
INSOLVENCY AND BANKRUPTCY FRAUDS IN INDIA

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“Honesty is the best policy when there's money in it “ – Mark Twain

ABSTRACT

They say the Jewish community in America owns most of the property and the reason behind it is the credit system that they excel in. The credit system forms the basis of a financial cycle that results in the growth of a business upfront along with the banking sector boosting itself in return and simultaneously paying for more economic growth. Each entity has a definite place and responsibility coupled with liabilities. If any of the entities fail to carry out their undertaken tasks as in fair trade, rather its promises are contractual or other it disrupts the whole cycle, and each entity involved suffers. The vital role of the banking sector in pumping capital into the economy after receiving it from the people is a simple backbone of today's economic growth; businesses. But what happens when the return to these banks and loan providers is halted by no just means and reasons rather than bad faith and tried to be justified via courts through fraud? In this paper, the researchers will try to study the menace of insolvency and bankruptcy fraud. Also, the recent high-profile frauds relating to bankruptcy and insolvency in India have been studied along with the mention of measures and safeguards that are present under Indian law to guard against such evils.

Keywords: Finance, Bank, Business, Fraud, Returns, Law

INTRODUCTION

“Life has come full circle for tycoons that had enjoyed debt-fuelled growth.”

Insolvency and Bankruptcy are two different terms that might have the same meaning but in a different ways. Insolvency means when a corporation or person cannot meet its financial dues which are debts in the due course of business and declare itself insolvent whereas Bankruptcy means when a judicial order has clearly stated that the corporation, business, or person is unable to pay its debts in the due course of time, and they have been declared bankrupt. The pattern which was been observed in the country was that there has been a constant increase in the cases of bankruptcy and insolvency due to which the country

faced severe losses like the world's worst bad debt pile in 2019 Nirmal Gangwal said "Many firms collapsed like a house of cards. The downfall was rather unprecedented." Not only this the insolvent and bankrupt persons have also caused image issues in the global world as many culprits, owners of defaulted corporations have managed to escape the country for a long period without facing any penalty for their wrongdoings. There have been always numerous laws regarding this issue but what this country lacked was a structured law or code whose main focus or purpose is to deal with issues relating to bankruptcy and insolvency. The lack of this law caused a delay as well as was building pressure on the courts as public money has been involved and they could not see any end to this road in near future. Hence it became very important for our country to work and develop a bill. It was in the year 2015 when India decided to act on the rise of insolvency and bankruptcy cases by bringing in a bill that was then formally introduced in Lok Sabha to make a single code on insolvency and bankruptcy in India. It was passed in 2016 and is looked at as a milestone for curbing the growing insolvencies and bankruptcies in the country. This would ultimately support the development of credit markets and encourage entrepreneurship in the country as this law would give strength to start-ups and create fear in the minds of a successful businessmen. The purpose of this act is not only to punish fraudulent businessmen but also to provide aid to innocent debtors who are unable to pay their debts. This is still a new budding or nascent law in India that can be evaluated and studied in many forms. It has a wide scope and can be analyzed and used for the betterment of the nation. If used in the correct direction it might help the country curb the debt gap.

Conceptual Framework –

There's a saying in the legal world that if there's a loophole in the law, one should find it and exploit it. However the same has been used by many on the other side of the law and for illegal matters, that wouldn't be the desired motto of the saying. The political connections and a seat in the wealthy lobbies make it easier to earn the trust and get the desired outcomes, many times beyond normal and allowed limits. It's harder to make money when you've no money rather than make more money when you already have capital.

In our country, the topic of capital fraud cant be discussed without the mention of the infamous case,

Illustrations in conceptual regard-

Vijay Mallya

Almost everyone knows the slogan, don't drink and drive but only the wise know the slogan don't drink and decide. Vijay Mallya is the chairman of United breweries, owner of an IPL team, and Ex-parliamentarian. Vijay Mallya as an owner of a best spirit selling company Kingfisher beer brand was advised by his council against getting into the airline business. He decided otherwise. The decision seemed right but not for too long. After its inception in 2005, kingfisher airlines went on to become India's no.1 domestic airline company and the first choice of many. However, due to governmental restrictions, it wasn't allowed to fly internationally. However, to go around it and fly internationally, Mallya leveraged' United breweries to buy DECCAN airlines which were labeled as a loss-making company, and merged it with kingfisher airlines but this idea didn't provide much profit and the company went into heavy loss by 2010. By 2012, the airline was forced to halt all its operations since it no longer could afford them. To keep his dream business afloat he continuously took loans from banks. An estimated loan of 9000 crores by 17 banks. Although SBI had declared him bankrupt other banks kept lending him loans because he was a member of the Rajya Sabha and he had the backing of various political entities. Around 2013, a consortium of various Indian-based banks led by the State Bank of India (SBI) approached United breweries for repayment of loans of an estimated Rs. 6000 crores. Since the loans weren't paid back, the UBHL as the guarantor of the airlines declared it as a wilful defaulter in 2014. The company was also alleged to not have paid the salary of its employees.

In March of 2016, Mallya fled to the UK, and soon after he was followed by India's extradition request. Mallya who has been since denying any fault on his part is facing allegations relating to cheating, criminal conspiracy, money laundering, and diversion of loans. Also, a few companies of his including Kingfisher airlines have been facing charges of violating the companies act 2013 and also the norms laid by the capital markets regulator. The other side of side story is that Mallya claims that he offered banks to pay 4000 crores for settlement but his proposal was refused. Banks are demanding at least 4900 crores which is the principal amount along with interest.

Approximate breakdown of loans taken by Vijay Mallya from various banks

Rs 1,600 crore	SBI
Rs 800 crore	PNB
Rs 800 crore	IDBI
Rs 650 crore	Bank of India
Rs 550 crore	Bank of Baroda
Rs 430 crore	United Bank of India
Rs 410 crore	Central Bank of India
Rs 320 crore	UCO Bank
Rs 310 crore	Corporation Bank
Rs 150 crore	State Bank of Mysore

Rs 140 crore	Indian Overseas Bank
Rs 90 crore	Federal Bank
Rs 60 crore	Punjab & Sind Bank
Rs 50 crore	Axis Bank

Mallya's extradition case hearing began around 2017 when he claimed that he was prepared to pay back the loans. All this while the government of India has been trying to extradite him from the UK. His extradition was approved by the home secretary of the UK. However, the case was pending in London high court where an appeal was filed by Mallya.

Meanwhile, Mallya remains on bail in the UK while a 'confidential' legal matter, believed to be related to an asylum application, is resolved in connection with the unrelated extradition proceedings. The most recent update on this case came a few weeks back in July of 2021 when the Insolvency and Companies Court of the London high court [granted a bankruptcy order](#) against Vijay Mallya, who has been fighting against his extradition to India since 2017, a year after he fled the country. Essentially it means, Mallya will now have to hand over all his debit and credit cards as well as his remaining assets to a bankruptcy trustee. This trustee will investigate further and determine his assets and liabilities. This evaluation will be used to pay back the bad debts incurred by the consortium of Indian banks.

The case of Nirav Modi and Mehul Chowksi

“ Fool me one-time shame on you, fool me twice shame on you, fool me three times shame on both of us”- Stephen King

Another recent case that caught the eye of the whole country and beyond was the case of Nirav Modi and Mehul Chowksi where they not only successfully frauded the banks for a whopping amount of Rs 14,000 crore but also both of them managed to escape the country right before the PNB scam was exposed to the public at large.

In this case, Nirav Modi and Mehul Chowksi, Punjab National Bank bankers had taken fake Letters of Undertakings (LoUs) at the PNBs Mumbai branch. The LoUs were opened in favor of Indian banks to import pearls where the guidelines of the reserve bank of India were ignored and the total period of payment is 90 days from the date of shipment. The overseas bank could not share the documents with PNB, which were made available to them by the firms at the time of availing credit. Nirav Modi was successful to get a fraudulent guarantee from PNB, he managed almost 1,212 guarantees over the next 74 months.

The Enforcement Directorate recovered bank token devices of the foreign dummy companies used by the fugitive diamond trader to transfer the fraudulent funds. It was also seen that Nehal Modi, brother of Nirav Modi had destroyed these devices and secured a server in the United Arab Emirates. The enforcement agency has so far seized movable and immovable properties of Rs 2362 crore in the PNB fraud case. Punjab National Bank then filed an FIR about the fraudulent activity and named three diamond firms. Modi not only did wrong to Punjab National Bank but also four other banks namely Dena, Corporation, Union Bank of India, and Bank of India.

Unlike Punjab National Bank, the corporation bank did not provide a false letter of the undertaking but provided a credit facility to Nirav Modi to be used by another company owned by him namely Firestar International Private Ltd. It is compulsory to honor the letter of credit for availing of these facilities. Instead of using credit facilities for genuine jewel and diamond export, the amount was siphoned off. The investigation into the Nirav scam had zeroed in on several transactions where fake invoices were raised to camouflage the round-tripping as an authentic deal. Even though the credit extended to his company was genuine, unlike the PNB loans where fraudulent Letters of Undertakings (LoUs) and Swift messages were used to create a sense of false security, this time the modus operandi was to back up the transactions through alleged fake invoices.

In the year 2018, as the matter unfolded, the company Firestar Diamond Incorporation filed for bankruptcy in the US court. The Indian authorities are not in favor of bankruptcy proceedings in the States. Interestingly, a few days later Gitanjali Gems owned by Mehul Chowksi (Nirav's uncle) filed for insolvency. This company owes Rs 12,558 crore to its lenders.

The ED also declared both (Nirav and Mehul) of them fugitive economic offenders (FEO). The notice is served to the director or CEO of the company. Nirav Modi was heavily penalized under several laws of India such as Income tax, GST, SEBI, Companies law.

Currently, the case is sub judice. The courts are yet to take a final decision but the US court has recently declined Nirav's petition for dismissal of fraud allegations against him.

These cases have been the apple of the eye of media groups and criticism all around because of the stature of the people involved and the number of assets involved. The question that rises from these instances is, Is the capital world secure enough from fraud? Is there any firewall in place to prevent such instances and if yes how could such people get away?

LEGAL FRAMEWORK REGARDING BANK FRAUDS, INSOLVENCY AND BANKRUPTCY IN INDIA

We can say the framework hasn't been airtight like many areas of Indian law. However, due to rising cases of these evils, the legislature and administration have mobilized considerably over the last decade.

The Companies Act, 2013 and the Insolvency and Bankruptcy Code, 2016 have been formed in a way that includes provision for the determination of sickness, application for revival, the appointment of interim/Company administrator, time-bound revival process, and if

revival is not possible, liquidation process through single regulator 'National Company Law Tribunal. The Companies Act, 2013 also provides for the regulation of insolvency which also includes the process of revival, including winding-up and liquidation of companies in the shortest time possible. It also constitutes a blueprint of international best practices based on various methods and models suggested by the United Nations Commission on International Trade Law (UNCITRAL). The powers and jurisdiction of the Company Law Board, Board of Industrial and Financial Reconstruction, and High Court in this regard, are being exercised by National Company Law Tribunal and Appellate Tribunal. The purpose of the establishment of this Tribunal is to prevent the multiplicity and burden of litigation before various courts or quasi-judicial bodies.

- The Insolvency and Bankruptcy Code 2016 (IBC)

The bankruptcy code is a solid set of rules for resolving insolvencies which previously was a long process that did not provide for an economically favorable setting. The code is formed in a way to protect the interests of small investors and make their life less complicated.

The Code also demarcates separate insolvency resolution processes for individuals, companies, and partnership firms. The IBC views to fill the vacuum left by the Sick Industrial Companies Act 1985 (repealed in 2003) which was the only legislation aimed at detecting failing companies and providing remedial measures for their revival or enhancement. Furthermore, the IBC also replaced the mechanism under the Companies Act 2013 of 'winding up' of companies arising out of default in repayment of debt.

- The Insolvency Law Committee constituted by the Ministry of Corporate Affairs submitted the second part of its Report in October 2018 after deliberating on the existing provisions of cross-border insolvency in the Insolvency and Bankruptcy Code, 2016 (sections 234 and 235) and the UNCITRAL Model Law on Cross Border Insolvency. The Committee noted that the existing provisions in the Code do not provide a comprehensive framework for cross-border insolvency matters. The Committee provided a comprehensive framework for this purpose based on the UNCITRAL Model Law on Cross-Border Insolvency, 1997. The Committee has proposed a draft Part on Cross Border Insolvency which could be made a part of the Code by inserting a separate part for this purpose.
- The IBC has emerged as one of the most utilized legislations for the resolution and recovery of debts. As per the Economic Survey 2020-21, 4117 applications have been admitted by the National Company Law Tribunal (Tribunal) since the implementation of the IBC on December 31, 2020. Whereas the number of companies successfully liquidated as of December 2020 is 1112.

Furthermore, the Reserve bank of India has also published guidelines forming a safeguard against bank frauds and other such related instances.

These directions are issued to provide a framework to banks enabling them to detect and report frauds early and take timely consequent actions like reporting to the Investigative agencies so that fraudsters are brought to book early, examining staff accountability, and doing effective fraud risk management.

These directions also aim to enable faster dissemination of information by the Reserve Bank of India (RBI) to banks on the details of frauds, unscrupulous borrowers, and related parties, based on banks' reporting so that necessary safeguards / preventive measures by way of appropriate procedures and internal checks may be introduced and caution exercised while dealing with such parties by banks.

Post Covid-19 situation in the country-

The world in the last two years has witnessed a pandemic that has certainly changed life for many. The humongous loss of lives and grief faced by people was unbearable to witness and the helplessness which humans have gone through has certainly changed them. It has turned life upside down for many, the impact of this novel covid-19 can never be expressed in sheer words. Similarly, many businessmen and corporations have brutally faced the reality of worldwide lockdowns imposed on different countries. Some small businesses have boomed with the support of Instagram, Facebook, and Whatsapp whereas some start-ups and well-established businesses, and corporations have not been able to survive well.

The government had anticipated that the lockdown imposed will disrupt the demand-supply chain which will eventually lead to a direct effect on the financial stability of the company. This not only impacted the company debtors but the fairly surviving company was pushed to a lower stage.

But the support provided by the government of India to all the entrepreneurs in these tough times helped them through these doomed days. The Government took a series of steps to help struggling businesses stay afloat last year. One was to prevent the initiation of the corporate insolvency resolution process (CIRP) against any corporate debtor for a default committed between March 25, 2020, and March 25, 2021 ("period of suspension"). Coupled with the restricted functioning of the National Company Law Tribunal (NCLT), activity under the Insolvency and Bankruptcy Code, 2016 (IBC) slowed significantly. For instance, only 161 new CIRPs were initiated between March and September 2020, in contrast to 889 CIRPs being initiated between March and September 2019 (per data reported by the Insolvency and Bankruptcy Board of India). This period will eventually be revoked and IBC will come to effect in full form.

But when the reality will hit and these pending cases will pile up before the court and be resolved, it is then we will be able to understand the ground reality. It predicted that the government will bring in more help packages, and ease down of laws to help the companies through this period viably rather than moving towards insolvency.

CONCLUSION

If Adam didn't bite the apple we wouldn't know the concept of sin similarly if newton didn't care about the apple we wouldn't know about gravity. The events that have emerged in the last decade have led to various acts on the parts of the government as well as the legislature to at least put a curb if not a complete blanket on fraud. It is truly a complete crackdown on such instances is not possible but when public money and assets are involved the responsibility and liability of the authorities are quite serious. In general, we can say these are white-collar crimes committed by unprincipled, unethical, and amoral persons who mostly take advantage of elite positions and political decorum and exploit the loopholes existing in the current system along with the not-so-strict procedure regarding these processes. We can say that these instances cannot be completely blotted out however the demand is for stronger legislation and framework which guards these institutions, assets, and in the general public interest.

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