Chapter 3

Legislative framework and its impact on revival of sick CPSEs

3.1 Insolvency framework in India

There is no single legislation in India providing for a systematic and cohesive system for rehabilitation and liquidation of enterprises including CPSEs. A number of legislations and regulations comprise the insolvency framework for commercial enterprises. While many financial sector laws have witnessed massive transformation after the liberalisation of the Indian economy, the insolvency law has not undergone the much needed reforms. Both, the winding up of companies under the Companies Act and rehabilitation under SICA remain cumbersome and long-drawn resulting in locking of huge national resources in these proceedings.

In most economies, the discipline of insolvency professionals is highly sophisticated and well-developed. In countries like United Kingdom, Australia, Canada and United States, and in most European countries, the insolvency professionals play an important role in resolution of insolvency. China introduced the concept of insolvency practitioners under the Enterprise Insolvency Law of the PRC which came into force in 2007. Insolvency practitioners are licensed in UK, Australia, Canada, China and other jurisdictions. There is no such discipline in India. There is no dedicated insolvency division or directorate in the Ministry of Corporate Affairs, GOI, which is responsible for administrating the corporate insolvency law. There is a department of official liquidators but there is no organized set up to manage insolvency related issues. The regulatory duties are also not clearly defined. Establishment of such dedicated insolvency directorate will enable effective and efficient administration of insolvency policy, regulation and legislative oversight and implementation. This becomes more relevant as after the enactment of Companies Bill, the Ministry of Corporate Affairs would also be responsible for administration of restructuring law which is currently under the Ministry of Finance. This is a standard practice in many countries. UK has a separate Insolvency Services department to deal with insolvency of enterprises. In Canada, there is a separate department of Superintendant of Bankruptcy. Similarly in Australia, Singapore and most developed systems there are dedicated divisions of the government to deal with insolvency matters.

Sick industrial Companies (Special Provisions) Act of 1985 (SICA)

- enacted to determine sickness and expedite revival of potentially viable units or closure of unviable units.
- under SICA, BIFR, a quasi-judicial body, was set up in 1987, to take appropriate measures for revival and rehabilitation of potentially sick industrial undertakings and for liquidation of non-viable companies.

(i) Sick Industrial Companies Act, 1985

In order to deal with the complex problem of industrial sickness prevailing in the eighties, GOI enacted a special legislation namely, the Sick Industrial Companies (Special Provisions) Act in 1985 commonly known as the SICA to determine sickness and expedite the revival of potentially viable units to allow idle investments in sick units productive or closure of unviable units to release the locked up investments for productive use elsewhere.

SICA applies to companies both in public and private sectors owning industrial undertakings. Under this Act, Board of Industrial and Financial Reconstruction (BIFR), a quasi-judicial body, was set up in 1987, to take appropriate measures for revival and rehabilitation of potentially sick industrial undertakings and for liquidation of non-viable companies. SICA 1985 was amended in 1991 for enabling referral of sick CPSEs to BIFR for their revival/ rehabilitation or closure.

National Company Law Tribunal (NCLT)

- Formed by repealing SICA/ BIFR.
- The proposed NCLT shall deal with revival/ rehabilitation of sick companies and also continue the functions and powers currently discharged by the Company Law Board, BIFR and the High Court in respect of winding up, liquidation etc.
- NCLT was yet to be constituted (January 2012).

With enactment of the Companies (Second Amendment) Bill, 2002 (the Second Amendment), SICA was sought to be repealed by Sick Industrial Companies (Special Provisions) Repeal Act, 2002 (SICA Repealed Act). However, the Second Amendment could not be implemented due to a court challenge. Consequently, the repeal of SICA remains un-notified and the old regime continues in operation. The Second Amendment proposed establishment of National Company Law Tribunal (NCLT) which would have jurisdiction to deal with both, rehabilitation and liquidation of companies. Besides this, NCLT shall also perform the functions and powers currently discharged by the Company Law Board. A reference of the sick CPSEs would no longer be automatic or mandatory and would require pervious approval of the GOI.

The Ministry of Corporate Affairs, GOI stated (November 2011) that NCLT could not be established due to legal challenges to its establishment. However, as per the judgment of Hon'ble Supreme Court (May 2010), the provisions for constitution of NCLT have been revised by the GOI and included in the Companies Bill, 2011.

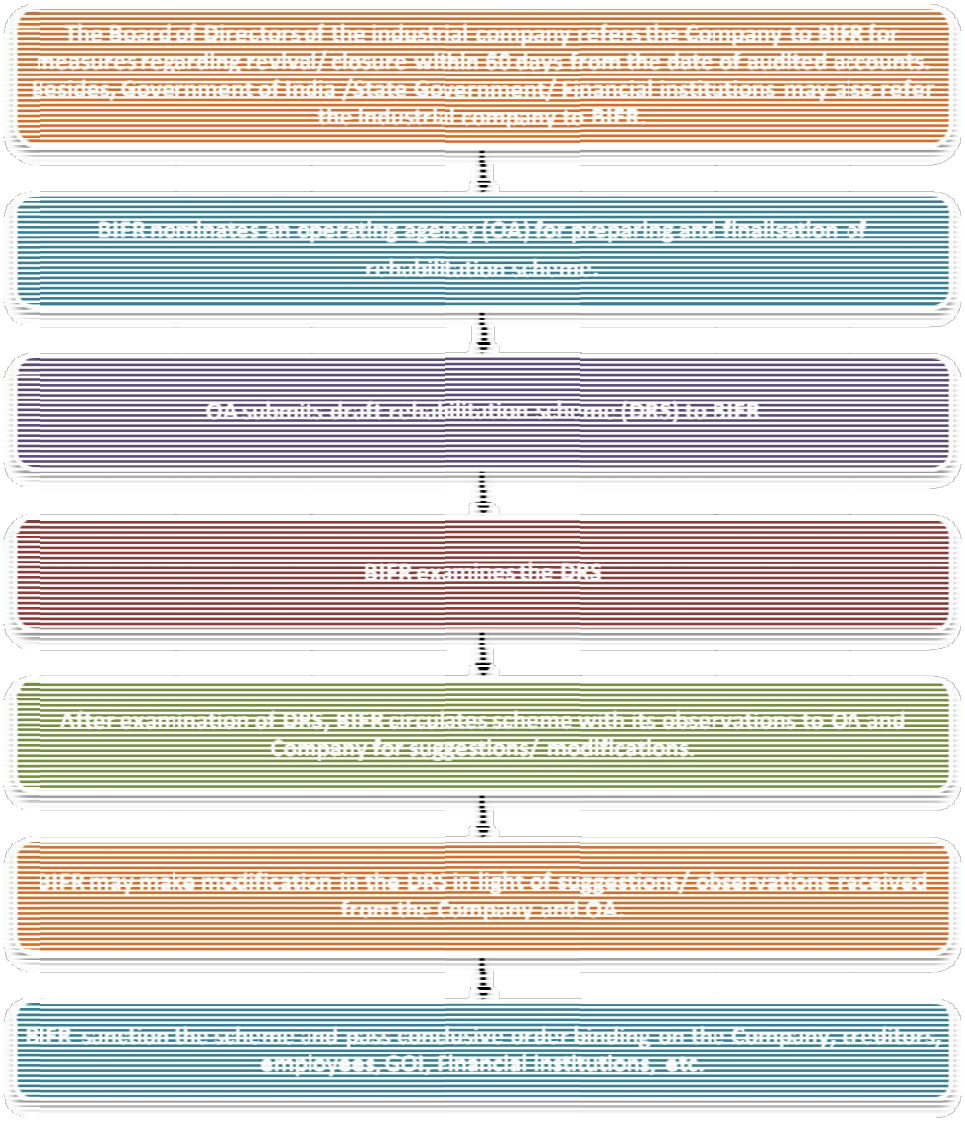
In the meanwhile, BIFR continues to function as a stop-gap arrangement.

Process of revival under BIFR

Under SICA, the industrial CPSEs whose accumulated losses are equal to or have exceeded their entire net worth are referred to BIFR. SICA was predominantly a remedial and ameliorative mechanism to take appropriate measures for revival and rehabilitation of potentially sick industrial undertakings and for liquidation/ closure of non-viable enterprises.

The process of revival of sick companies under BIFR is detailed below:

Flow chart of processing of revival schemes by BIFR



Inherent Flaws in BIFR Framework

Audit observed that the process of detection of sickness, formulation/ sanction and implementation of revival proposals of sick CPSEs under BIFR framework were found to have several inadequacies as discussed below:

- Under SICA, the industrial CPSEs whose accumulated losses are equal to or have exceeded their net worth are referred to BIFR. Though the objective of SICA was to secure timely detection of sick and potentially sick companies and speedy determination and enforcement of remedial measures, mostly the stage at which the sick industrial units are referred to BIFR does not leave much scope for their revival. In fact, the criteria does not provide for early reference of loss making companies for checking their incipient sickness. The UNCITRAL Legislative Guide recommends liquidity test should be preferred over balance sheet test. Failure to service debt should be the criteria for determining insolvency. Law should impose a duty on debtor to inform the creditors of the likely event of default. There should be ability for creditors to force the debtor to adopt corrective measures to prevent further deterioration of the enterprise or its value.

- Reference of sick CPSEs was linked to finalization of accounts i.e. within 60 days from the date of finalization of duly audited accounts for the financial year at the end of which the company has become sick, which in fact, came in the way of early reference to BIFR.

- Only the industries mentioned in the Industries (Development and Regulation) Act, 1951 are eligible to approach BIFR. All commercial enterprises are not entitled to approach BIFR. As a result many enterprises which are not companies incorporated under the Companies Act, 1956 or do not qualify as an industrial enterprise are disqualified from availing the restructuring opportunities provided by SICA.

- The central or state government, the RBI or a public or state financial institution or a scheduled bank may, if it has sufficient reasons to believe that any industrial company has become sick under SICA, make a reference in respect of such company to the BIFR.

  Rarely do banks file a reference before BIFR. Banks prefer to initiate recovery proceedings before Debt Recovery Tribunals (DRTs) or enforce security under SRFAESI.

- Any financial institution or bank on BIFR panel can act as the Operating Agency (OA). The role and responsibility of the OA is to prepare and propose, if possible, a scheme for the rehabilitation of the sick industrial company in accordance with the guidelines set out by the BIFR. Most of the times, BIFR appoints one of the secured creditors of the sick company as OA. They are interested parties having conflict of interest. This is an unusual practice as in

most sophisticated economies the plan is proposed by independent professionals with assistance from experts.

- Every draft scheme is circulated to every person who is required to provide financial assistance or give concessions for its consent within a period of 60 days from the date of such circulation. If no consent is received within this period, it is deemed that consent has been given and the BIFR may sanction the scheme. The scheme is binding on all concerned after its sanction. If the consent is not given by even a single person, BIFR cannot sanction the scheme and may adopt such other measures, including the winding up of the sick industrial company, as it may deem fit.

- Absence of framework of creditors committee deprives the restructuring system of a platform where creditors could come together to resolve issues in a timely and efficient manner. Formation of creditors committee is an established international best practice.

- In the case of CPSEs, referred to BIFR, it involved repeated inter-ministerial consultations and prolonged deliberations among various stakeholders. The entire enactment of SICA is structured in such a manner that it operates more by consensus rather than on the basis of decision-making by BIFR. Due to lack of powers to decide important issues, BIFR falls back upon the process of mobilizing consensus which is time-consuming. By the time decisions are taken and communicated, the plan has lost its viability resulting in failure of revival schemes even after sanction.

- SICA requires that the chairman and members of BIFR should be persons who have been or are qualified to be High Court judges or are persons of ability and integrity and have special knowledge and professional experience of not less than fifteen years in the field of science, technology, economics, banking industry, industrial reconstruction, investment, law, labour matters, industrial finance, industrial management, accountancy, marketing, administration or any other matter. However, mostly retired government officers or bankers are appointed to the BIFR.

- SICA provided immunity to the sick companies against legal action for recovery of money and suit for enforcement of any security or guarantee in respect of any loans and advances granted to the Company. Under this provision, companies can take undue advantage to avoid legal action after the failure of their projects and at the same time gain access to various benefits and concessions provided under the revival schemes. This immunity may continue for years in the absence of strict time frame.

- Though BIFR is required to complete the inquiry of sick companies within 60 days from the commencement of the inquiry, no timeline has been prescribed for sanction of the revival scheme.

- Recommendation for winding up of sick companies have to be forwarded to High Court by BIFR. The process of winding up takes about one year to 10 years after such recommendation is made.

- It was found that the proceedings before BIFR and High Courts take long. The UNCITRAL Legislative Guide recommends that the role of court should be balanced by the role of other participants such as the insolvency professionals/experts and creditors. Not only does it reduce the burden on courts, it also addresses the issue of lack of resources in the court system or lack of specific knowledge and experience of complex and technical aspects of insolvency law. In most developed systems, such as, UK, Australia, Canada, USA, the insolvency practitioners and creditors play an important part assisting the court and resolving the insolvency.

In brief, although SICA provides for preparation of the revival scheme within 90 days from the date of orders of the Board, no timeline has been prescribed for sanction of the scheme. This is therefore, fraught with the risk of uncertainty in timely sanction which in turn has an adverse cascading impact on the revival of the sick companies.

Further, SICA only provides for 'reasonable time' for the sick companies to make their net worth exceed the accumulated losses. However, again since no specific timeline has been prescribed for implementation of the scheme; this results in further delays. In fact, timely formulation of clear proposals for revival and closure in cases where revival schemes are unlikely to bear fruits is the essence of any revival strategy. Lack of effective monitoring arrangement of sanctioned schemes by the administrative Ministry adds to ineffectiveness in the implementation of the schemes.

With regard to the failure in taking timely action for revival, BIFR stated (December 2011) that as per SICA, potentially sick companies are also required to report their condition to BIFR. However, many such companies do not adhere to this requirement due to which BIFR is not able to take timely action in case of incipient sickness of companies.

(ii) Liquidation of Companies

The winding of companies under the Companies Act is a long and cumbersome process. The process of winding up of sick companies is started in the High Court on the recommendations of BIFR. Many CPSEs face liquidation proceedings in court from creditors. The officers of the Ministry of Corporate Affairs, GOI act as official liquidators. In fact, the Companies Act does not enable appointment of insolvency experts as liquidators. Provisions for appointment of professionals such as advocates, accountants, company secretaries, costs and works accountants and other experts as OL was allowed by Companies (Second Amendment) Act, 2002 which however, was never implemented.

The winding up is a time consuming procedure and generally takes between six to ten years. Such an inordinate delay has twin effects, one the cost of liquidation process comprising of security and administrative charges goes up and secondly and more importantly, the realizable value of the assets drops, that too often to absurd levels.

(iii) Corporate Debt Restructuring

The CDR mechanism introduced by RBI provides the informal out of court corporate restructuring mechanism. This mechanism is available to debtors in case of multi-creditor financing, with debt of ₹ 10 crore and above from banks and institutions. CDR is a non-statutory voluntary system based on Debtor- Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). All participants including debtors have to accede to the DCA. The DCA provides for a 'stand still' agreement binding for 90 days, or 180 days by both sides. Both the debtor and creditor(s) agree not to take recourse to any other legal action during the 'stand-still' period. This enables the CDR System to undertake the necessary debt restructuring exercise without any outside intervention, judicial or otherwise. There is no requirement of the borrower's account being a NPA or the borrower company being sick company under SICA or being in default for a specified period before reference to the CDR mechanism.

Potentially viable cases of NPAs get priority under CDR. BIFR cases are not eligible for restructuring under the CDR system except where specifically recommended by the CDR Core Group. The creditors are required to seek the approval from BIFR before implementing the CDR sanctioned package. The CDR mechanism has emerged as an effective and fast track tool for work outs, in particular because it can be invoked even before an asset turns non-performing. However, this mechanism is not used by the CPSEs.

(iv) Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

SRFAESI permits the secured creditors (if secured creditors hold 75 percent or more of the amount outstanding) to enforce their security interest in relation to the underlying asset without reference to a court. Secured creditors are required to give a 60 days written notice to the defaulting borrower upon classification of the corresponding loan as a non performing asset. If the borrower, who is under a liability to a secured creditor, makes a default in repayment of the secured debt or any installment thereof, secured creditors can proceed to act under SRFAESI.

SRFAESI provides the framework for establishment, ownership, operations and empowerments of Asset Reconstruction Companies (ARCs)[12] in India. SRFAESI provides

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[12] *Although the term 'Asset Reconstruction Company' has not been defined in SRFAESI, the term 'asset reconstruction' has been defined in section 2(1)(b), SRFAESI: " 'asset reconstruction' means acquisition by any securitisation company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance"; and 'reconstruction company' has been defined in section 2(1)(v), SRFAESI: " 'reconstruction company' means a*

for transfer of the financial assets (loans, debentures, etc., but not shares of the borrower, unless the shares are collateralized for the loan) from banks and institutions to ARCs. The RBI has, from time to time, issued various circulars, guidelines and notifications under SRFAESI pertaining to enforcement of security interest and on functioning of Secured Creditors and ARCs. SRFAESI has worked fairly well in spite of initial challenges faced by it.

(v) Board for Reconstruction of Public Sector Enterprises (BRPSE)

BRPSE was formed in December 2004 in DPE as an advisory body for sick CPSEs.

In addition to BIFR/ NCLT, in December 2004, GOI established the Board for Reconstruction of Public Sector Enterprises (BRPSE) in the Department of Public Enterprises (DPE) as an advisory body to address the:

- task of strengthening, modernisation, revival and restructuring of CPSEs including disinvestment/ closure and
- sale of both industrial and non-industrial units.

The recommendations of BRPSE are advisory in nature and are communicated to the concerned Administrative Ministry for implementation.

Process of revival under BRPSE

Under BRPSE, a reference can be made to the Board when a company has accumulated losses in any financial year equal to 50 per cent or more of its average net worth during the 4 years immediately preceding such financial year or if a company is sick within the meaning of SICA 1985. Under this arrangement, detection of loss making/sick CPSEs can be made much sooner. However, the recommendations of BRPSE are advisory in nature and lack enforceability.

The process of approval of revival schemes under BRPSE is detailed below:

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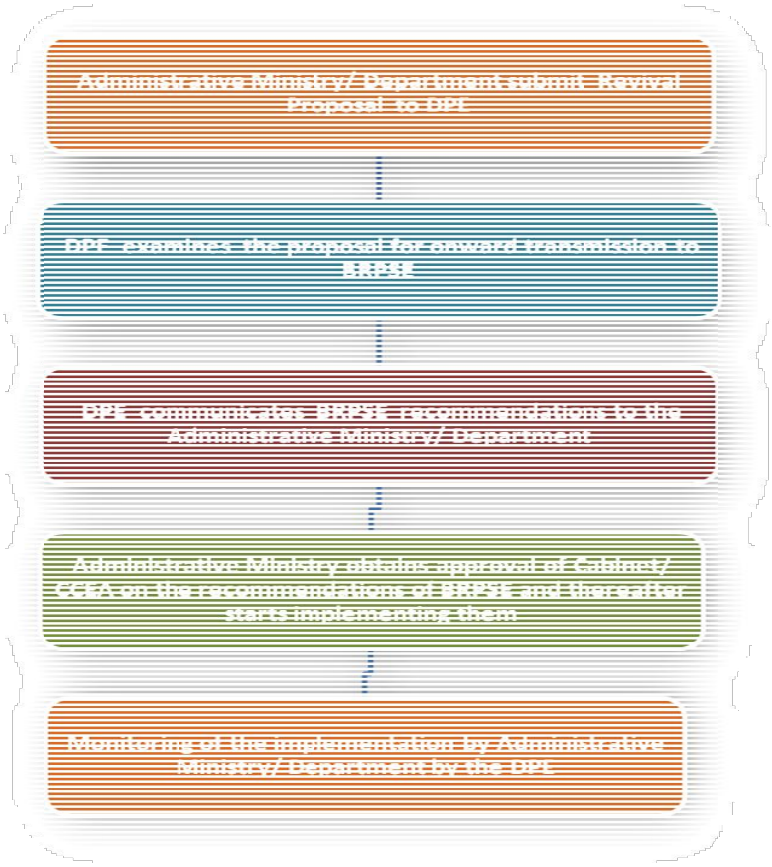
company formed and registered under the Companies Act, 1956 (1 of 1956) for the purpose of asset reconstruction".

Flow chart on processing of revival schemes by BRPSE



Inadequacies in BRPSE framework

Audit observed that procedural delays in formulation and sanction of revival schemes still persist under BRPSE due to the following reasons:

- The process involves consultations at multiple layers like Administrative Ministries, Department of Public Enterprises, relevant authorities and the BRPSE which examines and recommends the proposals.
- Approval procedure also involves multiple references to Committee of Secretaries, Group of Ministers and CCEA, etc.
- Some of the proposals took 1 year to 3 years for approval of the schemes due to protracted correspondence and consultations and lack of consensus amongst different agencies.
- Though two months time is prescribed for the BPRSE to finalise its recommendations from the date of receipt of the proposal, but no specific time frame has been prescribed for the CPSE and the Administrative Ministries for planning and formulation of the revival schemes. This resulted in delays in submission of revival proposals by sick CPSEs to the Board. Besides, the timeline of 8 weeks for the Administrative Ministries to seek the approval of the Cabinet/

CCEA on the recommendations of BRPSE is not strictly adhered to resulting in delay in the sanction of revival schemes.

- The terms of reference of BRPSE did not specify the timeline for implementation of sanctioned schemes nor were the modalities for review and monitoring of the sanctioned schemes prescribed for the Board. Some revival schemes have taken 4 years to over 10 years in implementing the scheme.
- The operational modalities of BRPSE basically excluded cases related to sale and disinvestment of CPSEs from its purview though these were provided for in its mandate, thus restricting the scope and functions of the Board. The matter was left to the DPE to decide different agency to be responsible for processing the recommendation in consultation with Department of Disinvestment and the Administrative Ministry.

In essence, the existing legislative and operational framework was found to be inadequate to effectively address the problem of sickness in CPSEs. Although SICA has been repealed since December 2003 due to its inherent weaknesses, the repeal has not come into effect as no alternative framework has yet been constituted in its place. Under NCLT, which is yet to be set-up after SICA Repeal Act of 2003, reference of loss making or sick CPSEs to NCLT is no longer automatic and requires prior approval of the Government.

This would result in accumulation of sick CPSEs falling outside the purview of NCLT. At the same time, many sick companies may not get referred to BRPSE since their reference is not a legal requirement under the existing framework. In the absence of clear cut policy framework, many loss making and potentially sick CPSEs would fail to receive timely intervention of the Government. Under the circumstances, non-revivable or chronically sick CPSEs will continue to receive non-plan budgetary support which will increase the burden on the national exchequer.

Recommendations:

Thus, the above situation indicates an urgent need for an appropriate mechanism empowered with a single point decision–making authority to effectively deal with the problems of sick/loss-making CPSEs. Moreover, in order to deal with the complexity of sickness in CPSEs, there is a need for a policy framework laying down detailed guidelines on the procedure/criteria to be followed for:

- determination/ identification of loss-making/sick CPSEs including non-revivable companies;
- revival/restructuring, disinvestment/sale/privatisation, exit/closure, etc. of sick CPSEs;
- planning/formulation, appraisal and approval of proposals; and
- implementation and monitoring of compliance.

The Department of Public Enterprises (DPE) stated (November 2011) that the proposed constitution of NCLT may reduce multiple layers in decision-making process. GOI will have the option to decide whether a sick CPSE is to be referred to NCLT or BRPSE. In either case, the proposed system will be an improvement over the present system. DPE further stated (December 2011) that the single-point appraising and decision making bodies are BRPSE and CCEA respectively.

Audit further observed that the reference of sick CPSEs to NCLT will not be automatic. It will require the approval of GOI and at the same time the reference to BRPSE is not made mandatory. This may result in accumulation of sick CPSEs outside the purview of both NCLT and BRPSE. Further, during exit conference (November 2011), Audit emphasized the need for framing of guidelines for formulation, approval and implementation of revival schemes which can be circulated to all the Administrative Ministries and monitored/ reviewed by a central authority. As regards single-point decision-making authority, the reply of DPE is not acceptable as CCEA is the final sanctioning authority for revival packages. Decision-making process involves multiple agencies resulting in divergent views, lack of consensus and prolonged deliberations making the process very time-consuming before submission for final sanction by CCEA.

On the recommendations made by audit, DPE stated (February 2012) that as per its constitution, BRPSE may either, *suo motu*, or upon reference made by the Administrative Ministry, consider such CPSE, if it is of the opinion that revival/ restructuring is necessary, for checking the incipient sickness. DPE further stated that the implementation of revival schemes is internally monitored by the Board of Directors and overseen by the concerned Administrative Ministry. Besides, BRPSE also reviews the implementation of revival plans and suggests corrective action, if required.

Audit is of the opinion that though BRPSE is empowered to *suo motu* consider such CPSEs for checking the incipient sickness, there is a need for an institutional mechanism for early identification of incipient sick CPSEs and their mandatory reporting by the Management/ Administrative Ministries to BRPSE. Also a well laid down monitoring procedure with periodicity specified for monitoring each stage of implementation of the revival schemes by a centralised authority needs to be put in place so that there is no diffusion of responsibility amongst the different agencies.

(vi) National Renewal Fund

GOI set up (February 1992) a fund called National Renewal Fund (NRF) to protect the interest of workers affected by industrial restructuring. The objectives of this fund were:

(a) To provide assistance to cover the costs of retraining and redeployment of employees arising as a result of modernisation, technology upgradation and industrial restructuring.

(b) To provide funds for compensation of employees affected by restructuring or closure of industrial units, both in the public and private sectors.

(c) To provide funds for employment generation schemes both in the organised and unorganised sectors in order to provide a social safety net for labour needs arising from the consequences of industrial restructuring.

The NRF was envisaged in two parts: (a) the National Renewal Grant Fund (NRGF) and the Employment Generation Fund (EGF). The NRGF was to deal with the immediate requirements of labour in sick units arising from revival or closure of such units. The funds were disbursed in the form of grants for re-training, redeployment, and counseling and placement services and for compensation to employees affected by rationalisation in industrial undertakings. It was also expected to provide resources for interest subsidies to enable financial institutions to provide soft loans for funding labour rationalisation resulting from the industrial restructuring of weak units. The EGF was expected to provide resources for employment generation. It was planned to provide funds in the form of grants for approved employment generation schemes for both the organised and the unorganised sectors.

Upto 1998-99, assistance from the NRF has been provided for implementation of Voluntary Retirement Scheme (VRS) in CPSEs, counseling/ redeployment scheme for workers rationalised from the organised sector. The Government introduced (May 2000) revised VRS and decided that from 2001-02, the administration of funds for VRS and retraining and rehabilitation of public sector workers would be centralised under the Department of Public Enterprises. Thereafter, Government abolished the NRF with effect from 12 July 2000.

The initiatives taken by the Government are elaborated below in a chronological order:

Table 3.1 – Government initiatives to revive sick CPSEs

Act/Law/ Body	Provisions	Current status
Companies Act, 1956 - Liquidation of Companies.	▪ The process of winding up of sick companies is started in the High Court on the recommendations of BIFR. ▪ The officers of the Ministry of Corporate Affairs act as official liquidators (OLs). ▪ The Companies Act does not enable appointment of insolvency experts as liquidators.	Provisions for appointment of professionals as OL were allowed by Companies (Second Amendment) Act, 2002 which however, were never implemented.
Sick Industrial Companies (Special Provisions) Act - SICA 1985	▪ GOI enacted a special legislation namely, the Sick Industrial Companies (Special Provisions) Act in 1985 commonly known as the SICA to determine sickness and expedite the revival of potentially viable units or closure of unviable units. ▪ SICA applies to companies both in public and private sectors owning industrial undertakings. ▪ Under this Act, Board of Industrial and Financial Reconstruction (BIFR), a quasi-judicial body, was set up in 1987, to take appropriate measures for revival and	SICA has been repealed in December 2003 and the work of revival and rehabilitation has been entrusted to National Company Law Tribunal (NCLT) to be created under the Companies (Second Amendment) Act 2002.

	rehabilitation of potentially sick industrial undertakings and for liquidation of non-viable companies. ▪ SICA 1985 was amended in 1991 for enabling referral of sick CPSEs to BIFR for their revival/ rehabilitation or closure.	
Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SRFAESI)	● Provides the framework for the setting up of asset reconstruction companies (ARCs) which can acquire NPAs from banks, financial institutions and housing finance companies, turn them around and resell them. ● SRFAESI also enables enforcement of security interest by banks and financial institutions without recourse to courts.	The RBI has, from time to time, issued various guidelines and notifications under SRFAESI pertaining to enforcement of security interest and on functioning of secured creditors and Asset Reconstruction Companies.
Corporate Debt Restructuring	▪ The CDR mechanism introduced by RBI provides the informal out of court corporate restructuring mechanism. ▪ This mechanism is available to debtors in case of multi-creditor financing, with debt of ₹ 10 crore and above from banks and institutions.	However, this mechanism is not used by the CPSEs.
Board for Reconstruction of Public Sector Enterprises (BRPSE)	▪ In addition to BIFR/ NCLT, in December 2004, GOI established the BRPSE in the DPE as an advisory body to address the task of strengthening, modernisation, revival and restructuring of CPSEs including disinvestment/ closure and sale of both industrial and non-industrial units. ▪ The recommendations of BRPSE are advisory in nature and are communicated to the concerned Administrative Ministry for implementation.	BRPSE has been discharging its role as advisory body till date for CPSEs.
National Renewal Fund (NRF)	▪ GOI set up (February 1992) NRF to protect workers' interest after industrial restructuring. ▪ Upto 1998-99, assistance from the NRF was provided for implementation of VRS in CPSEs, counselling/ redeployment scheme for workers rationalised from the organised sector. ▪ The Government introduced (May 2000) revised VRS and decided that from 2001-02, the administration of funds for VRS and retraining and rehabilitation of public sector workers would be centralised under the Department of Public Enterprises.	Government abolished the NRF with effect from 12 July 2000.

National Company Law Tribunal (NCLT)	▪ Due to delays inherent in the process of BIFR, GOI decided (December 2003) to set up National Company Law Tribunal (NCLT) to address sickness and bankruptcy under Companies (Second Amendment) Act 2002 by repealing SICA/ BIFR through Sick Industrial Companies (Special Provisions) Repeal Act 2003. ▪ The proposed NCLT shall deal with revival/ rehabilitation of sick companies and also continue the functions and powers currently discharged by the Company Law Board, BIFR and the High Court in respect of winding up, liquidation etc. ▪ A reference of the sick CPSEs would no longer be automatic or mandatory and would require pervious approval of the Government.	The Act has not been made effective and NCLT is yet to be constituted (January 2012). In the meanwhile, BIFR continues to function as a stop-gap arrangement.

3.2 Recent Initiatives by GOI for reform in the insolvency system

In December 2002, the Indian Parliament passed the Second Amendment to introduce improvements in revival and liquidation law. The Second Amendment which was the legislative product of recommendations of Justice Eradi committee provided for the setting up of a National Company Law Tribunal (NCLT) and its appellate tribunal to consider revival and rehabilitation of companies – a mandate presently entrusted to BIFR under SICA; and winding up of companies, the jurisdiction presently vested in the High Court. The Second Amendment sought to provide quick access to restructuring process. It required the board of directors of sick industrial company[13] to submit a draft scheme while making a reference to NCLT. It also provided an improved time frame for various stages of restructuring process and did away with the infamous provision of automatic stay.[14] This taking away of the provision altogether was a knee jerk reaction. It provided for debtor to disclose the relevant information in liquidation proceedings. The Second Amendment further provided for appointment of liquidator to be appointed from a panel of firms of chartered accountants, cost & work accountants, advocates, company secretaries or others, as may be prescribed. However, the role of professionals was restricted to liquidation proceedings. The Second Amendment has not come into effect.

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[13] *Section 46AA the Companies (Second Amendment) Act, 2002 defines sick industrial company as an industrial company which has at the end of any financial year accumulated losses equal to fifty percent or more of its average net worth during four years immediately preceding such financial year or failed to pay its debts within any three consecutive quarters on demand for its repayment by a creditor or creditors of such company.*

[14] *Section 22 of SICA, 1985*

The GOI has recently introduced the Companies Bill, 2011. Some highlights of the Companies Bill, 2011 as introduced in the Lok Sabha are discussed in some detail hereinafter.

- The Companies Bill provides for rehabilitation and liquidation under the same roof. The Companies Bill vests jurisdiction to deal with rehabilitation and liquidation of the companies in a neutral independent forum, NCLT with appeal to NCLAT. The NCLT will consist of a president and judicial and technical members.
- To avoid any delay, the jurisdiction of civil courts is barred on any matter on which NCLT/NCLAT is empowered to adjudicate. A time frame for rehabilitation and liquidation process has been envisaged under the Companies Bill.
- The Companies Bill prescribes liquidity test to examine the sickness of the company. Default in payment of matured debt on demand would trigger insolvency by debtor. This application shall be accompanied with (i) audited financials statement relating to the immediate preceding financial year, (ii) prescribed particulars and documents along with fee, and (iii) draft scheme of revival and rehabilitation. In case the sick company does not have any draft scheme to offer, the tribunal may direct interim administrator to take over the management of the company. In such an event, the directors and management shall extend their full cooperation to the interim administrator.

There is no mechanism to deal with cross-border insolvency. Ever since liberalization of India's economy, the country has witnessed significant growth in cross-border trade and investment. The country's fast growing economy is attracting global corporations to invest in Indian market. Recently, Indian companies have also grown into multinationals in character and have been making high profile acquisitions abroad. Many CPSEs have set up businesses overseas and acquired valuable assets in other jurisdictions. Foreign banks and creditors have extended finance to Indian assets and Indians companies including CPSEs have exposures overseas. But there is no effective mechanism for cooperation by Indian courts with courts of another country, or for administration of cross-border insolvencies and treatment of stakeholders, in the event insolvency proceedings start in any foreign jurisdiction involving assets or creditors in India. Many developed economies have adopted the Model Law on Cross Border Insolvency. Justice Eradi committee and later, Dr. J.J. Irani committee had categorically recommended adoption of UNCITRAL Model Law on Cross Border Insolvency, to provide an effective mechanism for dealing with cases of cross-border insolvency. However, this area has not been addressed in the Companies Bill.

Although provisions have been introduced in Companies Bill for formation of creditors committee, suitable substantive provisions should be made in law supplemented by rules on the appointment, voting and other substantive matters relating to creditors committee.[15] Ambiguity in this area may result in avoidable litigation.

[15] *Section 257 of the Companies Bill, 2011*

The secured creditors can commence the proceedings for rehabilitation if on a demand made by a secured creditors representing 50 percent or more of its outstanding amount of debt, the company fails to pay the debt within 30 days of demand or to secure or compound it to the satisfaction of creditors. The creditors can approach the tribunal for automatic stay simultaneously with an application for restructuring or rehabilitation, and to seize assets of debtor, for a limited stand still period of 120 days. No such right is available to unsecured creditors

The Companies Bill introduces the provisions for appointment of Company Liquidator (CL) in the winding up proceedings. CL shall be an independent person appointed out of the panel of professionals maintained by the central government. Such professionals must be having at least 10 years of experience in the company matters or such other qualifications. However, there are no provisions for their licensing, education and experience in insolvency or related areas. This poses the risk of easy empanelment of such professionals who may otherwise not be suitably qualified for appointment to provide the highly specialized services of insolvency. As they would be expected to discharge important functions, adequate accountability provisions are required.

Although the Companies Bill seeks to introduce the concept, it falls short of providing a suitable framework for Insolvency Professional (IP). The proposed appointment process of an IP as an administrator or company liquidator by Court is defective. As recommended by the UNCITRAL Legislative Guide such appointment should be made by Court only on recommendation of creditors and not at its own discretion. It should be the prerogative of largest creditors, secured or unsecured, to decide who should be appointed as administrator or liquidator, although such recommendation may be approved formally by court. Similarly, the qualification for appointment of IPs should be made stringent to ensure that people with adequate qualification and experience are appointed.

3.3 Need for convergence of State owned enterprises and private companies under one insolvency framework

The UNCITRAL Legislative Guide recommends that the same law should apply to both private and state-owned enterprises (SOEs), especially those SOEs which compete in the market place as distinct economic or business operations and otherwise have the same commercial and economic interests as privately-owned businesses. Creating a separate forum such as BRPSE amounts to providing a special treatment to select enterprises which may not be perceived well by the market.

A level playing field must be provided for private sector companies and CPSEs. Special treatment for CPSEs is not considered healthy or in conformity with international standards. Neither has it produced better results for CPSEs. Another important challenge is to ensure that there is a level-playing field in markets where private sector companies can compete with state-owned enterprises and that governments do not distort competition in the way they use their regulatory or supervisory powers.