Messy fix: the amended insolvency code

Less than 12 months after the Insolvency and Bankruptcy Code came into force with the goal of easing the resolution of corporate insolvency, the Central government has passed an ordinance that significantly amends the original law. The aim of the changes is clearly stated in the preamble: “...to strengthen further the insolvency resolution process, it has been considered necessary to provide for prohibition of certain persons from submitting a resolution plan, who, on account of their antecedents, may adversely impact the credibility of the processes.” The ordinance then specifies the categories of persons who are deemed ineligible to participate in resolving a corporate entity’s debt once it has been put under the process of insolvency resolution by creditors. Here lies the nub. While there is no quibble about the need to deny unscrupulous and wilful defaulters who have put banks and other creditors to substantial financial hardship the opportunity to regain control of corporate assets that have been put under resolution, the category of people barred is too broad and risks the very objectives of the original code. It is germane to remember here that the IBC is not intended to serve as a mere instrument of liquidation. Instead, it is to provide an enabling legal framework for the “reorganisation and insolvency resolution of corporate persons... in a time bound manner for maximisation of value of assets of such persons” and to promote entrepreneurship, among other goals.

By including promoters and those in management whose loan accounts are classified as non-performing assets for one year or more, as well as any person disqualified to act as a director under the Companies Act, the amendment risks becoming an instrument of blunt force that hurts more than it helps. As policymakers and central bankers have often pointed out, not all bad loans are a result of mala fide intent on the borrower’s part. Specifically, in cases where companies have ended up struggling to service debt as a result of unpredictable external factors that adversely impacted their operations and financials, barring the promoters of such firms from a chance to restructure and turnaround the business, merely because the loans have turned sour, is unfair to both the entrepreneur and the enterprise itself. For instance, steel companies were among the worst hit in the wake of the global downturn in commodity prices and depressed demand. It has been reported that the promoters of some of these debt-laden steelmakers were considering participating in bids to restructure the debt and businesses and hoping to run them again. By widening the scope and definition of those it considers ineligible to participate in the resolution process and, worse, making the amendments retrospective to cover even those cases already referred to the National Company Law Tribunal, the Centre may have ended up, unintentionally, throwing the baby out with the bathwater.

Revving up infrastructure spending is necessary, but not sufficient

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