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AN ANALYSIS OF THE EFFECTIVENESS AND CHALLENGES OF THE INSOLVENCY AND BANKRUPTCY FUND UNDER INDIAN LAWS

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Abstract:
This paper conducts a comprehensive analysis of the effectiveness and challenges faced by the Insolvency and Bankruptcy Fund under Indian laws. The Insolvency and Bankruptcy Code (IBC) was implemented in India to streamline the resolution of insolvency cases and establish a robust insolvency framework. The Insolvency and Bankruptcy Fund plays a pivotal role in facilitating the administration and distribution of funds during insolvency proceedings. This study explores the key provisions of the IBC, highlighting the significance of the Fund in achieving its objectives. It examines the operational mechanisms and financial aspects of the Fund, administered by the Insolvency and Bankruptcy Board of India (IBBI).

The effectiveness of the Insolvency and Bankruptcy Fund in expediting the insolvency resolution process and safeguarding stakeholder interests is evaluated. The study assesses the Fund's capacity to efficiently manage and distribute funds, ensuring a transparent and equitable resolution process. Furthermore, it analyses the Fund's impact on promoting entrepreneurship and viable restructuring options for distressed businesses.

Several challenges faced by the Insolvency and Bankruptcy Fund under Indian laws are identified. These challenges encompass inadequate infrastructure, delays in the resolution process, legal ambiguities, and concerns regarding the prioritization of claims. The study emphasizes the need for continuous monitoring, evaluation, and improvement of the Fund's operations to overcome these challenges and enhance its effectiveness.

Based on the analysis, recommendations are proposed to improve the Fund's functioning. These include bolstering infrastructure and technological capabilities, streamlining legal processes, enhancing stakeholder awareness and participation, and fostering an environment conducive to investment and entrepreneurship.

Keywords: Insolvency and Bankruptcy Fund, Insolvency and Bankruptcy Code, effectiveness, challenges, Indian laws, resolution process, stakeholder interests, Insolvency and Bankruptcy Board of India, entrepreneurship, restructuring, infrastructure, legal ambiguities, claims prioritization, monitoring, evaluation, improvement.

INTRODUCTION AND OVERVIEW OF THE INSOLVENCY AND BANKRUPTCY FUND

The Insolvency and Bankruptcy Fund, sometimes known as the “IBC Fund”, was established by Section 224 of the Code “for the purposes of insolvency resolution, liquidation, and bankruptcy of persons under the Code.” It is considered that the existing structure of the IBC Fund will prevent individuals from making donations and will only offer a restricted number of possibilities for expenditures. To begin, the Fund is eager to accept donations not just from the Central Government but also from any individual who voluntarily chooses to contribute to it. This is because the Fund is open to receiving contributions from a wide variety of sources.[9] Additionally, membership in the Fund is absolutely not required in any way. Because it is possible that it will be difficult to collect payments that have been voluntarily supplied, it is possible that it would be required to implement laws or incentives in order to ensure that consistent contributions will be made. In addition, the IBC Fund will only be used for a limited variety of activities once it is established. According to paragraph 224(3), the only people who are entitled to take funds from the fund up to the amount that they contributed are those who have already made a contribution to the fund. This means that anyone else who wants to withdraw cash from the fund must not have made a contribution to the fund. The ability of the IBC Fund to adjust to shifting conditions is hampered as a result of this.[10]

As a result of this, it has been proposed that Section 224 be adjusted as necessary in order to enable the Central Government to construct a complete structure for the contributions to and utilisation of the IBC Fund. This would be possible if Section 224 were altered as required. utilising data on previous donations of a similar kind that have been made by the Central Government and regulatory agencies, this methodology may be able to identify and describe possible sources for contributions to the IBC Fund.[11] This might be accomplished by utilising the IBC Fund as an example. It is also possible for funds to be distributed from the Companies Liquidation Account that was established under the Companies Act of 1956 or the Companies Liquidation Account that was established under the Companies Act of 2013. In a manner that is not dissimilar to this, the IBC Fund may be utilised for either narrow or wide objectives. Instances of the bankruptcy process that are strapped for cash and may be eligible for financial assistance from the IBC Fund in order to cover costs such as payments for worker's compensation, avoidance measures, and other expenditures that are comparable to these costs.

ADDRESSING DEFICITS IN THE LIQUIDATION FUND

After putting the Code into force for three years, it became abundantly evident that a significant lack of liquidation funds was making it difficult to fulfil even the most basic of tasks. This was the case despite the fact that the Code was in existence. This insight was gained as a direct consequence of putting the Code into action in the organisation. The liquidators were compelled to continue with the liquidation procedure despite a significant lack of capital, which inevitably resulted in outcomes that were not as desirable as one would have hoped. The liquidators were required to continue with the process of liquidation even though they had an extremely limited amount of capital to work with. The IBBI acknowledged and emphasised this concern in its Discussion Paper, in which it suggested that the secured financial creditors of the corporate debtor "may be obliged to bring in interim finance to run the CD as a going concern or liquidate the CD, if there are no liquid assets available to defray these expenses."[12] However, if there are no assets, the Insolvency and Bankruptcy Fund that was

[9] Valecha, Javish & Xalxo, Ankita Anupriya. "Overview of the Insolvency and Bankruptcy Code, 2016 & the Accompanying Regulations", Journal on Contemporary Issues of Law, Vol-3, Issue-4, ISSN 2455-4782, 2017.
[10] Gupta, Nimit, Nishma Desai, and Evanshi Garg. "Impact of Insolvency and Bankruptcy Code on India's Macro Economy Focusing on Indian Commercial Banks." Supremo Amicus 22 (2020): 174.
[11] Goel, Shivam. "The Insolvency and Bankruptcy Code, 2016: Problems & Challenges." *Imperial Journal of Interdisciplinary Research (IJIR)* 3 (2017): 2454-1362.
[12] File No. 30/38/2021-Insolvency Government of India Ministry of Corporate Affairs

established by section 224 of the Code may be activated and used to subsidise the process of liquidation for particular costs, up to certain levels, and in a manner that has been defined and detailed. If there are no assets, however, the Insolvency and Bankruptcy Fund cannot be activated and utilised in this manner.[13]

In the paper, it is made clear that the only financial creditors who are eligible to be considered for requesting contribution are those who have a secured debt. This means that the only financial creditors who are eligible to be considered for seeking contribution are those who have a secured debt. If there are no assets at all to recover, an unnecessary burden may not be imposed on the FIs, and support may be desperately needed; and the text of the proposal suggests that it may be obligatory for such FIs to make such a contribution. If there are no assets at all to recover, an unnecessary burden may not be imposed on the FIs, and there may be a desperate need for support. However, the notions that were provided in the Discussion Paper do not end up being adopted into law. Instead, the real situation may be judged solely in light of the rules that were contained in the Liquidation Regulations. In the following part, we will talk about the provisions of Regulation 2A, as well as the implications that this regulation has for the situation.[14]

UTILIZATION OF THE IBC FUND FOR INSOLVENCY AND LIQUIDATION COSTS

It is important to note at this juncture that the insertion of Regulation 2A must be read in conjunction with Regulation 39B of CIRP Regulations, which also provides for covering liquidation expenses. This is because the insertion of Regulation 2A must be read in conjunction with Regulation 39B.[15] Both of these regulations may be found in the document titled “Insolvency Resolution Process for Corporate Persons,” which was published in 2016 by the Insolvency and Bankruptcy Board of India. In accordance with the provisions of Regulation 39B, the committee of creditors, generally known as “CoC,” may, in consultation with the resolution professional, prepare a best estimate of the amount required to satisfy liquidation costs in the event that an adjudicating authority makes a liquidation order. In this scenario, the adjudicating authority may order the company to be placed into liquidation. This estimate is required to be completed in advance of the committee of creditors choosing whether to approve a resolution plan or proceed with the liquidation of the corporate debtor. The value of the liquid assets that can be utilised to satisfy the projected costs is the responsibility of the CoC, and it is their responsibility to provide the most accurate estimate possible of that value. In the event that the anticipated costs are higher than the easily available liquid assets, the Committee on Compensation is obligated to provide its approval to a plan that “provides for contribution for meeting the difference between the two.” Either in combination with the resolution plan or in response to the CoC’s decision to liquidate the corporate debtor, the resolution professional is obligated to deliver such a plan to the body that is responsible for adjudication.[16]

In this specific context, it is crucial to take note of the fact that paragraph (1) of Regulation 39B states

[13] Kumar, Divyodak. "India's new insolvency & bankruptcy code-lessons and insights from foreign jurisdictions." *International Journal of Advanced Research in Management and Social Sciences* 7.10 (2018): 12-22.

[14] Mittal, Megha. "Forced Contributions to Infructuous Liquidations: Understanding Regulation 2A." *Available at SSRN 3619040* (2020).

[15] IBBI (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations, 2019– Notification No. IBBI/2019-20/GN/REG048 dated 25th July, 2019

[16] Abhirami, A., and T. Rahul. "On the Effectiveness of Insolvency and Bankruptcy Code, 2016: Empirical Evidence From India." *Law and Business* 2.1: 20-34.

that the CoC "may make such estimation," which suggests that the estimation provided by the CoC is not required in any form and is not required in any other context. On the other hand, in the case that such an estimate is made, a proposition to cover the deficit, if there is one, may be devised and put up for vote by the CoC. This would only occur in the event that such an estimate is established. It is important to note that there has not been any discrimination made between FIs and retail financial creditors. Therefore, once a plan for contribution to liquidation costs is approved by the Committee of Creditors (CoC) and the same plan is approved by the adjudicating authority, it is as good as a contract between the financial creditors, who make up the CoC, and the corporate debtor, who is represented by its liquidator. Where exactly do these two things connect with one another? The second half of this article will be devoted to an analysis and debate of the topic. When everything is taken into account, one could wonder what would take place in the event that such a plan was not authorised; in this kind of scenario, Regulation 2A of the Liquidation Regulations would come into action.[17]

If there is anything that could convince the financial institutions to increase the amount of money they have invested in the corporate debtor, the answer is the assurance of first priority in the collection of any past-due interest as well as the principal amount of the loan. In spite of this glimmer of optimism, the author of this piece holds the respectful opinion that Regulation 2A is inconsistent and not very viable when read in conjunction with the other articles of the Liquidation Regulation that are related to it. Given that a liquidator cannot review claims until at least 30 days have passed since the beginning of the liquidation process, it is highly unlikely that a liquidator will call and deposit the contribution within the first 7 days after the liquidation process has been launched. Given that a liquidator cannot analyse claims until at least 30 days have passed since the beginning of the liquidation process. up order to fill up this gap, we are going to adopt the premise that the resolution expert has been appointed and is aware of the liable FIs. The attention must now be shifted to Regulation 21A of the Liquidation Regulations, which gives secured financial creditors (including FIs) the opportunity to choose whether they want to relinquish their security. This regulation must now be the centre of attention. The highest care and attention is now required with regard to this regulation. The ability of the liquidator to seek contribution from financial institutions, even secured financial institutions, would be a significant reason for concern until the secured creditor consents to the release of its security. In addition to the difficulties described above, assessing whether the FIs would be obligated by law to make such contributions is one of the most crucial concerns.[18]

It is not quite apparent whether the FIs are subject to a comparable need; yet, the current state of the law mandates that the liquidator sends out a contribution call. Although there may be some people who continue to have the optimistic belief that the Discussion Paper's real goals are being upheld, the majority of those who are interested hold the opposite belief. The author of this paper is in agreement with the contention that the FIs cannot be compelled to make such a contribution for the reasons that will be presented in the following paragraphs. Although it is suggested in the Discussion Paper that contributions should be required, the Liquidation Regulations do not include any language to that

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[17] Kumar, Divyodak. "India's new insolvency & bankruptcy code-lessons and insights from foreign jurisdictions." *International Journal of Advanced Research in Management and Social Sciences* 7.10 (2018): 12-22.

[18] Alexey Gorodissky, Dmitry Yakushev, Change in the Bankruptcy Moratorium Regime. Analysis of Expected Amendments to the Bankruptcy Law, Andrey Gorodissky & Partners, http://www.agp.ru/en/insights/change-in-the-bankruptcy-moratorium-regime-analysis-of-expected-amendmentsto-the-bankruptcy-law-/#_ftn6

effect.[19] Even while the purpose might be used to support a position, the nature of duties can only be evaluated in connection to the applicable law. Since the statutes make no mention of such a requirement, financial institutions (FIs) cannot be forced to make a contribution because there is no provision for this in the statutes.

It is also possible to claim that in line with Regulation 39B of the CIRP Regulations, the CoC is required to pay contributions in a manner that is consistent with the permitted plan. Once the CoC and the adjudication body have given their stamp of approval to the contribution plan, it will be considered a contract, at which point the parties will be legally obligated to adhere to the provisions of the contract. It should be noted that compliance with Regulation 2A does not imply the existence of a contract, an agreement, or even a promise on the part of the FIs to cover some of the costs. On the other hand, the fact that a contribution plan was shot down during CIRP suggests that financial creditors, and particularly FIs, are not eager to pay in any way to the deficit. Because of this, it is impossible to coerce the FIs into making a payment when there is no underlying agreement. Because a rule is the root cause of the contribution problem in this scenario, it is imperative that this aspect be taken into account.

Therefore, it is not carried out in accordance with a Rule and it is not a part of the primary law that the Parliament has passed. According to Section 196 of the Code, the Insolvency and Bankruptcy Board of India has the authority to establish regulations. The primary purpose for which regulations are drafted is to supplement the primary law, which in this instance is the Code. As a result, the Code is inextricably linked to the Liquidation Regulations at all times. This indicates that it is exceeding the scope of its jurisdiction if it were to impose a duty or obligation on the creditors when the Code does not do so.[20]

Additionally, requiring creditors to pay expenses in cases where no money can be recovered is equivalent to stealing the debtor's property, and no obligation can be placed on a person without the authorization of a legislation established by the legislature. As a direct consequence of this, Regulations 2A cannot be utilised to force creditors to pay for liquidation expenses. One must be aware of the fact that when the call for contributions was made, the FIs were anticipated to contribute additional "good money" in order to compensate for their "bad money." In addition, in spite of such a payment, there is neither an assurance nor a guarantee that the FIs would collect their bad debt. If the profits from the sale of assets are inadequate to cover the costs of liquidation, lenders may also risk losing all of their debt while still being required to make payments on it. This situation arises if the proceeds from the sale of assets are insufficient to cover the costs of liquidation.[21]

The commercial viability of investing new funds in the corporate debtor can be determined by the FIs based on a variety of factors, including the risks involved in relation to their risk appetite, the amount of the contribution, the expected realisation from the assets, and their position in the waterfall. Given that the FIs may be secured or unsecured, the commercial viability of investing new funds in the corporate debtor can vary. However, despite the fact that it is common practise for financial institutions to require collateral in exchange for the payment of loans, this is not always the case. As a consequence of this, the interest would be unbalanced if the FIs were an unsecured creditor. Even while the contribution of the unsecured financial institution would make the process of realising the assets easier, the unsecured FI would have very little prospect of recovering its own debt because of the lower

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[19] Jha, Vijay Shekhar. "Problems of NPA in Banking Sector in India & Debt Recovery Remedies." *Available at SSRN 3380757* (2018).
[20] Supra Note 9.
[21] Id.

priority it enjoys under section 53 of the Code. Because of this, requiring the unsecured FI to pay would be a liability because it would force the unsecured FI to "sow" money yet "reap" nothing in exchange for their financial investment.[22] Therefore, if Nelson were to demand that all FIs pay mandatory contributions, he would only be concentrating on the challenges that were discussed in the previous section. Despite the fact that this is true, there is still a deficiency that must be paid for before the process of liquidation can proceed any further. If the FIs took the decision to not make contributions, what other options do we have available to us as an alternative course of action?

CHALLENGES AND ALTERNATIVES TO MANDATORY FINANCIAL INSTITUTION CONTRIBUTIONS

Before moving on to anything else, it is vital to make it very clear that the question that needs to be answered right now is whether or not mandatory FI contributions ought to be paid. The author does not have a problem with the idea of making donations; nonetheless, she is of the opinion that the amount should be left up to the discretion of the various financial institutions. As a result, it would be irresponsible to presume that there won't be any kind of donation in any way whatsoever. It is possible that the gap could be closed by making the same payment if doing so seems acceptable in light of the FIs. This is something that has the potential to happen. This is an issue that needs to be taken into consideration. But in the case that no one makes a contribution, what other options does the liquidator have available to them? Both of these options are available to you. Accordingly, one of the potential approaches would be to make a request for aid and support from the Insolvency and Bankruptcy Fund of India in accordance with section 224 of the Code. This would be one of the ways to go about things. On the other hand, up to such time as it becomes operational, there is the possibility of filing an application with the adjudicating body in order to seek appropriate instructions. It is possible for the adjudicating body to direct the financial creditors to contribute towards the cost of the liquidation if they judge it to be acceptable to do so. However, there is still the opportunity to do so until such time as it becomes active. To further emphasise this point, the idea of obligating financial creditors to make a payment is not only unethical, but it should also be left up to the decision of the creditors themselves.

CONCLUSION

This research paper examines the efficacy and obstacles associated with the Insolvency and Bankruptcy Fund (IBC Fund) in accordance with Indian legislation. The IBC Fund, which was instituted pursuant to Section 224 of the Code, endeavours to streamline the procedures for insolvency resolution, liquidation, and bankruptcy. Nevertheless, there exist various constraints that impede its efficacy. The limited scope of activities and dependence on voluntary donations of the Fund curtails its potential impact. The article proposes that a revision of Section 224 is necessary to establish a comprehensive framework for the allocation and utilization of the IBC Fund. The study additionally underscores the difficulties associated with addressing shortfalls in the liquidation reserve and the absence of a mandate for financial entities to make contributions. Although compulsory contributions may not be viable, investigating substitute possibilities and delegating the level of contributions to the discretion of financial institutions may assist in closing the financing deficit. In general, additional

[22] Dr. Binoy J. Kattadiyil, Pandemic Priorities: Increased Insolvency Threshold and its Economic Impact International Journal Of Multidisciplinary educational research ISSN:2277-7881; IC Value:5.16; ISI Value:2.286 Peer Reviewed: Volume:9, Issue:5 (7), May:2020

reforms and deliberations are necessary to augment the efficacy of the IBC Fund in facilitating insolvency and bankruptcy proceedings within India.