

Government Policy and Legal Framework on Corporate Sickness

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Abstract - The Government Policy and legal framework of corporate sickness is vital for the corporate turnaround and free exit. The Political intent is manifested in the form of policy framework which in turn enables to structure a legal framework. The corporate sickness was not addressed adequately with policy and legal framework until Insolvency and Bankruptcy Code, 2016 addressed the issue focusing on maximization of value of assets. SICA failed due to lack compatibility between policy and legal framework. Market economy dynamics recommended by Dr. Omkar Goswami or Justice Erradi Balakrishna were not implemented adequately except in RDBFI and SARFAESI but not in SICA. This necessitated the setting of BLRC, which suggested path breaking economic legislation, IBC with four pillars viz., Insolvency and Bankruptcy Board of India, Information Utilities, Insolvency Professionals and Adjudicating Authorities. The judiciary is separated from regulations. Several reforms and behavioral dimensions to the Code enabled for consensus among stakeholders in creditors driven mechanism.

keywords - Government Policy , Corporate Sickness , legal framework of corporate sickness, IBC

INTRODUCTION

The Government policy and legal framework on corporate sickness has undergone paradigm shift with enactment of Insolvency Bankruptcy Code, 2016 (IBC)¹. IBC is a one stop solution by consolidation of several legislations. It has recognized ease to exit and focused on maximization of value of Assets and balancing the interests of stakeholders. The government policy and legal framework undergone several changes especially after 1985 with the enactment of Sick Industrial Companies (Special Provisions) Act, 1985 (SICA)² in the field of corporate sickness. The main focus of focus of the paper is what are the policy initiatives of Government in pre-independence and post-independence era in the field of corporate sickness. In post-independence era to trace the Government Policy and legal framework Prior to SICA, during SICA regime and after the repeal of SICA with the enactment of IBC, 2016.

Accordingly, the objectives of the paper are:

1. To comprehend the Government policy and legal initiative during pre-independence era.
2. To study the various committee reports and government policy and legal framework on corporate sickness in post-independence era prior to SICA
3. To study the purpose of SICA and critical evaluation of SICA and performance of BIFR – during the period 1985 to 2015.
4. To Review the Reports of Dr. Omkar Goswami committee, 1993; Justice Erradi Committee 2000 and Bankruptcy Laws Reforms Committee headed by Dr. T.K. Vishwanathan
5. To highlight the features of path breaking legislation IBC, 2016 – a paradigm shift

The government policies and legislations may create both positive and negative impact on the economy in general and on industrialization in particular. Until the IBC was enacted there was obscure in policy and legal framework.

Government Policy – Pre independence era:

The government policy towards industry and business during British rule was on the whole hostile. The first century of British rule, viz., the period of East India Company, saw the decline of nearly all the indigenous industries. There were many reasons for the decline viz., technological, economic and political. The doctrine of *laissez faire* (free trade) and practical selfish considerations of British industrial capitalism was the underlying philosophy of the government policy. The lack of adequate and proper infrastructure facilities was major impediment for industrialization³. According to Vera Anste,⁴ the State economic policies were not responsible for the country's stunted economy. L.C.A. Knowles⁵, has attributed the country's poverty to its religious attitudes and social institutions. There was no special focus on corporate sickness and the responsibility was with the promoters themselves.

Policy and Legal Framework in Post-Independence Era - an Overview:

The political philosophy of the government till 1977 was socialistic pattern of society and hence had opted for mixed economy. The major administrative controls and Reports of Committees Other Legislations on corporate sickness during 1947 to 2020 in post-independence era are as follows:

Industrial Licensing Policy

IDRA 1951⁶

Monopolies and Restrictive Trade Practices Act, 1969⁷

Companies Act, 1956⁸.

Tiwari Committee Report, 1981⁹
 Sick Industrial Companies (Special Provisions) Act, 1985
 Dr. Omkar Goswami Committee Report, 1993¹⁰
 Recovery of Debts Dues to Banks and Financial Institutions Act, 1993¹¹
 Justice Erradi Radhakrishnan Committee Report, 2000¹²
 Companies Act (Amendments) Act, 2002¹³
 SARFAESI Act, 2002¹⁴
 Companies Act, 2013¹⁵
 Bankruptcy Laws Reforms Committee headed by Dr. T.K. Vishwanathan¹⁶
 Insolvency and Bankruptcy Code, 2016

The IPRs are basically guided by the political philosophy. The IPR 1948 laid down the broad objectives of government policy in the field of industrial development. This resolution stressed the need for a policy of 'mixed economy' and thus struck a middle course between those who stood for nationalization of private enterprise and those who advocated free enterprise. Though corporate sickness was perceived very early in jute and cotton industries there was no specific policy initiated to manage the industrial sickness.

The IPR 1956 classified industries into Schedule-A and Schedule-B industries. In respect of Schedule-A industries future development would be exclusively looked after by the states, whereas in respect of Schedule B industries, generally initiative will be taken by State in the future, for its development. The third category of industries will be exclusively left to the private sector. The IPR of 1956 gives the broad policy framework of industrial development in India. IPR 1956 is the basis for the industrial development that took place during 1956 to 1991. In addition to the broad policy framework, government also enunciated industry specific policies/controls; guided the flow of financial assistance from development financial institution in to the industries where government wanted capacities to be created. The industrial sickness is a by-product of the process of industrialization in the aforesaid policy framework. However, there were no concrete measures were initiated.

Industrial Licensing:

The IDRA and other related corporate laws were enacted to implement the Industrial Policy Resolutions. IDRA, Companies Act, 1956 and MRTP Act 1969 put together prescribed the major legal framework, to the government in exercising its administrative and regulatory control on industry.

Among other objectives the IDRA has the following main objectives:

- i) Regulation of industrial development in accordance with IPR.
- ii) Avoidance of the concentration of ownership and control.
- iii) Ensuring balanced growth.
- iv) Reducing undue competition between them SSI units and large-scale industries.
- v) Enabling government to take over management of undertakings, which are being conducted in a manner detrimental to the industry or public interest.

However, due to loopholes in the system, policy and procedure the preventive and curative provisions of development and regulation of industries have not addressed the root cause of corporate failures. The Hazare and Dutt committee¹⁷ reported that the licensing policies have resulted in concentration of economic power, which was advantageous to large industrial houses (LIH). The Act has provided for exhaustive powers to the government to detect the impediments and provide appropriate remedial measures for industrial sickness. The Act largely focused on take-over by the government as the preventive and curative measures without adequate procedure for rehabilitation. In the process of takeover, the government ultimately failed in rehabilitating the units, for example, textile and jute industries. The Hazare and Dutt committees instead of addressing the basic hurdles causing stifling growth have focused on further regulations. They overlooked the micro problem and mainly provided for measures at macro level. Further, enacting of MRTP Act was again a failure on the part of government since it could not address the problem at the source. The licensing policy has become complex and contradictory due to multifarious objectives of the government

The Monopolies Inquiry Commission in 1964 came to the conclusion that the system of control in the shape of industrial licensing had restricted the freedom of entry for smaller entrepreneurs and so helped to produce the further concentration, a conclusion which was also endorsed by the Administrative Reforms Commission, 1968 and subsequently more vocally by the Industrial Licensing Policy Inquiry Committee, 1969. However, the MRTP Act could not counter this menace; rather it aggravated the problem in a different dimension. On many occasions, the corporate laws discussed could not operationalize the policies envisaged, resulting in certain negative factors in the industrialization process and one such factor is industrial sickness.¹⁸ Each of the corporate law referred above had its own objective in the industrial development and growth in compatible with industrial policy resolution. The reference of various corporate laws is taken in the study in different contexts to comprehend the direct or indirect impact of these laws on the corporate failure.

Towards Structural Adjustments during the 70's and 80's and Liberalization:

From around 1974-75, in response to the need for greater productivity and efficiency in the industrial economy in the wake of the shock of the oil price increases, first in 1973 and again in 1979, the government initiated a number of measures to

relax and liberalize licensing provisions. However, the economy did not switchover to market driven economy until 1991. Meanwhile the Janata Party Government announced a new Industrial Policy Statement on December 23, 1977. It did not replace the Industrial Policy Resolution of 1956 or the Industrial Licensing Policy of 1973 but only supplemented them by redefining some of the priorities. It claimed to differ from the 1956 Resolution mainly in two respects. They were:

- i) Giving priority to small scale and village industries and the so-called 'tiny sector' industries
- Providing for geographical dispersal of industries.

The Industrial Policy Statement of 1980 and 1982:

The policy statement stressed the need for toning up the management of public sector enterprises and identifying and initiating corrective measures in the case of inefficient enterprises in order to 'rehabilitate the public sector'. Meanwhile, the Tiwari Committee was set up in 1981 to study the problem of corporate sickness. Later the SICA was enacted based on the recommendations of Tiwari Committee. The committee report is discussed elsewhere in the study. There has been a structural change during 1980-1991; an exercise to pluck the constraints resulted from deficiencies in the system, policies and procedures. However, there was no adequate flexibility in policy and legal framework to bring about desired structural readjustments to combat corporate sickness.

The major policy measures on industrial sickness adopted by the government include: (i) soft loan scheme, (ii) merger policy of 1977, (iii) policy guidelines on sick units of 1978, (iv) new strategy of 1981, (v) financial assistance from the Financial Institutions (vi) different committees on industrial sickness¹⁹. In each of the aforesaid measures only certain specific issues of sickness are addressed. None of the measures covered all the aspects of sickness. Each of the measures differed from the other depending upon the purpose and context. While most of the measures pertain to financing the sick units some of the measures relate to modernization, etc. However, none of the policy measures except the policy 1978 addressed the problems of management factor, which is crucial. However, the policy 1978 is comprehensive and covered many aspects of sickness, viz., management, monitoring, etc. The new Strategy 1981 is basically meant for nationalization. These measures are mainly related to one aspect of turnaround measures. None of the measures focused on identifying the root cause of sickness and provided a mechanism for rehabilitation with comprehensive approach.

Corporate Sickness – Tiwari Committee Report:

Constitution of Tiwari Committee was a milestone in the policy initiative of corporate sickness. The Reserve Bank of India in the year 1981 constituted a Committee headed by Tiwari, the former chairman of Industrial Reconstruction Bank of India (IRBI). The Tiwari Committee Report²⁰ is discussed to examine to what extent the process and procedure suggested by various approaches to sickness are incorporated in the Tiwari Committee Report. Later in the year Sick Industrial Companies (Special Provisions) Act, 1985 was enacted based on the report.

Nature of SICA:

The legislation is intended to provide remedial and ameliorative measures. From the interpretational angle, the Act can be placed into the category of a special law. Board for Industrial and Financial Reconstruction (BIFR) constituted under the Act has a crucial role in implementing the objectives of SICA. The role of BIFR is regulatory and it operates under the framework of SICA. The Supreme Court in the Kamani Tubes Ltd 's case²¹ the BIFR was stamped with the *imprimatur* of the highest judicial forum. The objectives of the Act were: (i) timely detection of sickness; (ii) The speedy determination of remedial measures; (iii) The expeditious enforcement of the measures

The preamble to SICA is comprehensive and implicit. Supreme Court very well substantiates the preamble by explicitly explaining the object of the legislation in the case of Navnit and Kamani Vs. R.R. focusing on socioeconomic factors. However, SICA failed totally due to defective and regulatory framework. Primarily there were legal inconsistencies especially in arriving the criteria of corporate sickness viz 100 percent erosion of net worth; cash losses for 2 consecutive years and insisting for the elapse of 7 years for referring to Board for Industrial and Financial Reconstruction (BIFR)²². Later with amendments in 1998, 7 years was reduced to 5 years and cash loss criteria was dropped. Even after that these, the criteria only enabled failed units to be referred to BIFR instead of sick units. There was no compatibility between sickness criteria and objectives of the SICA. Ultimately even after 15 years of its operations, BIFR could hardly provide rehabilitation to less than 10 percent units registered with it and many units were referred to concerned High Court for winding up. Hence, the first Chairman of BIFR, referred as Board for Industrial Funeral rites²³. It was neither a proactive nor reactive legislation. There was obscurity during SICA regime in several reasons mainly because of pre liberalisation era, Licensee raj with protectionism. The market economy was not perceived despite recommendations of Goswami Committee²⁴

Commenting on the above, Narayanan (1994)²⁵ states that experience has shown that much of industrial sickness is due to mismanagement, whether deliberate or because of incompetence; but unfortunately, the BIFR does not have the machinery necessary to exercise the powers effectively, and there are other obstacles in the way. Due to the defective definition of sick industrial companies the entire procedure of BIFR has become a futile exercise.

SICA was developed on the basis of Tiwari Committee Report, 1981. However, it omitted certain vital recommendations like potential sick units to be considered for revival. SICA did not separate judiciary from administration. It was not a behavioral legislation; it was debtors' paradise and it motivated many managements to further the sickness to get registered with BIFR and could get moratorium for indefinite period. The recommendations of Goswami Committee for removing the barriers to corporate and industrial restructuring were virtually ignored.

The New Industrial Policy, 1991:

The New Industrial Policy 1991 came into effect from July 91 to open up the economy in consonance with the fast-moving globalization. However, the industrial sector was not adequately prepared to keep pace with the liberalization and

globalization at micro level. This has resulted in many companies becoming sick in the 90's. The BIFR could revive only a tenth of the total number of companies registered with it. The following are the major reforms in the New Industrial Policy that replaced all the previous policy documents²⁶:

- Abolishing the practice of industrial licensing for many items.
- Bringing down the areas earmarked for PSUs.
- Automatic FDI up to 51% of equity in select industries and for capital goods import.
- Flexibility in MRTP Act and FEMA
- Separate policy for SSI sector under Small-Scale Industry Policy announced in Aug 1991.

These reforms are suitable to a market economy with global perspective. The government control on business has undergone a sea-change. The opening up of at least nine industries in Schedule 'A' of the 1956 Industrial Policy Resolution and all the 12 industries in Schedule 'B' to private enterprises opened up new horizons for private sector industry. This enlarged the role of the private sector and also in making the public sector more efficient. Also, there were other important deregulatory measures such as the decontrol of the pricing and distribution of steel and iron.²⁷

On the one hand there are very efficient enterprises and on the other hand there are utterly inefficient units. Most sophisticated technology exists side by side with total technological obsolescence. In many industries there were in serious under-utilization of capacity on account of problems of the infrastructure²⁸. Indian industries were compelled to achieve the economic scale of production, to upgrade its technology to reduce its surplus manpower and to expand according to economic logic irrespective of dogmas, if it has to compete with goods from abroad both on the overseas market and the domestic market. Those, which are unable to improve their processes and products, will peter out. But the efficient ones will flourish and prosper, especially those that can successfully accept the challenges of competition and globalization. The major policy changes initiated in the industrial sector since July 1991 so far include removal of entry barriers, reduction of areas reserved exclusively for public sector, etc., as discussed.

However, due to flaws in the policy and legal framework the desired results are not forthcoming. Corporate sickness was one such major problem. The magnitude and dimension of sickness was growing despite special legislation on industrial sickness, viz., SICA. In spite of industrial and financial reforms the barriers to corporate and industrial restructuring exist.

Dr. Omkar Goswami Committee Report, 1993 and Companies (Amendment) Act, 2002.

Dr. Omkar Goswami during 1993 suggested (i) the mechanism how BIFR should function in market economy and suggested for setting up National Company Law Tribunals; (ii) the government must strengthen the process of recovering debt from working, viable companies. (iii) for the setting up of five Recovery Tribunals only for recovering corporate debts; (iv) suggested radically different SICA to aid fundamentally different ways of reorganization; (v) The onus of reorganization must shift from the state, BIFR, and secured creditors to the defaulting debtors (vi) It should be possible for the secured creditors to detect sickness and facilitate the debtor firms to take corrective measures well before the net worth of these firms turn negative; (vii) BIFR should be geared towards facilitation and quick arbitration. (viii) References should be voluntary, giving the firm and its claimants the freedom to choose without third-party intervention; (ix) The basis for industrial reorganization should be economic viability, subject to social constraints; (x) To detect 'incipient. sickness on a regular basis, 'one needs to convert the characteristic of a "flash report" into a "flow report", It is possible to design such an early warning signal on 'the basis of information available with the bank.

Justice Erradi Radhakrishnan Committee Report, 2000

The committee suggested for:

- (i) The jurisdiction, power and authority relating to winding up of companies shall be vested in a National Tribunal instead of the High Court as at present.; (ii) In addition, proposed Tribunal shall also have power to consider rehabilitation and revival of companies, a mandate presently entrusted to BIFR; (iii) Further; the jurisdiction and the powers presently exercised by Company Law Board under the Companies Act in future shall be exercised by the proposed Tribunals. Further; the jurisdiction and the powers presently exercised by Company Law Board under the Companies Act in future would be exercised by the proposed Tribunal. Based the recommendations, the Companies (Amendments) Act, 2002 was enacted and NCLT was constituted. However, NCLT could not be operative due to stay order from High court immediately after that. NCLT was revived after 2016 with IBC. This is where IBC has brought about paradigm shift with political will and administrative skill.

Other Laws:

The Debts Recovery Tribunal (DRT) enforces provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993²⁹ and also Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002.

Under the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993 banks approach the Debts Recovery Tribunal (DRT) whereas, under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 borrowers, guarantors, and other any other person aggrieved by any action of the bank can approach the Debts Recovery Tribunal. The setting up of a Debts Recovery Tribunal is dependent upon the volume of cases. Higher the number of cases within a territorial area, more Debts Recovery Tribunal would be set up.

Though SICA totally failed, the aforesaid two legislations have achieved the objectives of the said Acts, however freedom to exit in competitive environment, and protection stakeholders' interest and maximization of value of Assets necessitated further policy initiatives. To have comprehensive measure for Bankruptcy & Insolvency the BLRC committee was constituted.

Report of Bankruptcy Laws Reforms Committee headed by Dr. T.K. Vishwanathan, 2015

The Committee in its recommendations focused on:

- (a) The legislative track
- (b) Establishing the Regulator;
- (c) Initiating the industry of information utilities and phasing-in comprehensive adoption of these utilities;
- (d) Initiating the insolvency profession; and
- (e) Establishing world class adjudication infrastructure.

The committee also focused on timeline, maximization of value of Assets and balancing the interests of stakeholders.

What are the path breaking paradigm shift witnessed under IBC framework in providing one stop solution based on BLRC report.

The Code³⁰ is a comprehensive legislation 'to consolidate and amend the laws relating reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner.

GST and IBC are path-breaking legislations have been key in significantly changing India's perception globally as a business-friendly environment³¹. The IBC is benefitted from the cumulative experience of the rich history of bankruptcy law in the west, most notably in the US and UK and other countries. (Ajit Ranade, 2019)³².

Firstly, the Bankruptcy Law and Reforms Committee headed by Dr. T.K. Vishwanathan considered adequately the similar Code in US, UK and several other countries, then customized and improvised to suit the Indian Economy and Indian Business Environment. His recommendations were virtually emerged as IBC, 2016³³.

Secondly it has CIRP mechanism to provide timely insolvency resolutions. The Information Brochure of CIRP³⁴ published by IBBI state that the IBBI is a key pillar of the ecosystem responsible for implementation of the Code. It is a unique regular; regulates service providers as well as transactions. Further it has regulatory oversight over Insolvency Professionals, Insolvency Professional Agencies, Information Utilities, Registered Valuers and Registered Valuer Organizations. It writes regulations to govern transaction, namely Corporate Insolvency Resolution Process, Corporate Liquidation, Individual Insolvency, and Individual Bankruptcy under the Code and enforces the Code, rules and regulations made thereunder.

Thirdly, Insolvency and Bankruptcy Code, 2016 (IBC) has down lessons from the past failures of SICA. The recommendations of Dr. Omkar Goswami Committee and Justice Erradi Balakrishna have categorically suggested substantially the dynamics of market economy and need for ease of exit. These are considered in BLRC Report.

Fourthly, IBC is a behavioral law. It is Creditors driven while giving option of approaching the Code by both debtors and creditor. The BLRC recommendations is comprehensive and based on several of the international economic theories especially taking cognizance of a) endowment of resources b) Competition c) Innovation and how these factors can decide the fate of an entity. The market forces are given highest importance. The need for honorable exit is considered as a natural phenomenon while giving importance of ease of entry. Further cost of credit and availability of funds with the financial creditors envisages ease of entry and exit for the long run survival of not only financial creditor but also the growth of industries and economy in general. Therefore, IBC is a behavioral legislation based on creating a culture among stakeholders for consensus for win win situation in pragmatic perspective. The dynamic legislation is an economic legislation with a vision and strategic perspective and path creating platform for strategy focused resolutions and reorganization of corporate entities at micro level and economy at macro level.

Fifthly, The Code is a landmark piece of legislation which provides for institutionalized creditor-in-control mechanism for reorganization and insolvency resolution of corporate persons, partnerships firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit, while balancing the interests of all the stakeholders.³⁵

Finally, as observed by Dr. M.S. Shao³⁶ Chairman, IBBI, beyond revival of firms, the Code has ushered in significant behavioral changes resulting in substantial recoveries for creditors outside the Code and improving performance of firms. He further says it is important to consider what happens in the processes under the Code and what happens on account of the Code: This is where we need to understand the success of IBC as behavioral law from strategic perspective. In the Quarter Newsletter of IBBI, Jan-Mar.,2020³⁷ it is highlighted that the art of value maximization in CIRP. It requires one needs to read carefully while aiming to maximize the value in a corporate insolvency resolution process as unidirectional approach may yield sub-optimal outcomes. He elaborately focused on Liquidation value, Resolution value, fair value and enterprise value. In the Quarter Newsletter of IBBI, April-June.,2019³⁸ the chairman, IBBI states he focused on a resolve for resolution – the need for time bound insolvency resolution of corporate debtors for maximization of value of their assets, being the part of IBC (amendment) bill, 2019. In another Insolvency and Bankruptcy News, April- June, 2019, he highlighted how IBC a code for corporate governance – by laying down norms that seek to prevent failure of companies and rescue failing companies, the IBC has taken corporate governance to new heights in the country³⁹. He further brought out in July-September, 2019 Insolvency and Bankruptcy news, how IBC is focused on socio economic factors and protecting the interest of stakeholders. He says life of a company is a precious as that of a human. The IBC has added a new lifeline to rescue company when it experiences a serious threat to its life.⁴⁰

IBC is not only a proactive economic legislation but also has institutional mechanism under four pillars to provide solution based on onion process. The institutional development, institutional communication, balancing the interest of stakeholders with timely amendments are the success mantras of IBC. The professional approach and contribution of Insolvency Professionals, Committee of Creditors, Information Utilities, IBBI in maintaining the time line is commendable. The timely contribution of Adjudicating Authorities in upholding the preamble of the Code is speaks about ultimate success.

Summary

The Government Policy in pre-independence era was on the whole hostile to Indian industries. At the time of Independence, India was facing many crises apart from poverty. But there was no dearth of entrepreneurs. However, there were no adequate efforts made to bring structural changes in the industrial sector, to remove the impediments of sickness. The enactment of SICA is a milestone in the government policy measures on industrial sickness in respect of Non-SSI sick industrial companies. As SICA failed due to defective law and lack of market economy focus the Government took initiative in asking Dr. Omkar Goswami Committee and later Justice Erradi Balakrishnan Committees and ultimately BLRC were set up for appropriate recommendations in consonance with market economy. Ultimately on enactment of IBC one stop solution by consolidation of laws it provided for paradigm shift in approach and mechanism of corporate sickness. The political intent is fructified the policy and legal initiative in protecting the interest of stakeholders in competitive environment with ease to exit maximize the value of assets.

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