



A CRITICAL ANALYSIS OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016: EVALUATING ITS EFFECTIVENESS IN RESOLVING CORPORATE INSOLVENCY IN INDIA

Nikhil Kumar*

ABSTRACT

The Insolvency and Bankruptcy Code (IBC), 2016 was enacted to establish a consolidated and time-bound framework for resolving insolvency cases in the corporate sector. This paper provides a critical insight into the effectiveness of IBC in achieving its core objectives and the challenges it faces throughout its evolution. It focuses on whether the Code has succeeded in promoting entrepreneurship and investment, and maximising investment value by evaluating its transition from the pre-IBC era to the post-IBC era. The transition involves a shift from a Debtor-Centric Model to a Creditor-Initiated Insolvency Process. The research involves a doctrinal and analytical method, primarily focusing on statutory provisions and landmark case judgments. It highlights the key indicators of a successful Insolvency and Bankruptcy plan. The establishment of time-bound recovery systems and creditor-driven proceedings has resulted in a significant structural reform.

Despite its transformative intent, it is met with challenges such as high “haircuts” causing massive losses among creditors, and proceedings exceeding the given time period, though a time-bound mechanism is put into place. Other than that, low settlement and recovery rates are one of the issues that have been gaining prominence in recent years. Additionally, there is a scarcity of judicial authority to oversee insolvency proceedings, leading to a delayed procedure. Furthermore, people have highly criticised the Code for its injustice in financial distribution (Waterfall Mechanism) among operational and financial creditors, as well as questioned the constitutionality of the IBC and its tribunals (National Company Law Appellate Tribunals). The paper concludes that although the IBC has presented a significant structural reform, it is still developing. The Supreme Court describes the Code as an “economic

*BBA L.L.B.(HONS), FIFTH YEAR, AMITY UNIVERSITY, RANCHI.

experiment”; that is, it is still trying out new methods of application and is yet to reach its full potential.

Keywords: Insolvency, Bankruptcy, NCLAT, Creditor-Initiated Insolvency Process.

INTRODUCTION

An effective insolvency framework is crucial in order to maintain a stable and growing economy. In India, however, the insolvency regime prior to 2016 was marked by significant shortcomings. Acts like the Sick Industrial Companies Act, SARFAESI Act, and RDDBFI Act have all resulted in delayed proceedings, low recovery rates and overall losses for creditors. Therefore, there was an urgent need for a comprehensive legal framework to handle insolvency proceedings.

The Insolvency and Bankruptcy Code, 2016 was enacted to overcome such issues. The IBC consolidated all the previous insolvency laws into one and enacted a system that was beneficial for both the creditors (lenders) and debtors (borrowers). The Code aims to promote entrepreneurship, investment, revival of companies rather than liquidation, a time-bound process, and better settlement and recovery rates. The Code established the National Company Law Appellate Tribunal (NCLAT) and the Insolvency and Bankruptcy Board of India (IBBI), providing the much-needed legal framework for its implementation. One of the most prominent achievements of the Code is the transition from a debtor-centric process to a creditor-driven mode.

However, the Code is not flawless and faces various challenges during its application. Even though a time-bound procedure has been put into place, more than 70% of cases remain pending even after exceeding the given time period. In recent times, there has been an increase in haircuts, resulting in massive losses for creditors, while the debtors and Insolvency Professionals (IPs) are the ones who remain wealthy. People heavily criticise the Code's constitutionality and the legality of the tribunals (NCLATs and NCLTs). Petitioners criticise the hierarchy system among financial institutions, claiming that it gives the banks too much power and is unfair to operational creditors. This paper aims to analyse the effectiveness of the Insolvency and Bankruptcy Code and the various challenges it faces throughout its evolution.

INSOLVENCY LAWS PRE-IBC ERA (INSOLVENCY AND BANKRUPTCY LAWS) 2016

Before IBC (Insolvency and Bankruptcy Code), the issue of insolvency and bankruptcy was dealt with according to the following provisions –

Sick Industrial Companies (Special Provisions) Act 1985: This Act defined companies that have been in the industry for more than 5 years and have lost net worth over the income of any financial year as “sick companies”, who need government supervision to preserve themselves against potential bankruptcy. This Act required the companies to provide the board with the legal audits of net worth erosion from the date of finalisation. However, this process took excessive time, and companies started using it as a loophole to evade creditor lawsuits. The purview of this Act considered only large-scale corporations and failed to safeguard small-scale industries. Another problem lies in the inefficient application of the Act, as the BFIR failed to distinguish between a “sick company” and a business that’s simply losing money.¹

RBI Schemes - Corporate Debt Restructuring and Strategic Debt Restructuring –

RDDDBFI Act 1993 (The Recovery of Debts due to Banks and Financial Institutions Act, 1993): This Act established tribunals like Debt Recovery Tribunals (DRTs) and Appellate Tribunals (DRATs) for fast recovery of debt, more efficient than traditional methods, and defined various methods for modes of recovery such as attachment and sale of movable and immovable property, detaining the debtor and appointing a receiver for swift recovery.²

SARFAESI Act 2002 (The Securitisation and Reconstruction of Financial Assets and Enforcement of the Security Interest Act, 2002): This was established in the interest of financial institutions and banks, providing them with the right to auction the assets of the debtor to recover the debt without the involvement of the court. It applies to loans that fall under Non-Performing Assets (NPA). This Act requires the creditor to provide a 60-day notice to the debtor to pay the debt. The debtor can, however, appeal to the DRT (Debt Recovery Tribunal) in case of inability to pay the required amount. This law forbids debt recovery of such forms

¹ The Sick Industrial Companies (special provisions) Act, 1985 Act no. 1 of 1986

² The Recovery of Debts and Bankruptcy Act, 1993 Act no. 51 of 1993

against agricultural land, unsecured loans or cases where less than 20% of the principal or interest is due.³

Presidency Towns Insolvency Act 1908: This Act was established under the British colonial rule for recovery of debts among the presidency towns such as Calcutta, Madras and Bombay. This law fell under the jurisdiction of the then legal entity, the British Council, to seize and sell the assets of the debtors to recover debts and distribute them among the creditors.⁴

The Provincial Insolvency Act 1920: This Act is similar to the Presidency Towns Insolvency Act in terms of recovery of debt and legal entity; however, it differs in the scope of its application. The earlier Presidency Towns Insolvency Act considered only the presidency towns, whereas this Act operated in the rest of India. The minimum required debt for petition was Rs. 500, and the court orders were issued by civil courts rather than high courts.⁵

KEY OBJECTIVES OF IBC (INSOLVENCY AND BANKRUPTCY CODE)

- To consolidate and amend all existing laws related to insolvency in India.
- Time-Bound Recovery: IBC aims to resolve insolvency and bankruptcy cases within 180 days, extended to 330 days. Though the proceedings still surpass the given time period, it is still faster than the previous methods for debt recovery.
- IBC safeguards the creditors' interests by establishing a hierarchical order for debt recovery and enables them to initiate proceedings.
- It intends to protect the interests of both the parties involved. IBC helps in uplifting the value of assets rather than liquidating them. If it's not possible to liquidate the assets, IBC has provided another procedure for it.
- IBC promotes entrepreneurship.
- One of the main objectives was the establishment of a Board that exclusively looks into insolvency and bankruptcy matters (Insolvency and Bankruptcy Board of India).
- It strives to maximise the value of assets and revive the business if possible.
- IBC distinguishes between genuine business failure and fraud to protect the creditors from unjust practices.

³ The Securitisation and Reconstruction of Financial assets and Enforcement of Security Interest Act, 2002 Act no. 54 of 2002

⁴ The Presidency-Towns Insolvency Act, 1909 [Act No. 3 Of 1909]

⁵ The Provincial Insolvency Act, 1920 Act No. 5 Of 1920

- It has also put up a transparent system through information utilities to keep access to debt and credit information at all times.

CASE ANALYSIS

Case 1: Innoventive Industries Ltd. v ICCI Bank Ltd. (2017) –

This case is a landmark judgment in establishing the superiority of the Insolvency and Bankruptcy Code (IBC) over traditional state insolvency laws.⁶

Facts: Innoventive Industries Ltd. had secured a significant loan from ICICI Bank and had defaulted on payment. Thus, ICICI Bank filed an application under Section 7 of the IBC before the NCLT (National Company Law Tribunal) to start the insolvency process. However, Innoventive claimed that it was protected under the Maharashtra Relief Undertakings Act, and therefore could not be taken to court under insolvency.

Judgement:

- The Supreme Court ruled against Innoventive, thus establishing the superiority of the IBC over any state laws.
- The NCLT must admit the application once default has been established for speedy recovery.

Impact:

- Ensured speedy recoveries compared to previous insolvency proceedings that took 10-15 years.
- Emphasised a creditor-driven insolvency process.
- Superiority of IBC over any state laws

Case 2: Essar Steel India Ltd. v. Union of India –

This case was a landmark judgment in establishing the position of financial institutions, judicial authority and ensuring the sanctity of a resolution plan.⁷

⁶ Innoventive Industries Ltd. v. ICICI Bank, (2018) 1 SCC 407

⁷ Swiss Ribbons Pvt. Ltd. v. Union of India, (2019) 4 SCC 17

Facts: Essar Steel India Ltd., one of India's largest steel producers, owed more than Rs 49473 crore in debt to its creditors. Thus, a case was filed under Section 7 of the IBC by the financial creditors (banks) before the National Company Law Tribunal (NCLT). Various applicants submitted their plans for resolution, out of which ArcelorMittal and Numetal came out to be the most prominent ones. However, on investigation, it was found that Numetal had ties with the original owners of Essar Steel, i.e. the Ruia family.

Judgments: Therefore, under Section 29A, Numetal was kicked out of the race and in March 2019, NCLT approved ArcelorMittal's resolution plan. ArcelorMittal won the bid with approximately Rs 42000 crore, which was less than what the debtors owed, but banks were compliant. Another problem arose during the financial distribution process as NCLT invalidated CoC's (Committee of Creditors) decision and put an equal debt recovery plan in place. The financial institutions (banks) would lose billions if that happened. Thereafter, the case reached the Supreme Court, which overturned the NCLT's decision for an equal recovery plan and claimed that the debts should be paid in hierarchy and that banks lie at the top of the chain. The Court's decision claimed that unequals cannot be treated equally and invalidated NCLT's decision for an equal financial recovery plan. The Supreme Court also criticised the NCLAT and NCLT decision, saying that tribunals have no "residual equity jurisdiction" and should not intervene in bank-related matters. Though the case had well exceeded the limited time period (330 days) for liquidation of assets, relaxation was provided considering the circumstances. The Supreme Court provided a "clean slate" to ArcelorMittal, ensuring that the resolution applicant is not burdened by the past debts of the previous owners and thus promoting foreign investment under the IBC framework.

Impact on IBC:

- Emphasised creditor-driven insolvency process.
- Defined the extent of judicial authority.
- Promotes foreign investment.

Case 3: Swiss Ribbons Pvt. Ltd. vs. Union of India (2019) –

This case was a landmark judgment in establishing hierarchy among creditors and superiority of financial institutions (banks) in insolvency cases.⁸

⁸ Swiss Ribbons Pvt. Ltd. v. Union of India, (2019) 4 SCC 17

Facts: People challenged the Insolvency and Bankruptcy Code, claiming that it was unfair, unconstitutional and violated Article 14 (Right to Equality). People criticised the superiority of banks over operational creditors, claiming that it gave the banks too much power and operational creditors were at a loss by virtue of this arrangement. Furthermore, they petitioned against Section 29A, criticising the injustice of not allowing defaulter families to participate in auctions. They also questioned the constitutionality of NCLAT and NCLT.

Judgment: The Supreme Court ruled:

- NCLAT and NCLT are constitutional according to the Companies (Amendment) Act, 2017.
- IBC is constitutional and valid. The Court claimed that IBC is an “economic experiment” and aims to revive companies rather than liquidate them.
- Banks and operational creditors are not at par with each other, as the risks involved are different for both the institutions, and thus financial creditors deserve to be superior to operational creditors.
- The Court upheld that if 90% of the creditors agree, the case can be withdrawn if the owner decides to pay back the money.

Impact:

- Established constitutional authority of NCLAT and NCLT.
- Defined hierarchy among creditors.

Challenges faced by Insolvency and Bankruptcy Code (IBC) –

Time-bound Resolution: One of the prime objectives of IBC is to ensure a time-bound process; however, it has been observed that 78% of ongoing insolvency cases have exceeded the maximum litigation period (330 days).

Clear Slate Doctrine: Even though the successful resolution applicant is provided with a “Clean Slate” to mitigate the company, stakeholders often engage them in legal disputes, making the post-resolution process unpleasant.

Technological Difference: IBC is not on par with current business models such as startups and tech-driven businesses.

Low Settlement and Recovery Rates: In recent times, there has been a decrease in the settlement amounts and an increase in resolution periods, leading to low recovery rates. For example, the case for Reliance Communications Infrastructure Ltd. had a settlement amount of 0.92% of total debt, and it took four years for the procedure to be completed, making it inefficient.

Haircuts and Recovery rates: A haircut is the percentage deduction from the value of an asset when used as collateral. This results in high losses for the creditors while the debtors and insolvency professionals remain with their pockets filled.

Limited Judicial Bench: There is a shortage of judges to handle insolvency cases, resulting in a large number of pending cases.

Effectiveness of IBC Act -

Creditor-driven Proceedings: The IBC Act has defined a creditor-driven approach where the creditors can file a petition in case of default. This provides more autonomy to the lenders and makes them more agreeable to lending loans, hence promoting investment.

Time-bound Procedure: The IBC Act has established a time-bound process for insolvency cases, i.e. 180 days, extendable by 90 days. Even so, more than 70% of the cases exceed the given limited time period. However, the situation has improved quite a lot because earlier insolvency proceedings that used to take 10-15 years resulted in only losses for the creditors, while the debtors still owned the company.

Clean Slate Doctrine: This promotes investment, which is one of the primary objectives of the IBC Act, as the buyer of the company is provided a new start unburdened by the liabilities of the previous owners.

Improvement in Recovery Rates: Before the IBC Act, insolvency laws such as the SARFAESI Act and DRTs had very low recovery rates. IBC has significantly increased the recovery rates compared to the past. However, concerns have been arising over high haircuts.

RESEARCH METHODOLOGY

Research Design: This study adopts a doctrinal and analytical approach to analyse the effectiveness and legal framework of the Insolvency and Bankruptcy Code (IBC), 2016.

The research is primarily focused on the legal provisions and judicial interpretations rather than empirical field data. This design was chosen because the effectiveness of the IBC can be best understood through the evolution of insolvency laws established by the Supreme Court.

Sources of Data -

Primary Legal Sources:

- Insolvency and Bankruptcy Code, 2016
- Innoventive Industries Ltd. v. ICICI Bank
- Swiss Ribbons Pvt. Ltd. v. Union of India
- Essar Steel India Ltd. v. Union of India

Secondary Sources:

Supporting materials include law journals, scholarly articles, legal analyses, and reports. These help provide broader context and diverse perspectives on the IBC Act.

Data Analysis -

Doctrinal Analysis: A qualitative research methodology that involves analysis of statutes, legal provisions and case law was used.

Comparative Analysis: A comparison has been made to understand the significance of IBC in resolving insolvency cases before and after 2016.

Case Law Analysis: A detailed analysis of landmark cases is taken to understand the effectiveness and practical application of IBC.

Scope of the Study: This study is confined to the analytical approach of IBC laws and their practical application and does not cover cross-border or individual insolvency mechanisms.

Limitations: The IBC Act is still developing, as the Supreme Court describes it as an “economic experiment”. It still suffers from time-bound resolutions, low recovery rates and a limited legal judiciary bench.

Literature Review: Existing literature suggests that the Insolvency and Bankruptcy Code has significantly improved the state of insolvency cases in India. Before the IBC, various laws such

as the SICA Act, SARFAESI Act, and RDDBFI Act have all proven to fail due to delays, low recovery rates and a debtor-centric approach. Scholars such as Sengupta and Vardhan describe the pre-IBC era as a “fragmented landscape”. Scholars claim that statutes such as the Sick Industrial Companies Act failed because the cases went straight to the Board (BIFR) and stayed there indefinitely, causing massive losses among creditors. In fact, many companies started using this as a loophole to escape court proceedings. Due to such long delays, the value of the assets decreased over time, and the creditors were again at a loss. Acts such as SARFAESI, though they performed a speedy recovery, often ignored operational creditors and stakeholders and were always challenged by the borrowers, which resulted in further delay.

The IBC Code aims to establish a creditor-driven, time-bound process, achieve high recovery rates, promote investment and entrepreneurship, and revive the companies rather than liquidate their assets.

Judicial interpretations have always provided a better understanding of the practical application and constitutional framework of IBC.

The judgment in *Innoventive Industries Ltd. v. ICICI Bank* consolidated the supremacy of IBC over state laws.

The judgment in *Swiss Ribbons Pvt. Ltd.* consolidated the position of IBC in the Indian Constitution as petitioners questioned its constitutionality and effectiveness.

The judgment in *Essar Steel India Ltd. v. Union of India* further redefined the legal authority of NCLAT and NCLT and the “Clean Slate” doctrine, as well as a “creditor-driven” process. However, some scholars argue that the creditor-driven model undermines the position of operational creditors.

Furthermore, many scholars have identified structural and practical issues in the implementation of IBC, such as inconsistency in recovery rates, hierarchy among creditors and overburdened tribunals due to a limited judicial bench. With respect to the effectiveness of the IBC, several studies provide insight that the IBC has indeed improved insolvency cases in India.

CONCLUSION

The Insolvency and Bankruptcy Code, 2016 has significantly impacted insolvency cases in India. By introducing a time-bound, creditor-driven process, it has increased recovery rates and reduced delays.

The Code has consolidated all the previous insolvency laws into one, increased recovery rates, and reduced the time period for case proceedings from 10-15 years pre-IBC era to 2-4 years post-IBC era. One of the most prominent achievements of the Code compared to the previous insolvency laws is the transition from a debtor-centric process to a creditor-driven process. This transition has helped promote investment among creditors. Additionally, the Code aims to revive the company rather than liquidate its assets. The establishment of tribunals such as the National Company Law Tribunal (NCLT) and the Insolvency and Bankruptcy Board of India (IBBI) has provided the necessary legal framework for insolvency proceedings.

However, challenges persist as the IBC is not flawless. It suffers from low settlement and recovery rates in recent years. Huge haircuts have made the process inefficient, and even though there is a time-bound procedure, cases are pending even after exceeding the given time period. Furthermore, there is a scarcity of judicial benches, leading to delayed hearings. Judicial authority has also been a subject of dispute, as people question its constitutionality and authority. As the Supreme Court describes the IBC as an “economic experiment”, it is still trying out new methods of application, and it has yet to reach its full potential.