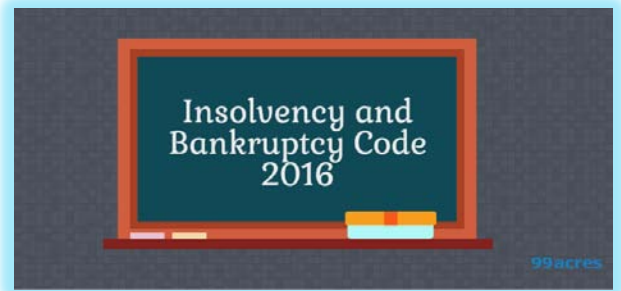


### Corporate Insolvency Resolution Process under the Bankruptcy Code and its impact on the Companies



#### ➤ Background

At present, there are multiple overlapping laws and adjudicating forums dealing with financial failure and insolvency of companies and individuals in India. The current legal and institutional framework does not aid lenders in effective and timely recovery or restructuring of defaulted assets and causes undue strain on the Indian credit system. Recognizing that reforms in the bankruptcy and insolvency regime are critical for improving the business environment and alleviating distressed credit markets, the Government introduced the Insolvency and Bankruptcy Code Bill in November 2015, drafted by a specially constituted 'Bankruptcy Law Reforms Committee' (BLRC) under the Ministry of Finance.

After a public consultation process and recommendations from a joint committee of Parliament, both houses of Parliament have now passed the Insolvency and Bankruptcy Code, 2016 (Code). While the legislation of the Code is a historical development for economic reforms in India, its effect will be seen in due course when the institutional infrastructure and implementing rules as envisaged under the Code are formed.

- Insolvency is when an individual or organization is unable to meet its outstanding financial debt towards its lender as it become due. Insolvency can be resolved by way of changing the repayment plan of the loans or writing off a part thereof. If it cannot be resolved, then a legal action may lie against the insolvent and its assets will be sold to pay off the outstanding debts. Generally, an official assignee/liquidator appointed by the Government of India, realizes the assets and allocates it among the creditors of the insolvent.
- Bankruptcy is a concept slightly different from insolvency, which is rather amicable. A bankruptcy is when a person voluntary declares himself as an insolvent and goes to the court. On declaring him as 'bankrupt', the court is responsible to liquidate the personal property of the insolvent and hand it out to its creditors. It provides a fresh lease of life to the insolvent.

## ➤ The Code

The Code offers a uniform, comprehensive insolvency legislation encompassing all companies, partnerships and individuals (other than financial firms). The Government is proposing a separate framework for bankruptcy resolution in failing banks and financial sector entities.

One of the fundamental features of the Code is that it allows creditors to assess the viability of a debtor as a business decision, and agree upon a plan for its revival or a speedy liquidation. The Code creates a new institutional framework, consisting of a regulator, insolvency professionals, information utilities and adjudicatory mechanisms, that will facilitate a formal and time bound insolvency resolution process and liquidation.

The Code repeals the Presidency Towns Insolvency Act, 1909, and Provincial Insolvency Act, 1920, as well as amends 11 legislations, including:

1. Indian Partnership Act, 1932
2. The Companies Act, 2013
3. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
4. Limited Liability Partnership Act, 2008,
5. Sick Industrial Companies (Special Provisions) Repeal Act, 2003

To avoid any further litigation in insolvency proceedings, the Code will have an overriding effect over all other laws. It is specifically provided that civil courts or authority not to have jurisdiction and also cannot grant any injunction. The Code as a new law, replacing over a dozen laws, when implemented post the infrastructure being put in place, will prove to be the most important step in evolving the regimen of recovery of bad debts. Moreover, there will be a definite surge in economic growth in view of the rigid timeframe prescribed in the Code for resolution of insolvency and liquidation proceedings.

## ➤ Need for an effective Insolvency and Bankruptcy Regime

The business failure affects all the stakeholders of a corporate including its lenders, shareholders, creditors, suppliers, customers, workers and central and state governments very adversely. It is, therefore, essential that the valuable resources including capital, manpower, machinery and management, are pulled out of the failed / unviable businesses at the earliest and are deployed in other profitable ventures. The viable businesses are, however, required to be re-organized at the earliest.

In a situation of corporate insolvency, if the stakeholders can make rational and quick decisions to deal with the said situation i.e. the decision about continuation of business, its re-

organization or its closure, a law to deal with the insolvency situation and the intervention of the courts may not be required. However, it has been observed that the stakeholders fail to take such decisions to deal with the situation of insolvency and, therefore, is the need for a corporate insolvency law.

An economy needs an effective Bankruptcy Law to deal with the situation where in the case of inability of a debtor to make the payment to its creditors as per the payment schedule, the right of the creditors to get the control over the affairs of the defaulting debtor does not get effected and that the debtor continues to have control over the affairs of its business. Though, contractually the creditors may have the right to get control over the business of the defaulting debtor, however, due to inefficiency of the prevailing legal system, they are not able to get the said control without the intervention of the court. In case, the legal system provides for adequate penalty and punishment for those who violate these contractual obligations, the intervention of the courts / tribunals in these matters can be minimized.

It is often said that “ in the absence of a bankruptcy law a firm’s assets would be sold as scrap and value would be lost”. As such, the law to deal with corporate insolvency / bankruptcy enables an economy to rescue the viable businesses and to pull out the valuable economic resources out of the unviable businesses through the liquidation process at the earliest without further depletion in the value of the assets so that the same can be deployed in other profitable economic activity.

### ➤ **Functions of a Corporate Insolvency Regime**

A corporate insolvency regime has the following functions:

- (i) It identifies the signs of insolvency at the earliest.
- (ii) Initiates the insolvency process quickly.
- (iii) Creates a collective platform of the stakeholders to enable them to take decisions about the future of the distressed entity
- (iv) Helps reorganization of the viable businesses;
- (v) Sends the unviable businesses to liquidation at the earliest to arrest any substantial loss in value.

### ➤ **Objectives of a Corporate Insolvency Regime**

A well designed corporate insolvency regime has the following policy objectives:

- (i) It should protect the interest of the creditors by reorganizing the viable businesses to the extent possible and should quickly liquidate the unviable businesses. Early completion of insolvency process also protects the interest of other stakeholders i.e. employees and shareholders

- (ii) A corporate insolvency regime should help in promoting the growth of an economy through efficient reallocation of resources, which otherwise remain locked in unviable / closed entities.
- (iii) An efficient corporate insolvency regime improves the rights of the creditors and incentivizes them to increase the supply of credit in the market. As a result, not only that the supply of credit in the market improves, the cost of credit also reduces improving the viability and competitiveness of the businesses.
- (iv) An efficient corporate insolvency regime improves business environment and thus encourages entrepreneurship. The same also results in improving the investor confidence.

#### ▪ **Insolvency Resolution Process**

The Code makes a significant departure from the existing resolution regimen by shifting the responsibility on the creditor to initiate the insolvency resolution process against the corporate debtor. Under the existing legal framework, the primary onus to initiate a resolution process lies with the debtor, and creditor may pursue separate actions for recovery, security enforcement and debt restructuring.

#### ➤ **Insolvency Resolution Process for Companies and Limited Liability Entities**

If the default is above Rs.1 Lakh (may be increased up to Rs.1 Cr by the Government, by notification), the creditor may initiate insolvency resolution process. The Code proposes two independent stages:

1. Insolvency Resolution Process – during which financial creditors assess whether the debtor's business is viable to continue and the options for its rescue and resurrection; and
2. Liquidation– if the insolvency resolution process fails or financial creditors decide to wind down and distribute the assets of the debtor.

#### ▪ **The Insolvency Resolution Process**

1. A financial creditor (himself or jointly with other financial creditors), an operational creditor or the corporate debtor (through Corporate applicant i.e. corporate debtor itself; or an authorised member, partner of corporate debtor; or a person who has control and supervision over the financial affairs of the corporate debtor) may initiate corporate insolvency resolution process in case a default is committed by corporate debtor.

2. An application can be made before the National Company Law Tribunal (NCLT) for initiating the resolution process. Operational creditor needs to give demand notice of 10 days to corporate debtor before approaching the NCLT. If corporate debtor fails to repay dues to operational creditor or fails to show any existing dispute or arbitration, then the operational creditor can approach NCLT.
3. Corporate insolvency process shall be completed within 180 days of admission of application by NCLT. Upon admission of application by NCLT, Creditors' claims will be frozen for 180 days, during which time NCLT will hear proposals for revival and decide on the future course of action. And thereupon, no coercive proceedings can be launched against the corporate debtor in any other forum or under any other law, until approval of resolution plan or until initiation of liquidation process.
4. NCLT appoints an interim Insolvency Professional (IP) upon confirmation by the Insolvency and Bankruptcy Board (hereinafter, "the Board") within 14 days of acceptance of application. Interim IP holds office for 30 days only. Interim IP takes control of the debtor's assets and company's operations, collect financial information of the debtor from information utilities.
5. NCLT causes public announcement to be made of the initiation of corporate insolvency process and calls for submission of claims by any other creditors.
6. After receiving claims pursuant to public announcement, interim IP constitutes the creditors' committee. All financial creditors shall be part of creditors' committee and if any financial creditor is related party of corporate debtor, then such financial creditor will not have any right of representation, participation or voting. Operational creditors should be part of Creditors' Committee (without voting right) if their aggregate dues are not less than 10% of the debt.
7. Creditors' committee shall meet first within seven days of its constitution and decide by 75% of votes either to replace or confirm interim IP as Resolution Professional. Thereupon, Resolution Professional is appointed by the NCLT upon confirmation by the Board. The creditors' committee, with a majority of 75% votes, can change Resolution Professional any time.
8. The creditors' committee has to then take decisions regarding insolvency resolution by a 75% majority voting.
9. If three-fourths of the financial creditors consider the case complex and require extension of time beyond 180 days, the NCLT can grant a one-time extension of up to 90 days.
10. Resolution Professional to conduct entire corporate insolvency resolution process and manage the corporate debtor during the period.
11. Resolution Professional shall prepare information memorandum for the purpose of enabling resolution applicant to prepare resolution plan. A resolution applicant means any person who submits resolution plan to the resolution professional. And upon

receipt of resolution plans, Resolution Professional shall place it before the creditors' committee for its approval.

12. Once a resolution is passed, the creditors' committee has to decide on the restructuring process that could either be a revised repayment plan for the company, or liquidation of the assets of the company. If no decision is made during the resolution process, the debtor's assets will be liquidated to repay the debt.

13. The resolution plan will be sent to NCLT for final approval, and implemented once approved.

#### ▪ **Liquidation**

1. The commencement of liquidation process takes place on account of:
  - (i) failure to submit the resolution plan to the NCLT within the prescribed period, or
  - (ii) rejection of resolution plan for non-compliance with the requirements of the Code,
  - (iii) or decision of creditors' committee based on vote of majority, or
  - (iv) contravention of resolution plan by the debtor.
2. During liquidation, no suit or other proceedings shall be instituted by or against the corporate debtor; except through the liquidator on behalf of corporate debtor with permission of the NCLT.
3. The Resolution Professional shall act as liquidator unless replaced.
4. The liquidator shall form an estate of all assets of corporate debtor called the liquidation estate.
5. Liquidator shall receive, verify and admit or reject, as the case may be, the claims of creditors within the prescribed time. Creditor may appeal to the adjudicator within 14 days.
6. A secured creditor may either relinquish its security interest to the liquidation estate and receive on first priority, the proceeds of the sale by the liquidator or realise its security interest by enforcing, realising, settling, compromising or dealing with the secured asset in accordance with such law as applicable to the secured interest. Any surplus amount so realised shall be tendered to the liquidator. In case of any shortfall in recovery, the secured creditors will be paid by the liquidator out of the assets of the corporate debtor. However, his claim will be junior to the unsecured creditors to the extent of the shortfall.

7. Assets will be distributed by the liquidator in the manner of priorities of debts laid in the Code (see below). Individual claimants or those claiming to have any special rights on assets of the debtor will form part of the liquidation process.
8. All sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund will be considered as priority dues and is not to be included in the liquidation estate and estate of bankrupt.
9. Upon the assets of corporate debtor completely liquidated and the liquidator making an application, the NCLT shall pass an order dissolving the corporate debtor.

### ➤ **Fast Track Corporate Insolvency Resolution Process**

The aim of the Insolvency and Bankruptcy code is to conclude the procedure within half of the default time period specified under the Code. The person or entity seeking the fast relief will have onus on the process at set-off and that person or entity that sets-off the Fast-track process must support that the case is fit for the Fast-track. Therefore, whosoever fills the application for fast track process under Chapter IV (Section 55) of the Insolvency and Bankruptcy Code will have to file the application along with the proof of the existence of default as evidenced by records available with an information utility or such other means as may be specified by the Board to establish that the corporate debtor is eligible for fast track corporate insolvency resolution process.

The Code has provided for a fast track insolvency resolution process in respect of corporate debtors, qualification to be notified by the Government. The process shall be completed in 90 days (extendable by maximum 45 days). Provisions of insolvency process apply to fast track insolvency. This will be an enabler for start-ups and small and medium enterprises to complete the resolution process quickly and move on.

### ➤ **Voluntary Liquidation of Corporate Person**

The Code provides for voluntary liquidation proceedings by corporate person who intends to liquidate itself and has not committed any default and can pay off its debts fully from proceeds of liquidation of its assets. The law requires a declaration to that effect from majority of directors of the company also stating that the company is not being liquidated to defraud any person. A resolution passed to this effect shall be approved by creditors representing two-thirds value of the company's debts. Voluntary liquidation commences when such resolution is passed by the creditors as above. Provisions of liquidation process apply to voluntary liquidation. Once the debtor is completely wound up and assets liquidated, the NCLT passes an order for its dissolution.

## ➤ Order of priority of payment of debts

The Code provides for priority with regard to distribution of proceeds following liquidation of the company or bankruptcy of individual or partnership as below:

i. Insolvency resolution cost and liquidation cost
ii. workmen's dues (for 24 months before commencement) and debts to secured creditor (who have relinquished their security interest)
iii. Wages and unpaid dues to employees (other than workmen) (for 12 months before commencement)
iv. Financial debts to unsecured creditors and workmen's dues for earlier period
v. Crown debts and debts to secured creditor following enforcement of security interest
vi. Remaining debts
vii. Preference shareholders
viii. Equity Shareholders or partners

Any surplus remaining after payment of debts shall be applied in payment of interest accrued since commencement date.

## ➤ Adjudicating Authority under the Code

At present, the High Courts, the Company Law Board (CLB), the Board for Industrial and Financial Reconstruction (BIFR) and Debt Recovery Tribunal (DRT) are having overlapping jurisdiction in the matter of debt recovery and restructuring. This gives rise to systemic delays and complexities in the process. The code intends to overcome these challenges and aims to reduce the burden on the courts as all litigation will be filed under the Code as under:

Under Part II, Chapter VI of the Code, National Company Law Tribunal (NCLT) would be adjudicating authority for insolvency resolution and liquidation of Companies, Limited Liability Partnerships (LLPs), any entity with limited liability under any law and bankruptcy of personal guarantors thereof. An appeal can be preferred from orders of NCLT to National Company Law Appellate Tribunal (NCLAT) within 30 days (15 days' extension if there is sufficient ground). Jurisdiction is territorial based on location of registered office of corporate person. Orders of NCLAT are appealable on a question of law to the Supreme Court within 45 days.

Vide its notification dated June 01, 2016, the Central Government has constituted 11 (eleven) Benches of the NCLT in exercise of its powers under sub-section (1) of section 419 of the new Companies Act, 2013. Of the said 11 benches, two shall be situated in New Delhi, and one each at Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai.



Under Part III, Chapter VI of the Code, Debt Recovery Tribunal (DRT) would be the adjudicating authority for insolvency resolution and bankruptcy of individuals, unlimited partnerships and partner/s thereof. Jurisdiction would be based on place of residence or works for gain or carries on business. Appeal can be made to Debt Recovery Appellate Tribunal (DRAT) within 30 days (15 days' extension if there is sufficient ground). Further appeal from DRAT would be within 45 days before the Supreme Court only on question of law. It is specifically provided that Civil courts or authority not to have jurisdiction and also cannot grant any injunction.

In keeping with the broad philosophy that insolvency resolution must be commercially and professionally driven (rather than court driven), the role of adjudicating authorities is limited to ensuring due process rather than adjudicating on the merits of the insolvency resolution.

### ➤ **New Institutions Proposed under the Code**

The Code has provided a host of new institutions to carry out the provisions of the Code, which are as below:

1. **Insolvency Professionals**: will conduct the insolvency resolution process, take over the management of a company, assist creditors in the collection of relevant information, and manage the liquidation process. The Code bestows such powers and duties upon the insolvency professional as required to efficiently drive the insolvency and liquidation process.
2. **Insolvency Professional Agency**: will accept registration, examine and certify the insolvency professionals. Such agencies are to be registered with and certified by the Insolvency and Bankruptcy Board of India.
3. **Insolvency and Bankruptcy Board of India**: This body will have regulatory over-sight over the Insolvency Professional, Insolvency Professional Agencies and Information Utilities. Under the Board's supervision, these agencies will develop professional standards, codes of ethics and exercise a disciplinary role over errant members leading to the development of a competitive industry for insolvency professionals. The Board is responsible for making guidelines and regulation on matters of insolvency and bankruptcy.

The Board shall consist of a Chairperson, three members from the Central Government not below the rank of Joint Secretary or equivalent – one each to represent the Ministry of Finance, the Ministry of Corporate Affairs and Ministry of Law, ex-officio; one member to be nominated by the Reserve Bank of India, ex officio; five other members to be nominated by the Central Government. The Chairperson and the other members shall be persons of ability, integrity and standing, who have shown capacity in dealing with problems relating to insolvency or bankruptcy and have special knowledge and experience in the field of law, finance, economics, accountancy or administration.

4. **Insolvency Information Utilities:** The Code provides for information utilities which would collect, collate, authenticate and disseminate financial information from listed companies and financial and operational creditors of companies. An individual insolvency database is also proposed to be set up with the goal of providing information on insolvency status of individuals.

Article by CS Sandeep Kumar Jain

# Insolvency & Bankruptcy Code, 2016



To speed up resolution of stressed assets in the country

**WHY**



**WHO**

Applicable to :  
Individuals,  
partnerships, LLPs and  
Corporates



Authority to decide insolvency application within 180 days (90 days extension allowed)

**WHEN**



**WHEN**

Fast track process of 90 days available for specified entities



Adjudicating authority:  
NCLT for corporates,  
DRT for individuals &  
partnership firms

**HOW**

