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## A BIRD'S VIEW OF INSOLVENCY AND BANKRUPTCY CODE, 2016

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### Introduction

The Government of India notified the Insolvency and Bankruptcy code (IBC) 2016 on 28th May 2016. This is the biggest economic reform of the era in India, only next to the Goods and Services Tax (GST). Prior to the enactment of this code, there was no an exclusive law for dealing with Bankruptcy and Insolvency in India. Insolvency of individual cases are dealt with under the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920. On the other hand, High courts handle the liquidation of Joint stock Companies. Sick Industrial companies Act (SICA) 1985, the securitisation and Reconstruction of financial Assets and Enforcement of security interest (SARFAESI) Act, 2002, the Recovery of Debt due to Banks and Financial Institutions Act, 1993 and Companies Act, 2013 are some of the other laws available in India to deal with the Insolvency of corporates. Under the new IB code 2016, the various laws pertinent to the Insolvency and Bankruptcy in India are consolidated and bring them under one roof.

The Insolvency and Bankruptcy code is an act to consolidate and amend the various laws relating to re-organisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, and entities to promote entrepreneurship, availability of credit and balance the interest of all the stake holders including alteration in the order of priority of payment of Government dues and to establish an insolvency and Bankruptcy Board of India, (IBB) and for matters connected therewith or incidental thereto.

The new legislation is needed to deal with Insolvency and Bankruptcy as the existing laws are inadequate, ineffective and result in undue delays in resolution. According to the World Bank report, establishing corporate insolvency in India takes more than 4 years, compared with just six months in Japan, eight months in Singapore, 1 year in UK, 1.5 years in US and 1.7 years in China. These delays are caused due to time taken to resolve cases in courts and confusion due to a lack of clarity about the current bankruptcy frame work. Multiplicity of laws has been a problem in the way of banks failing to recover their loan. Availability of this money is very essential for the banks to go about its business. A timely resolution of insolvency and Bankruptcy would certainly support the development of credit markets and encourage entrepreneurship, and in turn improving the investments which will pave the way for higher economic growth and development. The new code will expedite the process and resolution of bankruptcy pleas in the banking sector which is already in the grips of bad loan crisis. It also creates a level playing ground for both the creditors and debtors to address their concerns.

### **The Institutional Frame Work**

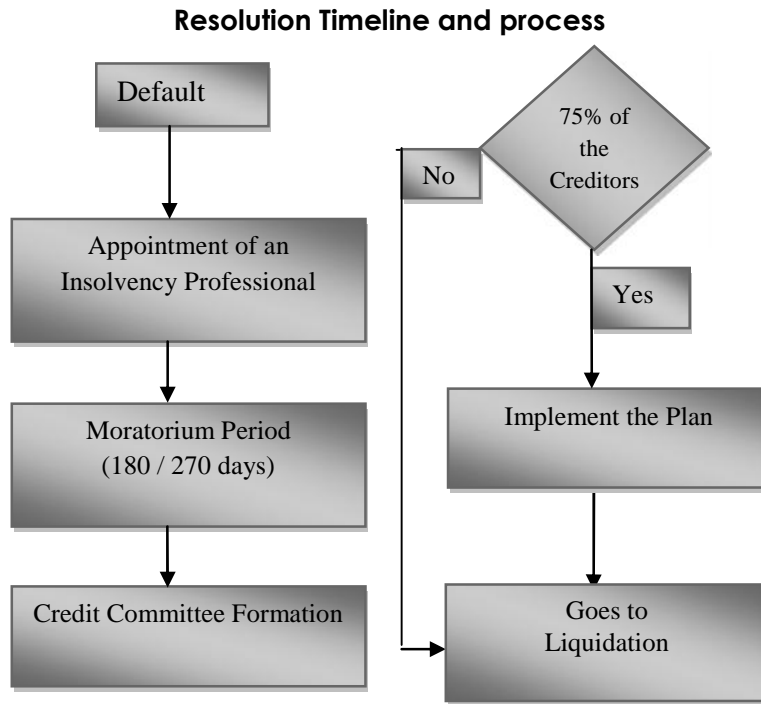
The present code not only consolidates all existing laws, but also specifies a time frame. The insolvency petition should be resolved within a time frame of 180 days after the process is initiated, plus a maximum of 90-day extension. Under the proposed law, a bankrupt entity is a debtor who will be adjudged as bankrupt by an adjudicating authority. The adjudicating authority under the new code is National Company Law Tribunal (NCLT) for companies and limited liability partnerships and Debt Recovery Tribunal (DRT) for Individuals and partnership firms. The code is not applicable to the entities which are engaged in providing financial services like Insurance, NBFC, Investment Companies etc.,

The code provides for the establishment of the Board called Insolvency and Bankruptcy Board of India (IBB). This is the apex body for promoting transparency and good governance in the administration of IBC. Insolvency professionals (IPS) are the persons enrolled with Insolvency Professional Agency (IPA) as its members and are approved members of the Board to proceed with Insolvency and Bankruptcy process. Insolvency professionals act as intermediaries who would play the key role in the efficient working of insolvency and bankruptcy processes. The Insolvency professionals should register with IBB and is required to obtain Certificate of Registration from the Board. The IBB promotes good professional and ethical conduct amongst these professionals to protect the interest of both debtors and creditors.

Information Utility means a person who is registered with the Board and shall obtain a certificate of registration from the Board to carry out its business as information utility. Under the new code the purpose of this intermediary is to remove information dependency on the debtors for critical information that is required to resolve

insolvency. This information is available to creditors, resolution professionals, liquidators and other stakeholders in insolvency and bankruptcy proceedings. The main obligation of the information utility is to collect, collate, authenticate and disseminate financial information of debtors in a universally accessible format.

### Features of Corporate Insolvency Resolution Process (IRP)



### Financial and Operational Creditors

The bankruptcy code makes a distinction between financial creditors (both secured and unsecured, who have extended credit for interest, instead of goods and services in exchange) and operational creditors (who have extended credit in exchange for goods and services). This distinction has been made in order to treat both the secured and unsecured creditors at par for the purpose of initiating Insolvency Resolution Process (IRP). This also empowers an operational creditor to trigger an IRP and attend all meetings of the creditor committee without any voting rights, since they are paid the liquidation value, at the least.

### Moratorium Period

Adjudicating authority (NCLT) will declare a moratorium period during which no action can be taken against the company or the assets of the company. Key focus will be on running the company on going concern basis. This operates as a calm period during which no judicial proceedings for recovery, enforcement of security interest, and sale or transfer of any assets can take place against the debtors. The order of moratorium shall have effect till the completion of corporate Insolvency process.

### **Credit Committee**

Committee of creditors means the committee which shall comprise of all financial creditors of the company or limited liability partnership firms. The party related to the insolvency petition should be excluded from the committee. Each creditor shall vote in accordance to voting share assigned. If 75% of creditors approve the resolution plan, the same needs implemented.

### **Trigger**

The primary principle of the IBC 2016 is to detect the distress at the earliest and resolve it. The occurrence of a single default will enable the IRP to be triggered. The process is little different for debtors, financial creditors and operational creditors. A Financial creditor may trigger the IRP by filing an application with NCLT upon the occurrence of a payment default for amounts owed to them or any other financial creditor. An operational creditor may trigger the IRP by issuing a notice to the debtor upon the occurrence of a payment default. Following the issue of such notice, the debtor may either repay or demonstrate the existence of a genuine dispute. If the debtor has not repaid or demonstrated the existence of a genuine dispute, after the lapse of 10 Days from the issuance of the notice, the operational creditor will be entitled to file an application with NCLT for initiating the IRP. Also the significant shareholders, management employees or service providers of a company who are capable of producing detailed audited financial information, may file for an IRP upon the occurrence of a default. The bankruptcy code prescribes penalties for false and frivolous triggers.

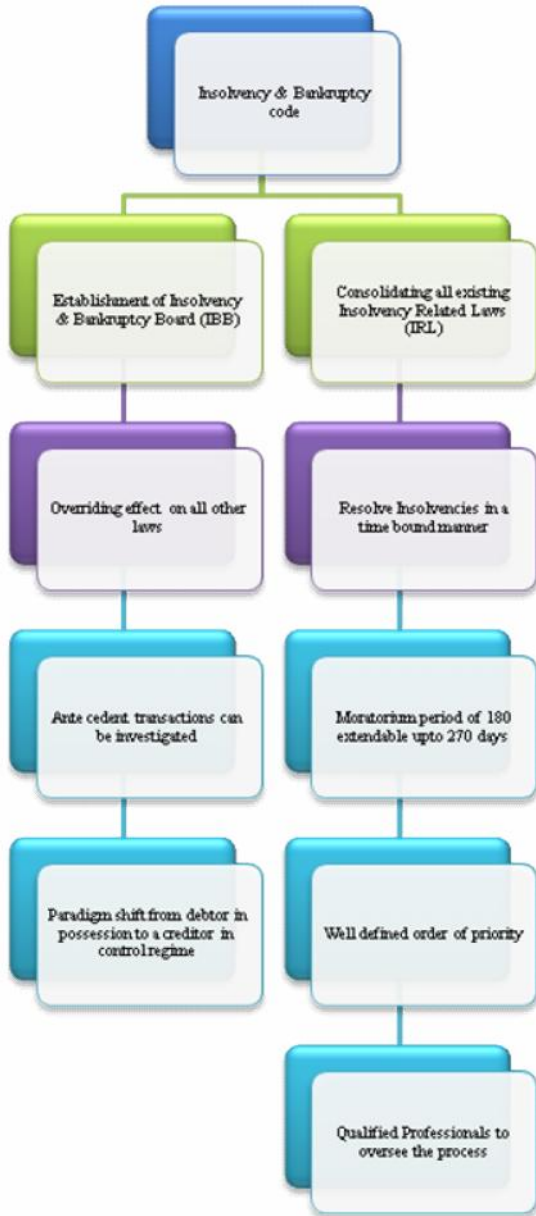
### **Debtor in Possession to Creditors in Control**

The IBC 2016 proposes a paradigm shift from the existing debtor in possession to a creditor in control regime. The debtors are no more in control during the IRP. The insolvency professional can be appointed by the board. They are empowered to effectively run and manage the entity, including its assets, as a going concern during the period that the Insolvency Resolution Process is pending, thereby addressing concerns of asset-stripping or siphoning during the Insolvency Resolution Process period. The new bankruptcy code suspends the powers of the Boards of Directors or the partners of the corporate debtors, as the case may be, upon the appointment of insolvency professionals. The new code also requires the suspended management of such entity to co-operate with the insolvency professional.

Any interim finance raised during the IRP period will have super priority within the resolution plan and during liquidation. If the insolvency professionals propose to raise interim finance before the formation of the creditor committee, approval of the existing secured creditors would be required. After the formation of creditor committee, any interim finance raised upto a prescribed threshold will require the prior approval of the creditor committee. If an agreement has been reached in respect of maintenance of the company as a going concern, the NCLT will close the case for

insolvency. In case when no such agreement has been reached, the NCLT may pass an order declaring the entity insolvent and notifying the period within which the liquidation will be deemed to have commenced.

**Key Aspects of IBC 2016**



If all the conditions as explained above are met, the NCLT will pass a liquidation order along with accompanying order to appoint a liquidator recommended by the regulator and move all the assets of the company into liquidation trust which will be managed by the liquidator. They will change the name of the company in the registration records to include the phrase "in liquidation" to its original name. The board of the company will be replaced by the creditor committee. Under the new IB Code, the liquidator continues to be responsible for maximising the value of the assets of the company in the most efficient manner of disposal. All the realisation from the assets will be distributed to the creditors according to the prescribed waterfall mechanism set out in the new code.

**Distribution Water Fall**

The priority of payment or distribution water fall, as it is technically called, set out in the new IBC are as follows:

1. Cost of IRP and liquidation
2. Secured creditors and work men dues (capped upto 2 years from the start of IRP)
3. Employees salaries (capped up to 1 year)
4. Due to unsecured financial creditors
5. Any amount due to Governments both the state and central, in respect of the whole or any part of the period of 2 years prior to the date of commencement of liquidation.
6. Any debts of secured creditors for any amount unpaid following the enforcement of security interest.

7. Any remaining debt; and
8. Remaining surplus to be distributed to share holders.

All distribution as per above water fall will be net of liquidator's fees. The liquidation process is an irreversible process after the expiry of a specified period from the passing of liquidation order.

### **Insolvency of Individuals under the new IBC**

The problems faced by the common man in the previous laws of insolvency are very much addressed by the new Insolvency and Bankruptcy code 2016. Individual borrowers and consumers can now start their lives afresh after being declared bankrupt. They have also the option of initiating Insolvency resolution process by themselves, in the happening of certain events. Debt Recovery Tribunal will substitute the District Courts under the new code.

There were no provision either under the Presidency Towns Insolvency Act, 1909 or Provisional Insolvency Act, 1920 for pre-bankruptcy insolvency resolution process and fresh start process for individuals. It is totally a new concept in India which would allow persons to get a fresh start to life under the new code. An individual can discharge all his current liabilities under a systematic and controlled manner, as per the procedure of insolvency resolution process enshrined in the new code. Separate recovery harassment from different creditors can thus be avoided. Another new concept which was hitherto not there in the earlier legislations is that of Insolvency Resolution professionals, who will be playing a major part during the insolvency process and also in creating information utilities.

The code also includes a new term called "excluded assets". Certain assets have been excluded to be claimed by the lenders. Accordingly excluded assets include

- a) Unencumbered tools, books, vehicles and other equipments that are necessary to the debtor or bankrupt for his personal use or for the purpose of his employment, business or vocation.
- b) Unencumbered furniture, household equipment and provisions as are necessary for satisfying the basic domestic needs of the bankrupt.
- c) Any unencumbered personal ornaments of debtor or his immediate family which cannot be parted with, in accordance with the religious usage.
- d) Any unencumbered life insurance policy or pension plan taken in the name of the bankrupt or his immediate family.
- e) Any unencumbered single dwelling unit owned by the debtor of such value as may be prescribed.

However, if the debtor has designed his "excluded assets" transaction merely with the intent to defeat the rights of the creditor, then the Trustee gets a right to examine and cancel such transaction.

If there is an evidence of actual default on payments, a single creditor or several creditors can jointly trigger insolvency. A resolution professional can be appointed by

the creditor. The bankruptcy process can also be initiated, if it is found that the insolvency resolution process was initiated to defraud the creditors. Similarly, if an individual is unable to pay his debts, he himself can trigger an insolvency process. If the individual's income and assets put together is less than the specified limits, he would be eligible for a discharge from the "qualifying debts" that include all unsecured debts except certain debts incurred due to fine or penalty imposed by the Court or a debt incurred in the past 3 months before filing a Fresh Start Process Application.

The following is the specified limits for an individual to file an application for bankruptcy:

- a. When the gross annual income of the debtor is not more than Rs.60,000.
- b. If the aggregate value of debtor's assets is not more than Rs.20,000.
- c. If the debtor does not own a dwelling unit.
- d. If the total value of the qualifying debts does not exceed Rs,35,000.
- e. If the debtor is not an un discharged bankrupt.

### **Water Fall Mechanism**

The code carries a clear focus on quick decision making. The new code also has a significant provision to the waterfall mechanism, whereby liquidation proceeds will be paid in the following sequential manner:

- Secured creditors
- Workmen's dues for 12 months
- Employees other than workmen
- Unsecured creditors.

An interesting thing to note is that the Government dues have been given the least priority and figure after most other dues. It would be interesting to note that the present laws protect not only financial creditors like banks etc. but also the operational creditors. As regards banks and financial institutions, the Government is working through a task force, to set up a separate legislation for financial institutions.

### **Conclusion**

India is in a revolutionary process of bringing ease of doing business. Enactment and implementation of the Insolvency and Bankruptcy Code 2016 will not only improve the Indian ranking on world map in ease of doing business but also it will improve credit market, GDP growth, FDI and over all business environment of the nation. The new Code is very distinct in the sense that it is the only law which is available to the financial and operational creditors and the debtors alike. This Code brings for the radical reforms with the special thrust on creditors driven insolvency resolution in a time-bound manner. It will improve the debt recovery rates and to maximize the realizable value of insolvent firms. The full benefits of the Code will be obtained in a situation where all the stakeholders collectively contribute in creating an ecosystem conducive to an effective, fair and expedient implementation of the Code. For the common man, it is clearly a win-win situation.

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