

# From Outdated to Effective: Revamping Bangladesh's Bankruptcy Law to Support Economic Stability and Growth

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## Abstract

Bangladesh, known globally as a low-cost garment manufacturing hub, is transitioning from a Least Developed Country to a "Developing Country" status. To sustain and accelerate this growth, the country is aggressively seeking Foreign Direct Investment (FDI) and pursuing various ambitious mega-projects. However, a critical area that requires attention is its bankruptcy law, which plays a crucial role in corporate governance and enterprise development. The existing Bankruptcy Act 1997 is outdated and ineffective, necessitating urgent reform. This study identifies the deficiencies in the current law and proposes updates to align it with international standards, particularly the UNCITRAL Model Law\* which includes provisions for cross-border insolvency. A unified legal framework for addressing non-performing loans is also recommended.

## Keywords

Bankruptcy Law, Insolvency Law, Bangladesh, Foreign Direct Investment, Corporate Governance

## Introduction

Bankruptcy is a legal mechanism for resolving debts when a firm is financially distressed, and it plays a vital role in market economies (White, 2007; Brunstad Jr., 2000). It involves the court-appointed receiver taking the debtor's assets to pay off creditors, ensuring protection for all parties involved. This process helps safeguard creditors' rights and allows debtors a fresh start (Bose, Filomeni, & Mallick, 2021; Alam & Azim, 2006). Bangladesh, having recently graduated from Least Developed Country (LDC) status, is moving towards Vision 2041, which includes increasing the investment-to-GDP ratio.

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\* The UNCITRAL Model Law is a legal framework developed by the United Nations Commission on International Trade Law to standardize and improve international commercial arbitration practices. It provides guidelines for arbitration procedures, aiming to ensure fairness, efficiency, and consistency in resolving cross-border disputes.

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The Bangladesh Economic Zone Authority (BEZA) aims to establish 100 economic zones, many of which are already operational. A robust bankruptcy regime is essential for attracting and sustaining FDI, and for improving corporate governance and enterprise development. However, the current Bankruptcy Act 1997 is inadequate and in need of reform to address institutional weaknesses common in emerging markets (Stiglitz, 2001). This paper aims to contribute to the reform debate by proposing future-oriented changes that align with international standards.

### **Objective of the Study**

The initiative to amend the Bankruptcy Act 1997 began in December 2017, when Bangladesh Bank submitted a draft amendment to the Ministry of Finance. Although a draft was published in 2020 for public feedback, no significant progress has been made since. The 2021-22 fiscal year budget also mentioned updating the bankruptcy law but with no real implementation. The proposed amendments primarily focus on addressing short-term issues without aligning with international standards. This study seeks to address this gap by proposing reforms that align with global best practices.

### **Methodology**

This study is based on a review of literature, interviews with judges and lawyers experienced in bankruptcy proceedings, and analysis of related scholarly articles, theses, international publications, and news reports.

### **Literature Review**

#### **1. Challenges in Bankruptcy and Debt Recovery in Bangladesh**

In Bangladesh, bankruptcy cases are handled under the general civil court system, despite the existence of a specialized Bankruptcy Court. This approach fails to address the unique demands of bankruptcy proceedings, such as the need for cost-effectiveness, efficiency, and speed (Mannan, 2016). Bankruptcy cases, including those under the Artha Rin Adalat Act, of 2003, intended to expedite debt recovery, are often mired in delays. The 'Speedy Money Loan Courts' designed to handle such cases are not equipped to deal with the complexities of bankruptcy involving transnational elements, leading to extended delays and frustrated parties, which undermines the effectiveness of the legal framework (Alam & Azim, 2006).

#### **2. Inefficiencies in Current Judicial Processes**

The inefficiencies are compounded by the inadequate infrastructure supporting these courts. Despite their role in debt recovery, Money Loan Courts are plagued by a shortage of judicial officers and significant delays in decision execution (Sobhan & Werner, 2003). These courts, along with Bankruptcy Courts, are critical to managing debt-related issues, yet the system's capacity to handle these cases swiftly and effectively remains limited. The existing number of judges assigned to handle cases under the Money Loan Court Act, of 2003, and the Bankruptcy Act, of 1997, is insufficient. An increase in the number of judges is necessary to address the backlog and ensure timely resolution of loan default cases (Khatun, 2018).

#### **3. Need for Procedural Reforms**

To address these issues, the revised Bankruptcy Act must incorporate time-bound procedures for Money Loan Courts.

These reforms should aim to expedite case resolution and enhance the overall efficiency of the bankruptcy system (Dey, 2019). Implementing such procedural changes will be crucial in reducing delays and improving the effectiveness of bankruptcy proceedings.

### **Few Bankruptcy Cases:**

#### **1. Apurna-Zahid Fashion Limited Bankruptcy Proceedings**

In August 2000, Apurna-Zahid Fashion Limited, a readymade garment factory located in Mirpur, Dhaka, failed to repay loans totaling BDT 480 million to Agrani Bank's Motijheel Corporate branch and Pubali Bank's Mirpur branch. The company's Managing Director, Zahidul Islam, filed for bankruptcy in Dhaka's bankruptcy court following the company's dissolution due to declining business and mounting debts. Prior to this, both banks had initiated multiple legal actions in Dhaka's courts to recover the outstanding amounts, with Agrani Bank claiming BDT 290 million and Pubali Bank BDT 190 million, inclusive of principal and interest. The loans were secured against the company's capital, and the legal actions began when the company defaulted in 2000. Despite Zahidul's bankruptcy petition, 20 years have elapsed without a bankruptcy declaration. Agrani Bank's lawyer, Mir Shawkat Hossain, noted that should Apurna-Zahid Fashion be declared bankrupt, the banks would be entitled to all movable and immovable assets of the company, which would then be sold to recover the outstanding debts. However, the legal process has faced significant delays. The hearing only commenced two years after the petition was filed, with the last recorded session in 2016. Zahidul did not attend subsequent hearings, further prolonging the resolution. Shawkat attributed these delays to the heavy caseload of additional district and metropolitan judges, who often do not prioritize bankruptcy cases, coupled with tactics used by defendants to postpone proceedings (Karim, 2021).

#### **2. Mabiya Ship Breaking Bankruptcy Case**

Mabiya Ship Breaking, based in Chattogram, defaulted on a substantial loan of BDT 770 million from Dhaka Bank, a sum significantly exceeding the company's total assets and mortgaged property. In 2015, Dhaka Bank initiated bankruptcy proceedings against the company in a Chattogram court. In response, Jahangir Alam, the company's Managing Director, sought a writ petition from the High Court to obtain a stay on the bankruptcy case. The High Court initially granted a six-month stay, which was subsequently extended multiple times. As of June 2021, the case had yet to proceed to a hearing (Karim, 2021).

#### **3. Sekandar Ali's Bankruptcy Case**

In 1989, Sekandar Ali from Kesharipur village, Bogura, borrowed BDT 500,000 from the Bariahat branch of Rajshahi Krishi Unnayan Bank. By 2000, the loan amount had increased to BDT 1 million. Sekandar filed a petition with a Bogura court, seeking to declare himself bankrupt due to the loan amount exceeding the value of his mortgaged property and other assets. The court granted the petition, declaring him bankrupt and ordering the seizure of his assets. However, upon execution, the bank discovered that Sekandar's assets consisted only of a dilapidated house and six decimals of land. It was revealed that Sekandar had utilized fraudulent mortgage papers to obtain the loan.

Ashraful Islam, the current manager of the Bariahat branch, commented on the case, noting that while the court's decision favored the bank, the outcome resulted in the bank's loss and the defaulter's gain due to the fraudulent documentation (Karim, 2021).

### **Challenges Facing Bangladesh's Bankruptcy Regime**

Bangladesh's bankruptcy framework is fraught with significant challenges that hinder its effectiveness and efficiency. The current Bankruptcy Act of 1997 falls short of international best practices and standards. Key issues include:

- 1. Preference for Local Creditors:** The Bankruptcy Act prioritizes local banks and financial institutions over foreign secured creditors, a practice inconsistent with the UNCITRAL Model Law on Cross-Border Insolvency. This bias discourages foreign investment and undermines confidence in the bankruptcy process (Mannan, 2016).
- 2. Lack of Provisions for Cross-Border Insolvency:** With increasing international business activities, cross-border insolvency cases have become more common. However, the 1997 Bankruptcy Act does not address such situations, leaving a significant gap in handling international insolvencies effectively (Mannan, 2016).
- 3. Restricted Access for Foreign Insolvency Practitioners:** Foreign insolvency practitioners face barriers when trying to access Bangladeshi courts. This restriction contradicts the UNCITRAL Model Law and complicates the process for foreign businesses operating in Bangladesh (Mannan, 2016).
- 4. Complicated Debt Recovery Process:** Businesspeople with malicious intent often take loans from multiple banks without repaying them. The Bankruptcy Court could consolidate debt recovery, but the Artha Rin Adalat (Speedy Money Loan Court) requires banks and creditors to file separate cases. This fragmented approach is costly and inefficient, with some defaulters exploiting loopholes to delay proceedings (Alam and Azim, 2006; Aziz, 2021).
- 5. High Costs and Low Recovery Rates:** The bankruptcy resolution process is costly and time-consuming, leading to low recovery rates. Improving these metrics is crucial for Bangladesh's performance in the World Bank's Ease of Doing Business ranking, which was paused in 2020 due to allegations of data manipulation (World Bank, 2020).
- 6. Indefinite Stay Orders:** Stay orders during bankruptcy proceedings often extend indefinitely, causing frustration and delays. This issue is exacerbated by procedural inefficiencies, including the handling of interlocutory petitions, delays in documentation, and challenges in appointing receivers (Alam and Azim, 2006).
- 7. Judicial Inefficiency:** The judicial process for bankruptcy is sluggish, with years needed to resolve debts, sell assets, and distribute proceeds due to a lack of experience and training in managing complex corporate insolvencies (Mannan, 2016).
- 8. Inefficient Business Salvage Strategies:** Courts tend to focus on rescuing weak and inefficient businesses rather than allowing them to fail through bankruptcy.

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<sup>1</sup> Sections 75 and 2(37), Bankruptcy Act 1997 (Bangladesh) read with section 5(o), Banking Companies Act 1991 (Bangladesh) and section 2(j) Financial Institutions Act 1993 (Bangladesh).

Banks also prefer to keep defaulters in business to recover funds, contrary to economic theories suggesting that bankruptcy should eliminate inefficient firms and improve overall market efficiency (White, 1989; White, 2007).

**9. Shortage of Qualified Insolvency Professionals:** Bangladesh lacks a robust network of qualified insolvency professionals and firms. The absence of dedicated expertise in property management and the burden of initial costs deter potential receivers (Alam and Azim, 2006).

**10. Inefficiencies Due to Parallel Courts:** The Artha Rin Adalat (Speedy Money Loan Court) operates alongside the Bankruptcy Court, creating redundancy and inefficiency. Banks and financial institutions prefer the Artha Rin Adalat for its quicker resolution, which undermines the effectiveness of the Bankruptcy Court (Alam and Azim, 2006).

**11. Personal Guarantees and Limited Liability:** Banks often rely on personal guarantees from directors rather than the Bankruptcy Act or Artha Rin Adalat, which contradicts the principle of limited liability and hampers enterprise development (Sobhan and Werner, 2003).

**12. Political Influence on Banking:** The banking sector in Bangladesh is heavily influenced by political pressures, with banks often coerced into issuing loans and avoiding actions against defaulters. This political interference, coupled with the vested interests of bank directors, exacerbates the challenges in managing defaults and maintaining financial stability.

Addressing these issues is crucial for reforming Bangladesh's bankruptcy regime and aligning it with international standards to enhance investor confidence and economic stability.

### **Enhancing Bangladesh's Bankruptcy Regime: Proposed Amendments and Considerations**

The Bankruptcy Act of 1997 in Bangladesh faces several critical challenges that need to be addressed to align with international standards and effectively meet contemporary business realities. While the Banking and Financial Institutions Division of the Ministry of Finance has proposed amendments to tackle some of these issues, additional reforms are necessary to address existing gaps and align with global best practices. The key areas for improvement include:

**1. Equitable Treatment of Creditors:** The current Bankruptcy Act prioritizes local banks and financial institutions over foreign secured creditors, which contravenes the principles outlined in the UNCITRAL Model Law on Cross-Border Insolvency. This preferential treatment undermines investor confidence and hampers the effectiveness of the bankruptcy process (White, 2011). Reforms should ensure equal treatment of all creditors, regardless of their origin.

**2. Cross-Border Insolvency Provisions:** With the increasing globalization of business and cross-border investments, cross-border insolvency has become a common issue. Notable cases, such as the Sunman Group's closure in Cambodia and Niko's financial difficulties in Bangladesh, underscore the need for comprehensive cross-border insolvency provisions in the Bankruptcy Act (Senbet & Wang, 2012; Mannan, 2016).

The amendment should include robust provisions to handle international insolvencies.

**3. Adoption of UNCITRAL Model Law:** Bangladesh should consider adopting the UNCITRAL Model Law on Cross-Border Insolvency, which facilitates the involvement of foreign insolvency practitioners and the recognition of foreign judgments by local courts (Alam & Azim, 2006). Even if full adoption is not feasible immediately due to current limitations, the amendments should align as closely as possible with UNCITRAL guidelines to enhance the effectiveness of the insolvency framework.

**4. Integration of Bankruptcy Courts:** Instead of treating the Bankruptcy Court as a secondary option following proceedings in the Artha Rin Adalat (Speedy Money Loan Court), it is recommended to merge these courts under a single comprehensive legal framework. This consolidation would streamline the process for handling non-performing loans and reduce complexities for both creditors and the judiciary (Alam & Azim, 2006).

**5. Revising Bankruptcy Thresholds:** The current threshold for debtors to apply for bankruptcy is set at BDT 20,000, which is relatively low compared to the BDT 500,000 required for creditors to initiate bankruptcy proceedings. This disparity can lead to potential misuse by debtors. It is suggested that the threshold for debtors be raised to BDT 250,000 to better reflect current economic conditions (Alam & Azim, 2006).

**6. Enhancing Professional Expertise:** There is a notable shortage of qualified professionals in the insolvency sector. Facilitating the involvement of Chartered Accountants, Cost and Management Accountants, Company Secretaries, and Lawyers in insolvency cases can significantly improve the quality of restructuring and liquidation proceedings (Batra, 2007). Establishing a professional body for insolvency practitioners and making the role of receiver more attractive are essential steps to enhance the insolvency system.

**7. Training for Judicial and Legal Personnel:** Judges, lawyers, and relevant government officials require specialized training to manage complex bankruptcy cases, including cross-border insolvencies. This training is crucial for effectively implementing the UNCITRAL Model Law and ensuring the competency of the insolvency system.

**8. Establishment of an Insolvency Training Center:** Setting up an insolvency training center to educate professionals such as accountants and lawyers on insolvency practices is essential. Support from international organizations like INSOL International could be beneficial in this regard.

**9. Dedicated Bankruptcy Courts:** It is proposed to establish a dedicated bench in every district court specifically for bankruptcy and Artha Rin Adalat cases. Holding these specialized court sessions once or twice a week can improve efficiency and case management (Ahmed, 2019).

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<sup>2</sup> INSOL International is a global organization dedicated to promoting best practices and high standards in insolvency, restructuring, and bankruptcy. It serves as a network for professionals in these fields to share knowledge and advance the practice internationally.

**10. Alternative Dispute Resolution (ADR):** Incorporating ADR mechanisms into the Bankruptcy Act could help reduce the time and costs associated with bankruptcy proceedings, offering a more efficient alternative to traditional litigation (Alam & Azim, 2006).

**11. Mitigating Political Influence:** Addressing political interference in the banking and financial sector is crucial for ensuring fair and transparent bankruptcy proceedings. Measures should be put in place to safeguard the autonomy of institutions like the Bangladesh Bank, ensuring that appointments, such as that of the Governor, are made with due impartiality and in accordance with the Bangladesh Bank Amendment Bill 2003.

By addressing these areas, Bangladesh can enhance its bankruptcy regime, ensuring it meets international standards and effectively handles the complexities of modern business environments.

## Conclusion

Amending established laws is often a challenging and time-consuming process. To ensure that Bangladesh's bankruptcy framework remains robust and relevant for the future, policymakers should adopt a long-term, forward-thinking approach. The proposed amendments to the Bankruptcy Act should align closely with UNCITRAL guidelines, particularly by incorporating provisions for cross-border insolvency, thereby elevating the law to international standards. Additionally, consolidating the existing legal framework into a single, comprehensive statute would streamline the resolution of non-performing loan issues and enhance the efficiency of bankruptcy proceedings. By taking these steps, Bangladesh can create a more effective and globally competitive bankruptcy regime.

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## Appendices:

### Interview Guide for Judges and Lawyers on Bankruptcy Law Reform in Bangladesh

#### Introduction:

##### 1. Professional Background

- Can you briefly describe your experience with bankruptcy cases in Bangladesh and your role in such cases?
- How long have you been involved in bankruptcy-related legal matters?

#### Assessment of Current Bankruptcy Law:

##### 2. Evaluation of Bankruptcy Act 1997

- How effective do you find the Bankruptcy Act 1997 in managing bankruptcy proceedings and resolving corporate financial distress?
- What are the major shortcomings of the current Bankruptcy Act as you have observed in your practice?

##### 3. Judicial and Procedural Challenges

- What are the main challenges you encounter in bankruptcy cases under the current Act?
- How do the procedural inefficiencies impact the resolution of bankruptcy cases?

##### 4. Case Examples

- Could you provide specific examples of bankruptcy cases that have highlighted the deficiencies of the current legal framework?
- What were the outcomes of these cases, and how did the legal framework affect these outcomes?

#### International Standards and Comparative Analysis:

##### 5. Alignment with International Practices

- How does the current Bankruptcy Act compare with international standards, such as the UNCITRAL Model Law?

- What specific provisions in the UNCITRAL Model Law do you believe are crucial for Bangladesh to incorporate?

#### **6. Cross-Border Insolvency**

- How does the existing bankruptcy law handle cross-border insolvency cases, if at all?
- What improvements are necessary to effectively manage international insolvency issues?

### **Proposed Reforms:**

#### **7. Recommendations for Reform**

- What reforms would you propose to address the deficiencies of the Bankruptcy Act 1997?
- How can the law be updated to better support corporate governance and enterprise development?

#### **8. Implementation and Challenges**

- What potential challenges do you foresee in implementing the proposed reforms to the Bankruptcy Act?
- How can these challenges be overcome to ensure successful reform?

#### **9. Integration with Other Legal Frameworks**

- How should the Bankruptcy Act be integrated with other related legal frameworks, such as those dealing with non-performing loans?
- What role should specialized courts or judicial bodies play in managing bankruptcy and insolvency cases?

### **Impact on Economic Development and FDI:**

#### **10. Influence on Foreign Direct Investment (FDI)**

- How does the current bankruptcy regime impact foreign direct investment in Bangladesh?
- What changes would enhance Bangladesh's attractiveness to foreign investors?

Final Insights:

#### **11. Future Directions**

- What is your vision for the future of bankruptcy law in Bangladesh?
- Are there any additional insights or considerations you believe are important for this reform effort?

### **Conclusion:**

#### **12. Additional Comments**

- Do you have any further comments or suggestions regarding the reform of Bangladesh's bankruptcy law?

### **Follow-Up Questions (if necessary):**

- Can you elaborate on any specific procedural reforms you think are critical?
- How can the training of judicial and legal personnel be improved to better handle complex bankruptcy cases?

This guide aims to obtain in-depth insights from judges and lawyers regarding the current state of bankruptcy law in Bangladesh, its alignment with international standards, and necessary reforms to enhance the effectiveness and efficiency of the bankruptcy regime.