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Ensouth

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N South

Advocates

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Managing Partner's message

It is our pleasure to bring to you the July 2016 issue of Ensouth. This time we focus on two 'burning' issues. The first goes to the very root of our democracy: freedom of speech.

Democracy is premised on the ideological foundation that Governments exist to execute the will of the people. Presumably, the people first express their will which is then transformed by those they elect into programs. Yet, we are faced with the absurd prospect that sections of Indians consider it criminal to have an opinion, especially when it "hurts the feelings" of some of them. In **Sedition is the new Arranged Marriage**, we ask how democracy can possibly function when what some want hurts the feelings of others?

This brings us to what I consider the biggest challenge to our economy: that strangely perverse ideological construct which punishes entrepreneurs for business failure. In **Sky High Crucifixion**, we examine how the persecution of Vijay Malliya makes absolutely no sense. Following up on that train of thought, we subject our new bankruptcy law to a critique in **Commercially Sustainable Bankruptcy**, and ask if it is likely to meet the challenge of an India searching desperately for entrepreneurship and growth.

Happy Reading!

Ranjeev Dubey
Managing Partner

Print Media

Comment-1

Fine Print: Sedition is the New Arranged Marriage

How can any democracy function if it criminalizes truthful speech?

Ranjeev C. Dubey

When Karl Marx observed in 1852 that history repeated itself, first as tragedy and then as farce, he could have been talking about our sedition law! Consider the absurdity of the situation we face today. Back in college, when my friends and I ranted from time to time about some perceived injustice or the other, our elders put it down to raging testosterone and indulgently laughed it off. In time, the anger faded. If it didn't, the parents found a nice girl and married the boy off, it being the default way to 'settle down' raging hormones! JNU circa 2016 changed that. Just how, when and why did sedition and jail become the new arranged marriage?

I am bewildered the more because India's sedition law is an apparition from another time, another ideology and another paranoia. We must bear in mind that sedition was not classified as a crime when the British wrote the Penal Code into the statute books in 1860, a mere two years after they suppressed the 'sepoy mutiny'. This did not mean that voices of dissent died immediately. Probably the most troublesome of these voices was that of the Wahabis, a home grown jihadi movement of armed resistance seeking a return to the glories of the Mughal Empire. The sedition law was added to the Penal Code in 1870, a statute already well capable of dealing with violence. This explains why sedition is about outlawing speech, rather than any overtly violent act. This law was then used ruthlessly in the following two decades to repress Wahabi and similar dissent.

By the turn of the century, British rule in India was well established but new dissenters were finding their voice. As you would expect, our sedition law now found new customers. In history repeating itself as tragedy, those seeking the same freedom as their colonial masters - Mahatma Gandhi, Bal Gangadhar Tilak, Anne Besant and countless others - were accused of sedition. Given this history, would you have expected such a law to survive our independence?

I would not have thought so. Clearly, section 124A goes against the tide of the times in prescribing jail for "Whoever by words, either spoken or written, or by signs or by visible representation or otherwise, brings or attempts to bring into hatred or contempt, or excites or attempts to excite disaffection towards the government established by law in India..." Given our democratic underpinnings, this makes little sense. Democracy thrives on accommodating divergence of opinion. It is premised on the basis that people will disagree. It leaves governance to those who constitute the majority view. How can we ever hope to discover what the majority want if voicing that opinion results in a three-year jail term?

The judiciary has always been cognizant of this problem. A mere 11 years after independence, the Allahabad High Court held this provision unconstitutional [Ram Nandan vs. State, AIR 1959 All 101] because it attacked the very roots of free speech. The state appealed and it wasn't till 1962 that the Supreme Court took up the issue [Kedar Nath Singh vs State Of Bihar; 1962 AIR 955]. It was a historic moment, occurring at the wrong time. The post-independence honeymoon with home grown politicians had ended and disillusionment had set in. The border dispute with China was at its high-pitched verbal best. India felt besieged, and very alone. In a classic case of middle-roading, the court used some creative reasoning to interpret the law in a way its framers could not have foreseen. First, it said that "the Government established by law" has to be distinguished from the persons for the time being engaged in carrying on the administration." This means that it is okay to hate this or that political party or the Governments they run. So long as you don't try to overthrow the Union of India, you are okay. Second, the court said, "the feeling of disloyalty to the Government established by law or enmity to it imports the idea of tendency to public disorder by the use of actual violence or incitement to violence." So long as you don't extol your friends to break India up by taking up arms and stuff like that, you should be okay.

This landmark ruling has not served to restrain the enthusiasm of the police to book trouble makers in a rising vortex of increasing absurdity. Thus when two emotional noisy oysters shouted pro-Khalistan slogans in front of (what else!) a movie hall in the wake of Indira Gandhi's assassination [Balwant Singh v State Of Punjab (AIR 1995 SC 1785)], the Supreme Court declined to magnify the trivial, observing that since "the slogans...were raised a couple of times only...and that neither the slogans evoked a response from any other person of the Sikh community or reaction from people of other communities, we find it difficult to hold that upon the raising of such casual slogans, a couple of times without any other act whatsoever, the charge of sedition can be founded."

The court has not changed its mind since. When Aseem Trivedi was arrested for a cartoon he drew for the website "India Against Corruption" [Sanskar Marathe Vs. State of Maharashtra and Ors. (2015 Cri LJ 3561)], the court held on a PIL that "there can be no real freedom unless thought is free, not free thought for those who agree with us but freedom for the thought we hate". Similarly, when our finance minister posted an article criticising the NJAC, the Judicial Magistrate, Kulpahar, Mahoba, U.P summoned him to answer the charge of sedition amongst others. The Allahabad High Court did not agree. In Arun Jaitley Vs. State of U.P. (2016 92 ALLCC 352), it held "The article merely seeks to voice an opinion and the view of the author of the need to strike a balance between the functioning of two important pillars of the country. It is surely not a call to arms."

The consistency of the courts in its thinking on this subject is matched by the consistency of the police in booking politically active people under it. Recently, the Gujarat reservation riots by the Patidar Patel community led to the filing of a rash of FIRs against its leaders. Were these speeches seditious? In Hardik Bharatbhai Patel Vs. State of Gujarat and Ors

(2016 CriLJ 225), the Gujarat High Court observed that The offence of sedition is the resultant of the balancing of two contending forces: namely, freedom and security. Freedom and security in their pure form are antagonistic poles: one pole represents the interest of the individual in being afforded the maximum right of self-assertion free from Governmental and other interference while the other represents the interest of the politically organized society in its self-preservation. It is impossible to extend to either of them absolute protection for as observed by Mr. Justice Frankfurter, "absolute rules would inevitably lead to absolute exceptions and such exceptions would eventually corrode the rules". Wise words indeed, as you would expect from our judiciary. In the result, it held that sedition was prima facie made out.

Even more recently, we have watched JNU erupt in what appears to be a storm in a teacup. A 'cultural meeting' called to protest against 'the judicial killing of Afzal Guru and Maqbool Bhat' and in solidarity with 'the struggle of Kashmiri people for their democratic right to self-determination' degenerated into a slugfest between two students unions. Anti-national slogans were raised by persons unknown. As the farce unfolded, the JNUSU president was arrested to be later beaten up by my learned friends in Patiala House. Consequently, my learned friends - whose job it is to uphold the law - now face charges of being in contempt of court before the Supreme Court! We wait with baited breath for the court to go where no court has gone before and decisively rein in these august members of the bar. Meanwhile, the rest of the nation, including but not being limited to Parliament, is now receiving some insightful lessons into what constitutes sufficient and appropriate nationalism by its righteous self-appointed thekedaars. Thus, a law designed by the British to suppress those who sought freedom is now being used to suppress those who think they have won their freedom. For good measure, a "masked man" raising anti national slogans has also retrospectively entered stage left in the JNU meet. Do I hear you laughing derisively, Karl Marx?

Even if a farce such as this did not play out, you cannot but be skeptical of such a law. If you watch news TV, you will know that we are a nation with very low incitement thresholds. India lives on the edge of its nerves, because we are a stressed-out, distrustful society with overwhelming daily provocations. Road accidents routinely transform into bus burning mobs. Disagreements over parking space instantly degenerate into hockey stick battles. This does not happen because someone makes a speech. Indeed, I would argue that words in isolation do nothing without material provocation, and where there is sufficient provocation, people don't need words. Indeed, the very ideas that people are dumb cattle easily incited by speech flies in the face of the idea that Indians are smart and understand their self-interest well enough to elect their leaders every five years. People react with violence because they are beside themselves with frustration and don't know what else to do. To fail to understand this is to miss the wood for the trees. It follows then that it is acts of violence against which India must act, not the verbiage that floats about in the environment. Instead, in the aftermath of most riots, we don't identify and convict the rioters who destroy public property. Instead we jail those who make those pathetic opportunistic speeches. That is not just missing the

flaming forest for the single burning tree; it's thinking that the poor little tree is all there is to the problem. Which is only a convoluted way of saying that by definition, sedition doesn't just throttle democracy: it misses the whole damn point.

Comment-2

Fine Print: Sky High Crucifixion

Economic development and job growth is untenable if we crucify promoters of bankruptcy businesses, instead of providing US style Chapter 11 protection.

Ranjeev C. Dubey

Vijay Mallya's public crucifixion reached a new high on April 7 2016 when 17 lending banks declined to accept his settlement offer, putting the Supreme Court in the unenviable position of asking him to make a full disclose of all assets held by him, his wife, and his children too. This comes in the backdrop of a relentless campaign to demonise the man who only yesterday was the Indian male glam-doll of choice, carrying our flag to the sort of snooty places that host F1 races. Since I lost all of 265,000 frequent flyer miles earned on my American Express card when Kingfisher Airlines ceased operating in October 2012, I would happily support the smear campaign but for the fact that my loss is trivial in the face of the hundreds of crores he lost.

That is also true for most other people bad mouthing Mallya. They blame him for losing the money. The idea that all businesses by definition carry "no fault" risk seemed alien to most people. Where do we get this idea that all businesses must by definition make money all the time? What is it exactly that Mallya is accused of? For the most, I hear that Mallya has no right to live his luxurious life when he owes hundreds of crores to banks. For anyone born less than 400 years back, that is indeed a very strange notion. The rise of oceanic trade between Europe on the one hand and both America and Asia on the other created a curious problem: about 25 per cent of all ships that plied the oceans were lost at sea to weather or pirates. To manage and distribute this risk, the Dutch and the English between themselves invented the joint stock company. This allowed individuals to buy a share of the risk (and the reward) of these perilous sea journeys. Laws were created to facilitate this risk sharing. These played a leading part in spurring the first wave of globalisation in the 17th Century. Names that come immediately to mind include the English East India Company established in 1602 and the Dutch East India Company established in 1600.

The idea of limiting liability as a lynchpin of business promotion is conceptually so fundamental (and brilliant) that it has become nearly universal to commercial life. We are talking restaurants and shoe shops here, not mega corporations. Promoters who operate under the protection of a company know that they don't threaten their life style or their family's welfare when they take a punt: all they risk is the money they actually put into the business. This allows businesses to grow and for risks to magnify without setting off alarm bells. The idea is so well understood that hospitals these days are run by

corporations: even law firms have started to become limited liability partnerships! Mallya hasn't done anything your doctor, your lawyer, even your dog food pet shop isn't doing.

This brings us to the second major argument against Mallya: Kingfisher's debts and the grave loss of 'public money'. Grave error informs this argument. What is any bank's job? They take deposits from the public at low interest rates, invest them in businesses as debt, earn interest, pay some of that money back to the depositors and keep the rest as profits. Banks have their risk taking shareholders like all other businesses do. In many mature economies (America being an excellent example), bankers see themselves as business partners to entrepreneurs, working with them to turn a profit. It is a sign of grave systemic immaturity when bankers begin to see themselves as bureaucratic cronies doling out loans to businessmen favoured by politicians. Indeed, it is a sign of another kind of immaturity to insist that promoters provide houses and personal guarantees as collateral security to every loan. This makes nonsense of the idea of limited liability and gravely undermines the entrepreneurial spirit. If India doesn't have millions of corporate jobs desperately seeking people to employ, it is at least partly because we seem to have this crazy chip on our shoulders about entrepreneurs and the ideological consequences of bankruptcy.

This brings me to the curious case of CBI receiving complaints from IDBI and UBI asking it to identify officers who may have shown "undue favour" to Kingfisher. This occurred in the backdrop of the revelation that Kingfisher received a loan of Rs 900 crore from IDBI Bank in 2009 even though the company had negative projections in the near term and a negative net worth. It goes without saying that every crime, if shown to be committed, must be investigated and punished. The main thing to bear in mind is that loans may be entirely justified even if a company has a negative net worth or negative financials or both. I'd love to discuss the financials of many celebrity internet-based businesses with you anytime you like. Indeed millions of people throw good money after bad only to keep hopes of recovering bad money alive. The bigger issue to bear in mind is that "undue favours" are equally criminal when conferred on both successful and failed companies. Singling out Mallya sounds like persecuting the loser only because he lost. If you persecute everyone who took an "undue favour" because there was no other way to navigate the Kafkaesque dungeons of India's crony capitalism, a lot of celebrity A-listers will break bread with Saharashree Subroto Roy!

This brings us to the heart of the great tragedy that is Vijay Mallya. How come this stunningly successful businessman met his Waterloo in the skies, high above the Indian sub-continent? The answer is simply his obsession with sexy airplanes. Airlines are by definition fragile businesses, especially in India where governments can kill them in a day. Aviation turbine fuel is way too expensive, is way too heavily taxed and represents 45 per cent of the operational cost of an airline. Indian 'aviation policy' is designed mainly to keep our national carrier alive, which as we all know loses orders of magnitude more money than Kingfisher ever did. This is no problem because the aviation minister talks to the finance minister and they take the taxpayers money and give it to the airline. So far,

CBI has never been invited to examine the criminality inherent in the 'undue favours' being shown to Indian Airlines.

When Jet and Kingfisher started to dominate Indian skies about 2010, Indian Airlines started to discount its tickets, forcing the others to react. Everyone totted up huge losses, which bothered Indian Airlines not a bit because it could always rely on the government to make those up. Everyone else lost money except Indigo, a budget carrier. Kingfisher and Jet reacted by buying budget carriers of their own - Air Deccan and Sahara - adding to their debts.

Meanwhile, in an attempt to stem the red, airlines tried to tap into international traffic. At this point, DGCA came up with its marvelous 5/20 guidelines, which allowed foreign airlines to fly in unhampered (and without reciprocal landing rights) but disallowed domestic airlines to fly out unless they had five years of experience and 20 aircraft. This policy favoured just one domestic airline, which everyone believed was especially beloved of aviation minister Praful Patel. Mallya tried instead to get the government to let him sell a meaningful share of his airline to international investors in 2011 but failed. Curiously, a year after Kingfisher went belly up, a change in FDI policy allowed Jet to sell equity to Etihad. Two years later, the Tatas put together a joint venture with Singapore Airlines and launched Vistara without a five-year track record or 20 airplanes in the kitty.

In the time since, Mallya tried repeatedly to settle his dues with banks but he simply couldn't get anyone to take a write down. This is entirely understandable. Any banker who settled the debt at a discount was going to get accused of corruption. Imagine the incentive system here: for a banker to lose all the money is ok but to recover only a part of it is to face criminal cases for life. A deal could be made at a political level, but then, what could Mallya offer for a payoff? As I look at what went on, while I am as happy as the next man to see a crime punished, seen from the prism of policy manipulation and crony capitalism, the worse I see is a man unable to 'manage' the system. So far, I have yet to meet a hemorrhaging vocal castigator who has a shred of hard evidence to actually show that Mallya did something he shouldn't have, or at any rate, something everyone who works here routinely doesn't have to do as a matter of course. The demonization of Mallya is a great workshop on how to run a smear campaign using only smoke and mirrors. Now we have the Supreme Court trying to bury Mallya's demons. I wait with bated breath.

The bottom line for me though addresses the larger macro issue. India needs development, growth, industry, infrastructure, business, jobs...the whole shooting lot. Someone needs to have the vision to do it, and someone needs to have the courage to fund it. The risk is at least everywhere the reward is. If you are going to penalize failure by sending the risk takers to jail, you will never find an entrepreneur willing to start a new venture in India, nor will you find a banker to fund the risk. If you are one of those who want the best for your children, is all this criminal investigation around business failure the best way to get there? Worse, if you are one of those who avoided the risk and

worked for a company all your life, what chance have you of putting bread on the table if you contribute to the promotion of an environment where no one wants to take the risk?

Comment-3

Fine Print: Commercially Sustainable Bankruptcy **A critique of India's new Bankruptcy Act** **Ranjeev C. Dubey**

Here is another of those Incredible India Ironies. We want you to 'Make in India', but if your business model fails, we want you flogged, crucified, drawn and quartered. From the purely entrepreneurial standpoint, India is a harsh medieval society where there exists no practical distinction between business bankruptcy, personal bankruptcy and social banishment. If you get a punt wrong, even the Supreme Court will ask you to submit a list of your wife's and children's assets so that creditors demands may be met. If you want Indians to 'Make in India', the law must provide a framework in which entrepreneurs can either revive their failing businesses or seamlessly exit them and take another shot at commercial success. The government hopes the newly-passed Insolvency and Bankruptcy law will do the trick. Is this new law quite the biggest thing since Narasimha Rao's 1992 'liberalisation' that the government is cranking it up to be?

I have my doubts. My apprehensions are best understood in the context of the practical reality that hit entrepreneurs of failing businesses. At the top of the heap is the plethora of laws that makes criminals out of them. Here's a small sampler. If a factory owner fails to pay excise duty or CENVAT to the government because he runs out of money, he risks going to jail for seven years. It's no better in the services business. If a service provider can't deposit the Service Tax he has collected, he also goes to jail for seven years. It's not just personal liberty that a businessman risks losing either. If a man has not deposited VAT under, say, the Delhi VAT Act, 2004, the Commissioner can recover the money by attaching and selling his moveable and immoveable properties.

It's not just the king's share of your revenue that creates a problem. It's labour, too. For instance, the law prescribes a jail term of 1-3 years for every employer who fails to deposit any provident fund contribution that has been deducted from a salary. Bear in mind that every business is a cash flow management game. A deduction is only a paper entry. A provident fund contribution may be shown as 'cut' from a salary, but the employer doesn't physically cut anything. Every manager has a 'pay by' date for everything. Failure to deposit a provident fund contribution is only proof that the employer ran out of money before it was time to deposit the contribution.

This same flawed logic informed a variety of other labour laws. The Employees State Insurance Act, 1948 prescribes imprisonment of between one and three years to every

employer who fails to pay any contribution that he has deducted from the wages of the employee. The Factories Act 1948 has a variety of rules that every employer must comply with. It includes stuff like the state of the walls of the workers' canteen. When the employer runs out of money, he can't whitewash the walls anymore. That results in potential imprisonment up to two years. It's the same with the Industrial Disputes Act. A bankrupt business can't pay wages and that is a breach of a wage settlement. That can result in six months in jail. That can also happen if an employer fails to honour his financial obligations to labour under the Payment of Bonus Act 1965, Payment of Gratuity Act 1972, Payment of Wages Act 1936, Minimum Wages Act 1948, and so forth. Before parting with this subject, allow me to add that every failed business has issued cheques that are subsequently dishonoured because the money runs out. Each of these is potentially a two-year prison term. In sum, shorn of the rhetorical flourish, Indian law sends entrepreneurs to jail for between three and seven years simply because they run out of cash.

What you get on the other side of the cash crunch is extortion at the hands of those who are capable of entrapping promoters in a myriad variety of criminal cases. They want the entrepreneur to give them a reason to go easy on them. This is one of the primary reasons promoters defalcate funds in the dying moments of their imploding businesses. What does our new law purport to do on this critical item? Section 14 allows the adjudicating authority overseeing the bankruptcy proceedings to declare a moratorium, which means that this section prohibits "the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority". This is fine so far as it goes, but it says nothing about the criminal prosecutions the promoter must contend with.

It seems to me self-evident that no business friendly bankruptcy law can work unless it provides a promoter an opportunity to restructure the business, or an easy exit, leaving him free to pursue new opportunities after he has cleaned out his house through the bankruptcy process. This is how it works in advanced economies, of which Silicon Valley is frequently quoted as a prime example. When businesses begin to become financially unsustainable, promoters rush to declare bankruptcy. Chapter 11 is designed to 'protect' the business and its employees, not its creditors. America believes its government must help a promoter escape financial ruin, rather than persecute him for his errors. No stigma attaches to a bankruptcy. Donald Trump has declared four business bankruptcies in 1991, 1992, 2004 and 2009, yet expects to become the president of the United States. He is not fighting extradition proceedings, his passport revoked, while he hides in a country home in UK. When a bankruptcy law operates on the flawed ideological assumption that every promoter must pay for his sins, and then allows such criminal cases to commence or continue, it forces the promoter to fight the bankruptcy action in order only to avoid the impending extortion and criminal prosecutions. The law defeats its own purpose.

That takes us to the peculiar problem of bankers' claims. Lenders are subordinate divinity

in India because they are seen as trustees of 'public money', whatever that means. I don't have the space to argue that there is nothing public about their revenue streams but that apart, the real problem is that if a business goes bad, the bankers will demand that you pay the principle amount due, all interest on it, and all penal interest charged at extortionist rates on the interest you did not pay when it was due. This is also not how it works with Chapter 11. Americans make no ideological assumption that bankers are doe-eyed babies in need of cuddling. The process will happily write off debts to bankers, employees and even suppliers if that is what it takes to revive the business.

This is not to say that I blame Indian bankers. Anyone who lets an industrialist off the hook in India gets accused of corruption. Why should the banker submit himself to this fate? The problem is attitudinal. We are a cynical, suspicious, distrustful society, very quick to make and believe all manner of incredible allegations without the slimmest evidence. This is not a problem any law can fix and the new bankruptcy law does not presume to do so. What it does try and do is promote a consensus culture. It creates a committee of bankers, 75 per cent of whom drive the fate of the bankruptcy business. That's an awful lot of people to corrupt: hopefully, that makes it possible to take a sensible collective decision that may not be seen to be corrupt! Still, this measure does not resolve the real problem facing bankrupt businessmen. So long as bankers continue to insist that personal guarantees be offered by every promoter, business bankruptcy will continue to mean personal ruin and the new law will not achieve its purpose. Tragically, dispensing with personal guarantees is not something we can legislate.

This brings up the hardest question of them all: if a business fails, who controls the business while its final fate is being determined? It seems to me that businesses fail for a variety of reasons. External risk factors are as likely to be the culprit as entrepreneurial blunders. Unless you are dealing with a crooked businessman, no one understands the business better than the current management. If a business can be revived, why not let the current management continue? Chapter 11 proceedings will move quickly to protect the business, leaving it entirely in the hands of the current management. Very rarely will you see a third party manager step in. We have decided instead to go with third party industry professionals and specialists. I suppose this comes from the mind-set that you cannot leave the business in the hands of a promoter who has manifestly shown great skill at running it into the ground. I understand where this comes from. Cricketers who lose matches are physically attacked for the same reason. This logic is flawed for at least two reasons. First, every business has a hidden value that does not appear in the books (and I am not only talking about the value of land under a factory that can only be recovered in 'black'). If every promoter of a dying business knows that he will compulsorily lose control over his business, and thereby its hidden salvage value, he will fight bankruptcy rather than embrace it. The law then defeats itself.

There is, too, a second reason. The ecosystem of third-party turnaround and liquidation professionals doesn't exist at this stage in India, but even if they did, why do you expect that their actions will differ from those of the Official Liquidators who have long done the

same job under our Company law? Bankruptcy laws in advanced economies exist to protect, promote and revive businesses, they don't exist to shut them down. I have dwelled much on the antics of these Official Liquidators in my latest book "Legal Confidential" (Penguin 2015) so I will spare you a repetition. Suffice for me to say that when it comes to a choice between reviving and shutting down a business, the promoter who has learnt from his mistakes knows what needs doing to revive it. He has an imbedded self interest in reviving a business if he is to salvage its true value. Conversely, a third-party professional with no great expertise in specifically the business he is managing through a court order is inherently incentivised to shut it down and appropriate the hidden salvage value. In that view of the matter, a law that automatically hands over failing businesses to strangers does not encourage entrepreneurs to 'Make in India'; it promotes a culture of 'junk and sack-off in India'. That's pretty oxymoronic for a government that wants to promote business in India.

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