



CORPORATE INSOLVENCY LAW IN INDIA

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Outline

The framework for bankruptcy resolution [in India]... is fragmented, complex, and fraught with delay... The legal structure is... to put it charitably, in a state of transition, but this state of affairs needs to be remedied quickly. Fortunately, the economy is doing well, but this state of affairs will not last forever. (Rajan Report, 2010).

- (1) The legal framework: India's formal corporate insolvency procedures
- (2) The law's failure: the controversial operation of corporate insolvency law in practice
- (3) Understanding the law's failure: results of an in-depth, long-range study

The legal framework

- Two formal (collective) procedures:
 - Liquidation under the Companies Act 1956
 - A UK transplant, with few differences ‘on the books’
 - Corporate rescue (‘rehabilitation’) under the Sick Industrial Companies Act 1985 (SICA)
 - Indian procedure, available only to one class of corporate debtor: ‘sick industrial companies’
 - For non-industrial companies: only formal route to reorganisation is the scheme of arrangement, again a UK transplant
- Alternatives to formal procedures:
 - The introduction of a ‘soft-law’ restructuring tool by the Reserve Bank of India for debtors with large exposure to multiple banks
 - The introduction of stronger debt enforcement tools for banks

The law's failure

- The popular consensus: Indian corporate insolvency law is dysfunctional; a 'failure'
- India ranked 134th (of 174 economies) in 'ease of closing business' rankings (*Doing Business Report*, World Bank)
 - Record of extraordinary delays and poor returns to creditors

India has the dubious distinction of being among the countries where it takes the longest time to go through bankruptcy in the world (10 years on average). Consequently, recovery rates are also very low... (Chakrabarti et al, 2007)

- Perception of mismatch between new market economy model and old, inefficient insolvency regime

The Indian system provides neither an opportunity for speedy and effective rehabilitation nor for an efficient exit... The Committee feels that the Indian economy is now at a stage where articulation of a comprehensive framework that addresses insolvency issues would make a material difference to the productivity of the economy... a review of the system for addressing corporate insolvency law... is urgently called for... (Irani Committee, 2005)

Understanding the law's failure: overview

- The existing literature:
 - Consensus on the failure of Indian corporate insolvency law
 - Consensus on need for reform, w/ strong emphasis on repeal
 - Underlying assumption: existing procedures are incapable of delivering efficient outcomes in insolvency
 - Little analysis of why this is so: of why India's existing procedures have 'failed' so spectacularly
- Unanswered question: why do India's existing procedures function as they do?
- My project:
 - Explaining the functionality of Indian corporate insolvency law
 - Long-range project that analyses operation of corporate insolvency law from independence to present day

Understanding the law's failure: SICA

- SICA: the rescue procedure for industrial companies
 - Target: industrial companies (the problem of 'industrial sickness')
 - Key features:
 - (1) Mandatory for insolvent industrial companies; moratorium; DIP
 - (2) Rehabilitation process controlled by tribunal – the Board for Industrial and Financial Reconstruction (BIFR) – with powers to:
 - Sanction a binding rehabilitation scheme, subject to 'veto';
 - Recommend liquidation.
 - (3) Liquidation process controlled by civil courts, which are apparently bound to give effect to BIFR's opinion and order winding-up
- The vision: speedy rehabilitation where possible; speedy liquidation where not
- In practice:
 - Outcomes: long delays, usually followed by liquidation (with further delays) in the civil courts; poor creditor returns
 - Caricature as a 'debtor haven', with specific complaints of creditor avoidance, asset siphoning, and (occasionally) creditor 'coercion' in rehabilitation schemes

Understanding the law's failure: SICA

- Explaining SICA's functionality:
 - Popular critique: 'bad law'
 - Debtor-in-possession + moratorium (informational asymmetries; perverse incentives to delay)
 - Challenging this critique:
 - Two key creditor protections: (a) the 'veto': no scheme without consent of affected institutional creditors; (b) the BIFR's liquidation power: no rehabilitation = binding liquidation recommendation
 - Suggests SICA was capable of delivering fast liquidation for economically distressed firms
 - Reviewing the evidence:
 - Original review of dataset of 1000+ cases
 - Archival research on central government / central bank policy
 - Qualitative fieldwork

Understanding the law's failure: SICA

- Results

- New evidence of judicial 'innovations' in the interpretation and application of SICA, in the period following India's transition to a market economy
- Three key innovations in the courts:
 - (1) Formal dilution of BIFR's power to make binding liquidation recommendation
 - (2) Development of *ad hoc* rehabilitation practice, in which debtors were afforded a series of further chances to propose hopeless schemes
 - (3) Re-interpretation of the moratorium: vulnerable creditors exempt
- Net effect:
 - Slows liquidation of hopelessly insolvent companies
 - Enhanced worker protections in the interim (in effect, a value shift from institutional creditors to workers, or a welfare subsidy)
 - Best explanation for record of delay and institutional creditor losses

Understanding the law's failure: SICA

- Explaining judicial innovation:
 1. The challenges of economic transition: hopelessly insolvent industrial companies, inherited from planned economy period, and precarious position of their workers
 - No opportunity for employment where whole industry defunct
 - Little/no social security safety net
 - Emergencies: worker suicides and starvation

This Court cannot be blind to the agonies and anguish of poor workmen when they knock at the doors... praying for justice (Logachandran v District Collector).

1. Confusion about the role of banks in new economic environment
 2. Good precedent: evidence of similar innovations in interpretation of liquidation law during planned economy period
- Towards a new theory of Indian insolvency law: the role of the courts



Questions?