COMPULSORY PRE- INSOLVENCY RESTRUCTURING: THE NEXT STEP IN THE PROGRESSION OF INSOLVENCY ECOSYSTEM

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INTRODUCTION:

The insolvency and restructuring matters are governed by the Insolvency and Bankruptcy Code (IBC), 2016.[1] It also governs the liquidation proceeding by the limited liability entities. However financial institutions are not included in it .Amidst mounting non-performing assets (NPA) and a spate of unsuccessful laws for the debt recovery, the Insolvency and Bankruptcy Code was enacted in 2016 and was acknowledged as the most ambitious economic legislation of India with a hope that it will lower losses in recovery of debt and yield a shorter time frame for resolution. In the past few years, the Insolvency and Bankruptcy Code has fallen short of expectations. In the 32nd report by the parliamentary standing committee on finance, it was observed that 71% of the cases have been pending with the National Company Law Tribunal for more than 180 days and creditors had to accept haircuts as large as 95% of the debt. Under IBC, speedy resolution is preferred as delays make it more likely that the resolution process will subsequently result in liquidation as well as erode the value of the company. While it is certainly imperative to boost the judicial infrastructure by increasing the number of trained judges, it would be more cautious to reduce the workload of the courts by encouraging early intervention at a pre- insolvency stage and thus, preventing company failure to begin with. A parallel approach through out of the court early restructuring literally similar to pre litigation mediation could be institutionalised in the Insolvency and Bankruptcy Code itself such that National Company Law Tribunal (NCLT) acts as a court of last resort if the company is forced into insolvency. With regards to the IBC, M.S Sahoo, former Chairperson of IBC Board of India opined that *"In the long run, the best use of Insolvency and Bankruptcy Code would be not using it at all. That would be the ultimate corporate governance"*

[1] Hereinafter referred to as IBC

FRAMEWORK FOR PRE- INSOLVENCY RESTRUCTURING MECHANISM:

While negotiations towards a voluntary Scheme of Arrangement (SOA) are mainly permitted under the Companies Act ,2013 as a debt restructuring instrument for both insolvent and solvent companies, it seems to be on the part of obsolescence. The Scheme Of Arrangement's unpopularity is perhaps owing to factors like excessive court's hindrance which leads to protracted restructuring process thus, shaking the confidence of the parties and freedom of holdouts by recalcitrant creditors. The insolvency regime would surely benefit from reviving the SOA mechanism by retaining the overarching theme of out of court debt from the substance and form of the EU directive on preventing restructuring frameworks through a four-pronged approach.

Firstly, section 138 of the Companies Act 2013 is silent on the counters of the duty of the internal auditors. The internal auditors play a pivotal role in pinning down a crisis situation. Certain indicators like late payments- statutory or otherwise, absence of systemic and regular business operations for the current financial years and liquidity ratios and debt service should trigger duty to warn the management or to require an interim auditor's report. This should be formally instituted in the Companies Act in order to enable prompt identification of early signs of distress, independent of the corporate insolvency resolution process of facilitate early restructuring.

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Secondly, a supermajority vote by all the creditors should be preferred without any classification for the adoption of the restructuring plan. This simplified process will avoid time consuming litigation against artificial distinctions between hierarchisation of creditors and classes belonging to the same class. Moreover it would overcome a shortcoming of SOA as per Section 230 of the Companies Act which requires an approval of 75% of each class of creditors, risking holdouts by those who compromise a majority in a particular class and therefore stalling the scheme. Initially the classification requirement has come under the scanner of difficulties to identify the class which has been discussed in State Bank of India and other v. Altstom Power Boilers by the Bombay High court. In the instant case The petitioners, the transferor companies, have prayed for sanction of the scheme of arrangement for amalgamation of the petitioners with the transferee company, under Sections 391 to 394 of the Companies Act, 1956, with effect from March 31, 2001.

Thirdly, rather than inculcating more layers within the present administrative machinery, the "Resolution Professionals" can be tasked with assisting the stressed companies during restructuring. After the supermajority votes of all the creditors and adoption of restructuring plans, the implementation should be made contingent on the confirmation of the resolution professional without court sanction. The Resolution professional would maintained oversight on the procedure, safeguarded minorities rights and informed decision making by the creditors. As per Section 34 of the Arbitration & Conciliation Act 1996, a limited provision of appeal may be permitted in specific circumstances in the interests of equity and fairness. When the restructuring plan envisages additional lending as supposed to rescheduling of debt and it ends up as loss for the employees.

Lastly the negotiations should be kept confidential as a part of pre -insolvency restructuring. Since the SOA procedure is marked with courts hindrance at every stage, it seems impractical to consider its confidentiality.

Hence, in India the social stigma attached with companies with financial distress makes them hesitant to peruse damages control. In this way they kick the can down the road. The erosion in the value in its assets eventually proves detrimental to the creditors. Confidentiality of the process will definitely ensure that there is freely negotiate of debtor without impacting their relationships adversely with other financial partners.

WHY SHOULD THE CORPORATE DEBTORS NOT TO BE LEFT TO THEIR OWN DEVICES DURING FINANCIAL UNCERTAINTY:

While the voluntary mechanism SOA is statutorily mandating stressed companies to resort to an early restructuring process in light of two reasons that stem from the economic climate of the country. First, the Indian companies are usually characterised by concentrated ownership wherein the promoter exercises board controller and management. Research have established that such centralisation of the powers might spell doom during a downward spiral because the top management tends to adopt a conservative stance by resisting change. Secondly, the MSME operational creditors that majorly forms the backbone of the country may prefer an out of the court settlement with debtors who are mainly on the brink of insolvency. This holds correct and true in the matter of Committee of Creditors Essar Steel India limited v. Satish Kumar Gupta, wherein the supreme court clearly held that Insolvency and Bankruptcy Code is binding on all claims whether non-financial or financial as the primary overarching aim is resolution of entity and not recovery of the debt. However, operational creditors cannot by choice opt for

contract for arbitration for dispute resolution and IBC in the event of arbitration. Thus, the debtor company might take an advantage of this vulnerability and not heed to operational creditors requests of early resolution unless compelled to do so.

CONCLUSION

Thus, it can be concluded that a pre-insolvency restructuring procedure will arrest the flow of the cases to National Company Law Tribunal giving it the latitude to concentrate on more arduous one and thus disposing them speedy. Exploration of restructuring and early crisis detention will also preserve the value of the company, being mutually beneficial for both creditors and debtors. This will not only restore faith in IBC but will also align the Indian regime that are prevailing in this realm internationally.