BALANCING INTERESTS OF SHAREHOLDERS UNDER THE INSOLVENCY AND BANKRUPTCY CODE 2016

***ARJUN S[1]**

'From hopeless end to endless hope'

-Dr. S.K. Gupta

India in the year of 2016 was at the brink of financial collapse. With the burden of over 4.3 trillion rupees[2] in the form of Non-Performing Assets (Herein after referred to as NPA/NPAs), the cost of India's pro-borrower policy had finally caught up with it. It was in the face of this crisis that on the 28th of May, 2016 did the govt of India formally announce the Insolvency and Bankruptcy Code, 2016 (Herein after referred to as the IBC)[3]. With the consolidation of past insolvency legislations, combined with certain key shifts in policy, the IBC coupled with surprising vigor on the part of the Govt. of India, shook the market priming India for future success with respect to finance, insolvency and liquidation. This paper shall aim to examine the unique nature of the IBC with specific reference to how the legislation manages to effectively manage the interests of the relevant stakeholders. In pursuit of the same it shall elaborate on the objectives of Insolvency regime in general, identify the relevant stakeholders of the IBC and finally rationalize the manner in which their various interests have been balanced along with any deficiencies in the same.

In order for any economy to operate effectively and efficiently under a capitalist regime, it must secure 3 rights for the enterprises and entrepreneurs operating within it. These rights include the right of a potential entrepreneur to enter market, this can be seen with how a country manages to build an environment that suitable and conducive to the entry and growth of new businesses and organizations, the right to continue operations freely refers to the right of an entrepreneur to continue operations with autonomy with respect to decision making and can be measured by means of studying the Ease Of Doing Business rating[4] of a particular county and finally the right to exit the market in the case the organization fails to operate according to prior expectations. Markets a filled with uncertainty, hence it comes as no surprise that many businesses fail each year. By ensuring that entrepreneurs can exit the market if they fail, an economy can ensure that resources aren't tied down in such failed endeavors, instead being used by the next best alternative and so on. Insolvency and Bankruptcy laws deal with securing this right.

The IBC, similar to other insolvency legislations, carries the burden of balancing the interests of certain key groups while establishing the insolvency process in a particular territory. In this

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[1] B. Com LLB,Gujarat National Law University

[2] Joice John, Arghya Kusum Mitra, Janak Raj, Deba Prasad Rath 'Asset Quality and Monetary Transmission in India' (2016) 37 RBIOP 1.

[3] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India).

[4] 'Ease of Doing Business Scores' (*Doing Business*) <https://www.doingbusiness.org/en/data/doing-business-score?topic=> accessed 18 May 2020.

regard, the manner in which the code deals with the elements such as the potential to revive the business, ensuring that assets are valued at the highest possible value as well as when a creditor may initiate insolvency under the IBC is of great significance while assessing the manner in which the Code has balanced the interests of the corporate debtor and its creditors, both operational and financial.

This brings us to one of the most significant change the IBC brought to the table over past insolvency regime, that is, the transition from the principle of 'debtor in possession' to 'creditor in control'. This means that previously. 'Debtor in Possession' refers to the manner or treatment of debtor drawn from the US Insolvency law, particularly under Chapter 11 Bankruptcy under the US bankruptcy code[5], where when a debtor files for bankruptcy protection however still retains control over the property to which creditors have legal claim under lien, that is the legal right against assets that were pledged as collateral to satisfy a debt[6] or other security interest[7]. This system presented major difficulties for secured creditors who were trying to initiate real change within management while the ailing business was still positive in net worth[8]. This was justified based on the presumption that while in possession the debtor might be able to take the necessary action to revive the ailing business. These thoughts however weren't grounded in the Indian reality where managers who were allowed to remain, often sanctioned infeasible schemes[9] while also subjecting creditors to the threat of strategic delay based on information asymmetry with respect to the concerned organization[10]. This US principle was then replaced by the UK principle of 'Creditors in Control'[11], enshrined in the Insolvency Act of 1986. This was done by means of the Committee of Creditors (Herein after referred to as the 'CoC'). Upon default to meet debt considerations, creditors were allowed to initiate insolvency procedures and replace existing management with committee appointed insolvency professionals.

This procedure addressed multiple interests. First, it ensured that the corporate debtor was given the best possible chance to survive. By authorizing creditors to alter the management of the organization, any deficiencies that impeded the debtor's capacity to pay back creditors could thus be ensured within the existing framework. Secondly by ensuring that the debtor was revived the possibility that debts would be paid back were enhanced significantly. Thirdly, by ensuring that

[5] Bankruptcy Reforms Act, 11 USC §§ 1101-1195 (1978).
[6] Will Kenton, 'Lien' (*Investopedia*, 12 March 2020) <https://www.investopedia.com/terms/l/lien.asp> accessed 18 May 2020.
[7] Will Kenton, 'Debtor in Possession (DIP)' (*Investopedia*, 14 May 2019) <https://www.investopedia.com/terms/d/debtorinpossession.asp> accessed 18 May 2020.
[8] Akshaya Kamalnath, 'Corporate Insolvency Resolution Law in India- A Proposal to Overcome the 'Initiation Problem'' (2019) UMKC Law Review Forthcoming <https://poseidon01.ssrn.com/delivery.php?ID=417031103127064023117066124120092095046013081059031002110085119120083123109003092081002029062028015025012127097103100112099090000008036054039019107000067109016104064095080073101001091072096100105092006000064098078123083089071093097090086078012125031100&EXT=pdf> accessed 19 May 2020.
[9] Omkar Goswami, *Corporate Bankruptcy in India: A Comparative Perspective* (Paris OECD 1996) 13.
[10] Id.
[11] Ernst & Young, 'How does the Insolvency Code Measure With The UK?' (*Mondaq,* 8 December 2016) <https://www.mondaq.com/india/insolvencybankruptcy/551286/how-does-the-corporate-insolvency-code-in-india-measure-with-the-uk> accessed 19 May 2020.

the organization is given a chance to take corrective measures prior to liquidation ensured that employment will not be terminated unnecessarily while at the same time giving them the required opportunities to safely transition to gainful employment, elsewhere. This scheme also enforced accountability on the management of the corporate debtor, for in effect making the decisions that led up to the default in payments, and proactively making shits in management that would prevent similar occurrences in the future. In spite of these efforts it cannot be denied that the reasons for the failure of certain organizations and businesses go beyond just poor management. Factors such as foreign exchange, in correct market analysis, changing customer preferences, market recession and depression as well as government policy play a crucial role in whether or not the organization performs according to expectations and in capable of meeting its debt burden. As many of these factors lay in the external environment of the business, that is outside the business' realm of active control[12], the possibility of liquidation, in some cases, cannot be escaped regardless of effective management changes.

This brings us to the second point, that is, how does the IBC ensure that assets are valued at their maximum and how exactly would it be helpful to the parties involved? Liquidation refers to the accounting process of ending a company's life [13] via the sale of the assets of the corporate debtor in order to pay of its liabilities and equity. Ensuring the greatest value of the assets would ensure that debts are paid off to the greatest possible extent. In the past, the snail-like pace of the insolvency process severely cost creditors value due to 2 reasons- it gave the existing management the ability to make moves that would hurt the value of assets, thereby discouraging the pursuance of liquidation and by means of depreciation of these assets over long periods of time, during which insolvency proceedings were on going.

The current insolvency regime has ensured that assets are liquidated at the best possible. Initially a total time of 270 days, that is 180 days with the option of 90 days extra, was provided to the CoC to come up with an agreeable insolvency resolution agreement post the initiation of the Corporate Insolvency Resolution Process (Herein after referred to as 'CIRP') by the National Company Law Tribunal (Herein after referred to as the 'NCLT')[14] . This limit was then raised to 330 days by the 2019 Amendment[15], only to be struct down, later, by the Supreme Court of India (Herein after referred to as the 'SC') and terms are 'Non-mandatory' in the *Essar Steele Case*[16].

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[12] Vedmani Hans, 'Business Environment – Conceptual Framework and Polices' (2018) 4(1) IESRJ https://www.iesrj.com/archive-sub?detail=BUSINESS_ENVIRONMENT__CONCEPTUAL_FRAMEWORK_AND_POLICIES> accessed 19 May 2020.

[13] Will Kenton, 'Liquidation' (*Investopedia,* 24 April 2019) <https://www.investopedia.com/terms/l/liquidation.asp> accessed 19 May 2020.

[14] Gireesh Chandra Prasad, 'Cabinet approves eight amendments to IBC to make resolution easier' (*Livement*, 17 May 2019) <https://www.livemint.com/politics/policy/cabinet-approves-eight-amendments-to-ibc-for-easier-resolution-1563361095180.html> accessed 19 May 2020.

[15] Mayur Shetty, Chintan Gandhi, 'Insolvency and Bankruptcy Code in 2019: Recent Amendments and Key Judgements' (*Mondaq,* 12 March 2020) accessed 19 May 2020.

[16] L Viswanathan, Dhananjay Kumar, (*Mondaq,* 22 November 2019) <https://www.mondaq.com/india/insolvencybankruptcy/866982/essar-steel-india-limited-supreme-court-reinforces-primacy-of-creditors-committee-in-insolvency-resolution> accessed 19 May 2020.

These alterations and amendments to how the IBC is applied and practiced balanced the requirement of early resolution as well as expectations of real world practices during such resolution, ensuring that creditors are non-victimized due to the impossibly strict timeline impose by the IBC while at the same time ensuring that if resolution is not possible, liquidation occurs as smoothly, with as high a value as possible.

Bringing us to next dimension of the IBC, that is the manner in which the IBC deals with different types of creditors, different dues, etcetera. One of the most significant conflicts with respect to the IBC considered the manner in which the Code dealt with different types of creditors, namely operation creditors and financial creditors. Financial creditors refer to anyone to whom a financial debt, such as a loan, is owed and includes all those to whom the debt is assigned or may be transferred to[17] whereas an Operation creditor refers to those to whom an operational debt is owed as[18]. There have been reports which have indicated that legislative intent behind the IBC tilted in the favor of financial creditors.[19] This however has been corrected in the 2019 amendment of the IBC which laid down a new system of preference, placing operational and financial creditors at the same level. Effectively ensuring that operational creditors are not left behind during the insolvency process.

Inclusion of relevant parties has risen to be a theme in recent cases that have involved the IBC. For example, the inclusion of home owners as financial creditors in the *Pioneer Urban Land and Infrastructure Case*[20], was a new landmark in terms of the recognition and protection of the rights of home owners and real-estate purchasers in India by the SC. Here the court declared that the Real Estate (Regulation and Development) Act, 2016 (Herein after referred to as the 'RERA') has to be read in unison with the IBC, and that in any circumstance or situation where the legislative instruments are in opposition, the IBC must be held over the RERA. This granted home owners to trigger insolvency proceeding under Section 7 of the IBC as well as representation in the CoC through an official representative[21] thus ensuring that their interests are taken care of, in the most effective and efficient manner possible.

Although the IBC at the moment seems to have finished the changes needed for it to survive the practicality test of application, the work, the author suggests is far from over. Certain moves with respect to the deficiencies of the IBC in protecting the interests of the organization from exploitation still persist. Issue under these deficiencies include but are not limited to the time and money costs associated with insolvency proceedings which come as issues of major relevance

[17] Aarohee Gursale, Sana Khan, 'Financial Creditor And Operational Creditor Under Insolvency And Bankruptcy Code, 2016' (*Mondaq*, 4 July 2017) <https://www.mondaq.com/india/insolvencybankruptcy/607738/financial-creditor-and-operational-creditor-under-the-insolvency-and-bankruptcy-code-2016> accessed 19 May 2020.
[18] Ibid.
[19] cf Chandra Prasad n(13).
[20] Abhilash Pillai, Tarun Aggarwal, 'Home Buyers= Financial Creditors: Supreme Court Reigns' (*India Corporate Law*, 14 August 2019) < https://corporate.cyrilamarchandblogs.com/2019/08/home-buyers-equivalent-financial-creditors-supreme-court-rules/> accessed 22 August 2020.
[21] Ibid.

for both small and major corporate debtors, as well as the fact the IBC in its pursuit to hand over power and control to the creditors, might have provided a large number of creditors the option for hostile takeover of control. These issues shall be discussed in greater detail along with what can be considered to prescriptions of policy below.

The time and costs of the insolvency process have been a major deterrent to widespread success. The reason for this has primarily been due to the time that is taken up in courts by means of ligation activities and the costs of professional service providers with respect to coming up with an appropriate corporate insolvency resolution Plan. The lack of personnel in the NCLT and the National Company Law Appellate Tribunal (Herein after referred to as the 'NCLAT') have played a very large role in creating the time burden that is associated with the insolvency process. This the 1st step has to be the establishment of a suitable procedure to hasten NCLT and NCLAT proceedings. This can be done by either increasing the pace of proceeding in terms of settlement or to increase the number of chambers that answer such claims. Establishment of a mechanism to toss out or prevent the occurrence of frivolous claims could also prove to be a suitable mechanism to deal with issues of time consumption and hastened insolvency resolution.

One solution in this regard that might prove to be quite suitable is to establish a method to incentivize faster resolution, bonuses could be issued to judges that deal with issues in an efficient and effective manner. The SC can also be courted to bring forward an efficiency plan by means of asking it to create a set of rules that hold judges accountable for unnecessary delays and even establishing a methodology to calculate and determine the efficiency of the members of this panel of the judiciary.

The inefficient practices of the Judiciary, however, constitute only one piece of a much bigger puzzle. The formation of insolvency plans also create quite a significant issue for the time and cost sheet of the parties in question. Insolvency resolution by no means is simple, but steps can be taken to ease the load on the system. We may once again look toward the British to pave the way to resolving this issue, one such mechanism is the existence of 'Prepacks' that stand for prepackaged insolvency resolution plans. These plans cut short the time frame of the insolvency resolution process while at the same drastically reducing the expenses that are associated with the formation of the plan. Prepacks have advantages that cater to a large variety of stake holders and is particularly suitable for financially distressed business that want to save value. Prepackaged insolvency is debtor driven in its orientation and is based on the debtor's willingness to participate.

The manner in which these benefits translate to the stake holders include, firstly, the preservation of value. News of financial distress and insolvency render a large amount of loss to the business as confidence in the business on the part of customers, suppliers and employees diminish drastically. The fast pace of prepackaged insolvency ensures that resolution is completed before news actually hits the market. This the overall value of the company is maintained and preserved. Secondly, employment preservation. Insolvency is characterized by large scale cost cutting of sometimes even the most essential of services that is those services that are rendered by employees. Prepackaged insolvencies avoid redundancies and thus prevent terminations of employee contracts thereby securing jobs. Creditors here benefit as well as they avoid the costs of large-scale severance payments and other due and compliances. For example, to costs of transfer of provident funds for a large organization that manages them on the basis of legal requirement present logistical costs many would deem tedious and problematic. Thirdly Business continuity, breakage of company operations and processes come at significant costs and loss. Companies shall be unable to operate if a lack of funds are available during insolvency, this however could be circumnavigated in the case that prepackages are included as a legitimate business practice in the Indian corporate insolvency regime.

Another crucial issue that the govt. has yet to address is the low bar for initiation of insolvency proceedings and how this might constitute a problem for businesses? The author proposes that low threshold that the IBC has imposed can create an environment where hostile initiations to take place. For example, the IBC enables any creditor to file for compulsory insolvency when the debtor has defaulted on payment to any other creditor. An opportunist creditor might use this opportunity to initiate insolvency proceedings, giving businesses no breathing room to operate in what is already quite a tight system of rules and regulations. Currently an option exists for the debtor to ask the creditor to whom the default has occurred to waive their right of claim to the same. The negligible likelihood of the same, however, prevents it from being exercised as a legitimate, realistically plausible alternative to the predicament of opportunistic initiation of insolvency proceedings, posing as a major threat to the balance of rights between the corporate debtor and its respective creditors.

Albeit the above threshold has in fact been raised due largely to the COVID-19 Outbreak, that however begs the question as to how the government plans on adjusting the code to suit the requirements of a post COVID economy. A relaxed code would without a doubt result in the greater mounting of debt, as warned by Raghuram Rajan[22] as is, which may have impacts that could last far beyond the pandemic in itself. Decisions to be made with respect to the government's policy on the adoption of either austerity or deficit financing to ensure the financial wellbeing of businesses is going to be a crucial factor in determining how the IBC shall evolve and grow as a legislation.The IBC over the course of its short existence has had quite a significant impact at the Indian corporate insolvency field and has appeared to suit India's modern needs better than any previous insolvency legislative instrument. It has also made significant strides forward to stabilize and provide for the needs of those depending on it by means of the precedents that that set by the courts as well as the infamous amendments made in 2019. That being said the author is of the opinion that a large portion of the road remains yet to be traversed, and that only time may tell what the destiny of the IBC holds.

[22] Gurneel Kaur, 'Raghuram Rajan Warns RBI of Mounting Bad Debts Due to Pandemic' (*Grain Mart India,* 7 August 2020) < https://www.grainmart.in/news/raghuram-rajan-warns-rbi-of-mounting-bad-debts-due-to-pandemic/> accessed 22 August 2020.