

Unveiling Stigma in Corporate Insolvency: Analyzing Legal Lessons for India's Insolvency Framework - A Comprehensive Examination

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Abstract

The historical stigma attached to personal bankruptcy, rooted in moral judgments and harsh penalties, has been a subject of extensive legal discourse. Initially perceived as a gross moral indiscretion, bankruptcy was historically viewed as a breach of trust, with debtors facing severe consequences. While some argue that public stigma against personal bankrupts has waned in recent decades due to factors such as industrialization and increased awareness of external financial pressures, others contend that the stigma persists, exacerbated by the widespread availability of bankruptcy information on the Internet. This article acknowledges the ongoing debate regarding the decline of bankruptcy stigma but emphasizes the consensus that both personal and corporate bankruptcies still carry a level of societal disapproval. While existing legal research predominantly focuses on personal bankruptcy, this study aims to bridge the gap by investigating the relationship between bankruptcy and stigma in the context of corporate insolvency. Recognizing the distinctions in effects and manifestations between personal and corporate bankruptcies, this research is crucial in understanding how stigma impacts entrepreneurs in different settings. While personal bankruptcies affect a broad spectrum of entrepreneurs, corporate bankruptcies specifically impact high-growth entrepreneurs associated with limited liability companies. By delving into this underexplored area, the article contributes to a comprehensive understanding of the complex interplay between bankruptcy and societal perceptions, shedding light on the potential implications for both personal and corporate insolvency.

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1. INTRODUCTION

The social stigma associated with personal bankruptcy has been widely discussed, with legal literature exploring its potential causes and persistence. Negative views toward personal bankruptcy are rooted in history and societal factors. In the past, debtors were treated as quasi-criminals and faced harsh penalties, including the death penalty. This was because bankruptcy was considered the debtor's responsibility. It is not the result of external factors. From a sociological point of view, filing for bankruptcy was seen as gross moral indiscretion, and bankrupts were stigmatized. By declaring bankruptcy, the debtor has violated its ethical obligation to repay the debt incurred and

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carelessly disregarded the trust of its creditors. Therefore, the perception that bankruptcy is a breach of trust and the imposition of harsh penalties have played an important role in increasing the stigma of self-bankruptcy.

It is argued that public stigma against bankrupts has declined in recent decades. A variety of factors, including industrialization and the expansion of consumer finance, are believed to be driving the shift in public opinion against personal bankruptcy. Other factors that have softened the stigma of bankruptcy include the growing awareness that financial failures may be due to external factors such as unemployment, inflation, and health care costs, rather than debtor misconduct, and

bankruptcy tolerance. The spread of law, etc. can be mentioned. At the same time, however, some scholars argue that the stigma of bankruptcy still exists, and has been reinforced by the widespread availability of information about personal bankruptcy filings on the Internet. Easy access to information increases the stigma associated with bankruptcy proceedings and is a significant deterrent to filing for bankruptcy for some individuals.

Despite the lack of consensus on the issue of decline, it is widely recognized that bankruptcies, whether personal or corporate, still carry a certain level of stigma that impedes the functioning of the system. While most legal research focuses on the stigma associated with personal bankruptcy due to its special nature, relatively little research has been done on corporate bankruptcy. This article attempts to examine the relationship between bankruptcy and stigma in the context of corporate bankruptcy. This research is important because the effects and manifestations of stigma and its issues are somewhat different from bankruptcy. However, both personal and corporate bankruptcies affect entrepreneurs, so there is some overlap between the two. However, there is a difference as personal bankruptcies affect a wide range of entrepreneurs whereas corporate bankruptcies only affect high-growth entrepreneurs who set up limited liability companies.

2. REVIEW OF LITERATURE

In a statistical report analysed the Insolvency and Bankruptcy Board of India (IBBI), post-2016, 365 businesses had successfully obtained the bankruptcy code's voluntary liquidation, some of which had generated a profit after paying off their debtors. A business can choose to be liquidated voluntarily with the approval of its shareholders and creditors if it has not yet committed any payment defaults. Voluntary liquidation may result from factors like economic unavailability, strategic considerations, or choices made by the entity's global parent. According to information that is separately accessible from IBBI, 1,042 voluntary liquidation cases had been started as of September 30, 2021. As it is regarded as a crucial factor that influences investors' choices when making investments, the government has been taking various actions to reduce the period for companies to leave a company. The trend was ascribed by experts to excessive delays in the resolution process and a decreased desire to buy stressed assets. According to the most recent statistics from the Insolvency and Bankruptcy Board of India, only 14% of corporate insolvency resolution processes (CIRPs) between December 1, 2016, and March 31, 2022, resulted in a resolution plan. (IBBI). 47% of CIRPs during that period were liquidated. 3,406 of the 5,258 business insolvency cases that were started have been resolved. Data from the closed cases revealed that 1,609 had liquidation orders and 480 had resolution plans approved. The total recovery for lenders where resolution took place decreased to 32.9% from 36.8% around September of last year through March 31, 2022, since the launch

of the IBC in 2016. In absolute terms, the realization for financial creditors as of the end of March 2022 was Rs 2.25 trillion, a significant increase over the Rs 1.31 trillion liquidation valuation. Up until the end of March 2022, financial creditors had accepted a total of Rs 6.84 trillion in claims¹. The pilot study on the statutes discussing disabilities and disqualifications of insolvent persons identifies that Section 164 of the Companies Act 2013 which states that A director can be disqualified if he is adjudged as an undischarged insolvent or has applied to be adjudicated as an insolvent and his application is pending. Article 191 of Constitution of India refers to A person is not qualified to become a Member of the Legislative Assembly or Legislative Council of a State if he is an undischarged insolvent Article 102 in the Constitution of India which pertains to A person shall be disqualified for being chosen as, and for being, a member of either House of Parliament if he is an undischarged insolvent. Removal/Disqualification of Membership for members of various Tribunals: Removal of membership from NGT if he is adjudged as insolvent – Sec. 10, National Green Tribunal Act. Removal of membership from NCLT if he is adjudged as insolvent - Sec. 417, Companies Act. Disqualification under the rules for registration of insolvency professionals: A person is not qualified to become an insolvency professional if he is an undischarged insolvent.

In conclusion, different statutes in India deal with the challenges posed by insolvency persons. Besides the well-known provisions of the Insolvency and Bankruptcy Code, several other Acts protect creditors' rights and provide for rehabilitation or liquidation of the insolvent. The Official Assignee plays a key role in managing the insolvent person's affairs in the Companies Act of 2013, in Article 191 of the Constitution of India, Article 102 of the Constitution of India, and in the removal or disqualification of membership for members of various tribunals, and the disqualification under the rules for registration of insolvency professionals are the acts and provisions that deal with the disabilities and disqualification of an Insolvent person.

3. RESEARCH PROBLEM

The need to eradicate the Stigma associated with corporate insolvency for the successful rescue and rehabilitation of distressed corporations and for promoting entrepreneurship and economic growth in the country. Exploring the Bankruptcy Stigma under the Bankruptcy Code in India and corporate insolvency under the Australian context.

4. RESEARCH OBJECTIVE

- To study the evolution of Stigma in Bankruptcy.
- To emanate the impact on companies that have been liquidated post the implementation of the insolvency and bankruptcy code.

¹ After 2016, how many Indian companies got liquidated instead of being revived – Statistics

- To make a comparative analysis of the disabilities and disqualifications of insolvent persons under various statutes.

5. RESEARCH QUESTION?

- Whether the Insolvency and bankruptcy code 2016 mitigates the stigma of bankruptcy?
IBC in fact has played an effective role in reducing the stigma associated with personal bankruptcy.
- Whether it is desirable to retain the stigma attached to bankruptcy?
The stigma of filing for bankruptcy can come in the form of negative views of friends and family, or it can be more concrete in the form of inability or difficulty in obtaining credit
- How is Stigma under Bankruptcy Experienced in India?
The law of insolvency emerged only after the British period, various laws and acts evolved over time.

6. RESEARCH METHODOLOGY

In the doctrinal approach, the researcher formulates a hypothesis, after which he relies on qualitative analysis of the primary source of data i.e., IBBI Annual Report (2021-2022). The research methodology is based on a pilot study of the above Annual Report and the doctrinal part is mainly based on the relationship between bankruptcy and the societal stigma with respect to the India. The following research also explains the changing perception of societal stigma in India and the potential causes of Stigma surrounding Personal Insolvency.

7. STIGMA AND BANKRUPTCY LAW

Social psychologists define stigma as a highly discrediting trait and deviation from expected social norms. Bankruptcy is a legal proceeding initiated when an individual or business is unable to pay its debts or obligations. This is known as bankruptcy. It will be a fresh start for those who cannot afford to pay the bills. Professor Ervin Goffman, in his book, states that society classifies individuals based on their characteristics. In his opinion, individuals with special characteristics acquire normal social status, while stigmatized individuals acquire questionable status in society. Goffman argues that people in stigmatized situations have the opportunity not to reveal their stigma to other members of society. Since bankruptcy is not easily recognized by others, it is considered a state of discredit and we try to hide it from others as much as possible. From a legal and economic perspective, the stigma of bankruptcy is a financial burden that can cause a great deal of emotional turmoil in the event of personal bankruptcy and hinder successful bailout attempts for failed businesses. It is an indirect cost. The English Companies Act of 1862 introduced personal bankruptcy legislation, but the stigma of being a by-product of bankruptcy predates the framework for corporate bankruptcy. To understand the stigma surrounding corporate bankruptcies, it is necessary to examine

how the bankruptcy stigma around personal bankruptcies has evolved. The harsh treatment of debtors is one of the reasons personal bankruptcies are stigmatized. In the early days, debtors were seen as thieves who stole creditors' money and trust. For this reason, enforcement of outstanding debts was directed to his family or individuals rather than the debtor's property. In ancient Hindu law, the Dharma Shastra scriptures contained the concept of debt and its repayment. The Dharma Shastra functioned as a rule and code of conduct in ancient times. According to ancient rules, not paying debts is a sin. If the debtor dies without paying the debt, the good deeds pass to the creditor. Manu Smriti allowed the creditor to recover the amount owed from the debtor by forcing the debtor to work. The creditor can keep the debtor's family and livestock in custody until the outstanding debt is settled. These rules have played an important role in exposing the serious social stigma surrounding Bankruptcy. To avoid these penalties, debtors often fled their creditors with their families, but this was easier in those days due to the lack of communication and the lack of political barriers restricting movement. For this reason, the first bankruptcy law was enacted in England in 1542, called "DO make bankruptcy". The statute of 1542 used the term "bankruptcy" in the title only once, while the rest of the laws used the term "bankruptcy" as "criminal". Used in the 1542 Act to identify a debtor, this negative term helped perpetuate the stigma surrounding bankruptcy. Another feature of the 1542 Act states that bankruptcy is an active act of the debtor. It is also known that people do not fall into bankruptcy on purpose, but they actively fall into bankruptcy through cheating or recklessness. The ability of the debtor to pay is irrelevant because once the wrongdoing, such as running away from the creditor, has taken place, the debtor has committed wrongdoing. In subsequent legislation, lawmakers expanded the meaning of the term "bankruptcy" to include bona fide trustees. From a social point of view, the debtors were shown to be stigmatized as deposits were viewed as morally indiscreet. This means that the debtor has deviated from its ethical obligation to repay its debts to the creditor and recklessly disregarded the trust the creditor has in the debtor. The betrayal of the debtor who betrayed the creditor's trust put an end to the sacred relationship between the two, which justified outrage and stigma. Self-control sparked admiration, but bankruptcy was condemned because debtors chose to run out of credit rather than live within their means. Thus, by going into debt, one is stigmatized and socially ignored because one does not meet social standards of thrift.

8. CHANGING PERCEPTION OF SOCIAL STIGMA

With the rise of consumer finance in the 1920s, social criticism of bankrupts began to wane. Rapid consumption growth and increased production of goods meant that the accumulation of consumption-oriented debt was viewed positively. Soon, in some societies, such as the United States, debt became associated with a higher standard of living and a sign of social status. There has also been a change in society's perception of the causes of

bankruptcy. In the 1960s, more and more people in the United States attributed bankruptcy to events beyond the debtor's control. Thus, economic and personal circumstances such as inflation, unemployment, stock market losses, and health care costs have been attributed to individuals' financial hardship. Additionally, recent bankruptcy and industry laws have played an important role in reducing the negative implications of bankruptcy. Legislation in the past has referred to bankruptcy trustees as "fraudsters, fraudsters, fraudsters, delinquents." Such negative labelling reinforced and perpetuated society's contempt for defaulters. However, since the 1970s, new bankruptcy laws have been introduced to reduce the stigma associated with bankruptcy. For example, the US Bankruptcy Code of 1978 replaced the term "bankruptcy" with "debtor" to reduce the stigma against bankruptcy. This change in terminology played an important role in expressing the desire of legislators and society to treat bankrupts like other debtors. Finally, media and legal advertising contributed to the decline in bankruptcy-related deviations. Widespread media coverage of bankruptcy filings by politicians and celebrities has made bankruptcy a legitimate response to financial difficulties. To stay competitive, many lawyers have also started advertising their services. These ads have reduced debtor investigation costs and reduced legal representation costs by providing debtors with accessible information about bankruptcy. As such, both media and legal advertising have played an important role in increasing bankruptcy filings and reducing the stigma associated with personal bankruptcy.

9. STIGMA IN THE INDIAN CONTEXT

The law of insolvency in India, like most other laws, owes its origin to English Law. Before the British came to India there was no indigenous law of insolvency in the country. The

earlier statute, dating back to the 16th century and subsequent years, contained only a rudimentary provision as to bankruptcy. The important statutes on the subject are the Bankruptcy Act passed by British Parliament in 1849, 1869, 1883, and 1914². The Indian Insolvency Act, 1848's key characteristics were that the Act was more for the benefit of the debtors than the creditors. The rules governing the discovery of an insolvent's assets were quite simple, and it was completely up to the creditors to establish misbehavior in support of an insolvent's request for discharge. The official assignee had very little authority. He had no authority to participate in any procedures; he could only collect assets. In accordance with Section 7 of the Act of 1848, the Official Assignee became the legal owner of all of the insolvent's property upon the making of a vesting order. The Companies Act of 1956, which addressed corporate insolvency at the time, provided for the liquidation and winding-up of companies, with the High Court serving as the final arbiter. However, the application of this act was hampered by excessive delays, a dearth of qualified official liquidators, and the management of the insolvent company providing insufficient information about the organization or its operations by the 19th century, Bombay had adopted the practice of locking up debtors in state jails for failing to pay their debts.³ However, the colonial authorities viewed this as a burden. Therefore, the Act of 1828, which established the initial process and framework for the adjudication of bankruptcy petitions, was meant to relieve debtors rather than punish them. It is well-known that protection from arrest or incarceration was granted to 85% of the 20,980 petitioners who filed for bankruptcy in Mumbai between 1860 and 1898. The limited window of time during which only the debtor could submit a settlement plan was not specified by SICA. Instead, the BIFR selected an operating agency (typically a bank or financial institution) to provide the resolution plan if it determined that the company's revival was viable or in the public interest.⁴

Collection of Data as to Number of Companies that Went into Liquidation Post-IBC 2016 CIRP CASES ADMITTED, CLOSED, AND ONGOING⁵

	Till March 31, 2022	In 2021-22
Total number of CIRP cases admitted	5258	834
Total CIRPs cases Closed	3406	608
Closure by: Appeal/Review/Settled/Others	731	52
Withdrawal u/s 12A	586	112
Approval of Resolution Plan	480	125
Commencement of Liquidation	1609	319
Ongoing CIRPs	1852	226

² Law Commission Report, 1964

³ <https://www.mca.gov.in/content/mca/global/en/data-and-reports/company-llp-info/incorporated-closed-month.html>

⁴ "The Sick Industrial Companies Act, 1985", Section 18(1)

⁵ <https://ibbi.gov.in/uploads/publication/7ccd38791123c80bc5d2cf12adf5ff8c5.pdf>

9.1 CIRPs ENDING IN RESOLUTION ⁶

CIRPs ENDING IN RESOLUTION ⁶		
Number of cases ending in Resolution	480	125
Time Taken:		
0-180 days	6	0
181-270 days	39	0
181-270 days	435	125
Average days	528	711
Total Admitted claims (Rs. in crore)	760598	209291
Admitted Claims of FCs	684901	195231
Admitted Claims of OCs	75697	14060
Total Realisable Amount (Rs. in crore)	234049	47030
The realizable amount by FCs	225294	46759
The realizable amount by OCs	8755	271
Total Realisable Amount by Claimants as % of Claims Admitted	30.77	22.47
Realizable Amount by FCs as % of their Claims Admitted	32.89	23.95
Realizable Amount by OCs as % of their Claims Admitted	11.57	1.93
Liquidation value (Rs. in crore)	131448	36922
Total Realisable Amount by Claimants as % of the Liquidation Value	178.05	127.38
Number of cases where realization is less than liquidation value	103	34
BIFR / Not going concerned in resolutions cases	159	36

9.2 CIRPs ENDING IN LIQUIDATION ⁷

CIRPs ENDING IN LIQUIDATION ⁷		
Number of cases ending in Liquidation	1609	319
Time Taken:		
0-180 days	130	6
181-270 days	331	20
270+ days	1148	293
Average days	412	654
Total Claims: (Rs. in crore)	795836	145003
Claims of FCs	715005	125232
Claims of OCs	80831	19771
Liquidation value (Rs. in crore)	56196	10654
Liquidation value as % of total admitted claims	7.06%	7.35%
Number of cases in which resolution plan(s) received but not approved	377	77

According to the most recent information provided by the Insolvency and Bankruptcy Board of India (IBBI), the number of distressed businesses liquidated under the bankruptcy law vastly outweighed those that were salvaged as of March's end. According to the data, from December 2016 to March 2022, 47% of corporate insolvency cases resulted in liquidation, compared to 14% which resulted in a resolution plan. To put it into perspective, only 3,406 of the 5,258 corporate insolvency cases that were started under the legislation up to March had been resolved. Up to 1,609 of the closed cases have resulted in a liquidation order, while 480 have seen resolution proposals approved. Even before they were brought into the insolvency process, the IBBI report stated that the majority of the enterprises that were liquidated had "almost

completely eroded" in terms of economic value. Less than 8% of the amount of the outstanding debt was the worth of their assets. Due to a discrepancy between the asset's listed value and the offer price, Indian lenders are forced to liquidate stressed assets under the Insolvency and Bankruptcy Code (IBC).

Companies that were liquidated after the Insolvency and Bankruptcy Code (IBC) went into effect in 2016 may suffer greatly from stigma. With the intention of fostering economic growth and lessening the strain on the financial system, the IBC was implemented in India to offer distressed enterprises a time-bound and effective resolution mechanism. According to the IBC, when a corporation goes through the liquidation process, its assets

⁶ <https://ibbi.gov.in/uploads/publication/7ccd38791123c80bc5d2cf12adfff8c5.pdf>

⁷ <https://ibbi.gov.in/uploads/publication/7ccd38791123c80bc5d2cf12adfff8c5.pdf>

are often liquidated to pay off its debts. The company closes as a result of this procedure frequently, costing its employees their jobs. The stigma associated with liquidation can be brought about by a variety of factors, like reputational harm, investor confidence, credit availability issues, employee effects, and social and customer interactions. Overall, the stigma connected to IBC liquidations can have a negative impact on a company's reputation, investor trust, creditworthiness, employment prospects, and business relationships. To overcome these obstacles, a determined effort must be made to re-establish trust, show improved financial health, and highlight future success possibilities.

10. CONCLUSION

The majority of corporate bankruptcy laws are consciously moving away from the liquidation culture and towards the corporate rescue culture. This is also true for the IBC, which sees the corporate debtor's rehabilitation and reorganization as its primary goal. However, the prevalence of stigma in the bankruptcy process poses a barrier to the successful materialization of the rescue culture. Even while the IBC unquestionably brought about a badly needed structural shift in India's bankruptcy structure, several aspects of the Code have actually entrenched and continued the stigma associated with failing enterprises. This includes the creditor-centric structure of the IBC and Section 29A(c). As stated in the document, section 29A(c) considers the corporate debtors' promoters and former management to be dishonest individuals who contributed to the

company's demise through their misbehavior. As a result of the creditor-in-possession model, the management is not only removed during the insolvency process but is also prevented from submitting a resolution plan.

The judicial pronouncements that adopted the language of the 2017 Amendment Bill on section 29A and used a purposeful interpretation to extend the applicability of the ineligibilities under this provision have served to further reinforce this skepticism towards management failure and business failure. Such a mindset, which underlies the court rulings and the legislative framework, is problematic because it tips the scales of the insolvency regime in favor of liquidation. Corporate executives are reluctant to start the insolvency procedure because of the stigma attached to insolvency, which delays the early detection of financial crises and destroys assets. Additionally, ex-ante decision-making by businesses and women is impacted by the unfavorable impression of insolvency. Therefore, it is necessary to lessen the stigma's severity to a bearable level in order to effectively restore troubled firms. PPIRP, a new legal innovation that shields the corporate debtor from public inspection and the stigma that goes along with it because of the informal character of the discussions, appears to hold promise as far as stigma is concerned. However, this paper's conclusion emphasizes that without long-term changes in how company failures and insolvency laws are seen, such legislative reforms alone would not reduce the stigma associated with bankruptcy.

11. CONFLICT OF INTEREST

Conflict of interest declared none

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