

THE NATIONAL COMPANY LAW TRIBUNAL (NCLT) READINESS

Insolvency and Bankruptcy Code



ALVAREZ & MARSAL



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INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (IBC) is a welcome overhaul of the existing framework for resolving corporate and individual insolvencies and bankruptcies. After a public consultation process and recommendations from a joint committee of Parliament, both houses of Parliament passed the IBC in May 2016. Subsequently, a four-member Insolvency and Bankruptcy Board of India (IBBI) was constituted in October 2016 led by Dr. M.S. Sahoo as Chairman. The main activity of IBBI is to regulate the functioning of insolvency professionals, insolvency professional agencies and information utilities under the IBC. Post the passing of the bill, the Ministry of Corporate Affairs (MCA) has been notifying portions of the IBC selectively. The speed with which the government has moved on the implementation of IBC is creditworthy and unprecedented. However, there are several challenges that still remain to be overcome for a successful implementation of the code, e.g., setting up information utilities, development of resolution professional industry, adequate judicial infrastructure, etc. In this report, we have focused on the adjudicating authority as one of the key pillars on which the success of the IBC depends.

Through this report, we have captured the voice of the largest lenders in India whose experiences have been soured by the state of affairs at the Debt Recovery Tribunal (DRT) and Board for Industrial and Financial Reconstruction (BIFR) and echo similar apprehensions for the adjudicating authorities.

THE CHALLENGES

Mammoth of pending corporate default cases

The National Company Law Tribunal (NCLT) was constituted on June 1, 2016 under Section 408 of the Company's Act, 2013. IBC proclaims NCLT to be the single adjudicating authority for all corporate default cases. This leaves NCLT with the challenging task of resolving **approximately 25,000 pending bankruptcy and insolvency cases** apart from other corporate cases.

- Under Section 466(1) of the Company's Act, 2013, the Company Law Board (CLB) is dissolved and approximately 4,000 pending cases in the CLB are bound to move to NCLT.
- BIFR is also dissolved as per the Sick Industrial Companies (Special Provisions) (SICA) Repeal Act and approximately 700 pending cases in BIFR (as of 2015) will move to NCLT as well.¹



- The high courts have approximately 5,200 winding-up and amalgamation cases that will be transferred to NCLT.
- DRTs are currently dealing with cases under the Recovery of Debts and Bankruptcy (RDB) Act, 1993 and appeals under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, with around 70,000 cases pending. Under IBC, while NCLT will resolve insolvency cases of companies and limited liability partnerships, DRT will handle cases of individual bankruptcy. Approximately 15,000 pending cases from DRT (assuming a 20–25 percent shift) have the potential for movement to NCLT (refer to Figure 1).

Further, an influx of new cases is also expected in the coming 2–3 years (influx rates for DRT and BIFR are at 15–20 percent per annum), leading to a major concern as to whether the NCLT will be able to cope with the projected caseload.

Lower judge productivity

Often the lack of presiding officers or judges at DRT has been touted as a major reason for the ineffectiveness of DRTs; a similar concern has been voiced by lenders for NCLTs as well. It might be possible to increase the number of judges; however, it is important to review whether the environment in which judges are placed is conducive to productivity. Even the Law Commission has expressed a concern that increasing the number of judges without adequate infrastructure may not reduce delay.² A closer look and comparison with the U.S. Bankruptcy Court system reveals a different picture from the common public discourse.

In the U.S., the 94 federal judicial districts with approximately 350 bankruptcy judges handle the bankruptcy cases. As of December 31, 2015, there were 1,235,401 pending cases across all districts, which is approximately 3,500 cases per judge. In India as of July 2016, there were 34 DRTs with seven vacancies

FIGURE 1: Pending cases at DRT

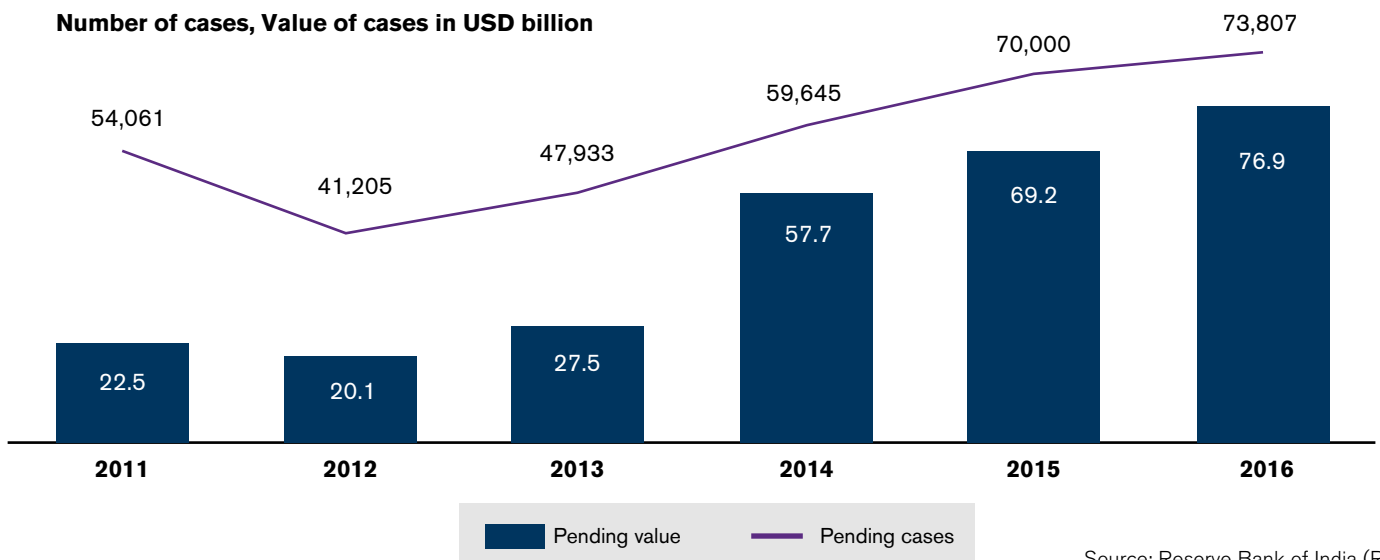
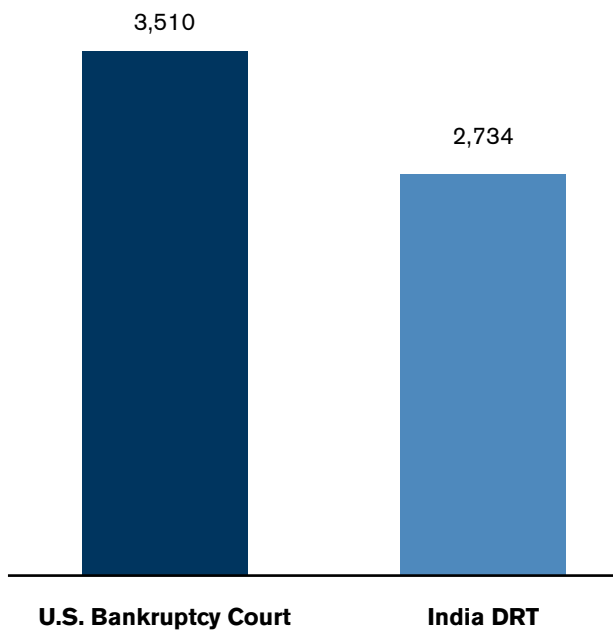


FIGURE 2: Pending Cases per Judge in U.S. Bankruptcy Courts & DRTs



(Aurangabad, Hyderabad, Jaipur, Kolkata – II, Madurai, Nagpur and Visakhapatnam). 73,807 cases are pending at DRTs, which is approximately 2,700 cases per judge; compared to the U.S., this is much lower (refer to Figure 2). But what is more interesting to compare is judge productivity, i.e., the ratio of judges to disposals per year (refer to Figure 3). In the U.S. over 2014 and 2015, the number of disposed cases were 1,074,261 and 963,820, respectively, which implies a productivity of approximately 2,900 disposals per judge per year. Compare that to India in 2013 and 2014, during which time DRTs disposed of 11,194 and 12,594 cases, respectively, which is a productivity of approximately 360 disposals per judge per year. This suggests that the problem of judicial delays may not be resolved just by increasing the number of judges.

Lack of administrative staff

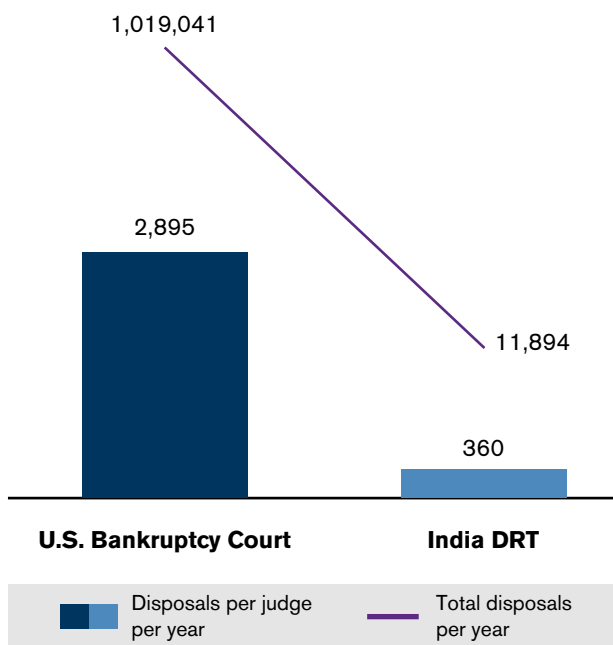
The working of the judiciary can be segregated into judicial versus administrative activities:²

- Judicial functions refer to allocating, listing and opining of cases in a time-bound manner in compliance with the applicable procedures.
- Administrative functions ensure that processes are followed, documents are submitted and stored, facilities are maintained and human resources are managed.

In the U.S., the assistant personnel in the bankruptcy courts are estimated to be 4,000–5,000 and can be divided into three categories: judicial, legal and administrative (refer to Figure 4.1).³

- Judicial assistance is in the form of Commissioners and Magistrate Judges. Commissioners are court appointed federal officers who provide assistance to judges in a variety of pretrial proceedings; Magistrates serve as “assistant judges” conducting a broad variety of pretrial and case management proceedings.
- Law clerks typically work under the supervision of a judge and provide assistance with legal research, drafting and other tasks related to case preparation and management. Staff attorneys work for the court and typically assist on briefings, case management, prehearing assistance, conducting settlement conferences, legal research, drafting of memoranda, etc.
- Administrative staff typically assist on case processing, management of court records, budget, automation, statistics, courtroom services, etc.

FIGURE 3: Total Disposals and Disposals per Judge per Year in U.S. Bankruptcy Courts and DRTs



In the United Kingdom, Her Majesty’s Courts and Tribunals Service (HMCTS) is an executive agency of the Ministry of Justice,

FIGURE 4.1: U.S. Bankruptcy Court

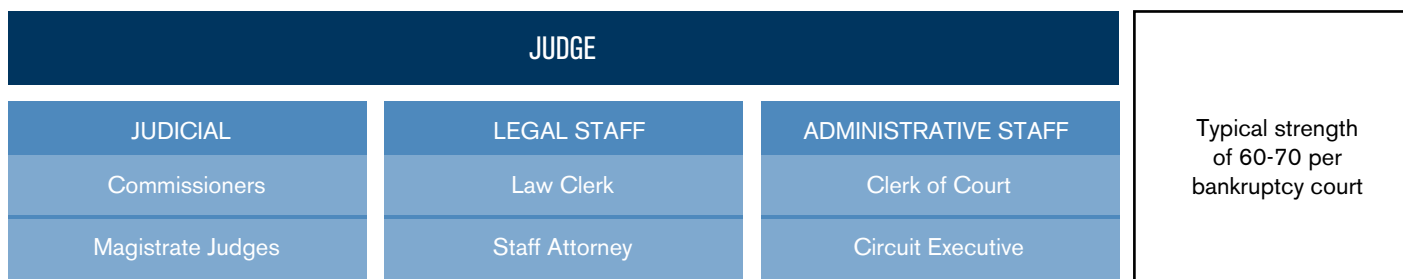


FIGURE 4.2: U.K. Court structure

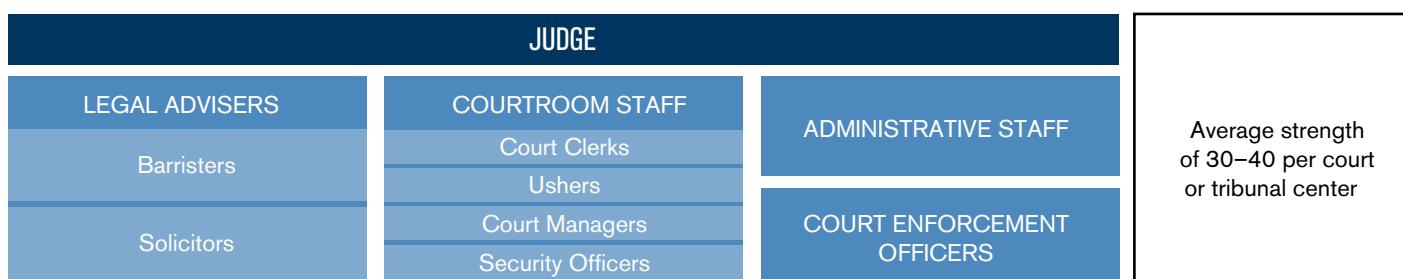
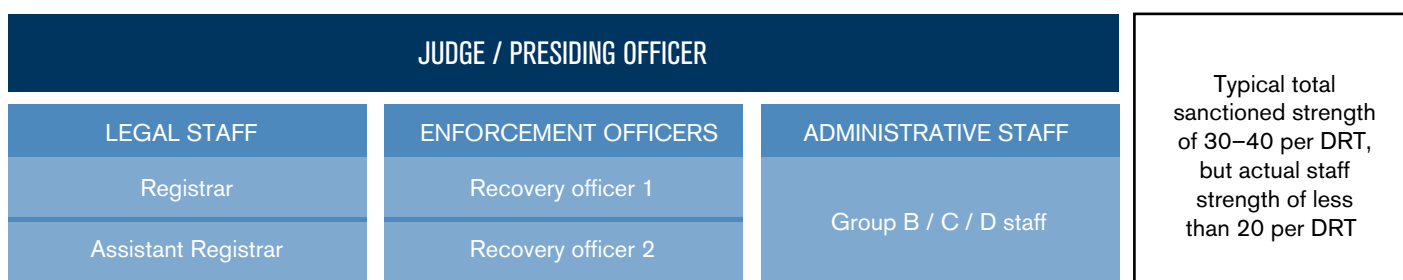


FIGURE 4.3: Indian DRT structure



responsible for administration of the courts of England and Wales. It employs around 16,000 full-time equivalent (FTE) staff and operates around 460 courts and tribunal hearing centers across England and Wales.⁴ Typical roles include the following (*refer to Figure 4.2*):

- Legal advisers are usually qualified barristers or solicitors who provide advice to magistrates on applicable laws and judicial procedure.
- Courtroom staff include court clerks (who assist the judges in managing the courtroom), ushers (who are responsible for preparing the courtroom, checking that witnesses, defendants and lawyers are present, etc.), court managers (who manage day-to-day operations of the court, e.g., maintaining relationships with external agencies) and security officers (who prevent and manage security incidents).
- Administrative staff help with the day-to-day running of the courts and their supporting offices, manage enquiries from the

public, book dates and times for court hearings, allocate cases to courtrooms, prepare lists of the day's court sessions and follow up on the court's judgments after a hearing.

- Court Enforcement Officers are responsible for enforcing Magistrates Court orders, which may require them to seize and sell the offender's goods to recover outstanding debts, etc.

In Indian courts, the responsibility of administration is assigned to the chief judicial officer of the court, which takes a significant amount of their time. Most of the DRTs struggle with infrastructure and under-staffing at the administrative level. Compared to the typical sanctioned strength of 30-40 (*refer to Figure 4.3*), DRTs have 15-20 staff and have to resort to hiring temporary staff at lower salaries. On a broad estimate, the total staff strength of DRTs is 600-1,000. The proposed strength of NCLT is 62 including judicial and technical members, but there is limited clarity on the strength of administrative staff, which will play a crucial role in improving the productivity of the judiciary.

THE NCLT READINESS

In the first phase, the MCA has set up 11 NCLT benches, one principal bench in New Delhi and one regional bench in New Delhi, Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai. These benches will be headed by the president and 16 judicial members and 9 technical members at different locations. Proposed total strength is not more than 62 (including judicial and technical members).

A. Is NCLT bench strength sufficient?

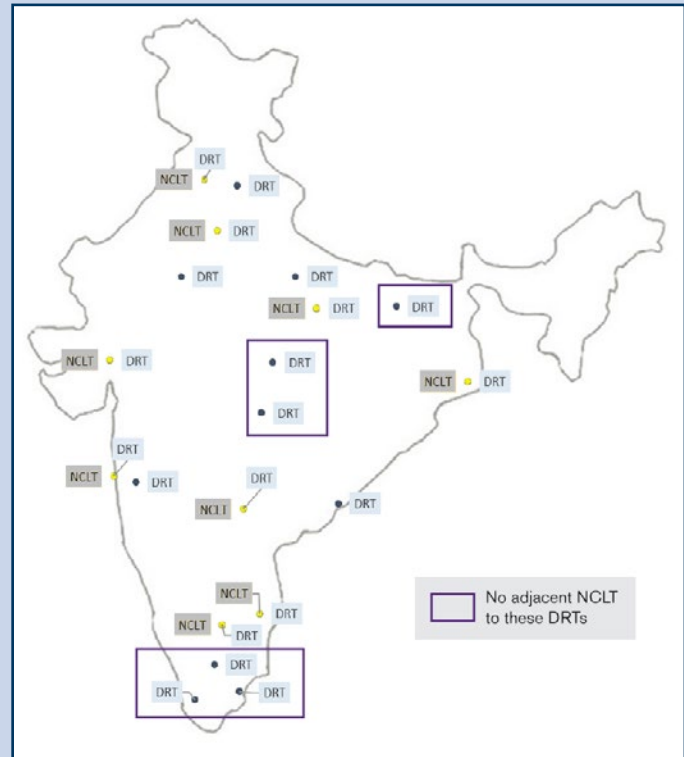
Assuming 25,000 cases move to NCLT and judicial bench strength ramps up to 50 in three years and a judge can handle 60 cases at any given point in time, it will take more than seven years to clear the current backlog.

Other key assumptions:

- A fourth of the cases will be related to liquidation and the remaining related to restructuring.
- The average time to resolve liquidation and restructuring cases will be three years (compared to the current 4.3 years) and 180 days, respectively, in Year 1. Also, we assume that every subsequent year the productivity will improve by 30 days and 10 days on average.

B. Are NCLT benches located appropriately?

Mapping the current DRT location with the NCLT raises a possibility that the transfer of cases from some of the DRTs to the adjacent NCLT might become a tall order for lenders requiring significant time and resources.



Lack of oversight

Apart from having the necessary infrastructure, U.S. bankruptcy courts have additional support in the form of trustees. The trustee manages and oversees the bankruptcy of each individual or business. The trustee is appointed by the regional office of the United States Trustee, which is a division of the Department of Justice, and is responsible for overseeing the administration of most bankruptcy cases. It has 21 regional offices and 95 field offices. Major responsibilities of U.S. Trustees include:⁵

- Appointing and supervising private trustees (accountants, lawyers, restructuring firms, etc.) to administer Chapter 7, 12 and 13 bankruptcy estates
- Taking legal action to enforce the requirements of the Bankruptcy Code

- Appointing professionals (restructuring firms) and convening creditors' committees in Chapter 11 business reorganization cases
- Ensuring that bankruptcy estates are administered promptly and efficiently, and that professional fees are reasonable

Apart from the above, U.S. Trustees are required to audit at least one out of every 250 cases filed, as well as any case in which income or expenses deviate significantly from the norm, which they must report directly to Congress.

In IBC, some of the responsibilities of the U.S. Trustee is envisaged as part of the role of an insolvency professional, but the role neither has a legal standing nor the authority to monitor and provide oversight on NCLT and the National Company Law Appellate Tribunal (NCLAT).

CHALLENGES FACED BY LENDERS IN DRTs / BIFR

Long resolution time

- “Majority of the time is spent on the procedural aspects rather than solution-oriented dialogue between stakeholders.”
- “Viability of projects / industries does not take precedence and hence the long time for resolution at BIFR.”

Judicial independence and capability

- “Perception of independence amongst the DRT judges is lacking; many parties are wary of using DRT for debt resolution.”
- “Outcome of the case is heavily dependent on which judge is assigned; mapping of judges to a case is not scientific but instead based on availability.”
- “Not all judges have industry-wise business judgement and rely more on a checklist and are too lenient in granting adjournments.”

Lack of administrative staff

- “In the U.S., even the start and end time slot is fixed for a hearing; in India, there is a gap of 4–4.5 months between two adjournments and multiple interim applications are required.”
- “No administrative staff; our lawyers have to take proactive action to ensure the slot is given.”
- “Scheduling a hearing in DRT takes a long time, and not more than 3–4 hearings can take place in a year.”
- “Scheduling a hearing in BIFR takes 6–9 months sometimes.”

Inconsistent procedures

- “Rules are different across DRTs, which creates confusion; e.g., Kolkata DRT requires all the pages to be signed, whereas Mumbai DRT requires signature only on the first and last page.”

Manual filings

- “There is no digitization at the DRTs; from scheduling to filing, everything is manual and takes up significant time and resources.”

RECOMMENDATIONS

Even though most of the respondents have had several undesirable and unsatisfactory experiences with the Indian judicial system in the past, all are acutely aware of the importance of the IBC and NCLT and its success. Highlighted below are some of the key recommendations based on our discussions with the respondents:

Staff legal and administrative personnel (U.S. Trustee or U.K. HMCTS-like structure)

- Authorities should put in place adequate legal and administrative staff to ensure that judges' time is utilized only for judicial duties. Legal staff should ensure adherence to procedures and administrative staff should manage scheduling, etc.

Stakeholder awareness

- Most of the lenders admit that there are still several queries of a technical and administrative nature that are unanswered and suggest a forum for discussion with MCA, IBBI and NCLT before the effective implementation is kicked off.
- Lenders envisage a significant change in resource allocation at their end; such a forum will help in planning appropriately.
- Judicial and technical members can also draw from the learning of U.S. and U.K. bankruptcy regimes.

Restrict case load at NCLT

- MCA and IBBI should release a guideline on the transfer of pending cases to NCLT from DRT or BIFR based on the size of exposure, size of consortium, case length, etc. The SICA Repeal Act provides for such transfer; however, there are no detailed guidelines.
- It is imperative to establish some success stories in the beginning to set the right tone, which is only possible if the number of cases at NCLT is limited from the beginning.

Ensure adequate bench strength

- Additional benches or judicial bench strength should be augmented based on the corporate case load at the adjacent DRTs.
- Authorities should explore the possibility of converting existing DRTs into NCLTs at the cities with multiple DRTs (e.g., Mumbai, Kolkata, Delhi, Chennai, Chandigarh, Ahmedabad).
- They should also consider the possibility of dedicated benches only hearing IBC matters at NCLT.



Build expertise over time

- Since NCLT will also handle all corporate cases under the Companies Act, 2013, it is important to build separate bench strength for bankruptcy cases to ensure that significant expertise develops over time leading to improved productivity.

Consistent procedures with maximum digitization

- A consistency in procedures across the NCLTs will not only reduce confusion but also save time and resources for the lenders (reduced legal cost, opportunity to outsource or centralize certain functions such as drafting, etc.).

Framework for Infrastructure Maintenance

- The DRTs are currently marred by the infrastructure issues including absence of permanent offices, lack of electricity connection and roofs that leak during rainy season (refer Figure 5). Most of the DRTs are caught up in legal disputes with building owners and face the risk of being evacuated from current premises. Further, some DRTs do not receive funds for telephones bills, stamps, court notices etc. and officials are forced to foot these bills to complete formalities and prevent stalling of cases.

FIGURE 5: Absence of permanent DRT offices

DRT	CURRENT OPERATING OFFICE
Delhi	Government owned hotel
Allahbad	Room of a rented house
Jaipur	Space meant for shop
Chandigarh	Lessor has moved court for vacating the premises

- Both NCLT and DRTs need to have an adequate infrastructure to function appropriately. The fees charged during the bankruptcy proceedings or a recurring fee can be further applied to fund for maintenance and upkeep of the premises and also to help the tribunals operate with the necessary infrastructure. This will not only enable smooth functioning of the NCLT but also improve the overall productivity of the judges and the officials.

Ensure continuous monitoring

- Judicial and technical members of NCLT and NCLAT must be monitored on a regular basis for performance, independence and integrity; key performance metrics should be defined and measured on a regular basis.
- The NCLT president should conduct an internal audit of large cases to ensure procedural discipline and judicial integrity.

NOTES AND REFERENCES

1. SICA matters will move to NCLT only if a fresh IBC application is made and admitted.
2. *“How to Modernize the Working of Courts and Tribunals in India”* by National Institute of Public Finance and Policy
3. *“Legal and Court Staff in the United States Judiciary”* by Federal Judicial Center, Washington D.C., U.S.
4. *Website of Department of Justice, U.K.*
5. *Web reference “thismatter.com”*

This report is the outcome of extensive secondary research, interviews with lenders in the Indian stressed asset market and learnings from A&M's global restructuring heritage of more than 30 years that delivers the best creditor recoveries. We have highlighted best practices from more efficient bankruptcy jurisdictions and suggested measures that are best suited in the Indian context.

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