

IBC: A back door for white collar criminal?

A healthy business environment is the backbone of a strong economy. A business makes contribution to various stakeholders such as shareholder, bankers, employees, creditors, customers, etc. Hence a failure of a business has cascading impact on all the stakeholders which may discourage entrepreneurship in the country. When a business ceases to continue as a going concern, all stakeholders suffer but the creditor and shareholders suffer the most due to diminution in the value of the assets. As a going concern, those assets are valued at fair market value as a business but when a business ceases to be going concern the assets are prone to be valued to liquidation value. A liquidation value is likely price of an asset when it is allowed insufficient time to sell on the open market. A liquidation value is typically lower than fair market value and is expected in the case of illiquid or unique purpose assets. For example, a ship is an illiquid and unique asset, the same shall have a liquidation value. If the same is not sold in short duration of time, the value of the ship may diminish significantly thereby making it a big piece of steel ultimately to be sold as scrap.

Insolvency and Bankruptcy Code (“the Act”) was introduced in 2016 to solve this menace. The preamble of the Act reads as follows:

“An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto.”

Hence the Act aims at maximising the value of assets of a corporate persons, partnership firms and individuals in a time bound manner. The Act further aims at promoting entrepreneurship, making credit available to those entrepreneurs and balancing the interest of all stakeholders including alteration in the order of payment of Government dues. This article deals only with corporate insolvency resolution process, i.e., insolvency resolution and liquidation for corporate person. Where any corporate commits a default of a minimum amount of one lakh rupees or a higher value as may be specified (*the Central Government has specified the minimum amount of default as “one crore rupees” by notification dated 28th March 2020*), a financial creditor or an operational creditor or a corporate debtor itself shall apply for initiation of corporate insolvency resolution process.

Corporate insolvency resolution process (CIRP) is generally considered as a recovery mechanism for creditors. But in true spirit the process involves a resolution plan through which the business of corporate debtor can be continued as a going concern thereby maximising the value of assets of the corporate debtor which shall result into minimum impact on all stakeholders. Resolution plan has been defined as a plan proposed by any person for insolvency resolution of the corporate debtor as a going concern. The CIRP may end with a resolution plan approved by National Company Law Tribunal (NCLT) or with the liquidation of the corporate debtor. The management of the affairs of the corporate debtor vests in resolution professional who shall make every endeavour to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern. Hence Resolution Professional (RP) play a pivotal role in leading the CIRP whose wisdom can result into successful resolution of the corporate debtor.

The CIRP provides a moratorium of 180 days which can be once extended by a period not exceeding 90 days. The moratorium provides various relief such as prohibition of suits or pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order, prohibition of any action to recover or enforce any security interest created by corporate debtor in respect of its property **including any action under SARFAESI Act 2002**, prohibition of transferring, encumbering, alienating or disposing of any of its assets or any legal right or beneficial interest by corporate debtor and prohibition of recovery of any property by an owner or lessor where such property is occupied by corporate debtor. Hence it provides relief from all proceedings including the provision of stringent SARFAESI Act, 2002.

Whereas the Act allows a corporate debtor to apply for initiation of CIRP, it may be an exit door by white collar criminals to get rid of all legal proceedings including proceedings from revenue departments and financial as well as operational creditor. Section 10 of IBC which allows a corporate debtor to apply for initiation of CIRP may become an easy exit door for the management which has been into mismanagement of funds. Hence the initiation of CIRP may become a fast track exit route for a corporate debtor considering the relief provided during moratorium declared u/s 13 of the Act for the purpose specified u/s 14 of the Act. The relief provided u/s 14 of the Act aims to help RP in conducting the business of the

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corporate debtor as a going concern. The same may not be possible due to various hurdles which would have existed had the moratorium not provided any such relief.

The resolution professional including interim resolution professional have been provided various rights such as access to all the books of accounts, records and other relevant documents of corporate debtor available with the corporate debtor, government authorities, statutory auditors, accountants and such other person as may be specified. The Act also prescribes various duties such as collecting all information relating to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor including information related to business operations for previous two years, financial and operational payments for previous two years, list of assets and liabilities as on a latest date and such other matters as may be specified. The list of duties also includes inviting prospective lenders, investors and any other persons to put forward resolution plans.

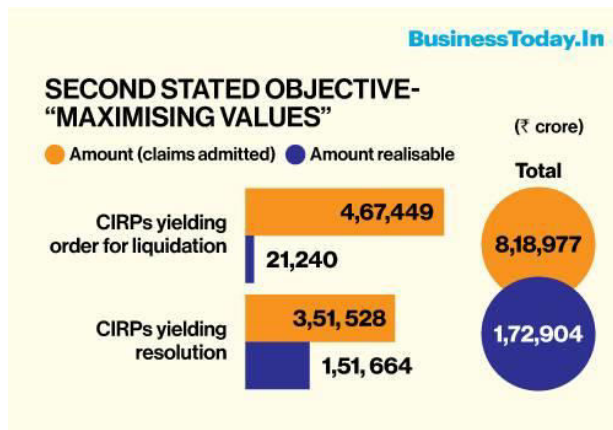
In case of amalgamation and merger, official liquidator has the duty to go through the scheme of the merger and to provide his objection, if any, against the approval of the scheme. The official liquidator has the duty to comment on whether the affairs of the transferor company has been conducted in a manner prejudicial to the interest of its members or public interest. Although the liabilities of the companies are transferred to the transferee company without any dilution still such representations are asked from the official liquidator. Whereas in the case of IBC, where the creditors are often taking big haircut against their dues, no such representations are asked by NCLT from the RP. That gives the corporate debtor an exit door where no questions or justifications are asked for the state of the company. Even representations from revenue and other concerned authorities are taken before approving the scheme of merger or amalgamation. But during the period of CIRP, no such objection is invited before the approval of resolution plan or liquidation as the case may be. Only after the liquidation is ordered, the revenue and other concerned authorities are informed of the same. Ease of business does not mean giving culpable an easy exit. There is a need of facts analysis so as to sense the gravity of the situation. Some of the figures and data from businessstoday.in updated as on February 26, 2020 have been provided here:

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FIRST STATED OBJECTIVE "SAVING LIFE"

Sl No	Category	No of cases
1	Cases referred to IBC so far	3,312
2	Ongoing process	1,961
3	Closed by dissolution	780
4	Closed on withdrawal/appeal	381
5	Closed by resolution	190

For 970 cases which have been closed through the IBC Process so far, 780 cases were liquidated. **Put it differently, 80% Mortality rate in the 'Saving life' process.**



For claims amounting to Rs 8.19 lakh crore, creditors have got "Maximum value" of Rs 1.73 lakh crore. **Resultant Haircut, whopping Rs 6.46 lakh crore in 970 cases closed, so far.** Hold on, another 1961 cases still under IBC Process.

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OVERALL RECOVERY UNDER IBC

Sl No	Category	Amount (claims admitted)	Amount realisable	Recovery %
1	Resolution	3,51,528	1,51,664	43%
2	Liquidation	4,67,449	21,240	5%
3	Total	8,18,977	1,72,904	21%
4	Less 7* out of first 12 large cases closed so far	2,13,731	1,12,894	53%
5	Excluding the outlier cases	6,05,246	60,010	10%

The 7 cases are, Electro steel, Bhusan Steel, Monnet Ispat, Essar Steel, Alok Industries, Bhusan Power & Steel, Jyoti Structures. **These 7 cases out of the total 780 cases closed so far are 1% by number but contribute 65% of total amount realisable and distort the correct picture of recovery under IBC in general. Excluding these 7 cases, IBC recovery so far is only 10%.**

“Only 51 liquidations have reached the final stage. Out of Rs 9,870 crore worth of claims, the creditors have received a princely sum of Rs 96 crore- that is right. Less than 1% after more than one year of running around, which will not compensate even the expenses incurred by the creditors. **In essence, many cases referred to IBC finally leading to liquidation may have a negative impact on the creditors.**”

The procedural aspects of CIRP are benchmark in dealing with those cases where the business failure is not a result of mismanagement of funds or other fraudulent management of the business. Where the business has failed due to market slowdown, stiff competition,

shortage of funds, etc, the Act deals with the case in an impeccable manner. Those cases need to be restructured so that the economic loss should be negligible or minimum which can be assured only if those business concerns continue as going concern. As already discussed, the Act provides moratorium with several reliefs which extend great help in maintaining the going concern status till the resolution plan is approved.

All the cases which come for initiation of CIRP can not or rather should not be treated in a uniform manner. In a factory after the production, the product goes through several quality checks which separate those products which do not pass it. Those quality checks ensure that defective product does not reach the end consumer; it's either repaired and sold to customer at discounted price or scrapped. Before the same is done, the reason for the failure is investigated and the accountability is ensured so that the same does not repeat. However when a resolution plan is approved or liquidation is ordered in CIRP, the Act has not mandated inquiry into any matter related to the promotion, formation or failure of the corporate debtor or the conduct of the business thereof. Only in the case of liquidation the Act read with regulations, the preliminary report which is to be submitted to NCLT shall mention whether the liquidator intends to make any further inquiry into those matters. It will be interesting to put up on record that in how many of liquidation order investigation has been intended by a liquidator. A business failure is matter of serious investigation and making it optional is not an option. The investigation report will have detailed reasons for the failure of business and those reasons will give two outputs; it will be case study for the existing and prospective entrepreneur as to how not to do the business and those personnel should be made personally liable who have acted fraudulently in the management of business. After all it's better for the society to learn from the failures of others instead of learning from their own failures.

So what are the remedies to deal with such cases? This back door can be closed and guarded by three; Government, Adjudication Authority and Resolution Professional. Until and unless the Act makes investigation mandatory, the other two in hierarchy will be without any direction to act in this way. The RP needs to make an in-depth investigation into the failure of the business with the help of other professional, if required. Finally in the middle of hierarchy is NCLT, the adjudication authority, which has to ensure the compliance of the Act in true spirit and to punish those culpable.

- **Role of Government:**

The Parliament needs to make amendment in the Act, Regulations and Rules. Until and unless the provisions of the Act are made stringent, bankers will continue to be reluctant in initiating CIRP. The reluctance is due to big haircut which banks have to take as a result of CIRP. Following amendments are required to make IBC laws in right direction:

- (a) A notice shall be sent, after initiation of CIRP or liquidation is ordered, to the income-tax authorities, the Reserve Bank of India, the Securities and Exchange Board, the Registrar, the respective stock exchanges, the Competition Commission of India established under sub-section (1) of section 7 of the Competition Act, 2002, if necessary, and such other sectoral regulators or authorities which are likely to be affected by the insolvency and liquidation process and shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals. The existing Act provides only for public announcement of initiation of CIRP.
- (b) Investigation into the formation, affairs and failure of the corporate debtor to be mandatory where huge losses accrue to creditors. A business going unviable to such an extent where no resolution plan has been reached RP or no resolution plan can be approved leading to liquidation of the corporate debtor, mandatory investigation is required in such cases. Where resolution plan has been considered and approved by NCLT, investigation in such cases shall be required if haircut crosses a predefined percentage. For example if creditors are to take a haircut of more than 20% of the outstanding amount then such cases shall require investigation. The term outstanding amount for this purpose shall be defined specifically and shall not include any interest accrued but not paid.
- (c) The period into which investigation shall be done can either be a specific time period such as 5 years or be based upon the date of certain events. The triggering point of initiation of CIRP is default of dues to creditors. Investigation into affairs may be done from the date of receipt of money from financial creditors or money received from the sale of goods received from operational creditors. The date on which money is received shall be the date from when the investigation shall begin with the purpose of whether the funds have been utilised for the purpose for which it was supposed to

be. The investigation into proper utilisation of funds shall partake the nature of propriety audit. Such audit shall be carried out by a qualified professional not related to the corporate debtor, financial creditor or operational creditor. A panel may be prepared for the empanelment of qualified professional with specified experience who shall do the propriety audit and assist RP in conducting the investigation.

- (d) An affidavit shall be taken from the directors of the company existed during the utilisation of funds received from financial creditor or from money received from the sale of goods from operational creditors. The affidavit shall state list of assets and beneficial interest which the directors own as on the date of utilisation of money and as on the date of initiation of CIRP. Any material increase in the assets and beneficial interest shall be supported by the source of such increase. A declaration shall be taken if there is an intentional omission in disclosing any asset, such asset shall be seized. The same shall be released only if satisfactory source of such asset is produced before the adjudicating authority and the authority is convinced that the source of the asset is from the legitimate income of the director.

- **Role of Resolution Professional:**

The resolution professional is the one who plays the key role in making CIRP a success. Being a RP is not an assignment which has to be completed as soon as possible but the same has to be completed as if the RP is managing his own business. When it comes to own business, every penny count and the sense of dedication change. The RP needs to deal with the CIRP as if his venture has failed and now, he has to revive the business with the help of legal machinery. The ground scenario has to be looked into and proper training of the RP is required. No doubt over the knowledge and capabilities, but a specific training is a must to how to manage the business in such scenario. In the case of statutory audit of big corporates, joint audit is done so that the work is distributed to provide efficient result. The same concept can also be made applicable to RP who has even bigger role to play. Management of the business is a great responsibility and needs expertise of the business as well. Hence the RP can be expected to hire professionals to assist in the process of CIRP or liquidation.

The RP has also to play the role of investigating officer in case the investigation is ordered by the adjudicating authority. The investigation will require more specialised

approach. The approach and methodology of investigation shall also be part of the training to be provided to RP.

- **Role of NCLT:**

National Company Law Tribunal, the Adjudicating Authority, is the governing body of CIRP. NCLT shall be given the authority to decide whether investigation shall be ordered in those cases where resolution plan has been approved but with deep haircut to the creditors. In those cases where investigation has not been ordered, NCLT shall provide in the judgement the reason for the same in detail. NCLT shall also be empowered to appoint a professional to assist RP in CIRP, liquidation or investigation of the corporate debtor. In those cases where fraud or mismanagement of funds have been established, NCLT shall lift the corporate veil and proceed accordingly.

These changes are aimed at increasing the efficacy in achieving the goal of the Act and will stop those using IBC as a back door to exit.