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Proposals for Reforms - The Indian Position

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I. THE PREVAILING CORPORATE INSOLVENCY & RESTRUCTURING SYSTEM

India does not have a composite law dealing with insolvency of companies. While Sick Industrial Companies (Special Provisions) Act,1985 deals with the revival and rehabilitation of corporate entities, the Companies Act,1956 deals with their liquidation and winding up.

In August 2001, the Companies (Amendment) Bill, 2001 and the Sick Industrial Companies (Special Provisions) Repeal Bill, 2001 were introduced in the Parliament of India. The Bills are the legislative products of the recommendations of Justice V.B. Eradi Committee which was set up by the Government of India in the year 1999 for remodelling the existing laws relating to insolvency and winding up of companies and bringing them in time with the international practices in this field. The Bills, if passed in their present form will bring the curtains down on the Sick Industrial Companies (Special Provisions) Act, 1985 and will restructure the Companies Act, 1956 in a big way leading to the new regime of tackling corporate rescue and insolvency procedures in India.

In July, 2002, the President of India promulgated an Ordinance on Asset Reconstruction and Realisation of Security Interest namely, Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002.

This paper brings out some of the salient provisions of the existing legislations and the Ordinance, highlights the weaknesses in the legislations, sets out some of the significant changes in the proposed enactments and the said Ordinance and provides a critical analysis of their provisions.

A. Sick Industrial Companies (Special Provisions) Act, 1985

Board for Industrial and Financial Reconstruction (BIFR)

SICA is basically and predominantly remedial and ameliorative in so far as it empowers the quasi judicial body, Board for Industrial and Financial Reconstruction to make appropriate measures for revival and rehabilitation of potentially viable sick industrial companies and for liquidation of non-viable companies. BIFR comprises of a chairman and not less then two and not more than fourteen members and shall be persons who have been or are qualified to be High Court judges or are persons of ability and integrity and have special knowledge and professional experience of not less then fifteen years in the field of science, technology, economics, banking industry, industrial reconstruction, investment, law, labour matters, industrial finance, industrial management, accountancy, marketing, administration or any other matter.

Invoking jurisdiction of SICA

SICA requires that when an industrial company has become a sick industrial company, the Board of Directors of the said company shall, within sixty days from the date of finalisation of the duly audited accounts of the company for the financial year as at the end of which a company has become a sick industrial company, make a reference to BIFR for determination of the measures which shall be adopted with respect to the company. However, if the Board of Directors has sufficient reasons even before finalisation of accounts to form an opinion that the company has become a sick industrial company, it shall, within sixty days after it has formed such an opinion, make a reference to the BIFR.[1]

[1] Section 15(1) of SICA.

With the promulgation of the said Ordinance, however, no reference can be filed by a company where the assets of the company have been acquired by an Asset Reconstruction Company. Further, a pending reference before BIFR shall abate if seventy five percent of secured creditors initiate action under the Ordinance.

The Central or State Government, Reserve Bank of India or a Public or State Financial Institution or a Scheduled Bank may, if it has sufficient reasons to believe that any industrial company has become a sick industrial company under SICA, make a reference in respect of such company to the BIFR.[2]

Sick Industrial Company

For the purposes of SICA, a sick industrial company means an industrial company (being a company registered for not less than five years and employing fifty or above workmen) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.[3] Net worth[4] has been defined as the sum total of the paid up capital and free reserves. For the purposes of networth, "free reserves" means all reserves credited out of the profits and share premium account but does not include reserves credited out of re-valuation of assets, write-back of depreciation provisions and amalgamation.

Registration of Reference and Enquiry by BIFR

The reference filed by a sick industrial company or by any of the parties prescribed under SICA is registered and placed before BIFR for consideration. The BIFR may make such inquiry, as it may deem fit for determining whether the company has become a sick industrial company.[5] If BIFR deems necessary or expedient so to do for the expeditious disposal of an inquiry, it may appoint any Operating Agency (OA) to enquire into and make a report with respect to such matters as may be specified in that order. If the BIFR comes to the conclusion that the company is not a sick industrial company, it shall reject the reference.

Preparation and sanction of scheme

- If on making an inquiry, the BIFR is satisfied that a company has become sick, it shall decide whether it is practicable for the company to make its net worth exceed the accumulated losses within a reasonable time on its own and shall give such company, such directions as it may deem fit to make its net worth exceed the accumulated losses.[6]

- If the BIFR decides that it is not practicable for a sick industrial company to make its net worth exceed the accumulated losses within a reasonable time and it is necessary in the public interest to adopt remedial measures, it may direct any OA to prepare a scheme providing for such measures in relation to such company as it considers necessary from out of the parameters laid down under the Act.[7]

- The OA, if possible, prepares a scheme providing, *inter alia* for any one or more of the measures – the financial reconstruction of the sick company by change in or take over of the management of the sick company; the amalgamation of the company with any other company; the sale or lease of a part or whole of any industrial undertaking of the sick company; the rationalisation of managerial personnel; such incidental, consequential or supplemental measures as may be necessary; change in Board of Directors etc.[8]

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[2] Section 15(2) of SICA.
[3] Section 3(1)(o) of SICA.
[4] Section 3(1)(ga) of SICA.
[5] Section 16 of SICA.
[6] Section 17(1) and Section 17(2) of SICA.
[7] Section 17(3) of SICA.
[8] Section 18 of SICA.

Operating Agency

The OA assists BIFR in the discharge of its functions. Generally, BIFR appoints any financial institution or bank on its panel to act as the OA. The role and responsibility of the OA is to prepare, if possible, a scheme for the rehabilitation of the sick industrial company in accordance with the guidelines set out by the BIFR.

Circulation / Sanction of scheme

- Where the scheme prepared by the OA relates to preventive, ameliorative, remedial and other measures with respect to any sick industrial company, it may provide for financial assistance by way of loans, advances or guarantees or reliefs or concessions or sacrifices from the Central Government, State Government, any scheduled bank or other bank, a public financial institution or state level institution or any institution or other authority to the sick industrial company.

- Every such scheme is required to be circulated to every person to provide financial assistance for its consent within a period of sixty days from the date of such circulation, If no consent is received within the said period, it is deemed that consent has been given and the BIFR shall sanction the scheme and on and from the date of such sanction, the scheme shall be binding on all concerned.

- If the consent so required is not given, in that case the BIFR may adopt such other measures, including the winding up of the sick industrial company, as it may deem fit.

Winding up of sick industrial company

Where the BIFR comes to the conclusion that it is not possible to revive the company and that it is just and equitable that the company should be wound up, it shall record and forward its opinion to the concerned High Court. The High Court, on the basis of this opinion, may order winding up of the company and may proceed and cause to proceed with the winding up of the sick industrial company in accordance with the provisions of the Companies Act, 1956.[9]

Suspension of legal proceedings and Contracts

Where in respect of an industrial company, an inquiry is pending or any scheme is under preparation or consideration or a sanctioned scheme is under implementation or where an appeal is pending, no proceedings for the winding up of the industrial company or for execution, distress or the like against any of the properties of the industrial company or against its guarantor or for the appointment of a Receiver shall lie or be proceeded with further except with the consent of the BIFR or as the case maybe, the Appellate Authority.[10]

Appellate Authority

There is an Appellate Authority for Industrial and Financial Reconstruction (AAIFR) which comprises of a retired High Court Judge as its chairman. The AAIFR hears appeals from the parties aggrieved by the orders of BIFR.

B. Companies Act, 1956

[9] Section 20 of SICA.
[10] Section 22 of SICA.

Companies Act, 1956 (1956 Act) inter alia deals with the winding up or liquidation of the companies incorporated under the said Act. The winding up of a company under the 1956 Act can be by an order of court or voluntary.

Cases in which a company may be wound up by the court

(a) The court may wind up a company[11]

(i) if the company has by special resolution resolved that it be wound up;

(ii) if the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;

(iii) if it is unable to pay its debts[12] ;

(iv) if a default is made in delivering the statutory report to the Registrar or in holding the statutory meeting;

(v) if the number of members is reduced in the case of a public company below seven and in the case of a private company below two;

(vi) if the court is of the opinion that it is just and equitable that the company should be wound up.

Who can present the petition for winding up ?

An application to the court for the winding up of a company, can be by way of a petition presented[13]

- by the company ;
- by any creditor or creditors including contingent or prospective ;
- by any contributory or contributories;
- by the Registrar of Companies;
- in a case falling under Section 243 of the Companies Act,1956, by any person authorised by the central government in that behalf.[14]

Power of court on hearing petition

On hearing a petition, the court may dismiss it or adjourn it conditionally/unconditionally or make any order of winding up or pass any interim order or make any other order as it may deem fit, including appointment of Provisional Liquidator.[15]

[11] Section 433 of Companies Act,1956.
[12] *A company shall be deemed to be unable to pay its debts - if a creditor to whom the company is indebted in a sum exceeding five hundred rupees, has served on the company a demand by registered post at its registered office requiring it to pay the sum so due and the company has for three weeks thereafter neglected to pay the sum; or if execution or other process issued on a decree or order of any court in favour of a creditor of the company is returned unsatisfied; or if it is proved to the satisfaction of the court that the company is unable to pay its debt.*
[13] Section 439 of Companies Act,1956.
[14] Such an application is made by Central Government if, on investigation into the affairs of the company, it finds that it is just and equitable that the company be wound up.
[15] Section 443 of Companies Act,1956.

Appointment of Official Liquidator

An Official Liquidator (OL)appointed by the Central Government shall be attached to each High Court who shall be a whole time officer unless the Central Government considers that there will not be sufficient work for a whole time officer in which case, a part time officer may be appointed.[16]

Custody of company's property

Where a winding up order has been made or where a Provisional Liquidator has been appointed, the Liquidator shall take into his custody or under his control all the property, effects and actionable claims to which the company is or appears to be entitled. All the property and effects of the company shall be deemed to be in the custody of the court as from the date of the order for the winding up of the company.[17]

Voluntary winding up

A company may be wound up voluntarily when the period if any, fixed for the duration of the company by the Articles has expired or the event, if any, has occurred on the occurrence of which the Articles provide that the company is to be dissolved and the company in general meeting passes a resolution requiring the company to be wound up voluntarily or if the company passes a special resolution that the company be wound up voluntarily.

Application of insolvency rules in winding up of insolvent companies

In the winding up of an insolvent company, the same rules shall prevail and be observed with regard to debts provable; the valuation of annuities and future and contingent liabilities; and the respective rights of secured and unsecured creditors as are in force for the time being under the law of insolvency with respect to the estates of persons adjudged insolvent provided that the security of every creditor shall be deemed to be subject to a pari passu charge in favour of the workmen to the extent of the workmen's portion therein and where a secured creditor instead of relinquishing his security and proving his debt opts to realise his security, the Liquidator shall be entitled to represent the workmen and enforce such charge.

Stay of legal proceedings on winding up order

- When a winding up order has been made or the OL has been appointed as Provisional Liquidator, no suit or legal proceeding can be commenced, or if pending at the date of the winding up order, can be proceeded with against the company except by leave of the court and subject to such terms as the court may impose.[18]

- The court which is winding up the company shall have jurisdiction to entertain or dispose of any suit or proceeding by or against the company; any claim made by or against the company. Secured creditors, however, can chose to stay outside the winding up proceedings.

- Any suit or proceeding by or against the company which is pending in any court other than in which the winding up of the company is proceeding may be transferred to and disposed of by that court.

Preferential payments

[16] Section 448 of Companies Act,1956.
[17] Section 456 of Companies Act,1956.
[18] Section 446 of Companies Act, 1956.

In the winding up of a company, workmen's dues and debts due to secured creditors to the extent such debts rank *parri passu* with such dues, shall be paid in priority to all other debts. The debts payable shall be paid in full unless the assets are insufficient to meet them in which case they shall abate in equal proportions.[19]

C. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Second) Ordinance, 2002

ASSET RECONSTRUCTION COMPANIES (ARC)

Chapter II of the Ordinance provides for the setting up of the Reconstruction and Securitisation Companies for "Securitisation" i.e. acquisition of financial assets from its owner, whether by raising funds by such Securitisation or Reconstruction Company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise. The Ordinance deals with the Registration of these Companies, their pre-requisite qualifications etc.

Measures for Asset Reconstruction

The measures that a Securitisation or Reconstruction Companies can take for the purpose of Asset Reconstruction are :

- Take-over of the management of the business of the borrower.
- Sale or lease of a part or whole of the business of the borrower.
- reschedulement of payment of debts payable by the borrower.
- Enforcement of security interest in accordance with the provisions of the ordinance.
- Settlement of the dues payable by the borrower.
- Taking possession of secured assets.

Additionally, such Company can perform the following functions :

- Acting as an agent for any bank or financial institution for the purpose of recovering their dues from the borrower on payment of such fees as may be mutually agreed.
- Acting as a Manager.
- Acting as a Receiver.

Acquisition of Rights of Interest in Financial Assets by ARC

An ARC can acquire financial assets by issuing a debenture or bond or any other security in the nature of a debenture for consideration agreed and by incorporating such terms in the agreement ; or entering into an agreement for the transfer of such financial assets to such company on such terms and conditions as may be agreed.

The terms and conditions of acquisition, including those relating to consideration for acquisition can be negotiated and agreed between the parties. However, such terms and conditions would have to be in consonance with the guidelines framed and directions issued by Reserve Bank of India from time to time under Section 12 of the Ordinance.

[19] Section 529 of Companies Act,1956.

Legal Consequences of Acquisition

- ARC shall be deemed to be the lender and all rights of lender shall vest in the ARC in relation to such financial assets.
- All contracts, deeds, bonds, agreements, power of attorney, grants of legal representation, permissions, approvals, consents or no objections and instruments relating to financial assets subsisting before the acquisition of financial assets by the ARC shall have full force and be enforced as if they had been issued in favour of ARC or as the case maybe.
- No suit, appeal or proceedings shall abated or be discontinued for the reasons of acquisition of financial assets by the ARC. However the appeal may be continued, prosecuted and enforced by or against the ARC. However, no reference can be filed by such company in respect of which acquisition of assets is carried out by an ARC.

Procedure for Acquisition - Notice of Acquisition

Though no procedure, as such, has been laid down under the Ordinance, a notice of acquisition may be sent to the Obligor (generally speaking, the borrower) or to any other concerned person (such as, co-lenders, statutory authorities etc.) and the Registering Authority in whose jurisdiction the asset is located. Such notice is not mandatory. The notice is not of proposed acquisition but of the acquisition already carried out. If any payment is received from the Obligor after acquisition, the same shall be in trust and be forwarded to ARC.

Registration of Transaction

Chapter IV of the Ordinance provides for setting up of a Central Registry to keep a record of Securitisation transactions, for filing of transaction etc. Only when the Rules are framed, the obligations of parties to acquisition under this Chapter would become known.

Resolution of Disputes

Disputes relating to non payment of any amount due including interest arising amongst Bank,FIs,ARC and Qualified Institutional Buyer shall be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996.

ENFORCEMENT OF SECURITY INTEREST

Invoking the Provisions Relating to Security of Interest

The Ordinance provides that where any borrower makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt has been classified by the secured creditor as non-performing asset, then, the secured creditor may call upon the borrower by way of a written legal notice to discharge in full, his liabilities within sixty days from the date of the notice failing which the secured creditor would be entitled to exercise all or any of the rights set out in sub section 4 of Section 13 of the Ordinance. The provisions of the Ordinance relating to security of interest can be invoked by :

- any bank or
- public financial institution under Section 4A of the Companies Act, 1956 or
- any institution specified by Central Government under sub clause (ii) of clause (h) of section 2 of Recovery of Debt due to Banks and Financial Institutions Act, 1993 or

- any other institution or non banking financial company as specified by Central Government or
- International Finance Corporation or a consortium thereof.

The provisions of the ordinance inter alia do not apply to any case in which the amount due is less than twenty per cent of the principal amount and interest thereon.

Non payment or part payment by borrower

If the borrower does not make full payment demanded or makes part payment in discharge of its liability, the creditor would be well within its rights to pursue its rights under the Ordinance.

Taking Possession of Assets

On the expiry of sixty days if the debt is not fully paid by the borrower, the officer(s) so authorised can enter the premises where the secured asset is lying and take its possession. If there is resistance or there is likely to be resistance from the borrower and/or its agents in the taking over of the possession, such officer may write a request to the Chief Metropolitan Magistrate (CMM) or the District Magistrate (DM) in whose jurisdiction such secured asset is situate to take possession.

Take Over of Management of Secured Assets

Another option available under the Ordinance is to take over the management of the business of the borrower. The manner and effect of take over has been set out under the Ordinance. While in possession of borrowers business, the secured asset can be sold simultaneously to recover the dues.

Appointment of Manager for the Secured Assets

The duties and responsibilities of the manager are not defined any where in the Ordinance. However, it appears that the function of a manager would be confined to managing the asset and not to sell or transfer the asset. The manager would be a custodian of the assets and will otherwise have full control over the asset to the extent empowered. Manager can be assigned the responsibility to manage the asset but can not be empowered to sell unless the manager is also acting under clause (a) of sub section (4) of section 13.

Procedure in case of Take Over of Co-financed Assets

In case of financial assets by more than one secured creditors or joint financing of a financial asset by secured creditors , no secured creditor shall be entitled to exercise any of the rights conferred on him unless exercise of such rights is agreed upon by the secured creditor representing not less than three fourth in value of the amount outstanding as on record date and such action shall be binding on all secured creditors

Appeal before Debt Recovery Tribunal

Any person (including borrower) aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorised officer under this chapter, may prefer an appeal to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measures had been taken. However, such appeal shall not be entertained by the Debts Recovery Tribunal unless the borrower has deposited with the debts Recovery Tribunal seventy-five per cent. of the amount claimed in the notice. Any person aggrieved by any order by the Debts Recovery Tribunal under section 17 may prefer an appeal to an Appellate Tribunal.

Protection to Secured Creditors

No suit, prosecution or other legal proceedings shall lie against any secured creditor or any of his officers or manager exercising any of the rights of the secured creditor or borrower for anything done or omitted to be done in good faith under this Ordinance. However, any offence by the company during the time the Directors of the secured creditor are holding appointment, would be treated as would an offence committed by a company in a normal case is treated. Meaning that such Directors would be fully responsible for the offence committed by the company.

Jurisdiction of Civil Court barred

No civil court will have jurisdiction over any of the matters stated under the Ordinance.

II. AUTHOR'S ANAYLSIS OF EXISTING LAWS :

SICA has proved to be a complete failure with BIFR having failed to turn around sick companies. Burdened with over Rs. 85,000 Crores of Non Performing Assets, the lenders find SICA to be the biggest obstacle to recover their dues. Only 254 companies had been revived till December, 2000- a measly 7 percent of the companies that approached BIFR since 1985. The 1956 Act is a slow and cumbersome legislation. The Ordinance, in as much as it talks of Reconstruction, is yet to be experienced since it is only a couple of months old.

Lack of comprehensive bankruptcy code and road map to bankruptcy

The existing Indian law lack a specific comprehensive Bankruptcy Code to deal with corporate bankruptcy, which encompass in itself the corporate restructuring possibilities preceding insolvency and winding up. The bankruptcy proceeding needs to be based on the fundamental objective of assets value maximisation, and hence the law has to facilitate protection of assets against all risks of further diversion, decay and destruction. A self contained Bankruptcy Code facilitates corporate restructuring and fast track winding up on insolvency. In the fast changing scenario of growing cross-border investment, trade and commerce, cross-border insolvency problems are bound to increase and a comprehensive Bankruptcy Code alone can address such issues taking into consideration international practices. There is a need to introduce the road map of the bankruptcy proceedings viz. application for initiating bankruptcy proceedings; appointment of Trustee: empowerment of the Trustee; operational and functional independence; accountability to the court, including the power of the court to remove Trustee in case of mismanagement; relationship with current management; monitoring or substitution; day-to-day operation, etc; time bound restructuring/recognition plan: who should submit; procedure of acceptance; mechanism to sell off; pro-active initiative of the Trustee; number of time-bound attempts for restructuring: decision to go for insolvency and winding up; and strategies for realisation and distribution.

Lack of timely commencement of proceedings and defective trigger point to invoke SICA jurisdiction

Under the existing law, a company can approach the BIFR for adopting steps for its revival, on erosion of its entire net worth. The erosion of entire net worth is too late a stage to attempt restructuring as by the time the net worth is eroded the company is too sick to be revived and has lost its resilience to restructure and revive itself.

Misuse of protection against recovery/distress proceedings

Under SICA, an automatic stay operates against all kind of recovery and distress proceedings against all creditors once the reference filed by the company is registered. This is the principal drawback of the existing legislation as this has led to BIFR becoming a haven for defaulting companies. Erring debtors have misused SICA to seek protection and moratorium from recovery proceedings. The companies are easily able to enter into the reference, sometimes by manipulating their accounts to reflect net worth erosion and are then able to attract immunity against the recovery action by the creditors and this benefit is then attempted to be perpetuated. Registration of reference is dependent upon the erosion of net worth and this can be achieved by accounting manipulations. The provisions for suspension of legal proceedings are misused and perpetuated. This problem arises due to the fact that unscrupulous promoters enter into the process of rehabilitation by manipulating sickness, take undue benefits arising out of delay in decision making of BIFR. If the reference is rejected, a fresh reference is filed with respect to accounts for the next year and the cycle goes on endlessly. There is no fear of reprisal or punitive action against the companies indulging in this malpractice.

Procedural and legal delays

There is inherent delay both, procedural and legal in proceedings before BIFR. The BIFR takes nearly one year to determine whether a company is sick. Thereafter, it takes around one year to formulate revival strategy. Consideration of the same also takes substantial time since banks and financial institutions have their own hierarchy in decision making, leading to avoidable delays and the decisions by the banks are also neither transparent, nor subject to judicial review. There is gross lack of co-ordination between the banks inter se and banks and financial institutions and many a times the whole process is held up due to adamancy of one of them delaying the whole process of rehabilitation. By the time decisions are taken and communicated, the plan, which had been conceived has lost its viability resulting in failure of revival schemes even after sanction.

Defective policy for appointment of BIFR members and their inadequate strength

SICA has become a rehabilitation centre for retired bureaucrats. Rather then appointment of experts to BIFR and AAIFR, the Government has by and large filled up the positions by appointing retired and influential bureaucrats who have no experience and expertise of revival and rehabilitation of companies. The highest number of members in BIFR at a given point of time has not exceed fifty percent of its sanctioned strength. With a large number of companies approaching BIFR for revival in the last decade, inadequate strength of members of BIFR has contributed to delay in disposal of cases.

Bureaucratisation of winding up proceedings

The process is hamstrung due to bureaucratisation of the winding up process through the Liquidators who are usually Government Officers associated with this process. The delay is also caused due to procedural delays in sale of assets and determination of amounts payable to the interested parties. As such, there is no fear on the part of the debtor corporations that failure of rehabilitation scheme would result in any loss or prejudice to it. This does not lead to any seriousness on the part of the management to succeed in the revival process.

Poor enforcement mechanism

SICA is a very comprehensive and self contained legislation as far as organisation is concerned. There are adequate penal provisions in SICA. However, the mechanism for its implementation is so poor that violations take place fearlessly leaving no fear for law. The misuse of the said forum in making an entry by manipulating/feigning sickness must be curbed by strict penal consequences for such misuse, which should be demonstrably used to ensure that no entity attempts to misuse these provisions. However, this aspect and solution to this problem has to be found out in the proposed legislation.

International insolvency in India

Indian insolvency laws do not have any extra-territorial jurisdiction, nor do they recognise the jurisdiction of foreign courts in respect of branches of foreign banks operating in India. Therefore, if a foreign company is taken into liquidation outside India, its Indian business will be treated as a separate matter and will not be automatically affected unless an application is filed before an insolvency Court for winding up of its branches in India. At present, thankfully, the Government is considering the adoption of UNCITRAL Model Law on Cross-Border Insolvency to meet the demands of globalisation of economy and to deal with international insolvency. This will radically change the orientation of Indian law and make it suitable for dealing with the challenges arising from globalisation and increasing integration of Indian economy with the world economy. While drafting the substantive and procedural rules of bankruptcy, international standards for both national and cross-border insolvency should be taken into consideration which, based on Indian situation, should be suitably incorporated.

In India, the winding up of companies under the 1956 Act is a long drawn affair. Before a company is finally dissolved with the sanction of the court, it takes years in obtaining the statement of affairs, books of account, records and assets, realisation of debts and sale of assets, settlement of list of creditors and contributories, distribution of assets to creditors, members etc. In the process, substantial corporate assets remain unrealised and undistributed. The inordinate delay in proceedings mars the possibilities of rapid use of productive assets lying dormant throughout the country. This process has been found to be completely ineffective.

Lack of Professional Liquidation Department

In India, the Liquidators work under the Ministry of Company Affairs of the Government of India. The Department of Official Liquidators lacks professionalism and works under a highly bureaucrat controls.

III. ONSET OF REFORMS IN INSOLVENCY AND RELATED LAWS

With the globalisation of economy, the issues relating to cross border insolvency assumed great significance and a need has been felt for long for bringing about reforms in this branch of law. Moreover, with the Indian economy having opened up for investment by foreign creditors and, internationally, the Indian corporate also making investments in companies outside, the issues relating to cross-border insolvency has also assumed great significance.

In the year 1999, the Government of India set up a High Level Committee headed by Justice V.B.Eradi, a superannuated Judge of Supreme Court of India to examine and make recommendations with regard to the desirability of changes in existing law relating to winding up of companies and a self-contained law on winding up of companies having regard to Sick Industrial Companies (Special Provisions) Act, 1985, and the Securities Contracts (Regulation) Act, 1956, with a view to creating confidence in the minds of investors, creditors, labour and shareholders.

The committee completed its work and submitted its report to the Central Government in the year 2000.

Recommendations of the Committee

The committee recommended that

- the jurisdiction, power and authority relating to winding up of companies should be vested in a National Tribunal which should be vested with the functions and power with regard to rehabilitation and revival of sick industrial companies, a mandate presently entrusted with BIFR under SICA.

- the 1956 Act should be suitably amended to take the power away from High Court and the transfer of the pending winding up proceedings to the Tribunal.

- the adoption of the international trend in law relating to corporate bankruptcy, namely, sell the assets first as quickly as possible, and relegate to a later stage the adjudication of claims and distribution of proceeds.

- an in-depth assessment of the office of Official Liquidators in view of inadequate and incompetent manpower and absence of latest office equipments and technologies.

- a liquidation committee consisting of creditors of the company on the lines of Section 141 of the Insolvency Act, 1986 of UK be set up to assist the Liquidator.

- the repeal of SICA and recommended the ameliorative, revival and reconstructionist procedures obtaining under it to be reintegrated in a suitably amended form in the structure of the 1956 Act.

- the procedure would be similar to the measures for Administration Order Procedure and winding up which are now provided integrally as part of U.K. Insolvency Act, 1986.

Cross-Border Insolvency

The committee sought guidance from the 'UNCITRAL Model Law on Cross-Border Insolvency' and the views expressed by the International Monetary Fund on key issues relating to 'Orderly and Effective Insolvency Procedures'. The Committee recommended that Part VII of the Companies Act,1956 should be suitably amended to incorporate the relevant provisions of 'UNCITRAL Model Law'.

The Committee noted the Cork Committee's suggestion to introduce the concept of Professional Insolvency Practitioners and recommended setting up of a panel of professionals and prescribes rules for their qualifications and appointments and uses their services as Liquidators.

The recommendations of the committee have since been translated into the Companies (Amendment) Bill, 2001 and the Sick Industrial Companies (Special Provisions) Repeal Bill, 2001.

IV: BROAD FEATURES OF THE PROPOSED BILL

National Company Law Tribunal

The Companies (Amendment) Bill,2001 proposes amendment of Article 323B of the Constitution of India and provisions of Part VII of the Companies Act, 1956 for setting up of a National Company Law Tribunal (NCLT) and its Appellate Tribunal. The Bill proposes repeal of SICA and abolition of Company Law Board.

Jurisdiction of NCLT

Under the proposed legislation, NCLT will have :

- the power to consider revival and rehabilitation of companies – a mandate presently entrusted to BIFR under SICA. SICA will be repealed and pending reference before BIFR and appeals before AAIFR would abate.

- the jurisdiction and power relating to winding up of companies vested in the High Courts. The winding up proceeding pending in High Courts shall stand transferred to the Tribunal.

- the jurisdiction & power exercised by Company Law Board under the Companies Act, 1956 be transferred to NCLT.

Structure of proposed Tribunal

- NCLT will consist of a President and such number of Judicial and Technical Members not exceeding sixty two in number.
- The President of NCLT will be a sitting or a former judge or any one qualified for appointment as a High Court Judge who will be appointed in consultation with the Chief Justice of India.

- The Principal Bench will be located at New Delhi and other Benches at principal seats of each High Court.
- Each of the Benches of NCLT will comprise of a Judicial Member and a Technical Member.

Invoking jurisdiction of NCLT

- The Bill requires that when an industrial company has become a sick industrial company, the Board of Directors of the said company shall make a reference to NCLT for determination of the measures which shall be adopted with respect to the company. However, the company will prepare and submit along with the reference a scheme for its revival and rehabilitation.

- Such a reference will be required to be filed within one hundred and eighty days from the date on which the Board of Directors has come to know the causes of making a reference. The reference would be accompanied with Auditors Certificate certifying causes of sickness.

- The Central Government or Reserve Bank of India or a State Government or a public financial institution or a State level institution or a scheduled bank may, if it has sufficient reasons to believe that any industrial company has become a sick industrial company under SICA, make a reference in respect of such company to NCLT.

Sick industrial company

A sick industrial company means an industrial company which has at the end of any financial year accumulated losses equal to fifty percent or more of its average net worth during four years immediately preceding such financial year or failed to pay its debts within any three consecutive quarters on demand for its repayment by a creditor or creditors of such company.

Net worth

Net worth means the sum total of the paid up capital and free reserves. For the purposes of net worth, “free reserves” means all reserves credited out of the profits and share premium account but does not include reserves credited out of re-valuation of assets write back of depreciation provisions and amalgamation.

Declaration of sickness

On receipt of a reference, the NCLT may make an order as to if the said industrial company has become a sick industrial company and such an order shall be final.

Enquiry by NCLT

On a reference received, the NCLT may make such inquiry, as it may deem fit for determining whether the said company has become a sick industrial company and may appoint an Operating Agency to enquire into the scheme for revival and make a report with respect to such matters as may be specified by it.

Preparation and sanction of scheme

- If after making an inquiry about the sickness of the company, NCLT is satisfied that a company has become sick, the NCLT shall decide whether it is practicable for the company to make its net worth exceed the accumulated losses or make the payment of its debt within a reasonable time. If NCLT decides that it is practicable for a sick company to make its net worth exceed the accumulated losses or make the payment of its debt within a reasonable time, it shall give the company, such directions as it may deem fit to make its net worth exceed the accumulated losses or make the payment of its debt within a reasonable time.

- If NCLT decides that it is not practicable for a sick industrial company to make its net worth exceed the accumulated losses within a reasonable time and it is necessary to adopt remedial measures, it may direct an Operating Agency to prepare a scheme providing for such measures in relation to such company as it considers necessary from out of the parameters laid down under the Bill.

- The Operating Agency, if possible, prepares a scheme providing, *inter alia* for any one or more of the measures – the financial reconstruction of the sick company by change in or take over of, management of the sick company; the amalgamation of the company with any other company; the sale or lease of a part or whole of any industrial undertaking of the sick company; the rationalisation of managerial personnel; such incidental, consequential or supplemental measures as may be necessary; change in Board of Directors etc.

- The creditors (if approved by atleast two-third creditors) of the company may also prepare a scheme for revival and rehabilitation and submit to NCLT.

Operating Agency

The Operating Agency has been defined under the Bill as a group of experts consisting of persons having special knowledge of business or industry in which the sick industrial company is engaged and includes public financial institutions, banks or any other person which may be specified as the Operating Agency by NCLT.

Circulation/Sanction of scheme

- Where the scheme prepared by the Operating Agency relates to preventive, ameliorative, remedial and other measures with respect to any sick industrial company, it may provide for financial assistance by way of loans, advances or guarantees or reliefs or concessions or sacrifices from the Central Government, State Government, any scheduled bank or other bank, a public financial institution or state level institution or any institution or other authority to the sick industrial company.

- Every such scheme is required to be circulated to every person to provide financial assistance for its consent within a period of sixty days from the date of such circulation. If no consent is received, it is deemed that consent has been given and NCLT shall sanction the scheme and on and from the date of such sanction, the scheme shall be binding on all concerned.

- However, if the consent so required is not given, in that case NCLT may adopt such other measures, including the winding up of the sick industrial company, as it may deem fit.

Winding up of sick industrial company

Where the NCLT comes to the conclusion that the sick industrial company is not likely to make its net worth exceed the accumulated losses within a reasonable time while meeting all its financial obligations and that it is not possible to revive the company in future and that it is just and equitable that the company should be wound up, it shall record its finding and order winding up of the company.

New time frame

- Reference to be filed within 180 days from the date the Board of Directors of the Company have come to know of the relevant facts giving rise to causes of such reference. The period is extendable by another 90 days.
- Enquiry stage – 21 days – extendable to 40 days.
- Final order on concluding enquiry within 60 days from commencement of enquiry - extendable by 90 days.
- Operating Agency to prepare a scheme in 60 days from the date of order – extendable to 90 days.
- Draft Scheme – suggestions/objections within 60 days.

- Sanction within 60 days.

Appellate Tribunal

There will be a National Company Law Appellate Tribunal (NCLAT) to hear appeals from the orders of NCLT. The Chairperson of NCLAT will be a sitting or retired Judge of Supreme Court of India or the Chief Justice of a High Court.

Cases in which company may be wound up by the court

Apart from the existing grounds, the following two additional grounds for winding up of a company are proposed to be added :

- If the company has acted against the interest of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.

- If the company has defaulted in filing with the Registrar its Balance Sheets and Profit & Loss Account or annual returns for five consecutive financial years.

- If the NCLT comes to the conclusion that the sick industrial company is not likely to make its net worth exceed the accumulated losses within a reasonable time while meeting all its financial obligations and that it is not possible to revive the company in future and that it is just and equitable that the company should be wound up.

Formation of Rehabilitation and Revival Fund

The new Bill requires the creation and setting up of a Rehabilitation and Revival Fund. The Bill requires levy and collection for the purposes of rehabilitation or revival or protection of assets of the sick industrial company, a cess at such rate not less than 0.005 per cent and not more than 0.1 per cent on the value of turn over of every company or its annual gross receipt which is ever more. This fund will be transferred to the Consolidated Fund of India and released to NCLT from time to time.

Appointment of Official Liquidator

The proposed Bill provides for:

- Official Liquidator to be appointed from a panel of professional firms of Chartered Accountants or a body corporate consisting of professionals or whole time or part time officers appointed by Central Government.
- their Remuneration to be approved by Tribunal.
- the creditor or contributory may appoint professionals or legal practitioner entitled to appear before Tribunal.

V: AUTHOR’S PERCEPTION OF THE NEW BILL[20]

No Comprehensive Bankruptcy Code and Road Map

[20] The analysis of the new provisions and the suggestions made in the paper are strictly authors own opinion based on his perception of the existing and the proposed legislations and do not necessarily represent the views of INSOL India.

The Bill stops short of providing comprehensive Bankruptcy Code to deal with corporate bankruptcy. The attempt in providing a solution by amending the 1956 Act is in a wrong direction. In the fast changing scenario of growing cross-border investment, trade and commerce, cross-border insolvency problems are bound to increase and a comprehensive Bankruptcy Code alone can address such issues taking into consideration international practices. It does not introduce the required road map of the bankruptcy proceedings viz. application for initiating bankruptcy proceedings; appointment of Trustee: empowerment of the Trustee; operational and functional independence; accountability to the court, including the power of the court to remove Trustee in case of mismanagement; relationship with current management; monitoring or substitution; day-to-day operation, etc; time bound restructuring/recognition plan: who should submit; procedure of acceptance; mechanism to sell off; pro-active initiative of the Trustee; number of time-bound attempts for restructuring: decision to go for insolvency and winding up; and strategies for realisation and distribution.

Tribunalisation of Justice

Though tribunalisation of justice is now a recognised trend, the Indian experiment with Tribunals has been nothing to boast about. They have largely failed to serve the purpose with which they are set up.

Over Burden

Flowing from such diverse dimensions of judicial functions, NCLT would be burdened with workload of enormous magnitude and in the process would be likely to lose focus on revival and rehabilitation of sick entities. Change in eligibility criterion for making a reference would itself generate greater work load. In the process, the objective of expedient disposal of the matter may become casualty; leave aside matters, which NCLT would have to decide relating to its other two functional roles. Though the number of Members has been fixed at sixty two, past performance has shown that even under SICA, with the number of Members fixed at fifteen (including the Chairman) the BIFR has never worked with a full contingent of Members and even now is functioning with less than 50% strength for the last two years.

Time frame for filing reference

In the existing provisions of SICA, it was experienced that the entry level for seeking ameliorative measures by the sick unit was too late owing to the criterion of hundred per cent erosion of net worth. Under the proposed Bill fifty per cent of erosion in average net worth for the last four years of the reference year or three successive defaults in paying instalments to the creditors becomes the deciding factor for entry level eligibility of a sick unit. However, the objective of bringing into purview of NCLT, a case of incipient sickness would be defeated considering the period of 180 days and a further extension by a further time period of 90 days being provided for filing a reference.

Definition of net worth and sick industrial company

Redefining net worth is a very good development though the proposed definition may also suffer from the same problem which besets the present legislation and that is to prevent and curb the flair for creative accounting by changing the accounting policies to feign sickness. This could have been curbed by making the definition of "erosion of net worth" and "accumulated losses" more clear and unambiguous. The new dispensation could have provided for a water tight definition, which could be linked to delegating the powers to the judicial forum put into place to implement the rescue legislation, to notify the accounting policies on the basis of which net worth/accumulated losses would be worked out for determining sickness.

Certificate by Auditors

The new provision for establishing a panel of Auditors to give certificate with regard to the parameters of sickness is a good move. However, it may turn out to be a duplication as under the present dispensation the Statutory Auditors are required to give their opinion on sickness of a company under the Manufacturing and other Companies (Auditors Report) Order, 1988. It is not clear as to how this duplication would help as the Auditors on the panel will come from the same stream of Chartered Accountants and may be liable to the same failings as the Statutory Auditors of the Company.

Lack of severe penal consequences

Lastly, the misuse of the said forum in making an entry by manipulating/feigning sickness must be curbed by strict penal consequences for such misuse, which should be demonstrably used to ensure that no entity attempts to misuse these provisions. However, this aspect and solution to this problem has to be found out in the proposed legislation.

Suspension of proceedings

In order to do away with the mischief of Section 22 like provision, the Bill takes away the provisions of suspension of recovery proceedings against sick companies and the guarantors which is not a good development as suspension of proceedings is a part of any good restructuring system. In any case, if the secured creditors feel that the moratorium protection is being misused, a pending reference before BIFR can always be frustrated if seventy five percent of secured creditors initiate action under the Securitisation Ordinance.

Trustees

The Government should also consider appointment of Trustees by the court from empanelled professional chartered accountant firms, law firms, consultants, financial institutions etc for managing the company as a going concern; initiating the process of negotiation for time-based restructuring of the company, and failing which, initiate insolvency proceedings to wind up the company. Trustee can be empowered to appoint financial advisers, managers, liquidators, auctioneers etc, to help the trustee in its functions with Trustees having to bear their remuneration.

Bankruptcy proceeding for banks and financial institutions

Bankruptcy proceedings against banks and financial institutions have a very special significance as it affects the domain of the monetary system and management and financial stability. In several developed countries there is a separate bankruptcy code for banks and financial institutions. In India, this is primarily a responsibility of Reserve Bank of India. The new law and procedure should be structured to handle the bankruptcy proceedings in the case of banks and financial institutions in consultation with the Reserve Bank of India.

International insolvency in India

Indian insolvency laws do not have any extra-territorial jurisdiction, nor do they recognise the jurisdiction of foreign courts in respect of branches of foreign banks operating in India. Therefore, if a foreign company is taken into liquidation outside India, its Indian business will be treated as a separate matter and will not be automatically affected unless an application is filed before an insolvency Court for winding up of its branches in India. At present, thankfully, the Government is considering the adoption of UNCITRAL Model Law on Cross-Border Insolvency to meet the demands of globalisation of economy and to deal with international insolvency. This will radically change the orientation of Indian law and make it suitable for dealing with the challenges arising from globalisation and increasing integration of Indian economy with the world economy. While drafting the substantive and procedural rules of bankruptcy, international standards for both national and cross-border insolvency should be taken into consideration which, based on Indian situation, should be suitably incorporated.

VI: SECURITISATION AND ASSET RECONSTRUCTION LAW : AN ANALYSIS

The concept of Securitisation has, of course, come a long way from the ordinary shares and has acquired a typical meaning of its own. It now means a device of structured financing where an originator pools together its rights and interests in an identified stream of cash flow which are in turn transformed into securities through the special purpose vehicle (transformation device). This method of Securitisation cannot be confused with a transaction of providing loan as in this case the ultimate holder of the security gets an ownership right in the very asset it has financed. Securitisation process is a highly complex and efficient financial arrangement and employs various tools like security enhancement, creates various classes of securities, involves concepts of synthetic Securitisation etc.

Asset Reconstruction as a concept is a financial tool for takeover of financial / non-financial assets and rebundling them to achieve maximum recoveries. The manufacturing assets may be rebundled into operating units for optimum gain and in case they cannot be converted into economic operating units, then disposing off the assets either on lump-sum basis or on piecemeal basis.

Coming to the various provisions of the Ordinance which deals with the Securitisation / Asset Reconstruction, I may point out to start with is that Securitisation transactions / Asset Reconstruction is being carried out in our country even before this Ordinance and as such the Ordinance at the most revalidates the said business and puts a regulatory framework for the conduct of the said business in this country.

The term Securitisation is defined in Section 2(1)(z) and means **"**acquisition of financial assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitisation company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise". The other definitions specific to the securitisation issues are the obligor [section 2(1)(q)] being a person liable to the originate to pay a financial asset or discharge any obligation in respect of the financial asset; originator [section 2(1)(r)] which means the owner of the financial asset which is to be acquired by a SC / ARC and security receipt section [2(1)(zq)] which means a receipt or security issued by a SC / ARC to a qualified institutional buyer pursuant to a scheme evidencing acquisition by the holder of an undivided right, title or interest in the financial asset.

It is very significant that the term originator has not been restricted to Banks and Financial Institutions and as such the business of securitisation can originate from entities other than Banks and Financial Institutions. The Ordinance also defines the "Securitisation Company" in terms of Section 2(1)(za) and a "Reconstruction Company" in terms of Section 2(1)(v) as a company formed and registered under the Companies Act, 1956 for the purpose of securitisation / asset reconstruction respectively.

However, in terms of Section 3, a Securitisation Company (SC) or an Asset Reconstruction Company (ARC) cannot carry on business of securitisation / asset reconstruction without obtaining a certificate of registration from the RBI. It is also provided that a SC / ARC shall have own funds of not less than Rs.2 Crores or such other amount not exceeding 15% of the total financial assets acquired or to be acquired by the securitisation. Section 3(3) also provides for various conditions which are required to be fulfilled for the purpose of registration including inter alia restriction on the number of directors who are nominees of the sponsors (promoters) of the SC / ARC to a maximum of half the Directors on the BOD on the Company, the SC / ARC not having incurred losses in the preceding three Financial Years and complying with the prudential norms specified by RBI etc.

Section 4 provides for cancellation of the certificate of registration by the RBI in certain cases. Section 5 provides for a SC / ARC to acquire financial assets of Banks or Financial Institution by issuing debentures or bonds or any other securities, for the agreed consideration, on terms and conditions as may be agreed and for transferring of such financial assets to the SC /ARC. This section provides for a deeming provision whereby on the acquisition of the financial assets of a Bank or Financial Institution, the SC / ARC shall become the lender and all the rights of the Banks and Institution shall vest in the said SC / ARC. Section 6 provides for the obligor to discharge its obligation to the SC / ARC once the financial asset is acquired by such company.

Section 7 provides for issue of security by the SC / ARC to Qualified Institutional Buyers (QIB) for raising funds from the said QIBs for formulating schemes for acquiring the financial assets and maintenance of separate and distinct account of each scheme for every financial asset so acquired. Section 7(3) also provides that in case of non-realisation of the financial assets, QIBs holding security receipt of not less than 75% of the value for the said scheme may call a meeting and resolution passed shall be binding on the SC / ARC. Section 8 provides for exemption from registration of the security receipt issued by the SC / ARC for transfer of such security receipts.

Section 9 provides wide powers to the SC / ARC for the purposes of Assets Reconstruction subject, of course, to guidelines to be framed by RBI in this regard which inter alia include the powers for takeover and change in management of the business of the borrower, sale or lease of part of whole of the business of the borrower, reschedulement of debts, settlement of dues of the borrower and enforcement of security interest and taking possession of the secured assets in accordance with the provisions of the Ordinance. It is significant that the power of takeover of business of borrower / charge of management is provided to a SC / ARC when such power is not provided to a Secured Creditors u/s 13(4).

Section 10 provides for other functions that can be performed by the SC / ARC including the power to act as Agent / Manager for Bank or FI for recovery of their dues in terms of section 13(4)(c). Section 11 provides for resolution of the disputes between SC, ARC, Secured Creditors etc. through the process of arbitration under the Arbitration and Conciliation Act 1996. Section 12 provides for powers of RBI to determine policy and issue directions.

ENFORCEMENT OF SECURITY INTEREST

The basic thrust of the Ordinance is on Enforcement of Security Interest. The rationale behind the provision for enforcement of security interest is the burgeoning problem of Non Performing Assets (NPA) faced by the Banks and FIs and the ineffectiveness of the existing legal system for recoveries of their dues. The Government of India concerned with the blockage of public funds in NPAs had taken a significant initiative in setting up Debt Recovery Tribunals (DRT) under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (DRT Act). Even though 29 DRTs and 5 DRATs have been set up, however, these forums have really been ineffective in making a dent in recovery of dues of the Banks and FIs. The Government of India felt that more drastic action is required and there has been a feeling that the legal set up has been a stumbling block in enforcing recoveries in as much as whatever legal system is set up for adjudication of the dues of the Banks and Institutions and recovery of the same, it gets bogged down by the rules of natural justice, pleadings etc. and the borrowers are able to find loopholes to delay the entire process. Thus arose the need to bye-pass the legal process altogether and give powers to the Banks and Institutions for foreclosure of their loans and enforcing their securities without going through the legal process.

This concept of bye-passing the legal system and enforcing the security interest unilaterally by the Banks and Institutions has come under great fire from the borrowers as also various Jurists and the vires of the Ordinance has been challenged before various High Courts. It is difficult to say whether the said provisions would be upheld by the judicial process or not. However, there is a emerging consensus amongst the intelligentia, the Banks / FIs, borrowers, Jurists that these provisions would need to be re-looked and would need a more practical, pragmatic and workable legislation so that this legislation also does not become ineffective and results in no practical benefit to the Banks and Institutions in the rough and tumble of their day-to-day operations and recoveries of their dues. Be it as it may, the provisions, concerning the enforcement of security interest are covered in Section 13 and 19 of the Ordinance. But before we proceed to analyse the same, we may analyse some of the significant terms defined in the Ordinance relating to the enforcement of security interest.

The first is obviously s Secured Creditor defined in Section 2(1)(zd) as a Bank or a Financial Institution and including a Debenture Trustee appointed by the said Bank / FI; a Securitisation Company (SC) or an Asset Reconstruction Company (ARC), in whose favour security interest is created for due repayment by a borrower of any financial assistance. The Term Bank (Section 2(1)(c) means a banking company (Section 5(c)) of Banking Regulation Act, 1949, corresponding new bank or SBI or a subsidiary bank or a bank notified by the Central Government for this purpose. A Financial Institution (Sec.2(1)(m) means a public financial institution within the meaning of Section 4A of Companies Act, 1956 any institution specified by Central Government under Section 2(h)(ii) of DRT Act, International Finance Coop. (established under International Finance Corporation (Status Immunities and Privileges) Act 1956) and any other institution or NBFL notified by Central Government for this purpose. The term “security interest” is defined in Section 2(1)(zf) and is a very broad definition covering any right, title interest of any kind upon property created in favour of the secured creditor. Financial asset defined in Section 2(1)(l) is also a very broad definition including inter alia claims to debt or receivables, secured or unsecured, any debt or receivable secured by mortgage of or charge on immovable property, mortgage, charge hypothecation of movable property or any beneficial interest in property.

Section 13 provides for the mechanism of enforcement of security interest where a secured creditor whose debt has become NPA can issue a notice to the borrower requiring the borrower in writing to discharge his dues within 60 days failing which the secured creditor shall be entitled to exercise its rights under sub section 4. Sub section 3 provides that the details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment should be set out in detail.

In case the borrower fails to discharge his liability within 60 days of issue of the Notice u/s 13(2), secured creditor is entitled to take one or more of the following measures as set out in Section 13(4) of the Ordinance.

Section 13(7) provides that the amounts received by the secured creditor by adopting the measures as mentioned in Section 13(4) shall be held by him in trust and be utilised firstly in payment of cost, charges and expenses of enforcement of the security interest, secondly in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the persons entitled thereto in accordance with the rights and interests. Section 13(9) provides that in case of financial asset held by more than one financial creditor or joint financing of the financial asset by secured creditors no creditor shall be entitled to exercise the right in terms of sub section 4 unless secured creditors representing not less than $3/4^{th}$ in value of the amount outstanding as on record date agree upon such action. The proviso to Section 13(9) further provides that in case of a company in liquidation, the amount realised from the sale of secured assets shall be distributed in accordance with the provisions of Section 529A of the Companies Act. Significantly, the provisions of Section 530 of the Companies Act have not been considered. As such the question of the priority to be given to the Statutory dues, workmen dues, ranking of the dues of the secured creditors etc. will create a lot of uncertainty and may lead the process of distribution of monies recovered by enforcement of security interest getting bogged down in long drawn litigation.

Section 13(10) provides that if the dues of the secured creditors are not satisfied even after enforcement of security interest they may file an application before the DRT for recovery of the balance amount. Section 13(11) provides for the right of the secured creditors to proceed against the guarantors or sell pledged assets without taking the recourse to the measures specified in Section 13(4). Section 13(12) provides that the rights of the secured creditor under the Ordinance maybe exercised by one or more officers authorised in this behalf in such a manner as may be prescribed. However, no such regulations prescribing the manner in which the officers of the secured creditors would be authorised have been issued as yet.

Section 13(13) is very significant as it provides for a bar on the borrower from dealing with the secured assets in any manner whatsoever (otherwise in the normal course of business) once notice under Section 13(2) is issued. As such, once notice u/s 13(2) is issued it acts as an automatic injunction against the borrower from dealing with or encumbering his assets.

Section 15 provides for the manner and effect of the takeover of management of the business of the borrower. There is a significant issue here in as much as the secured creditor has not been given power for takeover of management of business of the borrower in Section 13(4). The measure for takeover of business of borrower is only provided u/s 9 to a SC/ARC. However, section 15 provides for procedure to be followed by a "secured creditor" for taking the management of the business of the borrower. This section does not refer to SC or ARC. This anomaly would require to be sorted out as it may become difficult to implement the said provision in its present form. In any case the procedures as set out in Section 15 require the secured creditor to publish a notice in the newspaper, appointing directors of the borrower company and in case of non-corporate borrower the Administrator of the business. It further provides that on publication of such notice all persons holding office of director shall be deemed to have vacated the office and the directors/administrator appointed by the secured lender will take over the administration and management of the business of the borrower. The rights of the shareholders to nominate or appoint the director and pass resolution will also be suspended. Significantly, it also provides that no proceedings for winding up of the company or appointment of receiver shall lie except with the consent of secured creditor. This effectively means that the powers of the secured creditor would now clash with the powers of the High Court under the provisions of the Companies Act especially with respect to winding up of a company u/s 433 etc. of the Companies Act and the powers of the High Court shall be made subject to the consent of the secured creditor. This aspect also is subject to a substantive challenge as the powers of the High Court cannot be subject to the will of a creditor.

It is very significant that in terms of Section 17 of the Ordinance no right of appeal has been provided under the Ordinance when notice is issued u/s 13(2) upto the stage when measures have been taken u/s 13(4). It is only that after an action is taken u/s 13(4) that any person aggrieved by adoption of any of the measures under Section 13(4) may file an appeal before the DRT. However, under sub section 2 the appeal by the borrower shall not be entertained by the DRT unless 75% of the amount claimed by the said borrower in the notice u/s 13(2) is deposited. This is of course subject to DRT reducing or waiving the amount to be deposited for reasons to be recorded in writing. However, since the restriction for pre-deposit is only on the borrower, it is possible that appeals will be filed by other concerned parties viz. promoters, labour etc.

Chapter VI deals with various miscellaneous provisions. Section 31 provides that the Ordinance would not apply to a lien on any goods, money or security given under the Indian Contract Act, 1872 or Sale of Goods Act 1930, a pledge of movables within the meaning of section 172 of the Indian Contract Act 1872, creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act 1934, creation of security interest in any vessel as defined in Section 3(55) of the Merchant Shipping Act 1958, any conditional sale, hire-purchase or lease or any other contract in which no security interest has been created, any rights of unpaid seller under section 47 of the Sale of Goods Act 1930, any properties not liable to attachment or sale under the first proviso to sub-section (1) of section 60 of the Code of Civil Procedure 1908, any security interest for securing repayment of any financial asset not exceeding Rs.1 lac, any security interest created in agricultural land, any case in which the amount due is less than 20% of the principal amount and interest thereon.

Section 41 is another very significant provision whereby it is provided that the various enactments will be amended in the manner set out in the schedule. The amendment in section 4(a) of the Companies Act is consequential in as much as SC or ARC who has obtained registration u/s 3(4) of the Ordinance shall be treated as a Public Financial Institution. The amendment to Security Contract Regulation Act, 1956 (SCRA) is also consequential as the security receipts as defined in section 2 (zq) of the Ordinance is being inserted as sub clause 1(b) in clause 2(h) of the SCRA. However, the third amendment which inserts two provisos u/s 15(1) of the Sick Industrial Companies (Special Provisions) At, 1985 (SICA) are significant in as much as they provide for bar from filing references in cases where assets have been acquired by any SC or ARC u/s 5(1) of the Ordinance and also provides that in case where secured creditors representing not less than 3/4th in value of the amount outstanding against financial assistance disbursed to the borrower have taken measures to recover their debt under sub section 4 of section 13 of the Ordinance, then the reference which is pending before the BIFR shall abate. This amendment has the effect of making a significant alteration in the provisions of another enactment. It is not clear whether by this Ordinance, the SICA can be amended or whether a separate amendment will have to be carried out in SICA by a separate Ordinance / enactment and this aspect is also likely to lead to substantial litigation.

From the above it may be seen that the basic thrust of the working of the SC and ARC under the Ordinance is with respect to the Non Performing Assets (NPAs) of Banks and FIs and this seems to be the basic purpose of inclusion of the aspect into this Ordinance.

VII : CONCLUSION

The essential features governing a model formal restructuring process in any part of the world are common if not alike though they may be structured differently. SICA, in India, is structured, more or less, on the above principles. The question which, thus, arises for consideration is at to why SICA has failed to work. In my opinion, any sound legislative framework for its success is dependent upon predictable and effective judicial process coupled with efficacious enforcement mechanisms. We need to focus and improve upon our implementation and execution mechanism. Also, there is a need for more creative and commercial approach to corporate entities in financial distress and attempt to revive them rather than applying the more traditional and conservative approach of liquidation or bankruptcy. As such, the socio-economic compulsions dictate that before liquidating financially distressed companies, some attempts must be made towards corporate rescue operations.

The 2002 Ordinance is a hurried attempt to provide oxygen to the NPA ridden Banks and Financial Institutions. The Ordinance contains various vague and ambiguous provisions which are likely to lead to litigation and confusion. It is likely to multiply options as well as litigation.