The Provisions of SICA & Companies Act

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< EXECUTIVE SUMMARY >

◆SICA 1985 was a special legislation enacted in public interest with the twin objects of securing the timely detection of sick and potentially sick companies and speedy determination and enforcement of remedial measures. But some companies perceived SICA as an official exit route, thereby resulting into losses to creditors and increased NPA's in the banking sector SICA, 1985, was repealed by sick industrial companies (special provisions) Repeal Act, 2003. Many processions of SICA have been incorporated in chapter VIA (Section 424A-424L) is a considerably diluted form. The article below is a section wise Comparison between old provisions of SICA, 1985 and new provisions in Companies Act, 1956 with explanatory remarks on it, which indicates that the new Act has made an attempt to remove the bottlenecks and curb the practice of turning an operationally fit company into a sick unit.

INTRODUCTION

Sick Industrial Companies (Special Provisions) Act, 1985, as indicated by its title and preamble, was a special legislation enacted in public interest with the twin objects of

- securing the timely detection of sick and potentially sick companies
- speedy determination and enforcement of remedial measures i.r.o. such companies.

SICA was basically and predominantly a remedial and ameliorative, in so far as it empowered a quasi judicial body-Board for Industrial and Financial Reconstruction (BIFR), to take appropriate measures for revival and rehabilitation of potentially sick industrial undertakings and for liquidation of non-viable companies.

The author is members of the Institute. The views expressed herein are the personal views of the author and do not necessarily represent the views of the Institute.

FAILURE OF SICA, 1985

SICA, a well conceived concept, proved to be a major failure. The regulatory mechanism of SICA was effective only to a limited extent. Some companies perceived SICA as an official exit route. It not only saved them from the harsh legal proceedings but also gave access to various relief and concessions from the financial institutions. Section 22 of SICA created havoc in the banking sector and the quantum of non-performing assets increased at an alarming rate.

SICK INDUSTRIAL COMPANIES (SPECIAL PROVISIONS) REPEAL ACT, 2003

SICA 1985 after being amended twice, first in 1991and later in 1998, was repealed and replaced by Sick Industrial Companies (Special Provisions) Repeal Act, 2003. The work of revival and rehabilitation was entrusted to National Company Law Tribunal (NCLT) constituted under the Companies Act, 1956. Many provisions of SICA have been incorporated in Chapter VI A

(Section 424A-424L) in a considerably diluted form. Any appeal against the order of the NCLT will now be made to the NCLAT instead of Appellate Authority for industrial and financial reconstruction.

The basic premise of the provisions incorporated in Chapter VI A of the Companies Act is to plug the loopholes in the erstwhile SICA. The aim not only being to combat industrial sickness but also to reduce the same by ensuring that companies do not view declaration of sickness as an escapist route from legal provisions after the project failure and gaining access of various benefits\ concessions from the financial institutions.

APPLICABILITY

This Act is applicable only to industrial companies. No change in the definition of "industrial company". "Company" too shall the have the same meaning, as defined u\s 3 (1)(i) of the Companies Act, 1956.

Major Changes

Section no.	Provision in SICA	Provisions incorporated in the Companies Act	Remarks
2	The Act was for giving effect to the policy of the State towards securing the principles specified in clauses (b) & (c) of article 39 of the Constitution.	No corresponding protection under the Act.	The earlier provision was intended to avoid possible challenge to constitutional validity of SICA. However, the non-inclusion of similar declaration under the Act does not provide insulation from challenges under article 14 & 19 in view of article 31C.
3(1) (da)	Date of finalisation of duly audited accounts means the date on which the audited accounts of the company are adopted at the annual general meeting of the company	Omitted	Making of reference has been practically de-linked from the finalisation of accounts.
3(1) (ga)	Net worth means sum total of paid up capital & free reserves	Net worth means sum total of paid up capital & free reserves **less of provisions and expenses as may be prescribed** - 2(29A)	Earlier companies were not deducting provisions & expenses for computing net worth. Similarly, no provisions were made by the company even when such provisions were required to be made under the Accounting Standards. Now hopefully this loophole shall be plugged. If the expenses are shown in the balance sheet as assets and provision (required but not made in accounts) are deducted, the net worth, therefore, gets considerably reduced, and hence a sick industrial company can be detected much sooner.
Note: *Department of Company Affairs, vide letter no.4/28/8/-CL-X dated 2.9.1981, has clarified that accumulated losses shall be arrived at only after calculating un-provided depreciation.*			

3(1) (i)	Operating agency means public financial institution, State level institution, scheduled bank or any other person as may be specified by general or special order as its agency by the Board.	Operating agency is **group of experts consisting of persons having special knowledge in banking & industry in which sick industrial company is engaged** and includes public financial institution, State level institution, scheduled bank or any other any other person as may be specified by general or special order as its agency by the Board	The purview of the definition has been enlarged to include experts from the field of banking and finance as well. This will enable the NCLT to provide an effective revival scheme drafted by the experts in banking and industry to assist the sick company in rehabilitation
3(1)(o)	Sick industrial company means an industrial company (being registered for not less than 5 years) which has at the end of the any financial year accumulated losses equal to or exceeding its entire net worth.	Sick industrial company means an industrial company, which has at the end of any financial year: 2(46AA) ● accumulated losses exceeding 50% of average net worth during 4 years; or ● has **failed to repay debts to its creditor(s) in 3 consecutive quarters** on demand made in writing for such repayment.	The impact of this considerably tight modification can be summarized as under: i. No moratorium period. The holiday period of 5 years has been deleted. ii. Accumulated losses should exceed 50% of the average net worth during the last 4 years. iii. Inability to repay its creditors for 3 consecutive quarters on demand made by them in writing indicates weak liquidity status of the company, hence potentially sick. iv. Any one of the two conditions is sufficient to make the company sick.
4 to 14	Constitution and procedures of the BIFR and Appellate Authority.	Omitted	BIFR and Appellate Authority replaced by NCLT and NCLAT respectively.
15	Reference to the Board	Sec 424A is parallel to Sec 15 of SICA. Now the **company is required to submit a scheme of revival & rehabilitation at the time of making reference to the NCLT.** Such reference has to be made within: ● 180 days after the Board of Directors came to know about ● 60 days of final adoption of accounts. Further, it is also required to furnish a **certificate from auditor on the panel approved by NCLT** giving reasons for such reference.	The responsibility for preparation of revival & rehabilitation scheme has now been casted on the company making the reference to NCLT. Thus, it is no longer the duty of the banks\financial institutions to nurse a sick baby. Thus adoption or even preparation of accounts is not the basic criteria. Reference has to be made even when banks\ Financial institutions take over the assets under Securitisation & Reconstruction of Financial Assets, Enforcement & Security Act, 2002. This is a new provision. Auditor's certificate adds to the authenticity of such reference. The auditor has on the panel approved by NCLT in this regards.

		424A(5) provides that NCLT has to examine, as preliminary issue, whether the company is a sick industrial company u\s 2(46AA) even before considering the viability of the scheme of revival & rehabilitation.	Principal jurisdictional provision in favour of NCLT, empowering it to examine the basis of such reference even before analyzing the viability of the revival scheme. Reference may be rejected at this stage itself.
Note 1: As regards making of reference to Board, an industrial company can now make reference to NCLT u\s 424A. But now Government companies have been excluded from the provision of Chapter VI A of the Companies Act. U\s 424A(1), a government company can make a reference under the Act to NCLT only with prior approval of Central or State government. "Deemed government company" u\s 619B of the Companies Act, can not be regarded as a government company, hence can make a reference without the prior consent of the Central or State government.			
Note 2: All healthy companies are now required to pay a cess towards the "Rehabilitation & Revival Fund" for sick industrial companies that will be at the disposal of NCLT.			
16	Inquiry into the working of the sick industrial company by the Board. For expeditious disposal of the case the matter could be referred to operating agency by an order of the Board. The agency was required to furnish a report to the Board on completion of its inquiry into the matter. Further, Board may appoint one or more person to be the special director\s to the company to safeguarding the financial and other interests of the company or in public interest.	Sec 424A(5) empowers NCLT to examine as preliminary issue whether the company is a sick industrial company u\s 2(46AA). Thereafter, only in cases where NCLT may consider necessary, forward the matter for inquiry to operating agency.	Thus even before examining the viability of the scheme of revival proposed by the company, NCLT can check the genuineness of the reference made to it. Thus, inquiry by operating agency will only be to enable NCLT to decide the viability of the scheme and to assess whether the company has the ability to revive on its own. Else it would direct the preparation of scheme u\s 424D.
Note 1: Earlier BIFR was required to pass the final orders within 60 days from the commencement of inquiry. Now, first the operating agency shall submit its report to NCLT within 21 days (extendable upto 40 days by the Tribunal). The Tribunal shall conclude its inquiry within 60 days from the commencement of the inquiry, extendable upto 90 days by the Tribunal for the reasons to be recorded in writing. Note 2: No change in the provisions relating to the appointment of special directors. However, now special director will submit report to Tribunal within 60 days. He shall have the same powers as that of a director of a company, but shall not retire by rotation or be liable for prosecution etc.			

17	Powers of Board to make suitable orders on the completion of inquiry.	u\s 424C NCLT has to consider and decide whether it is practicable for the company to revive on its own within a reasonable time. Alternatively, it may direct any operating agency to prepare such scheme in accordance with the guidelines prescribed by it in this behalf.	No change, except that the words "make repayment of loan" have been inserted corresponding to the change made in the definition of "sick industrial company". Under SICA, 7-10 years was considered to be a reasonable time for the company to make its net worth exceed the accumulated losses. NCLT has, till now, not decided what should be the range of reasonable time, but definitely in the present standards 7-10 years is too long to be considered reasonable.
18	Preparation and sanction of scheme for revival & rehabilitation.	u\s 424D Operating agency to prepare the scheme for revival & rehabilitation **with specific regards to the guidelines of RBI**.	Scheme to be prepared within 60 days (extendable upto 90 days) as against earlier provision of 90 days.
		NCLT may review and modify the scheme, if necessary -424D(5)	No change in what the revival scheme should provide for, except that now it may provide for measures for repayment of debts. (consequential to the change in definition of sick industrial company)
		The draft scheme as vetted by Tribunal to be circulated- 424D(3)	Brief particulars of draft scheme **may** be published. Earlier "shall" was used, making publication of advertisement compulsory.
		Draft scheme **may** be sanctioned within 60 days from the date of advertisement\ circulation, extendable upto 90 days- 424D(4)	Earlier, there was no time limit. Further, "shall" was used making it compulsory for BIFR to sanction the scheme.
		Copy of the sanctioned scheme to be filed with the Registrar-424D(9)	New Provision
		Scheme may also be prepared by the creditors of the sick company, if agreed to by 75 % of creditors - 424D(11)	New Provision. Provisions i.r.o. preparation and sanction of scheme will also apply to the scheme prepared by the creditors-424D(12)
		Scheme shall be binding on creditors and all concerned -424D(13)	New Provision. But seems to be a duplication of Section 424D(10), which provides that the scheme shall be binding on the company and others.
19	Rehabilitation by giving financial assistance.	Similar provisions incorporated in Section 424E	No change
19A	Sick Industrial company\bank\FI\Government can apply to Board to continue the operations of the said company	Similar provisions incorporated in Section 424F	No change

20	Board was required to record and forward its opinion for winding up of the sick industrial company to the High Court.	**Tribunal can itself order the winding up of the company**, if it is of the opinion that the sick company is not likely to revive. Tribunal can appoint any officer of the operating agency to act as the liquidator. Further, Tribunal can also sell off assets of the sick company and distribute the proceeds in accordance with section 529A.	Section 20(2) of SICA becomes redundant as Tribunal can itself order winding up instead of merely forwarding its opinion to the High Court. This power was earlier vested with the High Court. This power was with BIFR under SICA.
Note: Significant provision incorporated u\s 424G(4), directing that the winding up should be completed within one year from the order of winding up.			
21	Operating agency to prepare inventory, list of creditors, valuation etc.	Similar provisions incorporated u\s 424H	No change
22	Suspensions of legal proceedings, contracts etc., thus providing complete immunity from legal suits, recovery proceedings and winding up petitions made during the inquiry and implementation of the scheme.	No parallel provision in the new law. Recovery proceedings and suits against the sick industrial company can continue even if enquiry is pending with NCLT or revival & rehabilitation scheme is pending for preparation or implementation.	No protection to sick industrial company against suits or legal proceedings for recovery of money or execution against property. However, winding up proceedings may be kept as these are with the same Tribunal.
23 and 23A	Proceedings in case of potentially sick industrial companies.	No parallel provisions in the Act.	
25	Appeal to AAIFR against the order of BIFR	Now appeal against the order of NCLT has to be made to NCLAT.	
28	BIFR required to furnish information and return to Central\ State Govt. and to collect from and furnish certain information to various authorities.	No corresponding provision.	

32(1)	Overriding impact over all other laws except, FEMA and Urban Land (Ceiling & Regulation) Act and also the Memorandum and articles of association of the company.	No parallel provision. **Overriding impact done away with.**	Various legal provisions under different enactments have to be complied with to make the sanctioned scheme effective.
33	Penalty for certain offences	Penalty of imprisonment upto 3 years and fine upto Rs.10 lacs for violation of orders of Tribunal, making false statements or giving false evidence or attempt to tamper records of reference or appeal.	Following changes incorporated: ● Limit of fine fixed upto Rs.10 lacs. ● "tamper records of reference or appeal"- recognised as a punishable offence.
34	Offences by companies	No parallel provision under the Act	
35	Central Govt. empowered to remove difficulties for the first 3 years.	No parallel provision under the Act	

CONCLUSION

The above analysis indicates that the new Act has made an attempt to remove the bottlenecks and curb the practice of turning an operationally fit company into a sick unit. The Government deserves a pat for creating an effective legal framework, wherein, the banks\ financial institutions will now not hesitate to provide capital assistance to industrial undertakings.

However, the absence of well-developed secondary markets in India raises considerable doubt regarding the effective enforcement of recovery proceedings. The lack of institutional framework for sale of assets of the sick unit delays the process, thereby diminishing the realization value of the asset. Moreover, no thought seems to have been given to curb the past practice of the sick units getting their assets bought back by kith and kin violating arms-length transaction.

The need of the time is *"turn arounders"*, specialised firms that exclusively work for the revival & rehabilitation of sick\ potentially sick units. This does not, however, undermine Government's responsibility to institute proper administrative measures to dissuade deliberate efforts from delaying the regulatory mechanism. ■

CORRIGENDUM

The book review on 'Managerial Accounting for Hospitals' authored by Shri G P Kulkarni - that was published at page no. 820 of the February 2004 issue of the Chartered Accountant Journal - was done by Shri S K Ganguly, FCA, a New Delhi based practicing member of the Institute. Omission of his name, by inadvertence, is deeply regretted.

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