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## INDIA'S NEW INSOLVENCY & BANKRUPTCY CODE – LESSONS AND INSIGHTS FROM FOREIGN JURISDICTIONS

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**Abstract:** *Insolvency, a Financial Condition, is the situation where the debtor is not in a position to pay back the creditor. Bankruptcy, a Legal Position, is the legal declaration of Insolvency. The new Insolvency and Bankruptcy Code 2016 covering insolvency, liquidation, voluntary liquidation and bankruptcy, has a sequential procedure of Insolvency resolution, failing which, it leads to Bankruptcy. Under the new law, there are five stages in all, through which the “resolution” process must pass from the time, a company files for bankruptcy. Our Code (IBC 2016) draws a demarcation between the financial institutions and others. Furthermore, a natural person (one who has its own legal personality) can evoke bankruptcy law in India. Individual bankruptcy cases emphasize more towards the economic rehabilitation of the debtor as compared to their corporate counterparts. India is one of the eminent countries where bank can give loan to the entrepreneur to pay back the loan.*

**Keywords:** *Insolvency, Bankruptcy, Liquidation, IBC 2016, NCLT, Debt, IBB*

Insolvency, a Financial Condition, is the situation where the debtor is not in a position to pay back the creditor. The signs of insolvency for this could be a slow-down in sales, missing of payment deadlines etc. Bankruptcy, a Legal Position, is the legal declaration of Insolvency. All Insolvencies need not lead to Bankruptcy. The new Insolvency and Bankruptcy Code 2016 has a sequential procedure of Insolvency resolution, failing which, it leads to Bankruptcy. Before the new Insolvency and Bankruptcy Code 2016 (IBC 2016), there were multiple overlapping laws and adjudicating forms dealing with financial failures and insolvency of companies and individual. So to improve the business environment and elevate distressed credit market, the government introduced the Code Bill in November 2015 which was drafted by a specially constituted Bankruptcy Law Reforms Committee (BLRC) under the ministry of finance. After a public concentration process and recommendation from a joint committee of parliament, both houses of parliament passed Insolvency and Bankruptcy Code 2016 (IBC 2016) on May 28, 2016.



The New Code (IBC 2016) covers insolvency, liquidation, voluntary liquidation and bankruptcy. The bill makes it easier for weak companies to exist or restructure their businesses. It offers a uniform comprehensive insolvency legislation encompassing all companies, partnerships and individuals (other than financial firms). The IBC 2016 allows the creditors to assess the viability of a debtor as a business decision, and agree upon a plan for its revival or a speedy liquidation. It creates a new institutional framework, consisting of a regulator, insolvency professionals, information utilities and adjudicatory mechanisms.

**Following are the key features of the Code:**

- The Code creates a formal Insolvency Resolution Process (IRP). A business or debtor who has defaulted on dues can initiate the IRP. Also, lenders and creditors to a firm, including employees (secured or unsecured) can do it too.
- Replace the current multi-pronged corporate insolvency laws by a single comprehensive law and empower all categories of creditors (whether secured, unsecured, domestic, international, financial or operational) to trigger insolvency resolution process, while permitting only “financial creditors” to participate in the decision-making.
- Providing for a single regulator and adjudicating forum to oversee/implement all insolvency and liquidation proceedings (certain institutional infrastructure has been put into place to assist the regulator/adjudicating forum in this process).
- The Code creates time bound processes for insolvency resolution of companies and individuals. The time decided is 180 days.
- If insolvency cannot be resolved, the assets of the borrowers may be sold to repay creditors.
- Within 180 days, 75% of the creditors must agree to a revival plan. If this minimum threshold is not met, the firm automatically goes into liquidation. If 3/4<sup>th</sup> of the creditors decide that the case is complex and cannot be addressed within 180 days, the adjudicator can grant a one-time extension of up to 90 days on the process.
- Criminal charges will apply if the insolvency professionals tasked with the job, notice any asset stripping by the promoters or responsible parties.
- Liquidation proceeds will then be used (after insolvency resolution process cost and liquidation cost to be paid in full) to clear debts owed to people in the order-



- Secured creditors, and then to pay.
  - Workmen's dues for 12 months.
  - Unpaid dues to employees other than workmen.
  - Financial dues owed to unsecured creditors.
  - Government taxes for 2 years, other debts.
  - Preference shareholders and equity shareholders will receive last priority for payment.
- Ahead of secured creditors, salaries of workers for up to 24 months will get first priority in case of liquidation of assets of a company.
  - There is provision for monetary penalty and jail term of up to 5 years for concealment of property, defrauding creditors and furnishing false information.
  - The Code also provides for fast track corporate insolvency resolution process to be completed in 90 days.
  - Bankruptcy applications as per this Code have to be filed within 3 months rather than the earlier 6 months.
  - Anyone declared bankrupt will be barred from holding public office, thereby ensuring that politicians and government officials cannot hold any public office if declared bankrupt.
  - For initiating proceedings under IBC, an application has to be filed before an adjudicating authority, i.e., National Company Law Tribunal (NCLT) for companies and Limited Liability Partnerships (LLPs) and Debit Recovery Tribunal (DRT) for individuals and partnership firms. Appeals from NCLTs and DRTs would lie before National Company Law Appellate Tribunal (NCLAT) and Debit Recovery Appellate Tribunal (DRAT) and further before the Supreme Court.

**There are different parties associated with insolvency. These are:**

- Insolvency Professionals and Agencies- The Insolvency professional agencies (IPAs) set up under the code can recruit the insolvency professionals (IPs) and regulate them. These professionals will also have the power and duty to control the assets of the debtor during the process.
- Information Utilities (IUs) - This is to maintain a range of financial information about firms. The duty of IU's is to collect and disseminate the information to facilitate the insolvency resolution process.



- Insolvency Regulator- The Insolvency regulator established under the Code, the Insolvency and Bankruptcy Board of India (IBBI) have the mandate to oversee the insolvency resolution in the country and regulate functioning of IPs, IPAs and IUs.
- The Insolvency and Bankruptcy Fund (IBF) - The purpose of this fund is insolvency resolution, liquidation and bankruptcy of persons under the Code. The credits of the fund include grants made by the central government; the amount deposited by the persons; interest earned on investments made from the fund etc. Any person, who has contributed to the IBF, may apply for withdrawal, in case of proceedings against him.
- Bankruptcy and Insolvency Adjudicators- There are two different adjudicators proposed by the code as two separate tribunals, to oversee the process of insolvency resolution for individuals and companies. The National Company Law Tribunal (NCLT) will have the jurisdiction over companies and Limited Liability Partnerships (LLPs), whereas the Debit Recovery Tribunal (DRT) will have the jurisdiction over the individuals and partnership firms. Appeals against the orders of these tribunals (NCLT and DRT) may be challenged before their respective Appellate Tribunals and further before the Supreme Court.
- Credit Committee- The primary aim of the committee is to ensure payments to operating creditors on a prescheduled priority order.
- Offences and Penalties- Under the corporate insolvency (first stream), the offences committed by the debtor, like concealing the property, defrauding creditors etc, will be punished with imprisonment up to 5 years with a fine of up to 1 crore rupees. The offences committed by an individual (second stream) like providing false information, the imprisonment will vary based on the evidence and fine up to 5 lakh rupees.

**Under the new law, there are five stages in all, through which the “resolution” process must pass from the time, a company files for bankruptcy. These stages are:**

1. When a loan default occurs, and either the borrower or the lender approaches The National Company Law Tribunal (NCLT) or the Debit Recovery Tribunal (DRT) for initiating the resolution process.



2. The creditor appoints an interim Insolvency Professional (IP) to take control of the debtor's assets and company's operations, collect financial information of the debtor from Information Utilities (IU) and constitute the creditor's committee.
3. The committee has to then take decisions regarding insolvency resolution by a 75% majority.
4. Once a resolution is passed, the 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.
5. The resolution plan will be sent to the tribunal for final approval, and implemented once approved.

#### **Why does India need Insolvency and Bankruptcy Code (IBC) now?**

India had age-old laws which are in conflict with each other. Lack of IBC had proved costly for the creditors, mainly banks, in most of the cases. For example, the recent case of Kingfisher Airlines. Indian banks are sitting on a huge pile of bad debts. The total stressed assets (Bad Debts) amount to 11% of the total lending (total Non Performing Assets (NPAs) is around 8 Lakh Crore and a huge amount of restructured loan). The Bad Loans grew from 3.49% (2013) to 8.3% (2015). As per Reserve Bank of India data, in June 2017 this value has reached to 12.6%, the highest level in at least 15 years. According to RBI just 12 companies (Dirty Dozen) are estimated to count for 25% of the gross NPAs, and were identified for immediate bankruptcy proceedings, while there are 488 others which have been given six months time to restructure their debts or be dragged to NCLT. At present there are around 70,000 pending liquidation. It takes almost four years to wind up an ailing company in India (almost the double the time taken in other countries like US and China). Not only this, prior to IBC, there were around 12 laws to tackle insolvency like Presidency Towns Insolvency Act 1909; Provincial Insolvency Act 1920; Sick Industrial Companies Act (SICA) 1985; Recovery of Debt Due to Banks and financial Institution Act 1993; Securitization and Reconstruction of financial Assets and Enforcement of Security Interest Act (SARFESIA) 2002; Companies Act 2013 etc. As clear from the data some of the Acts are more than 100 years old.

There was no Integrated Institutional System/Mechanism to resolve the insolvency. High courts, the Company Law board, the Board for Industrial and Financial Reconstruction



(BIFR), and the Debt Recovery Tribunals (DRTs) were having overlapping jurisdiction. Their inefficiency and ineffectiveness is reflected in the rising Non Performing Assets and Bad Loans due to systematic complexity to resolve the issues. Lack of coherent coordination, inadequacy and delays in results are always prone to red-tapism, chronic corruption and nepotism. So just like US Bankruptcy Code that provides for fairly quick liquidation or reorganization of business, India also needed a new code to prevent the economy from tumbling southwards.

**A look into the position of foreign countries (i.e. foreign counterparts of the code):**

**USA-** There is different laws for each state in USA. To deal with bankruptcy matters, there are separate courts. These courts were additional to the district court for each district. Article 1(Clause 4 of Section 8) of the Constitution of United States empowers government to enact uniform laws on the subject of Bankruptcy throughout all the States. Significant changes in the laws were enacted in the year 1978 and thereafter in 2005 through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 respectively. In US bankruptcy petition can be filed by individuals, partnerships as also corporate but not a government unit. Petitions are filed in District Level Courts known as US Bankruptcy Court. Only a person who resides in, or has a domicile, a place of business, or property in the US may file for bankruptcy. The law also deals with bankruptcy proceedings in foreign forums. There are separate protective provisions for adjustment to debt of family farmer, fishermen or individual with regular annual income. Separate provision for debts of a municipality also has been made. The court can also appoint an examiner to investigate the affairs of the debtor. Decisions of the Bankruptcy Courts are not collected and published in an official reporter produced by the government.

**UK-** The Insolvency Act of 1986 deals with the cases of individuals and companies in UK. The procedure here involves the filing of bankruptcy petition, and orders for bankruptcy being passed. Provision for protection of bankrupt's estate and investigations of his affairs as well as separate provisions for trustees in bankruptcy and administration by trustee have been made. Bankruptcy offences have been separately defined. Role of new professionals called "Insolvency Practitioners" has been recognized. Qualifications of these IPs have been laid down.



**China-** During last thirty years, China has been the world leader in economic growth. In China Ministry of Commerce is the regulatory body. The cases are dealt by people's court. The judge appoints an administrator. Civil law recovery action by any creditor is prevented by applying moratorium. In response to the growing demand of private entity bankruptcies, China has enacted the Enterprise Bankruptcy Laws of 2006 (2006 EBL).

**Canada-** The proceedings are regulated by office of the Superintendent of Bankruptcy in Canada. Various stages of bankruptcy appear to be dealt with by separate legislations there. The statutory framework for liquidation of the assets of an insolvent, whether individual, partnership or corporate and its distribution in fair and orderly way is dealt with under Bankruptcy and Insolvency Act (BIA).

**Singapore-** The bankruptcy related proceedings are regulated by Insolvency and Public Trustees Office in Singapore, the major hub for business all over the globe. Whenever an application to place the company under judicial management is made, an interim moratorium automatically comes into effect, to preserve the assets until the application is finally disposed off. The court may appoint an interim judicial manager. During the moratorium period, no steps can be taken to enforce security over the company's property. Singapore has evolved jurisprudence on the *pari passu* rule and anti-deprivation rule, and one cannot contract out of insolvency proceedings.

According to US Bankruptcy Code only a person who resides in, or has a domicile, a place of business, or property in the US may file for bankruptcy. Such "persons" include individuals, partnerships and corporations but not a government unit. Our Code (IBC 2016) also draws a demarcation between the financial institutions and others. Furthermore, a natural person (one who has its own legal personality) can evoke bankruptcy law in India. The difference in treatment of corporate and individual bankruptcy in US is in response to different policies and practices in two categories.

With regard to management control, under the US code, the company retains the management control while working to achieve pre-agreed goals within a certain timeframe. The Indian code provides for management control to pass over to resolution professionals with significant power, once an insolvency resolution is underway.

Individual bankruptcy cases emphasize more towards the economic rehabilitation of the debtor as compared to their corporate counterparts. In this sense our Code (IBC 2016)



applies to a broader group of people with fewer restrictions as compared to 2006 EBL in China. Chinese courts have substantive power because debtors are given less opportunity to reorganize through court system as also only a selective group of people can file for bankruptcy. This is because the conversion from complete liquidation to reorganization is more difficult in China once a creditor files for liquidation. The reason is that the judicial courts in China have more intervention than the Indian Tribunal.

The two situations of the debtor for liquidation filing appear to be very vague and no guidance is available in 2006 EBL. This is opposite to the Indian mechanism wherein a corporate debtor is only allowed to file an application for voluntary winding up when he is in a position to pay its creditors. Furthermore, unlike in the US, there is no requirement that liabilities actually exceed assets in order to file for bankruptcy in China. Again there is difference between our Code (IBC 2006) and its Chinese counterpart as under our Code, creditors voluntary winding up has been done away with. After initiation of a bankruptcy case, a Chinese court appoints an “administrator” similar to an “Insolvency Professional” (IP) in India.

There are not many countries where one can have loans to pay loans. India, however, is one of the eminent countries where bank can give loan to the entrepreneur to pay back the loan (the tribunal’s President Justice M M Kumar).

**It is thus clear that Code and Process is different in their own ways in different countries.**

**Our Code (IBC 2016) has been adopted and its base is the European Law.**

The Code (IBC 2016) is as litigation prone as any other law, is the view of experts. Several aspects of the IBC 2016 are likely to undergo through testing phase in the court of law yet. These includes issues related to approval or rejection of an insolvency petition, valuation of assets, arriving at the liquidation values, management of the company by resolution professionals, classification of debt into various classes and settlement of claims etc. There are some kind of overlapping provisions in the Code and require interpretation of the court. Some decisions of resolution professionals are also likely to be challenge. Stakeholders, if not satisfied with the outcome of proceedings, are likely to exhaust from the options of appeal prescribed in Code. All eyes are on courts now. The way they treat these cases and how quickly they resolve them is of importance. To ensure quick disposal of cases in the courts, government has to ensure the adequate number of judges, benches and





infrastructure, available to NCLT. Mindset of the court will also play a key role. Court, if follow the spirit of the Code and allow the commercial will of the creditors rather than strict legalistic point, the litigation risk will reduce, says lawyers. The key point here is for such litigation to be fairly and quickly resolved in the best interest of all stakeholders. The liability of resolution professionals under the Code is important to help avoid any conflict of interest. Experts say that insurance cover is an important requirement of the hour, for resolution professionals in India.

**Factors on which success of the Code (IBC 2016) is likely to depend are:**

- The procedures and jurisprudence that develops under the IBC over the next few months.
- Bankers need some shielding for discretionary settlements of sectors such as steel, power and textile which are in slump at present and banks would find difficulty in getting buyers for their assets as desired evaluation.
- A proper guideline is required to envisage role of promoters in the resolution process.
- Independence of IPs and non interventions by promoters in the resolution process.

**Advantages:**

- There will be one single law in place of multiple laws. This will remove the problem of overlapping jurisdiction.
- Creation of a new class of specialized Insolvency Professionals to help sick companies.
- Creation of Information Utilities to collate all information about debtors to prevent serial defaulters from misusing the system.
- Creation of multiple IUs will lead to complete financial information scattering.
- Ensure time-bound settlement of insolvency.
- Enable faster turnaround of businesses.
- Create a database of serial defaulters.
- Resolve India's Bad Debt problem which have crippled bank lending.
- The Code creates an Insolvency and Bankruptcy Fund.
- Improve India's position in the World Bank's Doing Business ranking.



### **Progress so far:**

ICICI Bank Ltd has filed an application in NCLT against Innoventive Industries Ltd to initiate a corporate insolvency process. This is the first case in India filed under IBC 2016. Pune based steel product maker had debt of Rs 955 Crore. The NCLT on August 14 2017, pronounced the first insolvency resolution order under IBC 2016, in matter of Synergies-Dooray Automotive Ltd, a maker of alloy wheels for cars. The company's plea for insolvency was admitted on January 23 2017. The resolution plan was submitted to NCLT on July 21 and the tribunal approved the plan on August 2. The final order was uploaded on the NCLT website on August 14. The NCLT has so far decided more than 655 cases under the IBC 2016 (the tribunal's President Justice M M Kumar, August 31,2017) since the Code became operational in December 2016.

The Code (IBC 2016) will definitely prove helpful to bring about far-reaching reforms with a thrust on creditor driven insolvency resolutions. It intends for early identification of financial failure and maximizing the asset value of insolvent firms. The Code also provides cross border insolvency through bilateral agreements and reciprocal arrangements with other countries. Implementation of the Code is a progressive step towards improving the investor's confidence and ease of doing business. If implemented firmly, the Code will also give a boost to the job creation promise through skill development mission (to create approximately 40 Crore jobs by 2022) and will also provide the required ecosystem for the success of "Make in India". This positive move will provide momentum to good governance and uphold rule of law, as, the people who file for bankruptcy will have to repay their debts. The objective of the law is that to prevent insolvency, if possible. If it cannot be done, resolve it at the earliest opportunity (IBBI Chairperson M S Sahu). Thus, with the implementation of the Code (IBC 2016) a historical development of economic growth in India has been started.

This piece of work is based solely on secondary sources.

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