THE DEMISE OF CORPORATE INSOLVENCY LAW IN INDIA: THE ROLE OF THE COURTS

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ABSTRACT

The subject of this thesis is the operation of corporate insolvency law in post-colonial India. Indian corporate insolvency law has been widely condemned as dysfunctional, critics complaining of extreme delays and a series of associated harms to creditors in the disposal of formal proceedings. Surprisingly little is known, however, about why the law has 'failed' creditors in this way - why the law operates as it does. That is the question that motivates this thesis. The thesis reports the results of an in-depth study of the introduction and development of India's two principal insolvency procedures for corporate debtors: liquidation (under the Companies Act 1956) and rescue (under the Sick Industrial Companies (Special Provisions) Act 1985, for industrial companies). The most significant contribution made by the thesis is the reporting of new evidence of the influence of judges on the development of these two insolvency procedures over time, drawn from an original analysis of a large body of Indian case law. This evidence suggests that the role of the courts (or more specifically, the role of judges) has been significantly underestimated in previous attempts to explain the demise of corporate insolvency law in post-colonial India.

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'Appellate Authority'	Appellate Authority for Industrial and Financial Reconstruction
'BIFR'	Board for Industrial and Financial Reconstruction
'BIFR Regulations'	Board for Industrial and Financial Reconstruction Regulations 1987
'CL'	Compulsory liquidation (only used as abbreviation in footnotes)
'CVL'	Creditors' voluntary liquidation
'IDA'	Industrial Disputes Act 1947
'IP'	Insolvency practitioner
'MVL'	Members' voluntary liquidation
'NCLT'	National Company Law Tribunal
'OA'	Operating agency
'RBI'	Reserve Bank of India
'SARFAESI'	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act 2002
'SICA'	The Sick Industrial Companies (Special Provisions) Act 1985
'TCR'	Tiwari Committee Report
'VL'	Voluntary liquidation (only used as abbreviation in footnotes)

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INTRODUCTION

The Indian system provides neither an opportunity for speedy and effective rehabilitation nor for an efficient exit…. The Committee feels that the Indian economy is now at a stage where articulation of a comprehensive framework that addresses insolvency issues would make a material difference to the productivity of the economy. The Committee is of the view that a review of the system for addressing corporate insolvency law in the Indian context is urgently called for.

(Irani Committee Report, 2005)

The framework for bankruptcy resolution [in India]… is fragmented, complex, and fraught with delay… The legal structure is… to put it charitably, in a state of transition, but this state of affairs needs to be remedied quickly. Fortunately, the economy is doing well, but this state of affairs will not last forever.

(Rajan Report, 2010)

The subject of this thesis is corporate insolvency law in post-colonial India. India's dazzling entrance onto the global economic stage has provoked a great deal of research on the Indian economy. One of the issues highlighted by this research is the state of Indian corporate insolvency law. The consensus (not only among economists, but also legal scholars and policy makers, both in India and elsewhere) is that Indian corporate insolvency law is dysfunctional. The existing corporate insolvency statutes have been condemned as 'unworkable'[1] or as a 'failure'[2], critics typically complaining of long delays and (relatedly) poor returns to creditors in the disposal of formal insolvency proceedings[3]. It has been suggested that the existing law is unfit for India's modern market economy - 'existing laws and systems have proved incapable of dealing with the

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1 Joydeep Mukherji, 'India's long march to capitalism' (2002) 1(2) *India Review* 29, 35: 'Laws for bankruptcy and liquidation remain largely unworkable'.

2 Advisory Panel on Institutions and Market Structure, *India's Financial Sector: An Assessment* (Foundation Books 2009) 417 (regarding India's corporate rescue procedure in the Sick Industrial Companies (Special Provisions) Act 1985, the subject of Part II of this thesis).

3 As to which, see further Chapter 4, Section 4.1.1, and Chapter 7, Section 7.1.1.

new economic dynamics'[4] – and a barrier to the provision of credit[5]. Reform has been long called for, and there have been a series of attempts at statutory revision (and even repeal) over the last decade. Though these attempts faltered[6], significant reform is now reportedly imminent[7].

This thesis is not concerned with the normative question of how corporate insolvency law in India *ought* to operate. It is concerned with the question of why it is that the existing law operates as it does. This question is an empirical one that has attracted surprisingly little scholarly attention to date[8]. The thesis offers a close study of the introduction and implementation (over time) of India's two principal insolvency procedures for corporate debtors: liquidation, under the Companies Act 1956, and rescue, under the Sick Industrial Companies (Special Provisions) Act 1985. Its primary contribution is to reveal new evidence of the role of the courts (specifically, the role of judges) in influencing the 'anti-creditor' functionality of these laws. The evidence suggests that the courts are far more implicated in the 'failure' of corporate insolvency law in India than the existing literature implies.

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[4] Sumant Batra, 'The Asian Recovery: Progress and Pitfalls' (Global Forum on Insolvency Risk Management, Washington DC, 2003), 2 <http://siteresources.worldbank.org/GILD/ConferenceMaterial/20157508/Batra%20-%20India%20-%20FINAL.pdf> accessed 20 August 2012.

[5] Report of the Committee on Financial Sector Reforms, *A Hundred Small Steps* (Sage Publications 2009) 152.

[6] For a range of reasons, including a challenge to the constitutionality of proposed reforms (as to which see further Chapter 3, text to n 127; see also Chapter 6, Section 6.4.1).

[7] With the enactment of the Companies Bill 2011, as to which see further Chapter 3 text to n 128, Chapter 6 text to n 154.

[8] See further the introductions to section 4.2 (in Chapter 4) and section 7.2 (in Chapter 7).

1.1 The scope of the thesis

This thesis considers only *corporate* insolvency law in India; the law relating to the bankruptcy of individuals is not considered. It focuses particularly on India's *collective* corporate insolvency procedures (those designed to mediate relations between a distressed debtor and all of its creditors)[9], and thus does not consider in any detail those procedures that do no more than enable the enforcement of an individual creditor's debt on a company's default, affecting other creditors only (if at all) as an incident of enforcement. The thesis is further confined to considering India's *formal* collective procedures (those provided by law), and thus does not consider the ways in which a corporate restructuring might be achieved informally, or by recourse to lender restructuring norms and/or contract. In the last two decades, there have been some significant developments in debt enforcement law and in out-of-court corporate restructuring practice in India[10]. These developments are an important part of the 'creditor rights system'[11] in India, but they cannot be considered in any detail here: this thesis focuses on India's formal corporate insolvency procedures, and how their 'failure' is to be explained.

The thesis considers the development and operation of India's two principal insolvency procedures for corporate debtors. Each procedure was established by federal

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[9] See Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986) 8-11.

[10] In debt enforcement law, by the introduction of specialist tribunals for debt recovery by institutional creditors (under the Recovery of Debts Due to Banks and Financial Institutions Act 1993) and later by the introduction of a new out-of-court collateral seizure right for secured creditors (under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002), as to which see further Chapter 3 n 190, Chapter 4 text to n 118. In restructuring, by the development (by the Reserve Bank of India) of a voluntary contract-based mechanism ('CDR', or 'Corporate Debt Restructuring') to facilitate the restructuring of debtors with exposure to multiple institutional creditors that exceeds (in aggregate) Rs 10 crore (Rs 100,000,000): see Cyril Schroff and Ashwani Puri, 'India' in Carolyn Boyle (ed), *Asia Pacific Restructuring and Insolvency Guide 2006* (Globe White Page 2006) 69, and 'Revised Guidelines on Corporate Debt Restructuring (CDR) Mechanism' (November 2005) <http://www.cdrindia.org/downloads/RBI-CDR-Circular-Nov05.pdf> accessed 15 August 2012.

[11] Advisory Panel on Institutions and Market Structure (n 2) ch VI.

legislation, and the commencement of either suspends (by the imposition of a stay) the rights of most[12] creditors to pursue individual debt enforcement actions against the debtor during the pendency of proceedings: both, then, are formal, collective procedures. The first procedure considered in the thesis – liquidation – was introduced in the British colonial period after the introduction of the same procedure in the UK, and was developed throughout that period to mirror developments in the UK[13]. The liquidation procedure is now contained in the Companies Act 1956, and applies to any company incorporated under that Act[14]. The second procedure is a rescue procedure provided under the Sick Industrial Companies (Special Provisions) Act 1985 (hereafter, 'SICA'). Where operative, that Act stays enforcement action by all creditors to enable the preparation of a plan for the reorganisation of a company's debts or the sale of its business[15] to which dissenting creditors may be bound[16]. But SICA applies to only one class of company: 'sick industrial companies'[17]. For other companies, the only formal route to a reorganisation of debts is a 'scheme of arrangement' under the Companies Act 1956[18]. Like the liquidation procedure, the scheme of arrangement mechanism was

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12 Although in the case of liquidation, the stay does not prevent the exercise of self-help remedies by secured creditors: see Chapter 3, text to n 189 (but see also n 192). On the stay under the Sick Industrial Companies (Special Provisions) Act 1985, see Chapter 6, text to n 95.

13 This history is considered in detail in Chapter 3.

14 Or any of the earlier company statutes: see Companies Act 1956, s 3.

15 Among other things: see SICA, s 18 and Chapter 6, text to n 116.

16 With the exception of one class of creditor, who cannot generally be bound without their consent: see Chapter 6, text to n 120 and Chapter 8, section 8.2.1.

17 See SICA, s 15, and Chapter 6, from text to 78.

18 This position would change on the enactment of the Companies Bill 2011, which would introduce a rescue procedure available to all classes of corporate debtor, whether or not 'industrial': see Chapter 6, text to n 154.

developed during the colonial period in accordance with its development in UK law[19]. A scheme of arrangement can be used by any company, solvent or otherwise, to achieve a binding compromise with its creditors or its members (or some class thereof), under court supervision[20]. It is thus a tool that can be used by distressed debtors to achieve a reorganisation of debts. But the commencement of scheme proceedings does not necessarily have any immediate effect on creditors: their ability to 'grab' the assets of the debtor in enforcement proceedings is unimpaired by scheme proceedings, unless the court supervising the proceedings orders a stay[21]. A complete study of the position of insolvent companies in India would undoubtedly include detailed treatment of schemes as a restructuring device. They cannot, however, be given anything more than tangential treatment in this thesis.

The thesis investigates the operation of India's two principal insolvency procedures over time, from 1956 (the year of the enactment of the Companies Act 1956, the first company statute enacted after India's independence in 1947)[22] to the present day. The thesis thus considers the law's operation not only in India's modern market economy, but also in the period that preceded India's economic liberalisation. Following independence, successive Indian governments pursued what has been described as an

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[19] See Chapter 3, text to n 37.

[20] See Companies Act 1956, ss 390 and 391.

[21] Which is it empowered to do under the Companies Act 1956, s 391(6). There is no equivalent to this provision in UK company law, although it has been held that a general court rule affording jurisdiction to stay an execution of a judgment or order can be exercised to support the negotiation of a scheme of arrangement: see *Sea Assets Limited v PT Garuda Indonesia (No. 2)* (EWHC Ch, 27 June 2001), noted in Louise Gullifer and Jennifer Payne, *Corporate Finance Law: Principles and Policy* (Hart Publishing 2011) [13.2.4.2].

[22] See further Chapter 3, section 3.2.1.

'inward-looking and highly interventionist' strategy for economic development[23]. Features of this period (somewhat crudely described in this thesis as the 'planned economy period')[24] included import substitution, high levels of state ownership and control in some sectors of the economy (including the industrial and financial sectors), and state barriers to firm entry and to firm exit (particularly in relation to industrial firms, as explored later[25] in the thesis)[26]. In the late 1970s and 1980s, low growth rates and 'dismal' industrial performance provided the impetus for some liberalisation initiatives[27], but it was not until 1991 – following a balance-of-payments crisis – that a 'deeper and more systematic'[28] program of liberalisation was announced, together with the negotiation of 'structural adjustment' loan support from the World Bank and the International Monetary Fund[29]. Features of the 1991 program included the promised relaxation of some historical barriers to the closure of insolvent firms[30], and the liberalisation of the Indian financial sector (previously subject to considerable state

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[23] Valerie Cerra and Sweta Chaman Saxena, 'What Caused the 1991 Currency Crisis in India?' (2002) 49(3) *IMF Staff Papers* 395, 400.

[24] The description is an oversimplification: there were important differences in the type and kind of controls imposed by each of the Central Government's five-year plans in the post-independence period, and in the extent to which they impacted on the private sector (for a brief review, see Vijay Joshi and IMD Little, *India: Macroeconomics and Political Economy* (World Bank 1994) chs 1 and 3). Nothing in the thesis turns on these nuances, however.

[25] See Chapter 4, text to n 44.

[26] See Cerra and Saxena (n 23) 400; Vijay Joshi and IMD Little, *India's Economic Reforms 1991-2001* (Clarendon Press 1996) [5.1] ('The strategy of Indian industrialization did not change much from Independence to 1990. It emphasized heavy industry, public ownership, and import substitution'); TN Srinivasan and Suresh Tendulkar, *Reintegrating India with the World Economy* (Institute for International Economics 2003) ch 1. On bank nationalisation, see Chapter 4, n 71.

[27] Arvind Panagariya, *India: The Emerging Giant* (OUP 2008) 79 (in Part 1, Section 3: 'Phase III (1981-88) Liberalization by Stealth'); see also Joshi and Little, *India: Macroeconomics and Political Economy* (n 24) 62-67; Arvind Subramanian, *India's Turn: Understanding the Economic Transformation* (OUP 2008) ch 1.

[28] Arvind Panagariya, 'India's Trade Reform' (2004) 1 *India Policy Forum 2004* 1, 6.

[29] See further Chapter 2, text to n 9.

[30] See further Chapter 2, text to n 40.

influence, including in relation to lending to insolvent or distressed debtors)[31]. The thesis considers developments in insolvency law, policy and practice in both the planned economy period and the market economy period (which can be defined for the purpose of this thesis as the period from 1991 to present day)[32]. This historical approach sets the thesis apart from much of the existing literature on corporate insolvency law in India, which focuses primarily on the law's operation in (and unsuitability for) India's modern market economy.

1.2 Structure and methodology

The thesis has two substantive parts, the first of which (Part I) is devoted to India's company liquidation procedure in the Companies Act 1956, and the second (Part II) to India's rescue procedure in SICA. Both Parts are motivated by the same question, introduced at the beginning of this chapter: the question of how the failure of India's two principal insolvency procedures can best be explained, or (more specifically) how the (dys)functionality of these procedures (their record of extreme delay and associated harms to creditors) can be explained. Both Parts are structured in the same way and use the same set of research techniques. These techniques include (i) analysis of documentary evidence of the legislative history of each insolvency procedure, drawn from various primary and secondary sources; (ii) analysis of documentary evidence of historical state policy on the treatment of insolvent firms (specifically, insolvent industrial firms), obtained through archival research in India and the UK; (iii) analysis of official

[31] See further Chapter 4, text to n 74.

[32] That is not to say that the process of liberalisation did not begin earlier (see above, n 27 and accompanying text). But the liberalisation reforms that most impacted on insolvency law (including both reforms targeting insolvency law directly, and those that had a more indirect but nevertheless significant effect on the law or its functionality, such as the liberalisation of the financial sector (see Chapter 4, from text to n 97)) did not occur until after the 1991 announcement of economic transition, such that the definition is an appropriate one for this thesis.

statistics on the use of each insolvency procedure over time; (iv) consideration of observations made by participants in a short series of semi-structured interviews, conducted in India[33] with senior practitioners, an economist, a restructuring expert, a former state industrialist, and a former chairman of the tribunal[34] that administers SICA[35][36] ; and (v) construction and analysis of large datasets of judicial decisions. The purpose of using multiple research techniques ('multiple tactics for observing and understanding')[37] was to build a complete a picture as possible of the introduction and development of the law over time:

> [E]very methodology provides a technique for studying how law works in the world, but each methodology comes with important caveats… we may wonder what we are missing by employing a single strategy when we seek to understand complex interactions, organisations and institutions that make up our legal systems…[38].

The first chapter of each Part[39] considers the law 'on the books', charting the introduction of the insolvency procedure to the statute book and subsequent statutory amendments, describing the key features of the statutory provisions in their current form, and noting any proposals for their reform. These chapters draw on various primary

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[33] One of the interviews was conducted by telephone shortly after leaving India.

[34] The Board for Industrial and Financial Reconstruction, as to which see Chapter 6, section 6.3.1.

[35] A total of seven interviews were conducted. Participants were selected on the basis of their legal or industry expertise (that is, the interviews were 'elite' interviews: Steinar Kvale and Svend Brinkmann, *Interviews: Learning the Craft of Qualitative Research Interviewing* (2nd ed, Sage 2009) 147). Semi-structured interviews are commonly used for elite interviewing: Peter Burnham and others, *Research Methods in Politics* (Palgrave Macmillan 2004) 205.

[36] Since this research technique involved human participants, the approval of Oxford's Central University Research Ethics Committee was required. This approval was granted in January 2010, and interviews were conducted in April 2010.

[37] Laura B Nielsen, 'The Need for Multi-Method Approaches in Empirical Legal Research' in Peter Cane and H Kritzer (eds), *The Oxford Handbook of Empirical Legal Research* (OUP 2010) 953.

[38] ibid 953-954.

[39] Chapter 3 (Part I) and Chapter 6 (Part II).

sources (particularly parliamentary debates and official reports) from both the colonial period and post-independence period, many of which are yet to be considered in any detail in the literature. The second chapter of each Part[40] considers the law 'in action', documenting the evidence of how the insolvency procedure operates in practice, and exploring the explanations suggested by others for why the law operates in this way. Again, these chapters draw on evidence that has not yet been considered in any detail in the existing literature, including the statistical evidence obtained from official reports on the use of each procedure over time[41], and the evidence of state policy on the treatment of insolvent industrial firms (including by the financial sector) that was obtained through archival research[42]. These chapters also draw on some observations made by participants in the semi-structured interviews conducted for the project. The third and final chapter of each Part[43] considers the evidence of the implementation of each insolvency procedure by judges in India's courts and (to a lesser extent) tribunals. This inquiry builds upon the existing literature on corporate insolvency law in India, aspects of which suggest that the law's 'anti-creditor' operation may be partly attributable to certain judicial practices and preferences[44]. The chapters report the construction of datasets of cases relating to each insolvency procedure: for the liquidation procedure, a dataset of all judgments on a creditor's petition to wind up a company on the basis that it is unable to pay its debts (454 judgments)[45]; for the SICA rescue procedure, a dataset of all available

[40] Chapter 4 (Part I) and Chapter 5 (Part II).

[41] Summarised in Appendices I and III.

[42] See further Chapter 7, text to n 116.

[43] Chapter 5 (Part I) and Chapter 8 (Part II).

[44] See further Chapter 4, from text to n 150; Chapter 7, from text to n 91.

[45] See further Chapter 5, section 5.1, and Appendix II.

cases relating to SICA-registered or former SICA-registered companies (1066 judgments)[46]. The datasets reveal a series of innovations by judges in the interpretation and application of the core insolvency statutes, innovations that appear to have caused delays and a series of associated harms to creditors in the disposal of proceedings. This evidence suggests that the influence of judges on the law's 'anti-creditor' functionality has been significantly underestimated.

Parts I and II are prefaced by Chapter 2 and followed by Chapter 9 (the concluding chapter). These two chapters situate the subject of corporate insolvency law in India in the context of broader thinking (by academics and by policy makers, including in international financial institutions such as the World Bank) about the relationship between law and development, particularly financial development. The insolvency law reform agenda in India was at least partly inspired by this broader intellectual framework (particularly through the development assistance offered by the World Bank in connection with India's economic liberalisation)[47] and continues to be significantly influenced by it (again, particularly through the ongoing law reform projects of the World Bank)[48]. These connections are surveyed in Chapter 2 and then revisited in Chapter 9, in light of the thesis findings. It is suggested that the thesis findings challenge some of the assumptions and claims that feature in academic and policy work on the relationship between law and (financial) development, and the methodologies on which they depend.

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[46] See further Chapter 8, section 8.1, and Appendices IV.

[47] See Chapter 2, Section 2.1.

[48] See Chapter 2, Section 2.2.

1.3 The contribution of the thesis

The thesis offers a close study of the introduction, development and demise of India's two principal insolvency procedures for corporate debtors. It makes a number of novel contributions, including what may be the first detailed account of the history of the introduction of liquidation law in the colonial period[49], and a more detailed account of the role of the state in industrial insolvency in the planned economy period than that offered by the existing literature[50]. But the most important contribution made by the thesis is the reporting of new evidence of the influence of the courts on the 'anti-creditor' operation of insolvency law in India. This evidence generates the central claim of the thesis: the claim that judges are far more implicated in the demise of corporate insolvency law in India than previously thought. This claim has implications for ongoing attempts at insolvency law reform in India, and for the broader intellectual framework that has driven that reform agenda to date.

[49] See Chapter 3.

[50] See Chapter 4, text to n 50 and Chapter 7, section 7.3.2.

CHAPTER 2

THE BROADER CONTEXT: LAW, FINANCE AND DEVELOPMENT

The focus of this thesis is (as Chapter 1 explained) on the operation of Indian corporate insolvency law in practice, and how that functionality can be explained. The primary contribution made by the thesis is the introduction of new evidence of the role of the courts (specifically, the role of judges) in influencing the operation of India's two formal corporate insolvency procedures. This evidence emerges from a detailed study of the introduction and implementation over time of each insolvency procedure. Most of this thesis – Part I (on liquidation under the Companies Act 1956), and Part II (on rescue under the Sick Industrial Companies (Special Provisions) Act 1985, or 'SICA') – is devoted to this study, and it is on this that the thesis rests.

This brief chapter has a different focus. Its purpose is to situate the subject of the thesis – corporate insolvency law in India - within the broader context of literature on the interrelationship between law and financial development, and law and development more generally. The question of whether and how law 'matters' to development[1] is of course central to the law reform projects of international development organisations and analysis of such projects (the 'law and development' literature)[2]. But the question has also attracted the attention of economists (and economic historians), political scientists, anthropologists and sociologists and others interested in explaining the performance and

[1] See Kenneth W Dam, *The Law-Growth Nexis* (Brookings Institution 2006) 230, describing the "'law matters' premise" as a 'major premise that has gained ascendancy in the development community, especially in academia and in multilateral agencies'.

[2] The definition suggested by David Trubek, 'Law and Development', in Neil J Smelser and Paul B Baltes (eds), *International Encyclopedia of the Social & Behavioural Sciences,* vol 12 (Pergamon 2001) 8443, which identifies the phrase as one 'usually used to describe legal assistance programs for developing countries and the related academic work'.

relative performance of developed economies over time. A large body of literature has been produced, and its breadth and complexity cannot be fully captured here. This chapter does no more than introduce some parts of the literature and (together with Chapter 9) explain how the thesis and its findings can be connected to it.

There are two reasons to attempt to locate the thesis within the broader context of literature on law and finance, and law and development. The first is that the literature introduced in this chapter helps to explain aspects of the insolvency law reform agenda in India, including the timing of initial reform proposals, and the ongoing focus of reformers (that is, the literature is part of the 'story' of insolvency law in India over time). The second is that the literature is associated with a number of claims about the influence of certain features of a legal system on development, and the channels by which this influence is exerted. Some of the findings of this thesis have relevance for these claims. They are therefore introduced here and then revisited in the concluding chapter, in light of the thesis findings.

2.1 The emergence of the Indian insolvency reform agenda: liberalisation and structural adjustment

Insolvency law reform does not appear to have been clearly on the Indian government agenda until the 1990s, even though there is evidence of a problem of delay in company liquidations from the early years of the operation of the Companies Act 1956[3]. Reform appears to have become a serious prospect in 1993, after the publication of a government-commissioned report – the 'Goswami Committee Report'[4] – on industrial

[3] See Chapter 4, text to n 8.

[4] 'Report of the Committee on Industrial Sickness and Corporate Restructuring' (hereafter, 'Goswami Committee Report'), extracted in HPS Pahwa, *Bharat's Sick Industries & BIFR* (8th ed, Bharat Law House 2009) Appendix 1.

sickness and corporate restructuring (the report focused mainly on the position of insolvent private sector industrial firms)[5]. The Committee was highly critical of both liquidation procedure and the SICA rescue procedure, noting (among other things) the record of lengthy delays under each[6]. It argued for radical reform, motivated by its desire to 'create a climate that encourages commercial restructuring and reorganization of financially sick but economically viable private sector firms, and facilitates the withdrawal of unviable ones'[7]. The Committee identified insolvency law reform as an essential component of the task of creating a 'much more economically rational, market driven, competitive industrial structure'[8] in India.

The emergence of the insolvency law reform agenda in India appears to have been at least partly linked to the negotiation of 'structural adjustment' loan support from the World Bank during 1991. The loan was one of two negotiated during the balance-of-payments crisis associated with India's formal economic liberalisation[9] - the other was with the International Monetary Fund[10], but its terms do not appear to be publicly accessible. 'Structural adjustment' lending was a tool deployed by the World Bank and IMF in the 1980s and 1990s in response to macroeconomic crises in developing

[5] On this choice of focus, see further Chapter 4, text to n 44.

[6] (n 4) [5.6] (liquidation), [3.3] (SICA). The Goswami Committee Report is considered in more detail in Chapter 7, section 7.2.

[7] ibid [1.6].

[8] ibid [6.1].

[9] See generally Valerie Cerra and Sweta Chaman Saxena, 'What Caused the 1991 Currency Crisis in India?' (2002) 49(3) *IMF Staff Papers* 395.

[10] See Arunabha Ghosh, 'Pathways Through Financial Crisis: India' (2006) 12 *Global Governance* 413, 417.

economies[11]. It has been defined by the World Bank as:

> Non-project lending to support programs of policy and institutional change necessary to modify the structure of an economy so that it can maintain both its growth rate and the viability of its balance of payments in the medium term[12].

The essential feature of structural adjustment lending appears to have been 'policy-based' conditionality[13]. Loans were expressed to be conditional on the implementation of policies by the borrowing nation, designed not only to stabilise the economy (by changes in monetary and fiscal policy, for example) but also to affect more fundamental 'structural' changes to it (such as reform of the financial sector, or public sector enterprises, or the industrial sector)[14]. As it developed, adjustment lending became associated with a particular set of policy prescriptions, described in law and development literature as the 'Washington consensus'[15], that were broadly designed to encourage states to:

> (a) pursue macroeconomic stability by controlling inflation and reducing fiscal deficits; (b) open their economies to the rest of the world through trade and capital account liberalization, and (c) liberalize domestic product

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[11] See Carl Jayarajah and William Branson, *Structural and Sectoral Adjustment: World Bank Experience, 1980-92* (World Bank 1995); Miles Kahler, 'Orthodoxy and Its Alternatives: Explaining Approaches to Stabilization and Adjustment' in Joan M Nelson (ed), *Economic Crisis and Policy Choice: The Politics of Adjustment in the Third World* (Princeton University Press 1990).

[12] Jayarajah and Branson ibid 107, citing 'Operational Manual Statement No. 3.58' (1982).

[13] As opposed to, for example, project-based lending to support an infrastructure development: see Edmar L Bacha and Richard E Feinberg, 'The World Bank and Structural Adjustment in Latin America' (1986) 14(3) *World Development* 333, 340; David Dollar and Jakob Svensson, 'What Explains the Success or Failure of Structural Adjustment Programmes?' (2000) 110 *Economic Journal* 894, 894.

[14] See Jayarajah and Branson (n 11) Part 1, detailing adjustment conditions in World Bank lending arrangements; Joan M Nelson, 'Introduction: The Politics of Economic Adjustment in Developing Nations' in Nelson (n 11) 3-4.

[15] A term developed by economist John Williamson in 1989 to describe the 10 areas he considered could 'arguably muster a fairly wide consensus as to the character of the policy reforms that debtor countries should pursue': John Williamson, *The Progress of Policy Reforms in Latin America* (Institute for International Economics 1990) 9; see also John Marangos, 'What happened to the Washington Consensus? The evolution of international development policy' (2009) 38 *Journal of Socio-Economics* 197, 198.

> and factor markets through privatization and deregulation[16].

One of the policy areas that became the target of structural adjustment arrangements was 'exit policy' – policy on firm closure, including insolvency and labour laws[17]. A review by the World Bank of adjustment lending between 1980 and 1992 suggests that the Bank came to regard the dismantling of domestic 'barriers to exit' as an essential complement to wider reforms, such as the liberalisation of the financial and industrial sectors:

> Successful adjustment in the industrial sector also requires that firms and activities rendered unprofitable by relative price changes be able to cease operations and release their resources to more productive uses. In many developing countries, government anticlosure regulations designed to limit layoffs and a weak legal framework for bankruptcies and foreclosures served as barriers to exit by inefficient producers. This limited the scope for resource reallocation in response to exchange rate adjustment, trade reforms, and price decontrol[18].

A 1990 Bank report on industrial restructuring similarly concluded:

> If policies make it difficult for firms to get out of unsuccessful ventures, enterprise owners and managers will avoid risks in undertaking new activities. Exit barriers often block decisive restructuring… Laws that facilitate mergers, acquisitions, reorganization, and bankruptcy are vital tools for competitive industrial restructuring. Firms that have failed

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[16] Charles Gore, 'The Rise and Fall of the Washington consensus as a Paradigm for Developing Countries' (2000) 28(5) *World Development* 789, 789-790 (but noting later that the 'consensus' changed over time, so that its key norms - 'free markets, private property and individual incentives, and a circumscribed role for government' – were emphasised differently at different points in the 1980s and 1990s, 792); see also David Kennedy, 'The "Rule of Law", Political Choices and Development Common Sense' in David M Trubek and Alvaro Santos (eds) *The New Law and Economic Development: A Critical Appraisal* (Cambridge University Press 2006) 129-131 and Chantal Thomas, 'Law and Neoclassical Economic Development in Theory and Practice: Toward an Institutionalist Critique of Institutionalism' (2011) 96 *Cornell Law Review* 967, 992-993 (again, also noting that the content of the consensus changed over time).

[17] Ira Lieberman, *Industrial Restructuring Policy and Practice* (World Bank 1990) 5-6.

[18] Jayarajah and Branson (n 11) 197, and 188 (suggesting that exit policy had only recently become a focus in adjustment programs). On the financial sector, see 153 (suggesting the construction of 'basic institutions, such as bankruptcy laws and procedures' was necessary for financial sector reform), and 151 ('Enterprises should be efficient and competitive enough to operate smoothly in a liberalized market-oriented financial environment').

> financially and economically must be allowed to fail legally, or the country's industry will remain stagnant and unproductive[19].

This interest in insolvency law appears to have reflected a broader growing interest within the Bank in law and law reform in the early 1990s, which has been linked by others[20] to the rise of 'new institutional economics' following the publication of North's *Institutions, Institutional Change and Economic Performance*[21]. The book considered, among other things, the impact of 'institutions' – defined by North as 'the rules of the game in a society, or more formally… the humanly devised constraints that shape human interaction'[22] (whether formal, such as law[23], or informal, such as norms[24]) – on economic performance[25]. In 1993, the World Bank published a report on 'evolving legal frameworks for private sector development' in transitioning economies in Central and Eastern Europe[26]. It expressly equated 'legal framework' with 'the rules of the game'[27], and suggested that the legal framework had 'at minimum four basic economic functions', of which the third was 'to set the rules for entry and exit of actors in and out of

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19 Lieberman (n 17) 6.

20 See for example Thomas (n 16) 994-997, 968-970, and Tor Krever, 'The Legal Turn in Late Development Theory: The Rule of Law and the World Bank's Development Model' (2011) 52(1) *Harvard International Law Journal* 287, 304-305.

21 (Cambridge University Press 1990).

22 ibid 3.

23 ibid Chapter 6.

24 ibid Chapter 5.

25 ibid Part I.

26 Cheryl W Gray, *Evolving Legal Frameworks for Private Sector Development in Central and Eastern Europe*, World Bank Discussion Paper 209 (World Bank 1993).

27 ibid 65, and the forward by N Birdsall, vii ('This transition requires comprehensive changes in the "rules of the game" – i.e. the legal framework for economic activity').

productive activities'[28]. Each function could be 'loosely related' to specific areas of law - in the case of exit, 'bankruptcy and liquidation laws'[29].

The World Bank's increasing interest in 'exit policy', including insolvency law, was clearly reflected in its approach to structural adjustment in India. Two Bank publications, one produced in 1987[30] and one in 1990[31], identified constraints on the closure of firms as a significant policy issue for India. The 1987 report identified restrictions on firm exit as one of a range of impediments to 'the process of adaptation to market pressures'[32] and observed:

> Bankruptcy and winding-up proceedings that currently take up to 10 years to complete could be simplified and executed more quickly so that non-viable units are wound up in a much more timely fashion. In general, there needs to be a readiness to 'cut losses' and transfer usable resources to other activities when a mistake has been made or when markets disappear[33].

Barriers to exit for industrial and public sector firms were identified as a deterrent to innovation and investment by entrepreneurs[34], and 'sick' firms as a 'burden' on financial

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[28] ibid 1.

[29] ibid.

[30] 'India: An Industrialising Economy in Transition' (Report No 6633-IN, Volume II: Main Report, May 7 1987) <www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1987/05/06/000009265_3960926055959/Rendered/PDF/multi0page.pdf> accessed 15 August 2012.

[31] Garry Pursell, 'Industrial Sickness, Primary and Secondary: The Effects of Exit Constraints on Industrial Performance' (1990) 4(1) *World Bank Economic Review* 103.

[32] (n 30) [3.55].

[33] ibid [3.153]. The report also acknowledged that the pace of adjustment would have to reflect the time needed to 'redeploy workers and assets from activities that will no longer be competitive' ([5.38]), and that 'some regulation' would be needed to protect workers' entitlements (e.g. pension entitlements) ([3.55]).

[34] Pursell (n 31) 110; 1987 report (n 30) [3.54] (on industrial firms).

institutions that precluded the 'efficient use of the nation's capital resources'[35]. An internal World Bank document[36] produced in the lead-up to the 1991 loan agreement with India identified the development of an 'exit policy' as a significant issue for the industrial sector ('The need to develop an exit policy consonant with a deregulated, competitive industrial system is recognised by the Government')[37] and for the public sector ('An effective mechanism needs to be created whereby unviable public enterprises can exit from the scene')[38], yet to be fully addressed[39].

The loan agreement between India and the World Bank[40] incorporated these concerns. The agreement obliged India to alter aspects of its insolvency regime as it applied to public sector enterprises (including by enabling the referral of 'sick' industrial public sector enterprises to SICA[41], and the adoption of a plan to initiate the 'closure or winding up of unviable central public enterprises')[42] and to streamline the SICA

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[35] 'By increasing the number of 'sick units', these barriers to adaptation impose an increasing burden on financial institutions and thereby inhibit the efficient use of the nation's capital resources': 1987 report (n 30) [3.54].

[36] 'India: Policies for Adjustment with Growth' (1991 Country Economic Memorandum, Report No. 9412-IN) <www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1991/08/23/000009265_3960930195417/Rendered/PDF/multi0page.pdf> 15 August 2012.

[37] ibid [2.21].

[38] ibid [2.38].

[39] ibid [14]: 'an exit policy, which is an important complement to easing entry, has not yet been formulated, though the Government clearly recognizes the need for such a policy'.

[40] More specifically the International Development Association, a member of the World Bank Group.

[41] 'Development Credit Agreement (Structural Adjustment Credit) between India and International Development Association' (5 December 1991) sch 3, cl 18 <www-wds.worldbank.org/external/default/WDSContentServer/WDSP/SAR/2004/12/14/531EBA3C5461A26385256F03000B70C8/1_0/Rendered/PDF/531EBA3C5461A26385256F03000B70C8.pdf> 15 August 2012. As enacted, SICA applied to only private sector industrial firms (see Chapter 6, section 6.3.2.2).

[42] ibid. The term appears to have been a modification of the Indian Central Government's own proposal for public sector enterprises, which was to refer those that were 'chronically sick and unlikely to be turned around' to the SICA rescue procedure: Government of India (Ministry of Industry) 'Statement on

procedure and strengthen the quasi-judicial body that administered it[43]. More generally, it obliged India to review 'the relevant laws and regulations governing labor relations and transfer of land, the role of state and local governments in industrial restructuring, and the procedures for liquidation under the Borrower's Companies Act of 1956'[44], and to formulate a 'satisfactory' policy that would 'facilitate the process of adjustment by industrial firms'[45]. India appears to have initially entrusted responsibility for this review to an 'inter-ministerial working group on industrial restructuring', established shortly before execution of the loan agreement[46]. This group reportedly recommended (among other things) changes to 'speed up the liquidation of bankrupt firms' and to 'improve and streamline' SICA procedure'[47], consistent with some of the terms of the loan. The report does not however appear to have been published, and its recommendations are not reported in any detail in secondary literature. It was, however, followed (the next year)

Industrial Policy' (July 24 1991) [39](D)(ii) <http://dipp.nic.in/English/Policies/Industrial_policy_statement.pdf> 15 August 2012. Unlike this proposal, the loan term contemplated two paths for public sector firms: the 'unviable' would simply be closed or wound up, while 'sick' firms would go through SICA (see further 'Report and Recommendation of the International Bank for Reconstruction and Development and the International Development Association to the Executive Directors on a proposed structural adjustment loan' (November 12, 1991) [76] <www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1991/11/12/000009265_3961002032121/Rendered/PDF/multi0page.pdf> 16 August 2012.

43 'Development Credit Agreement' (n 41) Schedule 3 cl 1(2). On SICA and its quasi-judicial administrator, see further Chapter 6.

44 ibid sch 3 cl 5(a).

45 ibid sch 3 cl 5(b), acknowledging that the policy would have to take into account 'the need for adequate safeguards for workers'. The insolvency terms of the loan agreement are also summarised in Ajeet N Mathur, 'The experience of consultation during structural adjustment in India (1990-92) (1993) 132(3) *International Labour Review* 331, 334-335.

46 'Advisory group to plan panel' *The Times of India* (November 7 1991) 15.

47 'India: Stabilizing and Reforming the Economy' (Report No. 10489-IN, World Bank, May 18 1992) [3.35] <www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1992/05/18/000009265_3961002174037/Rendered/PDF/multi0page.pdf> 27 August 2012.

by that of the Goswami Committee, and that report was widely publicised. The Goswami Committee report reviewed (among other things) the impact of labour law, property law and liquidation law on industrial restructuring[48], as the structural adjustment agreement had required, and called for reforms that would enable the speedy closure of 'unviable' firms' and the reallocation of their land and labour resources to 'best possible' use in the economy[49], just as the Bank had done.

The connection between the emergence of an insolvency law reform agenda in India and the World Bank's structural adjustment work should not be overstated. It has been suggested that India enjoyed more control in the negotiation of loan arrangements with the IMF and World Bank than other structural adjustment borrowers of the period[50], and that for some within the Indian government, the loan arrangements simply added 'credibility' to liberalisation reforms they had long sought[51]. There may well have been some internal demand for insolvency law reform by the time of the Goswami Committee report (for example, by the financial sector – a point explored further in Chapter 4)[52]. But there was also very strong opposition to such reform by organised labour. In 1991, for example, the announcement of 'exit policy' reform associated with structural adjustment was met with worker strikes[53]. This opposition made the 'exit

48 (n 4) Chapter 6.

49 ibid [1.3].

50 Kishore C Dash, 'India's International Monetary Fund Loans: Finessing Win-Set Negotiations within Domestic and International Politics' (1999) 39(6) *Asian Survey* 884, 898 and following (reporting strategies used by the Central Government to retain control and appeal to the Fund and Bank, including the appointment of former Bank/Fund employees to various ministries).

51 Ghosh (n 10) 417, 425.

52 See section 4.2.1.

53 'Exit policy being reconsidered?' *Times of India* (July 21 1991) 1; Editorial, 'Dialogue On Exit', *Times of India* (November 21 1991) 10; see also Mathur (n 45) 337. The Central Government arranged for the

policy' issue a highly sensitive one for Government (so much so that the Labour Minister was reported as denying the existence of any 'exit policy' altogether in a 1992 meeting with trade union representatives)[54]. In this context, it seems reasonable to suggest that the timing of the appointment of the Goswami Committee and the focus of its report (subsequently criticised by both organised labour[55] and industry groups[56]) was at least partly influenced by external factors associated with India's structural adjustment.

2.2 The ongoing reform agenda: evaluation by comparison

There were attempts in the mid-1990s to pass legislation to give effect to some of the proposals made by the Goswami Committee (and the inter-ministerial working group before it) for amendments to the liquidation provisions of the Companies Act 1956 and the provisions of the Sick Industrial Companies (Special Provisions) Act 1985[57], but these did not succeed. In 1995, a World Bank completion report on the structural adjustment loan arrangement with India concluded that only three of 25 'agreed actions' in the structural adjustment loan agreement were yet to be fully complied with: one was the formulation of 'satisfactory policy for adjustment by industrial firms', another was 'the

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establishment of a 'national renewal fund' to help workers with the costs of transition after firm closure: Mathur (n 45) 342; in more detail Ajeet N Mathur 'Industrial Restructuring in India and the National Renewal Fund' (Report for the Asian Development Bank, January 1993) Chapter IV <http://www2.adb.org/Documents/Reports/Consultant/26331-IND/26331-IND-TACR.pdf> 27 August 2012.

[54] 'No exit policy, says Sangma' *Times of India* (March 23 1992) 6, quoting the Minister as saying 'I have not come across any official document dealing with exit policy'; more generally, Mathur (n 45) 336: 'Although this [exit] policy was widely discussed the signals sent out by the Government were confusing and contradictory'.

[55] 'Fresh thinking on exit policy needed: Singh' *Times of India* (August 26 1993) 15.

[56] Kingshuk Nag, 'Industry opposes Goswami report' *Times of India* (August 29, 1993) 16.

[57] A bill was devised to amend the liquidation provisions of the Companies Act 1956 in 1993 (see Mathur (n 53) 17-18), and later to amend the Sick Industrial Companies (Special Provisions) Act 1985 (the Sick Industrial Companies Bill 1997, as to which see also Chapter 6, text to n 143). Neither were passed.

initiation of measures for restructuring/closure of patently unviable sick central public enterprises' – in other words, two of three of the conditions related to 'exit policy'[58]. The Bank concluded that there was sufficient evidence of preliminary efforts at reform[59] to warrant a finding of 'substantial' compliance with the conditions, noting it was 'conscious of the difficulty facing the Government in dealing more boldly with these politically sensitive issues'[60]. The formal association between 'exit policy' reform and India's structural adjustment arrangements with the World Bank appears to have ended at this point.

What followed in India was a series of official reports, all of which were critical of corporate insolvency law and recommended significant reform. The first[61] (released in 2000) was by a committee commissioned by the Central Government to review and 'remodel' insolvency law 'in line with latest developments and innovations in corporate laws and governance' and to recommend reforms to reduce delays 'in tune with international practice'[62]. The second[63] (2001) was by an advisory group constituted by the Reserve Bank of India to review compliance by Indian insolvency law with international standards and codes and to compare this compliance with that of other industrialised and

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58 'Project Completion Report: India' (Report No 14582, World Bank, June 9 1995) Part I, [19] <www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1995/06/07/000009265_3961019112852/Rendered/PDF/multi0page.pdf> 27 August 2012.

59 Specifically, the 'hardening of budget constraint vis-à-vis sick units' (as to which, see further Chapter 7, text to n 138) and the establishment of the National Renewal Fund for workers (as to which, see above n 53): ibid [20].

60 ibid.

61 'Report of the High Level Committee on Law Relating to Insolvency and Winding up of Companies' (31 July 2000), extracted in DP Mittal, *Taxmann's New Law Relating to Sick Industries* (Taxmann 2003), Appendix 6.

62 ibid [1.2].

63 'Report of the Advisory Group on Bankruptcy Laws' (May 2001) <www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=225> 27 August 2012.

emerging economies[64], among other things. The third (2005)[65] was by a committee commissioned by the Central Government to review Indian company law more generally, with the apparent purpose of producing a 'simplified compact law' that could (among other things) 'address the changes taking place in the national and international scenario' and 'enable adoption of internationally accepted best practices'[66]. More recently, two reports on the Indian financial sector (one by the 'Committee on Financial Sector Reforms'[67], set up by the Planning Commission; the other by the 'Advisory Panel on Institutions and Market Structure'[68], set up by a Central Government/Reserve Bank of India 'Committee on Financial Sector Assessment') considered insolvency law as part of their evaluation of the relative strength of India's 'creditor rights system'[69]. The content of these reports, and the attempts at statutory reform they engendered, are considered later in the thesis. They are referenced here because there is also a general connection between the focus of these reports (and their terms of reference) on *comparative* evaluation of Indian insolvency law – evaluation by comparison with the law of other jurisdictions and with international 'best practice' – and the emergence of new comparative methodologies in literature on the interrelationship(s) between law, finance and development being published over the same period.

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64 ibid [1.2].

65 Expert Committee on Company Law, 'Report on Company Law' (31 May 2005) <www.acga-asia.org/public/files/JJ%20Irani%20Report.pdf > 27 August 2012.

66 ibid Chapter I[7].

67 *A Hundred Small Steps* (Sage Publications 2009).

68 *India's Financial Sector: An Assessment* (Foundation Books 2009).

69 ibid Chapter VI; *A Hundred Small Steps* (n 67) 165 (identifying 'an effective legal framework for corporate insolvency' as an element of a 'well functioning system of credit').

While official committees in India were being tasked with evaluating insolvency law by comparison with law and practice in other jurisdictions, academics and policy-makers outside India were developing new methods for the systematic comparison of laws and legal systems across countries. Interest in cross-country analysis was ignited by a series of papers published in the late 1990s by four academics (Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer – all then at Harvard – and Robert Vishny, at the University of Chicago). The lead paper, 'Law and Finance'[70], reported a statistical analysis of the prevalence of certain legal rules 'pertaining to the rights of investors'[71] across 49 countries, and some measures of the 'quality of enforcement' of those rules[72]. The study was motivated by the hypothesis that 'differences in legal protection of investors might help explain why firms are financed and owned so differently in different countries'[73]. The authors identified a series of rules whose presence (or in some cases, absence[74]) offered shareholders or creditors protection in their relations with managers[75]. These were used as variables in two indices, one measuring shareholder protection and the other creditor protection (the 'creditor rights index'). The creditor rights index focused on the position of senior secured creditors in insolvency. The index scored countries between 0 and 4, with one point being awarded for: (a) rules imposing restrictions on entry into reorganisation proceedings, such as a requirement to obtain creditor consent (a country with no such restrictions scoring 0); (b) the absence of an

[70] (1998) 106(6) *Journal of Political Economy* 1113.

[71] And some substitutes for those rules: see ibid 1128, 1135.

[72] ibid 1115.

[73] ibid 1114.

[74] As with the automatic stay variable in the creditor rights index.

[75] ibid 1120-1121.

automatic stay rule in reorganisation (a country with an automatic stay scoring 0); (c) rules ensuring the priority of security interest holders in the distribution of proceeds of asset sales in insolvency (a country that afforded unsecured creditors a higher priority scoring 0); (d) rules entrusting management of the debtor's business to a court-appointed official or creditors, or divesting the debtor of power to administer its property, during reorganisation (a country with no such rule scoring 0). The 49 countries in the sample[76] were scored on each index, apparently on the basis of the law in 1995[77]. General measures of the quality of enforcement were added as proxies for the enforcement of the legal rules in the indices[78]. Countries were also coded by 'origin', meaning by the legal 'family' (common law, or French, German or Scandinavian civil law) to which they belonged, determined by the origin of their company or commercial law[79].

The 49 countries surveyed in 'Law and Finance' were found to vary on both the shareholder and creditor protection indices, and to do so systematically by legal origin. On both indices the English-origin countries (common law countries) offered overall the strongest protection, and French-origin countries the weakest[80]. The quality of law enforcement was also found to vary systemically by origin, but not in such a way as to

[76] The countries included were those with five or more publicly traded, domestic, non-financial firms with no government ownership in 1993: ibid 1117.

[77] This is not explained in the paper or dataset, but a later paper suggests this assessment date (Simeon Djankov, Caralee McLiesh and Andrei Shleifer, 'Private credit in 129 countries' (2007) 84 *Journal of Financial Economics* 299).

[78] 'Law and Finance' (n 70) Section V, drawing on various estimates of "law and order" in reports on country-risk by private agencies, available for 41 of the 49 countries in the sample: 1140.

[79] ibid Table 1; see also 1115, 1119.

[80] ibid 1129 (shareholder rights), 1138 (creditor rights), but acknowledging the German family score may have understated the extent to which secured creditors were protected; see also the summary at 1139.

substitute strong enforcement for weaker legal rules[81]. In a second paper[82], these findings were considered alongside evidence of the availability of external finance in each of the 49 countries, using various measures of debt and equity markets[83]. This paper reported that on the adopted measures common law countries provided better access to equity finance than civil law countries, and better access than French origin countries to debt finance[84]. The two findings (systematic variation in investor protection by origin; systematic variation in external finance by origin) were subsequently gathered together by the authors into the conclusion that 'legal families appear to shape the legal rules, which in turn influence financial markets'[85]. The assertion of causation from rules to markets relied on the origin variable, which the authors considered exogenous (because a country does not generally choose its legal family).[86] Origin came first, and with it law – markets followed:

> Because legal origins are highly correlated with the content of the law, and because legal families originated before financial markets had developed, it is unlikely that laws were written primarily in response to market pressures[87].

81 ibid 1141, 1145, 1151.

82 'Legal Determinants of External Finance' (1997) LII(3) *Journal of Finance* 1131.

83 ibid Section I.

84 German-origin countries did better than common-law countries on the debt measures, but France was at the bottom on equity and debt measures, suggesting 'low rights line up with small markets' (1139). The association between creditor rights index score and the debt measure was however found to be 'more tenuous' (1139), the authors concluding on a regression analysis that the index was not fully capturing the 'origin effect' ('French and Scandinavian civil law countries do have more narrow debt markets than common law countries, a difference not adequately captured by our creditor rights index': 1146).

85 'Investor protection and corporate governance' (2000) 58 *Journal of Financial Economics* 3, 9.

86 'Law and Finance' (n 70) 1126.

87 'Investor protection' (n 85) 9; see also 'Law and Finance' (n 70) 1126. In a recent review paper, La Porta, Lopez-de-Silanes and Shleifer acknowledge that origin might influence economic outcomes through a channel other than legal rules, but maintain 'legal origins are still exogenous, and to the extent that they shape legal rules protecting investors, these rules cannot be just responding to market development': 'The Economic Consequences of Legal Origins' (2008) XLVI *Journal of Economic Literature* 285, 298.

After 'Law and Finance', datasets were constructed to analyse cross-country variation in the regulation of firm entry (by comparing the number of official procedures for entry, and their official time and official cost)[88] and labour markets (by comparing aspects of employment law, collective bargaining law and social security law)[89], the 'effectiveness' of courts (by comparing the degree of 'formalism' in procedures for the eviction of residential tenants and the collection of dishonoured cheques)[90], and the independence of the judiciary (by comparing judicial tenure and the extent to which judicial decisions are 'a source of law')[91] and the impact of independence on property rights[92], *inter alia*. All reported some 'origin effect' - in summary, common law countries, when compared to French-origin countries, were found to be associated with less regulation of firm entry and labour markets, and 'less formalised and more independent judicial systems, which are in turn associated with more secure property rights and better contract enforcement'[93]. More recently, the shareholder and creditor protection indices from 'Law and Finance' were revisited. The creditor protection index was re-applied to a larger sample of countries (including the original 49) over a period of time (each year from 1978-2003)[94]. Some of the original rankings were adjusted, including India's

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88 Simeon Djankov and others, 'The Regulation of Entry' (2002) Feb *Quarterly Journal of Economics* 1.

89 Juan C Botero and others, 'The Regulation of Labor' (2004) Nov *Quarterly Journal of Economics* 1339.

90 Simeon Djankov and others, 'Courts' (2003) May *Quarterly Journal of Economics* 453. The formalism measure was designed to evaluate the extent to which courts departed from the 'idealised universal court' - 'the resolution of a dispute among two neighbors by a third, guided by common sense and custom' (457).

91 Rafael La Porta and others, 'Judicial Checks and Balances' (2004) 112(2) *Journal of Political Economy* 445, 453-454.

92 And other measures of 'economic freedom' (ibid 449-450) and 'political freedom'.

93 'The Economic Consequences of Legal Origins' (n 87) 298.

94 'Private credit in 129 countries' (n 77).

(downgraded from 4/4 to 2/4 as at 1995)[95], but the same 'origin effect' appeared[96]. A second study, 'Debt Enforcement around the World'[97], examined insolvency outcomes in 88 countries (not including India) using a hypothetical scenario that was evaluated by local practitioners to predict the time and cost of proceedings and whether the outcome would be piecemeal asset sale or preservation as a going concern; again, 'origin effects' were detected (common law countries scoring higher on an author-developed 'efficiency measure' than German or French origin countries)[98].

These cross-country studies were influenced by emerging literature on the question of why legal origin should exert such influence – why origin should 'matter in such a pervasive way for both rules and economic outcomes'[99]. This literature looks to the history of the common law and civil law traditions for evidence of the emergence of 'structural differences'[100] that might – assuming their persistence – explain differences in present-day outcomes in each tradition. One area of 'structural difference' emphasised by this literature is the role of the judiciary, relative to the executive and legislature, in the common law and French civil law traditions. France and England are said to have diverged in their approach to judicial independence, initially perhaps because the threat

[95] ibid 302, apparently on the basis that India had been originally coded using the scheme of arrangement provisions of the Companies Act 1956. But even treating the scheme as a reorganisation procedure, it is not clear how India could score 4/4 as at 1995: the preferential debt rule in liquidation (see Chapter 3, text to n 113) should have ensured a maximum score of 3.

[96] ibid 301, reporting 'common law countries having sharply higher creditor rights scores than French civil law countries'.

[97] Simeon Djankov and others, (2008) *Journal of Political Economy* 1105.

[98] ibid 1128, for the measure of efficiency, see 1119. Unlike 'Law and Finance' (n 70), the study coded origin by the origin of bankruptcy law specifically, rather than commercial or company law (see Table 1, A).

[99] 'Economic Consequences of Legal Origins' (n 87) 302.

[100] Paul G Mahoney, 'The Common Law and Economic Growth: Hayek Might Be Right' (2001) 30(2) *Journal of Legal Studies* 503, 505; Edward L Glaeser and Andrei Shleifer, 'Legal Origins' (2002) *Quarterly Journal of Economics* 1193, 1196.

of 'bullying' of courts by local barons was higher in France than in England[101], such that Crown control of courts was required[102]. Later, the English civil war and French revolution are said to have entrenched differences in the role of the judiciary. In this account[103], English judges are positioned in opposition to the expropriation of property by the Crown and 'executive intervention in the economy'[104], emerging from the civil war 'on the same winning side as the property owners'[105] to enjoy greater independence from the executive and an association with 'the protection of the rule of law and economic rights against royal power'[106]. In contrast, pre-revolutionary judges in France are characterised as powerful aristocrats ('part court, part legislature, and part administrative agency')[107] who benefited from upholding the Crown's 'controlled system of guilds and monopolies' and resisted Crown reforms that would have diminished their privileges[108]. These judges were 'on the wrong side of the French Revolution'[109] and their role was diminished by codification, which denied their law-making power and the prestige of

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101 Glaeser and Shleifer (n 100) 1200-1201.

102 Glaeser and Shleifer (n 100) 1195 (described in the 'Economic Consequences of Legal Origins' as the 'medieval explanation': (n 87) 4.2). Crown control of a court makes it more likely that decisions will reflect Crown preferences (1202), but this result may be considered preferable by local barons if they are 'more afraid of each other than of the King' (1196).

103 Described in 'The Economic Consequences of Legal Origins' as the 'revolutionary explanation': (n 87) 4.1.

104 Mahoney (n 100) 508-509, together with Parliament.

105 'Economic Consequences of Legal Origins' (n 87) 303.

106 Mahoney (n 100) 509; for other literature, see the review in 'Economic Consequences of Legal Origins' (n 87) 303.

107 Mahoney (n 100) 509-510.

108 Mahoney (n 100) 510.

109 'Economic Consequences of Legal Origins' (n 87) 303.

judicial office[110]. While French judges were controlled by the state through the Code, English judges enjoyed greater independence, including the freedom to develop rules. Differences in the degree of judicial independence and of judicial law-making power were later distilled into two 'channels' through which origin might affect financial development[111]: the 'political' channel, which connects judicial independence with the protection of property (particularly against state expropriation), and identifies property rights as 'the basis of financial development'[112]; and the 'adaptability' channel, which emphasises the flexibility of judge-made law, suggesting it might enhance the legal system's ability to 'adapt to changing financial circumstances'[113].

In a recent review of the literature, La Porta, Lopez-de-Silanes and Shleifer concluded that there was evidence to support the theory that origin exerts influence through the judiciary[114], but there was also evidence of origin's influence on government regulatory style[115] and on the 'actual legal rules' including statutory ones[116]. The evidence of wide-ranging influence suggested that origins could be understood as 'systems', specifically 'systems of social control of economic life'[117], gifting member countries with:

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110 ibid 303-304; Mahoney (n 100) 510-511.

111 Thorsten Beck, Asli Demirgüç-Kunt, and Ross Levine, 'Law and finance: why does legal origin matter?' (2003) 31 *Journal of Comparative Economics* 653; see also Simon Deakin, Priya Lele and Mathias Siems, 'The evolution of labour law: Calibrating and comparing regulatory regimes' (2007) 146(3) *International Labour Review* 133; Mathias M Siems, 'Legal Origins: Reconciling Law and Finance and Comparative Law' (2007) 52 *McGill LJ* 55, 61-62.

112 Beck, Demirgüç-Kunt and Levine, ibid 657.

113 Beck, Demirgüç-Kunt and Levine, ibid 660.

114 'Economic Consequences of Legal Origins' (n 87) 300 (suggesting there was evidence to support the 'judicial flexibility' theory) and Section 4.4.

115 ibid 310.

116 ibid 300.

117 ibid 326.

> [N]ot just specific legal rules (many of which actually change later), but also legal institutions (of which judicial independence might be the most important), human capital of the participants in the legal system, and crucially the strategy of the law for dealing with new problems[118].

The evidence was not to be interpreted as implying that reform of any one country's legal system was futile (i.e. 'origin is destiny')[119]. Instead, the evidence of the influence of origin was to be interpreted as suggesting that *some* features of a legal system are 'so hard-wired that changing them would be extremely costly and that reforms must be sensitive to legal traditions'. It was however possible to reform 'many' rules in a legal tradition without affecting its 'fundamentals', such as 'entry regulations, disclosure requirements, or some procedural rules in litigation'[120]. Bankruptcy procedure, such the availability of interlocutory appeals ('central to the civil procedure of civil law countries, yet result in a massive destruction of value in bankruptcy')[121], was specifically identified as a realistic procedural reform target:

> [A]spects of the formalism of bankruptcy procedures, which probably are the heritage of civil law, appear detrimental to efficiency at all levels of economic development and could be reduced without impinging the foundations of legal order[122].

Both the empirical and theoretical branches of the legal origins literature have been criticised. The design of the investor protection indices used in the foundational 'Law and Finance' paper – the indices that measured shareholder and creditor protection

118 ibid 307.

119 ibid 325.

120 ibid.

121 ibid 323, with reference to Djankov (n 77) above, among others.

122 ibid 324.

by the incidence of certain legal rules – attracted criticism[123] (although some criticisms were addressed when the indices were revisited)[124]. More fundamentally, the focus in the cross-country studies on law's (investor) protective functions has been characterised as reductionist:

> Law is a complex system that cannot be reduced to the enforcement of property rights and contracts for the purpose of creating an ideal market. That, however, is implied by theories that are based exclusively on bargaining models and seek to tip the bargaining process in favor of the investor constituency[125].

The accuracy of the legal origin classification given to some jurisdictions in the cross-country studies has been questioned, and the broader utility of classifying countries by origin doubted[126]. It has been also argued that the emphasis on the origin variable may obscure other variables that influence the development of legal rules (e.g. political variables[127]) or the development of markets ('the development of financial markets and

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123 For a review of the literature, see Siems (n 111) n32, and in relation to the creditor protection index specifically, see Rainer Haselmann, Katharina Pistor and Vikrant Vig, 'How Law Affects Lending' (2010) 23(2) *The Review of Financial Studies* 549, 550-551 and earlier Katharina Pistor 'Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies' (2000) 1 *European Business Organization Law Review* 59, Section 4.

124 See above text to n 94, and 'Economic Consequences of Legal Origins' (n 87) 291-292; John Armour and others, 'Law and Financial Development: What We Are Learning from Time-Series Evidence', (2009) *Brigham Young University Law Review* 1435, 1453; but see also Holgar Spamann, 'The "Antidirector Rights Index" Revisited' (2010) 23(2) *The Review of Financial Studies* 467, 468 (suggesting despite the emergence of new indices the original anti-director rights index 'continues to be widely used'). The creditor rights index was preserved when the index was revisited in 'Private credit in 129 countries' (n 77) but independently added to by Pistor (ibid) in a study of 24 transition economies over time. Later, Armour and others developed a more complex index again (see the summary in 'Law and Financial Development', 1461).

125 Katharina Pistor, 'Rethinking the "Law and Finance" Paradigm' (2009) *Brigham Young University Law Review* 1647, 1653, consistent with Katharina Pistor and Curtis Milhaupt's *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press 2008), which argued for the recognition of law's multiple functions (see 31-36).

126 Siems (n 111) 65 (suggesting that for around 80% of the 129 countries surveyed in 'Private credit in 129 countries' (n 77 above), the origin classification is 'far from clear'), 67-68 (suggesting that 'simple categorization' by family may ignore 'deeper legal structures, such as the question of how courts work or how new law, old law, and customs interact') and more generally 58 ('Comparatists increasingly emphasize that law is becoming international, transnational or even global, such that looking at legal traditions is considered less important'); see also Armour and others (n 124) Section B.

127 See the literature review and response in 'Economic Consequences of Legal Origins' (n 87) Section 6.

its determinants has taken a back seat to legal origin'[128]). Relatedly, the characterisation of the origin variable as exogenous has been questioned, critics favouring a more complex model of 'mutual influence' between law, the economy and the political system over one of 'linear, unidirectional change'[129]. It has been further noted that the processes of legal change, and the influences on such change, cannot be captured by cross-sectional assessment (i.e. assessment of the position across countries at a point in time), the methodology used in most origins studies[130]:

> It is not possible to say anything at all about the pace and direction of legal change using this approach, even though one of the core aspects of the legal origins claim is the suggestion that legal transplants which occurred decades – even centuries – ago still influence the content of laws today[131].

The theoretical explanations for origin's persistence have also attracted criticism. Their treatment of the process of transplantation has been said to overlook or obscure the complexity of the interaction between legal transplants and pre-existing institutions in host jurisdictions.[132] The accounts that identify the judiciary as the key site of 'structural difference' between the common and civil law traditions have been argued to rest on 'questionable stylised facts' that might over-emphasise, for example, differences in the degree of discretion and law-making power enjoyed by judges[133]. The more recent

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128 Pistor (n 125) 1653.

129 Armour and others (n 124) 1449, suggesting a 'coevolutionary' approach; Pistor (n 125) from 1658.

130 With the exception of Djankov's revision of the creditor rights index (n 77) and, more recently, the longitudinal work of Armour and others, who analysed creditor and shareholder protection (using a more complex index than the investor protection indices developed in 'Law and Finance') between 1995 and 2005 in 25 countries, finding evidence of an 'origin effect' in creditor protection (but not shareholder protection) (see the summary in 'Law and Financial Development' (n x)).

131 Deakin and others (n 111) 142.

132 Siems (n 111) 67; Armour and others (n 124) 1435-1436.

133 Deakin (n 111) 136-137.

positioning of the judiciary as one component of the 'system' that is legal origin, some features of which are 'hard-wired' (and therefore persisting) and other features of which are more peripheral (and therefore more readily reformed), has been critiqued as seriously incomplete:

> [T]hey [La Porta, Lopez-de-Silanes and Shleifer] argue that some rules can be changed without affecting the fundamentals of a legal system and that these rules will nonetheless affect economic outcome. Specifically, they argue, "[E]ntry regulations, disclosure requirements, or some procedural rules in litigation can be reformed without disturbing the fundamental of the legal system." No explanation is given as to why these rules and not others can be modified without affecting the fundamentals of a given legal system; moreover, no evidence is provided whether the specific rules they mention did in fact have the desirable impact on outcomes in real world cases. This, however, would be crucial before their framework should be used as a blueprint for regulatory reform[134].

Despite this criticism, the legal origins literature has proved influential, particularly in World Bank policy. The Bank part-funded several of the origin studies conducted after 'Law and Finance', including all four studies noted above (on regulation of firm entry, labour markets, the effectiveness of courts, and judicial independence)[135]. The Bank's involvement coincided with its public acknowledgment that the 'Washington consensus' policy prescriptions[136] had not focused strongly enough on the role of 'institutions' (defined, as North proposed, to include not only rules but also enforcement mechanisms, including the judiciary) in economic development[137]. The origins studies

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134 Pistor (n 125) 1647.

135 See above, text to n 88-91.

136 See above, text to n 15.

137 See Shahid J Burki and Guillermo Perry, *Beyond the Washington Consensus: Institutions Matter*, World Bank Latin American and Caribbean Studies (World Bank 1998) 'Introduction', and Chapter 1 (also noted in Thomas (n 16) 997-998); see later Legal Vice Presidency, 'Legal and Judicial Reform: Strategic Directions' (World Bank January 2003) 12 ('Subsequent practical experience suggested that reform efforts could not stop with policies designed to shrink the state and liberalize and privatize the economies, even if the formal laws became more open to private investment…It turned out that a lack of attention to institutions generally, especially legal ones, placed substantial limits on the reforms…') <www-

offered, as Pistor and Milhaupt have argued, evidence to support the Bank's conviction of the centrality of legal systems to development[138]. They also offered a methodology for the comparative evaluation of legal systems, one that would perhaps (as Kennedy has observed of empirical cross-country studies in general) help to 'sidestep the need for… detailed context specific analysis'[139]. The Bank drew on this methodology to develop its influential *Doing Business* report, which seeks to measure quantitatively aspects of the regulation of firms across countries. Among the 11 topics addressed in *Doing Business* is 'resolving insolvency', which uses the methodology developed in 'Debt Enforcement Around the World' (noted above)[140] to estimate the 'time, cost and outcome of insolvency proceedings'. India's ranking on this index is poor (in 2012, rank 128 of 183 economies)[141], and this poor ranking is popularly deployed as evidence of the 'failure' of Indian corporate insolvency law. Indeed, in the case of India's liquidation procedure, there appears to have been very little robust analysis of actual liquidation outcomes in India; instead, many critics simply rely on the *Doing Business* estimates (based on a single hypothetical case)[142] to evidence the law's failings. More generally, as this sub-section began by explaining, the Indian reform agenda has become increasingly focused on the comparative evaluation of India's insolvency law, or 'creditor rights system' more

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wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2003/10/24/000160016_20031024092948/Rendered/PDF/269160Legal0101e0also0250780SCODE09.pdf> 14 August 2012, also noted in David M Trubek 'The "Rule of Law" in Development Assistance: Past, Present and Future' in Trubek and Santos (n 16) 85.

138 Pistor and Milhaupt (n 125) 20.

139 Kennedy (n 16) 155.

140 See text to n 97.

141 See 'Country Tables' <www.doingbusiness.org/reports/global-reports/~/media/FPDKM/Doing%20Business/Documents/Annual-Reports/English/DB12-Chapters/Country-Tables.pdf> 14 August 2012.

142 See Chapter 4, section 4.1.1.

generally. This comparative focus may have been at the expense of closer analysis of the particular factors that have influenced the operation of insolvency law in India: as Chapters 4 and 6 explain, there have been very few in-depth studies of the development and operation of insolvency law in India over time. This thesis offers such a study.

CHAPTER 3

INDIA'S LIQUIDATION PROCEDURE: A LEGAL TRANSPLANT

If there is any underlying them running through the company legislation of a full half century in [colonial] India… it is a steadfast adherence to the policy that what was good for Britain must also be good for India.

(Rungta, 1970)

The substantive legislative structure of Indian company law, like that of other colonies, slavishly followed the English model. Even when substantial amendments were made to the local legislation, these were generally simply consolidations of the more frequent amendments made to English legislation. Even after independence, India continued to follow the English template, rarely diverging from what was now a familiar model.

(McQueen, 2008)

The company law is not a part of the indigenous law of India. It has come from England.

(Singh J *Bhagwati Devi Bubna v Dhanraj Mills Private Ltd*, 1968)

This chapter is the first of three (together comprising Part I) on India's company liquidation procedure, presently contained in the Companies Act 1956[1]. This chapter charts the development of Indian company liquidation law 'on the books' over time (that is, the law as contained in successive company law statutes)[2]. The chapter begins with the initial transplant of UK company legislation to British India. The first section charts this transplant and subsequent amendments made to the liquidation provisions during the colonial period, revealing how developments in the UK statutory regime were consistently reproduced by colonial legislatures in India. The second section is concerned with the contemporary, post-colonial, period. It begins with an analysis of the liquidation provisions of the Companies Act 1956, noting the few ways in which the Act departed from UK law as it then stood, before turning to consider post-1956

[1] In 2008, a bill was introduced that would repeal and replace the Act (the Companies Bill 2008, reintroduced in 2009 and 2011). If passed, the 2011 Bill would make several changes to the liquidation procedure, noted below text to n 129.

[2] Developments in the liquidation case law are considered in Chapter 5.

developments in liquidation law in each jurisdiction. Together, these two sections offer a close study of the evolution of more than one hundred sections of company law statute in two jurisdictions over more than 150 years. The core finding that emerges is that liquidation law has remained, on the books, remarkably stable and remarkably similar in the UK and India over time, with the only significant difference between the two jurisdictions being one of administrative burden (the allocation of responsibility for the law's administration). Although this finding is largely an historical one, it is also a finding that informs and illuminates the inquiry into the law's contemporary failure, taken up in Chapters 4 and 5.

3.1 A legal transplant: the colonial origins of Indian liquidation law

The first statute for the incorporation of companies by registration in British India[3] was the Registration of Joint Stock Companies Act of 1850[4]. The Act was modelled on the English Joint Stock Companies Act of 1844[5]; like its English counterpart, the Indian Act of 1850 afforded separate legal personality to registered companies, but not limited liability to their members[6]. Limited liability was introduced in the UK with the enactment of the Limited Liability Act of 1855[7], and entrenched in the consolidating

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3 For a brief history of British-administered India (initially under the control of the East India Company, then – following the Act for the Better Government of India 1858 (21 & 22 Vict c 108) – the Crown directly), see Jerry Dupont, *The Common Law Abroad: Constitutional and Legal Legacy of the British Empire* (William S Hein & Co 2001) from 480.

4 Act No. XLIII of 1850.

5 7 & 8 Vict c 110; Radhe Shyam Rungta, *The Rise of Business Corporations in India, 1851-1900* (CUP 1970) ch 3.

6 Act No. XLIII of 1850, ss XXXIX, XLII; Company Law Committee, *Report of the Company Law Committee* (the 'Bhaba Committee Report') (Department of Economic Affairs 1952) [20]; Rungta ibid 37. For the English provision providing for liability of shareholders, see Joint Stock Companies Act of 1844 s XXV.

7 18 & 19 Vict c 133.

Joint Stock Companies Act of 1856[8]. These developments were closely monitored by the central legislative body in British India (the Legislative Council of the Governor-General)[9], which first resolved to introduce a limited liability statute and then, following the enactment of the UK Act of 1856, to introduce a consolidating statute in India. The responsible 'law member'[10] of the Legislative Council (Mr Barnes Peacock, an English barrister who was later appointed Chief Justice of the Calcutta apex court[11]) proposed to follow the provisions of the UK Act of 1856 as closely as possible, apparently motivated by a desire to protect the interests of British traders in India:

> He [Mr Peacock] thought that it was very desirable that, upon such a subject as the formation of Joint Stock Companies with limited liability, the law of England and the law of India should be nearly alike as the circumstances of the two countries would permit; so that persons forming themselves into partnerships on the principle of limited liability in England, and desirous of carrying on either the whole or a portion of their business in India, might know that the Law in both countries was substantially the same, and that they would incur no greater risk in India than they would in England[12].

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[8] 19 & 20 Vict c 47. For an analysis of these early statutes, see John Armour, 'Codification and UK Company Law' in Association du Bicentenaire du Code de Commerce (ed), *Bicentenaire du Code de Commerce 1807-2007: Les Actes des Colloques* (Dalloz 2008), 3.1.

[9] Centralised legislative power was invested in the Council of the Governor-General by the Charter Act of 1833 (3 & 4 Will c 95), which was formally split into the Legislative and Executive Councils by the Charter Act of 1853 (16 & 17 Vict c 95): see Joseph Baptista, 'The Commercial Law of the Empire of India' in William Bowstead (ed) *The Commercial Laws of the World*, Vol XVI, 'British Dominion and Protectorates in Asia' (Sweet and Maxwell 1913) 9; Mahabir Prashad Jain, *Outlines of Indian Legal History* (NM Tripathi 1966) 608-611; 634-635.

[10] The Council was originally made up of three executive members and one legislative member. Its legislative branch was enlarged after 1853: see Jain ibid 611, 634.

[11] JA Hamilton, 'Peacock, Sir Barnes (1810–1890)', rev. Roger T Stearn, *Oxford Dictionary of National Biography* (Oxford University Press 2004). Peacock was involved in a number of ambitious codification projects in British India: Elizabeth Kolsky, 'Codification and the Rule of Colonial Difference: Criminal Procedure in British India' (2005) 23 *Law & History Review* 631, 670.

[12] *Proceedings of the Legislative Council of India, January to December 1856*, vol 2 (Imperial Legislative Council 1857) 604; reproduced in part in Rungta (n 5) 68; see also Rob McQueen, 'The Flowers of Progress: Corporations Law in the Colonies' (2008) 17 *Griffith Law Review* 383, 388. The assumption underlying Mr Peacock's statement was that the UK law was entirely contained on the statute book, with the result that transplant would produce a mirror image in British India: the reality, Armour has argued, is that the early statutes were far from a complete code (n 8 at 3.1-3.2).

The result was the Joint Stock Companies Act of 1857[13], enacted just prior to the formal transfer of control over British India from the East India Company to the Crown[14].

Part III of the English Act of 1856 had established a dedicated winding up procedure for companies registered under the Act. (Earlier company statutes had provided for the winding up and dissolution of companies, but these provisions 'piggy-backed' on the procedure applicable to bankrupt individuals).[15] The 1856 Act established two modes of winding up for companies - winding up by the court, on petition of a contributory or (in the case of a company that was 'unable to pay its debts') a creditor[16], and voluntary winding up (including by the special resolution of members)[17] – each administered by a liquidator, equipped with a range of powers to preserve, enhance and distribute the corporate estate[18]. In India, Mr Peacock had formed the view that the English liquidation provisions could be transplanted to India without 'material alteration',

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[13] Act No. XIX of 1857.

[14] See n 3 above.

[15] See Roy Goode, *Principles of Corporate Insolvency Law* (4th ed, Sweet & Maxwell 2011) [1-10], charting the legislative history prior to 1855. The Joint Stock Companies Act of 1844 (7 & 8 Vict c 111) provided that a company that committed any of a range of specified 'acts of bankruptcy' could be proceeded against 'in like manner as other bankrupts' (Section I). The Act was followed by the Joint Stock Companies Winding-Up Act of 1848 (11 & 12 Vict c 45), which moved the law closer to its modern form but still borrowed from bankruptcy procedure. After 1856, the 1844 and 1848 Acts (as amended) remained applicable to companies registered under earlier company statutes until 1862, when they were repealed by the Joint Stock Companies Act of that year (25 & 26 Vict c 89, Schedule III). See generally V Markham Lester, *Victorian Insolvency: Bankruptcy, Imprisonment for Debt, and Company Winding-up in Nineteenth-Century England* (OUP 1995) ch 6.

[16] Section LXIX, Joint Stock Companies Act 1856.

[17] Section CII(2), Joint Stock Companies Act 1856.

[18] Including, in compulsory liquidation, a stay on actions against the company and a prohibition on the disposal of company property after the making of the order (s LXXIII); a provision applying the rule in bankruptcy that invalidated transfers of property made 'by way of undue or fraudulent preference of any creditor' in a period leading up to liquidation (s LXXVI); a court power to compel document production from persons suspected of having company property, and to summon them for examination (s LXXVII). In both compulsory and voluntary liquidation, liquidators were given a range of powers, though these were initially exercisable only with leave in compulsory liquidation (see ss XC and CIV(7)).

apart from changes necessary to accommodate differences in the court hierarchy of each jurisdiction[19]. The liquidation provisions of the English Act of 1856 and the Indian Act of 1857 were otherwise almost identical[20].

Soon after, however, a further consolidating companies statute – the Companies Act of 1862[21] – was enacted in the UK, resulting in (among other things) a substantially revised set of provisions for company liquidation. The 1862 Act is regarded as a seminal one in the history of company law in the Commonwealth: it has been described as the foundation of modern UK company law[22], and as the 'definitive blueprint for commercial organisations in virtually all English colonies'[23]. In India, it soon provoked a corollary - the Indian Companies Act of 1866[24] - which was 'intended to render to Joint Stock Companies trading in India the same service which had been afforded to English Joint Stock Companies by the Companies Act, 1862'[25].

The liquidation provisions of the English (1862) and Indian (1866) Acts were almost identical[26]. In addition to the two modes of liquidation already available –

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[19] *Proceedings of the Legislative Council* (n 12) 610. On jurisdiction in compulsory winding-up, see further below, text to n 83.

[20] For minor differences, compare s LXXVII of the Indian Act of 1857 with s LXXX of the English Act of 1856 (invalidation of attachments in relation-back period); s XCIII of the Indian Act and s CII of the English Act (circumstances in which company could be voluntarily wound-up).

[21] 25 & 26 Vict c 89.

[22] *Report of the Review Committee on Insolvency Law and Practice* (the 'Cork Report') (Her Majesty's Stationery Office 1982) [75].

[23] Rob McQueen, 'Company Law as Imperialism' 5(2) (1995) *Australian Journal of Corporate Law* 187, 190.

[24] Act No. X of 1866; see also Rungta (n 5) at 212.

[25] Extract from the parliamentary debate that accompanied the introduction of the Bill, contained in *Abstract of the Proceedings of the Council of the Governor-General of India, assembled for the purpose of making laws and regulations 1865*, vol IV (Military Orphan Press 1866) 239.

[26] The only sections wholly omitted from the Indian Act of 1866 from the UK Act of 1862 were sections 78 (liability of female contributories); 114 (petition constituted a *lis pendens*); 157 (power of an assignee of a chose in action to sue); 158 (providing that debts of all descriptions, including contingent debts, were

compulsory winding up (a court-controlled process, triggered *inter alia* by a creditor petition alleging the company's inability to pay its debts), and voluntary winding up (a shareholder-controlled process) – a third was introduced: winding up 'subject to the supervision of the court'. This third mode was a hybrid (part shareholder, part court controlled) that was rarely used in either jurisdiction[27] and has now been abolished in the UK[28]. The two primary modes were both to be administered by a liquidator, remunerated out of the assets of the company[29]. The liquidator was given power (with the court's leave in compulsory winding up, without it in voluntary winding up) to bring or defend suits on behalf of the company, to carry on the business so far as necessary for the beneficial winding up of the company, to sell the company's property, and 'to do and execute all other things as may be necessary for winding up the affairs of the company and distributing its assets'[30].

provable); and 159 (empowering the court to direct the liquidator in a voluntary winding up to institute a prosecution for an offence against a company director, manager or officer) (but the latter two were added in the Indian Companies Act of 1913 (Act No. VII of 1913), ss 228 and 237(2)). The remaining sections were transplanted with few alterations, the only material difference appearing (as in 1856) in the provisions on court jurisdiction in compulsory liquidation (compare s 103 of the 1866 Act with s 81 of the 1862 Act), and see below text to n 83.

[27] UK - Cork Report (n 22) [660]; India - see data discussed in Chapter 4, Section 4.1.2, and historically, Committee on the Companies and MRTP Acts, *Report of the High-Powered Expert Committee on the Companies and MRTP Acts* (the 'Sachar Committee Report') (Ministry of Law, Justice and Company Affairs, 1978) [15.47].

[28] By the passage of the Insolvency Act 1986. In India, the Companies (Second Amendment) Act 2002 provided for the abolition of winding-up under the supervision of the court, but the Act is yet to be notified for commencement (see below, text to n 127). The Companies Bill 2011 would abolish this mode of winding up (see cl 270 of the Bill).

[29] In compulsory liquidation, as set by the court and payable out of company assets according to the priority set by the court (English 1862 Act ss 93 and 110; India 1866 Act ss 114 and 130); in voluntary liquidation, all properly incurred remuneration was payable out of company assets in priority to all other claims (England 1862 Act s 144; India 1866 Act s 160).

[30] CL - English Act s 95, Indian Act s 116; VL – English Act s 133(7), Indian Act s 149(7).

In a compulsory liquidation, suits against the company were stayed (unless the court gave leave)[31], any attachment, distress or execution against the property of the company after the commencement of the winding up[32] was declared void[33], and dispositions of the company's property between the presentation of the petition and the making of the winding up order were void (unless validated by the court)[34]. For all forms of liquidation, the fraudulent preference rule that applied in personal insolvency was extended to liquidation, invalidating any 'conveyance, mortgage, delivery of goods, payment, execution or other act relating to property' made or done by 'undue or fraudulent preference' within three months of the commencement of the commencement of the winding up[35]. The court was also given power to examine the conduct of any director, manager or officer suspected of any misfeasance or breach of trust, and to order contribution to the company's assets as compensation[36].

This framework was refined in the period leading up to India's independence in 1947, but not fundamentally altered. Nearly all refinements in India followed developments in the UK, although sometimes with some delay. In a voluntary liquidation, the court was given power to sanction a compromise or arrangement between the company and its creditors capable (on securing approval of the requisite majority of creditors) of binding dissenters, a provision that evolved into the modern

31 English Act s 87; Indian Act s 108. In a voluntary winding up the liquidator could apply to the court for a stay (see Goode (n 15) [5-08]; English Act s 138 and Indian Act s 154).

32 Deemed to relate back to the presentation of the petition: English Act s 84; Indian Act s 105.

33 English Act s 163; Indian Act s 183.

34 English Act s 153; Indian Act s 169.

35 English Act s 164; Indian Act s 184. The bankruptcy insolvency rule required proof of intention to prefer: see below n 189.

36 English Act s 165; Indian Act s 185.

scheme of arrangement in English and Indian company law[37]. For all modes of liquidation, categories of preferential debt (certain wage and tax debts), payable in priority to other debts, were introduced[38] and, later, given priority over assets secured by a floating charge[39]. The court was given power to order the examination of any person who had participated in the formation and promotion of the company, or who had been a director or other officer since then, and was suspected of fraud[40]. Two further avoidance provisions were added: one rendered certain mortgages and charges, where not delivered for registration within 21 days of creation, void against the liquidator and any creditor[41]; the other invalidated floating charges on the company's property given within three months of the commencement of the winding up, other than for new value[42].

New categories of criminal offences for directors and officers were introduced to target fraudulent and evasive conduct in the period leading up to an insolvent liquidation and during liquidation[43]. In compulsory liquidation, a new role was created for the 'official receiver' (officers attached to courts to administer personal insolvency

[37] England, Joint Stock Companies Arrangements Act 1870 (33 & 34 Vict c 104) s 2; Indian Companies Act 1882 (Act No. VI of 1882) s 203. See the Cork Report (n 22) [404] and for the modern equivalent (the scheme of arrangement), UK Companies Act 2006 Pt 26, Indian Companies Act 1956 Ch V.

[38] England, Companies Act 1883 (46 & 47 Vict c 28) s 4; Indian Companies (Amendment) Act 1887 (Act VI of 1887, introducing s200A to the 1882 Act) (see Bhaba Committee Report (n 6) 17; Rungta (n 5) 212). The Indian provision of 1887 included both Crown and wage debts, while the English provision initially included only wage debts (the preference rule for tax debts appearing in the Companies (Consolidation) Act 1908 (8 Edw 7 c 69), s 209). But it seems likely that the Indian addition was inspired by the English decision in *Re Henley & Co* (1878) LR 9 Ch D 469, as to which see also below n 56.

[39] England, Preferential Payments in Bankruptcy Amendment Act 1897 (60 & 61 Vict c 19) s 2, discussed in Goode (n 15) [8-51]; Indian Companies Act 1913 s 230(2)(b).

[40] England, Companies (Winding-Up) Act 1890 (53 and 54 Vict c 63) s 8(3), see also Cork Report (n 22) [85]; Indian Companies Act 1913 s 196.

[41] England, Companies Act 1907 (7 Edw 7 c 50) s 10; Indian Companies Act 1913, s 109.

[42] England, Companies Act 1907 s 13, see also Cork Report (n 22) [86]; Indian Companies Act 1913 s 233.

[43] England, Companies Act 1929 (19 & 20 Geo c 23) s 271; Indian Companies Act of 1913 s 238A, added by Companies (Amendment) Act 1936 (Act 22 of 1936) s 111.

proceedings) as the default liquidator[44]; new procedures were established for the gathering[45] and reporting[46] of information by the liquidator, and for holding her to account[47]; the rule invalidating dispositions made by the company between the presentation of the petition and the making of the order was extended, invalidating any disposition made at any time after the commencement of the winding up[48]; and the liquidator was given power to disclaim 'unprofitable contracts'[49]. Finally, voluntary liquidation was subdivided into members' voluntary liquidation (MVL), and creditors' voluntary liquidation (CVL). An MVL could be used only where directors could make a declaration of solvency[50]. A CVL – used where the declaration of solvency could not be

[44] England, Companies (Winding-Up) Act 1890 s 4; Indian Companies Act 1913 s171A, added by Companies (Amendment) Act of 1936, s 92. The Indian position hardened further after independence: see below, text to n 93.

[45] The 'statement of affairs', a report submitted to the liquidator by directors, detailing the company's finances: England, Companies (Winding-Up) Act 1890 s 7; Indian Companies Act 1913 s 177A, added by Companies (Amendment) Act 1936 s 96.

[46] The liquidator's statement, describing the company's finances and the causes of its failure, and indicating whether further inquiry should be made: England, Companies Winding-Up Act 1890 s 8(1); Indian Companies Act 1913 s 177B, added by Companies (Amendment) Act 1936, s 96.

[47] The liquidator was required to convene a meeting of creditors to decide whether a 'committee of inspection' (made up of creditors and contributories) should be appointed alongside her (England, Companies (Winding-Up) Act 1890 ss 6, 9; Indian Companies Act 1913 s 178A, added by s 98 of the Companies (Amendment) Act 1936, with some differences). The liquidator was also required to present accounts for audit by the nominated regulator, the Board of Trade in England (Companies Winding-Up Act 1890 s 20) or, in India, the court (Indian Companies Act 1913 s 182, added by Companies (Amendment) Act 1936 s 99). The liquidator was required to pay moneys received into an account with a specified bank (in England, the Bank of England; in India, banks scheduled by the RBI): England, Companies (Winding-Up) Act 1890 s 11; Indian Companies Act 1913 s 244A, added by Companies (Amendment) Act 1936 s 113.

[48] England, Companies (Consolidation) Act 1908 s 205(2); Indian Companies Act 1913 s 227(2).

[49] England, Companies Act 1929 s 267; Indian Companies Act 1913 s 230A, added by Companies (Amendment) Act 1936 s 107.

[50] England, Companies Act 1929 s 230; Indian Companies Act 1913 s 207 as substituted by Companies (Amendment) Act 1936 s 105. The Indian provision used a more generous definition of solvency than the English provision (ability to pay debts in full within three years of the commencement of winding up, rather than one).

made – afforded greater control to creditors[51]. The change was made in the UK in response to a perception that control of insolvent voluntary liquidations by shareholders with 'no real interest in the winding up' was 'anomalous'[52].

Developments in Indian liquidation law during the colonial period can be summarised in the following way. The liquidation procedure introduced in 1866 was an almost exact replica of that introduced in the UK in 1862. Almost all of the statutory revisions to the Indian scheme that followed were modelled on statutory revisions made in the UK. Those that did not appear to have an English statutory corollary were almost all inspired by English case law developments: four Indian statutory revisions (relating respectively to the meaning of 'debt' in the phrase 'inability to pay debts'[53]; the impact of a winding up order on employment contracts[54]; the appointment of a receiver of assets in

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[51] The liquidator in a CVL was required to summon a meeting of creditors, at which the directors would provide a statement of the company's affairs (England, Companies Act of 1929 s 238; Indian Companies Act 1913 s 209A, inserted by Companies (Amendment) Act 1936 s 105). In a conflict between creditors and the company (or its managers) over who should be liquidator, creditors would prevail (England, Companies Act of 1929 s 239; Indian Companies Act 1913 s 209B, inserted by Companies (Amendment) Act 1936 s 105). The creditors would fix the liquidator's remuneration (England, Companies Act 1929 s 241; Indian Companies Act 1913 s 209D, inserted by Companies (Amendment) Act 1936 s 105).

[52] Company Law Amendment Committee, *Report* (the 'Greene Committee Report') (HM Stationery Office 1926) [77]. In India, this important amendment was referred to only obliquely in parliamentary debate, the introducing member noting amendments to give creditors 'better control': *Legislative Assembly Debates* (Volume V 1936, Third Session of the Legislative Assembly, Government of India Press 1936) 3938.

[53] The Indian Act of 1882 defined 'debt' to exclude contingent or prospective liabilities, except in the case of life assurance companies (s 130). This amendment was a response to the English decision in *European Life Assurance Society (No 1)* (1869) LR 9 Eq 122 that the phrase 'unable to pay its debts', whilst accommodating both cash flow and balance sheet insolvency tests, did not permit consideration of prospective or contingent liabilities (see Goode (n 15) [4-04]; on the Indian adoption, see LP Russell, *The Indian Companies Act VI of 1882* (Education Society's Press 1885) 103). The amendment was reversed in the Indian Companies Act 1913 (s 163(iii)), following the same reversal in the UK (Companies Act 1907 s 28).

[54] The 1882 Indian Act provided that a compulsory winding up order was deemed to be notice of discharge to servants (s 137). This revision appears to have been a response to an English decision of same effect: *General Rolling Stock Company v Chapman's Case* (1865-66) LR 1 Eq 346 (see Russell (n 53) 115; Solomon Judah, *Handbook of Indian Company Law* (Butterworth & Co 1927) 267). In England, the rule remains a judge-expressed one today (Goode (n 15) [5-24]).

the hands of a liquidator in compulsory winding up[55]; and the application of the stay on attachment, distress and execution after the commencement of a compulsory winding up to Government creditors[56]) gave statutory effect to English case law. There was one statutory amendment in India that does not appear to have been referable to any development in England: a widening of one of the avoidance provisions[57], which could potentially have impacted on the ability of secured creditors to 'stand outside' the winding up and enforce their security out-of-court[58]. But in a decision of India's Supreme Court[59] handed down in the early post-independence period, the amendment was construed narrowly, the court finding that the legislature had not intended to effect any great change. In reaching this conclusion, the Court relied in part on the evidence of

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[55] The 1882 Indian Act provided 'a receiver shall not be appointed in the hands of an official liquidator' (s 141). Russell (n 53) links this provision to two English cases (*Perry v Oriental Hotel Co* (1870) LR 5 Ch 420, and *Campbell v Compagnie Generale de Bellegarde* (1875) 2 Ch D 181) in which it was held that the liquidator, rather than any third-party receiver, was the most appropriate person for the court to appoint to act as receiver for a secured creditor (118). But the Indian provision went further: the English cases had not precluded the appointment of a receiver *per se*, but rather resulted in the appointment of the liquidator *as receiver*; the English cases were only concerned with the appointment of a receiver *by the court*, leaving open the possibility of out-of-court appointments (Rizwaan Jameel Mokal, 'What Liquidation Does for Secured Creditors, and What It Does For You' (2008) 71(5) *Modern Law Review* 699, 718); in any case, Mokal argues that the English position was nothing more than a 'rule of practice' subject to exceptions (717). The Indian position was later reined in (by s 94 of the Indian Companies (Amendment) Act of 1936), and a 1956 amendment permitted the prohibition to be relaxed altogether with leave.

[56] Unlike its English counterpart, section 212 of the 1882 Indian Act provided that the avoidance provision would not apply to 'proceedings by Government'. Russell (n 53) suggests that the Indian exception followed *Re Henley* (1878) LR 9 Ch D 469, in which the Court of Appeal held that the Crown was exempt from the equivalent provision in the English Act of 1862 (165). In the UK, the House of Lords later held that *Henley* had been overtaken by the insertion of a preferential debt rule for the Crown (*Food Controller v Cork* (1923) AC 647; Henry Wrenbury, *Buckley on the Companies Acts* (14th ed, Butterworths 1981) 562, n 18), a decision that was later deployed by the Indian Federal Court to curtail the scope of the exception in s 212 (*Governor-General in Council v Shiromani Sugar Mills Limited (in liquidation)* AIR 1946 FC 16, [9]). For the position today, see below n 83.

[57] Section 108 of the Companies (Amendment) Act 1936, which added to s 232 of the Indian Companies Act 1913 (which invalidated any attachment, distress or execution against the property of the company made without leave after the commencement of the winding up) a prohibition on the 'sale' of any company property.

[58] As to which see text to n 190.

[59] *MK Ranganathan v Government of Madras* 1955 SCR (2) 374.

similarity between England and India: the provisions of the Indian Companies Act were 'almost bodily incorporated' from the English Companies Act and, absent the amendment, the position of a secured creditor in India was 'the same as that obtaining in England'[60]. The effect of its decision was to preserve this position.

Overall, then, the statutory revisions made to the Indian liquidation framework during the colonial period were derived from, or – in the one exceptional case – interpreted so as to achieve functional equivalence with, the UK. There were very few changes in the UK in the colonial period that were not precisely mirrored in India[61], although in a few instances the Indian corollary did not appear until after India's independence. These late revisions (all of which appeared in the Companies Act 1956, considered further below[62]) included the introduction of liability[63] for directors and others knowingly party to the carrying on of the business of a company 'with intent to

[60] ibid 384; see also TR Srinivasa Iyengar, Philip K Taiyal, and SN Bagga, *Encyclopedia of Company Law* (vol II, Law Book Co 1961) 198.

[61] There appear to be only two UK developments that were not followed at all: the vesting of jurisdiction to wind up companies with smaller capital in lower courts (effected by the UK Companies (Winding Up) Act 1890, s 1(3)) (see further below text to n 84); and provision for the appointment of special managers to assist official receivers (Companies (Winding-Up) Act 1890 s 5). Otherwise, the colonial legislature tended to import the English provisions exactly. Amendments were only made in relation to: (a) the role of the committee of inspection in a compulsory liquidation, which was narrower in India (below n 66); (b) the identity of the regulator of liquidators (in England, the Board of Trade; in India, the Central Government, see below, n 68), and their remit (the Indian provision leaving audit of liquidators' accounts to the courts, see above n 47); (c) the definition of solvency for the purpose of the declaration in an MVL, which in India was more generous (see above, n 50); (d) the appointment of receivers to assets in the hands of the liquidator, which in India was more difficult (see above, n 55); and (e) the impact of a compulsory winding up order on company property, the Indian legislature adding a provision deeming property to be in the custody of the court from the date of the order (see Companies (Amendment) Act 1936 s 97, altering s 178 of Indian Companies Act 1913), an amendment which has attracted little attention in the cases or commentary).

[62] Text to n 79.

[63] Personal liability for the debts of the company, and criminal liability (see provisions cited in footnote immediately below). A guilty director could also be restrained from taking part in the management of any company for a period of up to five years: see provisions cited in n 67 below.

defraud'[64]; the introduction of offences for directors and other officers who, prior to the company's entry into liquidation, obtained credit for the company by fraud, or disposed of company property 'with intend to defraud creditors'[65]; the relaxing of the requirement to obtain sanction for the exercise of some powers by a liquidator in a compulsory liquidation[66]; the introduction of a power to restrain 'fraudulent persons' from acting as directors[67]; and the strengthening of the supervision of liquidators in compulsory winding up[68].

Once these late developments are taken into account, it is clear that the English law of liquidation was – consistently and rigorously – transplanted to the Indian statute book up until (and slightly beyond) the end of the colonial period. These transplants were part of a wider project: the transplantation of English company law, of which liquidation law formed one part, to British India. This wider project was presented as one designed to appeal to the English investor, who would be assured of uniformity between the two jurisdictions. Uniformity would, the legislature hazarded, also help to minimise 'mistakes' by Indian judges in company law cases: they would benefit from the inherited 'wisdom' of the English, and from the discipline of the Privy Council, administering one company law across the Empire. The Companies Act of 1882, for example, was introduced with this statement from the responsible member of the

[64] England, Companies (Consolidation) Act 1929 s 275; India, Companies Act 1956 (No. 1 of 1956) s 542.

[65] England, Companies (Consolidation) Act 1929 s 273; India, Companies Act 1956 s 540.

[66] England, Companies (Winding-Up) Act 1890 s 12; India, Companies Act 1956 s 457. The Indian provision did not go as far as the English one, which also extended to the committee of inspection the power to sanction the exercise of those powers remaining non-exercisable without sanction.

[67] England, Companies (Consolidation) Act 1929 s 217; India, Companies Act 1956 s 203.

[68] In the UK, the Companies (Winding Up) Act of 1890 (s 25) made the Board of Trade, a government department, responsible for monitoring the conduct of liquidators in compulsory winding up. The Indian equivalent appeared in 1956 (s 463), but simply charged the 'Central Government' with responsibility.

Legislative Council:

> It seemed to the Government of India that the amendments [modeled on English statutory and case-law developments]… should be made for two reasons, first, because they were good in themselves, and, secondly, because it was desirable that the laws relating to such a subject as mercantile companies should be nearly as possible the same in India as in England. Any differences in such laws led to mistakes in the Indian courts, and must, to some extent, discourage English investors from putting their money into Indian companies.[69]

In 1913, the introduction of the Indian Companies Act was explained in similar terms:

> The differences which now consequently exist between the Indian and the English law, in themselves form strong ground for legislation. Ever since we have had any company legislation in India, the advantages of having our company law as similar as possible to the English law has been recognised by the Indian legislature… The English law has been studied and commented on comprehensively, and in adopting it, we also inherit the wisdom of the many learned persons who have devoted their time to its exposition: and when it is necessary to carry a case up to the Privy Council, it is manifestly convenient that the law which is to be argued in English should be substantially the same as the English law. Assimilation of the law also tends to produce a feeling of greater security in the breast of the British investor whose capital we wish to attract…[70]

By the time of the 1936 amendments to the Indian Companies Act 1913, the mood in the Indian legislature had shifted: nearly all of the debate that accompanied the 1936 Act focused on the specific problem of regulating 'managing agents' in India, an issue with which the UK had never grappled[71], and the explicit focus on appealing to the English investor was dropped. Despite this, the amendments made by the 1936 Act to liquidation were, as ever, derived entirely from the UK. Overall, it is no exaggeration to

[69] *Abstract of the Proceedings of the Council of the Governor-General of India, assembled for the purposes of making laws and regulations 1881* (Officer of the Superintendent of Government Printing 1882) 182 (Mr Stokes, introducing the bill).

[70] *Proceedings of the Council of the Governor-General in India, assembled for the purpose of making laws and regulations, April 1911 to March 1912* (Office of the Superintendent of Government Printing 1913) 657 (Mr Clark, introducing the bill).

[71] See the debate contained in *Legislative Assembly Debates (Official Report) 1936* (Volumes IV-VIII, Government of India Press 1936). As to managing agents, see Rungta (n 5) Ch 12.

suggest that, for the entire colonial period, India's liquidation law was on the books the liquidation law of England and Wales.

3.2 After independence: the development of Indian and English liquidation law 'on the books'

This section charts the development of liquidation law in India after colonial independence, analysing the extent to which India diverged from the English model – so entrenched in the colonial period – once given the opportunity. The section begins with the enactment of the Companies Act 1956, and then turns to consider post-1956 developments.

3.2.1 The Companies Act 1956

In 1950, the newly independent Government of India appointed a committee of twelve (chaired by CH Bhaba) to consider what changes should be made to the Companies Act 1913 'having due regard to the conditions necessary for the healthy growth of joint stock enterprises and the desirability of adequately safeguarding the interests of investors and the public'[72]. The appointment of the Bhaba Committee followed an earlier Government-commissioned investigation into the continuing suitability of the provisions of the 1913 Act, prompted by changing corporate practice and by news of company law reform in the UK, following the report of the Cohen Committee[73]:

> The [Cohen Committee] report recommended several far-reaching changes in the English Companies Act, 1929, and since the Indian Companies Act has been always largely based on the prevailing English company law, Government considered that the time was ripe for a further review of the Indian Companies Act[74].

[72] Bhaba Committee Report (n 6) [4].

[73] *Report of the Committee on Company Law Amendment* (the 'Cohen Committee Report') (HM Stationery Office 1945).

[74] Bhaba Committee Report (n 6) [1].

Much of the Committee's work was carried out by a sub-committee, tasked with comparing the provisions of the Indian Companies Act 1913 with those of the UK Companies Act 1948[75], and with the law of other jurisdictions, and making recommendations. The sub-committee's work was generally approved by the committee as a whole[76], which ultimately proposed 'comprehensive' changes to the provisions of the 1913 Act[77]. The Bhaba Committee Report led to the enactment of a new company statute – the Companies Act 1956 – that remains in force today[78].

The Companies Act 1956 made some important changes to India's liquidation procedure, many of which were inspired by developments in English law. As already noted above[79], the 1956 Act included a series of amendments that had been made in the UK during the colonial period but not yet given effect in India. Chief among these amendments were the introduction of new categories of liability for directors and others concerned in the management of insolvent companies (including personal and criminal liability for fraudulent trading, and criminal liability for obtaining credit with intend to defraud creditors), as recommended by the Bhaba Committee[80]. The 1956 Act also imported many of the amendments to English liquidation law made by the UK Companies Act 1948, including the lengthening of the 'twilight period' in which fraudulent preferences and floating charges (given other than for new value) could be

75 (11 & 12 Geo c 6).

76 Bhaba Committee Report (n 6) [9].

77 ibid [26].

78 The Act would be repealed and replaced by the Companies Bill 2011, if enacted.

79 See above, text to n 62.

80 Bhaba Committee Report (n 6) [220].

impugned[81], an amendment recommended by the Cohen Committee in response to evidence of English corporate practice[82].

Some differences between the Indian and English liquidation provisions, inherited from the colonial period, persisted. Of these few differences[83], the most significant related to court jurisdiction in compulsory liquidation. In the UK, the Companies (Winding-Up) Act 1890 split jurisdiction to wind-up between the High Courts and the (inferior) County Courts, requiring petitions for companies with paid-up capital of more than £10,000 to be filed in the High Court, and those under £10,000 to be filed in the County Courts[84]. Once a winding-up order was made, proceedings could also be transferred between the courts[85]. The Indian Companies Act 1913 did not go quite so far. It provided that the default court in all company law matters, including

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81 For fraudulent preferences, from three to six months; for floating charges, from three to twelve months: see ibid [219].

82 Cohen Committee Report (n 73) [146] (fraudulent preference), and [148], the Committee concerned that promoters could 'stave off the creditors for six months' from when they charged the property.

83 These differences were noted above, n 61. For compulsory liquidation, the significant differences that survived the 1956 Act were: (a) the continuing exception in India for Government creditors from the rule avoiding execution after the commencement of winding-up (compare s 537(2) of the Companies Act 1956 with s 228 of the UK Companies Act 1948), an exception that appears to allow - at best – a Government creditor to execute a judgment debt obtained prior to the commencement of winding-up, leave still being required to institute or continue any proceedings (see *Sebastian v Rubber Board* [1967] 37 CompCas 117 (Kerala); *Re Tanwar Finance P Ltd v Kanwar Ram Chander* [1979] 49 CompCas 827 (Delhi), the cases also appearing to confine the right of Government creditors to the period between petition filing and the making of the order); (b) the absence of any provision in India expressly empowering the court to appoint a 'special manager' to assist the liquidator (see s 263 of the Companies Act 1948); (c) a narrower role for the Indian committee of inspection, which unlike its English counterpart was not given power to sanction the exercise of the liquidator's powers (compare s 457 of the Companies Act 1956 with s 245 of the Companies Act 1948); (d) greater regulatory responsibility for the Indian courts, tasked with auditing liquidator accounts (a duty the UK entrusted to the Board of Trade) (compare s 462 of the Companies Act 1956 with s 249 of the Companies Act 1948); (e) a higher threshold for the appointment of an out-of-court receiver, the Indian provision requiring court leave (see s 453 of the 1956 Act). There is also one difference for voluntary liquidation, the Indian definition of 'solvency' for the purpose of determining whether the liquidation would be a MVL or a CVL being more generous (s 488 of the Companies Act 1956, s 283 of the Companies Act 1948). All remain points of difference today.

84 Section 1. For the current position, see below, text to n 195.

85 Section 3.

liquidation, was the High Court for the state in which the concerned company was registered, unless and until jurisdiction was specifically granted to the (inferior) District Court of that state by local government notification[86]. Otherwise, a compulsory liquidation case could be *transferred* to a District Court, but not initiated there[87]. The 1956 Act broadly maintained this position. Section 10(1) of the Act provided that the High Courts would exercise jurisdiction under the Act, except to the extent that jurisdiction was later conferred (by Central Government notification) on the District Courts. The legislature also added a restriction, following a recommendation from the Bhaba Committee[88]: the District Courts could not be given jurisdiction to wind-up companies with a paid-up capital of more than one lakh (100,000 rupees)[89]. The transfer power was preserved, with the result that the District Courts could continue a winding-up initiated in a High Court, but not – in the absence of notification (and only then in relation to small companies) – make the winding-up order itself. But it seems that notification was not given[90], with the result that only the High Courts presently have jurisdiction to make a winding-up order.

The Companies Act 1956 made two further material departures from the English law of company liquidation, both proposed by the Bhaba Committee. For voluntary liquidation, the Act inserted a provision prohibiting revision of the remuneration of the

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86 Indian Companies Act 1913, s 3.

87 Companies Act 1956 s 435. The transfer power first appeared in s 218 of the Indian Companies Act 1882, modelled on s 42 of the UK Companies Act 1867 (30 & 31 Vict c 131).

88 Bhaba Committee Report (n 6) [207]. On the relationship between this rule and the transfer power, see A Ramaiya, *Guide to the Companies Act* (10th ed, Wadhwa & Company 1984) 911.

89 Section 10(2)(b).

90 LC Goyle, *Company Winding Up* (Eastern Law House 1987) 3.

liquidator after its initial fixing[91], the Bhaba Committee noting evidence that liquidators had shown 'little anxiety to dispose of the proceedings energetically' and regularly sought increases in remuneration[92]. For compulsory liquidation, the Committee had recommended that a 'permanent official liquidator' be appointed to each High Court, and that this officer should at all times act as the liquidator in a compulsory winding up. The previous position, borrowed from the UK, was that the 'official receiver' attached to the court was a default liquidator who could be replaced by any other person subsequently appointed by the court to act. The Committee offered only these brief reasons for the proposed change:

> The office of a liquidator has two different aspects. In the first place, he wields the power of a company under the direction and control of the Court; and secondly he is at the same time the representative for some purposes of both creditors and contributories. We consider that it will be easy for a person to fill these dual roles, if he is a permanent officer of the Court under whose direction he has to function.[93]

The Committee's recommendation was given effect by the drafters of the Companies Bill 1955 and attracted little attention in the debate accompanying its passage. One member did note the change, praising it as a means to check abuse:

> When the concern is a dying concern, it is handed over to the liquidator to dismember. Very often, the last gasps are prolonged because of the energies of the liquidator, so that he may be able to dismember it and parcel out to himself and to his friends the carcass, which has plenty of value. Either he receives a fat salary, which he ordinarily does not like, or payment is one a percentage basis. If it is a fat salary, then the period of liquidation is unnecessarily prolonged and it goes into years and years… I welcome the measure.[94]

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[91] Sections 490 (MVL), 504 (CVL).

[92] Bhaba Committee Report (n 6) [212].

[93] Bhaba Committee Report (n 6) [213].

[94] *Lok Sabha Debates* (13 August 1955, Parliament Secretariat) 'Companies Bill', 10111.

The 1956 Act established the office of the 'official liquidator', appointed by the Central Government to each High Court[95]. The official liquidators would act in all compulsory liquidations[96]. Fees for the services of the official liquidator would be payable, out of the assets of the company, to the Central Government[97].

It is plain from the Bhaba Committee Report that the Committee did not regard either of these changes as particularly significant. The Committee prefaced its chapter on liquidation with the statement that, in contrast to the changes effected to liquidation law by the Companies (Amendment) Act 1936, its recommendations were 'largely procedural'[98]. The question of whether the Committee may have underestimated the impact of the second change – the removal of private liquidators from compulsory winding up – is taken up in Chapter 4 of this thesis[99]. For present purposes, it suffices to note that the Committee chose to retain the company liquidation procedure that had been established in the colonial period, and (with few exceptions) to recommend revisions in line with UK developments. This position was endorsed by the drafters of the 1956 Act, who made very few additional departures from the liquidation provisions of the UK Companies Act of 1948[100]. Overall, the framework for company liquidation laid down in the Companies Act 1956 was essentially that established in the colonial period: that which was transplanted from the UK.

95 Section 448.

96 Section 449.

97 Section 451(2).

98 (n 6) [205].

99 Section 4.2.2.

100 The only other notable departure made in the 1956 Act was the addition of a rule that the court would allow the company to make representations before appointing a provisional liquidator (s 450(2), which has no analogue in the 1948 Act).

3.2.2 After 1956: developments in liquidation law in India and the UK

3.2.2.1 India

In 1978, an expert committee appointed to review Indian company law observed that '[s]ince the enactment of the Indian Companies Act 1913, the core and substance of the winding up provisions have almost remained the same'[101]. Thirty years on, this statement remains an accurate summary of the development of Indian liquidation law in the post-independence period, at least as it has stood on the statute book: there have been relatively few changes to the liquidation provisions of the Companies Act 1956 since their introduction. The first amendments appeared in 1960, on the advice of another committee (the 'Sastri Committee')[102]. The 1960 Act[103] strengthened the position of official liquidators, including by providing for the appointment of deputy and assistant official liquidators in each High Court[104], by permitting official liquidators to seek early dissolution where they could not proceed with the winding-up, including for lack of funds[105], and by replacing the rule that the liquidator must always summon a meeting of creditors to determine whether a committee of inspection[106] was necessary with one

101 The Sachar Committee Report (n 27) [15.8].

102 The Companies Act Amendment Committee (the 'Sastri Committee'). The Sastri Committee's report is unavailable in full, but extracts are set out in Ramaiya, 10th ed (n 88).

103 Companies (Amendment) Act 1960.

104 Section 448(1A), inserted by s 166 of the 1960 Act.

105 Section 481(1) as amended by s 177 the 1960 Act. The 1960 Act also expanded the sanctions available where company officers failed to tender the statement of affairs to the liquidator (s 454(5), added by s 167 of the 1960 Act), gave the court power to order payment or delivery of property by anyone found to be indebted to the company or in possession of company property (s 477, as amended by s 176 of the 1960 Act), and empowered official liquidators to seek the assistance of local magistrates to collect company property (s 456(1A), inserted by s 169 of the 1960 Act).

106 Section 464(1), inserted by s 173 of the 1960 Act.

allowing the court to determine if a committee was required[107]. The Act also introduced another avoidance rule, borrowed from personal insolvency law (originally transplanted from the UK), to tackle voluntary transfers of company property (made other than in the ordinary course of business, or in favour of a good faith purchaser for consideration) made in the year preceding the commencement of winding up (whether compulsory or voluntary)[108].

Apart from one change made in 1965 to assist the liquidator in a voluntary liquidation[109], the provisions of the Companies Act 1956 were left undisturbed until 1985, when an important change was made to the preferential debts rule. Prior to the amendment, section 530 had provided (as the UK Companies Act 1948 provided[110]) that certain categories of Crown debt and employee debt were to be treated as preferential, with the result that they were payable before other pre-petition debts. Preferential debts were however only payable out of the assets available to general creditors or (in the event of their insufficiency) those assets subject to a floating charge, with the result that assets covered by other forms of security (*e.g.* a mortgage over immovable property) were not available to preferential creditors. The Companies (Amendment) Act 1985 altered this scheme to ensure that the claims of workers (not the Crown) were 'fully protected' by the

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107 In the Committee's view, the 'need for vigilance' by creditors against a company liquidator was lessened where, as in India, the liquidator was a Government official (Ramaiya, 10th ed (n 88) 955). A similar change was, however, also subsequently made in the UK, after the Cork Committee expressed concern at the costs of compulsory winding-up (see below, text to n 174).

108 Section 531A, inserted by s 185 of the 1960 Act. In the UK, this provision was the foundation for the modern rule on transactions at undervalue (see below, text to n 170, and John Armour, 'Transactions at Undervalue', in John Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Hart Publishing 2003) [2.12]-[2.13]).

109 The extension of the rule requiring company officers to submit a statement of affairs to voluntary liquidation: see s 511A of the Companies Act 1956, as added by s 56 of the Companies (Amendment) Act 1965.

110 Section 319.

creation of a 'statutory charge on *all secured assets* of the companies in favour of the workers'[111]. The change was presented as a departure from the UK, inspired by a welfare imperative:

> The precedence which the present law accords to the secured creditors over unsecured creditors and the status of the workers as an unsecured creditor are borrowed from Anglo-Saxon law. There are, however, certain countries of the world where notable departures has been made. Thus, in Canada and in some of the States in the [US], the wages of the employee enjoy a preferential claim in the event of the insolvency of the corporation and in some cases, the wages for labour get precedence over mortgage and other lien of corporate property. Keeping the interests of workers in a welfare State uppermost in mind, the present Bill has been introduced[112].

The 1985 Act amended section 529 of the Companies Act 1956 to provide that the security of every secured creditor would be deemed subject to a *pari passu* charge in favour of 'workmen' for their 'dues', defined to mean the aggregate of *all* outstanding wages and salary, accrued holiday remuneration, compensation for death or disablement, and pension, gratuity and provident fund dues (whenever they arose). Secured creditors and 'workmen' would share proportionately in the security, as this illustration in section 529 explains:

> The value of the security of a secured creditor of a company is Rs. 1,00,000. The total amount of the workmen's dues is Rs. 1,00,000. The amount of the debts due from the company to its secured creditors is Rs. 3,00,000. The aggregate of the amount of workmen's dues and of the amounts of debts due to secured creditors is Rs. 4,00,000. The workmen's portion of the security is therefore, one-fourth of the value of the security, that is Rs. 25,000.

A secured creditor could not avoid the operation of the provision by choosing to stand outside the winding up: where they did so, the liquidator could enforce the charge against

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[111] Speech of Shri Veerendra Patil, introducing the Bill: *Lok Sabha Debates* (May 16 1985, Parliament Secretariat) 'Companies (Amendment) Bill', 327 (emphasis added).

[112] ibid.

the creditor on behalf of workmen[113]. The 1985 Act added a further section (s 529A) that provides that workmen dues and secured debt (to the extent compromised by section 529) are payable out of the assets of the company in priority to all other debts, the effect of which is to ensure that a secured creditor deprived of the full value of its security can look (together with workmen) to the company's general assets for satisfaction.

The 1985 change only applied to 'workmen'. For other kinds of employee, the old preferential debt rule – which afforded preference only to limited categories of debt (wage claims, for example, were limited to those due for a period not exceeding four months within 12 months of commencement of the winding-up), subject to a maximum amount per claimant – was retained[114]. Who are workmen? Section 529 defines workmen as 'employees of the company, being workmen within the meaning of the Industrial Disputes Act 1947'[115]. The definition of a workman in the Industrial Disputes Act 1947 ('IDA') is any person '*employed* in any industry [defined to include 'any business, trade, undertaking, manufacture or calling of employers'] to do any manual, unskilled, skilled, technical, operational, clerical and supervisory work for hire or reward', *excluding* any person employed 'mainly in a managerial or administrative capacity' or in a 'supervisory' capacity with a wage over 10,000 rupees per month[116]. The requirement that the person be 'employed' means that the person must be in a 'master-servant'

[113] Section 529(1)(c)(a), as added by s 4 of the 1985 Act. See further below n 192.

[114] Section 530, see in particular s 530(8)(bb), providing that for the purpose of the section ' "employees" does not include a workman', added by s 6 of the 1985 Act.

[115] Section 529(3)(a), added by s 4 of the 1985 Act.

[116] Section 2.

relationship with their putative employer[117], a requirement that excludes *inter alia* contractors. A secured creditor seeking to recover from an insolvent company will, therefore, be directly affected by the enhanced preferential debt rule introduced in 1985 only to the extent that the company is indebted to its non-managerial servants[118].

When the legislature introduced the 1985 exception, it appears to have had a particular category of worker in mind: those deployed in the organised manufacturing sector, which was at that time (as explored in Chapter 4[119]) plagued by the problem of 'industrial sickness'. The preferential debt amendment was made in the same year that another significant change was made to Indian corporate insolvency law: the introduction of a formal rescue procedure for 'sick industrial companies' (insolvent medium and large-scale factory manufacturers)[120] by the enactment of the Sick Industrial Companies (Special Provisions) Act 1985. In his budget speech for 1985-1986, the Minister for Finance expressly linked the two developments, identifying the preferential debt amendment as an additional response to industrial sickness:

> Workers are the worst victims of industrial sickness. Under the present law, however, when companies are wound up, workers' dues rank low in priority compared to secured creditors. To my mind, labour is as much a factor of production as any other and it is unjust that the workers' dues should have a lower priority. In order to rectify this situation, we have taken a decision to introduce the necessary legislation so that legitimate dues of workers rank *pari passu* with secured creditors such as banks in the event of closure of the Company[121].

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[117] *Dharangadhara Chemical Works v State of Saurashtra* AIR 1957 SC 264, [9], noted in Vithalbhai B Patel, *Law on Industrial Disputes* (3rd ed, Orient Law House 1984) 368, 380.

[118] There may also, however, be an indirect procedural effect: see below, n 192.

[119] See Chapter 4, text to n 50.

[120] See Chapter 6, Section 6.3.2.2.

[121] 'Speech of Shri Vishwanath Pratap Singh, Minister of Finance, introducing the budget for the year 1985-1986', [28] <http://indiabudget.nic.in/bspeech/bs198586.pdf> 31 August 2012.

On a plain reading, the effect of the 1985 amendment appears broader, since the definition of 'workmen' in the IDA (the trigger for the enhanced preferential debt rule) is not confined to employees in the organised manufacturing sector. In practice, however, it seems that the primary beneficiaries of the protection offered by the IDA to 'workmen' may be those employed in the (organised) manufacturing sector, with at least some parts of the (organised) services sector reportedly escaping the operation of the Act[122] [123] [124]. This result is consistent with the historically privileged position of sick industrial companies in Indian insolvency policy, discussed in Chapter 4[125]. It suggests that the effect of the 1985 amendments, though significant, ought not to be overstated.

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[122] The large IT sector (including outsourcing), for example, appears to escape the IDA through the use of lengthy probationary periods, during which the person is not characterised as an 'employee', and through various state-issued exemptions from the operation of the IDA: see Carolyn Penfold, 'Off-Shoring and Decent Work: Worlds Apart?' (2008) 24(4) *International Journal of Comparative Labour Law and Industrial Relations* 573, 583 and fn 45.

[123] It seems that the unorganised sector almost always escapes the operation of the IDA (together with many other labour laws: Sonja Fagernas, 'Labour Law, Judicial Efficiency and Informal Employment in India' (2010) 7(2) *Journal of Empirical Legal Studies* 282, 287). This may be in part because workers are not always 'employed', more often working in a variety of 'different modes of self-employment, unpaid family labour and wage work' (National Commission for Enterprises in the Unorganised Sector, *The Challenge of Employment in India: An Informal Economy Perspective* (Academic Foundation 2009) [2.18]). But it is also because the word 'industry' in the definition of 'workmen' in the IDA has been interpreted by the Supreme Court to exclude the unorganised sector: 'the whole purpose of the Industrial Disputes Act is to focus on the resolution of industrial disputes and regulation of industrial relations and not to meddle with every little carpenter in a village' (*Bangalore Water Supply and Sewerage Board v A Rajappa* AIR 1978 SC 548, [111], as noted in Patel (n 117)). The exclusion of the unorganised sector is not particularly relevant to assessing the impact of the 1985 preferential debt rule in liquidation, for the reason that unorganised firms are by definition (according to the National Commission for Enterprises in the Unorganised Sector, or NCEUS) unincorporated ([2.16]): that is, they fall outside the operation of the Companies Act 1956. The agricultural sector is also largely unorganised (NCEUS, [2.17]) and to that extent similarly outside the Companies Act 1956. It is populated 'almost entirely of informal workers who are mainly the self-employed (65 per cent) or the casual workers (35 per cent)', who would in any event escape the definition of 'workmen' in the IDA: NCEUS, [2.22].

[124] Though even in the manufacturing sector the use of 'contract labour' to circumvent regulation has reportedly become more common: Ahmad Ahsan and Carmen Pages, 'All all labor regulations equal? Assessing the effects of job security, labor dispute and contract labor laws in India' (World Bank Policy Research Working Paper 4259, June 2007) 6 < http://siteresources.worldbank.org/SOCIALPROTECTION/Resources/SP-Discussion-papers/Labor-Market-DP/0713.pdf> 31 August 2012.

[125] Text to n 50.

In 2002, an attempt was made to dramatically overhaul Indian company law with the enactment of the Companies (Second Amendment) Act 2002 (not yet notified for commencement). The 2002 Act was designed to shift adjudicatory responsibility in company law matters, including compulsory winding-up, from the state High Courts to a new tribunal, the National Company Law Tribunal ('NCLT'). The Act also included some amendments to the compulsory liquidation provisions of the Companies Act 1956, the most significant of which was a reversal of the Babha Committee's decision to close the private market for liquidators: under the Act, the Tribunal would be empowered to appoint a liquidator in a compulsory winding-up from a panel of accountants, lawyers and company secretaries[126]. But a challenge to the constitutionality of the NCLT stalled the notification of the commencement of the Act. By the time the Supreme Court resolved (by largely dismissing)[127] the challenge in 2008, the Act had been overtaken by a proposal for a new companies statute.

The latest proposals for reform are contained within the draft Companies Bill 2011. The compulsory liquidation provisions of Bill are notably similar to those in the Companies Act 1956, with the addition of the core changes made by the 2002 Act (the adjudication of liquidation cases by the NCLT rather than the courts, and the return of private compulsory liquidators[128]), together with the insertion of a new corporate

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[126] Companies (Second Amendment) Act 2002 s 63. The Act also provided for the abolition of winding-up subject to the supervision of the court: s 93. Some of these changes appear to have also been included in an earlier bill (the Companies Bill 1993, as noted in 'Report of the Committee on Industrial Sickness and Corporate Restructuring', extracted in Pahwa HPS, *Bharat's Sick Industries & BIFR* (8th ed, Bharat Law House 2009) Appendix 1, [5.6), but this bill appears to be unavailable for inspection.

[127] In the Supreme Court decision in *Union of India v R Gandhi* (2010) (3) CTC 517. The Supreme Court upheld the constitutionality of the proposal to transfer adjudicatory responsibility from the courts to a tribunal, but found some aspects of the specific NCLT proposal (relating to the qualifications and tenure of tribunal members) unconstitutional, and recommended amendments.

[128] Companies Bill 2011 cl 275.

insolvency procedure ('administration', available to all classes of corporate debtor) that would function as an alternative to immediate liquidation[129] or as an exit from liquidation[130]. The other amendments to compulsory liquidation are reasonably minor[131], with the result that the Bill would, if enacted, offer Indian companies and their creditors much the same compulsory liquidation procedure as that founded in the colonial period, but supervised by a new adjudicatory body with access to a wider class of liquidators. Voluntary liquidation may undergo a more radical change: the Bill does not appear to explicitly make provision for insolvent voluntary liquidation (a CVL), with the apparent result – on the Bill's present drafting – that insolvent liquidations would have to be compulsory ones[132]. It is not clear, however, if this is in fact the intention of the drafters[133].

3.2.2.2 United Kingdom

In the UK, the liquidation provisions of the Companies Act 1948 were left undisturbed until the mid-1970s. The Insolvency Act of 1976 made a small number of changes,

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[129] See Chapter XIX.

[130] See cl 289, which permits the tribunal to order a stay in liquidation of up to 180 days to enable the company to pursue a scheme under Chapter XIX of the Bill.

[131] They include: some changes to the grounds (other than inability to pay debts) on which a company can be wound up (see cl 271); a new court power to order the directors of the company to file a statement of company affairs after the filing of a petition but *before* the making of the order (cl 274, presumably motivated by evidence of directors' recalcitrance to provide liquidators with this information: see Chapter 4, text to n 128); a new time limit for the making of an order on a petition (cl 273, 90 days) and the filing of the initial report by the liquidator (cl 281, 60 days); a new requirement that the liquidator expressly report on the viability of the business and the steps necessary to maximise value of the assets (cl 281(3)); the removal of the requirement that the liquidator obtain approval for the exercise of certain powers (cl 290); the creation of a new 'winding up committee', constituted by a nominee of secured creditors, the liquidator, and a professional nominated by the tribunal, to monitor the liquidator (s 277(4)-(5)).

[132] See cls 305 and 306(3), though the drafting is ambiguous.

[133] See the explanatory notes, which do not refer to the abolition of creditors' voluntary liquidation, and identify the clauses of the new bill as corresponding to existing clauses in the Companies Act 1956.

including the addition of a new court power to disqualify directors involved in the collapse of more than one company, where their conduct rendered them 'unfit' to manage a company[134] [135]. In 1977, the Government announced a more ambitious reform program, appointing a committee to carry out a 'fundamental and exhaustive reappraisal of all aspects of the insolvency laws of England and Wales'[136], chaired by Sir Kenneth Cork. The Cork Committee was asked to consider, among other things, the 'possibility of formulating a comprehensive insolvency system and the extent to which existing procedures might, with advantage, be harmonised and integrated'[137].

In its 1982 report, the Cork Committee responded by recommending the formulation of a uniform procedure to govern 'every application by a creditor, whether the debtor be an individual or a company'[138], administered by a single insolvency court[139]. For corporate debtors, this procedure would differ in important ways from that historically employed for a creditor's petition for a winding-up order. Under the Cork Committee's proposal, the court would, as previously, receive a creditor's petition and fix a hearing date not less than 21 days later, ordering service of the particulars on the debtor. But it would not immediately order advertisement of the hearing; instead, the debtor would be invited to privately pay the debt or dispute its validity. In the interim, the procedure would not be yet be regarded as a collective one:

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134 Section 9; see also Cork Report (n 22) [99].

135 The 1976 Act also eased the regulatory burden of the Board of Trade in liquidation cases, replacing the rule requiring audit of liquidator accounts with one permitting audit where considered necessary: see s 2.

136 Cork Report (n 22) 1.

137 ibid [522].

138 ibid [538].

139 ibid Chapter 20.

> At the outset, we intend the proceedings to be strictly on a one-to-one basis, with no advertisement and no publicity, and with every encouragement to the debtor to obtain the dismissal of the proceedings by paying off the applicant. If he fails to do so then the proceedings will be advertised and continued on a collective basis in the presence of all those creditors who wish to attend. Only from this moment, when the proceedings become 'collectivised', will the debtor fall to be regarded as an insolvent[140].

Crucially, the debtor's failure to pay or to validly dispute the debt would not necessarily lead to the making of a winding-up order. In the Committee's view, the practice of automatically making a winding-up order on proof of inability to pay debts had led to the unnecessary expenditure of 'money, time and manpower to cases in which wrongdoing is not suspected'.[141]

Instead, the Cork procedure would reserve winding-up orders for the 'comparatively few serious cases'[142], with the court free to select (after the making of an initial 'Protection Order'[143], on the advice of creditors[144]) from a range of orders, including a simple striking-off of the company; the liquidation of assets ('speedy realization of the insolvent asset's and distribution of the proceeds', without full investigation into the company's affairs)[145]; the making of a compulsory winding-up order (where investigation was required); the sanctioning of a 'voluntary arrangement'; and the

140 ibid [528].

141 ibid [626].

142 ibid [147].

143 An order making the official receiver the provisional liquidator, responsible for convening a meeting of creditors/contributories to determine which order to recommend. The protection order would also impose a stay on proceedings against the company, and require directors to provide a statement of affairs to the liquidator: [637], [640-641]. A protection order would ordinarily be made unless the debtor had an answer to the creditor's application: [633].

144 ibid [641].

145 ibid [647], [585].

appointment of an 'administrator'[146]. The 'voluntary arrangement' would be a new procedure, modeled on the voluntary arrangement in personal bankruptcy law, designed to enable (as an alternative to the complex scheme of arrangement) a compromise with creditors[147]. An 'administrator' would be a new court-appointed officer invested with all the powers of a receiver and manager appointed under a floating charge[148], and responsible for determining the viability of the company and (where in the interests of creditors and other stakeholders[149]) pursuing its rehabilitation[150] with the benefit of a moratorium. In cases where a floating charge holder was entitled to appoint a receiver and manager over the company's property, they would retain the right to do so (and in so doing preclude the appointment of an administrator[151])[152].

In addition to these proposals for structural reform, the Committee also recommended a series of supplementary changes. The Committee proposed heightened regulation of insolvency practitioners[153]; the introduction of an enhanced avoidance power for dispositions of company property made in the lead-up to the commencement

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146 ibid [627].

147 ibid [419]-[422].

148 Including the power to carry on the business of the company: ibid [498].

149 An administrator would not be appointed unless there was a reasonable possibility of a scheme for reconstruction or reorganisation, and the interests of creditors, shareholders, employees and others would be better served by an administration than liquidation or another procedure: ibid [506]. The Committee did not consider the rescue of a company valuable *per se* ('society has no interest in the preservation or rehabilitation of a company as such, though it may have a legitimate concern in the preservation of the commercial enterprise': [193]) but it was concerned that the existing law had sometimes forced 'potentially viable businesses capable of being rescued' into being closed down: [496].

150 ibid [498].

151 ibid [504].

152 Though the Committee did recommend clarifying the rights and duties of such receivers: ibid Chapter 8.

153 Including a rule disqualifying some persons from acting as IPs (ibid [744]), the introduction of minimum professional qualifications to act as an IP [756]-[758], the circumscribing of IP duties by statute ([788]).

of liquidation proceedings for less than full value, whether or not fraudulently[154]; the abolition of most categories of preferential debt for both the Crown[155] and for employees[156], the Committee taking the view that the enactment of other statutes for the protection of employees had rendered the preferential debt regime redundant[157]; a new rule requiring 10% of the net assets subject to a floating charge to be made available to unsecured creditors (in recognition of the fact that the abolition of preferential debts would typically benefit only the floating charge holder[158]); and heightened scrutiny of the conduct of directors of insolvent and near insolvent companies, through *inter alia* new liability for those engaged in 'wrongful trading' (a supplement to fraudulent trading)[159], and a stronger director disqualification regime[160]. In the program of legislative reform that followed, it was mostly these recommendations – rather than the proposals for structural reform – that were given effect.

The Insolvency Act 1985 (later incorporated into the consolidating Insolvency Act 1986) did give effect to two of the Cork Committee's proposals for structural

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[154] ibid [1231].

[155] ibid [1450].

[156] ibid [1433], provided that the limits of protection under the other employee protection statutes would be raised wherever offering lower than that which would have been given under the preference rule.

[157] 'The preferential treatment of employees in an insolvency in respect of their claims for unpaid wages was originally a social measure. It was introduced in an effort to ease the financial hardship caused to a relatively poor and defenceless section of the community… Since then, the position of wage earners has been greatly improved by the introduction of unemployment pay and other… benefits': ibid [1428].

[158] ibid [1488]-[1490].

[159] The fraudulent trading provision was not engaged by a director acting honestly but unreasonably (ibid [399]). The wrongful trading provision would target the incurring of liabilities with no reasonable prospect of repayment, making those who knew or ought to have known this personally liable: [1783].

[160] ibid Chapter 45.

reform. The Act introduced a new insolvency procedure – 'administration'[161] – available on court order (given evidence of the order being likely to achieve one or more prescribed purposes[162]) for insolvent[163] companies not already in liquidation. The administrator was empowered to pursue the rescue of the company[164] or of its business, and to manage the company in the interim (under the protection of a moratorium on creditor action). As the Committee recommended, the Act also featured various new provisions regulating the powers and duties of receivers and managers appointed over the whole (or substantially the whole) of the company's property by the holder of a floating charge, rebranded under the Act as 'administrative receivers'[165]. The appointment of an administrative receiver by a floating charge holder would preclude entry into administration[166].

The Insolvency Acts of 1985 and 1986 brought into one statute, for the first time, the provisions governing the treatment of insolvent individuals and those governing the treatment of insolvent companies. But the legislature stopped well short of the Cork Committee's most ambitious project: the development of a unified procedure to govern the treatment of both classes of debtors, in which the making of a

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161 Insolvency Act 1986, Part II.

162 Section 8(1)(a). The prescribed purposes were (a) the survival of the company, and the whole or any part of its undertaking, as a going concern, (b) the approval of a voluntary arrangement, (c) the sanctioning of a scheme of arrangement, (d) a more advantageous realisation of the company's assets than in winding-up. Later, these purposes were revised and organised into a hierarchy by the Enterprise Act 2002 (see below n 175).

163 Or companies likely to become insolvent ('the company is or is likely to become unable to pay its debts): s 8(1)(a).

164 Including by use of the newly introduced 'voluntary arrangement', as recommended by the Cork Committee: see above text to n 147 and Part I of the Insolvency Act 1986.

165 Part III, Chapter I of the Insolvency Act 1986.

166 Insolvency Act 1986 s 9(2)-(3).

winding-up or bankruptcy order would be reserved only for the most serious of cases. Bankruptcy procedure was substantially revised[167], but the company liquidation procedure was essentially preserved[168]. The Cork Committee's supplementary recommendations were simply grafted onto the existing liquidation framework: the liquidation provisions of the 1948 Act were parachuted into the Insolvency Act 1986, reformers simply adding new rules for the regulation of liquidators (and other insolvency practitioners)[169], the avoidance of transactions made at undervalue in the lead-up to liquidation[170], the liability of directors and others engaged in wrongful trading[171], the disqualification of company directors considered unfit to take part in the management of other companies[172], and the revision of preferential debts (by removing Crown preference[173]). A small number of other minor amendments were made, including two that had already been made in India (the dilution of the requirement that the official receiver always summon a meeting of creditors at the outset in a compulsory winding-up, and the introduction of an early dissolution power for official receivers faced with insufficient assets to meet the costs of liquidation)[174].

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[167] Stephen Schaw Miller and Edward Bailey, *Personal Insolvency: Law and Practice* (4th ed, LexisNexis 2008) [1.2].

[168] With the exception of the absence of winding-up subject to the supervision of the court, which the Cork Committee had recommended be abolished: ibid n 27; Insolvency Act 1985 s 88.

[169] Part XIII of the Insolvency Act 1986.

[170] Insolvency Act 1986 s 339.

[171] Insolvency Act 1986 s 214.

[172] Part II, Chapter 1 of the Insolvency Act 1985, migrated to Company Directors Disqualification Act 1986.

[173] Insolvency Act 1986 ss 175, 386.

[174] Insolvency Act 1986 ss 136 and 141; Insolvency Act 1986 s 202. The other noteworthy change was the removal of the requirement that a public examination be preceded by a report from the official receiver alleging fraud (Insolvency Act 1986 s 133, *cf* Companies Act 1948 s 270).

PART I: COMPANY LIQUIDATION

Since 1986, there have been several significant changes to the provisions of the Insolvency Act relating to corporate debtors, though few relate directly to company liquidation. The most significant changes were effected by the Enterprise Act 2002, which abolished the institution of administrative receivership, and made a number of important amendments to the administration procedure[175]. One effect of the introduction and revision of the administration procedure has been to increase the number of 'exit routes' available to an insolvent company, widening the alternatives to formal liquidation (it is now possible, for example, to move directly from administration to dissolution[176]). The liquidation procedure itself has seen little change since 1986, with the most significant amendments being the abolition of residual categories of Crown debt and the establishment of a 'ring-fenced fund' for unsecured creditors out of floating charge assets[177], and the reversal of a House of Lords decision[178] that assets subject to a floating charge could not be applied to meet liquidation expenses[179]. Apart from these changes, the statutory provisions governing company liquidation have remained in much the same form as they initially appeared in 1986, then mainly borrowed from the Companies Act 1948. The decision to reject the most ambitious of the Cork Committee's proposals has meant that the Committee's observation that the liquidation

[175] Including the insertion of a revised hierarchy of statutory purposes (Insolvency Act 1986 sch B1, s 3); see Goode (n 15) [11-05].

[176] Goode (n 15) [11-115].

[177] By the insertion of section 176A, added by s 252 of the Enterprise Act 2002; see Goode (n 15) [6-38].

[178] *Buchler v Talbot* [2004] 2 AC 298.

[179] By the insertion of s 176ZA of the Insolvency Act 1986; see further Goode (n 15) [8-32].

law of England and Wales has remained intact, with only 'minor modifications', since the Victorian era[180] remains apt today.

3.2.3 The relative position of creditors today under UK and Indian liquidation law 'on the books'

A review of successive companies statutes over time in India and the UK reveals the remarkable stability of the company liquidation procedure established in Victorian England and transplanted to British India. In the colonial period, Indian liquidation law perhaps unsurprisingly followed, almost 'slavishly'[181], developments in English liquidation law. In the post-independence period, deference to the English position diminished over time, resulting in some amendments being made unilaterally in each jurisdiction in the last three decades. These amendments mean that it is no longer possible to assert that the law of liquidation in India and the UK is virtually identical. But a review of developments in each jurisdiction also reveals that neither jurisdiction has disturbed the core features of the liquidation procedure established in the historical (colonial) period, as they might be expected to be perceived by an unsecured creditor.

In the paradigm case of an unsecured creditor seeking to wind up a corporate debtor, both jurisdictions permit the creditor to petition the court for a compulsory winding up order to be made on the basis that the company is insolvent, without demonstrating that the debtor's liabilities exceed its assets in any global sense (that is, without demonstrating balance sheet insolvency): instead, the debtor's failure to pay a

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[180] (n 22) [27].

[181] McQueen, 'The Flowers of Progress' (n 12) 400.

single debt on demand 'deems' it insolvent[182]. This feature means that the procedure is capable of serving a debt-enforcement function in the absence of cheaper enforcement alternatives; indeed, the Cork Committee considered debt enforcement to be one of three core functions served by English liquidation law:

> The insolvency laws are treated by the trading community as an important instrument in the process of debt recovery; the threat or imminence of insolvency proceedings as a weapon in persuading a defaulting debtor to pay or make proposals for the settlement of a debt cannot be underestimated as it constitutes, in the majority of cases, the sanction of last resort for the enforcement of obligations[183].

Both jurisdictions entrust the conduct of compulsory liquidation to an independent liquidator, subject to court control[184]. The liquidator is responsible for property collection and distribution, but also for investigating the company's affairs (the other two core functions identified by the Cork Committee)[185]. Powers ancillary to these functions include the ability to apply for the reversal of certain transactions entered into by the company prior to its liquidation, or for directors to be made personally liable for company debts and/or disqualified from directorship[186]. Both jurisdictions offer protection against the attempts of other creditors to circumvent the procedure: the procedure is collective, prohibiting the continuation of proceedings and enforcement against company property after the commencement of winding up. (Both jurisdictions

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182 Companies Act 1956 ss 433, 434; Insolvency Act 1986 ss 122 and 123 (provided the debt exceeds INR500 or £750 pounds respectively). The interpretation of these important sections by the Indian courts is considered in Chapter 5.

183 (n 22) [235](a).

184 Companies Act 1956 s 458; Insolvency Act 1986 s 167.

185 (n 22) [235].

186 Though the avenues for liability and for disqualification are fewer in India.

also, perhaps paradoxically[187], reward the diligent creditor who succeeds in recovering from a debtor prior to its liquidation, restricting the liquidator's power to recover such payments to those made with an intention to prefer the creditor[188].) Both jurisdictions also largely exempt secured creditors from this collective regime, permitting them to 'stand outside' a winding-up and instead look to the security[189], though it should be conceded that the position of the Indian secured creditor was historically weakened by the restrictive enforcement rules in Indian property law[190], and compromised further by the preferential debt rule change in 1985, both substantially (to the extent that debts are owed by the company to 'workmen'[191]) and procedurally[192]. Finally, both jurisdictions

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[187] The position taken by most commentators writing on English insolvency law, the intention element said to be inconsistent with the *pari passu* rationale: see Goode (n 15) [13-144].

[188] Companies Act 1956 s 531, importing the intention test from the Provincial Insolvency Act 1920 s 54; Insolvency Act 1986 s 239 (slightly differently formulated, but an intention-based test: see Goode (n 15) from [13-71]).

[189] *Ranganathan* (n 59); *Food Controller v Cork* (n 56).

[190] *Ranganathan* adopted the English position that a secured creditor was free to deploy any available out-of-court enforcement right against a debtor in liquidation, but Indian property law was historically antagonistic to the creation of such rights. Under the Transfer of Property Act 1882, all but one form of mortgage (the English mortgage, reportedly unattractive to creditors for stamp duty reasons) requires mortgagees to approach a court to effect a sale of mortgaged property on default: VP Sarathi, *Law of Transfer of Property* (5th ed, Eastern Book Company 2007) 154-166. The overall effect was that a secured creditor would need to pursue a debtor-in-liquidation in the civil courts, after obtaining the leave of the winding-up court (under s 446, ordinarily given: *Ranganathan*, n 59 above), but this process could be a slow one. Eventually, delays in the civil courts led to the establishment of debt recovery tribunals for institutional creditors (under the Recovery of Debts Due to Banks and Financial Institutions Act 1993), and the introduction of new out-of-court enforcement rights for secured institutional creditors (under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act 2002, 'SARFAESI', s 13). But the 1985 amendment rule may have compromised the exercise of the SARFAESI out-of-court enforcement right in liquidation (see below n 192).

[191] See above, text to n 114.

[192] In *International Coach Builders Ltd v Karnataka State Financial Corp* AIR 2003 SC 2012 (noted in YV Chandrachud, *Ramaiya Guide to the Companies Act* (16th ed, Wadhwa & Co 2004) 4164-4165) the apex court held that the 1985 preferential debt change meant that a secured creditor could not enforce its out-of-court enforcement right under the State Financial Corporations Act 1951 without seeking the leave of the court and associating the company liquidator (as the workers' representative) with the sale. The 1985 preferential debt amendment had brought about a 'qualitative change in the legal situation', as stated in *Ranganathan* (n 59) [15]. The decision could be applied to preclude the exercise of out-of-court enforcement rights under SARFAESI without the involvement of the liquidator, the result reached in *Pegasus Asset Reconstruction P Ltd v Haryana Concast Ltd* [2009] 152 CompCas 215 (Punjab & Haryana), but the opposite result was reached in

presently offer debtors an alternative to this court-controlled process: voluntary liquidation, subject (in insolvency) to creditor control.

Many of the differences that emerged between the two jurisdictions after colonial independence were ones of degree. The UK, for example, widened the range of avoidance powers available to a liquidator (adding the undervalue avoidance provision) and the sources of liability for directors (by the addition of a wrongful trading provision) and significantly expanded the director disqualification regime, while India made fewer revisions in these areas[193]. Both jurisdictions made inroads on the position of secured creditors, but with different points of emphasis: the UK revisions eroded the position of floating charge holders vis-à-vis unsecured creditors, while India's preferential debt change targeted the relationship between all secured creditors and a particular class of worker. There is, however, one area of more fundamental difference: the allocation of administrative burden in compulsory liquidation. The UK shares responsibility between superior and inferior courts[194], between court registrars and judges[195], and between private liquidators (subject to greater regulation since 1986) and court-attached official receivers. By comparison, the present Indian system (unless and until reformed by the

The Akola Oil Industries v State Bank of India 2005 (5) BomCR 706 (Bombay). In *Cybersys Infotech Ltd v District Magistrate* [2011] 163 CompCas 442 a judge of the High Court of Punjab & Haryana held that the question was undecided, without reference to *Pegasus*.

193 Adding only the avoidance rule for voluntary transfers (see above text to n 108).

194 Insolvency Act 1986 s 117.

195 Under the current practice direction (Ministry of Justice, *Practice Direction: Insolvency Proceedings* <www.justice.gov.uk/guidance/courts-and-tribunals/courts/procedure-rules/civil/contents/practice_directions/insolvency_pd.htm> (31 August 2012)) a winding-up order may be made by either a registrar or a judge (though the hearing must be in public): see [5.1]-[5.3]. There are applications that can only be heard by a judge (including an application for urgent interim relief, an application to restrain presentation or advertisement of a petition, and an application for the appointment of a provisional liquidator: [5.1]). Conversely, other orders can be made not only made by registrars, but also by court managers to whom the registrar delegates responsibility: [5.4]. See generally Derek French, *Applications to Wind Up Companies* (2nd ed, OUP 2008) [1.13].

enactment of the Companies Bill 2011[196]) makes superior courts exclusively responsible for company liquidation, gives far less responsibility to registrars[197] (a judge is involved even at the initial stage of admission of the petition)[198], and restricts the market for liquidators to court-attached, government-employed official liquidators. One important question raised by the existing literature is whether this difference can help to explain the extraordinary 'failure' of Indian liquidation law in practice – a law that today remains remarkably similar 'on the books' to English liquidation law, but functions entirely differently. This question is taken up again in the next chapter, which begins the inquiry into the failure of liquidation law in post-independence India.

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[196] See above, text to n 128.

[197] In contrast to the UK court rules, the Indian Companies (Court) Rules 1959 do not provide for registrars to make a winding-up order.

[198] Under the Companies (Court) Rules 1959 a petition for winding-up must go to a judge for its *admission* (see Companies (Court) Rules, Part III, 'Winding up petition and its hearing') a matter that would be dealt with in the UK by filing through the court registry: see Chapter 5, Section 5.2.1.

CHAPTER 4

THE FAILURE OF INDIA'S COMPANY LIQUIDATION PROCEDURE

It is virtually impossible to liquidate and wind up an unviable firm.

(Goswami Committee Report, 1993)

Barriers to entry have fallen [since economic liberalisation], but not to exit. Laws for bankruptcy and liquidation remain largely unworkable.

(Mukherji, 'India's long march to capitalism', 2007)

India's company liquidation procedure has been widely condemned as dysfunctional, as a 'failure'. This chapter is the first of two exploring the law's failure. The chapter begins by exploring the evidence of the operation of Indian liquidation law in practice, documenting the complaints (mostly focused on delays) that are typically made of the law's functionality. It then turns to consider previously unreported statistical evidence of the rate of company liquidations over time, evidence that suggests the near extinction of the procedures in India's modern market economy. The remainder of the chapter, together with the next, is devoted to considering why it is that India's liquidation procedure came to function as it did – why it came to 'fail'. In this chapter, the focus is primarily on explanations offered up by the existing literature; in the next, new evidence of the role of the courts in compulsory liquidation is considered, making the case for the formulation of a more court-centred explanation for the operation of Indian liquidation law.

4.1 The operation of India's liquidation procedure

4.1.1. Popular complaints: the evidence of the law's 'failure'

By far the most common complaint made of India's company liquidation procedure is a generalised allegation of delay: 'the winding up process is a long drawn out affair and before a company is finally dissolved with the sanction of the court, it takes years…'[1]. Although the consensus is that delays are extreme, actual data on the average duration of proceedings is difficult to obtain. For the market economy period, one measure of delay occasionally relied upon by critics is that reported by the World Bank in its *Doing Business* 'Resolving Insolvency' ranking, against which India has always fared poorly:

> The area of the *Ease of Doing Business* index where India fares worst is undoubtedly that of closing a business. India has the dubious distinction of being among the countries where it takes the *longest time to go through bankruptcy in the world* (10 years on average)[2].

The 'Resolving insolvency' ranking is not determined by reference to firm-level data (instead, it draws on responses by local participants to a survey positing a hypothetical bankruptcy scenario[3]), and its measure of time taken is not of the duration of a bankruptcy procedure, but of the estimated time it would take for a dominant secured

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[1] 'Report of the High Level Committee on Law Relating to Insolvency and Winding up of Companies' (the 'Eradi Committee Report') (31 July 2000), extracted in Mittal DP, *Taxmann's New Law Relating to Sick Industries* (Taxmann 2003), Appendix 6, [3.3]; see also TCA Anant and NL Mitra, 'The Role of Law and Legal Institutions in Asian Economic Development: The Case of India; Patterns of Change in the Legal System and Socio-Economy' (Harvard Institute for International Development Discussion Paper, November 1998) 33, 67, 69 <www.cid.harvard.edu/hiid/662.pdf> 30 August 2012; Sumant Batra, 'The Asian Recovery: Progress and Pitfalls' (Global Forum on Insolvency Risk Management, Washington DC, 2003) 23 <http://siteresources.worldbank.org/GILD/ConferenceMaterial/20157508/Batra%20-%20India%20-%20FINAL.pdf> accessed 20 August 2012; Sumant Batra, 'Proposals for Reform – The Indian Position' (Second Forum for Asian Insolvency Reform, Bangkok 2002) 11 <www.sumantbatra.com/pdf/papers/2nd_forum.pdf> 30 August 2012; MR Umarji, 'Trends and Developments in Insolvency Systems and Risk Management: The Experience of India' in MR Umarji, *Thoughts on Banking Sector Reforms* (Indian Banks' Association 2008) 159; 'Report of the Committee on Industrial Sickness and Corporate Restructuring' (the 'Goswami Committee Report'), extracted in Pahwa HPS, *Bharat's Sick Industries & BIFR* (8th ed, Bharat Law House 2009) Appendix 1 [5.6.2].

[2] Rajesh Chakrabarti and Sankar De (eds), 'Introduction', *Capital Markets in India* (SAGE Publications 2010) 28; see also Report of the Committee on Financial Sector Reforms, *A Hundred Small Steps* (Sage Publications 2009) 152; Sumant Batra, 'Insolvency Laws in South Asia: Recent Trends and Developments' (Fifth Forum for Asian Insolvency Reform, Beijing 2006) 6 <www.oecd.org/dataoecd/42/14/38184124.pdf> 10 May 2012.

[3] A financially distressed hotel, the scenario developed by Simeon Djankov and others in 'Debt Enforcement Around the World', (2008) 116(6) *Journal of Political Economy* 1105, though that survey excluded India).

institutional creditor of the hypothetical debtor to recover some of its debt[4]. Nevertheless, the time reported for India (in the 2012 report, 7 years)[5] clearly suggests a very poor perception of the average duration of proceedings by local stakeholders.

More direct evidence is provided by two firm-level studies of compulsory liquidation in the 1990s, both of which point to dramatic delays. The first[6], reported in 1993, analysed 1,857 firms in compulsory liquidation in 14 jurisdictions, and found 58% to have been in liquidation for more than 10 years; the second[7] analysed 3,195 firms in compulsory liquidation in 1999, finding 52% to have been in liquidation for the same period of time (an extraordinary 15% had been in liquidation for more than 25 years):

Table 1: Age-analysis of firms in liquidation in 14 states, published in 1993

	0-10 years	10-20 years	20-30 years	30-40 years	40-50 years	50 years +	(Total surveyed)
No. firms	774	506	346	184	44	3	(1,857)
As % of total	42%	27%	19%	10%	2%	(less than 1%)	

Source: author summary of data in A Mathur, 'Industrial Restructuring in India and National Renewal Fund', Table 3.2 (date on which firms were observed was not reported)

4 Whether by foreclosure, liquidation or reorganisation proceedings: 'Resolving Insolvency Methodology', <www.doingbusiness.org/methodology/resolving-insolvency> 1 May 2012. (It is not clear which proceeding is assumed applicable in India, although the absence of a formal rescue procedure for non-industrial firms probably means that respondents assume liquidation proceedings, the interpretation adopted by Batra in his analysis of the results in 'Insolvency Laws in South Asia' (n 2) Table 3).

5 'Resolving Insolvency' <www.doingbusiness.org/data/exploretopics/resolving-insolvency> 1 May 2012.

6 A Mathur, 'Industrial Restructuring in India and the National Renewal Fund' (Report for the Asian Development Bank, January 1993) <www2.adb.org/Documents/Reports/Consultant/26331-IND/26331-IND-TACR.pdf> 27 August 2012, also extracted in the Goswami Committee Report (n 1) [5.6.2].

7 Eradi Committee Report (n 1) Table 1.

Table 2: Age-analysis of firms in liquidation, as at 31 December 1999

	0-5 years	5-10 years	10-15 years	15-20 years	20-25 years	25 years +	(Total surveyed)
No. firms	1065	603	482	321	251	473	(3195)
As % of total	33%	19%	15%	10%	8%	15%	

Source: author summary of data reported in Eradi Committee Report, Table I.

There is less information available for the planned economy period, but anecdotal evidence suggests that the Central Government has always been troubled to some extent by delays in liquidation. Reports on the early years of the operation of the Companies Act 1956 include several references to the problem of delay[8], an observation reiterated by the Sachar Committee in its 1978 report on the operation of the Act[9]. It is not possible to determine from these reports whether delays have always been as severe as those reported for the 1990s, but one age-analysis of firms in liquidation in 1964 and 1965[10] suggests perhaps not, pointing to a slightly younger average liquidation age profile (with 75% under 10 years old):

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[8] See the *Second Annual Report on the Working and Administration of the Companies Act 1956* (Department of Company Law Administration 1959) 51-52 (although the report suggests that most 'long pending' liquidations had been filed under the provisions of the Indian Companies Act 1913, without the benefit of the changes introduced in 1956); *Eighth Annual Report on the Working and Administration of the Companies Act 1956* (Department of Company Affairs 1964) 25, observing the 'slow progress' of compulsory liquidations; *Tenth Annual Report on the Working and Administration of the Companies Act 1956* (Department of Company Affairs 1966) 42-43, reporting 'slight improvement' in delays in compulsory liquidation; *Eleventh Annual Report on the Working and Administration of the Companies Act 1956* (Department of Company Affairs 1967) 43, reporting delays in voluntary liquidation.

[9] Committee on the Companies and MRTP Acts, *Report of the High-Powered Expert Committee on the Companies and MRTP Acts* (the 'Sachar Committee Report') (Ministry of Law, Justice and Company Affairs 1978) [15.6], reporting (in language later borrowed by the Eradi Committee, noted above text to n 1) that 'the winding up process is a long drawn affair and before the companies are finally wound up, it takes years'.

[10] Contained in the *Ninth Annual Report on the Working and Administration of the Companies Act 1956* (Department of Company Affairs 1965), Table XXI.

Table 3: Age-analysis of firms in liquidation as at 31 March 1964 and 31 March 1965

	0-5 years	5-10 years	10-15 years	15 years +	(Total)
No. firms, as at 31 March 1964	1134	946	501	147	(2,728)
As % of total	42%	35%	18%	5%	
No. firms, as at 31 March 1965	1089	916	457	213	(2675)
As % of total	41%	34%	17%	8%	

Source: author compilation of data contained in *Ninth Annual Report on the Working and Administration of the Companies Act*, Table XXI.

Note: includes liquidations commenced under earlier company statutes as well as those under the 1956 Act.

Critics also complain of a series of consequences alleged to flow from extreme delays in liquidation. Delay in the sale of company assets by liquidators (one paper reporting an average of five to seven years before sale) [11] are unsurprisingly said to reduce the value of the corporate estate[12] and, as a corollary, to diminish returns to creditors[13]. The complaint of diminished returns is sometimes substantiated by reference to the *Doing Business* report, which includes in its 'Resolving Insolvency' ranking a measure of 'recovery rates'. Although (as noted above) this measure is only an estimate given in response to a hypothetical bankruptcy scenario, the results suggest an extraordinarily poor perception of creditor recovery rates in India, and contrast sharply with the perceived position in the UK: in 2012, India's expected 'recovery rate' was 20.1 cents on

[11] Anant and Mitra (n 1) 69.

[12] 'The process of liquidation and winding up is costly, inordinately lengthy and results in an almost complete erosion of asset value': Expert Committee on Company Law, 'Report on Company Law' (the 'Irani Committee Report') (31 May 2005) Chapter XIII, [3] <www.acga-asia.org/public/files/JJ%20Irani%20Report.pdf > 27 August 2012.

[13] Batra, 'Insolvency Laws in South Asia' (n 2) 6.

the dollar, while the UK's was 88.6 cents on the dollar[14]. Unsurprisingly, delay and its attendant consequences are also said to have reduced the attractiveness of liquidation procedure as a debt enforcement device:

> [I]n regard to the winding up proceedings against any company registered under the Companies Act, 1956, on account of rigid system of sale of assets of the company by the official liquidator appointed by the court, the delays are more pronounced. As a result of inordinate delays the lenders do not consider proceeding for insolvency as a viable mode for recovery of defaulted loans[15].

In contrast, the English liquidation procedure - a procedure that remains, as Chapter 3 explained, remarkably similar to India's 'on the books' – reportedly remains attractive to creditors as a disciplinary device: '[V]ery often this [the hope of inducing the company to pay the debt] is precisely the reason why the petition is launched'[16].

Some critics go further, exploring the macro-economic consequences of the law's failure to deliver value-maximisation *ex post* in firm liquidations. They point to the social cost arising from the 'hold-up' of assets in liquidation proceedings, preventing their redeployment elsewhere: 'the system prevents the reallocation of assets to their best use, and greatly wastes asset values of impaired debtors, to the detriment of the economy'[17]. A recent government-commissioned report on financial sector reform also explicitly connects delays in liquidation and other failings in India's 'credit infrastructure' with the cost of credit: 'these infirmities do impair the flow of credit'[18]. This shift in focus to *ex ante* effects is consistent with a broader shift in emphasis in bankruptcy theory,

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[14] (n 5).

[15] Umarji (n 1) 159.

[16] See Roy Goode, *Principles of Corporate Insolvency Law* (4th ed, Sweet & Maxwell 2011) [5-12]. See also Chapter 5, Section 5.2.2.

[17] *A Hundred Small Steps* (n 2) 152; Batra, 'Insolvency Laws in South Asia' (n 2) 6.

[18] *A Hundred Small Steps* (n 2) 152.

documented by Schwartz in 'A Normative Theory of Business Bankruptcy'[19], from *ex post* value maximisation to the *ex ante* effects of bankruptcy law and practice on the cost of capital.

4.1.2. Statistical evidence of the rate of company liquidations over time

Literature on the operation of India's liquidation procedure is surprisingly sparse; most critics simply condemn the law as dysfunctional, substantiating their critique (if at all) by making brief reference to the problem of delays and associated harms to creditors. (In contrast, the operation of India's rescue procedure for industrial companies, considered in Part II of this thesis, has attracted significantly more attention). There appears to have been little analysis of the impact of the law's perceived failings on recourse to the liquidation procedure, with the exception of Umarji's report (noted above)[20] of the diminished attractiveness of compulsory liquidation as a disciplinary device, and this additional observation by Batra:

> The key features of a sound insolvency system are absent [in India, and in neighbours Pakistan, Bangladesh, Sri Lanka and Nepal), and no material aspects of the law and process are observed…The absence of effective tools and instruments to supervise and manage the insolvency process *renders the liquidation process an insignificant part of market dynamics*[21].

Some data is however available on the rate of company liquidations in India over time. Since the enactment of the Companies Act 1956, the Central Government has published an annual report on the operation of the Act that includes descriptive statistics on the number of company registrations and liquidations (both solvent and insolvent)

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[19] [2005] 91 *Virginia Law Review* 1199.

[20] Text to n 15.

[21] 'Insolvency Laws in South Asia' (n 2) 6.

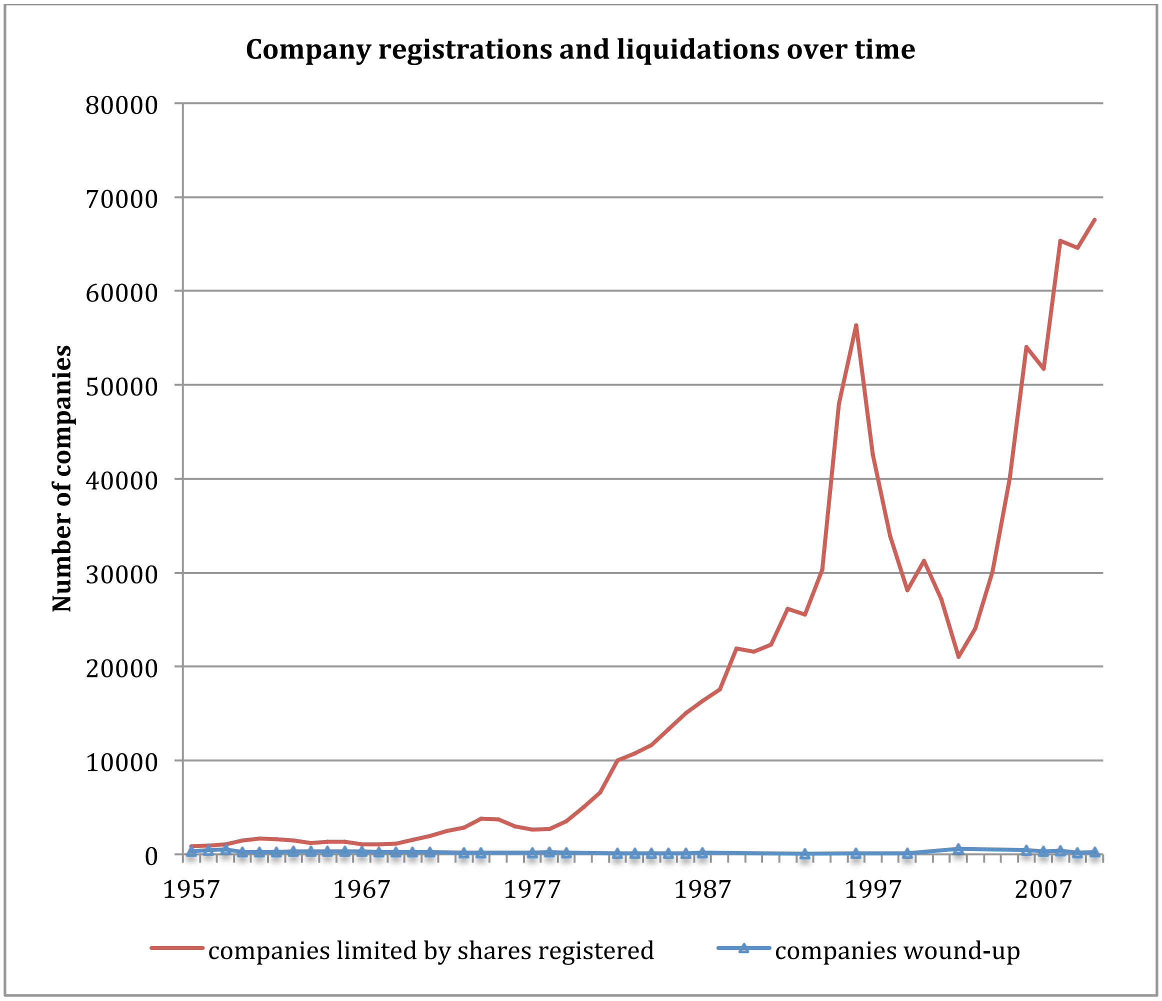
each financial year[22]. The full series of the report is difficult to obtain, but enough volumes are available to give a reasonably clear picture of trends in both the planned and market economy periods. Other government reports on the corporate population in India, published in various series, provide some supplementary information[23]. The available data (set out in Appendix I and depicted graphically in Chart 1 below) suggest a striking decline in company liquidations over time relative to company registrations. Contrast, for example, the fourth year of the commencement of the Act (1959-1960) with the year 2009-2010: in the year ending 31 March 1960, 1,452 companies limited by shares were registered, and 264 wound-up; in the year 31 March 2010, 67,570 companies limited by shares were registered, and 225 wound-up.

(turn to next page)

22 The *Annual Report on the Working and Administration of the Companies Act 1956*.

23 Including *Joint Stock Companies in India*, *Alphabetical List of Joint Stock Companies in India*, and *Registration and Liquidation of Joint Stock Companies in India*.

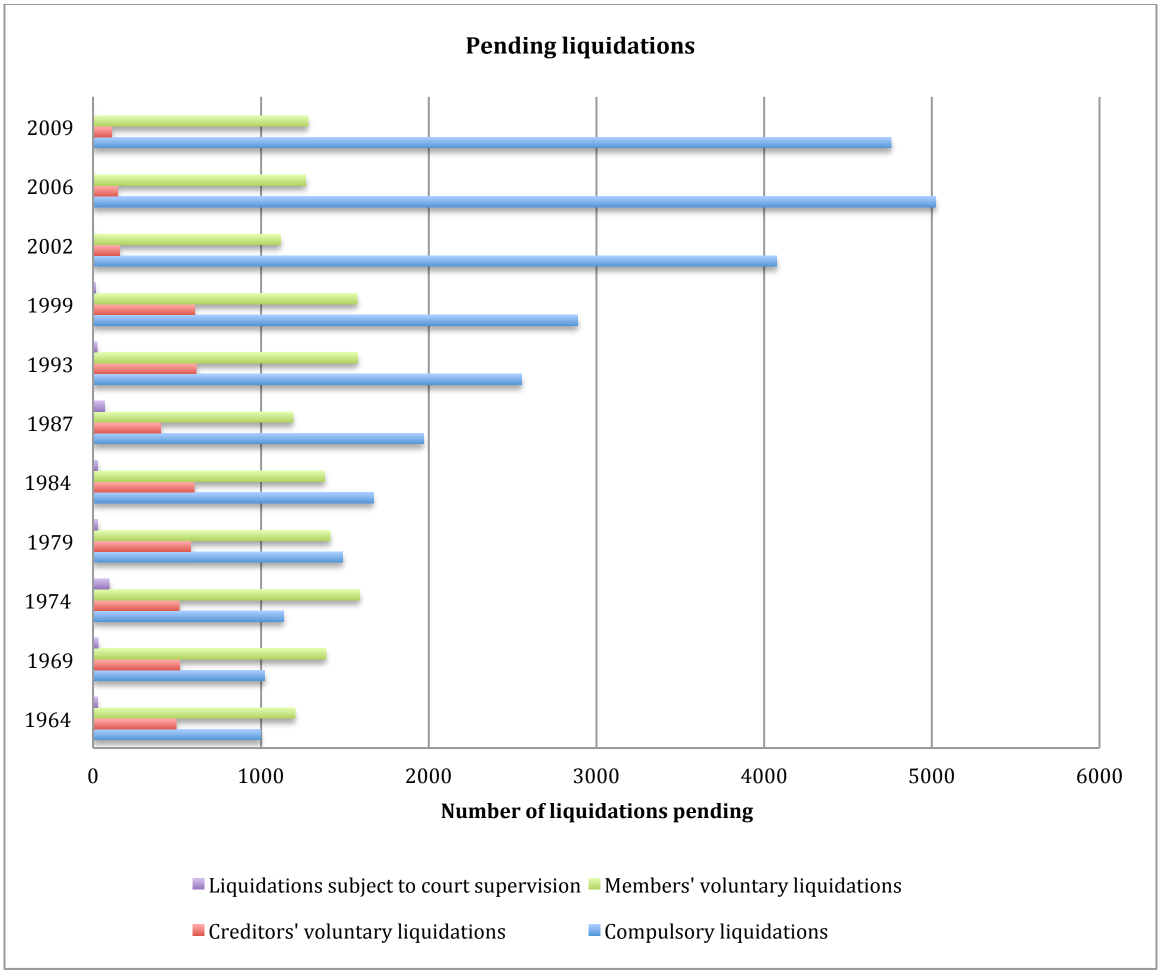
Chart 1:



Source: various publications identified in Appendix I, including editions of the *Annual Report on the Working and Administration of the Companies Act 1956*
Note: markers in the series 'companies wound-up' represent years for which the number of liquidations is known (no data available for years without markers).

The measure of 'companies wound-up' in Chart 1 includes both insolvent and solvent liquidations (that is members' voluntary liquidations, and compulsory liquidations ordered other than on the basis of a company's inability to pay its debts). The annual reports do however also provide some information about the number of firms in each type of procedure as at the end of each reporting year. This data is set out in Appendix I, and depicted (in summary form) in Chart 2 below. It suggests that compulsory liquidations have come over time to make up the highest proportion of *pending* liquidation cases in India.

Chart 2:



The increase in the proportion of pending compulsory liquidation cases over time could reflect an increase in the number of these cases relative to voluntary liquidation, and/or a longer timeframe for the resolution of compulsory cases than for voluntary ones. Other data that appears in some annual reports does suggest that there are more compulsory liquidations (relative to voluntary liquidations) today than there were in the early years of the Companies Act 1956. Of 469 liquidations in 1957-1958, 318 were members' voluntary liquidations ('MVLs'), 98 were creditors' voluntary liquidations ('CVLs') and 53 were compulsory liquidations (or liquidations subject to the supervision of the court)[24]; that is, most liquidations were solvent liquidations, and of the insolvent liquidations, more were voluntary than compulsory. The position in 1970-1974 and 2005-2010[25] is set out in Tables 4 and 5 below, suggesting diminishing recourse to voluntary liquidation (and especially insolvent, or creditors', voluntary liquidation) relative to compulsory liquidation.

Table 4: Liquidations by type, 1969-1974

Year	Total companies liquidated	Total voluntary liquidation	Total liquidation under court orders (compulsory or subject to supervision)
1969-1970	227	157	70
1970-1971	235	160	75
1971-1972	223	152	71
1972-1973	187	139	48
1973-1974	146	95	51

Source: *Eighteenth Annual Report on the Working and Administration of the Companies Act 1956* (Department of Company Affairs 1974) 23
Note: there are some discrepancies between the total liquidations reported here and those in Appendix I.

Table 5: Liquidations by type, 2005-2010

Year	Total companies liquidated	Total members' voluntary liquidations	Total creditors' voluntary liquidations	Total compulsory liquidations	Total liquidations ordered subject to supervision
2005-2006	464	84	0	380	0
2006-2007	324	75	2	247	0
2007-2008	376	86	4	236	50
2008-2009	196	61	0	135	0
2009-2010	225	81	4	140	0

Source: author compilation of data in *Annual Report on the Working and Administration of the Companies Act 1956*, 2005-2010

[24] *Second Annual Report on the Working and Administration of the Companies Act 1956* (1957) Chapter XI, [92].

[25] The annual reports issued for the 1960s did not include this information. Available annual reports for 1975-2004 do include a break down of new liquidations by type, but only for non-government companies.

The data should not however be interpreted as implying some significant increase in the total number of compulsory liquidations over time, or in insolvent liquidations more generally. A total of 1,138 compulsory winding-up orders were made between 2005 and 2010, as against 303,239 company registrations over the same period. Only *ten* new CVLs were reportedly commenced in the same period, suggesting the near extinction of insolvent voluntary liquidation. Assuming all compulsory liquidations were insolvent liquidations, and adding to those the number of liquidations ordered subject to the supervision of the court (as well as the 10 CVLs), the maximum number of *insolvent* liquidations for 2005-2010 was 1,198 as against 303,239 registrations. This compares with (making the same assumptions) 151 insolvent liquidations for 1957-1958, against 961 company registrations. These statistics suggest that Batra's claim that liquidation law forms an 'insignificant part' of the 'market dynamics' that govern the treatment of insolvent firms[26] is an understatement: they suggest that India's insolvent liquidation procedures are not merely (as the literature suggests) dysfunctional, because burdened by delay, but near defunct.

The information on recourse to India's company liquidation procedures is all the more striking when compared with rates of recourse to the equivalent procedures in the UK. Take the pre-financial crisis year of 2006-2007, for example: for that year, there were 429,700 new company registrations in England and Wales and 13,460 compulsory liquidations and CVLs[27]; in the same year, India registered 51,708 new companies but saw

[26] Text to n 21.

[27] Companies House, 'Statistical Tables on Companies Register Activities, 2006-2007' Table A1 and Table C2 <http://www.companieshouse.gov.uk/about/pdf/companiesRegActivities2006_2007.pdf> 30 August 2012.

only 249 enter the same liquidation procedures[28]. There are also differences in the relative use of the two insolvent liquidation procedures (compulsory liquidation *v.* CVL), with the voluntary procedure being used more often than the compulsory procedure in England and Wales (in 2007, for example, there were 5,785 compulsory liquidations and 7,675 CVLs; in India, 247 of 249 liquidations were compulsory)[29]. The company liquidation framework developed in the late 19th and early 20th centuries has retained its utility in the UK and in some of her former colonies (Australia, for example), but not – it seems – in India.

4.2 Explaining the failure of India's liquidation procedure

The demise of India's liquidation procedure presents something of a puzzle for scholars, whether considered alone, or by comparison with the continuing success of what appears to be essentially the same procedure in other jurisdictions. Despite this, there has been surprisingly little research into the operation of the law in India: although there is consensus that the law is dysfunctional, and ought to be condemned, critics have to date offered mainly cursory explanations for why it is that the law came to operate as it does - why it 'failed'. This section explores what explanatory literature there is on the failure of Indian liquidation law. It begins with an apparent *excursus*: an analysis of why criticism of the law's functionality and explanations for it emerged late, long after the law's apparent demise. It is suggested that Central Government policies in the planned economy period, particularly those relating to the role of banks and financial institutions as

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[28] See Appendix I and Table 5 above.

[29] See Table 5 above (India) and n 27 (UK; see also Goode (n 16) 30). A second jurisdiction that inherited the English liquidation framework – Australia – also appears to have a higher rate of recourse to CVLs than to compulsory liquidation: see Australian Securities and Investments Commission, 'Insolvency Statistics' <http://www.asic.gov.au/asic/asic.nsf/byheadline/Insolvency+statistics+-+Series+1+Companies+entering+external+administration?openDocument> 1 May 2012.

providers of corporate finance, may have resulted in diminished interest in, and reliance upon, formal insolvency procedures (that is, that 'demand-side' factors may have been in play). The section then returns to the market economy period, analysing the explanations that have been offered up by contemporary critics for the continuing failure of Indian liquidation law, notwithstanding apparent creditor demand for change.

4.2.1 Why failure matters: demand for an efficient company liquidation procedure

Though the evidence suggests that the problem of delay in company liquidation dates back (at least) to the earliest years of the operation of the Companies Act 1956, and that company liquidations (relative to registrations) had diminished to the point of obscurity by the 1980s, reported criticism of the law's functionality did not really appear until much later, in the 1990s. Prior to then, criticism was confined to a small number of government-commissioned reports (the Sachar Committee's report on company law, noted above[30], and a second report on the rehabilitation of insolvent industrial firms[31]; both were critical of delays in liquidation[32]). Company law textbooks (including one devoted to company liquidation law)[33] published in the planned economy period focused on the statutory provisions and the case law interpreting them, without reference to the

[30] (n 9).

[31] *Report of the Committee to Examine the Legal and Other Difficulties Faced by Banks in the Rehabilitation of Sick Industrial Undertakings and Suggest Remedial Changes Including Changes in the Law* (hereafter the 'Tiwari Committee Report') (RBI 1984).

[32] Sachar Report (n 9) [15.6]-[15.7]; Tiwari Committee Report (n 31), Appendix I, [8.6].

[33] LC Goyle, *Law & Practice of Company Winding Up* (Eastern Law House 1987).

broader evidence of the law's operation in practice[34]. It was not until the early 1990s that a more substantial body of criticism of Indian liquidation law emerged, both in government-commissioned reports (there were four such reports between 1993 and 2005)[35] and elsewhere[36].

The increase in interest in the operation of Indian insolvency law in the early 1990s was, as already noted in Chapter 2[37], closely connected with the dramatic economic reforms of that time. Recall that the 'structural adjustment' loan arrangement with the World Bank expressly required India to review liquidation procedure[38], to formulate a policy that would facilitate 'adjustment' by industrial companies, including by enabling their liquidation[39], and to conduct 'a review to reform the financial system'[40]. The two public reports that followed – the report of the Goswami Committee (appointed to consider various aspects of insolvency law as applied to industrial debtors, including

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34 See for example BKS Gupta, *Company Law* (Eastern Law House 1981) Chapter 32; A Singh, *Company Law* (7th ed, Eastern Book Company 1982) Chapter 22; HK Saharay, *Principles and Practice of Company Law in India* (2nd ed, Prentice Hall of India 1984), Chapter 23.

35 The Goswami Committee report (n 1), the Eradi Committee Report (n 1), the Irani Committee Report (n 12), and 'Report of the Advisory Group on Bankruptcy Laws' (hereafter, 'Advisory Group Report') (May 2001) <www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=225> 27 August 2012.

36 Including a series of publications by Sumant Batra, a legal practitioner in India, and by Omkar Goswami (together with others), an Indian economist (though most of these works focus primarily on India's other formal insolvency procedure – corporate rescue under SICA, considered in Part II – with less attention given to liquidation more generally).

37 Section 2.1.

38 See 'Development Credit Agreement (Structural Adjustment Credit) between India and International Development Association' (5 December 1991) Schedule 1, [4(c)], Schedule 3, [5(a)] (www-wds.worldbank.org/external/default/WDSContentServer/WDSP/SAR/2004/12/14/531EBA3C5461A26385256F03000B70C8/1_0/Rendered/PDF/531EBA3C5461A26385256F03000B70C8.pdf) (last accessed 1 May 2012).

39 ibid Schedule 3, [5(b)].

40 ibid Schedule 3, [22].

liquidation procedure) and the report of the Narasimham Committee on the financial sector – drew attention to liquidation procedure (condemned by the Goswami Committee as unworkable)[41] and to debt enforcement procedures (condemned by the Narasimham Committee as unworkable)[42]. At a basic level, then (as argued in Chapter 2) the apparent increase in interest in liquidation law in the 1990s might be characterised as at least partly a product of external pressures, exerted by India's international partners in structural adjustment. But this characterisation does little to explain the apparent absence of interest in the law's functionality prior to economic liberalisation, notwithstanding the decline in liquidation rates in the 1980s (while registration rates rose exponentially), and reports of delay in those liquidations that did occur.

A review of the reports of the Goswami and Narsimham Committees, together with other literature on corporate finance and insolvency in India in the 1980s and 1990s, helps to build a more sophisticated account of the relationship between India's economic reforms and the evidence of increasing demand for reform of company liquidation law. In summary, this literature points to two factors that may have diminished creditor recourse to, and scholarly interest in, company liquidation law in the planned economy period, one specific (relating to the recovery of debts owed by a particular class of company), the other general (relating to the lending, monitoring and recovery practices of banks and financial institutions). The first factor was the development of an extremely generous rehabilitation policy for insolvent industrial debtors, dependent in part on the provision of rescue finance by Indian banks and financial institutions. The mobilisation of the financial sector to deliver support to insolvent industrial firms was an example of a

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41 (n 1) [5.6].

42 Narasimham Committee, *Report on the Financial System* (Standard Book Co 1992) 59-60.

wider phenomenon at work - described by the Narasimham Committee as a practice of 'centralised direction over funds deployment'[43] – in which the central and state governments directed or encouraged the provision of finance by the financial sector to targeted classes of borrower, a second factor that may have indirectly influenced creditor recourse to (and expectations of) company liquidation law.

Though it has now become commonplace to condemn Indian insolvency law in general terms, the focus of reformers in the early market economy period was narrower: their focus was primarily on the treatment of insolvent *industrial* debtors, described in India as 'sick industrial companies'[44]. Nearly all of the insolvency-related conditions of India's structural adjustment agreement with the World Bank related to this class of debtor[45], and the focus of the Goswami Committee reflected this - the Committee's primary remit appears to have been industrial sickness[46], and its critique of liquidation law (though generalised) was a small part of its wider review of the treatment of sick industrial companies in India. A series of later works by Goswami (including the well-known *Corporate Bankruptcy in India*[47]) maintained this focus on industrial debtors[48], and it

[43] ibid 5; see further below, text to n 68.

[44] The origin of the phrase 'industrial sickness' is unclear, though it was reportedly first deployed in India (preface to SK Chakraborty and PK Sen (eds), *Industrial Sickness and Revival in India: Essays, Cases and Debates* (Indian Institute of Management 1980).

[45] See Schedule 3, [5] of the agreement (n 38).

[46] See the introduction to the Goswami Committee Report (n 1).

[47] Omkar Goswami, *Corporate Bankruptcy in India: A Comparative Perspective* (OECD 1996).

[48] TCA Anant and Omkar Goswami, 'Getting Everything Wrong: India's Policies Regarding 'Sick' Firms' in Dilip Mookherjee (ed), *Indian Industry: Policies and Performance* (OUP 1995); *Corporate Bankruptcy in India* ibid; O Goswami, 'Corporate Governance in India' in *Taking Action Against Corruption in Asia and the Pacific* (ADB 2002) 94.

was not until 2000, with the appointment of the Eradi Committee[49], that liquidation law was the subject of an in-depth inquiry.

This initial focus on industrial debtors reflected the enormous amount of attention devoted by successive Indian governments (both central and state) of the planned economy period to the problem of industrial sickness. A review of the Indian-published literature on the subject of industrial sickness[50] reveals the remarkable extent to which the issue of insolvency in the industrial sector[51] captured the attention of policy makers in post-independence India. It is clear from this literature that the two most well-known government responses to industrial sickness – the strengthening of the preferential debt rule for 'workers' in liquidation, enacted (as noted in Chapter 3)[52] with sick industrial companies in mind, and the introduction of a dedicated rescue procedure for medium and large-sized industrial firms (the subject of Part II of this thesis)[53] – were in fact preceded by a long series of initiatives directed to the problem of industrial sickness, dating back to at least 1950[54]. Some initiatives targeted particular categories of firm or particular states, a reflection of the sectoral and regional features of industrial

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[49] See the Eradi Committee Report (n 1).

[50] See AV Govak, *Industrial Sickness* (BR Publishing Corporation 1998); Chakraborty and Sen (n 44); DP Gupta, *Industrial Sickness and the Role of Reconstruction Agencies* (Chanakya Publications 1990); as well as books on SICA that include historical accounts (SK Seth, *Industrial Sickness: Evaluation under the Sick Industrial Companies Act* (Ganga Saran & Grand Sons 2003); PS Kaicker, *Taxmann's Sick Industrial Companies (Special Provisions) Act 1985: Law, Practice & Procedure* (Taxmann Allied Services 2000); M Narayanan, *Industrial sickness in India: the role of the BIFR* (Konark Publishers 1994)).

[51] As distinct from the services and agricultural sectors. On the relative contribution of these sectors to the economy, see Chapter 6, Section 6.1.

[52] Chapter 3, text to n 111.

[53] For the definition of a 'sick industrial company' under SICA, see Chapter 6, Section 6.3.2.2.

[54] With the reported enactment of the Sholapur Spinning and Weaving Company Ordinance, to enable the temporary takeover of management of a cotton textiles company: see Kaicker (n 50) [0.4-4].

sickness (the state of West Bengal, for example, was reportedly particularly prone[55]; the mill sector of the textile industry has been identified as the 'classical case' of industrial sickness[56])[57], others were more general[58]. These initiatives included legislation to enable the nationalisation of industrial companies[59], the take-over of their management[60] (including the takeover of management of a sick industrial firm already in liquidation, and the resumption of its business), or their merger with other firms[61].[62]

One of the striking features of the literature on the history of government intervention in sick industrial companies in the planned economy period is the repeated suggestion that the decision to intervene in a particular case (whether by management

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55 Anant and Goswami (n 48) 249; see also Govak (n 50), suggesting that industrial sickness first emerged 'in a serious form' in West Bengal (15); RK Panda and Raj Kishore Meher, *Industrial Sickness – A Study of Small-Scale Industries* (Ashish Publishing House 1992), reporting a 1983 study finding industrial sickness highest in West Bengal (followed by Maharashtra, Tamil Nadu, Uttar Pradesh, Karnataka and Gujarat): 5.

56 Garry Pursell, 'Industrial Sickness, Primary and Secondary: The Effect of Exit Constraints on Industrial Performance' (1990) 4(1) *World Bank Economic Review* 103, 110; see also Dietmar Rothermund, *India: The Rise of an Asian Giant* (Yale University Press 2008) ch 7.

57 The Cotton Textile Companies Management Undertaking and Liquidation or Reconstruction Act 1967, for example, targeted the cotton industry: see Govak (n 50) 150-151. The West Bengal Relief Undertakings (Special Provision) Act 1972, for example, was a state measure for sick units in West Bengal (as to which, see further, Chakraborty and Sen (n 44) 634).

58 Such as the management takeover provisions of the Industrial (Development and Regulation) Act 1951, discussed further below at n 60.

59 For example under the Sick Textile Undertakings (Nationalisation) Ordinance 1974, which enabled the nationalisation of 103 textile firms, entrusted to the National Textile Corporation: see Govak (n 50) 155-156; see also Kaicker (n 50) [0.4-3]; Mittal (n 1) [1.5-3].

60 For example under the Industrial Development and Regulation Act 1951. The take-over provisions of the Act were amended in 1971 to better facilitate intervention in sick industrial companies (Govak (n 50) 152-153, extracting the Statement of Objects and Reasons to the amending Act). As amended, the Act permits the takeover of management of any closed or mismanaged industrial firm by the Central Government, and provides a moratorium on 'suits or any other legal proceedings' by creditors (without Government permission) for firms under management takeover (s 18FH).

61 Including by the amendment of the Income Tax Act 1961 (s 72A) to enable carry-forward and set-off of accumulated losses by the acquirer (healthy) firm: see Govak (n 50) 158; Mittal (n 1) [1.5-4]; S Bhattacharya 'Sick Industries and Taxation', in Chakraborty and Sen (n 44); Gupta (n 50) 60-61.

62 For summaries, see Mittal (n 1) [1.5]; Narayanan (n 50) 4-6; Kaicker (n 50) [0.4]-[0.5].

take-over, merger, nationalisation, or the simple provision of rescue finance, discussed below) was not dependent on evidence of the company's ability to return to profitable trading. Rather, the literature suggests that 'public interest' considerations, including the maintenance of the employment of industrial workers, motivated many rescue attempts. Narayanan reports that the Central Government's early approach to management takeovers was a generous one, inspired by a desire to appease the electorate: 'whenever a unit became very sick and the life of the workers became miserable, government's solution was to take over the management of the unit'[63]. Govak links the failure of many takeovers[64], despite the 'large amount of public funds' sunk into targeted firms, to the Government's failure to assess firm viability: 'one of the basic flaws of the policy of take overs was that many of the units whose management were taken over were not viable and hence continued to make losses'[65]. In 1980, another commentator described the position in this way:

> The industrial units which do not generate sufficient surpluses over a period deserve to close down. In developed countries where competition is intense and survival of the fittest is the rule, such units do close down. But in India, because of shortage of capital assets and endemic unemployment, *official policies are directed to ensure that, as far as possible, industrial units do not close down as such closure renders productive assets idle and causes unemployment*[66].

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63 Narayanan (n 50) 4.

64 Eventually leading to increased selectivity in the takeovers policy Govak (n 50) 156; see also Narayanan ibid.

65 (n 50) 156. See also Gupta (n 50): 'the basic problem has been that potential viability was never the criterion, certainly as far as the units taken over under the I(D&R) Act are concerned' (156).

66 AK Bhuchar, 'Sickness in Industry – the role of the Reserve Bank of India', in Chakraborty and Sen (n 44) 50; see also Gupta (n 50) 158: 'Granted that the Government does not possess the Midas touch to convert all such losses into gains, the question is whether it has the political will to accept the free market logic of letting a mis-managed united die a natural death'.

In a semi-structured interview given for this project, one former industrialist who had been responsible for managing some nationalised industrial firms remarked that in his personal experience the purpose of nationalisation had been the preservation of employment: 'the basic purpose of nationalisation was to retain the employment of the workers'[67]. He recalled approaching the Central Government during the 1980s to seek cash infusions to enable wage payments by loss-making firms. (Workers personally petitioned him to ensure that he continued to do so, including – extraordinarily – by laying the bodies of deceased workers at the front of his family home).

The financial sector appears to have been integral to the delivery of the Central Government's rescue policy for industrial debtors in the planned economy period. The financial sector's involvement in industrial sickness grew from two core initiatives. The first, which is regularly reported in the literature, was the establishment of (non deposit-taking) development financial institutions for the specific purpose of enhancing the availability of credit to Indian industry[68], and assisting (including by the extension of further credit) with the rehabilitation of sick industrial companies[69] (including, for example, by providing finance for firms whose management had been taken over by the

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[67] For interview methodology, see Chapter 1, n 35.

[68] The development financial institutions historically specialised in term loans to industry: see Kunal Sen and Rajendra R Vaidya, *The Process of Financial Liberalization in India* (OUP 1997) 46-64; see also Kaushal Kumar Arora, *Development Banking in India* (Atlantic Publishers and Distributors 1992) 35-45. Finance from these institutions was reportedly readily extended to industrial borrowers: 'under a system of industrial licencing it was assumed though not explicitly stated that once an industrial licence was granted by the Government, financing by the Government owned institutions would follow automatically': Narasimham Committee Report (n 42) 102; see also Anant and Goswami (n 48) 247.

[69] Including by the establishment of the Industrial Reconstruction Corporation of India Ltd for the specific purpose of supporting the rehabilitation of sick industrial units: Arora ibid 43-44; see also see VV Chari, 'Inaugural Address' in *Management of Development Banks: Proceedings of a Seminar* (Management Development Institute 1975); Gupta (n 50) ch 5. The Industrial Development Bank of India also established a rehabilitation finance division in 1976 that delivered support to industrial units: Gupta (n 50) 80-81.

Central Government[70]). The second initiative, which appears to be under-reported in literature on Indian corporate insolvency law, was the development of central bank (Reserve Bank of India, or 'RBI') policy on coordination between development financial institutions and India's commercial banks (many of which had been earlier nationalised)[71], in relation to the extension of rescue finance to sick industrial companies. This strategy emerged during the 1970s[72] to become the Central Government's preferred strategy for sick industrial firms by the early 1980s, with management takeover and nationalisation strategies increasingly identified as mechanisms of last resort, to be deployed only after the failure of initial rehabilitation efforts by the financial sector[73].

The best evidence of the development of a stand-alone rescue strategy for coordinated deployment by banks and financial institutions appears from the report of the Tiwari Committee, a committee of bankers appointed by the RBI in 1981 to review the role of banks and financial institutions in the rehabilitation of sick industry[74]. The Tiwari Committee's report makes clear that the late 1970s shift in policy emphasis from

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[70] Govak (n 50) 32.

[71] See Christian Roland, *Banking Sector Liberalisation in India: Evaluation of Reforms and Comparative Perspectives on China* (Physica-Verlag 2008) [2.1.1], and (on the position post-liberalisation) [2.2]; Anshu SK Pasricha, 'On Financial Sector Reform in Emerging Markets: Enhancing Creditors' Rights and Securitising Non-Performing Loans in the Indian Banking Sector – An Elephant's Tale' (2007-2008) 55 *Buffalo Law Review* 325, 340-343. Both identify bank nationalisation as part of a 1960s government policy of 'social control' of banks.

[72] See the historical account in the Tiwari Committee Report (n 31) Chapter 1.

[73] See the Central Government's 'Statement of Policy on Sick Industries', 1978, extracted in Umesh K Chaudhary, *IDRA and Industrial Licensing* (Bharat Law House 1987) 777 (see [4(2)], suggesting that rehabilitation through state governments and financial institutions be pursued before any consideration of management takeover); later, see 'Policy on Sick Industries' No.7 (23) / 81 – CUS Government of India, Ministry of Industry, Department of Industrial Development, 15 February 1982, extracted in *Circulars relating to the Industrial and Export Credit Department, July 1978-June 1986* (vol 2, Reserve Bank of India) (contemplating an inquiry by banks and financial institutions as to whether they could revive a sick firm, before reference to the Central Government to consider nationalisation).

[74] Tiwari Committee Report (n 31).

nationalisation and management take-overs to direct intervention by the financial sector did not signal a withdrawal of the Central Government's historical commitment to the rescue of sick industrial debtors. Instead, it seems, there was simply a new conduit for the delivery of the state's rescue efforts. The Report suggests that the early 1980s position on the role of the financial sector in responding to industrial sickness was essentially this: (i) 'viable' sick industrial companies were assumed to be entitled to financial assistance (in the form of a coordinated rehabilitation package) from both development financial institutions and commercial banks[75]; (ii) 'viability' was defined extremely broadly – a unit was considered viable if it could be expected to be in a position to service its debts within *eight to ten years*[76]; (iii) some debtors that did not meet this description of viability nevertheless secured a rehabilitation package[77]. Other archived Reserve Bank of India documents of the period[78], together with some early

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[75] ibid ch 4, especially [4.10]-[4.11] (assumption of entitlement to rehabilitation package); [4.5] (features of package).

[76] ibid, [4.3].

[77] ibid, [4.15]-[4.16]; [3.10]. See further Part II, Chapter 7 text to n 31.

[78] See for example these two circulars issued to commercial banks: 'Sick Industrial Undertakings', DBOD.No.CAS.713/C.446 (SIU) A-79 (August 20, 1979), referring to the rehabilitation of non-viable companies for 'social' reasons; 'Standing Coordination Committee (SCC) (To Secure Ongoing Coordination Between Banks and Term-Lending Institutions') 'DBOD.No.CAS.BC.131/C.446 (SIU) T-80 (November 6 1980, noting a new agreement that viability was to be assessed on a 'realistic' basis (debt service within 8-10 years). Both are extracted in *Circulars relating to the Industrial and Export Credit Department July 1978-June 1986* ibid. For a later circular confirming the persistence of this position, see 'Advances on consortium basis – Coordination between banks and financial institutions – rehabilitation of sick units' IECD Circular IECD.No.PMS.171/C.446(C&P)-86/87, extracted in *Circulars relating to the Industrial and Export Credit Department July 1986-June 1989* (Reserve Bank of India). For information on access to historical RBI circulars, see Chapter 7 text to n 116. For the position on the enactment of SICA, see Chapter 7, text to n 122.

Indian-published literature on industrial sickness[79], provide further evidence of this position[80].

The generosity of this position to debtors appears to have been motivated in part by the perceived significance of the organised sector to India's economic growth path. The Tiwari Committee's report opens with this statement:

> Industrial sickness tends to cause loss of production very often leading to unemployment… and resulting in blocking of scarce resources of the banks and financial institutions, besides entailing loss of substantial revenue to the exchequer. The magnitude and incidence of industrial sickness are matters of serious concern… not merely due to the above factors, *but also because such a trend undermines public confidence in the functioning of the organised sector with attendant repercussions on the overall investment climate in the economy of the country*[81].

Of the other factors identified by the Tiwari Committee, it seems that unemployment was again heavily emphasised. In the Tiwari Committee's consultation process, banks complained that they should not be 'asked to continue holding operations in the public interest' for non-viable companies[82]. The Committee concluded that:

> [Q]uite often there are other considerations which compel the banks and financial institutions to carry on the rehabilitation programme… State Governments *which are mainly concerned with the question of sustaining employment opportunities* expect the banks and financial institutions to

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[79] See for example several chapters in Chakraborty and Sen (n 44) including AK Bhuchar, 'Sickness in Industry – the role of the Reserve Bank of India' (n 66) ('The position of banks is most unenviable. They are not only heavily involved in sick units but expected to further enlarge their commitment by way of rehabilitation and give various other concessions') (59), and P Singh, 'Experience of Commercial Banks in Financing Sick Industrial Undertakings', at 283; see also Gupta (n 50) 5-6.

[80] For more general references to the role of the financial sector in industrial sickness policy, see Goswami (n 47) 24 ('essentially a financial phenomenon, it [corporate sickness] reflects four decades of a 'supportive' response by the financial sector via indiscriminate, subsidised, and counter-incentive funding of persistently poorly performing companies'); Joshi V and Little IMD, *India's Economic Reforms 1991-2001* (Clarendon Press 1996) 212 (reporting that nationalised banks were 'encouraged' to lend to 'loss-making – even bankrupt' firms); Goswami Committee Report (n 1) [2.3.8], [2.3.9].

[81] Tiwari Committee Report (n 31) [1.1], emphasis added.

[82] ibid [3.17].

> continue to finance the sick industrial units, whether viable on commercial basis or not[83].

Writing at about the same time, one commentator identified the 'basic question' to be addressed as 'whether it is desirable for the banking system to follow a policy to sustain each and every sick unit unmindful of the losses involved', and observed:

> So far very little thought has been bestowed on this question by commercial banks; their decisions to nurse sick industrial units are in many cases conditioned by extraneous circumstances devoid of commercial judgment or considerations… Though, it is considered commendable and proper to support such units rather than liquidating them, *so as to protect the interests of employment alone*, yet valuable resources of the banking system are getting frittered away in such exercises.[84]

In its 1991 report on the Indian financial system, the Narasimham Committee characterised the policy that had required ('through general and sometimes specific instructions from Governments') banks to finance sick industrial companies, often 'against their better commercial judgment'[85], as one example of a wider phenomenon at work in the planned economy period: the phenomenon of 'directed credit programmes'[86]. The two best known examples of directed credit programmes had been geographical branch expansion policies, requiring banks to open branches in 'underbanked' areas[87], and 'priority sector' lending policies, which had prescribed minimum levels of (concessional) bank lending to particular sectors (such as small-scale agricultural

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83 ibid [4.15]-[4.16], emphasis added.

84 Singh P (n 79) 283, emphasis added.

85 Narasimham Committee Report (n 42) 31.

86 ibid 31-32. Directed credit programmes are ones that 'attempt to intervene in the way that banks allocate credit': CWM Naastepad, 'The Macro-Economic Effects of Directed Credit Policies: A Real-Financial CGE Evaluation for India' (2001) 32 *Development and Change* 491, 492.

87 (n 42) 27; see further R Burgess and R Pande, 'Do rural banks matter? Evidence from the Indian social banking experiment' (2005) 95(3) *American Economic Review* 780, and the unpublished response from A Panagariya, 'Bank branch expansion and poverty reduction: a comment'.

operators)[88]. In the Committee's view, directed credit programmes *had* resulted in an increase in the availability of credit to the targeted markets, but at great cost: 'the cost of a deterioration of the quality of the loan portfolio, the growth of overdues and consequent erosion of profitability'[89]. Lending to targeted sectors or borrowers had become an end in itself, divorced from the redistributional goals that had motivated the directed lending programmes:

> Fixation of targets for specific sector lending was essentially the means to achieve the broader goals of credit allocation but over the years the means appear to have become ends in themselves. The desire to attain credit targets has, we fear, meant inadequate attention to qualitative aspects of lending and consequent rise in loan delinquencies[90].

Of greatest concern to the Committee was the fundamental issue of government 'interference' in the lending decisions of institutional creditors:

> But by far the most serious damage to the system and one which has contributed to the decline in portfolio quality has been the evidence of political and administrative interference in credit decision making. Populism and political and administrative influence bordering on interference should have no place in the lexicon of banking and finance but unfortunately, over the years, competitive populism has affected banking and credit operations.[91]

The Narasimham Committee concluded that the 'pursuit of distributive justice should use the instrumentality of the fiscal rather than the credit system'[92], and

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[88] See further Roland (n 71) [2.1]; Pasricha (n 71) 343-345.

[89] (n 42) 29. For a review of the literature on the micro and macro economic impacts of directed credit programmes in India, see Naastepad (n 86).

[90] (n 42) at 29.

[91] (n 42) 32; see also J Hanson, 'Indian Banking: Market Liberalization and the Pressures for Institutional and Market Framework Reform', in Anne O'Krueger and Sajjid Z Chinoy (eds), *Reforming India's External Financial and Fiscal Policies* (Stanford University Press 2003) 101.

[92] Narasimham Committee Report (n 42) 42, 44.

recommended a dramatic policy shift, away from 'micro credit intervention'[93] (including by the gradual phasing out of directed credit programmes)[94] and towards financial sector autonomy, subject to the introduction of new, rule-bound (non-discretionary) prudential norms on asset classification, income recognition, and provisioning for bad and doubtful debts (modelled on Basel I)[95], supervised by a new agency (divorced from the RBI)[96]. These recommendations were almost immediately given effect: in 1992, the RBI announced phased implementation of the Committee's prudential norm recommendations for banks[97], and established a new supervisory authority – the Board for Financial Supervision – to monitor compliance. These changes were received as the Narasimham Committee had intended: as representing a 'paradigm shift from micro-regulation of the banking sector to a strategy of macro-management'[98]. Although priority sector lending rules remain (albeit in a more relaxed form) a feature of the liberalised banking regime in India[99], the historical directions on lending to sick industrial companies

[93] ibid 42.

[94] ibid 44.

[95] ibid 142 ('management of the banks and institutions must be given freedom to manage their institutions subject to their accountability for performance and compliance with well laid down prudential norms and guidelines and macro credit policies'), and ch V.

[96] ibid 130-131.

[97] 'Recognition of Income, Classification of Assets and Provisioning for Bad Debts', *RBI Monthly Bulletin* May 1992, 886, 886.

[98] Roland (n 71) 33; see similarly YV Reddy, 'Monetary and Financial Sector Reforms in India: A Practitioner's Perspective', in Kaushik Basu (ed), *India's emerging economy: performance and prospects in the 1990s and beyond* (MIT Press 2004) 69.

[99] The priority sector target for domestic banks remains at 40% but the list of 'priority' sectors has been widened, and lenders are now free to determine the interest rate on loans over a certain amount (Reserve Bank of India, 'Priority Sector Lending' <www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7402> 30 August 2012; Roland (n 71) 26).

appear (as reported in Part II of this thesis)[100] to have been quietly retired. More fundamentally, the banking sector has reportedly become increasingly concerned with its own profitability, as it faces greater regulation (including in relation to the classification and treatment of non-performing assets) and greater competition[101].

What impact did the directed credit programmes of the planned economy period have on company liquidation law? This is of course an empirical question, but it is possible to develop some initial hypotheses. In relation to insolvent *industrial* debtors, it seems plausible to suggest that the state's generous rehabilitation policy could have diminished creditor recourse to, and interest in the operation of, liquidation procedure. This seems highly likely in relation to institutional creditors, effectively mandated to pursue the rescue of sick industrial companies otherwise destined for liquidation. It might be objected here that institutional creditors would not necessarily have been affected by, or had any real interest in, liquidation procedure *even if* freed from the state's coercive rescue policy for industrial debtors (and the other effects of directed credit programmes): if secured, they could simply elect to 'stand outside' the proceedings and look to their security for satisfaction. There are at least three answers to this: first, as explained in Chapter 3[102], Indian institutional creditors have, relative to their English counterparts, fewer opportunities to seize collateral from debtors out-of-court, with the result that leave must normally be obtained in the liquidation proceedings before enforcing (that is, the process of 'standing outside' the liquidation is more complex, and

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[100] Chapter 7, text to n 127 and following.

[101] Rajesh Chakrabarti and Gaurav Chawla, 'Bank Efficiency in India since the Reforms: An Assessment' in Manoranjan Sharma, *Dynamics of Indian Banking: Views and Vistas* (Atlantic Publishers and Distributors 2008) 3; Hanson (n 91) 113.

[102] Text to n 190.

affected by the speed and conduct of the proceedings)[103]; secondly, as Mokal has argued, liquidation law appears to offer a number of benefits to secured creditors even where they elect to stand outside proceedings[104]; thirdly, whether or not they consider the commencement of liquidation proceedings attractive, creditors may nevertheless regard the *threat* of a liquidation petition as an attractive disciplinary device for use against a recalcitrant but not yet insolvent debtor[105], particularly where other debt enforcement or collateral seizure procedures are unworkable[106]. In short, there are several reasons why secured institutional creditors could have recourse to, or be otherwise interested in, liquidation procedure. But all these reasons were likely displaced in the Indian case by the state's policy on industrial debtors. For non-institutional creditors, the impact of industrial sickness policy is less clear, but if - as seems likely - all creditors benefited from the provision of rescue finance to these debtors, then they may have all had less reason to initiate liquidation proceedings[107]. More generally, the paradigm within which sick industrial firms were operating - one that was explicitly 'pro-rescue' in its orientation –

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[103] Chapter 3, n 190.

[104] Including indirect benefits from the exercise of the liquidator's investigative functions, which might 'deter misbehaviour and thus reinforce commercial morality', an outcome that might particularly benefit those who 'participate most frequently in commercial life' (such as, Mokal argues, institutional lenders): Riz Mokal, 'What Liquidation Does For Secured Creditors, And What It Does For You', (2008) 71(5) *Modern Law Review* 699, 707-708.

[105] See Chapter 3, text to n 183.

[106] As was the case in India from at least the early 1980s: see the report of the Tiwari Committee (n 31), ch VIII; later, see the report of the Narasimham Committee to similar effect (n 42, 59-60).

[107] Conversely, individual creditors might still have regarded the threat of proceedings as a useful device to compel faster payment of a debt, or to hasten the pace of rescue efforts by the state and institutional creditors.

might have been expected to influence the approach of the courts to the adjudication of liquidation petitions filed by creditors, at least for this class of debtor[108].

For *non-industrial* corporate debtors, the position appears more speculative, given the apparent absence of policy directions of the kind that governed the treatment of insolvent industrial firms. But it seems plausible to suggest that the cumulative effect of bank nationalisation and directed credit programmes (of which, as the Narasimham Committee argued, the policy on sick industrial debtors was but one example)[109] may have been to generally reduce institutional creditor recourse to, and interest in, liquidation law. The evidence of general banking practice, and in particular banks' reported disinterest in loan recoveries and monitoring[110], implies that this class of creditor would have had little reason to inquire into the operation of liquidation procedure, whether conceived as a debt enforcement, collective distribution, or public investigation device[111]. Some support for this hypothesis is offered by the 1976 decision of the Bombay High Court in *Central Bank of India v Mckenzies Ltd*[112], which concerned the admission of a bank creditor's petition to wind up a company[113]. The hearing had been postponed by the granting of 'about 30' adjournments over a four year period, all sought

[108] In fact, the evidence reported in Chapter 5 points clearly to the development of a series of 'pro-rescue' judicial innovations in company liquidation, some of which emerged in the planned economy period.

[109] See above, text to n 86.

[110] See above, text to n 89.

[111] The three functions of English liquidation law identified by the Cork Committee: see Chapter 3, text to n 185.

[112] [1977] 47 CompCas 306 (Bombay).

[113] The business of the company is not described in any detail in the judgment (*i.e.* it is not clear whether or not the respondent was an industrial firm).

by the respondent company but with the consent of the petitioning creditor. In admitting the petition, the judge observed:

> It cannot be forgotten that the bank is a nationalised bank… The [statute for the nationalisation of banks] was passed in order to serve better the needs of development of the economy in conformity with national policy and objectives and yet the bank has been merrily and mechanically agreeing and consenting to the adjournment of a winding-up petition... The interest has been mounting in the meantime. The rate of interest has become stale. There is complete absence of vigil and diligence on the part of the bank…[114]

The reforms of the 1990s could have been expected to change this position, giving banks and financial institutions – faced with enhanced regulation and stronger competition – fresh reason to inquire into the efficacy of debt enforcement and insolvency procedures. The Narasimham Committee itself acknowledged as much, urging improvements in India's creditor rights framework, especially in debt enforcement and collateral seizure procedures[115]. In the period that followed, the two central changes made to creditor rights – both recommended by (among others) the Narasimham Committee – were both made exclusively for the benefit of institutional creditors. Debt recovery tribunals were established to enable banks and financial institutions to avoid delays in enforcement in the civil courts[116]; later, after complaints of delays in those

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[114] ibid [21]; see also *State Bank of India v Hegde and Golay Ltd* [1988] 63 CompCas 581(Karnataka), describing the petitioner bank as negligent for permitting the respondent to pursue delay tactics (adjournment applications) in the winding-up petition for two years.

[115] 'The Committee is of the view that unless a proper judicial framework is established which could help banks and institutions in enforcing the claims against their clients speedily, the functioning of the financial system would continue to be beset with problems': (n 42) 60.

[116] By the enactment of the Recovery of Debts Due to Banks and Financial Institutions Act 1993. The introduction of such tribunals was originally recommended by the Tiwari Committee, which had proposed special legislation for the rehabilitation of sick industrial companies, and special legislation for the recovery of debts by institutional creditors from all classes of debtor (n 31, ch VIII). The first recommendation was given almost immediate effect with the enactment of SICA (the subject of Part II of this thesis), but the second recommendation was not given effect until after liberalisation, following the Narasimham Committee's endorsement.

tribunals[117], it was institutional creditors alone who benefited from the introduction of a new out-of-court/tribunal collateral seizure right[118]. The latter, controversial, change reportedly followed lobbying by some institutional creditors[119]. Though the pace of change has been much slower in insolvency law, the reform agenda remains linked to the needs of the financial sector. In 1999, a Reserve Bank of India report on restructuring 'weak' banks expressly connected the problem of non-performing assets in Indian banks with deficiencies in insolvency and debt enforcement laws:

> Prolonged litigation prompted by legal lacunae in different commercial enactments is one of the main reasons for the increase in the size of the banks' NPAs. Some of these enactments are several decades old and, in quite a few cases, out of line with the present day realities. These provisions need to be amended urgently and some new enactments are called for… Countries like Thailand and Malaysia which have undertaken extensive bank restructuring recently have within a short period enacted amendments to their bankruptcy laws and improved provisions for foreclosures and court procedures to ensure speedier enforcement of lenders' claims. Malaysia is also setting up specialised bankruptcy courts and steps have been taken there to plug loopholes that previously allowed borrowers to contract additional debts or dispose of their assets while restructuring... Our problems are similar and it would be of great help to banks' efforts in managing their NPAs if comparable laws are suitably enacted/amended urgently[120].

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117 MR Umarji, *Taxmann's Law & Practice Relating to Securitisation and Reconstruction of Financial Assets & Enforcement of Security Interest* (5th ed, Taxmann Publishing 2010) [0.9-1]; *Mardia Chemicals v Union of India* [2004] 4 SCC 311, [26], [36]. There is some empirical evidence that the introduction of the DRTs reduced delinquency rates and interest rates on larger loans: Sujata Visaria, 'Legal Reform and Loan Repayment: The Microeconomic Impact of Debt Recovery Tribunals in India' (2009) 1(3) *American Economic Journal: Applied Economics* 59.

118 By the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, as to which see also Chapter 3, n 190, and Umarji ibid.

119 John Armour and Priya Lele, 'Law, Finance and Politics: The Case of India' (2009) 43 *Law and Society Review* 491, 516, citing anecdotal reports (gathered during fieldwork by the authors) that 'a significant part of the impetus for SARFAESI came from the lobbying efforts of large private banks'.

120 Reserve Bank of India, 'Report of the Working Group on Restructuring Weak Public Sector Banks' (4 October 1999) [80]-[81] <www.rbi.org.in/scripts/PublicationReportDetails.aspx?UrlPage=&ID=46> 30 August 2012.

More recently, a 2010 report on the Indian financial sector (the 'Rajan Report')[121] reiterated the need for insolvency law reform, cautioning against complacency in light of improvements in debt enforcement[122], and linking (as noted earlier in this chapter) continuing deficiencies in India's 'credit infrastructure' (including its insolvency laws) with the availability of credit[123].

The history of 'centralised direction over funds deployment' in the planned economy period helps to build a fuller account of the rise of the creditor rights reform agenda in the market economy period, tying it to both external pressures associated India's 'structural adjustment', and the internal demands of a changing financial sector. This account – which positions the financial sector as a key driver of creditor rights reform – may also explain the apparent loss of momentum in insolvency law reform in more recent years: it may be, as the Rajan Report implies[124], that the dramatic strengthening of out-of-court enforcement rights for secured institutional creditors (regarded as having effected a 'marked change')[125] has relaxed pressure for reform from this constituency. This thesis is not, of course, concerned primarily with explaining the trajectory of insolvency law *reform*; rather, the focus is on explaining the operation of the

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121 *A Hundred Small Steps* (n 2).

122 ibid 152-153.

123 ibid 151-152.

124 ibid.

125 Jayati Sarkar and Subrata Sarkar, 'Debt and corporate governance in emerging economies' 16(2) 2008 *Economics of Transition* 293, 318 (reporting that SARFAESI is regarded as having effected a " 'marked change' in the repayment and recovery culture in banks and signalled to corporations that 'banks mean business'"; see also Rajesh Chakrabarti, William Megginson and Pradeep K Yadav, 'Corporate Governance in India' (2008) 20 *Journal of Applied Corporate Finance* 59, 69. For empirical evidence, see Vikrant Vig, 'Access to Collateral and Corporate Debt Structure: Evidence from a Natural Experiment' (working paper, May 2009) <http://marriottschool.net/emp/boyer/financeseminar/s10_11/Vikrant%20Vig%20F10.pdf> 30 August 2012 (reporting a decrease in secured debt post-SARFAESI, said to reflect borrower fears of early collateral seizure).

existing law. But here, too, the history of India's policy of 'social control' over banks and financial institutions may illuminate: the evidence set out in Chapter 5, which is devoted to considering the performance of the courts in compulsory liquidation cases, suggests that historical banking policy may have influenced not only creditor demand for liquidation procedure, but also judicial practice.

4.2.2 Why the law continues to fail creditors: existing explanations

Though reform of India's liquidation law has been firmly on the policy agenda since the 1990s, there has been surprisingly little analysis of why reform is necessary: why the law, as presently formulated, is unable to deliver. There is certainly no shortage of critics, ready to condemn the evidence of the law's functionality – to condemn delays, and associated harms to creditors and the credit market - but there appears to have been little research carried out on the reasons for the law's (dys)functionality. Only two works – both reports, commissioned by the Central Government – grapple with this question in any detail: the Sachar Committee's 1978 report on the Companies Act 1956 and the Eradi Committee's 2002 report on insolvency law[126].

The Sachar and Eradi committee reports focus primarily on delays in compulsory liquidation, and particularly on delays *after* the making of the winding-up order, when the official liquidator is entrusted with carriage of the winding-up (recall the Indian legislature's decision to entrust compulsory liquidation to court-attached, government

[126] A third report – the Goswami Committee Report (n 1) – also offers some analysis of the reasons for delay in company liquidation, but it is not clear from the report whether the Committee is describing company liquidation in general, or the particular position of sick industrial companies that are referred for liquidation after the failure of rescue attempts under SICA (see Chapter 7, text to n 14). The report is therefore given only secondary treatment in this section, though it is reconsidered in Part II.

employed 'official liquidators in 1956)[127]. The explanations for delay offered by each report are remarkably similar, with each portraying official liquidators as paralysed by a number of multiple (related) phenomena that collectively cause delay. The reports suggest that official liquidators are initially delayed by the managers of the insolvent firm, who are slow to provide the 'statement of affairs' detailing the company's assets and liabilities[128], and may resist the liquidator's attempts to access company books and assets[129]. The Eradi Committee report suggests that some managers 'deliberately delay' to slow the investigation of the official liquidator[130], while others are themselves victims of delay:

> There is always a time-lag of more than one year between the presentation of a petition for winding-up and the date on which the company is wound by the court. During the intervening period and even earlier in the case of a company which has stopped its operations, the company staff starts leaving and there is nobody left to maintain and preserve the records. In fact, since the records are not complete and not updated, the ex-directors are unable to submit the statement of affairs.[131]

The prosecution of those who fail to provide access or information, and the recovery of possession of withheld company books or assets, requires recourse to the courts, where

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127 See Chapter 3, text to n 93.

128 Sachar Committee Report (n 9) [15.12]-[15-13]; Eradi Committee Report (n 1) [3.5] ('the statement of affairs… is not filed with the OL *for years* in most of the cases').

129 Sachar Committee Report (n 9) [15.12] (books); Eradi Committee Report (n 1) [3.6] (books), [3.15] (assets). See also Goswami Committee Report (n 1) [5.6.8] (books).

130 (n 1) [3.6]. This was also the view of the Sachar Committee, who described directors' failure to file the statement of affairs with official liquidators as 'more often than not a deliberate one': (n 9) [15.14]; see also the Goswami Committee Report (n 1) [5.6.8]: 'The basic reason for directors delaying the process is to buy time to alter accounts, inflate their claims, and maintain unofficial control over the company's assets'.

131 (n 1) [3.8].

disposal of the proceedings is said to be slow[132]. The same problem of court delays reportedly confronts official liquidators who attempt to pursue 'delinquent' directors for compensation for breach of duty or for fraudulent trading[133], and even those who attempt the more basic task of pursuing the recovery of debts owed *to* the company by third parties: liquidators reportedly experience significant delay in obtaining and enforcing judgment decrees for the benefit of the insolvent company[134]. Both reports suggest further delays arise from procedural rules that require court approval at each stage of the winding-up (recall that the Indian rules contemplate greater court involvement than their English counterparts, and allow comparatively fewer of the court's functions to be exercised by registrars, rather than judges[135])[136]. In addition to these delays – essentially imposed on official liquidators by managers and by the courts – the reports suggest that official liquidators also suffer from internal resource constraints,

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[132] Sachar Committee Report (n 9) [15.23] (delays by magistrates empowered under s 456 to seize company property), and Eradi Committee Report (n 1) [3.5], [3.7], [3.24] ('Multiplicity of court proceedings is the main reason for abnormal delay in dissolution'); see also the Goswami Committee Report (n 1) [5.6.8]: 'in the event of prosecution [for failure to submit the statement of affairs], the case gets dragged on for another three to five years before the directors hand over the books…'. The Sachar and Eradi Committee reports also identify an additional hurdle for liquidators, suggesting that prosecution of directors for failure to provide the statement of affairs is hampered by the presence of a statutory qualification in s 454 of the Companies Act 1956 that the failure be one made 'without reasonable excuse', for which the burden of proof lies with the liquidator: (n 9) [15.18]; (n 1) [3.5].

[133] Sachar Committee Report (n 9) [15.40](iv); Eradi Committee Report (n 1) [3.23]: 'A large number of these cases [misfeasance/breach of duty cases under s 543] are pending in court for more than five to ten years'.

[134] Sachar Committee Report (n 9) [15.26]: 'experience has shown that execution through the Court takes a long time – the realization of the fruits of a decree is often only a consummation devoutly to be wished!' (the Sachar Committee recommended statutory reform to afford liquidators out-of-court enforcement rights, exercisable with court leave); Eradi Committee Report (n 1) [3.10]-[3.11]. See also the Goswami Committee Report (n 1) [5.6.10].

[135] Chapter 3, text to n 197.

[136] Sachar Committee Report (n 9) [15.37]-[15.38] (delays arising from requirement to obtain court approval for settlement of list of contributories); more generally, Eradi Committee Report (n 1) [3.26]-[3.27]: '[T]he official liquidator has to seek sanction of the court at each an (sic) every stage during the course of winding up proceedings… This entails delays due to normal court proceedings'.

including a 'paucity of qualified, competent and trained staff'[137], and in some cases inadequate funds to meet the costs of litigation, advertisement, or property preservation[138].

In Chapter 3, it was suggested that the most significant difference between Indian and English liquidation law 'on the books' is a difference of administrative burden in compulsory liquidation: recall that the English regime permits the appointment of liquidators from the private market, and shares supervisory responsibility between superior and inferior courts, and between judges and registrars; the Indian regime, in contrast, requires the appointment of a public servant as liquidator (the official liquidator), and allocates greater responsibility to superior courts and their judges[139]. The administrative features of the Indian regime are easily linked to the explanations for liquidation delays in the Sachar and Eradi Committee reports: two of the three factors emphasised in the reports (resource-constrained official liquidators and delayed courts) raise the issue of administrative capacity directly, while the third factor – managerial misbehaviour – could be plausibly explained by reference to the first two factors (with little prospect of enforcement of sanctions by resource-strapped liquidators in delayed courts, there may be less incentive for managers to comply). The hypothesis suggested by this analysis – that the failure of Indian liquidation law was a failure of administrative

137 Eradi Committee Report (n 1) [3.28]-[3.30]; see also Sachar Committee Report (n 9) [15.43].

138 Sachar Committee Report (n 9) [15.22] (filing fees in litigation); Eradi Committee Report (n 1) [3.16] (expenses associated with advertisements and property preservation). Where a company has no available assets, r 292 of the Companies (Court) Rules permits the official liquidator to incur expenses out of a 'permanent advance or other fund provided by the Central Government' (repayable out of any assets recouped in the liquidation), but the Eradi Committee reported that this was normally 'either not available or not adequate'. Both committees considered the position exacerbated by section 178 of the Income Tax Act 1961, which requires official liquidators to set aside out of company assets an amount equivalent to the preferential tax debt, reducing the assets available for discharging expenses: Sachar Committee Report (n 9) [15.28]; Eradi Committee Report (n 1) [3.21].

139 Chapter 3, text to n 194.

capacity – is implicit in the Eradi Committee's concluding recommendations, which included (i) the transfer of adjudicatory responsibility in insolvency matters from the High Courts to newly constituted company law tribunals[140], responsible for directly approving only 'important matters' such as sale of assets or distribution of proceeds (abolishing the procedural rules that require liquidators to seek court approval at each stage of the liquidation)[141], and (ii) the re-opening of the private market of liquidators for compulsory liquidation[142]. These two recommendations have featured in every major insolvency reform initiative since 2002[143], while the substantive compulsory liquidation provisions of the Companies Act 1956 have remained virtually untouched by reformers[144].

One question suggested by the 'administrative capacity' hypothesis is why – given reports of resource strain in compulsory liquidation – voluntary liquidation failed to emerge as a substitute for compulsory liquidation. (Recall that the evidence in fact points to diminishing recourse to voluntary liquidation over time[145]). As the Eradi Committee itself acknowledged, voluntary liquidation is largely free of court supervision:

> [T]he OL [official liquidator in compulsory liquidation] has to submit reports form time to time for consideration of the company judge on the

140 (n 1) [5.16(a)], [7.1].

141 ibid [7.20], [4.21] ('The present system of the liquidator seeking court's directions even for small matters not only causes delay in winding up but also wastes more valuable time of the court').

142 ibid [6.13], [7.4].

143 Including the Companies (Second Amendment) Act 2002, and the Companies Bills of 2008 and 2009. Indeed, they also appear to have featured in reform proposals made in 1993, as reported in Mathur 'Industrial Restructuring in India and the National Renewal Fund' (n 6) 17-18.

144 With the exception of the regulatory changes outlined above, the Companies Bill 2011 would make few changes to the liquidation provisions of the Companies Act 1956 (with the possible exception of a significant change to voluntary liquidation): see Chapter 3, text to n 128.

145 See above, from text to n 24.

> administrative as well as judicial side. This entails delays due to normal court proceedings. In contrast, by and large, there is hardly any interference by the court in… voluntary winding up[146].

The voluntary liquidator may be appointed from the private market, and the only role for the resource-constrained 'official liquidator' is an auxiliary one: the 1956 Act requires voluntary liquidators to submit the liquidation accounts to the official liquidator for scrutiny, prior to the company's formal dissolution[147]. Although the Sachar Committee reported that this requirement caused delay (official liquidators being unable to scrutinise reports quickly enough)[148], such delays occurred after the collection and distribution of company assets (that is, arguably at the stage of least significance to creditors). If compulsory liquidation failed for want of administrative capacity, it seems that voluntary liquidation need not have.

There is however a more fundamental difficulty with advancing the administrative capacity hypothesis, and that is that the literature is somewhat ambiguous as to whether delays in compulsory liquidation were in fact simply a product of inadequate resources, or 'capacity'. It is clear that both the Sachar and Eradi Committees did regard delays in the disposal of liquidation proceedings as at least partly a function of court capacity: both committees concluded that the number of judges allocated to company law matters in the High Courts was grossly inadequate[149]. But the Eradi Committee report also points clearly to a second kind of delay in compulsory

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146 (n 1) [3.2.7]. The Committee concluded that there was a 'need to encourage voluntary winding up of companies' ([7.11]).

147 Section 497 (members' voluntary liquidation); s 509 (creditors' voluntary liquidation), reportedly added in recognition of the fact that voluntary liquidations were not 'subject to scrutiny of either the Court or any other outside agency' (Sachar Committee Report (n 9) [15.49]).

148 Sachar Committee Report (n 9) [15.51].

149 Sachar Committee Report (n 9) [15.45]; Eradi Committee Report (n 1) [3.25].

liquidations: delays invited or imposed *by the court itself*. The report suggests, for example, that some judges insisted on the official liquidator pursuing civil claims for the recovery of small debts, notwithstanding that 'disposal of these cases takes a very long time and sometimes in a particular case, the legal expenses incurred far exceed the actual realisation'[150]; it also suggests that some judges devised arrangements to enable a company in liquidation to continue to operate its business (in some cases, '*for years*') subject to the making of 'interim payments' to the court[151]. (The Goswami Committee had earlier similarly complained of delays in asset sales in compulsory liquidation, which the Committee attributed to the court's worker-inspired preference for the sale of the company as a going concern, even where a piecemeal asset sale would have yielded a higher overall return for creditors)[152].

Most strikingly, the Eradi Committee also reported that some courts deliberately delayed in the making of the winding-up order itself (that is, after the filing of the petition, but *before* the order is made and the official liquidator appointed):

> It is normally observed that there is a substantial time lag between the date of presentation of the petition for winding up and the date of winding up order…. It was pointed out [to the committee] *that courts usually allow time to the company to pay off the creditors and ensure that the instalments fixed for the purpose are finally paid and this results in delay in disposal of such petitions*[153].

This allegation is one of deliberate delay, intended to enable the company to avoid entering liquidation. The idea of judicial resistance to the making of winding-up orders also features elsewhere in the literature: in a report for the Asian Development Bank in

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150 Eradi Committee Report (n 1) [3.10].

151 ibid [3.13].

152 Goswami Committee Report (n 1) [5.6.11].

153 (n 1) [4.12], emphasis added.

1998, for example, Anant and Mitra described the court's decision to make a winding-up order as dependent on its evaluation of whether liquidation was in the 'public interest'. The report suggests that this concept of 'public interest' – which the authors link to employee welfare - was initially utilised in cases involving the liquidation of sick industrial companies in the planned economy period:

> [I]n view of the contentious issues raised in Industrial units most of the cases ended up in [compulsory winding up or winding up subject to the supervision of the court]. Before the court can order winding up it had to examine whether it was in the public interest to do so. There was no clear-cut definition of what constituted public interest. This led to a vast degree of confusion. For example in a number of rulings the court has held "loss making" is not adequate to direct winding up! After the passing of Sick Industrial Companies Act 1985…this problem shifted from the courts to the BIFR. The Government thus took on the responsibility of not allowing any industry to die without considerations of the welfare of the workers and other issues of Public Interest[154].

In their 2001 report on Indian insolvency law, the RBI's 'Advisory Group on Bankruptcy Laws' made the same point but more broadly, without reference to the particular position of industrial companies. The Advisory Group suggested that the test for determining whether a company was unable to pay its debts did not depend on a 'rigid formula': rather, it was open to the court to 'refuse to hold the company insolvent on other considerations *including that of the public interest*'[155].

Sparse though it is, the existing literature on the failure of India's company liquidation law points to multiple causes of delay in compulsory liquidation. While some delays are characterised as a product of resource constraints, or administrative capacity, others are attributed to judicial practices and preferences: the courts, it is suggested, are

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154 Anant and Mitra (n 1) 68-69 (see also at 33: 'Companies can be wound up under the provisions of the Companies Act, but here too the requirements of public interest imply that the state or the court can block up winding up proceedings').

155 (n 35) 16, emphasis added.

both victims and perpetrators of delay. To date, the reform agenda appears to have been primarily premised on a resource-constraint/administrative capacity thesis of the law's failure, and there appears to have been little rigorous investigation into other potential causes of delay in liquidation. The final chapter of Part I makes an initial contribution to this neglected field. Chapter 5 presents the results of an inquiry, inspired by claims in the existing literature, into judicial practice in compulsory liquidation. The chapter reveals evidence of the development of a series of judicial innovations that slowed the pace of compulsory liquidations in India. This evidence substantiates the claim in the existing literature that judicial practice and judicial preferences contributed to delays in compulsory liquidation; indeed, it suggests that this claim should be elevated to fully compete with the resource claims that have to date appeared to dominate the reform agenda.

CHAPTER 5

EXPLAINING THE FAILURE OF INDIA'S COMPANY LIQUIDATION PROCEDURE

Although the Indian Companies Act is modelled on the English Companies Act, the Indian law is developing on its own lines… We will have to adjust, adapt, limit or extend, the principles derived from English decisions, entitled as they are to great respect, suiting the conditions of our society...
(Hind Overseas Pvt Ltd v Raghunath Prasad Jhunjhunwalla, Supreme Court, 1975)

Winding up is the last thing that the court would do and not the first thing that the court would do…
(Re Navjivan Trading Finance Pvt Ltd, Thakkar J, 1977)

The available evidence suggests that liquidation law is failing creditors in India's market economy, while the liquidation law of England and Wales – on which India's law was modelled, and which remains very similar 'on the books' to India's today - continues to serve creditors with general success. The existing literature, sparse though it is, points to two core explanations for continuing delays and associated creditor harms under the Indian procedure. The first draws attention to the most significant *formal* difference between the Indian and UK laws: the statutory allocation of responsibility for the administration of the compulsory liquidation procedure, with the Indian regime asking comparatively more of its superior courts (*v.* inferior ones), judges (*v.* registrars) and public (*v.* private) liquidators. A second explanation draws attention to judicial *practice*, suggesting that – at least in compulsory liquidation, where the court has a central role – judges may have deliberately delayed or otherwise resisted debtors' entry into liquidation, and imposed other delays in the winding-up of those already in liquidation. The first explanation – described in Chapter 4 as the 'administrative capacity' hypothesis[1] – appears to have significant traction among reformers.

[1] Text to n 139.

The primary purpose of this chapter is to explore the evidence for the allegations of judicial resistance to compulsory liquidation, including the specific claim (featured in Chapter 4[2]) that courts have at times entertained or orchestrated delays in the initial stages of a compulsory winding-up (that is, prior to the order being made). This allegation is arguably among the most significant from a creditor's perspective, since it goes not only to the efficacy of winding-up as a collective insolvency procedure, but also to its attractiveness as a disciplinary device (recall the Cork Committee's conclusion that the ability of a creditor to obtain a winding-up order on proof of failure to pay a single undisputed debt rendered liquidation an attractive debt enforcement device against recalcitrant debtors)[3].

The chapter draws mainly on primary evidence, obtained for the most part from an original review of all available judgments on a creditor's petition to wind-up a company on the basis that it is unable to pay its debts. The chapter begins with an overview of the methodology employed for the case review and the features of the case dataset. The second section discusses the results of the case review, reporting evidence of a series of judicial innovations in the substantive and procedural treatment of winding-up petitions in compulsory liquidation. These innovations have little or no counterpart in the UK. Their effect in India was to significantly delay and in some cases entirely defeat creditors' petitions. They are thus innovations that both substantiate and elevate the claim in the existing literature that judges are implicated in the 'anti-creditor' operation of liquidation procedure in India.

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[2] Text to n 153.

[3] Chapter 3, text to n 183.

5.1. Investigating the allegation of judicial resistance to compulsory liquidation: methodology

Section 433 of the Companies Act 1956 enables a court to order the winding-up of a company on the basis that it is insolvent (or, more precisely, on the basis that it is 'unable to pay its debts'). The literature suggests that courts have on occasion delayed in or otherwise resisted, including on public-interest grounds, the making of winding-up orders for insolvent companies. This chapter reports the results of a case review designed to evaluate the evidence for this claim.

The review was conducted using a subscription database of Indian cases called Manupatra[4]. The database was used to generate a list of all available cases decided on the insolvency ground (inability to pay debts) of section 433 of the Companies Act 1956. The review covered the life of the Companies Act 1956 to date, beginning with the Act's commencement and ending at 31 December 2011[5]. The specific focus of the review was the paradigm case of a creditor's petition; judgments on petitions filed by other stakeholders (such as contributories petitioning in their capacity as members) were discarded, even where one of the grounds alleged to found the petition was the company's inability to pay its debts[6]. (The vast majority of the decisions in the dataset

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[4] www.manupatrafast.com. For details of Manupatra's holdings, see http://www.manupatrafast.com/Default/Content-FINAL.pdf, which appears to suggest full coverage of Supreme Court and High Court judgments from at least 1956, with the exception of High Courts established later, and the exception of the Delhi High Court (where coverage appears to begin from 1966).

[5] The search ran was a 'Manu search' (full-text search) of Supreme Court and High Court judgments, using '433', refined by 'Companies Act', refined by 'unable to pay'. The search generated 801 results, which were all reviewed.

[6] Petitions by non-creditor stakeholders raise special questions of law that do not apply to creditors' petitions (see Companies Act 1956 s 439).

were in any event creditors' petitions). Judgments on a petition jointly filed by a creditor and another non-creditor stakeholder on the insolvency ground were retained.

The vast majority of the judgments obtained were first instance decisions on a creditor's petition, although the database also contained some appellate judgments[7]. The first instance judgments were compiled into a single dataset, organised chronologically. Each entry recorded (among other things) the case name, the High Court in which it was handed down, the judge, the name of the respondent company, the nature of the debt alleged to found the petition (for example a trade debt), the nature of the respondent's business, the order made, and any recorded appeal from the judgment. A total of 454 cases are included in the dataset, from 17 of India's 21 High Courts[8]. A breakdown of the cases by year and by jurisdiction appears in Appendix II. In summary, the High Courts most represented in the dataset are Delhi (16.75%), Punjab & Haryana (13.22%), Bombay (12.78%), Madras (8.81%) and Andhra Pradesh (8.37%). The dataset is dominated by cases handed down after economic liberalisation, with 366 of 454 handed down after 1991. The dataset does not contain any first instance judgments handed down before 1961, and very few from 1961-1970 (16) and 1971-1980 (17). The dataset widens in the 1980s (51 for 1981-1990), and again in the 1990s (130 for 1991-2000) and 2000s (229 for 2001-2010).

There are a number of possible explanations for the temporal skew in the dataset. It may be that the skew offers support for the hypothesis, articulated in Chapter 4[9], that

[7] These were all reviewed, but only included in the dataset where the corresponding first-instance decision was also available for inclusion in the dataset (and therefore able to be independently reviewed).

[8] Some High Courts have jurisdiction over more than one state or union territory. The 17 High Courts represented in the dataset represent 24 of 28 states and 7 of 7 union territories.

[9] Section 4.2.1.

liberalisation increased creditor demand for, and recourse to, debt enforcement and insolvency procedures (*i.e.* more petitions may have been filed post-liberalisation, producing more judgments). It is however clear that the dataset does not capture many of the judgments on petitions that were filed in the planned economy period: there appear to have been many more winding-up orders (and therefore at least as many petitions filed) than feature in the dataset. In the 1972-1973 accounting year, for example, 48 companies were ordered into compulsory liquidation[10]; for the same period, Manupatra holds two judgments in which a winding-up order was made, and a further two in which a petition for such an order was dismissed. It may be that the temporal skew reflects an increase in the number of published case law reporters over time[11], and/or an increase in the number of reported cases relating to winding-up. The evidence reported in this chapter suggests that developments in judicial practice and procedure and in the interpretation of the liquidation provisions of the Companies Act 1956 made the task of entertaining a creditor's petition more and more complex, rendering it increasingly difficult to deliver the kind of short simple judgment that might escape reporting. Whatever the reason for it, the paucity of judgments from the planned economy period means that any claims about judicial practice in that period should be treated with caution.

5.2. Results: the evidence of judicial innovation

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[10] Or winding up subject to the supervision of the court: see Chapter 4, Table 4.

[11] In 1958, the Law Commission reported only two specialist company reports, the Company Cases and Company Cases Supplement (Law Commission of India, *Reform of Judicial Administration* (14th report, Ministry of Law, Government of India 1958) 635). There are now at least two others (the Corporate Law Adviser, and the Company Law Journal).

There are three key areas of innovation revealed by the dataset of judgments on creditors' petitions to wind up companies on the basis that they were unable to pay their debts. The first relates to the formal process for the presentation and admission of petitions, the courts developing a special pre-admission procedure that added complexity and delay. The second relates to the period between the presentation of the petition and the making of any final order, the courts developing a practice of issuing interim orders that allowed respondents time to escape the proceedings (typically, by repaying the petitioner). The third relates to the developments in the substantive law on the question of when a debtor was to be held 'unable to pay its debts', and the role of the court on making such a finding.

5.2.1. The initiation of proceedings: admission of the petition

A creditor's application for the winding up of a company must be initiated by the filing of a petition[12] in the form prescribed by the Companies (Court) Rules 1959[13] (the Rules), supported by an affidavit that verifies the contents of the petition[14]. Once filed, the petition is put before a judge sitting in chambers (that is, without a hearing)[15]. The Rules contemplate the judge performing three tasks in chambers: admitting the petition (after scrutiny to ensure compliance with formalities), fixing a date for the hearing of the petition, and giving directions for the advertisement of the petition prior to the hearing[16].

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[12] Companies (Court) Rules 1959 r 11(15). The petition is filed in the High Court with jurisdiction over the state where the debtor has its registered office: Companies Act 1956 s 10.

[13] ibid r 95.

[14] ibid r 21.

[15] ibid r 96.

[16] ibid.

The Rules do not require the respondent company to be notified before the petition goes before the judge in chambers: they only require notice to be given to the company *after* the petition is admitted[17]. The Rules do, however, permit the judge to defer the third task (giving directions for advertisement) until after the company has received notice. Rule 96 provides:

> Upon the filing of the petition, it shall be posted before the Judge in Chambers for admission of the petition and fixing the date for the hearing thereof and for directions as to the advertisements to be published and the persons, if any, upon whom copies of the petition are to be served. *The Judge may, if he thinks fit, direct notice to be given to the company before giving directions as to the advertisement of the petition.*

Otherwise, the Rules do not contemplate the involvement of the respondent company at this initial stage, mirroring the position in the UK[18].

The public advertisement of a creditor's petition for winding-up may cause serious harm to the respondent company (it may, for example, trigger termination clauses in existing contracts, or lead to the withdrawal of support from lenders or suppliers)[19]. This makes the presentation of a petition a powerful tool, susceptible to misuse. A petitioner might, for example, file in the hope that the risk of reputational harm could induce the company to agree to some compromise it might otherwise have rejected[20]. It is therefore important that the company has an opportunity to apply to the court to

[17] The court must send a copy by registered post "immediately" after the petition is admitted: Companies (Court) Rules 1959 r 28(1). The petitioning creditor is required to serve a copy of the petition on the company: Companies (Court) Rules 1959 rr 27, 28(2) and Form 6, as interpreted in *Modern Dekor Painting Contracts Pty Ltd v Jenson and Nicholson (India) Ltd* [1985] 57 CompCas 675 (Bombay), *Skol Breweries Ltd v Sanman Distributors Pvt Ltd* AIR 1999 Bom 249 (Bombay), and *Donghee Vision Industrial Company Ltd v Tube Investments of India Ltd* [2001] 104 CompCas 460 (Madras).

[18] See Insolvency Rules 1986 r 4.7 (presentation and filing of petition, fixing of date of hearing); r 4.8 (service of the petition as sealed by the court on presentation). In the UK, the registrar may perform the task of issuing the sealed copies of the petition to the petitioner and fixing the date for hearing (*i.e.* there is no need for judicial involvement): see r 13.2 of the Insolvency Rules 1986.

[19] Edward Bailey and Hugo Groves, *Bailey and Groves: Corporate Insolvency – Law and Practice* (3rd ed, Lexis Nexis 2007) [14.82].

[20] *National Conduits P Ltd v SS Arora* AIR 1968 SC 279, [8].

restrain the advertisement of the petition. In the UK, courts have long recognised the right of a company to seek such an order by invoking the court's "inherent jurisdiction to stay proceedings where they amount to an abuse of its process"[21], an approach that was followed in India:

> If the petition is admitted, it is still open to the Company to move the Court that in the interest of justice of the prevent abuse of Court (sic), the petition be not advertised… The power to entertain such an application of the Company is inherent in the Court…[22]

For this safeguard to be an effective one, the company must have notice in advance of advertisement. In the UK, this procedural challenge is addressed by rule 4.11 of the Insolvency Rules 1986, which provides that advertisement cannot occur less than 7 business days after the company is served with a copy of the petition as sealed by the court. In India, the position is less certain: recall that rule 96 of the Companies (Court) Rules 1959 permits, but does not oblige, the judge to defer giving directions for advertisement until after the company has notice of the petition. A judge could theoretically admit a petition, fix a hearing date and order immediate advertisement, with the result that by the time the company receives notice, publication has already occurred.

In 1967, the question of when a petition should be advertised after its admission was put to the Supreme Court in *National Conduits (P) Ltd v SS Arora*[23], a decision on appeal from the Delhi High Court. A judge of the Delhi court had held that once a

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[21] *In Re A Company 0089 of 1894* [1894] 2 Ch 349, 350, noted in Derek French, *Applications to Wind Up Companies* (2nd ed, OUP 2008), [3.2.2.1] with other more recent authorities. The company can also intervene to restrain presentation of a petition: Roy Goode, *Principles of Corporate Insolvency Law* (4th ed, Sweet & Maxwell 2011) [5.14].

[22] *National Conduits* (n 20) [6] endorsing *Re A Company 0089 of 1894* ibid. The Supreme Court has also recognised the court's inherent jurisdiction to restrain the filing of a petition: *Cotton Corporation of India Limited v United Industrial Bank Limited* [1984] 55 CompCas 423 (SC), [23], as in the UK.

[23] AIR 1968 SC 279.

petition was admitted, the court was "bound forthwith" to order its advertisement[24]. The Supreme Court rejected this conclusion, a rather unsurprising result given that rule 96 expressly permits judges to defer giving directions on advertisement until after the company has notice of admission. The contrary view was one that would "make the Court an instrument, in possible cases, of harassment and even blackmail, for once a petition is advertised, the business of the Company is bound to suffer serious loss and injury"[25]. The Supreme Court did not, however, provide a clear solution to the procedural challenge of ensuring that a company would have sufficient notice to be able to restrain advertisement. Instead, it concluded that the Rules gave judges discretion to choose between one of three courses of action:

> When a petition is filed before the High Court for winding up of a company under the order of the Court, the High Court (i) may issue notice to the Company to show cause why the petition not be admitted; (ii) may admit the petition and fix a date for hearing, and issue a notice to the Company before giving directions about advertisement of the petition; or (iii) may admit the petition, fix the date of hearing of the petition, and order that the petition be advertised and direct the petition be served upon persons specified in the order[26].

This passage – the conclusion in *National Conduits* - is in some ways puzzling. Option (ii) appears to simply be a restatement of Rule 96, which permits a judge to choose whether to immediately give directions for advertisement, or delay doing so until after the company has been notified of the petition. Option (iii) appears to leave open the very risk that the Supreme Court was anxious to ameliorate: that the company would not be able to restrain an abusive petition before advertisement. Most surprising is the

[24] ibid [3].

[25] ibid [8].

[26] ibid [6].

inclusion of option (i), the issue of a "show cause" notice to the company before admitting the petition. Such a procedure does not feature anywhere in the Rules, which contemplate admission by a judge in chambers without involvement by the respondent. Nor does there appear to be much precedent for the use of such a procedure, except perhaps in Bombay[27]. The suggestion by the Supreme Court that notice be given *prior* to admission appears therefore to have been novel. This novelty was acknowledged in a subsequent decision of the Court, which characterised the pre-admission notice procedure proposed in *National Conduits* as an Indian improvement on the English remedy for *mala fide* petitions, the injunction[28]. In the later and widely cited decision of the Karnataka High Court in *Airwings Pvt Ltd v Viktoria Air Cargo GmbH*[29], the *National Conduits* admission procedure was explicitly recognised as a judicial innovation:

> [T]hough nowhere in the rules or the Act it is provided that notice to show-cause to the company can be issued prior to admission and advertisement, the Supreme Court by judicial interpretation of the relevant schemes of the Act and the Rules, has taken the aforesaid view which has held the field through-out till date[30].

The show-cause admission procedure proposed in *National Conduits* was one of three options identified by the Court as open to a judge on receipt of a winding-up petition. Over time, however, it came to prevail over the alternatives in the liquidation

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[27] See *Western India Theatres Ltd v Associated Bombay Cinemas Ltd* [1959] 29 CompCas 127 (Bombay), [4], suggesting that the practice of the court was to issue a notice asking the company to "show cause why the petition should not be proceeded with". It is not clear from this decision whether the practice was to give notice prior to admission or prior to advertisement, but a later decision of the same court suggests the latter: *Extrusion Processes Private Ltd v Jivabhai Marghabhai Patel* [1966] 36 CompCas 60 (Bombay), [8]. If this was the position, then the Bombay practice appears to have been no more than a robust exercise of the power in rule 96 to give notice prior to issuing directions on advertisement (i.e. option (ii) in *National Conduits*, rather than option (i)).

[28] *Cotton Corporation of India Limited v United Industrial Bank Limited* [1984] 55 CompCas 423 (SC), [24].

[29] [1995] 82 CompCas 447 (Karnataka).

[30] ibid [19].

practice of the High Courts. In the period immediately following *National Conduits*, the dataset points to early use of the pre-admission notice procedure in Bombay[31], and then in Delhi[32], Calcutta[33] and Karnataka[34], Punjab & Haryana[35], Madhya Pradesh[36], and Rajasthan[37]. The case law of the 1970s and 1980s is not, however, uniform: sparse though it is, the dataset does contain some cases in which notice does not appear to have been issued to the company until after admission[38]. By the 1990s, however, the procedure appears to have been firmly entrenched[39].

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31 See *In the matter of Advent Corporation Pvt Ltd* [1969] 39 CompCas 463 (Bombay), *Re British India General Insurance Co Ltd* AIR 1971 Bom 102 (Bombay), and *Central Bank of India v Mckenzies Ltd* [1977] 47 CompCas 306 (Bombay), decisions on whether a petition should be admitted after notice was given to the company. See also *Associated Biscuit Co P Ltd v TL Nambiar* [1978] 48 CompCas 481 (Bombay), [2].

32 *Bipla Chemicals Industries v Shree Keshariya Investment Ltd* [1977] 47 CompCas 211 (Delhi), [12], suggesting that *Extrusion Processes* (above n 27) could not survive *National Conduits* on this point. Show cause notices had been issued in the proceedings: [14]. See also *Naresh Fabs v Gudiya Exports P Ltd* [1986] 60 CompCas 114 (Delhi), [2]; *HL Narula v Northfield Automobiles Ltd* 30 (1986) DLT 204; *Indian Turpentine and Prisn Company Limited v Pioneer Consolidated Company of India Limited* [1988] 64 CompCas 169 (Delhi).

33 *All India General Transport Corporation Ltd v Raj Kumar Mittal* [1978] 48 CompCas 604 (Calcutta); *Re ML Bose & Co Pvt Ltd* AIR 1982 Cal 71 (Calcutta).

34 *New India Corporation v Nandavan Manufacturers and Traders P Ltd* [1983] 54 CompCas 32 (Karnataka); *Mukand Iron and Steel Works Ltd v Karnataka Steel and Wire Products Ltd* [1984] 56 CompCas 435 (Karnataka).

35 *Punjab National Bank v Vedsons Steel and Wires P Ltd* [1997] 88 CompCas 463 (Punjab & Haryana).

36 *Narendra Glass Works P Ltd v MP Beer Products Pvt Ltd* [1989] 65 CompCas 396 (Madhya Pradesh); *Manjulabai v Jayant Vitamins Ltd* [1991] 71 CompCas 443 (Madhya Pradesh).

37 *Hind Techno Machines Pvt Ltd v Jaipur Wire Industries Pvt Ltd* 1988 (2) WLN 580 (Rajasthan).

38 *Virendra Singh Bhandari v Nandlal Bhandari & Sons Ltd*, unreported decision of KN Shukla J in the High Court of Madhya Pradesh, 27 April 1981 [1]), *Nathu Ram Agrawal v Rajasthan Silicate and Glass Industries Private Limited* 1988 (1) WLN 432 (Rajasthan), [6]; see also appeal case *U.P. Twiga Fiberglass Ltd v Parekh Marketing P Ltd* [1985] 59 CompCas 886 (Allahabad). All three are cases in which notice was given after admission but before advertisement.

39 See for example *Keerat Kaur v Patiala Exhibition Private Ltd* [1991] 70 CompCas 728 (Punjab & Haryana), *Som Nath Jain v Oswal Agro Mills Limited* [2000] 100 CompCas 105 (Punjab & Haryana); *Re CJ Gelatine Products Ltd* [1994] 81 CompCas 890 (Bombay), *Jayabharat Credit Limited v Jalgaon Re-Rolling Industries Ltd* (1997) 99 BomLR 521 (Bombay); *Sharda Bhandari v Ananya Electroniks Ltd* [1993] 78 CompCas 167 (Delhi), *Mayar Traders Ltd v Akhil Services Ltd,* unreported decision of Usha Mehra J on 27 October 1993, Delhi High Court, see later *Madhya Pradesh Iron & Steel Company v GB Springs P Ltd v Mohta Bright Steel P Ltd* [2003] 117 CompCas 327 (Delhi), [6] (but leaving open possibility of pre-admission notice not being given if company does not respond to statutory demand); *G Subba Rao v Rasmi Die-castings Ltd* AIR 1998 AP 95 (Andhra Pradesh); *Sammarth Horological (P) Ltd v Yenkey Drugs and*

Recourse to the pre-admission procedure appears to have been influenced by another important Supreme Court decision, handed down in 1994: *Pradeshiya Industrial & Investment Corporation of U.P. v North India Petrochemical Ltd*[40] (hereafter, *PICUP v North India Petrochemical Ltd).* The case concerned the decision of a judge of the Allahabad High Court to admit a creditor's petition, affirmed on appeal to a larger bench of the same court. On appeal from the latter decision, the Supreme Court held that the petition should not have been admitted, given the respondent's evidence – heard at first instance in response to a show-cause notice – that the debt was *bona fide* disputed. The Court began its judgment by identifying the issue as being 'what exactly is the position in relation to the debt, on the facts'[41]. It concluded that:

> The defence raised… is a substantial one and not mere moon-shine. We find it difficult to appreciate the reasoning of the learned single judge when he holds that there are arguable issues and, therefore, the winding up petition has to be admitted. On this aspect the courts below failed to note that the admission of the winding up petition is fraught with serious consequence... [42]

The court added that there was also evidence that the company was 'financially sound'[43], concluding: 'Thus, we find no justification whatever for admitting the winding up petition'[44].

Pharmaceuticals Ltd 2001(1) ALD 402 (Andhra Pradesh), [18]; *Hi-Tech Gears Ltd v Yogi Pharmacy Ltd* [1998] 94 CompCas 250 (Allahabad); *Fortis Financial Services Ltd v KHSL Industries Ltd* [1999] 95 CompCas 622 (Allahabad); *Jindal Strips Limited v Hitek Industries (Bihar) Limited* 1998 (3) BLJR 2275 (Patna); *Ficom Organics Ltd v Laffans Petrochemicals Ltd* [2000] 99 CompCas 471 (Gujarat); *Hind Hosiery Mills Pvt Ltd v Anand Chemicals Co* [2003] 115 CompCas 739 (Calcutta); *Indian Oil Corporation Ltd v NEPC India Ltd* [2003] 114 CompCas 20 (Madras), [18]; *Mysore Sales International Ltd v United Breweries Ltd* [2002] 112 CompCas 391 (Karnataka). *Cf Iocee Exports Ltd v Sterling Computers Ltd* [2003] 44 SCL 572 (Madras) [3], suggesting notice was issued after admission).

[40] [1994] 79 CompCas 835 (SC).

[41] ibid [23].

[42] ibid [33].

[43] Including evidence that the company had recently paid a dividend: ibid [34].

The implication of *PICUP v North India Petrochemical Ltd* is that the process of admitting a petition requires a substantive inquiry into the validity of the petitioner's claim, an inquiry that would require the respondent company to be given opportunity to be heard (presumably by giving it notice prior to admission). This was the interpretation adopted by the Karnataka High Court a short time later, in the *Airwings* case[45]. The Karnataka court accepted that the Supreme Court decision virtually mandated the use of a show-cause notice procedure[46], except perhaps for a 'defunct' company[47]. The court also accepted that the decision to admit would turn on analysis of the validity of the petitioner's claim and the respondent's solvency:

> This latest decision of the Supreme Court puts the controversy beyond any pale of doubt that, in the case of a company which is a going concern and which is actually functioning, <u>even an order of admission of a company petition under section 433(e) may prove disastrous,</u> even leaving aside the advertisement order which would be still more pernicious, for, even at that stage after hearing the company<u>, it has to be decided whether the petitioning creditor is a creditor of the company</u>, whether any definite amount of debt is due to him…, whether the defence of the company in this connection is valid and not mere moonshine and whether it is prima facie shown that the company is plainly commercially insolvent… That very exercise [of investigating solvency] was undertaken by the Supreme Court on the material on record and it was found that as the company was not in such financial doldrums, it was not a fit case for admission.[48]

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44 ibid [35].

45 [1995] 82 CompCas 447 (Karnataka).

46 ibid [28], see also [26] and [39(II(b)]. The Court did however leave open the theoretical possibility of admitting the petition before issuing notice in its concluding remarks: [39(II(b)].

47 A company that has permanently 'closed its shutters', discharged workers and ceased 'commercial-cum-manufacturing activities'. Such a company would not suffer any reputational damage by admission and advertisement: [19]. *Cf Ashok Fashions Ltd v Meghdoot Acid and Chemicals* [1998] 91 CompCas 655 (Gujarat), [22], which appears to require pre-admission notice be given even to a defunct company.

48 *Airwings* (n 45) [16], and later to similar effect *Greenhills Exports (Private) Limited, Mangalore v Coffee Board, Bangalore* [2001] 106 CompCas 391 (Karnataka), [7.3]. See also *American Express Bank Ltd v Core Health Care Ltd* [1999] 96 CompCas 841 (Gujarat), [24], [28]; *Evans Fraser (India) Limited v Trig Detectives Private Limited* [2009] 148 CompCas 613 (Bombay), [14]; *Dallah Albaraka (Ireland) Ltd v Pentasoft Technologies Ltd* [2010] 157 CompCas 413 (Madras), [46]. On assessing solvency, see below Section 5.2.3.

These questions would have to be determined in a hearing at which the respondent would be heard. The result would be 'prima facie' findings[49], recorded in a written judgment susceptible to appeal (even, it seems, to the Supreme Court itself[50])[51].

The Supreme Court's initial view was that the show-cause procedure proposed in *National Conduits* would perform the same function as the injunction procedure in enabling the restraint of *mala fide* petitions, only better[52]. As it evolved, however, the *National Conduits* procedure came to bear little relation to its English counterpart. The injunction procedure is a safeguard that enables intervention by the respondent in a case that would otherwise proceed *without its involvement* to a public hearing. The fully-fledged *National Conduits* procedure adds an additional pre-hearing stage to the disposal of *all* petitions, whether or not the respondent would have otherwise contested it. At a minimum, the procedure would appear to add such delay as is necessary to give the respondent opportunity to be heard in relation to admission. Where the respondent does not respond to service of notice of the proposed admission, some courts have proceeded to admit the petition[53], but others have delayed of their own initiative so as to afford the

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49 That is, preliminary findings (see also *Reliance Infocomm Ltd v Sheetal Refineries Pvt Ltd* [2008] 142 CompCas 170 (Andhra Pradesh), [43]), capable of being departed from at the final hearing (see below, text to n 65).

50 Remarkably, *PICUP v North India Petrochemical Ltd* was not the last case in which a decision to *admit* a petition went to the Supreme Court: for another recent example see *Dolphin International Ltd v Gavs Laboratories P Ltd* (1999) 1 CallT 49 (SC).

51 *Airwings* (n 45) [37].

52 Text to n 28.

53 See for example *G. Subba Rao* (n 39) [2]; *Re Shekharaj Hotel (P) Ltd* [2002] 39 SCL 654 (Allahabad); *Delhi Stock Exchange Assn Ltd v Urvashi Enterprises Ltd* 122 (2005) DLT 569 (Delhi); *Sharda Mahajan v Maple Leaf Trading International P Ltd* [2007] 139 CompCas 718 (Delhi); *Satellite Television Asian Region Ltd v Kunvar Ajay Designer Saree P Ltd* [2009] 148 CompCas 62 (Gujarat), [9]. For earlier examples see *New India Corporation v Nandavan* (n 34); *Tube Investment of India Ltd v Everest Cycles Ltd* [1984] 56 CompCas 165 (Gauhati); *Narula v Northfield* (n 32).

respondent further time to object[54]. Courts have also granted adjournments at the request of the respondent so as to enable it to prepare objections[55], a practice dating back to the 1970s[56]. Where the respondent indicates its desire to be heard in opposition to admission, a timetable is agreed for the exchange of evidence by affidavits (or multiple affidavits) prior to the hearing[57]. In some cases the exchange of affidavits appears to have taken some years, suggesting case management failures[58].

At the admission hearing, the judge is required to determine whether there is a 'prima facie' case for winding up, including by investigating any alleged dispute over the

[54] See for example, *Caprihans India Ltd v Mey's Pharmaceuticals* AIR 1994 Delhi 178 (Delhi), [2] ('in spite of service respondent did not put in appearance, Therefore the case was renotified… on which date again no one put in an appearance, with the result that the Court admitted the petition'); *Dee Dee Electricals v Road Master Foods Limited*, unreported decision of Swatanter Kumar J in the High Court of Punjab and Haryana, 10 February 1999, [4]; *Sammarth Horological* (n 39); *Arun Kumar Jain H.U.F. v Hari Wire and Wire Products*, unreported decision of SP Mehrotra J in the Allahabad High Court, 10 May 2005. See also *Ashok Fashions v Meghdoot* (n 47), [22], suggesting that the court could proceed to admit a petition and order advertisement on the non-appearance of the respondent *only* if satisfied that the company is defunct with no revival prospects.

[55] See for example *Sharda Bhandari v Ananya* (n 39) [3] (recording adjournments at request of respondent, adding seven months); *Bhardwaj Gas Agency v Appenzell Petroleum Products Ltd* [1998] 94 CompCas 521 (Punjab and Haryana), [5]; *Sachda Anand Rosin Factory v Mukerian Papers Limited* (2000) 125 PLR 759 (Punjab & Haryana) [3] recording a series of adjournments granted at respondent's request, adding four months; *Hind Hosiery v Anand* (n 39) [3] (company failed to respond to notice in time, court nevertheless granted time to file affidavit in opposition to admission); *Rajearajeswari Packaging Products v Dev Fasteners Ltd* [2002] 108 CompCas 715 (Madras), [4] ('the respondent took time to file documents and the matter was listed on four different occasions').

[56] See *Central Bank v Mckenzies* (n 31) [18]; *Associated Biscuit v Nambiar* (n 31) [2]; *Mukand Iron v Karnataka Steel* (n 34) [4].

[57] See for example *Suvarn Rajaram Bandekar v Rajaram Bandekar (Sirigao) Mines Ptd Ltd* [1997] 88 CompCas 673 (Bombay) (recording exchange of affidavit, affidavit in reply, affidavit in rejoinder and affidavit in surrejoinder, all prior to admission); *Fortis Financial v KHSL* (n 39); *Hind Hosiery v Anand* (n 39) *Sharda Refrigeration Co (P) Ltd v Gupta Gasoline Distributor* [2005] 62 SCL 254 (Allahabad); *Pankaj Aluminium Industries Private Limited v Pankaj Extrusions Limited* [2009] 149 CompCas 660 (Gujarat). *Cf G. Claridge and Company Ltd v Nav Bharat Investments Ltd* [1977] 47 CompCas 428 (Bombay).

[58] See for example *BOI Finance Limited v Arvin Oxgyen Private Limited* [2006] 134 CompCas 626 (Gujarat), in which the petitioner appears to have delayed for three years between filing an affidavit in rejoinder and a further affidavit ([5]); *SIEL Ltd v Cosco Sales and Services* [2007] 78 SCL 335 (Delhi), [10]-[11] (noting that it had been two years since the respondent had been directed to file a reply, and nothing had occurred in the interim).

debt[59]. While the (English) injunction procedure requires the *respondent* company to establish a case for restraining the presentation or advertisement of a petition[60], the *National Conduits* procedure places the burden on the petitioner to satisfy the court that there is a 'case for winding up'[61] that would warrant admission:

> Normally, an opportunity is given to the Company to file an affidavit in answer to the winding up petition. All this takes place before the admission stage. If the Court comes to a conclusion that the Petitioner has made out a ground as mentioned in Section 433, then Court directs admission…[62]
>
> At this stage of admission of the petition, the court is concerned to see whether the respondent-company has been unable to pay its debts. The amount claimed must be one which is legally due and recoverable debt. The debt must be payable prima facie. The onus to a great extent is placed upon the petitioner to satisfy the court prima facie[63]…

Although this inquiry appears to require the court to consider issues that would otherwise arise for determination at the final hearing (such as whether there is a debt the company is unable to pay[64]), the admissions hearing does not appear to save later investigation of these issues. Instead, it seems that the preliminary nature of the findings made at admission stage makes it likely that the court will revisit the evidence at the final

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59 See discussion of *Airwings* above, text to n 45, and earlier *Claridge v Nav Bharat* (n 57) [12].

60 *Bryanston Finance Ltd v de Vries (No 2)* [1976] Ch 63, as to which see also French (n 21) [2.6.2]; *Southern Cross Group Plc v Deka Immobilien Investment GmbH* [2005] BPIR 1010, 'It was for the company to prove a *prima facie* case that the petition would fail and be an abuse of process of the court', [29]. On the onus where the application is to restrain advertisement, see similarly *Re a Company No 5282 of 2010* [2010] EWHC 3814 (Ch).

61 *Dolphin International v Gavs* (n 50) [9].

62 *Sheela Rani Textiles Limited v Sri Anjaneya Cotton Mills Private Limited* [2012] 169 CompCas 8 (Madras), [24].

63 *United Construction Company v Piccadilly Agro Industries Ltd* [2000] 101 CompCas 33 (Punjab & Haryana), [5]; see also *Claridge v Nav Bharat* (n 57) [12]; *Ashoka Industries v Tobu Enterprises Ltd* 2003 (65) DRJ 281 (Delhi), [5(vii)]; *Indian Oil v NEPC* (n 39) [18]; *Bharat Overseas Bank Ltd v Saritha Synthetic and Industries Ltd* [2004] 120 CompCas 419 (Andhra Pradesh), [21]-[22]; *Focus Management Consultants Pvt Ltd v Second Foundation India Pvt Limited* (2007) 3 CompLJ 127 (Delhi), [17].

64 See *Greenhills Exports v Coffee Board* (n 48) and the other cases noted in n 48 above.

hearing, risking significant duplication of judicial effort[65]. The susceptibility of the decision to admit a petition to appeal adds further complexity. There are a large number of reported cases of appeals from decisions to admit[66], suggesting that the *National Conduits* innovation has placed a burden on the appellate benches of the High Courts. The time lost through appeals appears to have been exacerbated by a 1970 decision of the Supreme Court to the effect that an appeal from a decision to admit a petition and order its advertisement could not be dismissed summarily: '[T]he appellate bench erred in summarily dismissing the appeal. It was bound to entertain the appeal and dispose of the same on merits'[67].

5.2.2. Between presentation and order: relief for debtors

Probably the most significant innovation revealed by the dataset is a widespread practice of affording the respondent company time to settle the petitioning creditor's claim, so as to enable the respondent to avoid the making of a winding-up order, or (at an earlier stage) advertisement of the hearing or even the admission of the petition.

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[65] As expressly acknowledged in *Hotline Teletubes & Components Ltd v AS Impex Ltd* (2004) 1 CompLJ 412 (Delhi), [9]; see similarly *Indian Oil v NEPC* (n 39) [42]; *Aventis Cropscience India Ltd v Nilgiris Fertilizers Ltd* [2005] 125 CompCas 139 (Madras), [12]; *Samar Man-Made Fibers Pvt Ltd v Alaukik Trading and Investment Pvt Ltd* [2005] 63 SCL 200 (Gujarat), [43]. *Cf Asian Electronics Limited v Murugan Power Systems (Private) Limited* II (2003) BC 424, [7] a judge of the Karnataka High Court finding it "unnecessary" to reconsider a defence that had been considered and rejected at admission stage.

[66] See for example *MCC Finance Ltd v Reserve Bank of India*, unreported decision of the Madras High Court, 6 July 2001 (VS Sirpurkar and Akbar Basha Khadiri JJ); *SRC Steel P Ltd v Bharat Industrial Corporation Ltd* (2005) 6 CompLJ 401 (Calcutta); *Bangalore Turf Club Limited v N Sundaraswamy* [2005] 124 CompCas 373 (Kerala); *IBA Health (India) P Ltd v Info-Drive Systems SDN BHD* [2010] 155 CompCas 323 (Karnataka); *Essar Steel Ltd v Gramercy Emerging Market Fund* [2003] 116 CompCas (Gujarat); *Evans Fraser v Trig* (n 48); *Vasu Tech Ltd v Ratna Commercial Enterprises Ltd* [2010] 156 CompCas 89 (Punjab & Haryana); *Cheran Holdings Pvt Ltd v Data Access (India) Ltd* (2010) 1 CompLJ 342 (Delhi). For an early example see *Premier Vegetable Products Ltd v United Asian Bank,* unreported decision of the Rajasthan High Court, 9 May 1980 (M.L. Shrimal and Mahendra Bhushan JJ).

[67] *Golcha Investment P Ltd v Shanti Chandra Barna* AIR 1970 SC 1350, [7].

Sparse though it is for the planned economy period, the dataset does provide some evidence of this practice in the early years of the Companies Act 1956. In the two clearest examples – a 1974 decision of the Orissa High Court, and a 1976 decision of the Calcutta High Court – judges resolved (without the consent of the petitioning creditor[68]) to defer the winding-up so as to enable the respondent to pay the petitioning creditor. In the Orissa decision (*Misrilal Dharamchand P Ltd v B Patnaik Mines P Ltd*[69]), the judge held that the petitioner, to whom the respondent had been 'hugely' indebted without repayment for over three years, was entitled to a winding-up order, which he made. But the judge was persuaded to stay the order for six months so as to enable the respondent (reportedly suffering from a temporary 'set-back') to repay the debts owing to the petitioner, although aware of no other case in which such a 'long period' had been given[70]. In the Calcutta decision (*All India General Transport Corporation Ltd v Raj Kumar Mittal*)[71], an admission case, the judge rejected the objections made by the respondent to the petition as *mala fide* and resolved to admit the petition. But he concluded by offering the respondent one month to repay the petitioner: if paid, the petition would be permanently stayed[72].

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[68] There are other cases in which the petition was withdrawn by the petitioner or in some way deferred with their consent, on reaching a compromise with the respondent: see *Re Advent Corporation* (n 31) [2]; *Re ML Bose* (n 33); more opaquely *Central Bank of India v Sukhani Mining and Engineering Industries Pvt Ltd* [1977] 47 CompCas 1 (Patna), [24]. See also *Re Bombay Castwell Engineering Pvt Ltd* [1984] 55 CompCas 75 (Bombay), *Techno Metal India P Ltd v Prem Nath Anand* [1973] 43 CompCas 556 (Calcutta) and *Marketing and Advertising Associates Pvt Ltd v Telerad Private Ltd* [1969] 39 CompCas 436 (Bombay), appeal cases recording a stay or deferral of a petition by consent.

[69] [1978] 48 CompCas 494 (Orissa).

[70] ibid [23]; noted in Harpal Singh, *Indian Company Law* (Tata McGraw-Hill Publishing Company Limited 1985), 327.

[71] [1978] 48 CompCas 604 (Calcutta).

[72] ibid [10].

Overall, however, there is more evidence in the dataset for the 1960s and 1970s of a second practice: one of adjourning the hearing or admission of a petition so as to enable the respondent to agree a compromise or settlement with *all* creditors[73] [74]. Like an order to afford the respondent time to pay the petitioner, the adjournment practice added delay to the disposal of petitions. But unlike the petitioner-focused payment orders made in Orissa and Calcutta, the adjournment practice was focused on achieving a global settlement with creditors, as a collective. The potential tension between the interests of the petitioning creditor and those of creditors as a whole in the early stages of a winding-up petition (essentially, a tension between the individual (disciplinary) and collective functions of winding-up) was the basis for one judge's decision, in the Bombay High Court, to refuse to permit a respondent to escape a petition by repaying the petitioners. Such an order, the judge reasoned, would ignore the interests of other creditors: "I, however, see no reason to refrain from passing a winding-up order merely by reason of such an offer unless a provision of that nature *is made for all the creditors appearing in the case and is consented to by them...*"[75] [76].

[73] See for example *State of Andhra Pradesh v Hyderabad Vegetable Products Co Ltd* AIR 1963 AP 243 (Andhra Pradesh), [2] (adjournment of nine months to enable respondent to 'find monies to satisfy its creditors or compound with them'); *Re Seksaria Cotton Mills Ltd* [1969] 39 ITR 475 (Bombay), [2] (twelve weeks before advertisement to devise a scheme); *Aluminium Corporation of India Ltd v Lakshmi Ratan Cotton Mills Co Ltd* AIR 1970 All 452 (Allahabad), [46]-[47] (year long adjournment granted for multiple reasons, including for company to convene a meeting of creditors to consider a scheme); *Bipla Chemicals v Keshariya* (n 32) [1]-[2] (at least three months of adjournments to raise funds to pay creditors).

[74] This appears to be the closest to the practice reported by the Eradi Committee, noted in Chapter 4 (text to n 153): 'courts usually allow time to the company to pay off *the creditors*'.

[75] *Re Focus Advertising Pvt Ltd* [1974] 44 CompCas 567 (Bombay), [2], emphasis added.

[76] The judge made a winding-up order, but the decision did not survive appeal: [1975] 45 CompCas 534 (Bombay). The appellate decision turned on opposition from a majority of creditors to winding-up, although the court also thought that the company's ability to pay-in an amount sufficient for the petitioners and others 'supportive' of the petition meant the order should not have been made ([80]-[81]).

Over time, however, it was the petitioner-focused, non-collective payment order (described in this chapter as the 'pay-to-exit order') that came to dominate judicial practice at the admission stage. In the 1980s, some judges continued to order adjournments to enable the respondent to pursue schemes or settlement with all creditors[77]; others, however, experimented with various petitioner payment orders for debts considered by the court to be undisputed[78] or part-disputed[79], compliance with which would permit the respondent to escape advertisement of the petition. In one of these cases[80] (again, from Orissa) the pay-to-exit order was made despite the non-appearance of the company at the hearing, the judge holding that the company deserved one year's 'breathing space' to repay the petitioner[81] (other orders were of a shorter duration)[82]. By the 1990s, the pay-to-exit practice appears to have become more popular than the collective adjournment practice. The dataset for the 1990s and 2000s offers a

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[77] *Mukand Iron v Karnataka Steel* (n 34) [7]-[8]; *State Bank of India v Hegde and Golay Ltd* [1988] 63 CompCas 581 (Karnataka) (the petitioner not objecting); *Tube Investment v Everest Cycles* (n 53).

[78] *Chemical Enterprises v Kalpanalok Ltd* [1984] 55 CompCas 552 (Punjab & Haryana) (order to pay judgment debt plus costs of civil proceedings and petition to petitioners within three weeks; if paid, petition dismissed); *Oriental Machinery and Civil Construction Ltd v Vikrant Tyres Ltd* 1985 (1) KarLJ 35 (Karnataka) (permit petitioner to withdraw principal owing, previously deposited by respondent into court as security for proceedings for counter-claim that were never pursued; petition dismissed); *Hind Techno v Jaipur Wire* (n 37) (the judge rejecting the respondent's dispute as not *bona* fide, but giving it 2.5 months to settle with the petitioner, failing which petition would be advertised); *Surindra Packers v Punjab Land Development and Reclamation Corporation Ltd* [1989] 66 CompCas 883 (Punjab & Haryana) (pay balance outstanding plus interest within one month, failing which petition would be advertised); *Hindon Foods Pvt Ltd v Golden Dragon Sea Food Factory Pvt Ltd* [1991] 70 CompCas 335 (Orissa) (one year stay to enable payment to petitioner) (it is not clear whether advertisement had already occurred in this case); *Punjab National Bank v Vedsons Steel* (n 35) [3] (recording four month pay-to-exit order before advertisement in 1985).

[79] *Naresh Fabs v Gudiya* (n 32) (no admission of petition if part payment made to petitioner of amount court finds undisputed and remainder deposited as security for civil proceedings, within 10 days); see also *S.N. Steel Corporation v Dany Dairy and Food Engineers Ltd* [1992] 73 CompCas 357 (Allahabad), [4].

[80] *Hindon Foods*, above n 78.

[81] ibid [9], inspired by *Misrilal Dharamchand P Ltd*, above text to n 69.

[82] Between 10 days and four months: see above, nn 78-79.

large number of examples of orders affording the respondent an opportunity to avoid advertisement or admission of a petition by paying the petitioning creditor off directly[83] or (less often) by paying the amount into court[84]. The purpose of these orders was to enable the respondent to avoid liquidation:

> In a winding-up petition, Courts often make orders for payment by the company in instalments, sometimes on the prayer of the company and sometimes by the Court but always by way of affording the company an opportunity to avoid being wound-up.[85]

How often were pay-to-exit orders made before the advertisement of a creditor's petition? One measure is provided by the 'admissions cases' in the dataset (those decisions clearly identifiable as ones on whether a petition should be admitted). There are 149 such decisions in the dataset between 1990 and 2010. In 52 of these decisions, the petition was dismissed. In 47 of the remaining 97 decisions (48%), a pay-to-exit order was either made by the judge or reported as having been previously made, suggesting a high rate of recourse to the procedure at admission stage. In the other cases, no such order was made at this stage (that is not to say, however, that a pay-to-exit

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83 See by way of example: *Straw Board Manufacturing Company Limited v Mahalakshmi Sugar Mills Company Limited* [1991] 71 CompCas 544 (Punjab & Haryana) (payment of the principal held undisputed within one month to avoid advertisement); *Maruti Udyog Ltd v Hindusthan Photo Film Mfg Co Ltd* [2001] 103 CompCas 960 (Madras); *Essar Gujarat Ltd (Steel Division) v United Ispat Udyog Pvt Ltd* [1999] 97 CompCas 842 (Himachal Pradesh) (2.5 months to pay principal and interest, failing which petition would be advertised); *Ganapati Commerce Ltd v Bank of Rajasthan* AIR 1919 Cal 261 (1) (Calcutta) (just under one year to pay a debt of Rs 11,17,10,937.11 by monthly instalments); *Ranjana Kumar v Indian Dyestuff Industries Ltd* [2001] 107 CompCas 579 (Bombay) (payment according to schedule proposed by respondent, default on two instalments leading to admission); *Ashoka Industries v Tobu* (n 63) [9], (four weeks to pay, failing which advertisement); *Enernorth Industries Inc v VBC Ferro Alloys Ltd* [2006] 133 CompCas 130 (Andhra Pradesh) (five weeks to pay to avoid advertisement).

84 See by way of example *Indian Duplicator Co Ltd v VPL Electronics and Engineering Ltd* [1991] 71 CompCas 589 (Delhi); *Suvarn Rajaram Bandekar v Rajaram Bandekar (Sirigao)* (n 57) [19]; *Hi-Tech Gears Ltd v Yogi* (n 39) [11]; *Mahesh Nathani v Sir Edward Dunlop Hospitals (India) Ltd* [2006] 129 CompCas 678 (Delhi), [23]. These judgments do not make clear what would happen after deposit, but another such order in Bombay was accompanied by a direction permitting withdrawal by the petitioner: *Re M/s Marine Container Services (India) Pvt Ltd* [2001] 106 CompCas 108 (Bombay), [14].

85 *Ganapati Commerce Ltd v Bank of Rajasthan* (n 83) [4].

order was not made later[86]). It is not clear why the orders were made in some cases at admission stage and not in others: the cases offer little insight into the principles governing the availability of this relief. In many cases, judges offered no reason for making the order; in others, they made only peripheral reference to the need to protect the company as a 'running company' or 'going concern'[87], or to protect its workers:

> [T]he court would like to grant time to the respondents to pay their liability, if they so wish. There is no dispute that it is a growing unit and has three factories and a lot of people are dependent for their livelihood on this company. But, equally true is that this cannot be raised a universal defence to a petition for winding up[88].

One decision of the Gujarat High Court suggested that the procedure was available wherever the respondent's defence to non-payment of the petitioner's debt was found to be not *bona fide* but not made *mala fide* either:

> Where the court comes to the conclusion that the defence is not bona fide (as distinguished from the conclusion that the defence is mala fide), the court may give the company an opportunity to pay the debt to the petitioner within the stipulated time limit.[89]

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[86] See *Munshi Ram Om Prakash, Bankers and Commission Agents v Arti Food and Fats Pvt Ltd* [2008] 142 CompCas 678 (Punjab & Haryana), or *Andhra Bank v Silver Line Technologies Ltd* [2008] 143 CompCas 458 (Bombay), where pay-to-exit opportunities appear to have been given for the first time after admission of the petition.

[87] *Fortis Financial v KHSL* (n 39) [10].

[88] *Bharti Telecom Ltd v Altos India Ltd* [2001] 106 CompCas 239 (Punjab and Haryana), [5]; see also *Ranjana Kumar v Indian Dyestuff* (n 83), the court influenced by evidence that the company employed 3,000 workers and was balance sheet solvent to defer admission; *Nepa Ltd v Jnanamandal Ltd* [2001] 107 CompCas 240 (Allahabad), [21]; *Motorola India Pvt Ltd and Motorola Inc v BPL Mobile Cellular Ltd* 2002-2-LW315 (Madras), [69], deferring advertisement.

[89] *Ficom Organics v Laffans* (n 39), [8(IV)(2)]. If the company's defence to non-payment was 'reeking of mala fide', the petition would instead be admitted and advertisement ordered. If the company's defence was neither 'substantial nor a moonshine', falling 'in the grey area', the court could require deposit of money in court and direct the petitioner to prove its claim in civil proceedings: [8](IV)] (on this, see also *NEPC India Ltd v Indian Airlines Limited* 100 (2002) DLT 14 (Delhi)). *Cf Hotline Teletubes v AS Impex Ltd* (n 65) [10], a judge holding that where a defence raised by the company is found not to be *bona fide*, there ought to be no delay in admission.

A small number of English decisions, all handed down in the nineteenth century, were occasionally cited in support of the Indian practice of affording the respondent an opportunity to escape a petition by repaying the petitioner:

> English cases are not wanting where it had been held that "the Court is not bound *ex debito justitiae* to make an immediate order to wind up a company", even whether a petitioning creditors' debt exceeding the required amount is admitted and not paid within time fixed by Statute after a demand by notice, without giving time or opportunity, in the exercise of its discretion, to make arrangements to pay up[90].

Of the two English decisions cited in support of this passage, only one offers evidence analogous to the Indian pay-to-exit practice: the decision in *Re Brighton Hotel*[91], in which Malins V-C ordered a petition by a creditor contributory for an undisputed debt to be stood over for a month to give the company opportunity to pay off the petitioner, enter voluntary liquidation or make other arrangements for continuing operations[92]. There is one other similar case handed down by the same judge[93], but the two cases appear to have been hardly mentioned at all in twentieth century English cases, except for one 1980 decision in which *Brighton Hotel* was distinguished[94], the court holding that the ordinary approach to a undisputed creditor's petition was that the creditor was 'prima facie

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[90] See *Aluminium Corporation v Lakshmi Ratan* (n 73) [15], later discussed in *Global Trust Bank Ltd v Killick Nixon Ltd* [2005] 128 CompCas 1007 (Bombay).

[91] (1868) LR 6 Eq Cas 339.

[92] The other decision, *In re Western of Canada Oil, Lands, and Works Company* (1873-74) LR 17 Eq 1, was one in which the petition was stood over at least in part because a 'large majority' of other creditors of the petitioner's class were opposed to winding-up (5-6) (as to which see further below).

[93] *Re King's Cross Industrial Dwellings Co* (1870-71) LR 11 Eq 149, the judge affirming the entitlement of a creditor to a winding order on establishing a company's inability to pay its debts, but allowing the company two weeks before advertisement to enable it to pay the petitioner. There was also an obiter suggestion from another judge in *Re General Rolling Stock Co Ltd* (1865) 34 Beav 314 (noted in French (n 21) [6.12.2]) that a company could be given time to repay the petitioner, at least if it was factually solvent (on the facts the company was not).

[94] *Re Camburn Petroleum Products Ltd* [1980] 1 WLR 86, Slade J suggesting Malin V-C had regarded the petition in *Brighton Hotel* as more of a contributory's petition than a creditor's petition: 93.

entitled to his order and is prima facie not bound to give time to enable the debtor to pay'[95]. A creditor's ability to threaten the *imminent* making of a winding-up order was identified by the Cork Committee in 1981 as central to the attractiveness of the procedure as a debt enforcement device[96].

The paradox of the Indian pay-to-exit practice is that despite being directed explicitly to the payment of a petitioner's debt, it appears to have reduced the law's capacity to perform a credible debt-enforcement function. The combination of the two innovations described thus far – the introduction of the pre-admission hearing, and the development of the pre-admission pay-to-exit practice – left creditors unable to threaten debtors with swift advertisement, rendering the procedure a poor tool for disciplining (by threat of publicity) the solvent but recalcitrant debtor. Instead, a petitioner must endure delay in the initial process of scheduling a hearing on admission, and then – where a pay-to-exit order is made – additional delay. Additionally, it seems that some debtors have succeeded in obtaining more than one pay-to-exit order. The decision in *Maruti Udyog Ltd v Hindusthan Photo Film Mfg Co Ltd*[97]*,* for example, records how a petition had been 'pending' for two years to enable the respondent to pay off the petitioner[98], before coming up for admission. The judge criticised the company for its 'casual' approach[99],

[95] There was jurisdiction for an adjournment, but such an order would only be given exceptionally: ibid 94. Although French suggests that 'occasionally' judges adjourn petitions for a short time to allow for payment to the petitioner, he does not cite any twentieth century English examples ((n 21) [6.12.2]). The text does give some examples of cases in which adjournments were granted to enable resolution with creditors as a collective, but also notes that 'lengthy adjournment of petitions is now generally deprecated' ([6.12.3.4]).

[96] See Chapter 3, text to n 183.

[97] [2001] 103 CompCas 960 (Madras).

[98] ibid [3].

[99] ibid [10], an attitude the judge attributed to the fact that a 'substantial' proportion of the company's shares were owned by the state.

but nevertheless resolved to give it another two months to pay to avoid advertisement[100]. Other debtors have secured a second pay-to-exit order when appealing the admission of a petition on their failure to comply with the first order[101]. Unsurprisingly, the cases suggest that some debtors simply regarded the order as a delaying tactic. The Patna High Court decision in *Jindal Strips Limited v Hitek Industries (Bihar) Limited*[102], for example, records how the court had given a debtor multiple opportunities to pay, but the only result was delay: 'but as the Court was taking lenient views, the opposite party started dilatory tactics on this plea or that plea on each and every date'[103]. In the Punjab and Haryana High Court, a debtor sought adjournments for four months on the promise of repaying the petitioner, but then 'took a somersault' to allege the debt was disputed: 'it appears that all this time was being gained to achieve such ends which would frustrate the proceedings'[104].

Procedural developments in the treatment of creditors' petitions at the pre-advertisement stage undoubtedly weakened the attractiveness of the liquidation procedure to petitioning creditors, but they also threatened the interests of other creditors. The key feature of the pre-admission or pre-advertisement pay-to-exit order is that it operates *prior* to public notification of the petition. Other creditors or potential creditors of the company could well be unaware of the petition during the lengthy pre-

100 ibid [23]. See also *Essar Gujarat Ltd (Steel Division) and Shree Venkatesh Trades and Agencies Pvt Ltd v Shree Kangra Steels Pvt Ltd* [1999] 97 CompCas 726 (Himachal Pradesh); *Cravatex Limited v Vitta Mazda Limited* [2001] 103 CompCas 189 (Gujarat); *Sheetal Fabrics v Coir Cushion Ltd* 120 (2005) DLT 693 (Delhi).

101 As in *Straw Board Manufacturing v Mahalakshmi Sugar* (n 83); similarly *Motorola India Ltd v DSS Mobile Communications Ltd* [2004] 56 SCL 601 (Delhi) (multiple appeals and further pay to exit orders made in consequence).

102 1998 (3) BJLR 2275 (Patna).

103 ibid [6]. See also *Dee Dee Electricals v Road Master* (n 54) [12].

104 *Bharti Telecom Ltd v Altos India* (n 88) [7].

admission period, a point acknowledged by Jayasimha Babu J in *Maruti Udyog Ltd* (above) when he observed, before deciding to give the respondent further time to pay, 'whether or not other creditors of the company are desirous of supporting this petition will be known when this petition is advertised and they will become aware of the petition'[105]. In some cases multiple petitions by creditors were filed but not joined together, pay-to-exit orders operating in each[106] – the respondent apparently free to choose whether to pay one petitioner, the other, or both. In *Ranbaxy Laboratories v MS Shoes East (I) Ltd*[107], there were twelve creditors' petitions on foot, but the judgment concerned only whether one of those should be admitted. During the pendency of that petition (over eighteen months), other petitioners had been paid in full, but the petitioner had not been paid[108]. The judge simply admitted the petition, noting that those other petitioning creditors who had been paid no longer pressed their petitions. The question of whether payments such as those made in *Ranbaxy* could be vulnerable to later avoidance appears to have been rarely considered. Under the Companies Act 1956, dispositions of company property after the commencement of a winding-up – defined as the date of the presentation of the petition[109] - are void, unless otherwise ordered by the court[110]. In one recent Delhi High

105 (n 97) [20].

106 As in *Jindal Strips* (n 102) (see [11]), in which there were two petitions, in both of which the respondent enjoyed adjournments to settle with the petitioner.

107 [1998] 93 CompCas 296 (Delhi).

108 ibid [5].

109 Section 441.

110 Section 536(2). The equivalent provision in the UK has been identified as one of the reasons for the reluctance of English courts to make 'repeated and lengthy adjournments' on the hearing of creditors' petitions: see 'Practice Note (Companies: Winding Up) [1977] 1 WLR 1066, extracted in French (n 21) [4.4.5.2]; the same point was made in India historically in relation to the adjournment practice noted above: *Ramesh Premchand Shah v Engineers' Enterprises Pvt Ltd* [1977] 47 CompCas 294 (Bombay), [11].

Court decision[111], the respondent company argued that payments made to the petitioner after the filing of a petition (pursuant to a pay-to-exit arrangement) were rendered void by the making of the winding-up order. The judge held that the payments fell outside the scope of the avoidance rule: attempts by debtors to 'salvage the situation' by paying off petitioning creditors were common, and such payments would not be required to be repaid[112]. Of course, the judge could simply have held that the payments fell outside the rule because they were authorised by the court (the avoidance rule applying only 'unless otherwise ordered by the court'), but such a response would not grapple with the underlying point – inequality of treatment between creditors – at all.

5.2.3 Substantive questions: solvency, and discretion

There are two features of the UK liquidation procedure that might be regarded as particularly important to creditors contemplating the initiation of winding up proceedings, or threatening to do so. The first relates to how a petitioner can prove that a company is 'unable to pay its debts'; the second relates to how a creditor can expect the court to act on proof of inability to pay debts. The first is a rule of statute[113], under which a company is deemed unable to pay its debts where a petitioner demonstrates the company's failure to pay a single, undisputed debt on demand. The second is a judicially developed maxim to the effect that a creditor who establishes the company's inability to

[111] *Motorola India v DSS Mobile* (n 101).

[112] ibid [28]. In reaching this conclusion, the judge expressed disapproval of an earlier decision of the Bombay High Court (*Castwell Engineering Corporation v Bombay Castwell Pvt Ltd* [1984] 55 CompCas 75), in which a judge had concluded that a petitioning creditor who was part-paid pursuant to a pay-to-exit order was not entitled to proceed with its petition without depositing into court payments received during the pendency of the petition (the petitioner declined, so the petition was dismissed).

[113] Presently contained in section 123(1) of the Insolvency Act 1986.

pay debts can ordinarily expect the court to exercise its discretion to make the order[114]. A review of the dataset of Indian judgments suggests that the position of petitioning creditors in India has developed differently. The solvency rule also appears in the Indian statutory provisions, but has on occasion been diluted by the courts, making it more difficult for petitioners to establish inability to pay debts. And although some judges endorsed the English maxim on a petitioner's entitlement to a winding up order, many others recognised a more wide-ranging discretion, rendering the position of a petitioner who succeeded in establishing inability to pay debts more uncertain.

Solvency

India's liquidation procedure offers creditors a number of routes to establishing the respondent's insolvency, or more precisely its 'inability to pay its debts', so as to enable the making of a winding-up order under section 433(e). Section 434(1) of the Companies Act 1956 provides that a company will be 'deemed' to be insolvent in certain circumstances, including where a creditor has served a statutory demand for payment of a debt (of more than 500 rupees) on the company and the debt remains unpaid after three weeks[115]. The deeming provision treats inability to pay a single (undisputed) debt as a signal of broader inability to pay debts on demand (or, in other words, of commercial or cash-flow insolvency)[116]. It relieves the petitioning creditor of any obligation to prove insolvency in some more global sense (for example, by showing that liabilities exceed assets, *i.e.* balance sheet insolvency): a creditor need have no more information about the

[114] See below, text to n 151.

[115] And also where execution or other process issued on a judgment in favour of a creditor is returned unsatisfied: section 434(1)(b).

[116] As acknowledged by Sir George Jessel MR in *Re Globe New Patent Iron and Steel Co* (1875) LR 20 Eq 337, 338.

company's affairs than that pertaining to his or her own debt to prove the company's inability to pay[117]. Indeed, the effect of the deeming provision is, as the Privy Council acknowledged in *Malayan Plant (Pte) Ltd v Moscow Narodny Bank Ltd*[118], that a company that is balance-sheet solvent may nevertheless be held 'unable to pay its debts', and wound-up[119]. The assumption that underlies the deeming provision appears to be that a financially distressed but economically sound company ought to be able to raise finance or otherwise negotiate out of a cash-flow crisis, and that a creditor is 'not bound to give time'[120] for it to do so.

In the UK, the equivalent provisions of the Insolvency Act 1986 (and before it, successive companies statutes) have long been interpreted generously to creditors, with courts being willing to accept a company's inability to pay its debts on simple proof of its failure to pay a single (undisputed) debt, without the creditor having to issue a formal statutory demand (that is, the deeming provision has been given an extended operation)[121]. Despite some early indications to the contrary[122], this position does not

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[117] *Deutsche Homoopathie-Union DHU-Arzneimittel GmbH v RK Import Private Limited and German Homeopathic Distributors* [2008] 145 CompCas 377 (Delhi), [8].

[118] [1980] UKPC 13 (8 May 1980).

[119] ibid, endorsing a statement from *Buckley on the Companies Act* that a 'it is useless to say that if its assets are realized there will be ample to pay twenty shillings in the pound: this is not the test. A company may be at the same time insolvent and wealthy… if it not have the assets available to meet its current liabilities it is commercially insolvent and may be wound up' (3) (also extracted in French (n 21) [6.3.2.2]). See also *Escorts Finance Ltd v Secur Finance Ltd* [2006] 131 CompCas 608 (Allahabad), [13].

[120] *Malayan Plant* ibid 3.

[121] This rule dates back to at least *Re Globe New Patent Iron and Steel* (n 116), in which Sir George Jessel MR held that the proof of non-payment was enough to show that the company was unable to pay its debts; noted in French (n 21) [6.6.4].

[122] See *Naresh Fabs v Gudiya* (n 32) [5], the judge holding that it was open to the court to treat the petition as a notice that would enliven the deeming provision; see also *Re Janzabar Manna Estate Limited* AIR 1931 Cal 692 (Calcutta) [13], noted in TA Ramachandran, *A Digest of Company Cases* (Company Law Institute of India 1957), 661.

appear to have been adopted in India: without service of a formal statutory demand, it seems that petitioners cannot rely on non-payment alone to evidence inability to pay debts[123] (that is, the deeming provision has been strictly construed). Additionally, some judges have gone further, weakening the effect of the deeming provision where it would otherwise be applicable, such that it is interpreted as raising no more than a 'presumption' about the company's financial position, capable of being rebutted by fuller evidence of solvency. There is little evidence of this in the planned economy period. Sparse though the case law is for this period, the available cases suggest that judges generally accepted evidence of non-payment in response to a statutory demand for an undisputed debt as proof of inability to pay debts[124] (though as to whether this

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[123] See for example *NL Mehta Cinema Enterprises P Ltd v Pravinchandra P Mehta* (1989) 91 BomLR 92 (Bombay), [13]; *B Viswanathan v Seshasayee Paper and Boards Ltd* [1992] 73 CompCas 136 (Madras), [22]; *PSVP Vittal Rao v Progressive Constructions Private Ltd*, unreported decision of the High Court of Andhra Pradesh, 28 December 1992, [73]; *Ramdas and Co v Kitti Steels Ltd* [2001] 103 CompCas 199 (Andhra Pradesh), [25]; *N Gopalakrishnan v Asianet Satellite Communications Ltd* [2001] 104 CompCas 276 (Kerala); *Motilal Agarwal v Diabari Tea Company Ltd* [2005] 128 CompCas 672 (Calcutta); *State Black Shipping Company and Viraj Overseas* [2005] 125 CompCas 831 (Delhi); *cf* perhaps *Evergreen Plywood Industries P Ltd v Circular Leasing and Resources P Ltd* [2005] 128 CompCas 698 (Calcutta). Two decisions - *Glass and Ceramic Decorators v Virat Crane Bottling Ltd* 2005(6) ALD 7 (Andhra Pradesh), and *SN Compunaary v RMD Publishers P Ltd* [2005] 59 SCL 309 (Rajasthan) – go further, suggesting that a petition cannot be admitted without proof of service of statutory demand.

[124] See *Re Advent Corporation* (n 31) [12] (rejecting the proposition that more was required to prove commercial insolvency than non-payment in response to receipt of a statutory demand); *C Hariprasad v Amalgamated Commercial Traders* AIR 1964 Mad 519 (Madras), [10], an appeal case in which the Madras High Court held that a judge at first instance had been wrong to suggest that the deeming provision gave rise to presumption that could be rebutted by evidence of solvency (the case went to the Supreme Court (*Amalgamated Commercial Traders P Ltd v ACK Krishnaswami* [1965] 35 CompCas 456 (SC)), but was decided on the basis that the debt was disputed, without discussion of the first instance judge's remarks); *Gulamhussein Ahmedalli and Co v Canhag Private Ltd* [1972] 42 CompCas 136 (Bombay), [4]-[5]; *Misrilal Dharamchand P Ltd v B Patnaik Mines P Ltd* [1978] 48 CompCas 494 (Orissa), [12]; *All India General Transport v Raj Kumar Mittal* (n 33); *Paramjit Lal Bhadwar v Prem Spinning and Weaving Mills Co Ltd* [1986] 60 CompCas 420 (Allahabad), [21] (but see below as to discretion, n 159); *Sarabhai Machinery v Haryana Detergents Ltd* [1986] 60 CompCas 169 (Punjab & Haryana), [8]; *Hedge and Golay Limited v State Bank of India* ILR 1987 KAR 2673 (Karnataka), [34] (an appeal case); *Narula v Northfield* (n 32) [7]; *Hind Techno v Jaipur Wire* (n 37) [18]; *Tinsukia Vastra Bhandar v Assam Tea Corporation* [1991] 72 CompCas 178 (Gauhati), [4] (but see below as to discretion). *Cf Re Reechem Private Ltd* [1985] 57 CompCas 200 (Andhra Pradesh), [40] and and perhaps similarly *Claridge v Nav Bharat* (n 57) [13]-[14].

necessarily led to the making of a winding-up order, see below, 'Discretion'). The position from the 1990s onwards is however more complex.

The complexity in the case law emerged in the mid-1990s, mostly in judgments handed down on the preliminary questions of whether a petition should be admitted or advertised. The development coincided with the entrenchment of the practice of holding a hearing to determine whether a petition should be admitted (the first judicial innovation noted above), as judges grappled with the question of what substantive issues were to be resolved before admission. In 1995, a judge of the Karnataka High Court handed down the decision in *Kanchanaganga Chemical Industries v Mysore Chipboards Ltd*[125], dismissing a creditor's petition founded on the respondent's inability to pay its debts. The petitioner relied on a statutory demand, but also alleged that the company's liabilities exceeded its assets (*i.e.* it was balance sheet insolvent) and that the company was commercially insolvent (*i.e.* not in a position to pay debts as they fell due)[126]. The petitioner tendered evidence of the respondent's acknowledgment of the debt and of the issuing of the demand, together with a reply containing a further acknowledgement. The judgment did not consider this evidence in any detail, the judge apparently having resolved to dismiss the petition at the pre-admission stage on the basis that it disclosed inadequate evidence of the company's broader financial position. On the crucial question of the role of the deeming provision in section 434(1), drawn to the court's attention by counsel for the petitioner, the judge observed:

> A proper demand… only gives the benefit of presumption that arises under it. Section 434 envisages the right of action to the creditor to initiate action for winding-up on the ground of the company's inability to

[125] [1998] 91 CompCas 646 (Karnataka).

[126] ibid [3].

> pay its debts. Though a petitioning creditor whose debt is not paid has a right *ex debito justitiae* to a winding-up order, clause (a) of sub-section (1) gives a statutory right to a creditor to have the company wound-up.
> To raise the presumption of inability to pay, it is not enough merely to show that the company has omitted to pay the debt despite service of statutory notice, *it must be further be shown that the company omitted to pay without reasonable excuse and the condition of insolvency in the commercial sense exists*[127].

The italicised statement – which negates the deeming provision, the effect of which would otherwise be to relieve the creditor of any obligation to evidence the broader financial position – was subsequently reiterated by an appellate bench of the Gujarat High Court[128], and by some members of the Andhra Pradesh High Court[129] (but not others, one expressly disapproving it[130]).

There do not appear to be very many cases as extreme as *Kanchanaganga Chemical Industries v Mysore Chipboards Ltd*, where the sole basis of dismissal appears to have been the petitioner's failure to evidence the respondent's 'inability to pay its debts', notwithstanding evidence of the service of a demand for an undisputed debt[131]. There is

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[127] ibid [6]-[7], emphasis added.

[128] *Ashok Fashions v Meghdoot* (n 47) [23] but attributing it to *Airwings P Ltd v Victoria Air Cargo GmbH* [1995] 84 CompCas 688 (Karnataka), although that decision did recognise the role of the deeming provision (see [39](II)(c)).

[129] See *Reliance Infocomm v Sheetal* (n 49) [45] (decision of Ramesh Ranganathan J); see also the decision of B Seshasayana Reddy J in *Venkateswara Flexo Pack P Ltd v Sampre Nutritions Ltd* [2011] 166 CompCas 281 (Andhra Pradesh), [14].

[130] *Bhupinder Investment Company P Ltd v Midland Industries Limited* 1998 (5) ALD 117 (Andhra Pradesh), [13] (decision of Krishna Saran Shrivastav J). For other judges who continued to give effect to the deeming provision, see below, nn 133 and 134.

[131] The closest analogue is *Rajearajeswari Packaging v Dev Fasteners* (n 55), a judgment on admission in which the petitioner established a debt and service of demand. But the petition was dismissed, apparently on the basis that it alleged only the company's failure to 'liquidate the outstanding', or to pay the debt, without alleging a broader inability to pay. The judge concluded that the company was financially sound, employed 300 workers and was 'continuing its business normally', and there was no evidence that the company was commercially insolvent. An appeal by the creditor was dismissed, the bench simply agreeing that there had been a 'thorough lack of pleading' by the petitioner: [2008] 144 CompCas 351 (Madras). The next closest example is probably *American Express v Core Health* (n 48), though the facts are more complex.

an additional, also small, body of cases in which the petitioner appears to have succeeded in getting a petition admitted or advertised, or a winding-up order made, only because they were able to demonstrate the company's broader inability to pay its debts, notwithstanding their reliance on an unsatisfied demand for a debt found undisputed[132]. But even if these two categories of case (those in which (i) the petition was dismissed on solvency grounds despite evidence of non-payment of an undisputed debt on demand, and (ii) the petition survived only because there was, in addition to such evidence, broader evidence of insolvency) are put together, they still amount to only a small number of cases turning explicitly on the application of a more demanding test of 'inability to pay debts' than the statute requires. There are more cases in which companies have been held unable to pay their debts on the basis of nothing more than evidence of non-compliance with a demand[133], with some judges expressly rejecting use of any more demanding test of insolvency[134]. An argument by a respondent that it was in fact able to pay its debts but had for some reason been unable to pay the petitioner's appears to have been most likely to generate an interim procedural indulgence (*e.g.* the

[132] See, for example, *Arvind Investment Consultant v Presto Finance Ltd* [1998] 94 CompCas 350 (Gujarat) (decision of JN Bhatt J), [14], identifying the deeming provision as raising a 'presumption' of inability to pay debts, but only where the petitioner demonstrates that the company has failed to pay 'without reasonable excuse', and finding this on the facts because the petitioner had shown non-payment of its debt as well as the company's inability to discharge other debts; *Ranbaxy Laboratories Ltd v MS Shoes East (I) Ltd* [1998] 93 CompCas 296 (Delhi), [10]-[13]; *BP Malini v Ramachandra Pesticides Pvt Ltd* [2001] 103 CompCas 444 (Karnataka); *Tata Iron and Steel Co Ltd v Fleetweld (India) Ltd* [2003] 115 CompCas 431 (Gujarat), [10]-[11] (decision of NG Nandi J).

[133] See for example *Industrial Designs Bureau v Falcon Gulf Ceramics Ltd* [1996] 86 CompCas 620 (Rajasthan) (judgment on admission); *Goodwill India Ltd v PSB Paper Mills Pvt Ltd* AIR 1996 P&H 60 (Punjab & Haryana), [8]-[9] (judgment on admission); *In the matter of Sunmick Exports Pvt Ltd, Deutsche Bank AG* 1999(3) BomCR 808 (Bombay), [9] (judgment on admission); *Asian Electronics v Murugan* (n 65) (winding up order).

[134] See for example *LKP Merchant Financing Ltd v Arvin Liquid Gases Limited* [2001] 103 CompCas 211 (Gujarat); *Som Nath Jain v Oswal* (n 39) [21]; *Enernorth Industries v VBC* (n 83) [35]; *Tata Iron and Steel Company Limited v Omega Cables Limited* [2009] 149 CompCas 459 (Madras), [16] (an appeal case) (but compare with a decision of the same court in *Yehuda Silberberg Ltd v Premier Poly Weaves* 2010-3-LW 856 (Madras), [34], an appeal case; *Deutsche Homoopathie-Union v RK Import* (n 117) [8A]; *Corporate Management Council of India P Ltd v Lonza India P Ltd* [2009] 150 CompCas 898 (Bombay), discussing *Re Advent Corporation* (n 31).

making of a pay-to-exit order, the 'safest' way to allow the company to prove its capacity to pay[135]). Cases in which judges explicitly applied a more demanding test of 'inability to pay debts' than would be required if the deeming provision were given effect appear to be fairly exceptional.

There is however one other (larger) series of cases, which might be called 'disputed debt' cases, in which petitioners may have also suffered from the application of an unnecessarily demanding test of inability to pay debts. It is not immediately obvious why the question of factual solvency would be relevant where the petitioner seeks winding-up on the basis of the respondent's inability to pay its debts, as evidenced by non-payment of a debt on demand, and that debt is found to be disputed. The ordinary result in such a case would be dismissal, the allegation of inability to pay debts having been found to depend on a debt that is disputed[136]. There are however a number of cases in which a creditor's petition appears to have been dismissed both on the basis that the debt on which the petitioner relies is *bona fide* disputed, *and* that the respondent is in any case solvent. Confusion over the relevance of solvency in a case in which the debt on which the petitioner relies is disputed may have been fuelled by the Supreme Court's decision in *PICUP v North India Petrochemical Ltd*, discussed above[137]. In the judgment (recall that the issue was whether a judge of the Allahabad High Court had been right to admit a creditor's petition), the Supreme Court identified two questions for determination: (i) whether there was a debt, and (ii) whether the company was 'unable to

[135] *Oswal Minerals v Mysore Calcides and Chemicals Pvt Ltd* [2000] 100 CompCas 100 (Karnataka), [3]. For a striking example of this approach, see *Ranjana Kumar v Indian Dyestuff* (n 83).

[136] As noted by the Supreme Court in *Amalgamated Commercial Traders v ACK Krishnaswami* (n 124) [14]. An alternative would be the continuation of the petition with a new creditor substituted for the original petitioner, under r 101 of the Companies (Court) Rules 1959.

[137] [1994] 79 CompCas 835 (SC), above text to n 40.

pay the same', the court suggesting inability was to be interpreted in the 'commercial sense', meaning 'unable to meet current demands'[138] (without noting the role of the deeming provision in helping establish this, even though the petition in question appears to have relied on it)[139]. The court concluded that there had been no justification for admission, finding both that the debt on which the petitioner relied was disputed, *and* that the financial position of the company was 'sound'[140]. The second finding may have been added to offer a complete answer to both questions framed by the Court at the outset, but its inclusion risked confusion. If the petition relied on the respondent's failure to pay a single debt (using the deeming provision), and that debt was disputed, then the allegation of inability to pay debts ought to have fallen away: there should have been no need for a separate positive finding of solvency.

Later cases suggest some judges struggled with this aspect of *PICUP*. In one Gujarat case[141], for example, counsel argued (in reliance on *PICUP*) that even if the court found that the debt on which the petitioner relied was undisputed and had been the subject of a valid demand, it would not admit the petition if the company could demonstrate its commercial solvency. The judge concluded that the relevance of solvency would depend on the strength of the defence given by the company for non-payment: if it was clear that the company's defence was a *bona fide* one, then the petition

[138] ibid [27]. This borrowed from the earlier judgment of the Calcutta High Court in *Bangasri Ice and Cold Storage Ltd v Kali Charan Banerjee* AIR 1962 Cal 613, but in that case the court also discussed the role of the deeming provision.

[139] This omission clearly influenced the judgment in *Kanchanaganga Chemical Industries v Mysore Chipboards Ltd* (n 125), the judge interpreting *PICUP* as requiring an inquiry into commercial solvency at the stage of admitting the petition (see [16]); *cf Corporate Management v Lonza* (n 134) [42].

[140] *PICUP* (n 137) [33]-[35].

[141] *Ficom Organics v Laffans* (n 39).

would be dismissed; if the defence was clearly not *bona fide*, the petition could be admitted (subject perhaps to a pay-to-exit order) [142]; if, however, the court could only tentatively conclude that the defence was not *bona fide,* then it would also have to 'give a prima facie or tentative finding that the company is commercially insolvent' before admitting[143]. When another counsel repeated the argument made to the Gujarat court in a recent Supreme Court case, the Supreme Court attempted to clarify the position by suggesting:

> An examination of the company's solvency may be a useful aid in determining whether the refusal to pay debt is a result of a bona fide dispute as to the liability or whether it reflects an inability to pay. Of course, if there is no dispute as to the company's liability, it is difficult to hold that the company should be able to pay the debt merely by proving that it is able to pay the debts... If the company refuses to pay, without good reason, it should not be able to avoid the statutory demand by proving, at the statutory demand stage, that it is solvent. In other words, commercial solvency can be seen as relevant as to whether there was a dispute as to the debt, not as a ground in itself, that means it cannot be characterized as a stand alone ground[144].

The difficulty with this approach is that it may tempt a fact-finder to be influenced by evidence of the company's solvency to hold that a debt is disputed, without a rigorous inquiry into the dispute's validity. There is some evidence of this occurring: in some cases, judges appear to have been led to dismiss a creditor's petition primarily by their finding that the company is commercially solvent and secondarily by their finding that the petitioner's debt is disputed[145]; in some others, judges appear to have been

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142 If the defence was made dishonestly, then admission would simply follow: ibid [8](IV). On the facts, the judge held that the defence was clearly not *bona fide* but was also not made dishonestly, such that admission could follow subject to a pay-to-exit order.

143 See similar statements in *Escorts Finance v Secur* (n 119) [16]-[19], and *Tubecon Products P Ltd v Arjun Technologies I Ltd,* unreported decision of Chitra Venkataraman J in the High Court of Madras, 1 March 2006.

144 *IBA Health (I) Pvt Ltd v Info-Drive Systems Snd. Bhd.* [2010] 159 CompCas 369 (SC), [22].

145 See for example *Yehuda Silberberg Ltd v Premier Polyweaves P Ltd* [2009] 147 CompCas 360 (Madras) (appeal dismissed 2010-3-LW 856), and *Dallah Albaraka v Pentasoft* (n 48), an even more extreme example from the same judge, emphasising the discretionary nature of the court's role (as to which see further

willing to accept that a debt was disputed on fairly spurious evidence, in the context of broader evidence that the company was otherwise solvent[146]. More generally, there appear to be a number of cases in which judges were very quick to characterise the petitioner's debt as disputed, sometimes without thorough evaluation of the respondent's defence[147], or in circumstances where the defence appeared weak[148] or related to only a part of the petitioner's debt[149], and even where the respondent did not appear at all, the judge simply creating a defence[150]. It is difficult to quantify how many petitioners

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below); *Haryana Telecom Ltd v Himachal Futuristic Communication Ltd* [2006] 133 CompCas 351 (Himachal Pradesh); see also *Tata Iron and Steel Co v Micro Forge (India) Ltd* [2001] 104 CompCas 533 (Gujarat), an appellate decision.

146 See for example *Mangal Finance Limited v Express Confectioners Pvt Ltd* [2000] 100 CompCas 399 (Patna); two judgments by the same judge in Bombay - *Virgin Records (I) P Ltd v Milestone Music Distribution P Ltd,* unreported decision of Kochar J in the Bombay High Court, 18 July 2001 (the judge also noting the availability of an alternative remedy, as to which see below text to n 177) and *Manipal Finance Corporation Ltd v CRC Carrier Ltd* [2001] 107 CompCas 288 (Bombay); *Hind Syntex Ltd v Dewas Textile Mills* [2003] 115 CompCas 51 (Madras), a judgment of AM Sapre J, as to which see further below n 183.

147 See for example *Dee Print Asia v Curefast Remedies Ltd* [1999] 98 CompCas 90 (Punjab & Haryana), [4].

148 See for example *Ranbaxy Laboratories Limited v Jerath Electronics and Allied Industries* 2000(2) ShimLC 342 (Himachal Pradesh), and two decisions of different judges in Madras - *Civicons Engineers and Contractors v Aurofood Limited* [2000] 100 CompCas 623 and *Ishwar Industries Ltd v Lakshmi Machine Works Ltd* [2010] 156 CompCas 219 – in which evidence that the respondent had filed an appeal against the decree debt on which the petitioner relied was sufficient to evidence a dispute; *Windson International v HM Electricals P Ltd* [2009] 148 CompCas 486 (Orissa).

149 See for example *BOC India Ltd v Zinc Products and Company Pvt Ltd* [2001] 103 CompCas 759 (Patna) (respondent appearing to concede liability for 3,03,686.59 of the 5,48,978.16 rupees claimed by the petitioner); *Thirukumara Trading Agency v Sleek Textiles Industries Ltd* [2008] 146 CompCas 4 (Madras), the judge finding the debt disputed despite an admission in relation to at least 65,603.30 of the 1,02,469 rupees claimed; *Indo Swiss Jewels Ltd v HMT Watches Ltd* [2010] 158 CompCas 292 (Karnataka). The position may have been exacerbated by the widely cited statement of a judge of the Madras High Court that any dispute as to the principal, 'however small' would scupper a petition (*Tube Investments of India Ltd v Rim and Accessories P Ltd* (1990) 3 CompLJ 322), a statement contrary to Supreme Court authority requiring a dispute to be 'substantial': *Mahusudan Gordhandas & Co v Madhu Woollen Industries Pvt Ltd* 1971 AIR 2600, [21]; see also *Indian Duplicator v VPL* (n 84).

150 See *KV Associates P Ltd v Matharu Chemical Industries* [2004] 120 CompCas 14 (Rajasthan) (judge inferred dispute from fact that the respondent stopped paying the petitioner, without respondent even making submissions); *European Metal Recycling Limited v Blue Engineering Private Limited* [2010] 154 CompCas 35 (Delhi) (judge suggesting some defences the respondent might have raised had it appeared, and dismissing the petition, also noting that there was no evidence of the company's financial position despite the petitioner's reliance on a statutory demand).

suffered from a judicial willingness to find a debt disputed: a large proportion of the petitions in the dataset were resolved by dismissal (242 of 454 judgments), the majority of these on the basis or part-basis that the debt was disputed; in many of these cases, it is not possible to evaluate the strength of the defence on the evidence provided in the judgment. It is therefore possible that other petitioners were prejudiced in this way, and wherever this occurred they were deprived of the benefit of the deeming provision, the effect of which should have been – wherever, on a proper examination, the debt was not actually disputed – to mandate a finding of inability to pay debts.

Discretion

Section 433(1) of the Companies Act 1956 provides:

> On hearing a winding up petition, the Court may –
>
> (a) dismiss it, with or without costs; or
>
> (b) adjourn the hearing conditionally or unconditionally; or
>
> (c) make any interim order that it thinks fit; or
>
> (d) make an order for winding up the company with or without costs, or any other order that it thinks fit…

This section provides no guidance on when the court should favour (d) - the making of the winding-up order – over the other orders. But in the UK, a series of judicial decisions handed down in the late nineteenth century established a 'maxim'[151] that a creditor who established a company's inability to pay debts was ordinarily entitled to a winding-up order (often expressed as an entitlement, at least as between creditor and company, to the order '*ex debito justitiae*', or as of right)[152]. The creditor's entitlement was

[151] *Re Chapel House Colliery Company* (1883) LR 24 Ch D 259, 268 (Cotton LJ).

[152] See *Bowes v The Directors, etc of The Hope Life Insurance and Guarantee Company* 11 E.R. 1383, 1388-1389; *Re Chapel House Colliery Company* ibid (subject to the discussion in n 153 below); *Re Krasnapolsky Restaurant and*

never absolute: judges recognised exceptions, of which the most important was that a petitioner could be defeated by evidence that an 'overwhelming majority of creditors has given its voice against winding-up'[153]. In the absence of recognised exceptional circumstances, however, a creditor would be entitled to expect the maxim to guide the exercise of the court's discretion, such that proof of inability to pay debts (for example, by proof of non-payment of the petitioner's non-disputed debt despite demand) could be expected to lead to the making of the order[154] [155].

A review of the dataset suggests that the Indian position on the exercise of the court's discretion to wind up a company found unable to pay its debts has always been (at least for the post-independence period, and perhaps longer) more complex. A few judges in the planned economy period endorsed the English *ex debito justitiae* maxim, expressing the view (with reference to English cases and textbooks) that a petitioning creditor was entitled[156] to the making of a winding up order, although not always

Winter Garden Company [1892] 3 Ch 174, 177; *Re Crigglestone Coal Company Limited* [1906] 2 Ch 327. See later *Re Amalgamated Properties of Rhodesia (1913) Limited* [1917] 2 Ch 115, 117-118, and the more recent authorities cited in French (n 21) [6.12].

[153] *Re Chapel House Colliery Company* ibid 270 (Bowen LJ); see earlier *Re Uruguay Central and Hygueritas Railway Company of Monte Video* (1879) LR 11 Ch D 372. Some of the judges in these cases suggested a second exception, where the petitioner could obtain no benefit from the winding-up, for example because the company had no assets which would be available to an unsecured petitioner, but this exception was reined in by *Re Crigglestone Coal Company Limited* ibid, and by a statutory amendment providing that a winding up order was not to be refused only on the basis that the company had no assets or no unencumbered assets: section 29 of the Companies Act 1907 (UK). The majority creditor 'exception' has been explained by reference to the collective nature of a winding-up, the petitioner said to act as representative for creditors as a class: *Crigglestone* 331-332; also noted in French (n 21) [6.12.1.4]. On the exception, see more recently *Re P&J Macrae Ltd* [1961] 1 WLR 229, and *Re J D Swain Ltd* [1965] 1 WLR 909.

[154] Although not necessarily immediately, with a few early English cases appearing to permit delays to enable repayment to the petitioner, as noted above (text to n 90).

[155] *Re Southard & Co Ltd* [1979] 1 WLR 1198, 1203 and 1204 (though on the facts the case was an exceptional one); *Re a company (No 0010382 of 1992), ex parte Computer Partnership Ltd* [1993] BCLC 597, 600, also noted in Goode (n 21) [5-19].

[156] Subject to the views of other creditors, as to which see generally *Mahusudan v Madhu Woollen* (n 149) [23].

immediately (a petitioner could be delayed by a procedural indulgence being given to the debtor, such as an adjournment or pay-to-exit order)[157]. But other judges of the same period expressed the view that the court had a wider-ranging discretion that permitted it to both delay the making of a winding-up order (by granting the debtor time to pay) *and* to entirely dismiss the petition, despite proof of inability to pay debts.

In a 1969 decision of the Allahabad High Court, a judge opined (partly in reliance on a 1939 decision of the same court)[158] that:

> [T]he court may, if there are sufficient counter-balancing equitable grounds, deny an immediate winding-up order or, in appropriate cases, *even refuse it altogether in spite of the proved inability of the company to pay its debts*. Exercise of such discretionary power must necessarily be governed by justice and equity[159].

In the 1970 decision in *Misrilal Dharamchand P Ltd v B Patnaik Mines P Ltd* (discussed above), the judge similarly opined that it was open to the court, on proof of inability to pay its debts, to make a conditional order (affording the respondent time to recover), or to simply refuse to order winding-up[160]. A series of subsequent decisions affirmed the

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[157] See the decisions of Vimadalal J in *Advent Corporation* (n 31) [7] and [14], citing *Buckley on the Companies Act*, 13th ed.; *Seksaria Cotton Mills Ltd* (n 73) ([1], but ordering a 3 month adjournment); *Re Focus Advertising Ltd* [1974] 44 CompCas 567 (Bombay) (successfully appealed on basis of view of majority of creditors: [1975] 45 CompCas 534). See also *Bipla Chemicals v Keshariya* (n 32) [16]-[17] (endorsing *Focus Advertising* at first instance, but noting possibility of interim relief at hearing stage); *Re Yashodan Chit Fund Pvt Ltd and Goel Bros Pvt Ltd v Yashodan Chit Fund Pvt Ltd* [1980] 50 CompCas 356 (Bombay), [5] (decision of RL Aggarwal J).

[158] *W.T. Henley's Telegraph Works Co Ltd v Gorakhpur Electric Supply Co Ltd* AIR 1936 All 840 (Allahabad), [16], Iqbal Ahmad J observing: 'It would thus appear that the company is unable to pay its debts. This fact, however, does not necessarily entitle the petitioner to an order for the winding up… as the discretion to pass such an order, even in the case of the inability of a company to pay its debts, is vested in this court…'.

[159] *Aluminium Corporation v Lakshmi Ratan* (n 73) [17], confining the English authorities on the *ex debito justitiae* maxim to their facts ([13]). This aspect of *Aluminium Corp* was endorsed in a later decision of the same court in *Paramjit Lal Bhadwar v Prem* (n 124) [20], and elsewhere (*State Trading Corporation of India Ltd v Punjab Tanneries Ltd* [1989] 66 CompCas 634 (Punjab & Haryana), [5]-[6]; *Jugalkishore Benarsidas v South India Saw Mills P Ltd* [1975] 45 CompCas 273 (Kerala), [9]-[10]).

[160] (n 124) [13]. On the facts, the judge held that a conditional order was more appropriate than dismissal: a six-month stay was ordered. The same reasoning was applied by a later judge in the same court in *Hindon Foods* (n 78), the judge acknowledging the court's discretionary role but finding no 'extraordinary

breadth of the court's discretion, and introduced a second related idea – that winding-up was a negative outcome, 'being in the nature of death sentence of a juristic person'[161], to be avoided wherever possible:

> Under section 433, the power of the court to wind up a company is discretionary and there is authority for the proposition that normally courts should be slow in directing the winding up of a company unless it becomes inevitable.[162]

The notion that winding up is 'the last thing that a court would do and not the first thing' has been linked to the 'pioneering' decisions of a judge of the Gujarat High Court in the 1970s (DA Desai J)[163], who appears to have sought out creative solutions (including the pursuit of schemes of arrangements, and the appointment of a provisional liquidator to work with a promoter to run a firm while a scheme was explored) to avoid the liquidation of some sick industrial firms[164]. In one case, this judge expressly retired the *ex debito justitiae* maxim, suggesting that it had been 'firmly entrenched' at a time when '*laissez faire* economy was the prevailing economic doctrine', but that changing conditions meant that it would be a 'bold' person that would maintain that the court's only concern was the interests of creditors and shareholders, and not employees[165]. A decade later, it

circumstance' that warranted rejecting the petition – a procedural indulgence (a pay to exit order) was sufficient ([9]).

161 *Haryana Telecom v Himachal Futuristic* (n 145) [36]; see also *Walnut Packaging Private Limited v The Sirpur Paper Mills Limited* 2009 (4) ALD 7, [8] ('The norm is to infuse new life into a company whose life is ebbing out and avoid euthanasia').

162 *Virendra Singh Bhandari v Nandlal* (n 38) [22]. No authority was cited in this passage. See also the earlier unreported decision of Aggarwal J in *Re Softsule Private Limited*, Bombay High Court, 8 January 1976, [21].

163 See *Re Navjivan Trading Finance Pvt Ltd* [1978] 48 CompCas 402 (Gujarat), [13], attributing the 'modern trend' against winding up wherever revival was possible to Desai J.

164 Schemes: *Re Hathising Manufacturing Company Ltd* [1976] 46 CompCas 59 (Gujarat) (textile mill); provisional liquidator: *Panchmahals Steel Limited v Universal Steel Traders* [1976] 46 CompCas 706 (Gujarat) (steel plant).

165 *Mansukhlal v MV Shah, Official Liquidator* [1976] 46 CompCas 279 (Gujarat), [18].

was also the Gujarat High Court that observed in a now widely-cited decision[166] that the court would exercise a 'sound discretion' in deciding to order winding-up, and that it was its duty to avoid liquidation where revival was possible, even for a company proved unable to pay its debts: 'It should be the policy of the court to attempt to revive though at the moment the company may not be solvent and may not be able to meet its obligations to creditors'[167].

At least one court warned against the recognition of a 'general expansive discretionary jurisdiction to deny a winding-up order if the existence of a debt and inability to pay are both established'[168]. By the 1990s, however, the notion that the court enjoyed such discretion was widely[169], though by no means universally[170], accepted. One of the factors identified as relevant to the exercise of the discretion was whether the company's failure to pay the petitioner was caused by a temporary downturn. Some

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166 *New Swadeshi Mills of Ahmedabad Ltd v Dye-Chem Limited* [1986] 59 CompCas 183 (Gujarat), PS Poti CJ and IC Bhatt J.

167 ibid [3]. On the facts, the bench declined to interfere with the winding up order made at first instance because there was no reasonable prospect of revival, but only after delaying the hearing for three months in the hope the company would propose a scheme.

168 *Hegde and Golay Limited v State Bank of India* ILR 1987 KAR 2673 (Karnataka), [41], citing *Palmer's Company Law* (23rd edition) on the *ex debito justitiae* maxim.

169 See for example *Tinsukia Vastra Bhandar v Assam Tea* (n 124) [6] (but resolving to make a three month pay to exit order rather than dismiss); *Dena Bank v Khatau Dyes and Fibres Ltd* [1995] 83 CompCas 632 (Bombay), [9] (but resolving that the petitioners were on the facts entitled to the order, subject to a three week stay); *Hansa Industries P Limited v MMTC Ltd* [2005] 124 CompCas 314 (Delhi), [23]; *Reliance Infocomm v Sheetal* (n 49) [43].

170 *Suvarn Rajaram Bandekar v Rajaram Bandekar (Sirigao)* (n 57) [18] ('that the company is unable to pay, is ex facie clear. The order for winding up must, therefore, go as a matter of course'); *Industrial Designs Bureau v Falcon Gulf* (n 133) [12]; *Punjab National Bank v Vedsons Steel* (n 35) [7] (expressly rejecting the notion that the court had power to resist making an order on the basis of the interests of shareholders, other creditors or employees where the company was proved unable to pay its debts); *Nepa v Jnamamandal* (n 88) [20]-[21] (rejecting the submission that the petition for an undisputed debt could be dismissed on the basis of the company's solvency, but holding that a pay to exit order was appropriate given the number of workers employed by the firm); *Star Textiles and Industries Ltd v Olive Tree Plantations P Ltd (No 1)* [2009] 149 CompCas 68 (Calcutta), [16] (statement of *ex debito* maxim, broadly endorsed on appeal: [2009] 149 CompCas 82 (Calcutta).

judges suggested that a court should resist the making of a winding-up order for a company suffering from a 'temporary lack of liquidity'[171] that prevented it from meeting current demands:

> The Company Judge would in such circumstances prod and push the Respondent Company to clear its outstandings but would be extremely reluctant to pronounce its civil death without affording it a reasonable time to resuscitate its resources[172].

A second factor identified as relevant to the exercise of discretion was the impact of liquidation on workers:

> In a case where the winding up of the company will throw a large number of workmen out of employment, the court will be very reluctant to orders winding up and will explore all possibilities to keep the company joint, if possible[173].

The recognition of this factor was assisted by 1981 decision of the Supreme Court, in which a majority held that workers were entitled to be heard by the court (both before admission and at any later hearing) given the impact that liquidation would have on their livelihood, the majority accepting that the court was in any case obliged to consider this

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[171] *Naresh Fabs v Gudiya* (n 32) [10] (on the facts a pay-to-exit order was made).

[172] *Madhya Pradesh Iron v GB Springs* (n 39) [7] (on the facts, a pay-to-exit order was made); see also *In re Kermeen Foods P Ltd* [1984] 58 CompCas 156 (Gujarat), [8], and the widely cited *Tata Iron and Steel v Micro Forge* (n 145) [20(4) and (14)], both appeal cases. See also *Sicon Limited, Bombay v Shree Panduranga Poultries Pvt Ltd Hyderabad* [2001] 103 CompCas 318 (Andhra Pradesh), [30], making the winding up order because the respondents had failed to persuade of the ' chance of resurrection', and to similar effect several decisions of Puj J in the Gujarat High Court, such as *Harmony Multimedia F Ltd v Parag Prints P Ltd* [2009] 150 CompCas 756 (Gujarat), and *Uti Bank Ltd v Shree Rama-Multitech Ltd* [2005] 126 CompCas 15 (Gujarat).

[173] *Indian Turpentine and Prsin Company v Pioneer* (n 32) [22], but finding that on the facts the number of workers was 'very small' and that the application of a few would not stand in the way of making the order; see also *Tata Iron and Steel v Micro Forge* (n 145) [20(5), (19)], [22]; *Manjulabai v Jayant Vitamins* (n 36), citing *Narendra Glass Works v MP Beer* (n 36) as authority for the proposition that 'in addition to other factors, the fact that the company has engaged a large number of employees and is running in profit would itself be a ground for not admitting a petition' (but in both cases the court also held that the petitioner's debt was disputed); *Oil and Natural Gas Corporation Ltd v HMT Limited*, unreported decision of BV Nagarathna J in the Karnataka High Court, 21 October 2009, [26]; *cf Punjab National Bank v Vedsons Steel* (n 35) [7], noted above n 170.

impact when deciding whether to make the order[174]. The majority concluded that it was appropriate to depart from English authority rejecting any such right of hearing, given the 'dethroning' of a *laissez faire* economic philosophy[175] in India, and the emergence of a new 'corporate philosophy' under socialism, under which 'capital and labour' were 'equal partners'[176]. The third factor identified by some judges as relevant to the exercise of discretion was the availability of an alternative remedy (most commonly, the possibility of enforcing the debt through a civil suit). This factor was perhaps the most contentious, with some judges clearly rejecting the notion that the availability of an alternative remedy should influence the exercise of the court's discretion[177], and others endorsing its relevance[178].

Again, it is difficult to quantify the impact that the recognition of these discretionary factors, or of the court's 'expansive discretionary jurisdiction' more generally, had on the outcome of petitions. There are a relatively small number of cases in which a petition was dismissed outright (despite a finding of inability to pay debts) explicitly on the basis of one or more of the discretionary factors. In *Canara Bank v*

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[174] *National Textile Workers' Union v PR Ramakrishnan* AIR 1983 SC 75 [6]-[8], PN Bhagwati J (with whom the other members of the majority agreed).

[175] ibid [18], Chinnappa Reddy J.

[176] ibid [4], [9], PN Bhagwati J; Baharul Islam J, [66]. In one of two dissenting judgments, Amarendra Nath Sen J restated the *ex debito justitiae* maxim and queried what value worker submissions would have in circumstances where the court was obliged, given proof of the company's inability to pay its debts, to order winding up: [77].

[177] See for example *Vivek Hire Purchase and Leasing Limited v Paisapower.com Private Limited* [2006] 129 CompCas 343 (Madras), [12]; *Bank of Nova Scotia v RPG Transmission Limited* [2006] 133 CompCas 172 (Delhi), an appellate decision, and the earlier decision by one of the appellate judges in *Rishi Pal Gupta v SJ Knitting and Finishing Mills Pvt Ltd* 4 (1998) CLT 15, [13]; *Central Bank of India v Sukhani* (n 68).

[178] See for example *Kitti Steels Limited v Sanghi Industries Limited* [2010] 154 CompCas 102 (Andhra Pradesh), [7] the judge considering section 443(2) (which allows the court to resist winding up sought *on just and equitable grounds* where satisfied that the petitioner is acting unreasonably in not pursuing another remedy) applicable to winding up on the basis of inability to pay debts, and similarly *Ashok Fashions v Meghdoot* (n 47) [24]; see also *HQ Chemicals Ltd v Care Formulators Pvt Ltd* 2002 (1) AllMR 465 (Bombay), [4].

Arihant Industries Ltd[179], the fact that the company had about '3,000 employees who are being paid their salaries regularly' was integral to the decision to dismiss a petition by several institutional creditors for an undisputed debt, despite years of the company failing to pay while the petition was pending. The liability of the petitioners was 'trivial' compared with the interests of other beneficiaries of revival, including employees.[180] In *National Research Development Corporation v Electro Flux P Ltd*[181], a judge of the Andhra Pradesh High Court dismissed a petition founded on an arbitral award that was, under the arbitration regime, equivalent to a court decree. The basis of dismissal was that the petitioner had an 'effective alternative remedy' that they had not yet pursued: civil execution proceedings[182]. The availability of an alternative remedy appears to have also motivated a series of dismissals by one judge in the Madhya Pradesh High Court between 2002 and 2003 (including where the debt was admitted), the judge also noting that the court was obliged to ensure that 'no running company be pushed into a winding up for one or two defaults'[183]. In other cases, however, the discretionary factors were simply bundled together with other factors, such that their influence on the outcome cannot be precisely evaluated: in one case, for example,[184] the petition was dismissed on the basis

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179 [2002] 110 CompCas 70 (Punjab & Haryana).

180 As well as the tax authorities and shareholders: ibid [25].

181 [2005] 127 CompCas 23 (Andhra Pradesh).

182 ibid [10]. The judgment implies that only the petitioner appeared, so the dismissal occurred without the respondent's request.

183 The judge was AM Sapre J. One example is *Kailashchandra Goyal v GJ Corogation P Ltd* (2003) 4 CompLJ 420 (Madhya Pradesh), in which the debt does not appear to have been disputed but the petition was dismissed, the judge concluding that winding up was a discretionary remedy, that the court could resist winding up where a petitioner was acting unreasonably in pursuing winding up over another remedy (again, citing s 443 – see n 178 above) and concluding that the petitioner should be confined to its civil remedy ([5]-[6]). A second example is *Swan Finance Limited v Pratibha Cold Storage (P) Ltd* (2003) 2 CompLJ 20 (Madhya Pradesh).

that there was a dispute (despite a previous admission by the respondent), the petitioner had an alternative remedy, and winding-up was in any case discretionary and not appropriate where the company was solvent, the judge concluding that the 'cumulative effect' of these factors was persuasive[185]. In addition to this, more indirect, evidence of impact, it is also clear that the discretionary factors – and the philosophy that underpinned them (that winding up was a 'last resort'[186], to be avoided where possible) – motivated the granting of procedural indulgences to debtors (such as pay-to-exit orders), such that a petition that survived an attempt at dismissal on discretionary grounds could nevertheless be delayed on those same grounds[187].

5.3 Conclusion

Critics agree that Indian liquidation law has 'failed' creditors, but there has been little research into the question of why the law has 'failed' – into why the law functions as it does. This chapter is a first attempt at a more rigorous analysis of the role played by the courts in influencing the law's (dys)functionality, inspired by the suggestion in the literature that judges may have occasionally worked to delay or defeat entry by debtors into compulsory liquidation. The evidence revealed in this chapter suggests that this claim should be elevated to compete with the 'administrative capacity' hypothesis that has dominated to date. Delays in compulsory liquidation were quite clearly not simply a

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184 *Madhya Pradesh Iron and Steel Company v Sikands Ltd* [2005] 64 SCL 162 (Delhi).

185 ibid [9]-[10]. For another example, see *Manjulabai v Jayant Vitamins Ltd* (n 36), dismissed on the basis that the company's counter-claim was not baseless, the company was 'financially stable', and in view of workers' pleas ([43]).

186 *K Appa Rao v Sarkar Chemicals Pvt Ltd* [1995] 84 CompCas 670 (Andhra Pradesh), [13].

187 See the description of case outcomes in nn 171 and 172 above; see also *Re Rishi Enterprises* [1992] 73 CompCas 271 (Gujarat), the court moved by the plight of 500 employees to adjourn a petition to give the company time to emerge from its 'crisis'.

product of resource constraints. It was judges who created the mandatory, complex pre-admission procedure and it was judges who entrenched the pay-to-exit practice, innovations that made the initiation of proceedings much slower and more complex. It was judges who added complexity to the substantive question of when a company was to be found 'unable to pay its debts', diluting the deeming provision offered by the statute, and who resisted fetters on their discretion to resist winding up companies despite proof of their inability to pay debts. These innovations made the task of the judge much more difficult, and the position of the creditor much more uncertain ('nobody can aspire to wind up a company as a matter of course'[188]) – indeed, the only certainty in many cases appears to have been delay.

[188] *Tata Iron and Steel v Micro Forge* (n 145) [20(2)].

CHAPTER 6

INDIA'S RESCUE PROCEDURE FOR INDUSTRIAL FIRMS

Sir, the total credit advanced to the sick units by financial institutions has increased by 91% from… 1979 to… 1983… the situation is alarming and at the same time the miseries of the workers are becoming very acute… I can give authentic reports that only in West Bengal for the last ten years, at least 100 workers of various factories die either of starvation or hang themselves. This is because they had no jobs as the industries were closed…

(Member for Howarh, Lok Sabha debate on the Sick Industrial Companies Bill, 1985)

The ill effects of sickness in industrial companies such as loss of production, loss of employment, loss of revenue to the Central and State Governments and locking up of investible funds of banks and financial institutions are of serious concern to the Government and society at large. The concern of the Government is accentuated by the alarming increase in the incidence of sickness in industrial companies… in order to fully utilise the productive industrial assets, afford maximum protection of employment and optimise the use of the funds of the banks and financial institutions, it would be imperative to revive and rehabilitate the potentially viable sick industrial companies as quickly as possible. It would be equally imperative to salvage the productive assets and realise the amounts due to banks and financial institutions… from the non-viable sick industrial companies through liquidation.

(Statement of Objects and Reasons for SICA, 1985)

Part I of this thesis was devoted to India's company liquidation procedure, contained in the Companies Act of 1956. Part II, which begins with this chapter, is devoted to India's corporate rescue procedure, contained in the Sick Industrial Companies (Special Provisions) Act 1985 ('SICA'). Unlike the liquidation provisions of the Companies Act 1956, which apply to all corporate debtors, SICA applies only to a subset of Indian companies: insolvent ('sick') industrial companies. This chapter begins with a brief explanation of the legislature's decision to target industrial firms for rescue, identifying (in the tradition of early, Indian-published, literature on SICA) the Act as one in a series of government initiatives directed to the perceived problem of 'industrial sickness' in post-independence India. The chapter moves to consider the specific circumstances that surrounded SICA's enactment, with particular reference to the influential role of a government committee (the 'Tiwari Committee') that recommended the enactment of rescue statute for industrial debtors. Next, SICA is considered, with an overview of its structure and core provisions. The chapter concludes by noting recent attempts at SICA's repeal, and a statutory amendment that has, in the interim, curtailed the scope and impact of SICA.

6.1 The legislature's target: Indian industry

The Sick Industrial Companies (Special Provisions) Act of 1985 (SICA) introduced India's first (and, at least for the moment[1], India's only) dedicated corporate rescue mechanism. But SICA's compass is a narrow one; the Act does not apply to companies in general, but rather to only one class of companies – 'sick industrial companies'. The definition of a 'sick industrial company' is rather complex, and is considered in more detail in section 6.3.2.2 below. In essence, however, SICA's target is insolvent companies in India's organised[2] manufacturing sector. Against evidence of the contribution of manufacturing to the Indian economy, this choice might seem a surprising one: in 2010-2011, Indian industry (of which manufacturing forms the major part[3]) contributed 27.8% of GDP (at factor cost), while services contributed 57.7% and agriculture 14.5%[4]. Industry's share was no greater at the time of SICA's enactment[5]; since then, the dramatic

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[1] The enactment of the Companies Bill of 2011 would fundamentally alter the position, resulting in a unified rescue procedure for all companies, whether or not industrial. On the progress of this and other recent attempts to repeal SICA, see section 6.4 below.

[2] The Indian manufacturing sector is conventionally divided into two parts: organised and unorganised. The organised part comprises manufacturing undertakings that are registered under the Factories Act 1948, being those with premises at which ten or more workers work with the aid of power (twenty workers without the aid of power): see Dipak Mazumdar and Sandip Sarkar, *Globalisation, Labor Markets and Inequality in India* (Routledge 2008) 165.

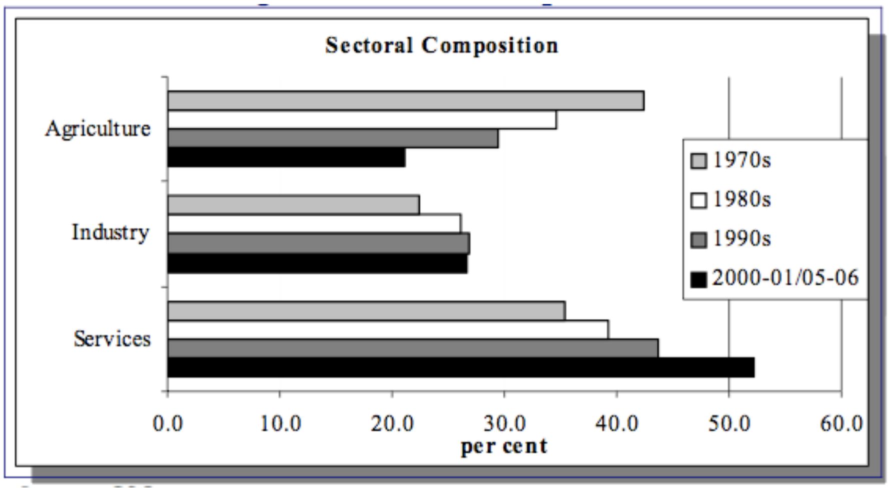
[3] 'Industry' includes mining and quarrying, manufacturing, electricity/gas/water supply, and construction. The quick estimates for 2010-2011 report a share of GDP of 15.8% for manufacturing, over half the share (27.8%) of industry (see Office of Economic Adviser to the Government of India, 'Key Economic Indicators' Table 2 <http://eaindustry.nic.in/Key_Economic_Indicators/Key_Economic_Indicators.pdf> 30 August 2012.

[4] Quick estimates for 2010-2011 in 'Key Economic Indicators' ibid, Table 2.

[5] In 1987-1988 (the year of SICA's commencement), industry's share of GDP was 26%, which included a 16% contribution by manufacturing (Arvind Panagariya, *India: The Emerging Giant* (OUP 2008) 13).

growth of the services sector has produced some striking adjustments between the contributions of agriculture and services (as Chart 3 below demonstrates), but industry's share has reportedly remained constant[6].

Chart 3: Sectoral composition in India over time (reproduced)



Source: reproduced from Subir Gokarn and Gunjan Gulati, *India: Country Growth Analysis* (ADB October 2006), Figure 2

Employment figures also suggest a small share of the employment market for Indian manufacturing. 2006-2007 data reports a 13.33% share of employment, a slight increase on the position in the mid-1980s[7]. SICA's target is a subset of this market – *organised* manufacturing – that employs fewer workers than the unorganised sector[8].

Recent research on SICA has tended to devote little time to considering the legislature's decision to single out industrial firms for rescue. The focus is, instead, on

[6] The contribution made by manufacturing as a subset of 'industry' has also reportedly remained relatively constant: Government of India, *Indian Economic Survey (2010-2011)* [9.84] <www.indiabudget.nic.in/budget2011-2012/es2010-11/echap-09.pdf> 30 August 2012.

[7] Office of the Economic Adviser, 'Handbook of Industrial Policy and Statistics, 2007-2008', Table 9.4 (reporting a 11.27% share for 1983) <http://eaindustry.nic.in/Industrial_Handbook_0708_Main.html> 30 August 2012; see also Arvind Subramanian, *India's Turn: Understanding the Economic Transformation* (OUP 2008), Table 2.1 (reporting data for 1980 and 2000); R Nagaraj, 'Industrial Policy and Performance since 1980: Which Way Now?' 2003 38(35) *Economic and Political Weekly* 3707, 3708, suggesting that the manufacturing sector's share of the workforce 'remained roughly constant at around 12 per cent' between 1981 and 2003.

[8] Vinesh Kathuria, Rajesh Raj S N, and Kunal Sen, 'Organised versus Unorganised Manufacturing Performance in the Post-Reform Period' (2010) XLV (24) *Economic and Political Weekly* 55, 63.

presenting a generalised critique of SICA as a corporate rescue law, measured against a familiar series of (efficiency-oriented) standards or benchmarks for value maximisation in rescue[9]. But a quite different approach appears from an earlier body of literature on SICA, published primarily in India during the first decade of SICA's operation. In this literature[10], SICA is analysed within the specific context of industrial sickness and industrial sickness policy in India. The Act is presented not as an isolated development in corporate insolvency law, but as one in a series of government initiatives specifically directed to the problem of industrial sickness in post-independence India.

The history of industrial sickness and industrial sickness policy was sketched in Part I of this thesis[11]. In summary, it appears that two concerns - first, a perception that sickness in industry posed a threat to India's plans to emerge as a self-sufficient, fully industrialised nation; secondly, an anxiety to protect the employment of workers in sick industrial companies – fuelled the emergence of a 'revival imperative', under which the rehabilitation of sick industrial companies was preferred to their closure, irrespective of economic viability. This imperative was partly given effect through the mobilisation of

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[9] See for example, 'Report of the High Level Committee on Law Relating to Insolvency and Winding up of Companies' (the 'Eradi Committee Report') (31 July 2000), extracted in DP Mittal, *Taxmann's New Law Relating to Sick Industries* (Taxmann 2003), Appendix 6; 'Report of the Advisory Group on Bankruptcy Laws' (the 'Advisory Group Report') (May 2001) <www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=225> 27 August 2012; Expert Committee on Company Law, 'Report on Company Law' (the 'Irani Committee Report') (31 May 2005) <www.acga-asia.org/public/files/JJ%20Irani%20Report.pdf > 27 August 2012. For an earlier and influential example of the same approach, see Omkar Goswami, *Corporate Bankruptcy in India* (OECD 1996) (*cf* the approach in earlier Goswami works, cited below in n 10). See further section 7.1.2.

[10] See for example 'Report of the Committee on Industrial Sickness and Corporate Restructuring' ('Goswami Committee Report'), extracted in HPS Pawha, *Bharat's Sick Industries & BIFR* (8th ed, Bharat Law House 2009) Appendix 1; Anant TCA and Omkar Goswami, 'Getting Everything Wrong: India's Policies Regarding 'Sick' Firms' in Dilip Mookherjee (ed), *Indian Industry: Policies and Performance* (OUP 1995); MS Narayanan, *Industrial sickness in India: the role of the BIFR* (Konark Publishers 1994); SS Khanka, *Industrial Sickness in India: Causes, Consequences and Cures* (Commonwealth Publishers 1995); Vijay Joshi and IMD Little, *India's Economic Reforms: 1991-2001* (OUP 1996), ch 5; A Govak, *Industrial Sickness* (BR Publishing Corporation 1998); later but in the style of the early texts, SK Seth, *Industrial Sickness: Evaluation under the Sick Industrial Companies Act* (Ganga Saran & Grand Sons 2003).

[11] See Chapter 4, text to n 44.

the financial sector to deliver coordinated rehabilitation packages to insolvent industrial debtors. As suggested in Part I, this is a history that suggests a quite different standard or benchmark for evaluating the efficacy of industrial sickness initiatives: a standard that prizes revival *per se* and, as a concomitant, contemplates a particular (supportive) role for institutional creditors in insolvency. This important point is revisited in some detail later in this Part[12]. For present purposes, it is enough to foreshadow that the historical approach to industrial sickness in India has reverberated throughout the life of SICA, notwithstanding the passage of dramatic economic reforms that altered key aspects of Central Government policy on the regulation of industry and the autonomy of the financial sector.

6.2 The impetus for SICA's enactment

6.2.1. The report of the Tiwari Committee

The immediate impetus for SICA's enactment was a report of a committee appointed by the Reserve Bank to investigate barriers to the rehabilitation of sick industrial companies, the 'Tiwari Committee'. It was the Tiwari Committee that recommended the enactment of a rescue statute for sick industrial companies, and much of its vision was directly translated into the final text of SICA. The report of the Tiwari Committee[13] provides a clear insight into the background to SICA's enactment, and industrial sickness policy of the period more generally. There is, however, surprisingly little treatment of the Committee's report in existing literature on SICA, perhaps because it is difficult to obtain.

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[12] See Chapter 7, Section 7.3.2.

[13] *Report of the committee to examine the legal and other difficulties faced by banks and financial institutions in the rehabilitation of sick industrial undertakings and suggest remedial changes in the law* (hereafter, 'Tiwari Committee Report' or 'TCR') (Reserve Bank of India 1983).

6.2.2 The appointment of the Tiwari Committee

In May 1981, the Reserve Bank of India established a committee chaired by Shri T Tiwari, the then Chairman of the Industrial Reconstruction Corporation of India (a financial institution[14]). Other members were drawn from the Reserve Bank of India, and various commercial banks and financial institutions[15]. The chief task of the Tiwari Committee was to 'examine the legal and other difficulties faced by the banks and financial institutions in rehabilitation of sick industrial undertakings and suggest remedial measures, including the changes required in various laws'[16]. The terms of reference for the Committee included:

- To review the existing 'criteria' adopted by banks and financial institutions when determining 'the suitability of a sick unit for revival';
- To identify the 'main constraints' in rehabilitation and the problems faced by banks involved;
- To identify the concessions that should 'normally be made' by parties involved in the rehabilitation of sick industry;
- To consider the need for special legislation for the rehabilitation of sick industry, its contents and feasibility; and
- To consider the need for special legislation for the recovery of debts by banks and financial institutions[17].

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[14] Or development bank: see Chapter 4, text to n 68.

[15] For the full list, see TCR (n 13) [1.12].

[16] ibid [1.12].

[17] ibid [1.12(ii),(iii),(v)]; [1.18(i), (ii)]. The latter two terms of reference were remitted to a legal sub-committee chaired by Shri S A Naik, then Legal Advisor to the Industrial Development Bank of India (another financial institution).

6.2.3 The recommendations of the Tiwari Committee

The Tiwari Committee[18] identified a range of methods for achieving the revival of sick industrial companies, including the takeover of management, the reorganisation of debts, the merger of the company with another, and the sale of the company's business (either within or outside liquidation). The Committee identified a series of obstacles to the use of these methods under existing law. In relation to reorganisations, the Committee doubted the utility of the scheme of arrangement (under the Companies Act 1956, originally a UK transplant[19]) as a device to achieve a binding compromise with creditors, suggesting the procedure was too expensive, time-consuming and complex to be 'responsive to the need for urgency and speed necessary for revival or rehabilitation'[20]. The liquidation procedure was also criticised, the Committee complaining of lengthy delays that resulted in the deterioration of asset value and the 'blocking' of funds owed to banks and financial institutions[21].

The Committee recommended the enactment of special legislation to enable 'speedy and effective action' for the rehabilitation of sick industrial units[22], using any of the revival methods identified above (management change, merger, reconstruction, sale of the business as a going concern, *etc*). The legislation would be administered by a new statutory authority, staffed by members drawn from 'specialised fields' such as finance,

[18] Or, more accurately, its legal sub-committee (see immediately above). The sub-committee report appears in Appendix II of the TCR.

[19] See Chapter 3 text to n 37.

[20] TCR (n 13) Appendix II, [5.6].

[21] ibid, Appendix II, [8.1].

[22] ibid, Appendix II, [10.1]; see also ch VI of the report.

accountancy, management, and law[23]. The statutory authority would be empowered to sanction a revival plan that would bind stakeholders[24], and alternatively (for those units found to be 'unviable')[25] to order by a 'summary procedure' the sale of the company's assets by auction and the distribution of proceeds to creditors (followed by a formal liquidation order, to be made in the courts on receipt of the statutory authority's recommendation)[26]. The decisions of the authority would be non-justiciable in the courts, except in an action for judicial review[27]. The Committee attached draft legislation to its report.

The Tiwari Committee envisaged a central role for banks and financial institutions under its new legislative scheme. This expectation flowed from the Committee's understanding (already summarised in Chapter 4)[28] of existing government policy on the role of institutional creditors in industrial sickness. The foundation of that policy was an assumption that 'viable' sick industrial companies were effectively entitled to rescue finance from commercial banks and financial institutions: 'when a sick industrial unit is identified as potentially viable… it becomes necessary to prepare and implement an objective and purposeful package for its rehabilitation'[29]. 'Viability' had previously been defined (in 'norms' evolved 'by consensus' between banks and financial institutions) as the ability to service debts at a concessional rate of interest 'within a

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[23] ibid, Appendix II, [11.22-11.24]; see also ch VII of the report.

[24] ibid, Appendix II, [11.23]; [11.28]; see also [7.9] of the report.

[25] As to the generous definition of 'viability', see next paragraph.

[26] TCR (n 13) Appendix II, [11.21]; draft Bill cl 30.

[27] ibid [7.4].

[28] See Chapter 4, text to n 75.

[29] TCR (n 13) [4.11].

reasonable period, say, about eight to ten years'[30]. The Committee acknowledged that even this (very generous) definition of 'viability' had sometimes been relaxed yet further in the past, noting the complaints of banks and financial institutions that they had been occasionally asked to 'continue holding operations solely on considerations of public interest', irrespective of viability[31]. It recommended a slight tightening of the viability definition[32], and that rehabilitation efforts be confined to the viable: banks and financial institutions were not to be required to finance rehabilitation 'in the name of socio-economic or public interest', unless the Central or State governments were prepared to protect the contributions made by banks and financial institutions, and offer a 'reasonable portion' of debt sacrifice themselves[33]. The Committee also cautioned that other stakeholders would have to be prepared to contribute to rehabilitation efforts, recommending concessions from government (including tax exemptions and protection of utilities supply)[34], management (including reduced remuneration)[35], labour (including voluntary retrenchment)[36] and shareholders[37]. But the Committee did not depart from

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30 ibid, [4.3], reporting that the norms were announced by the Standing Co-ordination Committee of the Reserve Bank in 1980.

31 ibid, [3.17]; see also [4.15]-[4.16].

32 The Committee recommended that a unit be considered 'viable' if it would be in a position to service debts (including those incurred by receipt of the rehabilitation 'package of concessions' from stakeholders) within a period of no more than seven years, and to repay restructured debts within ten years of the commencement of the package (ideally, it would also be able to declare a dividend within seven years): ibid [5.9]-[5.10].

33 ibid [4.16]; see also [5.11](d).

34 ibid [9.A]-[9.B].

35 ibid [9.C].

36 ibid [9.D].

37 ibid [9.E]. The Committee did not draw any distinction between shareholders and other classes of stakeholder (that is, it did not make the distinction between debt and equity that underpins the absolute priority rule in bankruptcy theory, as to which see Alan Schwartz, 'A Normative Theory of Business Bankruptcy' (2005) 91 *Virginia L Rev* 1199, 1202). It simply noted that, like other stakeholders,

the premise that 'viable' industrial companies (still generously defined) should be revived, and that institutional creditors would have a central role in their revival. Indeed, it cautioned that the enactment of special legislation 'should not divest the banks and financial institutions of their responsibility to tackle the problems of sickness of the industrial units assisted by them'[38]. Recourse to the Act would be a 'supplemental expedient'[39], appropriate for use after preliminary revival efforts failed.

The Tiwari Committee did make one allowance for banks and financial institutions. It acknowledged that delays in the courts had made it difficult for banks and financial institutions to recover debts from defaulting borrowers, both industrial and non-industrial[40], and recommended the establishment of tribunals that would 'in a summary way but following the principles of natural justice, adjudicate finally, within a time-bound schedule, all matters in relation to recovery of dues of the banks and financial institutions'[41]. Only the first of the Tiwari Committee's statutory recommendations – the enactment of legislation to facilitate the rescue of industrial companies – was given immediate effect. It was only after liberalisation, and an associated shift in policy to emphasise the autonomy and competitiveness of the Indian financial sector, that a second statute, the Recovery of Debts Due to Banks and Financial Institutions Act 1993 was enacted[42]. As Chapter 7 explains, the changes associated with liberalisation also freed the financial sector from the policy that had previously required

shareholders would have to do their part to assist rehabilitation efforts by 'voluntarily agreeing' to schemes that impacted on their shareholding. On the absolute priority rule and SICA, see Chapter 7, text to n 34.

[38] TCR (n 13) [6.3]; see also Appendix II, [11.4].

[39] ibid [6.3].

[40] ibid [8.1]-[8.2], but excluding agriculturists ([8.3(ii)]).

[41] ibid [8.3(vi)].

[42] See Chapter 4, n 116.

banks and financial institutions to finance the revival of industrial debtors[43], a policy on which the Tiwari Committee's report had been premised. But by this time, SICA had been enacted.

6.3 On enactment: an overview of SICA

The Sick Industrial Companies (Special Provisions) Bill was introduced to parliament in 1985, received assent on 8 January 1986 and came into full force on 15 May 1987. SICA's drafters endorsed the institutional framework proposed by the Tiwari Committee, establishing a new quasi-judicial body to oversee the rescue of sick industrial companies. With one notable exception[44], the provisions of SICA closely conformed to the Tiwari Committee's recommendations.

6.3.1 SICA's primary administrator: the BIFR

SICA established a new quasi-judicial body[45] – the Board for Industrial and Financial Reconstruction, or 'BIFR' – to administer the provisions of the Act. The BIFR is made up of a Chairman and 2-14 other members, appointed by the Central Government[46]. In line with the Tiwari Committee's recommendation, appointees to these positions can, but need not be, judges or former judges: SICA permits the appointment of any person with special knowledge of, and substantial experience in, areas the Central Government identifies as useful to the BIFR, as well as the appointment of those who are, have been

[43] See text to n 127.

[44] Considered below, text to n 124.

[45] Section 13 of SICA equips the BIFR and the Appellate Authority (as to which, see text to n 60 below) with a range of powers ordinarily enjoyed by civil courts under the Code of Civil Procedure 1908, including power to summon witnesses, and compel production of documents and other evidence. Both are deemed to be a 'civil court' for the purpose of the criminal law of contempt and perjury (s 14). See more generally Satyaranjan P Sathe, *The Tribunal System in India* (NP Triparthi 1996) 11-12; *Bharat's Sick Industries* (n 10) [4.3].

[46] SICA s 4(2).

or are qualified to be High Court judges.[47] Early appointees to the BIFR included a retired judge, an economist, and a retired executive director of the RBI, as well as a trade unionist.[48]

In most cases, the BIFR will be assisted in its work by an 'operating agency' (or 'OA'). An OA is appointed by the BIFR to assist with the rehabilitation of a SICA registered company. The OA is usually a bank or financial institution[49]; anecdotal reports suggest that the OA is typically a creditor of the sick industrial debtor[50]. The OA may be asked by the BIFR, for example, to assist with the initial task of determining whether the debtor is indeed a 'sick industrial company'[51] (a jurisdictional question, as to which see below)[52]; later, it might be asked to prepare a draft scheme of rehabilitation[53]. An OA is an agent of the BIFR, not of the sick industrial company to which it is appointed[54].

The BIFR sits in benches of at least two members[55]. The orders made by a BIFR bench, and the written reasons for those orders, are not published in any law reporter[56]

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47 Section 4(3).

48 Narayanan (n 10) 9.

49 Although under section 3(1)(a) an operating agency may be 'any person' appointed by the BIFR: see PS Kaicker, *Taxmann's Sick Industrial Companies (Special Provisions) Act 1985: Law, Practice & Procedure* (Taxmann Allied Services 2000) [3.2-5a].

50 Narayanan (n 10) 68; also assumed in *Bharat's Sick Industries* (n 10) [3.1.19]. For a recent example in which the OA was the company's main creditor, see *Pasupati Fabrics Ltd v Priyanka Overseas Pvt Ltd* [2006] 132 CompCas 113 (Delhi).

51 See SICA s 16(2).

52 Section 6.3.2.2.

53 See SICA s 17(3). On schemes, see section 6.3.3 below.

54 See Seth (n 10) 33; Kaicker (n 49) [16.4].

55 SICA s 12(2); Regulation 16 of the Board for Industrial and Financial Reconstruction Regulations 1987 (hereafter, 'BIFR Regulations').

56 Regulation 17 of the BIFR Regulations permits the BIFR to release its orders for publication in any 'authoritative report', but in practice this appears to be rare. See Chapter 8, text to n 1.

and are not otherwise publicly accessible to researchers[57], although extracts appear on an *ad hoc* basis in newspapers (as where the BIFR orders advertisement of an order, or where a BIFR order is reported by a journalist), in company announcements, and in related judgments of the civil courts (for example, where a stakeholder applies for judicial review of a BIFR order). Stakeholders in a SICA company enjoy a range of rights to notice of BIFR hearings and orders, and to be heard by the BIFR[58].

On a plain reading, SICA affords little scope for interference by the civil courts in the decision-making processes of the BIFR. The Act precludes the making of an appeal to the courts from any decision of the BIFR[59]. Those aggrieved by a BIFR decision are instead afforded a right of appeal to an internal body – the Appellate Authority for Industrial and Financial Reconstruction (the 'Appellate Authority') – also established under SICA. The Appellate Authority, which is chaired by a judge or former judge[60], is empowered to confirm, modify, or set aside any order of the BIFR, or remit a matter to the BIFR[61]. The jurisdiction of the civil courts is expressly ousted in relation to any

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57 Regulation 38(2) of the BIFR Regulations provides a right of access for researchers to BIFR files, but this right appears difficult to exercise: in a meeting with the responsible officer of the BIFR in Delhi in 2010, I was advised that it would not possible for me to access BIFR records, orders or case files.

58 'Interested persons' (defined to include shareholders, creditors and employees) can request to be heard (reg 20(6) and reg 3(h) of the BIFR Regulations). If the BIFR decides to hear the person, it must provide notice of the hearing date and then hear the person, provided they file written submissions in advance: reg 20(6), (8). The BIFR is required to publish 'short particulars' of any draft rehabilitation scheme in newspapers, inviting suggestions and objections from shareholders, creditors and employees (SICA s 18(3); BIFR Regulations, reg 29), and to consider those suggestions and objections (reg 30). The BIFR is also required to give an opportunity to be heard to 'all concerned parties' before resolving to recommend the liquidation: SICA s 20(1).

59 SICA s 26.

60 SICA s 5(2). The Government was of the view that this feature was essential to ensuring the constitutionality of SICA, given the ouster of the courts: see statement by the Minister of Finance, Shri Vishwanath Pratap Singh, in the parliamentary debate accompanying SICA's enactment: *Lok Sabha Debates* (9 December 1985, Parliament Secretariat) 'Sick Industrial Companies (Special Provisions) Bill', 280.

61 SICA s 25(2).

matter that the BIFR or the Appellate Authority are empowered to determine[62]. The only jurisdiction unaffected by this is the writ and supervisory jurisdiction conferred by the constitution on the High Courts of the states and on the Supreme Court as superior courts[63]. This jurisdiction (which cannot be abrogated by ordinary statute[64]) enables these courts to entertain applications for judicial review of any decision of the BIFR or the Appellate Authority. But the power of judicial review is, at least in principle[65], constrained on conventional common law grounds: the review is confined to confirming whether the order was validly made ('within the four corners of the SICA')[66], and would not appear to extend to a re-evaluation of its merits. The drafters did however entrust one aspect of the administration of SICA to the courts: under SICA, the High Courts of the states are responsible for ordering the winding-up of companies that the BIFR finds incapable of rehabilitation. This responsibility is, however, triggered by receipt of a liquidation opinion from the BIFR - that is, the core decision (whether to liquidate) is, at least on a plain reading,[67] the BIFR's to make.

The design of the BIFR conforms closely to the Tiwari Committee's vision of an independent authority staffed by experts, 'free to adopt a summary procedure'[68] for its

[62] Section 26 of SICA.

[63] Under Articles 226/227, 32 and 136 of the Constitution: see Kaicker (n 49) [26.5].

[64] Kaicker (n 49) [26.5].

[65] The practice, as Chapter 8 reveals, has been very different (see Section 8.2.2).

[66] *Bennett Coleman & Co Ltd v Appellate Authority for Industrial and Financial Reconstruction* [1996] 85 CompCas 230 (Delhi), [9] ('We are not sitting in appeal against the order of the Appellate Authority and our jurisdiction is limited').

[67] Again, the position is in practice quite different, due in part to a re-interpretation of the relevant provision of SICA (section 20, described in section 6.3.3. below) that has led to the High Courts assuming a far greater role in the primary decision: see Chapter 8, Section 8.2.3.

[68] TCR (n 13) [7.4].

decision-making, and insulated as far as constitutionally possible from the notoriously delayed courts. The reality has, however, been quite different. The expertise of BIFR members has been questioned, with one leading Indian insolvency practitioner describing the BIFR as 'a rehabilitation centre for retired bureaucrats':

> Rather than appointment of experts to BIFR and AAIFR, the Government has by and large filled up the positions by appointing retired and influential bureaucrats who have no experience or expertise of revival and rehabilitation of companies[69].

BIFR procedure has fallen far short of the Tiwari Committee's twin goals of 'finality and speed'[70]. Within the BIFR, there is a long tradition of extreme delays[71]; additionally, the evidence reported in Chapter 8 of this thesis suggests that the decisions of the BIFR have, in practice, rarely been treated as 'final'. Challenges to BIFR decisions are routine, and not only by recourse to the Appellate Authority: despite the formal insulation of SICA from the courts, it seems that judges in the High Courts have played a very active role in SICA matters, and in so doing added significant delay. The performance of the BIFR and the courts under SICA is considered in detail in Chapters 7 and 8. For now, it is sufficient to foreshadow that the BIFR has not functioned as the Tiwari Committee envisaged, or a plain reading of SICA might suggest.

6.3.2 The SICA procedure

6.3.2.1 Initiating rescue under SICA: referral to the BIFR

BIFR proceedings are typically initiated by a referral from the directors of a sick industrial company, for whom recourse to SICA is compulsory. Section 15(1) of SICA

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[69] Sumant Batra, 'Proposals for Reform – The Indian Position' (Second Forum for Asian Insolvency Reform, Bangkok 2002) 11 <www.sumantbatra.com/pdf/papers/2nd_forum.pdf> 30 August 2012.

[70] TCR (n 13) [7.4].

[71] See below Chapter 7, section 7.1.1.

mandates that an industrial company's directors refer the company to the BIFR within sixty days of the finalisation of audited accounts for the financial year during which it became a 'sick industrial company'[72] (on this definition, see immediately below). If the company's board concludes that the company is a 'sick industrial company' prior to the finalisation of the accounts, it is obliged to make the reference earlier, within sixty days of forming that opinion[73]. A failure to refer a sick industrial company is an offence, for which directors are personally liable, punishable by a fine and/or imprisonment for up to three years.[74] But there is little evidence of the BIFR pursuing directors who fail to make a timely referral[75]. It may be that, given the reported attractiveness of SICA to debtors and their managers[76], directors need little incentive to make a reference.

6.3.2.2 Determination of eligibility: 'sick industrial companies'

[72] *Core Healthcare Ltd v Standards Chartered Bank* [2001] 106 CompCas 70 (Gujarat) [10]-[13]. There is an exception for companies subject to SARFAESI proceedings: SICA s 15(1) (as to which see section 6.4.2).

[73] Proviso to SICA s 15(1), considered in *Oman International Bank SAOG v AAIFR* [2008] 143 CompCas 494 (Delhi).

[74] SICA s 33; Kaicker (n 49) [15.7]; *Polyolefins Industries Ltd vs Kosmek Plastics Manufacturing Ltd* [1990] 169 CompCas 527 (Bombay), [16]. A failure to make the referral in time does not, however, invalidate a later reference - courts have resisted characterising the sixty-day period as a limitation period (see for example *Esquire Polymers Ltd v AAIFR* [2005] 128 CompCas 601 (Bombay), [10], noted in *Bharat's Sick Industries* (n 10) [15.14]; *Oman International Bank v AAIFR* ibid [11]). But a reference could be rejected where referring directors are guilty of 'supine indifference' or lack *bona fides* (*Garware Chemicals Ltd v BIFR* [2004] 120 CompCas 315 (Bombay)).

[75] Under s 33 of SICA, the BIFR and Appellate Authority are empowered to refer any person who violates the provisions of SICA to a court. The BIFR does not publish data on the number of directors referred for prosecution for failure to comply with the referral obligation, so there is no direct evidence of the number of prosecutions. But some indirect evidence is provided from the large number of SICA cases that have reached the courts from the BIFR or AAFIR (typically, through challenges to BIFR or Appellate Authority orders). These cases, considered in Chapter 8, contain only one reference to the BIFR issuing a notice to directors threatening possible prosecution if they could not explain their delay: *Arambagh Paper Mills Private Ltd v BIFR* [2005] 128 CompCas 364 (Calcutta).

[76] See below text to n 80 and Chapter 7, text to n 24.

A reference filed with the BIFR will initially be scrutinised by the Registrar for compliance with formalities[77]. Once a company has been registered under SICA, the first task for the BIFR is a jurisdictional one: to confirm whether the newly registered company is a 'sick industrial company'[78]. If it is not, it is ineligible for relief, and the reference is dismissed as 'non-maintainable'. A high proportion of registered references are dismissed as non-maintainable[79], a fact that is said to evidence SICA's attractiveness to debtors[80].

An 'industrial company' was initially defined as a company, other than a 'government company', owning one or more 'industrial undertakings'.[81] But in 1992, an amendment[82] made in association with India's structural adjustment agreement with the World Bank[83] brought Government companies - that is, companies majority-owned by government[84] –within the definition. 'Industrial undertakings' are those undertakings 'pertaining to a scheduled industry carried on in one or more factories'.[85] A 'scheduled industry' is one engaged in the manufacture of any of the articles listed in the First Schedule to the Industries (Development and Regulation) Act 1951.[86] The scope of the

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[77] As required by the BIFR Regulations, ch II; see also Kaicker (n 49) [15.10].

[78] SICA s 16; see also *Real Value Appliances Ltd v Canara Bank* [1998] 93 CompCas 26 (SC), [23], also extracted in Mittal DP, *Taxmann's New Law Relating to Sick Industries* (Taxmann 2003) [9.9].

[79] See the data in Appendix III, discussed in Chapter 7, text to n 16.

[80] See Chapter 7, text to n 24.

[81] SICA s 3(1)(e) and (d), as made.

[82] Sick Industrial Companies (Special Provisions) Amendment Act 1991 s 2.

[83] See Chapter 2, text to n 40.

[84] SICA s 3(1)(d) as made, importing Companies Act 1956 s 617; SA Naik, *The Sick Industrial Companies (Special Provisions) Act 1985* (M&J Services Bombay 1987) 13.

[85] Excluding ancillary and small-scale industrial undertakings: see SICA s 3(1)(f); Kaicker (n 49) [3.2-3].

[86] SICA s 3(1)(n).

First Schedule is very wide, including the metallurgical, fuel, electrical, telecommunications, industrial machinery, textile, cement, and pharmaceutical industries. A scheduled industry will be carried on in a 'factory' if its manufacturing is carried out in premises (with power) by fifty workers or more, or (without power) by one hundred or more.[87] In short, the definition targets medium and large-scale companies that carry on factory manufacture and production: in other words, SICA's target is organised manufacturing[88].

The terms 'insolvency' or 'bankruptcy' do not feature in SICA. Instead, the Act uses the term 'sickness' to denote its measure of distress[89]. An industrial company will be 'sick' under SICA if: (i) it has been registered for at least five years, and (ii) it has, at the end of any one financial year, 'accumulated losses' that equal or exceed its 'net worth' (the sum of paid up capital and free reserves)[90]. The first (temporal) condition was apparently inserted to allow a company a reasonable amount of time to become profitable after start-up: in the debate that accompanied the Bill, the Minister for Finance explained 'whenever any company or factory starts functioning, it always sustains loss in the initial years.'[91]. The second (financial) condition has been described as a 'zero or negative net worth' balance-sheet test[92]. The decision to make insolvency a precondition

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87 Industries (Development and Regulation) Act 1951 s 3, incorporated by SICA s 3(2)(b); Kaicker (n 49) [3.2-3c].

88 See text to n 2 above. In the parliamentary debate that accompanied SICA's enactment, many members called for the extension of SICA to smaller companies, but the Government rejected this suggestion, the Ministry for Finance explaining that the BIFR would not be able to handle the volume of small-scale units (*Lok Sabha Debates* (9 December 1985) (n 60) 275).

89 See Chapter 4, n 44 and text.

90 Section 3(1)(o); as to 'networth', see s3(1)(ga).

91 *Lok Sabha Debates* (21 November 1985, Lok Sabha Secretariat), 'Sick Industrial Companies (Special Provisions) Bill', 302.

for relief has been criticised: on the one hand, the purpose of the mandatory referral rule is to ensure that 'immediate measures are taken for revival'[93]; on the other, the referral obligation arises only after the company has become a 'mortuary case'[94].

6.3.2.3 During the pendency of proceedings: interim protection of the debtor and its managers

During the pendency of proceedings, a moratorium prohibits recourse by creditors to the remedies ordinarily exercisable on a debtor's default (including petitioning for winding-up, suing for the recovery of money or the enforcement of any security interest, appointing a receiver, *inter alia*).[95] The moratorium applies from the time that the reference is registered[96] until the conclusion of BIFR proceedings (including for the full term of any rehabilitation scheme), unless the BIFR otherwise orders. A moratorium is a typical feature of corporate rescue procedures (without it, a distressed company may be powerless to prevent a 'break-up' of its assets by creditors, even where those assets are worth less when sold on a break-up basis than they would be if kept together)[97]. But the SICA moratorium has proved highly controversial, with critics partly attributing creditors' position of reported disadvantage under SICA to its presence[98].

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92 Advisory Group Report (n 9) 26; see also Anant and Goswami (n 10) 258-259, describing the test as a book-value balance-sheet one.

93 *Oman International Bank v AAIFR* (n 73) [11].

94 Mitra, cited in Nimrit Kang and Nitin Nayar, 'The Evolution of Corporate Bankruptcy Law in India' (2003-2004) *Money and Finance* 37, 44. See also, for example, Omkar Goswami, 'Corporate Governance in India' in *Taking Action Against Corruption in Asia and the Pacific* (ADB 2002) 94; Eradi Committee Report (n 9) [5.14]. SICA does make provision for reference of 'potentially' sick companies to the BIFR (s 23), but the BIFR is afforded only limited powers in relation to them (see Kaicker (n 49) [23A].

95 SICA s 22(1). For a full discussion of the moratorium, see Chapter 8 (section 8.2.4).

96 *Real Value Appliances v Canara Bank* (n 78) [23], interpreting 'when an inquiry is pending' in SICA s 22(1).

97 Douglas G Baird, 'Bankruptcy's Uncontested Axioms', (1998) 108(3) *Yale Law Journal* 573, 581-582; Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986) 151-152.

98 See Chapter 7, text to n 54.

A second feature of SICA – that it is a 'debtor-in-possession' procedure – has also proved controversial. Like the reorganisation procedure in Chapter 11 of the US Bankruptcy Code, and unlike the administration procedure in the UK Insolvency Act 1986[99], the commencement of SICA proceedings does not have the effect of displacing directors or their powers of management. The Tiwari Committee recommended that the BIFR be given power to remove directors prior to the sanctioning of any rehabilitation scheme, provided the company's affairs would be better managed as a result[100]. This recommendation presumably reflected the Committee's underlying conviction, evident throughout its report, that management failures were a key cause of industrial sickness[101]. But SICA's drafters did not implement this recommendation, and instead gave the BIFR power to order the removal of a director only as a term of a sanctioned rehabilitation scheme. (This break from the Tiwari Committee is puzzling, particularly given that the issue of management failures and frauds was raised repeatedly during the SICA parliamentary debate[102]). As a result, directors continue to exercise control during the period leading up to the sanctioning of a scheme or the issuing of a liquidation opinion – a period that in practice extends for several years[103] – although the BIFR has power to

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[99] For an analysis of the reasons for US/UK differences, see John Armour, Brian R Cheffins and David A Skeel, 'Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom' (2002) 55 *V and L Rev* 1699.

[100] Clause 24 of the Tiwari Committee's draft bill, TCR (n 13) 219-220.

[101] See TCR (n 13) Chapter II. The Committee relied on survey data by the Reserve Bank of India, and particularly on one study of 378 large sick industrial units that concluded that management deficiencies were 'the major cause of industrial sickness' ([2.12]). Remarkably, the Committee managed to entirely avoid engaging with the question of the relationship between industrial sickness policy (and particularly the availability of subsidised rescue finance) and the incidence of sickness (see [2.22]).

[102] For a series of examples, see *Lok Sabha Debates* (5 December 1985, Parliament Secretariat) 'Sick Industrial Companies (Special Provisions) Bill', 352-384.

[103] See Chapter 7 (section 7.1.1).

appoint a 'special director' or directors to the company's board[104], and where necessary to restrain the disposal of company assets, in the interim[105].

6.3.3 The BIFR's decision: rehabilitation, or liquidation

Once it has ascertained that a registered company is indeed a 'sick industrial company', the BIFR must determine whether the company should be 'rehabilitated'[106]. This task has two stages. In the first, the BIFR must determine whether the company is capable of rehabilitating on its own within a reasonable time, without its intervention[107]: if so, the BIFR must 'give such time to the company as it may deem fit' to recover[108]. SICA provides no guidance on the effect of such an order, but the provision has been received as one designed to afford a company time to privately negotiate a compromise with its creditors[109]. It seems that the success of this process depends on the company obtaining the consent of each creditor affected by the proposed compromise (that is, neither the company nor the BIFR have any power to compel a dissenting creditor to agree)[110],

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104 To safeguard the company's interests or in the public interest: SICA s 16(4). This power has however attracted little treatment in SICA commentaries. It seems that, at least in the early years of SICA's operation, special directors were appointed from a panel of retired bureaucrats (Narayanan (n 10) 66), a practice that may have diminished the role's significance.

105 SICA s 22A. The BIFR also has power to investigate misfeasance by any person who has taken part in the promotion, formation or management of the company and to order payment of compensation to the company, and to restrain banks and financial institutions from providing further financial assistance to such persons or their companies for a period: SICA s 24. There is no available data on the number of such orders made.

106 SICA does contemplate rehabilitation by sale of a company's business (a business, rather than corporate, rescue): see SICA s 18. But the primary focus of the SICA jurisprudence and SICA commentaries is on rescue of the company itself (see below, text to n 134, and *Upper India Couper Paper Mills Company Ltd v AAIFR* (1992) 75 CompCas 653 (Delhi)). This focus is also suggested by the 1997 attempt to amend SICA (the Sick Industrial Companies (Special Provisions) Bill 1997, see below section 6.4.1), which would have expressly required the BIFR to first attempt a reorganisation, then a going concern sale, and finally a liquidation (see cl 26).

107 SICA s 17(1); Goswami's *Corporate Bankruptcy* (n 9) 52.

108 SICA s 17(2).

109 Goswami's *Corporate Bankruptcy* (n 9) 52; Kaicker (n 49) [17-5].

which is perhaps why this stage of the procedure has received little attention in commentaries on SICA, which focus almost exclusively on the second stage of the process[111].

If the BIFR decides that it is not practicable for the company to 'make its networth exceed the accumulated losses' on its own (that is, rehabilitate on its own), the BIFR must determine whether it is nevertheless 'necessary or expedient in the public interest' to prepare a scheme of rehabilitation for the company[112] (the second stage). Where rehabilitation is considered in the public interest, the BIFR will direct the operating agency[113] to prepare a draft scheme[114]. The scheme, which should be prepared by the OA as quickly as possible (and 'ordinarily' within three months)[115], can provide for a reorganisation of debts, management change, merger with another company, rationalisation of the workforce, and the sale of all or part of the business[116]. Once sanctioned by the BIFR, the scheme binds the company, its members and (subject to one significant qualification, discussed immediately below) its creditors[117].

The 'public interest' test seems on its face a startlingly wide one, with potential to extend beyond the Tiwari Committee's already generous vision of rehabilitation for the

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110 Goswami's *Corporate Bankruptcy* (n 9) 52; Kaicker (n 49) [17.5], [17.6-2].

111 See for example *Bharat's Sick Industries* (n 10) [17]; Kaicker (n 49) [17]. There is no reliable source of data on the number of companies that have exited from SICA in the first stage. Descriptive statistics on the BIFR's output do not report separately on section 17(2) orders after 1992 (see Appendix III).

112 SICA s 17(3).

113 As to which, see above text to n 49.

114 SICA s 17(3).

115 SICA s 18(1).

116 SICA s 18.

117 SICA s 18(8), as amended by the Sick Industrial Companies (Special Provisions) Amendment Act 1993, as to which see Kaicker (n 49) [18-12] and *Bharat's Sick Industries* (n 10) [18.36] (identifying the amendment as clarificatory).

'viable', loosely defined[118]. Despite this, the test has received no critical attention in SICA commentaries or in the SICA case law[119]. The best explanation for this dearth of interest lies in a second provision of SICA that significantly curtails the BIFR's power to sanction a scheme. Under section 19 of SICA, the BIFR is required to obtain the consent of *every* institutional creditor – banks, financial institutions, and the Central Government and State Governments, whether or not secured – required to extend 'financial assistance' under any draft rehabilitation scheme[120]. 'Financial assistance' is defined to include both concessions on existing debt, and the provision of further credit[121]. The apparent effect of this provision, colloquially described as the creditor 'veto', is that the BIFR 'cannot compel'[122] a scheme:

> Since financial assistance is required in almost all cases of sick companies, the success or failure of the [BIFR] will depend entirely on its ability to persuade the banks and financial institutions concerned… to give such assistance[123].

[118] This possibility was expressly acknowledged in *Ranka Cables Ltd v AAIFR* [2001] 103 CompCas 30 (Andhra Pradesh), the judge observing of the public interest test: 'though it is not be practicable or desirable to sustain the company any further on the basis of the commercial principles, the public interest is so overwhelming that the industry must be sustained even at the cost of giving a go-bye to the established principles of commerce and economics' ([17], citing as an example a pharmaceutical company that produces an essential drug).

[119] A review of the cases in which section 18 of SICA has been considered or cited (some 78 cases, as held on Manupatra) reveals no judgment in which the 'public interest' test has been considered in any detail by the civil courts, with the exception of the obiter dictum in *Ranka Cables*, *ibid.*

[120] SICA s 19(1),(2). The drafting of s19 is complex, and has led some readers to mistakenly interpret the consent requirement as applying to all classes of creditors.

[121] SICA s 19(1); Kaicker (n 49) [19.5].

[122] *Bharat's Sick Industries* (n 10) [19.6]. On the necessity of consent, see *Cement Workers Union v BIFR* [2000] 100 CompCas 76 (Allahabad), [16]; *Kotak Mahindra Bank Ltd v AAIFR* [2008] 144 CompCas 588 (Delhi), [15]; *Gov of India, Department of Revenue v AAIFR* [2003] 115 CompCas 624 (Delhi); *ARC Cement Ltd v AAIFR* AIR 1998 Delhi 59, [13]; *Ranka Cables v AAIFR* (n 118); *Re Pharmaceutical Products of India Ltd* [2006] 131 CompCas 747 (Bombay), [22] ('even if one bank or financial institution was to withhold the consent, rehabilitation of a sick industrial company by giving financial assistance would be ruled out'); BIFR Regulations reg 34; Kaicker (n 49) [19.5]. The exercise of the section 19 power by banks and financial institutions is considered in Chapter 7, section 7.3.2, and the interpretation of section 19 by the BIFR and the courts in Chapter 8, section 8.2.1.

[123] Narayanan (n 10) 39.

The inclusion of section 19 was the most significant departure SICA's drafters made from the recommendations of the Tiwari Committee. (The Tiwari Committee, perhaps influenced by existing government policy on the role of institutional creditors in supporting the rehabilitation of sick industrial companies, envisaged a BIFR with power to sanction a scheme that would bind *all* creditors[124].) Despite the striking width of section 19, which appears to require unanimous consent from affected institutional creditors[125], the provision received little attention in the parliamentary debate that accompanied the enactment of SICA. The only statement on record (a comment from the Minister of Finance, who introduced the Bill), indicates that the Government was unwilling to go as far as to empower the BIFR to compel contributions from institutional creditors, but did nevertheless have an expectation that those creditors would support rehabilitation:

> The other side of the position was that the Board [BIFR] should have the power to grant all financial relief. I think that might be too harsh on the financial institutions and while financial institutions will be involved in making the package, I think, the discretion of the financial institutions should not be so fettered and I am sure that a package suggested by the Board after all considerations will be honoured by the financial institutions unless they have very extreme difficulty which they can present before the court[126].

The exercise of the creditor 'veto' right is considered in Chapter 7[127]. For present purposes, it is enough to note that it appears to be section 19, rather than the 'public interest' test in section 18, that functions as the gateway to rehabilitation. It seems that

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124 TCR (n 13) Appendix II, draft Bill clause 25(h), (j)(5).

125 Recently, there have been some judicial attempts to relax the rule in a scenario of a single creditor hold out (see Chapter 8, text to n 20).

126 *Lok Sabha Debates* (9 December 1985) (n 60) 280. It is not clear what the Minister meant by 'court', if not the BIFR, given the limited role afforded to the civil courts under the provisions of the Bill.

127 Section 7.3.2.

the 'public interest' test is invariably assumed satisfied at the outset[128], with the real constraints on rehabilitation emerging after the operating agency begins preparing the draft scheme (work that will include assessing the firm's 'viability')[129] and ultimately when institutional creditors are asked to consent to the scheme.

Where consent is refused[130], the BIFR may 'adopt such other measures, including the winding-up of the sick industrial company, as it may deem fit'[131]. Section 20(1) of SICA empowers the BIFR to recommend winding up where it is of the opinion that the company:

> is not likely to make its net worth exceed the accumulated losses within a reasonable time while meeting all its financial obligations and that the company as a result thereof is not likely to become viable in future and that it is just and equitable that the company should be wound up[132].

On a plain reading, the principal criterion (inability to make net worth exceed accumulated losses within a reasonable time) seems readily applicable to most SICA companies: after all, the BIFR's decision to recommend preparation of a scheme is also predicated on a finding that it is not practicable for the company to make its net worth exceed accumulated losses within a reasonable time[133]. It has long been held, however,

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128 As acknowledged by one early member of the BIFR: see Narayanan (n 10) 67 ('though unlikely, it is not impossible that there would be cases where the revival of the company many not be in the public interest').

129 For examples of this approach, see the factual history recounted in *Mittal Steels Ltd v AAIFR* [2004] 118 CompCas 661 (Karnataka); *PML Industries Ltd v BIFR*, unreported decision of Anand and Kathuria JJ in High Court of Punjab and Haryana, 17 May 2001.

130 Creditors asked to give financial assistance must actively refuse. Those who remain silent on receiving the BIFR's request are deemed to consent after sixty days: s 19(2).

131 SICA s 19(4).

132 SICA s 20(1), after consideration of all relevant facts and circumstances and after giving an opportunity to all concerned parties to be heard.

133 Above, text to n 112.

that the BIFR's power of liquidation is one of 'last resort', exercisable only on the failure of attempts at rehabilitation[134].

The BIFR is not empowered to actually make a winding-up order for a SICA company. Rather, the BIFR must forward its opinion that a company should be liquidated to the courts (specifically, the High Court for the state in which the company has its registered office[135]) to be given effect[136]. This arrangement is as the Tiwari Committee envisaged, but the Committee also recommended that the BIFR perform core liquidation functions (including the sale of assets and the distribution of proceeds), prior to the making of a winding-up order by the courts[137], with the result that the order would be no more than a formality to enable the dissolution of the company. SICA's drafters stopped somewhat short of this: the BIFR is permitted (though not obliged) to authorise the sale of assets in advance of the winding up order being made by the court[138], but cannot distribute the proceeds (instead, they are forwarded to the court for distribution in accordance with the liquidation provisions of the Companies Act 1956). In the parliamentary debate accompanying SICA's introduction, this decision to modify the Tiwari Committee's proposal was explained as a pragmatic one, designed to minimise the workload of the BIFR:

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[134] See *Maharashtra Tubes Ltd v State Industrial and Investment Corporation of Maharashtra Ltd* (1993) 78 Comp Cas 803 (SC), [6]; see also for example *JM Malhotra v Union of India* [1997] 89 Comp Cas 600 (Madras), [8]; *Anmol Dairy Ltd* (2002) 4 GLR 2005 (Gujarat), [9] ('it is not a matter of dispute that report under s 20… is to be submitted as a last resort'); see also Naik (n 84) 55; Kaicker (n 49) [20.1]; *Bharat's Sick Industries* (n 10) [20.3].

[135] *Re Dewas Synthetics Ltd* (2005) 123 CompCas 214 (Madhya Pradesh), noted *Bharat's Sick Industries* (n 10) [20.11].

[136] Section 20(1).

[137] See above, text to n 26.

[138] Section 20(4).

> [T]he main thrust [of SICA] is on rehabilitation and the main thrust of various provisions in the Bill is on keeping the industry alive… All these steps are envisaged in it to keep the unit healthy and it is only when all fail, then it is a question of liquidation and it was conceived that the Board [BIFR] should not be burdened with the procedures of liquidation because that is very lengthy and it will go to the appropriate forum in the High Court…
> The Board is not concerning itself with funeral ceremonies… Our purpose is to restore health and that is the function of the hospitals. If the hospitals get dead bodies, then the hospitals will not function…[139].

SICA's drafters did, however, endorse the Tiwari Committee's recommendation that the BIFR – rather than the courts – be responsible for making the decision to liquidate. They equipped the BIFR with power to issue a liquidation opinion and, borrowing language from the Tiwari Committee's draft bill, rendered that opinion apparently binding on the High Court receiving it: section 20(2) provides that 'the High Court *shall*, on the basis of the opinion… order winding-up'. A suggestion from one parliamentary member that the BIFR be required to obtain the consent of the 'concerned' state government[140] before sending its opinion to the courts was rejected, on the basis that it was the BIFR that was intended to be the 'final authority' on this decision:

> For any decision making there has to be a final authority. We have made provision for the Board [BIFR]. After the formation of the Board, if we give the power of veto to the States, and if they don't agree, then, there will be a deadlock. So, the Board has to be the final authority and that is what we have provided for[141].

In practice, however, developments in the judicial interpretation and application of SICA have significantly weakened the BIFR's position as the 'final authority' on the liquidation

[139] *Lok Sabha Debates* (9 December 1985) (n 60) 272, 279.

[140] Presumably the government of the state where the debtor is incorporated.

[141] *Lok Sabha Debates* (9 December 1985) (n 60) 301-302.

of sick industrial companies. These developments, and their impact on SICA's functionality, are considered in detail in Chapter 8.

6.4 The end of SICA: efforts at reform and repeal

6.4.1 Proposals for repeal

SICA is widely considered a failure. The specific criticisms made of the Act are considered in Chapter 7. It is useful, however, to preface that discussion with an acknowledgment of recent and ongoing attempts at SICA's repeal. The first forceful criticisms of SICA emerged in a series of works published in the early-mid 1990s by Indian economist Omkar Goswami (with others)[142]. By 1997, a bill had been introduced to substantially amend SICA, consistent with the Goswami critique[143]. The 1997 bill lapsed, but criticism of SICA grew. In 2001, following a series of reports on company and insolvency law commissioned by the Central Government[144], the Companies (Second Amendment) Bill 2001 was introduced. As Chapter 3 explained[145], the bill was to effect a dramatic change to the Companies Act 1956: the transfer of adjudicatory responsibility over company law matters from the state courts[146] to the new National Company Law Tribunal ('NCLT')[147]. SICA was also targeted: the bill provided for a new rescue

142 Including the Goswami Committee Report (n 10) and Anant and Goswami (n 10), and later Goswami, *Corporate Bankruptcy* (n 9).

143 The Sick Industrial Companies (Special Provisions) Bill 1997. The Bill is extracted in Kaicker's commentary (n 49, 369). The Bill appears to have been closely modelled on the draft Bill attached to the Goswami Committee Report (n 10).

144 Principally, the Eradi Committee Report (n 9), the Advisory Group Report (n 9), and the Irani Committee Report (n 9).

145 Text to n 126.

146 And the Company Law Board (established under the Companies Act 1956).

147 See Parts IB and IC of the Act.

procedure for industrial firms (modelled on SICA but with some differences)[148] to be administered by the NCLT, and a separate bill provided for SICA's repeal[149]. Both were passed[150], but litigation challenging the constitutionality of the NCLT delayed their commencement[151]. By the time the challenge was disposed of (seven years later)[152], the reform agenda had become more ambitious, with the Government now proposing the enactment of an entirely new companies statute. What followed was the Companies Bill of 2008, which again made provision for the establishment of the NCLT[153], but also provided for a new rescue procedure, available to all companies – whether or not industrial[154]. The bill is yet to be passed (despite being reintroduced in 2009 and 2011), but its passage is reportedly imminent, and with it SICA's repeal.

6.4.2 Interim relief for creditors: the SARFAESI amendment

The dominant complaint levelled at SICA is that the Act has functioned to inappropriately privilege its debtors at the expense of their creditors. The evidence of SICA's 'pro-debtor' functionality, and the reasons for it, are considered in Chapters 7 and 8. But it is important to note that creditor harm under SICA has been somewhat curtailed since 2002, when an amendment offered institutional creditors – for the first

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148 The key difference, also noted in Chapter 7 (text to n 56) was the absence of a moratorium.

149 Sick Industrial Companies (Special Provisions) Repeal Bill 2002.

150 Companies (Second Amendment) Act 2002; Sick Industrial Companies (Special Provisions) Repeal Act 2003.

151 Neither Act has been notified for commencement, but the fact that both have been enacted has led to confusion, with some concluding that the BIFR was abolished in 2003. The BIFR remains operational, and its hearing schedule is available on its website (www.bifr.nic.in).

152 As noted in Chapter 3, n 127.

153 Chapter XXVI of the Companies Bills of 2008 and 2009, Chapter XXVII of the Companies Bill 2011.

154 Chapter XIX of the Companies Bills of 2008 and 2009 and 2011.

time – an escape route from SICA. The amendment was contained within the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 ('SARFAESI'), introduced in Part I of this thesis (recall that SARFAESI afforded institutional creditors, *inter alia*, new out-of-court enforcement rights in relation to secured (and 'non-performing') debt[155]). SARFAESI also amended SICA by adding a proviso to enable secured institutional creditors of sick industrial companies to bring to an end pending BIFR proceedings, and pursue the debtor using their SARFAESI enforcement rights. Section 15 of SICA, as amended by SARFAESI, now provides that a reference that is 'pending' before the BIFR will 'abate' if secured creditors representing not less than ¾ in value of the secured[156] debt owed by a SICA debtor have 'taken any measures to recover their secured debt under [SARFAESI]'[157]. The concept of a 'pending reference' under SICA has been widely construed, such that institutional creditors have been able to rely on the amendment to bring to an end to

[155] Section 13 of SARFAESI; Chapter 4, text to n 118.

[156] The proviso does not actually refer to ¾ in value of 'secured' debt: it requires action by secured creditors 'representing not less than three-fourth in value of the amount outstanding against financial assistance disbursed to the borrower of such secured creditors'. 'Financial assistance' is not defined in SICA but is defined in SARFAESI (s 2(1)(k)) to incorporate the extension of credit by various means *by banks and financial institutions*. Assuming this definition is appropriately applied to s 15 of SICA, a plausible interpretation of the section is it that it requires action by secured creditors representing ¾ in value of the total credit advanced to the SICA debtor by banks and financial institutions, but courts appear to have treated the provision as simply requiring secured creditors representing ¾ in value of total secured debt: see for example *Alpine Industries Ltd v AAIFR* [2011] 162 CompCas 563 (Delhi); *Nouveaw Exports Private Limited v AAIFR* AIR 2010 Bom 159 (Bombay), [29].

[157] Proviso to section 15(1). A second proviso added to section 15 by SARFAESI limits the ability of companies that have not yet filed a reference with the BIFR to do so: under this proviso, no BIFR reference is to be made where 'financial assets have been acquired by any securitization company or reconstruction company under [SARFAESI]'. A 'financial asset' is defined in SARFAESI to include claims to any 'debt or receivables', whether secured or unsecured, security interests in property, and a debt (s 2(1)(l)). The apparent effect is to preclude a reference wherever there is an acquisition of a SICA company's debt by a securitisation or reconstruction company under SARFAESI, but this broad construction has been resisted: see *Asset Reconstruction Co India P Ltd v Shamken Spinners Ltd* AIR 2011 Delhi 17, [17], requiring an acquisition of at least 75% of the value of the financial assets.

proceedings that have been before the BIFR for years[158]. The result appears to be that institutional creditors are effectively insulated from further harm while they await the passage of the proposed reforms.

[158] See for example *Ravi Spinning Ltd v Union of India* (2006) (2) MhLj 145 (Bombay) (BIFR had already issued a liquidation opinion but company had challenged the opinion by appeal to Appellate Authority; in the period leading up to the hearing of the appeal, secured creditors resolved to act under SARFAESI: held, there was a 'pending reference' that abated by the decision of the requisite majority of secured creditors to enforce under SARFAESI, with the result that SICA proceedings were brought to an end); *Archana Spinners Ltd v Board for Industrial and Financial Reconstruction* [2009] 147 CompCas 387 (Madras) (BIFR had circulated a scheme for approval of institutional creditors who had failed to either consent or object, with the result that their silence amounted to 'deemed' consent (see above n 130); in the meantime, prior to the formal sanctioning of the scheme, the requisite majority of secured creditors took action under SARFAESI to enforce: held, the reference was 'pending' at the time of the action, and abated in consequence, with the result that the scheme could not be sanctioned); see also *Punjab National Bank v AAIFR* [2009] 149 CompCas 390 (Delhi) and *Nouveaw Exports v AAIFR* (n 156), departing from a decision to contrary effect in the Orissa High Court in *Noble Aqua Pvt Ltd v State Bank of India* AIR 2008 Ori 103.

CHAPTER 7

THE FAILURE OF INDIA'S CORPORATE RESCUE LAW

The Committee had the benefit of hearing the views of the Union Labour Secretary, Union Banking Secretary and experts representing financial institutions, commercial bodies and Indian Bankers Association on the subject. These organisations and persons have with one voice expressed a clear opinion that the BIFR and AAIFR have not been able to fulfil the purpose and mandate as envisaged under the SICA, of providing viable schemes for the revival of sick companies in a reasonable short time frame.

(Eradi Committee Report, 2000)

The SICA has failed to turn around sick companies. The BIFR has turned into a haven for defaulting borrowers who rushed to the BIFR solely for statutory protection from the creditors wanting their due.

(Batra, 'The Asian Recovery: Progress and Pitfalls', 2003)

Over the course of its relatively short life, SICA has achieved a remarkable degree of notoriety. Although narrower in scope than its liquidation counterpart – SICA applies only to a subset of Indian industry[1], while the liquidation procedure in the Companies Act 1956 (considered in Part I) is applicable to all incorporated debtors – SICA has attracted by far the most attention in literature on corporate insolvency law in India. The conclusion that emerges from this literature is that SICA and its administrator, the BIFR, ought to be condemned as 'failures'[2]. Much of the literature recommends the wholesale

[1] See Section 6.1.

[2] See for example the 'Report of the High Level Committee on Law Relating to Insolvency and Winding up of Companies' (the 'Eradi Committee Report') (31 July 2000), extracted in DP Mittal, *Taxmann's New Law Relating to Sick Industries* (Taxmann 2003), Appendix 6, ch 5; 'Report of the Advisory Group on Bankruptcy Laws' (the 'Advisory Group Report') (May 2001) <www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=225> 27 August 2012, [3.1], [3.5]; Expert Committee on Company Law, 'Report on Company Law' (the 'Irani Committee Report') (31 May 2005) <www.acga-asia.org/public/files/JJ%20Irani%20Report.pdf > 27 August 2012, ch XIII, [3]; Omkar Goswami, 'Corporate Governance in India' in *Taking Action Against Corruption in Asia and the Pacific* (ADB 2002) 94; Omkar Goswami, *Corporate Bankruptcy in India* (OECD 1996), ch 3; MR Umarji MR, 'Trends and Developments in Insolvency Systems and Risk Management: The Experience of India' in MR Umarji, *Thoughts on Banking Sector Reforms* (Indian Banks' Association 2008) 168-170; Sumant Batra, 'The Asian Recovery: Progress and Pitfalls' (Global Forum on Insolvency Risk Management, Washington DC, 2003) 2 <http://siteresources.worldbank.org/GILD/ConferenceMaterial/20157508/Batra%20-%20India%20-%20FINAL.pdf> accessed 20 August 2012.

repeal of SICA[3]: there is apparent agreement that the existing statutory framework is simply unable to deliver[4]. The position is summarised in the 2009 Report of the Committee on Financial Sector Reforms, which offers this blunt assessment:

> By far, the most difficult and most pressing issue facing India's ICR [insolvency and creditor rights] system is the need for a functioning and realistic reorganisation scheme… SICA and the related BIFR are considered failures[5].

But how and why did SICA come to 'fail' so spectacularly? This, and the next, chapter are devoted to this question. This chapter has three sections. In the first, the focus is on *how* it is that SICA is said to have failed (that which is cited as evidence of SICA's failure). The core criticisms levelled against SICA are set out, and the normative framework on which they are premised articulated. In the second and third sections, the focus is on *why* SICA failed in this way; or, put another way, on why SICA came to operate as it does. The second section reviews the explanations for SICA's failure that are advanced in the existing literature. In the third section, this literature is critically reviewed, leading to the suggestion that the existing explanations for SICA's operation leave a number of questions unanswered. This forms the basis for a fresh inquiry into SICA's operation in Chapter 8.

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3 See for example, Advisory Group Report ibid [3.1] ('the Act is, however, seriously flawed'); Eradi Committee Report ibid [5.16](a) ('Considering the criticisms of the working of the BIFR under the SICA, the Committee accepts the suggestion that the SICA should be repealed…'); Irani Committee Report ibid ch XIII. That is not to say that these reports focus exclusively on changing the law 'on the books' without considering the performance of the BIFR and the courts as SICA's administrators: see text to n 91 below.

4 As to what it is that SICA is expected to deliver, see section 7.1.2 below.

5 Report of the Committee on Financial Sector Reforms, *A Hundred Small Steps* (SAGE Publications 2009) 172.

7.1 How SICA failed

7.1.1 Popular criticisms of SICA

The most common criticism of SICA is delay: severe delay in the disposal of proceedings. A key element of the vision of SICA's drafters, and of the Tiwari Committee before them, was speed. The Act was intended to enable:

> [T]he *speedy* determination by a Board of experts of the preventative, ameliorative, remedial and other measures which need to be taken with respect to such [sick] companies and the *expeditious* enforcement of the measures so determined…[6]

This vision never became reality; from the early years of its operation[7] until the present day[8], the BIFR has laboured under a record of long delays. The BIFR's website indicates that 'normally' takes between 5 and 7 years for a company to be 'revived'[9]. Although it is not entirely clear, this statement does not appear to be an estimate of the total duration of proceedings for companies that emerge revived; rather, it appears to be an estimate of the number of years it will typically take for a company to become revived ('net worth positive', or balance sheet solvent[10]) *after* the sanctioning of a scheme[11]. Although the evidence is sparse, what data there is supports this interpretation, pointing to a period of

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[6] Preface to the introduction of the Sick Industrial Companies (Special Provisions) Bill: *Lok Sabha Debates* (20 November 1985, Lok Sabha Secretariat) 310.

[7] See for example the 'Report of the Committee on Industrial Sickness and Corporate Restructuring' (the 'Goswami Committee Report'), extracted in Pahwa HPS, *Bharat's Sick Industries & BIFR* (8th ed, Bharat Law House 2009) Appendix 1, Table [3.3], reporting on delays between 1987 and 1992.

[8] See most recently Institute of Company Secretaries of India, 'Emerging Insolvency in India: Issues & Options' (FAIR Paper 2010) 8 http://www.iica.in/images/confdetailpaper/Country_Report_on_Corporate_Insolvency_laws.pdf 30 August 2012; Irani Committee Report (n 2) ch XIII, [3].

[9] BIFR, 'Year Wise Performance', Note 1 <http://www.bifr.nic.in/geninfo.htm> 31 July 2012.

[10] See Chapter 6, text to n 92.

[11] See Note 1, 'Year Wise Performance' (n 9), which identifies companies as revived 'in the year in which Net Worth became positive and companies were discharged from the purview of SICA'.

considerable delay between the registration of a SICA reference and the BIFR's decision to sanction a scheme, or issue a liquidation opinion. In 2004, Kang and Nayar reported that it took the BIFR an average of 6.5 years to recommend liquidation, and an average of 7 years to sanction a rehabilitation scheme[12]. One more recent empirical project using a hand-collected dataset of SICA cases registered between 1991 and 2005 suggested that the BIFR took an average of 1602.67 days (4.4 years) to decide whether to rehabilitate or liquidate[13]. In any case, these reports capture only part of the delay for those companies recommended for liquidation. In these cases, there are consistent reports of severe further delays in the High Courts that are responsible for giving effect to the BIFR's liquidation opinion[14]: 'experience has… shown that the High Courts to which the final opinion of the Board as to winding up of a… sick industrial company is forwarded take several years to pass a winding up order'[15].

Over time, it is these liquidation cases that have come to dominate the BIFR's output. The descriptive statistics available on the BIFR's performance (summarised in Appendix III) indicate that between May 1987 and 30 September 2006, 5,412 cases were registered. A substantial proportion of these references (1,707 or 31.54%) were

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[12] Nimrit Kang and Nitin Nayar, 'The Evolution of Corporate Bankruptcy Law in India' (2003-2004) *Money and Finance* 37, Table 1, based on unidentified 2002 data.

[13] Anand Jha, 'Bankruptcy Resolution and Political Cost' (unpublished working paper, 26 August 2008, no longer available online) Table II; see also Cyril Schroff and Ashwani Puri, 'India' in Carolyn Boyle (ed), *Asia Pacific Restructuring and Insolvency Guide 2006* (Globe White Page 2006) 76 (reporting 'up to three or four years elapsing before the Board explores possible rehabilitation options and decides on winding up').

[14] Under section 20(2) of SICA (see Chapter 6, text to n 136). See Goswami's *Corporate Bankruptcy* (n 2) 87-88; Rahel Falk, 'Industrial Sickness in Indian Manufacturing' (2005, unpublished doctoral dissertation, Heidelberg) 153-154 < http://archiv.ub.uni-heidelberg.de/volltextserver/frontdoor.php?source_opus=5744> 1 July 2012; Vijay Joshi and IMD Little, *India's Economic Reforms: 1991-2001* (OUP 1996) 213; PS Kaicker, *Taxmann's Sick Industrial Companies (Special Provisions) Act 1985: Law, Practice & Procedure* (Taxmann Allied Services 2000) [20.3-5], 342; SK Seth, *Industrial Sickness: Evaluation under the Sick Industrial Companies Act* (Ganga Saran & Grand Sons 2003) 41.

[15] Kaicker ibid 342.

dismissed as non-maintainable after the BIFR's initial inquiry into whether the registered company was a 'sick industrial company'[16]. For those companies which were 'declared sick', 760 rehabilitation schemes were sanctioned and, of these, 485 companies declared 'no longer sick' after the implementation of the scheme (a further 127 were declared 'no longer sick' after becoming net-worth positive during the pendency of proceedings, giving a total of 612 'revived' companies). 1,303 were recommended for liquidation[17].

The BIFR's revival record has been cited, alongside delay, as evidence of SICA's failure:

> The effectiveness of the SICA… has been severely undermined by reason of the enormous delays involved in the disposal of cases by the BIFR. The success rate of revival of sick companies has fall too far short of the expectations due to several reasons[18].

Of course, a mere record of non-revival need not necessarily suggest failure, unless the statutory goal is understood to be revival *per se*; more evidence would be needed at firm level (as to the state of firms when entering SICA) to evaluate a record of non-revival against any other goal, such as value maximisation[19]. At minimum, however, some critics have suggested that the combination of delay *and* non-revival does suggest some failing on the part of the BIFR: a 'faulty appraisal' of the suitability of SICA companies for

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[16] See further below, text to n 25.

[17] See Appendix III, which summarises data from the Annual Economic Surveys from 1988-2007. The BIFR also publishes some data, some of which suggests that in more recent years the revival rate has increased (see 'Year Wise Performance' (n 9), reporting 899 debtors revived and 1,262 recommended for liquidation as at 30 September 2010). Other BIFR data, suggests, however that this revival figure may be incorrect (see 'Cases Declared No Longer Sick' <http://bifr.nic.in/dnls.htm> 30 August 2012, which reports 474 cases 'declared no longer sick' by 30 September 2010. Companies can also be revived by becoming net-worth positive during the pendency of SICA proceedings, but it seems doubtful that as many as 425 companies would have exited by this route given the historical evidence on the number of companies revived in this way: see Appendix III).

[18] Eradi Committee Report (n 2) [5.15]; see also for example, Umarji (n 2) 169; Batra, 'Progress and Pitfalls' (n 2) 2.

[19] See further below, section 7.1.2.

rehabilitation, or some other rehabilitation 'bias', that has needlessly delayed the liquidation of firms incapable of rehabilitation[20].

The overall trajectory of BIFR proceedings – lengthy delay, followed in the majority of cases by a liquidation opinion, the implementation of which is further delayed in the civil courts – is the starting point for most SICA critiques. But in much of the SICA literature, critics do more than simply complain of the record of delay and non-revival; they also connect this record (and particularly the record of delay) with a wider series of complaints about the impact of the process on debtors and their creditors. By far the most common complaint is that the likelihood of delays has perversely attracted debtors to SICA, lured by the promise of a lengthy moratorium during which they can, *inter alia,* shield the corporate estate from creditors. In this (the dominant) critique, the BIFR is caricatured as a 'haven' for misbehaving debtors[21], against which creditors have found themselves 'practically helpless'[22]: '[D]elay extends undue benefit to the company (debtor) and at the same time causes immense loss and injury to creditors who are unable to recover their dues due to umbrella of section 22 [the moratorium]...'[23]. As others have noted, data on the BIFR's performance provides possible evidence of the attractiveness of SICA to debtors: recall that a high percentage of SICA cases are dismissed at the first

[20] Seth (n 14); see also Goswami's *Corporate Bankruptcy* (n 2) 54, below, text to n 33. As to the beneficiaries of delay, see Chapter 8, Section 8.2.4).

[21] Batra, 'Progress and Pitfalls' (n 2) 2.

[22] Rajesh Chakrabarti, *The Financial Sector in India: Emerging Issues* (Oxford University Press 2006) 171; see also Schroff and Puri (n 13) 66 ('[the BIFR]… has largely been used by debtors to defeat creditors' claims'); Eradi Committee Report (n 2) [5.9]; Kang and Nayar (n 12) 46; *A Hundred Small Steps* (n 5) 173; Umarji (n 2) 169; Seth (n 14) 93.

[23] *Laxmichand Dayabhai (Exports) Company v Prestige Food Ltd* [2009] 149 CompCas 235 (Madhya Pradesh), [4].

stage of the BIFR's work[24] (the inquiry into whether a referred company is indeed a 'sick industrial company'), suggesting the possibility that 'firms engage in number management in order to seek bankruptcy protection'[25]. The problem of debtor 'abuse' of the SICA moratorium has also been regularly noted by judges and by litigants in the courts[26].

Two further complaints of debtor misbehaviour and associated creditor vulnerability are sometimes added to the primary complaint of creditor avoidance. The first is that some managers have siphoned off corporate assets during the (lengthy) course of SICA proceedings[27], causing further harm to creditor recovery prospects. The second complaint is that – in addition to suffering blows to the prospect of recovery on *existing* debt in the course of proceedings – institutional creditors have on occasion been 'coerced' into extending *additional* concessions to debtors as part of a rehabilitation scheme. This complaint has been expressly extended to include institutional creditors and the federal and state governments, notwithstanding the formal power of these stakeholders to refuse to extend 'financial assistance' under a rehabilitation scheme (the section 19 creditor 'veto')[28].

The claim that institutional creditors have been compelled to support rehabilitation schemes first appeared in a series of studies on industrial sickness in India

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[24] See above, text to n 16 and Appendix III.

[25] Jha (n 13) 21; see also Kang and Nayar (n 12) 46.

[26] See for example *Morgan Securities and Credit Pvt Ltd v Modi Rubber Ltd* AIR 2007 SC 683 (Supreme Court), [43]; *Biogenics India Ltd v BIFR* [2004] 122 CompCas 736 (Delhi), [7]; *Moti Prasad Agrawal v Pradeshiya Industrial and Investment Corporation of UP* 2002(4) AWC 3132 (Allahabad), [11]-[12].

[27] Advisory Group Report (n 2) [3.5]; Kang and Nayar (n 12) 46.

[28] See Chapter 6, text to n 120.

led by Indian economist Omkar Goswami[29]. These studies culminated in Goswami's *Corporate Bankruptcy in India: A Comparative Study*[30], probably the most influential work on SICA. In this work (and the studies that preceded it), Goswami complained that some SICA rehabilitation packages had been 'coerced' (typically, he thought, by a combination of promoter[31] and employee pressure[32]), even in 'highly unviable cases'; that many sanctioned schemes ultimately failed, revealing the BIFR's inability to distinguish between 'restructurable' and unviable companies and/or a bias in favour of rehabilitation *per se*[33]; and that these trends had benefited shareholders of those companies at immense cost to creditors, resulting in 'gross' violations of absolute priority rule[34]. Other scholars have also criticised rehabilitation efforts under SICA as misplaced or illusory, suggesting that SICA has targeted the 'wrong' firms for rescue, and that creditors have been paralysed from resisting this[35].

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[29] The Goswami Committee Report (n 7); TCA Anant and Omkar Goswami, 'Getting Everything Wrong: India's Policies Regarding 'Sick' Firms' in Dilip Mookherjee (ed), *Indian Industry: Policies and Performance* (OUP 1995); three other interim reports by Goswami, Anant and others are also listed in the bibliography to Goswami's *Corporate Bankruptcy in India* (n 2).

[30] *Corporate Bankruptcy in India* (n 2).

[31] Promoters are those associated with the establishment of a company: see generally Madhu Tyagi and Arun Kumar, *Company Law* (Atlantic Publishers 2003) ch 6.

[32] *Corporate Bankruptcy in India* (n 2) 56.

[33] ibid 56.

[34] ibid 83, drawing on a study of 23 SICA rehabilitation schemes for textile and engineering companies that all revealed 'FIs (secured creditors) taking major losses that eventually benefited equity'. See also Anant and Goswami (n 29) 269-271.

[35] Joshi and Little (n 14) 214, citing Goswami's *Corporate Bankruptcy in India*; Dietmar Rothermund, *India: the Rise of an Asian Giant* (Yale University Press 2008) 90-91, referencing Anant and Goswami (n 29); Advisory Group Report (n 2) [3.1], [3.5].

In Goswami's work, the BIFR is portrayed as 'wildly optimistic'[36] in its attempts to formulate rehabilitation schemes, but nevertheless constrained at least to some extent in its ability to implement those schemes by the requirement to obtain (institutional) creditor consent[37]. Other critics have gone further and accused the BIFR of overriding institutional creditors in the sanctioning of schemes, notwithstanding the formal consent requirement. This allegation of direct 'coercion' by the BIFR is unequivocally made in the 2001 report of the RBI's 'Advisory Group on Bankruptcy Laws', which describes rehabilitation under SICA in this way:

> These bodies [The BIFR and the Appellate Authority] carry on restructuring efforts under a 'command structure', often at a time when no restructuring is possible. The BIFR procedure is notoriously dilatory. Therefore, the debtor often takes the shelter of BIFR, firstly, to avoid payment of claims [the creditor avoidance allegation] and secondly, to extract whatever worth remains in the asset [the asset siphoning allegation]… Under the 'command' system *BIFR ignores the claims of the banks and financial institutions or imposes additional liability*… [the creditor coercion allegation][38].

Kang and Nayar also refer, without further elaboration, to 'situations where the BIFR forces concessions, such as subsidies from the government'[39]. Historian Dietmar Rothermund similarly observes of sick textile companies that entered SICA: 'BIFR remained ineffective and often saved bankrupt firms 'in the public interest', imposing 'sacrifices' on the creditors and enabling the mill-owners to profit from such measures'[40].

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[36] Goswami's *Corporate Bankruptcy* (n 2) 54.

[37] ibid 53-56. In the following chapter, Goswami suggests reasons why an institutional creditor might give its consent to a 'risky' rehabilitation scheme, including (particularly in the period before financial sector liberalisation) the possibility of 'ever-greening' of portfolios, as to which see further below, text to n 70.

[38] (n 2) [3.5].

[39] (n 12) 46.

[40] (n 35) 90. Rothermund cites Anant and Goswami (n 29) in support of this proposition, but that work does not expressly allege that the BIFR forced concessions on creditors.

How, then, did SICA 'fail'? Overall, the Act is said to have failed by inappropriately privileging its debtors at institutional creditor expense, including by enabling creditor avoidance, asset siphoning, and the inappropriate extraction of further value from creditors.

7.1.2 Normative foundations of popular SICA criticisms

Against what standard should the evidence of the operation of SICA in practice be evaluated? The dominant account of SICA's failure – in which the Act is said to have 'failed' by privileging its corporate debtors at institutional creditor expense – is premised on an efficiency-oriented standard that evaluates insolvency laws by their capacity to maximise the economic value of the debtor's estate. This much is expressly acknowledged in most SICA critiques[41]. Some SICA literature (specifically the Goswami works[42], and Joshi and Little's work[43]) offers a more detailed account of the relationship between this general goal (value maximisation *ex post*) and the particular function of corporate rescue laws. This account is essentially that of the 'proceduralists' in bankruptcy theory[44]. In the proceduralist account, not all insolvent firms are appropriate candidates for rescue: it is only where the maintenance of the company (as in a

41 See for example Sumant Batra, 'Proposals for Reform – The Indian Position' (Second Forum for Asian Insolvency Reform, Bangkok 2002) 10 <www.sumantbatra.com/pdf/papers/2nd_forum.pdf> 30 August 2012. ('bankruptcy proceeding needs to be based on the fundamental objective of asset value maximization…'); Advisory Group Report (n 2) [3.2], identifying the objectives of bankruptcy law as '(1) maximization of value of assets; (2) facilitating restructuring based on renegotiation; and (3) quick and fast track liquidation'; Irani Committee Report (n 2) Chapter XIII at [6.1] ('The [insolvency] framework should seek to preserve estate and maximise the value of assets; recognise inter se rights of creditors and provide equal treatment of similar creditors while dealing with small creditors equitably').

42 Goswami's *Corporate Bankruptcy* (n 2); Anant and Goswami (n 29).

43 (n 14).

44 For an introduction to the 'proceduralist' account and its 'traditionalist' rival, see Douglas Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108 *Yale Law Journal* 573.

reorganisation) or its business (as in a going concern sale) will yield a higher value than a piecemeal asset sale (as in a liquidation) that a rescue operation may be warranted. Put another way, only *financially* distressed – not *economically* distressed[45] – firms are suitable candidates for rescue, since by definition they are the firms in which there may be a 'going concern surplus'[46] that will be lost by a creditor race to 'grab' assets in insolvency or in the vicinity of insolvency (the 'tragedy of the commons' problem articulated by Jackson in his seminal *The Logic and Limits of Bankruptcy Law*)[47] [48]. It is this framework that explains why the evidence of apparently needless delay in the liquidation of 'unviable' firms, or costly and/or failed attempts at their rehabilitation, is considered so egregious: why it is a key indicator of SICA's 'failure'.

It is important to acknowledge that there is a tension between the normative framework deployed by SICA critics – a framework that prizes value maximisation, and as such contemplates a limited role for rescue – and that which was historically deployed to explain policy responses to industrial sickness in India. The history of industrial sickness policy, as introduced in Part I (Chapter 4)[49], is essentially a history in which

[45] As Alan Schwartz explains: 'Insolvency may be a function of economic distress, financial distress or both. Economic distress occurs when the firm cannot earn revenues sufficient to cover its costs, exclusive of financing costs. Such a firm has negative economic value. A firm is in financial distress alone if it would have positive earnings were it not required to service its debt': 'A Normative Theory of Business Bankruptcy' (2005) 91 *Virginia Law Review* 1199, 1200.

[46] Horst Eidenmuller, 'Trading in Times of Crisis: Formal Insolvency Proceedings, Workouts and the Incentives for Shareholders/Managers' (2006) 7 *European Business Law Review* 239, 241-242.

[47] That is, that 'the system of individual creditor remedies may be bad for the creditors *as a group* when there are not enough assets to go around': (Harvard University Press 1986) 10.

[48] This account is expressly adopted in Goswami's *Corporate Bankruptcy* (n 2) 37 ('bankruptcy reorganization… implicitly assumes that restructuring debts and liabilities to maintain a firm as a going concern preserves more value than either liquidating it piecemeal or selling it *in toto*…); see also Anant and Goswami (n 29) 262-263 and Joshi and Little (n 14) 216.

[49] Text to n 50.

corporate rescue was identified as a goal *in and of itself*, rather than as an *instrument* to achieve the higher-order goal of value maximisation. In this historically-entrenched framework, the evidence of losses to institutional creditors (whether by a reduction in recoveries on existing debt, or by the extension of further credit) would have been far from evidence of 'failure': recall that institutional creditors were, instead, both invited and expected to deliver subsidised support to industrial debtors in pursuit of the rescue goal.

This tension is largely obscured by the revisionist tendency of contemporary SICA critics to present the value maximisation goal as axiomatic, without reference to the Act's historical context. At the time of economic liberalisation, however, proposals for efficiency-oriented insolvency reforms were acknowledged for what they were – as ones requiring a dramatic change in insolvency philosophy. When the Goswami Committee released its 1993 report on industrial restructuring in India, it acknowledged that its recommendations for efficiency-oriented amendments[50] to SICA would require a fundamental policy change: 'The responsibility of industrial and corporate reorganization must shift from secured creditors and the State – *as is presently the case* – to the defaulting debtor firms'[51]. This change would be controversial, and the Central Government was aware of this. Its liberalisation promise of a new 'exit' policy for industrial firms (including the closure of 'patently unviable' firms)[52] was announced tentatively, in view of its political sensitivity:

> Appropriate exit policies are needed to capture the efficiency gains from policy reform and, at the same time, it is imperative that workers should

[50] Goswami Committee Report (n 7) [3.4.6].

[51] ibid [3.4.1].

[52] 'Statement of Finance Minister in Parliament, 16 December 1991', *RBI Monthly Bulletin* (January 1992) 153, [22].

> be protected from the adverse impact of the adjustment process to the maximum extent feasible… [E]ffort is under way to formulate a policy that would facilitate the process of industrial restructuring… This process will take some time since it will be necessary to build the political consensus necessary for ensuring durability of policy reform…[53].

Economic liberalisation did force at least one immediate change: the liberalisation of the financial sector freed banks and financial institutions from their historical obligation to support sick industrial debtors (see further below, section 7.3.2.). But the evidence presented in Chapter 8 suggests that the underlying tension between the historically entrenched 'pro-revival' philosophy and the efficiency-oriented philosophy of reform persisted well into the market economy period, influencing the practices and preferences of SICA's administrators (the BIFR and the civil courts) and, in turn, the operation of the Act.

7.2 Why SICA failed: popular explanations

Some SICA critics have attempted to explain why SICA operates as it does. This literature is small, and dominated by economists. (The absence of critical research by legal scholars is highly surprising, given SICA's notoriety). The research that has emerged tends to identify a multiplicity of factors at play, some relating to aspects of SICA's design (the Act as drafted), and others relating to aspects of SICA's implementation.

It is SICA's formal design (the statutory provisions 'on the books') that appears to have most captured the attention of scholars seeking to explain the Act's operation. SICA's moratorium – the device 'abused' by debtors – emerged early as an obvious candidate for blame, and still attracts considerable attention. A recent working paper by the Indian Institute of Company Secretaries identified the moratorium as the 'principal

[53] 'Memorandum on Economic Policies for 1991/92-1992/93', *RBI Monthly Bulletin* (January 1992) 158, [31].

drawback' of SICA, for the reason that it had 'led the BIFR to become a haven for defaulting companies'[54]. The earliest attempt at SICA's repeal (the Companies (Second Amendment) Act 2002 and Sick Industrial Companies (Special Provisions) Repeal Act 2003, noted in Chapter 6) would have led to the introduction of a rescue procedure that was similar to that in SICA, with the notable omission of any form of moratorium[55]. This omission was characterised by one commentator as a 'knee-jerk' response to the experience under SICA: 'This provision [section 22] is one of the major causes of the SICA's failure as legislation. However, repealing the provision all together appears to be a knee-jerk reaction to this shortcoming'[56]. Current reform proposals (as contained in the Companies Bill 2011)[57] would reinstate the moratorium in its current form, but it would no longer arise automatically (rather, an application would need to be made to the tribunal for its imposition)[58].

The presence of a moratorium may well, as Kang and Nayar have argued, give debtors an incentive to delay, and any such delay may enable debtors to engage in asset siphoning[59]. The threat of delay may also increase the likelihood of creditors' agreeing a compromise they might otherwise have rejected: Joshi and Little, for example, suggest that the prospect of delays in the liquidation of SICA companies 'obviously makes creditors more likely to agree a rehabilitation package which involves concessions on

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[54] (n 8) 9.

[55] As noted in Chapter 6, text to n 148.

[56] Batra, 'Progress and Pitfalls' (n 2) 9.

[57] See section 6.4.1.

[58] See Companies Bill cl 253(2) and (4).

[59] (n 12) 46.

their part'[60]. How is it, though, that debtors may credibly threaten to achieve, or in fact achieve, delay in the SICA process? It is perhaps this question that caused some SICA critics to turn their attention to a second feature of the Act - its interim protection of management, or 'debtor-in-possession' design[61]. This idea was given first and fullest expression by Goswami in his influential work *Corporate Bankruptcy in India*, a comparative study of corporate rescue procedures in India (SICA), the US (Chapter 11 of the US Bankruptcy Code) and the UK (administration under the Insolvency Act 1986, although Goswami was writing prior to the changes effected by the passage of the Enterprise Act 2002). Goswami identified both SICA and Chapter 11 as debtor-in-possession reorganisation mechanisms[62]. Common to each, he argued, was an 'overinvestment' problem in which 'over-leveraged, distressed firms attempt to restructure through risky investments that have negative net present values'.[63] Faced with the prospect of liquidation, firm managers could be perversely incentivised to propose high-risk rescue alternatives, knowing that the costs of failure would be borne by creditors (shareholders, entitled to nothing in an insolvent liquidation, could only gain from such an attempt)[64]. Control during the reorganisation process enhanced managers' prospects of persuading creditors to agree to such proposals: creditors suffered from informational asymmetries

[60] (n 14) 213.

[61] As to which, see Chapter 6, text to n 99.

[62] *Corporate Bankruptcy in India* (n 2) 56.

[63] ibid 61.

[64] This is a familiar account of the agency conflicts that can arise in the vicinity of insolvency, particularly in closely held firms (where manager and shareholder interests are more likely to be aligned, and managers are less likely to be affected by the reputational factors that constrain the behaviour of managers of publicly listed companies in the vicinity of insolvency): see Paul Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) 7 *European Business Organisation Law Review* 301, 306.

that would render them vulnerable to delay tactics by debtors and associated attempts at 'arm-twisting'[65]. In this way, delay and its attendant costs could (as modelled by Bebchuk and Chang, for the US case)[66] be used strategically to extract concessions from creditors.[67]

Earlier works by Goswami (principally, the Goswami Committee Report, and the chapter by Anant and Goswami that followed) pointed to a different set of explanations for the readiness of institutional creditors to support 'risky' rehabilitation schemes. These works acknowledged the influence of historical 'pro-revival' policy on industrial sickness, pursuant to which institutional creditors had been 'routinely called upon' (together with governments) to make sacrifices[68]. Anant and Goswami's work also acknowledged that the approach of institutional creditors in the pre-liberalisation period was influenced by the broader focus of the financial sector on increasing lending *per se*, rather than on supervising the performance of existing loan portfolios[69]. Most emphasised in these works, however, were what Goswami and his co-authors described as 'peculiar' historical accounting norms, including asset recognition and provisioning rules that had permitted banks to book interest whether or not paid and even where

[65] *Corporate Bankruptcy in India* (n 2) 43-45 (on US); 56 and 61 (identifying the same issues arising under SICA).

[66] Lucian Ayre Bebchuk and Howard F Chang, 'Bargaining and the Division of Value in Corporate Reorganisation' (1992) 8 (2) *Journal of Law, Economics and Organisation* 253, which analyses the ability of equity holders to extract more than 'their contractual right' in Chapter 11 reorganisations where they delay during the exclusivity period (273-274) (as to which see also Kevin A Kordana and Eric A Posner, 'A Positive Theory of Chapter 11' (1999) 74 *NYU Law Review* 161). On the exclusivity period and SICA, see below text to n 105.

[67] (n 2) 99-104.

[68] Goswami Committee Report (n 7) [4.1.13], more obliquely Anant and Goswami (n 29) 266-267.

[69] 'Until recently, the primary operational objectives of commercial banks and FIs were to maximize (i) deposits, (ii) loans, and (iii) the quantum of project finance': Anant and Goswami (n 29) 264; also Chapter 4, text to n 89.

'despite repeated defaults, the principal was not provisioned for and partly written down in the loan asset portfolio'[70]. These norms reportedly encouraged bankers to ignore and obscure the realities of their accounts:

> Recognising reality implied that many accounts would have to be treated as 'non-performing – which would reduce income flows in a bank's profit and loss account, and force it to write down the asset value of the loan… Thus, there were strong managerial incentives within lending institutions to support unhealthy, contaminated, as well as terminally sick accounts… the losses of these firms had to be met by pumping in more funds.[71]

But the Goswami works identify these factors as historical ones, displaced by the liberalisation of the financial sector[72]. That is perhaps why, by the time he published *Corporate Bankruptcy in India* in 1997, Goswami's focus had shifted to SICA's debtor-in-possession design: something else was needed to explain the continuing allegation of creditor vulnerability under SICA in the post-liberalisation period.

Goswami acknowledged that the record of delays in the liquidation of SICA companies had significantly impacted on the functionality of the Act. The BIFR's 'past reluctance to use the threat of liquidation to promote consensus' had precluded swift negotiation between stakeholders[73], and 'given promoters, banks, financial institutions, labour and the state governments tremendous opportunities for delaying matters'[74]. The 'virtual impossibility'[75] that a firm recommended for liquidation by the BIFR would be

70 Anant and Goswami (n 29) 264-265; Goswami Committee Report (n 7) [4.1.18].

71 Anant and Goswami (n 29) 265-265.

72 The Goswami Committee observed that once the Narasimham Committee reforms (as to which, see Chapter 4 text to n 92 and text to n 129 below) were implemented, there would be 'very little incentive left for banks or institutions to unnecessarily maintain operationally unviable industrial portfolios' (n 7, [4.1.20].

73 *Corporate Bankruptcy in India* (n 2) 53; see also Seth (n 14) 100.

74 ibid 55.

75 ibid 86.

swiftly wound up in the courts added further pressure to already-vulnerable creditors, increasing the likelihood that they would agree to 'risky' rehabilitation alternatives[76]. Ultimately, however, Goswami concluded (reasoning again by analogy with the US case) that even the credible threat of an efficient liquidation procedure could not fully overcome the bias against creditors 'inherent' in debtor-in-possession reorganisation[77]. Accordingly, he recommended an amendment to SICA that would displace managers and entrust control of rehabilitation to a BIFR-appointed independent administrator, with the powers and duties of an English administrator[78].

Goswami's thesis was endorsed by Joshi and Little[79], and appears to have also influenced the subsequent inquiry of the Eradi Committee into Indian insolvency law. In its 2000 report, the Committee noted this submission made to it during consultation:

> The main drawback of the SICA scheme is that it leaves the debtor company in possession of the assets which creates an asymmetry and imbalance between the debtor company and its creditors conferring on the inefficient or inept management an unmerited advantage…
> The debtor in possession allows the promoters to leverage informational advantages and to create tailor made delays in the proceedings by taking recourse to [the moratorium]…[80],

and went on to recommend that SICA be repealed and replaced by a mechanism modelled on UK administration[81]. In the attempt at SICA's repeal and replacement that

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[76] ibid 88.

[77] ibid 99; 105.

[78] ibid 106-107.

[79] (n 14) 216-217. The DIP critique also appears in TCA Anant and NL Mitra, 'The Role of Law and Legal Institutions in Asian Economic Development: The Case of India; Patterns of Change in the Legal System and Socio-Economy' (Harvard Institute for International Development Discussion Paper, November 1998) 43, 67, 69 <www.cid.harvard.edu/hiid/662.pdf> 30 August 2012, and Kang and Nayar (n 12) 46.

[80] (n 2) [5.9].

[81] ibid [5.16]; [6.6].

followed (the Companies (Second Amendment) Act 2002 reforms), the drafters stopped short of replacing SICA with a manager-displacing regime[82]. (Perhaps they reasoned that the absence of a moratorium in their replacement regime[83] would be an equally effective check on managerial indiscretion.) But two subsequent reports, one commissioned by the RBI, and the other by the Ministry of Company Affairs, both recommended reforms to enable the appointment of an independent administrator or trustee to insolvent companies attempting a reorganisation[84]. Current reform proposals (as contained in the Companies Bill 2011), would introduce a rescue procedure (available to all companies) supervised by a tribunal-appointed administrator capable (on the order of the tribunal) of taking over firm management[85].

Two further complaints have been made of SICA as it stands 'on the books'. The first is that SICA's definition of sickness is too narrow, capable of catching only the most severely distressed corporate debtors[86]. The second is that SICA's creditor veto power is too wide, enabling every institutional creditor affected by a rehabilitation

[82] Part VIA of the Companies (Second Amendment) Act 2002 was modeled quite closely on the existing provisions of SICA. There were some changes (such as those noted in n 55 above and nn 88 and 89 below), but the provisions of SICA governing the appointment and removal of managers (described in Section 6.3.2.3) were essentially preserved.

[83] See above, text to n 55.

[84] The RBI's Advisory Group on Bankruptcy Laws (n 2) observed that 'the most critical provision in the SICA is that the promoter/management bringing the entity to the BIFR remains in possession and creates incentives for stripping off assets' (46) and recommended that assets be vested in a trustee with power to 'dispense' with the board entirely, or co-manage the company with it (27-29); the Irani Committee (n 2) recommended that partial (and in some circumstances, full) control of corporate management pass to an independent administrator (chapter XIII, [14]).

[85] See ch XIX of the Companies Bill 2011, ss 253-260.

[86] Goswami Committee Report (n 7) [3.1.4]; Goswami's *Corporate Bankruptcy* (n 2) 48-51; Joshi and Little (n 14) 213; Mittal (n 2) [1.5-6]; Schroff and Puri (n 13) 76; Kang and Nayar (n 12) 44.

scheme to stall it[87]. Both issues appear to have been recognised by the Indian legislature: each attempt at SICA reform has featured amendments to the definition of 'sickness'[88] and to the scheme approval requirements[89]. None have been implemented[90].

One obvious difficulty with the 'law on the books' explanations is their inability to fully explain the allegations levelled at SICA's administrators: the BIFR, said to have condoned 'risky' rehabilitation schemes, 'coerced' concessions from creditors, and to have been 'disinclined' to liquidate; and the civil courts, alleged to have been generally slow to act in the liquidation of SICA companies. It is perhaps for this reason that a series of secondary explanations, focused on aspects of SICA's implementation, also emerged. One idea, advanced in some of the early Goswami works[91], is that the BIFR has been in some way 'biased' in favour of rehabilitation and against liquidation, perhaps motivated by concern for the welfare of employees[92]. This idea also features in the report of the Eradi Committee, who described their investigation into the BIFR in this way:

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87 Goswami Committee Report (n 7) [3.3.5]; Mittal (n 2) [1.5-6]; Anant and Mitra (n 79) 43; Batra, 'Proposals for Reform' (n 41) 11.

88 See Sick Industrial Companies (Special Provisions) Bill 1997, cl 3(p); Companies (Second Amendment) Act 2002, s 2(f); Companies Bill 2009, cl 229(1); Companies Bill 2011 (cl 253(1), all featuring some form of a cash-flow insolvency condition.

89 See Sick Industrial Companies (Special Provisions) Bill 1997 (cl 17), Companies (Second Amendment) Act 2002 (s 47), Companies Bill 2009 (cl 237), Companies Bill 2011 (cl 262) all enabling (to varying degrees) dissenting institutional creditors to be bound under a scheme.

90 But the BIFR and the courts have attempted to resist creditor holdouts: see Chapter 8, text to n 20.

91 See for example the Goswami Committee Report (n 7) [3.3.7]-[3.3.9], and (to a lesser extent) Anant and Goswami (n 29) 261, and Goswami (n 2) 54-55. In his most recent work on the subject, Goswami dropped reference to this factor, focusing more on features of SICA on the books: see 'Corporate Governance in India' (n 2) 94.

92 On this see also Joshi and Little (n 14) 212; Seth (n 14) 97; Ansgar Wohlschlegel, 'The Economics of Corporate Bankruptcy Law' (2002, unpublished doctoral dissertation, Heidelberg) 109 < http://archiv.ub.uni-heidelberg.de/volltextserver/volltexte/2002/3087/pdf/DissVeroeff.pdf > 30 August 2012.

> The Committee wanted to know… once it becomes clear that the secured creditors are not willing to make the necessary sacrifices by giving concessions about debts due to them, why the BIFR does not order winding up immediately. The response of the BIFR was… *that in view of the interests of labour, the BIFR makes endeavour till the last minute to obtain the consent of the secured creditor*[93].

One publication by a practitioner suggests that the BIFR has occasionally been accused of corruption: 'They [the courts] have never attracted allegations of corruption, as they are presided over by the high court judges. However, at times, fingers have been pointed at the BIFR[94].

More recently, two economists working at doctoral level at the University of Heidelberg turned to political economy theory to explain liquidation delays in the BIFR. In 2002, Wohleschlegel observed a correlation between workforce size and industrial sickness in India ('the industries most frequently affected by sickness are… the industries employing the largest number of workers')[95] and hypothesised that 'weak politicians seek the support of a highly-politicised working class and therefore are reluctant to send a sick firm into liquidation'.[96] He developed a model in which the private benefits enjoyed by politicians from control of sick firms might induce them to support the provision of subsidised finance *ex ante* and resist liquidation *ex post.*[97] In a subsequent empirical project entirely dedicated to Indian industrial sickness, Falk tested Wohleschelgel's model and found it to be 'original, but not especially convincing' in the Indian context[98]. She

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93 Eradi Committee Report (n 2) [5.8], emphasis added.

94 Batra, 'Progress and Pitfalls' (n 2) 16; see also Chapter 8, text to n 6.

95 Wohlschlegel (n 92) 111-112.

96 ibid 112.

97 ibid 112-113, and Section 4.4A.

98 Falk (n 14) 155.

doubted politicians' ability to realise the theorised benefits from control in practice, and emphasised that it was 'simply not the case that politicians are the only ones who can prevent liquidation' under SICA, given that responsibility for the liquidation of SICA companies lay with the civil courts[99].

The problem of liquidation delays in the courts has been explained in three further ways. First, these institutions are alleged to have been vulnerable to the delay tactics of SICA debtors and their promoters, including (most commonly) by the filing of spurious applications for judicial review of the BIFR's liquidation opinion, designed to delay the making of the winding up order.[100] Secondly, there is one suggestion that some courts may have invited such challenges: Kaicker reports that some courts were historically willing to stray outside the confines of judicial review to reconsider the merits of the BIFR's liquidation opinion, and that later judicial developments in the interpretation of section 20 further eroded the strength of the BIFR opinion[101]. Finally, the courts are said to have suffered generally at the hands of inefficient and inexperienced official liquidators who, as explained in Chapter 3, are responsible for the administration of compulsory liquidations[102], including SICA liquidations.

What, then, are the reasons offered for SICA's failure? Most SICA critics identify a range of factors, some relating to SICA as drafted (or, 'on the books') and others to SICA as applied in practice. This approach can make it difficult to discern whether

[99] ibid 154.

[100] Goswami's *Corporate Bankruptcy* (n 2) 87; Anant and Goswami (n 29) 283, fn 54; Kaicker (n 14) [20.3-5].

[101] Kaicker (n 14) [26.5], referring to the decision of the Supreme Court in *Rama Raju* v *Union of India* [1997] 89 Comp Cas 609 (SC), considered in Chapter 8, text to n 81.

[102] Batra, 'Proposals for Reform' (n 41) 11; Goswami's *Corporate Bankruptcy* (n 2) 87; Anant and Goswami (n 29) 283.

critics consider any one factor to have been determinative (with the notable exception of Goswami's *Corporate Bankruptcy in India*, in which the debtor-in-possession thesis is clearly presented and defended). But it is clear that to date most attention has been directed to SICA as drafted, and particularly to its moratorium, its definition of 'sickness', its interim protection of management, and the combined effect of these features. While some institutional factors are identified in the literature, not all are presented as evidence of institutional failing: delay in the implementation of the BIFR's liquidation opinions in the courts, for example, is more often presented as a product of debtor 'abuses' (the spurious filing of judicial review petitions, for example) than as a cause of them. And ultimately, all SICA critics agree that the only appropriate reform is repeal, perhaps the clearest evidence of a conviction that, in its current form, SICA is incapable of delivering: that the Act itself is 'seriously flawed'[103].

7.3 Why SICA failed: a framework for further inquiry

7.3.1 SICA as drafted: a rival perspective

In their search to explain SICA's 'pro-debtor' functionality, critics looked to those provisions of the Act that could empower or embolden debtors in their relations with creditors. The most complex accounts see several features of SICA – its moratorium, its interim protection of management, and its late-catching insolvency trigger – working together to create a framework in which debtors could be both incentivised to delay, and capable of achieving delay. This analysis could help explain not only the record of primary outcomes under SICA – delay, most often followed by liquidation – but also the

[103] Advisory Committee Report (n 2) [3.1].

more complex allegations of creditor harm, including the extraction of creditor support for 'risky' rehabilitation schemes.

Neat though it may be, this account obscures some features of SICA that might fairly be characterised as *creditor* empowering. There appear to be two such features: first, the creditor 'veto' power in section 19, which on its face requires the consent of every institutional creditor affected by a proposed rehabilitation scheme (whether in relation to existing debt or the extension of further credit); secondly, the BIFR's liquidation power in section 20, exercisable (*inter alia*) in response to a creditor 'veto', and apparently binding on the High Courts to which the BIFR's liquidation opinions are sent to be given effect. Taken together, these provisions suggest that SICA might – even as currently drafted – be capable of delivering relatively swift liquidation outcomes for economically distressed firms: a swiftly delivered 'veto' appears capable, on a plain reading of SICA, of generating a swift and binding liquidation opinion. To be sure, if the Act is interpreted (as it has been)[104] as requiring some attempt at rehabilitation before a liquidation opinion can be issued, some delay is inevitable. But SICA's drafters included no equivalent to the 'exclusivity period' in US Chapter 11 proceedings (a 120-day period in which the debtor alone has the right to propose a scheme)[105], thus clearing the way for a swifter veto. And they deliberately entrusted the decision to liquidate not to the courts - notorious even then for delays in liquidation[106] – but to a statutory authority (the BIFR), insulating the

[104] See Chapter 6, text to n 134.

[105] See E Warren, *Chapter 11: Reorganizing American Businesses* (Aspen, 2008) 136.

[106] See Chapter 6, text to n 21.

BIFR's liquidation decisions (as far as constitutionally possible)[107] from interference by the courts.

On this rival account SICA appears capable of functioning to deliver the swift liquidation of unviable companies. In practice, though, it has apparently proved incapable of delivering just that. Why?

7.3.2 Creditor behaviour: testing assumptions

The rival perspective set out above assumes – as the dominant SICA critique does – that, given the opportunity, institutional creditors would swiftly exercise a right to veto the rehabilitation of an economically distressed SICA debtor, propelling it into early liquidation. This assumption sits awkwardly, though, with the historical evidence of the role played by institutional creditors in the delivery of the India's 'pro-revival' policy for sick industrial debtors. Recall (from Chapters 4 of this thesis) that the position in the early 1980s, as reported by the Tiwari Committee, was that sick industrial debtors were effectively *entitled* to concessions from institutional creditors if they could be considered 'viable' in a very loose sense, and even where unviable, if the 'public interest' (including the interests of employees) demanded it[108]. Recall too (from Chapter 6 of this thesis) that although the Tiwari Committee thought this position too generous, and recommended restricting the availability of finance to 'viable' debtors (slightly less generously defined)[109], the Committee did not depart from the fundamental assumption that 'viable'

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[107] By rendering the decision apparently binding on the courts and precluding appeals to the courts from any BIFR decision, leaving open only the possibility of judicial review (see Chapter 6, text to n 60 and following; but see also Chapter 8, Sections 8.2.2 and 8.2.3.).

[108] Text to n 75.

[109] Text to n 32 and following.

sick industrial debtors would enjoy institutional creditor support for their revival[110]. What was the position on SICA's enactment? Did the inclusion of the section 19 veto power (a departure from the Tiwari Committee's recommendations)[111] signal a change in the position of institutional creditors vis-à-vis sick industrial debtors?

The literature offers little analysis of the relationship between historical policy on the financing of sick industrial debtors by institutional creditors and the exercise of the section 19 veto by those creditors under SICA, a symptom of the wider neglect of the historical context in contemporary SICA criticism. What analysis there is, however, suggests that the historical policy persisted in the early (pre-liberalisation) SICA years, despite the formal inclusion of a veto power for institutional creditors in section 19. As noted above[112], the Goswami Committee Report suggests that institutional creditor support for 'risky' rehabilitation in the early SICA years was partly attributable to official industrial sickness policy, pursuant to which creditors were 'routinely called upon' to finance revival efforts[113]. The early Goswami works, together with Narayanan's 1991 commentary on SICA, also reveal the channel through which this policy was communicated to institutional creditors: they suggest that the Reserve Bank of India ('RBI') issued 'guidelines' on what was expected of institutional creditors under SICA. Anant and Goswami suggest that, at least prior to 1992, RBI guidelines facilitated the sanctioning of risky rehabilitation schemes by among other things 'encouraging' the

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[110] Text to n 38.

[111] See Chapter 6, text to n 124.

[112] Text to n 68 above.

[113] Goswami Committee Report (n 7) [4.1.13].

provision of 'subsidised credit'[114]. Narayanan's commentary suggests that the guidelines functioned as default rules for the provision of sacrifices by institutional creditors under SICA:

> At the beginning, both the banks and [financial] institutions, as well as the Board [BIFR] itself were 'groping in the dark' to some extent. But in the course of time, it became clearly understood that the banks would not normally be asked to give anything beyond what the guidelines laid down by the Reserve Bank advised them to do; the [financial] institutions would also abide by these guidelines, though not bound by them; and the Board [BIFR] would not, as a rule, ask them to give anything beyond these guidelines[115].

But the existing literature offers very little analysis of the precise content of these guidelines, or of their status after economic liberalisation.

The RBI's historical guidelines on institutional lending to sick industrial debtors are, however, accessible to researchers. The guidelines were issued in the form of 'circulars' to scheduled commercial banks, which were subsequently collated into published volumes that are currently held in the RBI archives in Pune, India[116], and in a small number of university library collections[117]. These circulars unequivocally confirm the persistence of the Central Government's historical ('pro-revival') approach to industrial sickness in the early years of SICA's operation, and the continuing mobilisation of the financial sector to deliver that policy. To be sure, there were some changes to RBI policy during the pre-liberalisation period that might have been expected to diminish institutional creditor support for SICA schemes. In the period following SICA's

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114 Anant and Goswami (n 29) 268, fn 38.

115 *Industrial sickness in India: the role of the BIFR* (Konark Publishers 1994) 69.

116 The RBI archived collection is available for inspection with the permission of the Chief Archivist. I inspected the collection in April 2010.

117 At the time of their issue, some circulars were also noted (in summarised form) in the RBI's monthly bulletins, held in many university library collections.

enactment, the RBI strengthened bank monitoring and reporting arrangements by the introduction of a new 'health code' account classification system[118] and, later, a SICA-specific reporting scheme that required banks to report on their sick industrial accounts to the BIFR and the RBI[119]. The RBI issued specific guidelines on the nature and scope of reliefs and concessions that could be offered to 'viable' SICA debtors in rehabilitation schemes, and instructed banks to seek the consent of the RBI before offering assistance beyond those parameters[120]. But the definition of 'viability' remained wide[121]. Additionally, although at least one RBI publication identified the rehabilitation guidelines as a ceiling - up to which banks had *'discretion'* to support rehabilitation efforts[122] - other RBI circulars expressly *required* banks to offer such support.

In the most extraordinary example of these circulars – a 1987 circular issued to commercial banks – the RBI directly addressed the issue of the section 19 'veto' power in SICA. The RBI was uncompromising in its approach, advising banks to exercise

[118] Circular DBOD No.Vol.BC.136/C.249.85 'Credit Monitoring System' (7 November 1985), extracted in *Compendium of instructions issued by Department of Banking Operations and Development and Department of Supervision, up to 31 December 1995* (Reserve Bank of India) 6.79.

[119] Circular IECD.No.IRD.BC161/IR54/86-87 'Rehabilitation of sick industrial companies – establishment of Board for Industrial and Financial Reconstruction' [4] (February 24, 1987), extracted in *Circulars Relating to the Industrial and Export Credit Department, July 1986-June 1989* (Reserve Bank of India); see also *Trends and Progress of Banking in India 1986-1987* (RBI 1987) 82.

[120] See 'Rehabilitation of sick industrial companies – establishment of Board for Industrial and Financial Reconstruction' above [7]; IECD.No.IRD.234/IR-A 88-89 'Rehabilitation of sick industrial undertakings – parameters for provision of reliefs and concessions' (January 24, 1989). Both are extracted in *Circulars Relating to the Industrial and Export Credit Department, July 1986-June 1989* (Reserve Bank of India).

[121] Circular IECD.No.IRD.BC.132/SIU-A-85 'Parameters for provisions of reliefs/concessions by banks under rehabilitation packages evolved for sick units as potentially viable' (November 5 1985) at [4], extracted in *Chemiequip Ltd v Bank of Baroda* [1990] 69 CompCas 568 (Bombay), [4], adopting the Tiwari Committee's modified (but extremely generous) definition of viability.

[122] 'Credit Monitoring Arrangement', *RBI Monthly Bulletin* November 1988 1079, 1081.

'extreme caution' before refusing consent under section 19, and requiring every bank that proposed to refuse consent to notify the RBI of its intention to do so:

> In terms of section 19 of the Act, any agency required to provide financial assistance to the sick industrial company as part of the scheme has to specifically indicate its consent… *The need for any bank to withhold consent will not ordinarily arise, since the banks will be fully involved* in the preparation of the scheme... Most importantly, it should be noted that the Board is empowered under s 19(4) of the Act, to adopt such other measures, including the winding up, of the sick industrial company as it may deem fit, in case the required consent in respect of any scheme is not given... Banks are, therefore, advised that they should carefully weigh the alternatives and *proceed with extreme caution in deciding to withhold consent*. Banks are further advised that where exceptionally, for any reason, they desire to withhold such consent… they should immediately advise the Reserve Bank of their intention… *It is also emphasised that liquidity constraint cannot be regarded as an acceptable reason for withholding consent…*[123]

In 1990, the RBI reiterated this position, criticising some banks for having been 'fair weather friends' – willing to finance units when 'healthy' but not when sick. This approach was identified as a 'violation' of RBI instructions, which rendered it 'obligatory for the financing banks to participate in rehabilitation packages in respect of potentially viable sick units'. The RBI recorded that violations of its instructions were 'not at all appreciated' as they tended to '*defeat the national policy of revival of viable sick units*'[124]. In a

[123] 'Rehabilitation of sick industrial companies – establishment of Board for Industrial and Financial Reconstruction' (n 119) [9] (italics added). The RBI also appears to have addressed creditor holdouts: in one circular it noted evidence that some banks had attempted to 'keep themselves away from rehabilitation efforts'. It advised that there could be 'no occasion' for banks to resist a scheme where potential viability was established and the draft scheme was accepted by the relevant financial institutions and 'the two banks having the largest share': see 'Advances on consortium basis – Coordination between banks and financial institutions – Rehabilitation of sick units', IECD.No.PMS.171/C.446(C&P) 86-87, [20], extracted in *Circulars relating to the Industrial and Export Credit Department, July 1986-June 1989* (Reserve Bank of India); see also IECD.No.IRD.31/IR-A/90-91 'Rehabilitation of sick/weak industrial units' (21 December, 1990) [6], extracted in *Circulars relating to the Industrial and Export Credit Department*, *July 1989-June 1994* (Reserve Bank of India).

[124] Circular D.O.IECD.No.IRD.26/IR-A/89-90 'Rehabilitation of sick/weak industrial units' (April 9, 1990) [1]-[2], in *Circulars relating to the Industrial and Export Credit Department*, *July 1989-June 1994* (Reserve Bank of India).

circular issued one year later, the RBI reported on a meeting held between banks and members of the BIFR:

> Our extant instructions make it clear that participation by banks in rehabilitation packages for units found to be potentially viable is mandatory. Under no circumstances, should banks opt out of such participation. Reasons such as liquidity constraints, over-exposure, etc cannot be cited as reasons for non-participation[125].

More generally, the assumption that 'viable' sick industrial companies (generously defined) would benefit from coordinated attempts at rehabilitation by banks and financial institutions recurs throughout RBI publications of this (post-SICA, pre-liberalisation) period[126].

The RBI policy documents offer a remarkably clear insight into the position of institutional creditors in the period following SICA's enactment, a position that militates against an assumption of creditor autonomy. But it seems that this position changed dramatically after India's economic liberalisation, and in particular after financial sector liberalisation. The financial sector reforms associated with liberalisation were summarised in Chapter 4[127]. By the early 1990s, India's banks had substantial non-performing asset portfolios, partly constituted by sick industrial debts[128]; more generally, the sector was reportedly 'unprofitable, inefficient, and financially unsound'.[129] In its

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[125] Circular IECD.No.10/IRD/IR-A/91-92 'Rehabilitation of sick/weak industrial units' (August 5, 1991) [3], in *Circulars relating to the Industrial and Export Credit Department*, *July 1989-June 1994* (Reserve Bank of India).

[126] See for example the *Trends and Progress of Banking in India 1985-1986* (RBI 1986) [2.76]-[2.77]; P Ojha, 'Finance for the Cotton Textile Industry – Problems & Progress', *RBI Monthly Bulletin* (May 1987) 284, 293.

[127] See text to n 97.

[128] Vyuptakesh Sharan, *India's Financial Sector: An Era of Reforms* (Sage 2009) 10-11; Joshi and Little (n 14) 212; Narasimham Committee, *Report on the Financial System* (Standard Book Co 1992) 31.

[129] Joshi and Little (n 14) 111.

review of the financial system, the Narasimham Committee found (as noted in Chapter 4) that 'by far the most serious damage to the system' had been caused by 'political and administrative interference in credit decision making'[130]. Lending to sick industrial companies was specifically discussed: the Committee noted that commercial banks had been 'forced' to finance sick industrial units 'often against their better commercial judgment'[131], and that financial institutions had been obliged to add their support, often in pursuit of 'employment protection'[132]. The Committee also criticised the BIFR and the civil courts, suggesting that banks had suffered from their 'advice' and 'directions' to extend credit to sick units[133]. The Committee was emphatic in rejecting the historical approach:

> [In future] the decision to nurse a unit which is facing problems should be taken purely on professional and commercial considerations. The formulation of an appropriate and considerate exit policy by the Government, providing proper safeguards for workers should help in this process[134].

More generally, the Narasimham Committee recommended (as noted in Chapter 4) a complete shift in policy emphasis, away from the 'micro credit intervention'[135] and towards financial sector autonomy, subject to the introduction of new norms on asset

[130] Narasimham Committee Report (n 128) 30; for full quote see Chapter 4, text to n 91.

[131] ibid 31.

[132] ibid 103.

[133] ibid 31-32.

[134] ibid 66.

[135] ibid 42.

classification, income recognition, and provisioning for bad and doubtful debts[136]. Phased implementation of these recommendations was announced shortly thereafter[137].

What impact did the introduction of this new prudential framework have on lending to sick industry? Unsurprisingly, the RBI reported an increasing reluctance by institutional creditors to extend concessions to sick industrial debtors. In April 1995, the RBI reported that it had received 'persistent representations' that new norms on provisioning for bad and doubtful debts were acting as a 'disincentive' for the provision of additional finance to sick industrial companies. The RBI responded with a small concession - banks would not be required to make provision for additional facilities offered under SICA schemes for the first year after their disbursement[138]. The retreat was however only slight: in the same year, the RBI issued a circular on the compromise and settlement of non-performing assets, in which banks were cautioned to ensure that write-off decisions were 'judicious and in the best interests of the bank', without reference to the (historically privileged) position of industrial debtors[139].

Despite the clear tension between its historical instructions on lending to sick industrial companies and the post-liberalisation prudential framework, the RBI does not appear to have directly withdrawn its historical instructions, at least initially. Instead, it seems that the instructions were simply overtaken, a victim of the wider transition from 'micro-regulation' of credit decisions to 'macro-management'. Later, there is evidence to suggest that the RBI issued at least one circular expressly relaxing its historical directions.

136 ibid 142, and ch V.

137 See Chapter 4, text to n 97.

138 'Income Recognition, asset classification and provisioning', *RBI Monthly Bulletin* (July 1995) 620, [3].

139 'Compromise or negotiated settlements of Non-Performing Assets', *RBI Monthly Bulletin* (October-November 1995) 981, [4].

Tannan's Banking Law and Practice in India reports the issue of a circular (in or after 1998) that released banks from compliance with at least some of the RBI's directions on lending to sick industry. It reportedly afforded banks 'discretion' to make decisions on a case-by-case basis, consistent with their internal policy guidelines[140]. In other more recent publications, the RBI has consistently affirmed the autonomy of banks in lending decisions. In 2003, for example, RBI Deputy Governor Kamesam reported (with specific reference to industrial credit) that banks had progressed from 'complete dependence' on RBI instructions to 'a scenario where individual and portfolio level decisions on dispensation of credit are made by banks based on their commercial judgment and prudential guidelines'[141].

What evidence there is suggests that the change in creditor behavior that the RBI reported in 1995 – an increasing reluctance to support rehabilitation efforts – was a lasting one. Anecdotal evidence suggests institutional creditors increasingly refused to support SICA schemes after liberalisation: 'The reforms in the banking sector, with introduction of prudential norms and risk weighted classification has meant increasing reluctance of banks to increase exposure in marginal or failing units.[142] The SICA case law, considered in Chapter 8, reveals numerous examples of rehabilitation schemes that

[140] Mohan Lal Tannan, *Tannan's Banking Law and Practice* (LexisNexis Butterworths 2009) 932.

[141] 'Indian Economic Scenario: Yesterday, Today and Tomorrow', *RBI Monthly Bulletin* (October 2003); see also RBI, 'Prudential Guidelines on Restructuring of Advances by Banks' (27 August 2008) [1.1], [1.2] <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=4436&Mode=0> accessed 30 August 2012.

[142] Anant and Mitra (n 79) 44; see also A Govak, *Industrial Sickness* (BR Publishing Corporation 1998) 70, and Goswami (n 2) 90-91 (noting the new focus of creditors on maximising recoveries, but also predicting that some creditors would be forced into 'one-time settlements' in view of the impossibility of liquidation); more generally, Umarji (n 2) 162.

failed for want of creditor support[143]. Additionally, there is good evidence to suggest that the BIFR became increasingly forced to recommend liquidation: the data on the cumulative performance of the BIFR in Appendix III suggests an initial trend in favour of rehabilitation, later shifting (in the mid-to-late 1990s) to a trend in favour of liquidation[144]. The assumption that institutional creditors would, if given the opportunity, veto the rehabilitation of an economically distressed firm, propelling it into liquidation, may once have been misplaced, but appears no longer so.

7.3.3 Unanswered questions: a framework for further investigation

In the pre-liberalisation period, the first of the two core creditor protection mechanisms in SICA – the veto, the exercise of which should lead to the liquidation of a SICA debtor (the second creditor protection mechanism) - was suppressed. But in the post-liberalisation period, this protection was restored. What evidence there is suggests that institutional creditors did adjust their behavior accordingly, increasingly refusing to support the rehabilitation of SICA debtors. Despite this, the dominant criticisms of SICA's functionality – continuing delays, and associated debtor 'abuses' and creditor harms – persisted.

The mystery of creditors' continuing vulnerability under SICA clearly suggests the need for a robust inquiry into SICA's administrators: the BIFR, and the civil courts. It is these institutions that would seem most capable of constraining delays, and checking associated attempts at asset siphoning and creditor coercion. Occasional references to

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[143] See for example *ARC Cement Ltd v AAIFR* [1999] 97 Comp Cas 459 (Delhi); *Modi Industries Ltd v Nagar Palika, Modinagar* AIR 2000 All 271 (Allahabad); *Ranka Cables Ltd v AAIFR* [2001] 103 CompCas 30 (Andhra Pradesh); *BIFR v CMD, APS Star Industries Ltd* [2009] 152 Comp Cas 302 (Gujarat).

[144] Subject to n 17 above.

some institutional failures in the literature – a 'bias' by the BIFR against liquidation, a willingness by the courts to entertain challenges to BIFR liquidation opinions, and attempts by both to 'coerce' rehabilitation concessions[145] – strengthen the case for such an inquiry. In the next chapter, the results of an original investigation into the performance of SICA's administrators, drawn primarily from an analysis of all available SICA cases, are reported. The findings are consistent with those reported in Part I of the thesis. They point unequivocally to SICA's administrators – the BIFR and particularly the courts – as architects of SICA's 'pro-debtor' functionality in the post-liberalisation period.

[145] See text to n 38 above.

CHAPTER 8

EXPLAINING THE FAILURE OF INDIA'S RESCUE LAW

Law expands concepts to embrace social needs so as to become functionally effectual.
(A.P. Sen J, *Organo Chemical Industries v Union of India* (Supreme Court, 1979))

In the proceedings initiated under [SICA], the effort should always be to achieve the goal of revival of the sick company concerned. Even if an approved revival scheme is likely to take quite a long time to ensure real turnaround… it should not be considered as a negative aspect, although in the process, of course, the creditors may at times have to accept a longer time for recovery of their dues. In a social welfare State that we are, it is the collective duty and responsibility of all… to ensure social and economic protection for the weaker Section, and there can perhaps be no dispute that the lower echelons of the working class in private sector industries… belong to the class.
(Jayanta Kumar Biswas J, *Kanoria Jute and Industries Ltd v AAIFR* (2008))

It is clear that SICA has come to be regarded as a 'failed' legislative initiative, incapable of delivering creditors anything remotely resembling the *ex post* efficiency that critics crave. Instead, it seems, SICA offers creditors only lengthy delays and associated costs. What is less clear is *why* SICA came to operate in this way. Existing explanations for SICA's failure, explored in detail in Chapter 7, leave a number of important questions unanswered. The most striking of these concern the performance of SICA's administrators – the BIFR and the courts. On a plain reading of SICA, these institutions are equipped to deliver the swift liquidation of companies rejected for rehabilitation by institutional creditors. But this, of course, is precisely what they have failed to deliver.

In this chapter, new evidence of the performance of SICA's administrators is presented, drawn primarily from an original analysis of the SICA case law. In the first section of the chapter, the methodology deployed for the case review is explained and its constraints acknowledged. In the second section, the results are presented. Three innovations in the interpretation and application of SICA by its administrators (especially by the courts) are identified. The first two relate directly to delays in the liquidation of

SICA companies, and the third to the important question of *who benefited from delay*. Together, they suggest that the practices and preferences of SICA's administrators heavily influenced SICA's contemporary 'pro-debtor', 'anti-creditor' functionality.

8.1 Investigating the performance of SICA's administrators: methodology

There appears to have been little close analysis of the decisions of the BIFR, or of those of the civil courts in SICA matters. It is difficult to carry out research into the BIFR's decisions: as Chapter 6 explained[1], the BIFR does not publish written reasons for its orders in any systematic (accessible) way, and its decisions do not appear to feature (with the exception of a small selection of Appellate Authority decisions handed down in 1999 and 2000) in any law reporter. But the decisions of the courts, which are at a minimum responsible for entertaining applications for judicial review of orders of the BIFR and Appellate Authority, and for giving effect to the liquidation opinions of the BIFR, are accessible to researchers. To date, these decisions have attracted surprisingly little attention in the SICA literature (featuring only, if at all, in annotated commentaries on the Act[2]), perhaps because a plain reading of SICA suggests a narrow role for the courts, relative to the BIFR[3].

This chapter presents the results of what may be the first systematic review of the SICA case law. A dataset of judgments, dating from the Act's commencement (in 1987)

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[1] Text to n 57.

[2] The two most detailed are PS Kaicker, *Taxmann's Sick Industrial Companies (Special Provisions) Act 1985: Law, Practice & Procedure* (Taxmann Allied Services 2000) and HPS Pawha, *Bharat's Sick Industries & BIFR* (8th ed, Bharat Law House 2009).

[3] See Chapter 6, text to n 59.

to December 2010, was compiled using a subscription-only database[4]. The search parameters were set as widely as possible[5] so as to catch all decisions involving a SICA registered company, or a former or prospective SICA company. A total of 1,066 decisions were identified from a range of courts (including 77 decisions of the Supreme Court and 806 decisions of the state High Courts) and tribunals (see the breakdown of cases by year and court/tribunal in Appendix IV). Included in the dataset are not only cases in which the interpretation or application of the provisions of SICA formed part of the *ratio decidendi* (such as a decision by a High Court on receipt of a liquidation opinion from the BIFR, or a decision of a court or tribunal on whether the SICA moratorium could be raised as a defence to proceedings), but also cases in which SICA proceedings were simply antecedent to or otherwise tangentially connected with the question in issue (*e.g.* decisions on an aspect of the winding-up of a company that was previously recommended for liquidation by the BIFR, or on disputes between SICA companies and their workers). The purpose of this broad approach was to build as complete a picture as possible of the treatment of SICA companies in the court system, given the barriers to researching BIFR decisions. The broad approach proved fruitful, with a significant amount of evidence emerging not only from the formal holdings of cases, but also from the procedural history set out at the beginning of many judgments, documenting the history of proceedings.

[4] Indlaw, accessed at Columbia Law School during a stay as a visiting scholar. Most of the Indlaw holding is also available on Manupatra, which was used to verify aspects of the case review.

[5] A full-text search for 'Sick Industrial Companies', followed by the manual exclusion of cases that did not in fact concern an actual, former or prospective SICA registered company (mostly cases in which SICA or a SICA case had been referred to by analogy, and cases in which a reference to SICA appeared in a quote from another statute in issue).

Overall, the SICA case law captured in the dataset reveals the emergence of three judicial innovations that appear to have had a significant effect on SICA's functionality, slowing the liquidation of companies recommended for winding-up by the BIFR, and enhancing the position of workers and other classes of 'vulnerable' stakeholder or creditor in the interim. They are thus innovations that go to the very heart of complaints about SICA, substantiating and elevating the allegation that SICA's adjudicators were implicated in the Act's failure to meet creditor demand for swift liquidation of the 'unviable' after liberalisation. It is not contended in this chapter that these innovations were the only cause of delays and associated creditor harms under SICA; there are undoubtedly multiple variables at play. Nor is it suggested that these innovations occurred in every SICA case that reached the court system: the SICA case law is far from uniform, and there are some counter-examples for each innovation (acknowledged below). What *is* contended is that the cases offer strong evidence of the emergence and adoption across the High Courts (sometimes with the concurrence or under the leadership of the Supreme Court) of the three innovations, and that where deployed these innovations resulted in delay and other direct harms to creditors, particularly institutional creditors.

The dataset also provides some indirect evidence of the performance and practices of the BIFR, particularly where judges prefaced their decision with a *précis* of the history of the SICA proceedings. What evidence there is suggests that some of the judicial practices reported in this chapter were also occurring in the BIFR. This evidence is noted where relevant below, but a caution should accompany its introduction. In a semi-structured interview conducted in Mumbai for this project, one senior legal practitioner suggested that the decisions of the BIFR had been, at least at some points in time, affected by corruption[6]. When asked about the finding of the Eradi Committee (reported in Chapter 7)[7] that the BIFR had confessed to delaying in recommending liquidation for SICA companies 'in view of the interests of workers', the practitioner expressed scepticism, suggesting that corruption (by promoters or managers exerting influence over some BIFR members) was a rival explanation for such delays. The suggestion of corruption, which features only once and opaquely in the literature[8], underscores the difficulty of investigating the performance of the BIFR without access to the reasons for its decisions. The primary focus of this chapter is therefore on the more direct evidence of the treatment of SICA companies in the court and tribunal system.

8.2 The results: judicial innovation under SICA

This section begins by considering the evidence for one judicial innovation that *is* reported at various points in the literature (as noted in Chapter 7)[9]: the erosion of the institutional creditor 'veto' power in section 19 of SICA. As section 8.2.1 below explains, the SICA case law offers little evidence of the formal erosion of section 19. The remainder of this section is devoted to considering three innovations that appear far more clearly from the case law, innovations that appear to have caused significant delays and other harms to creditors (particularly institutional creditors) in the disposal of SICA proceedings.

8.2.1 The innovation that wasn't: formal preservation of the veto power

[6] On interview methodology, see Chapter 1, text to n 35.

[7] Text to n 93.

[8] See Chapter 7, text to n 94.

[9] See Chapter 7 text to n 38.

What the cases do not reveal is any widespread dismantling of the creditor veto power afforded by section 19. In general, judges appear to have regarded the requirement that institutional creditors consent to any rehabilitation scheme for which they are required to advance 'financial assistance' (whether by way of concession or further finance) as a real one:

> The court cannot direct any party to enter into an OTS [one time settlement, or compromise]… no one has a right to get OTS or rehabilitation as the same is really rescheduling of the loan and this can only be done by the bank or financial institution which granted the loan in its discretion[10].

Other cases indicate that the same approach was broadly adopted by the BIFR and Appellate Authority[11].

There are some exceptions to this general trend. In the first exceptional case, a judge of the High Court of Andhra Pradesh issued a writ of mandamus directing the institutional creditors of a SICA company to finance its rehabilitation, accepting the argument of the debtor that its sickness had been partly caused by the decision of those creditors (in the late 1980s, some seven years before the company's entry into the BIFR) to withdraw their support[12]. The decision did not however survive appeal, an appellate

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[10] *Haryana Steel and Alloys Ltd v IFCI Ltd* AIR 2007 Delhi 65 (Delhi), [20]. For cases upholding the consent requirement in section 19, see for example *Ranka Cables Ltd v AAIFR* [2001] 103 CompCas 30 (Andhra Pradesh at Hyderabad), [25]-[27]; *Government of India, Department of Revenue v AAIFR* [2003] 115 CompCas 624 (Delhi); *Kotak Mahindra Bank Ltd v AAIFR* [2008] 144 CompCas 588 (Delhi); *Core Healthcare Ltd v State of Gujarat* [2004] 121 CompCas 77 (Gujarat); *State of Haryana v AAIFR* (2009) 22 VST 210 (Punjab & Haryana); *Karnataka State Financial Corporation v AAIFR* AIR 2010 Kant 89 (Karnataka) (although the deemed consent fiction in s 19(2) applied on the facts); *Balaji Distilleries Ltd v Secretary to Government, State of Tamil Nadu* [2010] 157 CompCas 305 (Madras), [93].

[11] See for example *ARC Cement Ltd v AAIFR* AIR 1998 Delhi 359, reproducing (at [13]) an order of the BIFR explaining that a scheme could not be sanctioned without s 19 consent; for the Appellate Authority, see its reported decision in *Asiatic Oxygen v BIFR* 2000 1 CLJ 0145, in which the Authority clearly distinguished between institutional creditors, whose consent was required under section 19, and other classes of creditor.

[12] The judge reportedly relied on the doctrine of promissory estoppel, accepting the petitioning debtor's argument that the creditors were estopped from withholding finance previously promised (notwithstanding

bench concluding that 'no Court can direct the banks and financial institutions to revive or rehabilitate such sick industries by providing financial assistance'[13]. In another case, *Nasik People's Co-Operative Bank Ltd v Data Switchgear*[14], a creditor bank challenged the BIFR's decision to sanction a scheme, complaining that it had not consented to provide the concessions required of it under the scheme. The Delhi High Court dismissed the creditor's application for judicial review of the BIFR's decision, somewhat surprisingly finding it unnecessary to determine whether consent had been given[15], notwithstanding the bank's evidence that its own financial position was precarious (thanks to a 'mounting number' of non-performing assets)[16]. In a third case, *VDCS Enterprises Ltd v Union of India*[17], a Delhi High Court judge held that the BIFR had authority to direct an institutional creditor to compromise their claim against a SICA debtor on the terms set out in the RBI's historical guidelines on lending to SICA companies. The creditor expressly argued that it was no longer bound by the guidelines, having developed its own internal policies on lending to sick industry (an argument consistent with the history of the guidelines in Chapter 7 of this thesis[18]). The court rejected this argument, reasoning:

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that the loan agreements provided for such action if the debtor defaulted, which it had): see the summary of the judgment by appellate bench in *Industrial Finance Corporation of India Limited, New Delhi v Shree Krishna Oil Complex Limited, Hyderabad* (2002) 3 ALD 781 (Andhra Pradesh at Hyderabad) (the first instance judgment is unavailable).

[13] ibid [11]. The Bench did find some authority for the proposition that the lending decisions of banks and financial institutions were susceptible to judicial review, but cautioned that such a review could only disturb a decision 'so unfair or unreasonable that no reasonable person would have taken that action' ([26]).

[14] *Nasik People's Co-operative Bank Ltd v Datar Switchgear*, unreported decision of a divisional bench of the Delhi High Court, 31 October 2007.

[15] ibid [13].

[16] ibid [7].

[17] *VDCS Enterprises v Union of India* 125 (2005) DLT 385 (Delhi).

[18] See from text to n 139.

> It is clear that where the object is to prevent sickness in an industrial company or to ameliorate its lot and other measures are required to be taken in relation to a sick industrial company, the reliefs and concession or sacrifices can be directed by the BIFR to the Central Government, State Government, Banks, institutions and financial institutions so as to remove the sickness of such industrial company[19].

These exceptional cases may in part reflect confusion about the continuing relevance of historical policies on lending to sick industrial companies in the post-liberalisation period. In the absence of any real dialogue about the interrelationship between these historical policies and financial sector liberalisation, judges would have had good cause to be perplexed. But the outcome in at least two of the cases may also have been motivated by a second factor: in both *Nasik* and *VDCS*, the judge noted that all other institutional creditors had consented to the terms of the compromise[20], suggesting that the situation before the BIFR may have been one of a single creditor holdout. There is some evidence to suggest that the BIFR has increasingly come to regard itself as empowered to respond to creditor holdouts, notwithstanding the formal constraints of section 19. In a semi-structured interview given for this project, a former chairman of the BIFR suggested that the BIFR had changed its interpretation of section 19, with the result that it now considers itself able ('on rare occasions') to bind a dissenting institutional creditor to a rehabilitation scheme where the majority of other creditors have consented[21]. This development has recently received some judicial approval. In

[19] (n 17) [7]. In an extraordinary further move, the Delhi High Court ordered the creditor to *refund* any amount that the debtor had paid to the creditor 'over and above the RBI guidelines'. But with this, and one other possible exception (*Man Industrial Corporation Ltd v Rajasthan Financial Corporation* AIR 1997 Raj 108, in which a judge of the Rajasthan High Court appears to have applied the RBI guidelines to restrict an institutional creditor's entitlement to interest ([29])), the RBI guidelines feature only tangentially (if at all) in the SICA case law, appearing to confirm their demise after liberalisation.

[20] *Nasik* (n 14) [9], [18]; *VDCS* (n 17) [2]-[3].

[21] Interview given by telephone. On interview methodology, see Chapter 1, text to n 35.

Oman International Bank S.A.O.G. v AAIFR[22], the petitioning bank brought an action for judicial review of the BIFR's decision to sanction a rehabilitation scheme that enforced a compromise on the bank despite its objections. The BIFR had done so on the basis that more than 75% of secured lenders had offered their agreement, the dissenting creditor holding only 'about 7.23% of the total outstanding debt'[23]. The Delhi High Court dismissed the bank's application, holding that the BIFR was empowered under section 19 to overcome a 'minority creditor or minority group' seeking to scupper a scheme[24].

Overall, however, the position appears to be that – leaving the recent treatment of holdouts aside – there have been few exceptions to the general principle of respect for the creditor veto in section 19. Considered alone, however, this fact is apt to mislead. The evidence reported in this chapter suggests that the formal power of institutional creditors to propel a SICA company from rehabilitation to liquidation by the exercise of the veto was undercut, or rendered illusory, by other developments in the treatment of SICA companies in the courts. The effect of the judicial innovations reported below was to maroon institutional creditors in proceedings of indeterminate length, in which their claims would be indefinitely stayed while others were permitted to extract value from the SICA debtor. This helps to explain why, despite the preservation of their formal 'veto' tool, institutional creditors may have (at least before SARFAESI)[25] preferred to support

[22] [2010] 157 CompCas 149 (Delhi).

[23] ibid [4].

[24] The court appears to have reached this result by a new interpretation of section 19(4), which permits the BIFR to adopt 'such other measures', including winding-up, on failure to obtain consent: ibid [8]. There is no authority for this interpretation of the sub-section.

[25] See Chapter 6, Section 6.4.2.

'risky' rehabilitation schemes in which they settled their claims with SICA debtors on generous terms, in the hope of achieving an earlier exit from SICA.

8.2.2 The first innovation: developing a 'second chance' rehabilitation culture

Arguably the most important judicial innovation revealed by the SICA cases is a largely informal one: a judicial practice of permitting the SICA company, its promoters or its workers to explore the possibility of its rehabilitation *after* the issuance of a liquidation opinion by the BIFR. Relief came in a variety of forms, sometimes on an interim basis (for example, by a stay of the BIFR's liquidation opinion, or an adjournment of the hearing on the BIFR's liquidation opinion), and sometimes in the form of directions to propose a scheme, either before the court or (on remittance to) the BIFR. Since relief was often given on an interim basis, unaccompanied by written reasons, most of the evidence of this practice is indirect, appearing in the factual history set out in later judgments in the same proceedings, which sometimes reproduce or describe earlier interim orders in the case. Crucially, relief of this form did not depend on any finding of error on the part of the BIFR: what was being offered to petitioners was, to varying degrees and on a rather *ad hoc* basis, a form of merits review. The development of this practice was undoubtedly assisted by a second innovation (considered in the next section) – a change in the interpretation of section 20(2) of SICA, the provision governing the court's responsibility on receipt of a liquidation opinion from the BIFR – but does not appear wholly attributable to it[26].

Some judges appear to have been willing to order an indefinite stay of BIFR proceedings or of the BIFR's liquidation opinion. In *Modi Industries Ltd v Nagar Palika,*

[26] See below text to n 92.

Modinagar[27], for example, the Allahabad High Court records the case of a debtor who had been registered with the BIFR in 1991. In 1993, the BIFR indicated its intention to recommend liquidation, noting the refusal of institutional creditors to offer further finance, and that all efforts at revival had failed[28]. At that time, it seems (as reported in the factual history set out in the judgment) that the managers and workers of the SICA company jointly petitioned for a stay of the BIFR's liquidation opinion, apparently on the basis that – contrary to that opinion – rehabilitation was in fact possible[29]. A stay was ordered by the Allahabad High Court in December 1993 and, extraordinarily, was still operative when the decision in *Modi* was handed down in 1999[30]. In recounting the history of the case, the judges in *Modi* expressly noted their belief that the initial decision to order the stay had been influenced by the joinder of the company's workers to the petition[31]. The decision of the Gujarat High Court in *Narmada Aluminium Industries Ltd v Appellate Authority for Industrial and Financial Reconstruction*[32] provides a second example. The judgment records that the debtor was registered with the BIFR in 1991, and that the BIFR had made two attempts to rehabilitate the company by sanctioning a scheme (one in 1992, a second in 1996), but both schemes failed. The BIFR recommended liquidation in 2000, and its order was affirmed on appeal to the Appellate Authority. The BIFR

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27 AIR 2000 All 271 (Allahabad).

28 See the BIFR order extracted in the judgment, ibid [2].

29 ibid [6].

30 Although the stay was ordered in respect of only one of the debtor's 'units' (a sugar mill), it appears to have precluded the making of the winding-up order.

31 ibid [21]. For a further example, see *Mahesh Textiles Pvt Ltd v Mafatlal Engineering Industries Limited* 1994 (3) BomCR 281 (Bombay), which records the success of an employees' union in obtaining a stay of the BIFR's liquidation opinion.

32 (2005) 3 GLR 2296 (Gujarat at Ahmedabad).

order was, however, then stayed by the Gujarat High Court, apparently to allow the company further time to negotiate a compromise with creditors, provided the debtor pay some money (by instalments) to institutional creditors. No payment was ever made, but the stay persisted for 3.5 years:

> It is a very unhappy and unfortunate state of affairs that though the petitioner Company has availed of the interim relief for the last more than three and half years, no payment was made towards its commitment and… excuses were canvassed before the Court[33].

The Gujarat High Court resolved to vacate the stay, but then made its orders subject to a further two-week stay at the request of the debtor[34]! There are at least two other examples of improbably lengthy, unexplained stays of the BIFR's liquidation opinions[35]. In one of these cases, the directors were found to have 'succeeded in siphoning off the entire properties of the company'[36] during the pendency of the stay.

In other cases, judges simply adjourned the hearing of the BIFR's winding-up opinion to enable the pursuit of rehabilitation proposals. In *Varsha Spinning Mills Ltd*[37], for example, the subject company had moved unusually swiftly through the BIFR, a liquidation opinion being issued in under a year. But matters slowed once the opinion was forwarded to the Delhi High Court. An initial (unexplained) delay of 11 months was followed by three successive adjournments (amounting to a further one year's delay), given at the request of the debtor. The purpose of the adjournments was reportedly to

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33 ibid [29].

34 ibid [33].

35 *Re JK Satoh Agricultural Machines Ltd* [2007] 138 CompCas 955 (Allahabad), a stay of 15 years; *Akshaya Textiles Limited v The Tahsildar* [2008] 143 CompCas 66 (Madras), reporting an interim stay later 'made absolute' and apparently operational six years on.

36 *JK Satoh* ibid [16].

37 82 (1999) DLT 828 (Delhi).

enable further negotiations with creditors, but no proposal for rehabilitation was ever actually filed in court by the company[38]. In some cases such adjournments were granted despite evidence of *multiple* failed attempts at rehabilitation in the BIFR. The debtor in *Re BPL Display Device Ltd*,[39] for example, had been registered with the BIFR in 1993, and a scheme sanctioned shortly thereafter. The scheme was recognised as failed in 2004, on evidence the company had ceased meeting its liabilities to creditors under the scheme, and paying its workers. The BIFR then gave the company a series of extensions to enable it to submit a revised scheme, before issuing a winding-up opinion in 2008.[40] By the time the opinion reached the Allahabad High Court, the case had been pending for 15 years. But even then, it seems, one more chance was given: in the judgment, handed down some six months after the BIFR's opinion was received, the judge records that the court had also provided one more chance for stakeholders to submit a scheme.[41] [42]

Sometimes, judges permitted delays in the liquidation of SICA companies to allow objectors to explore the possibility of a formal scheme of arrangement, under the provisions of the Companies Act 1956. The decision of the Gujarat High Court in *Madhu Textiles Ahmedabad Ltd v Official Liquidator*[43] offers an example. In that case, the company had been registered with the BIFR in 1992; two failed attempts at schemes

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[38] ibid [7]. For a second example see *Kamdar Ladat Simiti v Nanikram Shobraj Mills Ltd* [2005] 125 CompCas 740 (Gujarat), recording that a workers cooperative obtained multiple adjournments of a hearing on the BIFR's liquidation opinion to enable it to propose a scheme, though none was ever filed: [27].

[39] [2009] 150 CompCas 280 (Allahabad).

[40] ibid [5]-[9].

[41] ibid [22].

[42] For other examples of judicial delay after multiple BIFR attempts at rehabilitation, see *Hathwa Vanaspati Limited v BIFR* (2000) 2 CompLJ 76 (Patna); *Re Bharat Steel Tubes Ltd* [2004] 118 CompCas 69 (Delhi); *Board Opinion v Hathising Mfg Co Ltd* [2003] 43 SCL 146 (Gujarat).

[43] I (2006) BC 98 (Gujarat at Ahmedabad).

followed before the BIFR recommended liquidation in 2000. After an unsuccessful appeal to the Appellate Authority, the company filed an application in the High Court responsible for giving effect to the BIFR's liquidation opinion, 'praying for the rehabilitation of the Company'[44]. This application was dismissed, and the BIFR's order was admitted as a petition for winding-up. The company appealed, and in 2002 persuaded the High Court to allow it to propose a scheme of arrangement. The company eventually put a scheme before the court in 2005, but it did not have the requisite approval of its creditors[45], and the High Court resolved that it was finally time to schedule a winding-up hearing:

> [T]he Court is of the view that the petitioner Company is not viable and Revival Scheme proposed by the petitioner Company is nothing but merely an eye-wash and it is only with a view to buy time so as to dispose of the assets of the company.[46]

In at least two other cases, judges accepted that it was possible for a scheme of arrangement to be proposed for a SICA company *after* (in both cases, long after) it had already been wound-up on the basis of the BIFR's opinion[47].

On other occasions judges remitted SICA cases back to the BIFR for further inquiry into the possibility of rehabilitation. Although these orders were made on applications for judicial review, they did not depend on the court finding any error in the BIFR's decision - the orders to remit were made on the merits. In *Kanoria Jute and*

44 ibid [5].

45 Or, it seems, workers: ibid [14].

46 ibid [17]. For a further example from the same court, see *BIFR v CMD, APS Star Industries Ltd* [2009] 152 CompCas 302 (Gujarat).

47 *Kumardhubi Metal Casting and Engineering Limited v Kumardhubi Karamchari Congress* [2005] (3) JCR 251 (Jharkhand); *Prestige Garden Estates Pvt Ltd v State of Karnataka* [2007] 139 CompCas 372 (Karnataka).

Industries Ltd v AAIFR[48], the Calcutta High Court entertained two writ petitions (by several unions and employees) challenging a liquidation opinion issued by the BIFR. The company had been registered under SICA in 1987, the BIFR issuing its liquidation opinion in 2002. The AAIFR had affirmed this opinion in 2005, after one more (failed) rehabilitation attempt. In the High Court, the petitioners applied for an order remitting the company to the BIFR on the basis that there were new promoters interested in rehabilitation. This application was opposed by one of the company's banks, counsel submitting 'there is absolutely no real chance of a remand order yielding any positive result'[49]. The judge nevertheless made the order, observing:

> In a social welfare State that we are, it is the collective duty and responsibility of all the concerned to ensure the social and economic protection for the weaker Section, and there can be no dispute that the lower echelons of the working class in private sector industries, such as a jute mill, belong to the class. An order of remand as suggested by all the parties in the cases, with the only exception of the Indian Bank…if made… will greatly serve the cause of the workers and employees of the company, though it may not serve the cause of creditors to the extent of their respective expectations…
>
> The question that has troubled me throughout the hearing is whether a remand order should be made even when the orders… do not seem to be vitiated by any apparent illegality or jurisdictional error. My considered view is that in cases such as these…the writ court should act not only for correcting a jurisdictional error for setting the wrong right, but as a constitutional court entrusted with the duty to ensure protection, preservation and enforcement of fundamental rights…[50] [51].

[48] [2009] 149 CompCas 555 (Calcutta).

[49] ibid [6].

[50] ibid [12]-[13], rejecting the request of the opposing bank to a separate order entitling it to proceed with recovery proceedings ([14]).

[51] For a further example from the same court, see the unreported decision of AK Mathur and GC Gupta in *Mining and Allied Machinery Corporation Ltd v Smt. Mita Mukherjee*, 12 June 2001. Elsewhere, see *BP Choudhury v Appellate Authority for Industrial and Financial Reconstruction* [1996] 86 CompCas 176 (Delhi); *Vasantha Mills Ltd v Industrial Reconstruction Bank of India* [1995] 83 CompCas 216 (Madras), in which the High Court's order returning the case to the BIFR does appear to have led to the sanctioning of a successful scheme (see the later report [2006] 133 CompCas 292 (Madras)). On flexibility in judicial review more generally, see *Penguin Textiles Ltd v Appellate Authority for Industrial and Financial Construction,* unreported decision of PK Misra J in the Madras High Court, 13 December 2002, [6].

Some of the orders given in pursuit of the rehabilitation imperative were highly creative. In *Board Opinion v Hathising Mfg Co Ltd*[52], a judge of the Gujarat High Court considered whether to make a winding-up order for a company recommended for liquidation after 12 years of failed attempts at rehabilitation in the BIFR. The judge accepted the correctness of the BIFR's liquidation opinion, finding that there was no possibility of revival, and that historical attempts at the company's revival had been at the expense of secured creditors:

> The net worth [of the company] could not exceed the accumulated losses within a reasonable period as ample opportunities were given to the company over a long span of more than 12 years. There is no possibility of reviving the company in the near future as the dues of the secured creditors were mounting up whereas the net worth of the company is totally eroded or virtually reduced to a very negligible amount…This court… accepts the opinion given by the Board[53].

But the judge declined to make the winding-up order immediately, concluding:

> [I]t is necessary to clarify that the court has not straightway passed the order of winding up though in the given facts and circumstances of the case, such an order could have been passed… *since the company is working and workmen are being paid their wages regularly*, the court thinks it fit and proper to impose the conditions on the company to pay equivalent amount to the secured creditors in their respective proportion which company is paying to the workmen every month... This arrangement is not only for a period of one month [the date scheduled for the winding-up hearing], but *till the dues of the secured creditors are paid*, this arrangement is directed to be continued and if any breach is committed at any point of time of this arrangement, the company would be ordered to be wound up[54].

In making this order, the judge may have been influenced by the fact that in a winding-up workers would be entitled to share equally with secured creditors in charged property,

52 [2003] 43 SCL 146 (Gujarat).

53 ibid [23].

54 ibid [25].

pursuant to the elevated preference rule in section 529 of the Companies Act 1956[55]. But the order made by the judge was not an order for distribution to pre-commencement creditors in a winding-up: it was an order permitting a company that was running at a loss to continue operations, its workers benefiting from wage payments, while secured creditors were forced to one side – entitled not to look to the whole of the debt or the property secured for that amount, but only to monthly 'instalments'[56].

There are counter-examples: cases in which judges had an opportunity to afford a SICA company a further chance at rehabilitation, but declined to do so. Some judicial review applications against BIFR liquidation opinions were simply rejected on conventional grounds, the judge finding no basis on which to interfere with the opinion, without any inquiry into the merits[57]. In those cases where judges did conduct some form of merits review (whether on an application for judicial review or in a straightforward hearing of the BIFR's liquidation opinion), they sometimes found no basis for reaching a conclusion different to that of the BIFR, notwithstanding stakeholder objection[58]. In some of these cases, however, this conclusion did not prevent

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[55] See above, Chapter 3, text to n 113.

[56] For another striking example, see *Union Bank of India v Official Liquidator HC of Calcutta* AIR 2000 SC 3642 (the Supreme Court overturning a judge's decision to authorise an asset sale at what was an undervalue on condition that the purchaser employ the company's workers, despite bank objection)

[57] See, for example: *BD Industries Ltd v BIFR* [1999] 98 CompCas 315 (Delhi); *Biogenics India Ltd v BIFR* [2004] 122 CompCas 736 (Delhi), the court concluding that the 'sole purpose' of the judicial review application by the company and its promoters was to delay exit from the SICA moratorium; *Raza Textiles Ltd v AAIFR* [1998] 94 CompCas 468 (Allahabad); *Hindustan Transmission Products Limited v AAIFR* 2001 (58) DRJ 736 (Delhi); *Mittal Steels Ltd v AAIFR* [2004] 118 CompCas 661 (Karnataka); *Khanna Rayon Industries Ltd v Union of India* 77 (1999) DLT 517a (Delhi); *Cement Workers Union v BIFR* [2000] 100 CompCas 76 (Allahabad). Crucially, however, there does not appear to have been any specific request made to the court to conduct a merits review in these cases: that is, they were framed simply as applications for judicial review, without more.

[58] See for example *Amei Power Limited v AAIFR* AIR 1999 AP 356 (Andhra Pradesh) (a judicial review case); *Madhu Fabrics Ltd v State Bank of India* [2001] 107 CompCas 487 (Gujarat) (a judicial review case); *Re Bharat Steel Tubes Ltd* (n 42) (a hearing on the BIFR's liquidation opinion); *Board Opinion v Rajprakash Spinning Mills Ltd* [2000] 102 CompCas 276 (Gujarat) (a hearing on the BIFR's liquidation opinion);

the court from offering some interim relief: in one, the court accepted the BIFR's opinion and ordered winding-up, but acceded to the company's request that the winding-up order be stayed for one month to enable the company to appeal and explore revival.[59] On the available cases, however, there appear to be more examples of cases in which relief was sought and offered than cases in which relief was sought and refused[60]. In any case, the number of cases in which relief *was* given suggests that, to the extent that they benefited from delay[61], SICA debtors and their stakeholders had good incentive to litigate for relief from immediate liquidation. A second fact – the apparent absence of adverse costs orders in judgments on failed challenges to BIFR's liquidation opinions – suggests these stakeholders may have had little incentive *not* to litigate.

To what extent was this practice mirrored in the BIFR and Appellate Authority? The factual history recounted in many of the cases suggests that many debtors benefited from multiple rehabilitation attempts before their case even reached the civil courts[62].

Debabrata Mukherjee v Dunbar Mills Ltd (2001) 1 Call T 370 (Calcutta) (an appeal from a decision at first instance to order liquidation of a SICA company), all cases in which the court accepted it had power to re-inquire into the correctness of the BIFR's liquidation opinion but found no basis for doing so on the facts, despite invitation to do so.

59 *Rajprakash* ibid [52]-[53]; see also *Madhu Fabrics Ltd v State Bank of India*, ibid, in which the judge decided to order winding up on the basis of the BIFR's opinion, but not before apparently allowing the petitioners a chance to prove their good faith in proposing a scheme ([25]).

60 This assessment may appear somewhat crude, but a more sophisticated quantitative assessment may be difficult to conduct, given that much of the evidence appears not from the *ratio* of a case but from the case history contained within judgments (recording, for example, previous interim relief orders granted), making it very difficult to directly compare the number of times relief against liquidation was sought and granted with the times when it was sought and refused.

61 As to which see Section 8.2.4, 'The third innovation: the moratorium interpreted'.

62 See for example the case histories set out in the following cases: *Cement Workers Union v BIFR* [2000] 100 CompCas 76 (Allahabad); *Allied International Products Ltd v AAIFR* [2001] 104 CompCas 481 (Delhi); *Re U.P. Cement Corporation Ltd (in liquidation)* [2002] 112 CompCas 562 (Allahabad); *Purshottam Sutwala v Pradeshiya Industrial and Investment Corporation of UP Ltd* [2004] 2 UPLBEC 1828 (Allahabad); *Cawnpore Sugar Works Ltd v Appellate Authority for Industrial and Financial Reconstruction* [2006] 129 CompCas 778 (Delhi); *Dewan Bahadur Ramgagopal Mills Limited v Board for Industrial and Financial Reconstruction* [2008] 142 CompCas

Again, however, the paucity of evidence of BIFR decision-making (and particularly the absence of written judgments) makes it difficult to evaluate how widespread this practice was, and what the reasons for it were.

8.2.3 The second innovation: the erosion of the BIFR's formal liquidation power

Section 20(2) of SICA provides:

> The High Court *shall*, *on the basis of the opinion of the Board, order winding-up* of the sick industrial company and may proceed and cause to proceed with the winding-up of the sick industrial company in accordance with the provisions of the Companies Act, 1956.

The plain meaning of this sub-section (and in particular the phrase 'shall… order winding-up') is that a receiving High Court is bound, on receipt of the BIFR's liquidation opinion, to order liquidation of a SICA company. Early SICA decisions endorsed this mandatory reading. In *IRBI v Textile Processing Corporation of India Ltd*,[63] an institutional creditor of a SICA company successfully appealed against the decision of a judge to treat receipt of the BIFR's liquidation opinion as a petition for winding up, admit it, and order it to be advertised. In allowing the appeal, the Calcutta High Court observed that the language of section 20 made 'quite clear that the Legislature has thought fit that in the case of a sick Undertaking a drastic action is to be taken',[64] and held that s 20(2) obliged a receiving High Court to order winding up.[65] The Bench expressly rejected the submission of an intervening workers' union that workers were entitled to be heard before the court

928 (Andhra Pradesh). See also Kaicker (n 2) [20.2-3] on rehabilitation attempts after appeal to the Appellate Authority.

[63] (1990) 1 CallT 152 (HC).

[64] ibid [10].

[65] ibid [12].

could give effect to the BIFR's opinion[66]. In *Ratlam Ispat Ltd v Greaves Feseco Ltd*, a Division Bench of the Delhi High Court similarly concluded that s 20(2) obliged a receiving High Court judge to wind up a company, and to do so under SICA, before proceeding with the winding up under the Companies Act 1956[67]. Early commentators, including one of the first members of the BIFR, took the same view[68]. The mandatory reading of section 20(2) is consistent with the general ouster provision in section 26 of SICA[69], which appears to leave courts with only their (theoretically circumscribed) powers of judicial review. The mandatory reading is also consistent with the Tiwari Committee's vision for SICA (recall the Committee's anxiety to circumvent liquidation delays in the courts)[70], and the vision of those who introduced the Bill (recall the Minister for Finance's observations that the BIFR was intended to be the 'final authority' on liquidation)[71].

The mandatory reading of section 20(2) is however irreconcilable with the evidence of the development of a 'second chance' rehabilitation practice in the courts (the first innovation documented above). This practice permitted many SICA companies

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66 ibid, [13].

67 [1991] 72 CompCas 548 (Delhi), [6]. See also the obiter discussions in *Ramniklal & Co v Wallace Flour Mills Co Ltd* [1993] 78 CompCas 546 (Bombay), [7]; *Modi Spinning and Weaving Mills Co Limited v UP State Electricity Board* AIR 1992 All 247 (Allahabad), [9].

68 SA Naik, *The Sick Industrial Companies (Special Provisions) Act 1985* (M&J Services Bombay 1987) [20.7]; Narayanan, an early member of the BIFR: 'Sub-section (2) of section 20 provides that the High Court *shall* on the basis of the opinion of the Board, order the winding up… In other words, the High Court will not go into the validity of the Board's opinion' (*Industrial sickness in India: the role of the BIFR* (Konark Publishers 1994) 43).

69 'No order passed… under this Act shall be appealable except as provided therein and no civil court shall have jurisdiction in respect of any matter which the [Appellate Authority] or [BIFR] is empowered to determine'; Chapter 6, text to n 62.

70 Chapter 6, text to n 26.

71 Chapter 6, text to n 141.

to avoid immediate liquidation on exit from the BIFR by arguing that there remained – on the merits - some prospect of rehabilitation. The effect of this practice was to dilute[72] and in some cases entirely negate[73] the BIFR's liquidation power. Section 20(2), as drafted and originally interpreted, should have foreclosed the development of this practice. The fact that it did not do so appears to be at least partly attributable to a dramatic change in the interpretation of the sub-section, adopted around the time of the formal announcement of India's economic liberalisation. This interpretative revolution arose out of a constitutional challenge to section 20, filed in the Madras High Court by workers of two SICA companies the BIFR had recommended be wound up[74]. The workers challenged section 20(2) as unconstitutional, arguing that it deprived a receiving High Court of any opportunity to apply its 'judicial mind' or 'judicial discretion' as it would in the case of an application for winding up under the Companies Act 1956, and that this was discriminatory (against sick industrial companies) contrary to Article 14 of the Indian Constitution. At first instance, Hadi J dismissed the challenge, finding it unnecessary to decide whether section 20(2) was indeed a mandatory provision. If it merely enabled the court to order winding up, then the same exercise of independent discretion would be applied to applications engendered by receipt of the BIFR's opinion; if it was mandatory, SICA created a separate class of companies, such that different treatment did not amount to unequal treatment under Article 14.[75]

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72 As in cases where the case was remitted to the BIFR.

73 As in cases where the court stayed the BIFR's liquidation opinion or adjourned the hearing on the opinion to permit fresh proposals for rehabilitation to be made before the court.

74 *D Ravikumar v Union of India* AIR 1995 Mad 58 (Madras).

75 ibid [6]-[7].

On appeal in *JM Malhotra v Union of India*,[76] a Division Bench of the Madras High Court broadly upheld the judge at first instance, although aspects of the judgment are complicated and unclear. The court identified s 20 as a mechanism of 'last resort', applied by the Board acting as a 'judicial body consisting of experts in the field'.[77] On the relationship between winding up in and outside SICA, the court reasoned:

> [W]hat sub-sections (1) and (2) of section 20 dispense with is only the requirement of section 439 and 440 [of the Companies Act]… for the purpose of initiating a proceeding for winding up [the filing of the petition]… *and also the enquiry into the question as to whether it is just and equitable to order winding up of the company*.[78]

Although the latter (emphasised) part of this statement clearly suggests that it would not be open to a receiving High Court to reconsider the BIFR's determination that it was just and equitable to wind up a SICA debtor, the court went on to suggest the opposite:

> [I]t appears to us that even though the opinion submitted by the Board forms the basis for ordering winding up … it is nevertheless open to the High Court to go into the correctness of the opinion… and decide as to whether it should proceed and cause to proceed with the winding up… Therefore, it cannot be held that is obligatory on the High Court to order winding up of the sick industrial company… without examining the correctness of such opinion, on hearing the concerned parties.[79]

The court cautioned however that the opinion of the Board was one of experts 'acting judicially', and as such should not 'lightly be brushed aside'. It was not unconstitutional to 'mutilate' the jurisdiction of the High Court by such deference: the jurisdiction to wind up was conferred by the legislature, and subject to modification by it.[80]

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[76] [1997] 89 CompCas 600 (Mad).

[77] ibid [8].

[78] ibid [8] (emphasis added).

[79] ibid.

[80] ibid.

The employees petitioned for special leave to appeal in the Supreme Court. That petition was rejected in a two-paragraph judgment that further muddied the ratio of *Malhotra*:

> We do not find any ground to interfere with the High Court's view which has rejected the challenge to the constitutional validity of [s20(2)]…
> It is obvious that sub-section (2) has to be construed to mean that the High Court has to take into account the opinion of the Board… *and is not to abdicate its own function of determining the question of winding up*. So read, sub-section (2) does not suffer from any infirmity. *This in substance is the view taken by the High Court*.[81]

There are two remarkable features of the Supreme Court's decision on the *Malhotra* appeal. The first is the Court's decision not to allow the special leave application, and to properly resolve the debate about the constitutionality of section 20(2)[82]. The second is the Court's decision nevertheless to strengthen that aspect of the Division Bench's decision that most favoured the employee petitioners: while the Bench thought it *open* to the High Court to reconsider the correctness of the BIFR's opinion, the Supreme Court (as Mittal notes)[83] appears to suggest this would be *compulsory* (the High Court is 'not to abdicate its own function of determining the question of winding up').

It is difficult to assess the extent to which the *Malhotra* revolution influenced the development of a 'second chance' rehabilitation practice in the courts. Certainly, some judges were aware of the decision and its implications. In *BIFR v Unity Steels Ltd*[84], a judge of the High Court of Gujarat held that the effect of *Malhotra* was to preclude the

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81 *Rama Raju v Union of India* [1997] 89 CompCas 609, 610 (emphasis added).

82 Particularly given section 2 of SICA, which is designed to render the Act immune from such constitutional challenges: see Kaicker (n 2) [20.3-3a], criticising the decision.

83 DP Mittal, *Taxmann's New Law Relating to Sick Industries* (Taxmann 2003) [12.7].

84 Unreported decision of M Parikh J of the Gujarat High Court on 19 July 1999; see to same effect (but without express reference to *Malhotra*) *SLM Industries Ltd v Rajendra Electrical Inds Ltd* [2007] 135 CompCas 243 (Gujarat).

court from immediately winding-up a SICA company on the basis of the BIFR's liquidation opinion. Instead, the opinion would have to be treated as a petition for winding up, admitted and advertised, and a winding-up hearing ordered. Anything else would be a breach of the court's duty 'not to abdicate its own function of determining the question of winding up'[85]. Judges in Calcutta[86], Andhra Pradesh[87], and Himachal Pradesh[88] reached the same conclusion about SICA winding-up procedure. In *Loharu Steel Industries Ltd v DCM Ltd*[89], a Division Bench of the Karnataka High Court allowed an appeal from a decision at first instance to wind-up a SICA company on the basis of the BIFR's opinion, the Bench finding that the judge had wrongly thought the court was required to order winding-up[90] [91].

Despite this evidence, there are a number of reasons to resist the hypothesis that the development of a 'second chance' rehabilitation culture in the courts should be attributed solely to the formal *Malhotra* development. There are at least three reported cases in which judges held that the High Courts could *not* resist giving effect to the

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[85] ibid [16].

[86] *Eastern Paper Mills v Board for Industrial and Financial Reconstruction* (2000) 1 CallT 69 (Calcutta), but *cf* of a later decision of the same court in *Debabrata Mukherjee v Dunbar Mills Ltd* (2001) 1 CallT 370 (Calcutta) in relation to the procedural point.

[87] *Re Charminar Papers Ltd* [2008] 82 SCL 288 (Andhra Pradesh), disapproving *Debrabata Mukherjee*, ibid.

[88] *Ashoka Alloy Steel Ltd v BIFR* [2008] 142 CompCas 915 (Himachal Pradesh).

[89] [2001] 107 CompCas 353 (Karnataka).

[90] ibid [8].

[91] For other cases in which judges identified *Malhotra* as a source of power to review the correctness of the BIFR's decision, see for example *Board Opinion v Hathising* (noted above, text to n 54); *Kamdar Ladat Simiti v Nanikram Shobraj Mills* (n 38); *Re Bharat Steel Tubes Ltd* (n 42 above); *BPMEL Sramik Union v Appellate Authority* AIR 1998 Cal 4 (Calcutta), [13]-[15]; *Amitabh Textile Mills Ltd v Official Liquidator* [2010] 153 CompCas 715 (Uttaranchal).

BIFR's liquidation opinion.[92] In other cases where judges did consider themselves empowered to offer relief from immediate liquidation, it is not always possible to ascertain whether they did so on the basis of *Malhotra* - relief was often given on an interim basis, without written reasons. More fundamentally, many of these relief orders extended well beyond *Malhotra*, which – even if construed at its widest – would only appear to permit reconsideration of rehabilitation prospects at the time the BIFR's opinion is received by the court. Some orders offered more generous relief than this before liquidation (*e.g.* lengthy adjournments of the winding-up hearing; indefinite stays of the BIFR's liquidation opinion), while others offered relief *after* liquidation (*e.g.* permission to pursue a scheme even after winding-up). In two semi-structured interviews conducted for this project, senior practitioner views appeared mixed on whether the *Malhotra* development had been causative of significant delay: one thought so, another thought not[93].

Nevertheless, the *Malhotra* development was an important one. It signalled the dilution of the BIFR's liquidation power, and suggested a new and expanded role for the courts in the liquidation of sick industrial companies, a role sanctioned by the apex court itself. That this development occurred at precisely the moment when liquidation was set to become a more likely outcome for SICA companies (the moment when institutional

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92 *Lakshmi Porcelains Ltd v Union of India* 1995 (35) DRJ 182 (Delhi) (decided after *Malhotra* was handed down but before it was reported, which may explain why the court entertained the same constitutional challenge); *DH Woodhead Ltd v Official Liquidator* [1998] 93 CompCas 467 (Punjab and Haryana), [8], though the court also suggested it was possible to pursue a scheme of arrangement under the Companies Act 1956 after winding up was ordered; *Re Modistone Ltd* 2003 (2) AllMR 117 (Bombay), [4], although the BIFR opinion does not appear to have been challenged before the court.

93 For interview methodology, see Chapter 1, text to n 35.

creditors acquired greater autonomy over, and responsibility for, their lending decisions *vis-à-vis* industrial debtors[94]) is striking.

8.2.4 The third innovation: the moratorium interpreted

The third innovation appears from the case law on the moratorium in section 22 (1) of SICA, which (as amended)[95] provides:

> Where in respect of an industrial company, an inquiry under section 16 is pending or any scheme referred to under section 17 is under preparation or consideration or a sanctioned scheme is under implementation or where an appeal under section 25 relating to an industrial company is pending, then, notwithstanding anything contained in the Companies Act 1956… or any other law… no proceedings for the winding up of the industrial company or for execution, distress or the like against the properties of the industrial company or for the appointment of a receiver in respect thereof and no suit for the recovery of money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans or advance granted to the industrial company shall lie or be proceeded with further, except with the consent of the Board or, as the case may be, the Appellate Authority.

A separate sub-section (section 22(3)) permits the BIFR to make a declaration suspending (for a period of up to seven years in total) contracts to which a SICA company is party, or declaring the rights or liabilities arising under such contracts enforceable 'with such adaptions' specified by the Board. This unusual provision, which appears to give the BIFR power to rewrite existing contracts, has attracted relatively little treatment in the cases, and there is little evidence of the extent of its use by the BIFR[96]. Most litigation has concerned the moratorium on recoveries in section 22(1).

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[94] See Chapter 7, text to n 141.

[95] In 1994, by the addition of the phrase 'and no suit for the recovery of money or for the enforcement of any security against the industrial company or of any guarantee in respect of any loans, or advance granted to the industrial company' (Sick Industrial Companies (Special Provisions) Amendment Act 1993). As to the position of guarantors after the amendment, see *Bharat's Sick Industries & BIFR* (n 2) [22.22].

[96] *Bharat's Sick Industries* (n 2) [22.64].

In the SICA literature, the moratorium is at the heart of creditor disadvantage under SICA. It is the legislative feature that enables debtors (in possession) to shelter from creditors, and to siphon off assets and coerce creditor compromise in the interim.[97] The SICA cases offer clear evidence of the harm suffered by institutional creditors under the moratorium, substantiating this claim in the literature. But they also reveal that the position of other creditors under the moratorium, especially workers, was rather different. In relation to debts incurred prior to a company's entry into SICA, the cases reveal that some types of unsecured debt, held by creditors perceived to be vulnerable by judges (including workers), were considered by the courts to be outside the scope of the moratorium entirely[98]. Post-commencement debts (those incurred after a company's entry into SICA) were also treated unevenly, with workers enjoying considerably more certainty of recovery than other creditors. If the first and second innovations help to explain delays under SICA, this innovation may help explain *who benefited* from delay.

8.2.4.1 Pre-commencement debts

Institutional creditors

Institutional creditors – including both government creditors (for tax debts)[99] and banks and financial institutions[100] – were, it seems, almost always barred from recovering pre-

[97] Chapter 7, text to n 54.

[98] That is, section 22 was held not to apply *at all*, such that there would be no need to obtain BIFR consent for the moratorium to be lifted.

[99] *Gram Panchayat v Shree Vallabh Glass Works Ltd* AIR 1990 SC 1017 (Supreme Court) (property tax); *Tata Davy Ltd v State of Orissa* AIR 1998 SC 928 (Supreme Court) (sales tax) (noted *Bharat's Sick Industries* (n 2) [22.53]); *Aar Kay Concast Ltd, Ludhiana v Union of India* 2000 (68) ECC 440 (Punjab & Haryana) (excise tax); *Ezy Slide Fastners Ltd v Joint Commissioner of Income Tax* [2004] 122 CompCas 242 (Gujarat) (income tax); see also for example *Fusion Engineering Products v State of Bihar* 1999 (112) STC 170 (Patna) (sales tax), *Modistone Ltd v State of Kerala* ILR 1999(2) Kerala 327 (Kerala) (sales tax); *cf Sol Pharmaceuticals Ltd v Mandal Revenue Officer, Nampally* 2007 (5) VST 580 (Andhra Pradesh).

commencement debts by the moratorium, unless the BIFR offered its consent under section 22(1). In the early decision in *Maharashtra Tubes Ltd v State Industrial & Investment Corporation*,[101] the Supreme Court signalled a broad approach to the interpretation of section 22 as applied to institutional creditors. In issue was whether a financial institution was barred by section 22 from exercising an out-of-court right under state law to take over the management or possession of industrial companies and sell assets over which it held security. At the time, the only potentially applicable provision in section 22 was its prohibition on '*proceedings* for the winding up of the industrial company or for execution, distress or the like against any of the properties of the industrial company'.[102] The Court held that section 22 was to be interpreted broadly,[103] and that the prohibition on 'proceedings' extended to the exercise of the out-of-court right.[104] The Court identified the 'main thrust' of SICA as revival, observing:

> It must be realised in the modern industrial that in the modern industrial environment large industries are generally financed by banks and statutory corporations created specially for that purpose and if they are permitted

[100] See for example, *Comet Filaments (India) Ltd v Pradeshya Industrial and Investment Corporation* [1989] 66 CompCas 124 (Allahabad), [13] (SICA registration precluded further execution by secured financial institution creditor); *Canara Bank v Ankit Granites Limited* [1999] 97 CompCas 511 (CLB) (SICA bars enforcement of security by bank); *ICICI Limited v Alpine Industries Ltd* AIR 1999 Bom 112 (Bombay) (company evaded receiver enforcement by making SICA reference in between court order appointing receiver and receiver taking possession); *Feena Petro Products Ltd. v Tamil Nadu Industrial Investment Corporation Ltd* [1999] 98 CompCas 205 (Madras) (company initially evaded recovery action by obtaining court order permitting it to make repayments to secured creditor by instalments, later defaulted on this but avoided enforcement by making SICA reference); *Syndicate Bank v Mullangie Spintex Pvt Ltd* 2010 (120) DRJ 212. Recall however that banks and financial institutions now enjoy an escape route from SICA following the commencement of SARFAESI: see Chapter 6, Section 6.4.2.

[101] (1993) 2 CompLJ 346 (SC).

[102] The prohibition on suits for enforcement of security was inserted shortly thereafter: see (n 95) above.

[103] (1993) 2 CompLJ 346 (SC) [13].

[104] ibid [12], [14].

> to resort to independent action in total disregard of [SICA proceedings] the entire exercise… would be rendered nugatory.[105]

Eight months earlier, the Supreme Court had endorsed a narrow interpretation of section 22 in relation to eviction proceedings brought against a SICA company with unpaid (pre-commencement) rent.[106] The Court had held such proceedings were not ones for 'execution, distress or the like against the properties of the industrial company',[107] and that the particular leasehold in issue was not in any case 'property'.[108] The decision became authority for the proposition that lessors and title financiers were not barred by section 22 from recovering possession from a SICA company,[109] thus enabling the dismemberment of businesses that *Maharashtra Tubes* was designed to preserve.

Although the Supreme Court's decision in *Maharashtra Tubes* might partly be explained as a reflection of the historical role of banks and financial institutions as providers of industrial rescue finance, the Court's central claim – that there would be no possibility of rescue under SICA if institutional creditors could escape the stay – was

[105] ibid [6], [14], also noted in *Bharat's Sick Industries* (n 2) ([22.60]) as suggesting a strong application of s 22 to banks.

[106] *Chamundi Mopeds Ltd v Church of South India Trust Association* AIR 1992 SC 1439, endorsed in the subsequent decision of the apex court in *Gujarat Steel Tube Co Ltd v Virchandbhai B Shah* AIR 1999 SC 3839.

[107] Not being proceedings 'for the recovery of money': *Chamundi* ibid [12]. In reaching this conclusion, the Court was influenced by its view that the legislature could not have intended for SICA companies to occupy premises rent-free ([12]), but an alternative would have been to develop a rule for the recovery of post-commencement liabilities, as the court subsequently did in *Deputy Commercial Tax Officer v Corromandal Pharmaceuticals* AIR 1997 SC 2027, see further n 144 below.

[108] *Chamundi* ibid [13].

[109] See for example *Credit Capital Finance Corporation v Foremost Industries Ltd* AIR 1996 Delhi 310 (Delhi); *Premier Industries (India) Ltd v Alliance Credit and Investments* [2000] 102 CompCas 456 (Calcutta); *Wipro Finance Ltd v Dee Pharma Ltd* 86 (2000) DLT 45 (Delhi); *Khatau Makanji Spinning and Weaving Co Ltd v Bapalal & Co* [2003] 113 CompCas 477 (Madras); *Sundaram Finance Limited v Kamaraj National Labour Organisation* (2004) II LLJ 25 (Madras); *Rohit Sidrammappa Abdulpurkar v Laxmi Vishnu Textile Mills* AIR 2009 Bom 56 (Bombay). The recovery of rental arrears was typically held barred by section 22, but see exceptionally *Karamjit Singh Gahunia v Dalmia Industries Ltd* 2001 (59) DRJ 768 (Delhi); *Garden Finance Ltd v Prakash Inds Ltd* AIR 2002 Bom 8 (Bombay).

surely correct. The difficulty for these creditors is that a stay under SICA could last for a very long time indeed. Section 22(1) expressly extends the stay to cover the full period of implementation of any rehabilitation scheme (recall that this could be a period of seven years or longer[110], and that the failure of one scheme does not preclude the sanctioning of another[111]), and the period of any appeal from the BIFR's liquidation opinion to the Appellate Authority[112]. Additionally, as noted above, judges were sometimes willing to remit cases back to the BIFR after both it and the Appellate Authority had concluded that rehabilitation was impossible, thereby further extending the stay[113]. Several cases suggest that even in those instances where judges did not remit cases back to the BIFR, preferring to explore (by stays and adjournments) the possibility of rehabilitation in court, the moratorium remained in place[114], although not always indefinitely[115]. Indeed,

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110 As in *Chhabi Rani Agro Industries Enterprises Ltd v Gubeshwari Solvent Pvt Ltd* 1993 (41) BLJR 1020 (Patna) and see also (for an example of an even longer stay during the course of BIFR rehabilitation) *Hyderabad Abrasives & Minerals (P) Ltd v Andhra Cements Ltd* [2003] 42 SCL 748 (Andhra Pradesh), both trade creditor cases; see similarly *Fusion Engineering v Bihar* (n 99) (tax arrears).

111 As in *Hyderabad Abrasives* ibid and *Cochin Malabar Estates and Industries Ltd. v Overseas Latex (P) Ltd* [2001] 107 CompCas 563 (Kerala), for example.

112 See for example *JM Bottlings Pvt Ltd v State of Tamil Nadu* [1994] 81 CompCas 921 (Madras), the court holding that an institutional creditor had not been entitled to take possession of assets of a SICA company during the pendency of an appeal by the company from the BIFR's liquidation opinion; similarly *Ambal Mills Ltd v Commercial Tax Officer (FAC), Central II* [2006] 131 CompCas 573 (Madras) (appeal still pending two years on); *Montari Industries Ltd v State Bank of Patiala* 2005 (1) DRTC 208 (DRAT, Delhi Bench); *Intercraft Limited v Cosmique Global* I (2011) BC 230 (Delhi).

113 Though not necessarily indefinitely: see for example *Vasantha Mills v Industrial Reconstruction Bank* (n 51), ordering payment of proceeds of sale of secured goods to the secured institutional creditor two years after the company was returned by the High Court to the BIFR.

114 Stays: see *Modi Industries v Nagar Palika, Modinagar* AIR 2000 All 271 (Allahabad) (stay of proceedings in BIFR by court, s 22 presumed to remain in force) and *Mahesh Textiles v Mafatlal* (n 31) (stay of BIFR liquidation opinion, s 22 held in force); *Narmada Aluminium Industries Ltd v AAIFR* (2005) 3 GLR 2296 (Gujarat), (secured creditors appear to have been compelled to wait for installment payments during stay); *cf* however *Chamundi Mopeds* (n 106) above. Adjournments: see *Kamdar Ladat Simiti v Nanikram* (n 38), recording that an order adjourning a hearing on a winding-up opinion to enable revival by a workers' cooperative was accompanied by an order that the provisional liquidator could advertise the sale of only those assets not required by the revival plan; see also *Re BPL Display Device Ltd* [2009] 150 CompCas 280 (Allahabad), in which the judge acknowledged that secured creditors were generally permitted to stand

as we have already seen, the rights of some institutional creditors remained compromised even after winding-up was eventually ordered[116].

Other creditors: depositors, trade creditors, tort creditors and workers

Section 22 does not, on a plain reading, distinguish (or offer any basis for distinguishing) between types of creditors in the application of the moratorium to pre-commencement debts. But the cases suggest that, in practice, section 22 was applied unevenly, with some unsecured creditors permitted by judges to escape the moratorium and recover in full. Take first the position of 'depositors': retail investors holding fixed deposits in SICA companies, acquired prior to the company's entry into SICA. Deposits are a species of unsecured corporate debt finance regulated in India by section 58A of the Companies Act 1956[117]. In at least two cases (both decided by a company law tribunal),[118] section 22 was held to bar the enforcement of any order for repayment of a deposit. But in other cases, depositors were more successful. In *Deepak Insulated Cable Corporation Ltd v Union of*

outside the liquidation, but appeared to regard the granting of permission as conditional on the High Court accepting the correctness of the BIFR's decision: [40].

115 See *Kanoria Jute and Industries Limited v Certificate Officer* [1999] 95 CompCas 330 (Calcutta), where a judge held that s 22 was no longer a bar to the recovery of pre-commencement tax arrears, four years after a stay was ordered against the BIFR's opinion that a rehabilitation scheme had failed; see similarly *Modi Industries v Nagar Palika* ibid (noted above, text to n 27), where the Division Bench held that the moratorium should be lifted to permit recovery of pre-commencement tax arrears, six years after a stay was granted of the BIFR's liquidation opinion.

116 See the discussion of *Board Opinion v Hathising* above, text to n 54. Additionally, secured creditors of SICA companies wound up in the civil courts still need to obtain the leave of the court to stand outside the liquidation and enforce (*Bank of India v Tata Iron and Steel Company Ltd* II (2006) BC 183 (Jharkhand)), a process that adds further delay (*Kesri Vanaspati Products Limited (in liq) v IDBI* III (2007) BC 620 (Rajasthan)).

117 See Sumit K Majumdar and Kunal Sen, 'The debt wish: rent seeking by business groups and the structure of corporate borrowing in India' (2006) 130 *Public Choice* 209; Bhabatosh Banerjee, *Financial Policy and Management Accounting* (7th ed, Prentice Hall 2005) 59.

118 *A Sesha Charyulu v Pennar Industries Ltd* [2004] 120 CompCas 208 (CLB) (execution of repayment order barred); *Re Uniplas India Ltd* 1997 (90) CompCas 74 (CLB) (proceedings for repayment barred).

India[119], the High Court of Karnataka held that proceedings for the repayment of deposits by a SICA company were not barred by section 22. The court reached this result by a rather creative route, reasoning that the deposit money was recoverable because held on trust:

> A deposit by the depositors is not a sum lent to the company but is a sum deposited with the company to be held in trust by the company till the time of maturity. It is not a loan in the strict sense of the term. Therefore, any claim made for return of a deposit made with the company cannot be termed as a suit for recovery of money due[120].

Deepak was subsequently applied in the same court to uphold an order requiring repayment of deposits by a SICA company,[121] the court emphasising the vulnerability of retail investors:

> These depositors are mostly from poorer section of the people. We are sure that the authorities in power would take serious view of the plight of this hapless depositors in their not getting their refund in these matters. Quick remedial measure is an urgent need to wipe out tears of this poorer section of the people that too at their old age.[122]

One case suggests the BIFR was notified of the decision in *Deepak*, and took it as authority for the proposition that section 22 was entirely inapplicable to deposits[123].

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[119] [2001] 106 CompCas 380 (Karnataka).

[120] ibid [8]. It seems that such an analysis would, if more generally adopted, entirely negate the utility of deposits as a source of corporate finance.

[121] *Electrex India v Usha D Rohra* [2007] 135 CompCas 157 (Karnataka). The decision is also noted together with *Deepak* in *Bharat's Sick Industries* (n 2) [22.62].

[122] *Electrex* ibid [15]. See also *Swati Basu v Duncan Industries Ltd,* unreported decision of Mr S.N. Basu in the State Consumer Disputes Redressal Commission, West Bengal, 11 June 2008, and *Krishan Mohan v M/s Electrex (India) Ltd*, unreported decision of Kapoor J and Ms R. Mittal in the State Consumer Disputes Redressal Commission, New Delhi, 25 September 2009, in which s 22 was considered no bar to either repayment of deposit or the payment of compensation under consumer protection legislation.

[123] See *Mahesh Chandra Sharma v Modern Threads Ltd,* unreported decision of President Shah J in the National Consumer Disputes Redressal Commission, New Delhi, 10 October 2007, [5].

Consider next the position of trade creditors. There are cases in which trade creditors were barred from recovery by section 22, notwithstanding lengthy delays in the disposal of SICA proceedings[124]. But there is at least one case where trade creditors successfully evaded the moratorium. In *Indian Bank v State of Karnataka*[125], section 22 was held inapplicable to the execution of an order entitling farmers to payment for the supply of sugarcane to a SICA company (a sugar factory) prior to its entry into SICA. In reaching this conclusion, the judge of the Karnataka High Court appeared influenced by the fact that the farmers had been obliged by state law to supply sugar cane to the factory[126] (that is, the creditors may have been involuntary creditors). But the judge also relied on a precedent that suggested workers were insulated from the moratorium (as to which, see below), reasoning that the position of the farmers was analogous to that of workers[127]. The court ordered the sale of the company's sugar and the disbursement of proceeds to the farmers[128].

Two other cases confirm the occasional insulation of involuntary creditors from the operation of the moratorium. In the fascinating case of *AS Nizar Ahmed & Company Ltd v Collector of Velore District*[129], a judge of the High Court of Madras held that section 22 was no bar to the enforcement of an environmental compensation order by a state environmental agency. The order, apparently made in response to a chemical spill,

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[124] *Chhabi Rani Agro Industries v Gubeshwari Solvent* (n 110); *Hyderabad Abrasives v Andhra Cements* (n 110); *MD Bhoruka Textiles Limited v M/S Kashmiri Rice Industries* [2009] 150 CompCas 518 (SC).

[125] (2004) 119 CompCas 705 (Karnataka).

[126] ibid [11], (ii).

[127] ibid [12].

[128] ibid [13].

[129] Unreported decision of E Padmanabhan J in the High Court of Madras on 1 April 2002.

required the company to compensate local individuals affected by the spill and pay for the clean-up operation. The judge held that the environmental statute under which the compensation order was made conflicted with SICA and that the later of the two statutes (the environmental statute) should prevail, reasoning:

> The recovery being for persons who have already been subjected to heavy or violent disturbances of environment and sustaining damages and lost their livelihood *requires more preference than a sick company, which tries to delay the reconstruction proceedings*[130].

In *Andhra Printers Ltd v Arjun Rao*[131], it was held that section 22 would not bar proceedings to recover damages in tort (on the facts, the tort of defamation). This decision is treated as authority by one commentator for the proposition that tort claims are generally outside the scope of the moratorium[132].

It is workers, however, who appear to have been most consistently insulated from the application of SICA's moratorium to pre-commencement debts. In a series of cases across the states, section 22 was held inapplicable to employee debts accrued prior to the commencement of SICA proceedings, allowing workers to both litigate their claims[133] and execute judgments against SICA debtors.[134] Judges reached this result by

130 ibid [24].

131 [2008] 141 CompCas 7 (Andhra Pradesh).

132 *Bharat's Sick Industries* (n 2) [22.2].

133 See for example *Rajnagar Textile Mills No. 1 v Textile Labour Association* [1998] 93 CompCas 447 (Gujarat); *Carona Ltd v Sitaram Atmaram Ghag* 2000 (3) AllMR 37 (Bombay); *Bengal Immunity Limited v Mukul Kumar Kar* (2004) 1 CallT 130 (Calcutta); *Duttatraya Laxman Kulkarni v Aurangabad Paper Mills* [2000] (87) FLR 173 (Bombay).

134 See for example *Baburao P Tawade v Hes Ltd Bombay* 1995(4) BomCR 144 (Bombay); *Parmeshwarnarayan v Collector* (2000) 1 GLR 521 (Gujarat); *Allwyn, A Unit of Voltas Ltd. v Deputy Labour Commissioner* [2000] 100 CompCas 694 (Madras); *Siruguppa Sugars and Chemicals Limited v Commissioner of Labour* 2002 (3) KarLJ 273 (Karnataka) (but see also the discussion of the appeal below n 142); *Mideast India Ltd v Shri KM Unni* [2003] 115 CompCas 184 (Delhi); *Ranjan Bhagwant Kedar v HMP Engineers Ltd* (2004) III LLJ 939 (Bombay); *K Logachandran v District Collector* (2009) 3 MLJ 440 (Madras); *cf Gujarat Factory and General Kamdar Union, Godhara v State of Gujarat* (1999) I LLJ 799 (Gujarat) and *Cement Corporation of India v P/O, Central Government Industrial Tribunal* (2002) II LLJ 405 (Punjab & Haryana), suggesting the need for BIFR consent before

different routes, including parliamentary intention ('the provisions of the Industrial Disputes Act cannot be controlled or intended to be curtailed by incorporation of section 22')[135], relative vulnerability ('a workman who is much sicker than a purported sick company')[136], and the constitutional right to life:

> Wages and terminal benefits to which the workers are entitled, must constitute and deemed to be part of their right to life. They are the minimum required for their sustenance and of their families. It is impossible in these situation to consider that for the purpose of rehabilitation of an industry workers must be denied their legitimate dues[137].

The plight of some of the workers who succeeded in recovering from SICA debtors was undoubtedly severe. Take, for example, the case of *K Logachandran v District Collector*[138], in which a worker had lost a limb in a workplace accident, and obtained an order for compensation from his employer. After the order was made, the company entered SICA proceedings, and it subsequently relied on section 22 to resist payment. The Madras High Court judge was ultimately moved by the worker's vulnerability to hold that section 22 would not bar enforcement of the compensation order[139]:

> A company which has become sick wants to revive; whereas a poor workman who has fallen sick struggles to survive; Revival or Survival?,

execution of claims for back-pay but not for the initial proceedings. See also *Bharat's Sick Industries* (n 2) [22.57]: 'Several courts have held that the provisions of section 22 will not stand in the way of workers making recovery of wages'.

135 *Parmesharnarayan* ibid [7].

136 *Bengal Immunity* (n 133) [13]; see also *Swadeshi Cotton Mills v Assistant Labour Commissioner* 2000 (1) AWC 591 (Allahabad), [16].

137 *Carona Ltd v Sitaram Atmaram Ghag* (n 133) [7]; see also *Rabindra Nath Banerjee v Certificate Officer* (2005) III LLJ 85 (Calcutta).

138 (n 134).

139 Again, a highly creative 'trust' analysis was employed: ibid [29], and above text to n 120.

> which overtakes the other?
> Seeking answer to these questions, a poor workman who has lost his right arm while at work 10 years ago, knocks at the doors of this Court for justice…
> One cannot expect the poor workmen who have lost their limbs to wait for the company getting rehabilitated in due course of time… Not only he, but his entire family would be left in the lurch… This Court cannot be blind to the agonies and anguish of poor workmen when they knock at the doors… praying for justice[140].

The judge in *Logachandran* perceived a contest between the SICA company and its workers, but the real contest was between workers and other creditors, creditors who *were* barred by the moratorium from recovery of pre-commencement debts. As with the first innovation, it seems clear that some judges who insulated workers from the application of section 22 to pre-commencement claims were influenced by their knowledge that, in a liquidation of the SICA debtor, workers would enjoy a preferential status[141]. Again, however, the effect of this innovation was in fact to significantly *elevate* the position of workers vis-à-vis secured creditors: workers who succeeded in persuading judges not to apply section 22 recovered *in full* and in advance of any winding-up, rather than being forced to wait, and then share *pari passu* with secured creditors[142].

8.2.4.2 Post-commencement debts

The absence of any provision in SICA to govern the treatment of liabilities incurred after the commencement of SICA proceedings appears to have generated a great deal of

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140 ibid [1], [31].

141 See for example *Carona Ltd v Sitaram Atmaram Ghag* (n 133) [7].

142 It is not clear to what extent secured creditors' security was also compromised in these cases: in one case (*Siruguppa Sugars and Chemicals Ltd v Commissioner of Labour* 2002 (3) KarLJ 273 (Karnataka)), a judge went as far as to expressly order enforcement of a worker claim by sale of property (stock) the subject of a security interest, despite the objections of the security holder (a bank). But this decision did survive a recent appeal (*Central Bank of India v Siruguppa Sugars and Chemicals Ltd* AIR 2007 SC 2804).

confusion in the civil courts. In some cases, judges confined the moratorium to pre-commencement liabilities, allowing post-commencement creditors to recover[143]. In others, judges distinguished between liabilities incurred after the commencement of SICA proceedings and liabilities incurred after the sanctioning of a rehabilitation scheme, allowing recovery only because the claims were ones arising after the sanctioning of a scheme[144]. In some cases, post-commencement creditors were barred by section 22 from recovering from a SICA debtor[145]. The only category of creditor that appears to have consistently escaped the application of section 22 was workers, judges almost always ordering the payment of worker entitlements arising after the commencement of SICA proceedings[146]:

> [SICA] is intended to make efforts for rehabilitation of the sick industrial companies, but it does not mean such rehabilitation can be made on the heaps of the skeleton of human beings. Pending rehabilitation, the workmen and their families cannot be forced into starvation.[147]

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[143] See for example *Tungabhadra Industries Ltd v Crown Oil and Dal Industries* [2002] 109 CompCas 468 (Karnataka); *Ashiana Paper Mills Pvt. Ltd v Punjab State Electricity Board* AIR 2008 P&H 119 (Punjab and Haryana); *Balaji Distilleries v Secretary to Government* (n 10).

[144] See for example *Pranami Press v Vinedale Distilleries Ltd* [1998] 94 CompCas 926 (Andhra Pradesh); *Taulis Pharma Ltd v Bengal Immunity Ltd* [2002] 108 CompCas 237 (Calcutta); *Unilab Chemicals & Pharmaceuticals v Smith Stanistreet Pharmaceuticals Ltd.* 1999 (2) AllMR 497 (Bombay); *Indian Steel and Wire Products Ltd v Kothari Metals* AIR 2007 Cal 207 (Calcutta); *Dewan Sugars Ltd v Central Government through Secretary, Finance* AIR 2009 All 2 (Allahabad), all relying on the Supreme Court's decision in *Deputy Commercial Tax Officer v Corromandal* (n 107), in which the Court held that s 22 did not bar the recovery of sales tax accruing after the sanctioning of a scheme.

[145] See for example the difficult decision of the Supreme Court in *Jay Engineering Works Ltd v Industry Facilitation Council* AIR 2006 SC 3252; *Bharat Heavy Plate and Vessels Ltd v Assistant Commissioner of Central Excise, Division II* [2006] 133 CompCas 41 (Andhra Pradesh) and *Eastern Steels v Fort Gloster Industries Ltd* [2008] 142 CompCas 543 (Calcutta), both decided on the basis that a scheme had not yet been implemented.

[146] See for example *Indian Plywood Manufacturing Company Limited v Commissioner of Labour, Karnataka* (1999) I LLJ 441 (Karnataka); *ISPL Industries Ltd. v SJ Mehta* [2003] 115 CompCas 726 (Gujarat); *Uptron India Ltd v Presiding Officer, Labour Court* (2004) II LLJ 378 UC (Uttaranchal); *Sarvaraya Textiles Limited v Commissioner, Employees Provident Fund Commission* [2002] 108 CompCas 406 (Andhra Pradesh); *Rashtriya Kamgar Sanghatana v GKW Ltd* 2004 (6) BomCR 182 (Bombay).

[147] *Indian Plywood* ibid [7].

Extraordinarily, the cases suggest that some workers continued to be paid wage entitlements during SICA proceedings *even after the company's factory had closed*: numerous cases record the payment of so-called 'idle wages' to workers[148]. A second factor – restrictive labour laws – meant it was very difficult for some SICA companies to choose to close industrial units, or to keep them open but retrench some of the workforce. It was this combination of factors that caused one employer in a SICA case to write this in a letter to the Bombay High Court:

> I submit that no workman can quibble or otherwise crib about his employment, on the one hand, and continue to stick or stay in the employment on the other, when it is clear that the employer is unable to run the employment, and is being forced to do so only because of some archaic and quaint labour laws, which have no relevance in the present changed scenario of doing business. I say that if the workmen are so unsatisfied with their employment, they should quit the employment voluntarily and stop mulching the company of wages, for receiving which wages concomitantly and admittedly in the first instance the workmen have no work to perform[149].

How were workers paid by loss-making or closed enterprises? The cases reveal payment or attempted payment by a number of different mechanisms, including grants by state governments, both directly[150] and indirectly (including most significantly by a range of state sales tax deferment schemes, which permitted companies to treat sales tax collected from customers as a 'loan', repayable years later, and apply the funds to running costs)[151];

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148 See for example *Shankar Vasudeo Masurkar v Shree Sitaram Mills* 2002 (3) BomCR 156 (Bombay); *Cement Corporation Employees Union v Union of India* (2009) II LLJ 347 (Madhya Pradesh); *Rahnagar Textile Mills No.1 Ahmedabad v Textile Labour Association, Ahmedabad* [1998] 93 CompCas 447 (Gujarat).

149 *Rashtriya Kamgar Sanghatana v GKW* (n 146) [15]. The workers succeeded in their action for wage recovery.

150 As reported in *Gujarat Trade Union Manch v Gujarat State Textile Corporation* [2000] 99 CompCas 461 (Gujarat).

151 As in *D Kamalakar Rao v State of Andhra Pradesh* [2002] 127 ST 306 (Andhra Pradesh); *Re U.P. Cement Corporation Ltd* [2002] 112 CompCas 562 (Allahabad), both of which expressly suggest the deferral scheme was designed to enable wage payments. For an example of a state statutory scheme for sales tax deferment

by directions to state government[152] or the state-owned parent company of a SICA company[153] to pay wages directly to employees of state-owned SICA companies (although neither of these orders survived appeal); and by interim asset sales[154].

8.3 Conclusion: SICA's failure reconsidered

Existing explanations for SICA's controversial 'pro-debtor' or 'anti-creditor' functionality focus primarily on SICA 'on the books', and only to a limited extent on SICA 'as applied' in the BIFR and by the civil courts. Puzzlingly, however, SICA *does*, as it appears on the books, seem capable of delivering a swift liquidation for economically distressed debtors. SICA's drafters equipped institutional creditors with power to 'veto' rehabilitation schemes for the unviable (section 19), and they entrusted the decision to liquidate to the BIFR, insulating such decisions – despite protest – from merits review by the civil courts (section 20). Why did SICA nevertheless in fact fail to deliver, even after institutional creditors increasingly exercised their veto in the post-liberalisation period?

The evidence uncovered in this chapter points to the courts, where judges diluted the BIFR's liquidation power, encouraged the pursuit of further (however futile) attempts

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for sick industrial companies, see *Commercial Tax Officer v Rastogi Steel Furniture* [2004] 135 STC 117(Rajasthan).

152 See the Supreme Court decision in *State of U.P. v Uptron Employees Union* AIR 2006 SC 2081, overturning an order at first instance that the State of Uttar Pradesh pay the outstanding wages of the employee of a SICA company. It is not clear if the decision at first instance was that in *Cement Workers Union v BIFR* [2000] 100 CompCas 76 (Allahabad), where a judge ordered wage payments by the State of U.P.

153 See the Supreme Court decision of *Punjab State Industrial Dev. Corporation Ltd v P.N.F.C. Karamchari Sangh* II (2006) BC 559 (SC), overturning an order at first instance in the liquidation of a SICA company that the veil be pierced to enable payment of wages by a state government (46.13%) shareholder.

154 As in *Binny Limited v AAIFR* AIR 2004 Mad 198 (Madras) [5]; *NGEF Ltd v Chandra Developers Pvt Ltd* [2005] 127 CompCas 822 (SC); *Dunlop Factory Employees Union v Dunlop India Ltd* [2005] 125 CompCas 820 (Madras); *Rashtriya Kamgar Sanghatana v GKW* (n 146) [5]. Where the assets being sold were subject to security in these cases, the secured creditors appear to have shared with workers in the sale proceeds (*NGEF*; *Dunlop;* also contemplated in *Binny*).

at rehabilitation, and both protected and elevated the position of SICA workers (and, on occasion, other classes of 'vulnerable' creditor) in the resulting period of delay. These innovations are not necessarily surprising, given SICA's historical context. The history of industrial sickness in India, as described in Chapter 4 of this thesis, is essentially a history of policies resisting the liquidation of sick industrial companies, at least in part so as to protect or appease their workers. The effect of the judicial innovations documented here was to preserve this historical approach at a time when it had come under threat from economic liberalisation (and especially the liberalisation of the financial sector, previously integral to the delivery of the state's rescue policy). Whether this was an act of judicial 'resistance' to liberalisation is unclear. A plausible alternative interpretation might be that the innovations were a product of the ambiguity created by a lack of robust dialogue on the relationship between liberalisation and historical industrial sickness policy,[155] a reflection perhaps of the political sensitivity of the question.[156] Whatever the motivation, however, the evidence of these judicial innovations suggests that the courts should be given a more central place in any explanation of the operation of India's corporate rescue procedure for industrial firms, as they ought to in explanations of the operation of India's liquidation procedure.

[155] See Chapter 7, text to n 139.

[156] See Chapter 7, text to n 53.

CHAPTER 9

CONCLUSION

This thesis reports the results of an in-depth study of the introduction, development and demise of India's two principal insolvency procedures for corporate debtors. Problems of delay and associated harms to creditors in the operation of these two procedures have been well documented, but there has been surprisingly little scholarly investigation into why the procedures operate in this way. The research that has been done to date (relating mostly to the SICA rescue procedure)[1] has often focused on the law 'on the books', alleging various deficiencies in the drafting of the statutory provisions. Little research appears to have been done to investigate how judges have approached their task of interpreting and applying these statutory provisions. This thesis reports the results of what is believed to be the first systematic analysis of a large body of Indian insolvency case law, revealing a series of innovations by judges in their implementation of the principal insolvency procedures. The evidence of these innovations suggests that the courts (and in particular, judges) played a much greater role in influencing the 'anti-creditor' operation of insolvency law than the existing literature suggests.

This short chapter summarises the key findings that emerged from Part I (on liquidation procedure) and Part II (on the SICA rescue procedure), and then considers some of their implications for the broader literature on law and finance (and law and development more generally) that was introduced in Chapter 2 of this thesis.

[1] There has been very little research on the operation of the liquidation procedure: see Chapter 4, text to n 126.

9.1. The thesis findings

9.1.1. Liquidation

Part I of the thesis was devoted to considering the liquidation procedure of the Companies Act 1956. It began by examining the introduction of the procedure in the colonial period, tracing the transplant of statutory provisions from successive UK company statutes[2] into successive company statutes in British India. As Chapter 3 explained, this was part of a broader transplantation project, driven by a desire to offer investors a uniform company law across the Empire[3]. Today, some sixty-five years after the end of colonial rule, India's liquidation procedure remains very similar on the statute book to that of the United Kingdom. In practice, however, the two procedures function entirely differently. During India's planned economy period, state policy on industrial sickness, and on the role of the financial sector more generally, may have somewhat reduced demand for an efficient company liquidation procedure[4]. But there appears to be a much greater demand for efficiency in India's modern market economy. The question therefore is why the procedure has proved incapable of meeting this demand, given the success of its progenitor in the UK. One explanation suggested by the existing (limited) literature points to the most significant area of formal difference between the Indian and UK procedures – their allocation of responsibility for the administration of compulsory liquidation (India asking relatively more of its superior courts, judges, and state liquidators) – and suggests that this difference 'on the books' may explain

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[2] And more exceptionally from English case law: see Chapter 3, text to n 53.

[3] Text to n 69.

[4] See Chapter 4, from text to n 101.

differences in practice: the 'administrative capacity', or resource constraint, hypothesis[5]. But the literature also suggests that some delays may have been caused by judges who were unwilling to make winding-up orders without first allowing debtors to reach an agreement with their creditors[6].

The central contribution of Part I is its report of a review of all available judgments on a creditor's petition to wind-up an Indian company on the basis of its inability to pay its debts, inspired by the brief suggestion in the existing literature of judicially-imposed delays in compulsory liquidation. The inquiry revealed (as reported in Chapter 5) how judges: (a) developed a time-consuming procedure for the admission of petitions[7], (b) developed a procedure to permit debtors to escape admission of a petition or the making of a winding-up order by payment to the petitioning creditor over time[8], and (c) added complexity to the meaning of 'inability to pay debts' and uncertainty to the exercise of their discretion in relation to companies found to be so unable[9], further weakening the position of petitioning creditors already prejudiced by the delays and uncertainties associated with the imposition of innovations (a) and (b). This evidence substantiates the suggestion in the existing literature of judicially imposed delays, and suggests that it should be elevated to fully compete with the 'administrative capacity' (resource constraint) account that appears to have led the reform agenda to date.

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[5] See Chapter 4, text to n 139.

[6] See Chapter 4, text to n 153.

[7] Chapter 5, section 5.2.1.

[8] Chapter 5, section 5.2.2.

[9] Chapter 5, section 5.2.3.

9.1.2. Rescue

Part II of the thesis was devoted to considering the rescue procedure in the Sick Industrial Companies (Special Provisions) Act 1985. It began with the history of the introduction of SICA, identifying the Act as one in a series of government responses to the problem of industrial sickness in the planned economy period. The history of industrial sickness policy in the planned economy period (as explained in Chapter 4 of the thesis)[10] is at its simplest a history of state generosity to industrial debtors, fuelled by an anxiety to promote the development of Indian industry and to protect workers in it. One of the conduits of the state's generosity was the financial sector, which was mobilised from the early 1980s to deliver coordinated rehabilitation packages to insolvent (even unviable) industrial debtors[11]. As Chapter 7 revealed, this policy persisted after the enactment of SICA. In the early years of SICA's operation, the RBI expressly directed institutional creditors to support the rehabilitation of SICA debtors, rendering the formal power of these creditors to veto such schemes (under section 19) somewhat illusory[12]. The position changed on the liberalisation of the financial sector, and India's newly autonomous (and increasingly competitive) institutional creditors reportedly increasingly resisted supporting the rehabilitation of sick industrial debtors[13]. Those debtors were not, however, forced into liquidation. Instead, they have been sheltered from debt enforcement and liquidation proceedings by the SICA procedure, under which the

[10] Text to n 44 and following.

[11] Chapter 4, text to n 68 and following.

[12] Chapter 7, text to n 116 and following.

[13] Chapter 7, text to n 138 and following.

prolonged exploration of rehabilitation prospects (even in 'highly unviable' cases) has enabled asset siphoning and the extraction of further concessions from creditors[14].

To date, attempts to explain SICA's 'pro-debtor' or 'anti-creditor' operation have focused mainly on the law 'on the books', emphasising the formal features of the Act that might assist debtors in their avoidance or coercion of creditors (a moratorium of indefinite duration; the interim protection of management)[15]. Less has been written about the features of the Act that appear, on a plain reading, to be rather more empowering of *creditors*: in particular, section 19, which gifts institutional creditors with power to veto any rehabilitation scheme; and section 20, which enables the BIFR to issue a liquidation opinion that is apparently binding on the High Court that receives it, thus enabling the delays ordinarily associated with the making of a compulsory liquidation order to be circumvented. These features suggest that SICA's administrators – the BIFR and the courts – *are* on a plain reading empowered to deliver the speedy liquidation of SICA debtors. There appears to be little explanation for the reports of extreme delays in the issuing of liquidation opinions by the BIFR and their disposal in the High Courts, apart from occasional references in the literature to a rescue bias in the BIFR[16], and the suggestion that courts have been delayed by judicial review challenges to liquidation opinions by stakeholders (and, according to one commentator, by their willingness of some judges to reconsider the merits of those opinions)[17].

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[14] Chapter 7, text to n 33.

[15] Chapter 7, section 7.2.

[16] Chapter 7, text to n 92.

[17] Chapter 7, text to n 101.

The central contribution of Part II of the thesis is its report of a review of all judgments relating to SICA companies (and former or prospective SICA companies), designed to gather evidence of the performance of SICA's administrators. The dataset did not include decisions of the BIFR, which are not available to researchers, and so could offer at best only indirect evidence of its performance. The core results of the review related to the performance of the courts, which are formally responsible for giving effect to the liquidation opinions of the BIFR, and for entertaining applications for judicial review (but not merits review) of the decisions of the BIFR and the Appellate Authority. The cases revealed (as reported in Chapter 8) how judges (a) diluted the BIFR's power to issue binding liquidation opinions, formally enabling reconsideration of the merits of such opinions by the High Courts[18], (b) encouraged the pursuit of further attempts at the rehabilitation of SICA debtors after the failure of such attempts in the BIFR[19], and (c) protected and elevated the position of workers (and, on occasion, other classes of 'vulnerable' creditor) in the period of delay associated with innovations (a) and (b)[20]. These innovations, which are mostly unreported in the existing literature, appear central to explaining the evidence of extreme delays (and associated harms to creditors) in the liquidation of SICA debtors.

9.1.3. Articulating the core claim

The findings in Parts I and II suggest that the role of the courts (and, in particular, the role of judges) has been significantly underestimated in attempts to explain the record of

[18] Chapter 8, section 8.2.3.

[19] Chapter 8, section 8.2.2.

[20] Chapter 8, section 8.2.4.

lengthy delays and associated harms to creditors in the disposal of formal insolvency proceedings in India. Put more simply, the evidence of judicial innovation suggests that the courts are far more implicated in the 'failure' of corporate insolvency law in India than the existing literature suggests. This is the core claim of the thesis. The claim is not that these innovations are the only significant source of delay in India's liquidation and SICA rescue procedures. More work needs to be done to evaluate the allegations of resource constraints in the courts and, more generally, to investigate the factors that were causative of delays in the BIFR (if research access can be negotiated). But the evidence uncovered in the thesis provides very good evidence of innovations that added significantly to delays under both procedures. The evidence should therefore feature prominently in any attempt to explain those delays.

9.2. Some implications of the thesis findings: the literature on law, finance and development revisited

The thesis is almost entirely dedicated to the close study of India's two formal corporate insolvency procedures. This study generates the key findings of the thesis, which help to answer the (previously neglected) question of how and why this particular part of Indian law developed as it did. But the study was prefaced by a brief introduction to some literature on a much more general subject: the subject of the relationship between law and financial development. Chapter 2 explored some of the connections between this literature and the subject of the thesis, explaining for example how the insolvency law reform agenda in India has been influenced by the broader work of policy-makers and academics on the impact of insolvency law and 'creditor rights' on financial development. The purpose of this final section is to sketch, in very preliminary terms, some of the implications of the story of corporate insolvency law in India for literature on the relationship between law and finance, and law and development more generally.

As Chapter 2 explained, one of the outputs of the 'legal origins' project was the development of new tools for the comparative assessment of corporate insolvency laws across countries, including an index for measuring the *ex post* efficiency of those laws – the index now used as the 'Resolving Insolvency' measure in the World Bank's *Doing Business* report[21]. The *Doing Business* insolvency measure is (as noted in Chapter 4)[22] widely cited as evidence of the 'failure' of corporate insolvency law in India. For the official committees that have been tasked with evaluating Indian insolvency law by comparison with the law and practice of other jurisdictions, the *Doing Business* report has offered straightforward evidence of the relative weakness of the Indian regime, and with it a mandate for reform[23]. Perhaps as a consequence, there appear to have been few attempts by these committees or others independently to gather evidence on how the existing law works in India, and why it works this way[24]. The evidence revealed in this thesis features barely, if at all, in the series of official committee reports that have driven insolvency law reform in India to date. And yet this evidence appears to be central to the efficacy of proposed reforms. The proposal to transfer adjudicatory responsibility for liquidation from the High Courts to a newly constituted tribunal, for example, was premised on the

[21] See Chapter 2, text to n 140.

[22] Section 4.1.1.

[23] See for Expert Committee on Company Law, 'Report on Company Law' (31 May 2005) [7.3] <www.acga-asia.org/public/files/JJ%20Irani%20Report.pdf > 27 August 2012; Advisory Panel on Institutions and Market Structure, *India's Financial Sector: An Assessment* (Foundation Books 2009) ch VI.

[24] With the exception of the Eradi Committee, which did gather some data: 'Report of the High Level Committee on Law Relating to Insolvency and Winding up of Companies' (the 'Eradi Committee Report') (31 July 2000), extracted in DP Mittal, *Taxmann's New Law Relating to Sick Industries* (Taxmann 2003) Appendix 6.

assumption that delays in the courts were to a significant extent a product of resource constraints[25]. The evidence revealed in this thesis suggests, however, that delays are by no means simply a product of resource-constraints: judicial practice and procedure in compulsory liquidation (the lengthy pre-admission procedure; the pay-to-exit procedure) appears to be a significant source of delay. This suggests that significant reductions in delay could be achieved *within* the High Courts by reform to practice and procedure, and moreover that *without* such reform, the mere transfer of liquidation procedure from one part of the legal system to another may not in fact significantly reduce delay[26]. In other words, for the existing system to be reformed, it must be well understood. This requires the gathering of much more detailed evidence than the *Doing Business* report or other comparative insolvency assessment tools can provide.

It might be argued that the *Doing Business* report is not intended to act as a substitute for in-depth analysis, but only as a preliminary diagnostic tool: a tool for identifying where 'a problem exists' and for pointing to 'specific regulations or regulatory procedures that may lend themselves to reform'[27]. But the Indian case suggests that there may be some risks associated with the uncritical application of *Doing Business* as a diagnostic tool. To diagnose 'problems' the *Doing Business* report must have a measure or standard of success, and the standard used in the 'Resolving Insolvency' component of the report is (as explained in Chapter 4)[28] *ex-post* value-maximisation. Legal systems are

[25] ibid [5.6].

[26] One relevant factor could be the extent to which appointments to the tribunal are made from the High Court judiciary.

[27] World Bank, 'About *Doing Business*: measuring for impact' (2012) <http://www.doingbusiness.org/~/media/FPDKM/Doing%20Business/Documents/Annual-Reports/English/DB12-Chapters/About-Doing-Business.pdf> 31 August 2012.

[28] Text to n 4.

ranked according to their ability to maximise the value of the assets of an economically viable but financially distressed debtor for the benefit of its creditors. The utility of this ranking as a diagnostic tool (a way to identify a 'problem') in any one jurisdiction will depend on the extent to which that jurisdiction also measures (or wishes to measure) the law's success by its ability to maximise value for creditors. In practice, however, countries differ markedly in the extent to which they endorse the value-maximisation goal:

> What is clear from any comparative survey is that the role of corporate insolvency law cannot be constructed in the abstract, and that the extent to which the law of a particular country adheres to or deviates from the principle of collective maximisation of returns for creditors in an insolvency is directly related to its pre-insolvency social and economic policy[29].

During the planned economy period in India, the value maximisation goal appears to have been afforded little weight in insolvency law and policy. Instead, both the state (in its industrial sickness policy)[30] and the courts (in their development of liquidation law more generally)[31] appear to have increasingly focused on the avoidance of liquidation *per se*, motivated at least in part by an anxiety to protect workers. In the market economy period, judges continued to endorse this goal, working to avoid the liquidation of insolvent companies by (in the case of liquidation) entrenching rescue strategies developed in the planned economy period[32], and (in the case of SICA) developing new strategies. The history of the development of this pro-rescue, anti-liquidation philosophy

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[29] Roy Goode, *Principles of Corporate Insolvency Law* (4th ed, Sweet & Maxwell 2011) [2-22].

[30] See Chapter 4, text to n 44.

[31] See Chapter 5, section 5.2.2 and section 5.2.3, 'Discretion'.

[32] Particularly the pay-to-exit order, and the pre-admission hearing procedure (the first two judicial innovations considered in Chapter 5).

is barely acknowledged in official reports on insolvency law in India[33]. Reformers have for the most part presented the value-maximisation (efficiency) goal as axiomatic, drawing on the *Doing Business* report to evidence the law's failure without acknowledging that the utility of its diagnosis is premised on a paradigm shift in insolvency philosophy[34]. This approach may well imperil the efficacy of reforms: in the absence of robust dialogue about the function of insolvency law in India's market economy, judges may well continue to give effect to the historically entrenched pro-rescue, anti-liquidation philosophy in the interpretation and application of new laws.

Legal origin theory identifies the judiciary as a site of 'structural difference' between the common law and (French) civil law traditions that may help to explain the evidence of origin's persisting effect. As Chapter 2 explained, one strand of this literature focuses on the *flexibility* of the common law judiciary, suggesting that differences in financial development across countries may be linked to the ability of judges to adapt the law to respond to 'changing economic conditions', the common law system offering (by its tolerance of judicially-developed rules, and of 'judicial discretion')[35] the greatest flexibility to do so[36]. In this theory, judicial flexibility is identified as a system advantage that equips courts to act to swiftly close 'gaps' between

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[33] With the exception of the Goswami Committee Report ('Report of the Committee on Industrial Sickness and Corporate Restructuring', extracted in HPS Pahwa, *Bharat's Sick Industries & BIFR* (8th ed, Bharat Law House 2009) Appendix 1), which did acknowledge that its proposals for efficiency-oriented reform would require a 'move away from the primacy of protection and nurturing the sick' ([3.4]), as noted in Chapter 7, text to n 51.

[34] See for example see Expert Committee on Company Law, 'Report on Company Law' (31 May 2005) ch XIII <www.acga-asia.org/public/files/JJ%20Irani%20Report.pdf > 27 August 2012.

[35] Thorsten Beck, Asli Demirgüç-Kunt, and Ross Levine, 'Law and finance: why does legal origin matter?' (2003) 31 *Journal of Comparative Economics* 653, 660.

[36] ibid 660 and 655; Chapter 2, text to n 113.

the needs of the economy and the legal system[37]. The basic lesson of the Indian insolvency case is that judicial flexibility can equally be exercised in ways that widen these gaps: that position the law against the market. The judicial development of a 'third chance' rehabilitation procedure under SICA, for example, allowed debtors to evade (at least for a time) the efficiency-oriented reforms associated with economic liberalisation, reforms that were intended to propel 'unviable' industrial debtors into liquidation. In liquidation law, the judicial entrenchment of the pre-admission hearing and the pay-to-exit procedure similarly coincided with economic liberalisation[38], resulting in delays that diminished the attractiveness of liquidation procedure to creditors at precisely the moment when they might have been expected to rely increasingly upon it. The effect of these innovations was to create something of a buffer between debtors (and, perhaps most importantly, their workers) and the demands of an increasingly competitive market. The evidence of these innovations suggests the need for a more nuanced account of the merits of judicial flexibility than that offered in existing legal origin theory: an account that explores in far more detail the particular factors (not only economic, but also socio-political) that may influence the exercise of judicial 'flexibility' in the common law tradition.

9.3. Concluding thoughts

Understanding the operation of corporate insolvency law in India requires much more than an analysis of the statutory provisions of the Companies Act 1956 and of SICA. The formal law is an amalgam of statutory and judge-made rules (part procedural; part

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[37] ibid (though not necessarily in the most efficient way possible: The Economic Consequences of Legal Origins' (2008) XLVI *Journal of Economic Literature* 285, 305).

[38] See Chapter 5, text to n 39 and n 83.

substantive), and the latter are at least as (if not more) important to understanding the law's operation as the former. This point may appear trite, but the fallacy of equating the formal law with the statute book appears to be widespread (perhaps because it is as old as company law in India: the transplantation project was premised on the assumption that uniformity of company law in the Empire could be achieved by the transplant of the statutes to the colonies). More fundamentally, India's corporate insolvency law cannot be understood if divorced from its history (especially the history of the development of the law in the planned economy period) or from its context (both economic, and socio-political). In other words, only in-depth analysis will do.

APPENDIX I: LIQUIDATION DATA

Company liquidations and registrations over time

Year ending	Total companies limited by shares registered	Total companies wound up	Source of data in bold
1957	*848*	**313**	*Joint Stock Companies in India*
1958	961	469	
1959	*1,095*	**531**	*Joint Stock Companies in India*
1960	*1,452*	**264**	*Joint Stock Companies in India*
1961	*1,683*	**276**	*Joint Stock Companies in India*
1962	*1,614*	**231**	*Joint Stock Companies in India*
1963	*1,497*	**280**	*Joint Stock Companies in India*
1964	1,227	**332**	*Joint Stock Companies in India*
1965	1,365	294	
1966	1,341	322	
1967	1,039	282	
1968	1,044	249	
1969	1,115	230	
1970	1,510	226	
1971	1,927	238	
1972	*2,524*		
1973	*2,860*	*206*	
1974	3,777	155	
1975	*3,696*		
1976	*2,988*		
1977	**2,649**	*168*	*Alphabetical List of Joint Stock Companies in India*
1978	2,668	213	
1979	3,488	192	
1980	*4,986*		
1981	*6,616*		
1982	10,019	110	
1983	*10,764*	*111*	
1984	11,619	113	
1985	13,347	125	
1986	15,056	140	
1987	16,311	152	
1988	**17,578**		*Registration and Liquidation of Joint Stock Companies*
1989	*21,891*		
1990	*21,597*		
1991	*22,342*		
1992	*26,145*		
1993	25,511	61	
1994	*30,291*		
1995	*47,928*		
1996	56,326	93	
1997	*42,551*		
1998	*33,938*		
1999	28,137	128	
2000	*31,289*		
2001	*27,187*		
2002	21,059	574	
2003	*24,051*		
2004	*30,076*		
2005	*40,059*		
2006	54,020	464	
2007	51,708	324	
2008	65,359	376	
2009	64,582	196	
2010	67,570	225	

Grey shading: sourced from Annual Report on the Working and Administration of the Companies Act 1956 for that year

Italics: data taken from subsequent Annual Report on the Working and Administration of the Companies Act 1956 (report for that year not available)

Bold: sourced other than from the Annual Report on the Working and Administration of the Companies Act 1956 (see source column)

Note: the liquidation data for 2001-2001 (574 liquidations) is inconsistent with other data set out in that Annual Report

Year ending	Total companies in liquidation	Total in compulsory liquidation	Total in creditors' voluntary liquidation	Total in members' voluntary liquidation	Total in winding up subject to supervision
1964	2728	1000	495	1205	28
1965	2675	1020	478	1148	29
1966	2659	1032	460	1128	29
1967	2742	1037	458	1218	29
1968	2841	1023	471	1316	31
1969	2962	1025	516	1389	32
1970	3085	1114	526	1404	41
1971	3245	1153	558	1493	41
No data available					
1974	3340	1137	515	1590	98
No data available					
1978	3402	1420	563	1388	31
1979	3512	1488	581	1414	29
No data available					
1982	3694	1599	638	1430	27
No data available					
1984	3684	1672	603	1381	28
1985	3041	1347	490	1176	28
1986	3826	1773	603	1394	56
1987	3636	1970	405	1192	69
No data available					
1993	4777	2557	616	1579	25
No data available					
1996	4891	2667	612	1596	16
No data available					
1999	5087	2889	606	1576	16
No data available					
2002	5357	4077	159	1118	3
No data available					
2006	6444	5025	148	1268	3
2007	6653	5180	138	1332	3
2008	6133	4764	112	1254	3
2009	6155	4758	112	1282	3
2010	6119	4785	100	1231	3

Source: author compilation of data contained in Annual Report on the Working and Administration of the Companies Act 1956

APPENDIX II: FEATURES OF DATASET OF LIQUIDATION CASES

Cases in dataset by year:

Year	No.	Year	No.	Year	No.	Year	No.	Year	No.	Year	No.
1961	1	1971	2	1981	5	1991	4	2001	24	2011	11
1962	0	1972	0	1982	6	1992	10	2002	25		
1963	1	1973	0	1983	5	1993	8	2003	19		
1964	1	1974	3	1984	5	1994	10	2004	37		
1965	1	1975	2	1985	4	1995	10	2005	29		
1966	0	1976	4	1986	3	1996	10	2006	15		
1967	3	1977	2	1987	2	1997	13	2007	17		
1968	2	1978	3	1988	8	1998	27	2008	16		
1969	6	1979	1	1989	7	1999	24	2009	28		
1970	1	1980	0	1990	6	2000	14	2010	19		
Total	*16*		*17*		*51*		*130*		*229*		*11*
											454

Note 1: The search parameters produced no results for 1956-1960
Note 2: The number of cases for 2011 will likely increase over time, as there is typically some delay in the release of reported cases

Cases in dataset by High Court jurisdiction

High Court	Jurisdiction	No. cases in dataset	As % of total
Delhi	National Capital Territory of Delhi	76	16.74
Punjab & Haryana	Punjab, Haryana, Chandigarh	60	13.22
Bombay	Maharashtra, Goa, Daman and Diu, Dadra and Nagar Haveli	58	12.78
Madras	Tamil Nadu, Pondicherry	40	8.81
Andhra Pradesh	Andhra Pradesh	38	8.37
Karnataka	Karnataka	32	7.05
Gujarat	Gujarat	25	5.51
Allahabad	Uttar Pradesh	24	5.29
Calcutta	West Bengal, Andaman and Nicobar Islands	21	4.63
Rajasthan	Rajasthan	18	3.96
Madhya Pradesh	Madhya Pradesh	18	3.96
Gauhati	Assam, Nagaland, Manipur, Meghalaya, Tripura, Mizoram, Arunachal Pradesh	11	2.42
Himachal Pradesh	Himachal Pradesh	10	2.20
Orissa	Orissa	9	1.98
Kerala	Kerala, Lakshadweep	7	1.54
Patna	Bihar	6	1.32
Jharkand	Jharkhand	1	0.22
		454	100

Note: High Courts unrepresented in dataset are Jammu and Kashmir, Chhattisgarh, Sikkim and Uttarakhand

APPENDIX III: PERFORMANCE OF THE BIFR

BIFR performance: cumulative data, 1987-2007

A. Annual Economic Survey	B. Survey date (as at):	C. References received under section 15 (cumulative)	D. References registered (cumulative)	E. Registered references dismissed as non-maintainable (cumulative)	F. Registered references not yet dismissed (D-E) (cumulative)	G. Section 17(2) order made (cumulative)	H. Rehabiitation schemes sanctioned (cumulative)	J. Declared no longer sick after scheme (cumulative)	K. "Dropped", on net worth becoming positive during enquiry (cumulative)	L. Total revived (J+K)	M. Winding up recommended
1988-1989	13.12.1988	880	618		618	52	16				16
1989-1990	31.1.1990	1168	835	128	707	98	69				49
1990-1991	31.3.1991	1382	1020	175	845	124	182				120
1991-1992	31.12.1991	1547	1117	191	926	131	225				155
1992-1993	31.12.1992	1772	1294	234	1060	(No longer reported)	394				191
1993-1994	30.9.1993	1924	1404	272	1132	(No longer reported)	415	16	3	19	242
1994-1995	30.9.1994	2207	1602	334	1268	(No longer reported)	463	(Not reported)	10		343
1995-1996	31.12.1995	2497	1756	383	1373	(No longer reported)	530	(Not reported)	(Not reported)		407
1996-1997	31.12.1996	2692	1853	406	1447	(No longer reported)	404	184	(Not reported)		496
1997-1998	31.3.1998	3148	2145	425	1720	(No longer reported)	625	202	25	227	579
1998-1999	30.11.1998	3441	2404	452	1952	(No longer reported)	609	214	27	241	606
1999-2000	30.11.1999	4001	2841	516	2325	(No longer reported)	646	223	29	252	658
2000-2001	31.12.2000	4575	3296	688	2608	(No longer reported)	557	249	35	284	824
2001-2002	31.12.2001	5192	3759	804	2955	(No longer reported)	550	296	40	336	953
2002-2003	31.10.2002	5675	4204	988	3216	(No longer reported)	575	321	46	367	1057
2003-2004	31.3.2004	6349	4924	1336	3588	(No longer reported)	627	359	58	417	1246
2004-2005	31.8.2004	6457	5029	1345	3684	(No longer reported)	635	367	60	427	1278
2005-2006	31.8.2005	6775	5300	1987	3313	(No longer reported)	637	385	(Not reported)		1306
2006-2007	30.9.2006	6991	5412	1707	3705	(No longer reported)	760	485	127	612	1303

Source: Author compilation of data in the Annual Economic Survey, issued by the Central Government in conjunction with the Annual Budget (see http://indiabudget.nic.in/). The Survey no longer included BIFR data after 2007. The BIFR also publishes some data, but it is in a form that is more difficult to interpret and may be less reliable (see http://www.bifr.nic.in/geninfo.htm, and Chapter 7, text to n 17).

Note 1: In addition to the cumulative total of 49 winding up opinions reported for 1989-1990, the survey also reported one sale of a company to a state government.

Note 2: There is no explanation in the Economic Surveys for why the cumulative totals drop for some measures in some years.

Note 3: In addition to the 1,707 references that had been dismissed as non-maintainable by 2006-2007, a further 218 had been dismissed as duplicate references.

APPENDIX IV: FEATURES OF DATASET OF CASES CONCERNING SICA COMPANIES

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TOTAL
Supreme Court		1	1	1		2	2	1	4	1	3	2	4	9	2	1	4	5	2	9	9	8	3	3	*77*
High Courts																									
Delhi					2	1	4	2	5	7	6	5	5	15	11	7	10	4	8	6	8	7	19	10	*142*
Bombay	1	1	1	1	2	3	3	2	2	1	5	5	14	11	13	6	6	14	5	7	9	5	4	4	*125*
Karnataka	1		2	1	2				1			2	3	1	5	2	3	2	1	1	3	1	3	2	*36*
Allahabad	1	1			1	1		1	3	4	4	3	6	3		6	2		2	4	2	2	2	2	*50*
Gujarat		1	1							2	2	7	3	1	7	4	3	5	7	2	3	9	1	2	*60*
Andhra Pradesh		1		2	2		1	2	5	2	1	4	3	7	6	5	3	1	3	4	1	7	1	1	*62*
Calcutta			1	2	2		1	1	3	1	2	4	6	2	12	4	5	3	3	1	8	6	3	1	*71*
Patna			1							1		3	3	1	1				1						*11*
Rajasthan			1	1		1	4	1	1	1		1		1	1	2	2	1		2	3	1			*24*
Orissa				1								1			1	1	1	1	1	1	1	1	1		*11*
Himachal Pradesh				1			1						1	1	1			1	1	1	1				*9*
Madras					1		3	8	4	2	4	4	4	5	5	7	5	5	4	7	8	14	11	4	*105*
Kerala					1							1	1	1	1			2				4			*11*
Punjab & Haryana						2		1				5	2	2	5	3	1		1	3	2	8	3	3	*41*
Madhya Pradesh							1	1	1	2	1	4	2	7	2	1	2	1	1	1	1	1	1		*30*
Jammu and Kashmir							1		1				1								1				*4*
Jharkhand																1	1		3			1	1		*7*
Uttaranchal																	1	1				2	2		*6*
Chhattishargh																		1							*1*
Tribunals																									
Company Law Board					1		1				3	1	5	2		2	2	1			2	3	2		*25*
Customs Excise and Service Tax Appellate Tribunal (including CEGAT decisions)							1	4				5	5	5	3	2	4	1	2	1	5	5	2	1	*46*
Customs and Central Excise Settlement Commission															1										*1*

APPENDIX IV: FEATURES OF DATASET OF CASES CONCERNING SICA COMPANIES

Monopolies and Restrictive Trade Practices Commission								1							1										*2*
State Consumer Disputes Redressal Commission									1					3			3	1			1	2			*11*
National Consumer Disputes Redressal Commission									1							1	1				1	1			*5*
Income Tax Appellate Tribunal									1	1	1		1		1	2	1	4	1		2	2	1		*18*
Sales Tax Tribunals										3				1	4										*8*
Appellate Authority (BIFR)												1	20	5											*26*
West Bengal Taxation Tribunal														2						1					*3*
Securities and Exchange Board of India																		2	3			1		1	*7*
Securities Appellate Tribunal															3		2		5	2		1			*13*
Debt Recovery Tribunal																		1	2						*3*
Debt Recovery Appellate Tribunal																		4	4	1	2	1	2	1	*15*
TOTAL	*3*	*5*	*8*	*10*	*14*	*10*	*23*	*25*	*33*	*28*	*32*	*58*	*89*	*85*	*86*	*57*	*62*	*61*	*60*	*54*	*73*	*93*	*62*	*35*	**1066**

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