



THE INSOLVENCY AND BANKRUPTCY LAWS IN INDIA : JURISPRUDENTIAL MICROSCOPIC EVALUATION

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Abstract

The Insolvency and Bankruptcy Code, 2016 was an attempt to consolidate a single law to deal with insolvency and bankruptcy cases in India. IBC is still evolving and testing waters. This emphasis and focus of this research paper be oriented towards the examines and evaluates the various western jurists who relate major economic principles to the existing and implicit object of the Code and the general objective of Insolvency and Bankruptcy law by the jurists..

Index Terms

Insolvency and Bankruptcy, Kantian Ethics, Categorical Imperatives, Jeremy Bentham, Utilitarianism, John Rawls, Theory of Justice, Libertarianism, John Locke.

Objective

The object of this research paper is to analyze the jurisprudential aspects of the Insolvency and Bankruptcy Code, 2016. This analysis has been on a purely legal basis – the jurisprudential theories behind law rather than the historical development of insolvency and bankruptcy in American and English laws.

Research Methodology

The present study has conducted extensive review of existing literature and adopted descriptive methodology for which secondary data collected from various reputed journals and database.

Hypothesis

No particular hypothesis has been taken for testing purpose as because the study is explanatory in nature for the jurisprudential aspects substantiating the Insolvency and Bankruptcy Laws of India links in light of western outlooks of various Jurists such as John Rawls, John Locke and Thomas Hobbes among others.

Through explanation it relates major economic principles to the existing and implicit object of the IBC Code and the subject matter.

Introduction

The *Preamble* and *Article 38* of the Constitution of India – the supreme law, envisions social justice as its arch to ensure life to be meaningful and liveable with human dignity. Social justice, equality and dignity of person are cornerstone of social democracy. The concept ‘social justice’, which the Constitution of India engrafted, consists of diverse principles essential for the orderly growth and development of personality of every citizen.

The jurisprudence of insolvency and bankruptcy has evolved through to time, to emerge today as a fundamental system for any nation. The current system can be analysed from different jurisprudential theories regarding morality, justice and property; serving the purpose of gleaning the underlying influences of the law and the aptness of the subject matter in the current economic scenario.

Kantian Ethics and Bankruptcy

Immanuel Kant proposed a system of ethics or morals, entirely derived from logic and reason. These morals are ‘*categorical imperatives*’ and are absolute in nature- have no exceptions in their application. Categorical imperatives are moral obligations which must be followed and are derived from reason - as distinct from hypothetical imperatives. Hypothetical imperatives are obligations and decisions arising out of desires of the person. For example, if one wants to get good grades in class, he must or is obliged to study. It is discretion of the person to follow such obligations, as it is directly related to his or her desires and interests.

Categorical imperatives are absolute and are not contingent on desires of persons, but on ‘*pure reason*’, Immanuel Kant proposed a two-prong method for determining individual choices (obligations) and thereby the categorical imperatives.

The first is that of ‘*universalization*’, Kant states that a moral rule (maxim) behind an act or choice, should never be contradictory, if universalized. Moral rule is any principle which directs or seeks to direct a person and such principle becomes a categorical imperative, if it can be universalized without contradiction.

Universalization is wherein if the principle is accepted and followed as compulsory and morally correct by all persons. In illustrative terms, the act of taking something which is not his/her own for gain, is ‘*stealing*’- being considered as a principle or ‘*maxim*’.

If the maxim of ‘*stealing*’ is universalized, everyone has moral obligation to steal- leading to a contradiction. Since, everyone can steal; there would be no ‘*gain*’ for the person who steals; thus contradicting the very purpose of the act of stealing.

Thus, a categorical imperative should be universal and not contradictory to the logical reasoning for the acts or obligations derived from the imperative. For example, the maxim that one must not lie. This categorical imperative is absolute in all circumstances; as if ‘*lying*’ as a maxim or moral rule is universalized; it will contradict with logic and reasoning.

The second is that persons must treat other persons as an ‘*end-in-themselves*’ and not ‘*mere*’ means.

The Kantian theory of ethics focused on reasoning of persons in making a decision and whether the same was in consensus with categorical imperatives. This meant that the consequence of the choice was not to be considered in Making ‘moral decisions’- decisions based on categorical imperatives. Illustratively, a person cannot

lie or be untruthful for a 'good cause' or for the greater good; as the act of lying is inconsistent with categorical imperatives.

Kant also examines 'duties' of persons, based on categorical imperatives. Kant states that there are two types of duties- duties to others and duties to oneself; classified into either 'perfect' or 'imperfect'. Duties to others can be perfect, if when they are universalized, they are impossible to negate or breach. Duties to others can be imperfect, if the duty when breached universally will lead to a contradiction with logic and reason.

For example, if the activity of charity is taken as a duty; it would be imperfect in nature. The duty if universalized as 'giving to persons with lesser means than oneself', then the economic and financial setup of society will crumble, due to the contradiction to the logic and reasoning of charity to better distribute resources and promote social welfare. Thus, in general imperfect duties are to be followed as much as possible, but perfect duties should be compulsory followed.

Immanuel Kant's theory postulates that the duty of keeping a promise is perfect in nature and breach of the same cannot be excused. If the maxim that 'it is correct by common law to breach or fail to act on a promise for any gain' is universalized, the contradiction will lead to an impossible scenario, whereby no-one will be able to coexist in society.

Thus, in essence, perfect duties and imperfect duties are both categorical imperatives and are 'moral' within the meaning of Kantian morality and ethics. According to Kant the moral system as derived from pure reason is the most viable source of law.

In relation to Code of insolvency and bankruptcy, 2016, the Kantian theory is embedded as a fundamental aspect to the resolution process. The Kantian theory ideally would require the protection of the rights of the creditors and the absolute enforcement of the debtors' duties- duties derived from promises, being a perfect duty.

The Kantian theory elucidates the critical difference in current times. The insolvency and bankruptcy code has provisions which seek to produce an efficient solution to the problem of the debtor; rather than being a strict enforcer of the creditor's rights and a punisher for the morally-impugned debtor who fails to keep his promise. Despite the Code not being in alignment with the absolutism of Kantian morality, it has incorporated certain aspects to further the philosophy of the debtor committing an immoral act.

The Code allows for liquidation of the debtor (corporate entity) or sale of the property of the debtor; as a recourse for the creditors. Admittedly, this is a secondary recourse- the first being that of formulating a debt-recovery or debt repayment plan through amicable resolutions between debtor and creditor.

The Code also provides for the 'fresh-start' process; which discharges the burden of the debtor in certain circumstances- which is unjustifiable by the Kantian perspective.

The Code explicitly avoids vesting time in the motives of the party and the origin or nature of the debt. For example, aspects as to whether the debt was taken with intent of repayment or whether the debtor had the intent to repay, but was unable due to unforeseen circumstances etc. These aspects can be incorporated as persuasive during the resolution process, but are not considered as determinative of the morality of the debtor's actions and the fundamental basis for deciding the problem of the creditor against the debtor,

The Code in its essence upholds some major aspects of Kantian philosophy and does not let the creditor's rights be tarnished. Although the code does not impute the Kantian morality in its absolutistic nature, it does reflect the moral issues of debt and debt-recovery, from a more consequence-based approach.

Utilitarianism and Bankruptcy

Utilitarianism theory, as propounded by **Jeremy Bentham** and expanded on by **Stuart Mill**; illustrates that human behaviour is based on 'pleasure' and 'pain'. It contends that moral principles are principles which seek to provide maximum happiness to maximum number of people. This is known as the 'principle of utility', as coined by **David Hume**.

The theory is more normative, as it justifies principles, not by broad morals; but by the consequences of the existence of such principles- the inherent utility of the principles. Bentham states that most morals can be reduced to be justifications of acts which maximize happiness to most or several persons.

Thus, a system of morals based on utility already exists and needs to be codified. Accordingly, Morality may change from time to time, depending on the utility or usefulness of the moral principle at any given time- a stark contrast to Kantian Philosophy which postulated that morals are unchanging.

There are two types of utilitarianism - Act utilitarianism and Rule utilitarianism. In brief, Act utilitarianism or classical utilitarianism is essentially where an act is considered objectively right, if it promotes happiness. Rule utilitarianism is wherein an act is objectively right if it conforms or corresponds to rules that promote happiness.

The major criticism of classical utilitarianism was that in certain circumstances it would justify acts such as murder and theft- as these acts may lead to maximum happiness to majority of persons. For example, a doctor may kill a person who have very less utility in society, in order to use his organs to save three others. Rule utilitarianism, seeks to promote the idea that rules and laws which seek happiness of majority persons should be the moral standard to be followed and considers the long-term happiness of society.

Thereby, according to utilitarianism, rules and moral standards should be based on the consequences of actions or omissions. The natural instinct of persons to avoid pain and seek pleasure, provides the basis for the moral standards to benefit others (maximum number of persons). Bentham and Mill substantiated the morality to benefit others; by stating that persons should act as if they had no vested interests and impartially, as if they were advising another.

Later, Philosopher **Henry Sidgwick** stated that the basis of morals and utility of acts was 'common sense'- a view considered as more defined, when compared vague terms used by **Bentham and Mill**.

In relation to property laws, Bentham believed that property should be utilized in a manner which benefits the society; but also recognized the right or interest of the owner of the property. In relation to debts of governments towards private persons, Bentham criticizes practice of rulers and government agencies to reduce or waive or diminish the debts. He supports the claim of the creditors whose rights cannot be diluted by sovereign power; as it causes pain to the creditors, apart from the general dissatisfaction of the citizenry.

In relation to 'forced exchanges', Bentham states "*exchanges may be forced, in order to prevent great loss; as in the case of land rendered inaccessible, unless a passage is taken across that of a neighbour*" and

“operations may also be justified, when the obstinacy of an individual, or a small number of persons, is manifestly injurious to the advantage of a great number”.

In principle, persons can be forced to enter a transaction which maybe against their personal interest, in cases where huge social loss may be incurred, if not entered into.

In respect to the Insolvency and Bankruptcy Code, 2016, the influence of modern utilitarianism is apparent. The objective of the Code is to achieve a solution which is suitable to maximum number of persons. The resolution of disputes is given a broader meaning, as the Code dwells into the economic and social concerns, rather than just the contractual provisions and other legal factors of the debt.

The Code seeks to benefit maximum people by providing a system through which an ideal solution for both parties can be sought. The traditional solution of liquidation or sale of assets of the debtor is kept as a last resort and the consequence-based analysis other solutions is done in each case of insolvency through proper mechanisms (insolvency professionals, Credit Committees etc. are setup). Thereby the system tries to derive the solution which gives maximum happiness to the maximum people.

For example, the settlement of disputes is based on data analysis and determination of viability of corporate recovery or re-construction or a probable repayment plan in cases of individual debtors. The system has adequate flexibility to be called ‘rule utilitarianism’, but this flexibility emphasises the lacuna in the utility principle. From the economic perspective, the search cost of deriving the optimal solution, may exceed the benefit of the solution when imposed- negating the utility principle.

Also, the problem of determining maximum happiness and criteria for the same, is left to the debtors and creditors; albeit in the framework of the Code’s laid-down mechanisms.

The criteria for making such a decisions can he ‘common sense’ or the ‘perspective of the bystander’ or such else as determinable by the acting parties. Although there are certain safeguards (such as the time limit, reports of insolvency professionals etc.) for making the solution for the dispute resolution as utilitarian as possible, the one chosen solution need not be the best solution, due to the inherent biases of the solution-makers (debtor and creditors).

Bentham believed that solutions should be based on the utility principle, even if the cost of that solution is to be borne by a select few - for the betterment of society as a whole. This may not be considered as ‘fair’, but is moral as it is in accordance with the principle of utility. This means that the system should ideally serve society (all persons), rather than being a mere tool to solve dispute between individual creditors and debtors. But as a matter of principle, the Code of 2016 is primarily concerned with resolving the dispute and in its application may not fully be utilitarian, as conceived by Bentham.

Thus, the Code of 2016 is utilitarian in nature, as it seeks to achieve India’s socialist objective of promoting and developing the Indian Credit or financial market.

Theory of Justice by John Rawls

The theory of justice as propounded by John Rawls is a branch of “*distributive Justice*”. He stated that justice is ‘*fairness*’. He proposed that justice is what a person perceives from the ‘original position’. In basic terms,

original position is wherein a person is stripped of all personal attributes and characteristics, but retains basic knowledge of economic theories, political status and human psychology. From the original position, the person perceives the world through the 'veil of ignorance'.

Thus, the person is unable to determine his position in society- gender, social class, richness or poverty etc. being unknown to the person. In this scenario, the person would frame policies and advocate for such measures and steps which would benefit the 'least well-off' or most- disadvantaged members of society.

Thus, the social system of Rawls sought to provide for equal opportunity for all and 'even the playing field'. Rawls argues that persons behind the veil will formulate two principles :-

The **first principle** of justice is that "each person is to have an equal right to the most extensive basic liberty compatible with a similar liberty for others." This principle addresses the dispensation of society's basic rights and liberties.

The **second principle** of justice is that "social and economic inequalities are to be arranged so that they are both.., reasonably expected to be to everyone's advantage, and...attached to positions and offices open to all." Rawls defines this second principle of justice as the difference principle. This principle governs the dispensation of the remainder of society's primary goods.

Thus, the theory purports that justice and justice system should distribute wealth equally and based on impartiality.

In relation to bankruptcy, the initial presumption is that the system of insolvency is to correct the inefficient distribution of wealth, The insolvency of a person or corporate does not affect only the debtor or the creditors, but customers, competitors, employees etc. and the credit market. Thus, a person behind the veil of ignorance has to provide for a system which benefits all persons who maybe the least well-off persons, as per the circumstance of the case.

The Code of 2016 is a welfare legislation which seeks to distribute wealth within the contours of justice. Rawls would support the intervention of the government, the process of debt-recovery on economic criteria and the efficiency of the system. The Code's provisions are based on Rawlsian justice, as the justice system seeks to distribute wealth in a manner which benefits the least well-off; to make all the parties involved have a gain in wealth and not subject to losses arising froth natural inequalities in life.

The system under the code analyses the debt situation and seeks to economically benefit every party involved, by making an arrangement which does not unjustly affect a single party's rights - as per the second principle of Rawls, The arbitration-like system of dispute resolution, with consideration of the adjudicating authority; enables the system to seek the most economically and socially effective solution.

The major critique of Rawlsian theory is that the deprivation of wealth of one, for another's sake cannot be 'justice'. Robert Nozick critique Rawlsian theory and stated that wealth of a person whether acquired by luck of birth or by hard work (Historic factors of property ownership) are his own and cannot be compelled to be given to others due to their lack of said wealth, In relation to bankruptcy, the wealth (property) of creditor (in most cases) cannot be denied to him, due to another person not having such wealth or inability to procure such wealth, While Rawlsian theory purports the legal system should re-distribute the wealth among parties of the dispute (direct and

indirect) to achieve ‘*distributive justice*’ as a part of social justice; the theory of **Robert Nozick** purports that the debt should be re-paid to creditor in full, as it is his property derived from historic factors- thereby meaning to distribute wealth to those who have rightful title over it.

However, in relation to bankruptcy, the goal of the justice system being redistribution of wealth for the economic goal of maximizing efficient usage of resources, the Rawlsian justice is preferable as it seeks out economic benefits in the long term- where debtors are encouraged to borrow funds and the credit market improves.

In conclusion, the provisions of the Code seem to be as per the social justice as propounded by Rawls, The institutions established by the code, the compromise-based system of dispute resolution etc. are socially and economically beneficial in their objective. The fresh start process under the code is especially Rawlsian in nature.

Libertarianism and John Locke

John Locke is one of main pioneers the libertarianism school of thought. He contends in his theory of Natural Rights that an individual has an intrinsic right over a property if he infuses the said property with his/her own labour. As a part of his theory, there are two provisos. The first one is that every man should take only that much resource as is required by him, second, that one should not cause spoilage of resources.

Unlike other philosophers of his time, he was an optimist regarding the state of humans before the establishment civil institutions and governments. He states that all humans are civil and the need for a government arises when there is a conflict with regard to property rights between two or more persons.

Adam Smith had previously provided the economic theory of “*the invisible hand*”. This theory contended that the forces of demand and supply of a commodity as well as labour would act as an invisible hand that shifted necessary resources to its optimum end use. John Locke was a philosopher who favoured the independence of market forces and opposed government intervention into economic forces of demand of supply. He is often misinterpreted as one who contradicts his own theory of natural rights as he states that one has to take resources for himself but make sure that he leaves enough for the rest of the world and supports ‘*capitalism*’ at the same moment.

On a closer analysis of the contributions of John Locke, it can be ascertained that he spoke of avoiding spoilage in terms of perishable goods. He gives the example of apples and plums that would last just for one week or several days; he states that these products should be taken only according to requirement and these perishable goods can also be exchanged with other goods that are more durable like metal pieces (referring to coins) or products like nuts that have a wider life if found in excess. Hence Locke here is referring to the value in exchange of a product rather than their value in use.

Locke is one of the first theorists of the social contract theory who states that all humans came together in a contract to appoint a state that would protect all of them so that each of them need not spend resources on fighting with each other. The concept of a contract is vital to Locke as he believes it’s a sign of a civil society. He further justifies punishments awarded to those who deviate from this contract through various monetary and non-monetary sanctions.

Locke also comments on slavery in terms of war; not just a war between two nation states but a war between two persons. He defines war as any person that chooses to place himself in a state of war against any of his peers. He states that anyone indulging in such activities forfeits his natural right to his opponent who defeats him. In this way, slavery can be justified; but he also states that freedom is vital to man's preservation and if one is enslaved, it would lead to death.

In terms of debt or loans, Locke is a supporter of the idea that flowing of money as a resource from one person to another who could possibly make better use of it, is beneficial to the economy. He states that market forces should decide factors like interest rates and surrounding conditions and trends of a debt. Insolvency and bankruptcy are the model conditions where Locke would suggest government intervention to be present. In cases where there is conflict of property rights, the government has to perform the duty of ascertaining each party's civil right that is vested in the property.

The judiciary as a whole is heading towards a Lockean ideal scenario, where the government would act merely as a facilitator for determining property rights and protector of the same mentioned rights. With the advent of alternative dispute redressal mechanism, the state allows parties to negotiate, conciliate and mediate outside court and reach to a conclusion that is fruitful for both parties.

The insolvency resolution process acts as mechanism that allows those creditors who see potential in their insolvent debtors to choose an action plan of repayment rather than direct liquidation. He is strictly against slavery or bounded labour as a method of punishment for an insolvent bankrupt individual. In conclusion, the Code is in terms with the vision of John Locke in regard of the role of government in a society. The act enables efficiency and flexibility for debtors and creditors, hence allowing market forces to determine the outcome rather than imposition of the will of the sovereign.

Conclusion

The Insolvency and Bankruptcy Code, 2016 is an indispensable fragment of finance and credit dynamics in the Indian economic environment. Insolvency refers to a scenario wherein the assets of a legal person are insufficient in comparison to its liabilities. Bankruptcy is whereby an insolvent person is legally declared as incapable of paying off the aggregate sum of debts. This Code seeks to achieve its object of securing the rights of creditors and economic efficiency.

The provisions and essence of the Code exhibit certain key jurisprudential concepts and ideologies. This broadens the scope of analysis to legal concepts such as that of property, morals and governance. Therefore, the Code can be better understood as a legal system to solve legal problems, rooted in socio-economic aspects which are highlighted by legal jurisprudence.

The Code of 2016 provides for several legal provisions which are attributable legal jurisprudential ideas such as morality of promises, nature of property, distributive form of justice etc. This culmination of ideas in the legislation from various perspectives is beneficial in providing for a solution-based approach, which enables such perspectives to be expressed in a legal and controlled manner.

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