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Don't delay insolvency reforms anymore

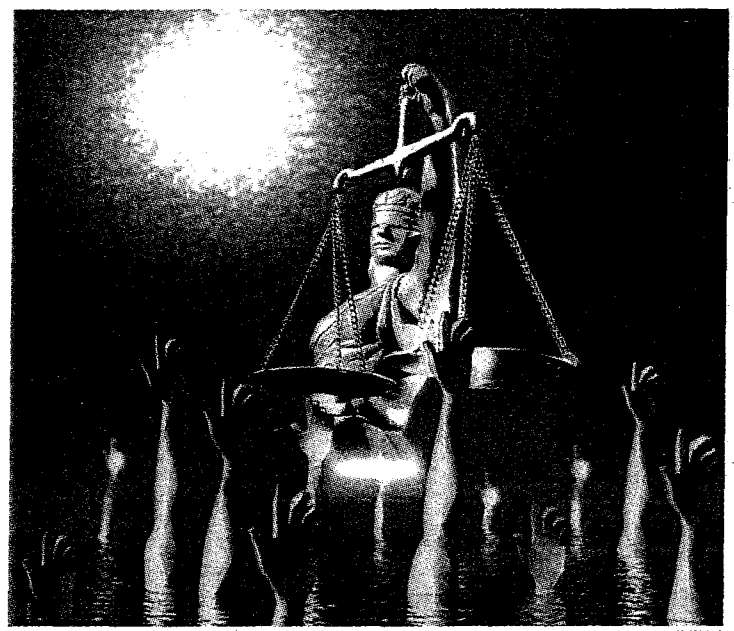
While World Is Undertaking Fourth-Generation Laws, India Is Yet To Implement First-Generation Reforms

Sumant Batra

THE fate of National Company Law Tribunal (NCLT), proposed as a special bankruptcy tribunal, remains uncertain even after five years of amendment in the company law in 2002. Provisions for NCLT were made following justice Eradi Committee report which recommended that jurisdiction for winding up of companies should be vested in NCLT and not high courts, as is presently. It further recommended that NCLT should deal with rehabilitation and revival of sick industrial companies, a jurisdiction presently entrusted with BIFR under Sick Industrial Companies (Special Provisions) Act, 1985. The setting up of NCLT, however, suffered a setback when Madras HC set aside certain provisions of the amendments, holding unconstitutional provision relating to the appointment of NCLT members. The matter is currently before the Supreme Court in an appeal preferred by the central government.

An efficient insolvency system is necessary to encourage enterprise, underpin investment and economic growth, and create wealth. It is vital to stability in commercial relationships and financial systems, advance important social objectives of maintaining public confidence in the corporate and financial sectors and promote sustainable growth in the private sector. It helps create a sound climate for investment, enable market participants to more accurately price, manage and control default risks and corporate failure, and encourage sound credit practice. An effective exit law promotes responsible corporate behaviour by encouraging higher standards of corporate governance, including financial discipline, to avoid consequences of insolvency; preserve employment through an effective system for rehabilitating financially distressed but viable enterprises while assuring maximum play in a fair reallocation of assets to more efficient market users through efficient liquidation system.

With the liberalisation of Indian economy, while many financial sector laws have undergone massive transformation, insolvency law, which is an essential part of any country's financial architecture, remains outdated and unreformed. Both the winding up of companies and rehabilitation remain a long-drawn process. This has been a deterrent for many foreign investors for which exit laws are as important as entry laws for taking investment decisions.



ALANKAR

ON FAST TRACK

Global investors will take a call on India, influenced by the reforms (or the absence of that). This is another area where China has moved ahead of India. It is hoped that the new insolvency law would be enacted soon and NCLT will become operational at the earliest

When JJ Irani Committee was constituted to review the company law, the ministry of corporate affairs included in its scope review of the insolvency law. The committee proposed significant changes in the insolvency law to make the restructuring and liquidation process speedy, efficient and effective. It proposed an early and easy access to debtor to explore revival opportunity triggered on default in payment of due debt. A limited standstill period is recommended. This provision was taken away by 2002 amendment due to its abuse by dishonest debtors seeking protection from creditors. To check its misuse, Irani Committee proposed that rather than automatic, stay should be on order of court made with consent of majority creditors. It has proposed measures that enable decisions by majority creditors on key issues, including voting on the plan through the establishment of creditors' committee. Recognition of the concept of insolvency practitioners is proposed to maximise resource use and application of skills. The current law does not support effective participation of professionals and experts in the process.

The other significant recommendations are: a definite and predictable timeframe of one year for rehabilitation and two years for the liquidation process; testing debtor's capacity to continue in management and its replacement by independent administrator failing such test; automatic stay on debtor's right to deal with assets, except in normal course of business; establishment of an Insolvency Fund to meet the costs of the insolvency process; public interests, government claims not getting precedence over private rights; rules dealing with jurisdiction, recognition of foreign judgments, cooperation and assistance among courts in different countries and choice of law, including by adoption of the UNCITRAL Model Law on Cross Border Insolvency.

Irani Committee reiterated the benefits of having NCLT as a special tribunal to deal with bankruptcy cases. It recommended that NCLT should have a general, non-intrusive and supervisory role in the rehabilitation and liquidation process. Greater intervention of the tribunal should be required only to resolve disputes by adopting a fast-track commercial approach observing the established legal principles of fairness in the process. NCLT should have experts to address the issues referred to it. Experts should be trained and educated on a continuous basis.

The recommendation of the committee when translated into law will bring the Indian law at par with global standards. The recommendations are based on established global principles, such as UNCITRAL legislative guide on insolvency law.

The global and domestic business community are keenly observing the developments. Global investors are standing on the Indian doorsteps waiting for new insolvency law to be enacted so that they can make investment decisions. While the world is undertaking third or fourth generation laws, India is yet to implement first-generation reforms. This is another area where China has moved ahead of India. It is hoped that the new insolvency law would be enacted soon and NCLT will be operational at the earliest.

(The author is partner, Kesar Dass B & Associates)