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AN ANALYTICAL STUDY ON INSOLVENCY AND SARFASI ACT 2002

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Abstract
The Securitisation Act empowers the banks and FIs to move on its own against a borrower whose assets are secured, and who has made some kind of evasion in repayment of the same.The Code plays a very important role in resolving issues faced in these ancient laws. Moreover, it unites laws relating to insolvency and abolishes the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920.The question that ascends for discussion is what happens to proceedings pending before different forums under the DRT Act and SARFAESI Act.With the IBC's aim of creating a level playing field for all lenders, according debenture trustees the same rights as other secured creditors (banks and financial institutions) is a useful step and is in line with that aim. And it is also significantly enlarging the scope of the information given in the CERSAI. Likewise, for transferring financial assets permitting the banks and financial institutions to ARCs prior to them being announced as non performing assets (90 days post a payment default) is also in line with the IBC's aim at before time detection and resolution of distress. Whereas these amendments are in proportion to the spirit of IBC, it is now essential to further clarify how these extra changes will merge into IBC and this is what the JPC should consider in its review.

Introduction

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (here-in-after referred to as The Securitisation Act) has been enacted with an intention to reinforce the creditors rights through foreclosure and enforcement of securities by the banks and financial institutions by discussing on the creditors the right to seize the secured asset and sell of the same in order to recover dues promptly bypassing the costly and very time consuming legal process through courts.

The Securitisation Act empowers the banks and FIs to move on its own against a borrower whose assets are secured, and who has made some kind of evasion in repayment of the same. The provisions of this Act shall have effect notwithstanding anything unreliable therewith contained in any other law for the time being in force or any instrument having outcome by virtue of any such law . Thus after fulfilling with the statutory provisions in the said act the banks .

Section 14(1)(c) of the Insolvency and Bankruptcy Code, 2016 clearly provides that during the insolvency resolution process as defined in the Code, the Code takes priority over the DRT Act and SARFAESI Act[1].

Centuries-old laws of the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920 supervised insolvency to take decisions for individuals and the Sick Industrial Companies Act, 1985 and Companies Act, 1956/2013 supervised insolvency intention for companies prior to the introduction of Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as the “Code”).

The Code plays a very important role in resolving issues faced in these ancient laws. Moreover, it unites laws relating to insolvency and abolishes the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920. Also, the Code recompense 11 laws, including the Companies Act, 2013, Recovery of Debts and Bankruptcy Act, 1993 (DRT Act), and Securitization and Reconstruction of the Financial Assets and Enforcement of the Securitization Act, 2002 (SARFAESI Act). From the amendments, it is clear that all these 11 Acts are affected by the enactment of the Code.

[1] Securitization and Reconstruction of financial Assets and Enforcement of Securities InterestAct 2002

Hence, the question that ascends for discussion is what happens to proceedings pending before different forums under the DRT Act[2] and SARFAESI Act.

The Code[3] devises two separate processes for corporate insolvency matters and individual/ un-incorporated bankruptcy matter. Part II of the Code deals with corporate insolvency mechanism pertaining to companies incorporated under the Companies Act, 1956 and 2013 and limited liability partnership incorporated under the Limited Liability Partnership Act, 2008; matters in this regard will be dealt by the National Company Law Tribunal. Part III deals with the bankruptcy process for individuals and partnership firms (unincorporated entities) and is maintainable before the Debt Recovery Tribunal. Both Parts II and III provide a detailed procedure for declaring a company, LLP, individual, or unincorporated entity

Section 14 of the Code (Falling In Part II) Reads As Follows
Section .14. Moratorium

1. Under provisions of sub-sections (2) and (3), the Adjudicating Authority on the insolvency commencement date, shall by order declare moratorium for prohibiting all of the following, namely:
   (a) The institution of suits or continuation of pending suits or proceedings against the corporate debtor, including execution of any judgment, decree, or order in any court of law, tribunal, arbitration panel, or other authority;
   (b) Transferring, encumbering, alienating, or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;
   (c) Any action to foreclose, recover, or enforce any security interest created by the corporate debtor in respect of its property including any action under the (SARFAESI Act 2002)[4]
2. The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.
3. The provisions of sub-section (1) shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.
4. The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process: Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of Section 31 or passes an order for liquidation of corporate debtor under Section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.

The abovementioned details clears that all pending proceedings are kept for a period of 180 days from the date of admission of the application to begin such proceeding in provisions of Section 12 of the Code,[5] and the Adjudicating Authority shall by Order state that no new action is allowed to be begin if the tribunal makes an order to that effect. While in the moratorium period, from disposing of its assets out of the ordinary course, the debtor will also be prevented. The ground for the idea of this moratorium is to provide a calm period for the debtor and creditors to discuss the rehabilitation of the company under the Code.

Though the provisions are not yet examined by the courts of law, Section 14(1)(c) of the Code visiblystates that during the insolvency resolution process as defined in the Code, the Code takes priority over the DRT Act and SARFAESI Act. In other words, presented actions will be stayed, and no new action can be start under the DRT Act and SARFAESI Act.

[2] Debt Recovery Tribunal
[3] Insolvency and Bankruptcy Code 2016
[4] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (54 of 2002)
[5]Time Limit for Completion of Insolvency Resolution Process

Likewise, the moratorium period is given in Section 85 of the Code for individuals and unincorporated entities, which reads as follows:

Effect of admission of application
On the date of admission of the application, the moratorium period shall commence in respect of all the debts.

During The Moratorium Period

1. Any pending legal action or legal proceeding in respect of any debt shall be deemed to have been stayed; and
2. Subject to the provisions of Section 86, the creditors shall not initiate any legal action or proceedings in respect of any debt.

During The Moratorium Period, The Debtor Shall:

1. Not perform as a director of any company, or directly or indirectly take part in or have interest in the promotion, formation, or management of a company;
2. Not dispose of or alienate any assets;
3. Notify his business partners that he is undergoing a fresh start process; Be requisite to inform prior to entering into any financial or commercial transaction of such value as may be notified by the Central Government, either individually jointly, that heis undergoing a fresh start process.
4. If names are different from the name in the application admitted under Section 84, disclosure of the name under which he enters into business transactions is necessary.
5. Not allowed to leave India except with the permission of the Adjudicating Authority.

The moratorium ceases to have effect after completion of the period of one hundred and eighty days starts from the date of admission unless the order admitting the application is revoked under sub-section (2) of Section 91.
A related provision is provided under Section 101 with respect to the insolvency resolution given under the Code. The period of 180 days begins from the date of admission as provided in Section 84 of the Code, and an option of revoking the moratorium period is provided under Section 91(2) of the Code.

In end, it is thus clear that for a period of 180 days as given in sections above, from the dates of different methods taken under the Code, the proceedings under the DRT Act and SARFAESI Act remain suspended, without affecting the limitation period for filing the same, though an order to that effect must be passed by the respective Adjudicating Authority.

The next stage that the security detained by a creditor may be affected with relevance to a corporate debtor is under the liquidation order. If a liquidation order is passed by the appropriate authority in terms of Section 33 of the Code, a creditor has two options:

A secured creditor can select to renounce his/her security interest and be part of the liquidation process in terms of Section 53, where, the dues of the secured creditor will rank higher in predilection of distribution; orA secured creditor can select to reside outside the liquidation process and enforce his/her security interest as per with Section 52 of the Code.

The position in esteem of individuals and unincorporated entities is different. In the event that a bankruptcy order is approved by the Adjudicating Authority, which is the Debt Recovery Tribunal, the bankruptcy order shall not affect the right of any secured creditor to comprehend or otherwise deal with his/her security interest in the similar manner as he would have been entitled in case the bankruptcy order was not passed. Although the legislature has made broad efforts to bring harmony between these laws, it is however to stand the test of implementation. Some immediate concerns are as follows:

Time-bound insolvency resolution needs the organization of several new entities. Moreover, given the pendency and disposal rate of Debt Recovery Tribunals, their present capacity may be insufficient to take up the extra role

(As of December 2014, there were 62,000 cases pending with Debt Recovery Tribunals, and the disposal rate has been about 10,000 cases per year.

Subsistence of multiple laws (the Code, DRT Act, and SARFAESI Act) and forums (NCLT and Debt Recovery Tribunals) to deal with the debt recovery troubles of secured creditors will result in interpretation and harmonization of various laws, leading to delay in insolvency proceedings.
Relationship of the Code with debt recovery laws such as the SARFAESI Act and DRT Act has not been fully concentrated on, and there is an evident tension between these statutes. Though, for an insolvency era to function effectively, clear harmonization for the interplay of the different laws will have to be done.

Moreover, the parties have the freedom to approach a forum dealing with Corporate Debt Restructuring (CDR) and Joint Lenders Forum (JLF). Applicability of the CDR and JLF proceedings on the Code will have to be mentioned separately.

As we believe that the NCLT and Debt Recovery Tribunal under the Code will perform effectively promoting the objective of the Code, and if strict timelines are followed, then the Code may inconsequence, improve the scenario of recovery for creditors and provide safeguards to honest insolvents.

Interaction between Security Enforcement Laws and Insolvency Laws
In the existing legal regime in India, there are multiple debt recovery and security enforcement laws (SARFAESI being an example) which create opportunity for each one recovery action, as conflicting to an insolvency law that deals with collective action. The previous is about enforcing a particular contract or foreclosing one or more specific security interest. Insolvency law on the other hand deals with combined assessment of practicality of the debtor's business as a going concern. If the business is initiated to be viable, resolution involves reorganization of the firm and its business and/or its debts. If the business is found to be unviable, then the firm is liquidated and secured financial creditors are given the right to enforce their security if they so choose.

It is critical that through an insolvency resolution process, the rights of debt recovery and enforcement of security interest be removed as that is the only way in which creditors can be made to take on collective action. If the secured financial creditors are known the right to enforce while an insolvency resolution is in motion, it is highly probable that they will select individual enforcement action which may challenge the whole resolution process, thereby damaging the interests of the other creditors. This is what occurs presently in India as maybe evidenced by the fact that banks rely mostly on SARFAESI and DRTs rather than creditor measures. (While they do undertake some forms of non collective out-of-court mechanisms such as CDR and JLF, arguably this is to get provisioning benefits. Also these measures distort the incentives in the credit process and skew the same towards large debtors and creditors). This issue is even more important in India given that secured credit from banks and financial institutions continues to be the dominant source of debt financing for companies. For example in 2012-13, above of all the basis of funds for non-financial firms in India, use amounted to 21.57% out of which bank credit alone was 15.20%. Multiple measures by different classes of creditors also direct to confusion and forum shopping.

Amendments required in SARFAESI Act for Indian bankruptcy reform SARFAESI Act, 2002 gives a safety net to secured financial creditors (banks and financial institutions) by empowering them to enforce their security interests not including the intervention of any court. On the other side, under IBC, the interests and rights of all kind of creditors have been included into concern that of secured creditors.

The usual question that occurs now is how these two parallel legal processes will coexist. More exclusively, how will the rights of secured creditors be administered in presence of both these laws and whether, going ahead, there may be any ground for conflict in the interaction between these two laws.

While taking away the rights of secured creditors to impose security as vested in them by SARFAESI may not thus be a feasible option at present, exclusive of the IBC having proven its success, it is vital that the provisions of SARFAESI are unite with IBC, such that the former Act does not challenge the effectiveness of the latter.

The IBC as approved in the Parliament contains provisions that explicitly refer to the rights of secured creditors under SARFAESI. Section 14(1)(c) of the IBC provides that the moratorium would apply to : "any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002." Accordingly this moratorium applies to all acts by any kind of creditor under SARFAESI. Also, Schedule 7 of the IBC amends SARFAESI to subject all collective action under SARFAESI to the provisions of the IBC.

Given that these terms are already incorporated in the IBC, now the SARFAESI Act also requires to be amended accordingly such that policies of both under these laws are follows with each other and there is no misunderstanding about applicability atthe specific stages of insolvency resolution the process of the laws to the specific economic actors.

Amendments to SARFAESI Act 2002 in Parliament

The projected changes in the amendment bill in concern with the SARFAESI Act significantly improve the rights of the asset reconstruction companies (ARCs) where the acquisition of assets of the debtor takes place, also with the debenture trustee as a secured creditor, explore the scope of powers of the RBI in regulating ARCs and extend the scope of the Central Registry (CERSAI) created under the Act.

With the IBC's aim of creating a level playing field for all lenders, according debenture trustees the same rights as other secured creditors (banks and financial institutions) is a useful step and is in line with that aim. And it is also significantly enlarging the scope of the information given in the CERSAI. Likewise, for transferring financial assets permitting the banks and financial institutions to ARCs prior to them being announced as non performing assets (90 days post a payment default) is also in line with the IBC's aim at before time detection and resolution of distress. Whereas these amendments are in proportion to the spirit of IBC, it is now essential to further clarify how these extra changes will merge into IBC and this is what the JPC should consider in its review.

Corrections in the SARFAESI Amendment Bill and the IBC

At First, the SARFAESI should consisting the manner in which each action thereunder can be taken in context of resolution and liquidation under the IBC. For example, any action under Section 13 of the amendment bill should be specific, by a bank or a financial institution or under the new Section 9 by ARCs will be focus to the moratorium under Section 14 of the IBC. It may possibly further be simplified that the shift of a financial asset from a financial institution or bank to an ARC during the moratorium under IBC would be permitted. Certainly, under IBC one would expect numerous secondary transfers of debt to occur during the insolvency resolution process (IRP) for creditors to be able to influence voting in the creditors' committee.

Following the 180 day period of IRP in the IBC there are two possibilities: (a) a resolution plan; or (b) liquidation. The SARFAESI amendments have to clarify that any enforcement action following the moratorium should be compliant with the IBC resolution plan that has been voted on by majority of creditors. In liquidation under IBCa, all secured creditors have the right to stand outside the proceedings and enforce their security using SARFAESI or otherwise. The SARFAESI amendments could clarify this as well and also the manner in which this would occur for instance mandating the secured creditors to inform the liquidator and pay their portion of the liquidation costs. Secondly an important feature of IBC is a mandatory moratorium during the IRP in order to stay all creditor action. The moratorium applies to the enforcement of security interests under the SARFAESI as well. However under the IBC as passed in the Parliament, the Central Government reserves the right to provide exemptions to specific transactions in consultation with a financial sector regulator. It is not clear why this exemption is needed

and how wide its scope can be.Does it mean this provision can be used to exempt secured creditors such as banks and financial institutions from enforcing their collateral during the moratorium?.

As a corollary, does this mean using this exemption, banks can invoke the SARFAESI Act to enforce their security even as an IRP is in progress triggered by another creditor? This could be dangerous and would defeat the purpose of the moratorium, not to mention strip the IBC of its very essence. The amendments to the SARFAESI Act do not provide any clarity on how such interactions between the two laws will be dealt with.This power of the central government should either be removed or the precise basis on which this power will be exercised should be tightly set out in the amendment Act. Since debt recovery action and insolvency resolution can be at loggerheads with each other for reasons described above, amendment to SARFAESI can specifically provide that individual debt recovery action would not be exempted under this provision. The central government should potentially exercise this right of exemption only for attachment of assets by enforcement authorities in the respect of financial crimes. Alternatively IBC needs to be amended or specific rules need to be written now, clarifying the reach of this provision.

Third, under the IBC, all corporate insolvency resolution cases will be adjudicated upon by the NCLT whereas all individual insolvency resolution cases will be dealt with by the DRTs. Even after the amendments, all SARFAESI cases will continue to be referred to DRTs as is the practice now. DRTs are overburdened with cases and highly capacity constrained.

The amendment bill itself mentions that approximately 70,000 cases are pending at DRTs for many years due to adjournments and prolonged hearings. Given this state of affairs, perhaps the corporate recovery cases under SARFAESI could be shifted to the newly constituted NCLT, in sync with the IBC. Given that NCLT itself will handle the IBC cases, existing winding up cases as well as adjudicate upon matters related to company law, perhaps only SARFAESI related appeals can be referred to the NCLT, to reduce the burden on DRTs. This presumes that NCLT will use new ideas in how to organise courts, without which it will rapidly collapse with a huge backlog of cases.

Fourth, in the IBC framework of `information utilities' (IU), there would be a private competitive industry of IUs. This is inconsistent with a single statutory CERSAI which is a monopoly.

Conclusion

In summary the following modification maybe proposed to the SARFAESI amendments:

1. Eliminate all kinds of SARFAESI enforcements from the exception provision of the moratorium under IBC that the central government to grant.
2. Give greater clarity regarding communication of the provisions of SARFAESI to IBC.
3. SARFAESI related appeals to NCLT.
4. Place CERSAI in the IBC concept of information utilities.

A main intent of the IBC is to have a united, consolidated law that applies to every economic actors. Effective accomplishment of IBC is now of utmost significance in order to achieve the goal of a simpler and faster resolution mechanism that produces a higher recovery rate. Lack of sufficient clarity in the proposed amendments to the SARFAESI Act will create uncertainty about the rights of secured creditors and dilute the working of the IBC in practice. The existence of dual laws (IBC and SARFAESI) and forums (NCLT and DRTs) to deal with the debt recovery problems of secured creditors will result in more time being spent in resolving confusion and create opportunity for litigation, the very problem that the IBC is aimed at resolving. This uncertainty needs to be addressed by the JPC reviewing the amendments.