

THE INSOLVENCY AND BANKRUPTCY CODE, 2016

INTRODUCTION:

Bankruptcy is **a legal status usually imposed by a Court**, on a firm or individual unable to meet debt obligations. The current Indian Bankruptcy legal framework is highly complex, developed out of multiple judicial forums resulting in a lack of clarity and certainty in jurisdictions. Decisions are often appealed, stayed or overturned by judicial forums having concurrent or overlapping jurisdictions. The pro-revival approach of the judicial systems leads to delay in the closure of unviable business since the standstill mechanism has been misused by corporate debtors. As a result, the average time to resolve insolvency in India is 4.5 years, further details are given in annexure-1. India has lowest recovery rate in the world at about 20% of debt value; further Details are given in Annexure-2.

The present legislative framework for bankruptcy and insolvency

INDIVIDUAL BANKRUPTCY AND INSOLVENCY is legislated under the Presidency Towns Insolvency Act, 1909, and the Provincial Insolvency Act, 1920. High courts have the jurisdiction over insolvency related matters in the erstwhile Presidency towns of Chennai, Kolkata and Mumbai. Subordinate courts hear cases of individual insolvency in all other areas, with the district court being the court of appeal.

CORPORATE BANKRUPTCY AND INSOLVENCY is covered in a complex of multiple laws, some for collective action and some for debt recovery. These are: Companies Act, 1956 and 2013 and SICA, 1985 – deals with restructuring of distressed industrial firms. Under this Act, the Board of Industrial and Financial Reconstruction assesses the viability of the industrial company, and refers an unviable company to the High Court for liquidation. SICA 1985 stands repealed, but the repealing enactment is yet to be notified.

DEBT RECOVERY

A civil court jurisdiction is the basic mechanism that is available to any creditor for debt recovery. If the loan is backed by security, this is enforced as a contract under the law. The Recovery of Debt due to Banks and Financial Institutions Act, 1993 gives banks and financial institutions greater powers to recover collateral at default. The law provides for the establishment of special Debt Recovery Tribunals (DRTs) to enforce debt recovery by these institutions. The law also provides for the Debt Recovery Appellate Tribunals as appellate forum. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 enables secured creditors to take possession of collateral without requiring the involvement of a court or tribunal. List of different committee constituted by the government for Insolvency law is given in annexure-3

WHAT IS THE NEED FOR AN INSOLVENCY AND BANKRUPTCY CODE 2016:

- ❖ Indian banks are sitting on a huge pile of bad debts. The total Non Performing Assets (NPAs) is around 4 Lakh Crore and a huge amount of restructured loans also. Thus the total stressed assets (Bad Debts) amount to 11% of the total lending.



- ❖ As a percentage of total loans, the bad loans grew from 3.49% (2013) to 8.3%(2015).
- ❖ Corporate bad loans constitute 56% of the total bad loans of state-run banks.
- ❖ At present, there are around 70000 pending liquidation.
- ❖ It takes almost 4 years to wind up an ailing company in India etc.
- ❖ There are around 12 laws (Some are more than 100 years old) to tackle Insolvency.
- ❖ Ease of doing Business – India is presently ranked 130 (Out of 189 countries) in 2015.
- ❖ Resolving Insolvency – India is presently ranked 136 (Out of 189 countries) in 2015.

THE INSOLVENCY AND BANKRUPTCY CODE, 2016

The objective of the Insolvency and Bankruptcy Code, 2016 is to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner. It will replace the existing bankruptcy laws and cover individuals, companies, limited liability partnerships and partnership firms. It will amend laws, including The Companies Act, to become the overarching legislation to deal with corporate insolvency. **The comparison of international bankruptcy laws with proposed framework is given in Annexure-4.**

➤ **Journey of The Insolvency and Bankruptcy Code, 2016 given in Annexure-5**

PRINCIPLES FOR A NEW CODE:

The Committee chose the following principles to design the new insolvency law:

- The Code will facilitate the assessment of viability of the enterprise at a very early stage
- The Code will enable symmetry of information between creditors and debtors.
- The Code will ensure a time-bound process to better preserve economic value.
- The Code will ensure a collective process.
- The Code will respect the rights of all creditors equally.
- The Code must ensure that, when the negotiations fail to establish viability, the outcome of bankruptcy must be binding.

FRAMEWORK OF CODE:

- **Insolvency and Bankruptcy Board of India (“Board”):** The Board will be set up as the regulator under the Code.
- **Insolvency Professionals:** The code proposes to regulate insolvency professionals and insolvency professional agencies. Under the oversight of the Board, these agencies will develop professional standards, codes of ethics and exercise a disciplinary role. Three sets of **Resolution Professionals** are sought to be appointed – **Interim Resolution Professional, Final Resolution Professional and Liquidator.**
- **Insolvency Information Utilities:** The Code proposes for information utilities which would collect, collate, authenticate and disseminate financial information from listed companies as well as financial and operational creditors of companies..
- **Insolvency Adjudicating Authority:** The adjudicating authority will exercise jurisdiction over cases by or against the debtor.



1. **The Debt Recovery Tribunal (“DRT”)** shall be the adjudicating authority (“**Adjudication Authority**”) with **jurisdiction over individuals and partnership firms** other than Limited Liability Partnerships (“**LLPs**”). Appeals from the order of the DRT will lie to the Debt Recovery Appellate Tribunal (“**DRAT**”);
2. **The National Company Law Tribunal (“NCLT”)** shall be the Adjudicating Authority with jurisdiction **over companies, other limited liability entities (including LLPs.)**
3. **National Company Law Appellate Tribunal (“NCLAT”)** shall be the appellate authority to hear appeals arising out of the orders passed by NCLT and the Regulator in respect of insolvency professionals or information utilities.

COMPANIES ACT, 2013:

Currently, the Companies Act 2013 permits the following parties to file an application before NCLT for a declaration that company is sick- (a) the company, (b) any secured creditor, (c) the Central Government, (d) the Reserve Bank of India, (e) State Government, (f) public financial institution, (g) a State level institution, (h) a scheduled bank. Even under the SARFAESI, 2002, debt enforcement rights are available for secured creditors only.

CORPORATE INSOLVENCY RESOLUTION PROCESS

A. Initiation of Proceedings.

- Where any corporate debtor (“**CD**”) commits a default in payment of debt, insolvency resolution process under the Code can be initiated by a financial creditor (“**FC**”), either by itself or jointly with other financial creditor, an operational creditor (“**OC**”) or by the CD itself, by filing an application in the NCLT. A default, for this purpose, includes a default in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the CD.
- FC is a creditor to whom a financial debt is owed and includes anyone to whom such debt is assigned/transferred. OC is one to whom an operational debt is owed i.e., debt in respect of goods or services including employment or debt arising under any law in force for the time being and payable to Central Government/State Government/Local Authorities.
- The FC has to move an application before the NCLT showing them the proof of default and proposing an interim Insolvency Professional (**IP**). The NCLT will then ascertain the existence of default from the records of an IU (i.e. information utilities) or on the basis of other evidence furnished by the creditor. However, in the case of an OC, the OC has to first serve a demand notice along with the proof of default, giving the debtor ten days to respond to dispute the claim. If the claim remains undisputed, then the OC can file an application before the Adjudicating Authority.

B. Steps after admission of application.



- NCLT would declare a moratorium period for prohibiting actions such as, institution of suits, continuation of pending suits/ proceedings against the CD including execution of any judgement, decree or order; disposal/encumbering of CD's assets or rights/interests therein; any action to foreclose, recover or enforce any security interest created by the CD, etc. thereafter it would appoint an interim IP.
- Issuance of public announcement of the initiation of insolvency resolution process and call for the submission of claims. And then Interim IP inter alia takes over the management and powers of the board of directors of the CD, and collects all information relating to assets, finances and operations of the CD for determining its financial position; collates all claims submitted by the creditors and constitutes a Committee of Creditors ("COC").
- The COC thereafter either resolves to appoint the interim IP as the IP or replaces the interim IP by appointing a new IP, in accordance with the prescribed procedure and the IP will then take over the management and assets of the CD, and can exercise the wide powers granted to it, in the manner prescribed under the Code. It will prepare an information memorandum in relation to the CD, on the basis of which the resolution applicant will prepare a resolution plan. IP will scrutinize the resolution plan and present it to the COC.
- The COC approved plan will be submitted to the Adjudicating Authority, for its acceptance, and it is only when the Adjudicating Authority, gives it a final nod that the resolution plan becomes binding upon all the stakeholders and the insolvency resolution process of the CD is initiated. In case the Adjudicating Authority rejects the plan, the liquidation process of the CD will commence.

C. Time Period.

- The Code mandates completion of the insolvency resolution process within a period of 180 days. This period can be extended for a period of up to 90 days, upon an application filed by the IP subject to authorization by the COC by a vote of 75%.
- The Code also envisages a fast track insolvency of CDs, within 90 days (further extendable upto 45 days), which has income and assets value below such limit, or which has such class of creditors or such amount of debt or such other category of persons, as notified by the Central Government. **Complete timeline is given in Annexure-6**

D. Liquidation Proceedings.

- Liquidation proceedings can be initiated against a CD if:
 - ❖ **The resolution plan** has not been approved by the Adjudicating Authority, or it does not receive a resolution plan within the prescribed time period;
 - ❖ **If the COC** with a 75% majority vote, decides to liquidate the debtor, but before confirmation of the resolution plan; or If an application is made for liquidating the CD in case of any violation of the resolution plan.



- ❖ **The Liquidator will** collate all the claims, verify and then either admit the claims or reject them. If any creditor's claim has been rejected, it may appeal to the Adjudicating Authority. The Adjudicating Authority is also empowered to avoid any preferential, undervalued and extortionate transactions, undergone at relevant time, which will adversely affect the assets of CD and eventually right of creditors, in the manner prescribed under the Code.

- ***The assets of the CD, in case of liquidation will be distributed in the following order:*** (i) fees of insolvency professional and costs related to the resolution process, (ii) workmen's dues and secured creditors, (iii) employee wages, (iv) unsecured creditors, (v) government dues and remaining secured creditors (any remaining debt if they enforce their collateral), (vi) any remaining debt, and (vii) shareholders. **List of priority is given under Annexure-7.**

CRITICS of CODE:

- Time-bound insolvency resolution will require establishment of several new institutional mechanisms. The current capacity of debt recovery tribunals may be inadequate to take the additional role.
- IPAs, regulated by the Board, will be created for regulating the functioning of IPs. This approach of having regulated entities further regulate professionals may be contrary to the current practice of regulating professionals.
- The order of priority to distribute assets during liquidation is unclear. For instance – why secured creditors will receive their entire outstanding amount, rather than up to their collateral value; why unsecured creditors have priority over trade creditors?
- The Code provides for the creation of multiple IUs. However, it's possible that complete information about a company may not be available through a single IU. This may lead to financial information being scattered across these IUs.
- The Code creates an Insolvency and Bankruptcy Fund. However, it does not specify the manner of usage of the fund.
- The priority being given to secured creditors relinquishing security needs specific attention, especially on account of the same having the potential to be misused, especially if the debtor and the secured creditor can collide and impair the collateral.

CONCLUSION: TOWARDS EASE OF DOING BUSINESS

- It is a progressive step towards improving the investor confidence and ease of doing business
- The possible demerits can be addressed through discussions and consensus building.
- If implemented earnestly, it will give boost to job creation promise through skill development mission and it will for success of **Make in India**.
- This will be a positive step and provide impetus to good governance and uphold rule of law, as, the people who file for bankruptcy will have to repay their debts.

Annexure are attached herewith

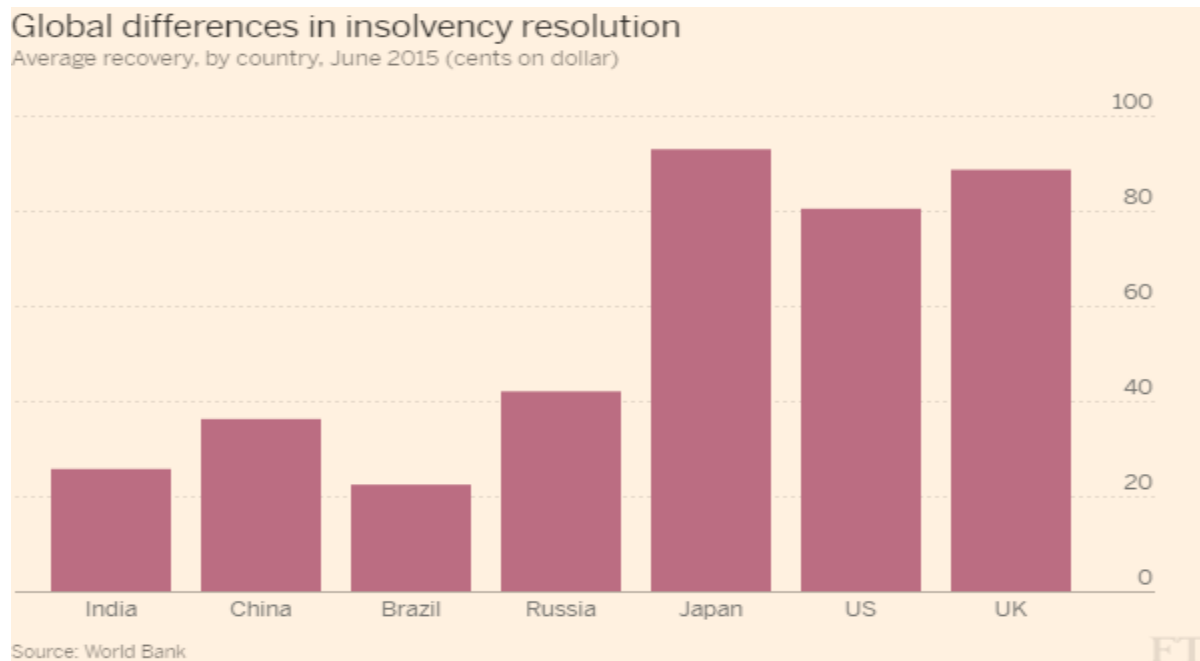


APPENDIX AND ANNEXURE

Annexure-1



Annexure-2



Annexure-3

GOVERNMENT COMMITTEES ON BANKRUPTCY REFORMS

Year	Committee	Outcome
1964	24 th Law Commission	Amendments to the Provincial Insolvency Act, 1920
1981	Tiwari Committee (Department of Company Affairs)	SICA, 1985
1991	Narasimham Committee I (RBI)	RDDBFI Act, 1993
1998	Narasimham Committee II (RBI)	SARFAESI Act, 2002.
1999	Justice Eradi Committee (GOI)	Companies (Amendment) Act, 2002, Proposed repeal of SICA
2001	L. N. Mitra Committee (RBI)	Proposed a comprehensive bankruptcy code.
2005	Irani Committee (RBI)	Enforcement of Securities Interest and Recovery of Debts Bill, 2011. (With amendments to RDDBFI and SARFAESI)
2008	Raghuram Rajan Committee (Planning Commission)	Proposed improvements to credit infrastructure.
2013	Financial Sector Legislative Reforms Commission (Ministry of Finance)	Draft Indian Financial Code which includes a, Resolution Corporation“ for resolving distressed financial firms.

Annexure-4

COMPARISON OF INTERNATIONAL BANKRUPTCY LAWS WITH PROPOSED FRAMEWORK

Action	United States	United Kingdom	India (Proposed Code 2016)
Initiation of proceedings	Debtors or creditors	Debtors or creditors	Debtors or creditors
Forum for proceedings	Court	Both in court and out of court procedures specified by the law.	Out of court
Administrator	United States Trustee (government employee)	Insolvency Practitioner (private)	Insolvency Professional (private)
Control of Debtor's assets	Debtor	Insolvency Practitioner	Insolvency Professional
Proposals to resolve insolvency made by	Debtor and creditors	Insolvency Practitioner	Creditors committee, consisting of financial creditors
Voting on proposals	Impaired creditors	All creditors	Creditors committee



			(secured and unsecured creditors)
Value of performance bond	US Trustee to determine the value of the bond	Bond value equivalent to the assets of the debtor, but capped at £5 million ⁹	Bond value equivalent to the assets of the debtor
Reporting financial information	Not required by law	Not required by law	Mandated by the Code

Annexure-5

JOURNEY OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016

Date	Events
21st December, 2015	The Code was introduced in Lok Sabha by Finance Minister Mr. Arun Jaitley
23rd December, 2015	The Code was referred to a Joint Committee of Parliament (Chairperson: Mr. Bhupender Yadav)
28th April, 2016	The Joint Committee submitted its report in Lok Sabha and Rajya Sabha
5th May, 2016	The Insolvency and Bankruptcy Code, 2016 was passed in Lok Sabha
11th May, 2016	The Insolvency and Bankruptcy Code, 2016 was passed in Rajya Sabha
28th May, 2016	Assented by the President of India and notified as the Insolvency and Bankruptcy Code, 2016 (31 of 2016)

Annexure-6

TIMELINES (AS STIPULATED IN THE CODE):

Particulars	Timelines (in days)
Filing of Insolvency application – Details of what needs to be mentioned in the application has been specified	X
Adjudicating Authority- admission or rejection of application - Before rejecting an application, the Adjudicating Authority shall give a notice to the applicant to rectify the defect in the application within 7 days. If admitted, Adjudicating Authority to declare moratorium upon admission.	X+14
Insolvency Resolution Professional appointment	(X+14) + 14
Constitution of Committee of Creditors Appointment of final resolution professional	(X+14) + 14 + 10
Submission of Resolution plan If approved- Moratorium ceases to have effect If rejected- Initiation of Liquidation Insolvency Resolution Process Completion	(X+14) + 180
Insolvency Resolution Process Extension	(X+14) + 180 +90



The following debts will be paid in priority given below:

1	Insolvency Resolution cost and liquidation cost
2	Debts to secured creditor (who have relinquished their security interest) and workmens' dues (for 24 months before commencement)
3	Wages and unpaid dues to employees (other than workmen) (for 12 months before commencement)
4	Financial debts to unsecured creditors and workmen's dues for earlier period
5	Crown debts and debts to secured creditor following enforcement of security interest
6	Remaining debts
7	Preference shareholders
8	Equity Shareholders or partners

SOURCES:

1. United States Code Title 11-Bankruptcy;
2. Sick Industrial Companies (Special Provisions) Act, 1985,
3. Recovery of Debt Due to Banks and Financial Institutions Act, 1993,
4. SARFAESI Act, 2002,
5. Companies Act, 2013,
6. Bankruptcy Law Reforms Committee, Ministry of Finance, November 2015,
7. Time to resolve Insolvency (years)", World Bank,
8. Starred Question No. 256, Lok Sabha, Answered on March 13, 2015, Ministry of Finance.
9. Report of the Joint Committee on the Insolvency and Bankruptcy Code, 2015,
10. United Kingdom Insolvency Act, 1986,
11. The Insolvency and Bankruptcy Code, 2016,
12. The Insolvency and Bankruptcy Code, 2015,
13. www.prsindia.org
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