



INSOLVENCY LAWS IN SOUTH ASIA: RECENT TRENDS AND DEVELOPMENTS

by Sumant Batra

**Meeting held on
27-28 April 2006**

This document reproduces a report by Mr. Sumant Batra written after the Fifth Forum for Asian Insolvency Reform (FAIR) which was held on 27-28 April 2006 in Beijing, China. It will form part of the forthcoming publication “Legal & Institutional Reforms of Asian Insolvency Systems”.

CORPORATE AFFAIRS DIVISION, DIRECTORATE FOR FINANCIAL AND ENTERPRISE
AFFAIRS
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
2 RUE ANDRÉ-PASCAL, PARIS 75116, FRANCE
[HTTP://WWW.OECD.ORG/DAF/CORPORATE-AFFAIRS/](http://www.oecd.org/daf/corporate-affairs/)

INSOLVENCY LAWS IN SOUTH ASIA: RECENT TRENDS AND DEVELOPMENTS

by Sumant Batra

South Asia is a multiracial and multilingual region, and the economic and legal systems of its countries reflect the customs of its various communities. Expanding at a rate in excess of 8% a year, the Indian economy is one of the fastest growing economies not only in the region but in the world. Constantly striving to raise the annual growth rate to 8-10%, the political leadership is taking steps to simplify tedious regulations and procedures, rationalise policies, and introduce an effective legal and regulatory framework in all sectors. In Sri Lanka, the breakdown of the cease-fire between the government and the Liberation Tigers of Tamil Elam continues to haunt the economy. Due to the cease-fire, Sri Lanka's economy grew at a rate of 6% of gross domestic product (GDP) in 2005. Sri Lanka continues to make steady progress in financial sector reforms, as well as in improving the efficiency of the banking sector. In Nepal, the Maoist insurgency brought the economic and financial system to a near state of collapse. The economic future of the country remains uncertain until a long-term political solution is achieved. Recent positive political developments have raised hopes of economic stability. A number of significant ordinances were issued in the last three years to introduce new laws or amend the existing as part of legal, judicial and financial sector reforms. These ordinances would require approval of the new parliament. Pakistan and Bangladesh continue to take measures to strengthen their financial and legal systems as part of their overall economic stabilisation programmes. Both countries have enacted copious legislation concerning the financial sector since 1990.

The legal and financial systems in the region have undergone significant transformation over the last two decades. Various reforms have been initiated aimed at promoting an efficient, well-diversified and competitive financial system with the ultimate objective of improving the allocative

efficiency of resources so as to accelerate economic development. Exceptions are India and Nepal where insolvency law reforms have not received the required attention and priority. Sri Lanka recently asked the World Bank to assess its insolvency system. The assessment report is expected to place insolvency reforms on the agenda.

1) Legal systems

Common law systems predominate in the countries in the region. The legal system of Nepal also has some elements of the continental legal system. Though the common law system of Sri Lanka is derived from English law, the Roman Dutch laws remain the residuary or the common law of Sri Lanka (Table 1).

Table 1: Legal systems and influence

	India	Pakistan	Sri Lanka	Bangladesh	Nepal
Legal System	Common Law	Common Law	Common Law	Common Law	Common Law
Influence	British	British	Roman Dutch	British	Continental

Sri Lanka has a fairly well-developed legal and judicial system. In some areas of the financial sector, its legal framework is rather modern and sophisticated. Over the past twenty years, the legal framework has been regularly updated, and a host of new amendments have been passed. Though this framework provides an adequate foundation for a modern financial system, it suffers from a number of weaknesses affecting most developing countries such as antiquated concepts, absence of laws for new developments, and unconsolidated and overlapping laws. Piecemeal amendments over many years have led to inconsistencies in laws that make enforcement difficult. However, Sri Lanka started a process of consolidation and simplification two years ago by appointing special committees to look into the matter.

The legal system of Bangladesh has also witnessed reforms. The most significant step taken by the government is the enactment of the new Artha Rin Adalat Act of 2003, which sets up separate courts for the speedy recovery of defaulted loans. The Bankruptcy Act was enacted in 1997 to

deal with cases of large loan defaults. In Pakistan, the legal environment is uniquely complex owing to the imbalance between creditor and debtor rights. The creditor-friendly laws have impacted the financial landscape, particularly the investment climate in Pakistan. Some laws are regarded as being overly punitive to debtors and as having frustrated attempts at restructuring. The National Accountability Ordinance of 1999 led to the creation of the National Accountability Bureau, permitted the presumption of guilt, and shifted the burden of proof to the accused. The target of this law was corruption in all its forms including non-payment or delayed payment of bank debt. It was clearly drafted in haste and was seriously flawed.¹ For borrowers, a new legal term/concept was introduced whereby any default to any government institution (even on a utility bill) of more than 30 days was defined as “wilful default”. Wilful defaulters were exposed to imprisonment, barred from holding any public office and put on the Exit Control List that barred them from foreign travel. Despite problems and difficulties, it is fair to state that a lot of progress has been made to improve the health and soundness of the financial sector in Pakistan in recent years. Although a few weak and vulnerable institutions remain in the banking sector and much more needs to be done, Pakistan is much stronger today compared to five years ago. There has been a strict monitoring and reduction of non-performing loans through the active involvement of the Corporate Industrial Restructuring Corporation and the Committee of Revival of Sick Units.

Largely influenced by common law, Nepal’s legal system was recently updated through the introduction of various laws. The Constitution of Nepal (1990) is the supreme law. The Muluki Ain (the Country Code, codified in 1853 and replaced in 1963), is the general law of the country and includes substantive and procedural provisions for criminal and civil matters. The process of introducing commercial laws into the legal system was started in the mid-1980s, and a number of new laws were introduced in the last decade. However, several laws affecting the corporate and private sectors were promulgated only recently. These laws include the Banking and Financial Institutions Ordinance 2004, the Secured Transactions Ordinance 2005, the Insolvency Ordinance 2005, the Companies Ordinance 2005, and the Securities Ordinance 2005. A few others such as the Asset Management Company Ordinance, the Company Ordinance, the Fiscal Transparency Ordinance and the Anti-Money Laundering Ordinance are under active consideration by the government.

¹ Ali Shaikh, Salman (2003), “Value Maximisation of Non-Performing Loans and Distressed Assets: Pakistan’s Experience”, Third Forum for Asian Insolvency Reform (FAIR).

India has undertaken significant legal reforms over the last two decades. In December 2002, the Indian parliament passed the Companies (Second Amendment) Act, 2002 (Second Amendment) to significantly restructure the Companies Act, 1956 (1956 Act) leading to a new regime that tackles corporate rescue and insolvency. The provisions of the Second Amendment are, however, yet to be notified. The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), which presently deals with the revival and rehabilitation of companies, was repealed by passage of the Sick Industrial Companies (Special Provisions) Repeal Bill, 2001 by the parliament. It too, is yet to be notified. Till then, the Board for Industrial and Financial Reconstruction (BIFR) set up under SICA continues to deal with revival and rehabilitation of companies, and the high court retains its jurisdiction as the liquidation court under the 1956 Act. In the same month of 2002, the Indian parliament passed further significant legislation. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFESI) regulates, for the first time, the securitisation and reconstruction of financial assets. SARFESI also deals with the enforcement of secured interests by secured creditors without the intervention of the court. In 2004, the government of India set up a High Level Expert Committee (the Dr. J.J. Irani Committee) to recommend, among other things, insolvency reforms. These are discussed later in this paper.

Globalisation and the opening of trade have led countries to consider adopting model laws and laws that come from fundamentally different legal jurisdictions. Today, the influence of a number of legal systems is visible in the region.

2) The legal framework for corporate insolvency

In all South Asian countries (except Nepal), the legal framework for corporate insolvency is provided under the company law, which deals with the winding up of companies. Nepal recently enacted the Insolvency Ordinance, 2005 (Insolvency Ordinance), which contains both the corporate insolvency and the rehabilitation framework. Except for Sri Lanka, where an official receiver is appointed from a panel of accountants to carry out the liquidation, in all other countries the liquidation is carried out by government liquidators. Although Nepal has notified the Insolvency Ordinance, it is yet to become operational. At present, the Office of the Company Registrar (OCR) conducts liquidations under the Companies Act, 1997 (Table 2).

Table 2: Governing laws

	India	Pakistan	Nepal	Bangladesh	Sri Lanka
Law of Liquidation	Companies Act of 1956	Companies Ordinance of 1984	Insolvency Ordinance of 2005*	Companies Act (Bangladesh) of 1994 Bankruptcy Act of 1997	Companies Act of 1982
Law of Rehabilitation	SICA Composition and Scheme of Arrangement under the Companies Act of 1956	Under Part IX of the Companies Ordinance of 1984	Insolvency Ordinance of 2005	No Law Composition and Scheme of Arrangement under the Companies Act	No Law Composition and Scheme of Arrangement under the Companies Act

*Although notified, the Insolvency Ordinance is yet to become operative. Until it does, corporate insolvency is carried out under the Companies Act 2053 (1997).

In all countries (excepting India), the legal framework for commercial insolvency provides only for liquidation; there are no provisions in the laws for reorganisation of businesses or companies. In Nepal, the Insolvency Ordinance, that was recently notified, introduces a statutory framework for insolvency for the first time. The Insolvency Ordinance is yet to become operative. Nepal does not currently have a law on the rehabilitation of companies in effect. In Pakistan, an informal process of rehabilitation exists. The informal system does not meet the established standards of informal out-of-court workouts.

3) Liquidation of companies

The winding up of companies in all countries in the region is outdated and inefficient. The liquidation of companies is a long drawn-out affair with no significant return from assets to the stakeholders (Table 3). It takes years to obtain statements of affairs, books of account, realisation of debts and sales of assets, distribution of assets to creditors, etc. before a company is finally dissolved with the sanction of the court. In the process, substantial

corporate assets remain unrealised and undistributed. The inordinate delay in proceedings mars the potential for the productive and rapid use of dormant assets throughout the country. The key features of a sound insolvency system are absent, and no material aspects of the law and process are observed. The law does respond to the needs of modern industry. The process of seizure of assets is cumbersome. The absence of effective tools and instruments to supervise and manage the insolvency process renders the liquidation process an insignificant part of market dynamics.

Table 3: Timing, cost and recovery rate of proceedings

Country	Time (years)	Cost (% of Estate)	Recovery Rate (cents/dollar)
Bangladesh	4.0	8.0	24.9
India	10.0	9.0	13.0
Nepal	5.0	9.0	24.5
Pakistan	2.8	4.0	39.9
Sri Lanka	2.2	18.0	35.6

Source: Doing Business 2005, World Bank

Except in India, very few cases of winding up are filed due to the inefficiency of the system. On the whole, liquidation regimes in the region are crying for reform. The regional average is far below that of OECD countries (Table 4).

Table 4: Efficiency of liquidation regimes

Indicator	Regional Average	OECD Average
Time (years)	5.2	1.7
Cost (percent of estate)	8.3	6.8
Recovery rate (cents on the dollar)	21.4	72.1

Source: Doing Business 2005, World Bank.

The liquidation laws of the countries in the region are quite similar. A company can be wound up for several reasons. These include failure to deliver statutory reports to the registrar, holding a statutory meeting, or commencing business within a year of the company's incorporation. Other reasons include: suspension of business for one year; reduction of the number of members below the statutory requirement; when the court views it just and equitable to wind up a company; non payment of debt; inability to satisfy a judgment, and so on and so forth. The commencement process is satisfactory but the minimum amount to trigger a winding up can be as small as INR 500 (Indian rupees) (approximately USD 5 (United States dollars)) in India and Sri Lanka.

All property and effects of the company are deemed to be in the custody of the court as from the date of the order for winding up of the company. The official liquidator is required to take all property that belongs or appears to belong to the company into his custody or control. All present or past members of the management, officers and agents of the company are required to hand over to the liquidator all properties, books and papers of the company. The liquidators are entitled to official aid for recovering possession or control of property of the company. The liquidator has to maintain proper accounts regarding receipts and payments, and furnish them to the court at least twice a year. The liquidators are government officials, except in Sri Lanka where the official receiver is appointed out of a panel of accountants. The government officials acting as liquidators have added to the inefficiency of the process for various reasons discussed later in this paper.

Unless the court orders otherwise, any transfer of property or delivery of goods made by the company (except in the ordinary course of business or in favour of the acquirer in good faith and for valuable consideration) shall be void if made within one year prior to commencement of winding up. The liquidator may disclaim, with leave of the court, any land burdened with onerous covenants, shares and unprofitable contracts, or property not readily saleable, within 12 months after the commencement of winding up or an extended period allowed by the court. The liquidator has the power to sell all properties whether tangible or intangible belonging to the company by public auction or by private contract, by sanction of the court or a committee of inspection.

All debts, including debts payable on contingency, and all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages, are admissible to proof. Claims may be classified as those that are entitled to preferential payments and those that

fall in the residuary class. Claims entitled to preferential payment are settled before dividends may become available for others. In Pakistan, as far as secured creditors are concerned, they are entitled to enforce their security by joining the winding up proceedings. The proceeds of such security, to the extent of the secured debt, are exclusively available for the secured creditors and cannot be reached by the liquidator. Other creditors are required to lodge their claims with the liquidator and furnish proof of their debts. They are not allowed by the court to pursue law suits.

When a liquidator is appointed, the board of directors of the company ceases to hold office. Unless required to continue the business of the company, the liquidator terminates the employment of all officers. They are also required to furnish a detailed statement of affairs to the official liquidator regarding the assets, debts and liabilities of the company, its properties and all its affairs. They are also bound to hand over all property of the company to the liquidator.

Once a winding up order for a company has been passed, no suit or other legal proceedings may be proceeded with or commenced by or against that company except with the leave of, and subject to any terms imposed by, the court responsible for the winding up. In Sri Lanka, a winding up order does not automatically stay the *parate* proceedings. In India, proceedings under the Recovery of Debts due to Banks and Financial Institutions Act, 1993 are exempt from stay against secured creditors in the event of a pending liquidation.

A debtor can commence winding up proceedings by presenting a voluntary winding-up petition. A voluntary winding-up takes place when: a) the company passes a resolution in its general meeting to that effect; b) the company resolves by special resolution that it be wound up voluntarily; or c) when the company resolves by extraordinary resolution that it cannot, by reason of liabilities, continue its business and that it is advisable to wind it up. A voluntary winding up process is expeditious as it receives co-operation from the debtor. Generally, companies that do not have many creditors resort to voluntary winding up.

The asset seizure process is cumbersome in the region. The sale is carried out by public auction and usually attracts significantly lower values than it would if the business were sold as a going concern.

4) The rehabilitation of companies

India is the only country in the region that has a formal law for rehabilitation of company's *viz.* SICA enacted in 1985. Nepal introduced the law of restructuring of companies recently by way of its Insolvency

Ordinance which is yet to become operational. The SICA is predominantly remedial and ameliorative in so far as it empowers the BIFR, a quasi-judicial body, to take appropriate measures for the revival and rehabilitation of potentially viable sick industrial companies, and for the liquidation of unviable companies.

The SICA requires that, when an industrial company becomes sick, the board of directors make a reference to the BIFR to determine what measures need to be adopted within sixty days from the date of finalisation of the duly-audited accounts of the company for the financial year in which it became sick. No reference can be filed by a company where the assets of the company have been acquired by an asset reconstruction company. Further, a pending reference before BIFR shall abate if 75 percent of secured creditors initiate action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Act, 2003 (SARFESI). The reference filed by a sick industrial company or by any of the parties prescribed under SICA is registered and placed before the BIFR for consideration.

The BIFR may make inquiries as it deems fit for determining whether the company has become a sick industrial company. If the BIFR deems it necessary or expedient for the expeditious disposal of an inquiry, it may appoint any Operating Agency (OA) to enquire into and make a report with respect to matters specified in that order. If the BIFR comes to the conclusion that the company is not a sick industrial company, it shall reject the reference. If on making an inquiry, the BIFR is satisfied that the company is sick, it shall decide whether it is practicable for the company to make its net worth exceed the accumulated losses within a reasonable time on its own, and shall give the company, directions as it may deem fit to make its net worth exceed the accumulated losses.

If the BIFR decides that it is not practicable for a sick company to make its net worth exceed the accumulated losses within a reasonable time, and it is necessary in the public interest to adopt remedial measures, it may direct any OA to prepare a scheme with measures as it considers necessary from out of the parameters laid down under the act. The OA prepares, if possible, a scheme providing, among other things, for any one or more of the following measures: the financial reconstruction of the sick company by change in or takeover of management; the amalgamation of the company with another company; the sale or lease of a part or whole of the sick company; the rationalisation of managerial personnel; incidental, consequential or supplemental measures as may be necessary; change in the board of directors; etc.

The OA assists the BIFR in the discharge of its functions. Generally, the BIFR appoints a financial institution or bank on its panel to act as the OA.

The role and responsibility of the OA is to prepare, if possible, a scheme for the rehabilitation of the sick industrial company in accordance with the guidelines set out by the BIFR. Where the scheme prepared by the OA relates to preventive, ameliorative, remedial and other measures, it may provide for financial assistance by way of loans, advances, guarantees, relief, concessions, or sacrifices from the central government, state government, any scheduled or other bank, a public financial institution or state level institution, or any institution or other authority. Every scheme must be circulated to the institutions that are to provide financial assistance for consent, and must be received within sixty days from the date of circulation. If no consent is received, it is deemed that consent has been given, the BIFR shall sanction the scheme, and the scheme shall be binding on all concerned. If the consent is not given, the BIFR may adopt other measures, including the winding up of the company, as it deems fit.

When the BIFR comes to the conclusion that it is not possible to revive the company, and that it is just and equitable that the company be wound up, it shall record and forward its opinion to the concerned high court. The high court, on the basis of this opinion, may order the winding up of the company, and may proceed and cause to proceed with the winding up of the company in accordance with the provisions of the Companies Act, 1956.

The provisions of SICA have been abused by errant debtors to seek protection and moratoria from recovery proceedings. Unscrupulous promoters are easily able to enter into the reference (sometimes by manipulating their accounts to reflect erosions of net worth), and are then able to achieve immunity against recovery actions by creditors. They then attempt to perpetuate that benefit. If the reference is rejected, a fresh reference is filed with respect to the accounts for the next year and the cycle goes on endlessly. Under SICA, an automatic stay operates against all kinds of recovery and distress proceedings against all creditors once the reference filed by the company is registered. This is the principal drawback of the existing legislation as this has led to the BIFR becoming a haven for defaulting companies. There is no fear of reprisal or punitive action against companies indulging in this malpractice.

There are inherent procedural and legal delays in proceedings before the BIFR. Sometimes, the BIFR takes nearly a full year to determine whether a company is sick. Time taken for preparing and sanctioning a scheme can run between three to four years. There is a lack of co-ordination between banks, and between banks and financial institutions, and often the whole process is held up due to the adamantness of one party, thus delaying the rehabilitation process. By the time decisions are taken and communicated, the plan has lost its viability, which results in the failure of revival schemes even after sanction. A need has long been felt for reform of this law.

In Sri Lanka, Pakistan and Bangladesh there are some provisions for compromise and schemes of arrangement under companies acts, but they are neither directed at nor facilitate the rehabilitation of companies. Creditors do not use their provisions for restructuring debts or settling dues with debtors. A compromise or arrangement can be proposed between a company and its creditors, or between the company and its members, or between the company and both its creditors and members. If a majority, representing three-fourths of the value of the creditors or members, agrees to a compromise or arrangement, the compromise or arrangement will, if sanctioned by the court, be binding on creditors, the members, and the liquidator. A court order sanctioning the compromise or arrangement is only effective once it is registered with the Registrar of Companies. Efforts to restructure banks have been made by adopting special initiatives from time to time.

In Pakistan, in cases of companies, schemes for rehabilitation are governed by Part-IX of the Companies Ordinance. If a scheme of compromise proposed by creditors is approved in the prescribed manner by the requisite majority of creditors and also by the court (after a hearing given to all who might be affected), the scheme becomes binding on all creditors, subject to adjustments as might be made by the high court. Such schemes may result in moratoria, extensions in time for payment of the debt, restructuring of the debt, or even a composition where a part of the debt may be written off. Unlike liquidation, which is aimed at settling claims in an organised manner and then dissolution of the company, a scheme of compromise ordinarily aims at continuing the operations of the company so that it can discharge its obligations as a going concern subject to the terms imposed by the scheme. In case of individuals, a composition and scheme of arrangement may be proposed by a debtor after he has been adjudged to be insolvent. After the scheme is approved, the court may grant a discharge to the debtor with the result that pre-petition debts are paid according to the scheme. The discharged bankrupt may start a new life thereafter, subject to whatever conditions might be imposed by the scheme.

Where a compromise or rehabilitation/reorganisation scheme is proposed between the company or creditors, or any class of them, an application may be moved by the company or any creditor requesting that the court order a meeting of all the creditors or class of creditors for their consent. If a majority of members representing three-fourths in value of the creditors or class of creditors present and voting in person or by proxy at the meeting agree to any compromise or arrangement, the same may be sanctioned by the court and become binding on all creditors or class of creditors and also on the company. If the company was in the process of being wound up, then the petition can also be moved by the liquidator.

There is little use of the provisions for arrangements and amalgamations to rescue businesses and undertake restructurings. Under the insolvency law and related procedures, there is little opportunity to preserve the business as a going concern to maximise value and enhance recovery for creditors. Generally, compromises and arrangements are used mainly for mergers and acquisitions, and not for restructurings. The availability of a restructuring law provides an option for banks to explore in the turnaround of businesses that face difficulties. A successful restructuring can result in assets remaining a part of the economic system compared to *parate* powers in Sri Lanka and India. Restructuring enhances returns on assets; there is, therefore, a need for a restructuring law.

In Pakistan, the Corporate Industrial Restructuring Corporation (CIRC), an asset management company, was created in September 2000 under broad legislation. It is a public sector corporation mandated by its enabling law “to make provisions for the acquisitions, restructuring, rehabilitation, management, disposition and realisation of non-performing loans” of public sector banks and financial institutions, *i.e.* the whole spectrum from rehabilitation to liquidation. All public sector financial institutions were required to offer their non-performing loans to CIRC. The rights to choose (cherry pick) which non-performing loans were acquired by CIRC and which ones “returned” to the parent bank(s) rested with CIRC. CIRC failed to develop the internal capacity to perform any role other than auctioning the non-performing loans it acquired. Secondly, by acquiring assets at a purchase price that was well below the forced sale values established by the banks themselves, the organisation had a negative effect on the secondary market price of industrial assets. Thirdly, the pricing methodology resulted in a situation whereby the asset management company generated a large profit on asset sales and left the parent bank(s) with a write-off which was larger than had CIRC not been created. Consequently, the combined failure of CIRC and the National Accountability Bureau forced regulators to revamp their whole strategy.²

The Committee of Revival of Sick Units (CIRSU) was created through a notification of Pakistan’s Ministry of Finance in May 2000. This body does not, therefore, operate under an enabling law. CIRSU comprises representatives from the large public sector financial institutions and senior industrialists. At the time of its creation three years ago, Pakistan’s economy was very fragile. The design objective was to create an entity that would probe the root causes of industrial sickness and come up with long-term solutions for sustainable growth in the major industrial clusters and

² *Ibid.*

segments. In practice, CIRSU chose to act as an “arbitration window” on non-performing loans between banks and borrowers. Periodic meetings are held in which very basic data is considered. In terms of actual revival, defined as a closed unit coming back into production, data is not maintained by CIRSU.

The concept of restructuring was introduced in the insolvency framework of Nepal for the first time through its Insolvency Ordinance. Till now, the insolvency regime of Nepal remained confined to liquidation. The Insolvency Ordinance provides the court with the power to explore the possibilities of restructuring at the time of considering the insolvency order. In case the court orders the reorganisation of a company, the reorganisation manager must prepare a reorganisation programme for the company. The reorganisation programme must include the schemes: to amortise the debts of the company and change the structure of its capital; sell any portion of the assets of the company and settle the claims of the creditors; effect a change in the nature of the claims of the creditors of the company and issue securities in consideration thereof; issue shares to the creditors of the company in consideration of their claims and thus enlist their participation in the capital investment; amalgamate the company with another company; change the management of the company; or take any other necessary action deemed appropriate by the court to reorganise the company.

The Insolvency Ordinance requires the reorganisation manager to invite claims along with evidence from creditors. Every secured or unsecured creditor having a debt claim against the company must submit the details of his claim along with evidence to substantiate it. The reorganisation manager shall convene a meeting of the creditors. The creditors’ meeting shall discuss the reorganisation programme presented by the reorganisation manager and adopt a resolution on any of the issues with or without any amendment, or liquidate the company immediately by not agreeing to the resolution.

5) The regulatory framework

An efficient insolvency system requires the bodies responsible for regulating or supervising insolvency administrators to be independent of individual administrators. They should set standards that reflect the requirements of legislation and public expectations of fairness, impartiality, transparency and accountability. Insolvency administrators should be competent to exercise the powers given to them and should act with integrity, impartiality and independence.

The regulatory framework for insolvency in the region is weak and bureaucratic. Since the liquidators are government officials, they are regulated by standard service regulations applicable to government employees. The supervisory role is left to the courts, which oversee the liquidation process. The registrar of companies has a limited supervisory role over liquidators (Table 5).

In Sri Lanka, no developed regulatory framework is available, nor is there a supervisory body responsible for regulating the conduct of official receivers and liquidators. This role is left to the courts, which oversee the liquidation process. The registrar of companies has some control over the liquidator. The liquidator is required to submit audited accounts to the registrar of companies. The registrar can monitor the liquidator and, where a liquidator does not perform his duties and duly observe the requirements imposed on him, or if any complaint is made to the registrar by any creditor or contributory, the registrar can inquire into the matter and, if necessary, report to the court under Section 282 of the Companies Act. The liquidator can obtain release from the court only if he satisfies the court by filing a final report confirming the disposal of assets, distribution of sales proceeds and the status of settled and unsettled claims.

The office of the Registrar of Companies lacks the capacity to administer the official receivers and the liquidation process. They are not exposed to any education and training and are not schooled in best practices. However, their integrity, impartiality and independence are not in doubt. There is a need to create a specialised insolvency administration office that would be responsible for administering the liquidation process and overseeing the liquidator's functions.

Nepal's Insolvency Ordinance provides for the establishment of the Insolvency Administration Office (IAO) to: register insolvency practitioners; issue and renew licenses; subject the management of insolvent companies to general supervision; investigate the official code of conduct to be complied with by insolvency practitioners; keep records of all insolvent companies; and discharge such other functions as are prescribed. The Insolvency Ordinance enables the government to designate any of its offices to work as the IAO until such time as the IAO is established. To date, the IAO has not been established nor has any substitute office been designated.

There was no regulatory framework under the Companies Act of 1997, and no one supervised liquidators except the Office of the Company Registrar, which did not have the capacity to discharge that function efficiently. The IAO could, when established, perform a very important role regulating and supervising insolvency practitioners. It is desirable that such an institution be established at the earliest. It should function independently

and be administered by persons with appropriate qualifications and knowledge. Such persons should be independent and of known integrity, and should be trained adequately from the beginning of their appointment and on an ongoing basis.

Table 5: Supervision of liquidators

India	Pakistan	Nepal	Bangladesh	Sri Lanka
Ministry of Company Affairs	No specific regulatory authority	Office of the Company Registrar (OCR)	No specific regulatory authority	Regulatory powers only with the court No other regulatory framework

India, Pakistan and Bangladesh face similar problems and challenges in the area of regulation, which rests with the respective concerned ministries. The government staff is neither adequately qualified nor trained to regulate the sophisticated insolvency process. Part of regulation is done by courts such as in India where every high court has an official liquidator attached to it. The performance standards of the regulating body have not been satisfactory, given the level of inefficiency and the lack of performance by the department of liquidators. There is a significant backlog of cases which hampers the quick and effective resolution of sick industrial companies.

Building an efficient insolvency framework can enhance the value of the insolvency process and make it meaningful for stakeholders. A regulatory framework that would provide credible oversight of insolvency practice needs to be established. This would also ensure that receivers, administrators and insolvency practitioners are competent, duly licensed and supervised, and that minimum standards of practice and expertise are maintained. Further, the regulators also need systematic and ongoing training in the area of insolvency.

6) The role of the judiciary

The judiciary is held in high esteem in the region, and is an important part of each country's internal structure. But, judicial procedures suffer from common weaknesses, such as: a lack of resources and specialisation; lack of

infrastructural and institutional capacity; and inefficient procedures and processes. The judiciary, as an institution, has played a very important role in the development of countries such as India and Sri Lanka as civilised societies that respect the rule of law. It remains largely independent and its integrity is not a matter of debate (though some concern exists in the region regarding political affiliations and the proximity that some judges maintain with the executive and politicians).

The courts perform an important role in the liquidation process (Table 6). Nepal did not provide for a role for courts. Under the Insolvency Ordinance, the commercial courts supervise the liquidation and restructuring process. India is going to experiment with a mix of judges and experts in the NCLT.

Table 6: Courts in the liquidation process

India	Pakistan	Nepal	Bangladesh	Sri Lanka
Designated company court in the high court of every state	High Court	No role of courts*	High Court	District Courts

*After the Insolvency Ordinance becomes operational, the commercial benches designated under the ordinance will supervise insolvency.

Although the lack of resources and infrastructure is a constraint, Sri Lanka has a well-regarded court system. The creation of the Commercial High Court has improved the situation in the area of insolvency law, but delays in the disposal of cases and appeals are common. The judiciary in Sri Lanka is fairly independent and impartial. The judges are held in high esteem in society and are under constant pressure to maintain transparency in imparting justice. Even though judges are highly regarded, the insolvency rules and regulations may not be firm, thus allowing for the potentially unfair exercise of discretion.

There are no specialised bankruptcy courts in Sri Lanka. Under the Companies Act, the district court, within whose jurisdiction the registered office of the company is situated, has the jurisdiction, among other things, to make orders in respect of winding up, amalgamation and compromises. A district court is a court of general jurisdiction, with unlimited civil jurisdiction in all civil, revenue, family, insolvency (of natural persons) and

testamentary matters. The absence of a specialised bankruptcy court and effective tools to supervise and manage the insolvency process makes the whole liquidation process an insignificant part of market dynamics.

Presently, winding up cases are heard by an additional district judge in Colombo, as most winding-up cases take place there. Most of the additional district judges do not have sufficient exposure to commercial law. Lack of facilities and insufficient competent staff affect the insolvency process. No established standards exist for evaluating the performance of the district courts and the judges that supervise the liquidation process. There is a need for training, continuous education and greater interaction of judges with insolvency experts. The quality of judges can be enhanced by providing for transparent, predictable and efficient rules of procedure that leave little room for corruption. The company court rules that govern the liquidation process require review to incorporate modern practices.

In India, there are two separate insolvency courts: the company courts and the BIFR. There are no specialised bankruptcy courts. The company courts are the part of the high court that hears winding up petitions. It is drawn by roster from the judges that make up the full bench of the high court in that state. While high court judges are well regarded and are known to be capable, some are inexperienced in insolvency. This is further complicated by the divergence in procedure between various high courts. SICA provides that the BIFR consist of a chairman, and not less than two, or more than fourteen members. All appointments are made by the central government. The chairman and members of the BIFR are to be drawn from persons of ability, integrity and standing who have special knowledge of and experience in science, technology, economics, banking industry, law, labour matters, industrial finance, management and reconstruction, accountancy or other special knowledge that in the opinion of the central government are useful to the board. In practice, political decisions drive appointments.

Under the Second Amendment, the BIFR would be dissolved and the jurisdiction of the company court transferred to the NCLT. The jurisdiction of high courts in matters pertaining to the Companies Act would also be shifted to the NCLT. The NCLT will have 10 benches across the country and an appeal bench in New Delhi. Any grievance with an appeal bench would have to be addressed to the Supreme Court. The NCLT will have powers and jurisdiction to deal with all the matters relating to the amalgamation, reconstruction, rehabilitation, oppression, mismanagement, revival, and winding up of companies. The proposed NCLT is to be composed of a president and not more than sixty-two judicial and technical members appointed by the central government. The president shall be a person qualified to be high court judge. Judicial members are to be chosen exclusively from persons with a strong legal background. Technical

members are to be chosen from persons with other backgrounds, mostly with strong experience in company law or accounting. As with the BIFR, members can also be chosen, provided their experience and knowledge are, in the opinion of the central government, useful to the tribunal.

Judges in India generally enjoy a high degree of independence. Judges at higher court levels enjoy a reputation that is equal to their peers in the leading developed countries. At lower levels of the judiciary, skills and court practices are wanting, especially in commercial areas. Greater specialisation of judges in commercial matters and insolvency is required. The lack of specialisation is a factor in the lack of uniformity in treatment, and the efficiency and handling of cases, which often leads to long drawn-out procedures that take many years to conclude. The creation of the NCLT will go some way toward redressing the inefficiencies of the existing regime. In commissioning the introduction of a new insolvency regime, administrators have flagged their concerns over the operation of the existing structure and recognised the inefficiencies inherent to a decentralised system of corporate insolvency management. The Second Amendment is, therefore, not a complete solution and has a number of defects.

In Nepal, the Insolvency Ordinance provides for insolvency proceedings to be conducted under the supervision of a commercial bench of courts as may be notified by the government in consultation with the Supreme Court of Nepal. No such notification has been issued to date. Till the promulgation of the Insolvency Ordinance, no role was provided for courts in the liquidation process, which was administered and supervised by the OCR.

The judiciary in Nepal is considered reasonably independent though there is a need to improve its efficiency and capability, particularly in commercial law. This can be achieved by enhancing the quality of judges appointed to the courts, and providing for transparent, predictable and efficient rules of procedure that leave little room for corruption. No established standards exist for evaluating the performance of judges. With the assistance from the Asian Development Bank, a national judicial academy was set up for the education and training of judges. Special training programmes on insolvency laws for court judges designated under the Insolvency Ordinance organised by the National Judicial Academy can assist in building the capacity of judges to deal with complex insolvency issues. There is also a need for judges and units with specific expertise in commercial and financial matters.³

³ World Bank (2005), *Nepal—Legal and Judicial Environment for Financial Sector Development—A Review by the World Bank*.

Prior to the promulgation of the Insolvency Ordinance, the principal participants in liquidation proceedings were the Office of the Company Registrar, liquidators, companies and auditors. There was no role for the courts. Under the outgoing system, there was limited scope and role for supervision by the Office of the Company Registrar. The companies in voluntary liquidation appointed their own liquidator for which no qualification criteria were prescribed. There was no material to judge the integrity of the participants. The process and players were inefficient and unregulated. There were no rules or procedures for conducting liquidation proceedings, and sufficient provisions did not exist to prevent fraud or contain abuse of the system.

The Insolvency Ordinance contains provisions that subject the principal participants to court process and accountability. The court may, (if a complaint is lodged against a licensed insolvency practitioner who fails to act in accordance with the license or the Insolvency Administration Office) report to that effect. The court can suspend or cancel the license after providing an opportunity for defence. The court may issue an order on the following grounds if a license holder: commits any act that is prohibited under the Insolvency Ordinance; carries out the duties negligently or fails to properly carry out duties; becomes bankrupt; or is convicted by a court for an offence of dishonesty or fraud. The court can replace the liquidator, and review the administrator and restructuring managers on the grounds set out under the Insolvency Ordinance.

In Pakistan, the court that administers liquidation is the high court having jurisdiction where the company is registered. The federal government is empowered to confer this jurisdiction on other civil courts as well, but this has not been done. Pakistan has high courts in each of its provinces, namely: Baluchistan, North Western Frontier Province, Sindh and Punjab. The Pakistan high court, though competent and high in its standards, has faced criticism of its independence in some cases. Political interference in the appointment process has raised concern over the continuing influence of the executive over the judiciary.

In general, courts in the region are ill-equipped with material resources. The sheer number of cases before the courts and the cumbersome legislative regime render the system ineffective. Another area of concern in the region includes the lack of independent appointment of judges to forums. The absence of any direct or indirect accountability of these quasi-judicial forums to the people also needs to be addressed. While the high court is generally held in high esteem, and considered impartial and objective, the same is not said of other courts, the lower courts or the tribunals. Written standards, guidelines, advisory opinions, complaint and investigation procedures, and tools to redress improprieties are largely lacking, and it

remains to be seen whether they will be adopted to guide new tribunals such as the NCLT which is being set up in India.

Bankruptcy cases should be overseen and disposed of by an independent court or a competent authority and assigned, where practical, to judges with specialised bankruptcy expertise. Significant benefits can be gained by creating specialised bankruptcy courts. The law should provide for a court or other tribunal to have a general, non-intrusive, supervisory role in the rehabilitation process. The court/tribunal or regulatory authority should be obliged to accept the decision reached by the creditors that a plan be approved or that the debtor be liquidated. Standards should be adopted to measure the competence, performance and services of a bankruptcy court. These standards should serve as a basis for evaluating and improving the courts. They should be enforced by adequate qualification criteria as well as training and continuing education for judges.

Similarly, firm and public rules and regulations, that help to prevent the corruption and undue influence that undermine public confidence in the system, do not exist. As discussed above, the court system is overworked and understaffed. This seems to have led in numerous instances to allegations of less than fair administration of justice. This, coupled with political rather than merit-based judicial appointments, has led to disputes being settled that are not based on a strict interpretation of law.

There are no performance standards that apply to the courts that have jurisdiction over insolvency or bankruptcy. Bankruptcy cases are handled following the general standards applicable to court procedures. There is no requirement for formal or ongoing training, which means that the experience and knowledge of judges in specialist areas can vary immensely. The Second Amendment (India) seeks to improve upon the standards to measure the competence, performance and services of the NCLT by defining necessary qualifications for the appointment of members of the NCLT and a transparent process for selection and appointment. However, the quality and skills of judges (newly appointed or existing), needs to be reinforced by continuing training. No provision has been made for evaluation procedures for judges based on the standards.

There is a clear need to develop and require specialised training in bankruptcy if such cases fall within a judge's competence and jurisdiction. Training should become more systematic and mandatory. Training will be essential in the event of the introduction of new rehabilitation procedures. It would be beneficial if a training manual were developed to assist those dealing with new or novel types of issues and proceedings.

There is also a need to adopt a specialised approach to resolution and disposal of insolvency cases by courts. Legalistic approaches lead to delays

in addition to having an impact on the outcome of proceedings. The supervision of courts should be unobtrusive in nature, confined to setting the roadmap of insolvency, and interjecting only to resolve questions of law. The courts should optimise the use of creditors' committee and professionals in their discharge of various insolvency processes. Questions of law, if raised, should be decided in a timely manner and, unless absolutely necessary, adjournments should be avoided.

An insolvency system should be based on transparency and accountability. Rules should ensure ready access to court records, court hearings, debtor and financial data and other public information. The court should be organised so that all interested parties (including the administrator, the debtor and all creditors) are dealt with fairly, objectively and transparently. To the extent possible, publicly available court operating rules, case practice and case management regulations should govern the court and other participants in the process. The court's internal operations should allocate responsibility and authority to maximise resource use. To the degree feasible, the court should institutionalise, streamline and standardise court practices and procedures. Judicial decision making should encourage consensual resolution among parties where possible, and otherwise undertake timely adjudication of issues with a view to reinforcing the predictability of the system through the consistent application of law. The court must have clear authority and effective methods of enforcing its judgments.

Court operations and decisions should be based on firm rules and regulations to avoid corruption and undue influence. The court must be free of conflicts of interest, bias and lapses in judicial ethics, objectivity and impartiality. Persons involved in a bankruptcy proceeding must be subject to rules and court orders must be designed to prevent fraud, other illegal activity or abuse of the bankruptcy system. In addition, the bankruptcy court must be vested with appropriate powers to deal with illegal activity or abusive conduct that does not constitute criminal activity.

7) The creditors committee

The existing legal framework in the region does not provide for creditors committees. SICA has no provisions for creditors committees. The Insolvency Ordinance in Nepal introduced the concept of a committee of creditors. The Irani Committee has also recommended creditor's committee for the proposed law on the restructuring of companies. In liquidation, there is a committee of inspections in the laws of India, Pakistan, Sri Lanka and Bangladesh (Table 7).

Table 7: Creditors committees

	India	Sri Lanka	Nepal	Pakistan	Bangladesh
Creditors Committee	None. There is a committee of inspections in liquidation which is rarely used.	None. There is a committee of inspections in liquidation which is rarely used.	Yes. 5 member committee. Terms and procedures not provided.	None. There is committee of inspections in liquidation.	None. There is committee of inspections in liquidation.
Secured Creditors	Fairly defined role. Right to initiate proceedings and seek information, in decision making. Needs improvement.	Fairly defined in liquidation law. Needs improvement.	Fairly defined. Needs improvement.	Fairly defined in liquidation law. Needs improvement.	Fairly defined in liquidation law. Needs improvement.
Unsecured Creditors	No right to initiate restructuring or participate under SICA.	No right to initiate restructuring or participate under SICA.	Can initiate proceedings. Role exists.	Can initiate liquidation only. Role insignificant.	None.

In Nepal, the establishment of creditors committees is limited to the liquidation process. The law does not prescribe: its role; the terms of reference; process of appointment; meetings; voting; or removal. Classes of

creditors are not established. The general assembly of creditors has to determine the jurisdiction and other issues at the time the committee is appointed. The committee cannot appoint a chairman of its choice; the liquidator or the restructuring manager, as the case may be, must chair the committee. The committee has to take decisions by simple majority and, in case of a tie, a draw of lots breaks the deadlock. The current provisions leave scope for manipulation, uncertainty and disputes. Provisions do not exist for consultation with the committee on important decisions. The creditors have no role in appointing the investigator, the reorganisation manager or the liquidator. There is no provision for the creditors' committee in reorganisation proceedings.

8) Insolvency professionals

Engagement of experts (insolvency practitioners) in the insolvency process enhances the efficiency of the insolvency system. Insolvency, bankruptcy, receivership, liquidation and voluntary administration can be complex. The absence of the involvement and participation of professionals possessing appropriate knowledge and skills can impact the quality and efficiency of the entire process. Currently, the laws in the region do not support effective participation of professionals and experts in the insolvency process. Government officials are appointed as liquidators in all South Asian countries except Sri Lanka. The laws do not provide the frameworks that recognise the various services that can be provided by professionals. There is no privatisation of any part of the insolvency process. Outsourcing is limited and disorganised. This has contributed to the inefficiency of the rehabilitation and liquidation process. Some progress was made in India with the passing of the Companies (Second Amendment) Act, 2002 (Second Amendment), which provides for the appointment of liquidators from a panel of firms of chartered accountants, cost and works accountants, advocates, company secretaries or others, as may be prescribed. The initiative was considered insufficient. In any case, it remains unimplemented, since the provisions of the Second Amendment were not notified by the government of India.

9) India: The Irani Committee Report: Opportunities for professionals

The constitution of the Dr. J.J. Irani Expert Committee offered a valuable opportunity to re-visit the issue of participation of insolvency professionals in the insolvency process for Indian policy makers. One of the key recommendations that the Irani committee made was to provide a larger

role for and participation of experts and professionals at various stages in the insolvency process. The Irani committee noted and recommended that:

...currently, the law does not support effective participation of professionals and experts in the insolvency process. There is no shortage of quality professionals in India. Disciplines of chartered accountancy, company secretaryship, cost and works accountancy, law etc. can act as feeder streams, providing high quality professionals for this new activity. In fact, private professionals can play a meaningful role in all aspects of process. Insolvency practice can also open up a new field of activity for service professionals while improving the quality of intervention at all levels during rehabilitation/winding up/liquidation proceedings. Law should encourage and recognise the concept of insolvency practitioners (administrators, liquidators, turnaround specialists, valuers etc.). Greater responsibility and authority should be given to insolvency practitioners under the supervision of the tribunal to maximise resource use and application of skills.

The inspiration for this recommendation is drawn from paragraph 394 of the UNCITRAL Legislative Guide on Insolvency which describes the concept of insolvency practitioner as follows:

Insolvency laws refer to the person responsible for administering the insolvency proceedings by a number of different titles, including administrators, trustees, liquidators, supervisors, receivers, curators, official or judicial managers, or commissioners. The insolvency representative may be an individual or, in some jurisdictions, a corporation or other separate legal entity. However appointed the insolvency representative plays a central role in the effective and efficient implementation of the insolvency law, with certain powers over debtors and their assets, a duty to protect those assets and their value, as well as the interests of creditors and employees, and to ensure that the law is applied effectively and impartially. Accordingly it is essential that the insolvency representative be appropriately qualified and possess the knowledge, experience and personal qualities that will ensure not only the effective and efficient conduct of the proceedings but also that there is confidence in the insolvency system.

If the recommendations of the Irani Committee, including those extracted above, meet the favour of policy makers, the Indian insolvency system will undergo a revolutionary change and come to a par with the international benchmark. Professionals will get the opportunity to participate and perform various roles in the insolvency process. They would be able to

be appointed as liquidators, administrators, valuers, turnaround advisors, and supervisors. In addition, they would be able to perform services such as representing and advising creditors committees, individual creditors and other stakeholders, investigators, inspectors, auctioneers, trustees, security advisors, etc.

Nepal has taken a giant leap forward by recognising the concept of insolvency practitioners in its Insolvency Ordinance. The new law provides for licensing of practitioners by the Insolvency Administration Office. Where the liquidation of a company is ordered, the court will appoint an insolvency practitioner as a liquidator, who will take charge of the debtor's management and assets, books and accounts. In restructuring proceedings, the insolvency practitioner also acts as a restructuring manager.

In other South Asian jurisdictions legal reforms are required to provide for the recognition of insolvency practitioners in the framework. Professionals in these countries should engage in a dialogue with policy makers to steer reforms in this area. In Sri Lanka, the Business Recovery and Insolvency Practitioners Association of Sri Lanka (BRIPASL) was established recently and is performing an important role in this direction. Similar initiatives are required in Pakistan and Bangladesh.

The abovementioned situation clearly reflects the growing concern that various Asian jurisdictions share with respect to the need for and importance of a recognised and efficient organisation of insolvency professionals that not only makes insolvency more efficient and expeditious, but also brings the values of the profession to existing insolvency regimes.

The introduction of the concept of insolvency practitioners offers a number of challenges for law makers and professionals. The main challenge is to agree on a suitable framework for insolvency practitioners and address implementation issues. This needs to be done before the law is drafted in India so that the concept is recognised in law and so that certain substantive and fundamental provisions are incorporated. In Nepal, regulations are required to address these issues.

Regulation

Insolvency affects the interests and rights of broad groups: creditors; employees; shareholders; and debtors. There is also a wider public interest in: limiting the damage of insolvency; supporting the efficient reallocation of resources to productive use; containing the risk of systemic failure; preventing misconduct and pursuing it when it occurs; maintaining confidence in the markets; and providing honest debtors the opportunity to start fresh. In the centre of this stands the insolvency practitioner who has

wide powers, duties, responsibilities and functions. This creates the need for a regulatory regime that: requires appropriate qualifications and experience; prescribes codes of professional conduct and ethics covering integrity, impartiality, independence and objectivity; and provides a mechanism for overseeing the performance and conduct of insolvency professional, and for dealing with abuses.

The regulatory framework could be statutory and more formal (as in the case of the other disciplines like advocates, chartered accountants, company secretaries and others). Alternatively, it could be less formal and implemented through a government-recognised self-regulated insolvency practitioners association as is the case in the United Kingdom. The other model is that of Australia where the Insolvency Practitioners Association of Australia (IPAA) and the government of Australia jointly regulate the profession (though the larger role is performed by IPAA). Indian models, like the Institute of Company Secretaries of India (ICSI) and other disciplines, may be worth emulating but would take time to establish if a new law needs to be enacted. The UK model could be ideal for a start. The government should encourage the setting up of an association of insolvency practitioners and provide it recognition.

Most jurisdictions, including the UK and Australia, have adopted licensing regimes. Such a regime is inevitable in India, and professionals should be ready for licensing. The beginning could be made by adopting the process provided in the concept paper and the recommendations of the Irani Committee: the preparation and maintenance of a panel of professionals and experts through an independent process and the appointment out of that by the National Company Law Tribunal (NCLT).

Qualifications: Education, knowledge and experience

The complexity of many insolvency proceedings makes it highly desirable that insolvency practitioners be appropriately qualified with the requisite knowledge of the law. Their knowledge should not only cover insolvency law, but also relevant commercial, finance and business law. Adequate experience in commercial and financial matters is also required. Insolvency practitioners will be required to demonstrate competence in carrying out their assigned functions in a range of different cases and circumstances that: are likely to be contentious; are in both liquidations and reorganisations; where time limits may be imposed; where commercial requirements have to be balanced against legal considerations; and where there is a need to serve the interests of others (such as creditors or the public interest). If further or more specialised knowledge is required in a particular case, it can always be provided by hired experts. Some insolvency laws also

require that a person appointed as an insolvency practitioner in a particular case have expertise and skills suited to that case, and knowledge of the debtor's particular business, its assets and the type of market in which it operates.

The UNCITRAL Guide notes that the qualifications required of a person to be appointed as an insolvency practitioner may vary depending upon the design of the insolvency regime with regard to the role of the insolvency practitioners (including whether the proceedings are liquidations or reorganisations) and the level of supervision of the insolvency practitioners (and of the insolvency proceedings generally) by the court. They may also vary depending upon the procedure for appointment. In determining the qualifications required for appointment as an insolvency practitioner, it is desirable that a balance be achieved between stringent requirements that lead to the appointment of a highly qualified person (which may significantly restrict the pool of professionals considered to be appropriately qualified and add to the costs of the proceedings), and requirements that are too low to guarantee the quality of service required. Where there is a lack of appropriately qualified professionals, the role given to the court in appointing and supervising insolvency practitioners may be an important factor in achieving the required balance.

Different systems adopt different approaches to ensure the appropriate qualification of insolvency practitioners, including: requirements for professional qualifications and examinations; licensing where the licensing system is administered by a government authority or professional body; specialised training courses and certification examinations; and requirements for levels of experience (generally specified in numbers of years) in relevant area (for example, finance, commerce, accounting and law, as well as in the conduct of insolvency proceedings). There may also be requirements for ongoing professional education to ensure familiarity with current developments in law and practice. Those systems that require some form of licensing or professional qualification and membership in professional associations often address issues of supervision and discipline. In addition, an insolvency practitioner may be subject to regulation by the court, a professional association, a corporate regulator or other body under legislation other than the insolvency law.

In addition to having knowledge and experience, it is also desirable that insolvency practitioner possesses certain personal qualities, such as integrity, impartiality and good management skills. Integrity may require that the insolvency practitioners have a sound reputation and no criminal record or record of financial wrongdoing or, in some countries, no previous insolvency or removal from a position of public administration.

Selection and appointment of insolvency practitioners

Whether it is by way of licensing, by panel or any other process, the fundamental prerequisite would be an additional qualification that can form the basis of licensing or empanelment. The Second Amendment leaves a huge gap in this area. While it provides for the creation of a panel from various disciplines, it does not prescribe any criteria to qualify for empanelment. In other words, while advocates, company secretaries and chartered accountants and others would be eligible, there is no basis for allowing or disallowing such a request.

Insolvency laws adopt a number of different approaches to selection and appointment of insolvency practitioners. The UNCITRAL Guide identifies four main selection processes in different country systems.

Insolvency practitioners can be selected from a number of different backgrounds such as from: the ranks of the business community; the employees of a specialised governmental agency; or from a private panel of qualified persons like lawyers, accountants or other professionals. In some jurisdictions, the insolvency law provides that a public official (entitled official trustee, official receiver, official assignee or some other name) will be automatically appointed to all insolvency cases or to certain types of insolvency cases. India follows this process under the Companies Act, 1956. In many countries, insolvency practitioners must be natural persons, but some countries provide that a legal person may also be eligible for appointment, subject to certain requirements such as that the individuals who undertake the work on behalf of the legal person are appropriately qualified and that the legal person itself is subject to regulation.

In many jurisdictions, it is the court that selects, appoints and supervises insolvency practitioners. The selection may be made from a list of appropriately qualified professionals at the discretion of the court. This is what is proposed by the Second Amendment. In some jurisdictions it may be made by reference to a roster, or through a rotation system, or by some other means such as the recommendation of the creditors or the debtor. Roster systems, while ensuring a fair and impartial distribution of cases, may have the disadvantage that they do not ensure the appointment of the most qualified person to conduct a particular case.

In some jurisdictions, a separate office or institution, which is charged with the general regulation of all insolvency practitioners, selects the insolvency practitioners after the court directs it to do so. This approach may have the advantage of allowing the independent appointing authority to draw upon professionals that have the expertise and knowledge to deal with the circumstances of a particular case, including: the nature of the debtor's business or other activities; the type of assets; the market in which the

debtor operates or has operated; the special knowledge required to understand the debtor's affairs; or some other special circumstance. The use of an independent appointing authority will depend upon the existence of an appropriate body or institution that has both the resources and infrastructure necessary to perform the required functions; otherwise, it will require the establishment of an appropriate body or institution.

Another approach allows creditors to play a role in recommending and selecting insolvency practitioners, provided that the selected person meets the qualifications for serving in the specific case. The approaches that rely upon the independent appointing authority and the creditor committee may serve to avoid perceptions of bias and assist in reducing the supervisory burden placed upon the courts. A different approach permits the debtor to appoint the insolvency practitioner in cases where the reorganisation proceedings are commenced by the debtor. This approach allows discussions to take place between the debtor and other parties, such as secured creditors, before commencement of the proceedings to familiarise the prospective representative with the business and to allow the debtor to select the insolvency practitioners that it considers best able to conduct the reorganisation. Concerns may be raised, however, as to the independence of insolvency practitioners. These may be addressed by permitting creditors, under appropriate circumstances, to replace an insolvency practitioners appointed by the debtor.

The Irani Committee proposes a process whereby empanelment is done by an independent body and appointment out of them by the NCLT. It is clear that it is essential to filter the feeder streams so that professionals possessing appropriate skills and knowledge can be appointed to provide the various services needed in the insolvency process. These professionals will be termed insolvency practitioners.

Remuneration

In addition to the reimbursement of expenses incurred in the course of the administration of the estate, insolvency practitioners are entitled to receive remuneration for their services. One of the main concerns that arises is the proper determination of the remuneration of insolvency practitioners. It is necessary that the remuneration be commensurate with the qualifications of the insolvency practitioner and the tasks they are required to perform, and achieve a balance between risk and reward in order to attract appropriately qualified professionals.

The UNCITRAL Guide examines several methods for calculating that remuneration. It notes that remuneration may be fixed: by reference to an approved scale of fees set by a government agency or professional

association; determined by the general body of creditors, the court or some other administrative body or tribunal in a particular case; based upon the time spent by the insolvency practitioner (and the various categories of person who are likely to work on the insolvency administration from office staff through to the principal appointee on administration of the estate); or based upon a percentage of the assets of the estate which are realised or distributed, or a combination of both (calculated at the end of the procedure when the assets have been sold and their value determined).

A time-based method operates in some cases as an incentive to maximise the time spent on administration without necessarily achieving a proportional return of value to the estate. An advantage of the commission system, at least from the creditors' perspective, is that at least some, if not a substantial proportion, of the assets recovered will be distributed to them. From the insolvency practitioner's point of view, however, it may be an uncertain method of calculation because the amount of work involved in an administration is not necessarily proportional to the value of assets available for distribution. It may also encourage an approach of "maximum return for minimum cost" and provide little incentive for undertaking functions that are not directly related to increasing returns to creditors, such as obligations to report to both the court and to creditors, and to assist regulatory authorities with investigations into the debtor's affairs and possible misconduct. This method of calculation may also lead, in large cases, to very large fees being paid out of the estate, which can deter both creditor and debtor applications.

In some countries, creditors play a role in fixing or approving the remuneration, having regard to factors such as the complexity of the case, the nature and degree of the responsibilities of the insolvency practitioners, and the effectiveness with which these have been discharged, as well as the value and nature of the assets of the estate.

Unattractive fees face the risk of discouraging the best talent from offering its services. The experts and the best of the professionals expect appropriate fees for their services. High fees paid to insolvency practitioners have been the subject of criticism and debate. Clearly, guidelines need to be established for remuneration.

In 2004, the United Kingdom took an initiative in this direction by issuing a Policy Statement entitled *The Fixing and Approval of the Remuneration of Appointees*, which sets out the court's approach to, and basis for, determining applications for remuneration. The statement identifies eight guiding principles by which applications are to be considered by the court, and considered by applicants in the preparation and presentation of their applications. These guiding principles are: justification;

benefit of the doubt (against the appointee); professional integrity; value of service rendered; fairness and reasonableness; proportionality; professional guidance; and practicality. Inspiration and guidance can be drawn from the 2004 principles.

Liability

The standard of care to be employed by the insolvency practitioner and its personal liability are important to the conduct of insolvency proceedings. Establishing a measure for the care, diligence and skill with which insolvency practitioners carry out their duties and functions requires that the difficult circumstances in which insolvency practitioners find themselves when fulfilling their duties be taken into account and balanced against payment of an appropriate level of remuneration and the need to attract qualified persons to act as insolvency practitioners. A balance is also desirable between a standard that will ensure competent performance of the duties of the insolvency practitioners and one that is so stringent that it invites lawsuits against insolvency practitioners and raises the costs of their services.

The insolvency law also needs to take into consideration the fact that the liability of insolvency practitioners often involves the application of law outside of insolvency or, where the insolvency practitioner is a member of a professional organisation, the relevant professional standards of the organisation. Under many legal systems, insolvency practitioners are liable in a civil action for damages arising from misfeasance or malfeasance, although different approaches are taken in setting the standard required. To some extent, the measure adopted will depend upon how the insolvency practitioner is appointed and the nature of the appointment (*e.g.* a private practitioner as opposed to a government employee). One approach may be to require insolvency practitioners to observe a standard no more stringent than would be expected to apply to the debtor in undertaking their normal business activities in a state of solvency (that of a prudent person in that position). Some countries, however, may require a higher standard of prudence in such a case because the insolvency practitioner is dealing with assets belonging to another person, and not its own assets. A different formulation is one based upon an expectation that the insolvency practitioner act in good faith for proper purposes. A further approach may be based upon the standard of care required to determine negligence.

One means of addressing the issue of liability for damages may be to require the insolvency practitioner to post a bond or take out insurance to cover the potential loss of assets or damages payable as a result of a breach of duties. A number of insolvency laws require both payment of a bond and

insurance (where the bond will cover one kind of damage and the insurance another), while others require only insurance. In some cases, the level of the bond required relates to the book value of the assets of the insolvency estate. In others, both the value of the bond and the amount of insurance cover required are established in the rules of the relevant professional association or regulatory body, or even in the insolvency law. A further distinction between the two approaches may relate to the procedure for making a claim for damages and whether it is different for claiming against a bond or against insurance.

Paying a bond or obtaining personal indemnity insurance, however, may not be possible in all countries and other solutions will be needed. In designing the solution to this issue, a balance may be desirable between controlling the costs of the service provided by insolvency practitioners and distributing the risks of the insolvency process among the participants, rather than placing it entirely upon the insolvency practitioners on the basis of availability of personal indemnity insurance.

Another issue may be the personal liability of insolvency practitioners for obligations incurred in the ordinary course of insolvency proceedings (particularly in reorganisation), such as those relating to the ongoing operation of the business. The advantages of adopting an approach that makes insolvency practitioners personally liable is that it creates certainty for suppliers to the debtor and may operate as a check to incurring debt. At the same time, however, it may also operate as a disincentive if the risk of personal liability far exceeds the fees that may be earned. One solution is to make only the assets of the estate liable, rather than the personal assets of the insolvency practitioners. A further issue of liability relates to the liability of insolvency practitioners for the wrongful acts of the debtor, depending upon the level of control the insolvency practitioner exercises over the debtor's activities. Under some laws, insolvency practitioners may be liable for the wrongful acts of the debtor during the period of their control. But it is not desirable that the insolvency practitioner be liable for acts of the debtor that occurred prior to their appointment such as, for example, environmental damage.

The legislation and implementation of the framework will require further study and discussion, and is expected to take time. There are a number of issues that need to be debated. It is therefore essential that, in the meantime, initiatives be adopted by policy makers and professional bodies that can create a suitable environment for smooth transition when a formal framework is created. The first initiative required is the setting up of an association of insolvency practitioners drawn from various feeder disciplines. The association should develop into a representative body that can enter into a dialogue with policy makers and debate the various issues to

form a consensus on the regime that should be created for insolvency practice.

10) Recent developments and ongoing reforms

In December 2002, the Indian parliament passed the Second Amendment to restructure the 1956 Act, leading to a new regime for corporate rescue. The Second Amendment proposes amendment of the provisions of the 1956 Act for setting up of a NCLT and its appellate tribunal. Under the proposed legislation, NCLT will have the power to consider: the revival and rehabilitation of companies; jurisdiction and power relating to the winding up of companies; and jurisdiction and power exercised by the Company Law Board under the 1956 Act. The Company Law Board will stand abolished. The government of India notified certain selective provisions to facilitate the setting up of the NCLT and appointing its chairman and members. The intention is to set up the tribunal, create infrastructure and then notify other provisions to provide jurisdiction to tribunals. The implementation of the Second Amendment, however, suffered a setback when, earlier this year, the Madras High Court set aside certain provisions of the amendment on a challenge made by the bar association of that court, thus bringing the setting up of the NCLT to a grinding halt. The high court found a few provisions relating to the appointment and conditions of service of members of the tribunal to be unconstitutional. The matter is currently before the Supreme Court of India in an appeal proffered by the government of India.

The rest of the provisions of the Second Amendment are yet to be notified, and the SICA has still not pulled the shutters down, as the Sick Industrial Companies (Special Provisions) Repeal Act 2002 passed by the parliament still awaits notification. Till then, while the BIFR continues to deal with the revival and rehabilitation of companies, the high court retains its jurisdiction as the liquidation court under the 1956 Act.

11) Ongoing reforms: the Dr. J. J. Irani Committee

The Second Amendment was received by stakeholders with caution. The alternative mechanism under the Second Amendment is perceived as an old tablet in a new foil. The powers and jurisdiction of the BIFR are now to lie with the tribunal with some cosmetic changes. The only substantial difference is that while the BIFR had the responsibility for attempting the revival of dying companies, the tribunal will have to not only attempt revival but also perform the last rites if the attempt fails. Barring a few

significant changes, the Second Amendment does little to solve the problems faced under SICA. No significant change is made to expedite the liquidation process and make the process efficient.

The Indian experience with rehabilitation has been so disappointing that there has been a knee jerk reaction by taking away the moratorium provision which, under SICA, sounded the death knell for many creditors. Under the existing provisions of SICA, it was experienced that the entry level for seeking ameliorative measures by the sick unit was too late, owing to the criterion of 100% erosion of net worth. Under the Second Amendment, 50% erosion in average net worth for the last four years of the reference year, or three successive defaults in paying instalments to creditors becomes the deciding factor for entry-level eligibility of a sick unit. However, bringing into the purview of the NCLT a case of incipient sickness would be defeated, considering the period of 180 days and a further extension of 90 days that are provided for filing a reference.

In other words, the Second Amendment does not provide a comprehensive law to deal with corporate bankruptcy. In the fast changing scenario of growing cross-border investment, trade and commerce, cross-border insolvency problems are bound to increase and only a comprehensive bankruptcy law can address such issues taking into consideration international practices. It does not introduce the required roadmap for bankruptcy proceedings *viz.* application for initiating bankruptcy proceedings; appointment and empowerment of the administrator; operational and functional independence; accountability to the court, including the power of the court to remove the administrator in case of mismanagement; the relationship with current management; monitoring or substitution; day-to-day operation; time-bound restructuring/recognition plan: who should submit; procedure of acceptance; mechanism to sell off; pro-active initiative of the administrator; number of time-bound attempts for restructuring; decision to go for insolvency and winding up; and strategies for realisation and distribution.

The establishment of the Dr. J. J. Irani Expert Committee on Company Law offered an excellent opportunity to deal with the weaknesses of the Second Amendment.

12) The Irani Committee recommendations

On 31 May 2005, the Dr. J.J. Irani Expert Committee on Company Law handed its report to the government of India. The committee was set up by the government to recommend a new company law, including the

insolvency law, as a part of the ongoing legal and financial sector reform process in the country.

The committee proposed significant changes in the law to make the restructuring and liquidation process speedy, efficient and effective. Recommendations are directed at restoring the eroded confidence of key stakeholders in the insolvency system while balancing their interests.

An early and easy access to debtors to explore revival opportunities that is triggered on default in payment of due debt is proposed. A limited standstill period was recommended. This provision was taken out by the 2002 amendment to the insolvency law due to its abuse by dishonest debtors seeking protection from creditors. To check its misuse, it was proposed that, rather than being automatic, stay should be on the order of the court, made with consent of the majority of the creditors. It proposed measures that enable decisions by the majority of creditors on key issues including voting on the plan through the establishment of a creditors committee. A separate committee for other creditors with no voting rights is also proposed.

The committee recommended the recognition of the concept of insolvency practitioners and suggested effective engagement of professions in the insolvency process to maximise resource use and the application of skills. Currently, the law does not support the effective participation of professionals and experts in the process.

Other significant recommendations include: a definite and predictable timeframe of one year for rehabilitation and two years for the liquidation process; testing debtor's capacity to continue in management and their replacement by independent administrators failing such test; automatic stay on the debtor's right to deal with assets except in the normal course of business; establishment of an insolvency fund to meet the costs of the insolvency process; public interests and government claims not getting precedence over private rights; rules dealing with jurisdiction, recognition of foreign judgments, co-operation and assistance among courts in different countries; and choice of law including by adoption of the UNCITRAL Model Law on Cross Border Insolvency.

It has been recommended that the NCLT should have a general, non-intrusive and supervisory role in the rehabilitation and liquidation process. Greater intervention of the tribunal should be required only to resolve disputes by adopting a fast track commercial approach observing the established legal principles of fairness. The tribunal should possess specialised human resources, who are trained and educated on a continuous basis.

The recommendations of the committee, when translated into law, will bring the Indian law up to international standards. The recommendations are based on established global principles such as the UNCITRAL Legislative Guide on Insolvency Law.

However, any sound legislative framework depends for its success upon a predictable and effective judicial process coupled with efficacious enforcement mechanisms. There is a need to focus and improve upon implementation and execution. Also, there is a need for more creative and commercial approaches to corporate entities in financial distress, and attempts to revive, rather than the more traditional and conservative liquidation or bankruptcy. As such, socio-economic compulsions dictate that before liquidating financially distressed companies, some attempts must be made to rescue them. The quality and skills of judges (newly appointed or existing), will need to be reinforced by continuing training.

The new law would offer tremendous opportunities to professionals to provide services in various forms through the insolvency process. The professionals need to prepare for the provision of such expert and specialised services. The respective professional bodies would need to establish appropriate education and training programmes for their members.

The international and domestic business and financial community are keenly observing developments in India. Many global investors are waiting at India's doorsteps for the new insolvency law to be enacted so that they can start making investments. It is hoped that the bill would be introduced in the parliament and passed as a law as soon as possible.

The recently promulgated Insolvency Ordinance in Nepal introduces a new legal framework for the insolvency of companies in Nepal. Until now, there was no law on reorganisation, while the repealed Company Act 2053 (1997) governed liquidation. The old law did not have any role for the courts; the highly inefficient Office of the Company Registrar supervised liquidation. In comparison, the Insolvency Ordinance is a fairly comprehensive legislation.

At present, a bill is in preparation in Pakistan whose object is stated to be "to amend and consolidate the law regarding corporate insolvency and financial rehabilitation". This bill, if enacted, would replace the existing corporate insolvency regime. The bill is divided into five chapters. The rehabilitation aspects of the proposed legislation bear similarity to the Chapter 11 provisions of the United State Bankruptcy Code. The first chapter covers general provisions which describe jurisdiction of the courts, the entities covered by the legislation, and the main roles of players. It visualises the creation of the office of an "official administrator", and the constitution of "advisory committees". The second chapter relates to case

administration and contains sub-chapters covering commencement and prosecution of cases, the role of officers (such as the administrator, who may also engage services of professionals); administration matters relating to committees and the examination of the debtor; and a sub-chapter relating to administrative powers. The third chapter relates to creditors, debtors, and the estate, while the fourth covers rehabilitation. The final chapter refers to provisions of existing law that stand repealed.

A distinctive feature of the new legislation is that commencement of the case operates as a stay of: all legal proceedings; attempts to collect or recover claims against the debtor that arose before the commencement of the case; exercise of right of set-offs; and also any acts aimed at creating, perfecting or enforcing any lien against the property of the estate or taking possession or control of the same. In the existing law, a petition for corporate re-organisation does not operate as an automatic stay. The court has the power, if it sees fit, to grant a stay. Under the proposed legislation, commencement of a case would at least ensure breathing space for the debtor while the rehabilitation plan is under the process of approval, so that the debtor would not be harassed by creditors or persons laying claim to the debtor's estate. The office of the liquidator would be substituted by that of the "official administrator".

Hopefully, Sri Lanka and Bangladesh will provide the necessary attention to the reforms required in this area.

There are considerable efforts underway in South Asian countries to introduce reforms into their respective systems. The ultimate impact of the actions put forward in these countries will be reflective of the degree of enforcement by regulators. There is a need to provide an insolvency regime that strikes a balance between liquidation and reorganisation. There is a need for more focus on implementation. Even a well-intentioned law, if not properly implemented, can fail to serve its purpose however good the law may be. The essential features governing a model formal restructuring process in any part of the world are common (if not alike), though they may be structured differently. Then why do they fail to work in one country and do well in another? Greater focus on improving implementation and execution is required. Also, there is a need for more creative and commercial approaches to corporate entities in financial distress, and greater efforts to revive them rather than applying the more traditional and conservative approach of liquidation or bankruptcy.