

Proceedings Report

Insolvency in Nepali Context

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Speakers:

Justice Bharat Upreti, Judge, Supreme Court

Bhesh Raj Sharma, Secretary, Ministry of Law and Justice

Maha Prasad Adhikary, Deputy Governor, Nepal Rastra Bank

Narayan Bajaj, Liquidator, Nepal Development Bank and Member, NIPA

Nepal Economic Forum (NEF), in association with Nepal Insolvency Practitioners' Association (NIPA) therefore organized a neftalk to bring about a holistic perspective on the laws, challenges and practical situation in regard to insolvency, in addition to building awareness of how insolvency is not a crime.

The talk started with Jitendra Rajbhandari, chairman of NIPA, briefly introducing the Association. NIPA was formed with the objective of disseminating information about insolvency in order to change the perception of looking at insolvency as a crime. Currently there are 15 members in NIPA, including 2 liquidators, required authorities as per Insolvency Act. The members also include lawyers, bankers, and various other individuals from the corporate sector.

Thereafter, Narayan Bajaj, the official liquidator for Nepal Development Bank took the floor. He identified three key factors that lead to banks and financial institutions facing insolvency – bad policy, bad management and bad luck. According to him, in the Nepali context, bad management is the primary cause for organizations facing insolvency. Taking the liquidation exercise for Nepal Development Bank, it can be said that its insolvency arose from an asset liability mismatch, which eventually led to interest liability of the organization exceeding its interest income. One of the reasons behind the asset liability mismatch he stated is “*related party lending*”, whereby the borrower is connected to the management, leading to fraudulent transactions, especially with an organizational structure, wherein one does not know where a role starts or ends. Therefore, the internal management needs to be efficient in reviewing the operations of a company.

According to data from companies that have gone into liquidation, 26% is due to poor supervision and lack of a regulatory body, 20% due to deficient bank management, 11% due to political influence and 15% due to connected lending and fraud.

According to Bajaj a continued study of these factors will eventually lead to a solution. Furthermore, Bajaj discussed contradictory points stated in the acts governing insolvency. For example, on liquidation of a company the board of directors does not automatically dissolve. Nepal Rastra Bank (NRB) has the right to liquidate the board under the NRB Act; however NRB is yet to do this. Another issue is the role of the court. Is their role just to appoint a liquidator or is it also to manage the liquidation process as a

whole? The role of the court is also essential in determining payment priorities and distribution of surplus funds, as the Insolvency Act does not differentiate between creditors, whereas other acts determine who should be prioritized while making payments. Furthermore, during debt recovery the recovery amount is established but there are no records of who owes the money to the company. In such situations the amount should be written off, but since there is no stipulated process to write off these bad debts in the current Act, the liquidator has a tough time reconciling such amounts. In most situations, organizations may be clinically dead, but legally alive as petitions for liquidation are simply filed with no action being taken.

These are pertinent issues, most of which usually goes unanswered, faced in the process of insolvency. According to Bajaj, only having an insolvency act is not enough, it is just as important to develop of a mechanism for implementation, preferably regulated by the NRB and security board so that a liquidator can finalize the process. The court must take a judiciary role in the process and finally all contradictory sections in the NRB Act and the Insolvency Act need to be amended to remove conflicts and ensure smooth implementation of the liquidation process.

Bhesh Raj Sharma, Secretary, Ministry of Law and Justice thereafter shared his insights. He stated that ministry has attempted to bring about special resolutions in the national as well as international context, to deal with the issues faced. However the problem, according to him stems from the public being misinformed. In such cases, when the NRB examines a bank, depositors panic and line up to get back their deposits. The public is unable to understand that the NRB examining a bank is a normal procedure. Sharma propagated, facilitating the re-creation of the Insolvency Act to address deficiencies and identify the role of the court, and its regulation. He also identified the requirement for a standard framework in the liquidation process.

Nepal Development Bank is the first company to be liquidated after the Act came into existence. The bank was ordered to go into liquidation by the Paten Appellate Court in January 2010 after the bank's financial situation could not be saved.

Likewise, in August 2011, the court ordered Samjhana Finance Company to go under liquidation for similar reasons. Law secretary Bhesh Raj Sharma also admitted that the legal provision for insolvency is not discretionary and the measure of one-size-fits-all is creating hassles in liquidation of different types of companies. "We at the Ministry of Law and Justice are open to discussions that will simplify the procedure," he said.

A member of the audience shared the case of Toscana Nepal Pvt. Limited, which was the first non-banking company to file for insolvency. He identified bad luck, rather than bad management or bad policy to be the reason behind its insolvency. He further stated the difficulty and costs involved in getting through all the procedures of the insolvency process due to the lack of a standard framework for companies choosing to file for insolvency. He pointed out that even after bankruptcy, there is a heavy fee involved for the company to declare bankruptcy.

Another member of the audience also expressed that the regulators and concerned authorities should first try to reorganize and restructure the companies instead of ordering them to shut shop and liquidate. For example, in the case Lehman Brothers, it went into administration and not directly into liquidation. First the assets of the company were sold off in order to pay off the creditors, and only thereafter it went into liquidation.

Audience member expressed that though insolvency laws have been around for nearly half a decade, corporations – both banking and non-banking – rarely seek liquidation to put an end to their problem even if they are having a hard time to even managing operating costs. It is this refusal to take the insolvency route that because the law has not been tested or problems addressed in Nepal.

One prominent point put forward by Narayan Bajaj, was in regard to the need for a legal framework that facilitates rehabilitation of doomed companies instead of forcing them to go under liquidation. The acts in place do not have provisions that favor the revival of companies on one hand and on the other hand make the liquidation processes long and bureaucratic. He also stated that in case a company goes insolvent due to bad management, provision must allow change of management to allow restructuring of the company. Currently, once the liquidation process starts, the liquidator is allowed to approach the court to allow revival of the company. However, revival depends on the decision of the court.

Bajaj also talked about the conflicting issues in the Insolvency Act and the Banks and Financial Institutions Act (BAFIA). With regards to the priority in payments made to the creditors, the BAFIA states that individual depositors will be the first recipients of money while the Insolvency Act states that employees and other liabilities will have to be prioritized. None of the acts mention the board of the company which leads to confusion with regards to who will get paid first. He also suggested that the NRB must encourage financial institutions to merge in order to avoid liquidation.

Justice Bharat Upreti, Judge, Supreme Court who was also involved in the framing of the Insolvency Act in 2006 stated the need for more practicality in the Act. He stated that when drafting the Insolvency Act, similar acts in other countries were taken as a basis; therefore this act lacks practicality in the Nepali context. In addition, due to the business sector being more dynamic than the banking sector, it is essential for the Insolvency Act to be closely revised and updated in accordance. One of the reasons for the impracticability of the act is due to the prevailing laws in the country. On one hand we would like to encourage companies to go into liquidation, however, once the insolvency process starts, the company is blacklisted, which acts as a de-motivator. For smooth implementation of the liquidation process, the board of management should be dissolved. In order to encourage declaring insolvency, insolvency and liquidation needs to be differentiated, stating that liquidation is the last resort to insolvency. Also, the payment priority of creditors needs to be listed down clearly.

Mahaprasad Adhikari, Deputy Director of Nepal Rastra Bank, was the last to take the floor. He pointed out that legal reform is necessary to encourage entrepreneurs to take corrective action with regards to

insolvency. He suggested that if a company willingly declares insolvency, then maybe provision for blacklisting could be waived. Regarding payment priority, he said that different priority lists for different sectors could be made. He ended his talk by stressing that Nepal Rastra Bank needs to review acts under its purview so that they are consistent with the Insolvency Act.

A member of the audience pointed out that the discourse has left out an important component of insolvency, which is individual insolvency. To this, Upreti replied stating that the reason individual insolvency, also referred to as bankruptcy, has not come into practice is due to what he referred to as the ‘one way traffic’. As per the act, only debtors are allowed to file for bankruptcy, whereas the creditors have no right to take the debtors to court to file for bankruptcy. Other reasons could be attributed to the cultural issues related to blacklisting. As soon as the insolvency process starts, the individual is blacklisted which acts as a huge de-motivator. However, there a few cases file, even at the Supreme Court level. What needs to be done is inform the entrepreneurs about the positive impacts of insolvency, with regards to the protection from harassment of the creditors.

Justice Upreti, thereafter requested the Secretary of Ministry of Law and Justice to address the problems in the legal process of implementing insolvency and find solutions as it requires involvement from the top. The long term goal can be to amend the act and bring about changes; however the legal process needs to be amended sooner in order to smoothen the insolvency process.

Bhesh Raj Sharma, Secretary of Ministry of Law and Justice, reiterated the fact that since the act has not been put into practice, it is difficult to pinpoint its flaws, whether it is regard to the lack of legal infrastructure, administrative issues or supervision. Also, it has not been established whether insolvency is so unpopular due to unwillingness to declare insolvency or due to the process being too complex. Again these questions will be answered once the act is practiced.

Sujeev Shakya, wrapped up the discussion series stating that the discussion has only begun with various issues raised, and that the NIPA must take this discussion forward. The confusion that is created through different laws must be addressed in order to bring about uniformity in the laws governing insolvency. The issue of bankruptcy is also huge. In Nepal, we only perceive the act from an organization perspective and not from an individual perspective. Shakya ended the talk by stressing two points that Nepal Economic Forum tries to bring out. Despite bringing in international consultants, the reason for the failure of the success of these acts is because we have failed to infuse the local elements into our strategies and policies. Secondly, he stated the importance of conducting the discourse of professional issues in English in order to start the process of globalization. He also stressed that it is time to make the acts in English so that nothing is lost in translation and in this regard that NEF is continuously working on bringing light to such issues.

Nepal Economic Forum is a non-profit organization dedicated to being the private sector interface to Nepal's economic development.