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Bankruptcy Law and Its Impact on Debenture Holder in India

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Abstract
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). Consequently, recovery rates are also very low. With the introduction of new company's act 2013 opened a new hope to companies facing a tough time. Incorporation of NCLT and NCLAT in new act and removal of multiple regulators like BIFR and intervention of High court are good initiative. It also broadened the scope of different types of companies coming under this law. Further chapter 7 and 11 type of codes are required to speed up the re organisation and liquidation process. On rights of debenture holders still things needed to be addressed. SURFAESI act and provisions of DRT's can be further extended to debenture holders in the line of Banks and Financial institutions for recovery of debts.

Key Words: Bankruptcy Law, Liquidation, BIFR, Debenture

Introduction
Insolvency is a situation when liability of a company exceeds its assets or in technical terms net worth which is also known as owner's contribution in a company turns negative. Leading to erosion of fund provided by lenders also known as borrowed fund. Term loans from financial institution or commercial banks and debentures are the major sources of borrowed fund. Insolvency turns into bankruptcy when court intervenes in the matter and gives it a legal status and takes step for refund of money to lender to the bankrupt company. There are separate rules in India for governing term loans and its recovery in case of defaults. Passing of SARFAESI Act and Legalisation of Debt Recovery Tribunals are few of them. Whereas in case of default on interest as well as principal repayment, rules and regulations are different.

Debentures are essential part of long term capital for corporate. Due to tax advantage on interest payment, post tax cost of debenture goes down and it reduces the overall cost of capital to companies. On the other side it carries lesser risk in comparison to equity and also income from debentures is constant. So debentures are win- win situation for both issuer i.e. corporate and investor. Situation gets worsened when a company defaults on payment of interest or principal. Investors are left with no other option but to take a legal recourse available in India to recover their outstanding amount. Although SEBI as a regulator of this instrument has taken some precautionary measure to safe guard the investor in the format of credit rating and made it mandatory for issuers to get their new issue rated by a registered credit rating agency. But this is not a fool proof mechanism to safe guard an investor. Credit rating agency gives an alphabetical rating to each issue in terms of their probability of default for interest or principal repayment. Till date there is no default for highest rated debentures rated by any of the credit rating agency. But there is no substantial evidence for lower rated securities. This paper tries to analyse the prevailing bankruptcy laws in India and how it competes on global arena with other developed economy. On the other side it will try to find out recourse available to debenture holders in case of bankruptcy in India.

Literature Survey

Khanna and Varottil 2012 said that, these include more efficient contract enforcement mechanisms and structures for sell-down of bonds. Contract enforcement can be enhanced by making the benefits of DRT and SARFAESI available to all bondholders rather than only to specific banks and financial institutions. This might at least temporarily minimize risk to bondholders, particularly of the retail variety. Other options for securitization or asset reconstruction under SARFAESI Act must equally be made applicable widely as they would benefit bondholders to sell down and provide an apt exit mechanism.

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). Consequently, recovery rates are also very low… (Chakrabarti et al, 2007). 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… a review of the system for addressing corporate insolvency law… is urgently called for... (Irani Committee, 2005)

Bankruptcy Law in India

Due to continuous loss making, poor planning or non viability of business forces a company to start defaulting on its financial commitments. Subsequently company turns sick and either it needs rehabilitation or liquidation. India does not have a clear law on corporate bankruptcy even though individual bankruptcy laws have been in existence since 1874. The current law in force was enacted in 1920 called the Provincial Insolvency Act. The legal definitions of the terms bankruptcy, insolvency, liquidation and dissolution are contested in the Indian legal system. There is no regulation or statute legislated upon bankruptcy which denotes a condition of inability to meet a demand of a creditor as is common in many other jurisdictions. Winding up of companies is in the jurisdiction of the courts which can take a decade even after the company has actually been declared insolvent. On the other hand, supervisory restructuring at the behest of the Board of Industrial and Financial Reconstruction is generally undertaken using receivership by a public entity.

In case of bankruptcy court orders the liquidation or winding up of a company by selling its asset to return the process to lenders. In India the process of winding up of companies is regulated by the Companies Act and is under the supervision of the court. Although article 19 (1)(g) of the Constitution of India gives freedom to practice any profession or to carry on any occupation, trade or business to the citizens of India, there are restrictions on closure of any industrial undertaking. Such restriction is justified on the ground that it is in public interest to prevent unemployment. As a result of such policy there is a freedom to undertake any industrial activity, but there is no freedom to exit.

In India, in order to tackle the problem of industrial sickness, Government of India had set up a Board for Industrial and Financial Reconstruction (BIFR), under the purview of Sick Industrial Companies (Special Provisions) Act,1985 (SICA). It had been established as a quasi-judicial body in the Department of Economic Affairs, Ministry of Finance, for revival and rehabilitation of potentially sick undertakings and for closure/liquidation of non-viable and sick industrial companies. The Industrial Finance Division of the ministry dealt with the appointment of the Chairman and the Members of BIFR and Appellate Authority for Industrial and Financial Reconstruction (AAIFR) as well as with all the other matters relating to industrial sickness.

Under SICA, it is mandatory for the Board of Directors of a sick industrial company to make a reference and report to BIFR for formulation of revival and rehabilitation schemes and other remedial measures to be adopted with respect to such a company.

The way Industrial sickness was being handled by the BIFR and time taken to settle the things were too long. It forced Government of India to propose to set up National Company Law Tribunal (NCLT) and

National Company Law Appellate Tribunal (NCLAT). Provisions have been incorporated in the Companies Bill, 2011 which has been introduced in the Lok Sabha on 14.12.2011. The establishment of NCLT and NCLAT as specialized Quasi Judicial Bodies with professional approach will have the following beneficial effects:
(i) reduce pendency of winding up cases and shorten the period of winding-up process;
(ii) avoid multiplicity and levels of litigation before High Courts and quasi-judicial Authorities like Company Law Board (CLB), Board for Industrial and Financial Reconstruction (BIFR) and Appellate Authority for Industrial and Financial Reconstruction (AAIFR) as all such matters will then be heard and decided by NCLT;
(iii) the appellate procedure will be streamlined with an appeal against order of the NCLT lying before NCLAT and with further appeal against the order of NCLAT lying with the Supreme Court only on points of law, thereby reducing the delay in appeals; and

(iv) the burden on High Courts will be reduced and BIFR and AAIFR will be dissolved.
The tribunal is to be set up under the Companies Act, 2013. The legislation is being implemented by the Corporate Affairs Ministry. The plan is to have to have about 12 to 13 NCLT benches in different parts of the country but a final decision is yet to be taken, To begin with, the existing benches of Company Law Board would be converted into NCLT ones. Then, in due course, new benches would be created.

Bankruptcy Law in USA
In contrast to India where directors of sick unit needed to report to BIFR earlier and now onward to NCLT for either rehabilitation or liquidation , in USA there is a structure of bankruptcy court for each judicial district in the country. Each state has one or more districts. There are 90 bankruptcy districts across the country. The court official with decision-making power over federal bankruptcy cases is the United States bankruptcy judge, a judicial officer of the United States district court. The bankruptcy judge may decide any matter connected with a bankruptcy case, such as eligibility to file or whether a debtor should receive a discharge of debts. Much of the bankruptcy process is administrative, however, and is conducted away from the courthouse. In cases under chapters 7, 12, or 13, and sometimes in chapter 11 cases, this administrative process is carried out by a trustee who is appointed to oversee the case.
There are altogether five chapters related to discharge of bankruptcy. For Corporate bankruptcy mainly two chapters are important, which are as follows:
Chapter-7 bankruptcy-
It entitled Liquidation, contemplates an orderly, court-supervised procedure by which a trustee takes over the assets of the debtor's estate, reduces them to cash, and makes distributions to creditors, subject to the debtor's right to retain certain exempt property and the rights of secured creditors. Because there is usually little or no non exempt property in most chapter 7 cases, there may not be an actual liquidation of the debtor's assets. These cases are called "no-asset cases." A creditor holding an unsecured claim will get a distribution from the bankruptcy estate only if the case is an asset case and the creditor files a proof of claim with the bankruptcy court. In most chapter 7 cases, if the debtor is an individual,
Chapter-11 bankruptcy –
Reorganization ordinarily is used by commercial enterprises that desire to continue operating a business and repay creditors concurrently through a court-approved plan of reorganization. The chapter 11 debtor usually has the exclusive right to file a plan of reorganization for the first 120 days after it files the case and must provide creditors with a disclosure statement containing information adequate to enable creditors to evaluate the plan. The court ultimately approves (confirms) or disapproves the plan of reorganization. Under the confirmed plan, the debtor can reduce its debts by repaying a portion of its obligations and discharging others. The debtor can also terminate burdensome contracts and leases, recover assets, and rescale its operations in order to return to profitability. Under chapter 11, the debtor normally goes through a period of consolidation and emerges with a reduced debt load and a reorganized business.

Bankruptcy and Debenture holders

Continuous loss to a company lead to its sickness and subsequently company starts defaulting on debt obligations. This is a matter of worry for investors giving fund to the organisation, since their return is lesser than other risk sharing fund like equity. So they cannot afford to miss any payment default. They look forward for the legal recourse available to them to recover their money.

Debentures are either secured by some asset or can be unsecured .When debentures are secured in nature and debenture trustees are taking care of debenture holder's interest, in this case of default by a company secured debenture holders can take charge of that asset against which the debenture was secured. They can liquidate the asset and can recover their money without forcing the company to go for liquidation.

But situation get worsened in the case of unsecured debentures and there is a default by company. In this case only recourse available to debenture holders is under company's act 1956, which is recently replaced by new company's act 2013. This act states that on the first hand it is a duty of debenture trustee is that he is required to file petition to the tribunal ,if he came to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due. Even after that if there is any default the only remedy available to debenture holder is to follow company's act, that states "a company shall be deemed to be unable to pay its debts if a creditor to whom the company is indebted in a sum exceeding five hundred rupees (it is not a misprint) neglects to take action in three weeks from the date of notice received". The Companies Act 2013 has raised this threshold to Rs 1 lakh. The 2013 Act gives life to still-born provisions of the amendments of 2002 while explicitly addressing 'insolvency' under Section 269 on "Rehabilitation and Insolvency Fund". This deals with rehabilitation, revival and liquidation of sick companies based on a balance sheet threshold, as it integrates provisions of SICA, 1985 into the Companies Act.

Conclusion

In India by adoption of Company's Act 2013, and by incorporating NCLT and NCLAT somehow we have moved towards better bankruptcy law. Which has somehow tried to remove multi regulator regime leading to abnormal delays and even provoking corporate for wilful default and enjoying the life on borrowed money. Still we are way behind we need to put some clear demarcation in terms of chapter 7or 11 codes so that genuine problems can be taken on case to case basis and chances of revival will be much better leading to recovery of lost money.

As far as right of debenture holders are concerned, still there is a lacuna in new company law 2013. It does not talk about right of retail investors in case of default. There is no recourse available to them apart from lengthy legal proceedings. Even applicability of SURFAESI act and debt recovery tribunals can be extended for debenture holders by giving debenture trustee a status similar to a bank or financial institution and they can act on behalf of debenture holders

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