

THE EFFICIENCY PROMISE OF THE BANKRUPTCY CODE

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The IBC is a reform measure that could aid our quest for faster growth if it works the way it was expected to. Let's sort out the problems that have held it back from doing exactly that

Three years after the adoption of the Insolvency and Bankruptcy Code (IBC), it remains a work in progress. Recent reports suggest the government may bring in a short, time-bound online bidding process to resolve corporate bankruptcy cases. This is likely to improve transparency and reduce litigation over business failures—an efficient way to deal with which is crucial for an economy to optimize its allocation of resources. The IBC, one of the Narendra Modi government's biggest reforms, had envisaged a mechanism by which creditors could wholly or partially recover their dues from a company unable to pay back, with the insolvent business taken over to be revived or sold off, so that it—or its assets—could swiftly get back to generating value under new ownership. In theory, it's about capital moving to the best hands. In practice, its intent has been thwarted much too often. At the heart of the IBC legislation was its time-bound approach to resolving insolvency cases, but the initial 270-day deadline proved inadequate, with several lenders unsure of their stance, some promoters trying every legal device to retain their firms, and the very process frequently getting caught in a judicial quagmire. Some high-profile cases have been plodding along for years now.

To be fair, the government has been trying to safeguard the system from abuse and assure all stakeholders of a fair deal. Last year, for instance, it amended the relevant Act to protect homebuyers, placing them at par with financial creditors. However, this was done in a hurry, it seems. Now that bankruptcy courts have been stormed with realty cases because even a lone homebuyer can file one, there is word that this part will be tweaked so that only a majority of such "creditors" can push the red button. A few other problems, thankfully, have already been addressed. This July, eight changes were made to ease the resolution process, the most important one being an extension of the maximum time that can be taken to a more realistic 330 days.

Will IBC cases move faster? Going by a fresh set of proposals that the government is reported to be considering, there is a good chance that they will. In case the assets or shares of a bust company are being auctioned, a clear time window would be specified for eligible bidders to place financial bids. So far, creditors of a company undergoing insolvency proceedings have been at liberty to negotiate with bidders on a case-to-case basis. This lends itself to a drama of bids and counter-bids, with bank officials being chased and lawyers sniffing around for opportunities to entrap the process in litigation. Moving this part online should speed up resolutions. No doubt, there's other work still to be done. The tribunals that deal with IBC cases could do with stricter guidelines to distinguish between financial and operational creditors. The latter are those owed money in the usual course of business, and blurring their demands with the claims of lenders could muddle things up. Likewise, secured lenders need to be marked apart from unsecured lenders with greater clarity. The former have contractual claims to collateral against unpaid loans, and these rights must take precedence over the claims of the latter. Resolution orders should not end up casting the basis on which banks lend money in doubt. The IBC is a major reform. Fully functional, it could yet live up to our expectations.

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