

Steps and Challenges in Insolvency Law Procedures: Learnings from Case Law

Aparna Ravi

March 23, 2015



Objectives

Analysis of case law on corporate insolvency proceedings to determine:

- Time taken/Loss Given Default
- Where bottlenecks in the process lie

Scope and Methodology

- Critical case study of High Court, Supreme Court and DRT/DRAT cases
- Period Covered – 2003 (Notification of SARFAESI Act) to 2014
- Judgments chosen on the basis of variations in number of creditors, debt structure, large and small companies

Principal Legislative Framework

Act	Purpose	Applies to	Forum
CA 1956	Winding up	All corporates	High Court
SICA 1985	Rescue and rehabilitation	Industrial companies	BIFR
RDDDBFI 1993	Debt recovery	Banks and financial institutions, debt of Rs. 10 lakhs or more	DRT/DRAT
SARFAESI 2002	Enforcement of security	Secured creditors	Does not require court involvement (appeals to DRT)

Provisions not yet in Force

Companies Act 2013

- Chapter XIX – rescue and rehabilitation, tries to address problems with SICA
- Chapter XX – winding up

Not operationalized as National Companies Law Tribunal remains entangled in litigation

Non-Statutory Mechanisms

- CDR
 - Voluntary debt restructuring process outside of court/tribunals for institutional creditors
 - Available for debtors with credit facilities over Rs. 10 crores
- Joint Lenders Forum
 - RBI guidelines for early recognition of financial distress
 - Mandatory setting up of JLF if debt remains overdue for 31 – 60 days and aggregate lender exposure is over Rs. 1000 million.

BIFR

BIFR (1987 – 2006):

- References made to BIFR: **5,412**
- Dismissed as non-maintainable: 1,707
- Dismissed as repeat references: 218
- Rehabilitation scheme sanctioned: **760**
- Liquidation recommendation: **1,303**

(Source: Ministry of Finance, Economic Survey 2006 – 2007 (Government of India 2007), para 7.47)

BIFR (contd.)

2013 – 93 references to BIFR

Current Status	Number
Sickness being considered	46
BIFR reference abated	21
Non-Maintainable/Withdrawn/De-registered	11
Abatement being considered	9
Rehabilitation scheme being considered	5

Case Law Review

High Courts

- Winding up petitions filed by creditors
- References from the BIFR for winding up
- Appeals from BIFR/Appellate Tribunal's decisions
- Challenges to enforcement action under SARFAESI where there are conflicts with RDDBFI Act or SICA
- Questions over jurisdiction of DRT

Case Law Review (contd.)

DRT/DRAT

- Debt recovery actions under RDDBFI Act
- Appeals by debtors against enforcement action under SARFAESI

Time Periods from Review of HC Cases

Measured from time of initial enforcement action or reference to BIFR to date of judgment

Time Taken	No. Of Cases	Comments
10 + years	7	5 were references from BIFR for winding up
5 – 10 years	3	
3 – 5 years	4	
Up to 2 years	5	3 of these involved FCCB holders

Likely to be an underestimate...

Numerous Cases dealing with Conflicts between laws

RDDBFI Act v. SICA

KSL & Industries Ltd. v. Arihant Threads Ltd (Civil Appeal 5225/2008, October 27 2014): Supreme Court held that Section 22 of SICA (moratorium) prevails over Section 34 of the RDDBFI Act (overriding effect).

Conflicts between Laws (contd.)

Can sale be made under SARFAESI Act without leave of company court once winding up proceedings have commenced?

- *Indian Bank v. Sub-Registrar (HC of AP and Telangana, decided on 11.11.2014)* – Yes
- *BHEL v. Arunachalam Sugar Mills (Madras HC, decided on 12.04.2011)* – No, need consent of OL
- *Krithika Rubber Industries v. Canara Bank (Karnataka HC, decided on 13.06.2013)* – DRT cannot order sale without consent of OL

Conflicts between Laws (contd.)

Can secured creditors initiate proceedings under SARFAESI while proceedings under the RDDBFI Act were pending?

- *M/S Digivision Electronics Ltd. v. Indian Bank (Madras HC, decided on July 7, 2005)* – No, need leave of DRT
- *Bank of India v. Ajay Finsec Pvt Ltd and Ors (OA No. 167 of 2001, decided on 28.11.2003)* – DRT ruled that banks could proceed with enforcement under SARFAESI while RDDBFI proceedings were pending
- *M/S Punea Cold Storage v. State Bank of India (AIR 2013 Part I; II (2013) BC 501 Patna HC)* - Cannot initiate proceedings under RDDBFI Act if SARFAESI enforcement action had begun

Often arose from parallel proceedings in different fora

BHEL v. Arunachalam Sugar Mills Ltd., decided on 12.04.2011 (Madras High Court)

- Secured Creditor 1 filed an application in the DRT for debt recovery
- Secured Creditor 2 filed a company petition for winding up
- Secured Creditor 3 entered into an MOU with Secured Creditor 1 to get paid upon Secured Creditor 1's recovery
- Trade creditor that had leased machinery to the debtor initiated proceedings invoking the arbitration clause in the contract
- Secured creditor 4 initiated proceedings under SARFAESI and sold assets by auction
- Unsecured creditor that had supplied a boiler to the debtor filed for debt recovery in the civil court

Conflicts over jurisdiction

- ***Jagdish Singh v. Heeralal (2013) 12 SCALE 358*** – SC held that SARFAESI Act ousted jurisdiction of civil court completely, even if related to parties other than the creditor and debtor
- ***Official Liquidator, U.P. and Uttarakhand v. Allahabad Bank AIR 2013 SC 1823*** – SC held that Company Court had no jurisdiction over matters pending before DRT, even if winding up petition was initiated. OL would need to file appeal to DRAT to protect other stakeholders

Unsecured Creditors generally not in the picture, BUT...

Handful of recent cases of FCCB holders being successful in initiating winding up petitions:

- *Wockhardt, Tulip Telecom, Zenith Infotech, Plethico Pharmaceuticals*
- *Court admitted winding up petition filed by bondholder trustees / allowed recovery for unsecured bondholders*
- *Recovery for bondholders still unclear in some cases*

Learnings so far...

- Need for a unified bankruptcy code for all aspects of a distressed company that applies to
 - all classes of companies and creditors
 - both liquidation and rescue and rehabilitation
- Single dedicated forum

Learnings so far...

Problems with the law

or

with its implementation?