

## Welcome support for the new bankruptcy law

The Supreme Court has delivered a powerful statement in support of the new bankruptcy law. It has instructed all lower courts to take into account the fact that the Insolvency and Bankruptcy Code, 2016 constitutes a paradigm shift. The judgement has come at a time when the Indian central bank has goaded lenders to move against large loan defaulters.

The recent court ruling in the case between ICICI Bank and Innoventive Industries has not received the attention it deserves. The private sector lender had initiated insolvency proceedings against the company because it defaulted on its loan commitments. The Supreme Court judgement is important because it clearly states that the Insolvency and Bankruptcy Code, 2016 overrides the confusing maze of state laws that companies could use in the future to avoid insolvency. Justice R.F. Nariman and Justice Sanjay Kishan Kaul have cited Article 54 of the Constitution to say that a Central law should prevail over state law whenever the two are contradictory.

The court ruling comes even as the Reserve Bank of India (RBI) has asked banks to move against another 28 large defaulters. The central bank action is a clear signal that regulatory forbearance is not an option given the mounting bad loans that now constitute the biggest risk to economic stability. Such firm action is now possible because the Insolvency and Bankruptcy Code empowers creditors for the first time ever.

The Supreme Court has liberally quoted parts of the report by the committee that worked on the reform of Indian bankruptcy law. Some of the arguments are worth reiterating here. First, the limited liability company is a contract between equity and debt. Equity owners are in full control as long as debt obligations are met. Creditors have no say in how the company is run. The situation flips in case of a default. Control should then be passed to creditors. Equity owners have no say.

Second, weak protection for creditors means that they are averse to lending. At least some part of the credit constraints in India can be traced back to this problem. The growth of a corporate bond market is also held back by the lack of a modern bankruptcy framework.

Third, control of a company is not a divine right. The control of a defaulting company should be transferred to the creditors. Speed of resolution is very important. Otherwise management teams retain control over companies despite defaults. This was the overarching approach till now. Management groups did not lose control even when companies had run into trouble.

Sreyan Chatterjee, Gausia Shaikh and Bhargavi Zaveri have built a database from the final orders passed by the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal in the six months since the bankruptcy law has become operational. A range of operational and financial creditors have moved against companies under the new law. However, there do seem to be some teething troubles as well. For example, the average time taken for disposal is 24 days, much more than the 14 days that the bankruptcy law has prescribed.

It is early days yet. There could be some procedural delays given the tight timelines provided in the Insolvency and Bankruptcy Code. There will be some legal setbacks as well. Consider the Supreme Court stay on the NCLT order initiating insolvency proceedings against Jaypee Infratech. Then there is the question of haircuts. The creditors to Synergies-Dooray Automotive will reportedly get only 6 paise for every 100 paise of loans. It remains to be seen how other cases are settled.

The Insolvency and Bankruptcy Code is undoubtedly a shot in the arm for Indian capitalism. The

economic reforms till now have been more successful in dealing with the problems of entry rather than the problems of exit. The latter is equally important, since it will allow capital to be reallocated to enterprises that will be able to put them to better use. The threat of loss of management control should also be a signal to management groups—especially the politically influential ones—that they cannot take creditors for granted.

It is good that the highest court in the land has very strongly reiterated the need for the new framework. The ruling should hopefully minimize the legal tangles that could emerge in the initial years of transition, especially from the lower courts.

*Do you think the Insolvency and Bankruptcy Code will help in early debt resolution? Tell us at [views@livemint.com](mailto:views@livemint.com)*

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