White Paper on NPA Scam & Banking Crisis & Introduction of Insolvency and Bankruptcy Code by Modi Government

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Introduction

When Narendra Modi assumed the Prime Minister's Office on 26th May, 2014, the economy of the country was on ventilator, suffocating from policy paralysis and jobless growth, coupled with all time high double digit inflation and all time low value of Indian Rupee. This was manifested from the Address to the Nation of the then Prime Minister Manmohan Singh on 22nd September, 2012 where he gave his infamous statement, "Money doesn't grow on trees - पैसे पेड़ पर नहीं उगते". Massive corruption at the top levels of the government and framing of policies favoring the crony capitalists had ruined our economy. It was the time when investors lost their faith in the countries government and even Indian Corporates had started having second thoughts and the world had started talking that 'I' in BRICS is shaky. All the sins of Congress-led UPA are in public domain, the state of economy they handed over to the Modi Government is an open secret.

This white paper is an attempt in this direction to sensitize people of the country about how the Congress Government manipulated our banking institutions and destroyed the financial sector. The extent of plunder was such that loans of large amount were dibursed to business persons who were close to the ruling government and its leaders, merely over a phone call, the scheme which was popularly called "Loan on Phone". The paper attempts to expose the culprits of "NPA Scam" who put the economy on a ticking time bomb leaving it for the next government to diffuse it. It was during the leadership of PM Modi that the NDA Government took prudent measures of introducing the Insolvency Code and Fugitive Economic Offenders Bill to effectively tackle the situation and restore the sanctity and capabilities of our banking institutions. The hardwork and dedication of current Government has paid off well and we are coming out of this NPA mess but it is imperative to expose the real patrons of fugitives like Vijay Malya and Nirav Modi who colluded together to plunder this public wealth; and those in positions of power who felicitated this loot must be unmasked and held accountable for their sins.

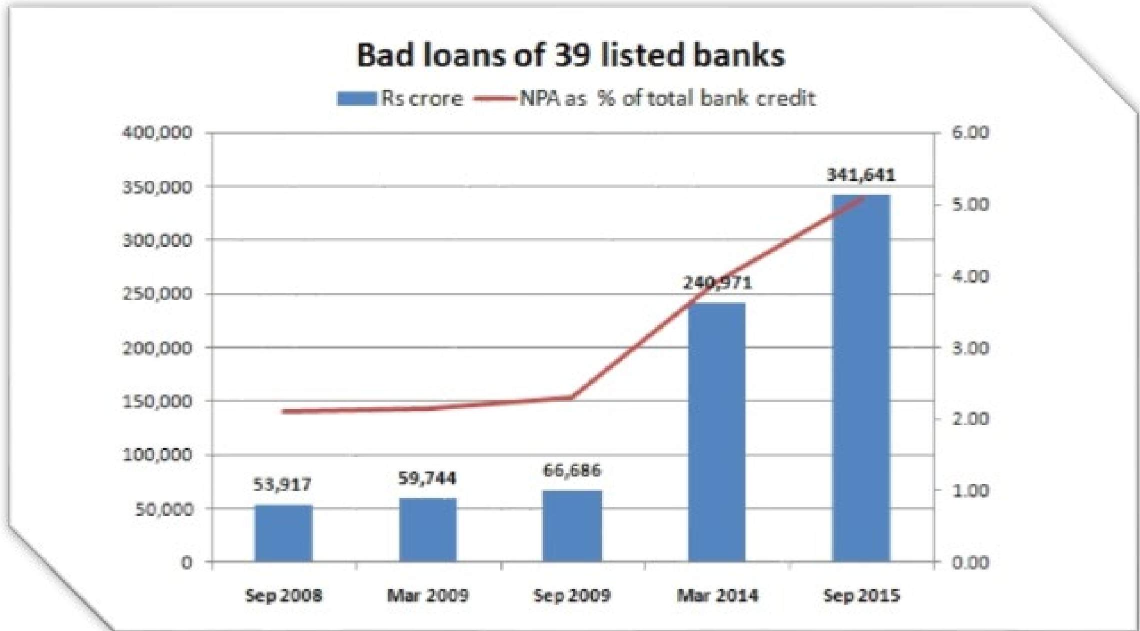
Shubhendu Anand

Editor

Time Bomb of Non-Performing Assets

The hardwork of NDA-I government led by Late Shri Atal Bihari Vajpayee was encashed by the subsequent UPA-I regime which utilized that economic boom to fund its electoral probabilities instead of capitalizing on those gains. Consequently UPA-II proved to be a catastrophic rule for the economic prospects of the country. This was the period when those in positions of power and responsibility devised a sophisticated plan to mercilessly plunder the public wealth. The authorities and management of the public sector banks were under undue influence to sanction loans on phone. These financial institutions were under so much political pressure that despite bleak prospects of return and without assessing the capacity of the debtor venture loans were given to those who seemed to be unable to repay the loan prima facie.

It is intriguing to see the statistics of the NPAs which reveal some interesting facts. The data, prior to 2009, reveals that those with most NPAs were mainly the private sector banks with ICICI Bank leading in the list which had an NPA of 4.18% of total lendings. As soon as UPA-II assumed power there was a sharp rise recorded in the NPA of public sector banks as well and things went out of control in March, 2014, a few months before Narendra Modi came to power. At this juncture NPA was touching the record high of around 4% of the total lendings. After Modi Government came to power, the balance sheet of the banks which were reluctant to reveal the true state of Non-performing Assets by refraining from declaring the distressed assets as such were compelled to follow the 90 day requirement of such accounts, which defaulted in paying interest as well as principal amount, to be declared as NPAs in the following quarter. The present paper attempts to explain the same story.



**Firstpost series on Culprits of NPA crisis.*

Now with the new government in power the outstanding figures in which we saw a sharp rise were not the results of any new lending leading to creation of Non-Performing Assets, but was the cure of already existing menace of NPAs which were not even declared so on the balance-sheet. This was the effect of the same addition.

It was UPA which developed the culture of clueless lending which former RBI Governer Raghuram Rajan narrated with an anecdote that "A promoter of a Company told him that a Managing Director of a Bank flagged 'blank cheques' in front of him offering him to fill whatever amount he wants". It, therefore, becomes imperative to bring out the real culprits who deliberately felicitated this plunder of public wealth and ensured near collapse of our banking sector.

Culprits of Banking Crisis

The Ministry of Finance, Government of India is divided into five different departments which includes Department of Expenditure, Department of Economic Affairs, Department of Financial Services, Department of Revenue and Department of Investment and Public Asset Management. The Department of Financial Services entails the functioning of the banking institutions and provides policy support to these institutions. Reserve Bank of India regulates and supervises Public as well as Private Sector banks by the mandate of Banking Regulation Act, 1949. It can-

i. Inspect the bank and its books and accounts.

ii. Examine on oath any director or other officer of the bank.

iii. Cause a scrutiny to be made of the affairs of the bank.

iv. Give directions to secure the proper management of the bank.

v. Call for any information of account details.

vi. Determine the policy in relation to advances by the bank.

vii. Direct special audit of the bank; and

viii. Direct the bank to initiate insolvency resolution process in respect of a default, under the provisions of Insolvency and Bankruptcy Code, 2016.

Further, in respect of Nationalised banks and the State Bank of India (SBI), under the provisions of the Banking Companies (Acquisition and Transfer of Undertakings) Acts of 1970 and 1980 ("Bank Nationalisation Acts") and the State Bank of India Act, 1955 ("SBI Act") respectively, inter alia-

1. RBI's nominee Director is a member on—

i. The Nationalised bank's Management Committee of the Board, which exercises the powers of the bank's Board with regard to credit proposals above specified threshold (section 9(3)(c) of the Bank Nationalisation Acts, and paragraph 13 of the Nationalised Banks (Management and Miscellaneous Provisions) Schemes of 1970 and 1980 made by the

Government under the Bank Nationalisation Acts), and

ii. the Executive Committee of the Central Board of SBI, which may deal with any matter within the competence of the Central Board subject to SBI General Regulations, 1955 and Central Board's directions (sections 19(f) and 30 of SBI Act, and regulation 46 of SBI General Regulations, 1955);

iii. RBI approves the appointment and fixes the remuneration of the bank's auditors (section 10 of the Bank Nationalisation Acts, and section 41 of the SBI Act); and

iv. RBI can appoint additional directors on the nationalised banks' Boards and State Bank of India's Central Board (section 9A of the Bank Nationalisation Acts, and section 19B of the SBI Act).

In addition, whole-time Directors of nationalised banks and State Bank of India are appointed in consultation with the RBI. RBI has powers under other laws as well, which include, inter alia, the power under section 12 of the Foreign Exchange Management Act, 1999 to inspect for compliance with the Act and rules etc. made there under. RBI also maintains the Central Repository of Information on Large Credits (CRILC) on aggregate fund-based and non-fund-based exposures of Rs. 5 crore and above of all banks.

Further, RBI maintains the Central Fraud Registry and banks report all frauds involving amount above Rs. 1 lakh to RBI. In addition, RBI's Master Directions on Frauds lay out guidelines on categorisation, reporting and review of frauds, along with norms for consequent provisioning. The powers of RBI are wide-ranging and comprehensive to deal with various situations that may emerge in all banks, including public sector banks. No proposal with regard to change in RBI's powers in respect of public sector banks is presently under consideration/consultation. Improvement in regulatory functioning being an ongoing process, Government engages with stakeholders, including RBI, and discusses issues as they evolve. (*Source—Press Information Bureau (PIB), GOI, on 8th January, 2019.)*

It is, therefore, imperative that the current leadership of the country is seized of the situation and those who were in the responsible positions during previous regime be held accountable and unmasked.

P. Chidambaram

(Finance Minister- 22 May 2004-30 November 2008 +31 July 2012 To 26 May 2014)

Dr. Manmohan Singh

(Finance Minister-- 30 November 2008 to 24th January, 2009)

D. Subbarao

(RBI Governor –5th Sep, 2008 to 4th Sep, 2013)

RaghuRam Rajan

(RBI Governor—4th Sep 2013 to 4th Sep, 2016)

Tight Grip of Fugitive Economic Offenders Act

The pressure of the NDA Government on the defaulters kept on mounting with the bonafide actions to curb the menace of rising NPAs which made such offenders suffocate within India. In order to escape from the grip of law, some of the defaulters chose to fly away from India to their safe heavens. Much to their dismay, the Union Government immediately came forward with a bill to effectively tackle the offenders who played a crucial roled in destroying Indian economy and then escaped. The Bill has been finally received the assent of the President of India on 31st July, 2018 and numbered as Act No. 17 of 2018 passed by the Parliament of India. As one of the unique legislations which deals effectively with such offenders, this legislation contains following key features—

i) The Act allows a person to be declared a Fugitive Economic offender if-

An arrest warrant has been issued against him for a specified offence where value involved is over 100 Crores and he has left the country and refuses to return for prosecution.

ii) To declare a person FEO an application in special court formed under Prevention of Money Laundering Act can be filed and time of 6 weeks would be given to accused to return and face the prosecution.

iii) Authorities will be allowed to provincially attach properties even while the application is pending in the special court.

iv) Upon declaration of FEO-

The properties of such offenders may be confiscated and vested in central government free of any encumbrances. The FEO and the company associated with the offender will be barred from filing and defending civil cases also.

v) ED is to be the nodal authority to implement the law.

The Act may lead to achieve following:

- The target of the Act will also be Benami Property and financial corruption in addition to such fraudsters and defaulters.
- The Act will definitely create a deterrent effect on big offenders.

It provides for confiscation of all property of offenders irrespective of whether it was acquired by proceeds of crime or not.

- It will improve the financial health of the country and its banking sector thereby providing a boost to our economy.

The Wonders of Insolvency and Bankruptcy Code

The bad debts of the banks have overwhelmingly been contributed by few corporations who were massively credited by the banks. Since a corporate is a separate legal entity and those behind it cannot be brought to book to recover the amount that has become bad debt, the government of the day realized the need of an effective tool in the hands of these banking institutions and creditors who could recover successfully from their corporate debtors by compelling for the liquidation of the assets of the company. As a consequence, a comprehensive Code in the form of Insolvency and Bankruptcy Code, 2016 was brought to streamline this process and make it time-bound & in fast-track mode so that bad debts and their write-offs don't become a norm for the Banks. Some of the special features of the Code include—

- **Unified Code**- This Code has replaced century old laws, viz. the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920, and amended many other laws including the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, the Sick Industrial Companies (Special Provisions) Act, 1985, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the Companies Act, 2013.

- **Clear Adjudication**- The Code has created two authorities for the redressal of claims of the creditors (whether secured or unsecured) and other stakeholders, viz,

  i) National Company Law Tribunal, for companies and limited liability partnerships

  ii) Debt Recovery Tribunal, for individuals and partnership firms.

- **Time bound mechanism**- The Code provides for time bound mechanism to come up with the resolution plan approved by the creditors. The process is mandated to be completed within 180 days, extendable by maximum 90 days.

- **Insolvency Resolution Process**- The Code proposes one clear resolution process for

corporates and non-corporates with the aim of resolving the disputes in a time bound manner.

• **Moratorium**- Moratorium means temporary prohibition of an activity. Under the Code, moratorium may be issued during the Insolvency Resolution Process. During the period of moratorium, no action can be taken against the company or the assets of the company.

• **Insolvency Regulatory Board**- The Code has established the 'Insolvency and Bankruptcy Board of India' as the regulator for the governance of Insolvency and Bankruptcy Law and Information Utilities.

• **Information Utilities**- For the first time in the history, this unique feature has been introduced. Information Utilities are established to function as a databank to collect, collate and disseminate the financial information. It facilitates creation of data with respect to debts and credits of all the business houses. It is intended to help in early detection of defaults and thus, triggering the insolvency resolution process at the earliest.

• **Order of priority in distribution of assets**- The Code has come up with a strict order of priority in paying off the dues, in case liquidation hits the corporates.

• **Offences –**Where any officer of corporate debtor immediately preceding twelve month willfully concealed any property or destroyed, mutilated or falsified accounts, such officer shall be punishable with imprisonment for a period of three years which may extend to five years or with fine of Rs. One lakh which may extend to Rs. One crore. Similar kind of offences are there for willful omission and against those who destroys, mutilate, alters or falsifies any books or records. [Clause 68 to 75]

IBC: An Evolving concept

The Insolvency Code is a legislation which deals with economic matters and, in the larger sense, deals with the economy of the country as a whole. The experiment contained in the Code passes constitutional muster. Amendments have been made in the short period in which the Code has operated, both to the Code itself as well as to subordinate legislation made under it. This process is an ongoing process which involves all stakeholders. In the working of the Code, the flow of financial resource to the commercial sector in India has increased exponentially as a result of financial debts being repaid. Approximately 3300 cases have been disposed of by the Adjudicating Authority based on out-of-court settlements between corporate debtors and creditors which themselves involved claims amounting to over INR 1,20,390 crores. Eighty cases have since been resolved by resolution plans being accepted. Of these eighty cases, the liquidation value of sixty three such cases is INR 29,788.07 crores. However, the amount realized from the resolution process is in the region of INR 60,000 crores, which is over 202% of the liquidation value. As a result of this, the Reserve Bank of India has come out with figures which reflect these results. Thus, credit that has been given by banks and financial institutions to the commercial sector (other than food) has jumped up from INR 4952.24 crores in 2016-2017, to INR 9161.09 crores in 2017-2018, and to INR 13195.20 crores for the first six months of 2018-2019. Equally, credit flow from non-banks has gone up from INR 6819.93 crores in 2016-2017, to INR 4718 crores for the first six months of 2018-2019. Ultimately, the total flow of resources to the commercial sector in India, both bank and non-bank, and domestic and foreign (relatable to the non-food sector) has gone up from a total of INR 14530.47 crores in 2016-2017, to INR 18469.25 crores in 2017-2018, and to INR 18798.20 crores in the first six months of 2018-2019. These figures show that the experiment conducted in enacting the Code is proving to be largely successful. The defaulter‘s paradise is lost. In its place, the economy‘s rightful position has been regained.

IBC: Its Outcomes

1. The banks in India now have no choice but to classify all large loans worth at least Rs. 2000 crore as non-performing assets (NPAs) immediately when they restructure it. Such NPAs should be resolved within 180 days failing which the account gets referred to the IBC Court.

2. India's rank on 'Resolving Insolvency' has climbed up to the 103 spot in 2018, from 138 in 2010.

3. The total value of claims in the ten resolution plans sanctioned by the NCLT is approximately Rs. 5524 crore, total value of liquidation value is Rs. 1430 crore and total realization expected is Rs. 1854 crore (average percentage of recovery equals 34% and median recovery equals 41%.)

4. Prior to the IBC, the average life of cases recommended for restructuring took between 4 to 8 years and those recommended for winding up even longer. The current law allows a maximum 270 days for resolution — an initial 180 days and 90 days of extra time.

5. The IBC introduced a shift from the 'debtor in possession' regime to a 'creditor in control' regime, making it a creditor friendly legislation.

6. In less than 6 months of the enactment of the IBC, the subordinate legislation was finalized and the corporate insolvency part of the law made majorly operational before the end of the year 2016. All this happened in less than two years.

7. By the end of Nov 2017, 2434 cases have been filed under the IBC and 2304 cases of winding up of companies transferred from various high courts. By the end of Feb 2018, 575 applications under the Code were admitted by the NCLT, out of which financial creditors filed 180, operational creditors 302, and 92 were filed by companies.

8. 1324 professionals have been registered as insolvency professionals and 72 as insolvency professional's entities with the IBBI till Feb 2018. The cases files till Dec involve approximately Rs. 1.28 lakh crore as default amount. The steel sector accounts for 45% of the total default amount.

9. The IBC has the potential of competing with some of the best insolvency systems in other jurisdictions on the strength of its unique characteristics. Its success can propel India as an attractive choice of jurisdiction for resolving insolvency.

10. A new regulator - The Insolvency and Bankruptcy Board of India (IBBI) was established to regulate the insolvency professionals and the insolvency resolution/liquidation process. Strict timelines were introduced for resolution and liquidation processes, shorter even than what is provided under the English law.

11. Eleven benches (one principal bench in New Delhi and regional benches in New Delhi, Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai) of NCLT were set up and designated as adjudicating authority under the IBC. The IBBI was established in October 2016 and, within days three insolvency professional agencies were registered by the IBBI.

12. National e-governance Services Limited was licensed as the first Information Utility by the IBBI.

13. To compliment the IBC, the RBI repealed all earlier out of court restructuring schemes (CDR, JLF, SDR, S4A, Flexible Restructuring, etc.) and provided for a new framework for resolving insolvency through an informal framework which requires credit rating agencies to be involved more in credit evaluation; in the event of default during a specified period, refer the account to the IBC; and implement resolution plan within 180 days (accounts with aggregate exposure equal to or more than Rs. 20 billion), or else refer to the IBC within 15 days. The RBI also revised guidelines for prudential norms.

14. The IBBI adopted an open door policy so that it remains accessible to market players. Experience under the IBC and new developments were analyzed on a nearly daily basis.

15. IBC was one of the major factors in India's jump on the World Bank's Ease of Doing Business Ranking to 100 in 2017 from 130 the previous year.

Moreover, year 2018 proved to be a constitutional litmus test for the Insolvency and Bankruptcy Code, 2016 (the "Code"), with ten Writ Petitions and one Special Leave Petition assailing the constitutional validity of the Code. Various matters were brought into question and on January 25, 2019, a judgment was pronounced by the Hon'ble Supreme Court on this batch of petitions in ***Swiss Ribbons Private Limited & Anr. v. Union of India***.

The key sub-text in Swiss Ribbons is set out in the Epilogue in the last three pages of the judgment:

> *"The Insolvency Code is a legislation which deals with economic matters and, in the larger sense, deals with the economy of the country as a whole. Earlier experiments, as we have seen, in terms of legislations having failed, 'trial' having led to repeated errors, ultimately led to the enactment of the Code. The experiment contained in the Code, judged by the generality of its provisions and not by so-called crudities and inequities that have been pointed out by the petitioners, passes constitutional muster."*

This conclusion is a future interpretative tool for all stakeholders and more so, for participants in the corporate insolvency resolution process (the "CIRP"). The Supreme Court has tacitly admitted to the game theory element inherent in CIRPs, and the Supreme Court will not be readily swayed in allowing traditional Common Law safe harbour principles of equity, reasonableness and fairness prevailing over purposive economic legislation and policy.

IBC addressing the issues of Non – Performing Assets

The issue of Non - Performing Assets (NPAs) in the Indian banking sector has become a subject of much discussion and scrutiny. **The Standing Committee on Finance** recently released a report on the banking sector in India, wherein it observed that banks' capacity to lend has been severely affected because of mounting NPAs.

Banks give loans and advances to borrowers. Based on the performance of the loan, it may be categorized as:

(i) a standard asset (a loan where the borrower is making regular repayments), or

(ii) a non-performing asset.

NPAs are loans and advances where the borrower has stopped making interest or principal repayments for over 90 days. Some of the factors leading to the increased occurrence of NPAs are external, such as decreases in global commodity prices leading to slower exports. Some are more intrinsic to the Indian banking sector. A lot of the loans currently classified as NPAs originated in the mid-2000s, at a time when the economy was booming and business outlook was very positive. Large corporations were granted loans for projects based on extrapolation of their recent growth and performance. With loans being available more easily than before, corporations grew highly leveraged, implying that most financing was through external borrowings rather than internal promoter equity. But as economic growth stagnated following the global financial crisis of 2008, the repayment capability of these corporations decreased. This contributed to what is now known as India's Twin Balance Sheet problem, where both the banking sector (that gives loans) and the corporate sector (that takes and has to repay these loans) have come under financial stress.

When the project for which the loan was taken started underperforming, borrowers lost their capability of paying back to the banks. The banks at this time took to the practice of **'ever greening'**, where fresh loans were given to some promoters to enable them to pay off their interest. This effectively pushed the recognition of these loans as non-performing to a later date, but did not address the root causes of their unprofitability.

The measures taken to resolve and prevent NPAs can broadly be classified into two kinds – first,

regulatory means of resolving NPAs per various laws (like the Insolvency and Bankruptcy Code), and second, remedial measures for banks prescribed and regulated by the RBI for internal restructuring of stressed assets.

The IBC was enacted in May 2016 to provide a time-bound 180-day recovery process for insolvent accounts (where the borrowers are unable to pay their dues). Under the IBC, the creditors of these insolvent accounts, presided over by an insolvency professional, decide whether to restructure the loan, or to sell the defaulter's assets to recover the outstanding amount. If a timely decision is not arrived at, the defaulter's assets are liquidated. Proceedings under the IBC are adjudicated by the Debt Recovery Tribunal for personal insolvencies, and the National Company Law Tribunal (NCLT) for corporate insolvencies.

The RBI, over the years, has issued various guidelines aimed at the resolution of stressed assets of banks. These included introduction of certain schemes such as:

(i) Strategic Debt Restructuring (which allowed banks to change the management of the defaulting company), and

(ii) Joint Lenders' Forum (where lenders evolved a resolution plan and voted on its implementation).

In line with the enactment of the IBC, the RBI, through a **circular in February 2018,** substituted all the specific pre-existing guidelines with a simplified, generic, time-bound framework for the resolution of stressed assets.

In the revised framework which replaced the earlier schemes, the RBI put in place a strict deadline of 180 days during which a resolution plan must be implemented, failing which stressed assets must be referred to the NCLT under IBC within 15 days. The framework also introduced a provision for monitoring of one-day defaults, where incipient stress is identified and flagged immediately when repayments are overdue by a day.

Earlier Insolvency and Liquidation proceedings were carried by the time consuming provisions of Companies Act and Sick Industries Companies Act alongwith the obsolete laws in the form of Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920. The need of such a comprehensive legislation was felt for a long time but unfortunately the vested interests prevented this. The maximum benefit of this code would be effected by Banks who are desperate to get back their dues from the debtors. The subsequent Amendments as well in the legislation keeping in mind the pragmatic consequences of the legislation has made it more sophisticated in terms of fulfilling its objectives.

Supreme Court Upholds the Constitutional validity of the Act

In a judgment delivered recently, the Supreme Court of India had upheld the constitutional validity of the Insolvency and Bankruptcy Code, 2016 in its entirety. In an extremely lucid 150 page judgment, Justices R.F. Nariman and Navin Sinha had discussed in detail about judicial restraint in matters pertaining to country's economic policy and legal nuances of the constitutional challenge to various provisions of the code. However, the most striking feature of the judgment was the court's acknowledgment of the improvement in the country's availability of credit to the commercial sector and the role of the new IBC in fostering economic development in the country.

The petitioners in the present Writ Petition had challenged the constitutional validity of various provision of the IBC as violative of Art.14 and being inconsistent with judicial precedents. Before plunging into the court's response to the challenge to the constitutional validity, it is pertinent to highlight the legal regime prior to the introduction of IBC, 2016.

I. Fragmented laws, multiple fora and ineffectiveness

Prior to the enactment of the code, an insolvency proceeding, whether corporate or an individual was subject to multiple and often conflicting regulations. If a corporate entity was to become insolvent, any creditor including other stakeholders of the company had the option of filing for liquidation under S.433 of the Companies Act. If the creditors were banks or other financial institutions, they could approach the DRT under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and subsequently under the SARFAESI Act, 2002 if the assets of the corporate debtor were secured. Recognising the need to mitigate the problems caused by recurring industrial sickness, the govt. passed the Sick Industrial Companies Act, 1985 ("SICA") in order to allow companies in distress to propose a restructuring package with the assistance of the Board for Industrial and Financial Restructuring ("BIFRI"). Thus, there were two separate legislations for recovery of debt by creditors and other stakeholders and for restructuring an ailing industry. Further, there were separate legislations for debt recovery by individuals and partnership firms.

This regime had created several problems for the creditors and the corporate debtor itself. First, the lack of a single forum for corporate insolvency resulted in the decisions rendered by fora like NCLT, BIFR appealable before the High Court. This created a strange situation where one forum could decide on the rights of the debtor, while the other could determine the rights of a creditor. Second, as noted by the Bankruptcy Law Reforms Committee in its report dated 04.11.2015, the delay caused by multiplicity of proceedings resulted in deterioration of the value of the assets of the sick company thereby mounting the non-performing assets. Lack of effective leadership during the reconstruction process coupled with delays meant that liquidation was the only option. The liquidation value too eroded with time as many assets suffered from a high economic rate of depreciation. Further, the complete bar on proceedings against a sick company including arbitration, enforcement of security interest etc. under S.22 of the SICA, 1985 was often misused by unscrupulous promoters.

All the problems with the previous legal regime had a direct bearing on the country's credit availability disproportionate to the country's status as a dynamic emerging economy. The World Bank (2014) report suggested that the average time to resolve insolvency was four years in India, compared to 0.8 years in Singapore and 1 year in London. The World Bank's Ease of Doing Business Index, 2015, ranked India as country number 135 out of 190 countries on the ease of resolving insolvency.

Thus, the new IBC was born out of the failures of the previous legal framework on insolvency and rehabilitation and in the backdrop of failing businesses and mounting debts owed to the banking sector, particularly public sector banks.

II. IBC – a new paradigm in the insolvency framework of the country

To overcome the infirmities of the previous corporate insolvency and rehabilitation framework, the Banking Law Reforms Committee (BLRC) was constituted on October, 2014 under the chairmanship of Mr. T.K. Viswanathan. The Committee recommended a complete overhaul of the insolvency regime and unify all the laws relating to insolvency under one umbrella legislation as mentioned in the Preamble of the Code. However, the most significant aspect of the Code is the priority given to resolution and reorganisation of corporate debtors as opposed to liquidation of a company to settle the dichotomy once and for all. As it was noted by the SC in Swiss Ribbons[1] , timely resolution of a corporate debtor in distress would go a long

1. Swiss Ribbons v. Union Of India 2019 SCC Online Sc 73

way to support the credit market in the country and the funds which are pumped back into the economy could ease the doing of business by facilitating further investments. This in turn, could boost economic growth and development. Thus, the Code was not merely a recovery legislation for creditors, rather, it provides a mechanism to ensure revival and continuation of a corporate debtor by seeking to preserve the value of the business. Also for the first time, a full time regulator, Insolvency and Bankruptcy Board of India was constituted to oversee the functioning of the Code followed by specially designated insolvency professionals and information utilities to collect, authenticate and disseminate financial information of corporate debtor for corporate resolution.

III. Challenges to the constitutional validity of the Code

In Swiss Ribbons v. Union of India[2] , the Supreme Court addressed the multi-fold challenges to the constitutional validity of various provisions of the Code. The court rejected the constitutional challenge posed by the petitioners and threw light on the role of courts qua economic legislations. Referring to the end of the Lochner era in the US wherein every economic legislation passed by the Congress was struck down on grounds of restriction on freedom of contract and economic ideologies of the judges thereby effectively preventing any scope for redistributive laws, the SC in Swiss Ribbons emphasized on the need for judicial restraint in legislations pertaining to the economic policy of the country. The comparative constitutional jurisprudence was further supported by precedents of the Indian courts where judicial deference was applied to legislative judgment in the field of economic regulation[3] unlike in matters purely relating to civil rights.

A. No defect in the appointment of the selection committee for selecting members of the NCLT and NCLAT - The petitioners had contended that the appointment process of selection committee for appointing members of the NCLT and NCLAT was inconsistent with the directives of the Supreme Court in Madras Bar Association v. Union of India[4], on the ground that the executive members in the committee outweighed the two judicial members. However, taking into account an additional affidavit filed by the Union of India, it was notified that a selection committee based on the SC guidelines was indeed constituted in 2015 and the process for appointing tribunal members had already commenced. The petitioner's contention

2. 2019 SCC Online SC 73
3. R.K. Garg v. UOI(1981) 4 SCC 675; See also Bhavesh D. Parish v. Union of India, (2000) 5 SCC 471; DG of Foreign Trade v. Kanak Exports, (2016) 2 SCC 226.
4. (2015) 8 SCC 583

that Section 412 (2) of the Companies Act still lingered on the statute books was countered by the bringing of an amendment to the same section dated 03.01.2018 and the violation was remedied.

B. NCLAT benches and the issue relating to the right ministry to be governing the NCLT and NCLAT- The petitioners contended that: (a) The National Company Appellate Tribunal (NCLAT) had its seat only in the national capital of New Delhi and this resulted in hardships to litigants who sought to appeal the order of a NCLT as they were forced to travel a long distance for getting their appeal heard. This was also in contravention to the directives issued by the SC in Madras Bar Assn. (II), wherein the SC had stated that the National Tax Tribunal (NTT) ought to have permanent benches at the seat of every jurisdictional High Court to ensure expediency in disposal of cases. (b) Referring to the same judgment in Madras Bar Assn. (II), the petitioners contended that the Ministry of Corporate Affairs was wrongly providing administrative support to the NCLT and NCLAT, as the same was a mandate on the Ministry of Law and Justice.

With regard to the first claim, the Attorney General, Mr. K.K.Venugopal had assured the establishment of circuit benches of NCLAT and the same was directed by the SC to occur within 6 months. With regard to the second claim the court urged the Union to comply with the letter and spirit of the judgment in Madras Bar Assn. (II) and assign to the appropriate ministry at the earliest.

C. Unreasonable classification between financial and operational creditors and the challenge through Art.14 of the Constitution – The petitioners contended that the differential treatment meted out to operational and financial creditors under the Code had no intelligible differentia and not connected to the object to be achieved. The Code only grants a right to the operational creditors to attend the meeting of the Committee of Creditors if they represent 10% of the aggregate amount of debt owed and do not have any power to vote in the Committee of Creditors proceedings inter alia, other differences. Relying on Shayara Bano v. Union of India[5], the petitioners contended that this treatment was violative of Art. 14 and manifestly arbitrary.

The SC relied upon the BLRC report to highlight the difference between both the categories based on the nature of the debt, financial competence and extent of evidence needed to trigger the insolvency resolution proceedings under the Code. The court concluded that there was

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5. (2017) 9 SCC

indeed a reasonable classification in pursuance of the nexus of the Code on the following grounds: (a) Most operational creditors are unsecured, as they seek payment for provision of goods & services unlike financial creditors who are banks and financial institutions and whose debt is mostly secured, (b) financial contracts generally involve large sums of money given on a term loan with specific repayment schedules whereas operational creditors contribute to the daily working of the business, (c) operational debts are recurring in nature and usually have dispute settlement clauses through private arbitration in stark contrast to financial creditors and (d) finally, financial creditors (mostly banks and financial institutions) engage in restructuring of the loan as well as reorganization of the corporate debtor‘s business when there is financial stress, which are things operational creditors cannot perform. Stressing on these differences, the SC upheld the constitutional validity of the differential treatment.

D. With regard to the notice period, triggering of insolvency resolution process and the shift from "The inability to pay debts" to "determination of default" – It was contended from the side of the petitioners that there was no scope for contesting an earlier "dispute" under S.5 for a financial creditor unlike for operational creditors. The SC referred to its earlier decision in Innoventive Industries[6] to highlight the differences between the scheme enumerated in S.7 and under S.8 of the Code and the reason for mandating a demand notice in case of operational creditors. According to the SC, insofar as the financial debts owed by the financial debtor, information regarding the same is easily available through the Information Utilities and controlled by the Information Utilities Regulation, 2017. As long as there was a "default", i.e. a debt was "due and payable" and not paid by the debtor, a financial creditor can file an application under S.7. In the case of operational creditors, a demand notice is to be served and a dispute, if any, can be raised by the financial debtor. The reason for treating operational creditors differently is to ensure, frivolous or petty amounts of default would not result in triggering the insolvency process.

To counterbalance the lack of participation and voting rights, the court also discussed the provisions enshrined in S.30 and S.31 that ensured operational creditors do not get an amount lesser than the liquidation value in cases of liquidation. Further, NCLT's have always ensured operational creditors were roughly given the same treatment as financial creditors and have also modified resolution plans when they have not adequately safeguarded their rights. Also, the petitioners claim regarding non availability of separate provisions for set-off and

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6. (2018) 1 SCC 407

counterclaim by the financial debtors was rejected as there were no express provisions barring financial debtors from claiming the same.

Further, the court also noticed a shift in the policy from one of "inability to pay debts under the repealed S.433(e) of the Companies Act, 2013 to "determination of default" under the Code. The reasons for the policy shift were: (a) predictability and certainty, (b) admission into the insolvency resolution process is primarily aimed at protecting the interests of the financial debtor and not to his prejudice, (c) preserving the economic interests of the debtor is prioritised over the cause of default and (d) liquidation should only be the last resort when restructuring is impossible.

E. Withdrawal of applications only in limited circumstances – Section 12A was inserted in the Code through an amendment in 2018 allowing for withdrawal of application submitted under Section 7,8,9 only on the approval of ninety percent voting share of the committee of creditors. The petitioners had challenged the unbridled power vested in the committee of creditors to reject an application even if a lawful settlement between the creditor and the debtor had been entered into. Also, it was contended that there was no provision to permit withdrawal after admission of the application.

The SC rejected these challenges on the ground that an insolvency resolution process involved a diverse group of stakeholders and was not restricted to the debtor and the creditor. Thus, the 90% threshold was justified. However, it was also clarified by the court that the tribunal could exercise its inherent powers[7] at any stage where the committee of creditors was not constituted.

F. The nature of information provided by private information utilities : prima facie evidence of default – The petitioner contended that the information provided by the information utilities cannot be considered as conclusive evidence. By assessing the object behind setting up the information utilities, the SC observed that it was introduced to reduce information asymmetry for improved credit risk assessment and improve recovery processes. Further, the court referred to Regulation 20 and 21 of the Information Utilities Regulation to conclude that the information about the corporate debtor had to be authenticated and verified which provided an opportunity to the financial debtor to contest its veracity.

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7. Rule 11, NCLT Rules, 2016

G. The status of insolvency resolution professionals: quasi-judicial or administrative in nature? – The SC clarified that resolution professionals did not possess any quasi-judicial power and were only vested with administrative powers based on a plain reading of S.18 (duties of a resolution professional) and CIRP Regulations. The court contrasted the position of the insolvency professional with that of a liquidator whose powers were enumerated under S.40-42 of the Code and who performed quasi-judicial functions. The liquidator can determine the value of claims admitted under Section 40 and such determination is appealable before the Adjudicating Authority. This is however, not the case with resolution professionals who cannot act in a number of matters without the permission of the committee of creditors. Thus, the resolution professional merely facilitated the resolution process.

H. Constitutionality of S.29A of the Code - This Section was first introduced by the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017. The purpose behind the ordinance was to ensure that once a company goes into the resolution process, not all persons should be allowed to submit a resolution plan. S.29A disqualifies certain members associated with the corporate debtor from submitting a resolution plan. Apart from the 4 statutory disqualifications of an undischarged insolvent, a person disqualified from acting as a director under the Companies Act, 2013 and one who is prohibited under the SEBI Act, the section also prohibited those who are corporate debtors and who, as on the date of the application making a bid, do not operationalize the account by paying the interest itself.

The petitioners had challenged this section on four grounds : (a) retrospective application of the section would impair the vested rights of erstwhile promoters which could trigger multiple litigations, (b) a blanket ban on all the promoters of the corporate debtor to submit a resolution plan is arbitrary as it blocked even good resolution plans by erstwhile promoters, (c) Not every NPA could be classified as wilful defaulters and the one year grace period to repay the debts was arbitrary, (d) relatives of erstwhile promoters were deemed to be "related parties" under S.24A and disqualified from submitting a resolution plan and the mere fact that somebody was a relative of an ineligible person cannot be a legitimate ground to prevent them from submitting a plan.

The SC negatived the challenge to the section on all the 4 grounds. With regard to the retrospective application, the SC referred to its earlier decision in Arcelor Mittal[8] to suggest

that S.29A did not grant any vested right upon any of the stakeholders eligible to submit a resolution plan. Since, there was no vested right, a retrospective application did not abridge any such right. In response to the second ground of challenge, the SC held that it is good law and policy decision to prevent certain persons whose acts resulted in the dire state of the corporate debtor from submitting a resolution plan. The SC took note of the Statement of Reasons and Objects to the Amendment and cautioned that persons who, with their misconduct contributed to defaults of companies or are otherwise undesirable, may misuse this situation due to lack of prohibition or restrictions to participate in the resolution or liquidation process, and gain or regain control of the corporate debtor.

With regard to the one-year grace period, the SC pointed out to relevant provisions in the RBI Master Circular in classifying a loan as a NPA and held that the one-year time period was judicious. As the court remarked in the context of a person who had been unable to service a debt within the time period stipulated under the RBI Guideline – "if the blind lead the blind, both shall fall into the ditch!" Finally, with regard to the objection to preventing a related person to a stakeholder from submitting a resolution plan, the court held that for a person to be disqualified from submitting a resolution plan, all the categories of persons mentioned in Section 5(24A) must show that such persons must be connected with the resolution applicant within the meaning of Section 29A (j). According to the court, if the terms 'relative' and 'related party' be read noscitur a socii, it would lead to the conclusion that the only persons who could be disqualified would be persons who are connected with the business activity of the resolution applicant.

I. Exclusion of MSME's from the ambit of S.29A – The reason for exclusion of MSME's from the purview of S.29A was contained in Para. 27.4 of the ILC Report, 2018 – "given that MSMEs are the bedrock of the Indian economy, and the intent is not to push them into liquidation and affect the livelihood of employees and workers of MSMEs, the Committee sought it fit to explicitly grant exemptions to corporate debtors which are MSMEs by permitting a promoter who is not a wilful defaulter, to bid for the MSME in insolvency"[9]. Thus, the reason for the exclusion was that management of an MSME might not attract interest from other resolution applicants apart from the promoters. If the promoters were not allowed to submit a resolution plan for these entities, liquidation will be the only option left.

8. (2019) 2 SSC 1 : 2018 SCC Online SC 1733
9. http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf

J. Constitutional validity of S.53 with regard to violation of Art.14 – The petitioners contended that, in the waterfall mechanism prescribed under S.53 of the Code, operational creditors did not feature higher in the order of priority and might not even get anything in the case of liquidation as they rank below all other creditors, including other unsecured creditors who happen to be financial creditors. The SC cited the BLRC Report and upheld the priority given to financial, secured and unsecured creditors over operational creditors. According to the report, repayment of financial debts infuses capital into the economy which can in turn be used by banks and financial institutions to lend further. Thus, there was indeed an intelligible differentia between the classification which sought to achieve the purpose of the Code.

Certainty and predictability are the hallmarks of a good legal system. This seminal judgment exemplifies both those values in the paradigm of commercial laws in India. The significance of the verdict extends beyond the upholding of the constitutional validity of IBC in its entirety. In fact, the court remarked about the efficient monitoring and oversight by the executive on the functioning of the Code and in bringing timely amendments. The SC also noted the changes in the macro-economic scenario brought about by the introduction of the IBC by referring to data published by RBI. Adjudicating authority have settled over 3,300 cases after the inception of IBC, out of which 80 cases have been resolved by resolution plans being accepted. The amount realized from the resolution process amounted to almost INR 60,000 crores, which is over 202% of the liquidation value. The court also looked at data pertaining to macro-economic indicators suggesting the positive impact of the legislation. For e.g., the credit given by banks and financial institutions to the commercial sector (other than food) had jumped up from INR 4952.24 crores in 2016-2017, to INR 9161.09 crores in 2017- 2018, and to INR 13195.20 crores for the first six months of 2018-2019. Similarly, credit flow from non-banks has gone up from INR 6819.93 crores in 2016-17 to INR 4,718 crores for the first six months of 2018-19. Ultimately, the total flow of resources to the commercial sector in India, both bank and non-bank, and domestic and foreign (relatable to the non-food sector) has gone up from a total of INR 14530.47 crores in 2016-2017, to INR 18469.25 crores in 2017-2018, and to INR 18798.20 crores in the first six months of 2018-2019.

The judgment also upheld the prerogative of the govt. to implement economic policies even if it is on a trial and error basis coupled with judicial restraint in economic issues. This can provide a huge relief and policy space to the govt. to implement key economic reforms without impediments unless they are manifestly arbitrary.

Case Study of Achievements of the Code

Empirical Data – Better Realization through IBC

A recent report by the Reserve Bank of India on the trends and progress of banking in India 2017-18, has shown an interesting comparison on the efficacy of the IBC in improving the recovery rate and in providing the lenders with better realization in compari¬son to the erstwhile regime of recovery.

Name of the Corporate	Debtor Percentage of the amounts realized by Financial Creditors Vis a Vis the amounts claimed
Electrosteel Steels Limited	40.38
Bhushan Steel Limited	63.50
Monnet Ispat & Energy Limited	26.26
Amtek Auto Limited	34.38
	*Source---Nishith Desai Associates Primer on IBC

Through faster resolution, the Code had one major objective – to address around Rs 10 trillion of non-performing assets (NPAs) in India's banking system. As the asset quality of banks gets better, it will promote new investments and consequent economic growth. An ecosystem for the new insolvency and bankruptcy process that took shape in 2017-18 is being used actively to resolve the bad loan problem in the banking sector, Economic Survey said.

The new Insolvency and Bankruptcy Code (IBC) has provided a resolution framework that will help corporates clean up their balance sheets and reduce debts. The code could ensure quicker resolution of NPA problems, especially in PSU banks. In fact, the Financial Stability Report issued by RBI in 2015 indicates that corporate sector vulnerabilities and

the impact of their weak balance sheets on the financial system needs closer monitoring. The time-bound insolvency resolution process would definitely help the financial services industry function better.

The code addresses the claims of both Indian and foreign creditors. Once IBC was introduced, like anything else, it was well advertised. As a result several foreign investors now begin to seek India is a legible place for investment. The reason for this is:

1. With smaller time frame for resolution, risk of losing investment was drastically reduced for foreign investors.
2. The foreign investors can now employ a flexible exist strategy.
3. More accentuation can be put towards start-ups that are more likely to succeed.
4. Even when a company goes insolvent, the IBC is geared towards maximizing the value of its assets. This in turn became a boon for investors.

These perks aided with the rise of many business buying and exit opportunities in India. To this day, the IBC has recovered more than 3 lakhs crores of debt. Out of which:

1. 1.2 lakhs crores at the pre-admission stage: even before the insolvency petition was admitted
2. 1.2 lakhs crores from resolved cases: Cases where the insolvency has been resolved
3. 60,000 crores from Non-Performing Assets.

IBC has been a game changer for creditor-borrower relationship. It is providing hope to the banking sector which was being crippled with mounting loans and defaults ultimately leading to Non-Performing Assets. So far around 1200 corporations have gone for Insolvency. There are 12 large defaulters which constitute top 25% of NPA. These are mainly Essar Steel, Bhushan Steel, Jaypee Infratech, Lanco Infratech, Alok Industries, Amtek Auto etc.

In the case of Essar, In Aug 2017, NCLT admits insolvency plea against Essar Steel filed by State Bank of India. The IBC amendment bars promoters of defaulting firm. In Feb 2018 final bids are received from Arcelor-Mittal and Numetal. NCLT finally approved Rs 42000 crore bid for Essar Steel. However, with IBC even a single creditor can file for bankruptcy and

recover their dues.

Under The Insolvency And Bankruptcy Code (Second Amendment) Act, 2018, homebuyers will get due representation in the committee of creditors (CoC) that takes a call on resolution proposals, making them an integral part of the decision making process. Homebuyers would be able to invoke Section 7 of the IBC against errant developers. Section 7 allows financial creditors to file application seeking insolvency resolution process. The move also comes at a time when many home buyers are facing hardships on account of delayed and incomplete real estate projects. However, the amended Insolvency and Bankruptcy Code (IBC) does not specify if homebuyers will be treated as secured or unsecured creditors. The homebuyer will have to prove which category of creditor he is qualified to be as per the agreement with the real estate company.

While the amendment may prove to be quite draconian for the real estate developers in the sense that the management & control (and eventually even shareholding) will be lost on a mere delay in delivery/ refund to a single flat buyer, it protects the interest of the home buyers by giving them a seat at the table. Further, even concerns about multiplicity of home buyers and their sheer number derailing the time bound process have been sufficiently addressed by inserting a new subsection 6A in section 21 which stipulates that all the home buyers will be represented by the qualified insolvency professional appointed by the NCLT bench concerned. The code aims at protecting the interest of consumers so that they won't become the victim of giant corporate debtors and/or real estate developers.

Reforms in the Banking Sector

Indradhanush

Since Modi government received a stressed banking system in advance from the previous government, it became imperative to bring big bang reforms to streamline the functioning of the banking system of the country. In order to deal with the increasing Non-Performing Assets (NPA) and strengthen the lending capacity of the banks, government came up with reforms in a phased manner in the form of Indradhanush I and Indradhanush II which has the following provisions to revamp the banking sector of the country.

Components of Mission Indradhanush-I

Mission Indradhanush I is a 7 step plan to address the challenges faced by public sector banks (PSBs).

The 7 parts include Appointments, Banks Board Bureau, Capitalization, De-stressing, Empowerment, Framework of Accountability and Governance Reforms.

Appointments - Separation of posts of CEO and MD to check excess concentration of power and smoothen the functioning of banks by induction of talent from private sector.

Bank Boards Bureau – It has replaced the appointments board of Public Sector Banks. It will advise the banks on how to raise funds and how to go ahead with mergers and acquisitions. It will also hold bad assets of public sector banks. It will be a step into eventual transition of the bureau into a bank holding company. It will separate the functioning of the banks from the government by acting as a middle link.

Capitalization - Capitalization of the banks by inducing Rs. 70,000 Crore into the banks in the next 4 years. Banks are in need of capitalization due to high NPAs and due to need to meet the new BASEL- III norms.

De-stressing - Solving issues in the infrastructure sector to check the problem of stressed assets in banks.

Empowerment - Greater autonomy for banks; more flexibility for hiring manpower.

Framework of accountability - The banks will be assessed on the basis of new key

performance indicators. These quantitative parameters such as NPA management, return on capital, growth and diversification of business and financial inclusion as well as qualitative parameters such as human resource initiatives and strategic steps to improve assets quality.

Governance Reforms - Gyan Sangam conferences between government officials and bankers have been held for resolving issues in banking sector and chalking out future policy.

Conclusion

In 2014, Modi Government received a paralyzed economy from the UPA regime. The deterioration of autonomous institutions had reached its peak during the Congress rule. Our banking institutions became victim of the organized loot that took place under the then government's nose. But the determination and perseverance of the present leadership devoted to the service of every individual including those who are at the bottom of the pyramid came of with a plan to immortalize our banking system in the form of Insolvency and Bankruptcy Code. The consistent efforts made by the Prime Minister, Finance Minister and their team have started yielding positive results their effects and hopefully very soon the Public Sector Banks which are often referred to as the lifeline of Indian Economy would be back on track.

NPAs

BANK

Insolvency & Bankruptcy