

# **THE INSOLVENCY AND BANKRUPTCY CODE, 2016**

*Mrs. Hetal Chitroda*

*Mrs. Jaya Ankur Singhania*

*(M/s. Jaya Sharma & Associates, Practicing Company Secretary Firm, Mumbai)*

## **INTRODUCTION**

A historical economic reform in India took place when The Code has now received President's assent on May 28, 2016 & passed the Insolvency and Bankruptcy Code, 2016. This is considered as the biggest economic reform next only to GST.

The Insolvency Code aims to provide a single comprehensive bankruptcy and insolvency law for all legal entities and natural persons. The Insolvency Code seeks to provide greater clarity in the law and facilitate the application of consistent and coherent provisions to different stakeholders affected either by business failure or inability to pay debt and will address the challenges being faced at present for swift and effective bankruptcy and insolvency resolution. The Insolvency Code seeks to improve the handling of conflicts between creditors and debtors, avoid destruction of value, distinguish malfeasance vis-a-vis business failure and clearly allocate losses in macroeconomic downturns.

This article deals with the major highlights of the Insolvency & bankruptcy code, 2016 and how the code is going to affect the Indian Economy.

## **THE INSOLVENCY AND BANKRUPTCY – THE CONCEPT**



**Insolvency:** Insolvency is a situation where individuals or companies are unable to repay their outstanding debt. It may be resolved by changing the repayment plan of the loans, or writing off part of the debt. If insolvency cannot be resolved, assets of the debtor may be sold to raise money, and repay the outstanding debt.

**Bankruptcy:** Bankruptcy is not exactly the same as insolvency. The word Bankruptcy is formed from the Latin words 'bancus' means a bench or table & 'ruptus' means broken. Technically, Bankruptcy occurs when a court has determined insolvency, and given legal orders for it to be resolved. Bankruptcy is a determination of insolvency made by a court of law with resulting legal orders intended to resolve the insolvency. Insolvency describes a situation where the debtor is unable to meet his/her obligations. Bankruptcy is a legal scheme in which an insolvent debtor seeks relief.

## **NEED OF THE INSOLVENCY & BANKRUPTCY LAW**

In India, the legal and institutional machinery for dealing with debt default has not been in line with global standards. The recovery action by creditors, either through the Contract Act or through special laws such as the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, has not had desired outcomes. Similarly, action through the Sick Industrial Companies (Special Provisions) Act, 1985 and the winding up provisions of the Companies Act, 1956 have neither been able to aid recovery for lenders nor aid restructuring of firms. Laws dealing with individual insolvency, the Presidential Towns insolvency Act, 1909 and the Provincial Insolvency Act. 1920, are almost a

century old. This has hampered the confidence of the lender. When lenders are unconfident, debt access for borrowers is diminished. This reflects in the state of the credit markets in India. Secured credit by banks is the largest component of the credit market in India. The corporate bond market is yet to develop.

The objective of the new law is to promote entrepreneurship, availability of credit, and balance the interests of all stakeholders by consolidating and amending the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner and for maximization of value of assets of such persons and matters connected therewith or incidental thereto.

The law aims to consolidate the laws relating to insolvency of companies and limited liability entities (including limited liability partnerships and other entities with limited liability), unlimited liability partnerships and individuals, presently contained in a number of legislations, into a single legislation. Such consolidation will provide for a greater clarity in law and facilitate the application of consistent and coherent provisions to different stakeholders affected by business failure or inability to pay debt.

#### ➤ **THE HIGHLIGHTS OF THE INSOLVENCY & BANKRUPTCY CODE, 2016**

- ❖ Clear, coherent and speedy process for early identification of financial distress and resolution of companies and limited liability entities if the underlying business is found to be viable.
- ❖ Two distinct processes for resolution of individuals, namely - “**Fresh Start**” and “**Insolvency Resolution**”.
- ❖ Debt Recovery Tribunal and National Company Law Tribunal to act as Adjudicating Authority and deal with the cases related to insolvency, liquidation and bankruptcy process in respect of individuals and unlimited partnership firms and in respect of companies and limited liabilities entities respectively.
- ❖ Establishment of an Insolvency and Bankruptcy Board of India to exercise regulatory oversight over insolvency professionals, insolvency professional agencies and information utilities.
- ❖ Insolvency professionals would handle the commercial aspects of insolvency resolution process. Insolvency professional agencies will develop professional standards, code of ethics and be first level regulator for insolvency professionals members leading to development of a competitive industry for such professionals.
- ❖ Information utilities would collect, collate, authenticate and disseminate financial information to be used in insolvency, liquidation and bankruptcy proceedings.
- ❖ Enabling provisions to deal with cross border insolvency.

The essential idea of the new law is that when a firm defaults on its debt, control shifts from the shareholders / promoters to a Committee of Creditors, who have 180 days in which to evaluate proposals from various players about resuscitating the company or taking it into liquidation. When decisions are taken in a time-bound manner, there is a greater chance that the firm can be saved as a going concern, and the productive resources of the economy (the labour and the capital) can be put to the best use. This is in complete departure with the experience under the SICA regime where there were delays leading to destruction of the value of the firm.

The vision of the new law is to encourage entrepreneurship and innovation. Some business ventures will always fail, but they will be handled rapidly and swiftly. Entrepreneurs and lenders will be able to move on, instead of being bogged down with decisions taken in the past.

### ➤ THE PROVISIONS OF THIS CODE SHALL APPLY TO

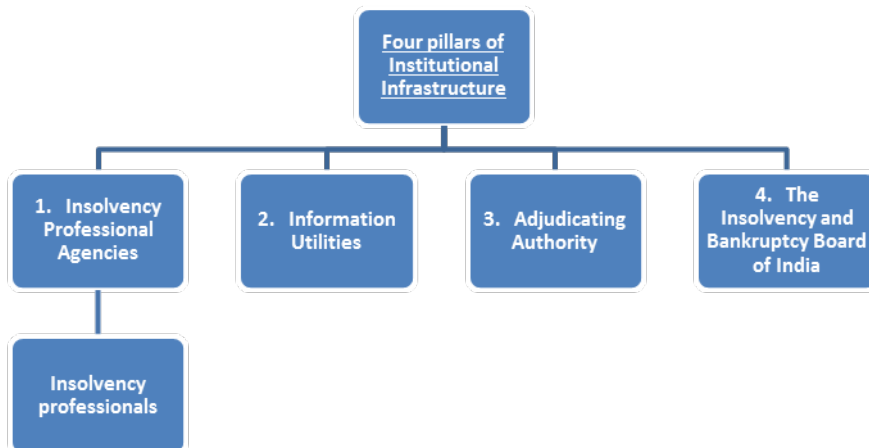
- ❖ any company incorporated under the Companies Act, 2013 or under any previous company law;
- ❖ any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act;
- ❖ any Limited Liability Partnership incorporated under the Limited Liability Partnership Act, 2008;
- ❖ such other body incorporated under any law for the time being in force, as the Central Government may, by notification, specify in this behalf; and
- ❖ Partnership firms and individuals.

### ➤ THE BANKRUPTCY CODE PROPOSES TWO AUTHORITIES TO DEAL WITH INSOLVENCY

- ❖ The National Company Law Tribunal will adjudicate cases for companies and limited liability partnerships
- ❖ The Debt Recovery Tribunal will do the same for individual and partnership firms.

Both will have appellate tribunals.

### ➤ A KEY INNOVATION OF THE INSOLVENCY AND BANKRUPTCY CODE IS FOUR PILLARS OF INSTITUTIONAL INFRASTRUCTURE



#### 1. The first pillar - Insolvency Professional Agencies

Institutional infrastructure is a class of regulated persons, the Insolvency Professionals. They would admit insolvency professionals as members and develop a code of conduct and promote transparency and best practice in governance.

**Insolvency professionals** – are licensed professionals appointed by Insolvency Professional Agencies who would take on the roles of resolution professional or liquidator/ bankruptcy trustee in an insolvency resolution process.

#### 2. The second pillar - Information Utilities

Institutional infrastructure is a new industry of Information Utilities. These would store facts about lenders and terms of lending in electronic databases. This would eliminate delays and disputes about facts when default does take place.

### 3. The third pillar - Adjudicating Authority

Institutional infrastructure is in adjudication. The **NCLT** will be the forum where firm insolvency will be heard and **DRTs** will be the forum where individual insolvencies will be heard. These institutions, along with their Appellate bodies, viz., NCLAT and DRATs will be adequately strengthened so as to achieve world class functioning of the bankruptcy process.

### 4. The fourth pillar - The Insolvency and Bankruptcy Board of India

- This body will have regulatory over-sight over the Insolvency Professional, Insolvency Professional agencies and information utilities.
- The Board shall be a body corporate having perpetual succession and a common seal, with power, subject to the provisions of this Code, to acquire, hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or be sued.
- The head office of the Board shall be at such place in the National Capital Region with offices at other places in India

#### ❖ Constitution of the Board:

- i. Chairperson;
- ii. three members from amongst the officers of 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;
- iii. one member to be nominated by the Reserve Bank of India, ex officio;
- iv. five other members to be nominated by the Central Government, of whom at least three shall be the whole-time members.

#### ➤ **BENEFITS OF THE CODE:**

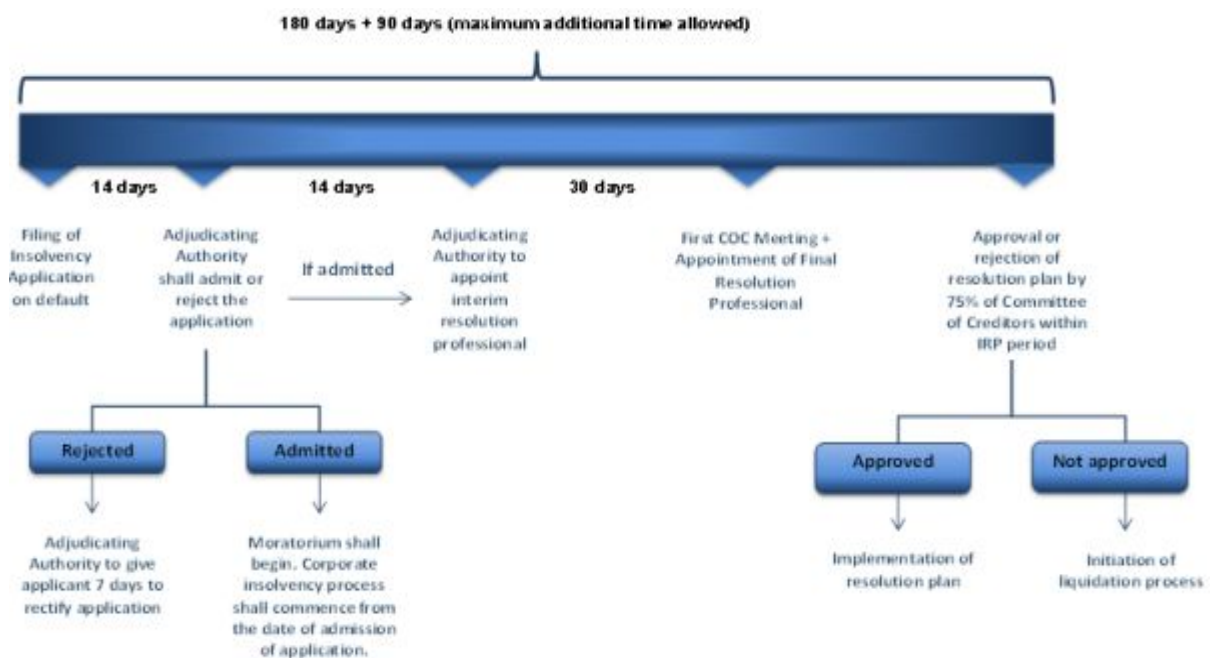
- ❖ **Simple Procedure to resolve insolvency.**
- ❖ **Code to help wind up sick businesses** - At present, it takes more than four years to resolve a case of bankruptcy in India, according to the World Bank. The code seeks to reduce this time to less than a year.
- ❖ **Cross-border insolvency** - The bankruptcy code has provisions to address cross-border insolvency through bilateral agreements with other countries. It also proposes shorter, aggressive time frames for every step in the insolvency process right from filing a bankruptcy application to the time available for filing claims and appeals in the debt recovery tribunals, National Company Law Tribunals and courts.
- ❖ **Protect workers of a bankrupt company** - To protect workers' interests; the code has provisions to ensure that the money due to workers and employees from the provident fund, the pension fund and gratuity fund shouldn't be included in the estate of the bankrupt company or individual. Further, workers' salaries for up to 24 months will get first priority in case of liquidation of assets of a company, ahead of secured creditors.

- ❖ **Fast Track Corporate Insolvency Resolution Process** - The Code has provisions for fast track corporate insolvency resolution process shall be completed within a period of ninety days from the insolvency commencement date.
- ❖ **Voluntary Liquidation of Corporate Persons, Firms and Individuals** - The Code also provides ways for a corporate person, Firms & Individuals who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings.
- ❖ **Concept of operational creditor** - Another unique feature of the Code is that it gives right to operational creditor to initiate procedure and the right is not limited to big creditors only who want their money back. Thus making it easier for creditors to get their dues cleared with a corporate.

## ➤ **BANKRUPTCY AND INSOLVENCY PROCESS FOR COMPANIES AND OTHER LIMITED LIABILITY ENTITIES**

The Insolvency Code provides a speedy process for insolvency resolution and liquidation for companies and other limited liability entities.

### ❖ **INSOLVENCY RESOLUTION PROCESS:**



- This shall be conducted by the resolution professional;
- It may be initiated by a financial creditor, an operational creditor or by the debtor itself by making an application to the Adjudicating Authority;
- The entire process will have to be completed within 180 days and may be extended by order for further period of 90 days in certain circumstances;
- Upon admission of application, the Adjudicating Authority will declare moratorium which prohibiting institution or continuation of any kind of litigation in any court of law, tribunal, arbitration panel or other authority against the corporate debtor;
- During this process, the management of the debtor and custody of the assets of the corporate debtor will be vested with the resolution professional to ensure protection of the assets of the debtor.

## ❖ LIQUIDATION PROCESS:



- This can be initiated against a corporate debtor 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.
- The Adjudicating Authority will pass an order for liquidation of the debtor.
- The insolvency resolution professional will act as liquidator for liquidation of the debtor.
- The assets of the corporate debtor, in case of liquidation will be distributed in the order as prescribed by the Code.
- Once the liquidation order is passed, no legal proceedings can be commenced or continued against the debtor.

## ➤ **BANKRUPTCY AND INSOLVENCY PROCESS FOR INDIVIDUALS AND PARTNERSHIP FIRMS**

### ❖ **Fresh Start Process**

This process may be initiated either by a debtor himself or through a resolution professional by making an application to the Adjudicating Authority for a discharge from their 'qualifying debts'. A period of interim –moratorium is to commence upon filing the said application in relation to all debts and the same is to cease to have effect on the date of admission or rejection of such application.

### ❖ **Insolvency Resolution Process**

An insolvency resolution process may be initiated by the creditor or the debtor. The negotiations will take place between the creditors and the debtor to arrive at an agreeable repayment plan for composition of the debts and affairs of the debtor, supervised by a resolution professional. The repayment plan will approval of a three-fourth majority of creditors in value. The repayment plan may authorise or require the resolution professional to:

- (a) carry on the debtor's business or trade on his behalf or in his name;
- (b) realize the assets of the debtor; or
- (c) administer or dispose of any funds of the debtor. The repayment plan will be implemented in supervision of the insolvency professional.

### ❖ **Bankruptcy Process**

This can be initiated only after the failure of the resolution process or non-implementation of repayment plan. The bankruptcy trustee is responsible for administration of the estate of the bankrupt and for distribution of the proceeds on the basis of the priority.

## ➤ **INSOLVENCY AND BANKRUPTCY FUND**

The Code creates an Insolvency and Bankruptcy Fund for the purposes of insolvency resolution, liquidation and bankruptcy of persons under the Code. The Fund will receive voluntary contributions from any person. In case of insolvency proceedings being initiated against the contributor, he will be allowed to withdraw his contribution for making payments to workmen, protecting his assets, etc.

## ➤ **AGREEMENTS WITH FOREIGN COUNTRIES**

The Central Government may enter into an agreement with the Government of any country outside India to enforce the provisions of the Code in relation to the assets or property of corporate debtor or debtor, including personal guarantor of a corporate debtor, situated in a country outside India.

## ➤ **OFFENCES AND PENALTIES**

The Code provides for the punishment in terms of imprisonment as well as fine for provision of false information by a debtor or a creditor in insolvency resolution process. The Code also provides for punishment for deliberate contravention of the provisions of the Code by an Insolvency Professional. The Code further specifies the punishment for providing false information or concealment by bankrupt.

## ➤ **CASE LAWS**

### ❖ **Marine Geotechnic LLC ("Marine") v Costal Marine Construction & Engineering Ltd.**

Bombay High Court Clarifies Law Regarding Execution Of A Foreign Decree And Bankruptcy Proceedings.

### ❖ **FACTS OF CASE**

Marine obtained an ex-parte default summary judgment for a sum of US \$ 437,731 from the US District Court. On September 15, 2012 Marine served a statutory notice demanding the aforesaid sum from Costal. On October 8, 2012, Costal replied denying liability and claiming that they were unaware of any such decree. Based on this, Marine initiated the present winding-up proceedings.

### ❖ **ARGUMENTS**

Marine contended that the valid decree against Costal had not been satisfied and thus was a 'debt due' by Costal to Marine.

Costal contended that the decree of the US District Court was not a decree from a reciprocating territory under Section 44A of the Civil Procedure Code ("CPC") and was hit by of Section 13 of the CPC being an ex-parte summary judgment with no evidence of service on Costal and no adjudication on merits. Hence the decree of the US District Court could not be considered as conclusive under Indian Law and the sum decreed there under could not constitute a 'debt due' by Costal to Marine. In light of this Costal contended that the winding-up proceedings were not maintainable.

### ❖ **JUDGMENT**

The Court dismissed the winding-up proceedings and opined as follows:

- Enforcement of decrees from a reciprocating and a non-reciprocating Territory.
- Enforceability of ex-parte default judgments in India.
- Initiating winding-up proceedings based on a foreign decree.

## ➤ **SCOPE OF WORK FOR PROFESSIONAL UNDER THE BANKRUPTCY AND INSOLVENCY PROCESS**

- Before filing for Insolvency and Bankruptcy process evaluate the Advantages and Disadvantages;
- Examine Bankruptcy Alternatives;<sup>3</sup>
- Determine Eligibility, Assess Property;

- Decide Whether to Reaffirm, Redeem, or Surrender Secured Debt;
- Attend Credit Counseling;
- Gather Important Documents and File the Paperwork;
- Attend the Creditors Meeting;
- Attend Personal Financial Management Counselling;
- Receive the Bankruptcy Discharge Notice.

## ❖ CONCLUSION

India currently ranks 136 out of 189 countries in the World Bank's index on the ease of resolving insolvencies. India's weak insolvency regime, its significant inefficiencies and systematic abuse are some of the reasons for the distressed state of credit markets in India today. The Code promises to bring about far-reaching reforms with a thrust on creditor driven insolvency resolution. It aims at early identification of financial failure and maximizing the asset value of insolvent firms. The Code also has provisions to address cross border insolvency through bilateral agreements and reciprocal arrangements with other countries.

The unified regime envisages a structured and time-bound process for insolvency resolution and liquidation, which should significantly improve debt recovery rates and revitalise the ailing Indian corporate bond markets.

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