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Recent Changes in Merger Control Regime Vis-À-Vis The Competition Act

Pallavi Mahajan

Early Market Exit in Insolvency and Bankruptcy Act 2016 and Prospective Impact on Start-Up Regime In India

Subhankar Das

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FOREWORD

It is with great pleasure that I place before you the fourth edition of RGNUL Financial & Mercantile Law Review. This law review was an endeavour on our part to better understand the financial market and its legal regimes, and to promote academic discourse.

The process that entailed publishing this edition was challenging, yet rewarding. I'm thankful to everyone across the globe who have supported in this endeavour. I would like to express my sincerest gratitude towards the members of our advisory board for their commitment. I would also like to thank our referees and contributors for their invaluable contribution.

The fourth edition of RFMLR covers a wide array of laws such as Company law, International Trade Law, Intellectual Property Law, Insurance Law and Banking Law. We, at the editorial board, are very pleased to note the warm response we received from the contributors.

We hope the review invokes your curiosity and serves as a niche instrument in honing your legal acumen.

Dr Anand Pawar

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ARBITRATION

INTERNATIONAL COMMERCIAL ARBITRATION

ANAHITA GAIND*

1. INTRODUCTION

Growing international trade and investment is tagged along by growth in cross-border commercial disputes. Provided with the need for an effective dispute resolution mechanism, international arbitration has become evident as the better option for settling cross-border commercial disputes and preserving business relationships. With an inflow of foreign investments, overseas commercial transactions, and open-ended economic policies acting as a catalyst, international commercial disputes entailing India are constantly rising. This has drawn colossal focus from the international community on India's international arbitration regime.

Due to inevitable controversial decisions by the Indian judiciary in the last years, especially in cases involving a foreign party, the international community has been vigilant on the development of arbitration laws in India. The Indian judiciary has often been denounced for its interference in

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international arbitrations and extra territorial application of domestic laws to foreign-seated arbitrations.

Nevertheless, the latest developments in the arbitration jurisprudence in and out of recent court decisions undoubtedly indicate the support of the judiciary in delegating India to adopt international best practices. Courts have adopted a pro-arbitration approach and a series of pro-arbitration rulings by the Supreme Court of India and High Courts have tried to change the arbitration landscape completely in India. From 2012 to 2015, the Supreme Court conveyed various landmark rulings taking a much needed pro-arbitration approach such as proclaiming the Indian arbitration law to be seat-centric; detaching the Indian judiciary's power to interfere with arbitrations seated outside India; mentioning non-signatories to an arbitration agreement to settle disputes through arbitration; defining the scope of public policy in foreign-seated arbitration; and determining that even fraud is arbitrable.

In betterment of measures taken by the Indian government in support of the 'ease of doing business in India', and after two terminated attempts in 2001 and 2010 to amend the arbitration law, on October 23, 2015, the President of India spreaded the Arbitration and Conciliation (Amendment) Ordinance, 2015. The Ordinance embodied the nub of major rulings passed in the last two decades, as well as most of the recommendations

of 246th Law Commission Report, and have explicated the major controversies that arose in recent years.

Subsequently, on December 17, 2015 and December 23, 2015 respectively, the Arbitration and Conciliation (Amendment) Bill, 2015 was passed by the Lok Sabha and Rajya Sabha respectively, with minor additions to the amendments instituted by the Ordinance. On December 31, 2015, the President of India signed the Bill and afterwards, gazette notification was made on January 1, 2016. Accordingly, the Arbitration and Conciliation (Amendment) Act, 2015 came into effect, from October 23, 2015. The Amendment Act is applicable prospectively to the arbitral proceedings commenced after October 23, 2015.

This paper aims to give an outline of the position of Indian law on international commercial arbitration both seated within and outside India and examines the recent judicial decisions in this field. The changes inserted by the Amendment Act are a step in the right direction in certifying that India moves towards being an arbitration friendly nation. This paper also throws light on the potential barriers faced by parties who are governed by the Act, with the new law in place.

2. Indian Arbitration Regime

2.1. History of Arbitration in India

Until the Arbitration and Conciliation Act, 1996, the law governing arbitration in India comprise mainly of three statutes:

a) The Arbitration (Protocol and Convention) Act, 1937

b) The Indian Arbitration Act, 1940 and

c) The Foreign Awards (Recognition and Enforcement) Act, 1961.

The 1940 Act was the general law governing arbitration in India and resembled the English Arbitration Act of 1934.

2.2. Background to the Arbitration and Conciliation Act, 1996

To tackle these concerns and with an essential motive to coax arbitration as a cost-effective and time-efficient mechanism for the settlement of commercial disputes in the national and international sphere, India in 1996, embraced a new legislation modeled on the Model Law in the form of the Arbitration and Conciliation Act, 1996. The Act was also brought in to give a speedy and effective dispute resolution apparatus to the existing judicial system, which was marred with inordinate delays and a backlog of cases.

3. SCHEME OF THE ACT

The Act has three meaningful parts. Part I of the Act tackles with domestic arbitrations and ICA when the arbitration is seated in India. Thus, arbitration seated in India between one foreign party and an Indian party, though defined as ICA is treated related to a domestic arbitration. Part II of the Act deals with only foreign awards[1] and imposition under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 or Convention on the Execution of Foreign Arbitral Awards, 1927 and Part III of the Act is a statutory incarnation of conciliation provisions.

In Part I, Section 8 controls the commencement of arbitration in India, Sections 3, 4, 5, 6, 10 to 26, and 28 to 33 manages the conduct of arbitration, Section 34 regulates the challenge to the award and Sections 35, and 36 tunes the recognition and enforcement of the award. Sections 1, 2, 7, 9, 27, 37, and 38 to 43 are ancillary provisions that either support the arbitral process or are structurally necessary.[2]

The courts have found that Chapters III to VI, specifically. Section 10 to 33 of Part 1 of the Act, include curial or

[1] A foreign award is award delivered in an arbitration seated out- side India.
[2] Bharat Aluminum Co. v. Kaiser Aluminum Technical Service, Inc., 2012 (9) SCC 552.

procedural law which parties would have independence to opt out from. The other Chapters of Part I of the Act form part of the proper law[3], accordingly, making those provisions non-derogable by parties subjected to Part I, even by contract.

Part II, on the other hand controls arbitration only in respect to the inception and identification/enforcement of a foreign award and no provisions under the same can be derogated by a contract between two parties.[4]

The intent of the Act is to provide a speedy and cost-effective dispute resolution mechanism, which would give parties irrefutability in their disputes. In 1996, the Act was passed with an outlook to bring in changes, but fell into a quarrel of its own. A number of decisions from the courts slowly but surely certified that the preferred seat in any cross-border contract was always a deeply consulted point and, more often than not, ended up being either Singapore, New York, or London, the established global arbitration centers. Foreign investors and corporates doing business in India were just not ready to risk the Indian legal system.

[3] Anita Garg v. M/S. Glencore Grain Rotterdam B.V., 2011(4) ARBLR 59 (Delhi).
[4] Bharat Aluminum Co. v. Kaiser Aluminum Technical Service, Inc., 2012 (9) SCC 552.

4. ARBITRATION AND CONCILIATION AMENDMENT ACT, 2015

The amendments presented by the Amendment Act have made remarkable changes to the Act and are in the right direction for explaining several issues keeping in mind the aims of the Act.

The Amendment Act issues strict timelines for execution of the arbitral proceedings along with the extent for resolving disputes by a fast track mechanism. In addition to the insertion of new provisions, the Amendment

Act has also proposed certain amendments to the existing provisions with regard to the process of appointment of an arbitrator and described the grounds of challenge of an arbitrator for lack of independence and impartiality. The Amendment Act, as a welcome move, supports for assistance from Indian courts even in foreign-seated arbitrations in the form of interim relief before the commencement of the arbitration. Further, the introduction of the 'cost follow the event' regime in the Act has been inserted to bring it in line with international standards. The process of enforcement and execution under the Act has also been efficient so that challenge petitions do not operate as an automatic stay on the execution process.

Below, the Amendment Act introduces the snapshots to the major amendments:

4.1. Pre-arbitral proceedings

4.1.1. *Independence and impartiality*

a) The Amendment Act has initiated comprehensive guidelines in relation to the independence, impartiality, and fees of arbitrators, bringing it at par with international standards.

b) Appointment of arbitrators to be done by Supreme Court in case of international commercial arbitrations and respective High Courts in case of domestic arbitrations purely in an administrative capacity.

c) Applications for appointment of an arbitrator to be disposed of expeditiously and endeavor to be made to dispose of within a period of (60) sixty days from date of service of notice on the opposite party.

d) Detailed schedule on ineligibility of arbitrators have been put in place.

4.1.2. *Interim reliefs*

a) Flexibility has been granted to parties with foreign- seated arbitrations to approach Indian courts in aid of foreign seated arbitration;
b) Section 9 applications to be made directly before High Court in case of international commercial arbitrations seated in India as well as outside.
c) Interim reliefs granted by arbitral tribunals seated in India are deemed to be order of courts and are thus enforceable in the new regime.
d) Post grant of interim relief, arbitration proceedings must commence within 90 days or any further time as determined by the court.

4.2. **Arbitral proceedings**

4.2.1. *Expeditious disposal*

a) A twelve-month timeline for completion of arbitration seated in India has been prescribed.
b) Expeditious disposal of applications along with indicative timelines for filing arbitration applications before courts in relation to interim reliefs, appointment of arbitrator, and challenge petitions;

c) Incorporation of expedited/fast track arbitration procedure to resolve certain disputes within a period of six months.

4.2.2. *Costs*

Detailed provisions have been inserted in relation to determination of costs by arbitral tribunals seated in India – introduction of 'costs follow the event' regime.

4.3. **Post-arbitral proceedings**

4.3.1. *Challenge and enforcement*

a) In ICA seated in India, the grounds on which an arbitral award can be challenged has been narrowed;

b) Section 34 petitions to be filed directly before High Court in case of international commercial arbitrations seated in India.

c) Section 34 petitions to be disposed of expeditiously and in any event within a period of one year from date on which notice is served on opposite party.

d) Upon filing a challenge, under Section 34 of the Act, there will not be any automatic stay on the execution of award – and more specifically, an order has to be passed by the court expressly staying the execution proceedings.

5. INTERNATIONAL COMMERCIAL ARBITRATION: MEANING

Section 2(1)(f) of the Act interprets an ICA to mean one arising from a legal relationship which must be considered commercial[5] where either of the parties is a foreign national or resident or is a foreign body corporate or is a company, association or body of individuals whose central management or control is in foreign hands. Thus, under Indian law, arbitration with a seat in India, but involving a foreign party will also be regarded as an ICA, and consequently subject to Part I of the Act. Where an ICA is held outside India, Part I of the Act would have no relevance on the parties but the parties would be subject to Part II of the Act.

The Amendment Act has removed the words 'a company' from the purview of the definition thereby hindering the definition of ICA only to the body of individuals or association. Thereafter, by deduction, it has been made clear that if a company has its place of incorporation as India then central management and control would be inapt as far as its determination of being an "international commercial arbitration" is concerned.

[5] 'Commercial' should be construed broadly having regard to the manifold activities, which are an integral part of international trade today (R.M. Investments & Trading Co. Pvt. Ltd. v. Boeing Co., AIR 1994 SC 1136).

The Supreme Court in the case of *TDM Infrastructure Pvt. Ltd. V. UE Development India Pvt. Ltd*. decided the scope of this section,[6]wherein, despite TDM Infrastructure Pvt. Ltd. having a foreign control, it was negotiated that, "a company incorporated in India can only have Indian nationality for the purpose of the Act."

Consequently, though the Act recognizes companies controlled by foreign hands as a foreign body corporate, the Supreme Court has eliminated its application to companies registered in India and having Indian nationality. Hence, in case a corporation has dual nationality, one based on foreign control and other based on registration in India, for the purpose of the Act, such corporation would not be regarded as a foreign corporation.

6. ARBITRABILITY UNDER INDIAN LAW

Arbitrability is one of the matters where the contractual and jurisdictional aspects of international commercial arbitration meet head on. It includes the simple question of what type of issues can and cannot be submitted to arbitration.

[6] TDM Infrastructure Pvt. Ltd. v. UE Development India Pvt. Ltd, 2008 (14) SCC 271.

In *Booz Allen and Hamilton Inc. v. SBI Home Finance Ltd*.[7] the Supreme Court examined the concept of Arbitrability in detail and held that the term 'Arbitrability' had distinct meanings in different contexts: (a) disputes capable of being judged through arbitration, (b) disputes covered by the arbitration agreement, (c) disputes that parties have mentioned to arbitration. It stated that in principle, any quarrel than can be decided by a civil court can also be resolved through arbitration. However, certain disputes may, by necessary implication, stand eliminated from resolution by a private forum. Such non-arbitrable disputes include: (i) disputes relating to rights and liabilities which improves or arise out of criminal offences; (ii) matrimonial disputes connecting to divorce, judicial separation, restitution of conjugal rights, or child custody; (iii) guardianship matters; (iv) insolvency and winding up matters; (v) testamentary matters and (vi) expulsion or tenancy matters governed by special statutes where the tenant enjoys statutory protection against eviction and only the specified courts are conferred jurisdiction to grant eviction or decide the disputes.

[7] Booz Allen and Hamilton Inc. v. SBI Home Finance Ltd, 2011 (5) SCC 532.

Also, the Supreme Court has discussed in *N. Radhakrishnan v. M/S Maestro Engineers*[8] that, where plea of fraud and serious malpractices are alleged, the court can only settle the matter and such a situation cannot be mentioned to an arbitrator. The Supreme Court also noticed that fraud, financial malpractice and collusion are allegations with criminal repercussions and as an arbitrator is a creature of the contract, he has restricted jurisdiction. The courts are more provided to adjudicate serious and complex allegations and are capable in offering a wider range of reliefs to the parties in dispute.

But the Supreme Court in Swiss Timing Limited v. Organizing Committee, Commonwealth Games 2010, Delhi[9] and World Sport Group (Mauritius) Ltd. v. MSM Satellite (Singapore) Pvt. Ltd.[10] embraced that allegations of fraud are not a bar to mention parties to a foreign-seated arbitration and that the only bars to denote parties to foreign-seated arbitrations are those, which are specified in Section 45 of Act. For instance, in cases where the arbitration agreement is either (i) null and void; or (ii) non-functional (iii) incapable of being performed. Thus, it appears that though allegations of fraud are not arbitrable in

[8] N. Radhakrishnan v. M/S Maestro Engineers, 2010 (1) SCC 72.
[9] Swiss Timing Limited v. Organizing Committee, Commonwealth Games 2010, Delhi, 2014 (6) SCC 677.
[10] World Sport Group (Mauritius) Ltd. v. MSM Satellite (Singapore) Pvt. Ltd., AIR 2014 SC 968.

ICA's with a seat in India the same bar would not apply to ICA's with a foreign seat.

Hence, there may be a certain degree of difference in the law of Arbitrability in India when equated to other jurisdictions. The distinctive treatment of domestic and international commercial arbitrations with regard to Arbitrability of issues makes it vital to find out whether the disputes referred to arbitration are arbitrable under law in arbitration involving Indian parties. Failure of the dispute being arbitrable may lead to the award being rendered unenforceable in India on grounds of breach of public policy of India.

7. INTERNATIONAL COMMERCIAL ARBITRATION WITH SEAT IN INDIA

As per the 2015 QMUL International Arbitration Survey, the five most preferable and broadly used seats for international commercial arbitration are London, Paris, Hong Kong, Singapore, and Geneva. For example, out of all disputes put forward to SIAC, one of the highest numbers of filings was generated from India.[11] Despite an elevated number of Indian parties opting for arbitration to settle their disputes, the number

[11] http://www.siac.org.sg (Sept. 2, 2016). There were 91 parties, which used SIAC in the year 2015, being the highest foreign nationality contributing to the SIAC caseload.

of such international arbitrations with seat in India has not grown notably. The laws applicable to ICA when seat of arbitration is India are dealt with below.

7.1. Notice of arbitration

Arbitration is said to have begun when the notice of arbitration needs the other party to take steps in connection with the arbitration or do something on his part in the matter of arbitration. Under Section 21 of the Act, a notice of arbitration has to be carried out to the other party, appealing that the dispute be referred to arbitration. The day, on which the respondent receives the notice, arbitral proceedings commence under the Act. In Notice of Arbitration, a party conveys:

a) An intention to refer the dispute to arbitration; and
b) The need that other party should do something on his part in that regard. This will overall be enough to define the commencement of arbitration under the Act.

7.1.1. *Applicability of Amendment Act*

The date of beginning of the arbitration in accordance with Section 21 of the Act is pivotal with regards the applicability of the Amendment Act. In the event, the date of commencement

is after October 23, 2015, the provisions of the Amendment Act will be relevant, as against the Act with respect to arbitral proceedings.

7.2. Referral to arbitration

Under Part I, the courts can denote the parties to arbitration if the subject matters of the dispute is controlled by the arbitration agreement. Section 8 of the Act supplies that if an action is brought before a judicial authority, which is subject-matter of an arbitration, upon an application by a party, the judicial authority is bound to mention the dispute to arbitration. It is important to note that the above application must be made by the party either before or at the time of making his first statement on the substance of the dispute and the application shall be accompanied by a duly certified or original copy of the arbitration agreement.

7.2.1. *Applicability of Amendment Act*

The Amendment Act confines the scope of the judicial authority's power to inspect the prima facie existence of a valid arbitration agreement, thereby reducing the threshold to refer a

matter before the court to an arbitration for purposes of arbitrations commenced on or after October 23, 2015.

More importantly, taking heed from the judgment of the Supreme Court in *Chloro Controls*[12], which effectively applied only to foreign-seated arbitrations, the definition of the word ‘party’ to an arbitration agreement has been expanded under the Amendment Act to also include persons claiming through or under such party.

Thus, even non-signatories to an arbitration agreement, insofar as domestic arbitration or Indian seated ICA, may also participate in arbitration proceedings as long as they are proper and necessary parties to the agreement.[13]

7.3. Interim reliefs

Under the Act, the parties can seek interim relief from courts and arbitral tribunals under Section 9 and 17 respectively.

A party may, before, or during arbitral proceedings or at any time after the making of the Arbitral Award but before it is enforced, apply to a court for seeking interim measures and

[12] Chloro Controls India (P) Ltd. v. Severn Trent Water Purification Inc., (2013) 1 SCC 641.
[13] Sukanya Holdings Pvt. Ltd. v. Jayesh H. Pandya, (2003) 5 SCC 531.

protections including interim injunctions under Section 9 of the Act.

The Arbitral Tribunal in accordance with Section 17 can also provide interim measures of protection or ask a party to provide appropriate security in connection with the matter of dispute, as is found appropriate during the course of the arbitral proceedings. However the powers of the Arbitral Tribunal were narrow compared to the powers of the court under Section 9 of the Act.

7.3.1. *Applicability of Amendment Act*

The Amendment Act has made important changes, which will affect the granting of interim relief in an arbitration proceedings commenced after October 23, 2015.

7.4. **Interim reliefs under Section 9**

If an arbitral tribunal has been constituted, the court will not entertain an application for interim protection under Section 9 of the Act unless the court finds that circumstances exist which may not render the remedy pro- vided under Section 17 ineffective.

Post the grant of interim protection under Section 9 of the Act, the arbitral proceedings must start off within a period of 90

days from the date of the interim protection order or within such time as the court may determine.

7.5. Interim reliefs under Section 17

Section17 has been revised to provide the Arbitral Tribunal the same powers as a 'civil court' in relation to the grant of interim measures. Remarkably, the Arbitral Tribunal would have powers to grant interim relief post award but prior to its execution. Further, the order passed by an Arbitral Tribunal in arbitrations seated in India will be regarded as to be an order of the court and will be enforceable under the Code of Civil Procedure, 1908 as if it were an order of the court, which provides clarity on its enforceability.

The intention seems to be to entrust significant powers with the Arbitral Tribunal and lessen the burden and backlog before the courts. There has been extensive confusion on the extent and scope of arbitrator's powers to grant interim relief, and enforceability of such orders has demonstrated difficult. This issue has been aptly addressed by making the enforceability of orders issued under Section 9 and 17 of the Act similar in case of domestic and international commercial arbitrations seated in India. However, in certain situations, a party will be in need to obtain an order of interim relief from a court only.

7.6. Appointment of Arbitrators

The parties are free to agree on a procedure for appointing the arbitrator(s). The agreement can provide for a tribunal consisting of three arbitrators and each party will appoint one arbitrator and the two appointed arbitrators will appoint the third arbitrator who will act as a presiding arbitrator.[14] If one of the parties does not appoint an Arbitrator within 30 days, or if two appointed Arbitrators do not appoint third Arbitrator within 30 days, the party can request Chief Justice of India ("CJI") to appoint an Arbitrator in case of international commercial arbitrations.[15] The CJI can authorize any person or institution to appoint an Arbitrator. Some High Courts have authorized District Judge to appoint an Arbitrator. In case of domestic arbitrations, application has to be made to Chief Justice of respective High Court within whose jurisdiction the parties are situated.[16]

7.6.1. *Applicability of Amendment Act*

If one of the parties does not appoint an arbitrator within 30 days, or if two appointed arbitrators do not appoint third arbitrator within 30 days, the party can request the Supreme

[14] Arbitration and Conciliation Act, 2015, §11(3).
[15] *Id*, §11(4).
[16] *Id*, §11(12).

Court or relevant High Court (as applicable) to appoint an arbitrator. [17]The Supreme Court/High Court can authorize any person or institution to appoint an arbitrator.[18] In case of an ICA, the application for appointment of arbitrator has to be made to the Supreme Court and in case of a domestic arbitration, the respective High Courts having territorial jurisdiction will appoint the Arbitrator.

The Amendment Act empowers the Supreme Court in an India-seated ICA and High Courts in domestic arbitration to examine the existence of an arbitration agreement at the time of making such appointment. [19] This should be noted against the threshold contained in a Section 8 application for referring a dispute to arbitration, which empowers a court only to merely examine the prima facie existence of an arbitration agreement.

The application for appointment of the arbitrator before the Supreme Court or High Court, as the case may be, is required to be disposed of as expeditiously as possible and an endeavor shall be made to do so within a period of 60 days; such appointment would not amount to delegation of judicial power and is to be treated as an administrative decision.

[17] *Id*, §11(6).
[18] *Id*, §11(6)(b).
[19] *Id,* §11(6)(a).

There has always been a concern in India with respect to the time taken for appointment of arbitrators due to the existing jurisprudence and procedure. The time frame for such appointment was usually 12- 18 months. This amendment seeks to address this delay by introducing a timeline and clarifying the procedure of appointment to be an exercise of administrative power by the courts.

7.7. Challenge to Appointment of Arbitrator

An arbitrator is supposed to be independent and impartial. If there are situations due to which his independence or impartiality can be challenged, he must reveal the circumstances before his appointment.[20] Engagement of an arbitrator can be challenged only if –

a) Situation exist that leads to justifiable doubts as to his independence or impartiality; or,
b) He does not have the qualifications agreed upon by the parties.[21]

The question to appointment has to be settled by the arbitrator himself. If he does not accept the challenge, the proceedings can go further and the arbitrator can make the arbitral award.

[20] *Id,* §12(1).
[21] *Id,* §12(3).

However, in such case, application for setting aside the arbitral award can be made to the court under Section 34 of the Act. If the court consents to the challenge, the arbitral award can be set aside.[22] Thus, even if the arbitrator does not take up the challenge to his appointment, the other party cannot stall further arbitration proceedings by rushing to the court. The arbitration can continue and challenge can be made in court only after the arbitral award is made.

7.7.1. *Applicability of Amendment Act*

The Amendment Act provides a structure for disclosure in the new Fifth Schedule. Such disclosure is in agreement with internationally accepted practices to be made relevant for arbitration proceedings commenced on or after October 23, 2015.

In the Amendment Act, the lawmakers have scheduled scenarios in Seventh Schedule, which may follow in justifiable doubts as to the independence and impartiality of an arbitrator such as 'relationship with the parties, counsel or the subject matter of the dispute, such as that of the employee of one of the parties'.[23] This is an symptomatic list in addition to banning situations that have been affirmed by case law such as the

[22] *Id,* §13(6).
[23] §11(5) of the Act inserted by the Amendment Act.

holding of the Supreme Court that the arbitrator cannot be qualified to arbitrate if he is the part of the contract.[24]

7.8. Challenge to Jurisdiction

Under Section 16 of the Act, an Arbitral Tribunal has capability to rule on its own jurisdiction, which incorporates ruling on any objections with respect to the existence or validity of the arbitration agreement. The doctrine of *'competence-competence'* extends to jurisdiction on the Arbitrators to adjudicate challenges to the arbitration clause itself. In *S.B.P. and Co. v. Patel Engineering Ltd. and Anr,*[25] the Supreme Court has held that where the Arbitral Tribunal was constituted by the parties without judicial intervention, the Arbitral Tribunal could determine all jurisdictional issues by exercising its powers of competence-competence under Section 16 of the Act.

7.9. Hearings and Written Proceedings

After submission of pleadings, unless the parties agree otherwise, the Arbitral Tribunal can determine whether there will be an oral hearing or whether proceedings can be conducted on the basis of documents and other materials.

[24] Indian Oil Corporation Ltd. v. Raja Transport Pvt. Ltd., (2009) 8 SCC 520.
[25] S.B.P. and Co. v. Patel Engineering Ltd. and Anr, 2005 (8) SCC 618.

However, if one of the parties requests the Arbitral Tribunal for a hearing, adequate advance notice of hearing should be given to both the parties.[26] Thus, unless one party requests, oral hearing is not compulsory.

7.9.1. *Applicability of Amendment Act*

For the speedy conclusion of the arbitration proceedings a provision has been introduced by the Amendment Act on the conduct of *'oral proceedings'* and appointing of *'sufficient cause'* in order to search for suspensions. The amended provision has also made a room for the tribunal to foist costs incorporating cautionary costs in case the party fails to provide enough reasoning for the adjournment sought.

The Amendment Act authorizes the time limit for conduct and behaviour of the arbitral proceedings have been efficient and arbitrators instructed to finish the entire arbitration proceedings within a span of 12 (twelve) months from the date the Arbitral Tribunal enter upon the reference.[27] However, a 6 months extension may be bestowed to the arbitrator by mutual consent of the parties.[28] Beyond 6 months, any additional extension

[26] Arbitration and Conciliation Act, 1996, §24.
[27] *Id*, §29A(1).
[28] *Id,* §29A(3) .

may be granted to the arbitrator at the judgment of the court [29] or else the proceedings shall stand discontinued.[30] An application for extension of time towards completion of arbitral proceedings has to be disposed of expeditiously.[31] There is also a proviso made for conferring on additional fees, as consented upon by the parties, to them for passing the award within the time span of 6 months.[32]

7.10. Fast Track Procedure

The Amendment Act has put new provisions to facilitate an expedited settlement of disputes based only on documents subject to the agreement of the parties. The tribunal for this purpose composes only of a sole arbitrator who shall be chosen by the parties.[33]

For the expressed purpose, the time limit for making an award under this section has been covered at 6 months from the date the Arbitral Tribunal enters upon the reference.[34]

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[29] *Id,* §29A(5).
[30] *Id,* §29A(4).
[31] *Id,* §29A(9) – the section endeavours the application to be disposed of within a period of 60 days.
[32] *Id,* §29A(2).
[33] *Id,* §29B(2).
[34] *Id,* §29B(4).

Parties can before constitution of the Arbitral Tribunal, admit in writing to manage arbitration under a fast track procedure.[35] Under the fast track procedure, unless the parties otherwise make an appeal for oral hearing or if the arbitral tribunal considers it essential to have oral hearing, the Arbitral Tribunal shall ask for the dispute on the basis of written pleadings, records and presentations filed by the parties without any oral hearing.[36]

7.11. Settlement during Arbitration

It is allowable for parties to reach at a mutual settlement even when the arbitration proceedings are going on. In fact, even the tribunal can make attempts to encourage mutual settlement.

If parties settle the dispute by mutual agreement, the arbitration shall come to an end. However, if both parties and the Arbitral Tribunal agree, the settlement can be taken down in the form of an arbitral award on agreed terms, which is then known as consent award. Such arbitral award shall have the same force as any other arbitral award.[37]

[35]*Id,* §29B(1).
[36]*Id,* §29B(3).
[37]*Id,* §30.

7.12. **Arbitral Award**

A settlement of an Arbitral Tribunal is termed as 'Arbitral Award'. An arbitral award includes interim awards. But it does not include interim orders passed by arbitral tribunals under Section 17. Arbitrator can decide the dispute "in justice and in good faith" only if both the parties expressly authorize him to do so.[38] The decision of Arbitral Tribunal will be by majority.[39] The Arbitral Award shall be in writing and signed by all the members of the tribunal.[40] It must state the causes for the award unless the parties have agreed that no reason for the award is to be given.[41] The Award should be dated and the place where it is made should be mentioned. A copy of the award should be given to each party. Arbitral Tribunals can also make interim awards.[42]

Under Section 30 of the Act, even in the lacking of any provision in the arbitration agreement, the Arbitral Tribunal can, with the explicit consent of the parties, negotiate or conciliate with the parties, to resolve the disputes mentioned for arbitration.

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[38] *Id,* §28(2).
[39] *Id,* §29.
[40] *Id,* §31(1).
[41] *Id*, §31(3).
[42] *Id,* §31(6).

7.13. **Challenge to an Award**

Section 34 makes facilities for the manner and reasons for challenge of the arbitral award. The time period for the challenge is before the expiry of 3 months from the date of receipt of the arbitral award. If that period runs out, the award holder can apply for execution of the arbitral award as a decree of the court. But as long as this period has not elapsed, enforcement is not possible.

Under Section 34 of the Act, a party can challenge the arbitral award on the following grounds-

a) The parties to the agreement are under some incapacity;
b) The agreement is void;
c) The award contains decisions on matters beyond the scope of the arbitration agreement;
d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the arbitration agreement;
e) The award has been set aside or suspended by a competent authority of the country in which it was made;
f) The subject matter of dispute cannot be settled by arbitration under Indian law; or
g) The enforcement of the award would be contrary to Indian public policy.

7.13.1. *Applicability of Amendment Act*

The Amendment Act has added an explanation to Section 34 of the Act. Within the clarification, public policy of Asian nation has been processed to mean solely if: (a) the creating of the award was induced or suffering from fraud or corruption or was in violation of Section 75 or 81; or (b) it's in dispute with the elemental policy of Indian law; or (c) it's in dispute with the foremost basic notions of the morality or justice. The Amendment Act clarifies that an award will not be set aside by the court merely on erroneous application of law or by re-appreciation of evidence.[43] A court will not review the deserves of the dispute when deciding whether or not the award is in dispute with the elemental policy of Indian law.[44] The change Act has conjointly introduced a brand new section providing that the award is also put aside if the court finds that it's vitiated by patent unlawfulness, that seems on the face of the award just in case of domestic arbitrations. For ICA sitting in Asian nation, 'patent illegality' has been keep outside the range of the mediation challenge.[45] A challenge beneath this

[43] Proviso to §34(2A) of the Arbitration and Conciliation Act, 2015.
[44] Explanation 2 to §48 of the Arbitration and Conciliation Act, 2015.
[45] Arbitration and Conciliation Act, 2015, §34(2A).

section may be filed solely when providing previous notice to the alternative party.[46]

A challenge has to be disposed of expeditiously and in any event within a period of one year from the date of the prior notice referred above.[47] The amended section conjointly states that wherever the time for creating associate application beneath Section 34 has invalid, then subject to the provisions of the CPC, the award may be implemented.

Under the Act, there was associate automatic keep once associate application to line aside the award beneath Section 34 of the Act was filed before the Indian courts. The change Act currently needs parties to file an extra application associated specifically obtain a keep by demonstrating the requirement for such keep to an Indian court.

8. EMERGING ISSUES IN INDIAN ARBITRATION LAWS

In the immediate years, there has been a lot of eagerness on some of the known issues involving the arbitration laws in India, such as (a) prospective applicability of the Amendment Act; (b) whether two Indian parties can select a foreign seat of arbitration; (c) whether it is possible to arbitrate a dispute arising over allegations of oppression and mismanagement.

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[46] *Id,* §34(5).
[47] *Id,* §34(6).

8.1. Prospective applicability of the amendment act

In the recent past, the Madras High Court in *New Tripur Area Development Corporation Limited v .M/s. Hindustan Construction Co. Ltd. & Ors*.[48] has ruled that the language used in the Section 26 of the Amendment Act only mentions to arbitral proceedings and not court proceedings due to removing of the language *"in relation to."* Section 26 of the Amendment Act is not applicable to the stage post arbitral proceedings.

However, the Calcutta High Court in *Electrosteel Castings Limited v. Reacon Engineers (India) Private Ltd.*[49] has given a opposing view, and held that the Amendment Act will not apply and Section 34 petitions in case of arbitration proceedings commenced prior to October 23, 2015, would act as automatic stay.

8.2. Conundrum surrounding two Indian parties having a foreign seat of arbitration

Even though this issue has been sermonized by a number of High Courts in the past, there is still no clarity on ability of

[48] New Tripur Area Development Corporation Limited v .M/s. Hindustan Construction Co. Ltd. & Ors. Application No. 7674 of 2015 in O.P. No. 931 of 2015.
[49] Electrosteel Castings Limited v. Reacon Engineers (India) Private Ltd., Judgment in Arbitration Petition No. 1710/2015, (Jan 14, 2016).

two Indian parties to select a foreign seat of arbitration. In *Addhar Mercantile Private Limited v. Shree Jagdamba Agrico Exports Pvt. Ltd.,*[50] the Bombay High Court opined that two Indian parties picking up a foreign seat and a foreign law governing the arbitration agreement could be considered to be contrary to public policy of the country.

Recently, in the case of *Sasan Power Ltd v. North America Coal Corporation India Pvt. Ltd*.,[51] the Madhya Pradesh High Court held that two Indian parties might conduct arbitration in a foreign seat under English law.

The Madhya Pradesh High Court primarily relied on the ruling in the case of *Atlas Exports Industries v. Kotak & Company*,[52] wherein the Supreme Court ruled that two Indian parties could contract to have a foreign-seated arbitration; although, the judgment was in context of the 1940 Arbitration Act. An appeal has been filed challenging this decision and is pending adjudication before the Supreme Court.

However, one must be cautious of the ruling in TDM Infrastructure, 100 wherein the court held that two Indian

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[50] Addhar Mercantile Private Limited v. Shree Jagdamba Agrico Exports Pvt. Ltd., Judgment in Arbitration Petition No. 910/2013,(June 12, 2015).
[51] Sasan Power Ltd v. North America Coal Corporation India Pvt. Ltd., Judgment in First Appeal No. 310/2015,(Sept. 11, 2015).
[52] Atlas Exports Industries v. Kotak & Company, (1999) 7 SCC 61.

parties could not derogate from Indian law by agreeing to conduct arbitration with a foreign seat and a foreign law.

8.3. Arbitrability of oppression and mismanagement cases

The Bombay High Court in *Rakesh Malhotra v. Rajinder Kumar Malhotra* delivered a landmark judgment on this issue,[53] wherein the court ruled that disputes concerning oppression and mismanagement cannot be arbitrated, and must be adjudicated upon by the judicial authority itself. However, in case the judicial authority finds that the petition is mala fide or annoying and is an attempt to avoid an arbitration clause; the dispute must be referred to arbitration. Probably, this could have an unintended influence on the prima facie standard in section 8, as amended and introduced by the Amendment Act.

The Bombay High Court submitted that a petition under Sections 397 and 398 of the Companies Act, 1953 might consist of conduct of clandestine non-contractual actions that ends in the mismanagement of the company's affairs or in the oppression of the minority shareholders, or both.

In such cases, even if there is an arbitration agreement, it is not essential that every single act must, ipso facto, connect with

[53] TDM Infrastructure Pvt. Ltd. v. UE Development India Pvt. Ltd., (2008) 14 SCC 271.

that arbitration agreement. Moreover, the fact that the dispute might influence rights of third parties who are not even the party to the arbitration agreement offers such disputes non-arbitrable. In addition to the above emerging issues, please find enclosed Annexure containing detailed list of our hotlines, which cover the analysis of the recent judgments and issues faced in the arbitration regime in India.

9. CONCLUSION

An invasive economy needs a reliable stable dispute resolution method so as to be able to attract foreign investment. With the intense backlog before Indian courts, industrial players in Asian country and abroad have developed a powerful preference to resolve disputes via arbitration.

In spite of Asian country being one in all the first signatories of the big apple Convention, arbitration in Asian country has not continually maintained with international best practices. However, the last 5 years have seen a major positive modification in approach. Courts and legislators have acted with a read to transfer Indian arbitration law in line with international observe.

With the pro-arbitration approach of the courts and therefore the modification Act in situ, there's cause to seem forward to

best practices being adopted in Indian arbitration law within the close to future. Exciting Times Square measure ahead for Indian arbitration jurisprudence and our courts square measure able to attack many matters addressing the interpretation of the modification Act.

BANKRUPTCY AND INSOLVENCY LAWS

CREDITOR SECURED: FACE OF CHANGED BANKRUPTCY LAW AND CORPORATE GOVERNANCE IN INDIA

PRATEEK SRIVASTAV*, DUSHYANT THAKUR**

1. INTRODUCTION

Use of credit mechanism is a widespread phenomenon involved in business with slight differences according to the sectors of the economy. Increasing role played by the credit itself is apparent from the fact that in the year, Rs. 62 trillion were disbursed by the banking sector in India. Effective Corporate Governance and effective Bankruptcy and Insolvency laws are essential factors which can complement culture of entrepreneurship and business growth by providing a structured and stable debt lending and recovery system. It inculcates a sense of financial soundness in the economy and assists the market participant in drawing the real picture by accurately assessing price, risk and consequences of non-performance and how to deal with it. Market discipline is maintained and any kind of asset deterioration gets mitigated

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through swift and reliable enforcement channels.

The term "bankruptcy" as believed by Mr. Justice Heath, although has Italian origin being derived from the word "banca" (banco) and "rotta" (rotto) which in literal sense means "broken bench", its immediate origin is a Latin term "bancus ruptus".[1] Lord Coke, assigning French origin to the term;bankrupt' said, "for *banque* in French is a *mensa*, and a *banquer* or exchanger is *mensarius*, and *route* is a sign or mark… and means one whole bank is removed, but a trace or mark is left behind."[2]

Bankruptcy, as per Lord Coke, was an apparent condition created by a person to deceive his or her creditor. He or she used to trick other men by getting possession of their goods and hide them in an unknown hidden place or own house.[3] Another British jurist, Justice Blackstone, defined "bankrupt" as "a trader, who secretes himself, or does certain other acts, tending to defraud his creditors."[4] Insolvency is a condition in which a debtor is unable to pay debts as they fall due or in the

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[1] Louis Edward Levinthal, *The Early History of English Bankruptcy,* 67 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 1, 2 (1919).

[2] WILLIAM COOKE, A COMPENDIUM SYSTEM OF BANKRUPT LAWS, 1 (1778).

[3] HENRY JUNIUS NOTT AND DAVID JAMESM'CORD, REPORTS OF CASES ARGUED AND DETERMINED IN THE SUPERIOR COURTS OF LAW IN THE STATE OF SOUTH CAROLINA, (1st ed. 1820).

[4] WILLIAM BLACKSTONE,COMMENTARIES ON THE LAWS OF ENGLAND: A FACSIMILE OF THE FIRST EDITION OF 1765—1769, (1979).

usual course of business[5] while bankruptcy is a statutory procedure by which the insolvent debtor obtains financial relief and undergoes a judicial reorganisation or liquidation of the debtor's assets for the benefit of creditors[6]. The Insolvency and Bankruptcy Code defines "bankrupt" as "any person adjudged as an undischarged insolvent"[7] and bankruptcy as a state of being bankrupt[8].

In the present time, there are two separate bodies of law emerged out the same historical roots, namely, personal bankruptcy law and corporate insolvency law. However, the subject matter of the paper is corporate bankruptcy law.

2. HISTORY OF INSOLVENCY LAWS

Ancient Hindu Texts contains no indication of anything approaching a system of bankruptcy. However, *Manu Samhita* contained rules for the recovery of debts[9] and defaulting debtors were accorded with extremely severe treatment, even if the default was bona fide in nature[10]. *Manu Samhita* says, "When a creditor sues the debtor, before the king, to repay the

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[5] BRYAN A. GARNER, BLACK'S LAW DICTIONARY, 867 (9th ed. 2009).
[6] *Ibid* at 166.
[7] S. 79(3) (c), Insolvency and Bankruptcy Code.
[8] S. 79 (4), Insolvency and Bankruptcy Code.
[9] DINSHAWFARDUNJIMULLA , THE LAW OF INSOLVENCY IN INDIA 1 (4th ed. 1997).
[10] Louis Edward Levinthal, *The Early History of Bankruptcy Law,* 66 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 223, 230 (1918).

debt due and for the purpose of obtaining back the possession of the property, he may force the debtor and make him pay by moral suasion, by suit of law, by artful management, or by the customary proceedings."[11]The creditor could have resorted to violent means, like killing debtor, his wife children, cattle or sieging him in his house, to recover the debt.

India did not have any indigenous law on bankruptcy before British came to the country.[12] In India, bankruptcy law, like in England, is essentially a creation of statute.[13] The Indian insolvency law has its origin in the English Law[14] and based on the Roman principle of *cessio bonarum*.[15] The Roman principle means assignment of a debtor's property to creditors.[16] First insolvency provisions in India can be traced back to S. 23 and 24 of the Government of India Act, 1800, through which, Recorder's Court at Bombay and the Supreme Court at Fort William and Madras were conferred with insolvency jurisdiction. In 1828, Statute 9 was passed, through which insolvency courts were set up in Presidency towns for the relief

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[11] MANU , MANU SAMHITA: THE LAWS OF MANU, 45 Chapter VIII para 47-49 (G. Buhler trans.,1886).
[12] *Supra* note 9, at 8
[13] District Board, Bijnor v. Mohammad Abdul Salam, (1947) 17 AWR 318.
[14] Law Commission of India, February 1964, 26th Report on Insolvency Laws, p.1.
[15] HALSBURY'S LAWS OF INDIA, INJUNCTION INSOLVENCY JUDGES 93 (Vol. 13, 2006)
[16] *Supra* note 5 at 259.

of insolvent debtor. This Act was marked as the beginning of special insolvency legislation in India.[17] The Act was to remain in force till 1833 but was continued until 1848 by subsequent legislations.[18] Indian Insolvency Act, passed in 1848, can be considered as another step in the development of insolvency laws in India. The Act repealed all other previous enactments. The 1848 Act remained in force for Bombay, Calcutta and Madras (Presidency-towns) till enactment of the Presidency-towns Insolvency Act, 1909 and covered the insolvency of individuals, partnerships and association of persons. However, for non- Presidency town areas, no insolvency law was present and the Provincial Insolvency Act, 1907 removed this lacuna. This Act was repealed by the Provincial Insolvency Act, 1920 and was in force in mofussils. The Law Commission of India, in its 26th report, recommended combining of the two laws, i.e., Presidency-towns Insolvency Act, 1909 and Provincial Insolvency Act, 1907, to make uniform insolvency law for the entire country.[19] However, this recommendation was not implemented.

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[17] *Supra* note 14.
[18] *Supra* note 9, at 8.
[19] *Supra* note 14.

3. HISTORY AND PERVIOUS PROVISIONS FOR CORPORATE INSOLVENCY LAWS IN INDIA AND ITS FLAWS

Bankruptcy and Insolvency is a subject matter of Concurrent List of the Constitution of India in its 9th Entry,[20] thus, enabling both state and centre to make laws related to the subject. Although law related to individual and partnerships was present in India, policy on corporate bankruptcy system was missing in India.[21] However, Union has the power to make laws related to winding up of a company (other than incorporation and regulation of a company).[22] Under the same power and on the recommendation of Bhabha Committee set up in 1950, parliament enacted the Companies Act, 1956. The Act governed winding up of registered companies[23] as well as winding up of unregistered companies[24]. Yet, no definition of Bankruptcy or Insolvency was present in the Act. It only dealt with the inability to pay debts. Practically, for Corporate Insolvency, it was the only law available. Under this law, the High Courts had the power to wind up a company.[25] The law prescribed certain circumstances under which a company could

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[20] The Constitution of India.
[21] DR. N.L.MITRAREPORT OF THE ADVISORY GROUP ON BANKRUPTCY LAWS, 12 (Reserve Bank of India 2001)
[22] The Constitution of India.
[23] Sec 425-560, Part 7, Companies Act, 1956.
[24] Part 10, Companies Act, 1956.
[25] Sec 433, Companies Act, 1956.

be wound up by a High Court, which, *inter alia* includes the inability of a company to pay its debts.[26] A company was deemed to be unable to pay its debts when the company failed to pay a sum exceeding Rs. 500 to the creditor to whom the debt was owed.[27] The process of winding up was preceded by liquidation. The Central Government was empowered to appoint a liquidator of the company[28], who was attached to each High Court, to carry out the liquidation process.[29] Payment of workmen dues and government dues was listed above the payment made to secured creditors because the Act was passed in the early years of industrialisation policy of India.

But, the provisions were not successful in dealing with corporate insolvency as according to report, the number of companies, which were inactive, among the registered ones reached 5.5 lakhs. Among this number, only a handful no. of cases got registered with High Courts and only about 300-600 got completed every year with an average time span of 5-8

[26] Sec 433 (e), Companies Act, 1956.
[27] Sec 434, Companies Act, 1956.
[28] Sec 449, Companies Act, 1956.
[29] Sec 448, Companies Act, 1956.

years for completion.[30]

Later, with increasing priority being given to industrial sector by the policy-makers, there was a rapid boom in the sector which also was accompanied with sickness of industries. In 1981, a committee was set up by the Reserve Bank of India under the chairmanship of Shri T. Tiwari to suggest remedies necessary for the revival of sick industrial units through the creation of a comprehensive legislation to deal with the problem of sickness. In September 1983, the committee submitted its report to the government and recommended the need for setting up of a quasi-judicial body through special legislation, especially for the purpose. Following the recommendations given by the committee, the Parliament enacted Sick Industrial Companies (Special Provisions) Act, 1985, ("SICA"). The Supreme Court in *Navnit R. Kamani v. R.R. Kamani*[31] said that the SICA was enacted with a view to:

a) Afford maximum protection of employment;

b) Optimize the use of funds of the companies;

c) Salvaging the production assets;

d) Realizing the amount due to the Banks etc.; and

[30] RajeswariSenguptaet al., *Evolution of the insolvency framework for non-financial firms in India,* 6 (Indira Gandhi Institute of Development Research, Working Paper No. 2016-018, 2016).
[31] Navnit R. Kamani v. R.R. Kamani, AIR 1989 SC 9.

e) To replace the existing time- consuming and inadequate machinery by efficient machinery for expeditious determination by a body of experts.

SICA can be said as the first law in India, which focused only on the restructuring of the companies, but the scope of the Act was limited only to "sick industrial companies". A sick industrial company means an industrial company[32], which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth.[33] The Act established Board for Industrial and Financial Reconstruction ("BIFR") and gave the onus to declare sickness of the firm to its directors. Upon such reporting, all claims, proceedings and suits against the firm stayed automatically. Under SICA, the debtor company was empowered to control its assets and operations even after it was declared "sick".

The lack of capacity at the BIFR and availability of only one bench in the country made the implementation of provisions difficult. Between 1987 and 2014, 15% of the cases were pending in BIFR and it took 5.8 years, on an average, for the closure of a suit.[34]

[32] Section 3(1) (e), Sick Industrial Companies Act, 1985.
[33] S. 3(1) (ga), Sick Industrial Companies Act, 1985.
[34] *Supra* note 30, at 8.

It was realized that civil courts were burdened with a recovery issue and a special tribunal can assist the banks and DFIs better in speedy recovery of debts due. With these observations, the first Narasimham Committee, a high-level committee set up to give recommendations on the Financial Systems, recommended the creation of tribunals to have jurisdiction over the matters related to debt recovery. So accordingly in 1993, Recovery of Debts due to Banks and Financial Institutions Act ("RDDBFI") which led to the establishment of Debt Recovery Tribunals ("DRT") and Debt Recovery Appellate Tribunals ("DRAT"). The intention behind the setup was to create specialized tribunals to facilitate expeditious recovery of debt from the defaulters by banks and a defined set of financial institutions.

While DRT was empowered to recover assets of debtor through an order along with the provision to detain him, the DRATs were one level up in the hierarchy, instituted to hear an appeal on the order of DRT.

Later with the recommendation of Second Narasimham Committee, *The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("SARFAESI Act")* was enacted to bring Reforms in Banking Sector. After RDDBFI, the efforts through SARFAESI Act was to further increase creditors' rights through enforcement of

secured assets and that too without court intervention.[35] It can also be said that as DRTs were ineffective, an alternative route was provided by the SARFAESI Act for recovery of debts.

Recommendation of the Narasimham Committee I and II also led to the establishment of Asset Reconstruction Companies (ARCs) who enabled the bank to offload their bad debts at a discount for resolution purpose. ARCs worked on the mechanism of purchasing NPAs, got accumulated in the Indian Banking Sector, from the banks for its recovery and resolution. The RBI, through detailed guidelines made, intended that sale and purchase of NPAs happened in a smooth and sound manner. Only companies which were registered were authorized to sell or purchase an NPA.

The problem with DRTs was a lack of availability of resources which affected the output from the tribunal as the process used to get delayed withal conversion rate of only 14% in 2013 and 17% in 2012[36]. Through SARFAESI, though the tribunal got extraordinary enforcement powers but those powers were not applicable on creditors other than banks and specified financial institutions. Also, the sale of NPAs by the banks to the ARCs

[35] Section 13, Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

[36] Reserve Bank of India, Report on Trends and Progress of Banking in India, 2008-2013.

was not as per the expectations.

The provisions present before passing of the Insolvency and Bankruptcy Code 2016 were highly fragmented ones. Rights were apportioned to creditors and debtors through separate Acts, which led to inconsistency in resolutions. Also, separate laws created separate judicial fore, which created the problem of overlapping jurisdiction. A review of judgments of DRTs and DRATs, the High Courts and the Supreme Court shows that this lack of clarity also has detrimental effect over interpretation of insolvency legislations in India.[37] Dearth of timely bankruptcy mechanism adds to the intricacy. It takes between 3 to 15 years for completely winding up the company under Companies Act, 1956.[38] Data collected for *Doing Business report* by the World Bank and International Finance Corporation signposts that it takes average of 4.3 years to completely resolve insolvency, costs 9.0% of the debtor's estate and recovery rate is at 25.7 cents on the dollar.[39] This also has unfavorable effect on credit market in India. World

[37] Aparna Ravi, *The Indian Insolvency Regime in Practice – An Analysis of Insolvency and Debt Recovery Proceedings* 10 (Indira Gandhi Institute of Development Research, Working Paper No. 2015-027, 2015).

[38] *Supra* note 30, at 12.

[39] WORLD BANK 2016, DOING BUSINESS 2016: MEASURING REGULATORY QUALITY AND EFFICIENCY 208 (World Bank ed., 13th ed. 2016).

Bank ranked India, in *Doing Business Report,* at 136 out of 189 economies in resolving insolvency.[40]

Acknowledging India's obscure bankruptcy laws, Companies (Second Amendment) Act, 2002 was enacted by the parliament. Significant changes were brought to the Companies Act, 1956 through this Act and SICA was repealed. The Act was passed following recommendations of a committee formed by the government under the chairmanship of a retired Supreme Court Judge Justice V. Balakrishna Eradi.

The Act gave new definition to the term "sickness" and National Company Law Tribunal was established. The Tribunal was to handle all the cases previously heard by BIFR, Company Law Board (as both of them were abolished through this Act) and the High Courts. It also introduced Rehabilitation and Revival Fund and Time bound restructuring and liquidation guidelines (the guidelines limited the process to 2 years). However, due to legal challenges, these could not be notified. Therefore, these provisions could not be implemented, as a result of which, previous provisions of the Companies Act, 1956 and SICA continue to remain in force.

New Companies Act was passed in the year 2013 and provisions under this Act were in line with the 2002 Act.

[40] *Ibid.*

4. INSOLVENCY & BANKRUPTCY CODE 2016

In 2014, on the recommendations of Bankruptcy Law Reforms Committee, set up by Ministry of Finance, under the chairmanship of Dr. T. K. Viswanathan, process for drafting comprehensive bankruptcy legislation began. The Code, with applicability on all non-financial corporations and individuals, was created with an intention to replace the existing framework. The Consolidate Code for insolvency and bankruptcy has introduced fresh principle and design of the resolution framework. The Code has also incorporated the recommendations of several past committees that were not taken into consideration earlier. Now, all sort of creditors, be it secured, unsecured, financial or operational, are empowered to initiate insolvency proceedings which wasn't the case with previous regime.

4.1. Time Bound Process

The corporate insolvency resolution process for body corporate aims to resolve insolvencies and the recovery of dues in a strict time-bound manner. The code prescribes for completion of the whole process within 180 days, which can be extended to 90 days for only one time with the consent of 75% of creditors, from the date of the admission of application for initiation of the process. An application needs to be filed in front of the

adjudicating authority to initiate the insolvency resolution process.[41]It has been made sure in the provisions that every step takes a reasonable time limit. For example, after receipt of the application, the Adjudication Authority must ascertain the existence of default within 14 days.[42] Also, order regarding admission or rejection of the application must be communicated within 7 days of such admission or rejection.[43] This suggests that time-bound processing is the essence of the Code.

4.2. Adjudicating Authority and Insolvency Regulator

National Company Law Tribunal, as defined in S. 408 of the Companies Act, 2013, has been made the Adjudication Authority and NCLAT the authority for appeal.[44]To avoid the toil due to overlapping jurisdiction, which was in previous regime, the code ensured that no Civil Court/ Authority has jurisdiction over matter, on which NCLT and NCLAT has jurisdiction. The application submitted to initiate the process should also have the proposal of name of the resolution professional who would act as an interim resolution

[41] Section 8, Insolvency and Bankruptcy Code, 2016.
[42] Section 7(4), Insolvency and Bankruptcy Code, 2016.
[43] Section 7(7), Insolvency and Bankruptcy Code, 2016.
[44] Section 5(1), Insolvency and Bankruptcy Code, 2016.

professional.[45]Once application is admitted, the Adjudicating Authority has to declare a moratorium along with appointing an interim resolution professional within 14 days[46] which shall be followed by public announcement of initiation of the process.[47] Through the Code, an Insolvency and Bankruptcy Board of India will be established to regulate all matters pertaining to insolvency and bankruptcy

4.3. Insolvency Professionals and Insolvency Resolution Process

The duty of interim resolution professional, apart from conducting the process, is to manage the affairs of corporate debtor and make every endeavour to preserve the value of the property from the date of his appointment.[48]The powers of the board of directors or the partners of the corporate debtor remains vested in the interim resolution professional and he may even appoint new employees and raise interim finance.[49]He continues till a committee of creditors is constituted and a resolution professional is appointed by the

[45] Section 7(3)(b), Insolvency and Bankruptcy Code, 2016.
[46] Section 16(1), Insolvency and Bankruptcy Code, 2016.
[47] Section 13, Insolvency and Bankruptcy Code, 2016.
[48] Section 17(1)(a), Section 20(1), Insolvency and Bankruptcy Code, 2016.
[49] Section 17(1)(b), Section 20(2), Insolvency and Bankruptcy Code, 2016.

committee which needs to happen within 7 days in the first meeting.[50]

Resolution professional, once appointed, has similar duties and powers as of interim resolution professional.[51]A resolution applicant has a right to submit a resolution plan to resolution professional who upon receiving it confirms that it meets certain conditions to be sent for approval of committee of creditors.[52] A resolution plan once approved has to be submitted to the Adjudicating Authority.[53] The authority then makes sure that the plan meets the requirements described in S. 30 and gives it binding effect upon all the stakeholders involved in the plan.[54] Then moratorium order passed earlier cease to have effect.[55]

4.4. Liquidation

An order is to be passed by the Adjudicating Authority for liquidation of corporate debtor if no resolution plan is received before completion of time period permitted for completion of resolution process or submitted plan is rejected due to non-

[50] Section 18, Section 21(1), Section 22, Insolvency and Bankruptcy Code, 2016.
[51] Section 23, Insolvency and Bankruptcy Code, 2016.
[52] Section 30, Insolvency and Bankruptcy Code, 2016.
[53] Section 30(6), Insolvency and Bankruptcy Code, 2016.
[54] Section 31(1), Insolvency and Bankruptcy Code, 2016.
[55] Section 31(3)(a), Insolvency and Bankruptcy Code, 2016.

compliance of requirement specified under section 31.[56] This order bars initiation of any other legal proceeding and is also a notice of discharge to the officers, employees and workmen of the corporate debtor.[57] The resolution professional then acts as a liquidator.[58] The liquidator has the power to take into custody or control all the assets, property, effects and actionable claims for evaluation after verification of creditors' claim on it. He can sell the property of the corporate debtor by public auction or even private contract.[59] Provisions are made in the code to bring the liquidation professional at par with the corporate debtor in term of decision making.[60] He may even form liquidation assets i.e. an estate of the assets to be held as a fiduciary for the benefit of all the creditors.[61]

4.5. Fast Track Corporate Insolvency Resolution

Going one step further, the code induct the concept of Fast Track Corporate Insolvency Resolution where the process has to be completed within 90 days and only a single extension 45 days is allowed. Also, there is a provision of fine and imprisonment, if it is felt by the authority that the process was

[56] Section 33(1), Insolvency and Bankruptcy Code, 2016.
[57] Section 33, Insolvency and Bankruptcy Code, 2016.
[58] Section 34(1), Insolvency and Bankruptcy Code, 2016.
[59] Section 35(1)(e), Insolvency and Bankruptcy Code, 2016.
[60] Section 35(1), Insolvency and Bankruptcy Code, 2016.
[61] Section 36, Insolvency and Bankruptcy Code, 2016.

initiated for any sort of misuse or violated the Section 14 of the Code.

5. COMPARISON WITH US, UK AND CHINA'S CORPORATE INSOLVENCY SYSTEM

In the United States ("US"), the Bankruptcy Reform Act, 1978 (as amended), which created bankruptcy code, governs bankruptcy. The Act led to the establishment of Bankruptcy Courts and jurisdiction. The Act is codified in Title 11. While discussing bankruptcy, both, insolvency of a company or of an individual can be referred to by the US attorneys. Bankruptcies can be filed by businesses either under Chapter 7 or under Chapter 11 of Title 11. Chapter 7 covers bankruptcy liquidation procedure while Chapter 11 deals with bankruptcy reorganization procedure.

In case of both UK and China, insolvency and bankruptcy is governed by a single legislation i.e. Insolvency Act 1986 ("IA") and Enterprise Bankruptcy Law 2006 ("EBL") respectively. High Court of England & Wales and The People's Court who have jurisdiction for this matter for UK and China respectively

Through the provision of initiation of an involuntary bankruptcy proceeding, creditor got leverage to initiate proceedings against any legal entity. This show creditor-

oriented approach in insolvency proceedings with bad debt losses. Also, strong domestic particularities exemplified by Articles 132 (with respect to the priority of existing social security debts) and Article 133 (with respect to the ongoing special regime for certain state-owned enterprises) of the 2006 Bankruptcy Law

5.1. **Objectives**

In the US insolvency regime, although provisions are available for reorganization as well as liquidation, main objective is protection and continuance of the company. Rescuing of company or achieving a better result constitute main objective of UK law, alone with protection of creditors' rights while in China, the provisions are available for reorganization, conciliation and liquidation as well. The feature of reorganization, where debtor company is allowed to continue its business operations, is new to the regime being inducted by EBL 2006. In UK, liquidation is the last resort where a liquidator was appointed to take control of the company distributes the assets to creditors according to their legal priority. In UK creditors' voluntary liquidation and compulsory liquidation were two modes to liquidate an insolvent company. New corporate insolvency system of India had main aim of consolidating all laws relating to corporate insolvency present

in India. It also aims at maximization of value of the beleaguered company's assets, protection of creditors' rights and meeting international standards.

5.2. Mode of Control

According to US laws, when bankruptcy is filed by company under Chapter 7, all operations of the firm are completely stopped and the company goes out of business. When bankruptcy is filed under Chapter 11, operations of the company is controlled by the debtor for the benefit of the creditors and overseen by the court. In case of ineffectiveness of the debtor's management, a trustee may be appointed. It can be said US corporate insolvency system has debtor-in-possession model.

In case of UK, an administrator or registered insolvency practitioner has these duties to the court and the creditors. All the power with management ceases to exist and gets vested in Administrator who can delegate those powers back to them if he feels it appropriate. The court cannot appoint an administrator if the application comes from the holder of a qualifying floating charge. The administrator has his role defined in the IA Act, 2000 and is empowered to do necessary things to manage the business and affairs of the company. UK's corporate insolvency system is that of trusteeship model.

There is also a provision of arrangements by way of reconstruction to be undertaken by liquidators in a voluntary winding up[62] as well as for compromising in accordance with creditors' rights in the act. The Companies Act 2006[63] takes care of statutory arrangements or compromises while, company voluntary arrangements, which refer to 'composition in satisfaction of [the company's] debts or a scheme of arrangement of companies' affairs are covered in IA, 1986.

While in China, the court-appointed administrator takes control of the debtor's estate and to a large extent administers the estate throughout the bankruptcy proceedings.[64] The resolution professional, appointed by committee of creditors, is responsible for resolution process as well as management of the firm. There is a provision of negotiable settlements on a variety of terms for the companies in distress where the parties can also opt for contractual binding over the settlement (between the company, its lenders and if possible, the general creditors) apart from proceeding within a statutory format.

India follows trusteeship model, in which management of the firms' affair is taken care by the resolution professional, appointed by the committee of creditors.

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[62] Section 110, Insolvency Act, 1986.
[63] Section 895, Companies Act, 2006.
[64] Article 22,Enterprise Bankruptcy Law, 2006.

5.3. Moratorium

The insolvency and bankruptcy code in India has extensive scope of applicability of moratorium where all other legal proceedings get frozen. The moratorium period began on the day when application for initiation of process is accepted which is quite similar to the other regimes. China is the only exception with limited scope of moratorium as litigation or arbitration resumes once administrator is designated. In UK, the administrator, in the moratorium period, is empowered to sell property free of security constituted by floating and fixed charges and free of any rights of third parties under HP agreements.

5.4. Committee of Creditors' and Reorganization Plan

Also, there is a provision for creation of creditors' committee like other legislations. In US, the courts oversees the process but is not involved in operations the Bankruptcy Code vests power and duties with Committee of Creditors'. The US and China has similar procedure of proceeding upon a reorganization plan with difference of time period allotted. In US, the trustee, according to this plan, liquidates all the assets and distribute the proceeds among the creditors on the basis of risk taken by them. In UK, administrator upon his appointment, send his proposals for achieving the purposes of the

Administration to the creditors. While in India, if the order is passed for liquidation of the corporate debtor, the resolution professional shall act as the liquidator for the process of liquidation.

6. COMPARISON OF THE CODE WITH INTERNATIONAL STANDARDS AND OBJECTIVES

Neither all objectives of the law can be laid down on a piece of paper nor the law can be expected to fulfil all the objectives This is because there cannot be a single rationale behind the law and the objectives sought to be achieved may be inconsistent with each other. However, it is important to keep the objectives in mind while framing the legislation.

Earlier a bankrupt was considered as a criminal. However, over a period of time, there has been a shift in objectives of bankruptcy laws and observing the same *Blackstone* said that bankruptcy laws are considered and should be for benefit of trade and founded on the principle of justice and humanity and rights should not be conferred only to the creditors but also to the debtor (bankrupt).[65] Expeditious, equal and economic distribution of proceeds from surrendered debtor's property and emancipation from creditor's demands upon such

[65] Blackstone's Commentaries, vol. 2 pp 471-472

surrender should be the chief aims of bankrupt laws.[66] Law Commission of India has enlisted two purposes of the insolvency laws, i.e., prevention of debtors from harassment of creditors, in case, he is unable to repay their debts and providing mechanism through which debts of the debtors can be satisfied.[67] Supreme Court said that the objective of insolvency law is seizure of an insolvent's property and distribution of the same among the creditors before the insolvent can squander the same.[68]

Although, attempts have been made by the World Bank[69] and IMF[70] to lay down the objectives of an insolvency law, it is not possible to enlist all the objectives of an insolvency law. However, the objectives laid down by UNITRAL can be considered as the most comprehensive one, which has tried to envelop most of the aims sought to be achieved by an insolvency law in a precise way. Because of this reason it becomes imperative to check if an insolvency law of a country fulfill the objectives laid down by UNITRAL. As per UNITRAL, key objectives, which should be achieved by

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[66] Henley's Bankrupt Law, 3rd ed., p. 1.
[67] *Supra* note 14.
[68] YenumulaMallu Dora v.PeruriSeetharatnam&Ors.AIR 1966 SC 918.
[69] The World Bank, *Principles and guidelines for Effective Insolvency and Creditor Rights Systems* (The World Bank 2001).
[70] International Monetary Fund, *Orderly & Effective Insolvency Procedures* (International Monetary Fund 1999).

insolvency legislation, are as follows[71]:

a) *Provide certainty in the market to promote economic stability and growth;*

b) *Maximize value of assets;*

c) *Strike a balance between liquidation and reorganization;*

d) *Ensure equitable treatment of similarly situated creditors;*

e) *Provide for timely, efficient and impartial resolution of insolvency;*

f) *Preserve the insolvency estate to allow equitable distribution to creditors;*

g) *Ensure a transparent and predictable insolvency law that contains incentives for gathering and dispensing information; and*

h) *Recognize existing creditors' rights and establish clear rules for ranking of priority claims.*

The advisory group on the bankruptcy laws set up by the Reserve Bank of India also narrowed down to similar set of objectives, which an insolvency law is expected to achieve. Incorporation of global principles of bankruptcy laws is among

[71] UNCITRAL, *Legislative Guide on Insolvency Law* 10 (UNCITRAL, 2005).

the objectives laid down by the Advisory Group.[72]

Bankruptcy Law Reforms Committee, in its report, kept three objectives in minds while suggesting Draft Insolvency and Bankruptcy Code, i.e., low time in resolution, low cost in recovery and higher levels of debt financing across a wide variety of debt instruments.[73]

Before the Insolvency and Bankruptcy Code came into force, the insolvency laws present in India were present in the form of separate legislations and the Code aims to consolidate the same. This is done with a view that greater clarity will be provided by such consolidation.[74] Further, it will lead to facilitation in application of provisions of the Code in consistent and coherent way. Appointment of a professional dedicated to the feature of handling only insolvency is an inclusion to ensure that process beings out the desired effect. Also a clear procedure has been laid down in the code, which will provide transparency in the insolvency laws, as the result of which the law will become predictable. Therefore, it can be said that the Code fulfills the objective of *ensuring a transparent and predictable insolvency law that contains*

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[72] *Supra* note 21, at 25.
[73] The report of the Bankruptcy Law Reforms Committee Volume I- Rationale and Design.
[74] Preamble,Insolvency and Bankruptcy Code, 2016.

incentives for gathering and dispensing information. The Indian corporate insolvency procedure strikes a good balance between reorganisation and liquidation. The first option available for the creditors is that of reorganisation. Therefore, the priority is given to protection of the company. In case, the resolution plan is not submitted to the Adjudication Authority within the maximum permitted period or rejects the resolution plan, order will be given for liquidation of the corporate debtor.

Objective of the Code, from the very starting, was to align the insolvency laws with the principles, standards and objectives laid down by various International Organizations. From the above analysis, it is clear that the Code is successful in coming a long way from previously present disintegrated insolvency laws to achieving the standards laid down by the international organizations.

7. EFFECT CODE ON STAKEHOLDERS OF CORPORATE GOVERNANCE

In the contemporary world, access to equity capital for long term investment is a feature that every company strives for. This feature is desired to establish market confidence and business integrity which can be created through good corporate governance. It definitely has a powerful effect in driving the growth of a company as has its influence in the matters of

profitability and growth of the company as well as output and investment decisions of firms through several channels. Effective governance helps in regulation and structuration of a firm by defining role and power and control of Ownership and management. It has a strong connection with development of financial intermediaries and capital market of a firm as well as corporate financing and investment patterns.

Corporate Governance was defined in the Cadbury Report as the system by which companies are directed and controlled.[75] It involves a set of relationships between a company and its stakeholders.[76] Stakeholders include not only shareholders and managers, but also employees, suppliers, customers, banks and other creditors, the government, various interest groups.[77]

7.1. Creditors' Rights

General commercial law governs relationship between company and its creditors.[78] Therefore, although other stakeholders are governed by respective branches of law (like

[75] The Financial Aspect of Corporate Governance (Cadbury Report)(1992).

[76] OCED, *OCEDPrinciples of Corporate Governance* 11 (Organization for Economic Co-operation and Development 2004).

[77] Tarek RoshdyGebba, *Corporate Governance Mechanisms Adopted by UAE National Commercial Banks*, 5 JOURNAL OF APPLIED FINANCE AND BANKING 23, 27 (2015).

[78] P. DAVIES, INTRODUCTION TO COMPANY LAW 65 (2nd ed. 2010).

consumers under Consumer Protection Act), creditors are provided safeguard under company law itself.[79]

Creditors need to be ensured that they get return on their investment and timely repayment is in the important for maintaining confidence of the creditors and is in the best interest of the company and thus, forms part of stakeholders under corporate governance. Also, larger amount on favourable terms can be borrowed by the companies with good corporate governance track record. Corporate governance deals with, "the set of methods to ensure that investors (suppliers of finance, shareholders and creditors) get a return on their investment."[80] Creditors exercise control for effective monitoring of their investments, or let us say, debts. Control can be exercised by the creditors over a firm, either actively or passively. Control is exercised actively through evaluation and checking of a firm's operations and its investment decisions and passively through collateral security. Through debt monitoring and exercising creditors' rights, creditors play a crucial role in corporate governance and serve as external monitors. When a company commits default, there is a transfer

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[79] Christopher J. Cowton, *Putting Creditors in Their Rightful Place-Corporate Governance and Business Ethics in the Light of Limited Liability*, 102 JOURNAL OF BUSINESS ETHICS 21, 27 (2011).

[80] Andrei Shleifer and Robert W. Vishny,*A Survey of Corporate Governance*, 52 THE JOURNAL OF FINANCE 737, 740-742 (1997).

of some control rights from the debtor company to the creditor and the creditor acquires right to repose the company's assets or throw the company into bankruptcy. Effective exercise of creditors' rights attracts the need of good and sound insolvency system, as, stronger the creditors' rights, better the corporate governance. This is because, creditors' powers to force a company to liquidate, provided by insolvency laws of a country, ultimately determines creditors' control rights over the defaulting firm.[81] Even OCED recognises importance of insolvency laws in its Principles of Corporate Governance by saying that "efficient and effective insolvency laws" help in "effective enforcement of creditors' rights" and thus, must accompany corporate governance framework.[82]

As per the Code, operation creditor and financial creditor are enabled to initiate Insolvency process. They also got a role to play in appointing resolution professional and extending the period of the corporate insolvency resolution process (if required) requires their consent. The financial creditors are provided with all sort of information related to the process. Also, they are protected from any act of debtor resulting into an undervalued transaction. Trusteeship model has been

[81] Cheryl W. Gray, *Creditors' Crucial Role in Corporate Governance*, 34 FINANCE & DEVELOPMENT 29, 29 (1997).
[82] *Supra* note 76, at 21.

adopted in India, which shows that main focus is on creditors' rights. Therefore, it can be said that the code has enhanced the creditors' rights as well as participation in the process. The attempt is to involve them and provide them suitable relief.

7.2. Promoters/ Shareholders

Shareholders have a vital role to play in corporate governance. Firstly, capital is provided to a company by its shareholders and secondly, rights of the shareholders are apprised in law.[83] A shareholder can also delegate the management of the investment to management group which includes relations with companies thus affecting corporate governance. Therefore, it is important to understand effect of corporate insolvency laws on shareholders.

Bankruptcy not only affects creditors, but is tough on the debtor company as well. Managers of the company get fired and its assets are liquidated.[84] Some argue that, even in bankruptcy, some portion of the firm must be protected for the shareholders otherwise they may take inane steps to protect the

[83] CORPORATE GOVERNANCE, CHRISTINE MILLAN 69 (4th ed. 2013).

[84] Douglas G. Baird, *The Hidden Virtues of Chapter 11: An Overview of the Law and Economics of Financially Distressed Firms* (Coase-Sandor Institute for Law & Economics Working Paper No. 43, 1997).

firm.[85] Interest of the shareholders must be protected, at least in case of reorganisation of the firm. Also, entrepreneurs are more likely enter into business where insolvency cost is low.[86] Therefore, insolvency laws should be designed in such a way so as to trim down loss of the shareholders.

Involvement of shareholders and board of directors is profound in the provisions for voluntary liquidation proceeding where the process is initiated voluntarily by a corporate person who has not committed any default. From inquiry to audits statements, shareholders are involved everywhere which assist in ensuring that shareholders are protected as much as possible. Also, it has been made responsibility of the resolution professional to protect and preserve the value of property of the corporate debtor. Also, primary focus of the code is on protection of the company through reorganisation process. Therefore, it can be said that although, focus is given more on creditor than the corporate debtor, provisions has been made to protect and preserve the value of shareholder's interest in the company's assets.

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[85] Cirmizi, Klapper&Uttamchandani, *The Challenges of Bankruptcy Reforms* 27(2) WorldBank Research Observer 185, 190 (2012).

[86] Leora Klapperet al., *Entry regulation as a barrier to entrepreneurship*, 82 JOURNAL OF FINANCIAL ECONOMICS 591, 608 (2006).

7.3. Employees and Workmen

In an organisation, employer and employee share some common and some individual interest. An employee associates himself/herself with an organisation for the sake of income or livelihood. This constitutes interest which an individual has in the present day while there may be a case that at some point in future, employees will often also be in receipt of a pension, if applicable, provided by the company's pension scheme.[87] A business in the market obtains its goodwill through skill and service of employee.

Insolvency period can be traumatic for employees of a company. At times, one may come across with profession who are associated with the organization for several decades and their professional growth depends largely on the development of the enterprise. Then, insolvency can have negative consequences on those employees. It is important to deal Job losses associated with insolvency or else it can have many adverse implications on the economy. It is important to keep in mind that companies should not be allowed to remain alive for the only purpose of preventing unemployment.[88]

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[87] *Supra* note 88, at 71.
[88] Interim Report of The Bankruptcy Law Reform Committee.

Through Insolvency law, the intention is to protect the interests of creditors, shareholders and the state as well as it is state's priority to safeguard the employee and workmen of the organization. Issues of fairness come to the fore as do considerations of rescue and design of the rules that allow efficient transfer of enterprises.[89]

Workmen's dues (for 24 months preceding the commencement of liquidation) have been kept on equal footing with the claims of secured creditors, which reflects the importance given to clear workmen's dues. Also wages and unpaid dues of the employees (other than workmen) have been kept on the third position of the priority list, even before the unsecured creditors. This two provisions show the attitude of corporate insolvency system towards employees and workmen of the debtors' company and importance given to clear their due and protection of their interests.

8. CONCLUSION

Insolvency law touches every sphere of credit system, from credit allocation to credit recovery. It also has a strong influence on corporate governance. An efficient insolvency framework complements effective corporate governance

[89] VANESSA FINCH, CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES 533 (1st ed. 2002).

framework. Indian legal system, before the incoming of the Insolvency and Bankruptcy Code 2016, remained affected from various problems which include weak and patch-worked legislation, slow judicial process and widespread corruption and resulted in abuse of insolvency regime in the country. Legislations, enacted initially were not able to cover aspects of insolvency. In the Companies Act 1956, the feature of corporate insolvency and definition of bankruptcy was missing. Also, the courts, which were already burdened with plethora of case, had jurisdiction of matters related to bankruptcy. SICA's ambit was limited to sick industries although it was the first legislation to cover the feature of reorganization. In SARFAESI and RDDBFI regime, due to lack of resource available to DRTs, desired effect could not be achieved. The Insolvency & Bankruptcy Code 2016 was the effort of the state to replace this system with regime originating out of consolidated code. The code ensures time-bound proceeding, tribunals with dedicated jurisdiction for insolvency-related matters and increased involvement of creditors in the proceeding. The Code matches the legislation of major economies of the world on almost all important aspects related to insolvency and is in line objectives laid due by major organisations of world. It has positive impact on creditors' rights and safeguards the interest of shareholders as well as the

employees. The change of regime has now to stand against the test of time with essential characteristics of a successful.

EARLY MARKET EXIT IN INSOLVENCY AND BANKRUPTCY ACT 2016 AND PROSPECTIVE IMPACT ON START-UP REGIME IN INDIA

SUBHANKAR DAS*

1. INTRODUCTION

With the objective of providing a certain degree of assurance to the creditors and the investors, the Bankruptcy and Insolvency Code, 2015 was passed by the NDA government which became an act on 28th of May 2016 with the purpose of helping investors and creditors in recovering investments.[1] The fact that India is a capital starved nation and is facing a major debt crisis continues to be a major impediment in its economic progress and development.[2] The presence of legislations like SARAFESI and Debts Recovery Act have been unsuccessful in recovery of money by the creditors and therefore the new Code aims to make recovery of debts hassle free and also ensure easy voluntary liquidation of companies. Under the aegis of Prime

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[1] Mahua Venkatesh, Jimsy Tapuria, *The new bankruptcy law will be yielding benefits in the long run*, THE HINDUSTAN TIMES, May 12, 2016, at 13.

[2] Remya Nair & Anil Padmanabhan, *Bankruptcy law will change how business is done: T.K. Vishwanathan* (July 13, 2016, 11:30 p.m.), http://www.livemint.com/Politics/y2D3JhMNSPKxxS74p1KZCP/Bankruptcy-code-will-change-how-business-is-done-TK-Viswana.html.

Minister Narendra Modi, and Department of Industries and Commerce, the Start-up India action plan was launched in January 2016.[3] The policy which aims for the development of entrepreneurial culture in India aims to encourage investors from India and abroad by making both domestic and Foreign Direct Investments hassle free.[4] In addition to that, the policy also intends to make use of the Bankruptcy and Insolvency Code and ensure that the investors can recover the money easily when the investments made do not earn the desired amount of profits.[5] Moreover, the start-up entities are also to be provided hassle free exit from the market in case they incur losses.

Through this paper, the author will aim to draw an analogy between the new start-up policy of India and the implementation of the Bankruptcy and Insolvency Act 2016 in the policy. Considering the nature of the start-up business regime, it is important to understand that to what extent, the

[3] Ruchika Chitravanshi, *PM Narendra Modi's dream project 'Start-up India' to be revamped to woo more participants*, THE ECONOMIC TIMES, June 22, 2016 at 14.

[4] Samiksha Jain, *Eight Things, Entrepreneurs like about PM Modi's Start-Up Policy in 2016* (July 1, 2016, 5:00 p.m.),https://www.entrepreneur.com/article/269797.

[5] Sohan Mishra, *Start-up India: This is the beginning of big bang start-up boom in India, says Softbank CEO,*THE HINDU, January 16, 2016, at 14.

favorable market exit options will be helpful or not.[6] During the course of this paper, the major objective would be to discuss about the major features of the abovementioned act and the new start up policy and find out the positive and negative impacts of hassle free market exits on the start-up regime in India and whether the new bankruptcy laws will help in expanding the number of start-ups or will it prove insufficient in attracting start-up entities in the Indian market.

2. OBJECTIVES AND SALIENT FEATURES OF THE ACT

As mentioned above, the major objective behind the prospective law is to ensure that, the creditors or investors have a suitable mechanism so as to enable them to recover any investments made in the form of money or tangible assets from the creditors.[7] It essentially aims to facilitate the ease of doing business in India, where India currently ranks at 130 as per a recent report of the World Bank.[8] Moreover, a report of the International Monetary Fund and the World Bank released in

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[6] Snigdha Sengupta, *Fine print of India's start-up policy* (July 4, 2016, 11:30 a.m.), http://www.livemint.com/Opinion/HxCGIWvOyVpMafvEkKZ1nI/Fine-print-of-Indias-startup-policy.html.

[7] Ens Economic Bureau, *Insolvency and Bankruptcy Code: A Legislation to promote investments, develop credit markets*, THE INDIAN EXPRESS, December 22, 2015, at 15.

[8] Aastha Dass, *New Bankruptcy Law to improve ease of doing business* (June, 21, 2016, 12:45 PM),http://indiatoday.intoday.in/story/new-bankruptcy-law-to-improve-ease-of-doing-business/1/552413.html.

2014 says that, the total outstanding debts of India amounts to 4.7 billion U.S. dollars which is the amount of foreign debts owed by India to its investors across the world.[9] Along with a staggering amount of foreign debts India also has a deficit of around 2.5 billion dollars in its reserves and which is attributed to the non-payment of outstanding debts to the creditors.[10] The Ministry of Finance in 2014, observed that India had recorded a Government Debt of 66.40 percent in comparison to the GDP as a result of which India is among the top 20 countries in the world with a government debt to GDP ratio.[11]

The new act is aimed at ensuring that recovery of debts and assets can happen in a hassle free manner, without causing much undue stress to the one who has invested in any form of business or has loaned out money or similar things to someone in need.[12] Before the passing of this prospective law, the biggest problem with the other legislations was that there were issues with regards to the application of legislations in the

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[9] The World Bank, *External Debt Stocks*, total (DOD, Current US$), (June 14, 2016, 11:45 AM), http://data.worldbank.org/indicator/DT.DOD.DECT.CD.

[10] M Allirajan, *India's External Debt Continues To Climb*, The Times of India, April 3, 2015, at 5.

[11] Ministry of Finance, Government of India, Government Debt, Status Paper, (June 20, 2016, 11:40 AM), http://www.finmin.nic.in/reports/GOVT_DEBT_July2013.pdf.

[12] Shaji Vikraman, *Explaining the Bankruptcy Law and the need to Have One*, THE INDIAN EXPRESS, November 5, 2015, at 12.

specific cases, i.e. under what condition what law was to be made applicable and which court would have the jurisdiction was a matter of utter confusion which further delayed the process of debt recovery in India.[13] Therefore, the new legislation is a comprehensive attempt at not only ensuring debt recovery but it aims to provide for a single legislation under whose ambit all possible cases in relation to debt recovery can be covered and thereby jurisdiction of the courts or other tribunals can be decided which are to adjudicate the matters on a case to case basis.[14] The act in question not only lays down essentially as to manner of debt-recovery, but in addition to that also facilitates the market exit of the companies or corporate houses who want to voluntarily exit the market through the winding-up process.[15] Moreover, it further code states that the winding up process is to be done in a period of 180 days extendable up to 90 days, which is the period in which winding up process is to be done.[16] If there is any fast track insolvency process which is supposed to take place, then

[13] INDIA Juris, The Insolvency and Bankruptcy Bill, (June 18, 2016, 11:45 PM), http://www.indiajuris.com/newsletter/pdf/bankruptcy-bill-2015.pdf.
[14] ENS Economic Bureau, *Debt and Redemption: Bankruptcy Bill Decoded*, THE INDIAN EXPRESS, May 15, 2016, at 13.
[15] Vinod Kothari, *Ushering in a New Corporate Bankruptcy Regime in India*, (June 18, 2016, 11:45 PM),http://indiacorplaw.blogspot.in/2015/11/ushering-in-new-corporate-bankruptcy.html.
[16] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India), § 14 cl.4.

in such a case, the process can be done within 90 days extendable to a period of 45 days.[17] It has often been observed that, in relation to debt recovery disputes are seen between the creditors and investors, however, the present law intends to formulate a process by which disputes can be resolved amicably and the actual amount for debt repayment can be decided by the creditor and investor before the company goes into the process of liquidation.[18]

As per a recent notification released by the Ministry of Finance, Government of India, the proposed legislation is aimed at recovery of an amount of Rs. 8 lakh crores, thereby streamlining the insolvency process in the country, which had earlier been governed by as many as eleven legislations including the presidency legislations and also the Recovery of Debts Act 1993, and aims at introducing one single legislation for recovering the debts.[19] In addition to the above, the newly passed legislation, aims at establishment of National Debts Recovery Tribunal and National Company Law Tribunal for

[17] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India), § 14 cl.5.

[18] Remya Nair, *Bankruptcy Law to be Rebooted*, LIVE MINT E-PAPER, July 19, 2016, at 14.

[19] Arup Roychoudhury, *Rajya Sabha Passes Bankruptcy Code*, BUSINESS STANDARD, May 12, 2016, at 17.

the systematic recovery of debts.[20] The new law further also states that the insolvency professionals will be responsible for handling the matters pertaining to insolvency and information utilities are to receive and utilize information pertaining to insolvency processes and provisions are sought to be made for easing of cross-border insolvency.[21] The major objective behind the newly proposed law is the facilitation of debt-recovery by virtue of reduction of procedural delays associated with it and ensuring that it happens within reasonable time.

3. MAJOR PROVISIONS AND INTENTION BEHIND INDIA'S NEW START-UP POLICY

In order to analyze effectively the effect of the new Insolvency and Bankruptcy Code 2016 on the start-up policies and start-up market in India, it is first important to mention the intentions and major provisions of the new start-up policy and the objectives intended to be achieved by it.[22] The biggest impediment to the growth of the start-up culture in any country is the amount of legal formalities required to start-up a new

[20] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India), § 211.
[21] Ministry of Finance, Press Release, *Parliament Passes the Insolvency and Bankruptcy Code*, (July 19, 2016, 7:00 AM), http://finmin.nic.in/press_room/2016/InsolvencyBankruptcyCode2016.pdf
[22] Sameer Kumar, *Startup India: Key Announcements In The Action Plan Unveiled By PM Modi*, THE NEW INDIAN EXPRESS, January 16, 2016, at 14.

business and the time and energy needed to do start one's company or firm.[23] Though India traditionally has been a favorable market for Foreign Direct Investment (FDI), however, the procedural formalities associated with starting-up in India has been the major reason for India's backwardness in the growth of start-up culture.[24] For example, to start-up a new business, the legal and procedural formalities take place within 7 days, and in Singapore, a business can be started up in 24 hours, therefore making it the most favorable destination for starting-up a new business.[25]

The new policy under the supervision of Prime Minister Mr. Narendra Modi and the Finance Minister Mr. Arun Jaitley, intends to do away with the procedural delays and legal hassles, with the objective of making India a hub for promoting

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[23] Vinay Vaish, *India: A Legal Business Guide for Start-Ups*, (July 26, 2016, 11:30 a.m.), http://www.mondaq.com/india/x/456322/Securities/A+Legal+Business+Guide+For+Startups,

[24] Ramanuj Mukherjee, *Why Indian Entrepreneurs struggle with the legal system and the bare essentials they need to know: Early-stage, pre-investment startups*, (July 23, 2016, 5:30 p.m.), http://blog.ipleaders.in/why-indian-entrepreneurs-struggle-with-the-legal-system-and-the-bare-essentials-they-need-to-know-early-stage-pre-investment-startups/.

[25] Peter Cohan, *Lessons on Start-up Commons from Hong Kong and Singapore*, (July 21, 2016, 7:00 p.m.), http://www.forbes.com/sites/petercohan/2013/01/21/lessons-on-start-up-commons-from-hong-kong-and-singapore/#45c833296736.

start-up culture.[26] As per a report of the World Bank in 2015, India improved its ranking in the ease of doing business, by moving up 12 places from 142 to 130 which is the biggest improvement among the South-East Asian economies.[27] Though this is considered to be a major improvement in the ease of doing business, however considering that India has always been a favorable market for Foreign Direct Investment (FDI), it is essential to take measures in order to improve the market conditions to make setting up of new business favorable for newly turned entrepreneurs.[28] Therefore, the aforesaid start-up policy intends to not only improve India's rank in improving the business regime in India but also provide a favorable environment i.e. a startup ecosystem to encourage new businesses and investments in the country.[29]

The start-up India policy defines, a "Start-up" as an entity, if it has not completed five years since the date of its incorporation, or it its turnover has not exceeded 25 crores in the previous financial year and it works for innovation, development of

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[26] Maulik Vyas, *On-Call Attorneys: Legal Support for start-ups with shoe-string budgets*, THE ECONOMIC TIMES, February 8, 2014, at 14.
[27] World Bank Group, *Ease of Doing Business in India* (July 8, 2016, 5:00 p.m.),http://www.doingbusiness.org/data/exploreeconomies/india/.
[28] K. George Varghese, *India moves up in 'ease of doing business' ranking*, THE HINDU, October 28, 2015, at 16.
[29] Economic Times Bureau, *Ease of Doing Business: India improves ranking, Singapore tops the list, says World Bank*, THE ECONOMIC TIMES, at 14.

technology and new products by making use of existing technology and intellectual property.[30] The new Start-up action plan has the following essential features to encourage new businessmen and angel investors in investing in Indian markets:[31] a) Tax exemption is to be provided to the start-ups on capital gains for the first 3 years b) provided that start-ups comply with the important labour and environment law statutes, they can go for self-certification c) Support to the start-ups by provision of funds worth Rs. 10,000 crore d) Tax exemption on Investments above Fair Market Value.

In order to do away with the legal complexities of starting up, the following provisions have been incorporated in order to attract budding entrepreneurs from entering into the business arena in India:

a) Legal Support and Fast-Tracking Patent Examination at lower costs.[32]

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[30] Department of Industrial Policy and Promotion, Notification No. GSR 180(E), (July 14, 2016, 11:30 a.m.),http://dipp.nic.in/English/Investor/startupindia/Definition_Startup_GazetteNotification.pdf.

[31] Department of Industrial Policy and Promotion, Action-India Start-Up Policy 2016, (July 12, 2016, 2:30 p.m.),http://dipp.nic.in/English/Investor/startupindia/StartupIndia_ActionPlan_16January2016.pdf.

[32] Express News Service, *Start-up India Plan on Jan 16: Modi on Mann Ki Baat*, THE NEW INDIAN EXPRESS, December 28, 2015, at 14.

b) Simplified procedures for Procurement of Start-ups by Public Sector Undertakings, without requirement of prior experience.[33]

c) A faster market exit regime for start-ups in case of losses, considering the nature of start-up businesses.[34]

4. EARLY MARKET EXIT AND IMPACT ON START-UPS

Considering the fact that the start-ups use innovation to expand business and are in their nascent stage, they are vulnerable to losses as due to market fluctuations or competitive pressure they may not be able to sustain themselves for a longer period of time.[35] A variety of reasons, such as lack of availability of capital for market investments, not getting the desired angel investors for making an investment in the start-ups and lack of resources to keep up with the requirements of a faster-growing economy are some of the innumerable factors which make it difficult for start-up entities to survive the cut-throat

[33] Tess Townsend, *What India's Narendra Modi Can Do for Indian Start-ups,* (July 15, 2016, 7:30 p.m.),http://www.inc.com/tess-townsend/india-narendra-modi-visit-silicon-valley-facebook.html.

[34] Ruchika Chitravanshi, *Start-Up India Initiative to get a rural avatar as Deen Dayal Upadhyay Rojagar Yojna*, THE ECONOMIC TIMES, March 28, 2016, at 16.

[35] Department of Industrial Policy and Promotion, *Start-Up India Action Plan* 2016, (July 21, 2016, 11:30 p.m.),http://dipp.nic.in/English/Investor/startupindia/StartupIndia_Action Plan_16January2016.pdf.

competition in the market.[36] To start-up a new business, a certain amount of capital is invested and in case the investments do not reap the desired benefits, problems arise, as the money invested is stuck up in the market, thereby causing hardships to the start-up entities and the angel investors who have invested their money in the markets.[37]

The process of winding-up and liquidation under the Companies Act, for example is in itself a cumbersome process which takes a lot of time irrespective of the fact as to whether it is compulsory or voluntarily done.[38] Even if a company was to go for a voluntary winding-up, it would require a resolution of board members in a board meeting, payment of fees to liquidator, filing of registration with the registrar of companies which in itself is a tedious process, which complicates the process of company exiting the market.[39] Furthermore, if a company is to undergo the process of liquidation, even then there is the requirement of the process of appointment of liquidator, who after his/her appointment is supposed to submit a report to the central government, and afterwards the

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[36] Economics National Bureau, *Govt. for Simpler entry and exit norms for start-ups*, THE HINDU, January 16, 2016, at 22.

[37] Preeti Balwani, *Law and Start-up India Story,* THE ECONOMIC TIMES, January 25, 2016, at 19.

[38] T.V. Narayanswamy, *Reopening of Sale Confirmed On Winding-Up*, 17, Corporate Law Adviser Articles, 4, 5 (2012).

[39] The Companies Act, 203, No. 18, Acts of Parliament, 2013 (India), § 270.

liquidation process is to take place.[40] Start-Up entities, under the prevalent laws can either register themselves as a Limited Liability Partnerships (LLP) under the Limited Liability Partnership Act, 2008 or as a Company under the Companies Act 2013.[41]

Even though, LLP is a better form of registering a start-up entity, yet entities intending to raise money from the public or a large number of investors, register themselves as companies, and failure to earn profits leads to liquidation and winding-up proceedings which makes exiting the market difficult thereby causing immense financial hardship to the owners and investors.[42]The new Bankruptcy regime, intends to bring about a change in the financial burdens that arise when either share capital or money invested gets stuck in the market, thereby facilitating the easier exit of start-up entities considering the fact that such businesses are not guaranteed to experience

[40] The Companies Act, 203, No. 18, Acts of Parliament, 2013 (India), § 361.
[41] Satish Chandra, *Why LLP Is Better for Start-Up,* (July 12, 2016, 11:30 p.m.), http://www.myonlineca.in/startup-blog/why-llp-is-better-for-startup.
[42] Nishith Desai Associates, *Start-Ups All You Need To Know*, (July 12, 2016, 7:00 p.m.),http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Start_-_Ups_What_You_Need_To_Know.pdf.

success after entering into the market.[43] The Insolvency and Bankruptcy Code intends to ensure that start-ups unable to register growth in their business can exit the market easily rather than being trapped due to the failure of their own investments or not being able to compete as per the market requirements.[44]

The new Insolvency and Bankruptcy Act (2016) provides for fast-track winding-up proceedings of start-up entities within a period of 90 days pursuant to an application for the winding-up of the company and appointment of the Insolvency professional.[45] The Insolvency professional can make an application to the adjudicating authority to further extend the proceedings by 45 days, if the need arises in order to ensure efficient winding-up of the start-ups.[46] It will be the responsibility of the Insolvency Professional, to ensure that the winding-up proceedings and the payment made to the creditors and investors in the form of assets is done within a period of

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[43] M.H. Bala Subramaniya, *New Generation Start-Ups In India, What can we learn from the past*? , 50, ECONOMIC AND POLITICAL WEEKLY, 4, 5 (2016).

[44] Rajiv Khaitan, *Government Announces Action Plan for Start-ups and RBI follows suit*, 4, SCC Online, 58 (2016).

[45] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India), § 56(1).

[46] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India), § 56(2).

six months.[47] After the appointment of the insolvency professional, the responsibility of the liquidator will be to ensure that there is a swift closure of business, sale of assets and repayment of creditors in accordance with the provisions of liquidation or winding-up for that purpose.[48] The liquidation process under the new law will respect the concept of limited liability, i.e. the partners or the directors would be liable only up to the extent of their individual liabilities to the shareholders or the creditors.[49]

Market experts have often viewed the ultimate aim of the start-ups is to survive the tough competition that surfaces in the prevalent business regime by increasing their valuation, by decreasing the valuation of their shares for attracting angel investors or venture capitalists to invest in their business.[50] Though offering discounts in share values for attracting investors is supposedly a good step in increasing the profits in the business, however, it is also a type of a gamble and that makes start-ups more prone to losses, thereby leading to the

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[47] INDUS Law, *The Start-Up Push,* (July 29, 2016, 11:30 p.m.), http://induslaw.com/publications/pdf/alerts-2016/march-2016.pdf?src=Website&month=16March2016.
[48] *Supra* note at 36.
[49] Diljit Tutus, Baljit Singh Kalha, *Why Your Start-up should be an LLP*, THE ECONOMIC TIMES, May 27, 2015, at 13.
[50] Rajeev Chandrasekhar, *With right set of policies, Start-Up India can change India's business landscape*, THE INDIAN EXPRESS, January 16, 2016, at 19.

requirement of easy exit routes for start-up entities.[51] The Hon'ble Minister of State, for Commerce and Industry, Ms. Nirmala Sitharaman observed that, starting a start-up is as important as somebody trying to exit it, thereby it is evident, that the Governmental policies to encourage a start-up ecosystem have to be conjoined with an easy exit route for start-ups who are unable to sustain themselves for a considerable period of time in the market.[52] Under the previous sub-topic, the rank of India with regards to the Ease of Doing Business, has been mentioned, the purpose behind which is to illustrate the fact that, it is the Governmental policies which play an important role in shaping up the manner in which the start-up culture grows or experiences a downfall during a particular period of time.[53] The World Bank has listed out, the following criteria for determining the ease of doing business index.[54]

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[51] Shutapa Paul, *Top Entrepreneurs react to India's new Start-up Policy*, FORBES INDIA MAGAZINE, (July 14, 2016, 8:30 p.m.), http://forbesindia.com/article/startup-india-2016/top-entrepreneurs-react-to-indias-new-startup-policy/41955/1.

[52] Ramesh Kumar, *Government working to make start, exit easy for start-ups*, THE HINDU, January 16, 2016, at 18.

[53] Sunil K. Goyal, *Modi Government's Policies Impacting Investments In Start-Ups,*BW BUSINESS WORLD (Jul 18, 2016, 5:30 p.m.), http://businessworld.in/article/Modi-Government-s-Policies-Impacting-Investments-In-Start-ups/07-06-2016-98882/.

[54] World Bank Group, *Ease of Doing Business Rankings* (July 8, 2016, 11:30 a.m.), http://www.doingbusiness.org/rankings.

a) The procedures, time, cost and capital requirements for the purpose of establishing a business in a country.[55]

b) Permits with regard to construction of office space i.e. the time and cost involved with the same.[56]

c) Whether credit is easily available without legal hassles and wastage of time.[57]

d) Whether the laws of the country where favorable for investors i.e. the level to which the investors are to disclose about themselves, in case an investment failed, how could they recover the amount.[58]

e) The level of taxes paid each year to the government.

f) The amount of hassles involved in foreign investment and cross border trading.

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[55] Simeon Djankoev, *"The Regulation of Entry*", 27, THE QUARTERLY JOURNAL OF BUSINESS, 17 (2002).

[56] International Trade Union Confederation, *World Bank takes major step on Labour standards*, (July 19, 2016, 8:30 p.m.), http://www.ituc-csi.org/world-bank-takes-major-step-on?lang=en.

[57] World Bank Group, *Doing Business2015*, *Going Beyond Efficiency Report* 12th Edition, (July 15, 2016, 9:30 p.m.), http://www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB15-Full-Report.pdf.

[58] Remya Nair, *World Bank's ease of doing business rankings: Suspense begins for NDA*, (July 29, 2016, 6:30 p.m.), http://www.livemint.com/Politics/FZCvAzV6qL8AZyYLREKM4K/World-Banks-ease-of-doing-business-rankings-Suspense-begin.html.

g) Enforceability of contracts, the time and cost involved and remedies for breach of contractual terms and obligations.[59]

h) Resolutions of insolvency, the time taken by start-ups to exit the market system, the time and cost needed to recover expenses or failed investments by the investors and the time needed for voluntary winding-up or self-market exit.[60]

From the above mentioned parameters, it can be easily made out that the insolvency resolution process plays a major role in nurturing the start-up business in a country, and the fact that India has a rather complicated insolvency process is a discouraging element in its quest to become a start-up hub considering the immense amount of potential, skill and resources in the country.[61] The author has earlier discussed about the fact that, Singapore is the top most country for starting up a business, with regards to the ease of doing

[59] Department of Industrial Policy and Promotion, *Initiatives on Improving 'Ease of Doing Business' in India*, (July 23, 2016, 7:45 p.m.), http://dipp.nic.in/English/Investor/Ease_DoingBusiness/EoDB_Intiatives_11December2015.pdf.

[60] Doing Business Group, *Measuring Regulatory Quality and Efficiency Economy Profile* 2016, India, (July 28, 2016, 8:30 p.m.), http://www.doingbusiness.org/Reports/Subnational-Reports/~/media/giawb/doing%20business/documents/profiles/country/IND.pdf.

[61] Rajeswari Sengupta & Anjali Sengupta, *Corporate Insolvency Resolution in India: Lessons from a cross-country Comparison*, 13, Indira Gandhi Institute of Developmental Research Review, 15, (2015).

business rankings.[62] To further eradicate the so-called stigma of being debtors, the threshold limit has been increased from $10,000 to $15,000, and the Minister of Law of Singapore, K Shanmugam, further stated that, his change seeks to encourage both debtors and creditors to resolve debts falling below the threshold, without resorting to the formal bankruptcy process. This will help such debtors avoid the inconveniences and social stigma associated with bankruptcy."[63] Before the advent of the new start-up policy recently, the Indian corporate Insolvency regime was channelized by multiplicity of statutory and judicial problems, unlike the regime in Singapore, where a uniform law precedes over all insolvency regimes pertaining to start-up and corporate entities, thereby resolving Insolvency disputes in an effective manner, thereby making market exit hassle free for both the start-up and corporate entities.[64]

Similarly, in New Zealand which is ranked second in the ease of doing business index, also has an insolvency regime which

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[62] World Bank Group, *Singapore Sets Global Standard in Business Regulations, Lao PDR Continues to Trail*, (July 18, 2016, 10:00 p.m.), http://www.worldbank.org/en/news/press-release/2011/10/20/singapore-sets-global-standard-business-regulations-lao-pdr-continues-trail.

[63] Singapore Business Review, *More debtors to avoid insolvency with proposed changes to bankruptcy laws*, (July 23, 2016, 8:00 p.m.), http://sbr.com.sg/financial-services/news/more-debtors-avoid-insolvency-proposed-changes-bankruptcy-laws.

[64] Sameer Mohan, *Start-Up in India, Stand-Up in Singapore,* (July 28, 2016, 10:30 p.m.),http://www.rediff.com/money/report/start-up-in-india-stand-up-in-singapore/20160120.htm.

is favorable for the start-up entities and the liquidation process in New Zealand is hassle free to the extent that, more than the stringency of the laws or the procedures, the liquidation process is carried out by the professional conduct of the lawyers, legal service professionals and the directors of the company or the start-up entities.[65] In addition to that, if one is to start-up in New Zealand then the companies can start-up with a no-asset procedure, i.e. insolvent individuals can start their business with support from the government and the governmental financial institutions without the need for having any amount of asset for establishment of a new business, after the concerned individual has turned insolvent.[66]

The new Bankruptcy Law is a welcome step with regards to encouraging the start-ups and also helping them to undergo easier liquidation and exit the markets easily in the event of non-profitability in business.[67] However, before a conclusion is drawn with regards to the credibility of the said law, an analysis has to be made with regards to the provisions of the

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[65] New Zealand Parliament, Insolvency Law Reform Bill- First Reading, (August 15, 2016, 10:30 p.m.), https://www.parliament.nz/en/pb/hansard-debates/rhr/document/48HansD_20060221_00001017/insolvency-law-reform-bill-first-reading.

[66] Trish Keeper, *New Zealand's No Asset Procedure: A Fresh Start At No Cost?* , 14, QUT LAW REVIEW, 8, (2014).

[67] Debasish Basu, *The Flaws in the Bankruptcy Laws*, The Business Standard, February 7, 2016, at 6.

said law for the purpose of determining its credibility in laying down easier routes for market exit and liquidation for insolvent start-up entities.[68]

5. INADEQUACIES IN THE INSOLVENCY LAW AND POTENTIAL PROBLEMS FOR START-UP ENTITIES

The biggest issue in the new laws on insolvency is the fact that, though there has an attempt which has been made herein for the unification of legal procedures associated with insolvency through a single law, yet, the existing laws, have not been repealed, which may lead to a confusion with regards to the fact as to whether the pre-existing laws could still have any effect upon the insolvency regime in the country.[69] In addition to that, as a matter of general parlance, the insolvency process is to take place within a span of 180 days[70], and is to be further

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[68] Rajiv Kumar, *Start and Exit Easy for Start-Ups Easy under the Bankruptcy Act*, (August 17, 2016, 9:30 p.m.), https://taxmantra.com/start-and-exit-easy-for-startups-with-insolvency-act/.

[69] Shishir Mehta & Kumar Saurabh Singh, *India: The New Insolvency and Bankruptcy Code*, 2016- *New Road and New Challenges*, (August 11, 2016, 11:30 p.m.), http://www.mondaq.com/india/x/495202/Insolvency+Bankruptcy/The+Insolvency+And+Bankruptcy+Code+2016+New+Road+And+New+Challenges.

[70] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India), § 12 cl. 1.

extended 270 days,[71] which further complicates the process as start-up entities which do not have enough money or financial security, could be forced to stay inside the market, which could be inconvenient for them, considering the fact that they would aim always for an early exit from the market.[72]

In addition to that, for insolvency applications to be made and for initiation of the said process, it is necessary for the passing of resolution by at least 75 per cent of the shareholders to carry out the insolvency process.[73] The mandatory requirement of 75 per-cent shareholders or members passing the resolution or bringing an interim relief could be managed by corporate entities who have been present in the market, for long to sustain themselves enough and can manage if there is a delay in the winding-up or liquidation process, however, the question arises as to how can start-up entities with less financial resources and investments, could sustain if an undue delay in the insolvency process occurs?[74]

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[71] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India), § 12 cl. 2.

[72] Novo Juris, *Benefits to "Start-Ups" under the Start-up India Action Plan*, (August 15, 2016, 9:30 p.m.), https://novojuris.com/2016/07/21/benefits-to-start-ups-under-the-startup-india-action-plan/.

[73] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India), § 21 cl. 8.

[74] ENS Economic Bureau, *Impelement Bankruptcy law in time bound manner: Arun Jaitley to officials,* THE INDIAN EXPRESS, August 24, 2016, at 5.

In addition to that, this act relies upon the professional conduct of the insolvency professionals or the insolvency boards, but the question that arises here is, how a regulatory mechanism can be imposed on them so as to ensure strict compliance with the provisions, as the insolvency laws are deemed to function as per the professional conduct of the individuals.[75]

Therefore considering the ambiguities in the present laws, it can be stated that the laws in question aren't favorable for start-up entities, as the clearly do not talk about the insolvency resolution time period and also considering the fact that unnecessary financial burden is imposed upon the start-up entities, owing to the fact that there is lack of financial power vested with the start-up entities which makes them vulnerable to market changes, and the lacunas in the insolvency process further expose them to crisis considering the lack of financial resources available with them.

6. CONCLUSION

The new Insolvency Law 2016 is a welcome measure which is intended at easing out the procedural lacunas and legal hassles associated with the insolvency resolution process in India. The new law is intended at functioning as a single law or entity

[75] The Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India), § 15 cl. 3(a).

which is aimed at making the insolvency process simpler, considering the fact that there is an existence of a number of laws whose existence complicates the insolvency process because of which it was inherently essential for having a single legislation to deal with the process. Considering the situation pertaining to the start-up entities, it can be said that though efforts have been made to ensure an easy exit route for them, however, the ambiguities in the provisions of the new law with regards to the time period and professionals who are supposed to carry out the insolvency process as it entirely depends upon their professional conduct more than the laws. Therefore, it can be concluded that though a positive step has been taken with regards to bringing an uniformity in relation to the insolvency laws, however, the lacunas in the provisions have to be addressed to ensure that the same does not cause any unnecessary legal hassles for the start-up entities.

CORPORATE RESCUE REGIME: PERSPECTIVES, ANALYSIS AND LESSONS

SHUBHAM PATEL*, SHIKHAR TONDON**

1. INTRODUCTION

"Corporate insolvency law is not merely concerned with the death and burial of the company".[1]

Traditional insolvency regimes aimed at the liquidation of the company once it seemed to be bankrupt. However, in the arena of modern insolvency regimes, it is thought advisable that before dumping the company for liquidation, a consideration must be made as to whether it can be brought back to life. If the insolvency is not fatal, rescue should be resorted to, to avert corporate death and liquidation.[2]

Rescue culture finds its roots back to the Report of the Review Committee on Insolvency Law and Practice (also known as the Cork Committee Report), a report submitted in 1982 by a committee headed by Sir Kenneth Cork, which had been given

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[1] VANESSA FINCH, CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLE, 4 (2d ed. Cambridge University Press 2009).

[2] *Id.*

the task to study the erstwhile insolvency laws of the United Kingdom.

According to Cork, a business concern has a lot of stake holders like the creditors, employees who are dependent on it for livelihood, capital contributors etc. Thus the liquidation of the company can lead to a sort of 'chain reaction', which can have a plethora of unpredicted consequences on the society.[3] Therefore a robust insolvency law should necessarily provide a mechanism which saves 'viable corporate enterprises'[4] from the scourge of liquidation.

Cork report had a significant impact on the English legislators and the concept of corporate rescue was included in the Insolvency Act, 1986.[5] The process of recue was renamed as the process of 'Administration', as it is popularly known in most jurisdictions**.**

In India, the scheme of corporate rescue in India has been inculcated in the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as 'the Code'), enacted recently and has been mentioned in Part II Chapter I of the Code. The concept has been renamed as the 'Corporate Insolvency Resolution

[3] *Report of the Review Committee on Insolvency Law and Practice*, 1982, Cmnd.8558, ¶ 204, (U.K.)
[4] *Id.* at ¶ 198.
[5] Insolvency Act, Part II (Eng.), (1986).

Process'. It is the brainchild of numerous reports and study of various administration regimes. The procedure adopted is somewhat same as typical administration process as discussed earlier, but with certain differences most of which are noteworthy and unique.

One of the major requirements for an economy which is resolving to grow is the availability of funds for the business, the cardinal principles to make sure that the funds flow consistently and considerably is to make sure that the entry as well as exit options are efficient and easy. Tedious and never ending bankruptcy proceedings make the investment from local as well as foreign investors go down. *"Where I can't exit, I shan't enter."*[6]

The World Bank's report *Doing Business 2016, Measuring Regulatory Quality and Efficiency* ranked India 130 out of 189 countries[7] on the basis of various indicators which include time, costs, returns to the creditors, participation and strength of the insolvency regimes, India is ranked 137 in terms of

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[6] Omkar Goswami, *The Urgent Need for the Fast Bankruptcy*, THE INDIAN EXPRESS, March 16, 2015, http://indianexpress.com/article/opinion/columns/the-urgent-need-for-fast-bankruptcy/.

[7] *Doing Business 2016, Measuring Regulatory Quality and Efficiency,* WORLD BANK GROUP, 208 (2016), http://www.doingbusiness.org/Doing%20Business/Documents/Annual-Reports/English/DB16-Full-Report.pdf [hereinafter *Doing Business Report 2016*].

Resolving Insolvency[8], with recovery rate of mere 25.7 cents per dollar[9], which when compared to Singapore (89.7 cents per dollar)[10], U.K. (88.6 cents per dollar)[11] and U.S.A. (80.4 cents per dollar)[12] highlights the plight of the Indian scenario. However, the then existing legal, political and social schemes did not provide the framework for efficient resolution of insolvency cases and thus considerably slowed down the pace of the industrial restructuring.[13]The two major reasons which appear for the failure of insolvency regimes. The first reason is the presence of multiple layers of laws which provide a mechanism of their own and therefore lead to presence of multiple cases in parallel legaluniverse.[14] Second, the pro rehabilitation attitude shown by the High Courts and the Supreme Court along with the laws which allowed prolonged liquidation proceeding.[15]

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[8] *Id.*
[9] *Id.*
[10] *Id.* at 232.
[11] *Id.* at 242.
[12] *Id.* at 243.
[13]Nimrit Kang & Nitin Nayar, *The Evolution of Corporate Bankruptcy Law in India*, I.C.R.A. Bulletin: Money and Finance 37, (Oct. 2003 - Mar. 2004).
[14] *Bharat Heavy Electricals Limited v. Arunachalam Sugar Mills Ltd.*, 2011 S.C.C. OnLine Mad. 581.
[15] Aparna Ravi, *The Indian Insolvency Regime in Practice – An Analysis of Insolvency and Debt Recovery Proceedings,* 3 INDIRA GANDHI INSTITUTE OF DEVELOPMENT RESEARCH, Working Paper No. 2015-027 (2015), *http://www.igidr.ac.in/pdf/publication/WP-2015-027.pdf.*

A number of countries have corporate rescue or restructuring regimes in place so that the going concern value of the company in distress can be preserved. The principle which guides the same is that business would have a lot more worth if it is preserved rather than if it is sold in pieces.[16] The Code was enacted with the view to resolve these issues and provide for a mechanism which deals with the rehabilitation and if needed liquidation of a company or other institutions in a fast and efficient manner, so as to maximize the gains of everyone.

The present work would focus upon the process of Corporate Rescue Regime as provided in the Code. The paper would discuss the procedure of rescue as envisaged in the code, in the backdrop of which the arrangement of the provisions and the intention of the framers thereby would be duly dealt with. This exercise would set the foundations for comparison of the Code with erstwhile Indian and the foreign rescue regimes, which would include the regimes from Singapore, the United Kingdom and the United States of America. The framer of the Code have attempted to make it very robust and infallible, and more importantly comprehensible in nature, so as to undo all the tribulations resulting from the sloppy and scattered

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[16] Omer Tene, *Revisiting the Creditors' Bargain: The Entitlement to the Going-Concern Surplus in Corporate Bankruptcy Reorganisations*, 19 Bankr. Dev. J. 287, 295 (2002-2003).

insolvency regime, existing prior to the enactment of the Code. However, it suffers from some frail characteristics which must be focused upon, so that the redressed problems do not recur. The paper would focus on the grey patches as are left in the Code and what more can be learnt from the above regimes so as to make the rescue regime better.

2. INSOLVENCY RESOLUTION PROCESS – UNDERSTANDING THE NUANCES OF THE PROCEDURE

To have the critical analysis of the Code and also to enable the reader to appreciate the grey areas of the Code, it is a primary requirement that the procedure of reviving a company, as envisaged in the Code, is properly understood. A cursory look at the Sections in the code in the linear manner would not be sufficient to know the practical application of the procedure. Therefore a simplified bird-eye view of the procedure has been described as under to enhance the readability of the process:

2.1. Application for initiation of process

The basic pre-requisite for initiation of process, which is common for all types of applicants, is occurrence of 'default' on part of the company. Default means inability to pay whole

or any part of debt[17], but such default should not be less than Rs. 1 lakh.[18] The adjudicating authority before whom the application is moved i.e. the National Company Law Tribunal (hereinafter referred to as 'NCLT')[19] would check the veracity of such default.

The process can be initiated and application for such can be moved by three categories of persons (applicants): a) financial creditors; b) operational creditors; c) the company itself.[20] However the manner in which the applicants would trigger the process[21] and the evidence required in order to prove 'default' differs for the three categories of applicants[22]and is provided under Sections 7, 9 and 10 respectively.

2.1.1. *Financial Creditors*

A financial creditor is a creditor who has lent money in form of loan and debt contracts[23] to the company and hence, to whom a

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[17] The Insolvency and Bankruptcy Code, 2016, § 3(12).
[18] The Insolvency and Bankruptcy Code, 2016, § 4 (1).
[19] The Insolvency and Bankruptcy Code, 2016, § 5(1).
[20] The Insolvency and Bankruptcy Code, 2016, § 6.
[21] Bankruptcy Law Reforms Committee, *Volume I: Rationale and Design*, 117 (2015) [hereinafter *BLRC: Rationale and Design*].
[22] *Id.* at 76.
[23] *Id*. at 22.

financial debt is owed by the company.[24]The financial creditors have to adduce direct evidences of the default. The best evidence in this regard is the information supplied to Information Utilities and the accounts.

2.1.2. *Operational Creditors*:

"Operational creditors are those whose liability from the entity comes from a transaction on operations."[25]In simpler words an operational creditor is that who provided goods or services to the corporate debtor and the payment for them is due[26], like supplier, employees etc. The legislature presumes that in case of operational creditors, there might not be any direct evidence of default and hence the procedure followed to prove the debt is what is practiced in UK as the *process of proving default by 'statutory demand'*.[27] This procedure is two-fold. Firstly the creditor sends demand notice of the alleged debt to the creditor. The debtor is supposed to reply within a certain time frame. If he disputes the claim, then the court has to decide upon the veracity of the claim as if it is a suit and in this suit the creditor

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[24] L.V.V. Iyer, *Is Bankruptcy Code flawed*, The Hindu (May 28, 2016), http://www.thehindu.com/business/Industry/is-bankruptcy-code-flawed/article8660821.ece.

[25] BLRC: Rationale and Design, *supra* note 21, at 77.

[26] IYER, *supra* note 24.

[27]https://www.gov.uk/statutory-demands(portal of government services and information).

becomes a necessary party. If he accepts the claim or fails to dispute within the time frame, then that itself would serve as evidence of default. A somewhat same two fold procedure is provided in Sections 8 and 9.

2.2. Admission of Application and order thereby (Section 13):

If all the formalities in the respective sections are complied with and the NCLT is satisfied that there has been a default it would admit the application and would issue the process to the applicant. Now the order of issue of process comprises of three orders:

a) Declaration of moratorium (Section 14)*:*

This is one of the most sacrosanct features of administration[28] which differentiates it from all the other insolvency procedures. Moratorium means an authorized postponement in deadline for paying a debt or performing an obligation.[29] In this, the court puts a bar on all the other recovery-related actions, to preclude them from activities like enforcement of security interest or filing civil suit of recovery or execution proceedings for recovery or winding-

[28] Ian Fletcheret al., Corporate Administration and Rescue Procedures, 50 (2d ed. Lexis Nexis UK 2004).
[29] BLACK'S LAW DICTIONARY 1101 (9th ed. 2009).

up petitions.[30] This gives what is called as a 'breathing space for the company'[31], by keeping the assets, contracts and goodwill intact and by preventing labour and fund wastage in litigation. The first implication of this would be that the creditors would not be able to file a suit for recovery of the debts.[32] In addition to this the suits which have already been filed before the issue of moratorium would also come to an end.[33] Not only this, even the successful suits of recovery whose execution is pending would also come to an end, and the execution couldn't be resorted to.[34] Secondly, no enforcement of security interest *in any form* can take place whether it is an action for selling of mortgaged/pledged property or enforcement of security interest under the SARFAESI act.

a) *Public announcement (Section 15):*

There should be a public announcement of the fact that the company has gone into the resolution process. The most important reason for this is to intimate to the creditors such fact. This is so because rescue procedure, in all

[30] Insolvency Act, 1986, c. 2, § 11 (3), sch. B1 (Eng.).
[31] David Pollard, *Corporate Insolvency: Employment and Pension Rights*, 21 (2d ed., Butterworths 2000).
[32] The Insolvency and Bankruptcy Code, 2016, § 14.
[33] *Id.*
[34] *Id.*

jurisdictions, involves full-fledged participation of creditors in the process, because it is very self-evident that creditors are the ones who stand to gain or lose the most in administration.[35] All the creditors who get intimated must, therefore, submit their claims.

b) Appointment of interim resolution professional (Section 16):

While submitting the application to the NCLT the applicant must also state the insolvency resolution professional (IRP) which it wants to appoint as the interim resolution professional and the NCLT appoints such IRP. It is this professional who conducts the administration proceedings until a permanent resolution professional (hereinafter 'permanent RP') is appointed. The duties of the interim resolution profession (hereinafter 'interim RP') can be divided into two categories (though no such bifurcation has been contemplated in the Code):

i. Functions relating to the process (Section 18):The interim RP set the foundations of the resolution process. Interim means 'for the time being'. His primary aim is to form a committee of creditors[36]

[35] Fletcher, *supra* note 28, at 94.
[36] The Insolvency and Bankruptcy Code, 2016, § 18 (c).

which in turn would appoint the permanent committee of creditors. For this purpose he collects all the claims which are received thanks to the public announcement. One of the other duties he has is what is called in the English law to prepare a 'statement of affairs'[37] of the company. A statement of affairs is a document that must be prepared by the debtors when a bankruptcy order has been passed against him, which contains details like assets, debts, liabilities, details of creditors and what security they hold.[38] It contains information [as prescribed by Section 18(a)], which would help in determining the financial status of the company.

ii. Functions relating to the business (Section 20): These functions are such which are entrusted to the interim RP for management and operations of the company *as a going concern*. It must be noted that the when a company goes into administration its business operations do not come to a standstill. The only difference being that the affairs of the company, which earlier delve over the board of directors, pass

[37] Insolvency Act, 1986, c. 7, § 47, sch. B1 (Eng.).
[38] M.K. Pithasaria& Mukesh Pithasaria, *Tax Law Dictionary,* 687 (Lexis Nexis 2013).

into the hands of the administrator[39] and it is the duty of the administrator to manage the operations of the enterprise as a going concern[40] and in that regard he has the authority to take such actions as the management of the company would have taken[41], like entering into contracts and human resource management and raising finance.[42]

3. FORMATION OF THE COMMITTEE OF CREDITORS:

After the collation of claims, the interim RP forms a committee of creditors, with the help of the claims collected.

Following things are worth noting about committee of creditors:

a) It only comprises of the financial creditors and not operational creditors. (The reason has been explained later).

b) Voting rights: Since creditors play a pivotal role in the administration process 'the collective will'[43] of the creditors must be ascertained for any approval. For that purpose voting is the instrument. One creditor one vote is not the policy. Concept of voting share is that each creditor

[39] Pollard, *supra* note 31, at 24.
[40] The Insolvency and Bankruptcy Code, 2016, § 20(1).
[41] Finch, *supra* note 1, at 21.
[42] The Insolvency and Bankruptcy Code, 2016, § 20(2).
[43] Fletcher, *supra* note 28, at94.

has votes in proportion of the financial debt the company owes to him.[44] Every approval requires majority of 75 percent of the total voting shares.[45]

c) First meeting must be held within 7 days of formation.[46]

3.1. Appointment of permanent resolution professional:

The first and the foremost task of the committee is to appoint a permanent RP. It has the option to continue with the interim RP as the permanent RP, or to appoint a new RP.

The permanent RP has more or less the same functions as the interim RP. He convenes the meeting of the committee of creditors.[47] However the difference is the functions which the interim RP was earlier authorized to perform independently, especially the functions under Section 20, now become subject to the scrutiny of the committee of creditors, under Section 28 and hence cannot be performed by the interim RP without its approval. Thus, the committee of creditors attains a *de facto* control over the enterprise.

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[44] The Insolvency and Bankruptcy Code, 2016, § 5 (28).

[45] Shishir Mehta et al., *The Insolvency and Bankruptcy Code, 2016-New Road and Challenges,*Practical Lawyer, July 2016, at 76. (2016) PL (CL) July 76.

[46] The Insolvency and Bankruptcy Code, 2016, § 22 (1).

[47] The Insolvency and Bankruptcy Code, 2016, § 24(2). `

3.2. Formation and approval of the resolution plan:

The permanent RP is to play a vital role in formation of the resolution plan. Resolution plan is the revival plan which has to be made in order to help the enterprise attain the purpose for which the rescue procedure has been undertaken. It has to be noted that the objectives of the purpose of administration are:

a) The company can possibly regain its financial health and can restart its functioning *'as a going concern'*.[48] This is the primary objective which the rescue plan should seek to achieve.

b) Even if the company is unable to get back to its original health and liquidation is inevitable, the creditors would recover a better value for their claims than they would have been if the company would have been liquidated without the attempt of rescuing it.[49]

The plan so made provides as to how the affairs of the company would be managed after the approval of the plan.

How resolution plan is prepared and who is to prepare it:

[48] Insolvency Act, 1986, c. 1, § 3, sch. B1 (Eng.).
[49] *Id.*

The RP makes an information memorandum on the basis of which the plans for revival has to be made.[50] A very interesting feature of the Code is that it gives rights to a wide variety of people to submit their respective resolution plans, and not merely to creditors and the IRPs. The RP has the duty to invite such plans from *'prospective lenders, investors, and any other person'*.[51]The persons who submit a resolution plan are called resolution applicants. Who all can be invited to submit a resolution plan would be subject to judicial interpretation of the term *'prospective lenders, investors, and any other person'*.

It is also pertinent to mention that the act does not detail about what should be the contents of the resolution plan. It does not guide as to the possible resolution techniques which can be adopted for revival and kept it open-ended. The only requirement is that whatever technique is adopted must contain should not be violative of any law.[52]

3.3. **Approval of the plan:**

The resolution plans so submitted have to pass thorough three stages of approval:

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[50] The Insolvency and Bankruptcy Code, 2016, § 29(1).
[51] The Insolvency and Bankruptcy Code, 2016, § 25(2)(h).
[52] The Insolvency and Bankruptcy Code, 2016, § 30(2)(e).

3.3.1. *Approval by the RP*

The RP who receives all the plans forwards them to the committee of creditors. Only such plans are forwarded which (a) conform to the information memorandum and (b) fulfills conditions mentioned in Section 30(2). Section 30(2) only mentions what all things *must* be included in the plan.

3.3.2. *Approval by the committee of creditors*

The committee which receives all the short listed plans would choose *one* of the plans by 75 percent votes. This plan so selected would be forwarded to the NCLT.

3.3.3. *Approval by NCLT (Section 31)*

The scrutiny of NCLT at this stage is limited. It does not deliberate on the commercial viability or whether some different plan would be preferable for creditors.[53] Instead the court satisfies itself that the decision of the creditors has been properly obtained and the conditions as mentioned in Section 30 (2) are complied with.

[53] World Bank, *Principles and Guidelines for Effective Insolvency and Creditor Rights System,* 51 (2001) [hereinafter *World Bank Report: Principles of Insolvency*].

4. RESULTS OF THE PROCESS

There are three possible results of the Insolvency Resolution Process once it has been initiated:

4.1. CASE 1: It may happen that the consensus is not reached as to a revival plan.

Following recourses are there:

a) If 180 days (after the admission of application) elapse and the adjudicating authority does not receive the resolution plan it can order liquidation.[54]

b) Even before the elapse of 180 days, the committee of creditors may intimate to NCLT that since no consensus is reached as to a workable resolution plan, the company should be liquidated[55], but such application cannot be made after the approval of the plan. Once approved the company has to go through that plan for the period remaining.

4.2. CASE 2: Consensus is reached as to plan but the Adjudicating Authority rejects the plan.

In such case NCLT will order liquidation.[56]

[54] The Insolvency and Bankruptcy Code, 2016, § 12(1) r/w. § 33(1) (a).
[55] Mehta, *supra* note 45, at 79.
[56] The Insolvency and Bankruptcy Code, 2016, § 33(1) (b).

4.3. CASE 3: Adjudicating authority accepts the plan.

In such case the company has to comply with the plan for the remaining period, i.e., till the completion of 180 days because once NCLT approves it, the plan cannot be revoked. However the Code fails to enact the various possibilities that can befall if the company completes its administration process of 180 days. After 180 days, two possibilities are there:

a) It is felt that a company cannot operate as a going concern, if the claims of the creditors are to be satisfied, then in that case, the company has to be put to liquidation, after the period of administration ends. Here it may be a possibility that after the revival attempt, the company regains such financial health so as to satisfy all the claims *in full*. Otherwise, it may be so that it is unable to regain adequate financial health and the creditors can realize their claims only *in part*.

b) If the consensus is reached as to the revival plan, and after taking recourse to that plan for the period of administration, it is felt that a company can operate as a going concern even after satisfying all the claims of the creditors then in such case, the company is not put for liquidation. Though

the 'success' of the process of administration is said to be this very state, it is highly unlikely.[57]

5. COMPARISONS WITH ERSTWHILE RESCUE REGIMES OF INDIA

It must be noted that the 2016 code is not the first attempt to imbibe the rescue culture in India. Prior to this, two other legislations namely- the Sick Industrial Companies (Special Provisions Act), 1985 and the Companies Act, 2013 also prescribed rescue and revival procedures.

5.1. The Companies Act, 2013.

The Companies Act, 2013 (hereinafter referred to as 'the Act') prescribes its rescue procedure under the heading **Revival and Rehabilitation of Sick Companies**.[58] This ranges from sections 253 to 269. However, the new code has repealed this part and substituted it with its own.[59] In such a scenario it is imperative to remark the differences between the two regimes.

5.1.1. *Increasing the power of Unsecured Creditors*

The first remarkable difference is that the Act and the Code is that whereas the former provides only for the secured creditors to initiate the administration proceedings, the latter creates no

[57] Finch, *supra* note 1, at 243.
[58] The Companies Act, 2013, Chapter XIX.
[59] The Insolvency and Bankruptcy Code, 2016, sch. 11, § 8.

such difference between the two. So apart from secured creditors, even the unsecured creditors and the company itself can initiate the process.

The very purpose of innovation of the process of administration is to take into account and focus on the claims of the unsecured creditors, who at the end receive nothing in the liquidation process.[60] The secured creditors mostly managed to realize their claim by liquidating the assets and by enforcement of security interest, thereby leaving only a few crumbs of bread for the unsecured creditors to nibble. Disallowing the unsecured creditors to initiate the rescue proceedings may have following disadvantages:

a) The very initiation of process would become rare, because secured creditors would prefer the process of liquidation which would lead to quicker realization of their claims, especially if the assets are enough to realize the secured debt.
b) The economic chain effect of not allowing the unsecured creditors to initiate the insolvency proceedings would be that the supply of unsecured credit would decrease in the market.[61] It has to be kept in mind that apart from equity (capital), debt is also one of the important modes of finance

[60] Finch, *supra* note 1, at 21.
[61] Bankruptcy Law Reforms Committee, *Interim Report*, 50 (2015) [hereinafter *BLRC: Interim Report*].

of companies business, and unsecured debt forms a large part of total debt. Moreover, due to strains in the economy, the secured credit which is mostly in the form of loans from bank and financial institutions is not always readily available.[62]

5.1.2. *Criterion to determine sickness*

According to the Act, the criterion to trigger the administration process is that a demand for it should be made by a collegiums of secured creditors who represent at least fifty percent of total debt of the Company[63], i.e., when a company defaults on major portion of its debt. However, the Banking Law Reform Committee (BLRC) that submitted its interim report in February 2015 was of the opinion that this criterion for initiating rescue proceedings by creditors may not facilitate early intervention and timely rescue. If a company has already defaulted on a major portion of its debt, it is quite likely that its financial condition has deteriorated to such an extent that it cannot be revived.[64]In pursuance of this recommendation, the Code simplified the test and allowed filing of applications *"if*

[62] *Id.*
[63] The Companies Act, 2013, § 253.
[64] BLRC: Interim Report, *supra* note 61, at 14.

the company is unable to repay a single undisputed debt exceeding one lakh rupees".[65]

Now as the definition of the term default suggests, default need not be of a particular magnitude. It can be any magnitude. Therefore a creditor representing even a miniscule part of total debt of the corporate debtor can also entitle a creditor to initiate the proceedings, even if the default is regarding a part of the debt owed to him, which is payable in installments. It is submitted that such a low threshold is not healthy as defaults so contemplated keep on happening in normal course of business. The BLRC assured that there would be less chances of frivolous filing of applications *"they would prefer individual enforcement over the collective rescue procedure"*.[66]This logic could have been valid in case of the Act. However it is flawed in present scenario as the Code, unlike the Act, also allows unsecured creditors to initiate the process. Thus premature and needless filing of petitions would take place as soon as the company defaults, as the unsecured creditors would be apprehensive of the secured creditors resorting to enforcement of security interest and former would be desperate to attain the moratorium order, to prevent the latter from doing so.

[65] *Id.*
[66] *Id.* at 15.

5.1.3. *Making the Rescue Procedure mandatory*

As discussed in point (i), a very peculiar feature of this code is that liquidation can be resorted to only after the administration process either ends or fails.[67] Therefore liquidation, as per the spirit of the Code, is the 'lender of last resort'. However, the spirit of the Act is somewhat different in the sense that liquidation is not the last option but is 'one of the options'. It was upon creditors (and that too only the secured creditors) to choose either liquidation or enforcement of security interest, or going for the revival and rehabilitation of the company. This code, on the contrary, makes it imperative for the liquidation to be preceded by rehabilitation or at-least an attempt of rehabilitation. It is obvious that giving of 'options' is not very wise if it is quite evident from practice and common sense that only one of the options would be taken recourse to. Consequently, provision of revival process under Chapter XIX of the Act would have been a dead letter, winding up and enforcement of security interest, being one of the other options. *However, how healthy is it to mandate the revival process is also a question to be taken into consideration.*

[67] The Insolvency and Bankruptcy Code, 2016, § 33 (1).

The BLRC was of the opinion that *"liquidation should not be seen as the measure of last resort"*.[68] The long-drawn and somewhat an extravagant process of revival should only be resorted to if the adjudicating authority is of the opinion that there are fair changes of revival; otherwise revival would prove to be a prodigal option. The most practical test so as to ensure whether or not there are fair chances of revival is *viability.*[69]Thus it is submitted that the revival process should be initiated if and only if the court *prima facie* believes that the company is viable.

Neither the code nor Act provided for such *prima facie* test. As per the Act, the court while allowing the petition for revival of companies under Section 256 is to only consider the factum of the sickness of the company, and only on that count can the court dismiss the petition *in limine.* However once admitted, the task of determining whether the company is viable enough to be revived or not is given to the committee of creditors. The decision of the committee of creditors is to be heard by the Tribunal under Section 258, on a date which may extend to as much as *ninety days* from the date of receipt of application under 256.[70]

[68] BLRC: Interim Report, *supra* note, at 17.
[69] *Id.*
[70] The Companies Act, 2013, § 258.

Under the Code, there is absolutely no provision of the *viability test*. The adjudicating authority while considering the applications for resolution, would not look into and reject the petitions *in limine* on the basis of the unviability; it can only do so on the failure to establish default or to complete procedural requirements.

A look at some of the robust foreign rescue regimes would suggest that the viability of the administration over and above liquidation is one of the tests which the court has to undertake at the threshold before ordering the initiation of administration.

5.1.4. *No distinction between Financial and Operational creditors*

As discussed earlier the Code, creates a clear divide between the financial and operation creditors. Their standing is different in two ways:

Firstly, they have to comply with different procedures in order to apply to the court for making order, the reason for which has been amply provided in preceding chapter.

Secondly, as it has been discussed earlier, operational creditors are not included in the committee of creditors. There are two reasons for such exclusion. The operational creditors are not well-versed in the art of handling insolvency. Secondly, they are unwilling to take the risk of postponing payments or

altering the terms of contracts so as to reduce debts.[71] Including them in the committee would retard the process. For example, it is more likely for a bank to reduce the interest rate but it is less likely for a supplier of goods to reduce price per capita for goods supplied.

6. THE SICK INDUSTRIAL COMPANIES (SPECIAL PROVISIONS) ACT, 1985

The Sick Industrial Companies (Special Provisions) Act, 1985, (hereinafter referred to as the 'SICA') was enacted in order to provide a preventive as well as remedial and revival measures as the period of 1980s saw an unprecedented increasing in the sickness of the industries. It is a special legislation. **References, Inquiries and Schemes**[72] which runs from Section 15 to Section 22 deals with information and determination of insolvency and the steps which follow. There are several distinctions between the Code and the SICA, as follows:

6.1. Nature of the Company:

The very fundamental of the differences between the SICA and the Code is that the former had only a limited scope and

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[71] BLRC: Rationale and Design, *supra* note 21, at 22.
[72] The Sick Industrial Companies (Special Provisions) Act, 1985, Chapter III.

applied only to the industrial companies, moreover this was also limited to the test of complete erosion of their net worth, whereas the latter encompasses all types of corporate debtors.

6.2. Determination of Sickness

Tests for determination of sickness of the company have also varied a great deal in the journey from the SICA to the Code. For a company to be declared sick under the SICA it needed to pass two tests –

a) that the said industrial company was registered for note less than 5 years, and

b) it accumulated losses exceeding its entire net worth at the end of the financial year.[73]

The Code however, has lowered the standard of this test, as per the provisions of the Code the corporate debtor falls 'sick' if the amount of default is one lakh or more, though the Central Government, under Sec. 4, has power to raise this limit but it needs to be less than one crore. As submitted earlier this approach is likely to do more harm than good.

[73] The Sick Industrial Companies (Special Provisions) Act, 1985, § 3 (o).

6.3. Initiation of Proceedings

The next distinction comes in form of as to who is deemed capable to ask for or trigger the whole process; the SICA has a very limited scope in this regards, as under Sec. 15 (1), it is Board of Directors of the company who have to make a reference within 60 days of finalisation of financial accounts of that year, or within 60 days when they have reasons to believe that company has gone sick before such finalization of accounts[74], and on several accounts to the Central Government, Reserve Bank, State Governments, Public Finance Institutions, State level Institution or a Scheduled Bank are also allowed to make reference to the Board, with the condition attached that they must have sufficient reasons.[75]. However in the present regime only the interested parties i.e. creditors and the debtor is only allowed to trigger the process and the other authorities which exercised powers to trigger the process under SICA are scraped.

6.4. Enquiry into chances of revival

According to SICA, the adjudicating authority i.e. the Board for Industrial and Financial Reconstruction (BIFR), after

[74] The Sick Industrial Companies (Special Provisions) Act, 1985, § 15, proviso 1.
[75] The Sick Industrial Companies (Special Provisions) Act, 1985, § 15 (2).

receiving reference under Section 15, would conduct a proper enquiry under Section 16. The subject matter of such enquiry would not only be to ascertain whether the company has become sick or not, but also to ensure that it is not *so* sick that it is beyond revival. When it is so, the court in place of ordering revival process, would, under Section 17(3) order liquidation, instead. The test to determine whether the company is *sick beyond revival* is that whether in a reasonable time, *'it is practicable for the company to make its net worth exceed its losses'*.

A very inherent problem with the Code is that the second test is missing. A look into foreign regimes such as Singapore and UK, would make it clear that for triggering the revival process the test it is not only necessary to determine whether or not the company is sick; rather, when this test is satisfied, it has also to determine that whether the company is not *so* sick that it is beyond reformation, and hence liquidation is the better option.

6.5. Moratorium

Both the regimes provide mechanism for protecting the interests of the company, by putting the bar instituting or proceedings in relation to winding up[76] or execution or

[76] *Church of South India Trust Association v. Wrapadis Ltd.*, (1990) Comp. Cas. 838.

realization of properties of the company; once the process to look into the sickness of the company is triggered, so as to protect the interests of the companies. The differences which arise are that the regime under the Code is time bound and moratorium lasts till the completion of corporate insolvency process, i.e.180 days which may be extended by 90 days more[77], whereas the SICA provided that the first declaration should not exceed two years which may be increased a year at a time, but not to exceed 7 years in total.[78] The regime under SICA also provides that with the prior permission of the Board, the proceedings can continue or be instituted[79], and even if the reference is registered before the board, provisions of moratorium are attracted.[80]

7. COMPARISON WITH FOREIGN RESCUE REGIMES

The present section deals with comparison of the present rescue regime in India with the pre-existing regimes in U.K., Singapore and U.S.A. Singapore and India both follow common law and have roots in English legal system; U.K. is place of origin of corporate insolvency laws, all the

[77] The Insolvency and Bankruptcy Code, 2016, § 12 (3).
[78] The Sick Industrial Companies (Special Provisions) Act, 1985, § 22 (3).
[79] *Gram Panchayat v. Shree Vallabh Glass Works Ltd.*, A.I.R. 1990 S.C. 1017.
[80] *Sponge Iron India Ltd. v. Neelima Steels Ltd.*, (1990) 68 Comp. Cas. 201.

three counties vis. India, U.K. and Singapore despite having the same roots of law are at different stages of development for the same. The regime in USA is one of the most efficient regimes, as US ranks 4 in matter of resolving insolvency and therefore is taken into consideration.

7.1. United Kingdom

The Schedule B1 of the Enterprises Act, 2002 prescribes the rescue procedure ('administration') of England. Since the 2016 Code, is based more or less on the same lines as the English law, a lot of parallels can be drawn between the two regimes:

a) Conditions of Moratorium.

b) Lack of provisions for amendment of revival plan in the execution period.

c) Allowing the corporate debtor (i.e. company itself to initiate the revival process).

It is difficult to mark material differences between the two regimes. Yet two differences are pointed out as follows.

7.1.1. *Determination of Insolvency*

In the English law, the threshold for determining whether a company is insolvent is whether the company 'is unable to pay

its debts' or 'is likely to become unable to pay its debts'.[81] The second phrase is added in order to facilitate timely intervention and not when the company is beyond the scope of revival.

The test is more or less subjective in nature unlike the very objective test of 'default' in India. Moreover the chance of triggering of the process is less than in the case of Indian code because the second phrase has been given a restrictive interpretation by courts.[82] The English Judiciary opines that it is very important to ascertain whether the process is genuinely required or not; unnecessarily subjecting the company to the risks and problems of administration and the expenses thereby is not wise.[83]

7.1.2. *Formation of revival plan*

In the English regime, the revival plan has to be formed primarily by the administrator and it has to be approved with or without modifications by the committee of creditors.[84] In the Indian regime, the plan can be formed by any corporate applicant like prospective creditors, lenders etc. and not necessarily the creditors and the IP who are participating in the process.

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[81] The Enterprises Act, 2002, sch. B1, § 11.
[82] *Highberry Limited v. Colt Telecom Group,* [2002] E.W.H.C. 2815 (Ch.).
[83]In re *Primlaks (U.K.) Ltd.,* (1989) 5 B.C.C. 710.
[84] The Enterprises Act, 2002, sch. B1, § 49 r/w. § 53.

7.2. Singapore

The revival process is known in Singapore as the process of 'Judicial Management' and is prescribed under Chapter VIIIA of the Companies Act, 1967. This Chapter which had Sections ranging from 227A to 227X was added via amendment in 2006. Singapore ranks first in Ease of Doing Business list prepared by the World Bank[85], it becomes important to mark some remarkable differences between the Singaporean regime and the Indian insolvency regimes.

7.2.1. *Threshold for determining insolvency*

It has already been discussed previously that the criterion to determine insolvency, or more precisely, to define the criterion to trigger the insolvency resolution process, is very low and also vague. The Singaporean law is very smooth and clear in this regard. It provides that the company or the creditors can apply for the judicial management if and only if three conditions are satisfied[86]:

a) 'The Company is or will be unable to pay its *debts'*.

b) There is a reasonable possibility to rehabilitate the company so that it can continue as a going concern.

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[85] Doing Business Report, *supra* note 7, at 232.
[86] Companies Act, 1967, § 227A.

c) The interests of the creditors are would be better served than by resorting to winding up.

In condition (a), it must be noted that the term is *debts* and not debt. Therefore a company can only fall within the trap of this condition only when it has *generally defaulted* on a 'substantial' portion of its debts[87] and not when it has defaulted on a single debt whereby that debt does not even form a substantial portion of total debt. The legislation does not specify on what part of debt the company must default. Whether the company is unable to pay its debts or it will be unable to pay is a question of fact, left to be determined by the court. The conditions (b) and (c) are also questions of fact which require judge based scrutiny, wherein the judge has to choose between judicial management and winding up. Judicial management is only viable and preferable over liquidation when company is not 'hopelessly insolvent'.[88] This test is also a question of fact, wherein the court must delve upon into the financial position of the company, determinable from its accounts.

Therefore there is no condition which is capable of being empirically defined or determined. The judge would decide the requirement for administering the company on the same

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[87] *Re Genesis Technologies International (S) Pvt. Ltd.,* [1994] 3 S.L.R. 390.
[88] *Id.*

conditions and if satisfied would then pass the judicial management order.[89]

The Insolvency Law Review Committee (hereinafter referred to as 'ILRC') of Singapore, in its 2013 report has, however, opined that the threshold provided in the Singaporean Law is way too high and is usually invoked when the condition of the company has deteriorated to such an extent that the company is beyond any reasonable hope of rehabilitation.[90] It pointed out high threshold was one of the reasons for failure of the regime. Thus the committee suggested replacing *"is or will be unable to pay its debts"* with *"is or is likely to become unable to pay its debts"*[91], it is in case of UK.

7.2.2. *Process of Election of Administrator*

In India, first the interim resolution professional is appointed and then the permanent resolution professional is appointed by committee of creditors thereafter.

In Singaporean law, the administrator (known as the judicial manager) is appointed by the applicant. The applicant who is

[89] Companies Act, 1967, § 227B.
[90] Insolvency Law Review Committee, *Final Report*, 84(2013) available at https://www.mlaw.gov.sg/content/dam/minlaw/corp/News/Revised%20Report%20of%20the%20Insolvency%20Law%20Review%20Committee.pdf [hereinafter *ILRC*].
[91] *Id.* at 95.

seeking the order of judicial management from the court has to specify in the application the person who it wants to appoint as the judicial manager. At this stage itself i.e. *before* the passing of judicial management order, if the creditors, who are in majority *in number as well as in value*, object the appointment, they can file such objection and they would be heard by the court in this behalf.[92]

The scheme in the Singaporean law seems to be simple since the issue of the appointment of administrator is resolved at the very stage of admission of application for judicial management. However, inviting of objections from creditors before the collection of claims and before advertising about the company going under administration[93] (all of which happens *after* passing of the judicial management order) could be a dead letter because most of the creditors, at this juncture, would not be aware of the company going into administration. Therefore it is unjustified.

The Indian scheme, though justified in this regard, is more or less long-drawn. Moreover, it has to be noted that there is no time-limit given within which the administrator has to form committee of creditors and summon a meeting unlike Singaporean law which prescribes period for 60 days. In

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[92] Companies Act, 1967, § 227B (3) (c).
[93] Companies Act, 1967, § 227B (4).

addition to that, the Code entrusts plethora of functions to the interim profession apart from formation of committee of creditors which includes functions relating to human resource management, raising finance, entering into contracts etc. He, while handling the charge, has to explain all the affairs, documents and the work done up till the date, to the permanent resolution professional who is more or less a novice regarding the affairs of the company.[94] This can lead to two problems:

a) The permanent resolution professional, so appointed afterwards, may or may not approve of these decisions of the interim professional and provide for a different *modus operandi*, which would lead to the negation of previous work and wastage of man-power.

b) The permanent resolution professional even if he accepts the previous measures, would take time get himself aware of the substantial work already done in pursuance of administration. It is anomalous to remove a person who has already familiarized himself with the working of the company and has laid the foundations of the administration procedure, and replace him with totally an unfamiliar person.

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[94] The Insolvency and Bankruptcy Code, 2016, § 23 (3).

7.2.3. *Veto to debenture holders*

This is another distinct and remarkable feature of the Singaporean regime. The court is *obliged* to dismiss an application for a judicial management order if the making of such an order is opposed by a debenture holder of debentures secured by a floating charge.[95] Whenever there in an application for judicial management the court must send notice and invite objections from such debenture holders.

At the very outset, it is imperative to mention that such condition in India could suffer the onslaughts of Article 14 (Right to Equality). It is so because debenture holders are nothing but holders of debt instruments. It would make unintelligible differentia between those debt instruments which are secured by floating charge and those which are secured by fixed charges. Creditors like banks which give loans on security on some specific assets would object the giving veto powers to debenture holders having a floating charge.

The ILRC has taken into arbitrariness of this power of the creditors and suggested diluting this power by rebalance of the relationship between judicial management and receivership. It opined that the decision whether to appoint a judicial manager or not, when there is such an objection, is to rest on the

[95] Companies Act, 1967, 227B (5).

discretion of court and the court would base its decision on criterion that which of the options would cause least prejudice.[96]

7.3. United States of America (USA)

USA had bankruptcy laws (It has to noted that, in the USA "bankruptcy" as a term is used for all the insolvency proceeding against legal or natural persons which is court administered) in force since long time, they changed with time to time, the present one being **Title 11 U.S.C. i.e. Bankruptcy Code**, this also entailed change in character with sometimes law being pro-debtor and other time pro-creditors; the present Chapter 11 is usually considered as pro-debtor rather than pro-creditor this label is because of several factors, chiefly because of the amount of control which is allowed after the company make an application under Chapter 11.[97] This however should not be taken to mean that it is against-creditor in nature. Chapter 11 allows the debtors, who wish to reorganize their

[96] ILRC, *supra* note 90, at 24.

[97] Gerard McCormack, Corporate Rescue Law In Singapore and The Appropriateness of Chapter 11 of the US Bankruptcy Code as a Model, 20 SAC L.J. 396, 406 (2008).

business certain advantages which are not available under Chapter 7.[98]

This section deals with analysis of Chapter 11 and allied provisions of the Title 11 of the United States Code i.e. U.S. Bankruptcy Code (hereinafter referred as Title) in the hindsight of the Insolvency and Bankruptcy Code, 2016.

7.3.1. *Initiation*

A case under Chapter 11 can commence in either a voluntary manner or by involuntary means. The voluntary process begins when the company files for reorganisation before a bankruptcy court. There is no requirement for a company to be 'insolvent' for being able to invoke the applicability and it is for this reason that deliberate insolvencies are prevalent in US. Chapter 11 is often used and regarded as strategic shield. *Manville*[99] case, provide best insights in this regards, where a solvent and profitable company filed for reorganization to reduce the liability it was facing due to asbestos-related claims, the court allowed the same and put a stay on claims as the company agreed to setup a trust to deal with future cases. The check though is that such company should have acted in good faith. If

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[98] Martin A. Frey et al., *Introduction to Bankruptcy Law*, 452 (5th ed. Delmar Cengage Learning 2006).

[99] In re, *Johns-Manville Corp.*, 26 B.R. 420 (1983).

bad faith is displayed, the recourse is not allowed, as happened in *SGL Carbon Corporation*[100]case, where the petition was dismissed. In India the Code however does not allow the filing of such petitions and corporate debtor moves forward only when default has already been committed.

The involuntary process as under the Title 11 U.S.C. §363 requires three creditors holding the next claims worth more than $10,000 file a petition that the company fails to pay the debts they become due, and that such debts/dues are bona fide and not a matter of conflict. If the petition has been filed in bad faith punitive damages may be awarded to it; In India however the position is somewhat different as there is no minimum number of required to file a petition, though the limit in form of amount exists.

7.3.2. *Special Court*

The scheme of effects under the Title is that a petition for bankruptcy is initiated in a Unites States Bankruptcy Court; every district has its separate bankruptcy court.[101] The jurisdiction of these courts is conferred with the joint interpretation of the Title 28 U.S.C. § 1334 (e) and the Title 11

[100] In re, *SGL Carbon Corporation*, 200 F.3d 154 (3rd cir. 1999).
[101] Frey, *supra note* 98, at 27.

U.S.C. § 541.[102] A case comes before the court after an order is passed for the same by the respective district court, most of the districts courts, in this regards, have standing orders to transfer the case[103]; it has jurisdiction all over the property and property rights of the debtor i.e. all over the debtor estate[104], but, it loses when the property is legally transferred.[105]

The Indian scenario however was plagued with multiple forums and tussle for jurisdiction, the Code resolves this by demarcating the jurisdiction and making NCLT the appropriate forum in the present case.

7.3.3. *Debtor in Possession*

In Chapter 11 no trustee is appointed as is done in Chapter 7 proceedings, the Debtor in Possession or DIP is a person from debtor's management who also serves as the capacity of a trustee. He is the person responsible for taking control over the business and has the rights and powers of a trustee.[106] The

[102] Paul P. Daley & George W. Shuster Jr., *Bankruptcy Court Jurisdiction*, 3 DePaul Bus. & Comm. L.J. 383, 389-390 (2004).
[103] Board of the Governors of the Federal Reserve System, *Study on the Resolution of Financial Companies under the Bankruptcy Code*, 8(July 2011), available at http://www.federalreserve.gov/publications/other-reports/files/bankruptcy-financial-study-201107.pdf.
[104] *Gilchrist v. General Electric Capital Corp.,* 262 F.3d 295, 303-304 (4th Cir. 2001).
[105] In re, *Fedpak Systems Inc.*, 80 F.3d 207, 214 (7th Cir. 1996).
[106] Frey, *supra note* 98, at 467.

DIP's works is "premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of a trustee"[107] and also on the assumption that this would allow the opportunity to reorganize would go without disruption that would have resulted if the trustee would have been appointed.[108] This however doesn't bar the appointment of the trustee and the same can be appointed on the request of the party in interest in case of fraud or gross misconduct or any such ground as provided[109], however, the reasons need to be strong, simple mismanagement won't be a sufficient ground.[110]

The Indian Code is different as the appointment of an administrator or 'resolution professional' is mandatory.

7.3.4. *Automatic Stay*

The Automatic Stay or Moratorium, which stops any continuing or future litigation or execution of order passed against the debtor, commences as soon as the petition is filed under Chapter 11. It allows the corporate-debtor to have a

[107] *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 345 (1985).
[108] Frey, *supra* note 98, at 467.
[109] Bankruptcy Code, 11 U.S.C. §1104(a)(1) (1978).
[110] In re, *Anchorage Boat Sales*, 4 Bankr.635 (1980).

breathing spell from his creditors[111] during which the corporate-debtor has an opportunity to make appropriate arrangements with the interested parties.[112] This however does not puts to an end the action of governmental authorities to an end, for example, environmental cleanup orders etc; whereas in Indian scenario all actions are put to an end.

Automatic stay is unique in another aspect, a secured creditor, or any party in interest, who is affected by the statutory stay, can apply for lifting for the stay, the company is under obligation to provide "adequate protection" for those whose interests are adversely affected by the stay.[113] Burden of proof is on the person claiming relief from the stay to show that he has interest in the property[114]; there is no such concept in Indian scenario. The idea of adequate protection and thus allowing filing relief is derived from the Fifth Amendment protection of property interests as enunciated by the US Supreme Court.[115]

The Title it is stringent (read economically) as it provides for punitive damages too in case of a willful violation and for

[111] H.R. 595, 95th Cong. (1977).
[112] McCormack, *supra* note 97.
[113] Bankruptcy Code, 11 U.S.C. §361 (1978).
[114] Bankruptcy Code, 11 U.S.C. § 362(g)(1) (1978).
[115] *Wright v. Union Central Life Ins. Co.*,311 U.S. 273 (1940).

damages even if the violation was in good faith, whereas in India violations attract fine and imprisonment which may be between 1 to 3 years, thus both jurisdictions treat violations seriously and punish them albeit in different manners.

7.3.5. *The 'Cramdown'*

The scheme of reorganisation as contained under Chapter 11 is not limited to the creditors but also includes the committee of shareholders and other interest holder parties. The confirmation of the reorganisation plan does not require acceptance from all the parties whose rights gets modified.[116] This calls for the procedure like cramdown comes into the picture; it permits the confirmation of the plan even if any particular class was opposing the same[117], literally forcing them to accept the same.[118] The only conditions attached are that it must be fair and equitable[119], and one class of impaired creditors must have accepted the same.[120]

In India however the only requirement for acceptance of a plan is that it must be accepted by 75% of the voting share of the

[116] Issac M. Pachulski, *The Cram Down and Valuation Under Chapter 11 of The Bankruptcy Code*, 58 N.C.L. Rev. 925, 926 (1979).
[117] Frey, *supra* note 98, at 513.
[118] McCormack, *supra* note 97, at 434.
[119] Bankruptcy Code, 11 U.S.C. § 1129(b) (1) (1978).
[120] McCormack, *supra* note 97, at 434.

financial creditors, and hence no provision of cramming down exists.

8. SUGGESTED CHANGES TO THE PRESENT REGIME

At the beginning of this paper it had been remarked that there have been certain grey patches left in the Code, which need to be redressed. After discussing all the erstwhile Indian regimes as well as certain foreign regimes, attempt has been made to fill up the various lacunae which have been identified during the course of research. Following suggestion are made in order to rectify the grey patches and to improve the present regime.

8.1. As regards the threshold for determining insolvency

There is a serious need to overhaul the criteria for determining when to initiate the resolution process. The criterion in India is only 'default'. But as seen from foreign regimes and SICA, the criteria should be two-fold: 1) default and 2) chances of revival. The first test is to ensure whether the financial condition of the company is *weak enough* to make it go through an insolvency process. The second test is to ensure whether the financial condition of the company is not *so* weak that it cannot be rescued and hence liquidation is better option. The second test therefore is to determine which of the two processes is more viable.

As regards the first test, the criterion to determine 'default' needs overhauling because, as it has been discussed, it is too low and frequently-achievable. The Indian legislature or judiciary would need to limit the scope of the term 'default' to certain *kinds* or m*agnitude* of default which would enable a creditors or a class of creditors to initiate revival proceedings against a company. The English and Singaporean regimes, by laying down anecdotal and subjective test, have left much of the determination of default to the court to examine, but in India, which is already over-burdened with litigation such subjective test would lead to unnecessary delays because unlike the Companies Act, 2013, the Code does not contain any time frame within which it has to order on the application under Sections 7, 8 and 10. Therefore a more objective test has to be inculcated. The present test of default though subjective, is not feasible. The best example of an objective test which can be taken is from the SICA regime wherein the criterion to determine 'sickness' is that the accumulated losses at the end of any year must exceed the total net worth.[121]

However it has to be noted that there is no scope for judiciary to lay down other conditions for triggering the process in the veil of interpreting the provision as the law is very clear and

[121] The Sick Industrial Companies (Special Provisions) Act, 1985, § 3 (o).

unambiguous. Therefore, alternatively, what it can do is to suggest an amendment to Section 3(12) in order to change the definition of 'default'.

As regards the second test, it has been previously stated that no provision in the Code has been made regarding it. The necessity of inculcating this test has been already discussed and hence it is suggested that amendments should be made in this regard.

8.2. As regards appointment of Resolution Professional and functions of interim RP

While comparing the Indian and the Singaporean regimes it was pointed out that various problems like duplication and negation of work can occur due to the two-phased process of the appointment of the administrator i.e. first the interim RP and then the permanent RP.

It is suggested that a better regime would be to prescribe a fixed time period within which committee of creditors should be formed which should not be more than 20-30 days of the appointment of the interim RP. During this period the only functions which the interim RP must be entrusted are those mentioned in Section 18 i.e. framing of accounts, collection of claims and formation of committee of creditors and not those

mentioned in Section 20. In such case, the actual tasks of the administration would be initiated by the permanent professional. The functions specified in Section 20 should be the domain of the permanent resolution professional only.

8.3. **As regards the differences created between operational and financial creditors**

It is concluded from the discussion that there *is* an intelligible differentia between the two types of creditors and the Indian regime by differentiating between the two has created a purple patch in the arena of insolvency regimes. Yet, the total exclusion of operating creditors from the committee of creditors is not desirable. The argument for removing them is that they can inhibit the formation of consensus as to revival plan, has been discussed earlier. A better regime could be that operational creditors should be a part of committee of creditors, but at the stage of approval of revival plan, this committee should be dissected so as to form different committees for operational and financial creditors in a way such that i) for financial creditors 75 percent voting share is required for approval (which is already mandated by the Code), and ii) for operational creditors it must be reduced to 25 percent of the total voting share of the operating creditors. Therefore though the operational creditors would participate in the resolution

process, yet they would have comparatively less say in the approval of resolution plan.

8.4. As regards the amendment of plan

If after initiation of execution, the plan seems to be unworkable or impossible to implement either the amendment of the plan or for the debtor to be liquidated with immediate effect.[122] The Indian regimes provides for none of the options. Once approved by the adjudicating authority the plan has to be continued till the completion of 180 days and that too, unamended. According to the World Bank, 'a plan should be capable of amendment (by vote of the creditors) if it is in the interests of the creditors.'[123] Most of the robust insolvency regimes like Singapore, Finland and USA and Japan provide for amendment of the plan in the execution phase. Thus it is submitted that the 2016 should either provide for the amendment of the resolution in the execution period or option to apply for the court to order liquidation if in the execution period the plan proves to be unworkable.

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[122] World Bank Report: Principles of Insolvency, *supra* note 53, at 52.
[123] *Id.*

8.5. **As regards the management of the company during administration process**

Once the process is triggered the Resolution Professional is transferred the control of the management of the company and he is vested with the powers of the board of directors. Though several foreign rescue regimes like one in the USA have provisions which lets the control of the company to vest in the existing management called debtor in possession (DIP), in whom as discussed above, duties and obligations of the trustee (equivalent to resolution professional in terms of the powers) vests and can be removed leading to appointment trustee, if he violates statutory provisions. This jurisprudence along with requisite checks can be brought to Indian context, as the DIP would have a better idea, than someone stranger, about the business and hence more chances of revival would be there.

8.6. **As regards to who submits the plan**

Resolution plan is most significant in regards of the present and future of the corporate debtor, in Indian context anyone related to the company can submit a resolution plan to the resolution professional, as the term ‘resolution applicant’ is defined as anyone who submits the plan to the resolution

professional[124], then the resolution professional checks them and places before the committee of the creditors to approve it. If the foreign regimes are looked into then though, there is no common consensus on as to who should propose the rescue plan, the US Code prescribes that first the corporate debtor should prepare the plan within 120 days and if it fails then others are allowed to propose the plans, whereas in UK the administrators proposes the resolution plan. There is a need to look into this aspect as there being no limit on who can propose the plans, there may a numerous numbers of plans being proposed as well as since no one can be said to be as deeply associated with the functioning of the company as management is the plans proposed may not take overall considerations of the circumstances which may later arise.

9. CONCLUSION

India is a developing country with a GDP around $2 trillion, which is growing at the rate of around 7% per annum.[125] The present government, in recent times, has shown keen determination to increase the industrial sector, for a market

[124] The Insolvency and Bankruptcy Code, 2016, § 5(25).

[125] ET Bureau, India's Q1 GDP growth slows to 7.1% in new worry for Modi government, The Economic Times, Sept. 1, 2016, http://economictimes.indiatimes.com/news/economy/indicators/indias-q1-gdp-growth-slows-to-7-1-in-new-worry-for-modi-government/articleshow/53946492.cms.

aspiring to grow the nexus between insolvency laws and credit availability is indisputable and so is need of a well functional insolvency regime. India was in critical need of a functional insolvency resolution framework, the present code is a step in achieving the same.

The UNCITRAL Legislative Guide on Insolvency flags out certain characteristics and objectives of insolvency regimes, the nine broad objectives are[126]:

a) *"Provision of certainty in the market to promote efficiency and growth.*
b) *Maximization of value of assets.*
c) *Striking a balance between liquidation and reorganisation.*
d) *Ensuring equitable treatment of similarly placed creditors.*
e) *Provisions of timely, effective and impartial resolution of insolvency.*
f) *Preservation of the insolvency estate to allow equitable distribution to creditors.*

[126] United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law, Part I*, 10-14 (2005), available at http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf.

g) *Ensuring a transparent and predictable insolvency law that contains incentives for gathering and dispensing information.*

h) *Recognition of existing creditor rights and establishment of clear rules for ranking priority of claims.*

i) *Establishment of a framework for cross-border insolvency."*

Though there is a wide array of difference between the social, economic and market structures of various countries all around the world, but most of insolvency law regimes tend to adhere to model characteristics laid down by the United Nations. The Code tries to fulfill most of the above stated characteristics and provides a robust mechanism to solve the insolvency questions as and when they arise.

If the corporate rescue regime is taken in isolation, there are some significant differences in the present and past Indian regimes, and also with several well working foreign regimes. The Indian insolvency framework is in nascent stage and the thus should be open to the lessons from other regimes, such as providing for one more objective test so as to check about insolvency and deliberations on the matters that whether Resolution Professional should control the management of the company or the framework of US and idea of DIP can be

adopted as the reasoning that the management would be better positioned to make decisions make much sense, are needed.

Further deliberations on the options like the corporate debtor should be firstly allowed to submit the plan; amendments into the plans after acceptance; and giving operational creditors more say are needed.

Lastly, the purpose of the insolvency law is to provide sufficient incentives to the creditors so that they refer the collective insolvency proceedings over individualized debt realizing mechanisms[127] and the present law provides enough reason to them to do the same.

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[127] Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements and Creditor's Bargain,* 91 Yale L.J. 857, 864 (1981-1982).

COMPETITION LAWS

RECENT CHANGES IN MERGER CONTROL REGIME VIS-À-VIS THE COMPETITION ACT

PALLAVI MAHAJAN*

1. INTRODUCTION

The Indian merger control regime under the Competition Act, 2002, has been in force for nearly five years. The merger control regime was originally issued by the Competition Commission of India (CCI) in May 2011. CCI has since then amended these regulations from time to time on the basis of the wholesale price index or fluctuations in exchange rate of rupee or foreign currencies. The Government has also the power to provide exemptions to certain enterprises from the provisions of the Act in public interest.

The provisions of the Competition Act are to be read together with the notifications issued, from time to time, by the Ministry of Corporate Affairs (MCA), Government of India and the Competition Commission of India (CCI)[1] Regulations, 2011. Exercising its powers, the Ministry of Corporate Affairs

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[1] The Competition Act, 2002.

(MCA) has previously enhanced the jurisdictional thresholds under the Competition Act and also introduced exemptions.[2]

Besides the CCI, there are sector-specific regulators such as the Department of Telecommunication, the Insurance Regulatory Authority of India, the State Electricity Regulatory Commissions, etc. which examine the sector-specific mergers under the relevant statutes. In addition, listed companies are also required to comply with the regulations of the Securities Exchange Board of India (SEBI), including that of the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011. Further, in case of acquisitions or amalgamations, the scheme of acquisition or amalgamation is required to be approved by the concerned High Court after taking comments from the Regional Directors in the Ministry of Corporate Affairs under the Companies Act, 1956 (since replaced by the Companies Act, 2013).

With regard to shake off the Indian inertia towards merger and acquisitions, on 5 March 2016, the Ministry has published Notifications S.O. 673(E), 674(E) and 675(E)[3] dated 4 March

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[2] *Notification dated March 4, 2011*, MINISTRY OF CORPORATE AFFAIRS, http://www.cci.gov.in/sites/default/files/notification/SO479%28E%29%2C480%282C482%28E%29240611.pdf.

[3] *Notification dated March 4, 2014*, MINISTRY OF CORPORATE AFFAIRS, http://www.cci.gov.in/sites/default/files/notification/SO%20673%28E%29-674%28E%29-675%28E%29.pdf.

2016, enhancing the existing jurisdictional thresholds under the Competition Act and amending and extending the existing exemptions for the target enterprise and group.

2. LEGISLATIONS GOVERNING THE MERGER CONTROL REGIME IN INDIA

The Competition Act, 2002, is the main statute for regulation of merger control in India. Further, the Competition Commission of India (CCI) (Procedure in Regard to the Transaction of Business Relating to Combinations) Regulations, 2011, as amended from time to time, serve as the implementing regulations; while the Competition Commission of India (CCI) (General) Regulations, 2009, clarify and streamline the procedure for notification and regulation of combinations[4]. Besides the Competition Act, the Companies Act, 2013[5] and the Takeover Code are the other principal laws which govern mergers and acquisitions in India. Foreign Direct Investment in India is governed by the FDI Policy issued by the Government of India and the provisions of the Foreign Exchange Management Act, 1999.

[4] Jitender Bhargava v CCI & Ors, Appeal 44 / 2013.
[5]The Companies Act, 2013.

3. KEY CHANGES BROUGHT IN BY THE MERGER CONTROL REGIME, 2016

The merger control regime in India has been in practice for over five years now and has significantly transformed the manner in which mergers and acquisitions activity is governed in India. Under the Competition Act, 2002, every two years, the Government is required to enhance or reduce the financial thresholds for big ticket transactions which may have an adverse effect on competition in the relevant market. The Government has also the power to provide exemptions to certain enterprises from the provisions of the Competition Act in public interest.

Three major changes were brought in by March 04, 2016 notification:[6]

a) Thresholds for pre-merger notification increased by 100%.

b) Target de-minimis threshold increased for a pre-merger notification.

c) Definition of Group revised unto 50%.

[6] Merger Notification & Review (N&P) subgroup developed RPs for Merger Notification to facilitate convergence-adopted by ICN-April 2006-non binding jum, 09-03-200.

3.1. Financial Jurisdictional Threshold enhanced by 100%

Section 5 of the Competition Act specifies the asset and turnover threshold limits which trigger the applicability of the notification requirement under the Act. Vide the notification dated March 4, 2011; the said thresholds were increased by 50%. Vide the latest notification dated March 04, 2016, the threshold, as in the original Competition Act, 2002, has now been increased by 100%.

The revised thresholds for notification to the Competition Commission of India are as follow:

S.No.	Nature of transaction	Assets	Turnover
1.	Acquisition by Investors (in India), Investors and the Target (jointly) have.	INR 1,000 crores	INR 3,000 crores
2.	Acquisition by Investors (in and outside India), Investors and the Targets (jointly) have.	USD 500 million (including at least INR 500	USD 1.5 billion (including at least INR 1,500

		crores in India)	crores in India
3.	Acquisition by the Investors (Group level) (in India), Investors Group and the Target (jointly) have.	INR 4,000 crores	INR 12,000 crores
4.	Acquisition by the Investors (Group level) (in and outside India), Investors Group and the Targets (jointly) have.	USD 2 billion (including at least INR 500 crores in India)	USD 6 billion (including at least INR 1,500 crores in India

3.2. **Increase in thresholds of De Minimis Exemption:**

De Minimis exemption in literal terms means small target exemption. The Ministry of Corporate Affairs (MCA) took cognizance of the fact that the small target transactions will

have negligible impact on the competition in the relevant market[7]. Hence, the Ministry of Corporate Affairs (MCA) through a notification dated March 4, 2011, and a corrigendum dated May 27, 2011 had introduced de minimis exemption to exempt the small target companies from the notification requirement under the threshold limit. Pursuant to Notification dated March 04, 2016, acquisitions where enterprises whose control, shares, voting rights or assets are being acquired, have assets of not more than 350 crores in India or turnover of not more than 1000 crores in India are exempt from section 5 of the Act for a period of 5 years[8].

Since the earlier notification was set to expire, the Ministry of Corporate Affairs has issued a new notification extending the period of applicability for another five years until 4 March 2021. Further, the Ministry has also increased the financial thresholds to exempt any enterprise being acquired with assets worth INR 350 crores or less, or having a turnover of not more than INR 1000 crores from the provisions of Section 5 as against the earlier threshold limits of INR 250 crores for assets and INR 750 crores for turnover respectively.

[7] Combination Registration No. C-2014/07/190
[8] Combination Registration No. C-2014/05/170.

3.3. Definition of Group revised unto 50%[9]

A "group" as defined under the Act, means two or more enterprises which, directly or indirectly,

a) are in a position to exercise 26% or more of the voting rights in another enterprise; or

b) appoint more than 50% of the members of the board of directors in another enterprise; or

c) control the management or affairs of another enterprise.

For the Group Test, provided above, all enterprises which form part of a "group" are to be considered for calculating the monetary thresholds.

The Ministry of Corporate Affairs, by way of a notification dated March 04, 2011, had revised the definition of group, to exempt enterprises exercising less than 50% (fifty per cent.) of voting rights in another enterprise, from filing a notification with the CCI, for a period of five years (i.e. valid until March 04, 2016). The Ministry of Corporate Affairs, by way of the Notification dated March 04, 2016, has further extended this exemption for another five years.

[9] Combination Registration No. C-2014/07/190

4. EFFECT OF THE CHANGES BROUGHT IN BY THE MERGER CONTROL REGIME

4.1. Effects of the revised jurisdictional thresholds

a) The thresholds provided under the Act are based on the combined value of assets and turnover of the parties to the transaction i.e., the acquirer and the target.

b) In case of an acquisition, the relevant entities for a Enterprise Test are the acquirer and the target enterprise (including its subsidiaries, units and divisions). For the Group Test, the relevant entities refer to the group to which the target enterprise would belong after the acquisition.

c) In case of a merger or amalgamation, the relevant entities for the Enterprise Test are the enterprise remaining after the merger or the enterprise created as a result of the amalgamation. In case of Group Test, it would be the group to which the enterprise remaining after the merger or created as a result of the amalgamation, would belong, post-transaction.

d) These thresholds are applicable on transactions where the binding agreement (in case of an acquisition) is signed or a public announcement is made or a final board approval (in

case of a merger or amalgamation) is passed, by the parties on or after March 04, 2016

e) The revised threshold limits are likely to facilitate the ease of doing business by exempting many transactions from the lengthy and time-consuming filing requirements as required by the Act.

4.2. Effects of the De Minims Exemption

a) The extension of the target-based exemption for another five years is a welcome measure, however, contrary to industry expectations; the government has not clarified on the inclusion of amalgamations in this notification. In the absence of specific coverage for amalgamations, the notification would continue to be available only in cases of 'acquisitions'.

b) The target enterprise (i.e. the enterprise whose control, shares, voting rights or assets are being acquired) is exempt from filing a notification with the CCI, if it has assets less than INR 350 crores (INR 3.5 billion) or turnover less than INR 1000 crores (INR 10 billion), in India, until March 04, 2021, irrespective of the parties or the group test (as provided below).[10]

[10] Combination Registration No. C-2014/07/190.

c) The Revised Target Exemption continues to be applicable on transactions effected by an acquisition only and is inapplicable in case of transactions effected by mergers and amalgamations.

d) In case of asset acquisitions, the "target" continues to be the enterprise housing the assets and not the assets themselves.

e) The Revised Target Exemption is applicable on acquisitions where the binding agreement is signed, or where a public announcement is made in terms of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, on or after March 04, 2016

4.3. **Effects of the definition of the Group extended**

a) For the purposes of calculating jurisdictional thresholds, enterprises that exercise more than 50% control over another enterprise will constitute "group".[11]

b) The validity of this exemption continues to remain questionable. The Act only empowers the MCA to exempt categories of enterprises or transactions from the purview

[11] Thomas Cook (India) Limited & Ors. v. Competition Commission of India, Appeal No.48 of 2014, order dated Aug. 26 2015 at para 21.

of the Act. However, the above “group” exemption has the effect of amending the Act, which is beyond the powers of the MCA. From a practical standpoint, the revised “group” exemption seems to be applied across the provisions of the Act.

5. BOTTLENECKS IN THE EXECUTION OF THE AMENDED MERGER CONTROL REGIME

a) The De Minimis Exemption seems to be lacking in scrutiny. The Competition Commission of India seems to have overlooked the existence of fragmented sectors and the possibility of a large acquirer to keep acquiring smaller companies and gain significant market share without the Competition Commission of India’s scrutiny.

b) The De Minimis Exemption has not been extended to transactions which have been structured as “mergers or amalgamations” and is restricted to “acquisitions”. This is obscurity in wording of the exemption seems to be a glitch.

c) The De Minimis Exemption applies only to the target group and missed the acquirer group. The Exemption threshold should be party neutral/agnostic and it should not just apply to the target

6. CONCLUSION

The merger control regime, 2016 is welcome change for the Indian trade and development. The regime advance the economy's projection of being a powerful and hub for international trade and development. Overall, CCI in a very short time has established itself as an efficient and credible competition regulator. The challenges associated with Indian merger control regime may perhaps be unique but are not impossible. A little bit of planning, careful reading of the law and continuous cooperation with CCI is all that is required to secure quick approvals for most transactions.

CORPORATE LAWS

EQUITY CROWDFUNDING IN INDIA: TOWARDS A REGULATORY FRAMEWORK

STUTI SHAH*

1. INTRODUCTION

Crowdfunding has emerged in recent times as an alternative means of raising capital for entrepreneurial ventures and small businesses trying to carve out a space in the market. Crowdfunding is increasingly gaining popularity in India and has been used for projects and campaigns such as Teach for India[1] and the Goa Project[2]. Several filmmakers have also relied on raising funds through crowdfunding.[3]The Securities and Exchange Board of India (SEBI) released a Consultation Paper on Crowd Funding in July, 2014 (hereinafter "**Consultation Paper"**), where it defined crowdfunding as a '*solicitation of funds from multiple Accredited Investors through a web-based platform or social networking site for a project, business venture or social cause*'.[4]

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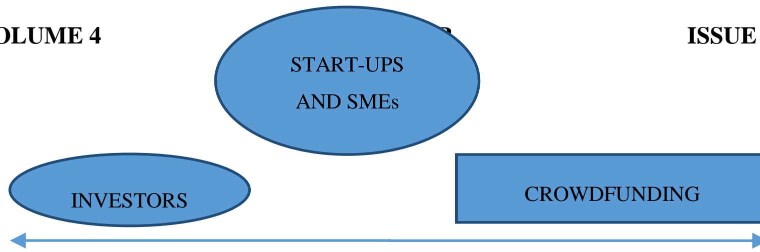
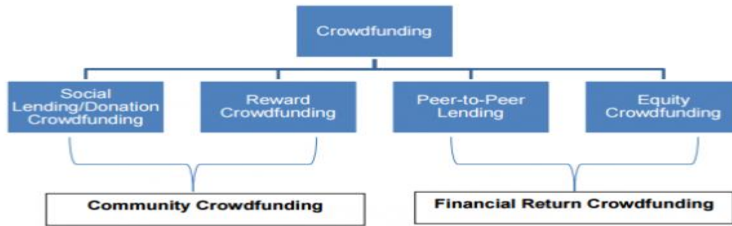
[1] TEACH FOR INDIA PROJECT, http://www.teachforindia.org/.
[2] THE GOA PROJECT, http://www.thegoaproject.com/.
[3] *See*, for e.g., Pawan Kunar, LUCIA*;* Abhay Kumar, PLACEBO.
[4] *Supra* note 2, p. 1.



Crowdfunding as an avenue of raising capital has three entities: the investors allowed to invest (hereinafter "**Accredited Investors**"), the small and medium enterprises (inclusive of start-up companies) allowed to raise funds through crowdfunding platforms (hereinafter "**SMEs**"), and the intermediaries (hereinafter "**Crowdfunding Platforms**") that facilitate the meeting of the Accredited Investors with the SMEs.

What do the Crowdfunding Platforms get in return for facilitating the meeting of the Accredited Investors and the SMEs? Crowdfunding Platforms charge a fee from both the Accredited Investor as well as the SME. The more credible the Crowdfunding Platform is, the higher is the rate of fee charged. Thus Crowdfunding Platforms are incentivized to have highly active screening committees to ensure that a large number of Accredited Investors choose their platform to invest, and this would in turn attract a large number of credible SMEs on such platforms.

The International Organisation of Securities Commission (hereinafter "**IOSCO**") has identified four types of crowdfunding:



Source: IOSCO Staff Working Paper - Crowd-funding: An Infant Industry Growing Fast , 2014

Donation crowdfunding is the solicitation of funds for social purposes, while reward crowdfunding is a category of crowdfunding where Accredited Investors receive existing or future tangible rewards for their investments.[5] Peer-to-peer lending allows for a debt based means of raising capital, where entrepreneurs are lent a certain sum of money which they have to pay back after a certain period of time (more often than not, with interest). Under equity based crowdfunding, equity shares of the company seeking funds are issued to the Accredited Investors as consideration for their investment.[6] The researcher will primarily be focusing on the niche area of equity based crowdfunding in the length of her paper.

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[5] *Supra,* note 2, p. 2.
[6] *Ibid,* p. 3

2. LOOK AT SEBI'S CONSULTATION PAPER

3. BACKGROUND

SEBI's framework in the Consultation Paper provides for crowdfunding as a means of raising capital, through a comparative study of the concept in several jurisdictions, and an assessment of benefits and risks associated with it. The Consultation Paper aims at reaching a regulatory framework for crowdfunding in India by identifying creative projects, benevolent causes, and start-up ventures as being ideal avenues for the same.[7]

Typically, SMEs are funded through loans from financial organisations, angel investors, or through private equity.[8] However, equity based crowdfunding has been gaining popularity as an alternative means of raising capital for start-up ventures and companies. Equity Crowdfunding Platforms in India include Ketto, Wishberry, catapult, etc.

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[7] *Ibid.*
[8] *Ibid,* p. 4

Table 1: Table Illustrating The Diffferent Equity Crowdfunding Platforms In India And Depicting Facts About Them

CROWDFUNDING SITES IN INDIA- OPPORTUNITIES AND FACTS					
	CATEGORY	**FUNDRAISED SO FAR**	**UPFRONT LISTING**	**SITE FEE**	**PAYMENT PRCOESSING FEE**
MILAAP	Social Causes	4.18 Million USD	Free	Their website claims that they disburse 100% to borrowers	Information Unavailable
KETTO.ORG	All	INR 4 Crores	Free	5%	5%
START51	All	INR 16,95,062	Free	5%	Information Unavailable
FUNDDREAMSINDIA	All	Information Unavailable	Free	5%	3.95%
WISHBERRY.IN	All	INR 4.5 crore	INR 2,500 plus taxes	10% (Includes Payment Processing Fee)	N/A

CATAPULT	All	INR 75 lacs	Rs 1,499	Standard- 10%; Premium- 15%, Advanced- 15% plus	Information Unavailable
BITGIVING	Social Causes	INR 35 Lacs	Free	Information Unavailable	Information Unavailable

Source: Table compiled on 12th May, 2015 by Binnews

3.1.1. *Towards Regulation*

Through the Consultation Paper, SEBI seeks to propose a regulatory mechanism and invites comments and suggestions in this regard. If the costs that are associated with regulation are excessive, then crowdfunding may not be a viable method at all. The optimum level of regulation should be such that it puts crowdfunding at an equal or higher advantage than private placements and initial public offers (hereinafter "**IPO**").

In its Consultation Paper, SEBI identifies equity based crowdfunding as being based on the private placement model under Section 42 of the Companies Act, 2013 (hereinafter "**Companies Act**"). The three parties who will be the subject

of regulations are: Accredited Investors, SMEs, and Crowdfunding Platforms.[9]

3.1.2. *Accredited Investors*

Potential investors must understand the inherent risks involved, the illiquid nature of the securities issued, and be capable of bearing any loss that may arise. In this context, SEBI proposes that only Accredited Investors be allowed to participate in crowdfunding. These include:

a) Qualified Institutional Buyers (hereinafter "**QIB**")

b) Companies incorporated under the Companies Act, having a net worth of at least INR 20 Crores

c) High Net Worth Individuals (hereinafter "**HNIs**"), where the minimum net worth should be INR 2 Crores

d) Eligible Retail Accredited Investors (hereinafter "**ERIs**"), who receive investment advice or have passed an appropriateness test.[10]

Apart from this, retail investors are eligible to invest only if they earn a minimum gross income of INR 10 Lakhs, and have properly filed tax returns for 3 years.Furthermore, to protect them from risks, SEBI wishes to impose an investment cap of

[9] *Ibid*, p. 30.
[10] *Ibid*, p. 31.

INR 60,000 on them, and prohibitthem from investing more than 10% of their net worth through crowdfunding.[11]

3.1.3. *SMEs:*

SMEs must satisfy the following conditions if they wish to be eligible to register themselves on a Crowdfunding Platform:

a) The SME allowed herein must be an early stage SME or a start-up that intends to raise a capital of not more than INR 10 Crores in a one year period;[12]

b) The SME must not be promoted, sponsored or related to any other group with a turnover of more than INR 25 Crores;

c) The SME cannot be more than 48 months old, and cannot be listed on any exchange;

d) The SME, its directors, promoters or associates must be 'fit and proper' persons as specified under Schedule II of Securities and Exchange Board of India (Intermediaries) Regulations, 2008;[13]

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[11] *Ibid,* p. 32.
[12] *Ibid,* p. 37.
[13] *Ibid,* p. 37.

e) The SME cannot use multipleCrowdfunding Platforms within a 1 year period and cannot directly or indirectly advertise their offer to the public in general;

f) Disclosures are required to be made at the time of registration with a Crowdfunding Platform, as well as at regular and ongoing intervals. This is so as to enable Accredited Investors to make an informed decision and keep a track of the appreciation of their investments. Though future projections are not ordinarily allowed, SEBI proposes that these be allowed owing to the lack of any business history. However, the projections made must be realistic.[14]

g) SEBI proposes that a private placement offer letter be submitted to the crowdfunding portal by the SME. This would contain the SME's name and registered address, issue size, description of the venture, past history of funding, history of prior refusal from a Crowdfunding Platform, financial statements, price of securities, rights and liabilities attached, details of the venture's management, major risks involved, and a dispute resolution

[14] *Ibid,* p. 40.

mechanism.[15] This would be circulated to Accredited Investors.

3.1.4. *Crowdfunding Platforms*

The main objective of crowdfunding is to keep fraudulent SMEs at bay. Therefore, the Consultation Paper suggests that:

a) All Crowdfunding Platforms must be registered with SEBI; these include recognized stock exchanges, SEBI registered depositories, and other SMEs with specific domain knowledge and experience. Technology business incubators, angel investors or private equity associations are also proposed to be allowed if they satisfy certain conditions.[16]

b) These entities must take reasonable measures to reduce the occurrence of fraud, and must conduct necessary due diligence. The directors, promoters and shareholders are also to be scrutinized. Any information presented by the SMEs must be verified, and information must be transmitted to SEBI as and when called for.[17]

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[15] *Ibid,* p. 39.
[16] *Ibid,* pp. 47-48.
[17] *Ibid,* p. 49.

c) The Crowdfunding Platform must also have a fair process, its own domain ID/ website recognized and certified by SEBI, and a procedure to address possible conflicts.

d) SEBI has also provided measures against the possibility of cyber crimes being committed.[18]

4. NECESSITY OF CROWDFUNDING

SEBI's Consultation Paper notes the gravity of the financial crisis of 2008, which caused the failure of several banks, making them reluctant to lend to small businesses as this might involve high risks and low returns.[19] SEBI, in the context of the financial crises and an stagnating IPO market, recognised the need to encourage innovative and sustainable ways of fund raising, and aims to provide an impetus to genuine SMEs.[20]

More recently, the Non- Performing Assets (hereinafter "**NPAs**") of banks have increased to such an extent, that the government has drafted a bill[21] to amend the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 to deal with these NPAs. Banks

[18] *Ibid,* p. 50.
[19] *Supra* note 1.
[20] *Ibid,* p. 27.
[21] Surabhi Aditi Nigam, *FM introduces Bill to fast tract recovery of bad debt*, (June 30, 2016), http://www.thehindubusinessline.com/economy/jaitley-introduces-amendments-to-fast-track-loan-recovery/article8585023.ece .

have become extremely cautious while lending to enterprises and there is additional pressure from the government too, to be highly selective while doing so.[22] Hence SMEs do not have a chance of borrowing money from banks as they have no previous experience to prove their credence, nor do they have any collateral to give. In such a situation, the avenue of crowdfunding as a means of raising capital has captured the imagination of the public.

SEBI's concerns lie in balancing out the impetus to be provided for SMEs vis-a-vis the systemic risks involved in crowdfunding as such.[23] The IOSCO working paper on crowdfunding (hereinafter "IOSCO Working Paper") referred to by SEBI,[24] notes that regulating a previously exempt sector might give credibility to transactions that are mired by risks, and it could attract less experienced investors who could stand to lose.[25]

[22] Dinesh Unnikrishnan, *Bank NPAs: The Rot Runs Deeper and the only Solution is more Radical Reforms*, (June 30, 2016),http://www.firstpost.com/business/bank-npas-the-rot-runs-deeper-and-the-only-solution-is-more-radical-reforms-2518888.html.

[23] *Supra* note 24, p. 28.

[24] Eleanor Kirby, Shane Worner, *Staff Working Paper of the IOSCO Research Department*, (June 27, 2016), http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf.

[25] *Supra* note 27, p. 14.

5. GOVERNING LEGISLATIONS IN INDIA

The existing legal framework which governs the raising of capital for a business venture comprises:

a) the Companies Act,

b) the Securities and Exchange Board of India Act, 1992 (hereinafter "SEBI Act"),

c) the Securities Contracts Regulation Act, 1956, and

d) the Depositories Act, 1996.

The two means by which capital can be raised are through a private issue of securities, and through a public offer.[26]Section 2(68)(iii) of the Companies Act, prohibits a private company from making invitations to the public to subscribe to the securities of the company. Therefore, to seek funds from the public, the company must be listed, and cannot be a private limited company. This presents the first hurdle to crowdfunding.

Section 24 of the Companies Act, provides that the issue and transfer of public securities are to be governed by the rules of SEBI. Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 (hereinafter

[26] CHAPTER III, RULE 23, COMPANIES (PROSPECTUS AND ALLOTMENT OF SECURITIES) RULES, 2014.

"ICDR"), require public issuers to adhere to very specific requirements such as the appointment of a merchant banker and registrar to the issue, filing of a draft offer document with SEBI, eligibility conditions, as well as detailed disclosures and risk highlights to be made.[27] Not only are such conditions a financial impossibility for SMEs who barely have any capital, but these disclosures pose great difficulty to the new entrants to the market who have very little know-how with regards to such disclosures and legal compliances.

Hence, the avenue of crowdfunding in India is governed by the following:

a) The idea of equity crowdfunding falls within this private placement model espoused by Indian corporate law.With respect to private placements, Section 42 of the Companies Act, along with Chapter III of the Companies (Prospectus and Allotment of Securities) Rules, 2014 (hereinafter "Companies Rules"), provides that private placements cannot be made to more than 200 persons in one financial year (excluding QIBs and employees of the company being offered securities under an employee stock option scheme

[27] SECURITIES AND EXCHANGE BOARD OF INDIA (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009.

(hereinafter "ESOPs")).[28] Each of such persons are to receive the offer by name, and there are also specific rules with respect to the mode of subscription by such persons.[29]

b) Further, Section 12(1) of SEBI Act requires intermediaries dealing in securities to be registered, and a certificate of registration obtained from SEBI. A Crowdfunding Platform would necessarily be such an intermediary, and would have to obtain a certificate in accordance with the rules of SEBI.

c) With regard to SMEs, SEBI has laid down several regulatory mechanisms in the recent past. SMEs can list their securities on an 'SME Segment' on recognised stock exchanges.[30] Various relaxations for such SMEs are provided under the ICDR: the draft offer document may be filed directly with the exchange, and requirement of filing it with SEBI first is done away with.[31] The eligibility criteria provided under Regulation 26 therein are not applicable to SMEs.[32] Half yearly returns may be filed instead of

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[28] RULE 14(2), COMPANIES (PROSPECTUS AND ALLOTMENT OF SECURITIES) RULES, 2014.
[29] RULE 14, *Ibid.*
[30] SEBI, LISTING OF SMALL AND MEDIUM ENTERPRISES (SMEs) AND START-UP COMPANIES ON SME PLATFORM WITHOUT MAKING AN INITIAL PUBLIC OFFER, (July 3, 2016), http://www.sebi.gov.in/cms/sebi_data/boardmeeting/1373435315913-a.pdf.
[31] *Ibid.*
[32] *Ibid.*

quarterly, and financial results need not be published in the newspaper.[33]

d) Another platform provided by SEBI for SMEs, is called the Institutional Trading Platform (hereinafter "ITP"). Only those SMEs which have not listed any securities on any recognised stock exchange are permitted to list their securities exclusively on the ITP.[34] It does not involve a private placement or public offer; the objective of the ITP is to provide an initial impetus for SMEs.[35] SEBI has made listing on the ITP attractive by making it cost effective, easy, and tax beneficial. By availing this option, SMEs can reduce their debt burden by attracting private equity players.

6. RISKS ASSOCIATED AND BENEFITS ACCRUED

6.1. Risks:

The central idea that backs crowdfunding is to solicit small investments from a large number of investors. The Consultation Paper attributes such cautions to investors whose risk tolerance is very low. Since investments in SMEs involve

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[33] *Ibid.*

[34] *Supra* note 2, p. 22.

[35] CHAPTER XC, SECURITIES AND EXCHANGE BOARD OF INDIA (LISTING OF SPECIFIED SECURITIES ON INSTITUTIONAL TRADING PLATFORM) REGULATIONS,2013

low liquidity and high risks, this could be dangerous to uninformed Accredited Investors.[36] The risks posed by raising capital through crowdfunding are several:

a) Since the solicitation of funds occurs through an online portal, in cases of default, fraud, or if the web portal shuts down, the Accredited Investors would have no recourse. The public funding here is sought for future possibilities, as against concrete business plans assessed for viability under existing regulations.

> Bubble and Balm, a soap manufacturing company in the UK, raised fundsthrough the equity crowdfunding platform Crowdcube in 2011. It closed overnight in, having raised money from 82 Accredited Investors, who lost 100% of their investments and had no way of contacting the company.

b) The internet plays a central role in crowdfunding, and its essentially wide reach could expose a larger number of people to risk by bypassing local laws as compared to traditional means of fundraising.[37]

c) SEBI also identifies systemic risks: illiquidity due to lack of a secondary market to sell the securities, potential of

[36] *Ibid*, p. 5.
[37] *Ibid*, p. 7.

money laundering, cross border jurisdictional disparities, lack of monitoring and transparency, and the inherent information asymmetry that arises as there is no mandated offer document.[38] In a regular issue of securities by a company, such securities can be freely traded in the market.[39]

d) Securities obtained through making investments by crowdfunding cannot be traded on Crowdfunding Platforms, as these companies will not be treated as listed companies. Accredited Investors do not have the option of selling their securities at a desired time. While a regular secondary market may not be permissible given the regulatory framework for stock exchanges, crowdfunding web portals can create a platform for information exchange.[40]

6.2. Advantages:

Nonetheless, equity crowdfunding has several advantages. The most significant one that appeals to SMEs is the lack of stringent regulation and requirement of several compliances. Companies that raise funds from 50 or more investors are

[38] *Ibid,* p. 8.
[39] SECTION 56, COMPANIES ACT, 2013.
[40] *Supra*, n. 28, p. 25.

required to release a public offer, regulated under the Companies Act, as well as the ICDR.[41] Using a web portal for crowdfunding, an entrepreneur can get across an idea and the project proposed can be financed by several hundreds of potential Accredited Investors. Other advantages include the spreading of risk and an overall boost to the economy.[42]

7. JURISDICTIONAL COMPARISON OF CROWDFUNDING REGULATIONS

In this chapter, the researcher has conducted a comparative study of the legal status of crowdfunding in other countries and the repercussions of such regulations on their respective economies.

7.1. The United States of America

The US has over-regulated crowdfunding through the Jumpstart Our Business Startups Act, 2012 (hereinafter "JOBS Act").[43] Though JOBS Act allows advertising and marketing a company's investment opportunities through social media, web based platforms etc. and a crowd sourced equity funding

[41] SECTION 42, COMPANIES ACT, 2013.
[42] Ibrahim, Darian M., *Equity Crowdfunding: A Market for Lemons?,* Minnesota Law Review, Forthcoming; William & Mary Law School (June 30, 2016), http://ssrn.com/abstract=2539786.
[43] *Supra* note 2, p. 11.

option allows SMEs to obtain moderate amounts of capital, the act also imposes caps as to the amount of money that can be raised per year through crowdfunding, disclosure documents and annual reports are to be filed with the regulating agency. Funding platforms are prohibited from offering investment advice or making recommendations.

7.2. The United Kingdom:

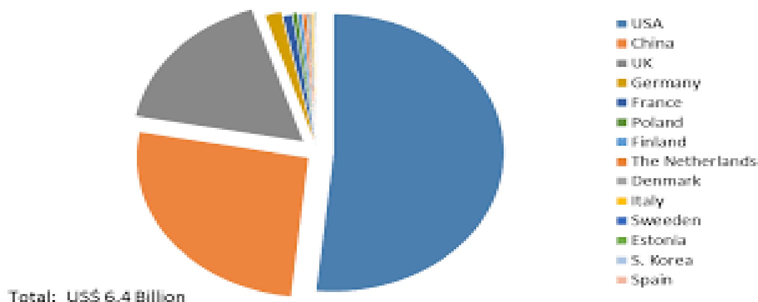
Similar to the US, the UK has several stringent regulations on crowdfunding in place which define investors as an exclusionary specific group and impose an upper cap on investment. A highly successful crowdfunding scene,[44] regulations in the UK further provide that adequate and fair information must be provided which is not misleading and risks should be highlighted.

A measure taken by the UK Government to make the avenue of crowdfunding risk averse is to make it mandatory for investors to pass an online appropriateness test to prove that they are aware of the risks.

[44] Samantha Hurst, *Half a Decade of Success, Crowncube Releases a New Video, Crowdfund Insider*, (June 28, 2016),https://www.crowdfundinsider.com/2016/07/87449-crowdcube-releases-new-introduction-video/.

7.3. New Zealand:

New Zealand is the most crowdfund-friendly jurisdiction in the world. The Financial Markets Conduct Act 2013, regulates equity based crowdfunding and peer to peer lending in New Zealand. A license must be obtained for portals as well as investment seekers to raise funds through crowdfunding. Though the statute imposes a cap on the amount that can be raised, it does not impose any base minimum or upper cap on the amount that is to be invested or imposes any distinction between retail and sophisticated investors.[45] This makes New Zealand conducive to this alternate means of raising capital.



Source: IOSCO Working Paper- Equity Crowdfunding country wise in September 2014.

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45 FINANCIAL MARKETS AUTHORITY, NEW ZEALAND GOVERNMENT, (June 29, 2016),https://fma.govt.nz/compliance/role/crowdfunding-platforms/.

8. CRITICAL ANALYSIS

The proposal made by SEBI in its Consultation Paper seeks to amalgamate a new law on crowdfunding with the existing laws regulating the raising of capital for a business venture. For the concept of crowdfunding to work well as an alternative mode of seeking investments, the amount of regulation needs to be optimum, and must balance out impetus creation as well as investor protection, and cover all the expected areas of risk. There are several issues arising from the proposed regulatory mechanism.

8.1. Clarification with regards to transfer of shares in secondary markets:

8.1.1. *Provision:*

The Consultation Paper provides for the transfer of securities in the following ways:[46]

a) Through a buyback of securities under the Companies Act;

b) To another accredited investor on the same portal where the securities were bought through crowdfunding; and

c) To a family member or relative or friend of the existing investor.

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[46] *Supra* note 46, p. 25.

8.1.2. *Analysis*

Not only is this list highly restrictive, but there is also a lack of a clear definition as to who constitutes a valid transferee for securities to be transferred to 'family members', 'relative' or 'friends'. This lacuna could give rise to informal, unregulated secondary markets, confusion and litigation. SEBI should provide us with a clarification on the definition of 'family member', 'relative' and 'friends', and possibly expand the ambit of its secondary market.

8.2. **Stance on Cross-border funding should be clarified:**

8.2.1. *Provision:*

No provision on Indian investors involved in crowdfunding opportunities in other jurisdictions.

8.2.2. Analysis*:*

Since crowdfunding essentially occurs on a web platform, it would be accessible to Accredited Investors outside the country as well. A foreign company may raise funds in India and foreign investors may participate in crowdfunding activities in India. It is also possible that Indian Accredited Investors may seek to be involved in crowdfunding opportunities in other jurisdictions. The corresponding

question to be answered is whether SEBI has a duty to protect Indian investors investing beyond Indian borders. This issue has not been addressed by the Consultation Paper.[47]

8.3. **Restricted coverage of the Consultation Paper:**

8.3.1. *Provision:*

The Consultation Paper states that crowdfunding shall be available only to unlisted public companies.

8.3.2. *Analysis:*

This provides a highly restricted coverage of the consultation paper. Considering that this model is meant to facilitate start-ups and fledgling businesses, and ensuring compliance with the stringent regulations that apply to public companies would be burdensome and costly for such SMEs, it is essential that entities such as private limited companies, one person companies, limited liability partnerships and sole proprietorships, which are all common business models used by SMEs should also be included.[48]

[47] *Supra* note 1, p. 26.
[48] *See* generally, *supra* note 49.

8.4. **List of Accredited Investors mentioned in paragraph 9.1.4 of the Consultation Paper should be expanded:**

8.4.1. *Provision:*

Definition of Accredited Investors has been explained on page 3 of the Introductory Chapter of this paper.

8.4.2. *Analysis:*

Accredited Investors as defined by SEBI would in practicality be very few in number. Furthermore, most of the Accredited Investors look to invest in risk-averse companies that have proven track records. Such Accredited Investors hardly finance entrepreneurs trying to convert their ideas into viable businesses. The exclusion of small investors is directly in conflict with the very notion of crowdfunding, which seeks to attract small sums from a very broad base of investors.

Restricting investments to only accredited Accredited Investors is simply a way to make existing venture capital and private equity investments more efficient using the internet.[49] Crowdfunding is meant to engage Accredited Investors who would otherwise not be able to invest in the capital market, as the investment amounts required from each individual investor

[49] *supra,* note 1, p. 24.

is small. The stringent eligibility criteria prescribed alienates 'crowds' from crowdfunding and makes it accessible to only a few elites, and isolates a large section of potential Accredited Investors.[50]

Though such an investment is inherently risky, the crowdfunding process can be structured in a manner that any loss to SMEs is small and bearable.[51] Jurisdictions such as US, France, and Canada allow small investors to participate in crowdfunding, and supplement this with appropriate safeguards for their protection.

8.5. **Permissible investment limit mentioned in paragraph 9.1.5 of the Consultation Paper should be modified:**

8.5.1. *Provisions:*

(a) Rule 14(2)(c) of the Companies Rules, to which crowdfunding is subject, mandates that the minimum size of each investment must be at least INR 20,000. (b) QIBs are required to collectively hold a minimum of 5% of the securities issued through crowdfunding.

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[50] *Ibid.*

[51] Bradford, Steven C., *Crowdfunding and the Federal Securities Laws*, 2012COLUM. BUS. L. REV.(June 30, 2016), http://digitalcommons.unl.edu/cgi/viewcontent.cgi?article=1118&context=lawfacpub.

8.5.2. *Analysis:*

As previously mentioned, QIBs are unlikely to invest in SMEs with no track record and slow and minimal returns. India should adopt New Zealand's provision in this regard and not have any base minimum with regards to investment limit. This will help deal with the following issues:

a) It is advisable that the language in the rules be changed to facilitate smaller investments by retail Accredited Investors in crowdfunding rounds (which would also potentially reduce their downside risk);

b) Furthermore, ventures which deal with ideas that do not have profitable returns (such as ventures for social causes or art work) significantly face the blow. No person would want to invest INR 20,000 when they know that the return that they will be receiving for the same is minimal.[52] A reduction in base limit would benefit such ventures and significantly further their cause;

c) Requiring QIBs to collectively hold a minimum of 5% of the securities issued through crowdfunding may impose an unrealistic burden on the issuer companies and defeat their fundraising attempts. This requirement might lead to a

[52] *Supra* note 49.

situation where the company succeeds in raising the requisite amount from HNIs and ERIs but cannot complete the transaction due to a shortfall in QIB investment. Hence, this requirement too should be done away with.

8.6. **Limit on number of investors up to 200 (excluding QIBs and employees of the company under ESOPs) should be amended:**

8.6.1. *Provision:*

A limit of 200 investors (excluding QIBs and employees of the company under ESOPs) is specified in Chapter III of the Companies Rules.

8.6.2. *Analysis:*

The objective of crowdfunding is to allow the public at large to participate in funding and earning returns from ventures that interest them.[53] This limit of 200 Accredited Investors specified in Chapter III of the Companies Rules, is inadequate and an amendment in such rules to allow up to 1,000 Accredited Investors, excluding QIBs or employees of the

[53] Belleflammea, Paul, Lambert, Thomas, Schwienbacher, Armin, *Crowdfunding: Tapping theRight Crowd*, , 29 J. Bus. Venturing, p. 585 (July 1, 2016),http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1578175.

company under a scheme of ESOPs should be allowed.[54] This suggestion could possibly supplement the precious suggestion on removing the base limit of investment for investment through crowdfunding. While the large number of shareholders may increase the transaction costs and cause administrative difficulties for the management, the issue can be dealt with by issuing shares with differential voting rights given to shareholders by issuing securities with differential voting rights.

Given that shares issued through crowdfunding would be regulated at various levels by both the Crowdfunding Platform as well as being under the purview of SEBI, the traditional arguments of not allowing newly established companies to issue such shares with varied rights may not be justifiable. Shares with differential voting rights are also viable from the perspective of crowdfunding Accredited Investors who would typically invest small amounts and would be primarily interested in getting a return, without expecting any substantial involvement in the day-to-day affairs of the company.

If this suggestion of increasing the maximum number of

[54] Debanshu Mukherjee, ShubhangiBhadada, and Ors, *Response to SEBI Consultation Paper on Crowdfunding in India*, VIDHI CENTRE FOR LEGAL POLICY, (June 28, 2016), https://static1.squarespace.com/static/551ea026e4b0adba21a8f9df/t/55702567e4b02d3071c80513/1433412967379/Vidhi+Crowdfunding+Paper.pdf.

permissible Accredited Investors to 1000 or more is accepted, then a requirement arises to modify the thresholds for initiating cases for oppression, mismanagement and class actions in the Companies Act (Sections 244 and 245). Given that most retail Accredited Investors will face coordination problems, it is recommended that a trustee be pointed to represent their interests and enforce their rights effectively.[55]

8.7. **Modification in requisite of disclosing future projectiles:**

8.7.1. *Provision:*

Due to the lack of history and track record, the Consultation Paper has made it necessary that issuers provide future projections of their business to facilitate Accredited Investors in decision making.

8.7.2. *Analysis:*

However, there is uncertainty about what should be the criteria to ensure that the projections are realistic and achievable and not misguiding in nature.

It is widely recognised that inclusion of forward-looking information in an offer document carries the risk of the promoters presenting an over-optimistic picture of the future potential of the business. Therefore, instead of requiring

[55] *Ibid.*

companies to provide future projectiles, issuers should be required to obtain a compulsory rating about the viability of the business from an independent analyst or business specialist.

8.8. Seeming ineptness of Crowdfunding Platforms:

8.8.1. *Provision:*

Provision on eligibility of Crowdfunding Platforms has been explained on pages 4 and 5 of this paper.

8.8.2. *Analysis:*

The following proposals for change in the functioning of Crowdfunding Platforms can be recommended to SEBI:

a) Crowdfunding Platforms, their managers/directors and other employees should not be permitted to invest in offerings on their platforms and not have any financial interest in the issuers;[56]

b) Crowdfunding Platforms in India, much like those in UK should supply the Accredited Investors with risk assessment forms which provide disclosures related to risks and other investor education materials, to ensure that investors understand the risks involved. The Accredited Investors should not be allowed to invest till they have fully

[56] *Ibid.*

read and signed such forms;

c) Maintain escrow accounts for transfer of funds and release them to the only after the investment threshold has been met. The Crowdfunding Platforms should guarantee the Accredited Investors of a suitable exit mechanism in case the issuer fails to reach the threshold;

d) The Crowdfunding Platform along with providing the function of an intermediary for the meeting of the investor and the enterprise, should also provide a platform for open communication in order for prospective investors to discuss the offering and its various aspects and to facilitate information exchanges between potential buyers and sellers (from within the community of registered Accredited Investors);

e) The Crowdfunding Platforms should also assist the issuer to produce the information required for making the necessary disclosures, as it is not easy for new business ventures to do this by themselves.

8.9. Mandatory security features and IT Policies to be put in place to make the crowdfunding platform secure from cybercrimes:

8.9.1. *Provision:*

There is no provision on ways to make the Crowdfunding Platform immune to cybercrimes.

8.9.2. *Analysis:*

The Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011 (hereinafter "**IT Rules**") make it mandatory for the company in concern to comply with reasonable security practices and procedures.[57] The IT Rules provide for a legislative framework for the protection of sensitive information which will also apply to Crowdfunding Platforms. Under these rules, the company will be deemed to have complied with 'reasonable security practices' if the conditions stated in the IT Rules are fulfilled.

[57] RULE 8(1), THE INFORMATION TECHNOLOGY (REASONABLE SECURITY PRACTICES AND PROCEDURES AND SENSITIVE PERSONAL DATA OR INFORMATION) RULES, 2011.

9. CONCLUSION

The process of crowdfunding has several associated risks that need to be necessarily addressed. SEBI's proposed regulations take into account the laws in several different jurisdictions and lay down many effective guidelines largely drawn from the UK model. Despite the presence of risks, equity based crowdfunding is also a new and helpful alternative in corporate finance. Research has shown that crowdfunding based on a profit-sharing model (especially through issuance of equity shares) can be conducive for early-stage SMEs as it creates a more sustainable and self-sufficient model of capital generation. The regulations espoused by SEBI in its Consultation Paper certainly provide a much better avenue of raising capital for SMEs than the existing avenues available to them.

It is important to have this avenue of crowdfunding regulated since start-ups have no previous track records, but it is also important not to over-regulate them or have an overkill on the budding entrepreneurs and their creative ideas. SEBI in its Consultation Paper has taken an overtly cautious approach and in doing so has taken the 'crowd' out of crowdfunding. Though regulations are necessary, the ones suggested by SEBI with regards to the number of Accredited Investors, the bracket of

Accredited Investors, and the cap on investment, may have to be relaxed or altered so as to ensure that the process is viable and beneficial, and does not get subsumed within the costs of regulation itself.

Any technological advancement brings with it new challenges for regulators and lawmakers. With regard to crowdfunding, SEBI has taken a very cautious approach, and has laid down guidelines that do not compromise investor protection. It has assessed the advantages as well as risks, and taken note of the shortcomings associated with crowdfunding. However, there are still several aspects that need to be clarified, and areas that need to be covered under regulation such as cross border crowdfunding transactions and secondary markets, which form important aspects of the very concept of crowdfunding.

Though SEBI made a substantial move in October 2013 by approving ITP, the initiative seemed to be a failure since not one of the 4,200 start-ups in India as at the end of the year 2015 had taken the initiative of getting listed on the ITP.[58] However, SEBI in the month of May this year, based on the suggestions of a panel headed by Narayan Murthy, is planning

[58] Anirudh Laskar, *Easier SEBI Rules Fail to Lure Start-ups to Launch*, LIVE MINT, (July 3, 2016), http://www.livemint.com/Companies/VL379geKEu4phiz6ALNWzK/Easier-Sebi-rules-fail-to-lure-startups-to-launch-IPOs.html.

to revamp its ITP regulations of 2013. If SEBI actualizes these suggestions and consequently regulates the avenue of crowdfunding, SEBI would manage to take the Indian economy by storm by giving SMEs a severe boost and make India a hub for investment and innovation.

It has been two years since SEBI released its Consultation Paper, but no guidelines or rules have been formulated in accordance with the responses received by SEBI. SEBI should regulate this avenue of raising capital soon since crowdfunding is the need of the hour, especially with the surge of Non-Performing Assets in the Indian economy which have made banks highly reluctant to lend money to enterprises, especially those with no prior experience. This could possibly stagnate several ideas and innovative enterprisesthus severely harming the economy in the long run. Why is SEBI not issuing rules or regulations with regards to crowdfunding? Is SEBI waiting for another Sahara like episode to take place in the avenue of crowdfunding before it regulates this avenue?

INTELLECTUAL PROPERTY RIGHTS

FAIR DEALING IN COPYRIGHT LAW: AN ANALYSIS VIS-À-VIS MEMES

VIDHATRI BHARTI*

1. INTRODUCTION

A labourer is worthy of sufficient wages. Likewise, a person is worthy to enjoy the sole benefits accrued from his intellectual property. This basic idea is what led to the conceptualization of the copyright.[1] With technological progress, there can be no denial of the fact that there has been increase in the value of 'brain work'. The Indian Copyright, 1957 is the legislation that dually serves the purpose of protecting from infringement of original work and providing a breather via §52 so as to make the Act corollary to the fundamental rights of a citizen, especially the right to expression.[2]

Memes, though a small part of the internet culture, are growing steadily. To define memes, they are actions, notions, and

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[1] *See* G.N. Okeke & Kennet Urzor, *An Appraisal of the Protection of Copyright under International Law*, 6.1 JOURNAL OF LAW AND CONFLICT RESOLUTION 7, 7-8 (Apr. 2014).

[2] INDIAN CONST. art.19, cl. 2.

mostly ideas that are transferred amongst individuals within the realms of the community.[3]

However**,** it is the very nature of meme, being an art form which derives its source usually from a prior existing work, that draws it into conflict with copyright law. The ensuing sections will deal in detail regarding the provision of fair dealing and its origin, and conclude with how memes are protected and come within the boundary of fair dealing at the hands of the legislature and in terms of prudence shown by the judiciary.

2. FAIR DEALING: AN OVERVIEW

Copyright is the legal right of the author, artist, composer, or other creator to control the use of their work. In general, copyright-protected works may not be copied, applied to, or affected by others without the permission of the creator. Release or the implementation of copyrighted works is also limited.[4] To this general rule, there is an exception (fair use),

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[3] Charalambos Konstantineas & George Vlachos, *Internet Memes. Humor in late modernity and encroachment upon the mainstream* (Oct. 13, 2016, 11:49 P.M.), http://www.inter-disciplinary.net/critical-issues/wp-content/uploads/2012/06/vlachosvispaper.pdf.

[4] Office Of The General Counsel, *Copyright and Fair Use: A Guide for the Harvard Community*, HARVARD UNIVERSITY (May. 31, 2016), http://ogc.harvard.edu/files/ogc/files/ogc_copyright_and_fair_use_guide_5-31-16.pdf.

which is discussed in detail in this section of the paper. The doctrine of fair use under copyright protection is an exclusive safeguard clause and forms an integral part of the copyright legislation. It is a provision which recognises a particular infringement to be fair. Fair use is the right to use a copyrighted work under certain conditions, without the permission of the copyright holder. The doctrine helps prevent rigid application of copyright law that would stifle the creativity the law strives to promote.[5] It allows one to use and build on previous work in a way that does not deprive unjustly the copyright owner the right to control their work and profit.[6] The reason for allowing the exception of fair dealing is that an infringing use of a copyrighted work can bring major public benefit than its denial.[7]

Lord Denning MR, when deciding *Hubbard* v. *Vosper*, observed that:

> *"It is impossible to define what is 'fair dealing.' It must be a question of degree. You must consider first the number and extent of the quotations and extracts. Are they altogether too many and too long to be*

[5]Harper & Row Publishers v Nation Enterprises, 471 US 539, 550 (1985).
[6] *Supra* note 3.
[7] T.G. Newby, *What's Fair Here is Not Fair Everywhere: Does the American Fair Use Doctrine Violate International Copyright Law?,*STANFORD LAW REVIEW51, 1633 (1999).

> *fair? Then you must consider the use made of them. If they are used as a basis for comment, criticism or review, that may be a fair dealing. If they are used to convey the same information as the author, for a rival purpose, that may be unfair. Next, you must consider the proportions.... Other considerations may come to mind also. After all is said and done, it must be a matter of impression....”*[8]

2.1. Historical Background

More than 40 countries with more than one third of the world population have fair use provisions in their copyright laws. These countries are in all regions of the world and at all levels of development. This doctrine of fair use was first developed by courts in England in the eighteenth century and codified in 1911.[9] In India, this doctrine is enshrined in §52, Indian Copyright Act, 1957 as 'fair dealing', while in the U.S., it is 'fair use' guaranteed §107, 17 U.S.C.

There are several international copyright treaties governing conditions for copyright exceptions. Copyrighted material is easy to move from one country to another, and is an important part of international trade. As a result, there are long-term

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[8] Hubbard v. Vosper, CA 1971 [1972] 2 WLR 38.

[9] JONATHAN BAND & JONATHAN GERAFI, THE FAIR USE/FAIR DEALING HANDBOOK 1 (March 2013).

efforts to create an international system of intellectual property rights related to effective protection of material produced in one country in others.[10] India is a party to many of such treaties.

The international standard for copyright exceptions and limitations is referred to as the 'three-step test.'[11]The test has its origins in the work of the 1967 Review Conference at Stockholm of the Berne Convention. Surprisingly, although given before the conference, the right of reproduction, the most fundamental right granted to authors, had not actually been stated in the Treaty, but it was generally recognized by national law. The Stockholm Conference aimed to remedy the situation, but it was difficult to do it without even recognizing that exceptions to the reproduction right already existed in national legislation worldwide. Therefore, the conference had decided to introduce a general right to reproduction in the Convention, while allowing exceptions to the law, but not to an extent that would allow Contracting Parties to maintain exceptions as big as to undermine the right of reproduction. The provision of the Stockholm Conference on the exceptions to the reproduction

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[10] Philip Ruddock, *An examination of fair use, fair dealing and other exceptions in the Digital Age*, FAIR USE AND OTHER COPYRIGHT EXCEPTIONS, ISSUES PAPER 10 (May. 2005).
[11] *Ibid.*

right, the three-step test, was finally adopted in 1971 in the Berne Act of the Paris Convention as Article 9(2).[12]

Article 9(2) of the Berne Convention provides:

> *It shall be a matter for legislation in the countries of the Union to permit the reproduction of such works in certain special cases, provided that such reproduction does not conflict with a normal exploitation of the work and does not unreasonably prejudice the legitimate interests of the author.[13]*
>
> *Since then, it has gained much more importance, majorly because of GATT 1994 on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement).*

Article 13 of the TRIPS Agreement provides:

> *Members shall confine limitations or exceptions to exclusive rights to certain*

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[12] Regional Workshop On Copyright And Related Rights In The Information Age organized by the World Intellectual Property Organization (WIPO) in cooperation with the Russian Agency for Patents and Trademarks (Rospatent) Moscow, *Limitations And Exceptions Under The "Three-Step-Test" And In National Legislation – Differences Between The Analog And Digital Environments by Mr. Roger Knights Assistant Director Copyright Directorate* 2-3 (May 22 to 24, 2001).

[13] Berne Convention for the Protection of Literary and Artistic Works of September 9, 1886 was completed at PARIS on May 4, 1896, revised at BERLIN on November 13, 1908, completed at BERNE on March 20, 1914, and revised at ROME on June 2, 1928, at BRUSSELS on June 26, 1948, at STOCKHOLM on July 14, 1967, and at PARIS on July 24, 1971, at 1335.

> *special cases which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the right holder.*[14]

This Article requires not only that national exceptions comply with the rights of reproduction using the three-step test, but also that exceptions to the exclusive rights of other contracts in the TRIPS Agreement comply with the criteria. Since then, this approach has been used in Article 10 of the WIPO Copyright Treaty of 1996 (WCT)[15] and Article 16 of the WIPO Treaty on Performances and Phonograms Treaty (WPPT).[16] Each of these

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[14] Asia-Pacific Industrial Property Centre, JIII, *Introduction to TRIPs Agreement*, JAPAN PATENT OFFICE, 18, ¶4.1.3.4 (Oct. 13, 2016, 08:30 P.M.), https://www.training-jpo.go.jp/en/images_x/uploads/text_vtr/pdf/TRIPs_Agreement.pdf.

[15] Article 10 of the WCT provides as follows:
"(1) Contracting Parties may, in their national legislation, provide for limitations and exceptions to the rights granted to authors of literary and artistic works under this Treaty *in certain special casesthat do not* conflict with a normal exploitation of the work *and do not* unreasonably prejudice the legitimate interests of the author.
"(2) Contracting Parties shall, when applying the Berne Convention, *confine* any limitations or exceptions to rights provided for therein *to certain special cases that do not* conflict with a normal exploitation of the work *and do not* unreasonably prejudice the legitimate interests of the author." (Emphasis added to highlight the structure of the provision). Paragraph (2) refers to any limitations or exceptions provided for in the Berne Convention. This does not allow any interpretation other than that the three-step test – or at least its second and three criteria – must be taken into account also for the application of the specific exceptions and limitations provided in the Convention.

[16]The continued adequacy of the test – also in view of any new technological, business method and social developments – has been further confirmed in the Beijing Treaty on Audiovisual Performances

agreements requires the exclusion of the rights in the contract which do not meet the test. In addition, the WCT, which obliges the parties to abide by all of the major provisions of the Berne Convention, requires that exceptions to the rights provided in Berne must also meet the criteria. Thus, at the international level, the test is now not only on the exceptions to the right of reproduction, but also, for e.g. the right of distributing and publishing of exceptions.[17]

As its name suggests, the test consists of three cumulative steps or conditions. Limitations or exceptions to exclusive rights must be confined to:

a) 'certain special cases';

b) which do 'not conflict with a normal exploitation' of the copyright material; and

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(BTAP), adopted in June 2012, which, in its Article 13, contains exactly the same provisions on the test as Article 16 of the WPPT adopted 16 years before.

[17]Australian Law Reform Commission,*Copyright and the Digital Economy (ALRC Report 122)* (Oct. 13, 2016, 10:20 P.M.), https://www.alrc.gov.au/publications/4-case-fair-use/fair-use-complies#_ftn198.

c) do 'not unreasonably prejudice the legitimate interests' of the rights holder.[18]

The statute of the United States, on the other hand, provides a broader preamble of representative cases and enunciates a four-factor test on similar lines.[19]

2.2. Fair Use vs Fair Dealing

Fair use is not defined in the Copyright Act in the United States, and it is widely accepted that the same definition is open to interpretation by a court on a case to case basis. As a result of the lack of legal definition, the right to use a patent is determined by the four Justice Story factor on the basis of experiments designed in the case of *Folsom* v. *Marsh*[20], which states:

> *"Look to the nature and objects of the selections made, the quantity and value of the materials used, and the degree in which the use may prejudice the sale, or diminish the profits, or supersede the objects, of the original work."*

This was used as a basis before the codification of copyright law in the United States. Many of the limitations and exception

[18] *Ibid*.
[19] Copyright Act, 17 U.S.C §107 (1976).
[20] Folsom v. Marsh, 9 F. Cas. 342, 348 (1841).

factors are now precisely codified in the Copyright Code. However, many non-infringing uses of work in the United States are not specifically listed, but, due to a broad "fair use" provision, are codified in 17 U.S.C. §107, that provides for four factors in determining whether the use is "fair use" and therefore, whether there is any violation of copyright. These four factors include:

a) the purpose and character of the use, including whether such use is of a commercial nature or for non-profit educational purposes;
b) the nature of the copyrighted work;
c) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
d) the effect of the use upon the potential market for or value of the copyrighted work.[21]

The United States Supreme Court in the case, *Campbell v. Acuff-Rose Music, Inc.*, emphasized that the four factors may not "*be treated in isolation, one from another. All are to be*

[21] Copyright Act, 17 U.S.C §107 (1976). The Visual Artists Rights Act of 1990 amended §107 by adding the reference to §106A. P.L. 101-650, December 1, 1990, 104 Stat. 5089. In 1992, §107 was also amended to add the last sentence. P.L. 102-492, November 2012, 106 Stat. 3145. (Oct. 14, 2016, 11:00 P.M.),http://www.copyright.gov/title17/92chap1.html#107.

explored, and the results weighed together in light of the purposes of the copyright."[22]

The open ended fair use doctrine provides a much broader scope as compared to legislations of other states. Moreover, flexibility in the fair use exception has allowed the courts to play an active role in the adaptation of American copyright law to significant changes in technology.[23]

The situation in India is different. The copyright holders are provided with rights as to their intellectual property and the fair use exceptions to these rights are given under §§ 39 and 52 of the Act. While §39 deals with acts not infringing broadcast reproduction rights and performer's rights, §52 lists the acts that do not constitute infringement of copyright. §39, besides providing for two exceptions to broadcast reproduction rights and performer's rights under sub-clauses (a) and (b) thereof, extends the exceptions to the protection of these two rights to those provided in respect of copyright infringement under §52 of the Act 'with any necessary adaptations and modifications' under sub-clause (c). The said sub-clause has not specified as to which provisions of §52 will apply to these two rights and has, therefore, left ample scope for the judiciary to interpret the

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[22] Campbell v. Acuff-Rose, 510 U.S. 569 (1994).
[23] *Supra* note 11, at 20.

same. However, there has not been any occasion for the courts to interpret §39(c) of the Act so far.[24]

In *Wiley Eastern Ltd. and Ors. v. Indian Institute Management*, in order to enforce the Fair Dealing with reference to the Constitution of India, it was stated by the Delhi High Court that:

> *"The basic purpose of Section 52 of the Indian Copyright Act, 1957 is to protect the freedom of expression under Article 19(1) of the Constitution of India...Section 52 is not intended by Parliament to negatively prescribe what infringement is."*[25]

The above comparison showcases that the Indian legislations have a very narrow scope as compared to its contemporaries. Therefore, a more precise scheme is required in the line of the U.S. legislation to avoid a legal quagmire.

[24] Latha R. Nair,*How Fair Are The Fair Dealing Exceptions Under Indian Copyright Law?*, 2 IJIPL 171, 172 (2009).

[25]Wiley Eastern Ltd. and Ors. v. Indian Institute Management, 61 (1996) DLT 28, ¶19.

Thus, the scope and the ambit of §39 is to be examined taking into consideration §52 of the Act. In the case of *ESPN Star Sports v. Global Broadcast News*[26], the court observed:

> *"No universal rule or standard exists; cases have to be decided on the peculiar facts. What may be unfair in one context may be perfectly fair in another and vice versa. There is a certain amount of elusiveness in evolving a thumb rule."*

3. FAIR DEALING VIS-A-VIS MEMES

According to the Oxford Dictionary, a meme is defined as an image, video, piece of text, etc., typically humorous in nature, which is copied and spread rapidly by Internet users, often with slight variations. Further, it is an element of a culture or system of behaviour passed from one individual to another by imitation or other non-genetic means.[27] It had its origin in 1970s from Greek mimēma, i.e. that which is imitated, on the pattern of gene.[28]

[26] ESPN Star Sports v. Global Broadcast News Ltd and Ors., 2008 (36) PTC 492 (Del).

[27] "meme.", *Oxford English Dictionary Online*, 2016, https://en.oxforddictionaries.com/definition/meme (Oct. 14, 2016).

[28] *See,* RICHARD DAWKINS, THE SELFISH GENE, Chapter 11, 169 (1976).

3.1. Memes: Fair Use of Previous Brainwork

The above definitions and interpretations of a meme as a part of the internet provide that memes are the humorous reproduction of another person's previous work and not necessarily a verbatim copy of it. It can be described as a piece of culture, typically a joke, which gains influence through online transmission.[29]

A meme, at its best, exposes a truth about something, and in its versatility, allows that truth to be captured and applied in new situations.[30] They have become a conventional type of humour which manifests in different formats.[31] The purpose of sharing memes is to promote an idea within the online community and one may always argue that the act of creating/sharing memes should be protected under the fair use provision. For example, a meme was created to parody the film 12 Years A Slave, playing off current events related to racism by former owner of the NBA team, Donald Sterling, even using the same aspect to advertise the film. In this ad of the film, the controlled

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[29] Patrick Davidson, *The Language Of Internet Memes*, THE SOCIAL MEDIA READER (2009).

[30] J. L. Zittrain, *Reflections on Internet Culture*, 13.3 JOURNAL OF VISUAL CULTURE 383-394 (2014).

[31] Linda K. Borzsei, *Makes a Meme Instead: A Concise History of Internet Memes*, NEW MEDIA STUDIES MAGAZINE, Iss. 7 (2013), http://works.bepress.com/linda_borzsei/2/.

protagonist is running - probably out of slavery and into the meme freedom. In the ad, the head of the actor was replaced by the NBA player, Chris Paul, who continues basketball, and the title changed to "12 Years a Clipper".[32] Such editing choices are designed for a description of the conflict between the original work and the underlying message. While the film 12 Years A Slave brings historical ethnic tensions to the lens, the meme is different in this respect as it refers to both ethnic tensions and modern "plantation mentality".

Without reference to the original work, the meme would have no comedy value, nor would the message behind it make sense.[33]

As mentioned in part I of the paper, the fair use/fair dealing doctrine and its provisions vary from State to State. While the condition of the United States and India has been described above in the previous part of this paper, in Australia, §41A of the Copyright Act, 1968[34] provides for fair dealing for the

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[32] Andrew F. Williams, *OP-ED: 12 Years a Clipper*, POST NEWS GROUP (Oct. 12, 2016, 12:30 P.M.), http://postnewsgroup.com/blog/2014/04/28/op-ed-12-years-clipper/.

[33] Terrica Carrington, *Grumpy Cat Or Copy Cat? Mimetic Marketing In The Digital Age*, GEO. MASON J. INT'L COM. L., Vol. 7 Winter Issue No. 2, 139, 152.

[34] §41A, The Copyright Act, 1968.

purpose of parody or satire but this is restricted to literary, dramatic or musical work.

§52(1)(a) of the Copyright Act of India allows for 'fair dealing with any work' for the purpose of private or personal use, criticism or review, etc.[35] Even though there is no express mention of parody or satire as an exception under the 'fair use' provision, in *Blackwood & Sons Ltd. v. A.N. Parasuraman*[36], it was held that:

> "*In order to constitute a fair dealing, there must be no intention on the part of the alleged infringer, to compete with the copyright holder of the work and to derive profits from such competition and also, the motive of the alleged infringer in dealing with the work must not be improper.*"

Thus, to be able to come under the ambit of the exception of fair dealing, a meme should:

a) Not intend to compete with the copyright holder, and

[35] §52, The Copyright Act, 1957: Certain acts not to be infringement of copyright. (1) The following acts shall not constitute an infringement of copyright, namely:
(a) a fair dealing with a literary, dramatic, musical or artistic work [not being a computer programme] for the purposes of-
(i)private use, including research;
(ii) criticism or review, whether of that work or of any other work.

[36] Blackwood & Sons Ltd. v. A.N. Parasuraman, AIR 1959 Mad. 410.

b) Not be created with the motive to derive profit out of competition, and dealing with the work must not be improper.

The Allahabad High Court, in the case of *S.K. Dutt v. Law Book Co. And Ors.,* observed that *"the infringement comes in when it can be shown that someone has, instead of utilising sources to originate his work, appropriated the labours of another by resorting to a slavish copy or more colourable imitation thereof"*.[37]

There is enough said about the doctrine of fair dealing and its application. However, there is little known about the issue of memes being an infringement of copyrighted pre-existing matter. The following part will give an analysis with respect to the rules established[38] on whether memes are impermissible by law?

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[37] S.K. Dutt v. Law Book Co. and Ors., AIR 1954 All 570.
[38] *Supra* note 22.

4. FACTORS AFFECTING THE DOCTRINE OF FAIR DEALING/FAIR USE: A FAIR ANALYSIS

In India, §52(1)(a) and (b)[39] specifically deal with the doctrine of fair dealing which approves of a fair dealing with a literary, dramatic, musical or artistic work for the purpose of criticism and review. A meme may not always be for criticising or reviewing a particular form of art nor can it be concluded that a meme is not fair dealing with the mentioned works. Thus, this leaves the position of the new-fangled memes vague. In this part of the paper, the position of memes according to the four step test discussed in the previous part will be analysed with reference to an example.

4.1. Factor one: The purpose and character of the use

When society and intellectual property laws allow memes to develop an arsenal of means of expression to the average

[39] §52, The Copyright Act, 1957: Certain acts not to be infringement of copyright. -(1) The following acts shall not constitute an infringement of copyright, namely:
(a) a fair dealing with a literary, dramatic, musical or artistic work [not being a computer programme] for the purposes of-
(i) private use, including research;
(ii) criticism or review, whether of that work or of any other work;
(b) a fair dealing with a literary, dramatic, musical or artistic work for the purpose of reporting current events-
(i) in a newspaper, magazine or similar periodical, or
(ii) by [broadcast] or in a cinematograph film or by means of photographs.

Internet intellectual property, the treatment of memes in ordinary conversation to determine their argument expands. In this scenario, the public who can be influenced grows and the opportunity to discuss and participate in the growth of civilization also increases.[40]

Given the example of the Alok Nath memes[41], its purpose was not to demean a television actor, or to infringe the copyright of a particular drama in which the still might have appeared, but rather, solely entertainment. It is with the reference to the particular picture along with the text that the audience understand the underlying meaning of the joke.

4.2. Factor two: Nature of work

This factor may or may not be in favour of a meme as, usually, the nature of a meme stands to be artistic. Thus, it would usually weigh in favour of a copyright-holder but only when the meme would stand to compete with the copyrighted work, which is rare. The process of becoming a meme involves a large transformation. Creativity is the means by which memes replicate and, therefore, thrive.[42]

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[40] *Supra* note 33.

[41] *How It All Started : Alok Nath* Memes, SCION SOCIAL BLOG (Oct. 12, 2016, 08:50 P.M.) http://scion-social.com/blog/started-alok-nath-memes/.

[42] David A. Simon, *Culture, Creativity, and Copyright*, 29 CARDOZO ARTS & ENT. L.J. 279, 294 (2011).

4.3. Factor three: Amount and substantiality of the work

The amount and substantiality of the portion used in relation to the copyrighted work as a whole, likely weighs in favour of the meme-creators as a meme usually only takes a single joke and a still frame from the original work, at least where the original work is, as in the present e.g., of a television personality and his expression or act in a television show. The meme is a still from his shows and does not take the 'heart' of the show.[43]

4.4. Factor four: Effect on the Potential Market or Value of the Copyrighted Work

Internet memes, by their existence, require an infringement of the intellectual rights of others. An Internet meme is made presentable, and can only proclaim its purpose when it's echoing mutation and imitation.[44] Thus, without certain infringement the meme would not be able to exist in its usual sense. Moreover, the effect of a meme, in particular, in the instant e.g., would be an advertisement of the copyrighted work.

There have been many cases upon the copyright issue of memes being used in commercial for marketing in the first

[43] *Supra* note , at 252.
[44] *See* 17 U.S.C. §106.

world countries.[45] For example, recently, Warner Brothers incorporated memes into its advertising schemes, resulting in lawsuits filed by copyright holders.[46] It raced into legal trouble, as it used Nyan Cat and keyboard playing cat which are two extremely popular memes as a sign of their video game "Scribblenauts". It lost the lawsuit against the creators of the meme.[47] One may conclude that the use of memes on social networking sites is generally 'fair use'. However, in case of advertising campaigns the advertisers must seek a license from the copyright-holder before cashing in on the popularity of the meme, lest it amounts to copyright infringement.

5. CONCLUSION

The Internet has definitely changed the world of intellectual property - and intends to further do so. But it is clear that while some memes may violate laws on copyright as a derivative work, it is in the interests of content owners that they have small pieces of content passed around on the Internet for free to be useful to provide users of the Internet more freedom to copy, as the very nature of meme brings it into conflict with the copyright laws and the provision of fair dealing in particular.

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[45] C.f. Ronak Patel, *First World Problems: A Fair Use Analysis of Internet Memes*, 20 UCLA ENT. L. REV. 235, 248 (2013).
[46] *Supra* note 36.
[47] Schmidt et al. v. Warner Bros. Entm't Inc., 824 F. Supp. 2d 1003 (2011).

Due to the highly transformative nature inherent to popular memes and the fact that memes often help to create a market for the original work, a meme that incorporates previously published but commercially undesirable photos and images is an exemption under fair use.[48] It is hard to state, in a dynamic world, whether a trend such as that of a meme is a phase in the history of media and technological communication, or will continue to be a relevant part of it, but analysing the current situation and from the above discussion, a conclusion that memes are not inconsistent with the exception of fair dealing can be drawn. However, whether or not a meme is an infringement of a copyrighted work depends on, inter alia, the purpose, subject matter and its degree of similarity.

[48] *Id.* at 158.

SECURITIES LAW

UNDERSTANDING THE CHINESE STOCK MARKET CRASH, 2015: A PRIMER TO CHINESE CAPITAL MARKETS LAW

ENAKSHI JHA*

1. INTRODUCTION

In an interconnected world described by cooperative monetary exercises, capital markets frame the foundation of exchanges. While capital markets are an umbrella term for a combination of monetary markets like value and security markets they work as an inseparable unit to empower money related exchanges. China today is a huge player in the realm of capital markets because of not just its potential outcomes that are getting to be accessible to other global players but also because of the exceptional size of the Chinese economy.

It is crucial to note that the Chinese capital markets are not as open while contrasted with other capital markets in the world, for example in the United States of America. The blockades of government regulation and approbation restrict the extent of entry into Chinese capital markets.[1] However, on the other

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[1] Dong Anshen & Han Liyu, *How Law Reform Enhances Trading on the Chinese Capital Market*, 10 Uniform Law Review, 226-227 (2005).

hand China's entrance into the World Trade Organization has made its internal securities market more appealing to investors globally.[2]

While perceiving the restrictions of Chinese capital markets, it is crucial to enlist China's financial force both in Asia and universally. In 1970 China endeavored an economic reform to replace the state owned and controlled economy to a market players' economy elucidated by multiple players. This prompted the conception of China's driving national security exchanges, the Shanghai and the Shenzhen stock Exchange.[3] These trades today assume a dynamic part and have the capability of getting to be bigger to empower more noteworthy worldwide collaboration.

China as a country is known for its saving patterns and the capital markets endeavor to channel such reserve funds to pump the financial markets, while regulating the same with the arrangement of national stock exchanges. The populace and savings are therefore motivators for development of Capital

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[2] Yuwa Wei, *Volatility of China's Securities Markets and Corporate Governance,* Suffolk Transnational Law Review, 207, (2005-2006)

[3] Serena Y. Shi, *Comment Dragons' House of Cards: Perils of Investing in Variable Interest Entities domiciled in the People's Republic of China and Listed in the United States*, 37 Fordham International Law Journal, 1265-1266, (2013-2014).

markets in China.[4] However, 2015 has seen the collapse of the very same stock exchanges in China. 24th August 2015 has been coined "Black Monday" following this catastrophic collapse in China.[5] The crisis unfortunately is not limited to China alone and its aftershocks have been felt across the world, as seen in the Dow Jones in America to the National Stock Exchange in India.[6]

This paper attempts to scrutinize the background of the crash in order to establish the key factors of Chinese capital markets that failed. Further the Author has adopted a comprehensive research model that analyses the overall Capital market activities in China, to explain the formation of this financial bubble. The Author also elucidates the deep and pervasive control of the Government in the capital markets, criticizing it for its inability to enable smooth functioning of markets in China. Lastly, the author briefly discusses the future of China and the impacts of the crash on the rest of the World.

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[4] *China: Financial Sector Assessment Program*, Financial Sector Assessment, (Nov 2011), http://www.worldbank.org/content/dam/Worldbank/doc/WB-Chinas-Financial-Sector-Assessment-Report.pdf.

[5] Frances Coppola *China's Black Monday Signals The End of Its Growth Cycle*, FORBES MAGAZINE, http://www.forbes.com/sites/francescoppola/2015/08/24/chinas-black-monday-signals-the-end-of-its-growth-cycle (last updated Aug 24, 2015).

[6] *Chinas Black Monday sends markets reeling across the globe,* THE GUARDIAN,http://www.theguardian.com/business/live/2015/aug/24/global-stocks-sell-off-deepens-as-panic-grips-markets-live (Aug 24, 2015).

2. UNDERSTANDING CHINESE CAPITAL MARKETS

In this chapter the Author introduces factors that have played an important role in the causation of the triggers of the Stock Market crash. While some factors have contributed directly and others have an ancillary contribution, the Author has attempted to elucidate all of them in congruence to form the basis of the latter sections of this paper. The factors have been analyzed below-

2.1. The trend of High Savings

Before the economic reforms in China in the 1970's the savings of the general population in was simply stored in State banks.[7] Be that as it may, with the rise of stock markets such investment funds have now become a capital source adding up to very nearly 40 percent of China's Gross Domestic Product.[8] Furthermore, the development of national securities exchanges has brought in procedures and regulations that have to be complied with to be a player in the Chinese capital markets.

In the past this was missing leaving State run companies and organizations without a checks and balance framework. Together these elements have prompted a more effective

[7] Solomon M. Karmel, *Emerging Securities Markets in China: Capitalism with Chinese Characteristics*, China Quarterly, 11-5, (1994).

[8] John H Makin, *Does China save and Invest Too Much,* No. 2, 26 CATO Journal, 316-317 (2006).

capital markets spine when contrasted with the past. Dissimilar to the regular myth encompassing Chinese companies, it is crucial to understand that organizations in China are actually encouraged to list in local capital markets as this permits greater economic participation and empowers the Chinese Government to check the threat of insider trading that has tormented Chinese companies.[9] In the absence of a clearly demarcated Corporate Governance code, this urges privately owned companies to be listed too, supporting competition in the market and thereby increasing transparency.[10]

2.2. Deciphering the Securities Market-

Until, 1992 the Peoples' Bank of China controlled the Chinese securities market. In 1992, this changed with the development of a regulatory structure. The monetary policy, economic atmosphere and the danger of distress lead to a squeezing need to frame a regulatory body that could unify the practices in the securities markets. The first Securities law was consequently formulated in 1998 to give standard practices and achieve norms of investor protection.[11]

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[9] DONG, *supra* note 1, at 225.

[10] Donald C. Clarke, *Law without Order in Chinese Corporate Governance Institutions*, 30 Nw. J. Int'l L. & Bus. 131 (2010)

[11] Daniel M Anderson, *Taking Stock in China: Company Disclosure and Information in China's Stock Markets*, 88 Georgetown Law Journal, 1919, (1999-2000).

The 214 Articles of this Statute direct the issuance and exchange of shares while indicating liabilities for disregarding any procurements of the Statute. It further perceives that admin or company law would oversee any lacunae in securities law.[12] Further, the types of shares in China are divided into tradable and non-tradable. Non-tradable shares are used only in private transactions, provided the governmental approval is met.[13] Tradable shares on the other hand are those shares that can be traded in both International and national stock exchanges.[14] This distinction is important to understand the Crash of 2015 as it forms the premise of a further classification of shares in China, which were the primary culprits of the crash.

2.3. Further Classification of Shares – Type A and Type B

This classification of shares is most important in understanding the Crash. The impacts of the classification have been addressed in the latter sections of the paper. Type A shares are those that are valuated and traded in Local currency and can only be help by domestic investors in China. On the other hand Type B shares are valued by the local currency, Yuan but can

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[12] *Id.*

[13] Yeung, Horace W. H., "*Non-Tradable Share Reform in China: Marching Towards the Berle and Means Corporation?*" (2009). COMPARATIVE RESEARCH IN LAW & POLITICAL ECONOMY. Research Paper No. 48/2009.

[14] ANNETTE KLEINBROD, THE CHINESE CAPITAL MARKET PERFORMANCE, PARAMETERS AND FURTHER EVOLUTION AND IMPLICATIONS FOR DEVELOPMENT, 84-85, (2008 ED.).

be traded in other foreign currencies. These are shares held by foreigners.[15] While the recent past has seen a slow but steady blurring in this distinction as the Chinese government has started allowing foreign investors to invest in Type A shares, it remains a pivotal factor in the crash.[16] To limit the scope of research the Author has not explored this model and focuses upon features of Type A shares instead.

Type A shares can be further classified based upon who owns the shares. There are three possible holders, the State, legal persons or individual investors. While the altter is freely tradable on national exchanges, the prior two are not and require State permission. Hence they are considered non-tradable shares.[17] It is important to keep this classification in mind while analyzing the latter sections of the causes of the crisis.

2.4. The Chinese Security Regulatory Commission (CSRC)

China saw the adoption of its corporate laws in 1994. Post this the regulatory body CSRC was formed. However, an ailing issue in China lies in the extent of governmental control on this

[15] Hui Huang, *The New Takeover Regulation in China: Evolution and Enhancement*, 42 The International Lawyer, 153-154, (2008).
[16] Woody Wu & Hua Zhang, *Shareholding Structure and Corporate Performance of Partially Privatized Firms: Evidence from Listed Chinese Companies*, 8 Pacific Basin Finance Journal, 587-593 (2000).
[17] ANNETTE, *supra* note 12, at 85-87.

body[18] Further, the absence of clearly codified rules and procedures in corporate law and the Securities Statute leads to misapplications of legal principles amounting in gross violations, especially in the light of company law and securities law overlapping.[19]

Hence despite having two separate codes, a rampant overlap persists. In 1994, an attempt to separate this overlap was made, giving the judiciary the power to fill any lacunae in securities law.[20] However, the over interference of the CSRC has ensured the opposite in multiple aspects, such as imposing Corporate Governance norms for duties not linked to the securities market. Further, this has ensured a lingering Government presence in Chinese securities markets dampening the movement towards privatization.[21]

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[18] Chenxia Shi, *Competition in China's Securities Market: Reform of Current Regulatory System*, 3 Loy. U. Chi. Int'l L. Rev. 213 (2006).

[19] Nicholas Calcina Howson, *"Quack Corporate Governance" As Traditional Chinese Medicine-The Securities Regulation Cannibalization of China's Corporate Law and a State Regulator's Battle Against Party State Political Economic Power*, 37 Seattle University Law Review 667-668, (2013-2014)

[20] Nicholas C. Howson, *Corporate Law in the Shanghai People's Courts: Judicial Autonomy in a Contemporary Authoritarian State*-1992-2008, 5 East Asia Law Review, 304-305 (2010).

[21] Chen Daisong, *Legal Developments in China's Securities Market During three decades of Reform And Opening-Up*, Asli Working Paper No. 005, Asian Law Institute and National University of Singapore.

2.5. Foreign Players in the Chinese Markets-

China directs the entry of foreign players and its capital administration policy prevents Chinese investors from putting their savings into certain investment classifications that are more alluring. This is combined with the low number of offerings in the Chinese securities sector prompting an inflated valuation of shares.[22] Together, these variables leave China helpless against a bubble crisis on account of any change in the securities law. The "Nationality Principle" which recognizes and differentiates between Chinese nationals and foreign investors entering the Chinese securities markets.[23]

Article 138 of the Securities Law mandates that only a Chinese company or individual can open an exchange account in China. Another shortcoming of this rule lies in the grouping of shares, which depends on corporate possession and the ensuing issuances of shares.[24] This is in contradiction with Western economies where stocks are arranged on the premise of

[22] Phillip Barber, *Bull in the China Market: The gap between investor expectations and auditor liability for Chinese Financial Statement* Frauds, 24 Duke Journal of Comparative and International Law, 349-350 (2014).

[23] Lee Ming Hau, *Encouraging Foreign Participation and Investment in Chinese Securities Markets*, 23 Singapore Law Review, 125-126 (2003).

[24] OECD (2011), Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission, OECD Publishing, http://dx.doi.org/10.1787/9789264119208-en.

expected profits or dividends, ensuring the markets valuation are self-governed.[25]

2.6. Heavy Reliance on Direct Financing

While most developing economies rely upon direct financing via an array of products such as issuance of shares and bonds, China continues to rely primarily upon Bank loans. [26]In the Chinese context these banks are state owned enterprises and reliance on other lending corporations is limited. This limited option of financing is ensured by the government to sustain the development of governmental agencies in the financial market.[27] Hence there is limited diversity in funding and this leads to a stagnating growth. When the sole financing route is impacted, it becomes a cause for a financial crisis like we have seen in 2015.

2.7. Limited products traded in China

The restricted compass of items exchanged on Chinese securities exchanges postures yet another test for the capital markets. Innovative items like financial derivatives have

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[25] *China's Capital Markets: The Changing Landscape*, KPMG, (2011), https://www.kpmg.com/cn/en/IssuesAndInsights/Publications/Doc/China-Capital-Markets-FTSE-201106.pdf

[26] Qi, Bin, *China Capital Markets Development Report : China Securities Regulation Commission*, (2008), https://openknowledge.worldbank.org/handle/10986/12643,

[27] Yuwa Wei, *Volatility of China's Securities Markets and Corporate Governance,* Suffolk Transnational Law Review, 207, (2005-2006).

restricted exploration in China, with securities exchanges concentrating essentially on shares and bond trading.[28] This happens because of shortcomings in the trading mechanism in China. Besides, Short selling techniques were not present in China for quite a while contrasted with other developing capital markets, for example, in India and were initiated by the Hong Kong-Shanghai Connect and became applicable only in March, 2015.[29]

3. DIRECT CAUSATION OF THE CRASH DUE TO THE FACTORS ANALYZED ABOVE

Keeping in mind the factors of Chinese capital markets, which are often distinct from other open economies both in the West and Asia, China has embarked on a path of its own. While this path has been obstructed by the crisis of 2015, it is essential to study the combination of the factors in the previous section and read them in congruence with other economic and policy considerations in China before the Crash.

Owing to the limited opportunities of investing money and the limitations on investing money abroad, Chinese individual

[28] Fabella, Raul; Madhur, Srinivasa. 2003. *Bond Market Development in East Asia: Issues and Challenges*, ASIAN DEVELOPMENT BANK.

[29] Lissa Jucca, *Shanghai-Hongkong Stock connect to allow short-term selling from March,* Reuters, http://www.reuters.com/article/2015/02/23/china-hongkong-connect-idUSL4N0VX0ET2015022 (last updated Feb 23, 2015).

investors find themselves with two options. The first is putting in savings in state owned banks and financial corporations, yielding much lower returns and no scope for diversification of assets.[30] Secondly, they have the option of exploring the vulnerable stock exchanges in China. The reasons for the same have been analyzed in the previous section. In the year preceding the Crash China introduced the Hong Kong – Shanghai Stock Connect.

This collaborative securities arrangement enabled smoother relationships with Hong Kong and was seen as a boost to Joint Ventures and companies located in Mainland china with a Hong Kong presence and vice versa.[31] As a result the stock markets saw a boost. Further, in the same year the Chinese media capped onto this trend and encouraged Chinese individual investors to invest in the two major exchanges (share markets). This was in alliance with the objective of the state and as is known the Government in China controls the media, leading to congruence in thinking.[32]

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[30] Chen Xindong, *Chinas Capital Markets; Untapped Potential*, Eurobiz, http://www.eurobiz.com.cn/chinas-capital-markets-untapped-potential/ , (last updated June 10, 2013),

[31] *The through train: stock connect's impact and future,* THOMSON REUTERS, (Dec, 2014). http://share.thomsonreuters.com/assets/forms/shanghai-hk-stock-connect-1008885.pdf

[32] Jim Zarroli, *Beijing Government spurred investors to make risky margin bets,* NATIONAL PUBLIC RADIO

Investors therefore flocked to the stock market, with the objective of higher returns in the Chinese capital markets vis-à-vis state owned banks. This led to a gradual inflation in the stock markets, with prices of shares soaring due to the demand from Chinese investors. While this scenario has been seen in the past with other stock market crashes, what sets the Chinese crash apart is the rampant use of margin lending to investors in order to be able to buy shares. Often the amounts lent were much higher than the expected profitability or returns that were stipulated by the companies' investors put money into.[33] Margin lending is a mechanism of financing in which a loan is provided to the investor for investing shares. In return the lender uses the same shares as security. China right before the crash gave out margin loans to the quantum of 339 billion dollars, leading to a flooding in the shares and their prices soared.[34]

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http://www.npr.org/2015/08/27/435113627/china-s-government-encouraged-ordinary-investors-to-make-risky-margin-bets, (last updated Aug 27, 2015).

[33] *China takes heavy hand to settle markets,* T D ECONOMIC OBSERVATION (July 9, 2015). https://www.td.com/document/PDF/economics/special/China_StockMarketRout.pdf

[34] Tracy Alloway, *China's Gray Market in Margin Lending Is Probably Massive*, BLOOMBERG BUSINESS, http://www.bloomberg.com/news/articles/2015-07-09/china-s-gray-market-in-margin-lending-is-probably-massive (last updated July 9, 2015).

While margin loan funding in itself is not a problematic concept in capital markets, it is Chinas non-regulation of the same that has facilitated this catastrophe. Fund Matching companies in China indulge in such margin lending without any regulation to enable peer-to-peer lending. However, this scheme of financing is not included in margin loans regulation and therefore remains unregulated. Investors, who buy and sell their shares often, leading to a fluctuation in share prices, use peer to peer financing in China.[35]

Unfortunately, China saw the rise of margin calls fueling the crisis. A margin call flows from margin lending and occurs when the lender realizes fluctuations in the stock market and fears devaluation of the securities held as collateral. Therefore the lender demands a greater collateral in the form of more shares, payment or disposal of currently held shares before values fall. This creates a domino effect as is best illustrated in the Chinese context.[36]

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[35] Gabriel Wildau, *China wary of killing stocks rally with margin lending curbs,*THE FINANCIAL TIMES, http://www.ft.com/intl/cms/s/19263298293b11e58613e7aedbb7bdb7,Authorised=false.html?siteedition=intl&_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F0%2F19263298293b11e5Dintl&_i_referer=&classification=conditional_standard&iab=barrier-app#axzz3odjDqWgP (last updated July 13, 2015).

[36] Ben Chu, China stock collapse: Why the country's market crash is not what it seems, The Independent. http://www.independent.co.uk/news/world/asia/china-stock-collapse-why-

Further, another aspect that sets this crash apart from the West is in the nature of investors. In China, the current crisis saw eighty percent of investors who had invested were individual investors trading independently on the Stock Exchange. This is unlike more modern, usually Western stock markets where institutional investors are the biggest contributors.[37] Pension funds, Mutual funds and insurance companies often invest their pooled funds on behalf of individual investors in the West, making the impact of this crisis closer to the Chinese populous who can seek no accountability of their losses post the crisis.

The savings trend in China contributed to this impact, as in the absence of the Western model of security systems; individuals are forced to save for the rainy day. The government itself has been accused of intentionally keeping interest rates of state banks low, to boost corporations in China, leading to the flocking of stock markets by individual investors.[38] Critics of the crash believe that beyond the falling prices and the crash,

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the-countrys-market-crash-is-not-what-it-seems-10477305.html ,(last updated Aug 28, 2015).

[37] *Chinas Black Monday sends markets reeling across the globe,* THE GUARDIAN, http://www.theguardian.com/business/live/2015/global-stocks-sell-off-deepens-as-panic-grips-markets-live (last updated Aug 24, 2015).

[38] Gywwn Guildfors, *Everything you've heard about Chinas stock market crash is wrong,* QUARTZ MAGAZINE, http://qz.com/8everything-youve-heard-about-chinas-stock-market-crash-is-wrong/ (last updated Aug 27, 2015).

there is a greater plague in China that is posed by the Governmental regulation at each step of the securities market. In attempting to adopt the Western securities market China has successfully put up a similar structure for capital markets but has failed to comply with the substantive legal requirements due to excessive governmental control.[39]

Answering the second most pertinent question regarding foreign investors, it is essential to recapitulate the classification of shares- Type A and B. In the given crisis the value of Type A shares was lost. Chinese individual investors or corporations can only own these shares. As a result the losses in Type B shares are limited to a mere 2 percent for foreign investors in China.[40] However, when viewed numerically the losses in Type A share also seem insulated due to China's 1.36 billion population. Research shows that only one in every 30 Chinese has lost money in the stock market crash. However the quantum and effects of this crash has extended to an already

[39] CHU B. (2013), CHINESE WHISPERS: WHY EVERYTHING YOU'VE HEARD ABOUT CHINA IS WRONG, (Weidenfeld and Nicolson, London) (2013).

40 Alfred Joyner, *China stock market crash explained in 90 seconds, International Business Times*, http://www.ibtimes.co.uk/china-stock-market-crash-explained-90-seconds-151695 (last updated Aug 25, 2015).

declining price of commodities such as Iron ore and crude oil, thereby impact the global economy.[41]

The trigger to this crisis as portrayed by the Chinese government was a news report by Journalist Wang Xiaolu who published a report on the speculation of the Chinese regulatory body, CSRC withdrawing funds.[42] This led to further confusion in the market and the chaos saw investors panicking and withdrawing their money as is common for most stock market crashes. However, the government has been grossly criticized for advancing this theory, as a crash of this magnitude is not due to a false report but only exposes the greater challenges that the Chinese securities market and regulations have been unable to address.[43] The attempt of the Government of China, to increase its production and efficiency by devaluing its currency in July, 2015 could be pointed to as the first domino to fall in this crash.

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[41] Keith Fitz-Gerald, *The Real Threat from China's Stock Market Crash,* The Blaze,http://www.theblaze.com/contributions/the-real-threat-from-stock-market-crash/ (last updated Sept. 4, 2015).

[42] *Chinese journalist jailed after stock markets crash coverage,* AL JAZEERA STAFF, http://america.aljazeera.com/articles/2015/8/27/chinese-journalist-jailed-over-stock-market-crash-coverage.html (last updated Aug 27, 2015).

[43] *China Is Trying to Blame Its Stock Market Crash on Journalists and Businessmen*, Vice News,https://news.vice.com/article/china-is-trying-to-blame-its-stock-market-crash-on-journalists-and-businessmen(last updated Aug 31, 2015)

The Chinese government has been accused of notoriously devaluing their currency for import- export trade profits and this supplemented by the recent fall in property prices could be individual triggers of the crash.[44] However, we must keep in mind while these triggered the crisis the causes of the same are more deeply rooted in Chinese securities law itself, as analyzed in Chapter I.

4. CONCLUSION

The Chinese stock market crash shows a very deeply rooted problem in the working and structure of Chinese capital markets. For a country that is a production hub and has a huge population, China has failed to provide adequate high yielding investment opportunities. China also has a savings trend that is higher than most other countries.

Yet the government in consonance with the Regulator, CSRC ensure limited options and vehicles for investment. This in turn hit individual investors in China who are plagued by the unfortunate investment opportunity in low interest rates providing state owned banks and corporations. Analyzing the slowing trend that followed in China after the introduction of

[44] Peter Spence, *china's stock market crash: five numbers you need to know,*the telegraph, http://www.telegraph.co.uk/finance/china-business/11772729/chinas-stock-market-crash-five-numbers-you-need-to-know.html (last updated july 31, 2015).

its economic reforms, the government urged investors to invest in state owned corporation listed on stock exchanges in India.

The minute classifications in types of shares governed by who holds what share further cements this control of the government in the securities market. The problems of shadow margin lending and short selling have been identified as triggers of the said crash. However it is essential to note that they are not triggers but only the first domino to fall due to the basic fallacies in the structure of Chinese capital markets. In adopting the Western structures of capital markets, China failed to provide an accompanying code of clear regulations that would govern securities.

Further, the scope of government intrusion limits markets from functioning independently. As a result of these factors, we saw a plummeting of the value of Type A shares, impacting not only China but also other stock markets in countries like the USA and India. Further this crisis has been linked to an already declining commodities price impacting jurisdictions across the world. Hence there is a pressing need for the Chinese government to step aside, let the regulators remain in a system of checks and balance and ensure that the free market runs the pricing and cycles of the stock market.