadways P. Ltd.,* (1990) 69 Com Cases 178, 1885 (Kar)
[14] (1976) 46 Com cases 87, 89 (Mad)
[15] See, Registrar of Companies v. Kavita Benefit Private Ltd., (1978) 48 Com Cases 231 (Guj).
[16] *T. S. Foundary Equipment Ltd. V. Gopi Ram Goyal,* (1981) Tax L R 92 (Cal)

CHAPTER 3

CORPORATE BANKRUPTCY: FUNCTIONS, AIMS AND OBJECTIVES

3.1 FUNCTION OF CORPORATE BANKRUPTCY

A number of US commentators, inspired by the law and economics movement have argued that the proper function of insolvency law can be seen in terms of a single objective: to maximise the collective returns to creditors.[xxvi] There are two views on functions of Bankruptcy. Firstly, an insolvent firm's employee may be ill suited to bear the costs of firm failure, and the bankruptcy policy must consider rationally the effects on employees of strict adherence to non-bankruptcy entitlements. Secondly, a question arises as to why bankruptcy firm should have a special obligation to protect their employees if firms outside bankruptcy do not. If social policy rationally favours workers, legislation could favour worker in all firms not just those that are unable to meet their debt obligations or find themselves in bankruptcy for some other reasons. Broadly bankruptcy law serves the following functions:

(1) It stays the creditors' individual right to collect and guarantees rateable distribution of asset value among creditors of the same contractual priority.
(2) It provides a forum for debt restructuring.
(3) It solves creditors' co-ordination problem and allows the creditor to save the direct and indirect costs of a race to grab assets.
(4) It increases the asset to be divided by protecting creditors from their own avarice, but leaves largely intact the non-bankruptcy entitlements of the shares of the assets.
(5) It should distinguish ordinary unsecured loans and typical high priority loans.
(6) It must quantify and compare claims arising from executory contracts, and claims arising from contracts that offer specific performance as a remedy for breach.

Rehabilitation of corporate debtors has emerged as one of the important function of bankruptcy. Initially, bankruptcy discharge policy was directed towards merchants only. Gradually, the benefits of discharge were extended to others.

3.2 OBJECTIVE AND VISIONS

The twin competing policies of insolvency law are the protection of creditors and the protection of debtors. However, objectives of corporate bankruptcy laws can be enlisted as follow:

a. Restoring the company to profitable trading
b. Maximising returns to creditors
c. Providing a fair and equitable system for the ranking of claims
d. Identifying the causes of the company's failure and imposing sanctions for culpable management by its directors and officers.

There are various visions of corporate insolvency laws. **'The creditor wealth maximisation and the creditors' bargain' vision** demands all policies and rules to be designed to ensure that the return to creditors as a group is maximised. The creditor wealth maximisation vision has been highly influential and has been put into legislative effect in some jurisdictions. It is a vision, however, that has been subject to extensive criticism. This, it has been said, fails to recognise the legitimate interests of many who are not defined as contract creditors: for instance, managers, suppliers, employees, their dependants and the community at large.[xxvii]

'A broad-based contractarian approach' is another vision, given by Donald Korobkin. Whereas Jackson seeks to justify insolvency law with reference to the rules that contract creditors would agree to from behind the veil of ignorance, Korobkin places behind the veil not merely contract creditors but representatives of all those persons who are potentially affected by a company's decline, including employees, managers, owners, tort claimants, members of the community, etc. These people chose the principles of insolvency law from behind a strict veil, ignorant of their legal status, position within the company or other factors that might lead them to advance personal interests. Korobkin argues that the parties in such a position of choice would opt for two principles to govern insolvencies. First, a 'principle of inclusion' would provide that all parties affected by financial distress would be eligible to press their demands. Second, a principle of 'rational planning' would determine whether and to what extent persons would be able to enforce legal rights and exert leverage.[xxviii]

'The Communitarian vision' countenances the redistribution of values so that, on insolvency, high-priority claimants may to some extent give way to others, including the community at large, in sharing the value of an insolvent firm.[xxix] It follows from the concerns of communitarianism that insolvency law should look to the survival of organisations as well as to their orderly liquidation.

'The forum vision' argues that insolvency process should not be seen in terms of substantive objectives only but it may be conceptualised in procedural terms. Philip Shuchman who propounds **'The ethical vision',** argues that the situation of the debtor, the moral worthiness of the debt and the size, situation and intent of the creditor should be taken into account in laying the foundations for insolvency law. [xxx] Then, there is **'the multiple values/eclectic approach'.** This approach, as exemplified by Warren and Korobkin sees insolvency process as attempting to achieve such ends distributing the consequences of financial failure amongst a wide range of actors; establishing priorities between creditors; protecting the interests of future claimants; offering opportunities for continuation, reorganisation, rehabilitation; providing time for adjustments; serving the interests of those who are not technically creditors but who have an interest in continuation of the business and protecting the investing public, jobs, the public and community interests.

CHAPTER 4

BANKRPTCY: LEGAL THEORY NAD POLCIY CONCERN

4.1 LEGAL THEORIES IN BANKRUPTCY

No general legal theory can satisfactorily explain a subject as complex as bankruptcy.[xxxi] The real intent of a theory is not to describe reality in precise terms. It is also true that theory must be derived from the legal experiences of cases, statutes, and parties that reacts to and acts upon.[xxxii] The economic explanation of bankruptcy, especially when it relates to reorganisation, focuses on the costs associated with having any bankruptcy law.[xxxiii] The counter-theory reminds that the collapse of a business enterprise implicates a broad range of diverse interests beyond the interests of those persons with cognizable state law claims against the assets of the business. The strength of the counter-theory has been its appreciation for those values, however unsystematically expressed, as exemplified by the normative theory Professor Korobkin derives from his bankruptcy choice model.[xxxiv]

4.1.1 BANKRUPTCY CLAIMS AND NON-BANKRUPCY ENTITLEMENTS

Bankruptcy may be considered as a procedure geared principally toward relieving an overburdened debtor from "oppressive" debt. Most bankruptcy process is concerned with creditor-distribution questions. The US bankruptcy code specifies some of the priority rules. The claimants who fare best in the bankruptcy process hold special entitlements under applicable non-bankruptcy law. Claims are determined so that participants in the allocation process may be assembled and the rules governing priorities determine whom, among the claimants, will get what and in what order. All bankruptcy law accord substantial respect to non-bankruptcy entitlements. Bankruptcy, in short, is a system designed to mirror the agreement one would expect the creditors to form among themselves were they able to negotiate such an agreement from an *ex ante* position. This approach is called the creditors' bargain.[xxxv]

4.1.2 COLLECTIVE LIQUIDATION

Collective liquidation has three benefits. Firstly, it reduces strategic costs. The absence of prior agreement might lead to a situation similar to what the game theorists call "prisoner's dilemma", the central feature of which is rational individual behaviour. Each creditor must

participate in collectively non-optimal "advantage taking" simply to avoid being taken advantage of. Secondly, it increases the aggregate pool of assets. Finally, collective liquidation implies administrative efficiency, thereby saving on the costs of individual collection proceedings. Fully secured creditors do not look into the above three points. As a result, the creditors themselves cannot be expected to negotiate this agreement, even though it would be in their joint interest to do so. A federal bankruptcy rule solves this problem by making available a mandatory collective system after insolvency has occurred.

4.2 POLICY ISSUES

There are various policy issues that need to be addressed before identifying the areas in Indian law that require a change. First we have the issue of 'default'. Default is a n event where the control of the assets shifts from the debtor to the creditor, thereby making the creditor the new owner of the assets. Default occurs when a borrower does not pay interest or repay the principal due to its creditors. Situation of default may lead to bankruptcy which is a process of breaking and rewriting contracts supervised by the court. Default may also lead to liquidation or workouts: the former involves the sale of firm's assets and distribution to claimants and the latter pertains to private renegotiation of contracts.

4.2.1 DEFAULTS

There is distinction between default caused by illiquidity and default caused by insolvency. In the former, the inability to pay debts results due to lack of realisable assets or income – this situation can be resolved short of bankruptcy. In the latter, default is caused by negative net worth where the liabilities exceed the assets. The cost imposed by bankruptcy on owners and providers of finance to the firm is also an additional cause of default.

4.2.2 PRIORITY PRINCIPLES

It has been experienced in many countries all over the world that sometimes an enthusiastic creditor may force liquidation of firms that might otherwise have survived. It is to avoid such 'creditors' rush' we have bankruptcy policy. Priority principles have been instrumental in deciding who should get what. The current law regulating the priorities rests on three priority principles:

1. If the first creditor to deal with the debtor makes an unsecured loan, it shares pro rata with later unsecured creditors in the debtor's assets on default.
2. If this initial creditor makes an unsecured loan a later creditor takes security, the later creditor has priority over the initial creditor in assets subject to the security interests.

3. If the initial creditor makes a secured loan, it generally has priority over later creditors in the assets in which it has security.

The last principle of "first in time is first in right" is known to have several exceptions. The most important of which is the purchase-money priority. A later creditor whose funds enable the debtor to purchase designated assets and who takes a security interest in these assets will have a priority in them despite an earlier security interest that would otherwise have granted senior rank to the initial secured lender.

4.2.3 THE PARI PASSU PRINCIPLE

One of the most fundamental principle s of bankruptcy is the *pari passu* principle of the pro rata principle. The principle ensures that each creditor is proportionately paid out of the pool of the bankrupt's estate pro rata according to his debt. However, in practice this principle is not honoured anywhere. What is done in most countries is that the creditors are paid according to a scale of priorities, which is usually in the following order:

1. Super-priority creditor;
2. Priority creditors;
3. Pari Passu creditors;
4. Deferred creditors;
5. Equity shareholders'
6. Expropriated creditors[xxxvi]

The super priority creditors, who are paid in full and who fall as an exception to the pari passu rule, include: (i) secured creditors, (ii) creditors with a set-off, (iii) title finance creditors, (iv) owners wrongfully deprived of their property, (v) creditors with a direct action, (vi) creditors with rights of recession.

The priority creditors are paid out of the available pool of assets after deduction of the claims of the super-priority creditors. The main classes are: 1.) Expenses of the insolvency proceedings 2.) Taxes 3.) Employee remuneration 4.) Others

The pari passu creditors rank third in the list and are generally the unsecured creditors of the bankrupt. The dividend is payable to them only after the claims of the super-priority and priority creditors are satisfied and as such their chances of receiving the dividend are either nil or very small.

The deferred creditors comprises of creditors who for some reason are deferred. They usually receive nothing on the insolvency. They are; equity creditors, equitably subordinated creditors, post-insolvency interest, creditors without an *escritura publica,* Consensually subordinated creditors.

4.2.4 PREFERENCES

All developed bankruptcy laws provide for the recapturing of the assets transferred by the debtor in the period preceding the commencement of insolvency proceedings. The basic requirements qualifying a transaction as preferential are that the transaction:

a. Prejudices other creditors of the debtor;
b. Occurs while the debtor is actually insolvent or renders him insolvent;
c. Occurs in a suspect period prior to the formal opening of insolvency proceedings.[xxxvii]

There are three objectives for the rules against preference. The main objective is to prevent the debtor from fraudulently concealing or transferring his assets beyond the reach of his creditors when he knows that his own insolvency is looming. The second object is to treat all the creditors equally even though formal insolvency proceedings have not yet begun. The final objective is that the rules against preferences are designed to discourage creditors with special leverage or who are especially diligent from harassing the debtor in financial difficulties to pay them off or secure them in priority to the others. However, there are some policies that may conflict with the above objectives. The first is the need for predictability and certainty that transactions with a party will be inviolable and be upheld in favour of third parties dealing with the party in good faith and for value. The second policy consideration against the recapture is that the debtor should be given an opportunity to trade out of his difficulties. The last policy consideration is that there is a conflict between the bankruptcy policy of equality of distribution and the policy that debtors should honour their obligations, for instance, the payment of mature debts.

4.2.5 CREDITORS' CO-ORDINATION

The first consequence of the creditors' co-ordination problem is that each creditor may expend excesses resources positioning him to win any race to an insolvent firm's assets. The creditor may anticipate the difficulties of negotiation and may plan to defect before other creditors do. Such planning may include monitoring the debtor so that the creditor has good information about when the race to grab assets is to begin. The creditors may collectively prefer to forego the expenses of monitoring and agree to share all assets rateably with other creditors of the same priority.

CHAPTER 5

CORPORATE BANKRUPTCY: COMPARATIVE TREND (WITH SPECIAL REFERENCE TO US AND UK)

5.1 BANKRUPTCY JURISDICTION

The jurisdiction of various countries can be classified into three groups, namely, Pro-Creditor, Pro-Debtor and Neutral. The first one allows a credit to protect himself against an insolvency, by security or set-off. The second one aims to maximise the defaulter's assets so as to increase the value of the assets before distribution.

The distinction between pro-creditor and pro-debtor jurisdictions is vague as no country subscribes to either of the view completely to the disregard of the other. There is consensus among the insolvency practitioners that private restructuring is by far the best option available. One such instance of ambiguity of a pro-creditor protection is the universal floating charge advocated by the Common Law countries where the capital-provider is given a priority of payment over the others.[xxxviii] The pro-debtor countries object to this practice as it prejudices the rights of the unsecured creditors. Some countries, especially the ones following the common law system insist in insolvency set-off[17], whereas certain others like France reject it. Most legal systems do not agree on the concept of set-off as they subscribe to the higher principle of *pari passu* payment of debts.

5.2 CRITERIA FOR JUDGING THE EFFICIENCY OF A BANKRUPTCY CODE

There are several criteria for judging the efficiency of a bankruptcy of a bankruptcy code. Modern jurisdictions have provisions that are beneficial to both creditors as well as debtors. Julian R. Franks and Walter N. Torous have evolved five criteria to judge the efficiency of bankruptcy codes.[xxxix]

(1) Premature and deferred liquidation;

(2) Adherence to the terms of the debt contract – extent to which the code minimises renegotiating problems;

(3) Direct costs of insolvency;

[17] The following illustration explains the concept of insolvency set-off. Two traders, trader A and trader B owe Rs. 100 to each other. Trader B becomes bankrupt. In such a situation trader A would set off his Rs 100 which he is entitled against the money he owes to trader B.

(4) Over or under-investment – indirect costs; and

(5) Other stakeholders' interest.

The following analysis compare the provisions of the United States Bankruptcy Code and the United Kingdom Insolvency Act in the light of the above five criteria. The Indian position is not analysed here specifically as the Indian provisions on liquidation are similar to the English provisions. However, the English Act went through a major modification in the year 1986. The analysis that follows will tremendously help in formulating a new approach for the Indian situation.

5.2.1 THE FIRST CRITERION

The efficiency of a code can be judged based on the incentives to liquidate prematurely or defer liquidation of the company. The US Code has strong incentives to maintain a firm as a going concern even when it is worth more in liquidation. In contrast, the UK Code which emphasises on the rights of creditors may in certain cases, give the priority to only one creditor, thus leading to premature liquidation. This seemingly bias of the US Code is justified by the fact that there are large shareholders, such as employees and suppliers, who are not usually party to the decision to liquidate. The US Code achieves this by giving power to the debtor-in-possession rather than directly to those other shareholders.

5.2.2 THE SECOND CRITERION

Chapter 11 of the US Code provide strong protection to the debtor-in-possession and, therefore, upsets the priority of claims. Shareholders are given the option of enjoying the gain if the value of the firm rises, without the possibility of loss if the value falls. The value of the option is increased if these parties can extend the period in chapter 11, since a longer period increases the probability that the firm value will rise and that shareholders will receive some payment. The UK Code of receivership results in a speedy settlement of claims and adherence to the maintenance of priority of claims. This is achieved because creditors obtain control of the company when it enters the formal insolvency process. Receivership may disadvantage unsecured creditors. The role of the new administrators has not produced any new radical change in bankruptcy law.

5.2.3 THE THIRD CRITERION

Size of the dead-weight costs of bankruptcy includes all the direct costs associated with bankruptcy process. Chapter 11 process can be expected to incur higher costs than that of receivership because it is much lengthier and it involves more day-to-day reporting to the court and to creditors.

5.2.4 THE FOURTH CRITERION

The fourth criterion deals with indirect costs, including lost investment opportunities or excessive investment. The US process allows the debtor to raise new financing to maintain the business as going concern. Such financing has priority over most pre-insolvency claims. In the UK, the receiver frequently raises funds from the secured creditors to keep the business going prior to sale. This also happens in administration. The debtor financing provisions of the US Code allow the court to give new capital supra priority. In the US, because of both the direct and indirect costs of bankruptcy process, there are strong incentives for the insolvent company to come to an agreement with creditors. Also, large creditors will come to a voluntary agreement with the company and then enter chapter 11 to obtain ratification. There are also incentives in the UK to reorganise privately. The effort to reorganise privately two very large companies, British and Commonwealth, were however successful. The current legislation in UK to reorganise privately. The high levels of workouts in the US reflects, in part at least, the high costs of the chapter 11process and its detterent effect. Where deviations in absolute priority occur in favour of shareholders the margin paid to the lenders will be higher. Margins also will be higher where the company can be maintained as a going concern when it is worth more in liquidation. In chapter 11, payments on financial leases must continue to be paid in reorganisation even though interest and repayments on other debts are stayed. In comparison, in administration such payments can be suspended by the court.

5.2.5 THE FIFTH CRITERION

The last criterion is based upon interest of stakeholders not represented in the bankruptcy process. US system indirectly gives considerable weight. The benefits to the shareholder of the company in chapter 11 may be offset by costs imposed on stakeholders in the companies. There is serious concern in US that chapter 11 process is being used by some firms to acquire a competitive advantage. If firms in an industry are generally in financial difficulties, then those firms entering chapter 11 may find access to new financing less costly than those firms

entering chapter 11 may find access to new financing less costly that those firms which are in distress but which have not entered bankruptcy. This result may follow from the provision which allows new financing raised in chapter 11 to take priority over pre-bankruptcy financing. It may be argued that, providing all firms have equal access to chapter 11, no competitive advantage exists. However, there are costs and benefits of chapter 11 reorganisation and workouts that affect firms asymmetrically.

5.3 THE UNITED STATES BANKRUPTCY CODE

The 1978 Bankruptcy Code replaced the Chandler Act, 1938, 1938. Chapter 11 allows a company to remain in operation while a plan of reorganisation is worked out with its creditors. Prior to this, a firm could only be maintained as a going concern through a costly and cumbersome process. Chapter 7 is available for the sole purpose of liquidation. In chapter 11, in order to increase the possibility that a firm would emerge as a going concern, the directors of the corporation were permitted to remain in charge and substantial rights were given to the debtor-in-possession. The rationale being that a more equity-oriented code would improve the chances of the firm remaining a going concern. The procedures contained in both chapter 7 and chapter 11 have been a subject of wide criticism and dissatisfaction. [xl] While chapter 7 is criticised for having the potential to lead healthy firms into liquidation, the procedure in chapter 11 is attributed as cumbersome and biased in favour of the incumbent management.[xli]

In a case under Chapter 7, the debtor or its creditors seek a liquidation of the debtor's assets and liabilities. An appointed trustee gathers the assets of the debtor and liquidates them to pay off the creditors. An individual debtor may retain certain exempt property and will receive a discharge of most debts so that she can obtain a "fresh start" unburdened by those debts. In a case under Chapter 11, the debtor hopes to avoid liquidation and seeks to reorganise its affairs and stay in business. The debtor may retain control of its affairs, may continue to operate its business as the "debtor-in-possession," and may exercise most of the power of a trustee.[xlii] The debtor-in-possession has the exclusive right for the first 120 days to propose a plan of reorganisation. After that time, creditors may propose plans of reorganisation or may seek liquidation. A chapter 11 reorganisation plan can take several forms. It may call for selling the business as a going concern and using the proceeds of the sale to pay the creditors. Alternatively, it may provide that the unsecured creditors trade their claims for stock in a reorganised entity that will continue in business. Or, the plan may simply change the way the

entity conduct business so that existing creditors can be repaid.[xliii] The theory behind reorganisation is that keeping eh business alive is better for creditors because doing so is a more efficient use of assets than liquidation. There is some doubt about the validity of these assumptions.[xliv] There is little doubt, however, that reorganisations produce more short term benefits for non-creditor beneficiaries, such as managers, other employees, and local taxing authorities, than do liquidations. In either liquidation or rehabilitation, the Code establishes a simple procedure for determining the existing liabilities of the debtor. Either the creditor or the debtor can file a proof of claim. If no party in interest objects, the claim will be allowed. If any party in interest objects to the proof of claim, the bankruptcy court must determine the amount of the claim and allow that amount. If someone has a claim against the debtor and that claim arose before the order for relief, he must participate in the bankruptcy case, or she will receive nothing from the liquidation or reorganisation of the debtor. The filing of a petition also automatically stays all actions by creditors to collect their debts.

The Code also recognises the property interests that persons, such as secured creditors, have in the debtor's property, prescribes the priorities for distribution of the assets of the debtor among creditors in the case of liquidations, requires meetings of creditors, and prescribes the procedures for devising and implementing a plan of reorganisation in Chapter 11.[xlv]

5.3.1 PROCEDURE IN CHAPTER 11

The debtor retains control of business, although occasionally the bankruptcy court appoints a trustee to oversee the firm's operation if management is guilty of fraudulent behaviour. The firm can operate or sell its assets. All payments of interest and principal on the debt cease while the firm is in chapter 11. Interest continues to accrue on fully secured debt but not on unsecured and under secured debt. The filing of a Bankruptcy petition automatically restrains almost all creditors from taking any action. The debtor has the exclusive right to propose a plan of reorganisation for the first 120 days after filing and has another 60 days to obtain creditor approval for the plan. The Court can extend the exclusivity time. Only when the plan is approved that reorganisation ends and creditors get paid.

A plan of reorganisation separates creditors into classes, usually based on the seniority of claims. Equity is always a separate class and each secured creditor is usually placed in a separate class. Approval of a plan of reorganisation requires a majority of each class of creditors by number and two-thirds by face value of claim.

5.3.2 WORKOUTS

Corporate rescue has evolved as an important feature of modern insolvency law aimed at resuscitating debtor companies in distress. The remedy outside the ambit of law is known as workouts or private consensual debt restructuring. The main advantages of formal proceedings are a statutory freeze

5.3.3 WORKOUTS V. CHAPTER 11

Most firms enter chapter 11 only after trying an informal reorganisation of workout outside the bankruptcy process. A workout can take place in the form of an exchange offer for outstanding debt, renegotiation of bond covenants or negotiating a reduction of interest payments and/ or an extension of loan maturities. Workouts generally involve lower direct costs than chapter 11 cases because the time spent in reorganisation is much shorter.

5.3.4 REASONS WHY WORKOUTS FAIL

There is a contrasting opinion that workouts are not feasible. The following are some of the key reasons for the failure of workouts in the United States.

(1) Trust Indenture Act, 1939 – For changing the principal amount, interest rate, or maturity date of a publicly held bond require the approval of 100% of the bondholders in contrast to the non-unanimity provisions of chapter 11.

(2) Chapter 11's automatic stay provision prevents a run on the firm's assets by secured creditors by providing an orderly means of settling claims. Such a provision cannot be employed in a workout.

(3) Workouts can have adverse tax effects. E.g., debt forgiveness is fully taxable in workout but not in chapter 11 reorganisations.

(4) If a firm experiences a change in control as a result of the workout, use of net operating tax-loss carry forwards can be restricted severely.

(5) Chapter 11 has the ability to avoid actual or potential legal judgements.

(6) Chapter 11 makes it easier to restructure a firm's assets since an asset which is collateral for secured debt may be sold with the court's approval.

Some firms combine the low administrative costs of a workout with the non-unanimity requirements and tax benefits of chapter 11, by filing a pre-package bankruptcy petition. In a pre-packaged bankruptcy a firm files for chapter 11 with a plan of reorganisation which has already been accepted by the required number of claimholders. The filing for bankruptcy and the filing a plan of reorganisation occurs simultaneously. Thus, chapter 11 aims to maintain the business as an ongoing concern, even if that reduces the proceeds available to creditors.

5.4 THE UNITED KINGDOME BANKRUPTCY CODE

The Insolvency Act of 1986 deals with all aspects relating to bankruptcy. Repayment of creditor's claim is the most important concern. Prior to 1986, it was highly creditor-oriented. The company came under the control of an insolvency practitioner. This method reduces the value of the company by encouraging its premature liquidation. The 1986 Insolvency Act designed to move towards a debtor type.

The 1986 Act followed a report by a Royal commission on Insolvency referred to as Cork Report (1982). Prior to the Act there were 3 possible routes to formal reorganisation:

(1) Liquidation;

(2) Receivership or administrative receivership;

(3) Voluntary reconstruction; and

(4) After 1986, an additional procedure was introduced requiring the appointment of an administrator.

5.4.1 Liquidator

Any creditor who is entitled to a debt in excess of 75pounds or a company could request for the appointment of a liquidator. In compulsory liquidation, permission of the Court of Chancery is essential. The liquidator can either sell the assets in whole or in piecemeal. He also has the responsibility of distribution and orderly winding up of the company.

5.4.2 Receivership

The Receiver is appointed by the creditor, who in this case will be called the Appointor. An Appointor must have particular type of security on the firm's assets, described as a fixed or floating charge. Receiver is appointed over the entire company's assets. The administrative receiver would realise those assets to clear the debts of the charge holder. He would then pass any remaining balance after his charges to the liquidator (if one is appointed) or to the company. In the absence of a secured creditor, a receiver cannot be appointed. The receiver's appointment cannot be challenged except on technical grounds. Other creditors may apply for

repayment or apply for appointment of liqidator. Although receiver and liquidator can work contemporaneously, the receiver usually is prevented from managing the firm on the liquidator's appointment. The receiver may seek to persuade other creditors that it is in their interests not to appoint a liquidator. Some of the creditor's claims may be purchased by the Appointor to prevent liquidator's appointment. The receiver will decide whether the firm should be maintained as a going concern. If the net cash flow is positive, the firm will continue. If the cash flow is negative, then the firm can be continued if new funds are raised either by a sale of assets or by a fusion of funds. If the realisable value exceeds the going concern value, then the receiver will sell the assets.

5.4.3 THE ADMINISTRATOR

The Administrator is appointed by the Companies Court, which is part of the Court of Chancery. An administrator may be appointed at the request of the company or the creditor. Like the receiver the administrator must be an insolvency practitioner. Once an order is granted, a liquidator or receiver cannot be appointed until the order to appoint the administrator is cancelled by the court. The initial appointment of an administrator by the court normally will be prevented if there is a creditor with a floating charge and he appoints an administrative receiver before the appointment of the administrator. There have so far been only a few appointments of administrator compared to many thousands of receiverships. Moreover, the same insolvency practitioner who serves as a receiver is usually appointed as the administrator.

5.4.4 WORKOUTS

Workouts are alternatives to formal reorganisation. The company's problems are resolved with the agreement of the principal creditors. Alternatively, the company may enter into a voluntary arrangement under the 1986 Act, or with the aid of the court through a Scheme of arrangement. Insolvency Act, 1986 requires a director to declare insolvency as soon as there is no longer a reasonable prospect of avoiding an insolvent liquidation. Failure can lead to disqualification.

5.4.5 REORGANISATION

The new British reorganisation procedure, known as an administration order, is intended to encourage reorganisation of failing firms. The English administration is an open procedure with a few rules as to the content of the administrator's proposals. The underlying principle is to preserve the balance of bargaining power – by not crushing creditors too completely but

shielding the company from enforcement actions and leaving the rest to negotiation. Under this procedure, the bankruptcy court appoints an outside official called the administrator who represents creditors generally. The administrator has up to three months to decide whether to reorganise the firm, sell it as a going concern, or liquidate its assets, and the automatic stay is applied to all creditors during this period. If the administrator decides that the firm should be reorganised, he proposes a plan to creditors who must approve it by a simple majority vote (by value). If creditors do not approve the plan, then the administration order ends and the firm is liquidated.[xlvi]

The managers of failing firms in Britain cannot invoke a collective bankruptcy liquidation procedure to prevent secured creditors from removing assets. They also cannot invoke the collective bankruptcy reorganisation procedure to stop secured creditors. Suppose a manager petitions the bankruptcy court for an administration order. Before the bankruptcy court issues the order, it notifies the firm's floating charge creditor. The floating charge creditor can block the administration order by immediately appointing a receiver. Unlike the practice in United States, the managers of failing firms cannot defeat creditors' attempts to claim their security by invoking a collective bankruptcy reorganisation procedure. As a result of this, the new administrator order procedure is not used frequently.

5.5 FRANCE

The new bankruptcy law in France is intended to save failing firms.[xlvii] Its primary objectives are "safeguarding the business" and "maintaining the firm's operating," while "discharging liabilities" ranks only third. As soon as the firm files for bankruptcy, an *outside official* who represents the interests of the State rather than the creditors is appointed by the bankruptcy judge. The firm continues to operate for during the "period of observation" which may last for six to eighteen months. During this period the court *may* order that managers may remain in control under the outside official's supervision or that managers be replaced. The outside official decides at the end of the period whether or not the firm should be saved.

The new legislation had modified the tradition role of the trustee in bankruptcy. The management functions previously performed by the trustee are now carried out by an 'administrator' (*administrateur*) appointed by the court in the declaration of bankruptcy. Claims which were previously submitted to and verified by a trustee are now submitted to an verified by a 'creditors' representative' (*representant des creanciers*) whose responsibility is

to act in the interest and on behalf of the creditors. The new legislation has abolished the *mass des creanciers,* previously known as a group consisting of the unsecured creditors existing as of the date of the declaration of bankruptcy. The new legislation has also increased the role the employees who are now often consulted during rehabilitation proceedings. For instance, the 'workers representation committee' is consulted prior to all economic lay-offs and prior to the court's adoption of a proposed plan.[xlviii]

5.6 GERMANY

The current law provides for bankruptcy reorganisation procedure. It seems to be even less frequently used than the British procedure. Under this procedure, the bankruptcy court appoints an outside official to take charge of the firm. An assembly of all creditors is called within one month and creditors may either confirm the outside official's appointment or substitute someone else. The official recommends to creditors whether the firm should be liquidated or reorganised and, if the latter, recommends a plan of reorganisation. The reorganisation plan must pay unsecured creditors at least 35% of their claims or 40% if payment is delayed for more than a year. Creditors at vote on the plan and to be accepted it must receive votes representing at least a majority of unsecured creditors and at least 50% of the value of unsecured claims. If the plan is not adopted, the firm is liquidated.

The German reorganisation procedure is rarely used because it does not include an automatic stay for secured creditors. Thus, secured creditors can terminate reorganisation proceedings at any time and, in effect, must agree voluntarily to any reduction in the value of their claims. Unsecured creditors' claims, in contrast, can be cut back in reorganisation, but most German firms have relatively little unsecured debt. This means that there is little gain from having a formal in-court reorganisation as opposed to an informal out-of-court workout with creditors. The high-required repayment rate to unsecured creditors is another deterrent to reorganisation, as is the high cost of a bankruptcy filing. Only about 1% of German bankruptcy filings are reorganisations. The new German bankruptcy is intended to make bankruptcy reorganisation more attractive to failing firms. It institutes an automatic stay in bankruptcy against secured creditors, so that reorganisation plans will be able to reduce the claims of both secured and unsecured creditors. It also provides for discharge of debt covered by the plan after seven years and it eliminates the minimum payoff requirement for unsecured debt.[xlix]

CHAPTER 6

INDIA: CORPORATE BANKRUPTCY LAWS

In India, bankruptcy law has not been consolidated like other jurisdiction discussed earlier. There is no policy on the corporate bankruptcy system in India. The Indian insolvency law is still embedded in the United Kingdom (UK) tradition under which the insolvency laws as such pertain to individual insolvencies, and insolvencies of artificial legal entities are pursued under the respective laws under which they are incorporated. While the UK has moved to a consolidated insolvency law, the same has not been done in India.

In 2001, the Report of the Advisory Group on Bankruptcy Laws, called the N L Mitra committee, made several recommendations on bankruptcy law reforms, the first among which was consolidation of bankruptcy laws into a separate code[l]. However, no legislative steps have still been taken in this regard. Several significant recommendations were also made by the Report of High Level Committee on Law relating to Insolvency of Companies (Balkrishna Eradi committee) that made its report to the Department of Company Affairs. The Eradi committee, among other things, went into the working of the offices of the official liquidator (OL) and certain facts pointed out by it, on the face of it, seemed sadly surprising. For instance, the data about the average time taken in resolution of winding up cases in different regions could go up to 25 years or above, with the eastern region taking the first prize as far as the time taken in concerned.[li] The sad state of affairs was explained by several factors such as non-filing of statement of affairs, inadequate staffing and equipment support at the OL offices, etc. The Eradi committee also went into the functioning of the Board for Industrial and Financial Reconstruction (BIFR), which is a quasi-bankruptcy proceeding.

6.1 RESTRUCTURING

Laws relating to insolvency of companies in India is governed by the Companies Act 1956 and restructuring of 'sick' or 'potentially' sick companies in certain specified industries are covered under the Sick Industrial Companies (Special Provisions) Act 1985 (SICA in short). The Securitisation, Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI in short) provides for the establishment of asset reconstruction companies (ARC in short), which would undertake the management/realisation of non-performing loans acquired from secured creditors by taking over, change the management.

While winding-up and schemes of arrangement are carried out under the aegis of the Courts, the Board for Industrial and Financial Reconstruction (BIFR in short) has been set up (under SICA) for the restructuring/rescue of sick companies.

There are other categories of companies incorporated under various specific statutes, including public sector banks and insurance companies are to go by liquidation and reconstruction process in accordance with government regulatory process and such are more of administrative in nature.

In brief, the following are the legal provisions for corporate restructuring and the manner in which the same is to be made presently:

6.1.1 REDUCTION OF SHARE CAPITAL

The need for capital reduction may arise due to many reasons, such as, accumulation of trading losses; incurring heavy capital expenses and assets of reduced or doubtful value, now commonly understood as Non Performing Assets. As a result, the original capital may either have become lost or a company may find that it has more resources than it can profitably employ. In either case a corporate doctor[18] shall advise capital reduction with a view to adjust the relation between capital and assets of the corporation.[lii] The Supreme Court of India summed up the procedure for such reduction as prescribed in Section 100-104 of the Companies Act in *Punjab Distilleries India Ltd. v. CIT*[liii] *as* follows:

(i) There is power given in the article to reduce the capital;

(ii) There will be a special resolution by the general body of a company reduction of capital in the manner envisaged in the scheme for reduction;

(iii) The company will file an application in the court for an order confirming the reduction of the capital;

(iv) Creditors are to be notified about the proposal for reduction and filing of the petition to the court for confirmation and settlement of list of objecting creditors;

(v) After the confirmation of the court to the proposal for reduction, it will be registered by the Registrar of the Companies;

[18] The term corporate doctor is used to signify an insolvency practitioner who may be an individual or a group of individuals or a firm. These professional should necessarily be equipped with knowledge on financial and accounting matters.

(vi) The registrar shall certify the substitution of the corresponding the memorandum of association; and

(vii) Implementing the schemes of the reduction.

This type of financial restructuring may be difficult because the Court may give an order to include the word "and reduced" with the name of the company and to continue to provide a standing notice to the public for reducing the capital of the company for the time stipulated in the order through the inclusion of the word as a part of the name.

6.1.2 COMPROMISE OR ARRANGEMENT WITH THE CREDITORS

A company may make a compromise or an arrangement with the creditor under Sec. 391 of the Companies Act. The arrangement contemplated by the section includes a reorganisation of the share capital of the company. The arrangement under that section is very wide and can take a company out of winding up.[liv] The pendency of a winding up petition or even passing of a winding up order does not prevent the court from considering any proper scheme for rescuing the company[lv] or a scheme being considered by the creditors independently in usual course. The procedure for such compromise or arrangement is as follows:

(i) An application is to be made by the company, or any creditor or any member of the company to the court for an order to be made by the court for holding a meeting;

(ii) If a majority in number of three-fourths in value of the creditors or members, as the case may be, present and voting in person or by proxy agree to any compromise or arrangement, the scheme shall be binding;

(iii) If sanctioned by the court;

(iv) A certified copy of the order of the court is to be filed with the Registrar.

Where a High Court makes an order, it shall have the power to supervise the carrying out of the compromise or arrangement. Section 394 provides for facilitating reconstruction and amalgamation of companies.

6.1.3 THE SICK INDUSTRIAL COMPANIES (SPECIAL PROVISIONS) ACT

SICA 1985 was a special legislation enacted in public interest with the twin objects of securing the timely detection of sick and potentially sick companies and speedy

determination and enforcement of remedial measures. But some companies perceived SICA as an official exit route, thereby resulting into losses to creditors and increased NPA's in the banking sector SICA, 1985, was repealed by sick industrial companies (special provisions) Repeal Act, 2003. Many processions of SICA have been incorporated in chapter VIA (Section 424A-424L) is a considerably diluted form.

6.1.3.1 RESTRUCTURING UNDER SICA

Under the Act, BIFR was established to detect sick and potentially sick industrial companies, the speedy determination by a board of experts of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies.[19] The provisions under this special Act are only meant for Industrial Undertakings and not for any other companies. The procedure of restructuring is as follow:

(a) The undertaking must be a sick company meaning thereby that

  (i) a company registered for not less than five years;

  (ii) at the end of any year its accumulated loss is equal to or exceeds the total paid up capital and free reserve;

(b) The Board of Directors shall within 60 days from the date of finalisation of the audited accounts of the year in which the company has fallen sick, make a reference to the BIFR

(c) The BIFR may make inquiry into the working of sick industry either by itself or though an operating agency and may appoint one or more persons to be special director of the company for safeguarding financial and other interests of the company;

(d) The BIFR may make any of the following order: (1) If it comes to the conclusion that the company should be given reasonable time, may give reasonable time to the company to make its net worth higher than the accumulated loss; or (2) If the above is not possible, the BIFR may direct an operating agency to submit a scheme of reconstruction within 90 days which may concern the financial reconstruction; change in or takeover of management; amalgamate with any other company; sale or lease out rationalisation of management and personnel. (3) The scheme may provide for

[19] BIFR is constituted by the Central Government under Section 4 of the Sick Industrial Companies (Special Provision) Act, 1985.

financial assistance by way of loans, advances or guarantees or relief or concessions or sacrifices from the Central Government. (4) If BIFR comes to the decision that the company cannot be revived, it may record its opinion to recommend winding up on the ground of just and equitable and refer the matter to the appropriate High Court for winding up of the company.

(e) Similar provision have been incorporated in the case of possible or potential sick companies of at least 4 years standing and losing fifty percent of its net worth.

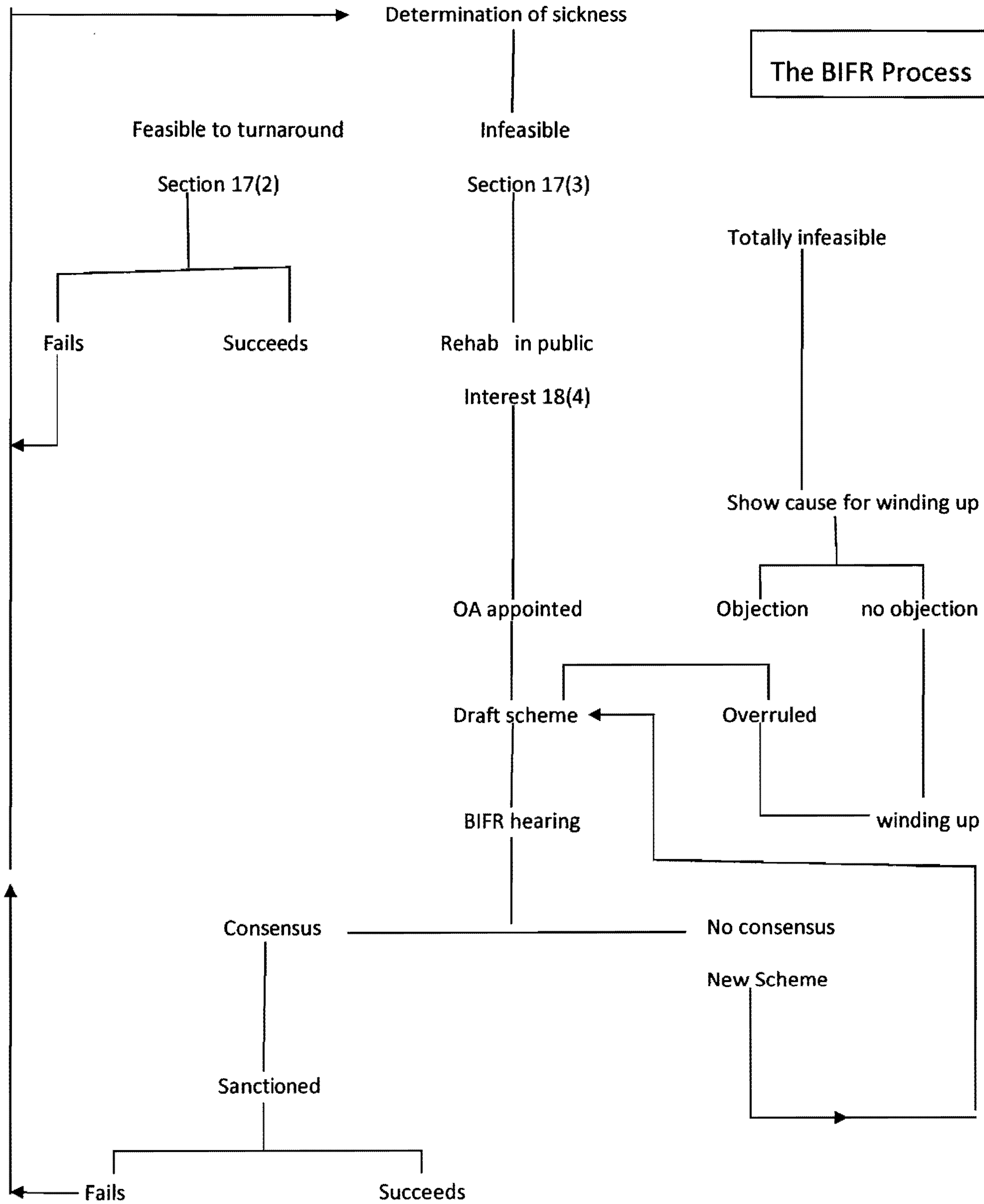
Once BIFR reaches the conclusion that the industry is sick, then the BIFR begins an investigation into the viability of the industry i.e., it tries to find out if by adoption of some scheme the sickness can be checked and cured. This viability study is done by inviting rehabilitation schemes prepared either by the promoters themselves or by some other new entrepreneurs or even by the workers co-operative.

The scheme so submitted is then subjected to intense scrutiny by experts in operating agency which usually a Financial Institution is having the necessarily skill and expertise. Once the agency submits a report, its recommendations are taken account of, after giving a fair hearing. The BIFR may adopt the 'sanctioned scheme' which may be to involve the assistance and co-operation of the Government, management, workers, financial institutions, banks etc. The assistance may take various shapes and forms, for example, it may be in the form of financial, technical or managerial assistance, or in the form of negotiation and counsel of the management and workers. Thus, the intention of adopting the new scheme is to remove root causes of the sickness and restore the health of the industry.

6.1.3.2 WORKING OF SICA

The main drawback of the SICA scheme is that it seemed to be so heavily loaded in favour of the debtor company that it created an asymmetry and imbalance between the interests of the debtor company and that of its creditor. Therefore, its restructuring had become necessary to undo this imbalance in keeping with the banking reforms. The definition of 'sick industrial company' in S.3(1)(o) and S.22 (i.e. suspension of legal proceedings against sick companies) of SICA and its judicial interpretation again in favour of debtor company, also contributed to create a situation, which culminated in repeal of SICA. As per S. 3(1)(o) 'sick industrial company' means an industrial company which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth and is registered for not less

CHART 1



than three years. The concept of 'sick industrial company' has been used, in many cases, by promoters and company management for preventing recovery and to avail of remissions and concessions, merely, by manipulating the accounts of the company in any financial year just to come within the purview of the definition of 'sick industrial company' as provided in SICA, and to escape from any further liability. Section 22 of the SICA provides for suspension of legal proceeding, contracts etc. with respect to the sick industrial company, in circumstance mentioned therein and with incidents specified under the provisions. The object of Section 22 is not to provide protection to unscrupulous persons; however, promoters and management of the companies have used this section as weapon to avoid payment to their creditors. These provisions apart, the elaborate procedure provided under the Act as also the spiralling pendency of the cases before the BIFR/ AAIFR resulted in near nullification of the object of the Act, a case proverbially, of a doctor attending the patient too late. The pendency and endemic delays also caused serious banking and labour concerns and increase in the cost of industrial restructuring/reformation.

Section 22 of the SICA accorded protection to the sick company from the legal proceedings both pending and future, if an inquiry in respect of the sick company was *pending* before the BIFR. This provision was judicially interpreted by the Supreme Court of India to include the protection to a Guarantor.[20] In an earlier judgment, the Supreme Court held that the protection under Section 22(1) of the SICA became applicable no sooner than the registration of the reference by the BIFR.[21] While the judicial interpretation was meant to give constructive and meaningful interpretations to the provisions of the SICA, it could not, as indeed it was not meant to, check the misuse of SICA and its 'usage as per convenience' of the erring promoters. Thus, while the courts enlarged the scope of the provisions of the SICA to aid industrial revival, it further incentivised the misuse of SICA by the erring promoters.

Thus, the working of the Act has brought into fore two main issues:

(1) The definition of sickness as defined in the Act; and
(2) The performance of the Board for Industrial and Financial Reconstruction (BIFR) since its constitution in 1987.

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[20] Patheja Brothers vs. ICICI reported in [2000] 26 SCL 404

[21] Real Value Appliances reported in JT [1998] 3 SC 715, the same This view was again followed by the Court in another judgment of *Rishab Agro Industries vs. PNB Capital Services Limited* reported in [2000] 25 SCL 461.

One criticism about the definition is that the detection of sickness comes very late at a stage where the company reaches the state where accumulated losses are large enough to wipe out its equity base and reserves. It becomes extremely difficult to design and implement a viable rehabilitation scheme.

The Justice Balakrishna Eradi Committee was appointed to look into the various aspects of the insolvency law. The Committee heard the views of Union Labour Secretary, Union Banking secretary, experts representing the financial institutions, Bankers' associations, representatives of BIFR, etc. The committee, after examining all the matters relating to insolvency laws and the concerns expressed by various bodies and experts, came to the conclusion that BIFR and its appellate body AAIFR have not been able to fulfil the purpose and mandate as envisaged under SICA of providing viable scheme for the revival and rehabilitation of sick companies in a reasonable short period of time. **The Eradi Committee took serious view of the matter that out of 3068 cases reported to BIFR from 1987 to 30th June, 2000, all but 1062 cases have been disposed of. The Committee noted that BIFR attempts to formulate scheme for revival and rehabilitation of sick industrial companies in consultations with the participating financial institutions, Banks and the secured creditors and that such steps usually take much more than two years.**[lvi]

In about 20% of the cases, the management tries to resort to accounting manipulation or do not come with clean hands and the reference to the Board is dismissed (the above table indicates that out of the 3068 cases 626 cases were dismissed). The absence of an independent Operating Agency also hinders the quick disposal of cases. The absence of assistance by a group of experts or an agency to undertake the viabilities of studies and propose revivals schemes and suitable funds for the BIFR is also attributed as a cause for its failure. The problem of delay is inherent in SICA procedures of revival and reconstruction is to great extent aggravated by the large-scale abuse of the provisions relating to suspension of legal proceedings, suits and enforcement of contracts and other remedies contained in section 22 of the Act. [22]

The main drawback of SICA scheme is that it leaves the debtor company in possession of the assets which creates an asymmetry and imbalance between the debtor company and its creditors conferring on the inefficient management an unmerited advantage. There are judicial decisions in support of the proposition that the pendency of a reference under section

[22] See Rishabh Agro Industries v. PNB Capital Services AIR 2000 SC 1735

16 of SICA does not create legal bar to the sick company disposing off its assets during such pendency.[23]

In line with the Eradi Report and long felt need and widespread criticism from different quarters, we saw the Companies (Amendment) Act, 2002 and repeal of SICA proposed to the new regime of tackling corporate rescue and insolvency procedures in India with a view to creating confidence in the minds of investors, creditors, labour and shareholders. The amended Act has suggested for change by combining the powers of the Courts, the BIFR and the CLB in one specialized NCLT in respect of liquidation of companies, schemes of arrangement/compromises and restructuring of sick companies, thus streamlining the regime. However, six years on, the intended Tribunal is yet to be constituted. Then we saw JJ Irani Committee Report 2005 formulated to review the laws concerning liquidation and restructuring of the companies recommended several revisions to the Companies Act, more particularly for a transparent and globally acceptable insolvency and restructuring procedures, almost three years have passed since the Irani Report was finalised and submitted, companies law currently being revamped, yet to be put in place.[24]

The Part VI A of the Companies Act, 1956 [25]aims to provide for a new, efficient and time bound mechanism for both revival/rehabilitation as well as winding up of sick industrial company within a reasonable period of time as against the existing system which takes about 18 to 25 years. The creation of rehabilitation fund for taking care of the workers of sick industrial companies and the investors as per the global standards, inclusion of experts and specialists in operating agency, National Company law Tribunal to act as winding up authority in contrast to BIFR, doing away with Section 22 of SICA, etc, would make the new provisions more effective and rational and would provide better mechanism for handling industrial sickness in the country which is one of the biggest problems plaguing the Indian Economy. But the successful implementation of Part VI A will be the responsibility of not only the Tribunal and its Appellate Authority but also of the Governments, creditors, lenders, financial institutions, banks and all those concerned with restructuring and rehabilitation of sick industrial companies. As a matter of caution, it must be remembered that BIFR was not the only body responsible for slow and poor implementation of SICA, but creditors, debtors

[23] AIR 1995 SC 1484

[24] Dr. J.J. Irani Report on Company Law, submitted to Ministry of Corporate Affairs, in May, 2005. Also available at http://www.primedirectors.com/pdf/JJ%20Irani%20Report-MCA.pdf

[25] incorporated by the Companies (Second Amendment) Act, 2002 (the date of commencement of which is yet to be notified; so far only Sections 2 and 6 have been notified)

Governments, banks and financial institutions were equally responsible as evident from the submissions made before Justice Eradi Committee. Although the new provisions are marked departure from the old provisions under SICA as well as marked improvement over SICA and it appears to be very promising, the responsibility for its successful implementation lies on all the parties concerned.

6.1.4 WINDING UP

The Companies Act, 1956 provides for four kinds of winding up namely:

(i) Members' voluntary winding up;
(ii) Creditors' voluntary winding up; and
(iii) Winding up by the Tribunal[26];

Winding up procedure aims to expedite the sale of assets and distribution of the proceeds. The international trend in law relating to corporate bankruptcy deals with selling the assets first as quickly as possible and relegate to a later stage the adjudication of claims and distributions of proceeds. Winding up is a means of dissolving a company.

6.1.4.1 UNABILITY TO PAY "DEBT"

Section 433(e) of Indian Companies Act 1956 deals with the tools available to the creditors where the company is unable to pay its debts. The creditors in that case can approach the court of law to get the company wound up in order to recover its debt. Section 433 specifies the grounds on which a company may be wound up by the court. Clause (e) of the section specifies one such ground namely, when the company is unable to pay its debts. Inability to pay debts is the most common ground for winding up of a company. The meaning of the term "debt" has been so elaborated by Lindley L.J., "a debt is a sum of money which is now payable or will become payable in the future by reason of present obligation".[27] In another case,[28] it was held, "in order to bring the case within the purview of clause (e) the court must be satisfied in the first instance that, there are in fact debts in the sense that there is a liability of the company in present". The Court also rejected as too broad a submission the contention

[26] According to Section 425 of the Indian Companies Act, the winding up of a company can be done by the Tribunal or can be wound up voluntarily.
[27] Webb v. Stenton (1883) 11 QBD 518 CA
[28] Registrar of Companies v. Kavita Benefit Pvt. Ltd, 48 Comp. Cases 231

that liabilities which may crystallise in future would also be relevant for the purpose of determining whether the company is unable to pay its debts.

The word debt cannot be extended to include unliquidated damages or an unidentified sum incapable of ascertainment immediately. It must be a definite and ascertained sum. A Company is deemed unable to pay a debt if the company is unable to pay the debt exceeding rupees five hundred after expiry of 3 weeks from the date of issuing of the notice claiming the payment by the creditor. Section 343 deals with the position when a company shall be deemed to be unable to pay its debts. The section deals with following provisions:

6.1.4.1.1 STATUTORY NOTICE

If a creditor to whom the Company owes a sum, has served on the company a notice demanding payment, and the company neglects to pay or otherwise satisfy him then, such a creditor can approach the court for an order of winding up. The debt must be really due and presently payable. If there is a *bona fide* and reasonable dispute as to a substantial part of the debt on which the petition is based, winding up will be refused, because, "when a debtor company believes even wrongly that it justified in law to refuse payment, such a refusal cannot be regarded as neglect to pay". Where a petition to wind up a company is to bring pressure upon the company in order to make it pay the petitioner cheaply and expeditiously, when the company desires to dispute the debt in the civil court, the petition is an abuse of the process of the court and is liable to be dismissed[29].

The effect of a notice under section 434 is to raise a presumption under the statute as to the inability of the company to pay the debt and its consequent insolvency, rendering the company liable to the extreme penalty of losing its existence by being compulsorily wound up by the court. In this connection the following observation of the Supreme Court sums up the law succinctly[30]: "The wishes of the creditor will be tested on the ground whether the case of the persons opposing the winding up is reasonable. Secondly, whether there are matters which should be inquired into and investigated if a winding up order is made. It is also well settled that a winding up order is not made on a creditor's petition if it would not benefit him or the company's creditors generally".

[29] P. Satyarazu v. Guntur Cotton Mills, AIR 1925 Mad. 199

[30] Ray J., in M. Gordhandas & Co. v. Madhu Woolen Industries (P) Ltd., AIR 1971 SC 2600

6.1.4.1.2 DECREED DEBT

A company is deemed as being unable to pay its debts if execution or other process issued on a decree or order of any court in favour of a creditor is returned unsatisfied in whole or in part. This is also a ground on which a creditor can file a petition for winding up. It may be noted here that a creditor may not choose to proceed under this provision and may instead serve a statutory demand under section 434(1) (a).

6.1.4.1.3 COMMERCIAL INSOLVENCY

If it is proved to the court that the company is unable to pay its debts, an order for the winding up of a company may be made. It has been held that for obtaining an order for winding up on this ground it should be shown that the company is, "plainly and commercially insolvent, that is to say that its assets and existing liabilities are much as to make the court fully satisfied that the existing and probable assets would be insufficient to meet the existing liabilities". Here it may be noted that what has to be ascertained is not whether the assets of the company if converted into cash would be sufficient to meet its liabilities, but whether the company is insolvent in a commercial sense, i.e., a perusal of the balance sheet of the company must show that its assets are not sufficient to meet its liabilities. This however is not a rigid formula and the court may refuse to hold the company insolvent on other considerations including that of public interest. Thus we can see that section 434 splits the concept of inability to pay debts under three sub-headings. This however, does not mean that these clauses are mutually exclusive. It was held in a case[31] that even if a creditor has obtained a decree, he can claim winding up under any of the other grounds and need not confine himself to the category of decree holders only.

6.1.4.2 MEMBERS' VOLUNTARY WINDING UP

A company may go for voluntary winding up by passing a special resolution, submitting a statement of solvency and appointing one or more liquidators for such purpose. The liquidator shall forthwith summon a meeting and prepare a statement of assets and liabilities of the company in order to proceed with the task of winding up proceedings.

[31] Seethai Mills Ltd. V. M. Perumalsamy, (1980) Comp. Cas. 422(Mad.)

6.1.4.3 CREDITORS' VOLUNTARY WINDING UP

If the members of the company resolving to go for voluntary winding up cannot submit a certificate of solvency the voluntary winding up procedure is regulated by the creditors with the help of a liquidator or liquidators appointed by the creditors. Both Members' voluntary winding up and creditors' voluntary winding up are cost and time efficient modes of liquidation.

6.1.5 STRIKING THE NAME OFF THE REGISTER

Apart from the aforesaid procedures of exit, there is another easy way of exit according to the provisions of section 560 of the Companies Act which provides for striking the name of the company off the register. This section provides that where the Register of Companies has reasonable cause to believe that a company is not carrying on business or in operation, he shall send to the company by post a letter inquiring whether the company is carrying on business or in operation. This letter should be followed by a reminder and if no answer is received the Registrar shall publish a Notice in the Official Gazette with a view to striking the name of the company off the Register. If the Registrar either receives answer from the company to the effect that the company is not carrying on business or in operation or does not within one month after sending the second letter receive any answer, he may publish in the Official Gazette and send to the company by a Registered Post a notice that on the expiration of three months from the date of that notice the name of the company mentioned therein will be struck off the register and the company will be dissolved unless a cause is shown to the contrary.

Further if in any case where a company is being wound up, the Registrar has reasonable cause to believe either that no liquidator is acting or that the affairs of the company have been completely wound up and any returns required to be made by the liquidator have not been made for a period of six consecutive months, the Registrar shall publish in the Official Gazette and send to the company or the liquidator, if any, a like notice as is provided in sub section (3) of section 560. At the expiry of the time mentioned in the notice referred to in sub-section (3) or (4) of section 560 the Registrar may, unless cause to the contrary is previously shown by the company, strike its name off the register, and shall publish notice

thereof in the Official Gazette and on the publication in the Official Gazette of such notice the company shall stand dissolved.[32]

6.1.6 WINDING UP BY THE TRIBUNAL

According to section 439 a petition has to be filed for the purposes of winding up by the court. The persons who may file such a petition are the following: (a) the Company; (b) Creditors; (c) Contributories; (d) Registrar and (e) the Central Government. In so far as the first three are concerned the section also says9 that a petition may be presented by all or any of them, meaning thereby that it is not necessary that petition under section 439 must always be presented by only "one" of them. All or any of them together may present a joint petition on the prescribed grounds.

6.1.6.1 CONDUCT OF WINDING UP PROCEEDINGS

Every winding up, whether it be by the Court or a voluntary winding up, is conducted in accordance with set rules and pattern. One of the first acts undertaken in a winding up is the appointment of a Liquidator, who takes under his charge all of the Company's assets and manages the affairs of the Company in a manner which would prove to be the most beneficial to the interests of the creditors, shareholders and the Company itself. Since a Liquidator is required to take into his charge the assets of the Company, he has the right to apply to the Court for recovery of any property of the Company in possession of other person. One of the most important assets of the Company is the 'uncalled capital' of the Company, because as Section 36(2) specifies, "all money payable by any member to the Company ... shall be a debt due from him to the Company". If some amount remains unpaid on the shares of a member, the Liquidator has the power to make a call on those shares. For this purpose, a Liquidator has to draw up a "list of contributories". A contributory is defined under Section 428 as " a person liable to contribute to the assets of a Company in the event of winding up and includes the holders of any shares which 9 Clause(d) of Section 439. are fully paid up". Of these contributories, the Liquidator has to make two lists: List A of the present members and List B of the past members.

[32] The procedure for striking off the company's name has been simplified under "Fast Track S. 560 Scheme". A defunct company's name may be struck off the register under section 560 within one month on compliance of certain formalities and payment of a lump sum fee for filing the overdue statutory documents/returns.

6.1.6.2 LIABILITY OF CONTRIBUTORS UNDER LIST A

List A is drawn up on the basis of the names appearing in the "Register of Members", at the time of commencement of the winding up proceedings. . If a person knowingly allows his name to appear on the register, he is later stopped from denying his liability as a member, i.e., he cannot be permitted to plead that though his name appears on the register he is not in reality a member. Such is the case because, a member's liability during winding up does not arise *ex contracta* (from a contract) but is *ex siege* (by virtue of his name appearing on the register). The situation, however, would not be the same if there is a total absence of an element of contract, for example, if shares are allotted to a person without his applying for them. In such situations, the Liquidator cannot place his name on the list of contributories.[33] Here it is important to note that although a member may owe the Company some money on the face value of his shares, he cannot be forced to pay anything until and unless there is a Court order to that effect and the Liquidator serves a call notice on the member in accordance with the order.[34] Such an order will be passed by the Court only if it is assured that the financial situation of the Company is so bad that unless such a call is made, the liabilities of the Company cannot be discharged [Section 470(1)]. The Liquidator, however, can make a call on the shares without sanction of the court in case the winding up is voluntary. Once a valid call is made by the Liquidator, the contributories' liability becomes a statutory debt, i.e., a new liability to pay the unpaid balance commences. In one case[35], it was observed thus: "It is settled in a long course of decisions that the members of a Company in liquidation are liable in respect of unpaid calls even though the calls were made by the Company before it went into liquidation and the suit of the Company for its realisation had become barred by time. The principle of these decisions is that Section 429 creates a new liability on the shareholders in respect of such calls, which is distinct from and independent of the rights which the Company had against them before the winding up."

Certain other points to be noted in regard with liability of present members:

a) If the list does not include a person's name, he may give notice to the Liquidator to make good the default. If the Liquidator fails to act within 14 days, the Court can issue necessary directions under Section 556.

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[33] H.H. Manabendra Shah v. Official Liquidator, (1977) 47 Comp Cas 356(Del).

[34] In re Sonardih Coal Co. Ltd., AIR 1930 ALL 617

[35] Pokhar Mal v. Flour and Oil Mills Co. Ltd. AIR 1934 Lah 1015

b) If a contributory dies either before or during winding up proceedings, then his liability automatically passes on to his legal representatives [Section 431].

c) If a contributory is adjudged insolvent, his place is taken by his assignee in insolvency proceedings [Section 431(1)].

d) If the contributory is a Company which is itself in the process of being wound up, the Liquidator of this Company will be the contributory on behalf of the Company.

6.1.6.3 LIABILITY OF PAST MEMBERS

Under certain specified circumstances even the past members may be held liable as contributories, in accordance with the qualifications and conditions laid down in Section 426 which are the following:

1) If a past member has ceased to be a member for more than a year before the commencement of winding up proceedings, he cannot be made liable;

2) The liability of a past member is limited to only those debts which were incurred by the Company during the period when he was a member that is he cannot be made liable for any debts incurred by the Company after he ceased to be a member;

3) A past member's liability to contribute does not arise unless, in the opinion of the Court, the present members cannot satisfy in full the Company's liabilities. Thus, the liability of past members is only secondary, the primary liability being that of the present members.

6.1.6.4 UNLIMITED LIABILITY OF SOME OFFICERS

This has been dealt with by section 427. Here it is interesting to note the provisions of section 322 which lays down that even in the case of a limited company the directors or managers are to have an unlimited liability if a specific provision to this effect is present in the Memorandum. Such members are not only liable as an ordinary shareholder in winding up proceedings, but are also required to make additional contribution as if they are members of an unlimited Company. The unlimited liability attaches to both present and past officers but in case of past officers qualifications under Section 426 apply.

6.1.6.5 PAYMENT OF LIABILITIES BY LIQUIDATOR

Once the Liquidator makes a call, collects the unpaid call money, converts the assets into cash, and determines the value of total available assets and the extent of the Company's debts, his primary duty then becomes the paying off of the liabilities of the Company. Any person having a claim against the Company has the right to claim it from the Liquidator. A secured creditor need not go through the usual channels for claiming his debt since he has the right to realise his security in settlement of his claim, but he is required to compensate the Liquidator for expenses incurred by him in preserving the security from being realised by other creditors. But he has been given an option of relinquishing his security and proving his claim like the other unsecured creditors. Previously, under this scheme, a secured creditor could override the claims of all other creditors, including the legitimate claims of the workmen. But since the Amendment Act of 1985, which amended Section 529, workers' claims are now equated with those of the secured creditors, by providing that the security of every creditor shall be subject to a *pari passu* charge in favour of the workmen, i.e., whenever a secured creditor wants to **20** enforce his security, the Liquidator shall have the power to represent the workmen in order to enforce the presumed charge in their favour. The amendment Act further added section 529-A providing for payment of the workmen's dues in priority of *all* other dues, and if the available assets are not sufficient to pay off all the liabilities in full, the payment shall abate in equal proportion. Section 530 which provides for 'preferential payments' has also been made subordinate to the provisions of Section 529-A. Once the Liquidator settles the list of claimants, i.e., persons to whom the Company owes money, he or she is required to start making payments to them out of the available assets in hand.

6.1.6.6 PREFERENTIAL PAYMENTS

Section 530 of the Companies Act specifies certain payments in priority to all other debts subject to payment of workmen's dues and debts due to secured creditors on a *pari passu* basis. This is a very important provision for the purposes of the present discussion as it brings out the pro-creditor and pro-dispensation bias of the Indian law. The payments to be made first are called 'preferential payments'. They have to be paid in priority to all other debts.[36]

[36] These debts are:

After retaining sums necessary for meeting the costs and expenses of winding up, the above debts have to be discharged forthwith to the extent assets are sufficient to meet them. Where the Liquidator carries on business for beneficial winding up, the taxes that become due on the profits are expenses of winding up. The fee payable to a chartered accountant for preparing the statement of affairs is also an expense of winding up. The preferential claims rank equally among themselves and have to be paid in full. But when the assets are Insufficient to meet them, they shall abate in equal proportion. By virtue of the provision in Section 178 of the Income Tax Act, 1961, Income Tax authorities have been claiming preference over other preferential **21** payments. But the Courts have always held that there is nothing in the Income Tax Law which interferes with or abrogates the provisions for priority of debts laid down in Section 530(1)(a) of the Companies Act.

6.1.6.7 INSOLVENCY LAWS AND PREFERENTIAL PAYMENTS

If a Company is being wound up on grounds of insolvency section 529 becomes applicable providing for application of insolvency laws to the payment of debts of the insolvent Company. Section 46 of the Provincial Insolvency Act, 1920 provides that if there have been mutual dealings between the debtor and the insolvent (creditor), only that amount which remains after giving a set-off can be recovered from the debtor. This right of set-off is also available to insolvent companies regardless of the provisions of See. 530. This apparent

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1. All revenues, taxes, cesses and rates due to the Central or a State Government or to a local authority. The amount should have become due and payable within twelve months before the winding up.
2. All wages or salary of any employee, in respect of services rendered to the Company and due for a period of four months only within twelve months before the winding up and any compensation payable to any workman under Chapter V-A of the Industrial Disputes Act, 1947. The amount is not to exceed one thousand rupees in the case of any one claimant.
3. All secured holiday remuneration becoming payable to any employee on the termination of his employment before, or by the effect of the winding up.
4. All amount due in respect of contributions payable during the twelve months before the winding up, under the Employees' State Insurance Act, 1948 or any other law.
5. All amounts due in respect of any compensation or liability for compensation under the Workmen's Compensation Act, 1923 in respect of death or disablement of any employee of the Company.
6. All sums due to any employee from a provident fund, a pension fund, gratuity fund or any other fund for the welfare of the employees maintained by the Company.
7. The expenses of any investigation held in pursuance of Section 235 or 237 in so far as they are payable by the Company.

conflict between Sections 529 and 530 was attempted to be resolved by the Supreme Court in *Official Liquidator v. Laxmikutty.*[37]

Finally, if any surplus amount is left it is utilised in paying back the shareholders in accordance with their rights, with the 'preference shareholders' being paid off first wherever the articles provide that the preference shareholders would be entitled to their arrears of dividends whether earned, declared or not in the event of winding up. Such a provision would entitle them to claim arrears even if the Company had neither commenced business nor earned any profits.[38] This dividend which is paid to the members is not construed as their income but deemed to be a refund of capital, even in cases where the dividend includes profits earned by the Liquidator [cases where he carries on the Company business for a more beneficial winding up]. If dividends remain unclaimed by either the creditors or contributories for a period of 6 months they should be deposited in the Reserve Bank, from where they can be claimed by any person after obtaining a Court order. If the dividends remain unclaimed for a period of 7years the amount is transferred to the Investor Protection Fund [section 205C].

6.1.6.8 FRAUDULENT PREFERENCE

Under the insolvency laws we have a concept of 'fraudulent transfers' which implies that a transfer or conveyance made by a debtor in favour of some particular creditor with intention to give a preferential treatment to that creditor or to defraud other creditors, such a transfer would be void if made within 3 months of an insolvency petition being presented against him and he is adjudged an insolvent. This concept of 'fraudulent transfers' is present in Company law also under section 531 and states that any transaction with a creditor entered into by a Company in preference of other creditors within six months prior to the date of

[37] In this case the Supreme Court held;
"It is true that section 530 provides for preferential payments, but the provision cannot in any way detract from full effect being given to section 529 and in fact the only way in which these two sections can be reconciled is by reading them together so as to provide that whenever any creditor seeks to prove his debt, the rule enacted in Section 46 of the Provincial Insolvency Act would apply and only that amount which is ultimately found due from him at the foot of the account in respect of mutual dealings should be recoverable from him and not that the amount recoverable from him should be recovered fully while the amount due to him should rank in payment after the preferential payments. We find that the same view has been taken by the English Courts on the interpretation of the corresponding provisions of the English Companies Act, 1948, and since our Companies Act is modelled largely on the English Companies Act, we do not see any reason why we should take a different view, particularly when that view appears fair and just".
[38] Globe Motors Ltd. v. Globe United Engg. and Foundry Co. Ltd., (1975)45 Com Cases 429(Del)

commencement of winding up is to be deemed a fraudulent preference of its creditors and is accordingly invalid. But if a Company makes payment to a creditor who is pressurising the Company with a threat of a suit and attachment of property, then such a payment cannot be called 'fraudulent' provided the debt was really due.[39] In the final analysis, whether a transaction is fraudulent or not depends entirely on the 'intention of the debtor' and nothing else. Further, under See. 532 a transfer or assignment by a Company of all its properties to a trust/trustee for the benefit of all its creditors is also void.

6.1.6.9 VOLUNTARY TRANSFER

Under Sec. 531 -A, a transfer of property whether movable or immovable or any delivery of goods by the Company within a period of one year prior to the presentation of a winding up petition is void as against the Liquidator, unless the following conditions are satisfied:
a) the transfer/ delivery was made in the usual course of Company business; and
b) the transfer was in favour of a purchaser or encumbrancer in good faith and for real and valuable consideration.

6.1.6.10 TRANSFER OF SHARES

When a Company is undergoing voluntary winding up, any transfer of shares or change in the status of member after commencement of such proceedings is void, unless a prior permission of the Liquidator is taken (Sec. 536). The same position prevails in case of winding up by Court or under supervision of Court, with the difference that such a transfer is valid if permission of Court is obtained either before or after the making of the transfer. In respect of attachments executions etc., the Liquidator has been given a free hand in deciding what is just, fair or reasonable in all such cases of transfers (either of shares or property), attachment,

[39] Official Liquidator v. Venkatratnam [(1996) 1 Comp LJ 243 (Andh.); "one of the creditors of a motor transport company sued the Company for debt and attachment of its buses before delivery of judgement. A compromise decree was passed by the Court, under which three of the Company buses were given to the creditor. A few days later the Company went into liquidation. The Liquidator claimed the buses back on the ground that it was a fraudulent preference of creditors and hence the transfer was invalid. Rejecting the claim the Court said: "If a debtor prefers one creditor to another on account of pressure that is put upon him, the payment cannot be regarded as a fraudulent preference .... Persons in charge of the management thought that it is profitable to discharge the debts by allotting some of the buses to the creditors".

distress of property or execution put in force without leave of Court, after commencement of winding up. Such transfers can be avoided (See. 537)[40].

6.1.4.11 PROCEEDINGS AGAINST DELINQUENT OFFICERS

Once a Company goes in for winding up, the Liquidator takes into his charge all the books and papers of the Company. While going through these books or during the course of his investigation he may come across information about the underhand dealings of some of the officers. These dealings may be either in their self interest or in connivance with the company defrauding the creditors either in general or at least some of the creditors by giving a preferential treatment to one or more creditors. When the Liquidator comes across these instances he has been given the power under various sections of the Act to prosecute these defaulting/delinquent officers and in some instances he can also make them pay back to the company the amount which the Company has lost due to their default (be it intentional or unintentional i.e., through negligence). The basic objective of these provisions seem to be that the Directors and other officers of the Company owe a fiduciary duty towards the Company and hence should be held liable when they fail in their duty by not acting in the best interests of the Company, creditors and shareholders. Since a Liquidator takes the overall charge of the Company on his appointment, he is automatically put in a fiduciary position and so is duty bound to prosecute such officers.

6.1.6.12 WORKMEN'S RIGHTS AND DUES

The rights of the workmen also figures up in the case of winding up of a company.[lvii] In National Textile Workers' Union v. Ramakrishnan[41] the Supreme Court held that the workers

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[40]The effect of this section was seen in *Rajratna Naranbhal Mills* v. *New quality Bobbin Works* [(1973)43 Comp Cas 131 (Guj) where a suit for recovery of debt was filed against the Company by a creditor who also got some shares of the Company attached on the same day. Later, a winding up petition was presented against the Company. After this, but before passing of a final order, a consent decree was passed in execution of which these attached shares were sold and a winding up order was passed later, and the Liquidator sought an order declaring the sale of shares as void and the consequential relief of recovery of the sale proceeds. Under section 537(1) any attachment or sale of a Company property without sanction of Court after commencement of winding up is void. and under See. 441(2), the commencement of winding up is from the time of presentation of petition. In view of these provisions, the Court had no option but to declare the sale void (as it had taken place after commencement of winding up) and the Liquidator entitled to the sale proceeds.

would be entitled to be heard in the matter of a petition to wind up a company as interveners and not as parties. The Court further held that after the winding up order was made, the workers could appeal against it, but once the order became final, the workers could not participate in any further proceedings in the course of winding up. It is normal that the winding up of a company will throw a large number of workmen out of employment. In such cases the court will be reluctant to order winding up and will try its best to explore all possibilities to keep the company going. Where the number of workmen is very small, the court may not follow this approach.[42]

Workmen are entitled to compensation under section 25-FFF of the Industrial Dispute Act since the closure of the company is consequent to the orders of winding up and not due to unavoidable circumstances beyond the control of the employer.[43] The workmen become secured creditors by operation of law as soon as the winding uporder is passed. They have a *pari passu* charge over the security which is held by the secured creditors under section 529. The workmen are entitled to an interest on the amount due to them at 12% per annum and rule 179 of the Company Court Rules which stipulate the interest at the rate of 4% per annum does not apply to worker who are secured creditors by operation of law.[44] The Companies Act now provides an overriding preferential treatment for the workmen's dues. Moreover, the amount of tax dues on capital gains arising out of the sale of the company's assets cannot be regarded as expenses incurred in winding up. The company cannot appropriate the amount towards costs so as to reduce the fund available for the workers' dues.[45]

6.1.6.13 Official Liquidator

Under the scheme of the Companies Act, 1956, in case of a company wound up by the High Court, the Official Liquidator (OL) becomes its liquidator (section 449). The OL is appointed by the Central Government in terms of section 448 and all matters relating to winding up of companies wound up by court are administered by him under the supervision, control and

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[41] (1983) 53 Com Cases 184. This decision was also followed in Katha Factory Mazdoor Sangh V. Laxmi Industrial & Trading Co. P. Ltd., (1988) 2 Comp LJ 67(All); Narendra Glass Works (p.) Ltd. V. M.P. Beer Products Pvt. Ltd., (1989) 65 Com Cases 396 (MP)

[42] Indian Turpentine & Rosin Co. Pioneer Consolidated Co. of India Ltd., (1988) 64 Com Cases 169, 183(Del)

[43] Shree Madhav Mills Ltd., In re, AIR 1967 Bom 219; this view was dismissed in Shanmugam (A.) v. Official Liquidator, (1992) 75 Com Cases 181, 195(Mad)

[44] S. Anthony Raj v. Shanmugam, (1994) 80 Com Cases 531 (Mad-DB).

[45] Polyolefins Industries Ltd. v. Kosmek Plastics Mfg. Co. Ltd., (1999) 98 Com Cases 481

direction of the court. OLs, Deputy Liquidators (Dy. OLs) and Assistant Official Liquidators (AOLs), belonging to Indian Company Law Service (Legal and Accounts branches) are appointed by the Department of Company Affairs depending upon the work load of each office. With the growth of the corporate sector in India, corporate mortality rate has also increases and OLs have been over-burdened with a large group of companies, in liquidation. The causes for the delay of the winding up proceedings can be attributed to the following:

(1) Delay in filing of Statement of Affairs under section 454 by the directors and officers of the company.
(2) Delay in handling over up-dated books of account and records by the management to the OL.
(3) Delay in realisation of debts
(4) Delay in taking over the possession and sale of assets.
(5) Non-availability of funds to meet the routine expenses of OL.
(6) Delay in settlement of list of creditors.
(7) Delay in the settlement of the list of contributories and payment of calls.
(8) Delay in finalisation of Income Tax proceedings.
(9) Delay in disposal of malfeasance proceedings under section 543(3).
(10) Long drawn court proceedings.
(11) Insufficient powers of the OL.
(12) Inadequate staff.

6.2 COMPARATIVE NOTE

The Indian position on corporate insolvency unfortunately does not have an substantial provision, barring a few exception in the Companies Act dealing with the winding up of foreign companies, that deal with issues articulated in this chapter. It is also lacking when on issues relating to cross-border insolvency. With the rapid growth of trade and commerce, which has transgressed all territorial and jurisdictional boundaries, corporate business is no longer seen as a matter of domestic concern. The Indian law, however, provides for situations where in a foreign company can start business in India. What it failed to foresee, and consequently provide for, was the possible insolvency of these foreign firms. It is not only the bankruptcy of foreign firms that fall under the realm of cross border insolvency but also bankruptcy proceedings wherein the assets and liabilities are distributed in more than one jurisdiction. The law needs to be attuned to the present

needs of the market. Restructuring and winding up principles have emerged over the past few years. These new trends need to be incorporated into the Indian legal framework.

Unlike the United States, which has a comprehensive code since 1978, the Indian law does not cater to the international issues on insolvency. In the light of the new development in international insolvency, a country like India needs expeditious change so as to upgrade and consolidate the bankruptcy. This involves an examination of not only SICA and Companies Acts but also the Recovery of Debts due to Banks and Financial Institutions Act, 1993, the Securities Contract (Regulation) Act, 1956 and the recommendations of the United Nations and International Monetary fund report "Orderly and Effective Insolvency Procedures – Key Issues".

CHAPTER 7

SUGGESTIONS AND CONCLUSION

7.1 SUGGESTIONS

As said earlier, the aim of the researcher wanted to study issues in corporate bankruptcy and evaluate the corporate bankruptcy law of India in view of those principles. Various high level committees are at the moment deliberating what an ideal code must envisage. The Indian position on corporate insolvency unfortunately does not have any substantial provision, barring a few exceptions in the Companies Act dealing with the winding up of foreign companies etc. With the rapid growth of trade and commerce, which has transgressed all territorial and jurisdictional boundaries, corporate business is no longer seen as a matter of domestic concern.

7.1.1 Bankruptcy: a separate branch of law

Bankruptcy law should be developed as an independent branch of law. A separate comprehensive Bankruptcy Code is required to deal with corporate bankruptcy.[lviii] Bankruptcy law and practice, therefore, has to be based not on adversarial process but to create a new ambience to either make a restructuring possible on renegotiations or initiating fast track insolvency and winding up proceedings. Hence, the same is not to be a part of the Companies Act; because of the fact that a wholesome Bankruptcy code shall facilitate corporate restructuring, fast track winding up on insolvency,, only compromise, arrangement and reconstruction at the instance of creditors (under sections 391 to 395 of the Companies Act) and voluntary winding up by members may be kept under the Companies Act and transferring the whole of the rest of winding up system to the Bankruptcy code.

New Bankruptcy Code should deal with restructuring of the companies acceptable to all parties through renegotiations replacing Sick Industrial Companies Act. In the changing situation of growing cross-border investment, trade and commerce, cross-boundary entities or ventures as well as foreign entities having Indian subsidiary and ventures. A comprehensive Bankruptcy code is bound to address such issues taking into consideration international practices. The code as such may be a creditor friendly keeping in mind that in India we have an imperfect market and the importance of credit system of India.

Bankruptcy proceeding should be based on the fundamental objective of asset maximisation and hence the law has to facilitate protection of assets against all risks of further decay and destruction.

7.2 OTHER SUGGESTIONS

The suggestions contained herein are largely those which have been suggested by various committees on bankruptcy and specially the Advisory Group on Bankruptcy.[lix]

- **A Comprehensive bankruptcy code:** There should be comprehensive corporate bankruptcy code which will incorporate the provisions relating reorganisation on renegotiation (similar to Chapter XI proceedings of US Bankruptcy Code), corporate insolvency leading to winding up and liquidation of a corporate entity and settlement of all other related issues including cross-border claims and counter claim settlement and cross-border corporate insolvency.
- **Companies Act:** Upon enacting a comprehensive Bankruptcy code, the provisions of Companies Act can be streamlined and simplified which would contain company formation, capitalisation and finance, management, corporate governance, accounts and accountability issues, investors' protection, reorganisation on bipartite renegotiations and enabling provisions for winding up according to Bankruptcy code.
- **SICA:** Since the comprehensive code shall include all issues relating to corporate bankruptcy, restructuring, renegotiations, restructuring and liquidation institutions, fast track procedure of liquidation, there should be complete repeal of Sick Industrial Company (Special Provisions) Act and abolition of BIFR. The existing proceedings pending before the BIFR should be transferred to the Bankruptcy court having jurisdiction.
- **Bankruptcy Institutions:** There should be provision for appointment of a professional bankruptcy institution, known as the Trustee, to be appointed by the Bankruptcy court from a designated panel for conducting restructuring on voluntary basis and failing restructuring, to initiate fast track liquidation. The trustees can be appointed only from professional bodies like Chartered Accountants firm, law firm, cost accountants of company's secretaries' organisation, a financial institution, companies having professional expertise and corporate managers' organisation. Again, the Trustees

appointed this procedure shall be governed by the bankruptcy code to the exclusion of any other central or state Act governing the Trustee.

- **Trustees' role as administrator/regulator of the entity:** This is the critical questions in bankruptcy cases that who shall remain in custody of the corporate properties and administer the same once there is a bankruptcy petition. The most critical provision in the SICA is that the promoter/management bringing the entity to the BIFR remains in possession and creates incentives for stripping off assets. Therefore, creditors are against most restructuring proposals. It is therefore recommended that if the owner/promoter/existing management files the petition for the bankruptcy of a company, the possession of the company with its entire assets and liabilities must be vested with the Trustee immediately without any loss of time. That ensures the first principle of maximisation of asset value. If a creditor files the petition the possession of the company's assets and liabilities shall vest on the Trustee as soon as the petition is allowed.
- **No office of liquidator:** The office of the official liquidator shall be closed and all powers and functions therein shall be exercised by the Trustee.
- **Trigger point:** The immediate trigger point is *the cash test*. The test provided in Section 434 of the Companies Act explaining when a company is deemed to have been unable to pay a debt, is a trigger point, simple and self-evident. Therefore, such a trigger test is the best. It is suggested that a minimum default limit *be raised to rupees one lakh* from the present prescription of rupees five hundred. Therefore, if a company fails to pay a debt of not less than rupees one lakh, on the claim being due, as soon as the payment is rightly asked for or is unable to secure it, the trigger is immediately operative.
- **Applicant for bankruptcy proceeding:** Once the trigger of a cash test is operative, the debtor itself or the concerned creditor may apply for bankruptcy proceedings. Whenever on the basis of audit accounts or other information available to the management it is satisfied that it is not in a position to pay its liabilities the management must bring the matter before the Board of Directors. If they fail to do so, they shall be personally liable for the payment of the liabilities. The Board shall make independent examination as to whether the company is competent to pay or not and this examination concludes that the company is unable to pay; the Board shall apply for bankruptcy proceedings. In case of any delay or non-observance, the members of the Board shall be personally liable for such liabilities. Such failure on the part of the Board of Directors renders them unfit to hold similar position in any company.

- **Coverage of Bankruptcy Proceedings:** A bankruptcy application is for starting a renegotiation for reorganisation, rescheduling payments, restructuring the organisation and failing of renegotiations proceed to corporate insolvency, winding up and liquidation of assets and payment of liabilities and dissolution of – the organisation in a strictly time bound manner.
- **Judicial institution:** The country needs a uniform and unitary judicial system in bankruptcy matters including validating the reorganisation attempts on voluntary basis with parties agreeing to readjust their respective rights and obligations. Hence, there should be a dedicated bench at every High Court to deal with issues in bankruptcy. The proceedings of the Bench shall be on a stipulated time basis.
- **Reorganisation**

  (i) The reorganisation proposal is formulated on two principles: (a) the voluntary principle; and (b) proportionate right in relation to the claim based on his realisable claim arising from absolute priority rule.

  (ii) A reorganisation plan can be considered provided 50% of the members attending and voting and having 75% of the total realisable claim agree to accept the proposal.

  (iii) The scheme must provide for dissenting claim holders to be paid or made secure their share of the realisable claim. As for example, suppose the approved realisable value of all assets is Rupees one lakh.
- **Power and function etc. of the Trustee:**

  (a) The Trustee shall have the power to appoint any expert for the purpose of conducting bankruptcy proceedings and matters incidental thereto.

  (b) The Trustee may itself draw a scheme for restructuring and place the same before the parties for guiding renegotiation or may receive restructuring plan for discussion from both the debtor and the creditor providing them definite time period.

  (c) The remuneration to be fixed by the court for the trustee should be incentive oriented, and efficiency compatible, as such, proportionate to the principle of maximisation of value of realisable assets. The remuneration must not be based on periodicity.
- **Time-line bankruptcy proceedings:** Bankruptcy proceedings should adhere to the following detailed time-line:

(a) If the bankruptcy application is filed by the borrower company, the court shall appoint the trustee *immediately* on receiving the petition which will empower the Trustee to take over the management of the company as well as all assets and liabilities. Such a step can be taken within a week.

(b) If the petition is submitted by the creditors, the court has to proceed on receiving the response from the company and hearing the parties on a day-today basis to preliminarily examine whether there is any substance in the petition, that is, whether the petition is to be allowed. Such procedure should not take more than a period of six weeks and once the petition is allowed. Trustees are to be appointed to take over the charge of the company.

(c) The Trustee shall immediately after his appointment prepare an inventory of assets and shall ensure protection of such assets. Thereafter, he shall submit a preliminary report annexing a statement of affairs, list of assets, list of secured and unsecured creditors and the latest annual audited balance sheet. Such report shall also provide the recommendation of the trustee as to whether there is any chance of restructuring. Such report and statement of affairs submitted to the court shall require not more than 4 weeks time.

(d) The Court at that stage may listen to objections filed on day-to-day basis, which should not take more than 4 weeks time.

(e) The Trustee shall simultaneously proceed with the efforts of restructuring by the arrangement of the meeting of the interested parties drawing any scheme of reconstruction by himself for the consideration of the meeting and allowing interested parties to submit restructuring plans. This exercise may be allowed to take place within 8 weeks time and circumstance requiring further time may be explained to the Court, upon which the court may allow further time upto 12 weeks. In extraordinary circumstances, the Court may further extend the time by a further 6 weeks.

(f) After the scheme is agreed upon the trustee shall place the scheme before the Court. The Court may seek any objections and listen to any petition contesting any term of the scheme before the Court approves the scheme to be implemented. The Court may require not more than 6 weeks time for this exercise.

(g) The Trustee shall then implement the scheme with the help of concerned parties and report about the progress to the Court from time to time, but at least once in every quarter.

(h) If there is no scheme of reconstruction possible within the stipulated time or the Trustee comes to the conclusion that the scheme is unworkable, the Court shall direct the trustee to go for winding up and liquidation.

(i) At that stage of going for winding up, the trustee shall ensure that the realisation of the asset value must be maximised. The trustee may dispose the company as a going concern or sell the assets piecemeal. The trustee shall report to the court about the progress of liquidation once in every quarter and if the liquidation is not complete at the end of the year shall also submit the reasons why it could not be completed.

- **Post-scheme Management:** The Trustee shall periodically at least once in a quarter in every year submit a report about the progress of the scheme to the court. On the report of the trustee the court may authorise the company to be given back to the management of the company after the scheme is implemented. The court may direct transfer earlier to the implementation of the scheme for the management to implement the scheme if recommended by the trustee. The creditors may file objections. The matter of transfer is to be decided by the court after disposing petitions and at the best interest of the company and its creditors.
- **Special provisions for certain Institutions:** Banks and financial institutions have many special interests to be looked into while proceeding for bankruptcy proceedings. Though, it is suggested that there is no need for a separate statute, special procedures for Banks and Financial Institutions have to be made in a separate chapter providing for the compulsory moratorium system, appointment of trustee on the advise of the Reserve Bank and special winding provisions for liquidation as stipulated in the Banking Regulation Act.

  Further, some institutions have special significance. Institutions like Insurance, Non banking financial institutions, tele-communication etc. have special significance for which reasons these are put to under different regulatory bodies. Institutions of this nature may also go for bankruptcy. In such cases the trustee is to be appointed on the advise of the respective authority. The authority may have some supervisory power at the stage of restructuring and winding up. The special procedure has to provide for the appointment of the Trustee by the Court in consultation with such regulatory authority from an approved panel prepared in consultation with the same authority. The Court may at all stages consult the regulating authority for smooth and effective conduct of the bankruptcy operation.
- **Special protection:** The protection of depositors' interest has to be ensured either through deposit insurance protection taken by the banks and financial institutions or by insurance taken by individual depositors.

- **Public Sector Undertaking and government companies:** No different procedure is required for public sector undertakings and Government companies as the recommended procedure can effectively deal with the same.
- **Priority of claims:** The Advisory Group recommends adherence to the principles of priority as laid down presently in the Companies Act. Issues concerning super preferences for institutions providing additional funds for restructuring be based upon agreement between the parties.
- **Workers' claim:** The Advisory Group is of the view that workers claims must have equal treatment with the secured creditor which shall also include workers claim on provident fund and other benefits like workmen's compensation, gratuity etc.
- **Other priority system:** The Advisory Group expressed it satisfaction with the present priority system and suggests that it shall continue the preferential claim status for Government debts, with the Government having the power to release the institution from such debt in appropriate cases.
- **Cross-border bankruptcy principles:** The Advisory Group recommends the formulation of cross-border insolvency principles in the following matters:

  (a) When assistance is sought by a foreign court or a foreign representative in connection with a foreign proceedings.

  (b) When assistance is sought in a foreign state in connection with a proceeding under Indian law.

  (c) A foreign proceeding and a proceeding under Indian law in respect of the same debtor are taking place concurrently.

  (d) Creditors or other interested persons in a foreign state having an interest in requesting the commencement of or participating under Indian law.

  (e) Authorisation of the Trustee to act in a foreign state.

  (f) Right of direct access wherein a foreign representative is entitled to apply directly to a court in India.

  (g) Application by a foreign representative to commence a proceeding under Indian law.

  (h) Participation of a foreign representative in a proceeding under Indian law.

  (i) Access to foreign creditors to proceeding under Indian law.

  (j) Notification to foreign creditors of a proceeding under Indian law.

  (k) Application for recognition of foreign proceeding – In India, we have only provisions in the Code of Civil Procedure for the recognition of foreign judgment. Foreign

proceedings can include efforts like reorganisation. It is, therefore, essential to recognise foreign proceedings not just foreign judgments.

(l) Relief that may be granted upon recognition of foreign proceedings.

(m) Protection of creditors and other interested persons.

(n) Intervention by a foreign representative in proceedings in India.

(o) Co-operation and direct communication between a court in India and foreign courts or foreign representatives.

(p) Co-operation and direct communication between the Trustee and foreign courts or foreign representatives.

(q) Commencement of a proceeding under Indian law after recognition of a foreign main proceeding.

(r) Co-ordination of a proceeding under Indian law and a foreign proceeding.

(s) Co-ordination of more than one foreign proceeding.

(t) Presumption of insolvency based on recognition of a foreign main proceeding

(u) Rule of payment in concurrent proceedings.

- **An orderly and effective insolvency procedures:**

  Procedures shall have to be laid down clearly stipulating (1) requirement of commencement of the liquidation proceedings; (2) qualification of the debtor (3) establishing and protecting the assets; (4) treatment of encumbered assets and secured creditors; (5) avoidance of pre-commencement transactions and transfer by stipulating grounds of fraudulent preference; (6) financial contract and netting; (7) priority of distribution and discharge. Grounds of ***fraudulent preference*** and the ***consequences stipulating cancellation of such fraudulent preferential treatment*** is a serious matter that the law must address.

7.3 CONCLUSION

In India there is an urgent need for a comprehensive insolvency law to cope up with the reforms in the corporate and financial sector. The problem of insolvency demands a permanent solution because of the rather high recurring cost of retaining bad debts on balance sheets of lenders. There is opportunity cost of funds locked up in bad loans. It calls for an integrated approach to insolvency and secured transactions in line with international practice. Insolvency law and practice need not be based on adversarial process. On the other hand, the thrust should be on restructuring, failing which, initiating

fast track insolvency and winding up proceedings. Business restructuring is a constant exercise in the emerging competitive environment. Corporate India needs an effective regulatory framework to facilitate revival, winding-up of sick industrial companies and realizing the assets of thousands crores of rupees stuck up in insolvency proceedings. There is urgent need in India to use law as an instrument of better decision-making for economic progress and prosperity rather than litigation.

India, therefore, needs to tread the path very carefully by adopting a harmonious approach in this regard. Replication of the global trends and presentation of a test line with such global trends to determine insolvency should be done cautiously. It is highly imperative that the adopted tests for determining insolvency should be in conformity with, and adaptive to, the Indian socio-economic set-up and should also be in conformity with rules settled by the Indian judiciary.

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ANNEXURE - A

COMPARISON OF LAWS IN UNITED STATES AND INDIA

PRINCIPLES	US BANKRUPTCY CODE	INDIAN LEGAL PROVISIONS
Penalty for persons who negligently or fraudulently prepare bankruptcy petitions.	Sec. 110 of US Code attaches personal liability to the *bankruptcy petition preparer,* liable with fine.	No provisions
Separate Bankruptcy Court	US has separate Bankruptcy Court	There is no separate winding up courts under the Companies Act.
Case administration	Bankruptcy proceedings may commence with debtor filing the petition, or one of the and the debtors' spouse. In involuntary cases, petition filed by all the general partners, in case of partnership, holder of a claim, or by a foreign representative of the estate.	Debtor may file, under Sec. 439 of the Companies Act, the company, any contributory or contributories, the registrar, creditor or creditors, in financial institutions by the Reserve Bank in involuntary cases.
Ancillary to foreign proceedings	Petition by the foreign representative	No provision
Bankruptcy Trustee	Individual and corporations can be trustee	In the place of Bankruptcy Trustee at the centre and state level in US with Bankruptcy Administrator, India has Official Liquidator in the corporate matter.
Meetings of creditors and equity security holders	Trustee to call the meetings and to preside over	The Official Liquidator in the case of corporate winding up by the court under Sec. 433(e) and in the case of voluntary winding up, the liquidator shall convene the meetings. See Sections 495-497 of the Companies Act.
Unpaid property	90 days for final distribution, after that trustee stops payment and remaining property presented to the court	Unpaid dividends and undistributed assets to be paid into the company's Liquidation account.
Trustee's power to operate business	Trustee is authorised by the statutes unless court otherwise directs. For the purpose Trustee may obtain	Liquidator of a company has the general power to carry on the business of the company so far as may be

	unsecured credit. If not able to take unsecured credit to operate the business, the court in special circumstances may allow with priority	necessary for the beneficial winding up
Priorities	Determination of secured status Priority among unsecured creditors is also stipulated in Section 507(11 USC) serially as priority in the following order: administrative expenses including any estate; claims after the case being filed but before the trustee is appointed; workers and employees' claim upto S 4,300 for each; contribution to employees benefit plans; unsecured claims of individuals to the extent of S 1950; debts to spouse; governmental claims; etc.	Acoording ot Companies Act, payments are classified into three categories, (a) Overriding preferential preference given to workers' claims and secured credit *stand pari passu;* (b) Preferential payments standing in one line, to government claims, claims of employees up to Rs. 20,000 per person; employees' terminal benefits; Employer's liability to contribute employees benefit funds; workmen's compensation; sums due to employees from Pension, Gratuity and other welfare fund; investigation expenses.; (c) Unsecured creditors standing in one line.
Subordination of claims	Contractual subordination of claims allowed under Sec. 510	Not allowed
Debtor's duties	Detail rules on debtors' duties are given in Sec. 521	No detail rules prescribed in both the Insolvency Acts and in the Companies Act.
Exempted properties	Exemptions on household and other properties are stipulated in Sec. 522	Sec 60 of Civil Procedure Code provides exemptions. There is a good deal of similarity with US provision with addition of agricultural property
Exemptions to discharge	Liabilities such as tax or taxation are not covered by discharge of the debtor	No such provision
Effect of discharge	Provided in Sec. 524 of the 11 USC	Many provision are similar for individual insolvency but there is no provision for discharge of Corporation

Statutory liens	Trustee's power to avoid under Sec. 548	Similar provision exists
Liquidation	Trusteeship	No provision
Reorganisation	In Chapter 11 1. Appointment of Trustee by the court at the request of a party in interest 2. US Trustee shall appoint a committee of creditors of unsecured claims 3. Committee to have powers to consult in possession, investigate, participate in the plan, request for appointment of Trustee 4. Debtor may file a plan within 120 days after the date of the order for relief 5. Any party in interest including the debtor, the trustee a creditors' committee, a creditor, a equity security interest holders' Committee, an equity security holder, any indenture trustee may file a plan 6. Post petition disclosure and solicitation 7. Acceptance of the plan 8. Confirmation of the plan 9. Implementation of the plan 10. Exemption from the securities laws 11. Special tax provision	Restructuring by capital reduction (100-102); Power to compromise or make arrangement with creditors and High Court to enforce the compromise (Sections 391-392); provision for amalgamation and reconstruction of companies (Sec. 394). Sick Industrial (Special Provision) Act provides for reconstruction as follows; 1. Board not a Trustee 2. Board of Director of the company becoming sick shall refer to the BIFR enquiry into sickness 3. an operating agency shall prepare a scheme to be sanctioned by the BIFR 4. BIFR specifies the operating agency in the order 5. Rehabilitation given by financial assistance.

ANNEXURE – B

COMPANRISON OF LAWS IN UNITED KINGDOM AND INDIA

Principle	UK Insolvency Act 1986	Indian Legal Situation
Who may propose a voluntary arrangement	Sec. 1 – the directors of the company; the administrator where an administration order is in force; the Liquidator where the company is being wound up.	S. 391 – company; any creditor; member of the company; the Liquidator where the company is being wound up. Under SICA 1985, the company.
Administration orders	Sec. 8 – (1)Empowers the court to make an administration order, during which the affairs, business and property of the company is managed by the administrator appointed by the court. (2) the purpose for whose achievement an administration order may be made are- the survival of the company, and the whole or any part of its undertaking, as a going concern; the approval of a company, and the whole or any Part I; The sanctioning under Sec. 425 of the Companies Act of compromise and any such persons as are mentioned in the company's assets than would be effected on a winding up; and the order shall specify the purpose or purposes for which it is made. (3) An administration order shall not be made in relation to a company after it has gone into liquidation.	No provision for administration orders or administrators. Sec. 448- The Official Liquidator attached to the High Court or the Official Receiver attached to the District court shall conduct the proceedings in winding up. Sec. 457 – (1) The liquidator in a winding up by the court shall have power, with the sanction of the court, to carry on the business of the company so far as may be necessary for the beneficial winding up of the company.
General powers of the administrator	Sec. 14 – The administrator of a company may do all such things as may be necessary for the management of the affairs, business and property of the company, and without prejudice tot the generality of paragraph (a) , has the powers specified in Schedule 1 of this Act; and in the application of that Schedule of the administrator of a company the words "he" and "him" refer to the administrator. The administrator also has the power to remove	No provisions.

	directors of the company and to appoint any person to be director of it, whether to fill a vacancy or otherwise, and to call any meeting of the members or creditors of the company. The administrator may apply to the court for directions in relation to any particular matter arising in connection with the carrying out of his functions. Any power conferred on the company or its officers, whether by this Act or the Companies Act or by MoA or AoA, which could be exercised in such a way as to interfere with the exercise by the administrator of his powers in not exercisable except with the consent of the administrator of his powers in not exercisable except with the consent of the administrator. In exercising his power the administrator in good faith and for value is not concerned to inquire whether the administrator is acting within this powers.	
Receivership	Sec. 29- (2) in this chapter "administrative receiver" means; a receiver or manager of the whole of a company's appointed by or on behalf of the holders of any debentures of the company secured by a charge which, as created, was a floating charge, or by such a charge and one or more other securities; or a person who would be such a receiver or manager but for the appointment of some other person as the receiver of part of the company's property.	No provision
Cross-border operation of receivership provisions	Sec. 72 – A receiver appointed under the law of either part of Great Britain in respect of the whole or any part of any property or undertaking of a company and in consequence of the company having created, was a floating charge may exercise this powers in the other part of Great Britain so far as their exercise in not	No provision

	inconsistent with the law applicable there. In subsection (1) "receiver" includes a manager and a person who is appointed both receiver and manager.	
Winding up of companies under the Companies Act	Sections 73 to 219	Similar provisions present Part VII – Sections 425 to 560
Winding up of unregistered companies	Sections 220 to 229	Similar provisions present. Part X – Sections 582 to 590
Insolvency Practitioners	Section 388 – A person acts as an insolvency practitioner in relation to a company acting – as its liquidator, administrator or administrative receiver, or as a supervisor of a voluntary arrangement approved by it under Part I. A person acts as an insolvency practitioner in relation to an individual by acting – as his trustee in bankruptcy or interim receiver of his property or as permanent or interim in the sequestration of his estate; or as trustee under a deed which is a deed of arrangement made for the benefit of his creditors or, in Scotland, a trust deed for his creditors; or as supervisor of a voluntary arrangement proposed by him and approved under Part VIII; or in the case of a deceased individual to the administration of whose estate this section applies by virtue of an order under section 421 (application of provisions of this Act to insolvent estates of deceased persons), as administrator of that estate.	No comprehensive definition.