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# **STUDY MATERIAL**

## **PROFESSIONAL PROGRAMME**

### **PART II**

# **CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP**

## **MODULE 2 PAPER 5**



**THE INSTITUTE OF  
Company Secretaries of India**

**भारतीय कम्पनी सचिव संस्थान**

**IN PURSUIT OF PROFESSIONAL EXCELLENCE**

Statutory body under an Act of Parliament

(Under the jurisdiction of Ministry of Corporate Affairs)

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# PROFESSIONAL PROGRAMME

## CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

Before the enactment of the Insolvency and Bankruptcy Code, there was no single law in the country to deal with insolvency and bankruptcy. There were multiple overlapping laws and adjudicating forums dealing with financial failure and insolvency of companies and individuals in India. The framework for insolvency and bankruptcy was inadequate, ineffective and resulted in undue delays in resolution. The legal and institutional framework did not aid lenders in effective and timely recovery or restructuring of defaulted assets and causes undue strain on the Indian credit system.

The objective of the Insolvency and Bankruptcy Code 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. An effective legal framework for timely resolution of insolvency and bankruptcy will not only encourage entrepreneurship but will also improve Ease of Doing Business, and facilitate more investments leading to higher economic growth and development.

The Insolvency and Bankruptcy Code, 2016 consolidates the existing framework by creating a single law for insolvency and bankruptcy. The Code applies to companies, partnerships, limited liability partnerships, individuals and any other body which the central government may specify.

Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures and case laws, for which sole reliance on the contents of this study material may not be enough. Besides, as per the Company Secretaries Regulations, 1982, students are expected to be conversant with the amendments to the laws made upto six months preceding the date of examination. The material may, therefore, be regarded as the basic material and must be read along with the original Bare Acts, Rules, Regulations, Case Law, Student Company Secretary e-bulletin and Chartered Secretary published by the Institute as well as recommended readings.

This Study Material is based on the provisions which are notified under Insolvency and Bankruptcy Code, 2016 and Companies Act, 2013. The amendments made up to December, 2019 have been incorporated in this study material. However, it may so happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore, advised to refer to the website of the Institute for updation of the study material.

Although care has been taken in publishing this study material, yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same are brought to its notice for issue of corrigendum in the Student Company Secretary e-bulletin. In the event of any doubt, students may write to the Directorate of Academics at [academics@icsi.edu](mailto:academics@icsi.edu).

**PROFESSIONAL PROGRAMME**  
**MODULE 2**  
**PAPER 5**  
**CORPORATE RESTRUCTURING, INSOLVENCY,**  
**LIQUIDATION & WINDING-UP (MAX MARKS 100)**

**Part II: Insolvency, Liquidation & Winding-Up (50 Marks)**

**Objective**

**Part II:** To acquire knowledge of the legal, procedural and practical aspects of Insolvency and its resolution.

**SYLLABUS**

14. **Insolvency:** Historical Background; Pillars of IBC, 2016 [IBBI, IPA, IP, AA, Information utility]; Key Definitions and Concepts; Insolvency Initiation/Resolution under sections 7, 8 and 10.
15. **Petition for Corporate Insolvency Resolution Process:** Legal Provisions; Procedure, Documentation; Appearance, Approval; Case Laws.
16. **Role, Functions and Duties of IP/ IRP/ RP:** Public announcement, Management of affairs and operations of company as a going concern, Raising of Interim Finance, Preparation of Information Memorandum.
17. **Resolution Strategies :** Restructuring of Equity & Debt; Compromise & Arrangement; Acquisition, Takeover & Change of Management; Sale of Assets; Valuation.
18. **Convening and Conduct of Meetings of Committee of Creditors:** Constitution of Committee of Creditors; Procedural aspects for meeting of creditors.
19. **Preparation & Approval of Resolution Plan:** Contents of resolution plan; Submission of resolution plan; Approval of resolution plan.
20. **Individual/ Firm Insolvency:** Application for insolvency resolution process; Report of resolution professional; Repayment plan; Discharge Order.
21. **Fresh Start Process:** Person eligible to apply for fresh start; Application for fresh start order; Procedure after receipt of application; Discharge order.
22. **Debt Recovery & SARFAESI :** Non-Performing Assets; Asset Reconstruction Company; Security Interest (Enforcement) Rules, 2002; Evaluation of various options available to bank viz. SARFAESI, DRT, Insolvency Proceedings; Application to the Tribunal/Appellate Tribunal.
23. **Cross Border Insolvency:** International Perspective and Global Developments; UNCITRAL Legislative Guide on Insolvency Laws; US Bankruptcy Code, Chapter 11 reorganization; Enabling provisions for cross border transactions under IBC.
24. **Liquidation on or after failing of Resolution Plan:** Initiation of Liquidation; Distribution of assets; Dissolution of corporate debtor.
25. **Voluntary Liquidation:** Procedure for Voluntary Liquidation; Powers and duties of the Liquidator; Completion of Liquidation.
26. **Winding-up by Tribunal under the Companies Act, 2013:** Procedure of Winding-up by Tribunal; Powers and duties of the Company Liquidator; Fraudulent preferences.

Case Laws, Case Studies and Practical aspects.

# LESSON WISE SUMMARY

## CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

### PART II: INSOLVENCY, LIQUIDATION & WINDING-UP (50 MARKS)

#### Lesson 14: Insolvency

The words “Insolvency” and “Bankruptcy” are generally used interchangeably in common parlance but there is a marked distinction between the two. Insolvency and bankruptcy are not synonymous. The term “insolvency” denotes the state of one whose assets are insufficient to pay his debts; or his general inability to pay his debts. The term “insolvency” is used in a restricted sense to express the inability of a party to pay his debts as they become due in the ordinary course of business. The word “bankruptcy” is the condition of insolvency. It is a legal status of a person or an entity who cannot repay debts to creditors. The bankruptcy process begins with filing of a petition in a court or before an appropriate authority designated for this purpose. The debtor’s assets are then evaluated and used to pay the creditors in accordance with law.

This study lesson has made an endeavour to focus on key aspects of insolvency, like, Pillars of IBC, 2016; Key Definitions and Concepts; Insolvency Initiation / Resolution; Regulatory framework governing Insolvency in various foreign countries etc.

#### Lesson 15: Petition for Corporate Insolvency Resolution Process

Part II of the Insolvency and Bankruptcy Code, 2016 deals with the insolvency resolution and liquidation for corporate persons. Part II of the Insolvency and Bankruptcy Code, 2016 lays down the following two independent stages:

- (i) Corporate Insolvency Resolution Process [Sections 4 and 6 to 32] and
- (ii) Liquidation [Sections 33 to 54 and Section 59]

Chapter II of Part II deals with corporate insolvency resolution process while Chapter III together with Chapter V of Part II governs the liquidation process for corporate persons.

In corporate insolvency resolution process, the financial creditors assess the viability of debtor’s business and the options for its revival and rehabilitation. If the corporate insolvency resolution process fails or the financial creditors decide that the business of the debtor cannot be carried on in a profitable manner and it should be wound up, the debtor’s business undergoes the liquidation process.

Since Corporate Insolvency Resolution Process holds paramount significance, this study lesson throws ample light on the following key areas- Persons who may Initiate Corporate Insolvency Resolution Process; Financial and Operational Creditor; Operational debt etc.

#### Lesson 16: Role, Functions and Duties of IP / IRP / RP

Insolvency professionals play a vital role in the insolvency and bankruptcy resolution process as envisaged under IBC. This entire insolvency and bankruptcy process is managed by a regulated and licensed professional namely the Insolvency Professional or an IP, appointed by the adjudicator. Insolvency professionals form a crucial pillar upon which rests the effective, timely functioning as well as credibility of the entire edifice of the insolvency and bankruptcy resolution process.

In view of the above, this study lesson has made an attempt to explore the critical facets, like, Definitions in the Insolvency and Bankruptcy Code, 2016; Enrolment and Registration of Insolvency Professionals; Functions and Obligations of Insolvency Professionals etc.

### **Lesson 17: Resolution Strategies**

Corporate Restructuring has gained substantial steam in past one or two decades in the world of business. Corporate Restructuring is an inorganic business strategy where one or more aspects of a business are redesigned to improve commercial efficiency, manage competition effectively, drive faster pace of growth, ensure effective utilization of resources, and fulfilment of stakeholders' expectations. It serves different purposes for different companies at different points of time and may take up various forms.

Restructuring typically occurs to address challenges or it can be driven by the necessity to make financial adjustments to its assets and liabilities. Mergers, amalgamations, acquisitions, compromises, arrangement or reconstruction are various forms of corporate restructuring exercises. The purpose of each of these restructuring exercises may be different but each of these exercises attempts to bring in more efficiency in the system.

Corporate Restructuring process in India is governed by the Companies Act, 2013, the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 and various other regulatory laws such as the Income Tax Act, 1961, the Competition Act, 2002, the Foreign Exchange Management Act, 1999, the Indian and State Stamp Acts and Insolvency and Bankruptcy Code, 2016. Chapter XV of the Companies Act, 2013 (comprising sections 230 to 240 regulates compromises, arrangement and amalgamations.

In light of the soaring significance of corporate restructuring process, this study lesson focuses on key topics like, Organisational Restructuring, Financial Restructuring, Debt restructuring, Formal Restructuring and Insolvency Proceedings etc.

### **Lesson 18: Convening and Conduct of Meetings of Committee of Creditors**

Section 21 and 24 of the Insolvency and Bankruptcy Code, 2016 make provisions relating to the committee of creditors. Section 21 deals with the constitution of committee of creditors while section 24 prescribes the modalities for the meeting of the committee of creditors.

Section 28 of the Code lists out certain actions that may be taken by the resolution professional only with the prior approval of the committee of creditors by a vote of 66 per cent of the voting shares.

The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 has added a new section 25A to provide for rights and duties of authorized representative of financial creditors.

Thus, in light of the soaring importance of the Committee of Creditors, this study lesson has laid emphasis on various elements of the Committee of Creditors; Exclusion of Related Party; Authorized Representative etc.

### **Lesson 19: Preparation and Approval of Resolution Plan**

With the onset of Insolvency and Bankruptcy Code, several new terminologies got coined, like, Resolution Plan, Resolution Applicant, Prospective Resolution Applicants etc. In light of this, it is imperative to delve deep into the concepts of Resolution Plan, Resolution Applicant etc. and various facets associated with them.

Since resolution holds a significant place in insolvency proceedings, in view of this, it is also equally essential to know about the persons who are ineligible to be Resolution Applicant.

This study lesson encompasses the vital components of the Insolvency and Bankruptcy Code (Amendment) Act, 2018, such as, an undischarged insolvent; wilful defaulter; related party etc.

## **Lesson 20: Individual/Firm Insolvency**

The Insolvency and Bankruptcy Code, 2016 outlines separate insolvency resolution processes for corporates and individuals/partnership firms. Chapter II of Part II of the Code deals with insolvency resolution process for corporates whereas Chapter III of Part III provides for insolvency resolution process for individuals and partnership firms.

The Insolvency and Bankruptcy Code, 2016 proposes two tribunals to adjudicate insolvency resolution cases. In the case of insolvency of companies and Limited Liability Partnerships (LLPs), the adjudicating authority is the National Company Law Tribunal (NCLT), while the cases involving individuals and partnership firms are handled by the Debts Recovery Tribunals (DRTs). Appeals from NCLT orders lie to the National Company Law Appellate Tribunal (NCLAT) and thereafter to the Supreme Court of India. For individuals and other persons, the adjudicating authority is the DRT. Appeals from DRT orders lie to the Debt Recovery Appellate Tribunal (DRAT) and thereafter to the Supreme Court.

In order to have an in-depth understanding on Individual / Firm Insolvency, this study lesson has laid emphasis on various essential aspects, like, Application by Debtor to Initiate Insolvency Resolution Process; Application by Creditor to Initiate Insolvency Resolution Process; Interim-moratorium etc.

## **Lesson 21: Fresh Start Process**

Fresh Start is a process of discharge of the qualifying debts of the debtor if the assets and income of a debtor are below a specified amount. Thus, debtors who have assets and income below specified level, and do not own their home, are eligible for a Fresh Start. Hence, only the debtor can file for a Fresh Start.

The fresh start process has been conceptualized for persons who owe relatively less amount of money and have little or no income or assets to repay their debts. The outcome of an application for fresh start is a discharge from the qualifying debts and the debtor shall not be required to pay the amount comprising of the qualifying debts for which a discharge order is made under section 92 of the Code.

In view of the above, this study lesson throws light on critical matters, like, Eligibility for Making an Application; Application for Fresh Start Order; Appointment of Resolution Professional; Admission or Rejection of Application by Adjudicating Authority etc.

## **Lesson 22: Debt Recovery & SARFAESI**

The banks and financial institutions (FIs) were facing numerous problems in recovery of defaulted loans on account of delays in disposal of recovery proceedings. The Government, therefore, enacted the Recovery of Debts and Bankruptcy Act, 1993 and SARFAESI Act in 2002 for the purpose of expeditious recovery of Non-Performing Assets (NPAs) of the banks and FIs.

In 2016, the Indian Parliament has passed the Enforcement of Security Interests and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Act, 2016 to improve the efficacy of Indian debt recovery laws. The amendment Act, 2016 introduces a number of changes to the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (SARFAESI Act) and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (DRT Act).

## **Lesson 23: Cross Border Insolvency**

The organisation of insolvency proceedings with an international element is not an easy or straightforward matter. Solutions to the phenomenon of cross-border insolvency are reliant on a number of complex and interrelated questions to which the courts and legislatures in different jurisdictions have provided varying answers.

Cross-border insolvency regulates the treatment of financially distressed debtors where such debtors have assets or creditors in more than one country. Typically, cross border insolvency is more concerned with the insolvency of companies which operate in more than one country rather than the bankruptcy of individuals.

United Nations Commission on International Trade Law (UNCITRAL), with the general mandate to further the progressive harmonization and unification of the law of international trade, has developed a Model Law which is designed to assist States to equip their insolvency laws with a modern legal framework to more effectively address cross-border insolvency proceedings concerning debtors experiencing severe financial distress or insolvency.

## **Lesson 24: Liquidation on or after Failing of Resolution Plan**

Sections 33 to 54 in Chapter III of Part II of the Insolvency and Bankruptcy Code, 2016 lay down the law relating to liquidation process for corporate persons.

An attempt is first made to resolve the insolvency of corporate debtor through corporate insolvency resolution process laid down in Chapter II of Part II of the Code. The provisions relating to liquidation in Chapter III of Part II of the Code comes into effect if the attempts to resolve corporate insolvency under Chapter II of the Code fail.

A corporate debtor may witness liquidation under the following four scenarios:

1. Where the Adjudicating Authority does not receive a resolution plan
2. Where the Adjudicating Authority rejects the resolution plan
3. Where, at any time before confirmation of resolution plan, the committee of creditors resolve to liquidate corporate debtor
4. Where the corporate debtor violates the terms of the resolution plan

Likewise, various critical dimensions emerging out of the liquidation on or after failing of RP have been captured in this study lesson. For instance, Bar to filing of suits and legal proceedings; Appointment of Liquidator and Fee to be Paid; Powers of Liquidator to Access Information.

## **Lesson 25: Voluntary Liquidation**

Section 59 in Chapter V of Part II of the Insolvency and Bankruptcy Code, 2016 provides for the initiation of voluntary liquidation proceedings by a corporate debtor which has not defaulted on any debt due to any person.

It is important to note that one may initiate voluntary liquidation proceedings, i.e. a corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under the provisions of Chapter V of Part II of the Code.

In view of the above interesting fact, this study lesson made an endeavour to explore various important angles, like, Procedural requirements; Conditions for voluntary liquidation proceedings of corporate person registered as company; Requirement of notification etc.

## **Lesson 26: Winding-up by Tribunal under the Companies Act, 2013**

Winding-up of a company is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such dissolution its assets are collected, its debts are paid off out of the assets of the company or from contributions by its members, if necessary. If any surplus is left, it is distributed among the members in accordance with their rights.

Winding-up is the process by which management of a company's affairs is taken out of its directors' hands, its assets are realized by a liquidator and its debts are realized and liabilities are discharged out of proceeds of realization and any surplus of assets remaining is returned to its members or shareholders. At the end of the winding up the company will have no assets or liabilities and it will, therefore, be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end.



# ARRANGEMENT OF STUDY LESSONS

## Module-2 Paper-5

### CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

#### Part II: Insolvency, Liquidation & Winding-Up (50 Marks)

S.No.	Lesson Title
14.	Insolvency
15.	Petition for Corporate Insolvency Resolution Process
16.	Role, Functions and Duties of IP/ IRP/ RP
17.	Resolution Strategies
18.	Convening and Conduct of Meetings of Committee of Creditors
19.	Preparation & Approval of Resolution Plan
20.	Individual/ Firm Insolvency
21.	Fresh Start Process
22.	Debt Recovery & SARFAESI
23.	Cross Border Insolvency
24.	Liquidation on or after Failing of Resolution Plan
25.	Voluntary Liquidation
26.	Winding-up by Tribunal under the Companies Act, 2013

## LIST OF RECOMMENDED BOOKS AND OTHER REFERENCES

### Module-2 Paper-5

## CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

### Recommended Readings and References:

1.	Bare Act	Insolvency And Bankruptcy Code, 2016 Companies Act, 2013
2.	Bharat Publication	Insolvency and Bankruptcy Code alongwith NCLT Rules
3.	Taxmann's	Insolvency and Bankruptcy Code, 2016
4.	V. S. Datey	Guide to Insolvency and Bankruptcy Code, Taxmann's Publications
5.	Prachi Manekar Wazalwar	NCLT and NCLAT – Law, Practice and Procedure, Bloomsbury Publication
6.	ICSI IIP Publications	1. Practical aspects of Insolvency Law 2. Insolvency and Bankruptcy (Rules and Regulations) 3. Voluntary Liquidation – A handbook
7.	A. Ramaiya	Guide to Companies Act, LexisNexis Butterworths, Wadhwa, Nagpur
8.	M.C. Bhandari	Guide to Company Law Procedures, LexisNexis, Butterworths Wadhwa Nagpur

### Important Websites :

- (a) [www.mca.gov.in](http://www.mca.gov.in)
- (b) [www.ibbi.gov.in](http://www.ibbi.gov.in)
- (c) [www.nclt.gov.in](http://www.nclt.gov.in)
- (d) [www.nclat.nic.in](http://www.nclat.nic.in)
- (e) [www.drt.gov.in](http://www.drt.gov.in)
- (f) [www.finmin.nic.in](http://www.finmin.nic.in)
- (g) [www.dipp.nic.in](http://www.dipp.nic.in)
- (h) [www.rbi.org.in](http://www.rbi.org.in)
- (i) [www.sebi.gov.in](http://www.sebi.gov.in)

*Students are advised to read relevant Bare Acts and Rules and Regulations relating thereto. 'Student Company Secretary' e-bulletin and 'Chartered Secretary' should also be read regularly for updating the knowledge.*

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# Lesson 14

## Insolvency

### LESSON OUTLINE

- Introduction
- Concept of insolvency and bankruptcy
- Insolvency framework in other countries
- Historical developments in insolvency laws in India
- Need of the Code
- Scheme of the Code
- Pillars under IBC
- Key definitions and concepts
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

The words “Insolvency” and “Bankruptcy” are generally used interchangeably in common parlance but there is a marked distinction between the two. Insolvency and bankruptcy are not synonymous. The term insolvency is used for individuals as well as organisations/ corporates. If insolvency is not resolved, it leads to bankruptcy in case of individuals and liquidation in case of corporates.

The Insolvency and Bankruptcy Code, 2016 is a consolidated legislation providing for insolvency resolution process of individuals, partnership firms, Limited Liability Partnerships and Corporate. The Code offers a uniform, comprehensive insolvency legislation encompassing all companies, partnerships and individuals.

The Code facilitates time-bound process for insolvency resolution and liquidation. It proposes to repeal and amend a number of legislations. The Code also introduces new regulator “Insolvency and Bankruptcy Board of India” (The Board). The adjudication process in relation to Corporates and LLPs would be under National Company Law Tribunal and in relation to individuals and partnerships under Debt Recovery Tribunal. This chapter also covers overall scheme of the Code, salient features of the Code and important definitions.

After reading this lesson you will be able to understand the historical background of insolvency resolution in India and abroad, need for the Code and various institutions established under the Code.

## INTRODUCTION

The word “bankruptcy” is widely believed to have originated from an Italian phrase “**banca rotta**” – “banca” means bench and “rotta” means broken. It is believed that the word “bankruptcy” originated from the trade that was carried out on **Ponte Vecchio**, a medieval segmental arch bridge over the Arno River, in Florence, Italy. In medieval Italy, if a banker, who conducted his marketplace transactions on a bench, was unable to meet business obligations and was in debt, his bench was broken in a symbolic show of failure and his inability to continue. This act of “**banca rotta**” or “breaking the bench” is believed to have evolved into the modern concept of bankruptcy.

### Concept of Insolvency, Bankruptcy and Liquidation

The words “Insolvency” and “Bankruptcy” are generally used interchangeably in common parlance but there is a marked distinction between the two. Insolvency and bankruptcy are not synonymous.

The term “**insolvency**” notes the state of one whose assets are insufficient to pay his debts; or his general inability to pay his debts. The term “insolvency” is used in a restricted sense to express the inability of a party to pay his debts as they become due in the ordinary course of business.

The word “**bankruptcy**” the condition of insolvency. It is a legal status of a person or an entity who cannot repay debts to creditors. The bankruptcy process begins with filing of a petition in a court or before an appropriate authority designated for this purpose. The debtor’s assets are then evaluated and used to pay the creditors in accordance with law.

Therefore, while insolvency is the inability of debtors to repay their debts, the bankruptcy, on the other hand, is a formal declaration of insolvency in accordance with law of the land. Insolvency describes a situation where the debtor is unable to meet his/her obligations and bankruptcy occurs when a court determines insolvency, and gives legal orders for it to be resolved. Thus insolvency is a state and bankruptcy is the conclusion.

The term insolvency is used for individuals as well as organisations/corporates. If insolvency is not resolved, it leads to **bankruptcy** in case of individuals and **liquidation** in case of corporates.

Section 79(4) of the Insolvency and Bankruptcy Code, 2016 defines the term “**bankruptcy**” as the state of being bankrupt.

According to Section 79(3) of the Code, “**bankrupt**” means

- (a) a debtor who has been adjudged as bankrupt by a bankruptcy order under section 126;
- (b) each of the partners of a firm, where a bankruptcy order under section 126 has been made against a firm; or
- (c) any person adjudged as an undischarged insolvent.

**Liquidation**, on the other hand, in its general sense, means closure or winding up of an corporation or an incorporated entity through legal process on account of its inability to meet its obligations or to pay its debts. In order to clear the indebtedness, the assets are sold at the most reasonable rates by a competent liquidator appointed in this regard.

## INSOLVENCY FRAMEWORK IN UK, USA AND INDIA

### United Kingdom

In England, the Act of Parliament of 34 & 35 Henry VIII, c 4 is regarded as the first legislation on the subject.



Promulgated in 1542 under the reign of Henry VIII, it was a strict and creditor supportive legislation enacted mainly for the benefit of creditors. This Act of 1542, was in fact akin to a criminal statute directed against men who indulged in wasteful expenditures and then refused to pay off debts incurred during the course of extravagance. The 1542 Act looked upon the debtors as offenders. There was no provision for the discharge of debtors and even future earnings of the debtors were not exempt from execution for the debt.

The early bankruptcy laws of England were an instrument of debt-collection and aimed at seizing the debtor's assets against the strong protections to private property offered by the Common law, since medieval times.

In the beginning of the eighteenth century, these strict and creditor supportive medieval laws began to lose its punitive nature. That is why a few authors maintain that the first real bankruptcy laws in England were 4 Anne, c. 17 (1705), and 10 Anne, c. 15 (1711) as unlike earlier statutes which looked upon debtors as offenders, the highlighting feature of the Statutes of Anne was the discharge of the bankrupt who conformed to the provisions of the law. While the additional rights given to the bankrupt under the 1705 Act were significant yet the Act was passed for the sole benefit of the creditors. In contrast, the primary focus of modern insolvency laws is not elimination of insolvent entities but on their rehabilitation and continuation of their business.

### **The Current Regulatory Framework in UK**

The Insolvency Act, 1986 and the Insolvency Rules, 1986 regulate the insolvency framework in the United Kingdom. The Insolvency Act, 1986 was enacted on the recommendation of the Cork Review Committee Report on Insolvency Law and Practice (1982). Prior to the enactment of the Insolvency Act, 1986, the law relating to insolvency in the UK was fragmented and was contained in the Bankruptcy Act, 1914, the Deeds of Arrangement Act, 1914, the Companies Act, 1948 and parts of the County Courts Act, 1959. These Acts were supplemented by the principles of common law and equity.

### **The Act of 1986 consolidated all**

- enactments relating to company insolvency and winding up,
- enactments relating to the insolvency and bankruptcy of individuals, and
- all other enactments bearing on these two subject matters, including the functions and qualification of insolvency practitioners, the public administration of insolvency, the penalisation and redress of malpractice and wrongdoing, and the avoidance of certain transactions at an undervalue.

The Insolvency Act, 1986 deals with the insolvency of individuals and companies and is divided into the following three groups.

- Group 1 deals with Company Insolvency
- Group 2 deals with Insolvency of Individuals and
- Group 3 deals with Miscellaneous Matters Bearing on both Company & Individual Insolvency

The Insolvency Act, 1986 introduced the following three new procedures in order to explore the possibility of bringing a burdened company back to life as a viable entity. These measures in the UK Insolvency Act, 1986 represent an attempt to emulate the 'rescue culture', a characteristic of the corporate sector in the US.

1. 'Company Voluntary Arrangements' (CVAs) – It provides a way where a company in financial difficulty can come to a binding agreement with its creditors.
2. 'Administration' – In this second option, an administrator is appointed by a court to suggest proposals to deal with the company's financial difficulties. This option offers companies a breathing space as the creditors are restrained from taking any action during this period.

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3. 'Administrative Receivership' – This third option permits the appointment of a receiver by certain creditors (normally the holders of a floating charge).

#### United States of America

America being a colony of the United Kingdom, followed the English bankruptcy system and like the UK system, American bankruptcy laws involved imprisonment until debts were paid or creditors agreed for the release of the debtor. There was no uniform law in America as bankruptcy laws differed from State to State. Some of these American states became infamous as debtor's havens because of their unwillingness to enforce commercial obligations.

The lack of uniformity in bankruptcy and debt enforcement laws adversely affected business and commerce between the states. Article I, Section 8, Clause 4 of the United States Constitution as adopted in the year 1789 made provision for the grant to Congress the power to establish uniform bankruptcy law throughout the United States.

The Congress enacted temporary bankruptcy statutes in 1800, 1841 and 1867 to deal with economic recessions. The Acts of 1800 and 1841 vested jurisdiction in the federal district courts. The district court judges were given the power to appoint commissioners or assignees to take charge of and liquidate a debtor's property. However, these laws were temporary measures and were repealed as soon as economic conditions stabilized.

There was not a permanent bankruptcy law in the United States of America until 1898 when the National Bankruptcy Act was enacted. This Act of 1898 was later amended in 1938 to provide for the rehabilitation of a debtor as an alternative to liquidation of assets. The National Bankruptcy Act, 1898 governed bankruptcy in the United States for 80 years until 1978, when after a thorough review of the then existing law and practice, the Bankruptcy Reform Act, 1978 was enacted.

The Bankruptcy Reform Act, 1978 superseded the National Bankruptcy Act, 1898 and established bankruptcy courts in each district and made provisions for the appointment of separate bankruptcy judges.

#### The Current Regulatory Framework in USA

"Bankruptcy Code", a federal law, governs bankruptcy in the United States of America. It is a uniform federal law that governs all bankruptcy cases in America. The Bankruptcy Code was enacted in 1978 by § 101 of the Bankruptcy Reform Act, 1978 and is codified as title 11 of the United States Code. The procedural aspects of the bankruptcy process are governed by the Federal Rules of Bankruptcy Procedure (Bankruptcy Rules).

Six basic types of bankruptcy cases are provided for under the Bankruptcy Code.

**Chapter 7** titled "Liquidation". In Chapter 7 Bankruptcy, a court-appointed trustee or administrator takes possession of non-exempt assets, liquidates these assets and then uses the proceeds to pay creditors.

**Chapter 9** titled "Adjustment of Debts of a Municipality". Chapter 9 Bankruptcy proceedings provides for reorganization which is available to municipalities. In Chapter 9 Bankruptcy proceedings a municipality (which includes cities, towns, villages, counties, taxing districts, municipal utilities, and school districts) get protection from creditors and a municipality can pay back debt through a confirmed payment plan.

**Chapter 11** titled "Reorganization". Unlike Chapter 7 where the business ceases operations and a trustee sells all of its assets, under Chapter 11 the debtor remains in control of its business operations and repay creditors concurrently through a court-approved reorganization plan.

**Chapter 12** was added to the Bankruptcy Code in 1986. It allows a family farmer or fisherman to continue to operate the business while the plan is being carried out.

**Chapter 13** enables individuals with regular income to develop a plan to repay all or part of their debts.

**Chapter 15** was added to the Bankruptcy Code in 2005. It provides mechanism for dealing with insolvency cases involving debtors, claimants and other interested parties involving more than one country. Under Chapter 15 a representative of a corporate bankruptcy proceeding outside the country can get access to the United States courts.

### Historical developments of Insolvency Laws in India

The law of Insolvency in India owes its origin to English law. India being a colony of the United Kingdom, followed the English insolvency system. In India, the earliest provisions relating to insolvency can be traced to sections 23 and 24 of the Government of India Act, 1800. These sections conferred insolvency jurisdiction on Supreme Court at Fort Williams (Calcutta), Madras and Recorder's Court at Bombay as the need for an insolvency law was first felt in Presidency Towns of Calcutta, Bombay and Madras where the British majorly carried on their trade. These Courts were empowered to make rules and grant relief to insolvent debtors.

Later insolvency courts were established in the Presidency-towns when Statute 9 (Geo. IV c. 73) was passed in 1828. This Act of 1828 marks the beginning of special insolvency legislation in India. The insolvency court had a distinct existence although the court was presided over by a Judge of the Supreme Court. The Act of 1828 was originally intended to remain in force for a period of four years but subsequent legislation extended its duration up to 1848. The Provisions of the Indian Insolvency Act was passed in 1848 and remained in force until the enactment of the Presidency Towns Insolvency Act, 1909. Later Provisional Insolvency Act was passed in 1920.

The Presidency Towns Insolvency Act, 1909 and Provisional Insolvency Act, 1920 were two major enactments that dealt with personal insolvency but the two differ in respect of their territorial jurisdiction. While Presidency Towns Insolvency Act, 1909 applied in Presidency towns of Calcutta, Bombay and Madras, the Provincial Insolvency Act, 1920 applied to all provinces of India. These two Acts were applicable to individuals as well as partnership firms.

The Insolvency and Bankruptcy Code, 2016 has repealed both the Presidency Towns Insolvency Act, 1909 and the Provisional Insolvency Act, 1920.

Before the enactment of the Insolvency and Bankruptcy Code, 2016, the provisions relating to insolvency and bankruptcy were fragmented and there was no single law to deal with insolvency and bankruptcy in India. Before the enactment of the Insolvency and Bankruptcy Code, 2016 the following Acts dealt with insolvency and Bankruptcy in India:

- The Presidency Towns Insolvency Act, 1909
- Provisional Insolvency Act, 1920
- Indian Partnership Act, 1932
- The Companies Act, 1956
- The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA)
- The Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDBFI Act)
- The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act, 2002)
- The Companies Act, 2013

Under the Constitution of India 'Bankruptcy & Insolvency' is provided in Entry 9 of List III (Concurrent List) in the Seventh Schedule to the Constitution. Hence both the Centre and State Governments are authorised to make laws on the subject.

### Government committees on bankruptcy reforms

Various committees were constituted from time to time by the Government to review the existing bankruptcy and insolvency laws in India. These committees analysed the laws and suggested reforms to bring the law in tune with ever evolving circumstances. Following is a snapshot of various committees constituted along with the outcome.

S.No	Year	Committee/Commission	Recommendations/Outcome
1	1964	Third Law Commission	Third Law Commission was established in 1961 under the Chairmanship of Justice J L Kapur. It submitted 26th Law Commission Report in 1964 proposing amendments to the Provincial Insolvency Act, 1920.
2	1981	Tiwari Committee	Following the recommendations of the Tiwari Committee, the Government of India enacted the Sick Industrial Companies (Special Provisions) Act, 1985, (SICA) in order to provide for timely detection of sickness in industrial companies and for expeditious determination of preventive and remedial measures.
3	1991	Narasimham Committee I	The government enacted Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993
4	1998	Narasimham Committee II	The committee's recommendations led to the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002.
5	1999	Justice Eradi Committee	Recommended setting up of a National Company Law Tribunal (NCLT) and proposed repeal of SICA.
6	2001	N L Mitra Committee	Proposed a comprehensive bankruptcy code.
7	2005	J J Irani Committee	The Committee proposed significant changes to make the restructuring and liquidation process speedier, efficient and effective and accordingly amendments were made to (RDDBFI) Act, 1993 and (SARFAESI), 2002.
8	2008	Raghuram Rajan Committee	Proposed improvements to credit infrastructure
9	2013	Financial Sector Legislative Reforms Commission	Recommended changes in Indian Financial Sector.
10	2014	Bankruptcy Law Reforms committee (BLRC)	Reviewed the existing bankruptcy and insolvency framework in the country and proposed the enactment of Insolvency and Bankruptcy Code as a uniform and comprehensive legislation on the subject.

### Need for a New Law

Before the enactment of the Insolvency and Bankruptcy Code, there was no single law in the country to deal with insolvency and bankruptcy. There were multiple overlapping laws and adjudicating forums dealing with financial failure and insolvency of companies and individuals in India. The framework for insolvency and bankruptcy was inadequate, ineffective and resulted in undue delays in resolution. The legal and institutional framework did not aid lenders in effective and timely recovery or restructuring of defaulted assets and causes undue strain on the Indian credit system.

Prior to the enactment of the Insolvency and Bankruptcy Code, the provisions relating to insolvency and bankruptcy for companies were made in the Sick Industrial Companies (Special Provisions) Act, 1985, the Recovery of Debt Due to Banks and Financial Institutions Act, 1993, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the Companies Act, 2013. These statutes provided for creation of multiple fora such as Board of Industrial and Financial Reconstruction (BIFR), Debt Recovery Tribunal (DRT) and their respective Appellate Tribunals. Liquidation of companies was handled by the High Courts. Individual bankruptcy and insolvency was dealt with under the Presidency Towns Insolvency Act, 1909, and the Provincial Insolvency Act, 1920.

The liquidation of companies was handled under various laws and different authorities such as High Court, and Debt Recovery Tribunal had overlapping jurisdiction which was adversely affecting the debt recovery process.

The objective of the Insolvency and Bankruptcy Code 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. An effective legal framework for timely resolution of insolvency and bankruptcy will not only encourage entrepreneurship but will also improve Ease of Doing Business, and facilitate more investments leading to higher economic growth and development.

### The Insolvency and Bankruptcy Code, 2016 – Introduction

The Insolvency and Bankruptcy Code Bill was drafted by a specially constituted “Bankruptcy Law Reforms Committee” (BLRC) under the Ministry of Finance. The Insolvency and Bankruptcy Code was introduced in the Lok Sabha on 21 December 2015 and was subsequently referred to a Joint Committee of Parliament. The Committee submitted its recommendations and the modified Code was passed by Lok Sabha on 5 May 2016. The Code was passed by Rajya Sabha on 11 May 2016 and it received the presidential assent on 28 May 2016.

The Insolvency and Bankruptcy Code, 2016 extends to the whole of India. However, Part III of the Code does not extend to the State of Jammu and Kashmir.

Section 1 of the Code provides that the Central Government may appoint different dates for different provisions of this Code and any reference in any such provision to the commencement of this Code shall be construed as a reference to the commencement of that provision.

The Insolvency and Bankruptcy Code, 2016 consolidates the existing framework by creating a single law for insolvency and bankruptcy. The Code applies to companies, partnerships, limited liability partnerships, individuals and any other body which the central government may specify.

Section 2 of the Insolvency and Bankruptcy Code, 2016 as amended vide the **Insolvency and Bankruptcy Code (Amendment) Act, 2018** provides that the provisions of the Code shall apply to –

- (a) any company incorporated under the Companies Act, 2013 or under any previous company law,
- (b) any other company governed by any special Act for the time being in force,

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- (c) any Limited Liability Partnership incorporated under the Limited Liability Partnership Act, 2008,
  - (d) such other body incorporated under any law for the time being in force, as the Central Government may, by notification, specify in this behalf,
  - (e) personal guarantors to corporate debtors,
  - (f) partnership firms and proprietorship firms; and
  - (g) individuals, other than persons referred to in clause (e)
- in relation to their insolvency, liquidation, voluntary liquidation or bankruptcy, as the case may be.

The Insolvency and bankruptcy Code, 2016 is one of the biggest economic reforms which provides a uniform and comprehensive insolvency legislation covering corporates, partnerships and individuals (other than financial firms). The Code gives both the creditors and debtors the power to initiate proceeding. It has helped India achieve a historic jump in the ease of doing business rankings by consolidating the law and providing for resolution of insolvencies in a time-bound manner.

### Key Objectives of the Insolvency and Bankruptcy Code, 2016

The objects clause of the Insolvency and Bankruptcy Code lays down the following key objectives:

1. To consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals
2. To provide for a time bound insolvency resolution mechanism
3. To ensure maximisation of value of assets,
4. To promote entrepreneurship,
5. To increase availability of credit
6. To balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and
7. To establish an Insolvency and Bankruptcy Board of India as a regulatory body
8. To provide procedure for connected and incidental matters.

### HOW CODE IS ORGANISED

The Insolvency and Bankruptcy Code, 2016 consists of total 255 sections organised in five Parts. Part II deals with insolvency resolution and liquidation for corporate persons whereas Part III lays down procedure for insolvency resolution and bankruptcy for individuals and partnership firms. Part IV of the Code makes provisions for regulation of Insolvency Professionals, Agencies and Information Utilities and Part V includes provisions for miscellaneous matters. The Code also has eleven Schedules which amends various statutes.

#### Part I Preliminary (Sections 1 to 3)

#### Part II Insolvency Resolution and Liquidation for Corporate Persons

- Chapter I Preliminary (Sections 4 to 5)
- Chapter II Corporate Insolvency Resolution Process (Sections 6 to 32)



- Chapter III Liquidation Process (Sections 33 to 54)
- Chapter IV Fast Track Corporate Insolvency Resolution Process (Sections 55 to 58)
- Chapter V Voluntary Liquidation of Corporate Persons (Section 59)
- Chapter VI Adjudicating Authority for Corporate Persons (Sections 60 to 67)
- Chapter VII Offences and Penalties (Sections 68 to 77)

### **Part III Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms**

- Chapter I Preliminary (Sections 78 to 79)
- Chapter II Fresh Start Process (Sections 80 to 93)
- Chapter III Insolvency Resolution Process (Sections 94 to 120)
- Chapter IV Bankruptcy Order for Individuals and Partnership Firms (Sections 121 to 148)
- Chapter V Administration and Distribution of the Estate of the Bankrupt (Sections 149 to 178)
- Chapter VI Adjudicating Authority for Individuals and Partnership Firms (Sections 179 to 187)

### **Part IV Regulation of Insolvency Professionals, Agencies and Information Utilities**

- Chapter I The Insolvency and Bankruptcy Board of India (Sections 188 to 195)
- Chapter II Powers and Functions of the Board (Sections 196 to 198)
- Chapter III Insolvency Professional Agencies (Sections 199 to 205)
- Chapter IV Insolvency Professionals (Sections 206 to 208)
- Chapter V Information Utilities (Sections 209 to 216)
- Chapter VI Inspection and Investigation (Sections 217 to 220)
- Chapter VII Finance, Accounts and Audit (Sections 221 to 223)

### **Part V Miscellaneous (Sections 224 to 255)**

- The First Schedule (see Section 245) amendment to the Indian Partnership Act, 1932
- The Second Schedule (see Section 246) amendment to the Central Excise Act, 1944
- The Third Schedule (see Section 247) amendment to the Income-tax Act, 1961
- The Fourth Schedule (see Section 248) amendment to the Customs Act, 1962
- The Fifth Schedule (see Section 249) amendment to the Recovery of Debts Due to Banks and Financial Institutions Act, 1993
- The Sixth Schedule (see Section 250 ) amendment to the Finance Act, 1994
- The Seventh Schedule (see Section 251) amendment to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- The Eighth Schedule (see Section 252) amendment to the Sick Industrial Companies (Special Provisions) Repeal Act, 2003
- The Ninth Schedule (see Section 253) amendment to the Payment and Settlement Systems Act, 2007

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- The Tenth Schedule (see Section 254) amendment to the Limited Liability Partnership Act, 2008
- The Eleventh Schedule (see Section 255) amendments to the Companies Act, 2013
- The Twelfth Schedule (see Section 29A(d)) Act for the purposes of clause (d) of Section 29A.

### Salient Features of the Insolvency and Bankruptcy Code, 2016

1. The Insolvency and bankruptcy Code, 2016 offers a uniform, comprehensive insolvency legislation covering all companies, partnerships and individuals. Financial firms are not included in the ambit of the Insolvency and Bankruptcy Code, 2016.
2. To ensure a formal and time bound insolvency resolution process, the Code creates a new institutional framework consisting of the Insolvency and Bankruptcy Board of India (IBBI), Adjudicating Authorities (AAs), Insolvency Professionals (IPs), Insolvency Professional Agencies (IPAs) and Information Utilities (IUs).
3. The Code provides for Insolvency Professionals (IPs), a class of regulated but private professionals having minimum standards of professional and ethical conduct, to act as intermediary in the insolvency resolution process. Insolvency Professional Agencies are designated to regulate Insolvency Professionals. These agencies conduct examinations to enrol Insolvency Professionals and enforce a code of conduct for their functioning. Following are the designated Insolvency Professional Agencies (IPAs) established under the Code:
  - The Indian Institute of Insolvency Professionals of ICAI,
  - ICSI Institute of Insolvency Professionals and
  - Insolvency Professional Agency of Institute of Cost Accountants of India

To regulate the working of Insolvency Professional Agencies (IPAs), the Insolvency and Bankruptcy Board of India (IBBI) has framed the following regulations in exercise of the powers conferred by the Insolvency and Bankruptcy Code, 2016:

  - The Insolvency and Bankruptcy Board of India (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016 and
  - The Insolvency and Bankruptcy Board of India (Insolvency Professional Agencies) Regulations, 2016.
4. The Insolvency Professionals control the assets of the debtor during the insolvency resolution process. The insolvency professional verifies the claims of the creditors, constitutes a committee of creditors, runs the debtor's business during the moratorium period and assists the creditors in finalising the revival plan. In liquidation, the insolvency professional acts as a liquidator and bankruptcy trustee. The Insolvency and Bankruptcy Board of India has framed the IBBI (Insolvency Professional) Regulations, 2016 to regulate the working of Insolvency Professionals. These regulations are amended from time to time by the Insolvency and Bankruptcy Board of India.
5. While the Insolvency professionals assist in the insolvency resolution proceedings envisaged in the Code, the Information Utilities, on the other hand, collect, collate, authenticate and disseminate financial information. The purpose of such collection, collation, authentication and dissemination financial information of debtors in centralised electronic databases is to facilitate swift decision making in the resolution proceedings. The Insolvency and Bankruptcy Board of India has framed the IBBI (Information



Utilities) Regulations, 2017. These regulations are amended from time to time by the Insolvency and Bankruptcy Board of India.

6. The Code provides for the constitution of a new insolvency regulator i.e., the Insolvency and Bankruptcy Board of India (IBBI). Its role includes overseeing the functioning of insolvency intermediaries i.e., insolvency professionals, insolvency professional agencies and information utilities as well as regulating the insolvency process. The members of the Board includes representatives from the central government as well as the Reserve Bank of India. The Board is empowered to frame and implement rules to regulate the profession as well as processes envisaged in the Code. The Bankruptcy Board of India has also been designated as the 'Authority' under the Companies (Registered Valuers and Valuation Rules), 2017 for regulation and development of the profession of valuers in the country.
7. The Code proposes two tribunals to adjudicate insolvency resolution cases. In the case of insolvency of companies and Limited Liability Partnerships (LLPs), the adjudication authority is the National Company Law Tribunal (NCLT), while the cases involving individuals and partnership firms are handled by the Debts Recovery Tribunals (DRTs). The insolvency proceeding will be initiated by NCLT or DRT, as the case may be, after verification of the claims of the initiator. Appeals from NCLT orders lie to the National Company Law Appellate Tribunal (NCLAT) and thereafter to the Supreme Court of India. For individuals and other persons, the adjudicating authority is the DRT. Appeals from DRT orders lie to the Debt Recovery Appellate Tribunal (DRAT) and thereafter to the Supreme Court.

To ensure that the insolvency resolution is commercially viable, the Code separates the commercial aspects from the judicial aspects and thus limits the role of adjudicating authorities to ensuring due process rather than adjudicating on the merits of the insolvency resolution.

8. To initiate an insolvency process for corporate debtors, the default should be at least INR 100,000. This limit may be increased by the Government up to INR 10,000,000. For individuals and unlimited partnerships, the minimum default amount is INR 1000. The Government may later revise the minimum amount of default to a higher threshold.
9. In resolution process for corporate persons, the Code proposes two independent stages:
  - (i) Insolvency Resolution Process, during which the creditors assess the viability of debtor's business and the options for its rescue and revival.
  - (ii) Liquidation, in case the insolvency resolution process fails or financial creditors decide to wind up and distribute the assets of the debtor.
10. The Code envisages two distinct processes in case of Insolvency Resolution Process (IRP) for Individuals/Unlimited Partnerships
  - (i) Automatic Fresh Start
  - (ii) Insolvency Resolution
11. The Code provides a Fresh Start Process for individuals under which they will be eligible for a debt waiver of up to INR 35,000. The individual will be eligible for the waiver subject to certain limits prescribed under the Code. Under the automatic fresh start process, eligible debtors can apply to the Debt Recovery Tribunal (DRT) for discharge from certain debts not exceeding a specified threshold, allowing them to start afresh.
12. A financial creditor (for a defaulted financial debt) or an operational creditor (for an unpaid operational

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debt) can initiate an Insolvency Resolution Process (IRP) against a corporate debtor. The defaulting corporate debtor, its shareholders or employees, may also initiate voluntary insolvency proceedings. The National Company Law Tribunal (NCLT) is the designated adjudicating authority in case of corporate debtors.

In case of individuals and unlimited partnerships, the insolvency resolution process consists of preparation of a repayment plan by the debtor. If approved by creditors, the DRT passes an order binding the debtor and creditors to the repayment plan. If the plan is rejected or fails, the debtor or creditors may apply for a bankruptcy order.

Section 11 of the Code disentitles the following persons to make an application to initiate corporate insolvency resolution process:

- (a) a corporate debtor undergoing a corporate insolvency resolution process; or
- (b) a corporate debtor having completed corporate insolvency resolution process twelve months preceding the date of making of the application; or
- (c) a corporate debtor or a financial creditor who has violated any of the terms of resolution plan which was approved twelve months before the date of making of an application under this Chapter; or
- (d) a corporate debtor in respect of whom a liquidation order has been made.

13. The Code provides for a time bound Insolvency Resolution Process for companies and individuals, which is required to be completed within 180 days (subject to a one-time extension by 90 days). Corporate insolvency resolution process shall mandatorily be completed within a period of three hundred and thirty days from the insolvency commencement date, including any extension of the period of corporate insolvency resolution process and the time taken in legal proceedings in relation to such resolution process of the corporate debtor. If the resolution plan does not get finalised or is rejected by NCLT or DRT on technical grounds, then assets of the debtor are sold to repay his outstanding dues.
14. The Code makes significant changes in the priority of claims for distribution of liquidation proceeds. In case of liquidation, the assets will be distributed in the following order: (i) fees of insolvency professional and costs related to the resolution process, (ii) workmen's dues for the preceding 24 months 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.

Before the enactment of the Insolvency and Bankruptcy Code, the Government dues were immediately below the claims of secured creditors and workmen in order of priority. Now the Central and State Government's dues stand below the claims of secured creditors, workmen dues, employee dues and other unsecured financial creditors.

15. The Code provides for the creation of Insolvency and Bankruptcy Fund. Section 224 of the Code provides that the following amounts shall be credited to the fund
  - (a) the grants made by the Central Government for the purposes of the Fund;
  - (b) the amount deposited by persons as contribution to the Fund;
  - (c) the amount received in the Fund from any other source; and

(d) the interest or other income received out of the investment made from the Fund.

Section 224(3) further provides that a person who has contributed any amount to the Fund may, in the event of proceedings initiated in respect of such person under the Code before an Adjudicating Authority, make an application to such Adjudicating Authority for withdrawal of funds not exceeding the amount contributed by it, for making payments to workmen, protecting the assets of such persons, meeting the incidental costs during the proceedings or such other purposes as may be prescribed.

16. The Code specifies stringent penalties for certain offences such as concealing property in case of corporate insolvency. The imprisonment in such cases may extend up to five years, or a fine of up to one crore rupees, or both.
17. In case of cross-border insolvency proceedings, the central government may enter into bilateral agreements and reciprocal arrangements with other countries to enforce provisions of the Code.

The Code repeals **the Presidency Towns Insolvency Act, 1909** and **the Provincial Insolvency Act, 1920**.

In addition, it amends the following 11 Acts:

- The Indian Partnership Act, 1932
- The Central Excise Act, 1944
- The Income-tax Act, 1961
- The Customs Act, 1962
- The Recovery of Debts Due to Banks and Financial Institutions Act, 1993
- The Finance Act, 1994
- The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- The Sick Industrial Companies (Special Provisions) Repeal Act, 2003
- The Payment and Settlement Systems Act, 2007
- The Limited Liability Partnership Act, 2008
- The Companies Act, 2013

## PILLARS OF INSOLVENCY AND BANKRUPTCY CODE, 2016

### (A) Insolvency and Bankruptcy Board of India (IBBI)

The Insolvency and Bankruptcy Code, 2016 provides for the constitution of a new insolvency regulator i.e., the Insolvency and Bankruptcy Board of India (IBBI). The Insolvency and Bankruptcy Board of India was established on 1st October 2016. It is a unique regulator which regulates a profession as well as processes under the Code. Its role includes overseeing the functioning of insolvency intermediaries i.e., insolvency professionals, insolvency professional agencies and information utilities. The Board is responsible for implementation of the Code that consolidates and amends the laws relating to insolvency resolution of **corporate persons, partnership firms and individuals** in a time bound manner. The Board is empowered to frame and enforce rules for various processes under the Code, namely, corporate insolvency resolution, corporate liquidation, individual insolvency resolution and individual bankruptcy.

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Section 188(2) of the Code provides that 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. As per section 189(4), the term of office of the Chairperson and members (other than ex officio members) shall be five years or till they attain the age of sixty-five years, whichever is earlier, and they shall be eligible for reappointment.

### Removal of member from office

Section 190 empowers the Central Government to remove a member from office if he –

- (a) is an undischarged bankrupt as defined under Part III;
- (b) has become physically or mentally incapable of acting as a member;
- (c) has been convicted of an offence, which in the opinion of the Central Government involves moral turpitude;
- (d) has, so abused his position as to render his continuation in office detrimental to the public interest.

Section 190 mandates that no member shall be removed under clause (d) unless he has been given a reasonable opportunity of being heard in the matter.

### Powers and Functions of the Board

Section 196(1) of the Code (**as amended by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**) provides that the Board shall, subject to the general direction of the Central Government, perform all or any of the following functions namely:

- (a) Register insolvency professional agencies, insolvency professionals and information utilities and renew, withdraw, suspend or cancel such registrations.
- (aa) promote the development of, and regulate, the working and practices of, insolvency professionals, insolvency professional agencies and information utilities and other institutions, in furtherance of the purposes of this Code.
- (b) Specify the minimum eligibility requirements for registration of insolvency professional agencies, insolvency professionals and information utilities.
- (c) Levy fee or other charges for carrying out the purposes of this Code, including fee for registration and renewal of insolvency professional agencies, insolvency professionals and information utilities.
- (d) Specify by regulations standards for the functioning of insolvency professional agencies, insolvency professionals and information utilities.
- (e) Lay down by regulations the minimum curriculum for the examination of the insolvency professionals for their enrolment as members of the insolvency professional agencies.
- (f) Carry out inspections and investigations on insolvency professional agencies, insolvency professionals and information utilities and pass such orders as may be required for compliance of the provisions of this Code and the regulations issued hereunder.
- (g) Monitor the performance of insolvency professional agencies, insolvency professionals and information utilities and pass any directions as may be required for compliance of the provisions of this Code and the regulations issued hereunder.

- (h) Call for any information and records from the insolvency professional agencies, insolvency professionals and information utilities.
- (i) Publish such information, data, research studies and other information as may be specified by regulations.
- (j) Specify by regulations the manner of collecting and storing data by the information utilities and for providing access to such data.
- (k) Collect and maintain records relating to insolvency and bankruptcy cases and disseminate information relating to such cases.
- (l) Constitute such committees as may be required including in particular the committees laid down in Section 197.
- (m) Promote transparency and best practices in its governance.
- (n) Maintain websites and such other universally accessible repositories of electronic information as may be necessary.
- (o) Enter into memorandum of understanding with any other statutory authorities
- (p) Issue necessary guidelines to the insolvency professional agencies, insolvency professionals and information utilities.
- (q) Specify mechanism for redressal of grievances against insolvency professionals, insolvency professional agencies and information utilities and pass orders relating to complaints filed against the aforesaid for compliance of the provisions of this Code and the regulations issued hereunder.
- (r) Conduct periodic study, research and audit the functioning and performance of to the insolvency professional agencies, insolvency professionals and information utilities at such intervals as may be specified by the Board.
- (s) Specify mechanisms for issuing regulations, including the conduct of public consultation processes before notification of any regulations.
- (t) Make regulations and guidelines on matters relating to insolvency and bankruptcy as may be required under this Code, including mechanism for time bound disposal of the assets of the corporate debtor or debtor.
- (u) Perform such other functions as may be prescribed.

Section 196(2) of the Code further provides that the Board may make model bye-laws to be adopted by insolvency professional agencies which may provide for:

- (a) The minimum standards of professional competence of the members of insolvency professional agencies.
- (b) The standards for professional and ethical conduct of the members of insolvency professional agencies.
- (c) Requirements for enrolment of persons as members of insolvency professional agencies which shall be non-discriminatory.

*Explanation.*— For the purposes of this clause, the term “non-discriminatory” means lack of discrimination on the grounds of religion, caste, gender or place of birth and such other grounds as may be specified.

- (d) The manner of granting membership.

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- (e) Setting up of a governing board for internal governance and management of insolvency professional agency in accordance with the regulations specified by the Board.
- (f) The information required to be submitted by members including the form and the time for submitting such information.
- (g) The specific classes of persons to whom services shall be provided at concessional rates or for no remuneration by members.
- (h) The grounds on which penalties may be levied upon the members of insolvency professional agencies and the manner thereof.
- (i) A fair and transparent mechanism for redressal of grievances against the members of insolvency professional agencies.
- (j) The grounds under which the insolvency professionals may be expelled from the membership of insolvency professional agencies.
- (k) The quantum of fee and the manner of collecting fee for inducing persons as its members.
- (l) The procedure for enrolment of persons as members of insolvency professional agency.
- (m) The manner of conducting examination for enrolment of insolvency professionals.
- (n) The manner of monitoring and reviewing the working of insolvency professional who are members.
- (o) The duties and other activities to be performed by members.
- (p) The manner of conducting disciplinary proceedings against its members and imposing penalties.
- (q) The manner of utilising the amount received as penalty imposed against any insolvency professional.

Section 196(3) states that the Board shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:

- (a) The discovery and production of books of account and other documents, at such place and such time as may be specified by the Board.
- (b) Summoning and enforcing the attendance of persons and examining them on oath.
- (c) Inspection of any books, registers and other documents of any person at any place.
- (d) Issuing of commissions for the examination of witnesses or documents.

### **(B) Insolvency Professionals (IPs)**

The Code provides for Insolvency Professionals (IPs) to act as intermediary in the insolvency resolution process. Insolvency professionals are a class of regulated but private professionals having minimum standards of professional and ethical conduct. Section 3(19) of the Code defines an “insolvency professional” as a person enrolled under section 206 with an insolvency professional agency as its member and registered with the Board as an insolvency professional under section 207.

An insolvency professional plays a very important role under the Code. He acts as a “resolution professional” in the corporate insolvency resolution process (specified in Part II of the Code which deals with corporate persons) as well as Part III of the (which deals with Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms) for conducting the fresh start process or insolvency resolution process.

An insolvency professional also acts as a liquidator in accordance with the provisions of Part II as well as a “bankruptcy trustee” for the estate of the bankrupt under section 125 in Part III of the Code.

### Enrolment and Registration of insolvency professionals

Section 206 lays down that no person shall render his services as insolvency professional under this Code without being enrolled as a member of an insolvency professional agency and registered with the Board.

Section 207(1) further lays down that every insolvency professional shall, after obtaining the membership of any insolvency professional agency, register himself with the Board within such time, in such manner and on payment of such fee, as may be specified by regulations. Section 207(2) empowers the IBBI to specify the categories of professionals or persons possessing such qualifications and experience in the field of finance, law, management, insolvency or such other field to act as insolvency professionals.

The Insolvency and Bankruptcy Board of India has framed **the IBBI (Insolvency Professional) Regulations, 2016** to regulate the working of Insolvency Professionals. These regulations are amended from time to time by the Insolvency and Bankruptcy Board of India.

### Functions and obligations of insolvency professionals

Section 208(1) of the Code provides that where any insolvency resolution, fresh start, liquidation or bankruptcy process has been initiated, it shall be the function of an insolvency professional to take such actions as may be necessary, in the following matters, namely:—

- (a) a fresh start order process under Chapter II of Part III;
- (b) individual insolvency resolution process under Chapter III of Part III;
- (c) corporate insolvency resolution process under Chapter II of Part II;
- (d) individual bankruptcy process under Chapter IV of Part III; and (e) liquidation of a corporate debtor firm under Chapter III of Part II.

Section 208(2) mandates that every insolvency professional shall abide by the following code of conduct:—

- (a) to take reasonable care and diligence while performing his duties;
- (b) to comply with all requirements and terms and conditions specified in the bye-laws of the insolvency professional agency of which he is a member;
- (c) to allow the insolvency professional agency to inspect his records;
- (d) to submit a copy of the records of every proceeding before the Adjudicating Authority to the Board as well as to the insolvency professional agency of which he is a member; and
- (e) to perform his functions in such manner and subject to such conditions as may be specified.

### (C) Insolvency Professional Agencies (IPA)

Section 3(20) of the Code defines “insolvency professional agency” as any person registered with the Board under section 201 as an insolvency professional agency.

Insolvency Professional Agencies are designated to regulate Insolvency Professionals. These agencies conduct examinations to enrol Insolvency Professionals and enforce a code of conduct for their functioning. In exercise of powers conferred by the Insolvency and Bankruptcy Code, 2016, the Insolvency and Bankruptcy Board of India (IBBI) has framed the following regulations to regulate the working of Insolvency Professional Agencies (IPAs):

- The Insolvency and Bankruptcy Board of India (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016 and



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- The Insolvency and Bankruptcy Board of India (Insolvency Professional Agencies) Regulations, 2016.

Following are the Insolvency Professional Agencies (IPAs) registered under the Code :

- The Indian Institute of Insolvency Professionals of ICAI
- ICSI Institute of Insolvency Professionals and
- Insolvency Professional Agency of Institute of Cost Accountants of India

Section 199 of the Code provides that save as otherwise provided in this Code, no person shall carry on its business as insolvency professional agencies under this Code and enrol insolvency professionals as its members except under and in accordance with a certificate of registration issued in this behalf by the Board.

According to Section 204 of the Code, an insolvency professional agencies perform the following functions, namely:

- (a) grant membership to persons who fulfil all requirements set out in its byelaws on payment of membership fee;
- (b) lay down standards of professional conduct for its members;
- (c) monitor the performance of its members;
- (d) safeguard the rights, privileges and interests of insolvency professionals who are its members;
- (e) suspend or cancel the membership of insolvency professionals who are its members on the grounds set out in its bye-laws;
- (f) redress the grievances of consumers against insolvency professionals who are its members; and
- (g) publish information about its functions, list of its members, performance of its members and such other information as may be specified by regulations.

### **(D) Adjudicating Authority (AA)**

Section 5(1) of the Code provides that the “Adjudicating Authority” for insolvency resolution and liquidation for corporate persons means National Company Law Tribunal constituted under section 408 of the Companies Act, 2013. Section 60(5) of the Code further provides that notwithstanding anything to the contrary contained in any other law for the time being in force, the National Company Law Tribunal shall have jurisdiction to entertain or dispose of –

- (a) any application or proceeding by or against the corporate debtor or corporate person;
- (b) any claim made by or against the corporate debtor or corporate person, including claims by or against any of its subsidiaries situated in India; and
- (c) any question of priorities or any question of law or facts, arising out of or in relation to the insolvency resolution or liquidation proceedings of the corporate debtor or corporate person under this Code.

Section 63 of the Code excludes the jurisdiction of the civil courts. It provides that no civil court or authority shall have jurisdiction to entertain any suit or proceedings in respect of any matter on which National Company Law Tribunal (NCLT) or the National Company Law Appellate Tribunal (NCLAT) has jurisdiction under this Code.

Similarly, in case of individuals and partnership firms, section 79(1) of the Code provides that the “Adjudicating



Authority” for insolvency resolution and bankruptcy for individuals and partnership firms is the Debt Recovery Tribunal constituted under sub-section (1) of section 3 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

Section 179(1) of the Code provides that subject to the provisions of section 60, the Adjudicating Authority, in relation to insolvency matters of individuals and firms shall be the Debt Recovery Tribunal having territorial jurisdiction over the place where the individual debtor actually and voluntarily resides or carries on business or personally works for gain and can entertain an application under this Code regarding such person.

Section 179(2) of the Code further provides that the Debt Recovery Tribunal shall, have jurisdiction to entertain or dispose of –

- (a) any suit or proceeding by or against the individual debtor;
- (b) any claim made by or against the individual debtor;
- (c) any question of priorities or any other question whether of law or facts, arising out of or in relation to insolvency and bankruptcy of the individual debtor or firm under this Code.

Section 180 of the Code excludes the jurisdiction of civil courts. The section provides that no civil court or authority shall have jurisdiction to entertain any suit or proceedings in respect of any matter on which the Debt Recovery Tribunal or the Debt Recovery Appellate Tribunal has jurisdiction under this Code.

Thus, the Insolvency and Bankruptcy Code proposes two tribunals to adjudicate insolvency resolution cases. In the case of insolvency of companies and Limited Liability Partnerships (LLPs), the adjudication authority is the National Company Law Tribunal (NCLT), while the cases involving individuals and partnership firms are handled by the Debts Recovery Tribunals (DRTs).

Appeals from NCLT orders lie to the National Company Law Appellate Tribunal (NCLAT) and thereafter to the Supreme Court of India. For individuals and other persons, the adjudicating authority is the DRT. Appeals from DRT orders lie to the Debt Recovery Appellate Tribunal (DRAT) and thereafter to the Supreme Court.

### (E) Information Utility (IU)

Section 3(21) of the Code defines an “information utility” as a person who is registered with the Board as an information utility under section 210.

The Insolvency professionals assist in the insolvency resolution proceedings envisaged in the Code, the Information Utility, on the other hand, collect, collate, authenticate and disseminate financial information. The purpose of such collection, collation, authentication and dissemination financial information of debtors is to facilitate swift decision making in the resolution proceedings. The Insolvency and Bankruptcy Board of India oversees the functioning of such information utilities. The Insolvency and Bankruptcy Board of India has framed **the IBBI (Information Utilities) Regulations, 2017**. These regulations are amended from time to time by the Insolvency and Bankruptcy Board of India.

**Obligations of information utility (Section 214)**

- (a) create and store financial information in a universally accessible format;
- (b) accept electronic submissions of financial information from persons who are under obligations to submit financial information under sub-section (1) of section 215, in such form and manner as may be specified by regulations;
- (c) accept, in specified form and manner, electronic submissions of financial information from persons who intend to submit such information;
- (d) meet such minimum service quality standards as may be specified by regulations;
- (e) get the information received from various persons authenticated by all concerned parties before storing such information;
- (f) provide access to the financial information stored by it to any person who intends to access such information in such manner as may be specified by regulations;
- (g) publish such statistical information as may be specified by regulations;
- (h) have inter-operability with other information utilities.

**Key Definitions and Concepts**

Sections 3, 5 and 79 of the Insolvency and Bankruptcy Code, 2016 define important terms used in the Code. Section 3 of the Code defines general important terms used in the Code whereas section 5 of the Code defines important terms relating to Insolvency Resolution and Liquidation for **Corporate Persons** covered in Part II of the Code. Similarly section 79 of the Code defines important terms relating to Insolvency Resolution and Bankruptcy for **Individuals And Partnership Firms** which is discussed in Part III of the Code.

**Definitions in Section 3 of the Code**

Section 3(37) provides that words and expressions used but not defined in the Insolvency and Bankruptcy Code, 2016 but defined in the Indian Contract Act, 1872, the Indian Partnership Act, 1932, the Securities Contract (Regulation) Act, 1956, the Securities Exchange Board of India Act, 1992, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, the Limited Liability Partnership Act, 2008 and the Companies Act, 2013, shall have the meanings respectively assigned to them in those Acts. Therefore, all such words and expressions not defined in the Code but defined in other Acts shall have the meanings assigned to them in those other Acts.

Section 3 states that unless the context otherwise requires,

1. "Board" means the Insolvency and Bankruptcy Board of India established under sub-section (1) of section 188 [Section 3(1)].
2. "Bench" means a bench of the Adjudicating Authority [Section 3(2)].
3. "Bye-laws" mean the bye-laws made by the insolvency professional agency under section 205 [Section 3(3)].
4. "Charge" means an interest or lien created on the property or assets of any person or any of its undertakings or both, as the case may be, as security and includes a mortgage [Section 3(4)].
5. "Claim" means –

- (a) a right to payment, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured or unsecured;
  - (b) right to remedy for breach of contract under any law for the time being in force, if such breach gives rise to a right to payment, whether or not such right is reduced to judgment, fixed, matured, unmatured, disputed, undisputed, secured or unsecured [Section 3(6)].
6. “Corporate Person” means a company as defined in clause (20) of section 2 of the Companies Act, 2013, a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008, or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider [Section 3(7)].
7. “Corporate Debtor” means a corporate person who owes a debt to any person [Section 3(8)].
8. “Core Services” means services rendered by an information utility for –
- (a) accepting electronic submission of financial information in such form and manner as may be specified;
  - (b) safe and accurate recording of financial information;
  - (c) authenticating and verifying the financial information submitted by a person; and
  - (d) providing access to information stored with the information utility to persons as may be specified [Section 3(9)].
9. “Creditor” means any person to whom a debt is owed and includes a financial creditor, an operational creditor, a secured creditor, an unsecured creditor and a decree holder [Section 3(10)].
10. “Debt” means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt [Section 3(11)].
11. “Default” means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not [paid] by the debtor or the corporate debtor, as the case may be [Section 3(12)].

Section 3(12) of the Code was amended by the **Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**. The aforesaid amendment substituted the word “repaid” with the word “paid” in section.

12. “Financial Information”, in relation to a person, means one or more of the following categories of information, namely:–
- (a) records of the debt of the person;
  - (b) records of liabilities when the person is solvent;
  - (c) records of assets of person over which security interest has been created;
  - (d) records, if any, of instances of default by the person against any debt;
  - (e) records of the balance sheet and cash-flow statements of the person; and
  - (f) such other information as may be specified [Section 3(13)].
13. “Financial Institution” means –
- (a) a scheduled bank;
  - (b) financial institution as defined in section 45-I of the Reserve Bank of India Act, 1934;

- (c) public financial institution as defined in clause (72) of section 2 of the Companies Act, 2013; and
  - (d) such other institution as the Central Government may by notification specify as a financial institution [Section 3(14)].
14. “Financial Product” means securities, contracts of insurance, deposits, credit arrangements including loans and advances by banks and financial institutions, retirement benefit plans, small savings instruments, foreign currency contracts other than contracts to exchange one currency (whether Indian or not) for another which are to be settled immediately, or any other instrument as may be prescribed [Section 3(15)].
15. “Financial Service” includes any of the following services, namely:—
- (a) accepting of deposits;
  - (b) safeguarding and administering assets consisting of financial products, belonging to another person, or agreeing to do so;
  - (c) effecting contracts of insurance;
  - (d) offering, managing or agreeing to manage assets consisting of financial products belonging to another person;
  - (e) rendering or agreeing, for consideration, to render advice on or soliciting for the purposes of –
    - (i) buying, selling, or subscribing to, a financial product;
    - (ii) availing a financial service; or
    - (iii) exercising any right associated with a financial product or financial service;
  - (f) establishing or operating an investment scheme;
  - (g) maintaining or transferring records of ownership of a financial product;
  - (h) underwriting the issuance or subscription of a financial product; or
  - (i) selling, providing, or issuing stored value or payment instruments or providing payment services [Section 3(16)].
16. “Financial Service Provider” means a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator [Section 3(17)].
17. “Financial Sector Regulator” means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government [Section 3(18)].
18. “Insolvency Professional” means a person enrolled under section 206 with an insolvency professional agency as its member and registered with the Board as an insolvency professional under section 207 [Section 3(19)].
19. “Insolvency Professional Agency” means any person registered with the Board under section 201 as an insolvency professional agency [Section 3(20)].
20. “Information Utility” means a person who is registered with the Board as an information utility under section 210 [Section 3(21)].

21. “Person” includes –
  - (a) an individual;
  - (b) a Hindu Undivided Family;
  - (c) a company;
  - (d) a trust;
  - (e) a partnership;
  - (f) a limited liability partnership; and
  - (g) any other entity established under a statute, and includes a person resident outside India [Section 3(23)].
22. “Property” includes money, goods, actionable claims, land and every description of property situated in India or outside India and every description of interest including present or future or vested or contingent interest arising out of, or incidental to, property [Section 3(27)].
23. “Secured Creditor” means a creditor in favour of whom security interest is created [Section 3(30)].
24. “Security Interest” means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person: Provided that security interest shall not include a performance guarantee; [Section 3(31)].
25. “Transaction” includes an agreement or arrangement in writing for the transfer of assets, or funds, goods or services, from or to the corporate debtor [Section 3(33)].
26. “Transfer” includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien [Section 3(34)].
27. “Transfer of Property” means transfer of any property and includes a transfer of any interest in the property and creation of any charge upon such property [Section 3(35)].

### Definitions in Section 5 of the Code

Section 5 belongs to Part II of the Code which lays down procedure for insolvency resolution and liquidation to be followed in case of **corporate persons**. Section 5 states that unless the context otherwise requires:

1. “Adjudicating Authority”, for the purposes of Part II, means National Company Law Tribunal constituted under section 408 of the Companies Act, 2013 [Section 5(1)].
2. “Constitutional Document”, in relation to a corporate person, includes articles of association, memorandum of association of a company and incorporation document of a Limited Liability Partnership [Section 5(4)].
3. “Corporate Applicant” means –
  - (a) corporate debtor; or
  - (b) a member or partner of the corporate debtor who is authorised to make an application for the corporate insolvency resolution process under the constitutional document of the corporate debtor; or

- (c) an individual who is in charge of managing the operations and resources of the corporate debtor; or
  - (d) a person who has the control and supervision over the financial affairs of the corporate debtor c
4. “Corporate Guarantor” means a corporate person who is the surety in a contract of guarantee to a corporate debtor [Section 5(5A)].

“Corporate Guarantor” was not defined in the original Code. This definition was added by the **Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**.

5. “Dispute” includes a suit or arbitration proceedings relating to –
- (a) the existence of the amount of debt;
  - (b) the quality of goods or service; or
  - (c) the breach of a representation or warranty [Section 5(6)].
6. “Financial Creditor” means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to [Section 5(7)].
7. “Financial Debt” means a debt along with interest, if any, which is disbursed against the consideration for the time value of money and includes –
- (a) money borrowed against the payment of interest;
  - (b) any amount raised by acceptance under any acceptance credit facility or its de-materialised equivalent;
  - (c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;
  - (d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;
  - (e) receivables sold or discounted other than any receivables sold on nonrecourse basis;
  - (f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing;

*Explanation* – For the purposes of this sub-clause,

- (i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and
- (ii) the expressions, “allottee” and “real estate project” shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016.

[The above Explanation to clause (f) of Section 5(8) was added vide the **Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**.

- (g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;

- (h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;
  - (i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clauses (a) to (h) of this clause [Section 5(8)].
- 8. “Financial Position”, in relation to any person, means the financial information of a person as on a certain date [Section 5(9)].
- 9. “Information Memorandum” means a memorandum prepared by resolution professional under sub-section (1) of section 29 [Section 5(10)].
- 10. “Initiation Date” means the date on which a financial creditor, corporate applicant or operational creditor, as the case may be, makes an application to the Adjudicating Authority for initiating corporate insolvency resolution process [Section 5(11)].
- 11. “Insolvency Commencement Date” means the date of admission of an application for initiating corporate insolvency resolution process by the Adjudicating Authority under sections 7, 9 or section 10, as the case may be.
- 12. “Insolvency Resolution Process Costs” means –
  - (a) the amount of any interim finance and the costs incurred in raising such finance;
  - (b) the fees payable to any person acting as a resolution professional;
  - (c) any costs incurred by the resolution professional in running the business of the corporate debtor as a going concern;
  - (d) any costs incurred at the expense of the Government to facilitate the insolvency resolution process; and
  - (e) any other costs as may be specified by the Board [Section 5(13)].
- 13. “Insolvency Resolution Process Period” means the period of one hundred and eighty days beginning from the insolvency commencement date and ending on one hundred and eightieth day [Section 5(14)].
- 14. “Interim Finance” means any financial debt raised by the resolution professional during the insolvency resolution process period and such other debt as may be notified [Section 5(15)].
- 15. “Liquidation Cost” means any cost incurred by the liquidator during the period of liquidation subject to such regulations, as may be specified by the Board [Section 5(16)].
- 16. “Liquidation Commencement Date” means the date on which proceedings for liquidation commence in accordance with section 33 or section 59, as the case may be [Section 5(17)].
- 17. “Liquidator” means an insolvency professional appointed as a liquidator in accordance with the provisions of Chapter III or Chapter V of this Part, as the case may be [Section 5(18)].
- 18. “Operational Creditor” means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred [Section 5(20)].
- 19. “Operational Debt” means a claim in respect of the provision of goods or services including employment or a debt in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority [Section 5(21)].



**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** substituted the word “repayment” with “payment” in Section 5(21) of the Code.

20. “Personal Guarantor” means an individual who is the surety in a contract of guarantee to a corporate debtor [Section 5(22)].
21. “Personnel” includes the directors, managers, key managerial personnel, designated partners and employees, if any, of the corporate debtor [Section 5(23)].
22. “Related Party”, in relation to a corporate debtor, means –
  - (a) a director or partner of the corporate debtor or a relative of a director or partner of the corporate debtor;
  - (b) a key managerial personnel of the corporate debtor or a relative of a key managerial personnel of the corporate debtor;
  - (c) a limited liability partnership or a partnership firm in which a director, partner, or manager of the corporate debtor or his relative is a partner;
  - (d) a private company in which a director, partner or manager of the corporate debtor is a director and holds along with his relatives, more than two per cent. of its share capital;
  - (e) a public company in which a director, partner or manager of the corporate debtor is a director and holds along with relatives, more than two per cent. of its paid-up share capital;
  - (f) anybody corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;
  - (g) any limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;
  - (h) any person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;
  - (i) a body corporate which is a holding, subsidiary or an associate company of the corporate debtor, or a subsidiary of a holding company to which the corporate debtor is a subsidiary;
  - (j) any person who controls more than twenty per cent. of voting rights in the corporate debtor on account of ownership or a voting agreement;
  - (k) any person in whom the corporate debtor controls more than twenty per cent. of voting rights on account of ownership or a voting agreement;
  - (l) any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor;
  - (m) any person who is associated with the corporate debtor on account of –
    - (i) participation in policy making processes of the corporate debtor; or
    - (ii) having more than two directors in common between the corporate debtor and such person;  
or
    - (iii) interchange of managerial personnel between the corporate debtor and such person; or



(iv) provision of essential technical information to, or from, the corporate debtor [Section 5(24)].

23. “Related Party”, in relation to an individual, means –

- (a) a person who is a relative of the individual or a relative of the spouse of the individual;
- (b) a partner of a limited liability partnership, or a limited liability partnership or a partnership firm, in which the individual is a partner;
- (c) a person who is a trustee of a trust in which the beneficiary of the trust includes the individual, or the terms of the trust confers a power on the trustee which may be exercised for the benefit of the individual;
- (d) a private company in which the individual is a director and holds along with his relatives, more than two per cent. of its share capital;
- (e) a public company in which the individual is a director and holds along with relatives, more than two per cent. of its paid-up share capital;
- (f) a body corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of the individual;
- (g) a limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, act on the advice, directions or instructions of the individual;
- (h) a person on whose advice, directions or instructions, the individual is accustomed to act;
- (i) a company, where the individual or the individual along with its related party, own more than fifty per cent. of the share capital of the company or controls the appointment of the board of directors of the company.

Explanation. For the purposes of this clause, –

- (a) “relative”, with reference to any person, means anyone who is related to another, in the following manner, namely: –
  - (i) members of a Hindu Undivided Family, (ii) husband, (iii) wife, (iv) father, (v) mother, (vi) son, (vii) daughter, (viii) son’s daughter and son, (ix) daughter’s daughter and son, (x) grandson’s daughter and son, (xi) granddaughter’s daughter and son, (xii) brother, (xiii) sister, (xiv) brother’s son and daughter, (xv) sister’s son and daughter, (xvi) father’s father and mother, (xvii) mother’s father and mother, (xviii) father’s brother and sister, (xix) mother’s brother and sister; and
  - (b) wherever the relation is that of a son, daughter, sister or brother, their spouses shall also be included

[Section 5(24A) added by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018].

24. “Resolution Applicant” means a person, who individually or jointly with any other person, submits a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25 [Section 5(25)].

The above definition of “Resolution applicant” was provided by **the Insolvency and Bankruptcy Code (Amendment) Act, 2018**. Originally, the definition of “resolution Applicant” was as follows:

“ResolutionApplicant” means any person who submits a resolution plan to the resolution professional.

25. "Resolution Plan" means a plan proposed by resolution applicant for insolvency resolution of the corporate debtor as a going concern in accordance with Part II [Section 5(26)].
26. "Resolution Professional", for the purposes of this Part, means an insolvency professional appointed to conduct the corporate insolvency resolution process and includes an interim resolution professional [Section 5(27)].
27. "Voting Share" means the share of the voting rights of a single financial creditor in the committee of creditors which is based on the proportion of the financial debt owed to such financial creditor in relation to the financial debt owed by the corporate debtor [Section 5(28)].

### Definitions in Section 79 of the Code

Section 79 belongs to Part III of the Code which lays down procedure for insolvency resolution and bankruptcy for **individuals and partnership firms**. Section 79 states that unless the context otherwise requires:

- (1) "Adjudicating Authority" means the Debt Recovery Tribunal constituted under sub-section (1) of section 3 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 [Section 79(1)].
- (2) "Associate" of the debtor means –
  - (a) a person who belongs to the immediate family of the debtor;
  - (b) a person who is a relative of the debtor or a relative of the spouse of the debtor;
  - (c) a person who is in partnership with the debtor;
  - (d) a person who is a spouse or a relative of any person with whom the debtor is in partnership;
  - (e) a person who is employer of the debtor or employee of the debtor;
  - (f) a person who is a trustee of a trust in which the beneficiaries of the trust include a debtor, or the terms of the trust confer a power on the trustee which may be exercised for the benefit of the debtor; and
  - (g) a company, where the debtor or the debtor along with his associates, own more than fifty per cent. of the share capital of the company or control the appointment of the board of directors of the company.

*Explanation* – For the purposes of this sub-section, "relative", with reference to any person, means anyone who is related to another, if –

- (i) they are members of a Hindu Undivided Family;
  - (ii) one person is related to the other in such manner as may be prescribed [Section 79(2)].
- (3) "Bankrupt" means –
  - (a) a debtor who has been adjudged as bankrupt by a bankruptcy order under section 126;
  - (b) each of the partners of a firm, where a bankruptcy order under section 126 has been made against a firm; or
  - (c) any person adjudged as an undischarged insolvent [Section 79(3)].
- (4) "Bankruptcy" means the state of being bankrupt [Section 79(4)].
- (5) "Bankruptcy Debt", in relation to a bankrupt, means –

- (a) any debt owed by him as on the bankruptcy commencement date;
  - (b) any debt for which he may become liable after bankruptcy commencement date but before his discharge by reason of any transaction entered into before the bankruptcy commencement date; and
  - (c) any interest which is a part of the debt under section 171 [Section 79(5)].
- (6) “Bankruptcy Commencement Date” means the date on which a bankruptcy order is passed by the Adjudicating Authority under section 126 [Section 79(6)].
- (7) “Bankruptcy Order” means an order passed by an Adjudicating Authority under section 126 [Section 79(7)].
- (8) “Bankruptcy Process” means a process against a debtor under Chapters IV and V of this Part [Section 79(8)].
- (9) “Bankruptcy Trustee” means the insolvency professional appointed as a trustee for the estate of the bankrupt under section 125 [Section 79(9)].
- (10) “Committee of Creditors” means a committee constituted under section 134; [Section 79(11)].
- (11) “Debtor” includes a judgment-debtor [Section 79(12)].
- (12) “Discharge Order” means an order passed by the Adjudicating Authority discharging the debtor under sections 92, 119 and section 138, as the case may be [Section 79(13)].
- (13) “Excluded Assets” for the purposes of this part includes –
- (a) unencumbered tools, books, vehicles and other equipment as 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 and his immediate family;
  - (c) any unencumbered personal ornaments of such value, as may be prescribed, of the debtor or his immediate family which cannot be parted with, in accordance with religious usage;
  - (d) any unencumbered life insurance policy or pension plan taken in the name of debtor or his immediate family; and
  - (e) an unencumbered single dwelling unit owned by the debtor of such value as may be prescribed [Section 79(14)].
- (14) “Excluded Debt” means –
- (a) liability to pay fine imposed by a court or tribunal;
  - (b) liability to pay damages for negligence, nuisance or breach of a statutory, contractual or other legal obligation;
  - (c) liability to pay maintenance to any person under any law for the time being in force;
  - (d) liability in relation to a student loan; and
  - (e) any other debt as may be prescribed [Section 79(15)].
- (15) “Firm” means a body of individuals carrying on business in partnership whether or not registered under section 59 of the Indian Partnership Act, 1932 [Section 79(16)].

- (16) “Immediate Family” of the debtor means his spouse, dependent children and dependent parents [Section 79(17)].
- (17) “Partnership Debt” means a debt for which all the partners in a firm are jointly liable [Section 79(18)].
- (18) “Qualifying Debt” means amount due, which includes interest or any other sum due in respect of the amounts owed under any contract, by the debtor for a liquidated sum either immediately or at certain future time and does not include— (a) an excluded debt; (b) a debt to the extent it is secured; and (c) any debt which has been incurred three months prior to the date of the application for fresh start process [Section 79(19)].
- (19) “Repayment Plan” means a plan prepared by the debtor in consultation with the resolution professional under section 105 containing a proposal to the committee of creditors for restructuring of his debts or affairs [Section 79(20)].
- (20) “Resolution Professional” means an insolvency professional appointed under this part as a resolution professional for conducting the fresh start process or insolvency resolution process [Section 79(21)].
- (21) “Undischarged Bankrupt” means a bankrupt who has not received a discharge order under section 138 [Section 79(22)].

### LESSON ROUND UP

- Insolvency is the state of one whose assets are insufficient to pay his debts; or his general inability to pay his debts.
- Bankruptcy is a legal status of a person or an entity who cannot repay debts to creditors
- In England, the first bankruptcy law was enacted in 1542, being Statute 34 Henry VIII. The existing UK insolvency framework is defined by the Insolvency Act 1986.
- Insolvency in USA is dealt by Bankruptcy Code enacted by US Congress in 1978.
- The Presidency Towns Insolvency Act, 1909 and Provisional Insolvency Act, 1920 were two major enactments that deal with individual insolvency.
- Corporate insolvency in India prior to enactment of IBC 2016 was governed by plethora of legislations.
- There were multiple overlapping laws and adjudicating forums dealing with financial failure and insolvency of companies and individuals in India.
- Insolvency and Bankruptcy Code is drafted by Bankruptcy Law Reforms Committee (BLRC) constituted by the Ministry of Finance.
- The Code applies to companies, partnerships, limited liability partnerships, individuals and any other body which the central government may specify.
- The Insolvency and Bankruptcy Code, 2016 consists of total 255 sections organised in five Parts.
- Sections 3, 5 and 79 of the Insolvency and Bankruptcy Code, 2016 define important terms used in the Code.
- The National Company Law Tribunal (NCLT) shall be the Adjudicating Authority with jurisdiction over companies, limited liability entities. Appeals from the order of NCLT shall lie to the National Company Law Appellate Tribunal (NCLAT).

- The Debt Recovery Tribunal (DRT) shall be the Adjudicating Authority with jurisdiction over individuals and partnership firms. Appeals from the order of DRT shall lie to the Debt Recovery Appellate Tribunal (DRAT).
- The Code establishes an Insolvency Regulator (The Insolvency and Bankruptcy Board of India) to exercise regulatory oversight over,
  - Insolvency Professionals,
  - Insolvency Professional Agencies; and
  - Information Utilities
- An insolvency resolution process can be initiated by either a creditor, or by the debtor, upon an event of default.
- The Code cover Insolvency of individuals, unlimited liability partnerships, Limited Liability partnerships (LLPs) and companies.
- Section 3(19) of the Code defines an ‘insolvency professional’ as a person enrolled under section 206 with an insolvency professional agency as its member and registered with the Board as an insolvency professional under section 207.
- Section 3(20) of the Code defines ‘insolvency professional agency’ as any person registered with the Board under section 201 as an insolvency professional agency.
- Section 3(21) of the Code defines an ‘information utility’ as a person who is registered with the Board as an information utility under section 210.
- The Code proposes to regulate insolvency professionals and insolvency professional agencies. Under Regulator’s oversight, 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 Code proposes 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.
- The Code proposes a swift process and timeline of 180 days for dealing with applications for corporate insolvency resolution. This can be extended for 90 days by the Adjudicating Authority as only one time extension.

### SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. Briefly explain the meaning of terms ‘insolvency’ and ‘bankruptcy’. Discuss historical developments of insolvency law in India.
2. Discuss the insolvency framework in the United Kingdom and the United States of America.
3. Mentions the reasons that lead to the enactment of the Insolvency and Bankruptcy Code, 2016. State objectives of the Code.
4. What are the salient features of the Insolvency and Bankruptcy Code, 2016?

- [illegible]

# Lesson 15

## Petition for Corporate Insolvency Resolution Process

### LESSON OUTLINE

- Introduction
- Persons who may initiate the CIRP
- Application for CIRP by Financial creditor
- Insolvency resolution by operational creditor
- Insolvency resolution by corporate applicant
- Persons not entitled to make application
- Time-limit for completion of process
- Withdrawal of application
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Insolvency and Bankruptcy Code, 2016 deals with the insolvency resolution and liquidation for corporate persons. Section 4 of the Insolvency and Bankruptcy Code, 2016 provides that Part II of the Code shall apply to matters relating to the insolvency and liquidation of corporate persons.

The Corporate Insolvency Resolution Process (CIRP) can be initiated by making an application to the NCLT by the Financial Creditors under Section 7, by Operational Creditors under Section 9, and by the Corporate Debtor under Section 10 of the IBC, 2016.

The basic departure from the old law in the new Code is that a company which has gone insolvent cannot start the Liquidation process at the primary stage until and unless it has gone through the process of Corporate Insolvency Resolution Process (CIRP). Under the said resolution process options for revival of the company are looked into and if the said resolution process fails then only the company goes into liquidation.

This chapter covers basics of corporate insolvency resolution process under the Code. Persons who can initiate the process, application process, persons entitled to make application and time-limit for completing CIRP, etc.

## INTRODUCTION

Part II of the Insolvency and Bankruptcy Code, 2016 deals with the insolvency resolution and liquidation for corporate persons. Section 4 of the Insolvency and Bankruptcy Code, 2016 provides that Part II of the Code shall apply to matters relating to the insolvency and liquidation of corporate debtors where the minimum amount of the default is **one lakh rupees**. The proviso to section 4 empowers the Central Government to specify, by notification, the minimum amount of default of higher value but it shall not be more than **one crore rupees**.

Part II of the Insolvency and Bankruptcy Code, 2016 lays down the following two independent stages:

- (i) Corporate Insolvency Resolution Process [Sections 6 to 32] and
- (ii) Liquidation [Sections 33 to 54 and Section 59]

Chapter II of Part II deals with corporate insolvency resolution process while Chapter III together with Chapter V of Part II govern the liquidation process for corporate persons.

The expression “corporate insolvency resolution process” is not defined in the Insolvency and Bankruptcy Code, 2016. **The Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016** defines the expression “corporate insolvency resolution process”. According to Rule 3(1)(b), “corporate insolvency resolution process” means the insolvency resolution process for corporate persons under Chapter II of Part II of the Code.

In **corporate insolvency resolution process**, the financial creditors assess the viability of debtor's business and the options for its revival and rehabilitation. If the corporate insolvency resolution process fails or the financial creditors decide that the business of the debtor cannot be carried on in a profitable manner and it should be wound up, the debtor's business undergoes the liquidation process.

In the **liquidation process**, the assets of the debtor are realised and distributed by the liquidator in accordance with the provisions of the Insolvency and Bankruptcy Code, 2016.

Chapter II of Part II (together with Chapter VII of Part II which contains provisions relating to offences and penalties) specifically deals with corporate insolvency resolution process. The Insolvency and Bankruptcy Code, 2016 also contains a provision for **Fast Track Corporate Insolvency Resolution Process** in Chapter IV of Part II of the Code and is applicable to small corporates as defined in Section 55(2) of the Insolvency and Bankruptcy Code, 2016.

### Persons who may Initiate Corporate Insolvency Resolution Process

Section 6 of the Insolvency and Bankruptcy Code, 2016 provides that where any corporate debtor commits a default, a **financial creditor, an operational creditor or the corporate debtor itself** may initiate corporate insolvency resolution process in respect of such corporate debtor in the manner as provided under Chapter II of Part II of the Code.

Thus in case of a default, the following people are entitled to initiate a corporate insolvency resolution process:

- i) a financial creditor,
- ii) an operational creditor or
- iii) the corporate debtor itself.

The term “**default**” means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not paid by the debtor or the corporate debtor, as the case may be [Section 3(12)]. According to section 3(8), a “**corporate debtor**” means a corporate person who owes a debt to any person.



The Insolvency and Bankruptcy Code, 2016 also defines the expressions “**financial creditor**” and “**operational creditor**”. According to Section 5(7), a “financial creditor” means any person to whom a **financial debt** is owed and includes a person to whom such debt has been legally assigned or transferred to and according to section 5(20) an “operational creditor” means a person to whom an **operational debt** is owed and includes any person to whom such debt has been legally assigned or transferred.

Thus, a “financial creditor” means any person to whom a financial debt is owed and an “operational creditor” means a person to whom an operational debt is owed and both these expressions also include persons to whom such debts have been legally assigned or transferred.

The Insolvency and Bankruptcy Code, 2016 also defines the expressions “financial debt” and “operational debt” in sections 5(8) and 5(21) of the Code respectively.

According to section 5(8) of the Code, a “financial debt” means a debt along with interest, if any, which is disbursed against the consideration for the time value of money. According to section 5(8), **a financial debt includes –**

- (a) money borrowed against the payment of interest;
- (b) any amount raised by acceptance under any acceptance credit facility or its dematerialised equivalent;
- (c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument;
- (d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;
- (e) receivables sold or discounted other than any receivables sold on non-recourse basis;
- (f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing;
- (g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price and for calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;
- (h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by a bank or financial institution;
- (i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in sub-clause (a) to (h) of this clause.

The definition of “financial debt” in section 5(8) of the Code was amended *vide* **the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**. The (Second Amendment) Act of 2018 added an Explanation in sub clause (f) of section 5(8). The Explanation clarifies that for the purposes of sub-clause (f) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing. Thus, an **allottee under a real estate project** (a buyer of an under-construction residential or commercial property) will now be considered as a financial creditor, as the amount raised from allottees for financing a real estate project has the commercial effect of a borrowing.

The **Explanation** further clarifies that the expressions, “allottee” and “real estate project” shall have the meanings respectively assigned to them in clauses (d) and (zn) of section 2 of the Real Estate (Regulation and Development) Act, 2016.

The Hon’ble Supreme Court of India has upheld the above stated legal position in the matter of *Pioneer Urban Land and Infrastructure Limited & Anr. v. Union of India & Ors.* dated 09.08.2019.

The expression “**operational debt**” as defined in section 5(21) of the Code means a **claim** in respect of the provision of goods or services including employment or a **debt** in respect of the payment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority.

The Insolvency and Bankruptcy Code, 2016 provides a simple test to initiate corporate insolvency resolution process. The Code adopts a default based test for initiating the corporate insolvency resolution process. A default based test for initiating the insolvency resolution process permits early intervention when the corporate debtor shows early signs of financial distress. Early recognition of financial distress is very important for timely resolution of insolvency.

Thus, where any corporate debtor commits a default of **one lakh rupees or above** as provided under section 4 of the Code, **a financial creditor, an operational creditor or the corporate debtor itself** may initiate corporate insolvency resolution process in the manner as provided under Chapter II of Part II of the Code.

The Insolvency and Bankruptcy Code, 2016 not only permits the corporate debtor itself to initiate the insolvency resolution process once it has defaulted on a debt but also the operational creditors to initiate the insolvency resolution process. These provisions bring the law in line with international practices, which permit unsecured creditors (including employees, suppliers etc. who fall under the definition of operational creditors) to file for the initiation of insolvency resolution proceedings.

### Initiation of Corporate Insolvency Resolution Process by Financial Creditor

Section 7 of the Insolvency and Bankruptcy Code, 2016 lays down the procedure for the initiation of the corporate insolvency resolution process by **a financial creditor or two or more financial creditors jointly**.

Section 7 of the Insolvency and Bankruptcy Code, 2016 reads as follows:

- “(1) A financial creditor either by itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government may file an application for initiating corporate insolvency resolution process against a corporate debtor before the Adjudicating Authority when a default has occurred.

Provided that for the financial creditors, referred to in clauses (a) and (b) of subsection (6A) of section 21, an application for initiation corporate insolvency resolution process against the corporate debtor shall be filed jointly by not less than one hundred of such creditors in the same class or not less than ten per cent. of the total number of such creditors in the same class, whichever is less:

Provided further that for financial creditors who are allottees under a real estate project, an application for initiating corporate insolvency resolution process against the corporate debtor shall be filed jointly by not less than one hundred of such allottees under the same real estate project or not less than ten per cent. of the total number of such allottees under the same real estate project, whichever is less:

Provided also that where an application for initiating the corporate insolvency resolution process against a corporate debtor has been filed by a financial creditor referred to in the first or second provisos and has not been admitted by the Adjudicating Authority before the commencement of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019, such application shall be modified to comply with the requirements of the first or second provisos as the case may be within thirty days of the commencement of the said Ordinance, failing which the application shall be deemed to be withdrawn before its admission.

*Explanation.*– For the purposes of this sub-section, a default 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 corporate debtor.

- (2) The financial creditor shall make an application under sub-section (1) in such form and manner and accompanied with such fee as may be prescribed.
- (3) The financial creditor shall, along with the application furnish –
  - (a) record of the default recorded with the information utility or such other record or evidence of default as may be specified;
  - (b) the name of the resolution professional proposed to act as an interim resolution professional; and
  - (c) any other information as may be specified by the Board.
- (4) The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub-section (2), ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the financial creditor under sub-section (3).
- (5) Where the Adjudicating Authority is satisfied that –
  - (a) a default has occurred and the application under sub-section (2) is complete, and there is no disciplinary proceedings pending against the proposed resolution professional, it may, by order, admit such application; or
  - (b) default has not occurred or the application under sub-section (2) is incomplete or any disciplinary proceeding is pending against the proposed resolution professional, it may, by order, reject such application:

Provided that the Adjudicating Authority shall, before rejecting the application under clause (b) of sub-section (5), give a notice to the applicant to rectify the defect in his application within seven days of receipt of such notice from the Adjudicating Authority.

- (6) The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (5).
- (7) The Adjudicating Authority shall communicate –
  - (a) the order under clause (a) of sub-section (5) to the financial creditor and the corporate debtor;
  - (b) the order under clause (b) of sub-section (5) to the financial creditor,

within seven days of admission or rejection of such application, as the case may be.”

***Filing of application against a corporate debtor before the Adjudicating Authority.***– Section 7 of the Insolvency and Bankruptcy Code, 2016 lays down the procedure for the initiation of the corporate insolvency resolution process by a financial creditor. Section 7(1) of the Code provides that a financial creditor either by itself or jointly with other financial creditors, or any other person on behalf of the financial creditor, as may be notified by the Central Government may file an application for initiating corporate insolvency resolution process against a corporate debtor before the National Company Law Tribunal when a default has occurred.

The aforesaid section 7 of the Code was amended by **the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**. Originally only the financial creditors were entitled to file an application for initiating corporate insolvency resolution process against a corporate debtor but after the enactment of the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, a financial creditor or any other person on behalf of the financial creditor, as may be notified by the Central Government, may also file an application for initiating corporate insolvency resolution process against a corporate debtor before the National Company Law Tribunal when a default has occurred.

The Explanation appended to section 7(1) makes it clear that for the purposes of section 7(1), a default 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 corporate debtor. Thus, a financial creditor can file an application for corporate insolvency resolution process even if the default is in respect of debt of another financial creditor.

**Furnishing of information by the financial creditor.**— Section 7(3) of the Code mandates that the financial creditor shall, along with the application for initiating corporate insolvency resolution process, furnish **a proof of default and the name of a resolution professional** proposed to act as the interim resolution professional in respect of the corporate debtor.

The requirement to provide proof of default aims at ensuring that financial creditors do not file frivolous applications or applications which prematurely put the corporate debtor into insolvency resolution proceedings for extraneous considerations.

**Time frame for ascertaining the existence of default.**— After the filing of the application, the National Company Law Tribunal shall ascertain the existence of a default from the records of an information utility or on the basis of other evidence furnished by the financial creditor within **fourteen days** of the receipt of the application.

Provided that if the Adjudicating Authority has not ascertained the existence of default and passed an order under sub-section (5) within such time, it shall record its reasons in writing for the same. [Section 7(4)].

**Admission of application.**— If the National Company Law Tribunal is satisfied as to the existence of the default and has ensured that the application is complete and no disciplinary proceedings are pending against the proposed resolution professional, it shall admit the application [Section 7(5)]. The National Company Law Tribunal is not required to look into any other criteria for admission of the application.

**Rejection of application.**— But if the National Company Law Tribunal finds that the default has not occurred or the application is incomplete or any disciplinary proceeding is pending against the proposed resolution professional, it may reject the application under section 7(5)(b). Before rejecting the application under section 7(5)(b), the National Company Law Tribunal shall give a notice to the applicant to rectify the defect in the application within **seven days** of receipt of such notice from the National Company Law Tribunal.

**Commencement of corporate insolvency resolution process.**— Sub-section (6) provides that the corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (5) of section 7.

**Communication of Order.**— Sub-section (7) provides that the NCLT shall communicate, within **seven days** of admission or rejection of such application, as the case may be

- (a) to the financial creditor and the corporate debtor where the application is accepted,
- (b) to the financial creditor where the application is rejected.

The Central Government has made **the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016** in exercise of the powers conferred by clauses (c), (d), (e) and (f) of sub-section (1) of section 239 read with sections 7, 8, 9 and 10 of the Insolvency and Bankruptcy Code, 2016.

The Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 apply to matters relating to the corporate insolvency resolution process and has come into force with effect from 1st day of December, 2016.

### Insolvency Resolution by Operational Creditor

Section 8 of the Insolvency and Bankruptcy Code, 2016 lays down the procedure for the initiation of the corporate insolvency resolution process by an operational creditor. The procedure for insolvency resolution by operational creditor laid down in section 8 differs from the procedure applicable to financial creditors under section 7 of the Code.

The rationale for a different procedure in case of operational creditor is based on the premise that the operational debts (such as trade debts, salary or wage claims) generally tend to be of smaller amounts (in comparison to financial debts) or are recurring in nature. The possibility of disputed debts in relation to operational creditors is also higher in comparison to financial creditors such as banks and financial institutions.

Section 8 of the Code reads as follows:

- “(1) An operational creditor may, on the occurrence of a default, deliver a demand notice of unpaid operational debt copy of an invoice demanding payment of the amount involved in the default to the corporate debtor in such form and manner as may be prescribed.
- (2) The corporate debtor shall, within a period of ten days of the receipt of the demand notice or copy of the invoice mentioned in sub-section (1) bring to the notice of the operational creditor –
  - (a) existence of a dispute, if any, or record of the pendency of the suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to such dispute;
  - (b) the payment of unpaid operational debt–
    - (i) by sending an attested copy of the record of electronic transfer of the unpaid amount from the bank account of the corporate debtor; or
    - (ii) by sending an attested copy of record that the operational creditor has encashed a cheque issued by the corporate debtor.

*Explanation.*– For the purposes of this section, a “demand notice” means a notice served by an operational creditor to the corporate debtor demanding payment of the operational debt in respect of which the default has occurred.”

**Demand notice or copy of invoice demanding payment of the debt.**– Section 8 provides that in case of a default, the operational creditor has to deliver a demand notice or a copy of an invoice demanding payment of the debt in default to the corporate debtor. A “**demand notice**” means a notice served by an operational creditor to the corporate debtor demanding payment of the operational debt in respect of which the default has occurred. [Section 8(1)]

**Existence of dispute or payment of debt.**– The corporate debtor has a period of ten days from the receipt of the demand notice or invoice to inform the operational creditor of the existence of a dispute regarding the debt claim or of the payment of the debt by either sending

- (i) an attested copy of the record of electronic transfer of the unpaid amount from the bank account of the corporate debtor, or
- (ii) an attested copy of record that the operational creditor has encashed a cheque issued by the corporate debtor. [Section 8(2)]

The procedure established in section 8 of the Code ensures that operational creditors, whose debt claims are usually smaller, are not prematurely putting the corporate debtor into the insolvency resolution process or initiating the process for extraneous considerations. The procedure laid down in section 8 also facilitate informal negotiations between such creditors and the corporate debtor. Such negotiations may result in a restructuring of the debt outside the formal proceedings.

### **Application for Initiation of Corporate Insolvency Resolution Process by Operational Creditor**

Section 9 of the Code reads as follows:

- “(1) After the expiry of the period of ten days from the date of delivery of the notice or invoice demanding payment under sub-section (1) of section 8, if the operational creditor does not receive payment from the corporate debtor or notice of the dispute under subsection (2) of section 8, the operational creditor may file an application before the Adjudicating Authority for initiating a corporate insolvency resolution process.
- (2) The application under sub-section (1) shall be filed in such form and manner and accompanied with such fee as may be prescribed.
- (3) The operational creditor shall, along with the application furnish –
  - (a) a copy of the invoice demanding payment or demand notice delivered by the operational creditor to the corporate debtor;
  - (b) an affidavit to the effect that there is no notice given by the corporate debtor relating to a dispute of the unpaid operational debt;
  - (c) a copy of the certificate from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available;
  - (d) a copy of any record with information utility confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available; and
  - (e) any other proof confirming that there is no payment of any unpaid operational debt by the corporate debtor or such other information, as may be prescribed.
- (4) An operational creditor initiating a corporate insolvency resolution process under this section, may propose a resolution professional to act as an interim resolution professional.
- (5) The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub-section (2), by an order –
  - (i) admit the application and communicate such decision to the operational creditor and the corporate debtor if, –
    - (a) the application made under sub-section (2) is complete;
    - (b) there is no payment of the unpaid operational debt;
    - (c) the invoice or notice for payment to the corporate debtor has been delivered by the operational creditor;
    - (d) no notice of dispute has been received by the operational creditor or there is no record of dispute in the information utility; and
    - (e) there is no disciplinary proceeding pending against any resolution professional proposed under sub-section (4), if any.



- (ii) reject the application and communicate such decision to the operational creditor and the corporate debtor, if –
  - (a) the application made under sub-section (2) is incomplete;
  - (b) there has been payment of the unpaid operational debt;
  - (c) the creditor has not delivered the invoice or notice for payment to the corporate debtor;
  - (d) notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility; or
  - (e) any disciplinary proceeding is pending against any proposed resolution professional:

Provided that Adjudicating Authority, shall before rejecting an application under subclause (a) of clause (ii) give a notice to the applicant to rectify the defect in his application within seven days of the date of receipt of such notice from the Adjudicating Authority.

- (6) The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (5) of this section.”

**Application by operational creditor before NCLT.**– Section 9(1) of the Code provides that if the operational creditor does not receive either the payment of the debt or a notice of existence of dispute in relation to the debt claim from the corporate debtor **within a period of ten days** from the date of receipt of the invoice or demand notice under section 8, he can file an application with the National Company Law Tribunal for initiating the insolvency resolution process in accordance with section 9 of the Code.

**Furnishing of information by operational creditor.**– Section 9(3) of the Code lays down that such application by the operational creditor shall be accompanied with:

- (a) a copy of the invoice demanding payment or demand notice delivered by the operational creditor to the corporate debtor;
- (b) an affidavit to the effect that there is no notice given by the corporate debtor relating to a dispute of the unpaid operational debt;
- (c) a copy of the certificate from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available;
- (d) a copy of any record with information utility confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available; and
- (e) any other proof confirming that there is no payment of any unpaid operational debt by the corporate debtor or such other information, as may be prescribed.

Section 9(3) of the Code was amended by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018. The (Second Amendment) Act, 2018 has amended sub-clause (c) and made optional the condition of filing certificate from financial institutions maintaining accounts of operational creditor to prove non-payment of operational debt. The (Second Amendment) Act, 2018 has also added sub-clauses (d) and (e) which provide other means of proving non-payment of operational debt by the corporate debtor.

**Admission of application.**– The National Company Law Tribunal shall admit the application and communicate such decision to the operational creditor and the corporate debtor within **fourteen days** of the receipt of such application if the following conditions are fulfilled.

- (a) the application made under sub-section (2) is complete,
- (b) there is no payment of the unpaid operational debt,

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- (c) the invoice or notice for payment to the corporate debtor has been delivered by the operational creditor,
- (d) notice of dispute has not been received by the operational creditor or there is no record of dispute in the information utility, and
- (e) there is no disciplinary proceeding pending against the proposed resolution professional. [Section 9(5)(i)]

**Rejection of Application.**— The National Company Law Tribunal shall reject the application and communicate such decision to the operational creditor and the corporate debtor within fourteen days of the receipt of such application if

- (a) the application is incomplete,
- (b) there has been payment of the unpaid operational debt,
- (c) the creditor has not delivered the invoice or notice for payment to the corporate debtor,
- (d) notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility, or
- (e) any disciplinary proceeding is pending against any proposed resolution professional. [Section 9(5)(ii)]

The National Company Law Tribunal shall before rejecting an application under sub-clause (a) of clause (ii) (i.e., where the application is incomplete) give a notice to the applicant to rectify the defect in his application within **seven days of the date of receipt of such notice** from the National Company Law Tribunal.

**Commencement of corporate insolvency resolution process.**— The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (5) of section 9. [Section 9(6)]

### Initiation of corporate insolvency resolution process by corporate applicant

Section 10 of the Insolvency and Bankruptcy Code, 2016 provides for the initiation of corporate insolvency resolution process by the corporate debtor itself. Section 10 reads as follows:

- “(1) Where a corporate debtor has committed a default, a corporate applicant thereof may file an application for initiating corporate insolvency resolution process with the Adjudicating Authority.
- (2) The application under sub-section (1) shall be filed in such form, containing such particulars and in such manner and accompanied with such fee as may be prescribed.
- (3) The corporate applicant shall, along with the application, furnish—
  - (a) the information relating to its books of account and such other documents for such period as may be specified;
  - (b) the information relating to the resolution professional proposed to be appointed as an interim resolution professional; and
  - (c) the special resolution passed by shareholders of the corporate debtor or the resolution passed by at least three-fourth of the total number of partners of the corporate debtor, as the case may be, approving filing of the application.
- (4) The Adjudicating Authority shall, within a period of fourteen days of the receipt of the application, by an order—
  - (a) admit the application, if it is complete and no disciplinary proceeding is pending against the proposed resolution professional; or



- (b) reject the application, if it is incomplete or any disciplinary proceeding is pending against the proposed resolution professional:

Provided that Adjudicating Authority shall, before rejecting an application, give a notice to the applicant to rectify the defects in his application within seven days from the date of receipt of such notice from the Adjudicating Authority.

- (5) The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (4) of this section.”

**Corporate applicant.**— Section 10(1) of the Code uses the expression “corporate applicant” and not a “corporate debtor”. According to section 5(5) of the Code, a “**corporate applicant**” means –

- (a) corporate debtor; or
- (b) a member or partner of the corporate debtor who is authorised to make an application for the corporate insolvency resolution process under the constitutional document of the corporate debtor; or
- (c) an individual who is in charge of managing the operations and resources of the corporate debtor; or
- (d) a person who has the control, and supervision over the financial affairs of the corporate debtor.

**Default by corporate debtor.**— In case of a default by corporate debtor, a corporate applicant thereof may file an application for initiating corporate insolvency resolution process with the Adjudicating Authority. The authorisation of a corporate applicant to file the application for initiating corporate insolvency resolution process is based on the premise that since they are the people likely to have the best information about the financial affairs of the corporate debtor and permitting such applicants to initiate the corporate insolvency resolution process would ensure timely intervention that is crucial for any corporate insolvency resolution process to succeed.

The corporate applicant can only initiate the corporate insolvency resolution process upon the occurrence of a default and not on mere likelihood of inability to pay debts. Therefore, a corporate applicant cannot trigger the corporate insolvency resolution process prematurely to abuse the provisions of the Code. Further, as the Code envisages the displacement of the management of the corporate debtor during the insolvency resolution process (which can also be permanent, depending on the outcome of the resolution process), corporate applicants would be deterred from initiating the insolvency resolution process for extraneous considerations.

**Furnishing of information by corporate applicant.**— Under section 10(3) of the Code, the corporate applicant is required to furnish, along with such application, (a) the information relating to its books of account, (b) the information relating to the resolution proposed to be appointed as an interim resolution professional, (c) the special resolution passed by shareholders of the corporate debtor or the resolution passed by at least three-fourth of the total number of partners of the corporate debtor, as the case may be, approving filing of the application.

Sub-section (3) of section 10 of the Code was amended by **the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**. The (Second Amendment) Act, 2018 provided for the requirement of special resolution passed by the shareholders of the corporate debtor or resolution passed by at least three-fourth of the total number of partners of the corporate debtor, as the case may be, for initiation of corporate insolvency resolution process by corporate applicant. The **(Second Amendment) Act, 2018** has also amended sub-section (4) to provide that the presence or absence of pending disciplinary proceedings against the proposed resolution professional shall be a ground for acceptance or rejection of application for corporate insolvency resolution process filed by the corporate applicant.

**Originally sub-section (3) of section 10 read as follows:**

- “(3). The corporate applicant shall, along with the application furnished the information relating to –
- (a) its books of account and such other documents relating to such period as may be specified; and
  - (b) the resolution professional proposed to be appointed as an interim resolution professional.”

**Admission or rejection of application.**– The NCLT shall thereafter admit the application within **fourteen days** from the date of receipt of the application if it is complete and no disciplinary proceeding is pending against the proposed resolution professional. The NCLT shall reject the application, if it is incomplete or any disciplinary proceeding is pending against the proposed resolution professional. The NCLT shall, before rejecting an application give a notice to the applicant to rectify the defects in the application within seven days from the date of receipt of such notice from the NCLT. [Section 10(4)]

**Commencement of corporate insolvency resolution process.**– The corporate insolvency resolution process shall commence from the date of admission of the application under sub-section (4) of section 10.

**Persons Not Entitled to Make Application**

Section 11 of the Code lists out the persons who are not eligible to make an application to initiate the corporate insolvency resolution process. According to section 11, the following persons shall not be entitled to make an application to initiate corporate insolvency resolution process under Chapter II of Part II of the Insolvency and Bankruptcy Code, 2016:

- (a) a corporate debtor undergoing a corporate insolvency resolution process; or
- (b) a corporate debtor having completed corporate insolvency resolution process **twelve months** preceding the date of making of the application; or
- (c) a corporate debtor or a financial creditor who has violated any of the terms of resolution plan which was approved **twelve months** before the date of making of an application under this Chapter; or
- (d) a corporate debtor in respect of whom a liquidation order has been made.

*Explanation I.* - For the purposes of this section, a corporate debtor includes a corporate applicant in respect of such corporate debtor.

*Explanation II.* - For the purposes of this section, it is hereby clarified that nothing in this section shall prevent a corporate debtor referred to in clauses (a) to (d) from initiating corporate insolvency resolution process against another corporate debtor.

Thus, according to section 11, a corporate debtor which is undergoing a corporate insolvency resolution process (at the time of such application) or has completed a corporate insolvency resolution process in the preceding twelve months is not entitled to file an application for initiating the corporate insolvency resolution process.

Clause (a) and (b) of section 11 ensure that corporate debtors do not have **repeated recourse to the corporate insolvency resolution process** in order to delay payment of debts or to keep assets out of the reach of creditors.

Similarly, a corporate debtor or a financial creditor who has violated any of the terms of the resolution plan that was approved twelve months before making an application for initiating the process is also not entitled to make an application for initiating the corporate insolvency resolution process. Clause (c) aims at ensuring that corporate debtors or financial creditors do not abuse the corporate insolvency resolution process for extraneous considerations in addition to ensuring compliance with the terms of the resolution plan. Lastly, a corporate debtor in respect of which a liquidation order has been passed is not allowed to initiate the insolvency resolution process again. Thus clause (d) ensures finality of the liquidation order.

### Time-limit for Completion of Insolvency Resolution Process

Section 12 of the Code which prescribes a time limit for completion of insolvency resolution process reads as follows:

- “(1) Subject to sub-section (2), the corporate insolvency resolution process shall be completed within a period of one hundred and eighty days from the date of admission of the application to initiate such process.
- (2) The resolution professional shall file an application to the Adjudicating Authority to extend the period of the corporate insolvency resolution process beyond one hundred and eighty days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of sixty-six per cent. of the voting shares.
- (3) On receipt of an application under sub-section (2), if the Adjudicating Authority is satisfied that the subject matter of the case is such that corporate insolvency resolution process cannot be completed within one hundred and eighty days, it may by order extend the duration of such process beyond one hundred and eighty days by such further period as it thinks fit, but not exceeding ninety days:

Provided that any extension of the period of corporate insolvency resolution process under this section shall not be granted more than once.”

Provided further that the corporate insolvency resolution process shall mandatorily be completed within a period of three hundred and thirty days from the insolvency commencement date, including any extension of the period of corporate insolvency resolution process granted under this section and the time taken in legal proceedings in relation to such resolution process of the corporate debtor.

Provided also that where the insolvency resolution process of a corporate debtor is pending and has not been completed within the period referred to in the second proviso, such resolution process shall be completed within a period of ninety days from the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Act, 2019.

**Time limit for completion of resolution process.**– Section 12(1) lays down that subject to sub-section (2), the corporate insolvency resolution process shall be completed within a period of **one hundred and eighty days** from the date of admission of the application to initiate such process.

**Extension of time.**– Section 12(2) provides that the resolution professional shall file an application to the NCLT to extend the period of the corporate insolvency resolution process beyond one hundred and eighty days, if he is instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of **sixty-six per cent** of the voting shares.

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has amended sub-section (2) of section 12 of the Code to recalibrate voting threshold from seventy-five per cent to sixty-six per cent for extension of corporate insolvency resolution process period by committee of creditors.

On receipt of application, if the NCLT is satisfied that the subject matter of the case is such that corporate insolvency resolution process cannot be completed within **one hundred and eighty days**, it may by order extend the duration of such process beyond one hundred and eighty days by such further period as it thinks fit, but such period cannot exceed **ninety days**. [Section 12(3)]

Thus, section 12 prescribe a time limit of 180 days, extendable by a further 90 days, for the completion of corporate insolvency resolution process. The application for the extension can only be made by the resolution professional and has to be supported by a resolution passed at a meeting of the committee of creditors by a majority of 66 per cent of the **voting shares**. Any such extension of the period of corporate insolvency resolution process under section 12 shall not be granted more than once.

“Voting share” means the share of the voting rights of a single financial creditor in the committee of creditors which is based on the proportion of the financial debt owed to such financial creditor in relation to the financial debt owed by the corporate debtor. [Section 5(28)]

The well-defined time limit is aimed at ensuring that commercially unviable corporate debtors are not kept in the resolution process for long periods and are liquidated basis the decision of the financial creditors at the earliest opportunity. The time limit would not only reduce the cost to creditors and other stakeholders (including employees and workmen) of a long-drawn out procedure but also avoid any depletion in value of the corporate debtor’s business/returns to creditors and other stakeholders. This would also enable promoters of failed businesses to exit the ventures swiftly.

### Withdrawal of Application Admitted under Section 7, 9 or 10

Section 12A was added by **the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**. The newly added section 12A provides that the Adjudicating Authority may allow the withdrawal of application admitted under section 7 or section 9 or section 10, on an application made by the applicant with the approval of ninety per cent voting share of the committee of creditors, in such manner as may be specified.

Before admission of the application, however, the Adjudicating Authority may permit withdrawal of the application on the request of the applicant under Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016. Form FA given under Regulation 30A of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 is required to be filed for withdrawal of the CIRP.

### LESSON ROUND UP

- Part II of the Insolvency and Bankruptcy Code, 2016 deals with the insolvency resolution and liquidation for corporate persons.
- Section 4 of the Insolvency and Bankruptcy Code, 2016 provides that Part II of the Code shall apply to matters relating to the insolvency and liquidation of corporate debtors where the minimum amount of the default is one lakh rupees.
- Section 6 of the Insolvency and Bankruptcy Code, 2016 provides that where any corporate debtor commits a default, a financial creditor, an operational creditor or the corporate debtor itself may initiate corporate insolvency resolution process.
- A ‘financial creditor’ means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to. [Section 5(7)]
- An ‘operational creditor’ means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred. [Section 5(20)]
- Section 7 of the Insolvency and Bankruptcy Code, 2016 lays down the procedure for the initiation of the corporate insolvency resolution process by a financial creditor or two or more financial creditors jointly.
- Section 7(3) of the Code mandates that the financial creditor shall, along with the application for initiating corporate insolvency resolution process, furnish a proof of default and the name of a resolution professional proposed to act as the interim resolution professional in respect of the corporate debtor.
- Section 8 the Insolvency and Bankruptcy Code, 2016 lays down the procedure for the initiation of the corporate insolvency resolution process by an operational creditor.
- Section 10 of the Insolvency and Bankruptcy Code, 2016 provides for the initiation of corporate

insolvency resolution process by the corporate debtor itself.

- Section 11 of the Code lists out the persons who are not eligible to make an application to initiate the corporate insolvency resolution process.
- Section 12(1) lays down that subject to sub-section (2), the corporate insolvency resolution process shall be completed within a period of one hundred and eighty days from the date of admission of the application to initiate such process. It can be further extended once by a period not exceeding ninety days by NCLT.
- Section 12A provides that the Adjudicating Authority may allow the withdrawal of application admitted under sections 7, 9 or 10, on an application made by the applicant with the approval of ninety per cent voting share of the committee of creditors, in such manner as may be specified.

### SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. Who can initiate corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016? Explain in brief.
2. Briefly explain the process of initiation of corporate insolvency resolution process by a Financial Creditor under the Insolvency and Bankruptcy Code, 2016.
3. Mention the steps involved in initiation of corporate insolvency resolution process by an Operational Creditor under the Insolvency and Bankruptcy Code, 2016.
4. What do you understand by 'Corporate Applicant'? Discuss the insolvency resolution process by a Corporate Applicant under the Insolvency and Bankruptcy Code, 2016.
5. Mention the persons who are not entitled to make an application for insolvency resolution process under the Insolvency and Bankruptcy Code, 2016.
6. Whether an application once admitted under section 7, 9 or 10 of the Insolvency and Bankruptcy Code, 2016 can be withdrawn? What is the time-limit envisaged under the Code for the completion of insolvency resolution process.



# Lesson 16

## Role, Functions and Duties of Insolvency Professional, Interim Resolution Professional and Resolution Professional

### LESSON OUTLINE

- Introduction
- Enrolment and registration of IP
- Functions and Code of Conduct for IP
- Moratorium and public announcement
- Appointment and functions of Interim Resolution Professional
- Appointment and Duties of Resolution Professional
- Preparation of Information Memorandum
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

An Insolvency Professional is one who is registered with the Insolvency and Bankruptcy Board of India (IBBI). They are enrolled with an Insolvency professional Agency and they are involved in the insolvency resolution process of an insolvent individual, companies, LLPs or partnerships.

Section 208(1) of the Code provides that where any insolvency resolution, fresh start, liquidation or bankruptcy process has been initiated, it shall be the function of an insolvency professional to take such actions as may be necessary. Registration of an insolvency professional shall be subject to the condition that he shall abide by following the Code of Conduct.

Upon the admission of insolvency resolution application before it, NCLT will make a public announcement for the submission of claims by the creditors. Also, NCLT appoints the interim resolution professional and declares Moratorium. Committee of Creditors takes decisions about the viability of the company. It may either appoint the interim resolution professional as a Resolution Professional or replace the interim resolution professional with a new Resolution Professional. Resolution Professional prepares an information memorandum for formulating a Resolution Plan.

This chapter covers basics of corporate insolvency resolution process under the Code. Functions of Adjudicating Authority, Interim Resolution professional, Resolution Professional, etc.



## INTRODUCTION

An Insolvency Professional (IP) plays a very important role under the Insolvency and Bankruptcy Code, 2016. He is a significant actor in the corporate insolvency resolution process. He acts as an “Interim Resolution Professional (IRP)” and “resolution professional (RP)” in the corporate insolvency resolution process (specified in Part II of the Code which deals with corporate persons) as well as a “resolution professional” under Part III of the (which deals with Insolvency Resolution and Bankruptcy for Individuals and Partnership Firms) for conducting the fresh start process or insolvency resolution process. As an interim resolution professional, he performs various functions such as the collection of claims, the collection of information about the corporate debtor, the constitution of the committee of creditors and the interim management of the company’s affairs and monitoring of the company’s assets till a resolution professional is appointed.

An insolvency professional also acts as a liquidator in accordance with the provisions of Part II as well as a “bankruptcy trustee” for the estate of the bankrupt under section 125 in Part III of the Code.

In the corporate insolvency resolution process, the insolvency professional runs the debtor’s business during the moratorium period, verifies the claims of the creditors and constitutes a creditors committee and helps the committee of creditors in arriving at a consensus for the revival and rehabilitation of the corporate debtor’s business. In liquidation, the insolvency professional acts as a liquidator and a bankruptcy trustee. Insolvency professionals is a class of professionals having minimum standards of professional and ethical conduct and are regulated by “Insolvency Professional Agencies”.

### Definitions in the Insolvency and Bankruptcy Code, 2016:

**Section 3(19):** “Insolvency Professional” means a person enrolled under section 206 with an insolvency professional agency as its member and registered with the Board as an insolvency professional under section 207.

**Section 5(18):** “Liquidator” means an insolvency professional appointed as a liquidator in accordance with the provisions of Chapter III or Chapter V of Part II, as the case may be.

**Section 5(27):** “Resolution Professional”, for the purposes of Part II, means an insolvency professional appointed to conduct the corporate insolvency resolution process and includes an interim-resolution professional.

**Section 79(9):** “Bankruptcy Trustee” means the insolvency professional appointed as a trustee for the estate of the bankrupt under section 125.

**Section 79(21):** “Resolution Professional” means an insolvency professional appointed under Part III as a resolution professional for conducting the fresh start process or insolvency resolution process.

## Enrolment and Registration of Insolvency Professionals

**Section 206** of the Insolvency and Bankruptcy Code lays down that no person shall render his services as insolvency professional under this Code without being enrolled as a member of an insolvency professional agency and registered with the Board.

Section 207(1) further lays down that every insolvency professional shall, after obtaining the membership of any insolvency professional agency, register himself with the Board within such time, in such manner and on payment of such fee, as may be specified by regulations. Section 207(2) empowers the IBBI to specify the categories of professionals or persons possessing such qualifications and experience in the field of finance, law, management, insolvency or such other field to act as insolvency professionals.



The Insolvency and Bankruptcy Board of India has made **the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016** to regulate the working of Insolvency Professionals. These regulations are amended from time to time by the Insolvency and Bankruptcy Board of India.

### Functions and Obligations of Insolvency Professionals

Section 208(1) of the Code provides that where any insolvency resolution, fresh start, liquidation or bankruptcy process has been initiated, it shall be the function of an insolvency professional to take such actions as may be necessary, in the following matters, namely:—

- (a) a fresh start order process under Chapter II of Part III;
- (b) individual insolvency resolution process under Chapter III of Part III;
- (c) corporate insolvency resolution process under Chapter II of Part II;
- (d) individual bankruptcy process under Chapter IV of Part III; and (e) liquidation of a corporate debtor firm under Chapter III of Part II.

Section 208(2) mandates that every insolvency professional shall abide by the following code of conduct:—

- (a) to take reasonable care and diligence while performing his duties;
- (b) to comply with all requirements and terms and conditions specified in the bye-laws of the insolvency professional agency of which he is a member;
- (c) to allow the insolvency professional agency to inspect his records;
- (d) to submit a copy of the records of every proceeding before the Adjudicating Authority to the Board as well as to the insolvency professional agency of which he is a member; and
- (e) to perform his functions in such manner and subject to such conditions as may be specified.

### The Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016

The Insolvency and Bankruptcy Board of India has made the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016 in exercise of the powers conferred by sections 196, 207 and 208 read with section 240 of the Insolvency and Bankruptcy Code, 2016. These regulations came into force with effect from 29th November 2016.

The IBBI (Insolvency Professionals) Regulations, 2016 makes provisions for the examination and registration of Insolvency Professionals with the Insolvency and Bankruptcy Board of India. These regulations also make provisions for the disciplinary proceedings against the insolvency professional as well as prescribes a code of conduct for insolvency professionals.

According to **Regulation 4**, no individual shall be eligible to be registered as an insolvency professional if he -

- (a) is a **minor**;
- (b) is not a person **resident** in India;
- (c) does not have the **qualification and experience** specified in regulations 5 and 9 of the IBBI (Insolvency Professionals) Regulations, 2016;
- (d) has been convicted by any competent court for an offence punishable with imprisonment **for a term exceeding six months** or for an offence involving **moral turpitude**, and a period of **five years** has not

elapsed from the date of expiry of the sentence. Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be registered;

- (e) he is an **undischarged insolvent**, or has applied to be adjudicated as an insolvent;
- (f) he has been declared to be of **unsound mind**; or
- (g) he is not a fit and proper person.

**First Schedule** to the aforesaid regulations prescribes a **code of conduct** for insolvency professionals. According to **Regulation 7(2)(h)**, the registration of an insolvency professional shall be subject to the condition that he shall abide by the following Code of Conduct specified in the First Schedule to the Regulations:

### **Code of Conduct for Insolvency Professionals**

#### ***Integrity and objectivity***

1. An insolvency professional must maintain integrity by being honest, straightforward, and forthright in all professional relationships.
2. An insolvency professional must not misrepresent any facts or situations and should refrain from being involved in any action that would bring disrepute to the profession.
3. An insolvency professional must act with objectivity in his professional dealings by ensuring that his decisions are made without the presence of any bias, conflict of interest, coercion, or undue influence of any party, whether directly connected to the insolvency proceedings or not.
- 3A. An insolvency professional must disclose the details of any conflict of interests to the stakeholders, whenever he comes across such conflict of interest during an assignment.
4. An insolvency professional appointed as an interim resolution professional, resolution professional, liquidator, or bankruptcy trustee should not himself acquire, directly or indirectly, any of the assets of the debtor, nor knowingly permit any relative to do so.

#### ***Independence and impartiality***

5. An insolvency professional must maintain complete independence in his professional relationships and should conduct the insolvency resolution, liquidation or bankruptcy process, as the case may be, independent of external influences.
6. In cases where the insolvency professional is dealing with assets of a debtor during liquidation or bankruptcy process, he must ensure that he or his relatives do not knowingly acquire any such assets, whether directly or indirectly unless it is shown that there was no impairment of objectivity, independence or impartiality in the liquidation or bankruptcy process and the approval of the Board has been obtained in the matter.
7. An insolvency professional shall not take up an assignment under the Code if he, any of his relatives, any of the partners or directors of the insolvency professional entity of which he is a partner or director, or the insolvency professional entity of which he is a partner or director is not independent, in terms of the Regulations related to the processes under the Code, in relation to the corporate person/ debtor and its related parties. 8. An insolvency professional shall disclose the existence of any pecuniary or personal relationship with any of the stakeholders entitled to distribution under sections 53 or 178 of the Code, and the concerned corporate person/ debtor as soon as he becomes aware of it, by making a declaration of the same to the applicant, committee of creditors, and the person proposing appointment, as applicable.

- 8A. An insolvency professional shall disclose as to whether he was an employee of or has been in the panel of any financial creditor of the corporate debtor, to the committee of creditors and to the insolvency professional agency of which he is a professional member and the agency shall publish such disclosure on its website.
- 9. An insolvency professional shall not influence the decision or the work of the committee of creditors or debtor, or other stakeholders under the Code, so as to make any undue or unlawful gains for himself or his related parties, or cause any undue preference for any other persons for undue or unlawful gains and shall not adopt any illegal or improper means to achieve any mala fide objectives.

***Professional competence***

- 10. An insolvency professional must maintain and upgrade his professional knowledge and skills to render competent professional service.

***Representation of correct facts and correcting misapprehensions***

- 11. An insolvency professional must inform such persons under the Code as may be required, of a misapprehension or wrongful consideration of a fact of which he becomes aware, as soon as may be practicable.
- 12. An insolvency professional must not conceal any material information or knowingly make a misleading statement to the Board, the Adjudicating Authority or any stakeholder, as applicable.

***Timeliness***

- 13. An insolvency professional must adhere to the time limits prescribed in the Code and the rules, regulations and guidelines thereunder for insolvency resolution, liquidation or bankruptcy process, as the case may be, and must carefully plan his actions, and promptly communicate with all stakeholders involved for the timely discharge of his duties.
- 14. An insolvency professional must not act with mala fide or be negligent while performing his functions and duties under the Code.

***Information management.***

- 15. An insolvency professional must make efforts to ensure that all communication to the stakeholders, whether in the form of notices, reports, updates, directions, or clarifications, is made well in advance and in a manner which is simple, clear, and easily understood by the recipients.
- 16. An insolvency professional must ensure that he maintains written contemporaneous records for any decision taken, the reasons for taking the decision, and the information and evidence in support of such decision. This shall be maintained so as to sufficiently enable a reasonable person to take a view on the appropriateness of his decisions and actions.
- 17. An insolvency professional must not make any private communication with any of the stakeholders unless required by the Code, rules, regulations and guidelines thereunder, or orders of the Adjudicating Authority.
- 18. An insolvency professional must appear, co-operate and be available for inspections and investigations carried out by the Board, any person authorised by the Board or the insolvency professional agency with which he is enrolled.
- 19. An insolvency professional must provide all information and records as may be required by the Board or the insolvency professional agency with which he is enrolled.
- 20. An insolvency professional must be available and provide information for any periodic study, research and audit conducted by the Board.

**Confidentiality**

21. An insolvency professional must ensure that confidentiality of the information relating to the insolvency resolution process, liquidation or bankruptcy process, as the case may be, is maintained at all times. However, this shall not prevent him from disclosing any information with the consent of the relevant parties or required by law.

**Occupation, employability and restrictions**

22. An insolvency professional must refrain from accepting too many assignments, if he is unlikely to be able to devote adequate time to each of his assignments.
23. An insolvency professional must not engage in any employment when he holds a valid authorisation for assignment or when he is undertaking an assignment.
- 23A. Where an insolvency professional has conducted a corporate insolvency resolution process, he and his relatives shall not accept any employment, other than an employment secured through open competitive recruitment, with, or render professional services, other than services under the Code, to a creditor having more than ten percent voting power, the successful resolution applicant, the corporate debtor or any of their related parties, until a period of one year has elapsed from the date of his cessation from such process.
- 23B. An insolvency professional shall not engage or appoint any of his relatives or related parties, for or in connection with any work relating to any of his assignment.
- 23C. An insolvency professional shall not provide any service for or in connection with the assignment which is being undertaken by any of his relatives or related parties.

*Explanation.-* For the purpose of clauses 23A to 23C, “related party” shall have the same meaning as assigned to it in clause (24A) of section 5, but does not include an insolvency professional entity of which the insolvency professional is a partner or director.

24. An insolvency professional must not conduct business which in the opinion of the Board is inconsistent with the reputation of the profession.

**Remuneration and costs**

25. An insolvency professional must provide services for remuneration which is charged in a transparent manner, is a reasonable reflection of the work necessarily and properly undertaken, and is not inconsistent with the applicable regulations.
- 25A. An insolvency professional shall disclose the fee payable to him, the fee payable to the insolvency professional entity, and the fee payable to professionals engaged by him to the insolvency professional agency of which he is a professional member and the agency shall publish such disclosure on its website.
26. An insolvency professional shall not accept any fees or charges other than those which are disclosed to and approved by the persons fixing his remuneration.
27. An insolvency professional shall disclose all costs towards the insolvency resolution process costs, liquidation costs, or costs of the bankruptcy process, as applicable, to all relevant stakeholders, and must endeavour to ensure that such costs are not unreasonable.

**Gifts and hospitality**

28. An insolvency professional, or his relative must not accept gifts or hospitality which undermines or affects his independence as an insolvency professional.

29. An insolvency professional shall not offer gifts or hospitality or a financial or any other advantage to a public servant or any other person, intending to obtain or retain work for himself, or to obtain or retain an advantage in the conduct of profession for himself.

### Declaration of Moratorium and Public Announcement

Section 13 of the Code lists the actions that the NCLT shall take after an application for initiating the corporate insolvency resolution process has been admitted.

After admitting the application under section 7 or section 9 or section 10, the NCLT shall, by an order:

- (a) declare a **moratorium** for the purposes referred to in section 14,
- (b) cause a **public announcement** of the initiation of corporate insolvency resolution process and call for the **submission of claims** under section 15, and
- (c) appoint an **interim resolution professional** in the manner as laid down in section 16. [Section 13(1)]

According to Section 13(2), the public announcement referred to in Section 13(1)(b) shall be made immediately after the appointment of the interim resolution professional.

The Insolvency and Bankruptcy Board of India has made **the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016** to regulate the insolvency resolution process for corporate persons. These regulations are amended from time to time by the Insolvency and Bankruptcy Board of India.

### Moratorium

Section 14 describes the effect of the moratorium declared under section 13 of the Code. Section 14 reads as follows:

“(1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:

- (a) the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority;
- (b) transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;
- (c) any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);

*Explanation.*—For the purposes of this sub-section, it is hereby clarified that notwithstanding anything contained in any other law for the time being in force, a licence, permit, registration, quota, concession, clearance or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law for the time being in force, shall not be suspended or terminated on the grounds of insolvency, subject to the condition that there is no default in payment of current dues arising for the use or continuation of the license or a similar grant or right during moratorium period.

(2) The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.

(2A) Where the interim resolution professional or resolution professional, as the case may be, considers the

supply of goods or services critical to protect and preserve the value of the corporate debtor and manage the operations of such corporate debtor as a going concern, then the supply of such goods or services shall not be terminated, suspended or interrupted during the period of moratorium, except where such corporate debtor has not paid dues arising from such supply during the moratorium period or in such circumstances as may be specified.

(3) The provisions of sub-section (1) shall not apply to –

- (a) such transaction, agreements or other arrangements as may be notified by the Central Government in consultation with any financial sector regulator or any other authority;
- (b) a surety in a contract of guarantee to a corporate debtor.

(4) The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:

Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of section 31 or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.”

**Prohibition of certain acts.**– On the insolvency commencement date, the NCLT shall by order declare moratorium for prohibiting all of the following acts:

- (a) the **institution of suits or continuation of pending suits or proceedings** against the corporate debtor including **execution** of any judgement, decree or order in any court of law, tribunal, arbitration panel or other authority,
- (b) **transferring, encumbering, alienating or disposing of** by the corporate debtor any of its **assets or any legal right or beneficial interest** therein,
- (c) any **action to foreclose, recover or enforce any security interest** created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002,
- (d) the **recovery of any property by an owner or lessor** where such property is occupied by or in the possession of the corporate debtor. [Section 14(1)]

“Insolvency commencement date” means the date of admission of an application for initiating corporate insolvency resolution process by the Adjudicating Authority under sections 7, 9 or section 10, as the case may be. [Section 5(12)]

Section 5(12) of the Code was amended by **the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**. The Second Amendment Act, 2018 added a proviso to section 5(12) to clarify that where the Interim Resolution Professional (IRP) is not appointed in the order admitting application under section 7, 9 or 10, the insolvency commencement date shall be the date on which such interim resolution professional is appointed by the Adjudicating Authority.

**Supply of essential goods or services.**– The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during the moratorium period. [Section 14(2)]

Access to certain goods and services during the insolvency resolution process may be important for ensuring orderly completion of the proceedings. However, the costs for such goods or services will have to be paid in priority to other costs as part of a resolution plan or during distribution of assets, in case the corporate debtor goes into liquidation.



**Exclusion of certain acts.**— The provisions of section 14(1) shall not apply to –

- (a) such transaction as may be notified by the Central Government in consultation with any financial regulator
- (b) a surety in a contract of guarantee to a corporate debtor. [Section 14(3)]

The Central Government has been given the power to notify transactions (in consultation with the appropriate financial sector regulators), which will be exempted from the moratorium in the interest of smooth functioning of the financial markets.

Section 14(3) of the Code was substituted by **the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** to provide that the moratorium shall not apply to a surety in a contract of guarantee to a corporate debtor.

**Effect of order of moratorium.**— The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process. Provided that where at any time during the corporate insolvency resolution process period, if the NCLT approves the resolution plan under section 31(1) or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be. [Section 14(4)]

Thus, the moratorium will continue to be in effect till the completion of the corporate insolvency resolution process or the approval of a resolution plan by the adjudicating authority or passing of the order by the Adjudicating Authority for liquidation of the corporate debtor, whichever is earlier.

**Declaration of moratorium serves the following purposes:**

- Ensures that multiple proceedings are not taking place simultaneously and thus avoids the possibility of potentially conflicting outcomes of related proceedings.
- Keeps the corporate debtor's assets together during the insolvency resolution process and facilitates orderly completion of the process,
- Ensures that the company may continue as a going concern while the creditors assess the options for resolution of default.
- Prohibition on disposal of the corporate debtor's assets ensure that the corporate debtor/management does not transfer its assets, thereby stripping the corporate debtor of value during the corporate insolvency resolution process.

**Public Announcement of Corporate Insolvency Resolution Process**

Section 15 lists out the particulars that a public announcement of the initiation of the corporate insolvency resolution process for the corporate debtor shall contain. The section provides that the public announcement of the corporate insolvency resolution process shall contain the following information:

- (a) Name and address of the corporate debtor under the corporate insolvency resolution process,
- (b) Name of the authority with which the corporate debtor is incorporated or registered,
- (c) Last date for submission of claims, as may be specified,
- (d) details of the interim resolution professional who shall be vested with the management of the corporate debtor and be responsible for receiving claims,
- (e) penalties for false or misleading claims, and
- (f) date on which the corporate insolvency resolution process shall close, which shall be the one hundred and eightieth day from the date of the admission of the application under sections 7, 9 or section 10, as the case may be. [Section 15]

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** amended clause (c) of sub-section (1) of section 15 to confer power upon the Insolvency and Bankruptcy Board to specify the last date for submission of claims.

### Appointment, Tenure and Duties of Interim Resolution Professional

Section 16 provides for the appointment and term of the Interim Resolution Professional by the adjudicating authority. The section reads as follows:

“(1) The Adjudicating Authority shall appoint an interim resolution professional on the insolvency commencement date.

(2) Where the application for corporate insolvency resolution process is made by a financial creditor or the corporate debtor, as the case may be, the resolution professional, as proposed respectively in the application under section 7 or section 10, shall be appointed as the interim resolution professional, if no disciplinary proceedings are pending against him.

(3) Where the application for corporate insolvency resolution process is made by an operational creditor and-

(a) no proposal for an interim resolution professional is made, the Adjudicating Authority shall make a reference to the Board for the recommendation of an insolvency professional who may act as an interim resolution professional;

(b) a proposal for an interim resolution professional is made under sub-section (4) of section 9, the resolution professional as proposed, shall be appointed as the interim resolution professional, if no disciplinary proceedings are pending against him.

(4) The Board shall, within ten days of the receipt of a reference from the Adjudicating Authority under sub-section (3), recommend the name of an insolvency professional to the Adjudicating Authority against whom no disciplinary proceedings are pending.

(5) The term of the interim resolution professional shall continue till the date of appointment of the resolution professional under section 22.”

**Appointment of Interim Resolution Professional.**– Section 16 provides that the NCLT shall appoint an interim resolution professional within **fourteen days** from the insolvency commencement date. [Section 16(1)]

Section 16(2) provides that where the application for corporate insolvency resolution process is made by a **financial creditor or the corporate debtor**, and the name of the resolution professional is proposed, then such person shall be appointed as the interim resolution professional provided no disciplinary proceedings are pending against him.

Section 16(3) provides that where the corporate insolvency resolution process is initiated on an application by an **operational creditor** and the operational creditor proposes the name of interim resolution professional, the adjudicating authority shall appoint such professional as the interim resolution professional if no disciplinary proceedings are pending against him.

Section 16(3) further provides that if the name is not proposed by the operational creditor, then the adjudicating authority shall make a reference to the Insolvency and Bankruptcy Board of India for recommending the name of a person to be appointed as the interim resolution professional.

The Board shall recommend the name of a resolution professional who meets the criteria stipulated in Clause 16(3) within **ten days** from the receipt of the reference. [Section 16(4)]



***Tenure of Interim Resolution Professional.–***

Section 16(5) originally provides that the term of the interim resolution professional shall not exceed thirty days from date of his appointment. But this sub-section was amended by **the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**. Now the term of the interim resolution professional continues till the date of appointment of the resolution professional under section 22 of the Code.

***Duties of Interim Resolution Professional.–*** Section 18 of the Code provides that the person appointed as the Interim Resolution Professional shall perform the following duties:

- (a) collect all information relating to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor, including information relating to
  - (i) business operations for the previous two years,
  - (ii) financial and operational payments for the previous two years,
  - (iii) list of assets and liabilities as on the initiation date, and
  - (iv) such other matters as may be specified.
- (b) receive and collate all the claims submitted by creditors to him, pursuant to the public announcement made under sections 13 and 15,
- (c) constitute a committee of creditors,
- (d) monitor the assets of the corporate debtor and manage its operations until a resolution professional is appointed by the committee of creditors,
- (e) file information collected with the information utility, if necessary, and
- (f) take control and custody of any asset over which the corporate debtor has ownership rights as recorded in the balance sheet of the corporate debtor, or with information utility or the depository of securities or any other registry that records the ownership of assets including
  - (i) assets over which the corporate debtor has ownership rights which may be located in a foreign country,
  - (ii) assets that may or may not be in possession of the corporate debtor,
  - (iii) tangible assets, whether movable or immovable,
  - (iv) intangible assets including intellectual property,
  - (v) securities including shares held in any subsidiary of the corporate debtor, financial instruments, insurance policies,
  - (vi) assets subject to the determination of ownership by a court or authority
- (g) to perform such other duties as may be specified by the Board.

Section 18 also specifies **the assets that cannot be taken over**. The Explanation appended to section 18 provides that for the purposes of this section, the term “assets” shall not include the following:

- (a) assets owned by a third party in possession of the corporate debtor held under trust or under contractual arrangements including bailment;
- (b) assets of any Indian or foreign subsidiary of the corporate debtor; and
- (c) such other assets as may be notified by the Central Government in consultation with any financial sector regulator.

### Management of Affairs of Corporate Debtor by Interim Resolution Professional

**Section 17(1)** of the Code provides that from the date of appointment of the Interim Resolution Professional,

- (a) the management of the affairs of the corporate debtor shall vest in the interim resolution professional,
- (b) the powers of the board of directors or the partners of the corporate debtor, as the case may be, shall stand suspended and be exercised by the interim resolution professional,
- (c) the officers and managers of the corporate debtor shall report to the interim resolution professional and provide access to such documents and records of the corporate debtor as may be required by the interim resolution professional,
- (d) the financial institutions maintaining accounts of the corporate debtor shall act on the instructions of the interim resolution professional in relation to such accounts and furnish all information relating to the corporate debtor available with them to the interim resolution professional.

**Section 17(2)** of the Code further provides that the interim resolution professional vested with the management of the corporate debtor, shall

- (a) act and execute in the name and on behalf of the corporate debtor all deeds, receipts, and other documents, if any,
- (b) take such actions, in the manner and subject to such restrictions, as may be specified by the Board,
- (c) have the authority to access the electronic records of corporate debtor from information utility having financial information of the corporate debtor,
- (d) have the authority to access the books of accounts, records and other relevant documents of corporate debtor available with government authorities, statutory auditors, accountants and such other persons as may be specified and
- (e) be responsible for complying with the requirements under any law for the time being in force on behalf of the corporate debtor.

Thus, section 17 lists out the various powers that an interim resolution professional shall have, including the power to do all acts and execute documents in the name of the corporate debtor as these powers are important for effective discharge of his responsibilities.

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has added clause (e) in sub-section 2 of section 17 to provide that the interim resolution professional shall be responsible for complying with the statutory requirements under applicable laws while managing the affairs of the corporate debtor.

Section 17 has been inserted keeping in mind the experience of a debtor-in-possession regime under **the Sick Industrial Companies (Special Provisions) Act, 1985**. Various committee reports which had analysed the provisions of the Sick Industrial Companies (Special Provisions) Act, 1985 had highlighted the debtor-in-possession regime as one of its fatal flaws. A debtor-in-possession regime which allows the existing management to remain in possession during the resolution process gives incentives to the management to propose and implement risky rescue measures, as the costs of failure (leading to liquidation) would largely be borne by creditors.

**The Sick Industrial Companies (Special Provisions) Act, 1985** now stands **repealed** (with effect from **1st December 2016**) as the Sick Industrial Companies (Special Provisions) Repeal Act, 2003 has been notified by the Government.

### Personnel to Extend Co-operation to Interim Resolution Professional

Section 19 imposes an obligation on the personnel and promoters of the corporate debtor to extend all assistance and cooperation required by the Interim Resolution Professional in the management of the affairs

of the corporate debtor. Where the personnel of the corporate debtor or any other person required to co-operate with the interim resolution professional do not extend cooperation or assistance to the interim resolution professional, the interim resolution professional may apply to the adjudicating authority for an order. The adjudicating authority may, by order, direct the person to comply with the instructions of the interim resolution professional or to provide information to the interim resolution professional.

**“Personnel”** includes the directors, managers, key managerial personnel, designated partners and employees, if any, of the corporate debtor. [Section 5(23)]

**Personnel, promoters or any other person associated with the management** – The personnel of the corporate debtor, its promoters or any other person associated with the management of the corporate debtor shall extend all assistance and cooperation to the interim resolution professional as may be required by him in managing the affairs of the corporate debtor. [Section 19(1)]

**Application to Adjudicating Authority for necessary directions** –Where any personnel of the corporate debtor, its promoter or any other person required to assist or cooperate with the interim resolution professional does not assist or cooperate, the interim resolution professional may make an application to the Adjudicating Authority for necessary directions. [Section 19(2)]

**Order by Adjudicating Authority** – The Adjudicating Authority, on receiving an application under sub-section (2), shall by an order, direct such personnel or other person to comply with the instructions of the resolution professional and to cooperate with him in collection of information and management of the corporate debtor. [Section 19(3)]

### Management of Operations of Corporate Debtor as Going Concern

Section 20 of the Code lays down that the Interim Resolution Professional has to manage the operations of the corporate debtor as a going concern to enable him to protect and preserve the value of the property of the corporate debtor. Section 20 of the Code reads as follows:

“(1) The interim resolution professional shall make every endeavour to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern.

(2) For the purposes of sub-section (1), the interim resolution professional shall have the authority-

- (a) to appoint accountants, legal or other professionals as may be necessary;
- (b) to enter into contracts on behalf of the corporate debtor or to amend or modify the contracts or transactions which were entered into before the commencement of corporate insolvency resolution process;
- (c) to raise interim finance provided that no security interest shall be created over any encumbered property of the corporate debtor without the prior consent of the creditors whose debt is secured over such encumbered property:

Provided that no prior consent of the creditor shall be required where the value of such property is not less than the amount equivalent to twice the amount of the debt.

- (d) to issue instructions to personnel of the corporate debtor as may be necessary for keeping the corporate debtor as a going concern; and
- (e) to take all such actions as are necessary to keep the corporate debtor as a going concern.”

**Manage operations of corporate debtor as a going concern** – The interim resolution professional shall make every endeavour to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern. [Section 20(1)]

**Authority of Interim Resolution Professional** – In order to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern, the Interim Resolution Professional shall have the following authority:

- (a) to appoint accountants, legal or other professionals,
- (b) to enter into contracts on behalf of the corporate debtor or to amend or modify the contracts or transactions which were entered into before the commencement of corporate insolvency resolution process,
- (c) to raise **interim finance** provided that no security interest shall be created over any encumbered property of the corporate debtor without the prior consent of the creditors whose debt is secured over such encumbered property,
- (d) to issue instructions to personnel of the corporate debtor as may be necessary for keeping the corporate debtor as a going concern, and
- (e) to take all such actions as are necessary to keep the corporate debtor as a going concern. [Section 20(1)]

**Interim Finance** – The Interim Resolution Professional has the power to raise interim finance as well as to enter into, amend or modify contracts on behalf of the corporate debtor. Clause (c) of sub-section (2) to section 20 provides that the Interim Resolution Professional shall have the authority to raise interim finance provided that no security interest shall be created over any encumbered property of the corporate debtor without the prior consent of the creditors whose debt is secured over such encumbered property. Thus, any interim finance raised by providing security of an encumbered property of the corporate debtor will require prior permission of the concerned creditor

The proviso appended to clause (c) of sub-section (2) to section 20 clarifies that no prior consent of the creditor shall be required where the value of such property is not less than the amount equivalent to twice the amount of the debt.

- “**Interim finance**” means any financial debt raised by the resolution professional during the insolvency resolution process period [Section 5(15)]
- Amount of any interim finance and the costs incurred in raising such finance is included in the “**insolvency resolution process costs**” [Section 5(13)]
- In case the corporate debtor goes into **liquidation**, the insolvency resolution process costs which includes interim finance and the costs incurred in raising such finance are paid from the sale of the liquidation assets in **priority** during the distribution of assets [Section 53]

Section 20 of the Code makes provision for raising interim finance while managing the operations of the corporate debtor as a going concern. A company which enters the insolvency resolution proceedings finds it extremely difficult to obtain credit, as lenders are often hesitant to lend to a troubled debtor. In order to address this issue, such interim finance is treated as a part of the insolvency resolution costs and is repaid in priority to other debt as part of resolution plan. Such priority also applies in distribution of assets in case the corporate debtor goes into liquidation.

### Appointment of Resolution Professional

One of the main functions of the committee of creditors (constituted by the Interim Resolution Professional under section 21 of the Code) is the appointment of the Resolution Professional.

**Appointment of Interim Resolution Professional** – Section 22 provides that at the **first meeting** of the committee of creditors which is held within **seven days** of its constitution, the committee of creditors by a majority vote of not less than **sixty-six per cent of the voting share** of the financial creditors, may either resolve to appoint the interim resolution professional as a resolution professional or to replace the interim resolution professional by another resolution professional. [Section 22(1) and Section 22(2)]

**Communication of decision** – According to clause (a) of sub-section 3 of section 22, where the committee of creditors resolves to continue the interim resolution professional as resolution professional, it shall communicate its decision to the interim resolution professional, the corporate debtor and the Adjudicating Authority. The appointment of interim resolution professional as resolution professional will be subject to a written consent from the interim resolution professional in the specified form.

**Application before Adjudicating Authority** – In case, if the committee of creditors resolves to replace the interim resolution professional, it shall file an application before the Adjudicating Authority for the appointment of the proposed resolution professional along with a written consent from the proposed resolution professional in the specified form. [Section 22(3)(b)]

**Confirmation by Insolvency and Bankruptcy Board** – The Adjudicating Authority shall forward the name of the resolution professional proposed under clause (b) of sub-section (3) to the Board for its confirmation and shall make such appointment after confirmation by the Board. [Section 22(4)]

If the Board does not confirm the name of the proposed resolution professional within ten days of the receipt of the name of the proposed resolution professional, the Adjudicating Authority shall, by order, direct the interim resolution professional to continue to function as the resolution professional until such time as the Board confirms the appointment of the proposed resolution professional. [Section 22(5)]

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** amended section 22 of the Code to provide for reduced voting threshold of sixty-six percent in place of seventy-five percent for obtaining the approval of the committee of creditors for appointment of resolution professional. The Second Amendment Act of 2018 has also amended sub-section (3) so as to require a written consent from the interim resolution professional in specified form before his appointment.

### Eligibility for Resolution Professional

Regulation 3 of the **Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016** lays down the following eligibility criteria for a resolution professional:

- (1) An insolvency professional shall be eligible to be appointed as a resolution professional for a corporate insolvency resolution process of a corporate debtor if he, and all partners and directors of the insolvency professional entity of which he is a partner or director, are independent of the corporate debtor.

A person shall be considered independent of the corporate debtor, if he:

- (a) is eligible to be appointed as an independent director on the board of the corporate debtor under section 149 of the Companies Act, 2013, where the corporate debtor is a company;
- (b) is not a related party of the corporate debtor; or
- (c) is not an employee or proprietor or a partner:
  - (i) of a firm of auditors or secretarial auditors in practice or cost auditors of the corporate debtor; or
  - (ii) of a legal or a consulting firm, that has or had any transaction with the corporate debtor amounting to five per cent or more of the gross turnover of such firm,

in the last three financial years.

- (1A) Where the committee decides to appoint the interim resolution professional as resolution professional or replace the interim resolution professional under section 22 or replace the resolution professional under section 27, it shall obtain the written consent of the proposed resolution professional in Form AA of the Schedule.

- (2) A resolution professional shall make disclosures at the time of his appointment and thereafter in accordance with the Code of Conduct.
- (3) A resolution professional, who is a director or a partner of an insolvency professional entity, shall not continue as a resolution professional in a corporate insolvency resolution process if the insolvency professional entity or any other partner or director of such insolvency professional entity represents any of the other stakeholders in the same corporate insolvency resolution process.

### **Resolution Professional to Conduct Corporate Insolvency Resolution Process**

**Section 23** provides that the resolution professional shall be responsible for carrying out the entire corporate insolvency resolution process and managing the operations of the corporate debtor during such process. For this purpose, the resolution professional shall exercise powers and perform duties as are vested or conferred on the interim resolution professional under Chapter II of Part II of the Code.

Section 23 also provides that where the resolution professional is appointed, under sub-section (4) of section 22, by the adjudicating authority upon confirmation by the Board, the interim resolution professional shall provide all the information, documents and records pertaining to the corporate debtor in his possession and knowledge to the resolution professional.

Section 23 of the Code reads as follows:

“(1) Subject to section 27, the resolution professional shall conduct the entire corporate insolvency resolution process and manage the operations of the corporate debtor during the corporate insolvency resolution process period:

Provided that the resolution professional shall continue to manage the operations of the corporate debtor after the expiry of the corporate insolvency resolution process period, until an order approving the resolution plan under sub-section (1) of section 31 or appointing a liquidator under section 34 is passed by the Adjudicating Authority.

(2) The resolution professional shall exercise powers and perform duties as are vested or conferred on the interim resolution professional under this Chapter.

(3) In case of any appointment of a resolution professional under sub-sections (4) of section 22, the interim resolution professional shall provide all the information, documents and records pertaining to the corporate debtor in his possession and knowledge to the resolution professional.”

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** amended section 23 of the Code to provide that the resolution professional shall continue to manage the operations of the corporate debtor after the expiry of corporate insolvency resolution process period until an order has been passed by the Adjudicating Authority under section 31.

### **Duties of Resolution Professional**

Section 25 sets out the duty of resolution professional to preserve and protect the assets of the corporate debtor, including the continued business operations of the corporate debtor and lays down the functions he may perform for the same. [Section 25(1)]

Section 25(2) provides that in order to preserve and protect the assets of the corporate debtor, including the continued business operations of the corporate debtor, the resolution professional shall undertake the following actions:

- (a) take immediate custody and control of all the assets of the corporate debtor, including the business records of the corporate debtor;



- (b) represent and act on behalf of the corporate debtor with third parties, exercise rights for the benefit of the corporate debtor in judicial, quasi-judicial or arbitration proceedings,
- (c) raise **interim finances** subject to the approval of the committee of creditors under section 28,
- (d) appoint accountants, legal or other professionals in the manner as specified by Board,
- (e) maintain an updated list of claims,
- (f) convene and attend all meetings of the committee of creditors,
- (g) prepare the information memorandum in accordance with section 29,
- (h) invite prospective resolution applicants, who fulfil such criteria as may be laid down by him with the approval of committee of creditors, having regard to the complexity and scale of operations of the business of the corporate debtor and such other conditions as may be specified by the Board, to submit a resolution plan or plans.
- (i) present all resolution plans at the meetings of the committee of creditors,
- (j) file application for avoidance of transactions in accordance with Chapter III, if any, and
- (k) such other actions as may be specified by the Board.

The resolution professional is also empowered to raise **interim finance** (whether secured or unsecured), with the prior approval of the committee of creditors. The interim finance raised under this section will also be covered as part of the “**insolvency resolution process costs**”.

### Replacement of Resolution Professional by Committee of Creditors

Section 27 provides that a resolution professional may be replaced at any time during the corporate insolvency resolution process by the committee of creditors by a sixty-six percent majority of voting shares.

The power under section 27 assumes significance particularly in a corporate insolvency resolution process initiated by a corporate debtor where the corporate debtor has appointed a resolution professional of its choice. The committee of creditors have the right to replace such resolution professional if they suspect collusion between the resolution professional and corporate debtor/management.

Section 27 of the Code reads as follows:

- “(1) Where, at any time during the corporate insolvency resolution process, the committee or creditors is of the opinion that a resolution professional appointed under section 22 is required to be replaced, it may replace him with another resolution professional in the manner provided under this section.
- (2) The committee of creditors may, at a meeting, by a vote of sixty-six per cent of voting shares, resolve to replace the resolution professional appointed under section 22 with another resolution professional, subject to a written consent from the proposed resolution professional in the specified form.
- (3) The committee of creditors shall forward the name of the insolvency professional proposed by them to the Adjudicating Authority.
- (4) The Adjudicating Authority shall forward the name of the proposed resolution professional to the Board for its confirmation and a resolution professional shall be appointed in the same manner as laid down in section 16.
- (5) Where any disciplinary proceedings are pending against the proposed resolution professional under sub-section (3), the resolution professional appointed under section 22 shall continue till the appointment of another resolution professional under this section.”

### Preparation of Information Memorandum

Section 29 read with **regulation 36 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016** lays down the preparation of an information memorandum as one of the main functions of the resolution professional. An information memorandum is envisaged to be prepared in order for the resolution applicants (market participants) to provide solutions for resolving the insolvency of the corporate debtor.

**Section 29(1)** provides that the resolution professional shall prepare an information memorandum in such form and manner containing such relevant information as may be specified by the Board for formulating a resolution plan.

**Section 29(2)** further provides that the resolution professional shall provide to the **resolution applicant** access to all relevant information in physical and electronic form, provided such resolution applicant undertakes:

- (a) to comply with provisions of law for the time being in force relating to confidentiality and insider trading,
- (b) to protect any intellectual property of the corporate debtor it may have access to, and
- (c) not to share relevant information with third parties unless clauses (a) and (b) of this sub-section are complied with.

The Explanation appended to Section 29 clarifies that for the purposes of this section, “**relevant information**” means the information required by the resolution applicant to make the resolution plan for the corporate debtor, which shall include the financial position of the corporate debtor, all information related to disputes by or against the corporate debtor and any other matter pertaining to the corporate debtor as may be specified.

“Resolution applicant” means a person, who individually or jointly with any other person, submits a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25 [Section 5(25)]

### LESSON ROUND UP

- Insolvency Professional (IP) acts as an Interim Resolution Professional (IRP) and Resolution professional (RP) in the corporate insolvency resolution process.
- An insolvency professional also acts as a Liquidator in accordance with the provisions of Part II as well as a Bankruptcy Trustee for the estate of the bankrupt under section 125 in Part III of the Code.
- The Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016 regulate the working of Insolvency Professionals. These make provisions for the examination and registration of Insolvency Professionals with the Bankruptcy and Insolvency Board of India.
- These regulations also make provisions for the disciplinary proceedings against the insolvency professional as well as prescribes a code of conduct for insolvency professionals. First Schedule to the aforesaid regulations prescribes a code of conduct for insolvency professionals.
- Section 13 of the Code lists the actions that the NCLT shall take after an application for initiating the corporate insolvency resolution process has been admitted. It includes declaration of moratorium, issue of public announcement and appointment of interim resolution professional.
- Section 14 of the Code contains provisions relating to effect of Moratorium during the corporate insolvency resolution process.
- Moratorium will continue from insolvency commencement date till the completion of the corporate



insolvency resolution process or the approval of a resolution plan by the adjudicating authority or the resolution of the committee of creditors to liquidate the corporate debtor, whichever is earlier.

- Section 15 lists out the particulars that a public announcement of the initiation of the corporate insolvency resolution process for the corporate debtor shall contain.
- Section 16 provides for the appointment and term of the Interim Resolution Professional by the Adjudicating Authority. The Adjudicating Authority shall appoint an interim resolution professional within fourteen days from the insolvency commencement date.
- Section 16(5) provides that the term of the interim resolution professional shall continue till the date of appointment of the resolution professional under section 22. Section 18 provides for the duties of Interim Resolution Professional.
- Section 17 provides for the management of affairs of corporate debtor by interim resolution professional, including the power to do all acts and execute documents in the name of the corporate debtor.
- Section 20 of the Code lays down that the Interim Resolution Professional has to manage the operations of the corporate debtor as a going concern to enable him to protect and preserve the value of the property of the corporate debtor.
- Regulation 3 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 lays down the eligibility criteria for appointment of a resolution professional.
- Section 25 sets out the duty of resolution professional to preserve and protect the assets of the corporate debtor, including the continued business operations of the corporate debtor and lays down the functions he may perform for the same.
- Section 27 provides that a resolution professional may be replaced at any time during the corporate insolvency resolution process by the committee of creditors by a sixty-six percent majority of voting shares.
- Section 29 read with regulation 36 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 lays down the preparation of an information memorandum. An information memorandum is envisaged to be prepared for the resolution applicants (market participants) to provide solutions for resolving the insolvency of the corporate debtor.
- ‘Resolution applicant’ means a person, who individually or jointly with any other person, submits a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25.

### SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. Briefly mention the requirements for registration as an Insolvency Professional (IP). Also state functions and obligations of IPs.
2. Discuss the Code of Conduct for insolvency professionals under the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016.
3. What do you understand by ‘Moratorium’? Discuss its importance in corporate insolvency resolution process under the Insolvency and Bankruptcy Code, 2016.
4. Explain in brief the duties of the Interim Resolution professional under section 18 of the Insolvency and Bankruptcy Code, 2016.

5. “One of the foremost duty of the Resolution professional is to manage the operations of the corporate debtor as a going concern to protect and preserve the value of the property of the corporate debtor.” Discuss salient provisions of the Code relating to management of operations of Corporate Debtor as going concern.
6. Explain the process of appointment of Resolution Professional under section 22 of the Insolvency and Bankruptcy Code, 2016.
7. What is ‘information memorandum’? Discuss provisions relating to preparation of information memorandum as per section 29 of the Insolvency and Bankruptcy Code, 2016.

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# Lesson 17

## Resolution Strategies

### LESSON OUTLINE

- Introduction
- Debt Restructuring
- Equity Restructuring
- Acquisition in Liquidation - Sale of Assets as a going concern
- Case Laws
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

An Insolvency Resolution Plan is a unique combination of financial, legal, management and technical features which would provide a reasonable assurance of sustainable viability over the period of recovery from internal or external stresses.

IBC does not restrict the form and manner of a resolution plan. A plan could involve the purchase of the equity or assets of the corporate debtor, the infusion of additional debt, the de-merger of debtor's businesses, financial "haircuts" taken by creditors, or the extinguishment of some liabilities.

Resolution Plans submitted by Resolution Applicants are to be considered by the RP and the CoC in accordance with the process laid down under the Request for Resolution Plan and under the IBC / IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. Section 30(2)(b) of IBC provides that a resolution plan should not be in contravention of any of the provisions of the law for the time being in force. In case, the Resolution Plan drawn-up by the Resolution Applicant envisages any relief or concessions from any State/ Central Government/ Authority, it is restricted only to the extent the same is permissible under the respective laws/ statutes/ policies.

A reading of this chapter will enable the readers to know about the various measures that may be taken under a resolution plan to be filed under the CIR Process and accordingly help them understand the strategy behind the said resolution plan.

## INTRODUCTION

The legislative framework in India for insolvency and bankruptcy proceedings provides for a wide range of resolution measures, viz. re-organisation by way of a merger or amalgamation, acquisition of control and change of management, demerger, slump sale and reconstruction or financial, capital and business/ operational restructuring and as such a resolution strategy may consist of one or more of such measures and/or any measure other than the said measures. Failure to reach an understanding/resolution with the creditors under the Code could lead to liquidation of the Corporate Debtor.

Part II of the Insolvency and Bankruptcy Code, 2016 deals with the insolvency resolution and liquidation for corporate persons. Section 4 of the Insolvency and Bankruptcy Code, 2016 provides that Part II of the Code shall apply to matters relating to the insolvency and liquidation of corporate debtors where the minimum amount of the default is **one lakh rupees**. The proviso to section 4 empowers the Central Government to specify, by notification, the minimum amount of default of higher value but it shall not be more than **one crore rupees**.

Part II of the Insolvency and Bankruptcy Code, 2016 lays down the following two independent stages:

- (i) Corporate Insolvency Resolution Process [Sections 4 and 6 to 32] and
- (ii) Liquidation [Sections 33 to 54 and Section 59]

Chapter II of Part II deals with corporate insolvency resolution process while Chapter III together with Chapter V of Part II governs the liquidation process for corporate persons.

The procedure for restructuring encompasses schemes of mergers, amalgamations, demergers, transfer/ sale of assets, restructuring of capital by way of cancellation/ delisting or any other modification in share capital, and restructuring of debts by ways of satisfaction or modification of security charge/ interest as suggested in Regulation 37 of the Insolvency And Bankruptcy Board Of India (Insolvency Resolution Process For Corporate Persons) Regulations, 2016 (CIRP Regulations) by way of which the liabilities of the distressed companies can be restructured and the state of insolvency can be resolved. In the event of initiation of a Corporate Insolvency Resolution Process against the Corporate Debtor under IBC 2016, the Resolution Professional shall invite resolution plans from the prospective Resolution Applicants, subject to the compliance of the conditions as laid down under Section 30(2) of the IBC, 2016 read with Regulation 38 of the CIRP Regulations.

Issuance of securities of corporate debtor in exchange for claims/ interests (of the creditors) can be used as a tool for restructuring in the resolution plans which has also been duly recognized/provided for in restructurings suggested under Regulation 37 of the CIRP Regulations that may be submitted by the Resolution Applicants to the Resolution professional for onward consent of the Committee of Creditors and thereafter the approval of the Adjudicating Authority. The same is done to bring the debt to a sustainable level either by waiver of excess debt or conversion into equity, or a combination of both.

Apart from the above, the Asset Reconstruction Companies (ARCs) set-up under the provisions of SARFAESI Act, 2002 may also acquire the debts of the Corporate Debtor from the lending Banks/ Financial Institutions (FIs) and subsequently restructure the same in post discussions and arrangement with the corporate debtor. The provisions of SARFAESI Act, 2002 also empower the lenders/ARCs to effect a change in management as a restructuring mechanism which can be achieved by applying to become resolution applicant or partnering with resolution applicant.

Nonetheless a resolution applicant shall opt for corporate restructuring in the CD (which might be mix of different methods of operational and financial restructuring) to revive it and improve its further financial performance. The Code has not specifically defined measures of restructuring for the resolution however the resolution applicant may introduce the required measures as per the situation of the corporate debtor.

## CORPORATE RESTRUCTURING

Corporate Restructuring is an inorganic business strategy where one or more aspects of a business are redesigned to improve commercial efficiency, manage competition effectively, drive faster pace of growth, ensure effective utilization of resources, and fulfillment of stakeholders' expectations. It serves different purposes for different companies at different points of time and may take up various forms.

Restructuring typically occurs to address challenges or it can be driven by the necessity to make financial adjustments to its assets and liabilities. Mergers, amalgamations, demergers, or reconstruction of capital structure are various forms of corporate restructuring exercises. The purpose of each of these restructuring exercises may be different but each of these exercises attempts to bring in more efficiency in the system so that the distress can be addressed.

The Insolvency and Bankruptcy Board of India has made the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 to regulate the Insolvency Resolution Process for Corporate Persons. Corporate Restructuring process in India under Insolvency and Bankruptcy Code, 2016 may be governed by the provisions of the Regulation 37 of CIRP Regulations; however the Code is silent on the measures of the resolution and restructuring of the corporate debtor. **Regulation 37**, as substituted *vide* Notification No. IBBI/2017-18/GN/REG024, dated 6<sup>th</sup> February, 2018 (w.e.f. 06 February 2018), provides that:

*"A resolution plan shall provide for the measures, as may be necessary, for insolvency resolution of the corporate debtor for maximization of value of its assets including but not limited to the following:*

- (a) transfer of all or part of the assets of the corporate debtor to one or more persons;*
- (b) sale of all or part of the assets whether subject to any security interest or not*
- (ba) restructuring of the corporate debtor, by way of merger, amalgamation and demerger;*
- (c) the substantial acquisition of shares of the corporate debtor, or the merger or consolidation of the corporate debtor with one or more persons*
- (ca) cancellation or delisting of any shares of the corporate debtor, if applicable;*
- (d) satisfaction or modification of any security interest*
- (e) curing or waiving of any breach of the terms of any debt due from the corporate debtor;*
- (f) reduction in the amount payable to the creditors;*
- (h) amendment of the constitutional documents of the corporate debtor;*
- (i) issuance of securities of the corporate debtor, for cash, property, securities, or in exchange for claims or interests, or other appropriate purpose;*
- (j) change in portfolio of goods or services produced or rendered by the corporate debtor;*
- (k) change in technology used by the corporate debtor; and*
- (l) obtaining necessary approvals from the Central and State Governments and other authorities."*

The suggested measure provided in clause (ca) has been inserted by Notification No. IBBI/2018-19/GN/REG031, dated 3<sup>rd</sup> July, 2018 (w.e.f. 04.07.2018) and clause (ba) has been inserted by Notification No. IBBI/2019-20/GN/REG052, dated 27<sup>th</sup> November, 2019 (w.e.f. 28.11.2019). These insertions clearly provide that the resolution applicant can opt for necessary restructuring strategy to alter and reconstruct the corporate structure of the corporate debtor to improve the efficiency and resolve the insolvency.

## CORPORATE RESTRUCTURING

Corporate Restructuring may be broadly categorized as follows:

- External restructuring
- Internal restructuring

These categories are briefly explained below.

### **1. External Restructuring**

It consist of merger and amalgamation of one company with another or demerger of one or more undertakings of a company into another company, acquisition of controlling stake in a company through purchase of majority stake in it, conversion of debt into equity, etc. The same are briefly explained hereunder.

#### **(i) Restructuring through mergers, amalgamation and demerger**

A company is merged, amalgamated or demerged to achieve improvement in efficiency in operational and financial performance of the company. In the insolvency proceedings of a corporate debtor, the resolution plan may provide for merger, forward or reverse of the corporate debtor with the resolution applicant (company) or any of its group companies to maximize the utilization of the assets of the corporate debtor. Similarly, the resolution applicant may provide to demerge one or more units of the corporate debtor to gain operational and financial efficiency.

In case of mergers /amalgamations or demergers, the consideration is in the form of equity shares in the merged /transferee entity, which are issued to the shareholders of the merging /transferor company based on the share exchange ratio determined on the basis of valuation of equity shares of each company. The funds available in the transferee company or its cash flow for the period after the merger /amalgamation or demerger is used for meeting capital expenditure and working capital requirements of the entity which has merged or transferred and for resolving the debt of the said entity. In addition, the entity, which has merged, gets the benefit of resources of the transferee company including its brands, goodwill, managerial inputs, technology, funds, expert manpower, etc. and the same helps it to improve its profitability. The restructuring through mergers /amalgamation and demerger may, in addition, require financial and operational restructuring, in order to make an effective resolution of the insolvency of the transferor entity.

#### **(ii) Restructuring through acquisition of controlling stake/ purchase of shares**

The resolution applicant may through a resolution plan acquire the controlling stake in the corporate debtor by either reducing or cancelling its existing paid up share capital and recapitalizing it by infusing further equity capital. Alternatively the resolution applicant may acquire the existing equity share capital of the company partly or fully by making payment of some nominal consideration to the shareholders of the Corporate Debtor and for meeting the requirement of funds of the Corporate Debtor, the Resolution Applicant may infuse the funds partly in equity or partly in the form of debt or fully in the form of debt only. The management of the Corporate Debtor including its board is also changed by the Resolution Applicant by appointing his nominee directors on the board and by appointing other key managerial personnel.

The same kind of restructuring was used in acquisition of Bhushan Steel Limited (after acquisition by Tata Group, it is named as Tata Steel BSL Limited, ("TBSL") by resolution applicant Bamnipal Steel Limited (subsidiary of Tata Steel Limited). Pursuant to the Resolution Plan, Bamnipal Steel Limited subscribed to 72.65% of the equity share capital of TBSL for an aggregate amount of Rs.158.89 crore and provided additional funds aggregating to Rs.35,073.69 crore to TBSL by way of debt/convertible debt, which were utilized to repay the dues of the Corporate Debtor.

#### **(iii) Restructuring through conversion of debt for issuance of securities**

It can be understood that the insolvency of a Corporate Debtor is mainly due to default in its debt whether financial debt or operational debt where it could not fulfill its repayment obligation. The Resolution Applicant on the basis of the assessment of the Corporate Debtor, may propose the conversion of debt of the Corporate Debtor into securities of the Corporate Debtor issued in favor of the creditors thereby changing the nature and

terms of the debt. The said securities may be in the form of equity share, preference share or debentures / bonds. As a result of the said restructuring, the existing debt of the Corporate Debtor is reduced to a sustainable level by conversion of the same into equity and by waiving substantial part of the unsustainable debt.

## 2. Internal restructuring

These two restructurings can be used simultaneously as required to resolve the insolvency of a corporate debtor. Following explanation can derive the need of the two restructurings in the resolution of the Corporate Debtor:

In the insolvency proceedings, the restructuring of corporate debtor is achieved through approval of the Resolution Plan by the Adjudicating Authority subsequent to the approval by its Committee of the Creditors. The resolution plan should opt for restructuring required for the corporate debtor depending upon various factors of the corporate debtor such as nature and size of business, industry, market size and situation, the financial creditors, internal policies, business relationship with the vendors and customers, applicable laws, etc. A resolution applicant is required to analyse all these factors and prepare/ formulate the resolution plan containing the appropriate restructuring strategies to take over the corporate debtor and to resolve its insolvency. As mentioned in earlier sections, the Regulation 37 of CIRP Regulations briefly lay down the external as well as internal restructuring strategies that may be opted by the resolution applicants. The internal restructuring includes operational and financial restructuring. These are discussed in detail as follows:

### (i) Operational Restructuring

Operational Restructuring involves improving the operational efficiency of the corporate debtor so as to increase its business receipts and profitability. It may consist of creation of new departments to serve growing markets or downsizing or eliminating departments to conserve overheads. A company may undertake restructuring to focus on a particular market segment leveraging its core competencies or may undertake restructuring to make the organization lean and efficient. This type of restructuring affects employees and involves layoffs or collaboration with third parties to upgrade skills and technical know-how.

In the Corporate Insolvency Resolution Process of the corporate debtor, the resolution applicant is advised to present their strategy backed by a business plan where the Operational restructuring to be introduced by it (resolution applicant) to resolve the insolvency state of the corporate debtor. Regulation 37 also suggests different methods of the Operational restructuring to bring out the efficiency of the Corporate Debtor. Operational restructuring in the corporate debtor undergoing Corporate Insolvency Resolution Process may be made through change in portfolio of goods or services produced or rendered by it, change in technology used by it or introducing any other changes in the operational structure as may be required.

Additionally, the Regulation 38 of CIRP Regulations also advocates a detailed business plan where Regulation 38(3), which was amended, by Notification No. IBBI/2018-19/GN/REG031, dated 3rd July, 2018 (w.e.f. 04-07-2018) provides for the following:

*“A resolution plan shall demonstrate that –*

- (a) it addresses the cause of default;*
- (b) it is feasible and viable;*
- (c) it has provisions for its effective implementation;*
- (d) it has provisions for approvals required and the timeline for the same; and*
- (e) the resolution applicant has the capability to implement the resolution plan”*

It clarifies that the Resolution Plan in itself should be complete in every aspect by detailing Corporate Restructuring including operational restructuring as required, to resolve the insolvency of the corporate debtor.



It is, thus, an essential element of the Resolution Plan to provide for the future way forward for the working of the corporate debtor.

## **(ii) Financial Restructuring**

Financial restructuring is the process of reorganizing the financial structure, which primarily comprises of equity capital and debt capital. There may be several reasons (financial and non-financial) that trigger the need for financial restructuring. Financial restructuring is undertaken either because of compulsion (to recover from financial distress) or as part of company's financial strategy to achieve better financial performance.

Financial restructuring is done for various business reasons such as to overcome poor financial performance, to gain market share, or to seize emerging market opportunities. Financial restructuring undertaken to recover from financial distress involves negotiations with various stakeholders such as banks, financial institutions, creditors in order to reduce liabilities.

Corporate financial restructuring involves a considerable change in the company's financial structure and is undertaken for various business reasons such as:

- To overcome poor financial performance by reduction of debt and interest cost
- To address external competition
- To regain market share
- To seize emerging market opportunities
- Risk reduction
- Development of core competencies

The two components of financial restructuring are:

- Debt Restructuring (restructuring of the debt being secured long-term borrowing, long-term unsecured borrowings, short term borrowing)
- Equity Restructuring (alteration or reduction or conversion of capital, buy-back).

### **Debt restructuring**

Debt restructuring is the process of reorganizing the whole debt capital of the company in negotiation with bankers, creditors, vendors to the terms to favor in improving the financial performance of the company. Debt capital of the company includes secured long term borrowing, unsecured long- term borrowing, and short term borrowings. Debt restructuring involves a reduction of debt and an extension of payment term or change in terms and conditions. Debt restructuring is more commonly used as a financial tool than compared to equity restructuring.

Restructuring includes alteration of (a) repayment period, (b) repayable amount, (c) the amount of installments, (d) rate of interest; rollover of credit facilities, sanction of additional credit facility, enhancement of existing credit limits, compromise settlements etc.

The resolution plan provides for restructuring of debt of the corporate debtor by different ways which include payment of their dues. These are briefly detailed as follows:

- a. Modification in payment period, where the resolution applicant may propose for partial upfront/ immediate payment of the claims of the financial creditors and balance in a period that is acceptable to them. Presently, the financial creditors depending upon the situation of the corporate debtor may agree for such restructuring however, it is desirable by Financial Creditors to get most of the payment upfront



as their dues had not been paid/ honored by the corporate debtor for long which led to the initiation of the CIRP.

- b. Conversion of the debt in some other instrument where the resolution applicant proposes to convert the debt or part of debt in equity or some other instruments such as redeemable debentures/ preference shares or optional convertible debentures/ preference shares etc. This restructuring may provide the corporate debtor a feasible and viable manner to honor its obligations and it may provide the financial creditors a safer and faster way to get the payment of their dues. In case of insolvent companies, however, the lenders may not be interested in converting the entire amount of their debt into equity and that they insist for the payment of the settlement amount over a very short period of time say from three months to one year and in addition to the said payment they may agree for accepting some percentage of restructured equity share capital of the Corporate Debtor, so that in case the Corporate Debtor revives and starts making profits, they may offload their equity and compensate them for the loss /sacrifice they have made while settling with the Corporate Debtor.
- c. Waiver of part of the principal, interest or other charges where the resolution applicant proposes for waiver for outstanding principal, interest and other charges, which in his opinion is not sustainable. The Resolution Applicant proposes to pay the agreed settlement amount after waivers as above said over a short period of time and in addition accept some percentage of the restructured equity capital of the Corporate Debtor.
- d. Modification in security of the secured financial creditors of the corporate debtor can also be used to restructure the debt to resolve its insolvency. The securities may be offered to be disposed off / released to discharge the entire or part of the claims of the financial creditors. The resolution applicant may bring in another financial partner/ investor for infusion of funds whiles the some or the total securities held by the Financial Creditors may be released in the favor of the new investor.
- e. Modification in credit limits may also be introduced through resolution plan where the fund based and non-fund based credit facilities are restructured and the credit limits are modified based on the actual requirement of the Corporate Debtor post resolution. Continuation of the credit limits, however, depends upon the creditworthiness of the resolution applicant.
- f. *Restructuring of secured long-term borrowings* – It is undertaken for reducing the cost of capital, improving liquidity and increasing the cash flow and is effected by making the modifications conversion etc. as stated above.
- g. *Restructuring of unsecured long-term borrowing* – It depends on the type of borrowing which can be in form of public deposits, private loans (unsecured), unsecured bonds or debentures. Here also objective is to reduce the interest cost, synchronization of the cash inflow and outflow by changing existing dues and /or the repayment period etc. The said restructuring also involves modification conversion etc. as stated above.
- h. *Restructuring of short-term borrowings* – These borrowings are restructured by converting some part of them as long term, reducing interest rate and /or existing dues and also by renegotiating the existing terms.

Until recently, there had been several debt restructuring mechanisms such as Framework for Revitalizing Distressed Assets, Corporate Debt Restructuring Scheme (CDR), The Joint Lenders' Forum (JLF), Flexible Structuring of Existing Long Term Project Loans, Strategic Debt Restructuring Scheme (SDR), Change in Ownership outside SDR, and Scheme for Sustainable Structuring of Stressed Assets (S4A). These schemes, based on various circulars and guidelines issued by the Reserve Bank of India (RBI), were used as a tool for restructuring the debt of a Corporate Debtor.

In order to harmonise and simplify the framework for the resolution of stressed assets, the Reserve Bank of India (RBI), vide a circular dated 07.06.2019 has withdrawn these schemes. The Joint Lenders' Forum (JLF), an institutional mechanism for resolution of stressed accounts, also stands discontinued. Therefore, before initiating insolvency proceedings against the corporate debtor, the banks/ financial institutions are required to recourse the formal restructuring as per the guidelines issued in the circular by RBI on 07.06.2019. The framework as provided by the RBI through circular issued on 07.06.2019; provides the procedure for debt restructuring of the company to resolve the distress situation.

## Equity Restructuring

Equity Restructuring involves reorganization of equity capital. Under the provisions of the Code, the equity restructuring can be brought out by various ways, which is generally part of the greater corporate restructuring process, operational or financial or both. The same includes the following:

- Alteration of share capital
- Reduction of share capital
- Buy-back of shares

### 1. Alteration of Share Capital

- Legal Provisions
  - Section 61 to 64 read with Section 13 and 14 of the Companies Act, 2013
  - Companies (Share Capital and Debentures) Rules, 2014.
  - National Company Law Tribunal Rules, 2016

### 2. Reduction of Share Capital

- Legal Provisions
  - Section 66 of the Companies Act, 2013
  - Rule 2 to 6 of the National Company Law Tribunal (Procedure for Reduction of Share Capital of Company) Rules, 2016
  - SEBI (LODR) Regulations, 2015.

### 3. Buy-Back

- Legal Provisions
  - Companies Act, 2013
  - Companies (Share Capital and Debentures) Rules, 2014.
  - Securities and Exchange Board of India (Buy-back of Securities) Regulations, 2018.

The strategies mentioned above for restructuring can be used jointly or independently depending upon the operational and financial assessment by the resolution applicant and negotiation with the CoC. The restructuring

strategies of mergers/ amalgamations/ demergers, etc. are mostly used for the purposes of corporate restructuring and have rarely been employed as a tool for debt restructuring. It may also be noted that the schemes of mergers, amalgamations and demergers may be approved by CoC and thereafter by Adjudicating Authority (NCLT).

### ACQUISITION UNDER THE CODE: EXEMPTION FROM SEBI TAKEOVER CODE

- The acquirers of distressed companies are not under the obligation to make an open offer. The relaxation is granted with an intention to ease the additional burden on the acquirer from infusing an additional capital pursuant to acquiring the stake in the company. Moreover, in majority of the distressed companies under CIRP or where CIRP process is over, the dues of even the secured creditors have not been paid in full and as a result the liquidation value in respect of equity shareholders is Nil.
- Furthermore, the provision is envisaged to boost acquisitions of such companies.
- The acquisition of Bhushan Steel Ltd. by Tata Steel Ltd., acquisition of Electrosteel Steels Ltd. by Vedanta Resources Ltd., acquisition of Monnet Ispat & Energy Ltd. by JSW Steel Ltd. under IBC and were exempted from the open offer requirements.

### Case Law- Acquisition of Bhushan Steel Ltd. by Tata Steel Ltd. upheld by Hon'ble NCLAT

The acquisition of Bhushan Steel Ltd (BSL) for ₹35,200 crore by Barnipal Steel Ltd (BNL) a subsidiary of Tata Steel Ltd. in May 2018, has been the first major case of acquisition of a major stressed asset under the Insolvency and Bankruptcy Code. BNL completed the acquisition of controlling stake of 72.65 per cent in BSL in accordance with the approved resolution plan under the Corporate Insolvency Resolution Process (CIRP) of the IBC. Tata Steel has paid Rs.35,200 crore in cash to acquire Bhushan Steel. It would pay another Rs.1,200 crore over next 12 months to operational creditors.

The promoters of BSL approached the National Company Law Appellate Tribunal (NCLAT) over issue of ineligibility of Tata Steel to acquire BSL. L&T, an operational creditor also approached the Hon'ble NCLAT over issue of unfair distribution of settlement amount for its claim under the provisions of IBC, 2016.

NCLAT upheld the acquisition of Bhushan Steel, rejecting allegations of its ineligibility by the promoters of the company. The NCLAT also rejected the claims of L&T, an operational creditor of Bhushan Steel Ltd, opposing Tata Steel's resolution plan seeking a higher priority in debt settlement.

The NCLAT said that Tata Steel UK, a foreign subsidiary of Tata Steel, which was fined by an English Court in February 2018 under UK Act, had a provision of 'imprisonment for a term not exceeding twelve months, or a fine, or both'. While, the provision in section 29A(d) of the Code, which deals with eligibility, stipulates "has been convicted for any offence punishable with imprisonment for two years or more", cannot be equated with Section 33(1)(a) of the U.K Act, said NCLAT. Section 29A of the IBC mandates that a person convicted for any offence punishable with imprisonment for two years or more is ineligible for submitting a resolution plan.

Over the claims of L&T, which had supplied goods and machineries over Rs.900 crore, NCLAT said that Tata Steel's resolution plan was fair towards operational creditors of Bhushan Steel which has a total demand of Rs.1,422 crore. The NCLAT observed that the company has allotted Rs.1,200 crore for them and L&T plea for a higher priority could not be accepted.

Moreover, it also declined the plea of the promoters family, contending Tata Steel's Resolution Plan' was illegal as it purports to transfer shares' of the 'preference shareholders' of Bhushan Steel without their consent for a fixed consideration of Rs.100 as against Rs.2,269 crore.

### RESOLUTION MEASURES UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

As stated earlier, the Insolvency and Bankruptcy Code, 2016 read with Regulation 37 of CIRP Regulations

provide for various measures to resolve the insolvency of the Corporate Debtor. These measures are detailed as follows:

➤ ***Transfer of all or part of the assets of the corporate debtor to one or more persons:***

The Resolution Applicant may acquire part of the assets and may opt to transfer some assets to one or more persons in order to fetch a better value towards the resolution of the Corporate Debtor. The consideration towards the said assets is utilized to repay the dues of Corporate Debtor to its creditors.

➤ ***Sale of all or part of the assets whether subject to any security interest or not:***

The Resolution Applicant, as its resolution strategy, may provide for sale of the assets of the Corporate Debtor in full or in part whether subject to any security interest or not. For example, if the Corporate Debtor holds assets which may be subject to the security interest and which may bring benefit to the Corporate Debtor on their sale (through sale of all or part of assets), the Resolution Applicant may provide for sale of such assets and provide for settlement of debt of the Corporate Debtor or infusion for improvement of operations of the Corporate Debtor or for activity of any other similar nature through the funds as realized from sale of such assets.

➤ ***Restructuring of the corporate debtor, by way of merger, amalgamation and demerger***

As discussed earlier, the Resolution Plan may also provide for merger/amalgamation/demerger or combination of such arrangements in order to resolve the Corporate Debtor, as best suited to it.

➤ ***The substantial acquisition of shares of the corporate debtor, or the merger or consolidation of the corporate debtor with one or more persons***

The Resolution Applicant may provide for the substantial acquisition of the shares of the Corporate Debtor or the merger or consolidation with one or more persons as may be beneficial to the Corporate Debtor to fetch the maximized value of its assets and resolve the state of insolvency.

➤ ***Cancellation or delisting of any shares of the corporate debtor, if applicable***

Equity restructuring by cancellation or reduction or delisting of shares of the Corporate Debtor may be quite useful in resolution of the Corporate Debtor as the same may save the RA from time consuming transfer procedures and other problems.

➤ ***Satisfaction or modification of any security interest***

The Resolution Applicant may also satisfy or modify any of the security interest(s) as held by the Financial Creditor(s) as part of the debt restructuring.

➤ ***Curing or waiving of any breach of the terms of any debt due from the corporate debtor:***

The Corporate Debtor may suffer from breach(es) of terms of the debt owed by it to the creditors which may play a vital role in the process of its acquisition by the Resolution Applicant. Thus, the Resolution Applicant in order to acquire the Corporate Debtor free from past breaches, non-compliances which may create problems in the future, as per its due diligence, may provide for cure of such breach(es) or may provide for waiver of such breach(es).

➤ ***Reduction in the amount payable to the creditors***

The Resolution applicant as part of the debt restructuring may provide for settlement of the debt of the creditors at a price lower than their dues/ claims since the payment of the entire dues/claims of the creditors may not be feasible and viable for the Resolution Applicant in order to acquire the Corporate Debtor and resolve its insolvency.

➤ ***Extension of a maturity date or a change in interest rate or other terms of a debt due from the corporate debtor***

The Debt Restructuring, as designed/ formulated by the Resolution Applicant for the Corporate Debtor (As a part of the Resolution Plan), may provide for the extension of maturity date or change in the interest rate or other terms of the debt due from the Corporate Debtor.

➤ ***Amendment of the constitutional documents of the corporate debtor***

Resolution Applicant, as part of the corporate restructuring may require the amendments in terms of the constitutional documents of the Corporate Debtor, Memorandum of Association and Articles of the Association which inter-alia other things, define the powers and duties of the members and Board of Directors of the Company. The amendments of the constitutional documents of the Corporate Debtor can aid the Resolution Applicant in process of acquisition of the Corporate Debtor and implementation of the Resolution Plan effectively.

➤ ***Issuance of securities of the corporate debtor, for cash, property, securities, or in exchange for claims or interests, or other appropriate purpose***

The Resolution Plan by the resolution applicant may provide for the issuance of the securities including shares or debentures of the Corporate Debtor in lieu of cash, property, securities or in exchange for the claims/ interests or other appropriate purpose. The resolution applicant may provide for issuance of securities of the Corporate Debtor to itself for the funds it might bring in, for the property it might bring in and may provide for issuance of the securities to creditors in conversion of their debt/ claims in full or in part as consideration to them or for any other appropriate purpose as may be beneficial or helpful in resolution of the Corporate Debtor.

➤ ***Change in portfolio of goods or services produced or rendered by the corporate debtor***

For operational/ organizational restructuring, the Resolution applicant may provide for change in portfolio of goods or services produced or rendered by the Corporate Debtor which may or may not be part of its current portfolio.

➤ ***Change in technology used by the corporate debtor***

The resolution applicant, may provide for the change in technology or process used by the Corporate Debtor for the resolution of insolvency of the Corporate Debtor as there may be case that the Corporate Debtor may be suffering from obsolete technologies or process.

➤ ***Obtaining necessary approvals from the Central and State Governments and other authorities***

The Resolution Applicant, if required, would provide for obtaining the necessary approvals (on basis of current processes/ goods/ services of the Corporate Debtor or on the basis of the future operational processes/goods/ services of the Corporate Debtor as required under the Resolution Plan) from the Central and State Government and other authorities.

## **ACQUISITION OF CORPORATE DEBTOR UNDER LIQUIDATION THROUGH SALE OF ASSETS AS A GOING CONCERN**

Chapter VI (comprising regulations 32 to 40) of the **IBBI (Liquidation Process) Regulations, 2016** makes the following provisions for the realization of assets. The IBBI has inserted Regulation 32A in the **IBBI (Liquidation Process) Regulations, 2016** to provide for methods to sale of assets as a going concern as a resolution measure for the CD.

### **Regulation 32A of IBBI (Liquidation Process) Regulations, 2016**

Regulation 32A states as follows:

(1) Where the committee of creditors has recommended sale under clause (e) or (f) of regulation 32 or where

the liquidator is of the opinion that sale under clause (e) or (f) of regulation 32 shall maximise the value of the corporate debtor, he shall endeavour to first sell under the said clauses.

(2) For the purpose of sale under sub-regulation (1), the group of assets and liabilities of the corporate debtor, as identified by the committee of creditors under sub-regulation (2) of regulation 39C of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 shall be sold as a going concern.

(3) Where the committee of creditors has not identified the assets and liabilities under sub-regulation (2) of regulation 39C of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, the liquidator shall identify and group the assets and liabilities to be sold as a going concern, in consultation with the consultation committee.

(4) If the liquidator is unable to sell the corporate debtor or its business under clause (e) or (f) of regulation 32 within ninety days from the liquidation commencement date, he shall proceed to sell the assets of the corporate debtor under clauses (a) to (d) of regulation 32.”

Regulation 32 of Liquidation Regulations provides as below:

“The liquidator may sell

- (a) an asset on a standalone basis;
- (b) the assets in a slump sale;
- (c) a set of assets collectively;
- (d) the assets in parcels;
- (e) the corporate debtor as a going concern; or
- (f) the business(s) of the corporate debtor as a going concern:

Provided that where an asset is subject to security interest, it shall not be sold under any of the clauses (a) to (f) unless the security interest therein has been relinquished to the liquidation estate.”

## Case Laws

### Case 1

In the matter of *Y. Shivram Prasad & Ors. v. S. Dhanapal & Ors.*, the NCLAT passed the impugned order of liquidation as Committee of Creditors did not find any resolution plan viable and feasible. The promoters submitted that they should have been given an opportunity to settle the dues. While rejecting the said submission, the NCLAT clarified that settlement can be made only at three stages, i.e., before admission, before constitution of CoC and in terms of section 12A of the Code and such stages were over in this instant matter. It, however, observed that during the liquidation process, it is necessary to take steps for revival and continuance of the Corporate Debtor by protecting it from its management and from a death by liquidation.

Wherein this Appellate Tribunal having noticed the decision of the Hon'ble Supreme Court in *“Swiss Ribbon Pvt. Ltd. & Anr. v. Union of India & Ors. (Supra)”* and *“Meghal Homes Pvt. Ltd.”* observed and referring to the matter of *“Swiss Ribbon Pvt. Ltd. & Anr. v. Union of India & Ors. (Supra)”* where Hon'ble Supreme Court observed that *“What is interesting to note is that the Preamble does not, in any manner, refer to liquidation, which is only availed of as a last resort if there is either no resolution plan or the resolution plans submitted are not up to the mark. Even in liquidation, the liquidator can sell the business of the corporate debtor as a going concern”* and NCLAT in its matter further held that *“in view of the provision of Section 230 and the decision of the Hon'ble Supreme Court in ‘Meghal Homes Pvt. Ltd.’ and ‘Swiss Ribbons Pvt. Ltd.’, we direct the ‘Liquidator’ to proceed in accordance with law. He will verify claims of all the creditors; take into custody and control of*



all the assets, property, effects and actionable claims of the 'corporate debtor', carry on the business of the 'corporate debtor' for its beneficial liquidation, etc. as prescribed under Section 35 of the Code. If the members or the 'Corporate Debtor' or the 'creditors' or a class of creditors like 'Financial Creditor' or 'Operational Creditor' approach the company through the liquidator for compromise or arrangement by making proposal of payment to all the creditor(s), the Liquidator on behalf of the company will move an application under Section 230 of the Companies Act, 2013 before the Adjudicating Authority i.e. National Company Law Tribunal, Chennai Bench, in terms of the observations as made in above. On failure, as observed above, steps should be taken for outright sale of the 'Corporate Debtor' so as to enable the employees to continue".

## Case 2

In the matter of *Edelweiss Asset Reconstruction Company Ltd. v. Bharati Defence and Infrastructure Ltd.*, the Resolution professional (RP) filed an application seeking approval of the resolution plan submitted by an Resolution Applicant, who is a Financial Creditor with 82.7% voting share in the CoC. The plan provided that the Resolution Applicant will sell the Corporate Debtor in two years. NCLT, Mumbai Bench noted that the plan does not give due consideration to the interest of all stakeholders, seeks several exemptions, and contains a lot of uncertainties and speculations. It provides for generation of income from ongoing operations and no upfront money is brought in by the Resolution Applicant. The NCLT Bench also noted that the Resolution Applicant has proposed to hold majority equity in the Corporate Debtor, run its operations, enhance its value and over a period endeavour to find a suitable investor/buyer for the same. Relying on the judgement in the matter of Binani Industries Limited, the NCLT Bench observed:

".....resolution plan is for insolvency resolution of the Corporate Debtor as a going concern and not for the addition of value and intended to sale the Corporate Debtor". It observed that Resolution Applicant is essentially extending the CIRP period to find an investor, which is not the intention of the legislature. It further observed: "If the ultimate object in the resolution plan is to sell the company, then it can be achieved by sale as a going concern during the liquidation process". Accordingly, it rejected the resolution plan and ordered for liquidation.

## LESSON ROUND UP

- Corporate restructuring may be broadly categorized as external restructuring and internal restructuring. External restructuring consists of mergers, amalgamation, acquisition of controlling stake, conversion of debt into equity and internal restructuring consists of operational and financial restructuring.
- The two components of financial restructuring are debt restructuring (restructuring of the secured long-term borrowing, long-term unsecured borrowings, short-term borrowing) and equity restructuring (alteration or reduction of capital, buy-back).
- Debt restructuring is the process of reorganizing the whole debt capital of the company in negotiation with bankers, creditors, vendors. Debt restructuring involves a reduction of debt and an extension of payment terms or change in terms and conditions.
- Regulation 37 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 provides that a resolution plan shall provide for the measures, as may be necessary, for insolvency resolution of the corporate debtor for maximization of value of its assets.
- Equity Restructuring involves reorganization of equity capital, which includes Alteration of share capital, Reduction of share capital and Buy-back of shares.



## SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation)*

1. Discuss the resolution strategies available for insolvency resolution of the corporate debtor under the Insolvency and Bankruptcy Code, 2016.
2. Mention the advantages and disadvantages of debt restructuring and equity restructuring.
3. Mention the measures that a resolution plan shall provide for insolvency resolution of the corporate debtor for maximization of value of its assets under Regulation 37 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

[illegible]

# Lesson 18

## Convening and Conduct of Meetings of Committee of Creditors

### LESSON OUTLINE

- Committee of Creditors
- Committee with only operational creditors
- Meetings of Committee of Creditors
- Rights and Duties of Authorised Representative of Financial Creditors
- Approval of Committee of Creditors for Certain Actions
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

‘Committee of Creditors’ consists of the financial creditors of the Corporate Debtor. This Committee forms the decision making body of the various routine tasks involved in Corporate Insolvency Resolution Process (CIRP), responsible for giving approval to the IRP/ RP to carry out actions that might affect the CIRP.

Section 24 of the Code contains provisions relating to the meetings of the Committee. The members of the committee of creditors may meet in person or by such electronic means as may be specified. All meetings of the committee of creditors shall be conducted by the resolution professional.

Committee of Creditors takes decisions about the viability of the company. It may either appoint the interim resolution professional as a Resolution Professional or replace the interim resolution professional with a new Resolution Professional. Resolution Professional prepares an information memorandum for formulating a Resolution Plan.

Committee approves/ rejects the Resolution Plan, extension of CIRP, decides upon liquidation of the Corporate Debtor, ratifies expenses borne by the RP etc. In short, all decisions having an impact on the Corporate Debtor shall first be approved by the Committee.

This chapter covers basics of the constitution of Committee of Creditors, its meetings and approvals required from committee, etc.

## COMMITTEE OF CREDITORS

Section 21 and 24 of the Insolvency and Bankruptcy Code, 2016 make provisions relating to the committee of creditors. Section 21 deals with the **constitution** of committee of creditors while section 24 prescribes the **modalities for the meeting** of the committee of creditors.

**Section 28** of the Code lists out certain actions that may be taken by the resolution professional only with the prior approval of the committee of creditors by a vote of **66 per cent** of the voting shares.

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has added a new section 25A to provide for **rights and duties of authorised representative** of financial creditors.

The Insolvency and Bankruptcy Board of India has made the **Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016** in exercise of the powers conferred under sections 5, 7, 9, 14, 15, 17, 18, 21, 24, 25, 29, 30, 196 and 208 read with section 240 of the Insolvency and Bankruptcy Code, 2016. These regulations make detailed provisions for effectively regulating the Insolvency Resolution Process for Corporate Persons and are amended from time to time by the Insolvency and Bankruptcy Board of India.

Section 21 of the Code provides as follows:

“(1) The interim resolution professional shall after collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a committee of creditors.

(2) The committee of creditors shall comprise all financial creditors of the corporate debtor:

Provided that a financial creditor or the authorised representative of the financial creditor referred to in sub-section (6) or sub-section (6A) or sub-section (5) of section 24, if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors:

Provided further that the first proviso shall not apply to a financial creditor, regulated by a financial sector regulator, if it is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares, prior to the insolvency commencement date.

(3) Subject to sub-sections (6) and (6A), where the corporate debtor owes financial debts to two or more financial creditors as part of a consortium or agreement, each such financial creditor shall be part of the committee of creditors and their voting share shall be determined on the basis of the financial debts owed to them.

(4) Where any person is a financial creditor as well as an operational creditor,

(a) such person shall be a financial creditor to the extent of the financial debt owed by the corporate debtor, and shall be included in the committee of creditors, with voting share proportionate to the extent of financial debts owed to such creditor;

(b) such person shall be considered to be an operational creditor to the extent of the operational debt owed by the corporate debtor to such creditor.

(5) Where an operational creditor has assigned or legally transferred any operational debt to a financial creditor, the assignee or transferee shall be considered as an operational creditor to the extent of such assignment or legal transfer.

(6) Where the terms of the financial debt extended as part of a consortium arrangement or syndicated facility provide for a single trustee or agent to act for all financial creditors, each financial creditor may

- (a) authorise the trustee or agent to act on his behalf in the committee of creditors to the extent of his voting share;
- (b) represent himself in the committee of creditors to the extent of his voting share;
- (c) appoint an insolvency professional (other than the resolution professional) at his own cost to represent himself in the committee of creditors to the extent of his voting share; or
- (d) exercise his right to vote to the extent of his voting share with one or more financial creditors jointly or severally.

(6A) Where a financial debt –

- (a) is in the form of securities or deposits and the terms of the financial debt provide for appointment of a trustee or agent to act as authorised representative for all the financial creditors, such trustee or agent shall act on behalf of such financial creditors;
- (b) is owed to a class of creditors exceeding the number as may be specified, other than the creditors covered under clause (a) or sub-section (6), the interim resolution professional shall make an application to the Adjudicating Authority along with the list of all financial creditors, containing the name of an insolvency professional, other than the interim resolution professional, to act as their authorised representative who shall be appointed by the Adjudicating Authority prior to the first meeting of the committee of creditors;
- (c) is represented by a guardian, executor or administrator, such person shall act as authorised representative on behalf of such financial creditors,

and such authorised representative under clause (a) or clause (b) or clause (c) shall attend the meetings of the committee of creditors, and vote on behalf of each financial creditor to the extent of his voting share.

(6B) The remuneration payable to the authorised representative-

- (i) under clauses (a) and (c) of sub-section (6A), if any, shall be as per the terms of the financial debt or the relevant documentation; and
- (ii) under clause (b) of sub-section (6A) shall be as specified which shall be form part of the insolvency resolution process costs.

(7) The Board may specify the manner of voting and the determining of the voting share in respect of financial debts covered under sub-sections (6) and (6A).

(8) Save as otherwise provided in this Code, all decisions of the committee of creditors shall be taken by a vote of not less than fifty-one per cent. of voting share of the financial creditors:

Provided that where a corporate debtor does not have any financial creditors, the committee of creditors shall be constituted and shall comprise of such persons to exercise such functions in such manner as may be specified.

(9) The committee of creditors shall have the right to require the resolution professional to furnish any financial information in relation to the corporate debtor at any time during the corporate insolvency resolution process.

(10) The resolution professional shall make available any financial information so required by the committee of creditors under sub-section (9) within a period of seven days of such requisition.”

**Constitution of committee of creditors –** Section 18 of the Code which lists out the duties of Interim Resolution Professional specifically provides that the Interim Resolution Professional shall collect all information relating

to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor as well as receive and collate all the claims submitted by creditors to him, pursuant to the public announcement made under sections 13 and 15 of the Code.

**Section 21(1)** further provides that the Interim Resolution Professional shall after collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a committee of creditors.

According to section 3(6), a “**claim**” means –

- (a) a right to payment, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured, or unsecured;
- (b) right to remedy for breach of contract under any law for the time being in force, if such breach gives rise to a right to payment, whether or not such right is reduced to judgment, fixed, matured, unmatured, disputed, undisputed, secured or unsecured.

**Composition of committee of creditors** –Section 21(2) provides that the committee of creditors shall comprise all financial creditors of the corporate debtor.

According to section 5(7) of the Code, a “financial creditor” means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to.

**Exclusion of related party** –First proviso to section 21(2) provides that a financial creditor or the authorised representative of the financial creditor, if it is a related party of the corporate debtor, shall not have any **right of representation, participation or voting** in a meeting of the committee of creditors.

According to section 5(24), a “**related party**”, in relation to a corporate debtor, means-

- (a) a director or partner of the corporate debtor or a relative of a director or partner of the corporate debtor;
- (b) a key managerial personnel of the corporate debtor or a relative of a key managerial personnel of the corporate debtor;
- (c) a limited liability partnership or a partnership firm in which a director, partner, or manager of the corporate debtor or his relative is a partner;
- (d) a private company in which a director, partner or manager of the corporate debtor is a director and holds along with his relatives, more than two per cent. of its share capital;
- (e) a public company in which a director, partner or manager of the corporate debtor is a director and holds along with relatives, more than two per cent. of its paid- up share capital;
- (f) anybody corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;
- (g) any limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;
- (h) any person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;

- (i) a body corporate which is a holding, subsidiary or an associate company of the corporate debtor, or a subsidiary of a holding company to which the corporate debtor is a subsidiary;
- (j) any person who controls more than twenty per cent. of voting rights in the corporate debtor on account of ownership or a voting agreement;
- (k) any person in whom the corporate debtor controls more than twenty per cent. of voting rights on account of ownership or a voting agreement;
- (l) any person who can control the composition of the board of directors or corresponding governing body of the corporate debtor;
- (m) any person who is associated with the corporate debtor on account of-
  - (i) participation in policy making processes of the corporate debtor; or
  - (ii) having more than two directors in common between the corporate debtor and such person; or
  - (iii) interchange of managerial personnel between the corporate debtor and such person; or
  - (iv) provision of essential technical information to, or from, the corporate debtor.

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** also added second proviso to section 21(2) which clarifies that the first proviso shall not apply to a financial creditor, regulated by a financial sector regulator, if it is a related party of the corporate debtor solely on account of conversion or substitution of debt into **equity shares** or instruments convertible into equity shares, **prior to the insolvency commencement date**.

According to section 3(18) of the Code, a “**financial sector regulator**” means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government.

The committee of creditors is composed of financial creditors of the corporate debtor as the financial creditors have the capability to assess the commercial viability of the corporate debtor and are willing to modify the terms of the debt contracts in negotiations between the creditors and the corporate debtor.

Hon’ble Supreme Court has in the matter of *Swiss Ribbon Pvt. Ltd. & Anr. Vs. Union of India & Ors.* (date of judgment 25.01.2019) held that the classification under IBC between financial creditors and operational creditors is based on an intelligible criteria and is neither discriminatory nor arbitrary nor violative of Article 14 of Constitution of India;

Operational creditors, on the other hand, are not equipped to decide on matters relating to commercial viability of the corporate debtor, nor are they generally willing to take the risk of restructuring their debts in order to ensure the management of operations of corporate debtor a going concern.

**Where a person is both financial as well as operational creditor** – Section 21(4) provides that where any person is a financial creditor as well as an operational creditor, then such person shall be considered a financial creditor to the extent of the financial debt owed by the corporate debtor. Such person shall be included in the committee of creditors and shall have a **voting share** proportionate to the extent of financial debts owed to such creditor.

Thus, financial creditors who are also operational creditors are given representation on the committee of creditors only to the extent of their financial debts.

Clause (b) of sub-section (4) of section 21 clarifies that such person shall be considered to be an operational creditor to the extent of the operational debt owed by the corporate debtor to such creditor.

According to section 5(28), “**voting share**” means the share of the voting rights of a single financial creditor in the committee of creditors which is based on the proportion of the financial debt owed to such financial creditor in relation to the financial debt owed by the corporate debtor.

**Assignment or legal transfer of operational debt** – Section 21(5) further provides that where an operational creditor has assigned or legally transferred any operational debt to a financial creditor, the assignee or transferee shall be considered as an operational creditor to the extent of such assignment or legal transfer.

**Financial debts to two or more financial creditors as part of consortium or agreement** – Section 21(3) provides that subject to sub-sections (6) and (6A), where the corporate debtor owes financial debts to two or more financial creditors as part of a consortium or agreement, each such financial creditor shall be part of the committee of creditors and their voting share shall be determined on the basis of the financial debts owed to them.

**A single trustee or agent to act for all financial creditors** – Section 21(6) of the Code provides that where the terms of the financial debt extended as part of a consortium arrangement or syndicated facility provide for a single trustee or agent to act for all financial creditors, each financial creditor may

- (a) authorise the trustee or agent to act on his behalf in the committee of creditors to the extent of his voting share;
- (b) represent himself in the committee of creditors to the extent of his voting share;
- (c) appoint an insolvency professional (other than the resolution professional) at his own cost to represent himself in the committee of creditors to the extent of his voting share; or
- (d) exercise his right to vote to the extent of his voting share with one or more financial creditors jointly or severally.

**Sub-section 6A.– The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has added a new sub-section 6A to section 21 to provide for a mechanism to allow participation of security holders, deposit holders and all other classes of financial creditors which exceed a certain number, in meetings of committee of creditors through an **authorised representative**.

**A trustee or agent to act as authorised representative.**– Where a financial debt is in the form of securities or deposits and the terms of the financial debt provide for appointment of a trustee or agent to act as authorised representative for all the financial creditors, such trustee or agent shall act on behalf of such financial creditors [Section 21(6A)(a)]

**Financial debt owed to a class of creditors exceeding the specified number** – Where a financial debt is owed to a class of creditors exceeding the number as may be specified, other than the creditors covered under clause (a) or sub-section (6), the interim resolution professional shall make an application to the Adjudicating Authority along with the list of all financial creditors, containing the name of an insolvency professional, other than the interim resolution professional, to act as their authorised representative who shall be appointed by the Adjudicating Authority prior to the first meeting of the committee of creditors. [Section 21(6A)(b)]

Clause (aa) of Sub-Regulation (1) of Regulation 2 of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 provides that under Clause (b) of sub-section (6A) of Section 21 of IBC, class of creditors means a class with at least ten financial creditors.

**Guardian, executor or administrator** – Where a financial debt is represented by a guardian, executor or administrator, such person shall act as authorised representative on behalf of such financial creditors [Section 21(6A)(c)]

All such authorised representative under clause (a) or clause (b) or clause (c) of sub-section 6A shall attend the



meetings of the committee of creditors, and vote on behalf of each financial creditor to the extent of his voting share.

**Board to specify the manner of voting and the determining of the voting share** – The Board may specify the manner of voting and the determining of the voting share in respect of financial debts covered under sub-sections (6) and (6A). [Section 21[(7)]

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has substituted sub-section (7). Before its substitution, sub-section (7) stood as follows:

“(7) The Board may specify the manner of determining the voting share in respect of financial debts issued as securities under sub-section (6).”

**Remuneration payable to authorised representative** – **The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has also added sub-section (6B) to section 21. It provides that the remuneration payable to the authorised representative under clauses (a) and (c) of sub-section (6A), if any, shall be as per the terms of the financial debt or the relevant documentation; and under clause (b) of sub-section (6A) shall be as specified which shall be form part of the insolvency resolution process costs.

According to section 5(13), of the Code, the “**insolvency resolution process costs**” means –

- (a) the amount of any interim finance and the costs incurred in raising such finance;
- (b) the fees payable to any person acting as a resolution professional;
- (c) any costs incurred by the resolution professional in running the business of the corporate debtor as a going concern;
- (d) any costs incurred at the expense of the Government to facilitate the insolvency resolution process; and
- (e) any other costs as may be specified by the Board.

The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 has added sub-sections (6A) and (6B) to section 21 of the Code. Sub-section (6A) provides for a mechanism to allow participation of security holders, deposit holders and all other classes of financial creditors which exceed a certain number, in meetings of committee of creditors through an authorised representative. Sub-section (6B) provides for remuneration payable to such authorised representative.

**Decisions of the committee of creditors.**– Sub-section (8) to section 21 of the Code provides that except as otherwise provided in the Code, all decisions of the committee of creditors shall be taken by a vote of not less than **fifty-one per cent** of voting share of the financial creditors.

The proviso to this sub-section clarifies that in the event there are no financial creditors for a corporate debtor, the committee of creditors shall be constituted consisting of such persons and exercise such function in such manner as may be specified.

**Financial information** – The committee of creditors shall have the right to require the resolution professional to furnish any financial information in relation to the corporate debtor at any time during the corporate insolvency resolution process. [Section 21(9)]

The resolution professional shall make available any financial information so required by the committee of creditors under sub-section (9) within a period of **seven days** of such requisition. [Section 21(10)]

According to section 3(13), “**financial information**”, in relation to a person, means one or more of the following categories of information, namely:

- (a) records of the debt of the person;
- (b) records of liabilities when the person is solvent;
- (c) records of assets of person over which security interest has been created;
- (d) records, if any, of instances of default by the person against any debt;
- (e) records of the balance sheet and cash-flow statements of the person; and
- (f) such other information as may be specified.

### Committee with only operational creditors

**Regulation 16** of the **Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016** deals with situations where either the corporate debtor has no financial debt or where all financial creditors are related parties of the corporate debtor. Regulation 16 provides as follows:

- (1) Where the corporate debtor has no financial debt or where all financial creditors are related parties of the corporate debtor, the committee shall be set up in accordance with this Regulation.
- (2) The committee formed under this Regulation shall consist of members as under:
  - (a) eighteen largest operational creditors by value:
 

Provided that if the number of operational creditors is less than eighteen, the committee shall include all such operational creditors;
  - (b) one representative elected by all workmen other than those workmen included under sub-clause (a); and
  - (c) one representative elected by all employees other than those employees included under sub-clause (a).
- (3) A member of the committee formed under this Regulation shall have voting rights in proportion of the debt due to such creditor or debt represented by such representative, as the case may be, to the total debt.

Explanation – For the purposes of this sub-regulation, ‘total debt’ is the sum of-

- (a) the amount of debt due to the creditors listed in sub-regulation 2(a);
- (b) the amount of the aggregate debt due to workmen under sub-regulation 2(b); and
- (c) the amount of the aggregate debt due to employees under sub-regulation 2(c).
- (4) A committee formed under this Regulation and its members shall have the same rights, powers, duties and obligations as a committee comprising financial creditors and its members, as the case may be.

### Meeting of Committee of Creditors

Section 24 of the Code prescribes the following **modalities** for the meeting of the committee of creditors.

- (1) The members of the committee of creditors may meet in person or by such other electronic means as may be specified. [Section 24(1)]
- (2) All meetings of the committee of creditors shall be conducted by the resolution professional. [Section 24(2)]

- (3) The resolution professional shall give notice of each meeting of the committee of creditors to:
  - (a) members of committee of creditors, including the authorised representatives referred to in sub-sections (6) and (6A) of section 21 and sub-section (5),
  - (b) members of the suspended Board of Directors or the partners of the corporate persons, as the case may be,
  - (c) operational creditors or their representatives if the amount of their aggregate dues is not less than **ten percent** of the debt [Section 24(3)]
- (4) The directors, partners and one representative of operational creditors, as referred to in sub-section (3), may attend the meetings of committee of creditors, but shall not have any right to vote in such meetings. The absence of any such director, partner or representative of operational creditors, as the case may be, shall not invalidate proceedings of such meeting. [Section 24(4)]
- (5) Subject to sub-sections (6), (6A) and (6B) of section 21, any creditor who is a member of the committee of creditors may appoint an insolvency professional other than the resolution professional to represent such creditor in a meeting of the committee of creditors:  
 Provided that the fees payable to such insolvency professional representing any individual creditor will be borne by such creditor. [Section 24(5)]
- (6) Each creditor shall vote in accordance with the voting share assigned to him based on the financial debts owed to such creditor. [Section 24(6)]
- (7) The resolution professional shall determine the voting share to be assigned to each creditor in the manner specified by the Board. [Section 24(7)]
- (8) The meetings of the committee of creditors shall be conducted in such manner as may be specified. [Section 24(8)]

**Regulation 18 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016** provides that a resolution professional may convene a meeting of the committee as and when he considers necessary, and shall convene a meeting if a request to that effect is made by members of the committee representing thirty three per cent of the voting rights.

#### **Quorum at the meeting**

**Regulation 22 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016** provides that

(1) A meeting of the committee shall be quorate if members of the committee representing at least thirty three percent of the voting rights are present either in person or by video conferencing or other audio and visual means:

Provided that the committee may modify the percentage of voting rights required for quorum in respect of any future meetings of the committee.

(2) Where a meeting of the committee could not be held for want of quorum, unless the committee has previously decided otherwise, the meeting shall automatically stand adjourned at the same time and place on the next day.

(3) In the event a meeting of the committee is adjourned in accordance with sub-regulation (2), the adjourned meeting shall be quorate with the members of the committee attending the meeting.

## Rights and Duties of Authorised Representative of Financial Creditors

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has added a new section 25A to provide for rights and duties of authorised representative of financial creditors.

- (1) The authorised representative under sub-section (6) or sub-section (6A) of section 21 or sub-section (5) of section 24 shall have the right to participate and vote in meetings of the committee of creditors on behalf of the financial creditor he represents in accordance with the prior voting instructions of such creditors obtained through physical or electronic means. [Section 25A(1)].
- (2) It shall be the duty of the authorised representative to circulate the agenda and minutes of the meeting of the committee of creditors to the financial creditor he represents. [Section 25A(2)].
- (3) The authorised representative shall not act against the interest of the financial creditor he represents and shall always act in accordance with their prior instructions:

Provided that if the authorised representative represents several financial creditors, then he shall cast his vote in respect of each financial creditor in accordance with instructions received from each financial creditor, to the extent of his voting share:

Provided further that if any financial creditor does not give prior instructions through physical or electronic means, the authorised representative shall abstain from voting on behalf of such creditor. [Section 25A(3)].

- (3A) Notwithstanding anything to the contrary contained in sub-section (3), the authorised representative under sub-section (6A) of section 21 shall cast his vote on behalf of all the financial creditors he represents in accordance with the decision taken by a vote of more than fifty per cent of the voting share of the financial creditors he represents, who have cast their vote:

Provided that for a vote to be cast in respect of an application under section 12A, the authorised representative shall cast his vote in accordance with the provisions of subsection (3).

- (4) The authorised representative shall file with the committee of creditors any instructions received by way of physical or electronic means, from the financial creditor he represents, for voting in accordance therewith, to ensure that the appropriate voting instructions of the financial creditor he represents is correctly recorded by the interim resolution professional or resolution professional, as the case may be. [Section 25A(4)].

The Explanation appended to section 25A makes it clear that for the purposes of section 25A, the “electronic means” shall be such as may be specified.

## Approval of Committee of Creditors for Certain Actions

**Section 28 of the Code** lists out certain actions that may be taken by the resolution professional only with the prior approval of the committee of creditors by a vote of **66 per cent** of the voting shares. The aim of this section is to secure consent of the committee of creditors for certain specific matters. If the resolution professional takes any of the actions listed in section 28(1) without obtaining the consent of the committee of creditors, such action shall be void. The resolution professional may also be liable to be replaced.

Section 28(1) provides that notwithstanding anything contained in any other law for the time being in force, the resolution professional, during the corporate insolvency resolution process, shall not take any of the following actions without the prior approval of the committee of creditors:

- (a) raise any interim finance in excess of the amount as may be decided by the committee of creditors in their meeting;

- (b) create any security interest over the assets of the corporate debtor;
- (c) change the capital structure of the corporate debtor, including by way of issuance of additional securities, creating a new class of securities or buying back or redemption of issued securities in case the corporate debtor is a company;
- (d) record any change in the ownership interest of the corporate debtor;
- (e) give instructions to financial institutions maintaining accounts of the corporate debtor for a debit transaction from any such accounts in excess of the amount as may be decided by the committee of creditors in their meeting;
- (f) undertake any related party transaction;
- (g) amend any constitutional documents of the corporate debtor;
- (h) delegate its authority to any other person;
- (i) dispose of or permit the disposal of shares of any shareholder of the corporate debtor or their nominees to third parties;
- (j) make any change in the management of the corporate debtor or its subsidiary;
- (k) transfer rights or financial debts or operational debts under material contracts otherwise than in the ordinary course of business;
- (l) make changes in the appointment or terms of contract of such personnel as specified by the committee of creditors; or
- (m) make changes in the appointment or terms of contract of statutory auditors or internal auditors of the corporate debtor.

Section 28(2) mandates that the resolution professional shall convene a meeting of the committee of creditors and seek the vote of the creditors prior to taking any of the actions under sub-section (1).

No action under sub-section (1) shall be approved by the committee of creditors unless approved by a vote of sixty-six per cent. of the voting shares. [Section 28(3)]

(4) Where any action under sub-section (1) is taken by the resolution professional without seeking the approval of the committee of creditors in the manner as required in this section, such action shall be void. [Section 28(4)]

(5) The committee of creditors may report the actions of the resolution professional under sub-section (4) to the Board for taking necessary actions against him under this code. [Section 28(5)]

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has amended section 28 of the Code to reduce the threshold for voting from 75% to 66% for approval of committee of creditors in respect certain actions provided in sub-section (1) of section 28.

### LESSON ROUND UP

- Section 21 and 24 of the Insolvency and Bankruptcy Code, 2016 make provisions relating to the committee of creditors (CoC). Section 21 deals with the constitution of CoC while section 24 prescribes the modalities for the meeting of the CoC.
- Section 28 of the Code lists out certain actions that may be taken by the resolution professional only with the prior approval of the committee of creditors by a vote of 66 per cent of the voting share.
- Section 21(1) further provides that the Interim Resolution Professional shall after collation of all claims

received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a committee of creditors.

- Section 21(2) provides that the committee of creditors shall comprise all financial creditors of the corporate debtor.
- First proviso to section 21(2) provides that a financial creditor or the authorised representative of the financial creditor, if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors.
- Section 21(4) provides that where any person is a financial creditor as well as an operational creditor, then such person shall be considered a financial creditor to the extent of the financial debt owed by the corporate debtor.
- ‘Voting share’ according to section 5(28), means the share of the voting rights of a single financial creditor in the committee of creditors which is based on the proportion of the financial debt owed to such financial creditor in relation to the financial debt owed by the corporate debtor.
- The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 has added sub-sections 6A and 6B to section 21 of the Code. Sub-section 6A provides for a mechanism to allow participation of security holders, deposit holders and all other classes of financial creditors which exceed a certain number, in meetings of committee of creditors through an authorised representative. Sub-section 6B provides for remuneration payable to such authorised representative.
- Sub-section 8 to section 21 of the Code provides that except as otherwise provided in the Code, all decisions of the committee of creditors shall be taken by a vote of not less than fifty-one per cent of voting share of the financial creditors.
- The members of the committee of creditors may meet in person or by such other electronic means as may be specified. [Section 24(1)]. All meetings of the committee of creditors shall be conducted by the resolution professional. [Section 24(2)].
- Section 28 of the Code lists out certain actions that may be taken by the resolution professional only with the prior approval of the committee of creditors by a vote of 66 per cent of the voting shares. If the resolution professional takes any of the actions listed in section 28(1) without obtaining the consent of the committee of creditors, such action shall be void. The resolution professional may also be liable to be replaced.

### SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. What do you understand by Committee of Creditors (CoC) under the Insolvency and Bankruptcy Code, 2016? Discuss the constitution of CoC.
2. Mention the modalities for the conduct of meeting of Committee of Creditors under the Insolvency and Bankruptcy Code, 2016.
3. Explain in brief provisions relating to constitution of ‘Committee with only operational creditors’ where either the corporate debtor has no financial debt or where all financial creditors are related parties of the corporate debtor.
4. Mention the rights and duties of ‘authorized representative’ of Financial Creditors under section 25A of the Insolvency and Bankruptcy Code, 2016.
5. List out the actions which require prior approval of the Committee of Creditors under section 28 of the Insolvency and Bankruptcy Code, 2016.

[illegible]





# Lesson 19

## Preparation and Approval of Resolution Plan

### LESSON OUTLINE

- Meaning of resolution plan and resolution applicant
- Persons not eligible to be Resolution Applicant
- Mandatory contents of Resolution Plan
- Inviting Prospective Resolution Applicants
- Submission of Resolution Plan
- Approval of Resolution Plan
- Appeal
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

A resolution plan is a proposal that aims to provide a resolution to the problem of the corporate debtor's insolvency and its consequent inability to pay-off debts. Resolution plan shall resolve insolvency, maximise the value of assets of the corporate debtor, and promote entrepreneurship, availability of credit, and balance the interests of all the stakeholders. The resolution plan is not a sale, or auction, or recovery or liquidation but a resolution of the Corporate Debtor as a going concern.

It needs to be approved by the committee of creditors (COC), and comply with some mandatory requirements prescribed in the Code. Once approved, the Resolution Professional will send the plan to the NCLT after certifying that the plan meets the requirements of the Code. If the NCLT is also satisfied that the plan meets the requirements, it will pass an order approving the plan.

Section 31(1) of the Code makes the resolution plan, once approved by the NCLT, binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan. By avoiding liquidation, the inherent business value in the debtor will be preserved. The approval of a resolution plan, therefore, may be considered a successful outcome of the process.

After reading this lesson you will be able to understand the meaning of resolution plan, its submission related aspects and approval process.

## MEANING OF RESOLUTION PLAN AND RESOLUTION APPLICANT

According to section 5(26), a ‘**resolution plan**’ means a plan proposed by resolution applicant for insolvency resolution of the corporate debtor as a going concern in accordance with Part II”.

*Explanation.* - For removal of doubts, it is clarified that a resolution plan may include provisions for the restructuring of the corporate debtor, including by way of merger, amalgamation and demerger.

**The Insolvency and Bankruptcy Code (Amendment) Act, 2018** also substituted the definition of “resolution applicant” in section 5(25) of the Code. The substituted definition provides that a “**resolution applicant**” means a person, who individually or jointly with any other person, submits a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25.

## Persons not Eligible to be Resolution Applicant

**The Insolvency and Bankruptcy Code (Amendment) Act, 2018** added a new section 29A. The newly added section 29A declares certain persons ineligible to be a resolution applicant and prohibits such persons from submitting a resolution plan. Section 29A was later amended by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018.

Section 29A as amended by the **Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** provides that a person shall not be eligible to submit a resolution plan, if such person, or any other person acting jointly or in concert with such person –

- (a) is an **undischarged insolvent**;
- (b) is a **wilful defaulter** in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949;
- (c) at the time of submission of the resolution plan has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter, classified as non-performing asset in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949 or the guidelines of a financial sector regulator issued under any other law for the time being in force, and at least a period of one year has lapsed from the date of such classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor:

Provided that the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to nonperforming asset accounts before submission of resolution plan:

Provided further that nothing in this clause shall apply to a resolution applicant where such applicant is a financial entity and is not a related party to the corporate debtor.

Explanation I. – For the purposes of this proviso, the expression “**related party**” shall not include a financial entity, regulated by a financial sector regulator, if it is a financial creditor of the corporate debtor and is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares, or completion of such transactions as may be prescribed, prior to the insolvency commencement date.

Explanation II. – For the purposes of this clause, where a resolution applicant has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter, classified as non-performing asset and such account was acquired pursuant to a prior resolution plan approved under this Code, then, the provisions of this clause shall not apply to such resolution applicant for a period of three years from the date of approval of such resolution plan by the Adjudicating Authority under this Code;

- (d) has been convicted for any offence punishable with imprisonment –

- (i) for **two years** or more under any Act specified under the Twelfth Schedule; or
- (ii) for **seven years** or more under any law for the time being in force:

Provided that this clause shall not apply to a person after the expiry of a period of two years from the date of his release from imprisonment:

Provided further that this clause shall not apply in relation to a connected person referred to in clause (iii) of Explanation I;

- (e) is disqualified to act as a director under the Companies Act, 2013:

Provided that this clause shall not apply in relation to a connected person referred to in clause (iii) of Explanation I;

- (f) is prohibited by the Securities and Exchange Board of India from trading in securities or accessing the securities markets;
- (g) has been a **promoter or in the management or control of a corporate debtor** in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the Adjudicating Authority under this Code:

Provided that this clause shall not apply if a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place prior to the acquisition of the corporate debtor by the resolution applicant pursuant to a resolution plan approved under this Code or pursuant to a scheme or plan approved by a financial sector regulator or a court, and such resolution applicant has not otherwise contributed to the preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction;

- (h) has executed a **guarantee** in favour of a creditor in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted under this Code and such guarantee has been invoked by the creditor and remains unpaid in full or part;
- (i) is subject to any **disability**, corresponding to clauses (a) to (h), under any law in a jurisdiction outside India; or
- (j) has a connected person not eligible under clauses (a) to (i).

Explanation I. – For the purposes of this clause, the expression “**connected person**” means –

- (i) any person who is the promoter or in the management or control of the resolution applicant; or
- (ii) any person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; or
- (iii) the holding company, subsidiary company, associate company or related party of a person referred to in clauses (i) and (ii):

Provided that nothing in clause (iii) of Explanation I shall apply to a resolution applicant where such applicant is a financial entity and is not a related party of the corporate debtor:

Provided further that the expression “**related party**” shall not include a financial entity, regulated by a financial sector regulator, if it is a financial creditor of the corporate debtor and is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or

instruments convertible into equity shares, or completion of such transactions as may be prescribed, prior to the insolvency commencement date;

Explanation II – For the purposes of this section, “**financial entity**” shall mean the following entities which meet such criteria or conditions as the Central Government may, in consultation with the financial sector regulator, notify in this behalf, namely: –

- (a) a scheduled bank;
- (b) any entity regulated by a foreign central bank or a securities market regulator or other financial sector regulator of a jurisdiction outside India which jurisdiction is compliant with the Financial Action Task Force Standards and is a signatory to the International Organisation of Securities Commissions Multilateral Memorandum of Understanding;
- (c) any investment vehicle, registered foreign institutional investor, registered foreign portfolio investor or a foreign venture capital investor, where the terms shall have the meaning assigned to them in regulation 2 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 made under the Foreign Exchange Management Act, 1999;
- (d) an asset reconstruction company registered with the Reserve Bank of India under section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- (e) an Alternate Investment Fund registered with Securities and Exchange Board of India;
- (f) such categories of persons as may be notified by the Central Government.

### **Inviting Prospective Resolution Applicants**

The resolution professional, under clause (h) of sub-section (2) of section 25, invites prospective resolution applicants, who fulfil such criteria as may be laid down by him with the approval of committee of creditors, having regard to the complexity and scale of operations of the business of the corporate debtor and such other conditions as may be specified by the Board, to submit a resolution plan or plans.

The resolution professional prepares an information memorandum which contains all relevant information required by the resolution applicant to make the resolution plan for the corporate debtor. Such information includes information relating to the financial position of the corporate debtor, all information related to disputes by or against the corporate debtor as well as any other matter pertaining to the corporate debtor as may be specified. Section 29(2) provides that the resolution professional shall provide to the resolution applicant access to all relevant information in physical and electronic form, provided such resolution applicant undertakes

- (a) to comply with provisions of law for the time being in force relating to confidentiality and insider trading;
- (b) to protect any intellectual property of the corporate debtor it may have access to; and
- (c) not to share relevant information with third parties unless clauses (a) and (b) above are complied with.

### **Expression of Interest (EOI) issued by Resolution Professionals**

EOI is a document describing requirements or specifications and seeking information from potential investors/bidders that demonstrate their ability to meet those requirements. In the field of insolvency and bankruptcy, EOIs are invited from investors or consortium of investors (also known as bidders) meeting the specified eligibility criteria in terms of financial and technical capabilities to submit resolution plans for the Corporate Debtor undergoing corporate insolvency resolution process or fast track insolvency resolution process under the provisions of the Code.

The EOI is issued by the Resolution Professional on behalf of the Committee of Creditors in the form of a public advertisement. The document prescribes the last date for receipt of EOI from potential investors or bidders. Subsequently, the Committee of Creditors shall discuss and finalize the best resolution plan that shall lead to a favourable outcome for all the stakeholders of the Corporate Debtor.

### Mandatory contents of the Resolution Plan

Regulation 38 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, lists down the mandatory contents of the resolution plan as follows:

- (1) The amount payable under a resolution plan -
  - (a) to the operational creditors shall be paid in priority over financial creditors; and
  - (b) to the financial creditors, who have a right to vote under sub-section (2) of section 21 and did not vote in favour of the resolution plan, shall be paid in priority over financial creditors who voted in favour of the plan.
- (1A) A resolution plan shall include a statement as to how it has dealt with the interests of all stakeholders, including financial creditors and operational creditors, of the corporate debtor.
- (1B) A resolution plan shall include a statement giving details if the resolution applicant or any of its related parties has failed to implement or contributed to the failure of implementation of any other resolution plan approved by the Adjudicating Authority at any time in the past.
- (2) A resolution plan shall provide:
  - (a) the term of the plan and its implementation schedule;
  - (b) the management and control of the business of the corporate debtor during its term; and
  - (c) adequate means for supervising its implementation.
- (3) A resolution plan shall demonstrate that –
  - (a) it addresses the cause of default;
  - (b) it is feasible and viable;
  - (c) it has provisions for its effective implementation;
  - (d) it has provisions for approvals required and the timeline for the same; and
  - (e) the resolution applicant has the capability to implement the resolution plan.

### Submission of Resolution Plan

Section 30 of the Code prescribes the manner in which a resolution plan may be submitted by a resolution applicant.

The resolution professional is required to submit each resolution plan, which conforms to the criteria in section 30(2), to the committee of creditors who shall approve a resolution plan by a by a vote of not less than **sixty-six percent** of voting share of the financial creditors, after considering its feasibility and viability, and such other requirements as may be specified by the Insolvency and Bankruptcy Board of India.

Once the resolution plan is approved by the committee of creditors, it is then presented to the adjudicating authority for its approval.

**Resolution plan by resolution applicant** – Section 30(1) of the Code provides that a resolution applicant may submit a resolution plan along with an affidavit stating that he is eligible under section 29A to the resolution professional prepared on the basis of the information memorandum.

**Requirement of filing affidavit. – The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** amended section 30(1) of the Code. After this amendment, a resolution plan is required to be accompanied with an affidavit by the resolution applicant stating that he is eligible under section 29A of the Code.

**Examination by resolution professional –** Section 30(2) further provides that the resolution professional shall examine each resolution plan received by him to confirm that each resolution plan –

- (a) provides for the payment of insolvency resolution process costs in a manner specified by the Board in priority to the payment of other debts of the corporate debtor;
- (b) provides for the payment of the debts of operational creditors in such manner as may be specified by the Board which shall not be less than the amount to be paid to the operational creditors in the event of a liquidation of the corporate debtor under section 53;
- (c) provides for the management of the affairs of the Corporate debtor after approval of the resolution plan;
- (d) The implementation and supervision of the resolution plan;
- (e) does not contravene any of the provisions of the law for the time being in force
- (f) confirms to such other requirements as may be specified by the Board.

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has added an Explanation to sub-section (2) of section 30 to clarify that for the purposes of clause (e), if any approval of shareholders is required under the Companies Act, 2013 or any other law for the time being in force for the implementation of actions under the resolution plan, such approval shall be deemed to have been given and it shall not be a contravention of that Act or law.

**Resolution plans to be submitted to committee of creditors –** The resolution professional shall present to the committee of creditors for its approval such resolution plans which confirm the conditions referred to in sub-section (2) of section 30. [Section 30(3)].

**Approval by committee of creditors –** Section 30(4) of the Code provides that the committee of creditors may approve a resolution plan by a vote of not less than **sixty-six percent** of voting share of the financial creditors, after considering its feasibility and viability, the manner of distribution proposed, which may take into account the order of priority amongst creditors as laid down in sub-section (1) of section 53, including the priority and value of the security interest of a secured creditor and such other requirements as may be specified by the Board.

Provided that the committee of creditors shall not approve a resolution plan, submitted before the commencement of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 where the resolution applicant is ineligible under section 29A and may require the resolution professional to invite a fresh resolution plan where no other resolution plan is available with it:

Provided further that where the resolution applicant referred to in the first proviso is ineligible under clause (c) of section 29A, the resolution applicant shall be allowed by the committee of creditors such period, not exceeding thirty days, to make payment of overdue amounts in accordance with the proviso to clause (c) of section 29A:

Provided also that nothing in the second proviso shall be construed as extension of period for the purposes of the proviso to sub-section (3) of section 12, and the corporate insolvency resolution process shall be completed within the period specified in that subsection]:



Provided also that the eligibility criteria in section 29A as amended by the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 shall apply to the resolution applicant who has not submitted resolution plan as on the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018.

**Attending the meeting of committee of creditors** – The resolution applicant may attend the meeting of the committee of creditors in which the resolution plan of the applicant is considered.

Provided that the resolution applicant shall not have a right to vote at the meeting of the committee of creditors unless such resolution applicant is also a financial creditor. [Section 30(5)]

**Submission of approved resolution plan** – The resolution professional shall submit the resolution plan as approved by the committee of creditors to the Adjudicating Authority. [Section 30(6)]

**Changes brought about by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 in section 30 –**

- A resolution applicant to file an affidavit stating that it is eligible under section 29A.
- Added an Explanation to sub-section (2) of section 30 to clarify that if any approval of shareholders is required under the Companies Act, 2013 or any other law for the time being in force for the implementation of actions under the resolution plan, such approval shall be deemed to have been given and it shall not be a contravention of that Act or law.
- Substituted sub-section (4) of section 30, inter alia, reducing the threshold for voting from 75% to 66% for approving a resolution plan by committee of creditors.

## Approval of Resolution Plan

Section 31 provides for the review of the resolution plan sanctioned by the committee of creditors by the Adjudicating Authority.

**Approval by Adjudicating Authority** – Section 31(1) provides that if the Adjudicating Authority is satisfied that the resolution plan as approved by the committee of creditors under sub-section (4) of section 30 meets the requirements as referred to in sub-section (2) of section 30, it shall by order approve the resolution plan. Such resolution plan shall be binding on the corporate debtor and its employees, members, creditors, including the Central Government, any State Government or any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed, guarantors and other stakeholders involved in the resolution plan.

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** added to a proviso to sub-section (1) of section 31. The newly added proviso provides that the Adjudicating Authority, before passing an order for approval of resolution plan under sub-section (1) to section 31, shall satisfy that the resolution plan has provisions for its effective implementation.

**Rejection of resolution plan** – Where the Adjudicating Authority is satisfied that the resolution plan does not confirm to the requirements referred to in sub-section (1), it may, by an order, reject the resolution plan. [Section 31(2)].

**Effect of Order of approval under section 31(1)** – Section 31(3) provides that if the adjudicating authority passes an order of approval under sub-section (1) of section 31,

- (a) the moratorium order passed by the Adjudicating Authority under section 14 shall cease to have effect; and
- (b) the resolution professional shall forward all records relating to the conduct of the corporate insolvency resolution process and the resolution plan to the Board to be recorded on its database.

**Securing necessary approvals –The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**

has added a new sub-section (4) to section 31. The newly added sub-section (4) provides that the resolution applicant shall, pursuant to the resolution plan approved under sub-section (1), obtain the necessary approval required under any law for the time being in force within a period of one year from the date of approval of the resolution plan by the Adjudicating Authority under sub-section (1) or within such period as provided for in such law, whichever is later.

The proviso to sub-section (4) lays down that where the resolution plan contains a provision for combination, as referred to in section 5 of the Competition Act, 2002, the resolution applicant shall obtain the approval of the Competition Commission of India under that Act prior to the approval of such resolution plan by the committee of creditors.

**Measures required for implementation of Resolution Plan**

Regulation 37(1) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 provides that a resolution plan shall provide for the measures, as may be necessary, for insolvency resolution of the corporate debtor for maximization of value of its assets, including but not limited to the following:-

- (a) transfer of all or part of the assets of the corporate debtor to one or more persons;
- (b) sale of all or part of the assets whether subject to any security interest or not;
- (ba) restructuring of the corporate debtor, by way of merger, amalgamation and demerger;
- (c) the substantial acquisition of shares of the corporate debtor, or the merger or consolidation of the corporate debtor with one or more persons;
- (ca) cancellation or delisting of any shares of the corporate debtor, if applicable;
- (d) satisfaction or modification of any security interest;
- (e) curing or waiving of any breach of the terms of any debt due from the corporate debtor;
- (f) reduction in the amount payable to the creditors;
- (g) extension of a maturity date or a change in interest rate or other terms of a debt due from the corporate debtor;
- (h) amendment of the constitutional documents of the corporate debtor;
- (i) issuance of securities of the corporate debtor, for cash, property, securities, or in exchange for claims or interests, or other appropriate purpose;
- (j) change in portfolio of goods or services produced or rendered by the corporate debtor;
- (k) change in technology used by the corporate debtor; and
- (l) obtaining necessary approvals from the Central and State Governments and other authorities.

**Appeal**

Section 32 of the Code deals with appeals from an order approving the resolution plan. Section 32 lays down that any appeal from an order approving the resolution plan shall be in the manner and on the grounds laid down in sub-section (3) of section 61.

32A. (1) Notwithstanding anything to the contrary contained in this Code or any other law for the time being in force, the liability of a corporate debtor for an offence committed prior to the commencement of the corporate insolvency resolution process shall cease, and the corporate debtor shall not be prosecuted for such an offence from the date the resolution plan has been approved by the Adjudicating Authority under section 31, if the

resolution plan results in the change in the management or control of the corporate debtor to a person who was not-

- (a) a promoter or in the management or control of the corporate debtor or a related party of such a person; or
- (b) a person with regard to whom the relevant investigating authority has, on the basis of material in its possession, reason to believe that he had abetted or conspired for the commission of the offence, and has submitted or filed a report or a complaint to the relevant statutory authority or Court:

Provided that if a prosecution had been instituted during the corporate insolvency resolution process against such corporate debtor, it shall stand discharged from the date of approval of the resolution plan subject to requirements of this sub-section having fulfilled:

Provided further that every person who was a “designated partner” as defined in clause (j) of section 2 of the Limited Liability Partnership Act, 2008 or an “officer who is in default”, as defined in clause (60) of section 2 of the Companies Act, 2013, or was in any manner in-charge of, or responsible to the corporate debtor for the conduct of its business or associated with the corporate debtor in any manner and who was directly or indirectly involved in the commission of such offence as per the report submitted or complaint filed by the investigating authority, shall continue to be liable to be prosecuted and punished for such an offence committed by the corporate debtor notwithstanding that the corporate debtor’s liability has ceased under this sub-section.

(2) No action shall be taken against the property of the corporate debtor in relation to an offence committed prior to the commencement of the corporate insolvency resolution process of the corporate debtor, where such property is covered under a resolution plan approved by the Adjudicating Authority under section 31, which results in the change in control of the corporate debtor to a person, or sale of liquidation assets under the provisions of Chapter III of Part II of this Code to a person, who was not –

- (i) a promoter or in the management or control of the corporate debtor or a related party of such a person; or
- (ii) a person with regard to whom the relevant investigating authority has, on the basis of material in its possession, reason to believe that he had abetted or conspired for the commission of the offence, and has submitted or filed a report or a complaint to the relevant statutory authority or Court.

Explanation.- For the purposes of this sub-section, it is hereby clarified that,-

- (i) an action against the property of the corporate debtor in relation to an offence shall include the attachment, seizure, retention or confiscation of such property under such law as may be applicable to the corporate debtor;
- (ii) nothing in this sub-section shall be construed to bar an action against the property of any person, other than the corporate debtor or a person who has acquired such property through corporate insolvency resolution process or liquidation process under this Code and fulfils the requirements specified in this section, against whom such an action may be taken under such law as may be applicable.

(3) Subject to the provisions contained in sub-sections (1) and (2), and notwithstanding the immunity given in this section, the corporate debtor and any person, who may be required to provide assistance under such law as may be applicable to such corporate debtor or person, shall extend all assistance and co-operation to any authority investigating an offence committed prior to the commencement of the corporate insolvency resolution process. According to section 61(3), an appeal against an order approving a resolution plan under section 31 may be filed on the following grounds:

- (i) the approved resolution plan is in contravention of the provisions of any law for the time being in force,
- (ii) there has been material irregularity in exercise of the powers by the resolution professional during the corporate insolvency resolution period,

- (iii) the debts owed to operational creditors of the corporate debtor have not been provided for in the resolution plan in the manner specified by the Board,
- (iv) the insolvency resolution process costs have not been provided for repayment in priority to all other debts, or
- (v) the resolution plan does not comply with any other criteria specified by the Board.

### LESSON ROUND UP

- ‘Resolution applicant’ means a person, who individually or jointly with any other person, submits a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25. [Section 5(25)]
- ‘Resolution plan’ means a plan proposed by resolution applicant for insolvency resolution of the corporate debtor as a going concern in accordance with Part II. [Section 5(26)]
- The Insolvency and Bankruptcy Code (Amendment) Act, 2018 added a new section 29A which declares certain persons ineligible to be a resolution applicant and prohibits such persons from submitting a resolution plan.
- The resolution professional, under clause (h) of sub-section (2) of section 25, invites prospective resolution applicants, who fulfil such criteria as may be laid down by him with the approval of committee of creditors.
- As per section 30(1) a resolution applicant may submit a resolution plan along with an affidavit stating that he is eligible under section 29A to the resolution professional prepared on the basis of the information memorandum.
- The resolution professional is required to submit each resolution plan, which conforms to the criteria mentioned in section 30(2), to the committee of creditors who shall approve a resolution plan by a vote of not less than sixty-six percent of voting share of the financial creditors. Once the resolution plan is approved by the committee of creditors, it is then presented to the adjudicating authority for its approval.
- Section 31(4) provides that the resolution applicant shall, pursuant to the resolution plan approved under sub-section (1), obtain the necessary approval required under any law for the time being in force within a period of one year from the date of approval of the resolution plan by the Adjudicating Authority under sub-section (1) or within such period as provided for in such law, whichever is later.
- The proviso to Section 31(4) lays down that where the resolution plan contains a provision for combination, as referred to in section 5 of the Competition Act, 2002, the resolution applicant shall obtain the approval of the Competition Commission of India under that Act prior to the approval of such resolution plan by the committee of creditors.
- Resolution plan approved by the Adjudicating Authority under section 31(1) shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.
- After approval of resolution plan the moratorium order passed by the Adjudicating Authority under section 14 shall cease to have effect; and the resolution professional shall forward all records relating to the conduct of the corporate insolvency resolution process and the resolution plan to the Board to be recorded on its database.

- Section 32 of the Code deals with appeals from an order approving the resolution plan. Section 32 lays down that any appeal from an order approving the resolution plan shall be in the manner and on the grounds laid down in sub-section (3) of section 61.

## SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. What is meant by 'resolution plan'? Mention the aspects examined by resolution professional for confirming a resolution plan and presenting the same to Committee of Creditors.
2. Section 29A inserted in the Insolvency and Bankruptcy Code, 2016 provides for the persons who are not eligible to be resolution applicant. Discuss the provisions in brief.
3. Mention the provisions relating to the approval of resolution plan under section 31 of the Insolvency and Bankruptcy Code, 2016.
4. State the changes brought about in section 30 of the Insolvency and Bankruptcy Code, 2016 by the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018.
5. What are the grounds on which an appeal against an order approving a resolution plan under section 31 of the Insolvency and Bankruptcy Code, 2016 may be filed?

[illegible]



# Lesson 20

## Individual/Firm Insolvency

### LESSON OUTLINE

- Introduction
- Application by debtor for insolvency resolution
- Application by creditor for insolvency resolution
- Interim-moratorium
- Appointment of Resolution Professional
- Moratorium
- Public Notice and Claims from Creditors
- Repayment plan
- Summoning of Meeting of Creditors
- Report of Meeting of Creditors on Repayment Plan
- Order of Adjudicating Authority on Repayment Plan
- Implementation and Supervision of Repayment Plan
- Discharge Order
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

The Insolvency and Bankruptcy Code, 2016 under Part III contains provisions for insolvency resolution and bankruptcy for individuals and partnership firms. While corporate insolvency has been restricted to corporate persons, the scope of personal insolvency is much wider, and covers all individuals and partnerships.

Sections 94 to 120 in Chapter III of Part III of the Insolvency and Bankruptcy Code, 2016 deals with insolvency resolution process for Individuals and Partnership Firms. Under Chapter III of Part III of the Code, both debtor as well as the creditor can initiate the insolvency resolution process.

The 'Insolvency Resolution Process' provides a mechanism for creditors and debtors to renegotiate a repayment plan.

Though the provisions related to insolvency resolution of individual and partnership firm have been notified under the Code, no statutory regulations providing the form and manner for initiating insolvency resolution process have been notified yet by the Insolvency and Bankruptcy Board of India.

After reading this lesson you will be able to understand the process of making application, provisions relating to moratorium, appointment of resolution professional, and repayment plan.



## INTRODUCTION

Sections 94 to 120 in Chapter III of Part III of the Insolvency and Bankruptcy Code, 2016 deal with insolvency resolution process for Individuals and Partnership Firms.

The Insolvency and Bankruptcy Code, 2016 outlines separate insolvency resolution processes for corporates and individuals/partnership firms. Chapter II of Part II of the Code deals with insolvency resolution process for corporates whereas Chapter III of Part III provides for insolvency resolution process for individuals and partnership firms.

The Insolvency and Bankruptcy Code, 2016 proposes two Tribunals to adjudicate insolvency resolution cases. In the case of insolvency of companies and Limited Liability Partnerships (LLPs), the adjudicating authority is the National Company Law Tribunal (NCLT), while the cases involving individuals and limited liability partnerships are handled by the Debts Recovery Tribunals (DRTs). Appeals from NCLT orders lie to the National Company Law Appellate Tribunal (NCLAT) and thereafter to the Supreme Court of India. For individuals and other persons, the adjudicating authority is the DRT. Appeals from DRT orders lie to the Debt Recovery Appellate Tribunal (DRAT) and thereafter to the Supreme Court.

Under Chapter III of Part III of the Code, both debtor as well as the creditor can initiate the insolvency resolution process.

## APPLICATION BY DEBTOR TO INITIATE INSOLVENCY RESOLUTION PROCESS

Section 94 of the Insolvency and Bankruptcy Code, 2016 lays down the eligibility criteria for filing of an application for insolvency resolution by a debtor who has committed a default. An application under section 94 of the Code may be filed by the debtor personally, or through a resolution professional.

**Initiation of insolvency resolution process by debtor** – According to sub-section (1) of section 94, a debtor who commits a default may apply, either personally or through a resolution professional, to the Adjudicating Authority for initiating the insolvency resolution process, by submitting an application.

**Application for insolvency resolution by Partner of firm** – Sub-section (2) makes it clear that where the debtor is a partner of a firm, such debtor shall not apply under this Chapter (i.e., Chapter III of Part III) to the Adjudicating Authority in respect of the firm unless all or a majority of the partners of the firm file the application jointly.

Thus, if the debtor is an unlimited liability partnership firm, an application can be filed only if it is consented to by all or majority of the partners in number.

**“Firm”** means a body of individuals carrying on business in partnership whether or not registered under section 59 of the Partnership Act, 1932. [Section 79(16)]

**Debts in respect of which application can be submitted** – Sub-section (3) provides that an application under sub-section (1) shall be submitted only in respect of debts **which are not excluded debts**.

According to section 79(15), an **“Excluded debt”** means –

- (a) liability to pay fine imposed by a court or tribunal;
- (b) liability to pay damages for negligence, nuisance or breach of a statutory, contractual or other legal obligation;
- (c) liability to pay maintenance to any person under any law for the time being in force;
- (d) liability in relation to a student loan; and
- (e) any other debt as may be prescribed.

**Who is not entitled to initiate the insolvency resolution process.** – According to sub-section (4) of section 94, a debtor shall not be entitled to make an application under sub-section (1) if he is –

- (a) an undischarged bankrupt;
- (b) undergoing a fresh start process;
- (c) undergoing an insolvency resolution process; or
- (d) undergoing a bankruptcy process.

Sub-section (5) further provides that a debtor shall not be eligible to apply under sub-section (1) if an application under this Chapter has been admitted in respect of the debtor during the period of twelve months preceding the date of submission of the application under this section.

**Form and manner of application.** – The application referred to in sub-section (1) shall be in such form and manner and accompanied with such fee as may be prescribed. [Section 94(6)]

### Application by Creditor to Initiate Insolvency Resolution Process

Section 95 provides for an insolvency resolution process application by a creditor(s). In relation to a partnership debt owed to the creditor, the creditor may file an application against the firm or one or more of the partners, provided that separate applications made against partners of the same firm shall be consolidated and heard together. An application under section 95 may be filed by the creditor personally, or through a resolution professional.

**Initiation of insolvency resolution process by creditor** – According to sub-section (1) of section 95, a creditor may apply either by himself, or jointly with other creditors, or through a resolution professional to the Adjudicating Authority for initiating an insolvency resolution process under this section by submitting an application.

**Partnership debt owed to creditor.** – Sub-section (2) provides that a creditor may apply under sub-section (1) in relation to any partnership debt owed to him for initiating an insolvency resolution process against

- (a) any one or more partners of the firm; or
- (b) the firm.

**Consolidation of proceedings** – Sub-section (3) further provides that where an application has been made against one partner in a firm, any other application against another partner in the same firm shall be presented in or transferred to the Adjudicating Authority in which the first mentioned application is pending for adjudication and such Adjudicating Authority may give such directions for consolidating the proceedings under the applications as it thinks just.

**Supporting documents** – According to sub-section (4), an application under sub-section (1) of section 95 shall be accompanied with details and documents as may be specified by the Board relating to:

- (a) the debts owed by the debtor to the creditor or creditors submitting the application for insolvency resolution process as on the date of application;
- (b) the failure by the debtor to pay the debt within a period of **fourteen days** of the service of the notice of demand; and
- (c) relevant evidence of such default or non-repayment of debt.

**Supply of copy of application to debtor** – Sub-section (5) provides that the creditor shall also provide a copy of the application made under sub-section (1) to the debtor.

**Form and manner of application** – The application referred to in sub-section (1) of section 95 shall be in such form and manner and accompanied by such fee as may be prescribed. [Section 95(6)]

The details and documents required to be submitted under sub-section (4) shall be such as may be specified. [Section 95(7)]

### Interim-moratorium

Section 96 provides for interim moratorium which shall commence on the date of the application initiating the insolvency resolution and shall cease to have effect on the date of admission of such application. During the period of interim moratorium any pending legal action or proceeding in respect of the debts of the debtor shall be deemed to have been stayed and secondly, an embargo will be placed on the creditors for the commencement of any legal action or proceeding in respect of the debts of the debtor. The purpose of this interim moratorium is to provide a facilitative environment for the debtor to initiate the process.

The Central Government has been given the power to notify transactions (in consultation with the appropriate financial sector regulators), which will be exempted from the moratorium in the interest of smooth functioning of the financial markets in the country.

**Interim-moratorium and its effect on legal action or proceeding** – According to sub-section (1) of section 96, when an application is filed under section 94 or section 95 an interim-moratorium shall commence on the date of the application in relation to all the debts and shall cease to have effect on the date of admission of such application, and during the interim-moratorium period:

- (i) any pending legal action or proceeding in respect of any debt shall be deemed to have been stayed; and
- (ii) the creditors of the debtor shall not initiate any legal action or proceedings in respect of any debt.

**Interim moratorium to operate against all partners of firm** – Sub-section (2) provides that where the application has been made in relation to a firm, the interim moratorium under sub-section (1) shall operate against all the partners of the firm as on the date of the application.

**Exclusion of certain transactions.** – The provisions of sub-section (1) shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator. [Section 96(3)]

According to section 3(18) of the Code, a “**financial sector regulator**” means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government.

### Appointment of Resolution Professional

Section 97 of the Code provides for the appointment of resolution professional. An application for insolvency resolution process may be made by the debtor either personally or through a resolution professional. In the former case, the Insolvency and Bankruptcy Board nominates a resolution professional and in the latter case, the adjudicating authority directs the regulatory board to do a background check on the resolution professional who has filed the application. In both cases, the final appointment of the resolution professional is done through an order of the adjudicating authority.

**Procedure when application for insolvency resolution process is filed through resolution professional** – Sub-section (1) of section 97 provides that if the application under section 94 or 95 is filed through a resolution professional, the Adjudicating Authority shall direct the Board within **seven days** of the date of the application to confirm that there are no disciplinary proceedings pending against resolution professional.

Sub-section (2) further provides that the Board shall within **seven days** of receipt of directions under sub-section (1) communicate to the Adjudicating Authority in writing either –

- (a) confirming the appointment of the resolution professional; or
- (b) rejecting the appointment of the resolution professional and nominating another resolution professional for the insolvency resolution process.

**Procedure when application for insolvency resolution process is not filed through resolution professional** – According to sub-section (3) of section 97, where an application under section 94 or 95 is filed by the debtor or the creditor himself, as the case may be, and not through the resolution professional, the Adjudicating Authority shall direct the Board, within **seven days** of the filing of such application, to nominate a resolution professional for the insolvency resolution process.

Sub-section (4) further provides that the Board shall nominate a resolution professional within ten days of receiving the direction issued by the Adjudicating Authority under sub-section (3).

**Appointment of resolution professional** – The Adjudicating Authority shall by order appoint the resolution professional recommended under sub-section (2) or as nominated by the Board under sub-section (4). [Section 97(5)]

**Copy of the application for insolvency resolution process.** – A resolution professional appointed by the Adjudicating Authority under subsection (5) shall be provided a copy of the application for insolvency resolution process. [Section 97(6)]

### Replacement of Resolution Professional

Section 98 provides for the grounds and the manner in which a resolution professional can be replaced with another resolution professional in an insolvency resolution process initiated under section 94 or section 95 of the Code.

**Application to Adjudicating Authority** – Where the debtor or the creditor is of the opinion that the resolution professional appointed under section 97 is required to be replaced, he may apply to the Adjudicating Authority for the replacement of the such resolution professional. [Section 98(1)]

**Reference to Insolvency and Bankruptcy Board** – The Adjudicating Authority shall, within **seven days** of the receipt of the application under sub-section (1) make a reference to the Board for replacement of the resolution professional. [Section 98(2)]

**Recommendation by Insolvency and Bankruptcy Board** – The Board shall, within **ten days** of the receipt of a reference from the Adjudicating Authority under sub-section (2), recommend the name of the resolution professional to the Adjudicating Authority against whom no disciplinary proceedings are pending. [Section 98(3)]

**Implementation of the repayment plan** – Without prejudice to the provisions contained in sub-section (1), the creditors may apply to the Adjudicating Authority for replacement of the resolution professional where it has been decided in the meeting of the creditors, to replace the resolution professional with a new resolution professional for implementation of the repayment plan. [Section 98(4)]

**“Repayment plan”** means a plan prepared by the debtor in consultation with the resolution professional under section 105 containing a proposal to the committee of creditors for restructuring of his debts or affairs. [Section 79(20)]

**Confirmation by Insolvency and Bankruptcy Board** – Where the Adjudicating Authority admits an application made under sub-section (1) or sub-section (4), it shall direct the Board to confirm that there are no disciplinary proceedings pending against the proposed resolution professional. [Section 98(5)]

**Communication by Insolvency and Bankruptcy Board** – The Board shall send a communication within ten days of receipt of the direction under sub-section (5) either –

- (a) confirming appointment of the nominated resolution professional; or
- (b) rejecting appointment of the nominated resolution professional and recommend a new resolution professional. [Section 98(6)]

**Order by Adjudicating Authority** – On the basis of the communication of the Board under sub-section (3) or subsection (6), the Adjudicating Authority shall pass an order appointing a new resolution professional. [Section 98(7)]

**Directions to resolution professional** – The Adjudicating Authority may give directions to the resolution professional replaced under sub-section (8) –

- (a) to share all information with the new resolution professional in respect of the insolvency resolution process; and
- (b) to co-operate with the new resolution professional in such matters as may be required. [Section 98(8)]

### Submission of Report by Resolution Professional

**Submission of Report by Resolution Professional** – Section 99 of the Code provides the manner in which the resolution professional should make a report either recommending acceptance or rejection of the application for insolvency resolution process.

Section 99 provides that where the debt for which an application has been filed by a creditor is registered with the information utility, its validity cannot be contested by the debtor, however, the debtor has the right to prove the repayment of any debt by presenting evidence to the resolution professional.

**Report by resolution professional** – Sub-section (1) of section 99 provides that the resolution professional shall examine the application referred to in section 94 or section 95, as the case may be, within **ten days** of his appointment, and submit a report to the Adjudicating Authority recommending for approval or rejection of the application.

**Proof of repayment of debt** – According to sub-section (2), where the application has been filed under section 95, the resolution professional may require the debtor to prove repayment of the debt claimed as unpaid by the creditor by furnishing –

- (a) evidence of electronic transfer of the unpaid amount from the bank account of the debtor;
- (b) evidence of encashment of a cheque issued by the debtor; or
- (c) a signed acknowledgment by the creditor accepting receipt of dues.

Sub-section (3) provides that where the debt for which an application has been filed by a creditor is registered with the information utility, the debtor shall not be entitled to dispute the validity of such debt.

**Further information or explanation** – Sub-section (4) lays down that for the purposes of examining an application, the resolution professional may seek such further information or explanation in connection with the application as may be required from the debtor or the creditor or any other person who, in the opinion of the resolution professional, may provide such information.

Sub-section (5) mandates that the person from whom information or explanation is sought under sub-section (4) shall furnish such information or explanation within **seven days** of receipt of the request.

**Examination of application by resolution professional** – According to sub-section (6) of section 99, the resolution professional shall examine the application and ascertain that –

- (a) the application satisfies the requirements set out in section 94 or 95;
- (b) the applicant has provided information and given explanation sought by the resolution professional under sub-section (4).

**Recommendation by resolution professional** – Sub-section (7) provides that after examination of the application under sub-section (6), he may recommend acceptance or rejection of the application in his report.

**Where debtor is eligible for a fresh start** – Where the resolution professional finds that the debtor is eligible for a fresh start under Chapter II, the resolution professional shall submit a report recommending that the application by the debtor under section 94 be treated as an application under section 81 by the Adjudicating Authority. [Section 99(8)]

**Recording of reasons** – The resolution professional shall record the reasons for recommending the acceptance or rejection of the application in the report under sub-section (7). [Section 99(9)]

**Copy of report to debtor or creditor** – The resolution professional shall give a copy of the report under sub-section (7) to the debtor or the creditor, as the case may be. [Section 99(10)]

### Admission or Rejection of Application

Section 100 requires the adjudicating authority to pass an order either accepting or rejecting the application for insolvency resolution process within the prescribed time frame of 14 days from the date of submission of the report under section 99.

The failure of the insolvency resolution process on any of the three grounds contemplated in section 121 entitles the creditor to file for bankruptcy of the debtor under chapter IV of Part III of the Code. One of such grounds is mentioned in sub-section 4 of section 100 which entitles the creditor to file for a bankruptcy order under Chapter IV of Part III of the Code.

**Admission or rejection of application by Adjudicating Authority** – The Adjudicating Authority shall, within **fourteen days** from the date of submission of the report under section 99 pass an order either admitting or rejecting the application referred to in section 94 or 95, as the case may be. [Section 100(1)]

**Instructions for the purpose of conducting negotiations** – Where the Adjudicating Authority admits an application under sub-section (1), it may, on the request of the resolution professional, issue instructions for the purpose of conducting negotiations between the debtor and creditors and for arriving at a repayment plan. [Section 100(2)]

**Supply of documents** – The Adjudicating Authority shall provide a copy of the order passed under subsection (1) along with the report of the resolution professional and the application referred to in section 94 or 95, as the case may be, to the creditors within seven days from the date of the said order. [Section 100(3)]

**Entitlement of creditor to file for bankruptcy** – If the application referred to in section 94 or 95, as the case may be, is rejected by the Adjudicating Authority on the basis of report submitted by the resolution professional or that the application was made with the intention to defraud his creditors or the resolution professional, the order under sub-section (1) shall record that the creditor is entitled to file for a bankruptcy order under Chapter IV. [Section 100(4)]

### Moratorium

Section 101 provides that an order admitting an application for insolvency resolution has the effect of a fresh moratorium from the date of such admission for a period of **one hundred and eighty days**, or up to the date on which an **order approving the repayment plan** is passed by the adjudicating authority under section 114, whichever is earlier. On the passing of such order, irrespective of the acceptance or rejection of the application, the interim moratorium under section 96 comes to an end.



**Duration of moratorium** – Sub-section (1) of section 101 provides that when the application is admitted under section 100, a moratorium shall commence in relation to all the debts and shall cease to have effect at the end of the period of **one hundred and eighty days** beginning with the date of admission of the application or on the date the Adjudicating Authority passes an order on the repayment plan under section 114, whichever is earlier.

**Effect of moratorium** – According to sub-section (2), during the moratorium period:

- (a) any pending legal action or proceeding in respect of any debt shall be deemed to have been stayed;
- (b) the creditors shall not initiate any legal action or legal proceedings in respect of any debt; and
- (c) the debtor shall not transfer, alienate, encumber or dispose of any of the assets or his legal right or beneficial interest therein;

**Moratorium to operate against all partners of firm** – Sub-section (3) provides that where an order admitting the application under section 96 has been made in relation to a firm, the moratorium under sub-section (1) shall operate against all the partners of the firm.

**Exclusion of certain transactions** – According to sub-section (4) of section 101, the provisions of this section shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.

### Public Notice and Claims from Creditors

Section 102 provides for the issuance of a public notice by the adjudicating authority inviting claims from the creditors of the debtor. The objective of section 102 is to provide an opportunity to all the creditor to be a part of the repayment plan.

**Issuance of public notice** – According to sub-section (1) of section 102, the Adjudicating Authority shall issue a public notice within **seven days** of passing the order under section 100 inviting claims from all creditors within **twenty-one days** of such issue.

According to sub-section (3), such notice shall be –

- (a) published in at least one English and one vernacular newspaper which is in circulation in the state where the debtor resides;
- (b) affixed in the premises of the Adjudicating Authority; and
- (c) placed on the website of the Adjudicating Authority.

**Inclusion of certain details** – According to sub-section (2), the notice under sub-section (1) shall include –

- (a) details of the order admitting the application;
- (b) particulars of the resolution professional with whom the claims are to be registered; and
- (c) the last date for submission of claims.

### Registering of Claims by Creditors

Section 103 requires the creditors to register their claims with the concerned resolution professional by sending the details of their claims.

According to sub-section (1) of section 103, the creditors shall register claims with the resolution professional by sending details of the claims by way of electronic communications or through courier, speed post or registered letter. The creditor shall also provide to the resolution professional, personal information and such particulars as may be prescribed.



Sub-section (2) provides that in addition to the claims referred to in sub-section (1), the creditor shall provide to the resolution professional, personal information and such particulars as may be prescribed.

### Preparation of List of Creditors

Section 104 provides for the preparation of list of creditors by the resolution professional. Such a list is required for the purposes of organising meetings of creditors and for matters relating to the repayment plan.

Section 104 provides that :

- (1) The resolution professional shall prepare a list of creditors on the basis of –
  - (a) the information disclosed in the application filed by the debtor under section 94 or 95, as the case may be;
  - (b) claims received by the resolution professional under section 102.
- (2) The resolution professional shall prepare the list mentioned in sub-section (1) within **thirty days** from the date of the notice.

### Repayment plan

Section 105 of the Code provides for the preparation of a repayment plan by the debtor in consultation with the resolution professional. The repayment plan will contain terms as per which the debtor will repay his debts to his creditors. The creditors are not involved in the preparation of the repayment plan, therefore, the repayment plan will contain reasons why the creditors may be expected to agree to the repayment plan.

**Preparation of repayment plan** – According to sub-section (1) of section 105, the debtor shall prepare, in consultation with the resolution professional, a repayment plan containing a proposal to the creditors for restructuring of his debts or affairs.

**Inclusion of certain details in repayment plan** – According to sub-section (3), the repayment plan shall include the following details:

- (a) justification for preparation of such repayment plan and reasons on the basis of which the creditors may agree upon the plan;
- (b) provision for payment of fee to the resolution professional;
- (c) such other matters as may be specified.

**Authorisation under repayment plan** – Sub-section (2) of section 105 provides that 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; or
- (b) realise the assets of the debtor; or
- (c) administer or dispose of any funds of the debtor.

### Report of Resolution Professional on Repayment Plan

Section 106 of the Code provides for the preparation of a report by the resolution professional on the repayment plan. Such report is to be submitted to the adjudicating authority along with the repayment plan.

**Submission of repayment plan along with report of resolution professional** – Sub-section (1) of section 106 provides that the resolution professional shall submit the repayment plan under section 105 along with his report on such plan to the Adjudicating Authority within a period of twenty-one days from the last date of submission of claims under section 102.

**Report of resolution professional** – According to sub-section (2), the report referred in sub-section (1) shall include that

- (a) the repayment plan is in compliance with the provisions of any law for the time being in force;
- (b) the repayment plan has a reasonable prospect of being approved and implemented; and
- (c) there is a necessity of summoning a meeting of the creditors, if required, to consider the repayment plan:

The proviso to sub-section (2) of section 106 provides that where the resolution professional recommends that a meeting of the creditors is not required to be summoned, reasons for the same shall be provided.

**Time and place of meeting of creditors** – According to sub-section (3), the report referred to in sub-section (2) shall also specify the date on which, and the time and place at which, the meeting should be held if he is of the opinion that a meeting of the creditors should be summoned.

Sub-section (4) provides that for the purposes of sub-section (3) –

- (a) the date on which the meeting is to be held shall be not less than fourteen days and not more than twenty-eight days from the date of submission of report under subsection(1);
- (b) the resolution professional shall consider the convenience of creditors in fixing the date and venue of the meeting of the creditors.

### Summoning of Meeting of Creditors

Section 107 provides for the summoning of meeting of creditors.

**Issuance of notice** – Sub-section (1) of section 107 provides that the resolution professional shall issue a notice calling the meeting of the creditors at least **fourteen days** before the date fixed for such meeting.

According to sub-section (2), the resolution professional shall send the notice of the meeting to the list of creditors prepared under section 104.

Sub-section (3) further provides that the notice sent under sub-section (1) shall state the address of the Adjudicating Authority to which the repayment plan and report of the resolution professional on the repayment plan has been submitted and shall be accompanied by –

- (a) a copy of the repayment plan;
- (b) a copy of the statement of affairs of the debtor;
- (c) a copy of the said report of the resolution professional; and
- (d) forms for proxy voting.

**Proxy voting.** – According to sub-section (4), the proxy voting, including electronic proxy voting shall take place in such manner and form as may be specified.

### Conduct of Meeting of Creditors

Section 108 provides for the conduct of meeting of creditors by the resolution professional. In the meeting, the creditors may decide to approve, modify or reject the repayment plan. if modifications are suggested by the creditors, the resolution professional shall ensure that consent of the debtor is obtained for each modification.

The meeting of the creditors shall be conducted in accordance with the provisions of this section and sections 109, 110 and 111. [Section 108(1)]. In the meeting of the creditors, the creditors may decide to approve, modify or reject the repayment plan. [Section 108(2)]

The resolution professional shall ensure that if modifications are suggested by the creditors, consent of the debtor shall be obtained for each modification. [Section 108(3)]

The resolution professional may for a sufficient cause adjourn the meeting of the creditors for a period of not more than **seven days** at a time. [Section 108(4)]

### Voting Rights in Meeting of Creditors

Section 109 provides for voting rights and determination of voting share in meeting of creditors. The weightage of the vote shall depend on the value of the debt on the date of admission of the application for insolvency resolution process under section 100.

**Creditor's right to vote** – A creditor shall be entitled to vote at every meeting of the creditors in respect of the repayment plan in accordance with voting share assigned to him. [Section 109(1)]

**Determination of voting share** – The resolution professional shall determine voting share to be assigned to each creditor in the manners specified by the Board. [Section 109(2)]

**Non-entitlement to vote** – A creditor shall not be entitled to vote in respect of a debt for an unliquidated amount. [Section 109(3)]

A creditor shall not be entitled to vote in a meeting of the creditors if he –

- (a) is not a creditor mentioned in the list of creditors under section 104; or
- (b) is an associate of the debtor. [Section 109(4)]

### Rights of Secured Creditors in relation to Repayment Plan

Section 110 sets out the rights of the secured creditors in a repayment plan prepared under the present chapter i.e., Chapter III of Part III of the Code. A secured creditor may or may not like to give up on his right to enforce security during the period of implementation of the repayment plan. A secured creditor participating in the meetings of the creditors and voting in relation to the repayment plan will be required to give up his right to enforce his security. However, in the event the secured creditor does not want to give up his right to enforce his security, he may vote on the repayment plan in respect of his unsecured debt, and his consent will be required if any term of the repayment plan affects his right to enforce security.

**Participation and voting in meetings of creditors** – Secured creditors shall be entitled to participate and vote in the meetings of the creditors. [Section 110(1)]

**Forfeiture of secured creditor's right to enforce security** – A secured creditor participating in the meetings of the creditors and voting in relation to the repayment plan shall forfeit his right to enforce the security during the period of the repayment plan in accordance with the terms of the repayment plan. [Section 110(2)]

**Affidavit by secured creditor** – Where a secured creditor does not forfeit his right to enforce security, he shall submit an affidavit to the resolution professional at the meeting of the creditors stating –

- (a) that the right to vote exercised by the secured creditor is only in respect of the unsecured part of the debt; and
- (b) the estimated value of the unsecured part of the debt. [Section 110(3)]

**Separate debts** – In case a secured creditor participates in the voting on the repayment plan by submitting an affidavit under sub-section (3), the secured and unsecured parts of the debt shall be treated as separate debts. [Section 110(4)]

**Concurrence of the secured creditor** – The concurrence of the secured creditor shall be obtained if he does not participate in the voting on repayment plan but provision of the repayment plan affects his right to enforce security. [Section 110(5)]

The **Explanation** appended to section 110 makes it clear that for the purposes of this section, “period of the repayment plan” means the period from the date of the order passed under section 114 till the date on which the notice is given by the resolution professional under section 117 or report submitted by the resolution professional under section 118, as the case may be.

### Approval of Repayment Plan by Creditors

Section 111 of the Code provides that the repayment plan or any modification to the repayment plan shall be approved by a majority of more than three-fourth in value of the creditors present in person or by proxy and voting on the resolution in a meeting of the creditors.

### Report of Meeting of Creditors on Repayment Plan

Section 112 requires the resolution professional to prepare a report on the proceedings of the meeting of the creditors on repayment plan.

Sub-section (1) of section 112 provides that the resolution professional shall prepare a report of the meeting of the creditors on repayment plan.

Sub-section (2) further provides that the report under sub-section (1) shall contain –

- (a) whether the repayment plan was approved or rejected and if approved, the list the modifications, if any;
- (b) the resolutions which were proposed at the meeting and the decision on such resolutions;
- (c) list of the creditors who were present or represented at the meeting, and the voting records of each creditor for all meetings of the creditors; and
- (d) such other information as the resolution professional thinks appropriate to make known to the Adjudicating Authority.

### Notice of Decisions taken at Meeting of Creditors

Section 113 mandates the resolution professional to provide a copy of the report of the meeting of creditors prepared under section 99 to:

- (a) the debtor;
- (b) the creditors, including those who were not present at the meeting; and
- (c) the Adjudicating Authority.

### Order of Adjudicating Authority on Repayment Plan

Section 114 provides for an order by the adjudicating authority approving or rejecting the repayment plan.

**Approve or rejection of repayment plan.** – According to sub-section (1), the Adjudicating Authority shall by an order approve or reject the repayment plan on the basis of the report of the meeting of the creditors submitted by the resolution professional under section 112.

The proviso to sub-section (1) of section 114 provides that where a meeting of creditors is not summoned, the Adjudicating Authority shall pass an order on the basis of the report prepared by the resolution professional under section 106.

**Directions for implementing of repayment plan** – The order of the Adjudicating Authority approving the repayment plan may also provide for directions for implementing the repayment plan. [Section 114(2)]

**Modification of repayment plan** – Where the Adjudicating Authority is of the opinion that the repayment plan requires modification, it may direct the resolution professional to re-convene a meeting of the creditors for reconsidering the repayment plan. [Section 114(3)]

### Effect of Order of Adjudicating Authority on Repayment Plan

Section 115 provides that a repayment plan approved by the adjudicating authority under section 114 is binding on all the creditors mentioned in the repayment plan as well as the debtor and take effect as if proposed by the debtor in the meeting. [Section 115(1)]

Sub-section (2) provides that where the Adjudicating Authority rejects the repayment plan under section 114, the debtor and the creditors shall be entitled to file an application for bankruptcy under Chapter IV of Part III of the Code.

A copy of the order passed by the Adjudicating Authority under sub-section (2) shall be provided to the Board, for the purpose of recording an entry in the register referred to in section 196. [Section 115(3)]

### Implementation and Supervision of Repayment Plan

Section 116 requires the resolution professional appointed under section 97 or under section 98 to supervise the implementation of the approved repayment plan. [Section 116(1)]

The resolution professional may apply to the Adjudicating Authority for directions, if necessary, in relation to any particular matter arising under the repayment plan. [Section 116(2)]

The Adjudicating Authority may issue directions to the resolution professional on the basis of an application under sub-section (2). [Section 116(3)]

### Completion of Repayment Plan

Section 117 provides for the sharing of certain documents by the resolution professional after completion of the repayment plan.

Sub-section (1) to section 117 provides that the resolution professional shall within **fourteen days** of the completion of the repayment plan, forward to the persons who are bound by the repayment plan under section 115 and the Adjudicating Authority, the following documents:

- (a) a notice that the repayment plan has been fully implemented; and
- (b) a copy of a report by the resolution professional summarising all receipts and payments made in pursuance of the repayment plan and extent of the implementation of such plan as compared with the repayment plan approved by the meeting of the creditors.

**Extension of time** – The resolution professional may apply to the Adjudicating Authority to extend the time mentioned in sub-section (1) for such further period not exceeding **seven days**. [Section 117(2)]

### Repayment Plan Coming to End Prematurely

Section 118 makes provision regarding the premature ending of repayment plan. A repayment plan is deemed to have come to an end prematurely if it does not get fully implemented within the period as mentioned in the repayment plan. The resolution professional is required to provide a report and the adjudicating authority shall pass an order stating that the plan has not been completely implemented and the debtor or the creditor whose claims have not been satisfied are entitled to file for bankruptcy of the debtor under chapter IV of Part III of the Code.

The time period for the completion of the implementation of the repayment plan cannot be extended, and thus the participants are required to act in the most efficient manner for its implementation. Penalties may be

imposed under criminal law and other relevant sections of Chapter VII of Part III of the Code if anyone adopts dilatory tactics to unreasonably delay the implementation of the plan.

**Premature ending of repayment plan** – A repayment plan shall be deemed to have come to an end prematurely if it has not been fully implemented in respect of all persons bound by it within the period as mentioned in the repayment plan. [Section 118(1)]

**Report to Adjudicating Authority on premature ending** – Where a repayment plan comes to an end prematurely under this section, the resolution professional shall submit a report to the Adjudicating Authority which shall state –

- (a) the receipts and payments made in pursuance of the repayment plan;
- (b) the reasons for premature end of the repayment plan; and
- (c) the details of the creditors whose claims have not been fully satisfied. [Section 118(2)]

**Order by Adjudicating Authority** – The Adjudicating Authority shall pass an order on the basis of the report submitted under sub-section (2) by the resolution professional that the repayment plan has not been completely implemented. [Section 118(3)]

**Who may apply for bankruptcy** – The debtor or the creditor, whose claims under repayment plan have not been fully satisfied, shall be entitled to apply for a bankruptcy order under Chapter IV. [Section 118(4)]

**Copies of documents** – The Adjudicating Authority shall forward to the persons bound by the repayment plan under section 115, a copy of the –

- (a) report submitted by the resolution professional to the Adjudicating Authority under sub-section (2); and
- (b) order passed by the Adjudicating Authority under sub-section (3). [Section 118(5)]

The Adjudicating Authority shall forward a copy of the order passed under subsection (4) to the Board, for the purpose of recording entries in the register referred to in section 196. [Section 118(6)]

## Discharge Order

Section 119 provides for the resolution professional to apply to the Adjudicating Authority for a discharge order in relation to the debts mentioned in the repayment plan. The repayment plan may provide for a discharge on the completion of the implementation of the repayment plan or for an early discharge. Early discharge i.e., discharge before the completion of the implementation of the repayment plan, results in the legal recognition by the adjudicating authority of the successful compliance by the debtor with the terms of the repayment plan and that he is no longer considered to be undergoing an insolvency resolution process.

**Application to Adjudicating Authority for discharge order** – On the basis of the repayment plan, the resolution professional shall apply to the Adjudicating Authority for a discharge order in relation to the debts mentioned in the repayment plan and the Adjudicating Authority may pass such discharge order. [Section 119(1)]

**Options in repayment plan** – The repayment plan may provide for –

- (a) early discharge; or
- (b) discharge on complete implementation of the repayment plan. [Section 119(2)]

**Record of entries** – The discharge order shall be forwarded to the Board, for the purpose of recording entries in the register referred to in section 196. [Section 119(3)]

**Discharge of any other person** – The discharge order under sub-section (3) shall not discharge any other person from any liability in respect of his debt. [Section 119(4)]



### Standard of Conduct

Section 120 provides that the resolution professional shall perform his functions and duties in compliance with the code of conduct provided under section 208.

Section 120 requires that the resolution professional must adhere to the prescribed code of conduct.

### LESSON ROUND UP

- The Insolvency and Bankruptcy Code, 2016 outlines separate insolvency resolution processes for corporates and individuals/partnership firms.
- Sections 94 to 120 in Chapter III of Part III of the Insolvency and Bankruptcy Code, 2016 deals with insolvency resolution process for Individuals and Partnership Firms. Under Chapter III of Part III of the Code, both debtor as well as the creditor can initiate the insolvency resolution process.
- Section 94 of the Insolvency and Bankruptcy Code, 2016 lays down the eligibility criteria for filing of an application for insolvency resolution by a debtor who has committed a default. An application under section 94 of the Code may be filed by the debtor personally, or through a resolution professional.
- Section 95 of the Code provides for an insolvency resolution process application by a creditor(s). In relation to a partnership debt owed to the creditor, the creditor may file an application against the firm or one or more of the partners, provided that separate applications made against partners of the same firm shall be consolidated and heard together.
- Section 96 provides for interim moratorium which shall commence on the date of the application initiating the insolvency resolution and shall cease to have effect on the date of admission of such application.
- Section 97 of the Code provides for the appointment of resolution professional. An application for insolvency resolution process may be made by the debtor either personally or through a resolution professional.
- Section 98 provides for the grounds and the manner in which a resolution professional can be replaced with another resolution professional in an insolvency resolution process initiated under section 94 or section 95 of the Code.
- Section 99 of the Code provides the manner in which the resolution professional should make a report either recommending acceptance or rejection of the application for insolvency resolution process.
- Section 100 requires the adjudicating authority to pass an order either accepting or rejecting the application for insolvency resolution process within the prescribed time frame of 14 days from the date of submission of the report under section 99.
- Section 101 provides that an order admitting an application for insolvency resolution has the effect of a fresh moratorium from the date of such admission for a period of one hundred and eighty days, or up to the date on which an order approving the repayment plan is passed by the adjudicating authority under section 114, whichever is earlier.
- Section 102 provides for the issuance of a public notice by the adjudicating authority inviting claims from the creditors of the debtor. Section 104 provides for the preparation of list of creditors by the resolution professional. Such a list is required for the purposes of organising meetings of creditors and for matters relating to the repayment plan.



- Section 105 of the Code provides for the preparation of a repayment plan by the debtor in consultation with the resolution professional. Section 106 of the Code provides for the preparation of a report by the resolution professional on the repayment plan. Such report is to be submitted to the adjudicating authority along with the repayment plan.
- Section 108 provides for the conduct of meeting of creditors by the resolution professional. In the meeting, the creditors may decide to approve, modify or reject the repayment plan.
- Section 109 provides for voting rights and determination of voting share in meeting of creditors. The weightage of the vote shall depend on the value of the debt on the date of admission of the application for insolvency resolution process under section 100.
- Section 113 mandates the resolution professional to provide a copy of the report of the meeting of creditors prepared under section 99. Section 114 provides for an order by the adjudicating authority approving or rejecting the repayment plan.
- Section 115 provides that a repayment plan approved by the adjudicating authority under section 114 is binding on all the creditors mentioned in the repayment plan as well as the debtor and take effect as if proposed by the debtor in the meeting.
- Section 116 requires the resolution professional appointed under section 97 or under section 98 to supervise the implementation of the approved repayment plan. Section 117 provides for the sharing of certain documents by the resolution professional after completion of the repayment plan.
- The resolution professional shall perform his functions and duties in compliance with the code of conduct provided under section 208. Section 120 requires that the resolution professional must adhere to the prescribed code of conduct.

### SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. Discuss in brief the provisions relating to filing of an application by debtor (individual/firm) for insolvency resolution under section 94 of the Insolvency and Bankruptcy Code, 2016.
2. Mention the provisions under section 95 of the Insolvency and Bankruptcy Code, 2016 relating to filing of an application by creditor for insolvency resolution.
3. Discuss in brief the procedure for appointment of Resolution Professional under Chapter III of Part III of the Insolvency and Bankruptcy Code, 2016 that deal with insolvency resolution process for Individuals and Partnership Firms.
4. Write a note on 'Moratorium' under section 101 of the Insolvency and Bankruptcy Code, 2016.
5. What do you understand by 'Repayment Plan' under section 105 of the Insolvency and Bankruptcy Code, 2016?
6. Discuss in brief the provisions relating to Meeting of Creditors.
7. What are the rights of secured creditors in relation to a Repayment Plan?

[illegible]

[illegible]

# Lesson 21

## Fresh Start Process

### LESSON OUTLINE

- Introduction
- Eligibility for making application
- Application for Fresh Start Order
- Appointment of Resolution Professional
- Examination of Application by Resolution Professional
- Effect of Admission of Application
- Application against Decision of Resolution Professional
- Replacement of Resolution Professional
- Discharge Order
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Sections 80 to 93 in Chapter II of Part III of the Insolvency and Bankruptcy Code, 2016 make provisions relating to fresh start process. Under the automatic fresh start process, eligible debtors can apply to the Adjudicating Authority for discharge from certain debts not exceeding a specified threshold and can start afresh without any liabilities.

This process is available only to those debtors whose gross annual income does not exceed sixty thousand rupees; the aggregate value of the assets does not exceed twenty thousand rupees; the aggregate value of the qualifying debts does not exceed thirty-five thousand rupees and do not have a dwelling unit.

Only the debtor can file an application for fresh start for discharge of his debt. A resolution professional (RP) examines the application and submits a report to the DRT, recommending acceptance or rejection of the application. On consideration of the report of the RP, the DRT passes an order, either admitting or rejecting the application. If the application is admitted, the creditors have an opportunity to object to the process on limited grounds. On conclusion of the process, the DRT passes an order for the discharge of the debtor or revokes the admission of the application. The discharge order writes off the unsecured debts, allowing the debtor to start afresh, subject to an entry in the credit history.

After reading this lesson you will be able to understand the concept of fresh start process, application procedure and process involved in fresh start process.

## INTRODUCTION

Sections 80 to 93 in Chapter II of Part III of the Insolvency and Bankruptcy Code, 2016 make provisions relating to fresh start process. Under the automatic fresh start process, eligible debtors can apply to the **Adjudicating Authority** for discharge from certain debts not exceeding a specified threshold and can start afresh without any liabilities.

According to the Insolvency and Bankruptcy Code, 2016, in the case of companies and Limited Liability Partnerships (LLPs), the adjudication authority is the National Company Law Tribunal (NCLT), while the cases involving individuals and partnerships are handled by the Debts Recovery Tribunals (DRTs). Therefore, Debt Recovery Tribunal (DRT) is the adjudicating authority for individuals and unlimited partnerships and an application for fresh start process shall be filed before it.

The fresh start process has been conceptualized for persons who owe relatively less amount of money and have little or no income or assets to repay their debts. The outcome of an application for fresh start is a discharge from the **qualifying debts** and the debtor shall not be required to pay the amount comprising of the qualifying debts for which a discharge order is made under section 92 of the Code.

According to section 79(19) of the Code, a “**qualifying debt**” means amount due, which includes interest or any other sum due in respect of the amounts owed under any contract, by the debtor for a liquidated sum either immediately or at certain future time and does not include

- (a) an excluded debt;
- (b) a debt to the extent it is secured; and
- (c) any debt which has been incurred three months prior to the date of the application for fresh start process.

According to section 79(15), an “Excluded debt” means –

- (a) liability to pay fine imposed by a court or tribunal;
- (b) liability to pay damages for negligence, nuisance or breach of a statutory, contractual or other legal obligation;
- (c) liability to pay maintenance to any person under any law for the time being in force;
- (d) liability in relation to a student loan;
- (e) any other debt as may be prescribed.

Thus excluded debts, secured debts and debts incurred **three months** prior to the date of the application for fresh start process are outside the purview of fresh start process. Provisions relating to Fresh Start Process have not yet been notified.

## ELIGIBILITY FOR MAKING AN APPLICATION

Section 80 lays down the eligibility criteria for the debtor for the purposes of making an application for a fresh start process.

**Who may file application for fresh start** – Section 80(1) lays down that a debtor, who is unable to pay his debt and fulfils the conditions specified in sub-section (2) of section 80, shall be entitled to make an application for a fresh start for discharge of his qualifying debt under Chapter II of Part III of the Code.

**Conditions for filing application for fresh start** – Sub-section (2) lays down conditions for filing of an application for fresh start. Sub-section (2) provides that a debtor may apply, either personally or through a resolution professional, for a fresh start under Chapter II of Part III of the Code in respect of his qualifying debts to the Adjudicating Authority if –

- (a) the gross annual income of the debtor does not exceed sixty thousand rupees;
- (b) the aggregate value of the assets of the debtor does not exceed twenty thousand rupees;
- (c) the aggregate value of the qualifying debts does not exceed thirty-five thousand rupees;
- (d) he is not an undischarged bankrupt;
- (e) he does not own a dwelling unit, irrespective of whether it is encumbered or not;
- (f) a fresh start process, insolvency resolution process or bankruptcy process is not subsisting against him; and
- (g) no previous fresh start order under this Chapter has been made in relation to him in the preceding twelve months of the date of the application for fresh start.

### Application for Fresh Start Order

Section 81 provides for the imposition of an interim moratorium. The purpose of the interim moratorium is to provide a conducive environment for the debtor to initiate a fresh start process. The moratorium provisions shall have effect from the date of filing of such application up to the date on which such application is admitted or rejected by the adjudicating authority.

**Interim-moratorium** – Section 81(1) lays down that when an application is filed under section 80 by a debtor, an interim-moratorium shall commence on the date of filing of said application in relation to all the debts and shall cease to have effect on the date of admission or rejection of such application, as the case may be.

**Legal action or proceeding** – Section 81(2) further lays down that during the interim-moratorium period,

- (i) any legal action or legal proceeding pending in respect of any of his debts shall be deemed to have been stayed; and
- (ii) no creditor shall initiate any legal action or proceedings in respect of such debt.

**Form and manner of application** – The application under section 80 shall be in such form and manner and accompanied by such fee, as may be prescribed. [Section 81(3)]

**Information to be provided** – According to sub-section (4) of section 81, the application under sub-section (3) shall contain the following information supported by an affidavit, namely:

- (a) a list of all debts owed by the debtor as on the date of the said application along with details relating to the amount of each debt, interest payable thereon and the names of the creditors to whom each debt is owed;
- (b) the interest payable on the debts and the rate thereof stipulated in the contract;
- (c) a list of security held in respect of any of the debts,
- (d) the financial information of the debtor and his immediate family for up to **two years** prior to the date of the application;
- (e) the particulars of the debtor's personal details, as may be prescribed;
- (f) the reasons for making the application;
- (g) the particulars of any legal proceedings which, to the debtor's knowledge has been commenced against him;
- (h) the confirmation that no previous fresh start order under this Chapter has been made in respect of the qualifying debts of the debtor in the preceding twelve months of the date of the application.

### Appointment of Resolution Professional

Section 82 of the Code provides for the appointment of resolution professional. According to section 79(21) of the Code, a “**resolution professional**” means an insolvency professional appointed under Part III as a resolution professional for conducting the fresh start process or insolvency resolution process.

An application for fresh start may be made by the debtor either personally or through a resolution professional. In the former case, the Insolvency and Bankruptcy Board nominates a resolution professional for the fresh start process and in the latter case, the adjudicating authority seeks confirmation from the Insolvency and Bankruptcy Board that there are no disciplinary proceedings against the resolution professional who has filed the application. In both cases, the final appointment of the resolution professional is done through an order of the adjudicating authority.

**Where application is filed through resolution professional** – (1) Where an application under section 80 is filed by the debtor through a resolution professional, the Adjudicating Authority shall direct the Board within seven days of the date of receipt of the application and shall seek confirmation from the Board that there are no disciplinary proceedings against the resolution professional who has submitted such application. [Section 82(1)]

(2) The Board shall communicate to the Adjudicating Authority in writing either –

- (a) confirmation of the appointment of the resolution professional who filed an application under sub-section (1); or
- (b) rejection of the appointment of the resolution professional who filed an application under sub-section (1) and nominate a resolution professional suitable for the fresh start process. [Section 82(2)]

**Where application is filed by debtor himself** – According to sub-section (3) of section 82, where an application under section 80 is filed by the debtor himself and not through the resolution professional, the Adjudicating Authority shall direct the Board within seven days of the date of the receipt of an application to nominate a resolution professional for the fresh start process.

**Nomination of resolution professional by Board** – The Board shall nominate a resolution professional within **ten days** of receiving the direction issued by the Adjudicating Authority under sub-section (3). [Section 82(4)]

**Appointment of resolution professional by Adjudicating Authority** – Sub-section (5) of section 82 lays down that the Adjudicating Authority shall by order appoint the resolution professional recommended or nominated by the Board under sub-section (2) or sub-section (4), as the case may be.

**Copy of the application for fresh start** – A resolution professional appointed by the Adjudicating Authority under subsection (5) shall be provided a copy of the application for fresh start. [Section 82(6)]

### Examination of Application by Resolution Professional

Section 83 prescribes the manner in which the resolution professional should make a report either recommending acceptance or rejection of the application for fresh start.

**Report by resolution professional** – According to sub-section (1) of section 83, the resolution professional shall examine the application made under section 80 within **ten days** of his appointment, and submit a report to the Adjudicating Authority, either recommending acceptance or rejection of the application.

Sub-section (2) of section 83 further provides that the report referred to in sub-section (1) shall contain the details of the amounts mentioned in the application which in the opinion of the resolution professional are–



- (a) qualifying debts; and
- (b) liabilities eligible for discharge under sub-section (3) of section 92.

**Calling for further information or explanation in connection with application for fresh start** – Under sub-section (3) of section 83, the resolution professional may call for such further information or explanation in connection with the application as may be required from the debtor or any other person who, in the opinion of the resolution professional, may provide such information.

Sub-section (4) lays down that the debtor or any other person, as the case may be, shall furnish such information or explanation within **seven days** of receipt of the request under sub-section (3).

**Presumption of debtor's inability to pay his debts** – According to sub-section (5), the resolution professional shall presume that the debtor is unable to pay his debts at the date of the application if –

- (a) in his opinion the information supplied in the application indicates that the debtor is unable to pay his debts and he has no reason to believe that the information supplied is incorrect or incomplete; and
- (b) he has reason to believe that there is no change in the financial circumstances of the debtor since the date of the application enabling the debtor to pay his debts.

**Rejection of application** – Sub-section (6) lays down that the resolution professional shall reject the application, if in his opinion –

- (a) the debtor does not satisfy the conditions specified under section 80; or
- (b) the debts disclosed in the application by the debtor are not qualifying debts; or
- (c) the debtor has deliberately made a false representation or omission in the application or with respect to the documents or information submitted.

**Recording of reasons** – The resolution professional shall record the reasons for recommending the acceptance or rejection of the application in the report to the Adjudicating Authority under sub-section (1) and shall give a copy of the report to the debtor. [Section 83(7)]

### Admission or Rejection of Application by Adjudicating Authority

Section 84 provides for the acceptance or rejection of the application for fresh start by the adjudicating authority.

According to section 84(1), the Adjudicating Authority may within **fourteen days** from the date of submission of the report by the resolution professional, pass an order either admitting or rejecting the application made under sub-section (1) of section 81.

The order passed under sub-section (1) accepting the application shall state the amount which has been accepted as qualifying debts by the resolution professional and other amounts eligible for discharge under section 92 for the purposes of the fresh start order. [Section 84(2)]

A copy of the order passed by the Adjudicating Authority under sub-section (1) along with a copy of the application shall be provided to the creditors mentioned in the application within two days of the passing of the order. [Section 84(3)]

### Effect of Admission of Application

Section 85 provides that an order admitting an application for fresh start has the effect of a fresh moratorium from the date of such admission for a period of one hundred and eighty days, or up to the date on which the order admitting such application is revoked under section 91, as the case may be. On the passing of such order,

irrespective of the acceptance or rejection of the application, the interim moratorium under section 81 comes to an end.

**Commencement of moratorium** – On the date of admission of the application, the moratorium period shall commence in respect of all the debts. [Section 85(1)]

**Effect of moratorium** – During the moratorium period –

- (a) any pending legal action or legal proceeding in respect of any debt shall be deemed to have been stayed; and
- (b) subject to the provisions of section 86, the creditors shall not initiate any legal action or proceedings in respect of any debt. [Section 85(2)]

Sub-section (3) of section 85 provides that during the moratorium period, the debtor shall –

- (a) not act as a director of any company, or directly or indirectly take part in or be concerned in the promotion, formation or management of a company;
- (b) not dispose of or alienate any of his assets;
- (c) inform his business partners that he is undergoing a fresh start process;
- (d) be required to inform prior to entering into any financial or commercial transaction of such value as may be notified by the Central Government, either individually or jointly, that he is undergoing a fresh start process;
- (e) disclose the name under which he enters into business transactions, if it is different from the name in the application admitted under section 84;
- (f) not travel outside India except with the permission of the Adjudicating Authority.

**Cessation of moratorium** – The moratorium ceases to have effect at the end of the period of one hundred and eighty days beginning with the date of admission unless the order admitting the application is revoked under sub-section (2) of section 91. [Section 85(4)]

### Objections by Creditor and their Examination by Resolution Professional

Section 86 gives the creditors a right to object to the inclusion of their debt as a qualifying debt for discharge or object to any material inconsistency in the details of such debt, by filing an application to the resolution professional.

**Grounds for objection** – Any creditor mentioned in the order of the Adjudicating Authority under section 84 to whom a qualifying debt is owed may, within a period of **ten days** from the date of receipt of the order under section 84, object only on the following grounds, namely: –

- (a) inclusion of a debt as a qualifying debt; or
- (b) incorrectness of the details of the qualifying debt specified in the order under section 84. [Section 86(1)]

**Mode of filing objection** – A creditor may file an objection under sub-section (1) by way of an application to the resolution professional. [Section 86(2)]

**Supporting Documents** – The application under sub-section (2) shall be supported by such information and documents as may be prescribed. [Section 86(3)]

**Every objection to be considered** – The resolution professional shall consider every objection made under this section. [Section 86(4)]

**Examination of objections** – The resolution professional shall examine the objections under sub-section (2) and either accept or reject the objections, within **ten days** of the date of the application. [Section 86(5)]

The resolution professional may examine on any matter that appears to him to be relevant to the making of a final list of qualifying debts for the purposes of section 92. [Section 86(6)]

**Steps to be taken by resolution professional** – On the basis of the examination under sub-section (5) or sub-section (6), the resolution professional shall -

- (a) prepare an amended list of qualifying debts for the purpose of the discharge order;
- (b) make an application to the Adjudicating Authority for directions under section 90; or
- (c) take any other steps in relation to the debtor. [Section 86(7)]

### Application against Decision of Resolution Professional

Section 87 lists out the grounds on which an aggrieved creditor or debtor may make an application to the adjudicating authority challenging the action of the resolution professional taken under section 86.

**Grounds for application to the Adjudicating Authority** – According to sub-section (1) of section 87, the debtor or the creditor who is aggrieved by the action taken by the resolution professional under section 86, may, within ten days of such decision, make an application to the Adjudicating Authority challenging such action on any of the following grounds, namely:

- (a) that the resolution professional has not given an opportunity to the debtor or the creditor to make a representation; or
- (b) that the resolution professional colluded with the other party in arriving at the decision; or
- (c) that the resolution professional has not complied with the requirements of section 86.

**Order by Adjudicating Authority** – Sub-section (2) of section 87 provides that the Adjudicating Authority shall decide the application referred to in sub-section (1) within **fourteen days** of such application and make an order as it deems fit.

**Action against resolution professional** – According to sub-section (3), where the application under sub-section (1) has been allowed by the Adjudicating Authority, it shall forward its order to the Board and the Board may take such action as may be required under Chapter VI of Part IV against the resolution professional.

### General Duties of Debtor

Section 88 lists out the duties of the debtor. According to section 88, the debtor shall –

- (a) make available to the resolution professional all information relating to his affairs, attend meetings and comply with the requests of the resolution professional in relation to the fresh start process.
- (b) inform the resolution professional as soon as reasonably possible of –
  - (i) any material error or omission in relation to the information or document supplied to the resolution professional; or
  - (ii) any change in financial circumstances after the date of application, where such change has an impact on the fresh start process.

### Replacement of Resolution Professional

Section 89 provides for the grounds and the manner in which a resolution professional can be replaced with another resolution professional in a fresh start process.

**Application to Adjudicating Authority** – Where the debtor or the creditor is of the opinion that the resolution professional appointed under section 82 is required to be replaced, he may apply to the Adjudicating Authority for the replacement of such resolution professional. [Section 89(1)]

**Reference to Insolvency and Bankruptcy Board** – The Adjudicating Authority shall within seven days of the receipt of the application under sub-section (1) make a reference to the Board for replacement of the resolution professional. [Section 89(2)]

**Board to recommend name of insolvency professional** – The Board shall, within ten days of the receipt of a reference from the Adjudicating Authority under sub-section (2), recommend the name of insolvency professional to the Adjudicating Authority against whom no disciplinary proceedings are pending. [Section 89(3)]

The Adjudicating Authority shall appoint another resolution professional for the purposes of the fresh start process on the basis of the recommendation by the Board. [Section 89(4)]

**Directions by Adjudicating Authority** – The Adjudicating Authority may give directions to the resolution professional replaced under sub-section (4) –

- (a) to share all information with the new resolution professional in respect of the fresh start process; and
- (b) to co-operate with the new resolution professional in such matters as may be required. [Section 89(5)]

### Directions for Compliances of Restrictions

Section 90 provides that the resolution professional may apply to the adjudicating authority for directions.

**Application to Adjudicating Authority for directions** – According to sub-section (1) of section 90, the resolution professional may apply to the Adjudicating Authority for any of the following directions, namely:

- (a) compliance of any restrictions referred to in sub-section (3) of section 85, in case of non-compliance by the debtor; or
- (b) compliance of the duties of the debtor referred to in section 88, in case on noncompliance by the debtor.

Sub-section (2) further provides that the resolution professional may apply to the Adjudicating Authority for directions in relation to any other matter under Chapter II of Part III for which no specific provisions have been made.

### Revocation of Order Admitting Application

Section 91 sets out the grounds on which the resolution professional may submit an application to the Adjudicating Authority seeking revocation of its order made under section 84. The object of section 91 is to provide for rescinding the fresh start process where due to any change in the financial circumstances of the debtor, the debtor becomes ineligible for a fresh start process or the debtor acts in violation of certain provisions of the Code.

**Application to Adjudicating Authority by resolution professional** – The resolution professional may submit an application to the Adjudicating Authority seeking revocation of its order made under section 84 on the following grounds, namely: -

- (a) if due to any change in the financial circumstances of the debtor, the debtor is ineligible for a fresh start process; or
- (b) non-compliance by the debtor of the restrictions imposed under sub-section (3) of section 85; or
- (c) if the debtor has acted in a mala fide manner and has wilfully failed to comply with the provisions of this Chapter. [Section 91(1)]

**Order by Adjudicating Authority** – The Adjudicating Authority shall, within fourteen days of the receipt of the application under sub-section (1), may by order admit or reject the application. [Section 91(2)]

**Effect of admission of application** – On passing of the order admitting the application referred to in sub-section (1), the moratorium and the fresh start process shall cease to have effect. [Section 91(3)]

**Copy of the order** – A copy of the order passed by the Adjudicating Authority under this section shall be provided to the Board for the purpose of recording an entry in the register referred to in section 196. [Section 91(4)]

### Discharge Order

Section 92 provides for the passing of a discharge order by the adjudicating authority at the end of the moratorium period for discharge of the debtor from the qualifying debts. Further, the discharge order shall also provide for the discharge of penalties, penal interest and other sums owed under any contract, in respect of the qualifying debts, from the date of the application for fresh start to the date of the discharge order.

A discharge order discharges only the debtor. Such discharge order is recorded in the financial history of the debtor.

**Preparation and submission of final list of qualifying debts** – The resolution professional shall prepare a final list of qualifying debts and submit such list to the Adjudicating Authority at least **seven days** before the moratorium period comes to an end. [Section 92(1)]

**Discharge order by Adjudicating Authority** – The Adjudicating Authority shall pass a discharge order at the end of the moratorium period for discharge of the debtor from the qualifying debts mentioned in the list under sub-section (1). [Section 92(2)]

**Discharge of debtor from liabilities** – Without prejudice to the provisions of sub-section (2), the Adjudicating Authority shall discharge the debtor from the following liabilities, namely: -

- (a) penalties in respect of the qualifying debts from the date of application till the date of the discharge order;
- (b) interest including penal interest in respect of the qualifying debts from the date of application till the date of the discharge order; and
- (c) any other sums owed under any contract in respect of the qualifying debts from the date of application till the date of the discharge order. [Section 92(3)]

Sub-section (4) of section 92 provides that the discharge order shall not discharge the debtor from any debt not included in sub-section (2) and from any liability not included under sub-section (3).

**Entry in register** – The discharge order shall be forwarded to the Board for the purpose of recording an entry in the register referred to in section 196. [Section 92(5)]

**Discharge of any other person** – Sub-section 6 to section 92 clarifies that a discharge order under sub-section (2) shall not discharge any other person from any liability in respect of the qualifying debts.

### Standard of Conduct

Section 93 of the Code provides that the resolution professional shall perform his functions and duties in compliance with the code of conduct provided under section 208.

Thus, section 93 requires that the resolution professional adheres to the prescribed code of conduct.

### LESSON ROUND UP

- Sections 80 to 93 in Chapter II of Part III of the Insolvency and Bankruptcy Code, 2016 make provisions relating to fresh start process. The fresh start process has been conceptualized for persons who owe relatively less amount of money and have little or no income or assets to repay their debts.
- The outcome of an application for fresh start is a discharge from the qualifying debts and the debtor shall not be required to pay the amount comprising of the qualifying debts for which a discharge order is made under section 92 of the Code.
- Thus excluded debts, secured debts and debts incurred three months prior to the date of the application for fresh start process are outside the purview of fresh start process. Section 80 lays down the eligibility criteria for making an application for a fresh start process.
- Section 81 provides for the imposition of an interim moratorium. The moratorium provisions shall have effect from the date of filing of such application up to the date on which such application is admitted or rejected by the adjudicating authority.
- Section 82 of the Code provides for the appointment of resolution professional. An application for fresh start may be made by the debtor either personally or through a resolution professional.
- Section 83 prescribes the manner in which the resolution professional should make a report either recommending acceptance or rejection of the application for fresh start. Section 84 provides for the acceptance or rejection of the application for fresh start by the adjudicating authority.
- Section 85 provides that an order admitting an application for fresh start has the effect of a fresh moratorium from the date of such admission for a period of one hundred and eighty days, or up to the date on which the order admitting such application is revoked under section 91, as the case may be. On the passing of such order, irrespective of the acceptance or rejection of the application, the interim moratorium under section 81 comes to an end.
- Section 86 gives the creditors a right to object to the inclusion of their debt as a qualifying debt for discharge or object to any material inconsistency in the details of such debt, by filing an application to the resolution professional.
- Section 87 lists out the grounds on which an aggrieved creditor or debtor may make an application to the adjudicating authority challenging the action of the resolution professional taken under section 86. Section 89 provides for the grounds and the manner in which a resolution professional can be replaced with another resolution professional in a fresh start process.
- Section 91 sets out the grounds on which the resolution professional may submit an application to the Adjudicating Authority seeking revocation of its order made under section 84. The object of section 91 is to provide for rescinding the fresh start process where due to any change in the financial circumstances of the debtor, the debtor becomes ineligible for a fresh start process or the debtor acts in violation of certain provisions of the Code.
- Section 92 provides for the passing of a discharge order by the adjudicating authority at the end of the moratorium period for discharge of the debtor from the qualifying debts.

### SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. What is 'Fresh Start Process' under the Insolvency and Bankruptcy Code, 2016? State the eligibility for making an application for Fresh Start Process.

2. Mention the information an application for Fresh Start shall contain under section 81 of the Insolvency and Bankruptcy Code, 2016.
3. Describe the manner in which the resolution professional should make a report either recommending acceptance or rejection of the application for fresh start under section 83 of the Code.
4. What is the effect of admission of an application for Fresh Start under section 85 of the Code?
5. How can a creditor object to the inclusion of their debt as a qualifying debt for discharge or object to any material inconsistency in the details of such debt in an order for Fresh Start?
6. Write a note on 'Discharge Order' under section 92 of the Insolvency and Bankruptcy Code, 2016.

[illegible]





# Lesson 22

## Debt Recovery & SARFAESI

### LESSON OUTLINE

- Introduction
- SARFAESI Act, 2002
- Asset Reconstruction Companies
- Measures for asset reconstruction
- Enforcement of security interest by creditors
- Security Interest (Enforcement) Rules, 2002
- Debt Recovery
- Debt Recovery Tribunals (DRT)
- Application to the DRT
- Modes of Recovery
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

The SARFAESI Act, 2002 gives detailed provisions for the formation and activities of Asset Securitization Companies. Scope of their activities, capital requirements, funding, etc. are given by the Act. RBI is the regulator for these institutions.

As a legal mechanism to insulate assets, the Act addresses the interests of secured creditors (like banks). Several provisions of the Act give directives and powers to various institutions to manage the NPAs. The Act facilitates the reconstruction of financial assets which are acquired while exercising powers of enforcement of securities or change of management or other powers which are proposed to be conferred on the banks and financial institutions.

Debts Recovery Tribunals (DRT) and Debts Recovery Appellate Tribunals (DRAT) have been constituted for establishment of Tribunals for expeditious adjudication and recovery of debts due to Banks and Financial Institutions and for matters connected therewith.

Original Applications to be filed by Banks and Financial Institutions before Debt Recovery Tribunal for recovery of dues not less than Rs.10 lakhs, under Recovery of Bank Due to Banks & Financial Institutions Act, 1993.

Bank can simultaneously initiate proceedings under SARFAESI Act, 2002 as well. Any person aggrieved on account of order passed by DRT may file an appeal before DRAT.

## INTRODUCTION

In the traditional lending process, a bank makes a loan, maintaining it as an asset on its balance sheet, collecting principal and interest, and monitoring whether there is any deterioration in borrower's creditworthiness.

This requires a bank to hold assets till repayment of loan. The funds of the bank are blocked in these loans and to meet its growing fund requirement a bank has to raise additional funds from the market. Securitisation is a way of unlocking these blocked funds.

One of the most prominent developments in international finance in recent decades and the one that is likely to assume even greater importance in future is securitisation. Securitisation is the process of pooling and repackaging of homogenous illiquid financial assets into marketable securities that can be sold to investors. Basically Securitisation is a method of raising funds by way of selling receivables for money.

The process leads to the creation of financial instruments that represent ownership interest in, or are secured by a segregated income producing asset or pool of assets. The pool of assets collateralises securities. These assets are generally secured by personal or real property (e.g. automobiles, real estate, or equipment loans), but in some cases are unsecured (e.g. credit card debt, consumer loans).

### How Securitisation gained importance?

When a borrower, who is under a liability to pay to secured creditor, makes any default in repayment of secured debt or any instalment thereof, the account of borrower is classified as non-performing asset (NPA). NPAs constitute a real economic cost to the nation because they reflect the application of scarce capital and credit funds to unproductive uses. The money locked up in NPAs are not available for productive use and to the extent that banks seek to make provisions for NPAs or write them off, it is a charge on their profits. High level of NPAs impact adversely on the financial strength of banks who in the present era of globalization, are required to conform to stringent International Standards.

The public at large is also adversely affected because bank's main source of funds are deposits placed by public. Continued growth in NPA portfolio threatens the repayment capacity of the banks and erode the confidence reposed by them in the banks.

Prior to the enactment of SARFAESI, the banks had to take recourse to the long legal route against the defaulting borrowers beginning from filing of claims in the courts. A lot of time was usually spent in getting decrees and execution thereof before the banks could make some recoveries. In the meantime the promoters could seek the protection of BIFR and could also dilute the securities available to banks. The Debt Recovery Tribunals (DRTs) set up by the Govt. also did not prove to be of much help as these get gradually overburdened by the huge volume of cases referred to them. All along, the banks were feeling greatly handicapped in the absence of any powers for seizure of assets charged to them.

All these issues gave the passage for evolution of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). This Act is a unique piece of legislation which has far reaching consequences and has overriding power over the other legislations and it shall go in addition to and not in derogation of certain legislations.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 was enacted with a view to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The Act enables the banks and financial institutions to realise long-term assets, manage problems of liquidity, asset liability mismatch and improve recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets

by adopting measures for recovery or reconstruction. The said Act further provides for setting up of asset reconstruction companies which are empowered to take possession of secured assets of the borrower including the right to transfer by way of lease, assignment or sale and realise the secured assets and take over the management of the business of the borrower.

With increasing levels of non-performing or stressed assets in the Indian financial services sector, reforming the debt recovery and bankruptcy framework has been a key focus area for the Indian government. The Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016 was introduced in Lok Sabha on May 11, 2016. It seeks to amend four laws: (i) Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), (ii) Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDBFI), (iii) Indian Stamp Act, 1899 and (iv) Depositories Act, 1996.

Following the enactment of the Insolvency and Bankruptcy Code, 2016 (Bankruptcy Code), the Indian parliament has passed the Enforcement of Security Interests and Recovery of Debt Laws and Miscellaneous Provisions (Amendment) Act, 2016 to improve the efficacy of Indian debt recovery laws. The amendment act introduces a number of changes to the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 (SARFAESI Act) and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (DRT Act). These changes have come into effect as per the government notifications in the Official Gazette.

## STATEMENT OF OBJECTS AND REASONS OF SARFAESI ACT

It is necessary at the outset, to reiterate the statement of objects and reasons for the SARFAESI Act, which reads as under:

The financial sector has been one of the key drivers in India's efforts to achieve success in rapidly developing its economy. While the banking industry in India is progressively complying with the international prudential norms and accounting practices, there are certain areas in which the banking and financial sector do not have a level playing field as compared to other participants in the financial markets in the world. There is no legal provision for facilitating securitisation of financial assets of banks and financial institutions. Further, unlike international banks, the banks and financial institutions in India do not have power to take possession of securities and sell them. Our existing legal framework relating to commercial transactions has not kept pace with the changing commercial practices and financial sector reforms. This has resulted in slow pace of recovery of defaulting loans and mounting levels of non-performing assets of banks and financial institutions. Narasimham Committee I and II and Andhyarujina Committee constituted by the Central Government for the purpose of examining banking sector reforms have considered the need for changes in the level system in respect of these areas. These Committees, *inter alia*, have suggested enactment of a new legislation for securitisation and empowering banks and financial institutions to take possession of the securities and sell them without the intervention of the court.

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002 was promulgated on the 21st June, 2002 to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto. The provisions of the Ordinance of liquidity, asset liability mismatches and improvement in recovery by exercising powers to take possession of securities, sell them and reduce non-performing assets by adopting measures for recovery or reconstruction."

The main purpose of the SARFAESI Act is to enable and empower the secured creditors to take possession of their securities and to deal with them without the intervention of the court and also alternatively to authorise any securitisation or reconstruction company to acquire financial assets of any bank or financial institution.

The SARFAESI Act, 2002 has empowered the Banks and Financial Institutions with vast power to enforce the securities charged to them. The Banks can now issue notices to the defaulters to pay up the dues and if they fail to do so within 60 days of the date of the notice, the banks can take over the possession of assets like factory, land and building, plant and machinery etc. charged to them including the right to transfer by way of lease, assignment or sale and realize the secured assets. In case the borrower refuses peaceful handing over of the secured assets, the bank can also file an application before the District Magistrate or Chief Metropolitan Magistrate for taking possession of assets. The Banks can also take over the management of business of the borrower. The bank in addition can appoint any person to manage the secured assets the possession of which has been taken over by the bank. Banks can package and sell loans via “Securitisation” and the same can be traded in the market like bonds and shares.

### **Apex Court Upheld Constitutional Validity of the SARFAESI Act**

The SARFAESI Act, 2002 was challenged in various courts on grounds that it was loaded heavily in favour of lenders, giving little chance to the borrowers to explain their views once recovery process is initiated under the legislation. Leading the charge against the said Act was Mardia Chemicals in its plea against notice served by ICICI Bank. The Government had, however, argued that the legislation would bring about a financial discipline and reduce the burden of Non-Performing Assets (NPAs) of banks and institutions.

In *Mardia Chemicals Ltd. v. UOI* [2004] 59 CLA 380 (SC), it was urged by the petitioner that

- (i) there was no occasion to enact such a draconian legislation to find a short-cut to realise non-performing assets ('NPAs') without their ascertainment when there already existed the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 ('Recovery of Debt Act') for doing so;
- (ii) no provision had been made to take into account lenders liability;
- (iii) that the mechanism for recovery under Section 13 does not provide for an adjudicatory forum of inter se disputes between lender and borrower; and
- (iv) that the appeal provisions were illusory because the appeal would be maintainable after possession of the property or management of the property was taken over or the property sold and the appeal is not entertainable unless 75 per cent of the amount claimed is deposited with the Debts Recovery Tribunal ('DRT').

The Hon'ble Supreme Court held that though some of the provisions of the Act 2002 be a bit harsh for some of the borrowers but on those grounds the impugned provisions of the Act cannot be said to be unconstitutional in the view of the fact that the objective of the Act is to achieve speedier recovery of the dues declared as NPAs and better availability of capital liquidity and resources to help in growth of economy of the country and welfare of the people in general which would sub-serve the public interest.

The Supreme Court observed that the Act provides for a forum and remedies to the borrower to ventilate his grievances against the bank or financial institution, inter alia, with respect to the amount of the demand of the secured debt. After the notice is sent, the borrower may explain the reasons why the measures may or may not be taken under Sub-section (4) of Section 13. The creditor must apply its mind to the objections raised in reply to such notice. There must be meaningful consideration by the Court of the objections raised rather than to

ritually reject them and to proceed to take drastic measures under Sub-section (4) of Section 13. The court held that such a procedure/mechanism was conducive to the principles of fairness and that such a procedure was also important from the point of view of the economy of the country and would serve the purpose in the growth of a healthy economy. It would serve as guidance to secured debtors in general in conducting their affairs.

The court opined that the fairness doctrine, cannot be stretched too far, such communication is only for the purposes of the secured debtors knowledge and cannot give an occasion to the secured debtor to resort to any proceeding, which are not permissible under the provisions of the Act. Thus, a secured debtor is not allowed to challenge the reasons communicated or challenge the action likely to be taken by the secured creditor at that point of time unless his right to approach the DRT as provided under section 17 matures on any measure having been taken under Sub-section (4) of Section 13.

Moreover, another safeguard is also available to a secured borrower within the framework of the Act i.e. to approach the DRT under Section 17 though such a right accrues only after measures are taken under Sub-section (1) of Section 13.

The Hon'ble Supreme Court, however, found that the requirement of deposit of 75 per cent of the amount claimed before entertaining an appeal (petition) under Section 17 is an oppressive, onerous and arbitrary condition and against all the canons of reasonableness. Held this provision to be invalid and ordered that it was liable to be struck down. The amount of deposit for making an appeal has since been reduced to 5% of the amount claimed, to keep it reasonable and also to check the genuineness of the Appellant.

## Definitions

Section 2 of The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) defines various terms used in the Act.

Section 2 (1): In the SARFAESI Act, unless the context otherwise requires-

- (a) "Appellate Tribunal" means a Debts Recovery Appellate Tribunal established under sub-section (1) of section 8 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993);
- (b) "asset reconstruction" means acquisition by any [asset reconstruction company] of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance;
- (ba) "asset reconstruction company" *means a company registered with Reserve Bank under section 3 for the purposes of carrying on the business of asset reconstruction or securitisation, or both;*
- (c) "bank" means –
  - (i) a banking company; or
  - (ii) a corresponding new bank; or
  - (iii) the State Bank of India; or
  - (iv) a subsidiary bank; or
  - (iva) a multi-State co-operative bank; or
  - (v) such other bank which the Central Government may, by notification, specify for the purposes of this Act;
- (f) "borrower" means any person who has been granted financial assistance by any bank or financial

institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a asset reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance or who has raised funds through issue of debt securities.

(g) “Central Registry” means the registry set up or cause to be set up under sub-section (1) of section 20;

(ga) “company” means a company as defined in clause (20) of section 2 of the Companies Act, 2013

(ha) “debt” shall have the meaning assigned to it in clause (g) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993) and includes –

(i) unpaid portion of the purchase price of any tangible asset given on hire or financial lease or conditional sale or under any other contract;

(ii) any right, title or interest on any intangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of such intangible asset or an obligation incurred or credit otherwise extended to enable any borrower to acquire the intangible asset or obtain licence of such asset;

(i) “Debts Recovery Tribunal” means the Tribunal established under sub-section (1) of section 3 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993; name changed Recovery of Debts and Bankruptcy Act, 1993

(ia) “debt securities” means *debt securities listed in accordance with the regulations made by the Board under the Securities and Exchange Board of India Act, 1992.*

(j) “default” means –

(ii) non-payment of any debt or any other amount payable by the borrower to any secured creditor consequent upon which the account of such borrower is classified as non-performing asset in the books of account of the secured creditor; or

(iii) non-payment of any debt or any other amount payable by the borrower with respect to debt securities after notice of ninety days demanding payment of dues served upon such borrower by the debenture trustee or any other authority in whose favour security interest is created for the benefit of holders of such debt securities;

(k) “financial assistance” means any loan or advance granted or any debentures or bonds subscribed or any guarantees given or letters of credit established or any other credit facility extended by any bank or financial institution [including funds provided for the purpose of acquisition of any tangible asset on hire or financial lease or conditional sale or under any other contract or obtaining assignment or licence of any intangible asset or purchase of debt securities;

(l) “financial asset” means debt or receivables and includes –

(i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or

(ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or

(iii) a mortgage, charge, hypothecation or pledge of movable property; or

(iv) any right or interest in the security, whether full or part underlying such debt or receivables; or



- (v) any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or
- (va) any beneficial right, title or interest in any tangible asset given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire such tangible asset; or
- (vb) any right, title or interest on any intangible asset or licence or assignment of such intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of such intangible asset or an obligation incurred or credit otherwise extended to enable the borrower to acquire such intangible asset or obtain licence of the intangible asset; or
- (vi) any financial assistance;
- (m) “financial institution” means –
  - i. a public financial institution within the meaning of section 4A of the Companies Act, 1956;
  - ii. any institution specified by the Central Government under sub-clause (ii) of clause (h) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993;
  - iii. the International Finance Corporation established under the International Finance Corporation (Status, Immunities and Privileges) Act, 1958
  - iiia. a debenture trustee registered with the Board and appointed for secured debt securities;
  - iiib. asset reconstruction company, whether acting as such or managing a trust created for the purpose of securitisation or asset reconstruction, as the case may be
  - iv. any other institution or non-banking financial company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934, which the Central Government may, by notification, specify as financial institution for the purposes of this Act;
- (ma) “financial lease” *means a lease under any lease agreement of tangible asset, other than negotiable instrument or negotiable document, for transfer of lessor’s right therein to the lessee for a certain time in consideration of payment of agreed amount periodically and where the lessee becomes the owner of the such assets at the expiry of the term of lease or on payment of the agreed residual amount, as the case may be;*
- (n) “hypothecation” means a charge in or upon any movable property, existing or future, created by a borrower in favour of a secured creditor without delivery of possession of the movable property to such creditor, as a security for financial assistance and includes floating charge and crystallisation of such charge into fixed charge on movable property;
- (na) “negotiable document” *means a document, which embodies a right to delivery of tangible assets and satisfies the requirements for negotiability under any law for the time being in force including warehouse receipt and bill of lading;*
- (o) “non-performing asset” means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, [doubtful or loss asset, –
  - a) in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body;

- b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank;
- (q) “obligor” means a person liable to the originator, whether under a contract or otherwise, to pay a financial asset or to discharge any obligation in respect of a financial asset, whether existing, future, conditional or contingent and includes the borrower;
- (r) “originator” means the owner of a financial asset which is acquired by a asset reconstruction company for the purpose of securitisation or asset reconstruction;
- (s) “property” means –
  - i) immovable property;
  - ii) movable property;
  - iii) any debt or any right to receive payment of money, whether secured or unsecured;
  - iv) receivables, whether existing or future;
  - v) intangible assets, being know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature as may be prescribed by the Central Government in consultation with Reserve Bank.
- (t) qualified buyer means a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or asset reconstruction company which has been granted a certificate of registration under sub-section (4) of section 3 or any asset management company making investment on behalf of mutual fund or a foreign institutional investor registered under the Securities and Exchange Board of India Act, 1992 or regulations made thereunder, any category of non- institutional investors as may be specified by the Reserve Bank under sub-section (1) of section 7 or any other body corporate as may be specified by the Board;
- (z) “securitisation” means acquisition of financial assets by any asset reconstruction company from any originator, whether by raising of funds by such asset reconstruction company from qualified buyers by issue of security receipts representing undivided interest in such financial assets or otherwise;
- (zb) “security agreement” means an agreement, instrument or any other document or arrangement under which security interest is created in favour of the secured creditor including the creation of mortgage by deposit of title deeds with the secured creditor;
- (zc) “secured asset” means the property on which security interest is created; (zd) “secured creditor” means –
  - I. any bank or financial institution or any consortium or group of banks or financial institutions holding any right, title or interest upon any tangible asset or intangible asset as specified in clause (I);
  - II. debenture trustee appointed by any bank or financial institution; or
  - III. an asset reconstruction company whether acting as such or managing a trust set up by such asset reconstruction company for the securitisation or reconstruction, as the case may be; or
  - IV. debenture trustee registered with the Board appointed by any company for secured debt securities; or
  - V. any other trustee holding securities on behalf of a bank or financial institution, in whose favour security interest is created by any borrower for due repayment of any financial assistance.

- (ze) “secured debt” means a debt which is secured by any security interest;
- (zf) “security interest” means right, title or interest of any kind, other than those specified in section 31, upon property created in favour of any secured creditor and includes –
  - i. any mortgage, charge, hypothecation, assignment or any right, title or interest of any kind, on tangible asset, retained by the secured creditor as an owner of the property, given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or credit provided to enable the borrower to acquire the tangible asset; or
  - ii. such right, title or interest in any intangible asset or assignment or licence of such intangible asset which secures the obligation to pay any unpaid portion of the purchase price of the intangible asset or the obligation incurred or any credit provided to enable the borrower to acquire the intangible asset or licence of intangible asset;
- (zg) “security receipt” means a receipt or other security, issued by a *asset reconstruction company* to any *qualified buyer* pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitisation;

### Asset Reconstruction Companies [ARC]

“**Asset Reconstruction Company**”, means a company registered with Reserve Bank under section 3 of SARFAESI Act for the purposes of carrying on the business of asset reconstruction or securitisation, or both.

The problem of non-performing loans created due to systematic banking crisis world over has become acute. Focused measures to help the banking systems to realise its NPAs has resulted into creation of specialised bodies called asset management companies which in India have been named asset reconstruction companies (‘ARCs’). The buying of impaired assets from banks or financial institutions by ARCs will make their balance sheets cleaner and they will be able to use their time, energy and funds for development of their business. ARCs may be able to mix up their assets, both good and bad, in such a manner to make them saleable.

The main objective of asset reconstruction company (‘ARC’) is to act as agent for any bank or financial institution for the purpose of recovering their dues from the borrowers on payment of fees or charges, to act as manager of the borrowers’ asset taken over by banks, or financial institution, to act as the receiver of properties of any bank or financial institution and to carry on such ancillary or incidental business with the prior approval of Reserve Bank wherever necessary. If an ARC carries on any business other than the business of asset reconstruction or securitisation or the business mentioned above, it shall cease to carry on any such business within one year of doing such other business.

### Regulation of Securitisation and Reconstruction of Financial Assets of Banks and Financial Institutions

Section 3 of SARFAESI Act deals with the Registration of **Asset Reconstruction Companies**

- (1) No asset reconstruction company shall commence or carry on the business of securitisation or asset reconstruction without –
  - (a) obtaining a certificate of registration granted under this section; and
  - [(b) *having net owned fund of not less than two crore rupees or such other higher amount as the Reserve Bank, may, by notification, specify:*

**Provided** that the Reserve Bank may, by notification, specify different amounts of owned fund for different class or classes of *asset reconstruction companies*:

**Provided further** that an *asset reconstruction company*, existing on the commencement of this Act, shall make an application for registration to the Reserve Bank before the expiry of six months from such commencement and notwithstanding anything contained in this sub-section may continue to carry on the business of securitisation or asset reconstruction until a certificate of registration is granted to it or, as the case may be, rejection of application for registration is communicated to it.

- (2) Every asset reconstruction company shall make an application for registration to the Reserve Bank in such form and manner as it may specify.
- (3) The Reserve Bank may, for the purpose of considering the application for registration of an asset reconstruction company to commence or carry on the business of securitisation or asset reconstruction, as the case may be, require to be satisfied, by an inspection of records or books of such asset reconstruction company, or otherwise, that the following conditions are fulfilled, namely: –
  - (a) that the asset reconstruction company has not incurred losses in any of the three preceding financial years;
  - (b) that such asset reconstruction company has made adequate arrangements for realisation of the financial assets acquired for the purpose of securitisation or asset reconstruction and shall be able to pay periodical returns and redeem on respective due dates on the investments made in the company by the qualified buyers or other persons;
  - (c) that the directors of asset reconstruction company have adequate professional experience in matters related to finance, securitisation and reconstruction;
  - (d) [\*\*\*]
  - (e) that any of its directors has not been convicted of any offence involving moral turpitude;
  - [(f) *that a sponsor of an asset reconstruction company is a fit and proper person in accordance with the criteria as may be specified in the guidelines issued by the Reserve Bank for such persons;*
  - (g) that asset reconstruction company has complied with or is in a position to comply with prudential norms specified by the Reserve Bank;
  - [(h) that asset reconstruction company has complied with one or more conditions specified in the guidelines issued by the Reserve Bank for the said purpose.
- (4) The Reserve Bank may, after being satisfied that the conditions specified in sub-section (3) are fulfilled, grant a certificate of registration to the asset reconstruction company to commence or carry on business of securitisation or asset reconstruction, subject to such conditions, which it may consider, fit to impose.
- (5) The Reserve Bank may reject the application made under sub-section (2) if it is satisfied that the conditions specified in sub-section (3) are not fulfilled:

**Provided** that before rejecting the application, the applicant shall be given a reasonable opportunity of being heard.

- (6) Every asset reconstruction company, shall obtain prior approval of the Reserve Bank for any substantial change in its management including appointment of any director on the board of directors of the asset reconstruction company or managing director or chief executive officer thereof or change of location of its registered office or change in its name:

**Provided** that the decision of the Reserve Bank, whether the change in management of a *asset reconstruction company* is a substantial change in its management or not, shall be final.

*Explanation.* – For the purposes of this section, the expression “substantial change in management” means the change in the management by way of transfer of shares or *change affecting the sponsorship in the company by way of transfer of shares* or amalgamation or transfer of the business of the company.

### Cancellation of Certificate of Registration (Section 4)

Section 4 of the SARFAESI Act deals with the Cancellation of certificate of registration.

- (1) The Reserve Bank may cancel a certificate of registration granted to asset reconstruction company, if such company –
  - (a) ceases to carry on the business of securitisation or asset reconstruction; or
  - (b) ceases to receive or hold any investment from a qualified buyer or
  - (c) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or
  - (d) at any time fails to fulfil any of the conditions referred to in clauses (a) to (g) of sub-section (3) of section 3; or
  - (e) fails to –
    - I. comply with any direction issued by the Reserve Bank under the provisions of this Act; or
    - II. maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or
    - III. submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or
    - IV. obtain prior approval of the Reserve Bank required under sub-section (6) of section 3:

**Provided** that before cancelling a certificate of registration on the ground that the *asset reconstruction company* has failed to comply with the provisions of clause (c) or has failed to fulfil any of the conditions referred to in clause (d) or sub-clause (iv) of clause (e), the Reserve Bank, unless it is of the opinion that the delay in cancelling the certificate of registration granted under sub-section (4) of section 3 shall be prejudicial to the public interest or the interests of the investors or the *asset reconstruction company*, shall give an opportunity to such company on such terms as the Reserve Bank may specify for taking necessary steps to comply with such provisions or fulfilment of such conditions.

- (2) An asset reconstruction company aggrieved by the order of cancellation of certificate of registration may prefer an appeal, within a period of thirty days from the date on which [such order of cancellation] is communicated to it, to the Central Government:

**Provided** that before rejecting an appeal such company shall be given a reasonable opportunity of being heard.

- (3) An asset reconstruction company, which is holding investments of qualified buyers and whose application for grant of certificate of registration has been rejected or certificate of registration has been cancelled shall, notwithstanding such rejection or cancellation be deemed to be a asset reconstruction company

until it repays the entire investments held by it (together with interest, if any) within such period as the Reserve Bank may direct.

### Acquisition of rights or interest in financial assets (Section 5)

- (1) Notwithstanding anything contained in any agreement or any other law for the time being in force, any *asset reconstruction company* may acquire financial assets of any bank or financial institution –
  - (a) by issuing a debenture or bond or any other security in the nature of debenture, for consideration agreed upon between such company and the bank or financial institution, incorporating therein such terms and conditions as may be agreed upon between them; or
  - (b) by entering into an agreement with such bank or financial institution for the transfer of such financial assets to such company on such terms and conditions as may be agreed upon between them.
- (1A) Any document executed by any bank or financial institution under sub-section (1) in favour of the asset reconstruction company acquiring financial assets for the purposes of asset reconstruction or securitisation shall be exempted from stamp duty in accordance with the provisions of section 8F of the Indian Stamp Act.
 

**Provided** that the provisions of this sub-section shall not apply where the acquisition of the financial assets by the asset reconstruction company is for the purposes other than asset reconstruction or securitisation.
- (2) If the bank or financial institution is a lender in relation to any financial assets acquired under sub-section (1) by the asset reconstruction company, such asset reconstruction company shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to such financial assets.
- (2A) If the bank or financial institution is holding any right, title or interest upon any tangible asset or intangible asset to secure payment of any unpaid portion of the purchase price of such asset or an obligation incurred or credit otherwise provided to enable the borrower to acquire the tangible asset or assignment or licence of intangible asset, such right, title or interest shall vest in the asset reconstruction company on acquisition of such assets under sub-section (1).
- (3) Unless otherwise expressly provided by this Act, all contracts, deeds, bonds, agreements, powers-of-attorney, grants of legal representation, permissions, approvals, consents or no-objections under any law or otherwise and other instruments of whatever nature which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of financial asset under sub-section (1) and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial assets, be of as full force and effect against or in favour of the asset reconstruction company, as the case may be, and may be enforced or acted upon as fully and effectually as if, in the place of the said bank or financial institution, asset reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of asset reconstruction company, as the case may be.
- (4) If, on the date of acquisition of financial asset under sub-section (1), any suit, appeal or other proceeding of whatever nature relating to the said financial asset is pending by or against the bank or financial institution, save as provided in the third proviso to sub-section (1) of section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 the same shall not abate, or be discontinued or be, in any



way, prejudicially affected by reason of the acquisition of financial asset by the asset reconstruction company, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the asset reconstruction company, as the case may be.

- (5) On acquisition of financial assets under sub-section (1), the asset reconstruction company, may with the consent of the originator, file an application before the Debts Recovery Tribunal or the Appellate Tribunal or any court or other Authority for the purpose of substitution of its name in any pending suit, appeal or other proceedings and on receipt of such application, such Debts Recovery Tribunal or the Appellate Tribunal or court or Authority shall pass orders for the substitution of the asset reconstruction company in such pending suit, appeal or other proceedings.

#### **Transfer of pending applications to any one of Debts Recovery Tribunals in certain cases (Section 5A)**

- (1) If any financial asset, of a borrower acquired by a asset reconstruction company, comprise of secured debts of more than one bank or financial institution for recovery of which such banks or financial institutions has filed applications before two or more Debts Recovery Tribunals, the asset reconstruction company may file an application to the Appellate Tribunal having jurisdiction over any of such Tribunals in which such applications are pending for transfer of all pending applications to any one of the Debts Recovery Tribunals as it deems fit.
- (2) On receipt of such application for transfer of all pending applications under sub-section (1), the Appellate Tribunal may, after giving the parties to the application an opportunity of being heard, pass an order for transfer of the pending applications to any one of the Debts Recovery Tribunals.
- (3) Notwithstanding anything contained in the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, any order passed by the Appellate Tribunal under sub-section (2) shall be binding on all the Debts Recovery Tribunals referred to in sub-section (1) as if such order had been passed by the Appellate Tribunal having jurisdiction on each such Debts Recovery Tribunal.
- (4) Any recovery certificate, issued by the Debts Recovery Tribunal to which all the pending applications are transferred under sub-section (2), shall be executed in accordance with the provisions contained in sub-section (23) of section 19 and other provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 shall, accordingly, apply to such execution.

#### **Notice to obligor and discharge of obligation of such obligor (Section 6)**

- (1) The bank or financial institution may, if it considers appropriate, give a notice of acquisition of financial assets by any asset reconstruction company, to the concerned obligor and any other concerned person and to the concerned registering authority (including Registrar of Companies) in whose jurisdiction the mortgage, charge, hypothecation, assignment or other interest created on the financial assets had been registered.
- (2) Where a notice of acquisition of financial asset under sub-section (1) is given by a bank or financial institution, the obligor, on receipt of such notice, shall make payment to the concerned asset reconstruction company, as the case may be, and payment made to such company in discharge of any of the obligations in relation to the financial asset specified in the notice shall be a full discharge to the obligor making the payment from all liability in respect of such payment.
- (3) Where no notice of acquisition of financial asset under sub-section (1) is given by any bank or financial institution, any money or other properties subsequently received by the bank or financial institution, shall



constitute monies or properties held in trust for the benefit of and on behalf of the asset reconstruction company, as the case may be, and such bank or financial institution shall hold such payment or property which shall forthwith be made over or delivered to such asset reconstruction company, as the case may be, or its agent duly authorised in this behalf.

#### **Issue of security by raising of receipts or funds by Asset Reconstruction Company (Section 7)**

- (1) Without prejudice to the provisions contained in the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 (15 of 1992), any asset reconstruction company, may, after acquisition of any financial asset under sub-section (1) of section 5, offer security receipts to qualified buyers or such other category of investors including non-institutional investors as may be specified by the Reserve Bank in consultation with the Board, from time to time, for subscription in accordance with the provisions of those Acts.
- (2) A asset reconstruction company may raise funds from the qualified buyers by formulating schemes for acquiring financial assets and shall keep and maintain separate and distinct accounts in respect of each such scheme for every financial asset acquired out of investments made by a qualified buyer and ensure that realisations of such financial asset is held and applied towards redemption of investments and payment of returns assured on such investments under the relevant scheme.
- (2A) (a) The scheme for the purpose of offering security receipts under sub-section (1) or raising funds under sub-section (2), may be in the nature of a trust to be managed by the *asset reconstruction company*, and the *asset reconstruction company* shall hold the assets so acquired or the funds so raised for acquiring the assets, in trust for the benefit of the *qualified buyers* holding the security receipts or from whom the funds are raised.  
 (b) The provisions of the Indian Trusts Act, 1882 shall, except in so far as they are inconsistent with the provisions of this Act, apply with respect to the trust referred to in clause (a) above.
- (3) In the event of non-realisation under sub-section (2) of financial assets, the qualified buyers of a asset reconstruction company, holding security receipts of not less than seventy-five per cent of the total value of the security receipts issued under a scheme by such company, shall be entitled to call a meeting of all the qualified buyers and every resolution passed in such meeting shall be binding on the company.
- (4) The qualified buyers shall, at a meeting called under sub-section (3), follow the same procedure, as nearly as possible as is followed at meetings of the board of directors of the asset reconstruction company, as the case may be.

#### **Exemption from registration of security receipt (Section 8)**

Notwithstanding anything contained in sub-section (1) of section 17 of the Registration Act, 1908, –

- (a) any security receipt issued by the asset reconstruction company, as the case may be, under sub-section (1) of section 7, and not creating, declaring, assigning, limiting or extinguishing any right, title or interest, to or in immovable property except insofar as it entitles the holder of the security receipt to an undivided interest afforded by a registered instrument; or
- (b) any transfer of security receipts, shall not require compulsory registration.

### Measures for Asset reconstruction (Section 9)

Section 9 deals with the measures for Asset Reconstruction.

- (1) Without prejudice to the provisions contained in any other law for the time being in force, an asset reconstruction company may, for the purposes of asset reconstruction, provide for any one or more of the following measures, namely: –
  - (a) the proper management of the business of the borrower, by change in, or take over of, the management of the business of the borrower;
  - (b) the sale or lease of a part or whole of the business of the borrower;
  - (c) rescheduling of payment of debts payable by the borrower;
  - (d) enforcement of security interest in accordance with the provisions of this Act;
  - (e) settlement of dues payable by the borrower;
  - (f) taking possession of secured assets in accordance with the provisions of this Act;
  - (g) conversion of any portion of debt into shares of a borrower company:

**Provided** that conversion of any part of debt into shares of a borrower company shall be deemed always to have been valid, as if the provisions of this clause were in force at all material times.

- (2) The Reserve Bank shall, for the purposes of sub-section (1), determine the policy and issue necessary directions including the direction for regulation of management of the business of the borrower and fees to be charged.
- (3) The asset reconstruction company shall take measures under sub-section (1) in accordance with policies and directions of the Reserve Bank determined under sub-section (2).

### Other functions of asset reconstruction company (Section 10)

Section 10 deals with the other functions of asset reconstruction company.

- (1) Any asset reconstruction company registered under section 3 may –
  - (a) act as an agent for any bank or financial institution for the purpose of recovering their dues from the borrower on payment of such fee or charges as may be mutually agreed upon between the parties;
  - (b) act as a manager referred to in clause (c) of sub-section (4) of section 13 on such fee as may be mutually agreed upon between the parties;
  - (c) act as receiver if appointed by any court or tribunal :

**Provided** that no *asset reconstruction company* shall act as a manager if acting as such gives rise to any pecuniary liability.

- (2) Save as otherwise provided in sub-section (1), no asset reconstruction company which has been granted a certificate of registration under sub-section (4) of section 3, shall commence or carry on, without prior approval of the Reserve Bank, any business other than that of securitisation or asset reconstruction :

**Provided** that a *asset reconstruction company* which is carrying on, on or before the commencement of this Act, any business other than the business of securitisation or asset reconstruction or business

referred to in sub-section (1), shall cease to carry on any such business within one year from the date of commencement of this Act.

*Explanation.* – For the purposes of this section, *asset reconstruction company* does not include its subsidiary.

### **Resolution of disputes (Section 11)**

Section 11 deals with the resolution of disputes. It provides that where any dispute relating to securitisation or reconstruction or non-payment of any amount due including interest arises amongst any of the parties, namely, the bank, or financial institution, or *asset reconstruction company* or *qualified buyer*, such dispute shall be settled by conciliation or arbitration as provided in the Arbitration and Conciliation Act, 1996, as if the parties to the dispute have consented in writing for determination of such dispute by conciliation or arbitration and the provisions of that Act shall apply accordingly.

### **Power of Reserve Bank to determine policy and issue directions (Section 12, 12A and 12B)**

Section 12 deals with the power of Reserve Bank to determine policy and issue directions.

- (1) If the Reserve Bank is satisfied that in the public interest or to regulate financial system of the country to its advantage or to prevent the affairs of any asset reconstruction company from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such asset reconstruction company, it is necessary or expedient so to do, it may determine the policy and give directions to all or any asset reconstruction company in matters relating to income recognition, accounting standards, making provisions for bad and doubtful debts, capital adequacy based on risk weights for assets and also relating to deployment of funds by the asset reconstruction company, as the case may be, and such company shall be bound to follow the policy so determined and the directions so issued.
- (2) Without prejudice to the generality of the power vested under sub-section (1), the Reserve Bank may give directions to any asset reconstruction company generally or to a class of asset reconstruction companies or to any asset reconstruction company in particular as to –
  - (a) the type of financial asset of a bank or financial institution which can be acquired and procedure for acquisition of such assets and valuation thereof;
  - (b) the aggregate value of financial assets which may be acquired by any asset reconstruction company;
  - (c) the fee and other charges which may be charged or incurred for management of financial assets acquired by any asset reconstruction company;
  - (d) transfer of security receipts issued to qualified buyers.

### **Section 12A deals with the power of Reserve Bank to call for statements and information**

It states that the Reserve Bank may at any time direct a asset reconstruction company to furnish it within such time as may be specified by the Reserve Bank, with such statements and information relating to the business or affairs of such asset reconstruction company (including any business or affairs with which such company is concerned) as the Reserve Bank may consider necessary or expedient to obtain for the purposes of this Act.

### **Section 12B deals with the power of Reserve Bank to carry out audit and inspection**

- (1) The Reserve Bank may, for the purposes of this Act, carry out or caused to be carried out audit and inspection of an asset reconstruction company from time to time.

- (2) It shall be the duty of an asset reconstruction company and its officers to provide assistance and co-operation to the Reserve Bank to carry out audit or inspection under sub-section (1).
- (3) Where on audit or inspection or otherwise, the Reserve Bank is satisfied that business of an asset reconstruction company is being conducted in a manner detrimental to public interest or to the interests of investors in security receipts issued by such asset reconstruction company, the Reserve Bank may, for securing proper management of an asset reconstruction company, by an order –
  - (a) remove the Chairman or any director or appoint additional directors on the board of directors of the asset reconstruction company; or
  - (b) appoint any of its officers as an observer to observe the working of the board of directors of such asset reconstruction company:

**Provided** that no order for removal of Chairman or director under clause (a) shall be made except after giving him an opportunity of being heard.

- (4) It shall be the duty of every director or other officer or employee of the asset reconstruction company to produce before the person, conducting an audit or inspection under sub-section (1), all such books, accounts and other documents in his custody or control and to provide him such statements and information relating to the affairs of the asset reconstruction company as may be required by such person within the stipulated time specified by him.

### Enforcement of Security interest by a Creditor (Section 13)

- (1) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882, any security interest created in favour of any secured creditor may be enforced, without the intervention of the court or tribunal, by such creditor in accordance with the provisions of this Act.
- (2) Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub- section (4) :

Provided *that* –

- (i) the requirement of classification of secured debt as non-performing asset under this sub- section shall not apply to a borrower who has raised funds through issue of debt securities; and
  - (ii) in the event of default, the debenture trustee shall be entitled to enforce security interest in the same manner as provided under this section with such modifications as may be necessary and in accordance with the terms and conditions of security documents executed in favour of the debenture trustee.
- (3) The notice shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower.
- (3A) If, on receipt of the notice under sub-section (2), the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within fifteen days of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower:

Provided that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under section 17 or the Court of District Judge under section 17A.

- (4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely : –

- (a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;
- (b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset :

Provided that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt :

Provided further that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt;

- (c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
  - (d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.
- (5) Any payment made by any person to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.
- (5A) Where the sale of an immovable property, for which a reserve price has been specified, has been postponed for want of a bid of an amount not less than such reserve price, it shall be lawful for any officer of the secured creditor, if so authorised by the secured creditor in this behalf, to bid for the immovable property on behalf of the secured creditor at any subsequent sale.
- (5B) Where the secured creditor, referred to in sub-section (5A), is declared to be the purchaser of the immovable property at any subsequent sale, the amount of the purchase price shall be adjusted towards the amount of the claim of the secured creditor for which the auction of enforcement of security interest is taken by the secured creditor, under sub-section (4) of section 13.
- (5C) The provisions of section 9 of the Banking Regulation Act, 1949 shall, as far as may be, apply to the immovable property acquired by secured creditor under sub-section (5A).
- (6) Any transfer of secured asset after taking possession thereof or takeover of management, by the secured creditor or by the manager on behalf of the secured creditor shall vest in the transferee all rights in, or in relation to, the secured asset transferred as if the transfer had been made by the owner of such secured asset.
- (7) Where any action has been taken against a borrower, all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from the borrower and the money which is received by the secured creditor shall, in the absence of any contract to the contrary, be held by him in trust, to be applied, firstly, in payment

of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

- (8) Where the amount of dues of the secured creditor together with all costs, charges and expenses incurred by him is tendered to the secured creditor at any time before the date of publication of notice for public auction or inviting quotations or tender from public or private treaty for transfer by way of lease, assignment or sale of the secured assets, –
- (i) the secured assets shall not be transferred by way of lease assignment or sale by the secured creditor; and
  - (ii) in case, any step has been taken by the secured creditor for transfer by way of lease or assignment or sale of the assets before tendering of such amount under this sub-section, no further step shall be taken by such secured creditor for transfer by way of lease or assignment or sale of such secured assets.
- (9) Subject to the provisions of the Insolvency and Bankruptcy Code, 2016, in the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than sixty per cent in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors :

Provided that in the case of a company in liquidation, the amount realised from the sale of secured assets shall be distributed in accordance with the provisions of Act:

Provided further that in the case of a company being wound up on or after the commencement of this Act, the secured creditor of such company, who opts to realise his security instead of relinquishing his security and proving his debt under the Act, 1956, may retain the sale proceeds of his secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of the Act:

Provided also that the liquidator referred to in the second proviso shall intimate the secured creditor the workmen's dues in accordance with the provisions of the 1956 and in case such workmen's dues cannot be ascertained, the liquidator shall intimate the estimated amount of workmen's dues under that section to the secured creditor and in such case the secured creditor may retain the sale proceeds of the secured assets after depositing the amount of such estimated dues with the liquidator:

Provided also that in case the secured creditor deposits the estimated amount of workmen's dues, such creditor shall be liable to pay the balance of the workmen's dues or entitled to receive the excess amount, if any, deposited by the secured creditor with the liquidator:

Provided also that the secured creditor shall furnish an undertaking to the liquidator to pay the balance of the workmen's dues, if any.

*Explanation.* – For the purposes of this sub-section, –

- (a) "record date" means the date agreed upon by the secured creditors representing not less than [sixty per cent] in value of the amount outstanding on such date;
- (b) "amount outstanding" shall include principal, interest and any other dues payable by the borrower to the secured creditor in respect of secured asset as per the books of account of the secured creditor.



- (10) Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.
- (11) Without prejudice to the rights conferred on the secured creditor under or by this section, the secured creditor shall be entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measures specified in clauses (a) to (d) of sub-section (4) in relation to the secured assets under this Act.
- (12) The rights of a secured creditor under this Act may be exercised by one or more of his officers authorised in this behalf in such manner as may be prescribed.
- (13) No borrower shall, after receipt of notice from the secured creditor transfer by way of sale, lease or otherwise (other than in the ordinary course of his business) any of his secured assets referred to in the notice, without prior written consent of the secured creditor.

#### **Assistance by Chief Metropolitan Magistrate or the District Magistrate (Section 14)**

- (1) Where the possession of any secured asset is required to be taken by the secured creditor or if any of the secured asset is required to be sold or transferred by the secured creditor under the provisions of this Act, the secured creditor may, for the purpose of taking possession or control of any such secured asset, request, in writing, the Chief Metropolitan Magistrate or the District Magistrate within whose jurisdiction any such secured asset or other documents relating thereto may be situated or found, to take possession thereof, and the Chief Metropolitan Magistrate or, as the case may be, the District Magistrate shall, on such request being made to him-
  - a) take possession of such asset and documents relating thereto; and
  - b) forward such asset and documents to the secured creditor.

Provided that any application by the secured creditor shall be accompanied by an affidavit duly affirmed by the authorised officer of the secured creditor, declaring that –

- (i) the aggregate amount of financial assistance granted and the total claim of the Bank as on the date of filing the application;
- (ii) the borrower has created security interest over various properties and that the Bank or Financial Institution is holding a valid and subsisting security interest over such properties and the claim of the Bank or Financial Institution is within the limitation period;
- (iii) the borrower has created security interest over various properties giving the details of properties referred to in sub-clause (ii) above;
- (iv) the borrower has committed default in repayment of the financial assistance granted aggregating the specified amount;
- (v) consequent upon such default in repayment of the financial assistance the account of the borrower has been classified as a nonperforming asset;
- (vi) affirming that the period of sixty days notice as required by the provisions of sub-section (2) of section 13, demanding payment of the defaulted financial assistance has been served on the borrower;



- (vii) the objection or representation in reply to the notice received from the borrower has been considered by the secured creditor and reasons for non-acceptance of such objection or representation had been communicated to the borrower;
- (viii) the borrower has not made any repayment of the financial assistance in spite of the above notice and the Authorised Officer is, therefore, entitled to take possession of the secured assets under the provisions of sub-section (4) of section 13 read with section 14 of the principal Act;
- (ix) that the provisions of the Act and the rules made thereunder had been complied with.

Provided further that on receipt of the affidavit from the Authorised Officer, the District Magistrate or the Chief Metropolitan Magistrate, as the case may be, shall after satisfying the contents of the affidavit pass suitable orders for the purpose of taking possession of the secured assets within a period of thirty days from the date of application.

Provided further that if no order is passed by the Chief Metropolitan Magistrate or District Magistrate within the said period of thirty days for reasons beyond his control, he may, after recording reasons in writing for the same, pass the order within such further period but not exceeding in aggregate sixty days:

Provided also that the requirement of filing affidavit stated in the first proviso shall not apply to proceeding pending before any District Magistrate or the Chief Metropolitan Magistrate, as the case may be, on the date of commencement of this Act.

- (1A) The District Magistrate or the Chief Metropolitan Magistrate may authorise any officer subordinate to him, –
  - (i) to take possession of such assets and documents relating thereto; and
  - (ii) to forward such assets and documents to the secured creditor.
- (2) For the purpose of securing compliance with the provisions of sub-section (1), the Chief Metropolitan Magistrate or the District Magistrate may take or cause to be taken such steps and use, or cause to be used, such force, as may, in his opinion, be necessary.
- (3) No act of the Chief Metropolitan Magistrate or the District Magistrate any officer authorised by the Chief Metropolitan Magistrate or District Magistrate done in pursuance of this section shall be called in question in any court or before any authority.

### **Manner and effect of takeover of Management (Section 15)**

- (1) When the management of business of a borrower is taken over by a asset reconstruction company under clause (a) of section 9 or, as the case may be, by a secured creditor under clause (b) of sub-section (4) of section 13], the secured creditor may, by publishing a notice in a newspaper published in English language and in a newspaper published in an Indian language in circulation in the place where the principal office of the borrower is situated, appoint as many persons as it thinks fit –
  - (a) in a case in which the borrower is a company as defined in the Companies Act, 1956, to be the directors of that borrower in accordance with the provisions of that Act; or
  - (b) in any other case, to be the administrator of the business of the borrower.
- (2) On publication of a notice under sub-section (1), –
  - (a) in any case where the borrower is a company as defined in the Companies Act, 1956, all persons

holding office as directors of the company and in any other case, all persons holding any office having power of superintendence, direction and control of the business of the borrower immediately before the publication of the notice under sub-section (1), shall be deemed to have vacated their offices as such;

- (b) any contract of management between the borrower and any director or manager thereof holding office as such immediately before publication of the notice under sub-section (1), shall be deemed to be terminated;
  - (c) the directors or the administrators appointed under this section shall take such steps as may be necessary to take into their custody or under their control all the property, effects and actionable claims to which the business of the borrower is, or appears to be, entitled and all the property and effects of the business of the borrower shall be deemed to be in the custody of the directors or administrators, as the case may be, as from the date of the publication of the notice;
  - (d) the directors appointed under this section shall, for all purposes, be the directors of the company of the borrower and such directors or as the case may be, the administrators appointed under this section, shall alone be entitled to exercise all the powers of the directors or as the case may be, of the persons exercising powers of superintendence, direction and control, of the business of the borrower whether such powers are derived from the memorandum or articles of association of the company of the borrower or from any other source whatsoever.
- (3) Where the management of the business of a borrower, being a company as defined in the Companies Act, 1956, is taken over by the secured creditor, then, notwithstanding anything contained in the said Act or in the memorandum or articles of association of such borrower, –
- (a) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;
  - (b) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;
  - (c) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.
- (4) Where the management of the business of a borrower had been taken over by the secured creditor, the secured creditor shall, on realisation of his debt in full, restore the management of the business of the borrower to him:

Provided that if any secured creditor jointly with other secured creditors or any asset reconstruction company or financial institution or any other assignee has converted part of its debt into shares of a borrower company and thereby acquired controlling interest in the borrower company, such secured creditors shall not be liable to restore the management of the business to such borrower.

#### **No compensation to directors for loss of office (Section 16)**

- (1) Notwithstanding anything to the contrary contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act of any contract of management entered into by him with the borrower.

- (2) Nothing contained in sub-section (1) shall affect the right of any such managing director or any other director or manager or any such person in charge of management to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

### Application against measures to recover secured debts (Section 17)

- (1) Any person (including borrower), aggrieved by any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor or his authorised officer under this Chapter, may make an application along with such fee, as may be prescribed, to the Debts Recovery Tribunal having jurisdiction in the matter within forty-five days from the date on which such measure had been taken:

Provided that different fees may be prescribed for making the application by the borrower and the person other than the borrower.

*Explanation.* – For the removal of doubts, it is hereby declared that the communication of the reasons to the borrower by the secured creditor for not having accepted his representation or objection or the likely action of the secured creditor at the stage of communication of reasons to the borrower shall not entitle the person (including borrower) to make an application to the Debts Recovery Tribunal under this sub-section.

- (1A) An application under sub-section (1) shall be filed before the Debts Recovery Tribunal within the local limits of whose jurisdiction –
- (a) the cause of action, wholly or in part, arises;
  - (b) where the secured asset is located; or
  - (c) the branch or any other office of a bank or financial institution is maintaining an account in which debt claimed is outstanding for the time being.
- (2) The Debts Recovery Tribunal shall consider whether any of the measures referred to in sub-section (4) of section 13 taken by the secured creditor for enforcement of security are in accordance with the provisions of this Act and the rules made thereunder.
- (3) If, the Debts Recovery Tribunal, after examining the facts and circumstances of the case and evidence produced by the parties, comes to the conclusion that any of the measures referred to in sub-section
- (4) of section 13, taken by the secured creditor are not in accordance with the provisions of this Act and the rules made thereunder, and require restoration of the management or restoration of possession, of the secured assets to the borrower or other aggrieved person, it may, by order, –
- (a) declare the recourse to any one or more measures referred to in sub-section (4) of section 13 taken by the secured creditor as invalid; and
  - (b) restore the possession of secured assets or management of secured assets to the borrower or such other aggrieved person, who has made an application under sub-section (1), as the case may be; and
  - (c) pass such other direction as it may consider appropriate and necessary in relation to any of the recourse taken by the secured creditor under sub-section (4) of section 13.
- (4) If, the Debts Recovery Tribunal declares the recourse taken by a secured creditor under sub-section (1) of section 13, is in accordance with the provisions of this Act and the rules made thereunder, then, notwithstanding anything contained in any other law for the time being in force, the secured creditor

shall be entitled to take recourse to one or more of the measures specified under sub-section (4) of section 13 to recover his secured debt.

(4A) Where –

- (i) any person, in an application under sub-section (1), claims any tenancy or leasehold rights upon the secured asset, the Debt Recovery Tribunal, after examining the facts of the case and evidence produced by the parties in relation to such claims shall, for the purposes of enforcement of security interest, have the jurisdiction to examine whether lease or tenancy, –
    - a. has expired or stood determined; or
    - b. is contrary to section 65A of the Transfer of Property Act, 1882; or
    - c. is contrary to terms of mortgage; or
    - d. is created after the issuance of notice of default and demand by the Bank under sub-section (2) of section 13 of the Act; and
  - (ii) the Debt Recovery Tribunal is satisfied that tenancy right or leasehold rights claimed in secured asset falls under the sub-clause (a) or sub-clause (b) or sub-clause (c) or sub-clause (d) of clause (i), then notwithstanding anything to the contrary contained in any other law for the time being in force, the Debt Recovery Tribunal may pass such order as it deems fit in accordance with the provisions of this Act.
- (2) Any application made under sub-section (1) shall be dealt with by the Debts Recovery Tribunal as expeditiously as possible and disposed of within sixty days from the date of such application:
- Provided that the Debts Recovery Tribunal may, from time to time, extend the said period for reasons to be recorded in writing, so, however, that the total period of pendency of the application with the Debts Recovery Tribunal, shall not exceed four months from the date of making of such application made under sub-section (1).
- (3) If the application is not disposed of by the Debts Recovery Tribunal within the period of four months as specified in sub-section (5), any part to the application may make an application, in such form as may be prescribed, to the Appellate Tribunal for directing the Debts Recovery Tribunal for expeditious disposal of the application pending before the Debts Recovery Tribunal and the Appellate Tribunal may, on such application, make an order for expeditious disposal of the pending application by the Debts Recovery Tribunal.
- (4) Save as otherwise provided in this Act, the Debts Recovery Tribunal shall, as far may be, dispose of application in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the rules made thereunder.

### **Appeal to Appellate Tribunal (Section 18)**

- (1) Any person aggrieved, by any order made by the Debts Recovery Tribunal under section 17, may prefer an appeal along with such fee, as may be prescribed to the Appellate Tribunal within thirty days from the date of receipt of the order of Debts Recovery Tribunal:

Provided that different fees may be prescribed for filing an appeal by the borrower or by the person other than the borrower.

Provided further that no appeal shall be entertained unless the borrower has deposited with the

Appellate Tribunal fifty per cent of the amount of debt due from him, as claimed by the secured creditors or determined by the Debts Recovery Tribunal, whichever is less:

Provided also that the Appellate Tribunal may, for the reasons to be recorded in writing, reduce the amount to not less than twenty-five per cent of debt referred to in the second proviso.

- (2) Save as otherwise provided in this Act, the Appellate Tribunal shall, as far as may be, dispose of the appeal in accordance with the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and rules made thereunder.

### **Right to lodge a caveat**

Section 18C deals with the right to lodge a caveat. It provides that:

- (1) Where an application or an appeal is expected to be made or has been made under sub-section (1) of section 17 or section 17A or sub-section (1) of section 18 or section 18B, the secured creditor or any person claiming a right to appear before the Tribunal or the Court of District Judge or the Appellate Tribunal or the High Court, as the case may be, on the hearing of such application or appeal, may lodge a caveat in respect thereof.
- (2) Where a caveat has been lodged under sub-section (1), –
  - (a) the secured creditor by whom the caveat has been lodged (hereafter in this section referred to as the caveator) shall serve notice of the caveat by registered post, acknowledgement due, on the person by whom the application has been or is expected to be made under sub-section (1);
  - (b) any person by whom the caveat has been lodged (hereafter in this section referred to as the caveator) shall serve notice of the caveat by registered post, acknowledgement due, on the person by whom the application has been or is expected to be made under sub-section (1).
- (3) Where after a caveat has been lodged under sub-section (1), any application or appeal is filed before the Tribunal or the court of District Judge or the Appellate Tribunal or the High Court, as the case may be, the Tribunal or the District Judge or the Appellate Tribunal or the High Court, as the case may be, shall serve a notice of application or appeal filed by the applicant or the appellant on the caveator.
- (4) Where a notice of any caveat has been served on the applicant or the Appellant, he shall periodically furnish the caveator with a copy of the application or the appeal made by him and also with copies of any paper or document which has been or may be filed by him in support of the application or the appeal.
- (5) Where a caveat has been lodged under sub-section (1), such caveat shall not remain in force after the expiry of the period of ninety days from the date on which it was lodged unless the application or appeal referred to in sub-section (1) has been made before the expiry of the said period.

### **Right of borrower to receive compensation and costs in certain cases (Section 19)**

Section 19 provides that if the Debts Recovery Tribunal or the Court of District Judge, on an application made under section 17 or section 17A or the Appellate Tribunal or the High Court on an appeal preferred under section 18 or section 18A, holds that the possession of secured assets by the secured creditor is not in accordance with the provisions of this Act and rules made thereunder and directs the secured creditors to return such secured assets to the concerned borrowers or any other aggrieved person, who has filed the application under section 17 or section 17A or appeal under section 18 or section 18A, as the case may be, the borrower or such other person shall be entitled to the payment of such compensation and costs as may be determined by such Tribunal or Court of District Judge or Appellate Tribunal or the High Court referred to in section 18B.

### Setting up of Central Registry (Section 20)

- (1) The Central Government may, by notification, set-up or cause to be set-up from such date as it may specify in such notification, a registry to be known as the Central Registry with its own seal for the purposes of registration of transaction of securitisation and reconstruction of financial assets and creation of security interest under this Act.
- (2) The head office of the Central Registry shall be at such place as the Central Government may specify and for the purpose of facilitating registration of transactions referred to in sub-section (1), there may be established at such other places as the Central Government may think fit, branch offices of the Central Registry.
- (3) The Central Government may, by notification, define the territorial limits within which an office of the Central Registry may exercise its functions.
- (4) The provisions of this Act pertaining to the Central Registry shall be in addition to and not in derogation of any of the provisions contained in the Registration Act, 1908, the Companies Act, 1956, the Merchant Shipping Act, 1958, the Patents Act, 1970, the Motor Vehicles Act, 1988, and the Designs Act, or any other law requiring registration of charges and shall not affect the priority of charges or validity thereof under those Acts or laws.

### Integration of registration systems with Central Registry

Section 20A deals with the Integration of registration systems with Central Registry. Section 20A states that:

- (1) The Central Government may, for the purpose of providing a Central database, in consultation with State Governments or other authorities operating registration system for recording rights over any property or creation, modification or satisfaction of any security interest on such property, integrate the registration records of such registration systems with the records of Central Registry established under section 20, in such manner as may be prescribed.

*Explanation.* – For the purpose of this sub-section, the registration records include records of registration under the Companies Act, 2013, the Registration Act, 1908, the Merchant Shipping Act, 1958, the Motor Vehicles Act, 1988, the Patents Act, 1970 (39 of 1970), the Designs Act, 2000 or other such records under any other law for the time being in force.

- (2) The Central Government shall after integration of records of various registration systems referred to in sub-section (1) with the Central Registry, by notification, declare the date of integration of registration systems and the date from which such integrated records shall be available; and with effect from such date, security interests over properties which are registered under any registration system referred to in sub-section (1) shall be deemed to be registered with the Central Registry for the purposes of this Act.

### Delegation of powers

Section 20B deals with the Delegation of powers. It provides that the Central Government may, by notification, delegate its powers and functions under this Chapter, in relation to establishment, operations and regulation of the Central Registry to the Reserve Bank, subject to such terms and conditions as may be prescribed.

### Central Registrar (Section 21)

Section 21 deals with the Central Registrar. Section 21 states that:



- (1) The Central Government may, by notification, appoint a person for the purpose of registration of transactions relating to securitisation, reconstruction of financial assets and security interest created over properties, to be known as the Central Registrar.
- (2) The Central Government may appoint such other officers with such designations as it thinks fit for the purpose of discharging, under the superintendence and direction of the Central Registrar, such functions of the Central Registrar under this Act as he may, from time to time, authorise them to discharge.

### **Register of Securitisation, reconstruction and security interest transactions**

Section 22 deals with the Register of securitisation, reconstruction and security interest transactions. Section 22 states that:

- (1) For the purposes of this Act, a record called the Central Register shall be kept at the head office of the Central Registry for entering the particulars of the transactions relating to –
  - (a) securitisation of financial assets;
  - (b) reconstruction of financial assets; and
  - (c) creation of security interest.
- (2) Notwithstanding anything contained in sub-section (1), it shall be lawful for the Central Registrar to keep the records wholly or partly in computer, floppies, diskettes or in any other electronic form subject to such safeguards as may be prescribed.
- (3) Where such register is maintained wholly or partly in computer, floppies, diskettes or in any other electronic form, under sub-section (2), any reference in this Act to entry in the Central Register shall be construed as a reference to any entry as maintained in computer or in any other electronic form.
- (4) The register shall be kept under the control and management of the Central Registrar.

### **Filing of transactions of securitisation, reconstruction and creation of security interest**

Section 23 provides that the particulars of every transaction of securitisation, asset reconstruction or creation of security interest shall be filed, with the Central Registrar in the manner and on payment of such fee as may be prescribed

Provided that the Central Government may, by notification, require registration of all transactions of securitisation, or asset reconstruction or creation of security interest which are subsisting on or before the date of establishment of the Central Registry under sub-section (1) of section 20 within such period and on payment of such fees as may be prescribed.

- (2) The Central Government may, by notification, require the registration of transaction relating to different types of security interest created on different kinds of property with the Central Registry.
- (3) The Central Government may, by rules, prescribe forms for registration for different types of security interest under this section and fee to be charged for such registration.

### **Modification of security interest registered under this Act.**

Section 24 provides that whenever the terms or conditions, or the extent or operation, of any security interest registered under this Chapter are or is modified, it shall be the duty of the asset reconstruction company or the secured creditor, as the case may be, to send to the Central Registrar, the particulars of such modification, and the provisions of this Chapter as to registration of a security interest shall apply to such modification of such security interest.



### Satisfaction of Security interest (Section 25)

Section 25 deals with the Asset Reconstruction Company or secured creditor to report satisfaction of security interest. Section 25 states that:

- (1) The asset reconstruction company or the secured creditor as the case may be, shall give intimation to the Central Registrar of the payment or satisfaction in full, of any security interest relating to the asset reconstruction company or the secured creditor and requiring registration under this Chapter, within thirty days from the date of such payment or satisfaction.
- (1A) On receipt of intimation under sub-section (1), the Central Registrar shall order that a memorandum of satisfaction shall be entered in the Central Register.
- (2) If the concerned borrower gives an intimation to the Central Registrar for not recording the payment or satisfaction referred to in sub-section (1), the Central Registrar shall on receipt of such intimation, cause a notice to be sent to the asset reconstruction company or the secured creditor calling upon it to show cause within a time not exceeding fourteen days specified in such notice, as to why payment or satisfaction should not be recorded as intimated to the Central Registrar.
- (3) If no cause is shown, the Central Registrar shall order that a memorandum of satisfaction shall be entered in the Central Register.
- (4) If cause is shown, the Central Registrar shall record a note to that effect in the Central Register, and shall inform the borrower that he has done so.

### Right to Inspect

Section 26 deals with the right to inspect particulars of securitisation, reconstruction and security interest transactions. Section 26 provides that:

- (1) The particulars of securitisation or reconstruction or security interest entered in the Central Register of such transactions kept under section 22 shall be open during the business hours for inspection by any person on payment of such fee as may be prescribed.
- (2) The Central Register referred to in sub-section (1) maintained in electronic form, shall also be open during the business hours for the inspection by any person through electronic media on payment of such fee as may be prescribed.

### Rectification by Central Government in matters of registration, modification and satisfaction

Section 26A deals with the rectification by Central Government in matters of registration, modification and satisfaction, etc. It states that:

- (1) The Central Government, on being satisfied –
  - (a) that the omission to file with the Registrar the particulars of any transaction of securitisation, asset reconstruction or security interest or modification or satisfaction of such transaction or; the omission or misstatement of any particular with respect to any such transaction or modification or with respect to any satisfaction or other entry made in pursuance of section 23 or section 24 or section 25 of the principal Act was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors; or
  - (b) that on other grounds, it is just and equitable to grant relief, may, on the application of a secured creditor or *asset reconstruction company* or any other person interested on such terms and

conditions as it may seem to the Central Government just and expedient, direct that the time for filing of the particulars of the transaction for registration or modification or satisfaction shall be extended or, as the case may require, the omission or mis-statement shall be rectified.

- (2) Where the Central Government extends the time for the registration of transaction of security interest or securitisation or asset reconstruction or modification or satisfaction thereof, the order shall not prejudice any rights acquired in respect of the property concerned or financial asset before the transaction is actually registered.

### **Registration by secured creditors and other creditors**

Section 26B deals with the registration by secured creditors and other creditors. Section 26B states that:

- (1) The Central Government may by notification, extend the provisions of Chapter IV relating to Central Registry to all creditors other than secured creditors as defined in clause (zd) of sub-section (1) of section 2, for creation, modification or satisfaction of any security interest over any property of the borrower for the purpose of securing due repayment of any financial assistance granted by such creditor to the borrower.
- (2) From the date of notification under sub-section (1), any creditor including the secured creditor may file particulars of transactions of creation, modification or satisfaction of any security interest with the Central Registry in such form and manner as may be prescribed.
- (3) A creditor other than the secured creditor filing particulars of transactions of creation, modification and satisfaction of security interest over properties created in its favour shall not be entitled to exercise any right of enforcement of securities under this Act.
- (4) Every authority or officer of the Central Government or any State Government or local authority, entrusted with the function of recovery of tax or other Government dues and for issuing any order for attachment of any property of any person liable to pay the tax or Government dues, shall file with the Central Registry such attachment order with particulars of the assessee and details of tax or other Government dues from such date as may be notified by the Central Government, in such form and manner as may be prescribed.
- (5) If any person, having any claim against any borrower, obtains orders for attachment of property from any court or other authority empowered to issue attachment order, such person may file particulars of such attachment orders with Central Registry in such form and manner on payment of such fee as may be prescribed.

### **Effect of the registration of transactions**

Section 26C deals with the Effect of the registration of transactions, etc. Section 26C states that:

- (1) Without prejudice to the provisions contained in any other law, for the time being in force, any registration of transactions of creation, modification or satisfaction of security interest by a secured creditor or other creditor or filing of attachment orders under this Chapter shall be deemed to constitute a public notice from the date and time of filing of particulars of such transaction with the Central Registry for creation, modification or satisfaction of such security interest or attachment order, as the case may be.
- (2) Where security interest or attachment order upon any property in favour of the secured creditor or any other creditor are filed for the purpose of registration under the provisions of Chapter IV and this Chapter, the claim of such secured creditor or other creditor holding attachment order shall have priority

over any subsequent security interest created upon such property and any transfer by way of sale, lease or assignment or licence of such property or attachment order subsequent to such registration, shall be subject to such claim:

**Provided** that nothing contained in this sub-section shall apply to transactions carried on by the borrower in the ordinary course of business.

### Right of Enforcement of Securities

Section 26D deals with the right of enforcement of securities. Section 26D states that:

Notwithstanding anything contained in any other law for the time being in force, from the date of commencement of the provisions of this Chapter, no secured creditor shall be entitled to exercise the rights of enforcement of securities under Chapter III unless the security interest created in its favour by the borrower has been registered with the Central Registry.

**Section 26E deals with the Priority to secured creditors.** Section 26E states that:

Notwithstanding anything contained in any other law for the time being in force, after the registration of security interest, the debts due to any secured creditor shall be paid in priority over all other debts and all revenues, taxes, cesses and other rates payable to the Central Government or State Government or local authority.

*Explanation.* – For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016, in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code.

### Penalties

Section 27 provides that if a default is made –

- (a) in filing under section 23, the particulars of every transaction of any securitisation or asset reconstruction or security interest created by asset reconstruction company or secured creditor; or
- (b) in sending under section 24, the particulars of the modification referred to in that section; or
- (c) in giving intimation under section 25, every company and every officer of the company or the secured creditor and every officer of the secured creditor who is in default shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues:

**Provided** that provisions of this section shall be deemed to have been omitted from the date of coming into force of the provisions of this Chapter and section 23 as amended by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016.

### Penalties for non-compliance of direction of Reserve Bank (Section 28)

Omitted by the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016 w.e.f. 1-9-2016.

### Offences

Any person who contravenes the provisions of this Act or of any rules made thereunder shall be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.

### Non-Applicability in certain cases

As per Section 31 the provisions of this Act shall not apply to –

- (a) a lien on any goods, money or security given by or under the Indian Contract Act, 1872 or the Sale of Goods Act, 1930 or any other law for the time being in force;
- (b) a pledge of movables within the meaning of section 172 of the Indian Contract Act,
- (c) creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934;
- (d) creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958;
- (e) [omitted]
- (f) any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930;
- (g) any properties not liable to attachment (excluding the properties specifically charged with the debt recoverable under this Act) or sale under the first proviso to sub-section (1) of section 60 of the Code of Civil Procedure, 1908;
- (h) any security interest for securing repayment of any financial asset not exceeding one lakh rupees;
- (i) any security interest created in agricultural land;
- (j) any case in which the amount due is less than twenty per cent of the principal amount and interest thereon.

### Civil Court not to have jurisdiction

Section 34 provides that no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Debts Recovery Tribunal or the Appellate Tribunal is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act or under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

### Limitation Act (Section 36)

Limitation Act, 1963 is applicable to the claims made under this Act. Accordingly, no secured creditor shall be entitled to take all or any of the measures under Sub-section (4) of Section 13, unless his claim in respect of the financial asset is made within the period of limitation prescribed under the Limitation Act, 1963.

### Applicability of other Acts

Section 35 provides that the provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

In accordance with Section 37, the provisions of this Act or the rules made thereunder shall be in addition to and not in derogation of, the Companies Act, 1956, the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 or any other law for the time being in force.

## SECURITY INTEREST (ENFORCEMENT) RULES, 2002

### Demand notice

Rule 3(1) provides that the service of demand notice as referred to in sub-section (2) of section 13 of the SRFAESI Act shall be made by delivering *including hand delivery* or transmitting at the place where the borrower or his agent, empowered to accept the notice or documents on behalf of the borrower, actually and voluntarily resides or carries on business or personally works for gain, by registered post with acknowledgement due, addressed to the borrower or his agent empowered to accept the service or by Speed Post or by courier or by any other means of transmission of documents like fax message or electronic mail service.

**Provided** that where authorised officer has reason to believe that the borrower or his agent is avoiding the service of the notice or that for any other reason, the service cannot be made as aforesaid, the service shall be effected by affixing a copy of the demand notice on the outer door or some other conspicuous part of the house or building in which the borrower or his agent ordinarily resides or carries on business or personally works for gain and also by publishing the contents of the demand notice in two leading newspapers, one in vernacular language, having sufficient circulation in that locality.

(2) Where the borrower is a body corporate, the demand notice shall be served on the registered office or any of the branches of such body corporate as specified under sub-rule (1).

(3) Any other notice in writing to be served on the borrower or his agent by authorised officer, shall be served in the same manner as provided in this rule.

(4) Where there are more than one borrower, the demand notice shall be served on each borrower.

(5) The demand notice may invite attention of the borrower to provisions of sub-section (8) of section 13 of the Act, in respect of time available to the borrower, to redeem the secured assets.

### Reply to Representation of the borrower (Rule 3A)

After issue of demand notice under sub-section (2) of section 13, if the borrower makes any representation or raises any objection to the notice, the Authorized Officer shall consider such representation or objection and examine whether the same is acceptable or tenable.

- (a) If on examining the representation made or objection raised by the borrower, the secured creditor is satisfied that there is a need to make any changes or modifications in the demand notice, he shall modify the notice accordingly and serve a revised notice or pass such other suitable orders as deemed necessary, within fifteen days from the date of receipt of the representation or objection.
- (b) If on examining the representation made or objection raised, the Authorized Officer comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within [fifteen days]<sup>63</sup> of receipt of such representation or objection, the reasons for non-acceptance of the representation or objection, to the borrower.
- (c) If on examining the representation made or objection raised, the Authorized Officer comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within fifteen days of receipt of such representation or objection, the reasons for non-acceptance of the representation or objection, to the borrower.

### Procedure after issue of notice (Rule 4)

If the amount mentioned in the demand notice is not paid within the time specified therein, the authorised officer

shall proceed to realise the amount by adopting any one or more of the measures specified in sub- section (4) of section 13 of the Act for taking possession of movable property, namely: –

- (1) Where the possession of the secured assets to be taken by the secured creditor are movable property in possession of the borrower, the authorised officer shall take possession of such movable property in the presence of two witnesses after a Panchnama drawn and signed by the witnesses as nearly as possible in Appendix I to these rules.
- (2) After taking possession under sub-rule (1) above, the authorised officer shall make or cause to be made an inventory of the property as nearly as possible in the form given in Appendix II to these rules and deliver or cause to be delivered, a copy of such inventory to the borrower or to any person entitled to receive on behalf of borrower.
- [(2A) The borrower shall be intimated by a notice, enclosing the panchnama drawn in Appendix I and the inventory made in Appendix II.
- (2B) All notices under these rules may also be served upon the borrower through electronic mode of service, in addition to the modes specified under rule 3.
- (3) The authorised officer shall keep the property taken possession under sub-rule (1) either in his own custody or in the custody of any person authorised or appointed by him, who shall take as much care of the property in his custody as an owner of ordinary prudence would, under the similar circumstances, take of such property:  
  
Provided that if such property is subject to speedy or natural decay, or the expense of keeping such property in custody is likely to exceed its value, the authorised officer may sell it at once.
- (4) The authorised officer shall take steps for preservation and protection of secured assets and insure them, if necessary, till they are sold or otherwise disposed of.
- (5) In case any secured asset is: –
  - (a) a debt not secured by negotiable instrument; or
  - (b) a share in a body corporate;
  - (c) other movable property not in the possession of the borrower except the property deposited in or in the custody of any court or any like authority, the authorised officer shall obtain possession or recover the debt by service of notice as under: –
    - (i) in the case of a debt, prohibiting the borrower from recovering the debt or any interest thereon and the debtor from making payment thereof and directing the debtor to make such payment to the authorised officer; or
    - (ii) in the case of the shares in a body corporate, directing the borrower to transfer the same to the secured creditor and also the body corporate from not transferring such shares in favour of any person other than the secured creditor. A copy of the notice so sent may be endorsed to the concerned body corporate's Registrar to the issue or share transfer agents, if any;
    - (iii) in the case of other movable property (except as aforesaid), calling upon the borrowers and the person in possession to hand over the same to the authorised officer and the authorised officer shall take custody of such movable property in the same manner as provided in sub-rules (1) to (3) above;

- (iv) movable secured assets other than those covered in this rule shall be taken possession of by the authorised officer by taking possession of the documents evidencing title to such secured assets.

#### **Valuation of movable secured assets (Rule 5)**

After taking possession under sub-rule (1) of rule 4 and in any case before sale, the authorised officer shall obtain the estimated value of the movable secured assets and thereafter, if considered necessary, fix in consultation with the secured creditor, the reserve price of the assets to be sold in realisation of the dues of the secured creditor.

#### **Sale of movable secured assets (Rule 6)**

- (1) The authorised officer may sell the movable secured assets taken possession under sub-rule (1) of rule 4 in one or more lots by adopting any of the following methods to secure maximum sale price for the assets, to be so sold –
  - (a) obtaining quotations from parties dealing in the secured assets or otherwise interested in buying such assets; or
  - (b) inviting tenders from the public; or
  - (c) holding public auction including through e-auction mode; or
  - (d) by private treaty.

- (2) The authorised officer shall serve to the borrower a notice of thirty days for sale of the movable secured assets under sub-rule (1):

Provided that if the sale of such secured assets is being, effected by either inviting tenders from the public or by holding public auction, the secured creditor shall cause a public notice in the Form given in Appendix II-A to be published in two leading newspapers, including one in vernacular language, having wide circulation in that locality.

Provided further that if sale of movable property by any one of the methods specified under sub-rule (1) fails and the sale is required to be conducted again, the authorised officer shall serve, affix and publish notice of sale of not less than fifteen days to the borrower for any subsequent sale.

- (3) Sale by any methods other than public auction or public tender, shall be on such terms as may be settled between the secured creditors and the proposed purchaser.
- (4) The authorized officer shall upload the detailed terms and conditions of the sale of the movable secured assets on the web-site of the secured creditor, which shall include,
  - (a) details about the borrower and the secured creditor;
  - (b) complete description of movable secured assets to be sold with identification marks or numbers, if any, on them;
  - (c) reserve price of the movable secured assets, if any, and the time and manner of payment;
  - (d) time and place of public auction or the time after which sale by any other mode shall be completed;
  - (e) deposit of earnest money as may be stipulated by the secured creditor;
  - (f) any other terms or conditions which the authorised officer considers it necessary for a purchaser to know the nature and value of movable secured assets.



**Issue of certificate of sale (Rule 7)**

- (1) Where movable secured assets is sold, sale price of each lot shall be paid as per the terms of the public notice or on the terms as may be settled between the parties, as the case may be and in the event of default of payment, the movable secured assets shall be liable to be ordered for sale again.
- (2) On payment of sale price, the authorised officer shall issue a certificate of sale in the prescribed form as given in Appendix III to these rules specifying the movable secured assets sold, price paid and the name of the purchaser and thereafter the sale shall become absolute. The certificate of sale so issued shall be prima facie evidence of title of the purchaser.
- (2A) All notices under these rules may also be served upon the borrower through electronic mode of service, in addition to the modes prescribed under sub-rule (1) and sub-rule (2) of rule 8.
- (3) Where the movable secured assets are those referred in sub-clauses (iii) to (v) of clause (1) of sub-section (1) of section 2 of the Act, the provisions contained in these rules and rule 7 dealing with the sale of movable secured assets shall, mutatis mutandis, apply to such assets.

**Sale of immovable secured assets (Rule 8)**

- (1) Where the secured asset is an immovable property, the authorised officer shall take or cause to be taken possession, by delivering a possession notice prepared as nearly as possible in Appendix IV to these rules, to the borrower and by affixing the possession notice on the outer door or at such conspicuous place of the property.
- (2) The possession notice as referred to in sub-rule (1) shall also be published as soon as possible but in any case not later than seven days from the date of taking possession, in two leading newspapers in two leading newspapers, one in vernacular language having sufficient circulation in that locality, by the authorised officer.
- (3) In the event of possession of immovable property is actually taken by the authorised officer, such property shall be kept in his own custody or in the custody of any person authorised or appointed by him, who shall take as much care of the property in his custody as a owner of ordinary prudence would, under the similar circumstances, take of such property.
- (4) The authorised officer shall take steps for preservation and protection of secured assets and insure them, if necessary, till they are sold or otherwise disposed of.
- (5) Before effecting sale of the immovable property referred to in sub-rule (1) of rule 9, the authorised officer shall obtain valuation of the property from an approved valuer and in consultation with the secured creditor, fix the reserve price of the property and may sell the whole or any part of such immovable secured asset by any of the following methods: –
  - (a) by obtaining quotations from the persons dealing with similar secured assets or otherwise interested in buying the such assets; or
  - (b) by inviting tenders from the public;
  - (c) by holding public auction including through e-auction mode; or
  - (d) by private treaty.

Provided that in case of sale of immovable property in the State of Jammu and Kashmir, the provisions

of Jammu and Kashmir Transfer of Property Act, 1977 shall apply to the person who acquires such property in the State.

- (6) The authorised officer shall serve to the borrower a notice of thirty days for sale of the immovable secured assets, under sub-rule (5):

Provided that if the sale of such secured asset is being effected by either inviting tenders from the public or by holding public auction, the secured creditor shall cause a public notice in the Form given in Appendix IV-A to be published in two leading newspapers including one in vernacular language having wide circulation in the locality.

- (7) Every notice of sale shall be affixed on a conspicuous part of the immovable property and the authorised officer shall upload the detailed terms and conditions of the sale, on the web- site of the secured creditor, which shall include;

- (a) the description of the immovable property to be sold, including the details of the encumbrances known to the secured creditor;
- (b) the secured debt for recovery of which the property is to be sold;
- (c) reserve price of the immovable secured assets below which the property may not be sold;
- (d) time and place of public auction or the time after which sale by any other mode shall be completed;
- (e) deposit of earnest money as may be stipulated by the secured creditor;
- (f) any other terms and conditions, which the authorized officer considers it necessary for a purchaser

to know the nature and value of the property.

- (8) Sale by any method other than public auction or public tender, shall be on such terms as may be settled between the secured creditor and the proposed purchaser in writing.

#### **Time of sale, issue of sale certificate and delivery of possession, etc. (Rule 9)**

- (1) No sale of immovable property under these rules, in first instance shall take place before the expiry of thirty days from the date on which the public notice of sale is published in newspapers as referred to in the proviso to sub-rule (6) of rule 8 or notice of sale has been served to the borrower:

Provided further that if sale of immovable property by any one of the methods specified by sub-rule (5) of rule 8 fails and sale is required to be conducted again, the authorised officer shall serve, affix and publish notice of sale of not less than fifteen days to the borrower, for any subsequent sale.

- (2) The sale shall be confirmed in favour of the purchaser who has offered the highest sale price in his bid or tender or quotation or offer to the authorised officer and shall be subject to confirmation by the secured creditor:

Provided that no sale under this rule shall be confirmed, if the amount offered by sale price is less than the public notice of sale is published in newspapers as referred to in the proviso to sub-rule (6) or notice of sale has been served to the borrower reserve price, specified under sub-rule (5) of rule 8:

Provided further that if the authorised officer fails to obtain a price higher than the reserve price, he may, with the consent of the borrower and the secured creditor effect the sale at such price.

- (3) On every sale of immovable property, the purchaser shall immediately, i.e. on the same day or not later than next working day, as the case may be, pay a deposit of twenty-five per cent of the amount of the

sale price, which is inclusive of earnest money deposited, if any, to the authorised officer conducting the sale and in default of such deposit, the property shall be sold again.

- (4) The balance amount of purchase price payable shall be paid by the purchaser to the authorised officer on or before the fifteenth day of confirmation of sale of the immovable property or such extended period as may be agreed upon in writing between the purchaser and the secured creditor, in any case not exceeding three months.
- (5) In default of payment within the period mentioned in sub-rule (4), the deposit shall be forfeited and the property shall be resold and the defaulting purchaser shall forfeit all claim to the property or to any part of the sum for which it may be subsequently sold.
- (6) On confirmation of sale by the secured creditor and if the terms of payment have been complied with, the authorised officer exercising the power of sale shall issue a certificate of sale of the immovable property in favour of the purchaser in the form given in Appendix V to these rules.
- (7) Where the immovable property sold is subject to any encumbrances, the authorised officer may, if he thinks fit, allow the purchaser to deposit with him the money required to discharge the encumbrances and any interest due thereon together with such additional amount that may be sufficient to meet the contingencies or further cost, expenses and interest as may be determined by him.

Provided that it after meeting the cost of removing encumbrances and contingencies there is any surplus available out of the money deposited by the purchaser such surplus shall be paid to the purchaser within fifteen day, from date of finalisation of the sale.

- (8) On such deposit of money for discharge of the encumbrances, the authorised officer [shall issue or cause the purchaser to issue notices to the persons interested in or entitled to the money deposited with him and take steps to make the payment accordingly.
- (9) The authorised officer shall deliver the property to the purchaser free from encumbrances known to the secured creditor on deposit of money as specified in sub-rule (7) above.
- (10) The certificate of sale issued under sub-rule (6) shall specifically mention that whether the purchaser has purchased the immovable secured asset free from any encumbrances known to the secured creditor or not.

### Appointment of Manager (Rule 10)

- (1) The Board of Directors or Board of Trustees, as the case may be, may appoint in consultation with the borrower any person (hereinafter referred to as the Manager) to manage the secured assets the possession of which has been taken over by the secured creditor.

Provided that the manager so appointed shall not be a person who is, or has been, adjudicated insolvent, or has suspended payment or has compounded with his creditors, or who is, or has been, convicted by a criminal court of an offence involving moral turpitude.

- (2) The Manager appointed by the Board of Directors or Board of Trustees, as the case may be, shall be deemed to be an agent of the borrower and the borrower shall be solely responsible for the commission or omission of acts of the Manager unless such commission or omission are due to improper intervention of the secured creditor or the authorised officer.
- (3) The Manager shall have power by notice in writing to recover any money from any person who has acquired any of the secured assets from the borrower, which is due to may become due to the borrower.

- (4) The Manager shall give such person who has made payment under sub-rule (3) a valid discharge as if he has made payments to the borrower.
- (5) The Manager shall apply all the monies received by him in accordance with the provisions contained in sub-section (7) of section 13 of the Act.

#### **Procedure for recovery of shortfall of secured debt (Rule 11)**

- (1) An application for recovery of balance amount by any secured creditor pursuant to sub-section (10) of section 13 of the Act shall be presented to the Debts Recovery Tribunal in the form annexed as Appendix VI to these rules by the authorised officer or his agent or by a duly authorised legal practitioner, to the Registrar of the Bench within whose jurisdiction his case falls or shall be sent by registered post addressed to the Registrar of Debts Recovery Tribunal.
- (2) The provisions of the Debts Recovery Tribunal (Procedure) Rules, 1993 made under Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993), shall mutatis mutandis apply to any application filed by under sub-rule (1).
- (3) An application under sub-rule (1) shall be accompanied with fee as provided in rule 7 of the Debts Recovery Tribunal (Procedure) Rules, 1993.

#### **Application to the Tribunal/Appellate Tribunal (Rule 12)**

- (1) Any application to the Debt Recovery Tribunal under sub-section (1) of section 17 shall be, as nearly as possible, in the form given in Appendix VII to the Rules.
- (2) Any application to the Appellate Tribunal under sub-section (6) of section 17 of the Act shall be, as nearly as possible, in the form given in Appendix VIII to the said Rules. Any appeal to the Appellate Tribunal under section 18 of the Act shall be, as nearly as possible, in the form given in Appendix IX to the said Rules.

### **DEBT RECOVERY**

#### **Need and Object**

Recovery of Debts [Due to Banks and Financial Institutions, Insolvency and Bankruptcy of Individuals and Partnership Firms]<sup>1</sup> Act, 1993 was passed by the Parliament of India, with a view to provide for the establishment of Tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions, [insolvency resolution and bankruptcy of individuals and partnership firms]<sup>2</sup> and for matters connected therewith or incidental thereto. It extends to the whole of India except the State of Jammu and Kashmir. It shall be deemed to have come into force on the 24th day of June, 1993.

Sub-section 1(4) provides that [Save as otherwise provided, the provisions of this Code]<sup>3</sup> shall not apply where the amount of debt due to any bank or financial institution or to a consortium of banks or financial institutions is less than twenty lakh rupees as specified by the Central Government may, by notification on Sept 6, 2018.

The Act provides a procedure that is distinct from the existing Code of Civil Procedure in order to ensure a speedy adjudication. The Act also provides for the setting up of a separate set of tribunals to hear such matters and these tribunals are termed as Debt Recovery Tribunals (DRTs).

1. Substituted for "Due to Banks and Financial Institutions" by the Insolvency and Bankruptcy Code, 2016, w.e.f. Dec 1, 2019.

2. Inserted by the Insolvency and Bankruptcy Code, 2016, w.e.f. Dec 1, 2019.

3. Substituted for "The provisions of this Act" by the Insolvency and Bankruptcy Code, 2016, w.e.f. Dec 1, 2019.

With a view to help financial institutions recover their bad debts quickly and efficiently, the Government of India has constituted thirty nine Debt Recovery Tribunals and five Debt Recovery Appellate Tribunals all over the country.

Each Debts Recovery Tribunal is presided over by a Presiding Officer. The Presiding Officer is generally a Judge of the rank of District and Sessions Judge. A Presiding Officer of a Debts Recovery Tribunal is assisted by a number of officers of other ranks, but none of them need necessarily have a judicial background. Therefore, the Presiding Officer of a Debt Recovery Tribunal is the sole judicial authority to hear and pass any judicial order.

Each Debts Recovery Tribunal has two Recovery Officers. The work amongst the Recovery Officers is allocated by the Presiding Officer. Though a Recovery Officer need not be a judicial Officer, but the orders passed by a Recovery Officer are judicial in nature, and are appealable before the Presiding Officer of the Tribunal.

The Debts Recovery Tribunals are fully empowered to pass comprehensive orders like Civil Courts. The Tribunals can hear cross suits, counter claims and allow set offs. However, they cannot hear claims of damages or deficiency of services or breach of contract or criminal negligence on the part of the lenders.

The Debts Recovery Tribunals can appoint Receivers, Commissioners, pass ex-parte orders, ad-interim orders, interim orders apart from powers to review its own decision and hear appeals against orders passed by the Recovery Officers of the Tribunals.

The recording of evidence by Debts Recovery Tribunals is somewhat unique. All evidences are taken by way of an affidavit. Cross examination is allowed only on request by the defense, and that too if the Tribunal feels that such a cross examination is in the interest of justice. Frivolous cross examination may be denied. There are a number of other unique features in the proceedings before the Debts Recovery Tribunals all aimed at expediting the proceedings.

Any liability (inclusive of interest) which is claimed as due from any person by a bank or a financial institution or by a consortium of banks or financial institutions during the course of any business activity undertaken by the bank or the financial institution or the consortium under any law for the time being in force, in cash or otherwise, whether secured or unsecured, or assigned, or whether payable under a decree or order of any civil court or any arbitration award or otherwise or under a mortgage and subsisting on, and legally recoverable on, the date of the application.

### **Important Definitions**

Section 2 of the Recovery of Debts Due to Banks and Financial Institutions, Insolvency and Bankruptcy of Individuals and Partnership Firms Act, 1993 (the Act) defines various terms used in the Act, as given under:

“Appellate Tribunal” means an Appellate Tribunal established under sub-section (1) of Section 8.[ Section 2(a)]

“Bank” means

- (i) banking company;
- (ii) a corresponding new bank;
- (iii) State Bank of India;
- (iv) a subsidiary bank; or
- (v) a Regional Rural Bank;
- (vi) a multi State co-operative bank [Section 2(d)]

“Banking Company” shall have the meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949 [Section 2(e)]

“Chairperson” means a chairperson of an Appellate Tribunal appointed under Section 9. [Section 2(ea)]

“Debts” means any liability (inclusive of interest) which is claimed as due from any person by a bank or a financial institution or by a consortium of banks or financial institutions during the course of any business activity undertaken by the bank or the financial institution or the consortium under any law for the time being in force, in cash or otherwise, whether secured or unsecured, or assigned, or whether payable under a decree or order of any civil court or any arbitration award or otherwise or under a mortgage and subsisting on, and legally recoverable on, the date of the application [*and includes any liability towards debt securities which remains unpaid in full or part after notice of ninety days served upon the borrower by the debenture trustee or any other authority in whose favour security interest is created for the benefit of holders of debt securities.*] [Section 2(g)]

Debt securities” means debt securities listed in accordance with regulations made by the Securities and Exchange Board of India under the Securities and Exchange Board of India Act, 1992. [Section 2(ga)]

“Financial institution” means –

- (i) a public financial institution within the meaning of Section 4A of the Companies Act, 1956;
- (ia) the securitisation company or reconstruction company which has obtained a certificate of registration under sub-section (4) of section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- (ii) such other institution as the Central Government may, having regard to its business activity and the area of its operation in India, by notification, specify. [Section 2(h)]

‘Presiding officer’ means the presiding officer of the Debts Recovery Tribunal appointed under Sub-section (1) of Section 4[Section 2(ja)]

Section 2(jb) “property” means—

- (a) immovable property;
- (b) movable property;
- (c) any debt or any right to receive payment of money, whether secured or unsecured;
- (d) receivables, whether existing or future; and
- (e) intangible assets, being know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature, as may be prescribed by the Central Government in consultation with Reserve Bank. [Section 2(ja)]

“Security interest” “security interest” means mortgage, charge, hypothecation, assignment or any other right, title or interest of any kind whatsoever upon property, created in favour of any bank or financial institution and includes –

- (a) such right, title or interest upon tangible asset, retained by the bank or financial institution as owner of the property, given on hire or financial lease or conditional sale which secures the or any credit provided to enable the borrower to acquire the tangible asset; or
- (b) such right, title or interest in any intangible asset or licence of any intangible asset, which secures the obligation to pay any unpaid portion of the purchase price of the intangible asset or the obligation

incurred or any credit extended to enable the borrower to acquire the intangible asset or licence of intangible asset[ Section 2(lb)]

“Tribunal” means the Tribunal established under Sub-section (1) of Section 3[Section 2(o)]

## ESTABLISHMENT OF TRIBUNAL

Section 3 of the Act deals with the establishment of tribunal. Section 3 states that:

- (1) The Central Government shall, by notification, establish one or more Tribunals, to be known as the Debts Recovery Tribunal, to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act.
- (1A) The Central Government shall by notification establish such number of Debts Recovery Tribunals and its benches as it may consider necessary, to exercise the jurisdiction, powers and authority of the Adjudicating Authority conferred on such Tribunal by or under the Insolvency and Bankruptcy Code, 2016.
- (2) The Central Government shall also specify, in the notification referred to in sub-section (1), the areas within which the Tribunal may exercise jurisdiction for entertaining and deciding the applications filed before it.

The details of the Tribunals constituted as of now –

### Debt Recovery Appellate Tribunals (DRATs)

DRAT Allahabad, DRAT Chennai, DRAT Delhi, DRAT Kolkata, DRAT Mumbai.

### Debt Recovery Tribunals

DRT-I Ahmedabad, DRT-II Ahmedabad, DRT Allahabad, DRT Aurangabad, DRT Bangalore, DRT-I Chandigarh, DRT-II Chandigarh, DRT-1 Chennai, DRT-2 Chennai, DRT Coimbatore, DRT Cuttak, DRT Ernakulam, DRT Guwahati, DRT Hyderabad, DRT Jabalpur, DRT Jaipur, DRT-1 Kolkata, DRT-2 Kolkata, DRT-3 Kolkata, DRT Lucknow, DRT-1 Mumbai, DRT-2 Mumbai, DRT-3 Mumbai, DRT Nagpur, DRT-1 New Delhi, DRT-2 New Delhi, DRT-3 New Delhi, DRT Patna, DRT Pune, DRT Visakhapatnam, DRT Ranchi, DRT Madurai. 6 DRTs were later established at Bangaluru, Chandigarh, Dehradun, Hyderabad, and Siliguri.

## Composition of Tribunal (Section 4)

- (1) A Tribunal shall consist of one person only (hereinafter referred to as the Presiding Officer) to be appointed, by notification, by the Central Government.
- (2) Notwithstanding anything contained in sub-section (1), the Central Government may –
  - (a) authorise the Presiding Officer of any other Tribunal established under any other law for the time being in force to discharge the function of the Presiding Officer of a Debt Recovery Tribunal under this Act in addition to his being the Presiding Officer of that Tribunal; or
  - (b) authorise the judicial Member holding post as such in any other Tribunal, established under any other law for the time being in force, to discharge the functions of the Presiding Officer of Debts Recovery Tribunal under this Act, in addition to his being the judicial Member of that Tribunal.

### Qualifications for appointment of Presiding Officer and Term

**Section 5** provides that a person shall not be qualified for appointment as the Presiding Officer of a Tribunal unless he is, or has been, or is qualified to be, a District Judge.



**Section 6** provides that the Presiding Officer of a Tribunal shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment. Provided that no person shall hold office as the Presiding Officer of a Tribunal after he has attained the age of sixty-five years.

Section 7 deals with the Staff of Tribunal. Sub-section (1) provides that the Central Government shall provide the Tribunal with one or more Recovery Officers and such other officers and employees as that government may think fit. Sub-section (2) states that the Recovery Officers and other officers and employees of a Tribunal shall discharge their functions under the general superintendence of the Presiding Officer. Sub-section (3) provides that the salaries and allowances and other conditions of service of the Recovery Officers and other officers and employees of a Tribunal shall be such as may be prescribed.

### **ESTABLISHMENT OF APPELLATE TRIBUNAL**

As per Section 8 (1) of the Act, the Central Government shall, by notification, establish one or more Appellate Tribunals, to be known as the Debts Recovery Appellate Tribunal, to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act:

Provided that the Central Government may authorise the Chairperson of any other Appellate Tribunal, established under any other law for the time being in force, to discharge the functions of the Chairperson of the Debts Recovery Appellate Tribunal under this Act in addition to his being the Chairperson of that Appellate Tribunal.

(1A) The Central Government shall, by notification, establish such number of Debt Recovery Appellate Tribunals to exercise jurisdiction, powers and authority to entertain appeal against the order made by the Adjudicating Authority under Part III of the Insolvency and Bankruptcy Code, 2016.

(2) The Central Government shall also specify in the notification referred to in sub-section (1) the Tribunals in relation to which the Appellate Tribunal may exercise jurisdiction.

(3) Notwithstanding anything contained in sub-sections (1) and (2), the Central Government may authorise the Chairperson of one Appellate Tribunal to discharge also the functions of the Chairperson of other Appellate Tribunal.

### **Composition of Appellate Tribunal, Qualifications and its Term**

Section 9 of the Act provides that an Appellate Tribunal shall consist of one person only (hereinafter referred to as the Chairperson of the Appellate Tribunal) to be appointed, by notification, by the Central Government.

Section 10 of the Act deals with the qualifications for appointment of Chairperson of the Appellate Tribunal. It provides that a person shall not be qualified for appointment as the Chairperson of an Appellate Tribunal unless he:

- (a) is, or has been, or is qualified to be, a Judge of a High Court; or
- (b) has been a member of the Indian Legal Service and has held a post in Grade I of that service for at least three years; or
- (c) has held office as the Presiding Officer of a Tribunal for at least three years.

Section 11 provides that the Chairperson of an Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office and shall be eligible for reappointment:

Provided that no person shall hold office as the Chairperson of an Appellate Tribunal after he has attained the age of seventy years.

**JURISDICTION, POWERS AND AUTHORITY OF TRIBUNALS (Section 17)**

- (1) A Tribunal shall exercise, on and from the appointed day, the jurisdiction, powers and authority to entertain and decide applications from the banks and financial institutions for recovery of debts due to such banks and financial institutions.
- (1A) Without prejudice to sub-section (1), –
  - (a) the Tribunal shall exercise, on and from the date to be appointed by the Central Government, the jurisdiction, powers and authority to entertain and decide applications under Part III of Insolvency and Bankruptcy Code, 2016.
  - (b) the Tribunal shall have circuit sittings in all district headquarters.
- (2) An Appellate Tribunal shall exercise, on and from the appointed day, the jurisdiction, powers and authority to entertain appeals against any order made, or deemed to have been made, by a Tribunal under this Act.
- (2A) Without prejudice to sub-section (2), the Appellate Tribunal shall exercise, on and from the date to be appointed by the Central Government, the jurisdiction, powers and authority to entertain appeals against the order made by the Adjudicating Authority under Part III of the Insolvency and Bankruptcy Code, 2016.

**Power of Chairperson of Appellate Tribunal (Section 17A)**

- (1) The Chairperson of an Appellate Tribunal shall exercise general power of superintendence and control over the Tribunals under his jurisdiction including the power of appraising the work and recording the annual confidential reports of Presiding Officers.
- (1A) For the purpose of exercise of general powers of superintendence and control over Tribunals under sub-section (1), the Chairperson may –
  - (i) direct the Tribunals to furnish, in such form, at such intervals and within such time, information relating to pending cases both under this Act and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, or under any other law for the time being in force, number of cases disposed of, number of new cases filed and such other information as may be considered necessary by the Chairperson;
  - (ii) convene meetings of the Presiding Officers of Tribunals periodically to review their performance.
- (1B) Where on assessment of the performance of any Presiding Officer of the Tribunal or otherwise, the Chairperson is of the opinion that an inquiry is required to be initiated against such Presiding Officer for misbehavior or incapacity, he shall submit a report to the Central Government recommending action against such Presiding Officer, if any, under section 15, and for reasons to be recorded in writing for the same.
- (2) The Chairperson of an Appellate Tribunal having jurisdiction over the Tribunals may, on the application of any of the parties or on his own motion after notice to the parties, and after hearing them, transfer any case from one Tribunal for disposal to any other Tribunal.

**Bar of Jurisdiction (Section 18)**

On and from the appointed day, no court or other authority shall have, or be entitled to exercise, any jurisdiction, powers or authority (except the Supreme Court, and a High Court exercising jurisdiction under articles 226 and 227 of the Constitution) in relation to the matters specified in section 17:

[Provided that any proceedings in relation to the recovery of debts due to any multi-State co-operative bank pending before the date of commencement of the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2012 under the Multi-State Co-operative Societies Act, 2002 (39 of 2002) shall be continued and nothing contained in this section shall, after such commencement, apply to such proceedings.

#### **APPLICATION TO THE TRIBUNAL (Section 19)**

- (1) Where a bank or a financial institution has to recover any debt from any person, it may make an application to the Tribunal within the local limits of whose jurisdiction –
  - (a) [the branch or any other office of the bank or financial institution is maintaining an account in which debt claimed is outstanding, for the time being; or
  - (aa) [the defendant, or each of the defendants where there are more than one, at the time of making the application, actually and voluntarily resides, or carries on business, or personally works for gain; or
  - (b) any of the defendants where there are more than one, at the time of making the application, actually and voluntarily resides, or carries on business, or personally works for gain; or
  - (c) the cause of action, wholly or in part, arises:

Provided that the bank or financial institution may, with the permission of the Debts Recovery Tribunal, on an application made by it, withdraw the application, whether made before or after the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2004 for the purpose of taking action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, if no such action had been taken earlier under that Act:

Provided further that any application made under the first proviso for seeking permission from the Debts Recovery Tribunal to withdraw the application made under sub-section (1) shall be dealt with by it as expeditiously as possible and disposed of within thirty days from the date of such application:

Provided also that in case the Debts Recovery Tribunal refuses to grant permission for withdrawal of the application filed under this sub-section, it shall pass such orders after recording the reasons therefor.

- (1A) Every bank being, multi-State co-operative bank referred to in sub-clause (vi) of clause (d) of section 2, may, at its option, opt to initiate proceedings under the Multi-State Co-operative Societies Act, 2002 (39 of 2002) to recover debts, whether due before or after the date of commencement of the Enforcement of the Security Interest and Recovery of Debts Laws (Amendment) Act, 2012 from any person instead of making an application under this Chapter.
- (1B) In case, a bank being, multi-State co-operative bank referred to in sub-clause (vi) of clause (d) of section 2 has filed an application under this Chapter and subsequently opts to withdraw the application for the purpose of initiating proceeding under the Multi-State Co-operative Societies Act, 2002 (39 of 2002) to recover debts, it may do so with the permission of the Tribunal and every such application seeking permission from the Tribunal to withdraw the application made under sub-section (1A) shall be dealt with by it as expeditiously as possible and disposed of within thirty days from the date of such application:

Provided that in case the Tribunal refuses to grant permission for withdrawal of the application filed under this sub-section, it shall pass such orders after recording the reasons therefor.

- (2) Where a bank or a financial institution, which has to recover its debt from any person, has filed an application to the Tribunal under sub-section (1) and against the same person another bank or financial institution also has a claim to recover its debt, then, the later bank or financial institution may join the applicant bank or financial institution at any stage of the proceedings, before the final order is passed, by making an application to that Tribunal.
- (3) Every application under sub-section (1) or sub-section (2) shall be in such form, and shall be accompanied with true copies of all documents relied on in support of the claim along with such fee, as may be prescribed:

Provided that the fee may be prescribed having regard to the amount of debt to be recovered:

Provided further that nothing contained in this sub-section relating to fee shall apply to cases transferred to the Tribunal under sub-section (1) of section 31.

[*Explanation* – For the purposes of this section, documents includes statement of account or any entry in banker's book duly certified under the Bankers' Books Evidence Act, 1891

- (3A) Every applicant in the application filed under sub-section (1) or sub-section (2) for recovery of debt, shall –
  - (a) state particulars of the debt secured by security interest over properties or assets belonging to any of the defendants and the estimated value of such securities;
  - (b) if the estimated value of securities is not sufficient to satisfy the debt claimed, state particulars of any other properties or assets owned by any of the defendants, if any; and
  - (c) if the estimated value of such other assets is not sufficient to recover the debt, seek an order directing the defendant to disclose to the Tribunal particulars of other properties or assets owned by the defendants.
- (3B) If any application filed before the Tribunal for recovery of any debt is settled prior to the commencement of the hearing before that Tribunal or at any stage of the proceedings before the final order is passed, the applicant may be granted refund of the fees paid by him at such rates as may be prescribed.
- (4) On receipt of application under sub-section (1) or sub-section (2), the Tribunal shall issue summons with following directions to the defendant –
  - (i) to show cause within thirty days of the service of summons as to why relief prayed for should not be granted;
  - (ii) direct the defendant to disclose particulars of properties or assets other than properties and assets specified by the applicant under clauses (a) and (b) of sub-section (3A); and
  - (iii) to restrain the defendant from dealing with or disposing of such assets and properties disclosed under clause (c) of sub-section (3A) pending the hearing and disposal of the application for attachment of properties
- (4A) Notwithstanding anything contained in section 65A of the Transfer of Property Act, 1882, the defendant, on service of summons, shall not transfer by way of sale, lease or otherwise except in the ordinary course of his business any of the assets over which security interest is created and other properties and assets specified or disclosed under sub-section (3A), without the prior approval of the Tribunal:

Provided that the Tribunal shall not grant such approval without giving notice to the applicant bank or financial institution to show cause as to why approval prayed for should not be granted:

Provided further that defendant shall be liable to account for the sale proceeds realised by sale of secured assets in the ordinary course of business and deposit such sale proceeds in the account maintained with the bank or financial institution holding security interest over such assets.

- (5) (i) The defendant shall within a period of thirty days from the date of service of summons, present a written statement of his defence including claim for set-off under sub-section (6) or a counter-claim under sub-section (8), if any, and such written statement shall be accompanied with original documents or true copies thereof with the leave of the Tribunal, relied on by the defendant in his defence:

Provided that where the defendant fails to file the written statement within the said period of thirty days, the Presiding Officer may, in exceptional cases and in special circumstances to be recorded in writing, extend the said period by such further period not exceeding fifteen days to file the written statement of his defence;

(ii) where the defendant makes a disclosure of any property or asset pursuant to orders passed by the Tribunal, the provisions of sub-section (4A) of this section shall apply to such property or asset;

(iii) in case of non-compliance of any order made under clause (ii) of sub-section (4), the Presiding Officer may, by an order, direct that the person or officer who is in default, be detained in civil prison for a term not exceeding three months unless in the meantime the Presiding Officer directs his release:

**Provided** that the Presiding Officer shall not pass an order under this clause without giving an opportunity of being heard to such person or officer.

*Explanation.* – For the purpose of this section, the expression ‘officer who is in default’ shall mean such officer as defined in clause (60) of section 2 of the Companies Act, 2013.

- (5A) On receipt of the written statement of defendant or on expiry of time granted by the Tribunal to file the written statement, the Tribunal shall fix a date of hearing for admission or denial of documents produced by the parties to the proceedings and also for continuation or vacation of the interim order passed under sub-section (4).
- (5B) Where a defendant makes an admission of the full or part of the amount of debt due to a bank or financial institution, the Tribunal shall order such defendant to pay the amount, to the extent of the admission within a period of thirty days from the date of such order failing which the Tribunal may issue a certificate in accordance with the provisions of sub-section (22) to the extent of the amount of debt due admitted by the defendant.
- (6) Where the defendant claims to set-off against the applicant's demand any ascertained sum of money legally recoverable by him from such applicant, the defendant may, at the first hearing of the application, but not afterwards unless permitted by the Tribunal, present a written statement containing the particulars of the debt sought to be set-off along with original documents and other evidence relied on in support of claim of set-off in relation to any ascertained sum of money, against the applicant.
- (7) The written statement shall have the same effect as a plaint in a cross-suit so as to enable the Tribunal to pass a final order in respect of both the original claim and of the set-off.
- (8) A defendant in an application may, in addition to his right of pleading a set-off under sub-section (6), set up, by way of counter-claim against the claim of the applicant, any right or claim in respect of a cause of action accruing to the defendant against the applicant either before or after the filing of the application but before the defendant has delivered his defense or before the time limited for delivering his defence has expired, whether such counter-claim is in the nature of a claim for damages or not.

- (9) A counter-claim under sub-section (8) shall have the same effect as a cross-suit so as to enable the Tribunal to pass a final order on the same application, both on the original claim and on the counter-claim.
- (10) The applicant shall be at liberty to file a written statement in answer to the counter-claim of the defendant within such period as may be prescribed.
- (10A) Every application under sub-section (3) or written statement of defendant under sub-section (5) or claim of set-off under sub-section (6) or a counter-claim under sub-section (8) by the defendant, or written statement by the applicant in reply to the counter-claim, under sub-section (10) or any other pleading whatsoever, shall be supported by an affidavit sworn in by the applicant or defendant verifying all the facts and pleadings, the statements pleading documents and other documentary evidence annexed to the application or written statement or reply to set-off or counter-claim, as the case may be:

Provided that if there is any evidence of witnesses to be led by any party, the affidavits of such witnesses shall be filed simultaneously by the party with the application or written statement or replies filed under sub-section (10A).
- (10B) If any of the facts or pleadings in the application or written statement are not verified in the manner provided under sub-section (10A), a party to the proceedings shall not be allowed to rely on such facts or pleadings as evidence or any of the matters set out therein.
- (11) Where a defendant sets up a counter-claim in the written statement and in reply to such claim the applicant contends that the claim thereby raised ought not to be disposed of by way of counter-claim but in an independent action, the Tribunal shall decide such issue along with the claim of the applicant for recovery of the debt.
- (12) [\*\*\*]
- (13) (A) Where, at any stage of the proceedings, [the Tribunal on an application made by the applicant along with particulars of property to be attached and estimated value thereof, or otherwise is satisfied that the defendant, with intent to obstruct or delay or frustrate the execution of any order for the recovery of debt that may be passed against him, –
  - (i) is about to dispose of the whole or any part of his property; or
  - (ii) is about to remove the whole or any part of his property from the local limits of the jurisdiction of the Tribunal; or
  - (iii) is likely to cause any damage or mischief to the property or affect its value by misuse or creating third party interest, the Tribunal may direct the defendant, within a time to be fixed by it, either to furnish security, in such sum as may be specified in the order, to produce and place at the disposal of the Tribunal, when required, the said property or the value of the same, or such portion thereof as may be sufficient to satisfy the certificate for the recovery of debt, or to appear and show cause why he should not furnish security.
- (B) Where the defendant fails to show cause why he should not furnish security, or fails to furnish the security required, within the time fixed by the Tribunal, the Tribunal may order the attachment of the whole or such portion of the properties claimed by the applicant as the properties secured in his favour or otherwise owned by the defendant as appears sufficient to satisfy any certificate for the recovery of debt.
- (14) [\*\*\*]



- (15) The Tribunal may also in the order direct the conditional attachment of the whole or any portion of the property specified under sub-section (13)
- (16) If an order of attachment is made without complying with the provisions of sub-section (13), such attachment shall be void.
- (17) In the case of disobedience of an order made by the Tribunal under sub-sections (12), (13) and or breach of any of the terms on which the order was made, the Tribunal may order the properties of the person guilty of such disobedience or breach to be attached and may also order such person to be detained in the civil prison for a term not exceeding three months, unless in the meantime the Tribunal directs his release.
- (18) Where it appears to the Tribunal to be just and convenient, the Tribunal may, by order, –
  - (a) appoint a receiver of any property, whether before or after grant of certificate for recovery of debt;
  - (b) remove any person from the possession or custody of the property;
  - (c) commit the same to the possession, custody or management of the receiver;
  - (d) confer upon the receiver all such powers, as to bringing and defending suits in the courts or filing and defending applications before the Tribunal and for the realization, management, protection, preservation and improvement of the property, the collection of the rents and profits thereof, the application and disposal of such rents and profits, and the execution of documents as the owner himself has, or such of those powers as the Tribunal thinks fit; and
  - (e) appoint a Commissioner for preparation of an inventory of the properties of the defendant or for the sale thereof.
- (19) Where a certificate of recovery is issued against a company as defined under the Companies Act, 2013 (18 of 2013) and such company is under liquidation, the Tribunal may by an order direct that the sale proceeds of secured assets of such company be distributed in the same manner as provided in section 326 of the Companies Act, 2013 or under any other law for the time being in force.
- (20) The Tribunal may, after giving the applicant and the defendant, an opportunity of being heard, in respect of all claims, set-off or counter-claim, if any, and interest on such claims, within thirty days from the date of conclusion of the hearings, pass interim or final order as it deems fit which may include order for payment of interest from the date on which payment of the amount is found due up to the date of realisation or actual payment.
- (20A) Where it is proved to the satisfaction of the Tribunal that the claim of the applicant has been adjusted wholly or in part by any lawful agreement or compromise in writing and signed by the parties or where the defendant has repaid or agreed to repay the claim of the applicant, the Tribunal shall pass orders recording such agreement, compromise or satisfaction of the claim.
- (20AA) While passing the final order under sub-section (20), the Tribunal shall clearly specify the assets of the borrower over which security interest is created in favour of any bank or financial institution and direct the Recovery Officers to distribute the sale proceeds of such assets as provided in sub-section (20AB).
- (20AB) Notwithstanding anything to the contrary contained in any law for the time being in force, the proceeds from sale of secured assets shall be distributed in the following orders of priority, namely: –
  - (i) the costs incurred for preservation and protection of secured assets, the costs of valuation, public notice for possession and auction and other expenses for sale of assets shall be paid in full;



- (ii) debts owed to the bank or financial institution.

*Explanation* – For the purposes of this sub-section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency and bankruptcy proceedings are pending in respect of secured assets of the borrower, the distribution of proceeds from sale of secured assets shall be subject to the order of priority as provided in that Code.

- (21) (i) The Tribunal shall send a copy of its final order and the recovery certificate, to the applicant and defendant.
- (ii) The applicant and the defendant may obtain copy of any order passed by the Tribunal on payment on such fee as may be prescribed.
- [(22) The Presiding Officer shall issue a certificate of recovery along with the final order, under sub- section (20), for payment of debt with interest under his signature to the Recovery Officer for recovery of the amount of debt specified in the certificate.
- (22A) Any recovery certificate issued by the Presiding Officer under sub-section (22) shall be deemed to be decree or order of the Court for the purposes of initiation of winding up proceedings against a company registered under the Companies Act, 2013 (18 of 2013) or Limited Liability Partnership registered under the Limited Liability Partnership Act, 2008 (9 of 2008) or insolvency proceedings against any individual or partnership firm under any law for the time being in force, as the case may be.
- (23) Where the Tribunal, which has issued a certificate of recovery, is satisfied that the property is situated within the local limits of the jurisdiction of two or more Tribunals, it may send the copies of the certificate of recovery for execution to such other Tribunals where the property is situated :  
  
Provided that in a case where the Tribunal to which the certificate of recovery is sent for execution finds that it has no jurisdiction to comply with the certificate of recovery, it shall return the same to the Tribunal which has issued it.
- (24) The application made to the Tribunal under sub-section (1) or sub-section (2) shall be dealt with by it as expeditiously as possible and every effort shall be made by it to complete the proceedings in two hearings, and to dispose of the application finally within one hundred and eighty days from the date of receipt of the application.
- (25) The Tribunal may make such orders and give such directions as may be necessary or expedient to give effect to its orders or to prevent abuse of its process or to secure the ends of justice.

#### **FILING OF RECOVERY APPLICATIONS, DOCUMENTS AND WRITTEN STATEMENTS IN ELECTRONIC FORM (Section 19A)**

- (1) Notwithstanding anything to the contrary contained in this Act, and without prejudice to the provisions contained in section 6 of the Information Technology Act, 2000, the Central Government may by rules provide that from such date and before such Tribunal and Appellate Tribunal, as may be notified, –
  - (a) application or written statement or any other pleadings and the documents to be annexed thereto required to be filed shall be submitted in the electronic form and authenticated with digital signature of the applicant, defendant or any other petitioner in such form and manner as may be prescribed;
  - (b) any summons, notice or communication or intimation as may be required to be served or delivered under this Act, may be served or delivered by transmission of pleadings and documents by electronic form and authenticated in such manner as may be prescribed.

- (2) Any interim or final order passed by the Tribunal or Appellate Tribunal displayed on the website of such Tribunal or Appellate Tribunal shall be deemed to be a public notice of such order and transmission of such order by electronic mail to the registered address of the parties to the proceeding shall be deemed to be served on such party.
- (3) The Central Government may by rules provide that the electronic form for the purpose specified in this section shall be exclusive, or in the alternative or in addition to the physical form, therefor.
- (4) The Tribunal or the Appellate Tribunal notified under sub-section (1), for the purpose of adopting electronic filing, shall maintain its own website or common website with other Tribunals and Appellate Tribunal or such other universally accessible repositories of electronic information and ensure that all orders or directions issued by the Tribunal or Appellate Tribunal are displayed on the website of the Tribunal or Appellate Tribunal, in such manner as may be prescribed.

*Explanation.* – For the purpose of this section, –

- (a) ‘digital signature’ means the digital signature as defined under clause (p) of section 2 of the Information Technology Act, 2000 (21 of 2000);
- (b) ‘electronic form’ with reference to an information or a document means the electronic form as defined under clause (r) of section 2 of the Information Technology Act, 2000.

The application made to Tribunal for exercising the powers of the Adjudicating Authority under the Insolvency and Bankruptcy Code, 2016 shall be dealt with in the manner as provided under that Code.

#### **APPEAL TO THE APPELLATE TRIBUNAL (Section 20)**

- (1) Save as provided in sub-section (2), any person aggrieved by an order made, or deemed to have been made, by a Tribunal under this Act, may prefer an appeal to an Appellate Tribunal having jurisdiction in the matter.
- (2) No appeal shall lie to the Appellate Tribunal from an order made by a Tribunal with the consent of the parties.
- (3) Every appeal under sub-section (1) shall be filed within a period of thirty day from the date on which a copy of the order made, or deemed to have been made, by the Tribunal is received by him and it shall be in such form and be accompanied by such fee as may be prescribed :

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of thirty days if it is satisfied that there was sufficient cause for not filing it within that period.

- (4) On receipt of an appeal under sub-section (1) [or under sub-section (1) of section 181 of the Insolvency and Bankruptcy Code, 2016, the Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.
- (5) The Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Tribunal.
- (6) The appeal filed before the Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Section 21 provides that where an appeal is preferred by any person from whom the amount of debt is due

to a bank or a financial institution or a consortium of banks or financial institutions, such appeal shall not be entertained by the Appellate Tribunal unless such person has deposited with the Appellate Tribunal fifty per cent of the amount of debt so due from him as determined by the Tribunal under section 19:

Provided that the Appellate Tribunal may, for reasons to be recorded in writing, reduce the amount to be deposited by such amount which shall not be less than twenty-five per cent of the amount of such debt so due to be deposited under this section.

## **PROCEDURE AND POWERS OF THE TRIBUNAL AND THE APPELLATE TRIBUNAL**

Section 22 deals with the procedure and powers of the Tribunal and the Appellate Tribunal.

Sub-section (1) provides that the Tribunal and the Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice. The proceedings before the Debt Recovery Appellate Tribunal is governed by Debt Recovery Appellate Tribunal (Procedures) Rules, 1993. In addition, Section 22 of the Act permits the Tribunal and the Appellate Tribunal to regulate their own procedure including the places at which they shall have their sittings.

Sub-section (2) provides that the Tribunal and the Appellate Tribunal shall have, for the purposes of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:

- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavits;
- (d) issuing commissions for the examination of witnesses or documents;
- (e) reviewing its decisions;
- (f) dismissing an application for default or deciding it ex parte;
- (g) setting aside any order of dismissal of any application for default or any order passed by it ex parte;
- (h) any other matter which may be prescribed.

Sub-section (3) provides that any proceeding before the Tribunal or the Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228, and for the purposes of Section 196, of the Indian Penal Code, 1860 and the Tribunal or the Appellate Tribunal shall be deemed to be a civil court for all the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Sub-section (4) provides that for the purpose of proof of any entry in the 'bankers books', the provisions of the Bankers' Books Evidence Act, 1891 (18 of 1891) shall apply to all the proceedings before the Tribunal or Appellate Tribunal.

Section 22A provides that the Central Government may, for the purpose of this Act, by rules, lay down uniform procedure consistent with the provisions of this Act for conducting the proceedings before the Tribunals and Appellate Tribunals.

## **RIGHT TO LEGAL REPRESENTATION AND PRESENTING OFFICERS**

Section 23(1) provides that a Bank or a Financial Institution making an application to a Tribunal or an appeal to an Appellate Tribunal may authorise one or more legal practitioners or any of its officers to act as Presenting Officers and every person so authorised by it may present its case before the Tribunal or the Appellate Tribunal.

Sub-section (2) states that the defendant may either appear in person or authorise one or more legal practitioners or any of his or its officers to present his or its case before the Tribunal or the Appellate Tribunal.

### **Limitations**

Section 24 states that the provisions of the Limitation Act, 1963, shall, as far as may be, apply to an application made to a Tribunal.

### **RECOVERY OF DEBT DETERMINED BY TRIBUNAL**

Section 25 states that the Recovery Officer shall, on receipt of the copy of the certificate under sub-section (7) of section 19, proceed to recover the amount of debt specified in the certificate by one or more of the following modes, namely: –

- (a) attachment and sale of the movable or immovable property of the defendant;
- (aa) taking possession of property over which security interest is created or any other property of the defendant and appointing receiver for such property and to sell the same
- (b) arrest of the defendant and his detention in prison;
- (c) appointing a receiver for the management of the movable or immovable properties of the defendant;
- (d) any other mode of recovery as may be prescribed by the Central Government.

### **Validity of certificate and amendment thereof**

Section 26 deals with the Validity of certificate and amendment thereof. It states that:

- (1) It shall not be open to the defendant to dispute before the Recovery Officer the correctness of the amount specified in the certificate, and no objection to the certificate on any other ground shall also be entertained by the Recovery Officer.
- (2) Notwithstanding the issue of a certificate to a Recovery Officer, the Presiding Officer shall have power to withdraw the certificate or correct any clerical or arithmetical mistake in the certificate by sending an intimation to the Recovery Officer.
- (3) The Presiding Officer shall intimate to the Recovery Officer any order withdrawing or cancelling a certificate or any correction made by him under sub-section (2).

### **Stay of proceedings under certificate and amendment or withdrawal thereof**

Section 27 deals with the Stay of proceedings under certificate and amendment or withdrawal thereof. Section 27 provides that:

- (1) Notwithstanding that a certificate has been issued to the Recovery Officer for the recovery of any amount, the Presiding Officer, may by an order, grant time for payment of the amount, provided the defendant makes a down payment of not less than twenty-five per cent of the amount specified in the recovery certificate and gives an unconditional undertaking to pay the balance within a reasonable time, which is acceptable to the applicant bank or financial institution holding recovery certificate.
- (1A) The Recovery Officer shall, after receipt of the order passed under sub-section (1), stay the proceedings until the expiry of the time so granted.
- (1B) Where defendant agrees to pay the amount specified in the Recovery Certificate and proceeding are

stayed by the Recovery Officer, the defendant shall forfeit right to file appeal against the orders of the Tribunal.

- (1C) Where the defendant commits any default in payment of the amount under sub-section (1), the stay of recovery proceedings shall stand withdrawn and the Recovery Officer shall take steps for recovery of remaining amount of debt due and payable.
- (2) Where a certificate for the recovery of amount has been issued, the Presiding Officer shall keep the Recovery Officer informed of any amount paid or time granted for payment, subsequent to the issue of such certificate to the Recovery Officer.
- (3) Where the order giving rise to a demand of amount for recovery of debt has been modified in appeal, and, as a consequence thereof the demand is reduced, the Presiding Officer shall stay the recovery of such part of the amount of the certificate as pertains to the said reduction for the period for which the appeal remains pending.
- (4) Where a certificate for the recovery of debt has been received by the Recovery Officer and subsequently the amount of the outstanding demands is reduced [or enhanced] as a result of an appeal, the Presiding Officer shall, when the order which was the subject-matter of such appeal has become final and conclusive, amend the certificate or withdraw it, as the case may be.

#### Other modes of recovery (Section 28)

- (1) Where a certificate has been issued to the Recovery Officer under sub-section (7) of section 19, the Recovery Officer may, without prejudice to the modes of recovery specified in section 25, recover the amount of debt by any one or more of the modes provided under this section.
- (2) If any amount is due from any person to the defendant, the Recovery Officer may require such person to deduct from the said amount, the amount of debt due from the defendant under this Act and such person shall comply with any such requisition and shall pay the sum so deducted to the credit of the Recovery Officer :

Provided that nothing in this sub-section shall apply to any part of the amount exempt from attachment in execution of a decree of a civil court under section 60 of the Code of Civil Procedure, 1908.

- (3) (i) The Recovery Officer may, at any time or from time to time, by notice in writing, require any person from whom money is due or may become due to the defendant or to any person who holds or may subsequently hold money for or on account of the defendant, to pay to the Recovery Officer either forthwith upon the money becoming due or being held or within the time specified in the notice (not being before the money becomes due or is held) so much of the money as is sufficient to pay the amount of debt due from the defendant or the whole of the money when it is equal to or less than that amount.  
  
(ii) A notice under this sub-section may be issued to any person who holds or may subsequently hold any money for or on account of the defendant jointly with any other person and for the purposes of this sub-section, the shares of the joint holders in such amount shall be presumed, until the contrary is proved, to be equal.  
  
(iii) A copy of the notice shall be forwarded to the defendant at his last address known to the Recovery Officer and in the case of a joint account to all the joint holders at their last addresses known to the Recovery Officer.

(iv) Save as otherwise provided in this sub-section, every person to whom a notice is issued under this sub-section shall be bound to comply with such notice, and, in particular, where any such notice is issued to a post office, bank, financial institution, or an insurer, it shall not be necessary for any pass book, deposit receipt, policy or any other document to be produced for the purpose of any entry, endorsement or the like to be made before the payment is made notwithstanding any rule, practice or requirement to the contrary.

(v) Any claim respecting any property in relation to which a notice under this sub-section has been issued arising after the date of the notice shall be void as against any demand contained in the notice.

(vi) Where a person to whom a notice under this sub-section is sent objects to it by a statement on oath that the sum demanded or the part thereof is not due to the defendant or that he does not hold any money for or on account of the defendant, then, nothing contained in this sub-section shall be deemed to require such person to pay any such sum or part thereof, as the case may be, but if it is discovered that such statement was false in any material particular, such person shall be personally liable to the Recovery Officer to the extent of his own liability to the defendant on the date of the notice, or to the extent of the defendant's liability for any sum due under this Act, whichever is less.

(vii) The Recovery Officer may, at any time or from time to time amend or revoke any notice under this sub-section or extend the time for making any payment in pursuance of such notice.

(viii) The Recovery Officer shall grant a receipt for any amount paid in compliance with a notice issued under this sub-section, and the person so paying shall be fully discharged from his liability to the defendant to the extent of the amount so paid.

(ix) Any person discharging any liability to the defendant after the receipt of a notice under this sub-section shall be personally liable to the Recovery Officer to the extent of his own liability to the defendant so discharged or to the extent of the defendant's liability for any debt due under this Act, whichever is less.

(x) If the person to whom a notice under this sub-section is sent fails to make payment in pursuance thereof to the Recovery Officer, he shall be deemed to be a defendant in default in respect of the amount specified in the notice and further proceedings may be taken against him for the realisation of the amount as if it were a debt due from him, in the manner provided in sections 25, 26 and 27 and the notice shall have the same effect as an attachment of a debt by the Recovery Officer in exercise of his powers under section 25.

- (4) The Recovery Officer may apply to the court in whose custody there is money belonging to the defendant for payment to him of the entire amount of such money, or if it is more than the amount of debt due, an amount sufficient to discharge the amount of debt so due.
- (4A) The Recovery Officer may, by order, at any stage of the execution of the certificate of recovery, require any person, and in case of a company, any of its officers against whom or which the certificate of recovery is issued, to declare on affidavit the particulars of his or its assets.
- (5) The Recovery Officer may recover any amount of debt due from the defendant by distraint and sale of his movable property in the manner laid down in the Third Schedule to the Income-tax Act, 1961.

#### **APPLICATION OF CERTAIN PROVISIONS OF INCOME-TAX ACT**

Section 29 of the Act provides that the provisions of the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time shall,



as far as possible, apply with necessary modifications as if the said provisions and the rules referred to the amount of debt due under this Act instead of to the Income-tax. Provided that any reference under the said provisions and the rules to the “assessee” shall be construed as a reference to the defendant under the Act.

Furthermore, Section 30, after amendment by the Amendment Act, 2000, gives a right to any person aggrieved by an order of the Recovery Officer, to prefer an appeal to the Tribunal. Thus now an appellate forum has been provided against any orders of the Recovery Officer which may not be in accordance with the law. There is, therefore, sufficient safeguard which has been provided in the event of the Recovery Officer acting in an arbitrary or an unreasonable manner.”

### **APPEAL AGAINST THE ORDER OF RECOVERY OFFICER**

Any person aggrieved by an order of the Recovery Officer made under this Act may, within thirty days from the date on which a copy of the order is issued to him, prefer an appeal to the Tribunal. On receipt of an appeal, the Tribunal may, after giving an opportunity to the appellant to be heard, and after making such inquiry as it deems fit, confirm, modify or set aside the order made by the Recovery Officer in exercise of his powers under Sections 25 to 28 (both inclusive).

### **DEPOSIT OF AMOUNT OF DEBT DUE FOR FILING APPEAL AGAINST ORDERS OF THE RECOVERY OFFICER**

Section 30A states that where an appeal is preferred against any order of the Recovery Officer, under section 30, by any person from whom the amount of debt is due to a bank or financial institution or consortium of banks or financial institutions, such appeal shall not be entertained by the Tribunal unless such person has deposited with the Tribunal fifty per cent of the amount of debt due as determined by the Tribunal.

### **TRANSFER OF PENDING CASES (SECTION 31)**

(1) Every suit or other proceeding pending before any court immediately before the date of establishment of a Tribunal under this Act, being a suit or proceeding the cause of action whereon it is based is such that it would have been, if it had arisen after such establishment, within the jurisdiction of such Tribunal, shall stand transferred on that date to such Tribunal :

Provided that nothing in this sub-section shall apply to any appeal pending as aforesaid before any court:

Provided further that any recovery proceedings in relation to the recovery of debts due to any multi- State co-operative bank pending before the date of commencement of the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Act, 2012 under the Multi-State Co-operative Societies Act, 2002, shall be continued and nothing contained in this section shall apply to such proceedings.

(2) Where any suit or other proceeding stands transferred from any court to a Tribunal under sub- section (1), –

- (a) the court shall, as soon as may be after such transfer, forward the records of such suit or other proceeding to the Tribunal; and
- (b) the Tribunal may, on receipt of such records, proceed to deal with such suit or other proceeding, so far as may be, in the same manner as in the case of an application made under section 19 from the stage which was reached before such transfer or from any earlier stage as the Tribunal may deem fit.



## POWER OF TRIBUNAL TO ISSUE CERTIFICATE OF RECOVERY IN CASE OF DECREE OR ORDER

Section 31A specifies the power of Tribunal to issue certificate of recovery in case of decree or order. It states that :

- (1) Where a decree or order was passed by any court before the commencement of the Recovery of Debts Due to Banks and Financial Institutions (Amendment) Act, 2000 and has not yet been executed, then, the decree-holder may apply to the Tribunal to pass an order for recovery of the amount.
- (2) On receipt of an application under sub-section (1), the Tribunal may issue a certificate for recovery to a Recovery Officer.
- (3) On receipt of a certificate under sub-section (2), the Recovery Officer shall proceed to recover the amount as if it was a certificate in respect of a debt recoverable under this Act.

## PRIORITY TO SECURED CREDITORS

Section 31B provides that notwithstanding anything contained in any other law for the time being in force, the rights of secured creditors to realise secured debts due and payable to them by sale of assets over which security interest is created, shall have priority and shall be paid in priority over all other debts and Government dues including revenues, taxes, cesses and rates due to the Central Government, State Government or local authority.

*Explanation* – For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code.

## ACT TO HAVE OVER-RIDING EFFECT

Section 34 provides that save as provided under subsection (2), the provisions of this Act shall have effect notwithstanding anything inconsistent herewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.

Sub-section (2) states that the provisions of this Act or the rules made there-under shall be in addition to, and not in derogation of, the Industrial Finance Corporation Act, 1948, the State Financial Corporations Act, 1951, the Unit Trust of India Act, 1963, the Industrial Reconstruction Bank of India Act, 1984, the Sick Industrial Companies (Special Provisions) Act, 1985 and the Small Industries Development Bank of India Act, 1989.

## LESSON ROUND UP

- Securitisation is the process of pooling and repackaging of homogenous illiquid financial assets into marketable securities that can be sold to investors.
- The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 is enacted with a view to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto.
- The SARFAESI Act, 2002 has empowered the Banks and Financial Institutions with vast power to enforce the securities charged to them. The Banks can now issue notices to the defaulters to pay up the dues and if they fail to do so within 60 days of the date of the notice, the banks can take over the possession of assets like factory, land and building, plant and machinery etc.

- ‘Asset Reconstruction Company’ means a company registered with Reserve Bank under section 3 of SARFAESI Act for the purposes of carrying on the business of asset reconstruction or securitisation, or both. Section 3 of SARFAESI Act deals with the Registration of Asset Reconstruction Companies.
- Any security interest created in favour of any secured creditor may be enforced, without the intervention of the Court or Tribunal, by such creditor in accordance with the provisions of this Act.
- Any borrower or any other person aggrieved by the action of the secured creditors can file an appeal to the concerned Debt Recovery Tribunal (DRT).
- Any person aggrieved by the order of DRT, may prefer an appeal to the Appellate Tribunal within thirty days from the date of receipt of the order of Debt Recovery Tribunal.
- Section 31 of the Act contains provisions relating to non-applicability of the Act in certain cases. Section 34 provides that no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Debts Recovery Tribunal or the Appellate Tribunal is empowered by or under this Act
- Any person who contravenes the provisions of this Act or of any rules made thereunder shall be punishable with imprisonment for a term which may extend to one year, or with fine, or with both.
- Limitation Act, 1963 is applicable to the claims made under this Act. Section 35 provides that the provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.
- In exercise of the powers conferred by section 38 read with section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the Central Government notified Security Interest (Enforcement) Rules, 2002.
- Rule 8(6) of the Rules of 2002 provides the necessary safeguard if the action is taken in arbitrary and unreasonable manner and if the valuation of the property is not properly fixed. The whole object of Rule 8 (6) of the Rules of 2002 appears to be that the borrower gets clear thirty days’ notice before the sale takes place. During this period, the borrower can raise objections and can also point out before the appropriate forum as regards the correct and true valuation of the property.
- Recovery of Debts and Bankruptcy Act, 1993 is an Act to provide for the establishment of Tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions and for matters connected therewith or incidental thereto.
- The Act was passed to provide for the speedy adjudication of matters relating to recovery of debts due to banks and financial institutions.
- The Recovery of Debts and Bankruptcy Act, 1993 is a comprehensive Code dealing with all the facets pertaining to adjudication, appeal and realization of the dues payable to the banks and financial institutions.
- Section 19 of the Act deals with the procedure for making application to the Tribunal.
- Section 20 of the Act deals with provisions for an appeal to an Appellate Tribunal having jurisdiction in the matter.
- The Tribunal and the Appellate Tribunal have the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908.

- The Recovery Officer may proceed to recover the amount of debt by any of the specified modes under Section 25 of the Act.
- Any person who is aggrieved by an order of Recovery Officer may prefer an appeal to the Tribunal. The Debts Recovery Tribunal has the powers under the Act to make an enquiry as it deems fit and confirm, modify or set aside the order made by the Recovery Officer.
- The auction, sale and challenge are completely codified under the Act, regard being had to the special nature of the legislation.
- The provisions of the Limitation Act, 1963, shall, as far as may be, apply to an application made to a Tribunal.
- Section 34 provides that save as provided under subsection (2), the provisions of this Act shall have effect notwithstanding anything inconsistent herewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.

### SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. What is securitization? Mention the reasons behind enactment of the SARFAESI Act, 2002?
2. Write a note on Asset Reconstruction Companies citing the measures it can take under section 9 of the SARFAESI Act, 2002?
3. What are the provisions relating to assistance of Chief Metropolitan magistrate or District magistrate for taking possession of a secured asset?
4. Mention provisions relating to 'demand notice' under rule 3 of Security Interest (Enforcement) Rules, 2002.
5. Explain the 'Right to lodge a caveat' under SARFAESI Act, 2002.
6. State the salient features of the Recovery of Debts and Bankruptcy Act, 1993.
7. Explain in brief the procedure for making application to the Tribunal under section 19 of the Recovery of Debts and Bankruptcy Act, 1993.
8. Write a note on the powers of the Tribunal and Appellate Tribunal under the Recovery of Debts and Bankruptcy Act, 1993.

[illegible]



# Lesson 23

## Cross Border Insolvency

### LESSON OUTLINE

- Introduction
- Key objectives of effective and efficient Insolvency Law
- Development of UNCITRAL Model law
- Salient features of Model law
- UNCITRAL Legislative Guide on Insolvency Law
- World Bank Principles – Effective Insolvency and Creditor Rights
- US Bankruptcy Code
- Enabling provisions for cross border transactions under IBC
- Recent developments in India
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Cross-border insolvency (sometimes called international insolvency) regulates the treatment of financially distressed debtors where such debtors have assets or creditors in more than one country.

Cross-border insolvency problems are not limited to the failure of major international businesses. Property located in a foreign country may provide security for a debt so that domestic assets can be used to pay unsecured creditors. Foreign creditors may have valid claims in domestic bankruptcy cases, and domestic creditors may have valid claims in foreign bankruptcy cases. Any one of these situations raises a transnational insolvency problem.

The adoption of national or international legal regimes to address the cross-border insolvency cases are not only unpredictable and time-consuming in their application, but lack both transparency and the tools necessary to address the disparities and, in some cases, conflicts that may occur between national laws and insolvency regimes. These factors have impeded the protection of the value of the assets of financially troubled businesses and hampered their rescue.

UNCITRAL, with the general mandate to further the progressive harmonization and unification of the law of international trade, has developed a Model Law which is designed to assist States to equip their insolvency laws with a modern legal framework to more effectively address cross-border insolvency proceedings.

Further, the World Bank has also contributed to legislative developments in dealing with cross-border insolvency. US Bankruptcy Code is considered as one of the effective ways of rehabilitation of bankrupt corporates.

After reading this lesson you will be able to understand the overall view of UNCITRAL Model Law, World Bank principles, US Bankruptcy Code and other recent developments.

## INTRODUCTION

Cross-border insolvency (sometimes called international insolvency) regulates the treatment of financially distressed debtors where such debtors have assets or creditors in more than one country. In recent times, the number of cross-border insolvency cases has increased significantly. The increasing frequency of cross-border insolvencies reflects the continuing expansion of global trade and investment. However, national insolvency laws are often ill-equipped to deal with cases of a cross-border nature and they have by and large not kept pace with the trend. Fraud by insolvent debtors, in particular by concealing assets or transferring them to foreign jurisdictions, is another increasing problem, in terms of both its frequency and its magnitude.

There is also a lack of communication and coordination among courts and administrators from concerned jurisdictions. These deficiencies frequently results in inadequate and inharmonious legal approaches, which hamper the rescue of financially troubled businesses. Such inadequate and uncoordinated legal approaches, uncondusive to a fair and efficient administration of cross-border insolvencies, impede the protection of the assets of the insolvent debtor and affect the maximization of the value of those assets. Such approaches are not only unpredictable and time-consuming in their application, but also lack transparency and the necessary tools to address the issues. All these factors adversely affect the value of the assets of financially troubled businesses and hampers their rescue. Moreover, the absence of predictability in the cross-border insolvency processes impedes capital flow and is a disincentive to cross-border investment.

The organisation of insolvency proceedings with an international element is not an easy or straightforward matter. Solutions to the phenomenon of cross-border insolvency are reliant on a number of complex and interrelated questions to which the courts and legislatures in different jurisdictions have provided varying answers.

Cross-border insolvency problems are not limited to the failure of major international businesses. A domestic business may have foreign branches or subsidiaries, or a foreign business may have domestic branches or subsidiaries. Property located in a foreign country may provide security for a debt so that domestic assets can be used to pay unsecured creditors. Foreign creditors may have valid claims in domestic bankruptcy cases, and domestic creditors may have valid claims in foreign bankruptcy cases. Any one of these situations raises a transnational insolvency problem.

## KEY OBJECTIVES OF EFFECTIVE AND EFFICIENT INSOLVENCY LAW

Although approaches in different countries may vary but there is a broad agreement that an effective and efficient insolvency regime should aim to achieve the following key objectives in a balanced manner:

1. Maximization of value of assets
2. Ensuring equitable treatment of similarly situated creditors
3. Provision for timely, efficient and impartial resolution of insolvency
4. Preservation of the insolvency estate to allow equitable distribution to creditors
5. Ensuring a transparent and predictable insolvency law that contains incentives for gathering and dispensing information
6. Recognition of existing creditor rights and establishment of clear rules for ranking of priority claims
7. Establishment of a framework for cross-border insolvency

## The United Nations Commission on International Trade (UNCITRAL)

The United Nations Commission on International Trade Law (UNCITRAL) is a subsidiary body of the General Assembly. The United Nations Commission on International Trade Law (UNCITRAL) was established by the General Assembly in 1966 [Resolution 2205 (XXI) of 17 December 1966].



The Commission carries out its work at annual sessions, which are held in alternate years at United Nations Headquarters in New York and at the Vienna International Centre at Vienna.

The United Nations Commission on International Trade Law prepares international legislative texts for use by States in modernizing commercial law and non-legislative texts for use by commercial parties in negotiating transactions.

**Examples of Legislative texts:**

- UNCITRAL Model Law on International Commercial Arbitration
- UNCITRAL Model Law on Cross Border Insolvency
- UNCITRAL Model Law on Procurement of Goods, Construction and Services
- UNCITRAL Model Law on International Credit Transfers
- UNCITRAL Model Law on Electronic Commerce

**Examples of Non-legislative texts:**

- UNCITRAL Arbitration Rules
- UNCITRAL Conciliation Rules
- UNCITRAL Notes on Organizing Arbitral Proceedings
- UNCITRAL Legal Guide on International Countertrade Transactions

## UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAWS<sup>1</sup>

The Legislative Guide on Insolvency Law was prepared by the United Nations Commission on International Trade Law (UNCITRAL). The project arose from a proposal made to the Commission in 1999 that UNCITRAL should undertake further work on insolvency law, specifically corporate insolvency, to foster and encourage the adoption of effective national corporate insolvency regimes.

An exploratory meeting to consider the feasibility of such a project was held in December 1999. On the basis of the recommendation of that meeting, the Commission gave Working Group V (Insolvency Law) a mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.

The first draft of the legislative guide on insolvency law was considered by Working Group V in July 2001 and work developed through seven one-week sessions, the final meeting taking place in late March 2004. In addition to representatives of the 36 member States of the Commission, representatives of many other States and a number of international organizations, both intergovernmental and non-governmental, participated actively in the preparatory work. The work was also undertaken in close collaboration with Working Group VI (Security Interests), to ensure coordination of the treatment of security interests in insolvency with the legislative guide on secured transactions being developed by UNCITRAL.

The final negotiations on the draft legislative guide on insolvency law were held during the thirty-seventh session of UNCITRAL in New York from 14 to 21 June 2004 and the text was adopted by consensus on 25 June 2004. Subsequently, the General Assembly adopted resolution 59/40 of 2 December 2004 in which it expressed its appreciation to UNCITRAL for completing and adopting the Legislative Guide.

1. [https://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf) last accessed on 18 January 2019.

## Organization and Scope of the Legislative Guide

The Legislative Guide on Insolvency Law is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations.

The Guide discusses issues central to the design of an effective and efficient insolvency law, which, despite numerous differences in policy and legislative treatment, are recognized in many legal systems.

The Legislative Guide also discusses the increasing use and importance of other tools for addressing insolvency, specifically restructuring negotiations entered into voluntarily between a debtor and its key creditors, which are not regulated by the insolvency law.

## Purpose

The purpose of the Legislative Guide on Insolvency Law is to assist the establishment of an efficient and effective legal framework to address the financial difficulty of debtors. The Legislative Guide provides a comprehensive statement of the key objectives and principles that should be reflected in a State's insolvency laws. It is intended to inform and assist insolvency law reform around the world, providing a reference tool for national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations. The advice provided aims at achieving a balance between the need to address a debtor's financial difficulty as quickly and efficiently as possible; the interests of the various parties directly concerned with that financial difficulty, principally creditors and other stakeholders in the debtor's business; and public policy concerns, such as employment and taxation. The Legislative Guide assists the reader to evaluate the different approaches and solutions available and to choose the one most suitable to the local context.

## Relevance to International Trade

It is increasingly recognized that strong and effective insolvency regimes are important for all States as a means of preventing or limiting financial crises and facilitating rapid and orderly workouts from excessive indebtedness. Such regimes can facilitate the orderly reallocation of economic resources from businesses that are not viable to more efficient and profitable activities; provide incentives that not only encourage entrepreneurs to undertake investment, but also encourage managers of failing businesses to take early steps to address that failure and preserve employment; reduce the costs of business; and increase the availability of credit. Comparative analysis of the effectiveness of insolvency systems has become both common and essential for lending purposes, affecting States at all levels of economic development.

Much of the legislation relating to corporations and particularly to their treatment in insolvency deals with the single corporate entity, notwithstanding that the business of corporations is increasingly being conducted, both nationally and internationally, through enterprise groups - groups of corporations, sometimes very large, that are interconnected by various forms of ownership and control. These groups, found extensively in both emerging and developed markets, are a common vehicle for conducting international trade and finance. When some or all of the constituent parts of such groups become insolvent, there are currently very few domestic law regimes and no international or regional legal regimes that can effectively coordinate the conduct of the resulting insolvency proceedings, often involving multiple jurisdictions.

## Key Provisions

The Legislative Guide is divided into four parts.

*Part one* discusses the key objectives of an insolvency law, structural issues such as the relationship between insolvency law and other law, the types of mechanisms available for resolving a debtor's financial difficulties and the institutional framework required to support an effective insolvency regime.

*Part two* deals with core features of an effective insolvency law, following as closely as possible the various stages of an insolvency proceeding from their commencement to discharge of the debtor and closure of the proceedings. Key elements are identified as including: standardized commencement criteria; a stay to protect the assets of the insolvency estate that includes actions by secured creditors; post-commencement finance; participation of creditors; provision for expedited reorganization proceedings; simplified requirements for submission and verification of claims; conversion of reorganization to liquidation when reorganization fails; and clear rules for discharge of the debtor and closure of insolvency proceedings.

*Part three* addresses the treatment of enterprise groups in insolvency, both nationally and internationally. While many of the issues addressed in *parts one* and *two* are equally applicable to enterprise groups, there are that only apply in the enterprise group context. *Part three* thus builds upon and supplements *parts one* and *two*. At the domestic level, the commentary and recommendations of *part three* cover various mechanisms that can be used to streamline insolvency proceedings involving two or more members of the same enterprise group. These include: procedural coordination of multiple proceedings concerning different debtors; issues concerning post-commencement and post-application finance in a group context; avoidance provisions; substantive consolidation of insolvency proceedings affecting two or more group members; appointment of a single or the same insolvency representative to all group members subject to insolvency; and coordinated reorganization plans. In terms of the international treatment of groups, *part three* focuses on cooperation and coordination, extending provisions based upon the Model Law on Cross-Border Insolvency to the group context and, as appropriate, considering the applicability to the international context of the mechanisms proposed to address enterprise group insolvencies in the national context.

*Part four* focuses on the obligations that might be imposed upon those responsible for making decisions with respect to the management of an enterprise when that enterprise faces imminent insolvency or insolvency becomes unavoidable. The aim of imposing such obligations, which are enforceable once insolvency proceedings commence, is to protect the legitimate interests of creditors and other stakeholders and to provide incentives for timely action to minimize the effects of financial distress experienced by the enterprise.

### UNCITRAL Legislative Guide on Insolvency Law *vis-a-vis* UNCITRAL Model Law on Cross-Border Insolvency

A model law generally is used differently than a legislative guide. Specifically, a model law is a legislative text recommended to States for enactment as part of national law, with or without modification. As such, model laws generally propose a comprehensive set of legislative solutions to address a particular topic and the language employed supports direct incorporation of the provisions of the model law into a national law.

The focus of a legislative guide, on the other hand, is upon providing guidance to legislators and other users and for that reason guides generally include a substantial commentary discussing and analysing relevant issues. It is not intended that the recommendations of a legislative guide be enacted as part of national law as such. Rather, they outline the core issues that it would be desirable to address in that law, with some recommendations providing specific guidance on how certain legislative provisions might be drafted.

## UNCITRAL MODEL LAW ON CROSS BORDER INSOLVENCY<sup>2</sup>

### Purpose

The UNCITRAL Model Law on Cross-Border Insolvency, adopted in 1997, is designed to assist States to equip their insolvency laws with a modern, harmonized and fair framework to address more effectively instances of

2. <https://www.uncitral.org/pdf/english/texts/insolven/1997-Model-Law-Insol-2013-Guide-Enactment-e.pdf> last accessed on 18 January 2019.

cross-border insolvency. Those instances include cases where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place.

The Model Law is designed to assist States to equip their insolvency laws with a modern legal framework to more effectively address cross-border insolvency proceedings concerning debtors experiencing severe financial distress or insolvency. It focuses on authorizing and encouraging cooperation and coordination between jurisdictions, rather than attempting the unification of substantive insolvency law, and respects the differences among national procedural laws. For the purposes of the Model Law, a cross-border insolvency is one where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place.

### Relevance to International Trade

Although the number of cross-border insolvency cases has increased significantly since the 1990s, the adoption of national or international legal regimes equipped to address the issues raised by those cases has not kept pace. The lack of such regimes has often resulted in inadequate and uncoordinated approaches to cross-border insolvency that are not only unpredictable and time-consuming in their application, but lack both transparency and the tools necessary to address the disparities and, in some cases, conflicts that may occur between national laws and insolvency regimes. These factors have impeded the protection of the value of the assets of financially troubled businesses and hampered their rescue.

The UNCITRAL Model Law has been adopted in as many as 44 countries and, therefore, forms part of international best practices in dealing with cross border insolvency issues. The model law deals with four major principles of cross-border insolvency, namely

- direct access to foreign insolvency professionals and foreign creditors to participate in or commence domestic insolvency proceedings against a defaulting debtor;
- recognition of foreign proceedings & provision of remedies;
- cooperation between domestic and foreign courts & domestic and foreign insolvency practitioners; and
- coordination between two or more concurrent insolvency proceedings in different countries. The main proceeding is determined by the concept of centre of main interest (“COMI”).

### Key Provisions

The Model Law focuses on four elements identified as key to the conduct of cross-border insolvency cases: access, recognition, relief (assistance) and cooperation.

#### (a) Access

These provisions give representatives of foreign insolvency proceedings and creditors a right of access to the courts of an enacting State to seek assistance and authorize representatives of local proceedings being conducted in the enacting State to seek assistance elsewhere.

#### (b) Recognition

One of the key objectives of the Model Law is to establish simplified procedures for recognition of qualifying foreign proceedings in order to avoid time-consuming legalization or other processes that often apply and to provide certainty with respect to the decision to recognize. These core provisions accord recognition to orders issued by foreign courts commencing qualifying foreign proceedings and appointing the foreign representative of those proceedings. Provided it satisfies specified requirements, a qualifying foreign proceeding should be recognized as either a main proceeding, taking place where the debtor had its centre of main interests at the

date of commencement of the foreign proceeding or a non-main proceeding, taking place where the debtor has an establishment. Recognition of foreign proceedings under the Model Law has several effects - principal amongst them is the relief accorded to assist the foreign proceeding.

### (c) Relief

A basic principle of the Model Law is that the relief considered necessary for the orderly and fair conduct of cross-border insolvencies should be available to assist foreign proceedings. By specifying the relief that is available, the Model Law neither imports the consequences of foreign law into the insolvency system of the enacting State nor applies to the foreign proceedings the relief that would be available under the law of the enacting State. Key elements of the relief available include interim relief at the discretion of the court between the making of an application for recognition and the decision on that application, an automatic stay upon recognition of main proceedings and relief at the discretion of the court for both main and non-main proceedings following recognition.

### (d) Cooperation and coordination

These provisions address cooperation among the courts of States where the debtor's assets are located and coordination of concurrent proceedings concerning that debtor. The Model Law expressly empowers courts to cooperate in the areas governed by the Model Law and to communicate directly with foreign counterparts. Cooperation between courts and foreign representatives and between representatives, both foreign and local, is also authorized. The provisions addressing coordination of concurrent proceedings aim to foster decisions that would best achieve the objectives of both proceedings, whether local and foreign proceedings or multiple foreign proceedings.

## Purpose of Model Law

The Preamble to UNCITRAL Model Law on Cross-Border Insolvency provides that:

The purpose of this Law is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

- (a) Cooperation between the courts and other competent authorities of this State and foreign States involved in cases of cross-border insolvency;
- (b) Greater legal certainty for trade and investment;
- (c) Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
- (d) Protection and maximization of the value of the debtor's assets; and
- (e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

## Scope of application

1. UNCITRAL Model Law on Cross-Border Insolvency applies where:

- (a) Assistance is sought in this State by a foreign court or a foreign representative in connection with a foreign proceeding; or
- (b) Assistance is sought in a foreign State in connection with a proceeding under [identify laws of the enacting State relating to insolvency]; or

- (c) A foreign proceeding and a proceeding under [identify laws of the enacting State relating to insolvency] in respect of the same debtor are taking place concurrently; or
- (d) Creditors or other interested persons in a foreign State have an interest in requesting the commencement of, or participating in, a proceeding under [identify laws of the enacting State relating to insolvency].

UNCITRAL Model Law on Cross-Border Insolvency does not apply to a proceeding concerning [designate any types of entities, such as banks or insurance companies, that are subject to a special insolvency regime in this State and that this State wishes to exclude from this Law]. [Article 1]

### **Principle of Supremacy of International Obligations**

Article 3 provides that to the extent the Model Law conflicts with an obligation of the State enacting the Model Law arising out of any treaty or other form of agreement to which it is a party with one or more other States, the requirements of the treaty or agreement prevail.

### **Competent Court or Authority**

The functions under the Model Law relating to recognition of foreign proceedings and cooperation with foreign courts shall be performed by the court, courts, authority or authorities as specified in the Model Law who are competent to perform those functions in the enacting State. [Article 4]

### **Interpretation**

In the interpretation of Model Law, regard is to be had to its international origin and to the need to promote uniformity in its application and the observance of good faith. [Article 8]

### **DEFINITIONS**

- (a) “Foreign proceeding” means a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation;
- (b) “Foreign main proceeding” means a foreign proceeding taking place in the State where the debtor has the centre of its main interests;
- (c) “Foreign non-main proceeding” means a foreign proceeding, other than a foreign main proceeding, taking place in a State where the debtor has an establishment within the meaning of sub-paragraph (f) of this Article;
- (d) “Foreign representative” means a person or body, including one appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor’s assets or affairs or to act as a representative of the foreign proceeding;
- (e) “Foreign court” means a judicial or other authority competent to control or supervise a foreign proceeding;
- (f) “Establishment” means any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.
- (g) The word “State”, as used in the preamble and throughout the Model Law, refers to the country that enacts the Law (the “enacting State”). The term should not be understood as referring, for example, to a state in a country with a federal system.



## GENERAL PROVISIONS

### Scope of application (Article 1)

According to Article 1 of the Model Law, it applies where:

- (a) Assistance is sought in the enacting State by a foreign court or a foreign representative in connection with a foreign proceeding; or
- (b) Assistance is sought in a foreign State in connection with a proceeding under the laws of the enacting State relating to insolvency; or
- (c) A foreign proceeding and a proceeding under the laws of the enacting State relating to insolvency in respect of the same debtor are taking place concurrently; or
- (d) Creditors or other interested persons in a foreign State have an interest in requesting the commencement of, or participating in, a proceeding under the laws of the enacting State relating to insolvency.

It further says that the Model Law does not apply to a proceeding concerning any types of entities, such as banks or insurance companies, that are subject to a special insolvency regime in a State and that State wishes to exclude from the Law (the type of entity to be excluded may be designated).

Banks or insurance companies are mentioned as examples of entities that the enacting State might decide to exclude from the scope of the Model Law. The reason for the exclusion would be that the insolvency of such entities gives rise to the particular need to protect vital interests of a large number of individuals, or that the insolvency of those entities usually requires particularly prompt and circumspect action (for instance to avoid massive withdrawals of deposits). For those reasons, the insolvency of such types of entities is in many States administered under a special regulatory regime. The enacting State might decide to exclude the insolvency of entities other than banks and insurance companies.

### Types of foreign proceedings covered

To fall within the scope of the Model Law, a foreign insolvency proceeding needs to possess certain attributes. These include the basis in insolvency-related law of the originating State; involvement of creditors collectively; control or supervision of the assets and affairs of the debtor by a court or another official body; and reorganization or liquidation of the debtor as the purpose of the proceeding. Within those parameters, a variety of collective proceedings would be eligible for recognition, be they compulsory or voluntary, corporate or individual, winding-up or reorganization. It also includes those proceedings in which the debtor retains some measure of control over its assets, albeit under court supervision (e.g. suspension of payments, “debtor in possession”). An inclusive approach is also used as regards the possible types of debtors covered by the Model Law.

### Principle of supremacy of international obligations (Article 3)

Article 3 provides that to the extent the Model Law conflicts with an obligation of the State enacting the Model Law arising out of any treaty or other form of agreement to which it is a party with one or more other States, the requirements of the treaty or agreement prevail.

### Competent court or authority (Article 4)

The functions under the Model Law relating to recognition of foreign proceedings and cooperation with foreign courts shall be performed by the court, courts, authority or authorities as specified in the Model Law who are competent to perform those functions in the enacting State.



## ACCESS OF FOREIGN REPRESENTATIVES AND CREDITORS TO COURTS IN STATE ENACTING MODEL LAW

### Right of direct access (Article 9)

A foreign representative is entitled to apply directly to a court in the State enacting law. Article 9 is limited to expressing the principle of direct access by the foreign representative to courts of the enacting State, thus freeing the representative from having to meet formal requirements such as licences or consular action.

### Application by a foreign representative to commence a proceeding (Article 11)

According to Article 11, a foreign representative is entitled to apply to commence a proceeding under the laws of the enacting State relating to insolvency, if the conditions for commencing such proceeding otherwise met.

A foreign representative has this right without prior recognition of the foreign proceeding because the commencement of an insolvency proceeding might be crucial in cases of urgent need for preserving the assets of the debtor.

The Model Law avoids the need to rely on cumbersome and time-consuming letters rogatory or other forms of diplomatic or consular communications that might otherwise have to be used. This facilitates a coordinated, cooperative approach to cross-border insolvency and makes fast action possible.

In addition to establishing the principle of direct court access for the foreign representative, the Model Law:

- (a) Establishes simplified proof requirements for seeking recognition and relief for foreign proceedings, which avoid time-consuming “legalization” requirements involving notarial or consular procedures (Article 15);
- (b) Provides that the foreign representative has procedural standing for commencing an insolvency proceeding in the enacting State (under the conditions applicable in the enacting State) and that the foreign representative may participate in an insolvency proceeding in the enacting State (Articles 11 and 12);
- (c) Confirms, subject to other requirements of the enacting State, access of foreign creditors to the courts of the enacting State for the purpose of commencing in the enacting State an insolvency proceeding or participating in such a proceeding (Article 13);
- (d) Gives the foreign representative the right to intervene in proceedings concerning individual actions in the enacting State affecting the debtor or its assets (Article 24);
- (e) Provides that the mere fact of a petition for recognition in the enacting State does not mean that the courts in that State have jurisdiction over all the assets and affairs of the debtor (Article 10).

Upon recognition of a foreign proceeding, the foreign representative is entitled to participate in a proceeding regarding the debtor under the laws of the enacting State relating to insolvency (Article 12).

Article 12 is limited to giving the foreign representative procedural standing (or “procedural legitimation”) to make petitions, requests or submissions concerning issues such as protection, realization or distribution of assets of the debtor or cooperation with the foreign proceeding and does not vest the foreign representative with any specific powers or rights.

### Protection of creditors and other interested persons

Foreign creditors have the same rights regarding the commencement of and participation in a proceeding under the laws of the enacting State relating to insolvency as creditors in the State.

The Model Law contains following provisions to protect the interests of the creditors (in particular local creditors), the debtor and other affected persons:

- availability of temporary relief upon application for recognition of a foreign proceeding or upon recognition is subject to the discretion of the court; it is expressly stated that in granting such relief the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected (Article 22, paragraph 1);
- the court may subject the relief it grants to conditions it considers appropriate; and
- the court may modify or terminate the relief granted, if so requested by a person affected thereby (Article 22, paragraphs 2 and 3).

In addition to those specific provisions, the Model Law in a general way provides that the court may refuse to take an action governed by the Model Law if the action would be manifestly contrary to the public policy of the enacting State (Article 6).

### **Notification to foreign creditors of a proceeding (Article 14)**

Article 14 of the Model Law provides that whenever under laws of the enacting State relating to insolvency, a notification is to be given to creditors, such notification shall also be given to the known creditors that do not have addresses in the State. The court may order that appropriate steps be taken with a view to notifying any creditor whose address is not yet known. The main purpose of notifying foreign creditors is to inform them of the commencement of the insolvency proceeding and of the time-limit to file their claims.

Such notification shall be made to the foreign creditors individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate. No letters rogatory or other, similar formality is required. When a notification of commencement of a proceeding is to be given to foreign creditors, the notification shall:

- (a) Indicate a reasonable time period for filing claims and specify the place for their filing;
- (b) Indicate whether secured creditors need to file their secured claims; and
- (c) Contain any other information required to be included in such a notification to creditors pursuant to the law of this State and the orders of the court.

## **RECOGNITION OF A FOREIGN PROCEEDING AND RELIEF**

### **Application for recognition of a foreign proceeding (Article 15)**

Article 15 defines the core procedural requirements for an application by a foreign representative for recognition. In incorporating the provision into national law, it is desirable not to encumber the process with additional requirements beyond these requirements. A foreign representative may apply to the court for recognition of the foreign proceeding in which the foreign representative has been appointed. An application for recognition shall be accompanied by:

- (a) A certified copy of the decision commencing the foreign proceeding and appointing the foreign representative; or
- (b) A certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative; or
- (c) In the absence of evidence referred to in subparagraphs (a) and (b) above, any other evidence acceptable to the court of the existence of the foreign proceeding and of the appointment of the foreign representative.

An application for recognition shall also be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative. The court may require a translation of documents supplied in support of the application for recognition into an official language of State.

The Model Law presumes that documents submitted in support of the application for recognition need not be authenticated in any special way, in particular by legalization. According to Article 16, the court is entitled to presume that those documents are authentic whether or not they have been legalized. “Legalization” is a term often used for the formality by which a diplomatic or consular agent of the State in which the document is to be produced certifies the authenticity of the signature, the capacity in which the person signing the document has acted and, where appropriate, the identity of the seal or stamp on the document.

In respect of the provision relaxing any requirement of legalization, the question may arise whether that is in conflict with the international obligations of the enacting State. Several States are parties to bilateral or multilateral treaties on mutual recognition and legalization of documents. According to Article 3 of the Model Law, if there is still a conflict between the Model Law and a treaty, the treaty will prevail. In order not to prevent recognition because of non-compliance with a mere technicality, the law allows evidence other than that specified; that provision, however, does not compromise the court’s power to insist on the presentation of evidence acceptable to it.

It further requires that an application for recognition must be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative. That information is needed by the court not so much for the decision on recognition itself but for any decision granting relief in favour of the foreign proceeding. In order to tailor such relief appropriately and make sure that the relief is consistent with any other insolvency proceeding concerning the same debtor, the court needs to be aware of all foreign proceedings concerning the debtor that may be under way in third States.

### **Decision to recognize a foreign proceeding (Article 17)**

Subject to Article 6, a foreign proceeding shall be recognized if:

- (a) The foreign proceeding is a proceeding within the meaning as defined under Article 2;
- (b) The foreign representative applying for recognition is a person or body within the meaning as defined under Article 2;
- (c) The application meets the requirements of Article 15; and
- (d) The application has been submitted to the court referred to in Article 4.

The foreign proceeding shall be recognized as a foreign main proceeding if it is taking place in the State where the debtor has the centre of its main interests; or as a foreign non-main proceeding if the debtor has an establishment within the meaning of sub-paragraph (f) of Article 2 in the foreign State.

The purpose of Article 17 is to indicate that, if recognition is not contrary to the public policy of the enacting State and if the application meets the above said requirements, recognition will be granted as a matter of course. A decision to recognize a foreign proceeding would normally be subject to review or rescission, as any other court decision.

### **Subsequent information (Article 18)**

The foreign representative shall inform the court immediately, if from the time of filing the application for recognition of the foreign proceeding, there is:

- (a) Any substantial change in the status of the recognized foreign proceeding or the status of the foreign representative’s appointment; and

- (b) Any other foreign proceeding regarding the same debtor that becomes known to the foreign representative.

It is possible that, after the application for recognition or after recognition, changes may occur in the foreign proceeding that would have affected the decision on recognition or the relief granted on the basis of recognition. For example, the foreign proceeding may be terminated or transformed from a liquidation proceeding into a reorganization proceeding, or the terms of the appointment of the foreign representative may be modified or the appointment itself terminated. The technical modifications in the status of the proceedings or the terms of the appointment are frequent, but that only some of those modifications are such that they would affect the decision granting relief or the decision recognizing the proceeding; therefore, the provision only calls for information of “substantial” changes.

#### **Relief that may be granted upon application for recognition of a foreign proceeding (Article 19)**

According to Article 19, from the time of filing an application for recognition until the application is decided upon, the court may, at the request of the foreign representative, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant relief of a provisional nature, including:

- (a) Staying execution against the debtor’s assets;
- (b) Entrusting the administration or realization of all or part of the debtor’s assets located in a State to the foreign representative or another person designated by the court, in order to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy; and
- (c) Any relief mentioned in Article 21.

Relief available under Article 19 is provisional in the sense that, the relief terminates when the application for recognition is decided upon; however, the court is given the opportunity to extend the measure, as provided in Article 21. The court may refuse to grant relief under this Article if such relief would interfere with the administration of a foreign main proceeding.

#### **Effects of recognition of a foreign main proceeding (Article 20)**

Once foreign proceeding is recognized which is a foreign main proceeding, the following are the effects:

- (a) Commencement or continuation of individual actions or individual proceedings concerning the debtor’s assets, rights, obligations or liabilities is stayed;
- (b) Execution against the debtor’s assets is stayed; and
- (c) The right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.

The effects provided by Article 20 are not discretionary in nature. These flow automatically from recognition of the foreign main proceeding. The automatic effects under Article 21 apply only to main proceedings.

#### **Relief that may be granted upon recognition of a foreign proceeding (Article 21)**

Upon recognition of a foreign proceeding, whether main or non-main, where it is necessary to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief, including:

- (a) Staying the commencement or continuation of individual actions or individual proceedings concerning the debtor’s assets, rights, obligations or liabilities, to the extent they have not been stayed under Article 20;

- (b) Staying execution against the debtor's assets to the extent it has not been stayed under Article 20;
- (c) Suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor to the extent this right has not been suspended under Article 20;
- (d) Providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities;
- (e) Entrusting the administration or realization of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court;
- (f) Extending relief granted under Article 19; and
- (g) Granting any additional relief that may be available to a person or body administering a reorganization or liquidation under the law of the enacting State under the laws of that State.

Upon recognition of a foreign proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in the State enacting the Model Law to the foreign representative or another person designated by the court, provided that the court is satisfied that the interests of creditors are adequately protected.

In granting relief under this Article to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under the law of the enacting State, should be administered in the foreign non-main proceeding or concerns information required in that proceeding.

### **Protection of creditors and other interested persons (Article 22)**

The court may under Article 22, at the request of the foreign representative or a person affected by relief granted, or at its own motion, modify or terminate such relief. In granting or denying relief under Article 19 or 21, or in modifying or terminating relief, the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected.

The idea underlying Article 22 is that there should be a balance between relief that may be granted to the foreign representative and the interests of the persons that may be affected by such relief.

### **Actions to avoid acts detrimental to creditors (Article 23)**

Under many national laws both individual creditors and insolvency administrators have a right to bring actions to avoid or otherwise render ineffective acts detrimental to creditors. Such a right, insofar as it pertains to individual creditors, is often not governed by insolvency law but by general provisions of law (such as the civil code); the right is not necessarily tied to the existence of an insolvency proceeding against the debtor so that the action may be instituted prior to the commencement of such a proceeding. The person having such a right is typically only an affected creditor and not another person such as the insolvency administrator. Furthermore, the conditions for these individual-creditor actions are different from the conditions applicable to similar actions that might be initiated by an insolvency administrator.

The procedural standing conferred by Article 23 extends only to actions that are available to the local insolvency administrator in the context of an insolvency proceeding, and the Article does not equate the foreign representative with individual creditors who may have similar rights under a different set of conditions. Such actions of individual creditors fall outside the scope of Article 23.

The Model Law expressly provides that a foreign representative has "standing" to initiate actions to avoid or otherwise render ineffective legal acts detrimental to creditors. The provision is drafted narrowly in that it does not create any substantive right regarding such actions and also does not provide any solution involving conflict of laws. The effect of the provision is that a foreign representative is not prevented from initiating such actions by the sole fact that the foreign representative is not the insolvency administrator appointed in the enacting State.

**Intervention by a foreign representative in proceedings (Article 24)**

Upon recognition of a foreign proceeding, the foreign representative may, provided the requirements of the law of the State are met, intervene in any proceedings in which the debtor is a party. The purpose of Article 24 is to avoid the denial of standing to the foreign representative to intervene in proceedings merely because the procedural legislation may not have contemplated the foreign representative among those having such standing. The Article applies to foreign representatives of both main and non-main proceedings.

**Cooperation with Foreign Courts and Foreign Representatives**

Chapter IV (Articles 25-27), on cross-border cooperation, is a core element of the Model Law. Its objective is to enable courts and insolvency administrators from two or more countries to be efficient and achieve optimal results. Cooperation as described in the chapter is often the only realistic way, for example, to prevent dissipation of assets, to maximize the value of assets.

Articles 25 and 26 not only authorize cross-border cooperation, they also mandate it by providing that the court and the insolvency administrator “shall cooperate to the maximum extent possible”. The Articles are designed to overcome the widespread problem of national laws lacking rules providing a legal basis for cooperation by local courts with foreign courts in dealing with cross-border insolvencies.

Enactment of such a legal basis would be particularly helpful in legal systems in which the discretion given to judges to operate outside areas of express statutory authorization is limited. However, even in jurisdictions in which there is a tradition of wider judicial latitude, enactment of a legislative framework for cooperation has proved to be useful. To the extent that cross-border judicial cooperation in the enacting State is based on the principle of comity among nations, the enactment of Articles 25-27 offers an opportunity for making that principle more concrete and adaptable to the particular circumstances of cross-border insolvencies.

The Articles in chapter IV leave certain decisions, in particular when and how to cooperate, to the courts and, subject to the supervision of the courts, to the insolvency administrators. For a court to cooperate with a foreign court or a foreign representative regarding a foreign proceeding, the Model Law does not require a previous formal decision to recognize that foreign proceeding.

**Cooperation and direct communication between courts or foreign representatives (Article 25)**

The court is entitled to communicate directly with, or to request information or assistance directly from, foreign courts or foreign representatives. The ability of courts, with appropriate involvement of the parties, to communicate “directly” and to request information and assistance “directly” from foreign courts or foreign representatives is intended to avoid the use of time-consuming procedures traditionally in use, such as letters rogatory.

**Cooperation and direct communication between a person or body administering a reorganization or liquidation under the law of the enacting State and foreign courts or foreign representatives (Article 26)**

Article 26 on international cooperation between persons who are appointed to administer assets of insolvent debtors reflects the important role that such persons can play in devising and implementing cooperative arrangements, within the parameters of their authority. The provision makes it clear that an insolvency administrator acts under the overall supervision of the competent court. The Model Law does not modify the rules already existing in the insolvency law of the enacting State on the supervisory functions of the court over the activities of the insolvency administrator.

According to Article 27, Cooperation may be implemented by any appropriate means, including:



- (a) Appointment of a person or body to act at the direction of the court;
- (b) Communication of information by any means considered appropriate by the court;
- (c) Coordination of the administration and supervision of the debtor's assets and affairs;
- (d) Approval or implementation by courts of agreements concerning the coordination of proceedings;
- (e) Coordination of concurrent proceedings regarding the same debtor;
- (f) The enacting State may wish to list additional forms or examples of cooperation.

## CONCURRENT PROCEEDINGS

### Commencement of a proceeding after recognition of a foreign main proceeding (Article 28)

After recognition of a foreign main proceeding, a proceeding under the laws of the enacting State relating to insolvency may be commenced only if the debtor has assets in the State enacting the Model Law. The effects of that proceeding shall be restricted to the assets of the debtor that are located in such State and to the extent necessary to implement cooperation and coordination under Articles 25, 26 and 27 to other assets of the debtor that, under the law of such State, should be administered in that proceeding.

Article 28, in conjunction with Article 29, provides that recognition of a foreign main proceeding will not prevent the commencement of a local insolvency proceeding concerning the same debtor as long as the debtor has assets in the State.

### Coordination of a proceeding (Article 29)

Article 29 gives guidance to the court that deals with cases where the debtor is subject to a foreign proceeding and a local proceeding at the same time. Where a foreign proceeding and a proceeding under the laws of the enacting State relating to insolvency are taking place concurrently regarding the same debtor, the court shall seek cooperation and coordination under Articles 25, 26 and 27, and the following shall apply:

- (a) When the proceeding in the State (which has enacted Model Law) is taking place at the time the application for recognition of the foreign proceeding is filed,
  - (i) Any relief granted under Article 19 or 21 must be consistent with the proceeding in such State; and
  - (ii) If the foreign proceeding is recognized in such State as a foreign main proceeding, Article 20 does not apply;
- (b) When the proceeding in such State commences after recognition, or after the filing of the application for recognition, of the foreign proceeding,
  - (i) Any relief in effect under Article 19 or 21 shall be reviewed by the court and shall be modified or terminated if inconsistent with the proceeding in this State; and
  - (ii) If the foreign proceeding is a foreign main proceeding, the stay and suspension referred to in Article 20 shall be modified or terminated, if inconsistent with the proceeding in such State;
- (c) In granting, extending or modifying relief granted to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets which, according to the law of the enacting State, should be administered in the foreign non-main proceeding or concerns information required in that proceeding.

The salient principle embodied in Article 29 is that the commencement of a local proceeding does not prevent or terminate the recognition of a foreign proceeding. This principle is essential for achieving the objectives of the Model Law in that it allows the court in the enacting State in all circumstances to provide relief in favour of the foreign proceeding.



### Coordination of more than one foreign proceeding (Article 30)

Article 30 deals with cases where the debtor is subject to insolvency proceedings in more than one foreign State and foreign representatives of more than one foreign proceeding seek recognition or relief in the enacting State. The provision applies whether or not an insolvency proceeding is pending in the enacting State. If, in addition to two or more foreign proceedings, there is a proceeding in the enacting State, the court will have to act pursuant to both Article 29 and Article 30.

In respect of more than one foreign proceeding regarding the same debtor, the court shall seek cooperation and coordination under Articles 25, 26 and 27, and the following shall apply:

- (a) Any relief granted under Article 19 or 21 to a representative of a foreign non-main proceeding after recognition of a foreign main proceeding must be consistent with the foreign main proceeding;
- (b) If a foreign main proceeding is recognized after recognition, or after the filing of an application for recognition, of a foreign non-main proceeding, any relief in effect under Article 19 or 21 shall be reviewed by the court and shall be modified or terminated if inconsistent with the foreign main proceeding; and
- (c) If, after recognition of a foreign non-main proceeding, another foreign non-main proceeding is recognized, the court shall grant, modify or terminate relief for the purpose of facilitating coordination of the proceedings.

The objective of Article 30 is similar to that of Article 29 in that the key issue in the case of concurrent proceedings is to promote cooperation, coordination and consistency of relief granted to different proceedings. Such consistency will be achieved by appropriate tailoring of relief to be granted or by modifying or terminating relief already granted. Unlike Article 29, which, as a matter of principle, gives primacy to the local proceeding, Article 30 gives preference to the foreign main proceeding, if there is one.

### Rule of payment in concurrent proceedings (Article 32)

Without prejudice to secured claims or rights in rem, a creditor who has received part payment in respect of its claim in a proceeding, pursuant to a law relating to insolvency, in a foreign State, may not receive a payment for the same claim in a proceeding under the laws of the enacting State relating to insolvency regarding the same debtor, so long as the payment to the other creditors of the same class is proportionately less than the payment the creditor has already received.

The rule set forth in Article 32, also referred to as the hotchpotch rule, is a useful safeguard in a legal regime for coordination and cooperation in the administration of cross-border insolvency proceedings. It is intended to avoid situations in which a creditor might obtain more favourable treatment than the other creditors of the same class by obtaining payment of the same claim in insolvency proceedings in different jurisdictions.

## WORLD BANK PRINCIPLES — EFFECTIVE INSOLVENCY AND CREDITOR RIGHTS SYSTEMS

The World Bank Principles were originally developed in 2001 in response to a request from the international community in the wake of the financial crises in emerging markets in the late 90s. At the time, there were no internationally recognized benchmarks or standards to evaluate the effectiveness of domestic creditor rights and insolvency systems. The World Bank's initiative began in 1999, with the constitution of an ad hoc committee of partner organizations, and with the assistance of leading international experts who participated in the World Bank's Task Force and Working Groups. The Principles were vetted in a series of five regional conferences, involving officials and experts from some 75 countries, and drafts were placed on the World Bank's website for public comment. The Bank's Board of Directors approved the Principles in 2001 for use in connection with the joint IMF-World Bank program to develop Reports on the Observance of Standards and Codes (ROSC), subject to reviewing the experience and updating the Principles as needed.

From 2001 to 2004, the Principles were used to assess country systems under the ROSC and Financial Sector Assessment Program (FSAP) in some 24 countries in all regions of the world. Assessments using the Principles have been instrumental to the Bank's developmental and operational work, and in providing assistance to member countries. This has yielded a wealth of experience and enabled the Bank to test the sufficiency of the Principles as a flexible benchmark in a wide range of diverse country systems. In taking stock of that experience, the Bank has consulted a wide range of interested parties at the national and international level, including officials, civil society, business and financial sectors, investors, professional groups, and others.

In 2003, the World Bank convened the Global Forum on Insolvency Risk Management (FIRM) to discuss the experience and lessons from the application of the Principles in the assessment program. The forum consisted of over 200 experts from 31 countries to discuss the lessons from the principles and to discuss further refinements to them. During 2003 and 2004, the Bank also convened three working group sessions of the Global Judges Forum, involving judges from approximately 70 countries, who have assisted the Bank in its review of the institutional framework principles and in developing more detailed recommendations for strengthening court practices for commercial enforcement and insolvency proceedings. Other regional fora have also provided a means for sharing experience and obtaining feedback in areas of the Principles, including the Forum on Asian Insolvency Reform (FAIR) from 2002-2004 (organized by OECD and co-sponsored with the Bank and the Asian Development Bank), and Forum on Insolvency in Latin America (FILA) in 2004 organised by the Bank.

In the area of the insolvency law framework and creditor rights systems, staffs of the Bank maintained participation in the UNCITRAL working groups on insolvency law and security interests and liaised with UNCITRAL staff and experts to ensure consistency between the Bank's Principles and the UNCITRAL Legislative Guide on Insolvency Law. The Bank has also benefited from an ongoing collaboration with the International Association of Insolvency Regulators (IAIR) to survey regulatory practices of IAIR member countries and develop recommendations for strengthening regulatory capacity and frameworks for insolvency systems. A similar collaboration with INSOL International has provided feedback and input in the area of directors' and officers' liability and informal workout systems.

Based on the experience gained from the use of the Principles, and following extensive consultations, the Principles have been thoroughly reviewed and updated. The revised Principles have benefited from wide consultation and, more importantly, from the practical experience of using them in the context of the Bank's assessment and operational work.

The World Bank Principles have been designed as a broad-spectrum assessment tool to assist countries in their efforts to evaluate and improve core aspects of their commercial law systems that are fundamental to a sound investment climate, and to promote commerce and economic growth. Efficient, reliable and transparent creditor rights and insolvency systems are of key importance for reallocation of productive resources in the corporate sector, for investor confidence and forward looking corporate restructuring. These systems also play a pivotal role in times of crisis to enable a country and stakeholders to promptly respond to and resolve matters of corporate financial distress on systemic scales.

The Principles emphasize contextual, integrated solutions and the policy choices involved in developing those solutions. The Principles highlight the relationship between the cost and flow of credit (including secured credit) and the laws and institutions that recognize and enforce credit agreements (Part A). The Principles also outline key features and policy choices relating to the legal framework for risk management and informal corporate workout systems (Part B), formal commercial insolvency law frameworks (Part C) and the implementation of these systems through sound institutional and regulatory frameworks (Part D).

The principles have broader application beyond corporate insolvency regimes and creditor rights. The Principles are designed to be flexible in their application, and do not offer detailed prescriptions for national systems. The

Principles embrace practices that have been widely recognized and accepted as good practices internationally. As legal systems and business and commerce are evolutionary in nature, so too are the Principles, and it is anticipated that these will continue to be reviewed going forward to take account of significant changes and developments.

## THE WORLD BANK PRINCIPLES – A SUMMARY

A brief summary of the key elements of the World Bank Principles for effective insolvency and creditor rights systems is given below:

### 1. Credit Environment

**Compatible credit and enforcement systems:** A regularized system of credit should be supported by mechanisms that provide efficient, transparent and reliable methods for recovering debt, including seizure and sale of immovable and movable assets and sale or collection of intangible assets, such as debt owed to the debtor by third parties. An efficient system for enforcing debt claims is crucial to a functioning credit system, especially for unsecured credit. A creditor's ability to take possession of a debtor's property and to sell it to satisfy the debt is the simplest, most effective means of ensuring prompt payment. It is far more effective than the threat of an insolvency proceeding, which often requires a level of proof and a prospect of procedural delay that in all but extreme cases make it not credible to debtors as leverage for payment.

**Collateral systems:** One of the pillars of a modern credit economy is the ability to own and freely transfer ownership interests in property, and to grant a security interest to credit providers with respect to such interests and rights as a means of gaining access to credit at more affordable prices. Secured transactions play an enormously important role in a well-functioning market economy. Laws on secured credit mitigate lenders' risks of default and thereby increase the flow of capital and facilitate low cost financing. Discrepancies and uncertainties in the legal framework governing security interests are the main reasons for high costs and unavailability of credit, especially in developing countries.

The legal framework for secured lending addresses the fundamental features and elements for the creation, recognition and enforcement of security interests in all types of assets, movable and immovable, tangible and intangible, including inventories, receivables, proceeds and future property, and on a global basis, including both possessory and non-possessory interests. The law should encompass any or all of a debtor's obligations to a creditor, present or future and between all types of persons. In addition, it should provide for effective notice and registration rules to be adapted to all types of property, and clear rules of priority on competing claims or interests in the same assets. For security rights and notice to third parties to be effective, they must be capable of being publicized at reasonable costs and easily accessible to stakeholders. A reliable, affordable, public registry system is therefore essential to promote optimal conditions for asset based lending. Where several registries exist, the registration system should be integrated to the maximum extent possible so that all notices recorded under the secured transactions legislation can be easily retrieved.

**Enforcement systems:** A modern, credit-based economy requires predictable, transparent and affordable enforcement of both unsecured and secured credit claims by efficient mechanisms outside of insolvency, as well as a sound insolvency system. These systems must be designed to work in harmony. Commerce is a system of commercial relationships predicated on express or implied contractual agreements between an enterprise and a wide range of creditors and constituencies. Although commercial transactions have become increasingly complex as more sophisticated techniques are developed for pricing and managing risks, the basic rights governing these relationships and the procedures for enforcing these rights have not changed much. These rights enable parties to rely on contractual agreements, fostering confidence that fuels investment, lending and commerce. Conversely, uncertainty about the enforceability of contractual rights increases the cost of credit to compensate for the increased risk of non-performance or, in severe cases, leads to credit tightening.

**Credit information systems:** A modern credit-based economy requires access to complete, accurate and reliable information concerning borrowers' payment histories. This process should take place in a legal environment that provides the framework for the creation and operation of effective credit information systems. Permissible uses of information from credit information systems should be clearly circumscribed, especially regarding information about individuals. Legal controls on the type of information collected and distributed by credit information systems may often be used to advance public policies, including anti-discrimination laws.

Privacy concerns should be addressed through notice of the existence of such systems, notice of when any information from such systems is used to make adverse decisions, and access by data subjects to stored credit information with the ability to dispute and have corrected inaccurate or incomplete information. An effective enforcement and supervision mechanism should be in place that provides efficient, inexpensive, transparent and predictable methods for resolving disputes concerning the operation of credit information systems along with proportionate sanctions which encourage compliance but that are not so stringent as to discourage operations of such systems.

**Informal corporate workouts:** Corporate workouts should be supported by an environment that encourages participants to restore an enterprise to financial viability. Informal workouts are negotiated in the "shadow of the law." Accordingly, the enabling environment must include clear laws and procedures that require disclosure of or access to timely and accurate financial information on the distressed enterprise; encourage lending to, investment in or recapitalization of viable distressed enterprises; support a broad range of restructuring activities, such as debt write-offs, reschedulings, restructurings and debt-equity conversions; and provide favourable or neutral tax treatment for restructurings. A country's financial sector should promote an informal out-of-court process for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure—especially in markets where enterprise insolvency is systemic.

## 2. Insolvency Law Systems

**Commercial insolvency:** Though approaches vary, effective insolvency systems have a number of aims and objectives. Systems should aspire to:

- (i) integrate with a country's broader legal and commercial systems;
- (ii) maximize the value of a firm's assets and recoveries by creditors;
- (iii) provide for both efficient liquidation of nonviable businesses and those where liquidation is likely to produce a greater return to creditors and reorganization of viable businesses;
- (iv) strike a careful balance between liquidation and reorganization, allowing for easy conversion of proceedings from one proceeding to another;
- (v) provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors;
- (vi) provide for timely, efficient and impartial resolution of insolvencies;
- (vii) prevent the improper use of the insolvency system;
- (viii) prevent the premature dismemberment of a debtor's assets by individual creditors seeking quick judgments;
- (ix) provide a transparent procedure that contains, and consistently applies, clear risk allocation rules and incentives for gathering and dispensing information;
- (x) recognize existing creditor rights and respect the priority of claims with a predictable and established process; and
- (xi) establish a framework for cross-border insolvencies, with recognition of foreign proceedings.

Where an enterprise is not viable, the main thrust of the law should be swift and efficient liquidation to maximize recoveries for the benefit of creditors. Liquidations can include the preservation and sale of the business, as distinct from the legal entity. On the other hand, where an enterprise is viable, meaning it can be rehabilitated, its assets are often more valuable if retained in a rehabilitated business than if sold in a liquidation. The rescue of a business preserves jobs, provides creditors with a greater return based on higher going concern values of the enterprise, potentially produces a return for owners and obtains for the country the fruits of the rehabilitated enterprise.

The rescue of a business should be promoted through formal and informal procedures. Rehabilitation should permit quick and easy access to the process, protect all those involved, permit the negotiation of a commercial plan, enable a majority of creditors in favor of a plan or other course of action to bind all other creditors (subject to appropriate protections) and provide for supervision to ensure that the process is not subject to abuse.

### 3. Implementation: Institutional and Regulatory Frameworks

Strong institutions and regulations are crucial to an effective insolvency system. The institutional framework has three main elements: the institutions responsible for insolvency proceedings, the operational system through which cases and decisions are processed and the requirements needed to preserve the integrity of those institutions – recognizing that the integrity of the insolvency system is the linchpin for its success.

### 4. Overarching considerations of sound investment climates

**Transparency, accountability and corporate governance:** Minimum standards of transparency and corporate governance should be established to foster communication and cooperation. Disclosure of basic information – including financial statements, operating statistics and detailed cash flows – is recommended for sound risk assessment. Accounting and auditing standards should be compatible with international best practices so that creditors can assess credit risk and monitor a debtor's financial viability. A predictable, reliable legal framework and judicial process are needed to implement reforms, ensure fair treatment of all parties and deter unacceptable practices.

Corporate law and regulation should guide the conduct of the borrower's shareholders. A corporation's board of directors should be responsible, accountable and independent of management, subject to best practices on corporate governance. The law should be imposed impartially and consistently. Creditor rights and insolvency systems interact with and are affected by these additional systems, and are most effective when good practices are adopted in other relevant parts of the legal system, especially the commercial law.

**Transparency and Corporate Governance:** Transparency and good corporate governance are the cornerstones of a strong lending system and corporate sector. Transparency exists when information is assembled and made readily available to other parties and, when combined with the good behavior of "corporate citizens," creates an informed and communicative environment conducive to greater cooperation among all parties. Transparency and corporate governance are especially important in emerging markets, which are more sensitive to volatility from external factors. Without transparency, there is a greater likelihood that loan pricing will not reflect underlying risks, leading to higher interest rates and other charges. Transparency and strong corporate governance are needed in both domestic and cross-border transactions and at all phases of investment—at the inception when making a loan, when managing exposure while the loan is outstanding, and especially once a borrower's financial difficulties become apparent and the lender is seeking to exit the loan.

Transparency increases confidence in decision making and so encourages the use of out of court restructuring options. Such options are preferable because they often provide higher returns to lenders than straight liquidation through the legal process—and because they avoid the costs, complexities and uncertainties of the legal process.

**Predictability:** Investment in emerging markets is discouraged by the lack of well-defined and predictable risk



allocation rules and by the inconsistent application of written laws. Moreover, during systemic crises investors often demand uncertainty risk premiums too onerous to permit markets to clear. Some investors may avoid emerging markets entirely despite expected returns that far outweigh known risks. Rational lenders will demand risk premiums to compensate for systemic uncertainty in making, managing and collecting investments in emerging markets. The likelihood that creditors will have to rely on risk allocation rules increases as fundamental factors supporting investment deteriorate. That is because risk allocation rules set minimum standards that have considerable application in limiting downside uncertainty, but that usually do not enhance returns in non-distressed markets. During actual or perceived systemic crises, lenders tend to concentrate on reducing risk, and risk premiums soar. At these times the inability to predict downside risk can cripple markets. The effect can impinge on other risks in the country, causing lender reluctance even towards untroubled borrowers.

### United States Bankruptcy Code

In the United States of America, all bankruptcy cases are handled in federal courts under rules outlined in the “Bankruptcy Code”, a federal law. It is a uniform federal law that governs all bankruptcy cases in America. The Bankruptcy Code was enacted in 1978 by § 101 of the Bankruptcy Reform Act, 1978 and is codified as title 11 of the United States Code. The procedural aspects of the bankruptcy process are governed by the Federal Rules of Bankruptcy Procedure (Bankruptcy Rules).

Six basic types of bankruptcy cases are provided for under the Bankruptcy Code.

- **Chapter 7** titled “Liquidation”. In Chapter 7 Bankruptcy, a court-appointed trustee or administrator takes possession of non-exempt assets, liquidates these assets and then uses the proceeds to pay creditors.
- **Chapter 9** titled “Adjustment of Debts of a Municipality”. Chapter 9 Bankruptcy proceedings provides for reorganization which is available to municipalities. In Chapter 9 Bankruptcy proceedings a municipality (which includes cities, towns, villages, counties, taxing districts, municipal utilities, and school districts) get protection from creditors and a municipality can pay back debt through a confirmed payment plan.
- **Chapter 11** titled “Reorganization”. Unlike Chapter 7 where the business ceases operations and a trustee sells all of its assets, under Chapter 11 the debtor remains in control of its business operations and repay creditors concurrently through a court-approved reorganization plan.
- **Chapter 12** was added to the Bankruptcy Code in 1986. It allows a family farmer or fisherman to continue to operate the business while the plan is being carried out.
- **Chapter 13** enables individuals with regular income to develop a plan to repay all or part of their debts.
- **Chapter 15** was added to the Bankruptcy Code in 2005. It provides mechanism for dealing with insolvency cases involving debtors, claimants and other interested parties involving more than one country. Under Chapter 15 a representative of a corporate bankruptcy proceeding outside the country can get access to the United States courts.

### Chapter 11 Reorganization

American bankruptcy procedures enable sick Companies to restructure its debt obligations even while remaining operational. In this context, one must recognise that in the US the wellknown Chapter 11 bankruptcy proceedings are considered as re-organization/ resurrection process for corporates. Many companies are known to have revived under Chapter 11. Further, Chapter 11 ensures the emergence of companies with sustainable debt levels and profitable working. Chapter 11 bankruptcy proceedings are available to every business, whether organized as a corporation, partnership or sole proprietorship, and to individuals, although it is most prominently used by corporate entities.

Chapter 11 consists of sections 1101 to 1174 and is divided into following four sub-chapters:

- Sub-chapter I – Officer and administration (Sections 1101 to 1116)
- Sub-chapter II – The plan (Sections 1121 to 1129)
- Sub-chapter III – Post confirmation matters (Sections 1141 to 1146)
- Sub-chapter IV – Railroad reorganization (Sections 1161 to 1174)

One of the most remarkable events in recent business history has been the decision of General Motors Corporation USA to file bankruptcy proceedings — a decision forced on the company after it lost market share in the ongoing recession. Its assets were significantly lower than its liabilities. It has emerged from 40 days bankruptcy protection after creating a “new GM” made up of the best assets with fewer brand, fewer employees, etc. For that matter, Chapter 11 could even recover WorldCom which emerged from bankruptcy as MCI during 2004.

Section 363 under Chapter 11 of US Bankruptcy law is an established procedure which enables companies to sell assets free of debts and encumbrances to preserve the value of the enterprise. A company under Chapter 11 can choose to sell off particular assets. A bankrupt company, the “debtor,” might use this Code to “reorganize” its business and become profitable again.

The key to a successful Chapter 11 case is the continued operation of the debtor’s business. In addition to running the business, the debtor or the trustee must fulfil additional duties required by the Bankruptcy Code and work with creditors, the court, and other parties to obtain financing for ongoing business operations.

### Salient Features of Chapter 11

- Chapter 11 is not a declaration of insolvency.
- Companies don’t file under Chapter 11 to liquidate; they do so in order to continue operating and to take the necessary steps to emerge as a financially stronger business, reorganizing their operations or balance sheet or in some cases by selling substantially all its assets.
- Management remains in control of the business during the chapter 11 rehabilitative process. Trustees, administrators and monitors typically are not appointed.
- Chapter 11 normally does not cause interruption to business operations.
- The company is given breathing room during the process - an “automatic stay” generally prevents parties from taking legal action against the company or taking the company’s assets.
- Most publicly-held companies prefer to file under Chapter 11 rather than Chapter 7 because they can still run their business and control the bankruptcy process. Chapter 11 provides a process for rehabilitating the business of the company.

Sometimes the company successfully works out a plan to return to profitability; sometimes, in the end, it liquidates. Under Chapter 11 reorganization, a company usually keeps doing business and its stock and bonds may continue to trade in securities markets.

The U.S. Trustee, the bankruptcy arm of the Department of Justice, appoints one or more committees to represent the interests of creditors and stockholders in working with the company to develop a plan of reorganization to enable it to get out of debt. The plan must be accepted by the creditors, bondholders, and stockholders, and confirmed by the court. However, even if creditors or stockholders vote against the plan, the court can disregard the vote and still confirm the plan if it finds that the plan treats creditors and stockholders fairly.

Committees of creditors and stockholders negotiate a plan with the company to relieve the company from repaying part of its debt so that the company is able to get back to its normal condition.



After the committees work with the company to develop a plan, the bankruptcy court must find that it legally complies with the Bankruptcy Code before the plan can be implemented.

Thus, Chapter 11 bankruptcy involves a reorganization plan that accommodates debt reorganization through a payment plan and the major advantage is that the debtors generally remain in possession of their property and operate their business under the supervision of Court. Chapter 11 debtors also often keep a substantial portion of their assets. The provisions of Chapter 11 allow the debtor, relief from pending obligations and the opportunity to reorganize its business and restructure debts while continuing to operate the business. Under this chapter a company can choose to sell off particular assets. Accordingly, subsidiaries outside US need not be included in the Chapter 11 filings.

There is therefore no change in the legal status of its subsidiaries that are kept out of Chapter 11 filings. Further, Debtors Audit, Debtors Counselling, Mandatory debtor education, etc. are provided under US Bankruptcy laws which help in minimizing the fraudulent bankruptcies. In the light of the above, a need is felt to have similar legal framework in India which allows continuity of business during bankruptcy proceedings, control over the management of company filing bankruptcy application, keeping subsidiaries / certain assets outside the purview of bankruptcy application, etc. in line with Chapter 11 of US Bankruptcy Code.

### **Enabling provisions for cross border transactions under Insolvency and Bankruptcy Code, 2016**

Sections 234 and 235 of the Insolvency and Bankruptcy Code, 2016 make provisions to deal with cases involving cross border insolvency.

**Agreements with foreign countries** – Section 234 empowers the central government to enter into an agreement with other countries to resolve situations pertaining to cross border insolvency. Section 234 of the Code provides that:

The Central Government may enter into an agreement with the Government of any country outside India for enforcing the provisions of this Code. [Section 234(1)]

The Central Government may, by notification in the Official Gazette, direct that the application of provisions of this Code in relation to assets or property of corporate debtor or debtor, including a personal guarantor of a corporate debtor, as the case may be, situated at any place in a country outside India with which reciprocal arrangements have been made, shall be subject to such conditions as may be specified. [Section 234(2)]

**Letter of request to a country outside India in certain cases** – Section 235 of the Code lays down that notwithstanding anything contained in this Code or any law for the time being in force if, in the course of insolvency resolution process, or liquidation or bankruptcy proceedings, as the case may be, under this Code, the resolution professional, liquidator or bankruptcy trustee, as the case may be, is of the opinion that assets of the corporate debtor or debtor, including a personal guarantor of a corporate debtor, are situated in a country outside India with which reciprocal arrangements have been made under section 234, he may make an application to the Adjudicating Authority that evidence or action relating to such assets is required in connection with such process or proceeding. [Section 235(1)]

The Adjudicating Authority on receipt of an application under sub-section (1) and, on being satisfied that evidence or action relating to assets under sub-section (1) is required in connection with insolvency resolution process or liquidation or bankruptcy proceeding, may issue a letter of request to a court or an authority of such country competent to deal with such request. [Section 235(2)]

The current cross border insolvency framework in India is dependant on India entering bilateral agreements with other countries. Finalisation of bilateral agreements is a long drawn process as it involves long term negotiations and thus takes a lot of time. Moreover, every trade is distinct and thus it would be difficult for the adjudicating authorities to enforce the agreements/treaties entered into with other countries.

### Insolvency Law Committee on Cross Border Insolvency

The Ministry of Corporate Affairs has constituted the Insolvency Law Committee (ILC) to recommend amendments to the Insolvency and Bankruptcy Code of India, 2016. The Committee has submitted its 2nd Report to the Government on 16 October 2018 recommending amendments in the Insolvency and Bankruptcy Code, 2016 with respect to cross-border insolvency. The Insolvency Law Committee (ILC) has recommended the adoption of the UNCITRAL Model Law of Cross Border Insolvency, 1997 as it provides for a comprehensive framework to deal with cross border insolvency issues.

The necessity of having Cross Border Insolvency Framework under the Insolvency and Bankruptcy Code arises from the fact that many Indian companies have a global presence and many foreign companies have presence in India. Inclusion of comprehensive legal framework dealing with cross border insolvency will be a major step forward and will bring Indian Insolvency Law at par with that of matured jurisdictions.

### Key recommendations of the Committee

**Applicability:** The Committee recommended that at present, draft Part Z should be extended to corporate debtors only.

**Duplicity of regimes:** The Committee noted that currently the Companies Act, 2013 contains provisions to deal with insolvency of foreign companies. It observed that once Part Z is enacted, it will result in a dual regime to handle insolvency of foreign companies. It recommended that the Ministry of Corporate Affairs undertake a study of such provisions in the Companies Act, 2013 to assess whether to retain them.

**Reciprocity:** The Committee recommended that the Model Law may be adopted initially on a reciprocity basis. This may be diluted subsequently upon re-examination. Reciprocity indicates that a domestic court will recognise and enforce a foreign court's judgment only if the foreign country has adopted similar legislation to the domestic country.

**Access to Foreign Representatives:** The Model Law allows foreign insolvency professionals and foreign creditors access to domestic courts to seek remedies directly. Direct access with regards to foreign creditors is envisaged under the Code even presently. With respect to access by foreign insolvency professionals to Indian courts, the Committee recommended that the Central Government be empowered to devise a mechanism that is practicable in the current Indian legal framework.

**Centre of Main Interests (COMI):** The Model Law allows recognition of foreign proceedings and provides relief based on this recognition. Relief may be provided if the foreign proceeding is a main proceeding or non-main proceeding. If the domestic courts determine that the debtor has its COMI in a foreign country, such foreign proceedings will be recognised as the main proceedings. This recognition will result in certain automatic relief, such as allowing foreign representatives greater powers in handling the debtor's estate.

For non-main proceedings, such relief is at the discretion of the domestic court. The Committee recommended that a list of indicative factors comprising COMI may be inserted through rule-making powers. Such factors may include location of the debtor's books and records, and location of financing.

**Cooperation:** The Model Law lays down the basic framework for cooperation between domestic and foreign courts, and domestic and foreign insolvency professionals. Given that the infrastructure of adjudicating authorities under the Code is still evolving, the cooperation between Adjudicating Authorities and foreign courts is proposed to be subject to guidelines to be notified by the Central Government.

**Concurrent Proceedings:** The Model Law provides a framework for commencement of domestic insolvency proceedings, when a foreign insolvency proceeding has already commenced or vice versa. It also provides for coordination of two or more concurrent insolvency proceedings in different countries by encouraging cooperation between courts. The Committee recommended adopting provisions in relation to these in draft Part Z.

**Public policy considerations:** Part Z provides that the Adjudicating Authority may refuse to take action under the Code if it is contrary to public policy. The Committee recommended that in proceedings where the Authority is of the opinion that a violation of public policy may be involved, a notice must be issued to the Central Government. If the Authority does not issue notice, the Central Government may be empowered to apply to it directly.

### LESSON ROUND UP

- Cross-border insolvency regulates the treatment of financially distressed debtors where such debtors have assets or creditors in more than one country.
- A company is said to be insolvent when its liabilities exceed its assets which results in its inability to pay off the debts. Cross border insolvency issues arise when a non-resident is either a debtor or contributory or creditor.
- Since National insolvency laws have by and large not kept pace with the trend, they are often ill equipped to deal with cases of cross border nature. It hampers the rescue of financially troubled business.
- The United Nations Commission on International Trade Law (UNCITRAL) prepares international legislative texts for use by States in modernizing commercial law and non-legislative texts for use by commercial parties in negotiating transactions.
- The Legislative Guide on Insolvency Law was prepared by UNCITRAL on insolvency law, specifically corporate insolvency, to foster and encourage the adoption of effective national corporate insolvency regimes in 2004.
- The Legislative Guide on Insolvency Law is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations.
- The UNCITRAL Model Law on Cross-Border Insolvency, adopted in 1997, is designed to assist States to equip their insolvency laws with a modern, harmonized and fair framework to address more effectively instances of cross-border insolvency.
- The Model Law focuses on four elements identified as key to the conduct of cross-border insolvency cases, i.e., access, recognition, relief (assistance) and cooperation.
- In the United States of America, all bankruptcy cases are handled in federal courts under rules outlined in the Bankruptcy Code, a federal law. The Bankruptcy Code was enacted in 1978 and is codified as title 11 of the United States Code.
- Sections 234 and 235 of the Insolvency and Bankruptcy Code, 2016 make provisions to deal with cases involving cross border insolvency.
- Section 234 of the Code empowers the central government to enter into an agreement with other countries to resolve situations pertaining to cross border insolvency.

### SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. What is cross border insolvency? Mention the objectives of effective and efficient insolvency regime across the world.
2. Write a note on UNCITRAL Model Law on Cross Border Insolvency.

3. Mention the key provisions of the UNCITRAL Legislative Guide on Insolvency Laws.
4. How are bankruptcy cases dealt in the USA? Mention the six type of bankruptcy cases provided under the CS Bankruptcy Code.
5. Under UNCITRAL Model Law, what are the reliefs that may be granted upon recognition of a foreign proceeding under Article 21?
6. What are the World Bank Principles?
7. Discuss the cross border insolvency provisions contained in the Insolvency and Bankruptcy Code, 2016.

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# Lesson 24

## Liquidation on or after Failing of Resolution Plan

### LESSON OUTLINE

- Introduction
- Initiation of Liquidation
- Appointment of Liquidator
- Powers and duties of Liquidator
- Liquidation Estate
- Consolidation of claims
- Distribution of assets
- Dissolution of corporate debtor
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Sections 33 to 54 in Chapter III of Part II of the Insolvency and Bankruptcy Code, 2016 lay down the law relating to liquidation process for corporate persons. Liquidation of corporate person is considered to be the last resort in order to recover money.

Liquidation process for corporate person can be initiated only when the resolution plan as required to be submitted by the resolution professional is not received by the Adjudicating Authority or it rejects the resolution plan due to non-compliance of the specified requirements at any time before the expiry of maximum permitted period of corporate insolvency resolution process or fast track corporate insolvency resolution process. The resolution professional appointed to conduct the corporate insolvency resolution process shall also act as liquidator for the corporate debtor. In order to avoid any ambiguity, the power and duties of the liquidator have been clearly stated in the chapter itself.

Once the assets of the corporate debtor have been liquidated, the liquidator shall finally make an application to adjudicating authority for the dissolution of corporate debtor. The adjudicating authority on receipt of dissolution application order the dissolution of corporate debtor from the very date on which it has passed the dissolution order in this regard. It shall be ensured that the dissolution order copy is filed with the concerned authority with which the corporate debtor is registered.

This lesson will help you to understand the situations when liquidation of corporate person is initiated, appointment of Liquidator, steps to be taken by Liquidator before proceeding for liquidation, steps taken by the NCLT and the steps to be taken after NCLT order, etc.

## INTRODUCTION

Sections 33 to 54 in Chapter III of Part II of the Insolvency and Bankruptcy Code, 2016 lay down the law relating to liquidation process for corporate persons.

An attempt is first made to resolve the insolvency of corporate debtor through corporate insolvency resolution process laid down in Chapter II of Part II of the Code. The provisions relating to liquidation in Chapter III of Part II of the Code comes into effect if the attempts to resolve corporate insolvency under Chapter II of the Code fail.

The Insolvency and Bankruptcy Board of India has made **the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016** to regulate the liquidation process under Chapter III of Part II of the Insolvency and Bankruptcy Code, 2016. These regulations are amended from time to time by the Insolvency and Bankruptcy Board of India.

## INITIATION OF LIQUIDATION

Section 33 of the Code lists out the triggers for initiating the liquidation process for corporate persons. Section 33 of the Code reads as follows:

“(1) Where the Adjudicating Authority,

- (a) before the expiry of the insolvency resolution process period or the maximum period permitted for completion of the corporate insolvency resolution process under section 12 or the fast track corporate insolvency resolution process under section 56, as the case may be, does not receive a resolution plan under sub-section (6) of section 30; or
- (b) rejects the resolution plan under section 31 for the non-compliance of the requirements specified therein, it shall –
  - (i) pass an order requiring the corporate debtor to be liquidated in the manner as laid down in this Chapter;
  - (ii) issue a public announcement stating that the corporate debtor is in liquidation; and
  - (iii) require such order to be sent to the authority with which the corporate debtor is registered.

(2) Where the resolution professional, at any time during the corporate insolvency resolution process but before confirmation of resolution plan, intimates the Adjudicating Authority of the decision of the committee of creditors approved by not less than sixty-six per cent. of the voting share to liquidate the corporate debtor, the Adjudicating Authority shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub-section (1).

*Explanation.* – For the purpose of this sub-section, it is hereby declared that the committee of creditors may take the decision to liquidate the corporate debtor, any time after its constitution under sub-section (1) of section 21 and before the confirmation of the resolution plan, including at any time before the preparation of the information memorandum.

(3) Where the resolution plan approved by the Adjudicating Authority is contravened by the concerned corporate debtor, any person other than the corporate debtor, whose interests are prejudicially affected by such contravention, may make an application to the Adjudicating Authority for a liquidation order as referred to in sub-clauses (i), (ii), (iii) of clause (b) sub-section (1).

(4) On receipt of an application under sub-section (3), if the Adjudicating Authority determines that the corporate debtor has contravened the provisions of the resolution plan, it shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub-section (1).



(5) Subject to section 52, when a liquidation order has been passed, no suit or other legal proceeding shall be instituted by or against the corporate debtor:

Provided that a suit or other legal proceeding may be instituted by the liquidator, on behalf of the corporate debtor, with the prior approval of the Adjudicating Authority,

(6) the provisions of sub-section (5) shall not apply to legal proceedings in relation to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.

(7) The order for liquidation under this section shall be deemed to be a notice of discharge to the officers, employees and workmen of the corporate debtor, except when the business of the corporate debtor is continued during the liquidation process by the liquidator.”

**When liquidation can be ordered** – Section 33 provides for the liquidation of the corporate debtor in following four scenarios:

1. Where the Adjudicating Authority does not receive a resolution plan
2. Where the Adjudicating Authority rejects the resolution plan
3. Where, at any time before confirmation of resolution plan, the committee of creditors resolve to liquidate corporate debtor
4. Where the corporate debtor violates the terms of the resolution plan

**1. Where the Adjudicating Authority does not receive a resolution plan** – If the Adjudicating Authority, before the expiry of the insolvency resolution process period or the maximum period permitted for completion of the corporate insolvency resolution process under section 12 or the fast track corporate insolvency resolution process under section 56, as the case may be, does not receive a resolution plan under sub-section (6) of section 30, it shall pass an order requiring the corporate debtor to be liquidated in the manner as laid down in Chapter III of Part II of the Code. [Section 33(1)]

**2. Where the Adjudicating Authority rejects the resolution plan** – If the Adjudicating Authority rejects the resolution plan under section 31 for the non-compliance of the requirements specified therein, it shall pass an order requiring the corporate debtor to be liquidated in the manner as laid down in Chapter III of Part II of the Code.

In both the scenarios above i.e, where the Adjudicating Authority does not receive a resolution plan or where the Adjudicating Authority rejects the resolution plan, it shall:

- (i) issue a public announcement stating that the corporate debtor is in liquidation; and
- (ii) require such order to be sent to the authority with which the corporate debtor is registered. [Section 33(1)]

**3. Where, at any time before confirmation of resolution plan, the committee of creditors resolve to liquidate corporate debtor** – Where the resolution professional, at any time during the corporate insolvency resolution process but before confirmation of resolution plan, intimates the Adjudicating Authority of the decision of the committee of creditors approved by not less than **sixty-six percent** of the voting share to liquidate the corporate debtor, the Adjudicating Authority shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub-section (1). [Section 33(2)]

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has amended sub-section (2) of section 33 to provide for a reduced threshold from seventy-five percent to **sixty-six percent** of voting share for obtaining the approval of the committee of creditors for making an application to the Adjudicating Authority to pass a liquidation order.

**4. Where the corporate debtor violates the terms of the resolution plan** – Where the resolution plan approved by the Adjudicating Authority is contravened by the concerned corporate debtor, any person other than the corporate debtor, whose interests are prejudicially affected by such contravention, may make an application to the Adjudicating Authority for a liquidation order as referred to in sub-clauses (i), (ii), (iii) of clause (b) sub-section (1). [Section 33(3)]

On receipt of an application under sub-section (3), if the Adjudicating Authority determines that the corporate debtor has contravened the provisions of the resolution plan, it shall pass a liquidation order as referred to in sub-clauses (i), (ii) and (iii) of clause (b) of sub-section (1). [Section 33(4)]

**Bar to filing of suits and legal proceedings** – Section 33(5) provides that subject to section 52, when a liquidation order has been passed, no suit or other legal proceeding shall be instituted by or against the corporate debtor:

Provided that a suit or other legal proceeding may be instituted by the liquidator, on behalf of the corporate debtor, with the prior approval of the Adjudicating Authority,

Section 33(6) further provides that the provisions of sub-section (5) shall not apply to legal proceedings in relation to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.

**“Financial Sector Regulator”** means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government. [Section 3(18)]

**Liquidation order to be deemed to be a notice of discharge** – The order for liquidation under section 33 shall be deemed to be a notice of discharge to the officers, employees and workmen of the corporate debtor, except when the business of the corporate debtor is continued during the liquidation process by the liquidator. [Section 33(7)]

### Appointment of Liquidator and Fee to be paid

Section 34 of the Code provides for the appointment of liquidator and the fees to be paid to him.

According to section 5(18) of the Code, a **“liquidator”** means an insolvency professional appointed as a liquidator in accordance with the provisions of Chapter III or Chapter V of this Part, as the case may be.

**Resolution Professional to act as liquidator** – Section 34(1) provides that where the Adjudicating Authority passes an order for liquidation of the corporate debtor under section 33, the resolution professional appointed for the corporate insolvency resolution process under Chapter II shall, subject to submission of a written consent by the resolution professional to the Adjudicating Authority in specified form, shall act as the liquidator for the purposes of liquidation unless replaced by the Adjudicating Authority under subsection (4).

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** has amended section 34 so as to require a written consent of resolution professional in specified form for appointment as a liquidator.

**Powers to vest in liquidator** – Section 34(2) further provides that on the appointment of a liquidator under section 34, all powers of the board of directors, key managerial personnel and the partners of the corporate debtor, as the case may be, shall cease to have effect and shall be vested in the liquidator.

**Personnel of corporate debtor to extend all assistance and cooperation to the liquidator** – Section

34(3) mandates that the personnel of the corporate debtor shall extend all assistance and cooperation to the liquidator as may be required by him in managing the affairs of the corporate debtor and provisions of section 19 shall apply in relation to voluntary liquidation process as they apply in relation to liquidation process with the substitution of references to the liquidator for references to the interim resolution professional.

**Replacement of resolution professional** – Sub-section (4) of section 34 makes provision for the replacement of resolution professional. According to sub-section (4), the Adjudicating Authority shall by order replace the resolution professional, if

- (a) the resolution plan submitted by the resolution professional under section 30 was rejected for failure to meet the requirements mentioned in sub-section (2) of section 30; or
- (b) the Board recommends the replacement of a resolution professional to the Adjudicating Authority for reasons to be recorded in writing; or
- (c) the resolution professional fails to submit written consent under sub-section (1).

For the purposes of clause (a) and clause (c) of sub-section (4), the Adjudicating Authority may direct the Board to propose the name of another insolvency professional to be appointed as a liquidator. [Section 34(5)]

The Board shall propose the name of another insolvency professional along with written consent from the insolvency professional in the specified form within **ten days** of the direction issued by the Adjudicating Authority under sub-section (5). [Section 34(6)]

The Adjudicating Authority shall, on receipt of the proposal of the Board for the appointment of an insolvency professional as liquidator, by an order appoint such insolvency professional as the liquidator. [Section 34(7)]

**Fee for the conduct of liquidation proceedings** – Section 34(8) provides that an insolvency professional proposed to be appointed as a liquidator shall charge such fee for the conduct of the liquidation proceedings and in such proportion to the value of the liquidation estate assets, as may be specified by the Board.

The fees for the conduct of the liquidation proceedings under sub-section (8) shall be paid to the liquidator from the proceeds of the liquidation estate under section 53. [Section 34(9)]

### Powers and Duties of Liquidator

Section 35 provides a non-exhaustive list of powers and duties of the liquidator to ensure orderly completion of the liquidation proceedings.

Section 35(1) provides that subject to the directions of the Adjudicating Authority, the liquidator shall have the following powers and duties:

- (a) to verify claims of all the creditors;
- (b) to take into his custody or control all the assets, property, effects and actionable claims of the corporate debtor;
- (c) to evaluate the assets and property of the corporate debtor in the manner as may be specified by the Board and prepare a report;
- (d) to take such measures to protect and preserve the assets and properties of the corporate debtor as he considers necessary;
- (e) to carry on the business of the corporate debtor for its beneficial liquidation as he considers necessary;
- (f) subject to section 52, to sell the immovable and movable property and actionable claims of the

corporate debtor in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels in such manner as may be specified:

Provided that the liquidator shall not sell the immovable and movable property or actionable claims of the corporate debtor in liquidation to any person who is not eligible to be a resolution applicant.

- (g) to draw, accept, make and endorse any negotiable instruments including bill of exchange, hundi or promissory note in the name and on behalf of the corporate debtor, with the same effect with respect to the liability as if such instruments were drawn, accepted, made or endorsed by or on behalf of the corporate debtor in the ordinary course of its business;
- (h) to take out, in his official name, letter of administration to any deceased contributory and to do in his official name any other act necessary for obtaining payment of any money due and payable from a contributory or his estate which cannot be ordinarily done in the name of the corporate debtor, and in all such cases, the money due and payable shall, for the purpose of enabling the liquidator to take out the letter of administration or recover the money, be deemed to be due to the liquidator himself;
- (i) to obtain any professional assistance from any person or appoint any professional, in discharge of his duties, obligations and responsibilities;
- (j) to invite and settle claims of creditors and claimants and distribute proceeds in accordance with the provisions of this Code;
- (k) to institute or defend any suit, prosecution or other legal proceedings, civil or criminal, in the name of or on behalf of the corporate debtor;
- (l) to investigate the financial affairs of the corporate debtor to determine undervalued or preferential transactions;
- (m) to take all such actions, steps, or to sign, execute and verify any paper, deed, receipt document, application, petition, affidavit, bond or instrument and for such purpose to use the common seal, if any, as may be necessary for liquidation, distribution of assets and in discharge of his duties and obligations and functions as liquidator;
- (n) to apply to the Adjudicating Authority for such orders or directions as may be necessary for the liquidation of the corporate debtor and to report the progress of the liquidation process in a manner as may be specified by the Board; and
- (o) to perform such other functions as may be specified by the Board.

Section 35(2) further provides that the liquidator shall have the power to consult any of the stakeholders entitled to a distribution of proceeds under section 53.

First proviso to section 35(2) provides that any such consultation shall not be binding on the liquidator. The second proviso further provides that the records of any such consultation shall be made available to all other stakeholders not so consulted, in a manner specified by the Board.

### **Powers of Liquidator to Access Information**

Section 37 provides that the liquidator shall have the power to access any information systems for the purpose of admission and proof of claims and identification of assets to be held in the liquidation estate. This power to access information ensures easier verification of claims and identification of assets and liabilities of the corporate debtor.

**Power to access any information systems** – Section 37(1) provides that notwithstanding anything contained in any other law for the time being in force, the liquidator shall have the power to access any information

systems for the purpose of admission and proof of claims and identification of the liquidation estate assets relating to the corporate debtor from the following sources:

- (a) an information utility;
- (b) credit information systems regulated under any law for the time being in force;
- (c) any agency of the Central, State or Local Government including any registration authorities;
- (d) information systems for financial and non-financial liabilities regulated under any law for the time being in force;
- (e) information systems for securities and assets posted as security interest regulated under any law for the time being in force;
- (f) any database maintained by the Board; and
- (g) any other source as may be specified by the Board.

**Financial information required by creditors** – The creditors may require the liquidator to provide them any financial information relating to the corporate debtor in such manner as may be specified. [Section 37(2)]

The liquidator shall provide information referred to in sub-section (2) to such creditors who have requested for such information within a period of **seven days** from the date of such request or provide reasons for not providing such information. [Section 37(3)]

### Liquidation Estate

Section 36 provides for the creation of a liquidation estate comprising the assets of the corporate debtor as set out in section 36(3). Section 36 also lists out the assets which are to be excluded from the liquidation estate. The Central Government has been given the power to notify assets, in consultation with the appropriate financial sector regulators, which will be excluded from the estate in the interest of efficient functioning of the financial markets.

Section 36(1) provides that for the purposes of liquidation, the liquidator shall form an estate of the assets mentioned in sub-section (3), which will be called the liquidation estate in relation to the corporate debtor.

Section 36(2) further provides that the liquidator shall hold the liquidation estate as a fiduciary for the benefit of all the creditors.

**Liquidation estate shall comprise all liquidation estate assets** – Section 36(3) provides that subject to sub-section (4), the liquidation estate shall comprise all liquidation estate assets which shall include the following:

- (a) any assets over which the corporate debtor has ownership rights, including all rights and interests therein as evidenced in the balance sheet of the corporate debtor or an information utility or records in the registry or any depository recording securities of the corporate debtor or by any other means as may be specified by the Board, including shares held in any subsidiary of the corporate debtor;
- (b) assets that may or may not be in possession of the corporate debtor including but not limited to encumbered assets;
- (c) tangible assets, whether movable or immovable;
- (d) intangible assets including but not limited to intellectual property, securities (including shares held in a subsidiary of the corporate debtor) and financial instruments, insurance policies, contractual rights;
- (e) assets subject to the determination of ownership by the court or authority;

- (f) any assets or their value recovered through proceedings for avoidance of transactions in accordance with this Chapter;
- (g) any asset of the corporate debtor in respect of which a secured creditor has relinquished security interest;
- (h) any other property belonging to or vested in the corporate debtor at the insolvency commencement date; and
- (i) all proceeds of liquidation as and when they are realised.

**What shall not be included in the liquidation estate assets** – According to section 36(4), the following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation:

- (a) assets owned by a third party which are in possession of the corporate debtor, including –
  - (i) assets held in trust for any third party;
  - (ii) bailment contracts;
  - (iii) all sums due to any workmen or employee from the provident fund, the pension fund and the gratuity fund;
  - (iv) other contractual arrangements which do not stipulate transfer of title but only use of the assets; and
  - (v) such other assets as may be notified by the Central Government in consultation with any financial sector regulator;
- (b) assets in security collateral held by financial services providers and are subject to netting and set-off in multi-lateral trading or clearing transactions;
- (c) personal assets of any shareholder or partner of a corporate debtor as the case may be provided such assets are not held on account of avoidance transactions that may be avoided under this Chapter;
- (d) assets of any Indian or foreign subsidiary of the corporate debtor; or
- (e) any other assets as may be specified by the Board, including assets which could be subject to set-off on account of mutual dealings between the corporate debtor and any creditor.

### Consolidation of Claims

Section 38 prescribes a time period for the collection of claims by the liquidator. It also specifies the methods by which different categories of creditors can submit and prove their claims.

**Receipt or collection of claims** – Section 38(1) provides that the liquidator shall receive or collect the claims of creditors within a period of **thirty days** from the date of the commencement of the liquidation process.

**Submission of claim by financial creditor** – According to section 38(2), a financial creditor may submit a claim to the liquidator by providing a record of such claim with an information utility.

In cases where the information relating to the claim is not recorded in the information utility, the financial creditor may submit the claim in the same manner provided for the submission of claims for the operational creditor under sub-section (3).

**Submission of claim by operational creditor** – An operational creditor may submit a claim to the liquidator in such form and in such manner and along with such supporting documents required to prove the claim as may be specified by the Board. [Section 38(3)]

**Claims by creditor who is partly a financial and partly an operational creditor** – A creditor who is partly



a financial creditor and partly an operational creditor shall submit claims to the liquidator to the extent of his financial debt in the manner as provided in sub-section (2) and to the extent of his operational debt under sub-section (3). [Section 38(4)]

**Withdrawal or variation of claims** – A creditor may withdraw or vary his claim under section 38 within **fourteen days** of its submission. [Section 38(5)]

### Verification of Claims

Section 39 prescribes the procedure to be followed for the verification of claims by the liquidator.

According to section 39(1), the liquidator shall verify the claims submitted under section 38 within such time as specified by the Board.

The liquidator may require any creditor or the corporate debtor or any other person to produce any other document or evidence which he thinks necessary for the purpose of verifying the whole or any part of the claim. [Section 39(2)]

### Admission or Rejection of Claims

Section 40 lays down the procedure for the admission and rejection of claims.

**Admission or rejection of claims** – The liquidator may, after verification of claims under section 39, either admit or reject the claim, in whole or in part, as the case may be. But if the liquidator rejects a claim, he shall record in writing the reasons for such rejection. [Section 40(1)]

**Communication of decision** – The liquidator shall communicate his decision of admission or rejection of claims to the creditor and corporate debtor within **seven days** of such admission or rejection of claims. [Section 40(2)]

### Determination of Valuation of Claims

Section 41 provides that the liquidator shall determine the value of claims admitted under section 40 in such manner as may be specified by the Insolvency and Bankruptcy Board of India.

### Appeal Against the Decision of Liquidator

According to section 42, a creditor may appeal to the Adjudicating Authority against the decision of the liquidator accepting or rejecting the claims within fourteen days of the receipt of such decision.

**The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018** amended section 42 to provide clarity that a creditor may appeal to the Adjudicating Authority against the decision of the liquidator in both the scenarios i.e., acceptance or rejection of claims.

### Preferential Transactions and Relevant Time

Related parties often possess information of the corporate debtor's financial affairs and may collude with him to siphon off assets with the knowledge that the corporate debtor might become insolvent in the near future. Section 43 invalidates transfers of property or an interest thereof given during the relevant time to a person for the benefit of a creditor, surety or guarantor on account of antecedent debt or other liabilities which have the effect of putting such creditor, surety or guarantor in a better position than the position which he would have been in if such transfer had not been made.

Section 43 also prescribes the relevant time for avoidance of transactions which may amount to preferences.

**Application to Adjudicating Authority for avoidance of preferential transactions** – Section 43(1) lays down that where the liquidator or the resolution professional, as the case may be, is of the opinion that the corporate



debtor has at a relevant time given a preference in such transactions and in such manner as laid down in sub-section (2) of section 43 to any persons as referred to in sub-section (4), he shall apply to the Adjudicating Authority for avoidance of preferential transactions and for, one or more of the orders referred to in section 44.

**When corporate debtor shall be deemed to have given a preference** – According to section 43(2), a corporate debtor shall be deemed to have given a preference, if–

- (a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor; and
- (b) the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position than it would have been in the event of a distribution of assets being made in accordance with section 53.

**Exceptions** – Section 43(3) provides that for the purposes of sub-section (2), a preference shall not include the following transfers:

- (a) transfer made in the ordinary course of the business or financial affairs of the corporate debtor or the transferee;
- (b) any transfer creating a security interest in property acquired by the corporate debtor to the extent that –
  - (i) such security interest secures new value and was given at the time of or after the signing of a security agreement that contains a description of such property as security interest, and was used by corporate debtor to acquire such property; and
  - (ii) such transfer was registered with an information utility on or before thirty days after the corporate debtor receives possession of such property:

Provided that any transfer made in pursuance of the order of a court shall not, preclude such transfer to be deemed as giving of preference by the corporate debtor.

**Explanation** – For the purpose of sub-section (3) of section 43, “**new value**” means money or its worth in goods, services, or new credit, or release by the transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the liquidator or the resolution professional under this Code, including proceeds of such property, but does not include a financial debt or operational debt substituted for existing financial debt or operational debt.

**When preference shall be deemed to be given at a relevant time** – Section 43(4) lays down that a preference shall be deemed to be given at a relevant time, if –

- (a) It is given to a related party (other than by reason only of being an employee), during the period of two years preceding the insolvency commencement date; or
- (b) a preference is given to a person other than a related party during the period of one year preceding the insolvency commencement date.

### Orders in Case of Preferential Transactions

Section 44 specifies the orders that may be passed by the Adjudicating Authority in relation to the avoidance of a preferential transaction. These orders are passed to reverse the effects of the preferential transaction and require the person to whom the preference is granted to pay back any gains he may have made as a result of such preference.

Section 44 lays down that the Adjudicating Authority, may, on an application made by the resolution professional or liquidator under sub-section (1) of section 43, by an order:

- (a) require any property transferred in connection with the giving of the preference to be vested in the corporate debtor;
- (b) require any property to be so vested if it represents the application either of the proceeds of sale of property so transferred or of money so transferred;
- (c) release or discharge (in whole or in part) of any security interest created by the corporate debtor;
- (d) require any person to pay such sums in respect of benefits received by him from the corporate debtor, such sums to the liquidator or the resolution professional, as the Adjudicating Authority may direct;
- (e) direct any guarantor, whose financial debts or operational debts owed to any person were released or discharged (in whole or in part) by the giving of the preference, to be under such new or revived financial debts or operational debts to that person as the Adjudicating Authority deems appropriate;
- (f) direct for providing security or charge on any property for the discharge of any financial debt or operational debt under the order, and such security or charge to have the same priority as a security or charge released or discharged wholly or in part by the giving of the preference; and
- (g) direct for providing the extent to which any person whose property is so vested in the corporate debtor, or on whom financial debts or operational debts are imposed by the order, are to be proved in the liquidation or the corporate insolvency resolution process for financial debts or operational debts which arose from, or were released or discharged wholly or in part by the giving of the preference:

**Transactions in good faith and for value** – An order by the Adjudicating Authority under section 44 shall not –

- (a) affect any interest in property which was acquired from a person other than the corporate debtor or any interest derived from such interest and was acquired in good faith and for value;
- (b) require a person, who received a benefit from the preferential transaction in good faith and for value to pay a sum to the liquidator or the resolution professional.

**Presumption** – For the purpose of this section, it is clarified that where a person, who has acquired an interest in property from another person other than the corporate debtor, or who has received a benefit from the preference or such another person to whom the corporate debtor gave the preference, -

- (a) had sufficient information of the initiation or commencement of insolvency resolution process of the corporate debtor;
- (b) is a related party, it shall be presumed that the interest was acquired, or the benefit was received otherwise than in good faith unless the contrary is shown. [Explanation I to section 44]

**Effect of public announcement** – A person shall be deemed to have sufficient information or opportunity to avail such information if a public announcement regarding the corporate insolvency resolution process has been made under section 13. [Explanation II to section 44].

## Avoidance of Undervalued Transactions

Section 45 provides for the avoidance of undervalued transactions.

**Application to Adjudicating Authority** – According to section 45(1), if the liquidator or the resolution professional, as the case may be, on an examination of the transactions of the corporate debtor referred to in sub-section (2) determines that certain transactions were made during the relevant period under section 46, which were undervalued, he shall make an application to the Adjudicating Authority to declare such transactions as void and reverse the effect of such transaction in accordance with this Chapter.

**When transaction shall be considered undervalued** – Section 45(2) provides that a transaction shall be considered undervalued where the corporate debtor–

- (a) makes a gift to a person; or
- (b) enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor, and such transaction has not taken place in the ordinary course of business of the corporate debtor.

### Relevant Period for Avoidable Transactions

Section 46 prescribes the relevant period during which a transaction must be entered into for it to be challenged as a transaction at undervalue.

According to section 46(1), in an application for avoiding a transaction at undervalue, the liquidator or the resolution professional, as the case may be, shall demonstrate that –

- (i) such transaction was made with any person within the period of one year preceding the insolvency commencement date; or
- (ii) such transaction was made with a related party within the period of two years preceding the insolvency commencement date.

Sub-section (2) of section 46 empowers the Adjudicating Authority to require an independent expert to assess evidence relating to the value of the transactions mentioned in section 46 .

### Application by Creditor in Cases of Undervalued Transactions

Section 47 provides for an application to the Adjudicating Authority by creditors, shareholders or partners of the corporate debtor to set aside a transaction at undervalue where the liquidator or resolution professional has not reported such transaction to the adjudicating authority.

**Application by creditor, member or a partner of a corporate debtor** – According to section 47(1), where an undervalued transaction has taken place and the liquidator or the resolution professional as the case may be, has not reported it to the Adjudicating Authority, a creditor, member or a partner of a corporate debtor, as the case may be, may make an application to the Adjudicating Authority to declare such transactions void and reverse their effect in accordance with this Chapter.

**Order by Adjudicating Authority** – Sub-section (2) further lays down that where, the Adjudicating Authority, after examination of the application made under sub-section (1), is satisfied that –

- (a) undervalued transactions had occurred; and
- (b) liquidator or the resolution professional, as the case may be, after having sufficient information or opportunity to avail information of such transactions did not report such transaction to the Adjudicating Authority,

it shall pass an order-

- (a) restoring the position as it existed before such transactions and reversing the effects thereof in the manner as laid down in section 45 and section 48;
- (b) requiring the Board to initiate disciplinary proceedings against the liquidator or the resolution professional as the case may be.

### Order in Cases of Undervalued Transactions

Section 48 lists out the orders that may be passed by the adjudicating authority setting aside the transaction at undervalue. According to section 48, the order of the Adjudicating Authority under sub-section (1) of section 45 may provide for the following:

- (a) require any property transferred as part of the transaction, to be vested in the corporate debtor;
- (b) release or discharge (in whole or in part) any security interest granted by the corporate debtor;
- (c) require any person to pay such sums, in respect of benefits received by such person, to the liquidator or the resolution professional as the case may be, as the Adjudicating Authority may direct; or
- (d) require the payment of such consideration for the transaction as may be determined by an independent expert.

### Transactions Defrauding Creditors

Section 49 strikes at transactions entered into with the intention of prejudicing the interests of a person who has made or may make a claim against the corporate debtor. According to section 49, where the corporate debtor has entered into an undervalued transaction as referred to in sub-section (2) of section 45, the Adjudicating Authority shall make an order-

- (i) restoring the position as it existed before such transaction as if the transaction had not been entered into; and
- (ii) protecting the interests of persons who are victims of such transactions.

But before passing any order under section 49, the Adjudicating Authority must be satisfied that such transaction was deliberately entered into by such corporate debtor –

- (a) for keeping assets of the corporate debtor beyond the reach of any person who is entitled to make a claim against the corporate debtor; or
- (b) in order to adversely affect the interests of such a person in relation to the claim.

The proviso appended to section 49 makes it clear that an order under section 49 –

- (a) shall not affect any interest in property which was acquired from a person other than the corporate debtor and was acquired in good faith, for value and without notice of the relevant circumstances, or affect any interest deriving from such an interest, and
- (b) shall not require a person who received a benefit from the transaction in good faith, for value and without notice of the relevant circumstances to pay any sum unless he was a party to the transaction.

### Extortionate Credit Transactions

Section 50 strikes at extortionate credit transactions entered into by the corporate debtor in the period of two years preceding the insolvency commencement date.

**Application for avoidance of extortionate credit transactions** – Section 50(1) lays down that where the corporate debtor has been a party to an extortionate credit transaction involving the receipt of financial or operational debt during the period within **two years** preceding the insolvency commencement date, the liquidator or the resolution professional as the case may be, may make an application for avoidance of such transaction to the Adjudicating Authority if the terms of such transaction required exorbitant payments to be made by the corporate debtor.

**Board to specify the circumstances** – According to sub-section (2), the Board may specify the circumstances in which a transactions which shall be covered under sub-section (1).

**Exception** – The Explanation appended to section 50 clarifies that for the purpose of this section, any debt extended by any person providing financial services which is in compliance with any law for the time being in force in relation to such debt shall in no event be considered as an extortionate credit transaction.

### Orders of Adjudicating Authority in Respect of Extortionate Credit Transactions

Section 51 prescribes the orders that may be passed by the adjudicating authority setting aside extortionate credit transactions.

Section 51 provides that where the Adjudicating Authority after examining the application made under subsection (1) of section 50 is satisfied that the terms of a credit transaction required exorbitant payments to be made by the corporate debtor, it shall, by an order –

- (a) restore the position as it existed prior to such transaction;
- (b) set aside the whole or part of the debt created on account of the extortionate credit transaction;
- (c) modify the terms of the transaction;
- (d) require any person who is, or was, a party to the transaction to repay any amount received by such person; or
- (e) require any security interest that was created as part of the extortionate credit transaction to be relinquished in favour of the liquidator or the resolution professional, as the case may be.

### Secured Creditor in Liquidation Proceedings

Section 52 provides for options exercisable by a secured creditor. In a liquidation proceeding, the secured creditor may realise its security interest outside the liquidation proceedings or choose to relinquish its security interest and participate in the distribution of assets. If a secured creditor decides to realise its security, the amount of insolvency resolution process costs payable by the secured creditor shall be deducted from the realised proceeds. If there is a surplus realised from the enforcement of a security interest, the secured creditor has to account for the same to the liquidator. Similarly, if the proceeds of the realisation of the secured assets are not sufficient to pay the debts owed to the secured creditor, he may claim under section 53 for such unpaid amount.

**Options before secured creditor** – According to section 52(1), a secured creditor in the liquidation proceedings may –

- (a) relinquish its security interest to the liquidation estate and receive proceeds from the sale of assets by the liquidator in the manner specified in section 53; or
- (b) realise its security interest in the manner specified in this section.

**“Security interest”** means right, title or interest or a claim to property, created in favour of, or provided for a secured creditor by a transaction which secures payment or performance of an obligation and includes mortgage, charge, hypothecation, assignment and encumbrance or any other agreement or arrangement securing payment or performance of any obligation of any person:

Provided that security interest shall not include a performance guarantee. [Section 3(31)]

**Liquidator to be informed** – Where the secured creditor realises security interest under clause (b) of subsection (1), he shall inform the liquidator of such security interest and identify the asset subject to such security interest to be realised. [Section 52(2)]

**Verification by liquidator** – Sub-section (3) lays down that before any security interest is realised by the secured creditor under this section, the liquidator shall verify such security interest and permit the secured creditor to realise only such security interest, the existence of which may be proved either –

- (a) by the records of such security interest maintained by an information utility; or
- (b) by such other means as may be specified by the Board.

**Secured assets** – A secured creditor may enforce, realise, settle, compromise or deal with the secured assets in accordance with such law as applicable to the security interest being realised and to the secured creditor and apply the proceeds to recover the debts due to it. [Section 52(4)]

**Realisation of secured asset** – Section 52(5) provides that if in the course of realising a secured asset, any secured creditor faces resistance from the corporate debtor or any person connected therewith in taking possession of, selling or otherwise disposing of the security, the secured creditor may make an application to the Adjudicating Authority to facilitate the secured creditor to realise such security interest in accordance with law for the time being in force.

The Adjudicating Authority, on the receipt of an application from a secured creditor under sub-section (5) may pass such order as may be necessary to permit a secured creditor to realise security interest in accordance with law for the time being in force. [Section 52(6)]

**Account to the liquidator for surplus** – According to section 52(7), where the enforcement of the security interest under sub-section (4) yields an amount by way of proceeds which is in excess of the debts due to the secured creditor, the secured creditor shall-

- (a) account to the liquidator for such surplus; and
- (b) tender to the liquidator any surplus funds received from the enforcement of such secured assets.

**Deduction of insolvency resolution process costs** – Sub-section (8) lays down that the amount of insolvency resolution process costs, due from secured creditors who realise their security interests in the manner provided in section 52, shall be deducted from the proceeds of any realisation by such secured creditors, and they shall transfer such amounts to the liquidator to be included in the liquidation estate.

**Unpaid debts of secured creditor** – Where the proceeds of the realisation of the secured assets are not adequate to repay debts owed to the secured creditor, the unpaid debts of such secured creditor shall be paid by the liquidator in the manner specified in clause (e) of sub-section (1) of section 53. [Section 52(9)]

### Distribution of Assets

Section 53 deals with distribution of assets in liquidation. The Insolvency and Bankruptcy Code, 2016 makes significant changes in the priority of claims for distribution of liquidation proceeds. In case of liquidation, the assets will be distributed in the following order, in case of liquidation: (i) fees of insolvency professional and costs related to the resolution process, (ii) workmen's dues for the preceding 24 months 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.

According to priority of claims, unsecured financial creditors shall be paid before the Government. This is intended to promote alternative sources of finance and the consequent development of bond markets in India.

**“Liquidation cost”** means any cost incurred by the liquidator during the period of liquidation subject to such regulations, as may be specified by the Board. [Section 5(16)]

**“Liquidation commencement date”** means the date on which proceedings for liquidation commence in accordance with section 33 or section 59, as the case may be. [Section 5(17)]

**Order of priority** – Sub-section (1) of section 53 provides that notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period as may be specified, namely: -

- (a) the insolvency resolution process costs and the liquidation costs paid in full;
- (b) the following debts which shall rank equally between and among the following:



- (i) workmen's dues for the period of twenty-four months preceding the liquidation commencement date; and
- (ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52;
- (c) wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;
- (d) financial debts owed to unsecured creditors;
- (e) the following dues shall rank equally between and among the following: -
  - (i) any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;
  - (ii) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;
- (f) any remaining debts and dues;
- (g) preference shareholders, if any; and
- (h) equity shareholders or partners, as the case may be.

**Contractual arrangements between recipients with equal ranking** – Sub-section (2) lays down that any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under that sub-section shall be disregarded by the liquidator.

**Deduction of fees payable to liquidator** – Sub-section (3) makes provision for deduction of fees payable to liquidator. It provides that the fees payable to the liquidator shall be deducted proportionately from the proceeds payable to each class of recipients under sub-section (1), and the proceeds to the relevant recipient shall be distributed after such deduction.

**Explanation** – The Explanation appended to section 53 clarifies that for the purpose of this section-

- (i) at each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each of the debts will either be paid in full, or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full; and
- (ii) the term “workmen's dues” shall have the same meaning as assigned to it in section 326 of the Companies Act, 2013.

### **Dissolution of Corporate Debtor**

Section 54 provides that after the affairs of the corporate debtor have been wound up and its assets are completely liquidated, the liquidator shall make an application to the adjudicating authority for the dissolution of the corporate debtor.

**Application to the Adjudicating Authority** – Sub-section (1) of section 54 lays down that where the assets of the corporate debtor have been completely liquidated, the liquidator shall make an application to the Adjudicating Authority for the dissolution of such corporate debtor.

**Date of dissolution** – According to sub-section (2), the Adjudicating Authority shall on application filed by the liquidator under sub-section (1) order that the corporate debtor shall be dissolved from the date of that order and the corporate debtor shall be dissolved accordingly.

**Copy of Order** – A copy of an order under sub-section (2) shall within **seven days** from the date of such order, be forwarded to the authority with which the corporate debtor is registered. [Section 54(3)]



## LESSON ROUND UP

- Liquidation provisions in Chapter III of Part II of the Code comes into effect if the attempts to resolve corporate insolvency under Chapter II of the Code fail. Section 33 of the Code lists out the triggers for initiating the liquidation process for corporate persons.
- Section 34 of the Code provides for the appointment of liquidator and the fees to be paid to him. 'Liquidator' means an insolvency professional appointed as a liquidator in accordance with the provisions of Chapter III or Chapter V of this Part, as the case may be.
- The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 has amended section 34 so as to require a written consent of resolution professional in specified form for appointment as a liquidator.
- Section 35 provides a non-exhaustive list of powers and duties of the liquidator to ensure orderly completion of the liquidation proceedings.
- Section 37 provides that the liquidator shall have the power to access any information systems for the purpose of admission and proof of claims and identification of assets to be held in the liquidation estate.
- Section 36 provides for the creation of a liquidation estate comprising the assets of the corporate debtor as set out in section 36(3). Section 36 also lists out the assets which are to be excluded from the liquidation estate.
- Section 38 prescribes a time period for the collection of claims by the liquidator. It also specifies the methods by which different categories of creditors can submit and prove their claims.
- According to section 42, a creditor may appeal to the Adjudicating Authority against the decision of the liquidator accepting or rejecting the claims within fourteen days of the receipt of such decision.
- Section 53 deals with distribution of assets in liquidation. The Insolvency and Bankruptcy Code, 2016 makes significant changes in the priority of claims for distribution of liquidation proceeds.
- 'Liquidation cost' means any cost incurred by the liquidator during the period of liquidation subject to such regulations, as may be specified by the Board.
- 'Liquidation commencement date' means the date on which proceedings for liquidation commence in accordance with section 33 or section 59, as the case may be.
- Section 54 provides that after the affairs of the corporate debtor have been wound up and its assets are completely liquidated, the liquidator shall make an application to the adjudicating authority for the dissolution of the corporate debtor.

## SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. Discuss the grounds for the initiation of Liquidation process for corporate persons by the Adjudicating Authority.
2. Mention the powers and duties of Liquidator under section 35 of the Insolvency and Bankruptcy Code, 2016.
3. Write a note on Liquidation Estate.
4. What orders can be passed by the Adjudicating Authority for the avoidance of a preferential transaction?
5. What is the order of priority in distribution of proceeds from the sale of the assets during liquidation?



# Lesson 25

## Voluntary Liquidation

### LESSON OUTLINE

- Voluntary Liquidation for Corporate Persons
- Broad steps involved in the voluntary liquidation
- IBBI (Voluntary Liquidation Process) Regulations, 2017
- Initiation of Liquidation
- Effect of Liquidation
- Power and duties of Liquidator
- Completion of Liquidation
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Voluntary liquidation of a company is governed by the provisions of section 59 of Insolvency and Bankruptcy Code, 2016 and IBBI (Voluntary Liquidation Process) Regulations, 2017. The corresponding provisions under the Companies Act, 2013 in this regard have been repealed.

Section 59 under Chapter V of the Code deals with voluntary liquidation of corporate persons. Section 59(1) of the Code explains that, a corporate person who is intending to liquidate it voluntarily and has not committed any default may initiate voluntary liquidation proceedings under the provisions of this chapter.

The Code gives a clear procedure in case of voluntary liquidation of corporate person under Section 59. Together with the Code, the Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulation, 2017 also explains about the process involved in the voluntary liquidation of the companies.

Starting from the declaration of solvency to the final report is explained in a detailed manner in the Code and the Regulation. The Regulation also explains about the realisation of assets and the distribution of the proceeds, effect of voluntary liquidation and also the books and the registers to be maintained by the liquidator in case of voluntary liquidation.

The lesson covers about declaration of solvency, general meeting for initiating voluntary liquidation, intimation to other regulatory authorities, effect of voluntary liquidation, the dissolution of corporate debtor, etc.

## VOLUNTARY LIQUIDATION OF CORPORATE PERSONS

Section 59 in Chapter V of Part II of the Insolvency and Bankruptcy Code, 2016 provides for the initiation of voluntary liquidation proceedings by a corporate debtor which has not defaulted on any debt due to any person.

The Insolvency and Bankruptcy Board of India has made **the Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017** to regulate the voluntary liquidation of corporate persons under Chapter V of Part II of the Insolvency and Bankruptcy Code, 2016.

**Who may initiate voluntary liquidation proceedings** – According to sub-section (1) of section 59, a corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under the provisions of Chapter V of Part II of the Code.

Thus, in order to initiate voluntary liquidation proceedings under Chapter V of Part II of the Code, a corporate person who intends to liquidate itself voluntarily, must have not committed any default.

**Procedural requirements** – Sub-section (2) of section 59 provides that the voluntary liquidation of a corporate person under sub-section (1) shall meet such conditions and procedural requirements as may be specified by the Insolvency and Bankruptcy Board of India.

**Conditions for voluntary liquidation proceedings of corporate person registered as company** – Sub-section (3) of section 59 lays down that without prejudice to sub-section (2), voluntary liquidation proceedings of a corporate person registered as a company shall meet the following conditions:

- (a) a declaration from majority of the directors of the company verified by an affidavit stating that –
  - (i) they have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation; and
  - (ii) the company is not being liquidated to defraud any person;
- (b) the declaration under sub-clause (a) shall be accompanied with the following documents:
  - (i) audited financial statements and record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later;
  - (ii) a report of the valuation of the assets of the company, if any prepared by a registered valuer;
- (c) within four weeks of a declaration under sub-clause (a), there shall be –
  - (i) a special resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily and appointing an insolvency professional to act as the liquidator; or
  - (ii) a resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily as a result of expiry of the period of its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, as the case may be and appointing an insolvency professional to act as the liquidator:

The proviso appended to sub-section (3) of section 59 lays down that if the company owes any debt to any person, creditors representing two thirds in value of the debt of the company shall approve the resolution passed under sub-clause (c) within **seven days** of such resolution.

Though the procedure to be followed for voluntary liquidation proceedings under Chapter III is largely similar to the procedure to be followed for insolvent liquidation under Chapter III of the Code yet there are marked differences:

1. To initiate voluntary liquidation proceedings, where the corporate debtor is a company, the directors have to provide a **declaration of solvency** and a declaration that the company is not being liquidated to **defraud** any person.
2. The declarations have to be accompanied by (a) the audited financial statements of the company and (b) a record of its business operations for the previous two years or the period since its incorporation whichever is later.
3. Further, a report of the valuation of the assets of the company prepared by a registered valuer has to be provided.
4. A resolution in favour of the voluntary winding up of the company and appointment of an insolvency professional as the liquidator has to be passed within four weeks of the declaration under clause (a) of sub-section (3) of section 59.
5. Where the company owes any debt to any person, creditors representing two-thirds in value of the debt of the company shall approve the resolution passed under sub-clause (c) within seven days of such resolution.

**Requirement of notification** – Sub-section (4) lays down that the company shall notify the Registrar of Companies and the Board about the resolution under sub-section (3) to liquidate the company within **seven days** of such resolution or the **subsequent approval by the creditors**, as the case may be.

**Date of Commencement of voluntary liquidation proceedings** – According to sub-section (5), subject to approval of the creditors under sub-section (3), the voluntary liquidation proceedings in respect of a company shall be deemed to have commenced from the date of passing of the resolution under sub-clause (c) of sub-section (3).

**Provisions to apply** – The provisions of sections 35 to 53 of Chapter III and Chapter VII shall apply to voluntary liquidation proceedings for corporate persons with such modifications as may be necessary. [Section 59(6)]

**Application to Adjudicating Authority** – As per sub-section (7) of section 59, where the affairs of the corporate person have been completely wound up, and its assets completely liquidated, the liquidator shall make an application to the Adjudicating Authority for the dissolution of such corporate person.

**Order by Adjudicating Authority** – The Adjudicating Authority shall on an application filed by the liquidator under sub-section (7), pass an order that the corporate debtor shall be dissolved from the date of that order and the corporate debtor shall be dissolved accordingly. [Section 59(8)]

Thus, once the affairs of the corporate debtor have been wound up and its assets completely liquidated, the liquidator shall make an application to the adjudicating authority for the dissolution of the corporate debtor and the corporate debtor shall be dissolved by the order of the adjudicating authority.

**Copy of Order** – A copy of an order under sub-section (8) shall within fourteen days from the date of such order, be forwarded to the authority with which the corporate person is registered. [Section 59(9)]

### Broad steps involved in the voluntary liquidation

- a) Submission of declaration(s) to ROC, stating that the company will be able to pay its dues and is not being liquidated to defraud any person;
- b) Passing of special resolution for approving the proposal of voluntary liquidation and appointment of liquidator, within four weeks of the aforesaid declaration(s). If a corporate person owes debts, approval of two-third majority creditors would also be required;
- c) Public announcement inviting claims of all stakeholders, within five days of such Approval, in newspaper as well as on website of the corporate person;

- d) Intimation to the ROC and the Board about the Approval, within seven days of such Approval;
- e) Preparation of preliminary report about the capital structure, estimates of assets and liabilities, proposed plan of action etc., and submission of the same to a corporate person within forty-five days of such Approval;
- f) Verification of claims, within thirty days from the last date for receipt of claims and preparation of list of stakeholders, within forty-five days from the last date for receipt of claims;
- g) Opening of a bank account in the name of the corporate person followed by the words 'in voluntary liquidation', in a scheduled bank, for the receipt of all moneys due to the corporate person;
- h) Sale of assets, recovery of monies due to corporate person, realization of uncalled capital or unpaid capital contribution;
- i) Distribution of the proceeds from realization within six months from the receipt of the amount to the stakeholders;
- j) Submission of final report by the liquidator to the corporate person, ROC and the Board and application to the National Company Law Tribunal (NCLT) for the dissolution;
- k) Submission of NCLT order regarding the dissolution, to the concerned ROC within fourteen days of the receipt of order.

### **INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (VOLUNTARY LIQUIDATION PROCESS) REGULATIONS, 2017**

These Regulations came into force on 1st April, 2017. These Regulations shall apply to the voluntary liquidation of corporate persons under Chapter V of Part II of the Insolvency and Bankruptcy Code, 2016. Some of the salient provisions are discussed below:

#### **Initiation of Liquidation**

(1) Without prejudice to section 59(2), liquidation proceedings of a corporate person shall meet the following conditions, namely:

- (a) a declaration from majority of
  - (i) the designated partners, if a corporate person is a limited liability partnership,
  - (ii) individuals constituting the governing body in case of other corporate persons,
 as the case may be, verified by an affidavit stating that-
  - (i) they have made a full inquiry into the affairs of the corporate person and they have formed an opinion that either the corporate person has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the liquidation; and
  - (ii) the corporate person is not being liquidated to defraud any person;
- (b) the declaration under sub-clause (a) shall be accompanied with the following documents, namely:
  - (i) audited financial statements and record of business operations of the corporate person for the previous two years or for the period since its incorporation, whichever is later;
  - (ii) a report of the valuation of the assets of the corporate person, if any prepared by a registered valuer;
- (c) within four weeks of a declaration under sub-clause (a), there shall be:

- (i) a resolution passed by a special majority of the partners or contributories, as the case may be, of the corporate person requiring the corporate person to be liquidated and appointing an insolvency professional to act as the liquidator; or
- (ii) a resolution of the partners or contributories, as the case may be, requiring the corporate person to be liquidated as a result of expiry of the period of its duration, if any, fixed by its constitutional documents or on the occurrence of any event in respect of which the constitutional documents provide that the corporate person shall be dissolved, as the case may be, and appointing an insolvency professional to act as the liquidator:

Provided that the corporate person owes any debt to any person, creditors representing two-thirds in value of the debt of the corporate person shall approve the resolution passed under sub-clause (c) within seven days of such resolution.

(2) The corporate person shall notify the Registrar and the Board about the resolution under sub-regulation (1) to liquidate the corporate person within seven days of such resolution or the subsequent approval by the creditors, as the case may be.

(3) Subject to approval of the creditors under sub-regulation (1), the liquidation proceedings in respect of a corporate person shall be deemed to have commenced from the date of passing of the resolution under sub-clause (c) of sub-regulation (1).

### Effect of liquidation

(1) The corporate person shall from the liquidation commencement date cease to carry on its business except as far as required for the beneficial winding up of its business.

(2) Notwithstanding the provisions of sub-section (1), the corporate person shall continue to exist until it is dissolved under section 59(8).

### Appointment of Liquidator

(1) An insolvency professional shall not be appointed by a corporate person if he is not eligible under Regulation 6.

(2) The resolution passed under regulation 3(2)(c) or under section 59(3)(c), as the case may be, shall contain the terms and conditions of the appointment of the liquidator, including the remuneration payable to him.

Eligibility for appointment as liquidator

An insolvency professional shall be eligible to be appointed as a liquidator if he, and every partner or director of the insolvency professional entity of which he is a partner or director is independent of the corporate person.

*Explanation:* A person shall be considered independent of the corporate person, if he-

- (a) is eligible to be appointed as an independent director on the board of the corporate person under section 149 of the Companies Act, 2013 (18 of 2013), where the corporate person is a company;
- (b) is not a related party of the corporate person; or
- (c) has not been an employee or proprietor or a partner-
  - (i) of a firm of auditors or secretarial auditors or cost auditors of the corporate person; or
  - (ii) of a legal or a consulting firm, that has or had any transaction with the corporate person contributing ten per cent or more of the gross turnover of such firm,

at any time in the last three years.



(2) An insolvency professional shall not be eligible to be appointed as a liquidator if he, or the insolvency professional entity of which he is a partner or director is under a restraint order of the Board.

(3) A liquidator shall disclose the existence of any pecuniary or personal relationship with the concerned corporate person or any of its stakeholders as soon as he becomes aware of it, to the Board and the Registrar.

(4) An insolvency professional shall not continue as a liquidator if the insolvency professional entity of which he is a director or partner, or any other partner or director of such insolvency professional entity represents any other stakeholder in the same liquidation.

### **Proof of claim**

A person, who claims to be a stakeholder, shall prove his claim for debt or dues to him, including interest, if any, as on the liquidation commencement date.

### **Verification of claims**

(1) The liquidator shall verify the claims submitted within thirty days from the last date for receipt of claims and may either admit or reject the claim, in whole or in part, as the case may be, as per section 40 of the Code.

(2) A creditor may appeal to the Adjudicating Authority against the decision of the liquidator as per section 42 of the Code.

### **Manner of sale**

The liquidator may value and sell the assets of the corporate person in the manner and mode approved by the corporate person in compliance with provisions, if any, in the applicable statute.

Explanation: “assets” include an asset, all assets, a set of assets or parcel of assets, as the case may be, in relation to sale of assets.

## **Proceeds of Liquidation and Distribution of Proceeds**

### **Distribution**

(1) The liquidator shall distribute the proceeds from realization within six months from the receipt of the amount to the stakeholders.

(2) The liquidation costs shall be deducted before such distribution is made.

(3) The liquidator may, with the approval of the corporate person, distribute amongst the stakeholders, an asset that cannot be readily or advantageously sold due to its peculiar nature or other special circumstances.

### **Completion of liquidation**

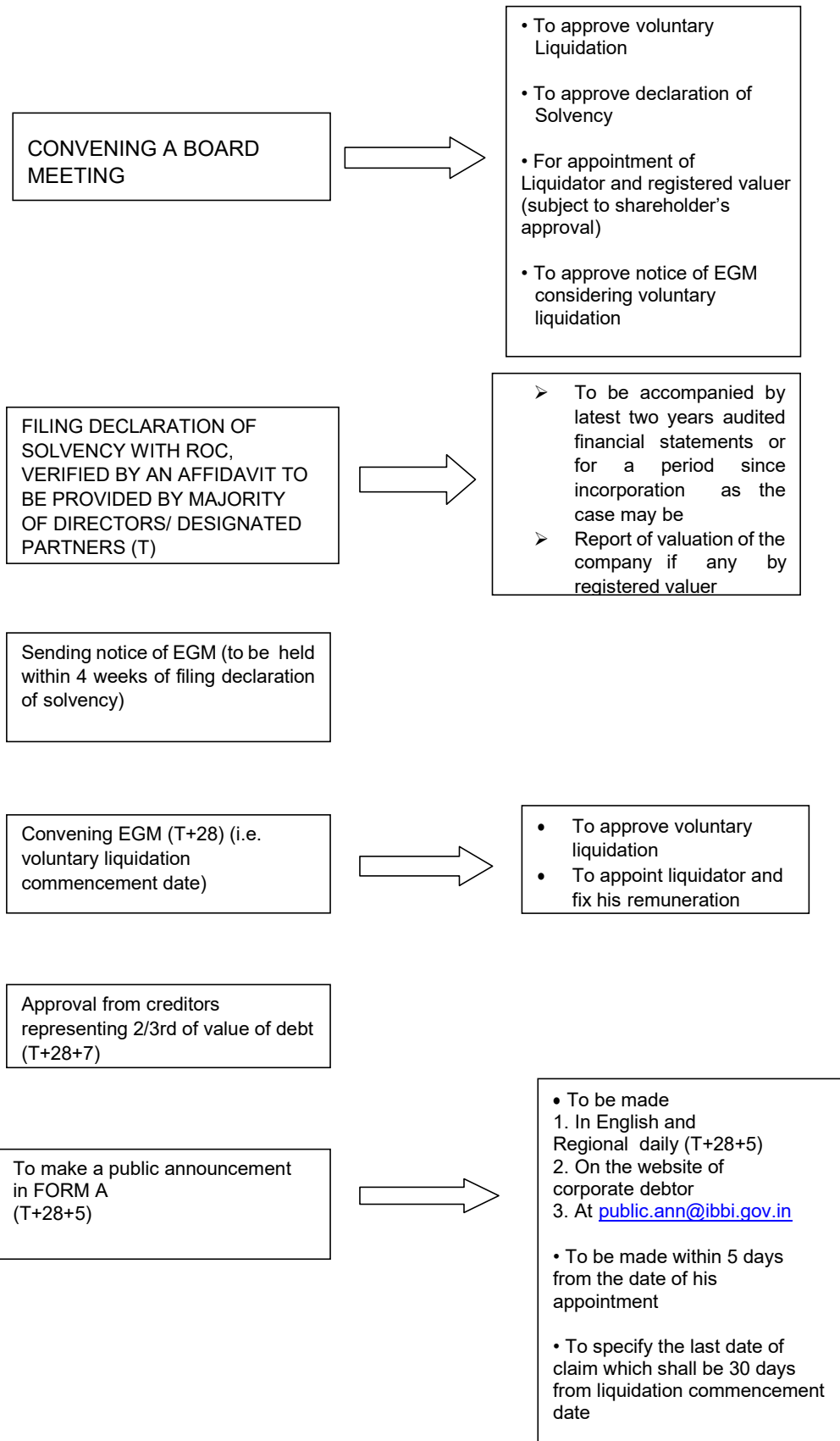
(1) The liquidator shall endeavor to complete the liquidation process of the corporate person within twelve months from the liquidation commencement date.

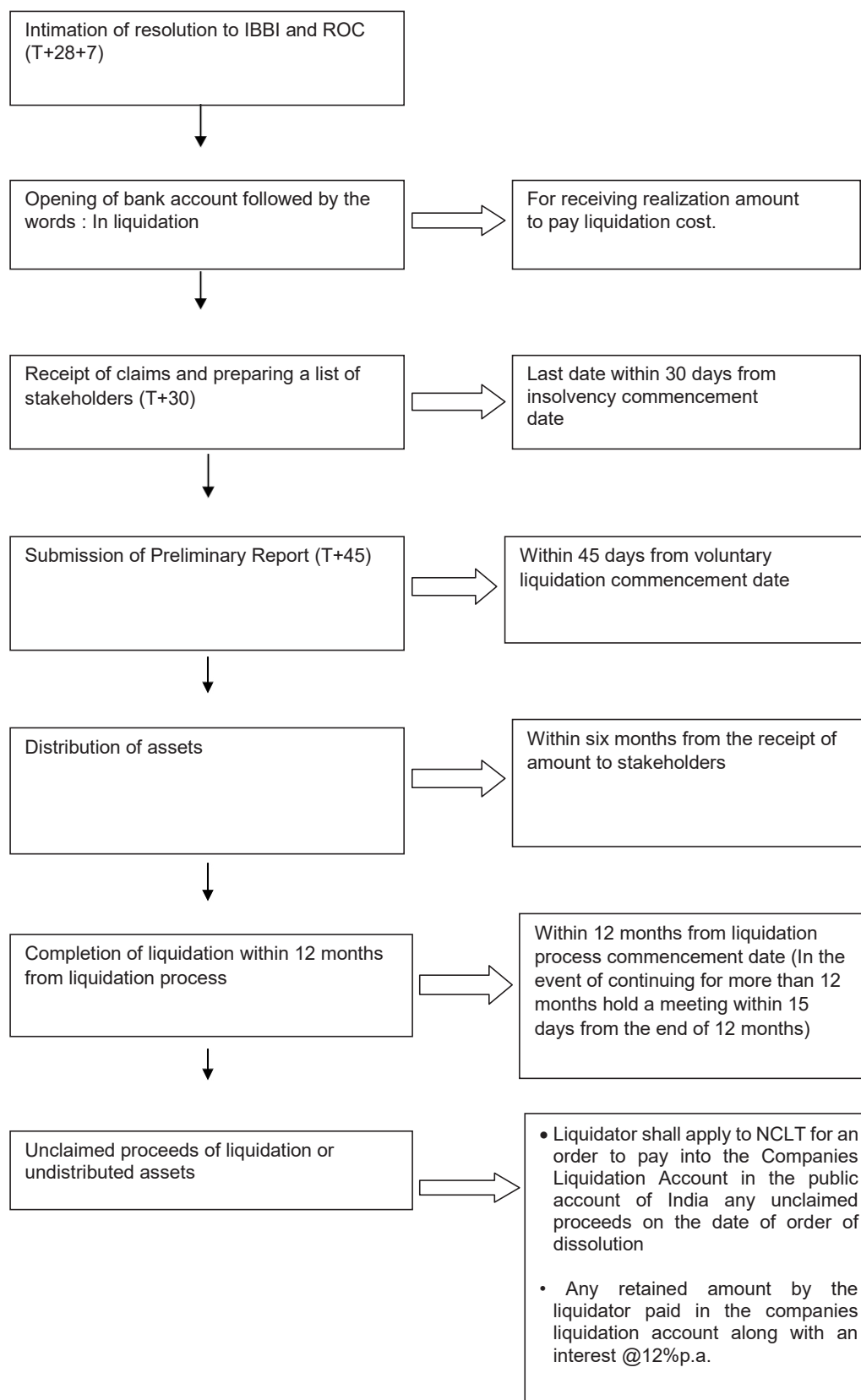
(2) In the event of the liquidation process continuing for more than twelve months, the liquidator shall hold a meeting of the contributories of the corporate person within fifteen days from the end of the twelve months from the liquidation commencement date, and at the end every succeeding twelve months till dissolution of the corporate person.

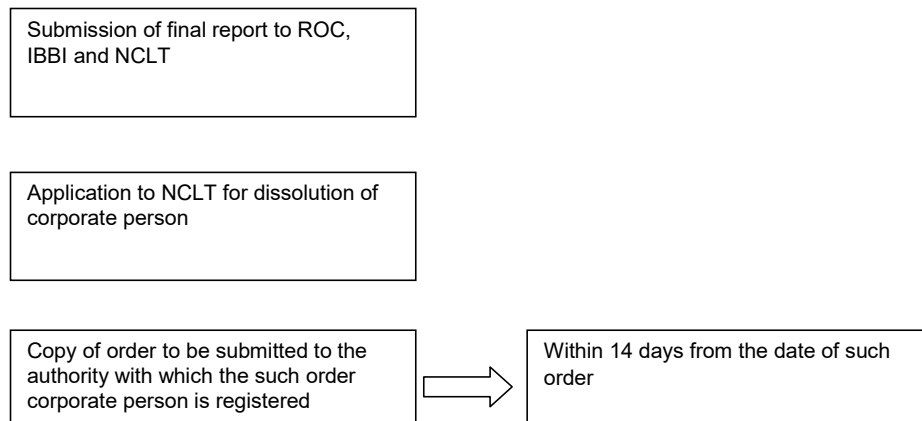
### **Preservation of records**

The liquidator shall preserve a physical or an electronic copy of the reports, registers and books of account referred to in Regulations 8 and 10 for at least eight years after the dissolution of the corporate person, either with himself or with an information utility.

## Flowchart – Voluntary Liquidation Process







### LESSON ROUND UP

- As per section 59, a corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings under the provisions of Chapter V of Part II of the Code.
- The Insolvency and Bankruptcy Board of India has made the IBBI (Voluntary Liquidation Process) Regulations, 2017 to regulate the voluntary liquidation of corporate persons.
- The corporate person shall from the liquidation commencement date cease to carry on its business except as far as required for the beneficial winding-up of its business.
- It is required to submit a declaration to ROC, stating that the company will be able to pay its dues and is not being liquidated to defraud any person.
- Passing of special resolution for approving the proposal of voluntary liquidation and appointment of liquidator, within four weeks of the aforesaid declaration(s). If a corporate person owes debts, approval of two-third majority creditors would also be required.
- Public announcement is issued inviting claims of all stakeholders, within five days of such approval, in newspaper as well as on website of the corporate person.
- A person, who claims to be a stakeholder, shall prove his claim for debt or dues to him, including interest, if any, as on the liquidation commencement date.
- The liquidator shall verify the claims submitted within thirty days from the last date for receipt of claims and may either admit or reject the claim, in whole or in part, as the case may be, as per section 40 of the Code.
- The liquidator may value and sell the assets of the corporate person in the manner and mode approved by the corporate person in compliance with provisions, if any, in the applicable statute.
- The liquidator shall distribute the proceeds from realization within six months from the receipt of the amount to the stakeholders.
- The liquidator shall endeavor to complete the liquidation process of the corporate person within twelve months from the liquidation commencement date.

### SELF TEST QUESTIONS

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).*

1. What is Voluntary Liquidation under the Insolvency and Bankruptcy Code, 2016?

2. Mention the conditions a corporate person registered as a company shall meet for initiation of Voluntary Liquidation proceedings.
3. Write in brief the steps involved in Voluntary Liquidation process.
4. Discuss the differences between the procedure to be followed for voluntary liquidation proceedings and the procedure to be followed for liquidation under Chapter III of the Code.
5. Write a note on the Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017.

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# Lesson 26

## Winding-up by Tribunal under the Companies Act, 2013

### LESSON OUTLINE

- Introduction
- Important Changes brought about by IBC
- Winding up by Tribunal : Grounds
- Petition for the winding-up
- Powers of the Tribunal
- Directions for filing statement of affairs
- Company Liquidators and their appointments
- Removal and replacement of liquidators
- Submission of the reports by the Company Liquidator
- Advisory Committee
- Submission of periodical reports to the Tribunal
- Powers and duties of the company liquidator
- Audit of Company liquidator's accounts
- Overriding Preferential Payments
- Fraudulent preferences
- Companies (Winding-Up) Rules, 2020
- LESSON ROUND UP
- SELF TEST QUESTIONS

### LEARNING OBJECTIVES

Chapter XX of the Companies Act, 2013 regulates the winding-up of companies in India. Section 255 of the Insolvency and Bankruptcy Code, 2016 has been notified with effect from November 15, 2016, and by virtue of Section 255, the Companies Act, 2013 stands amended in accordance with Schedule XI of the Code. The aforesaid Schedule XI now defines the term 'winding-up' by introducing a new Section 2(94A) to the 2013 Companies Act, 2013 as 'winding-up' under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016.

Section 271 of the Companies Act, 2013 lays down that a Tribunal may order for winding-up a company, if a petition under section 272 of the Companies Act, 2013 is presented to the Tribunal, with any of the grounds provided under section 271. The Companies Act, 2013 provides for effective time bound winding-up process. It also provides for aspects such as new grounds of winding-up by NCLT, report of company liquidator, more powers to company liquidator, valuation of assets by registered valuer, professional assistance, simplification of provisions by providing exclusive right to creditors to appoint the committee of inspection, remedy for fraudulent preference and so on.

After reading this lesson you will be able to understand the provisions relating to the winding-up under the Companies Act, 2013. However, it is to be mentioned that the Companies (Winding-up) Rules, 2020 have been notified on 24th January, 2020. These Rules shall come into force on 1st April, 2020.

## INTRODUCTION

Winding up is a means by which the dissolution of a company is brought about. The main purpose of winding up of a company is to realize the assets and pay the company's debts expeditiously and fairly in accordance with the law. If any surplus is left, it is distributed among the members in accordance with their rights.

It may be noted that on winding up, the company does not cease to exist as such except when it is dissolved. Even after commencement of the winding-up, the property and assets of the company belong to the company until the dissolution takes place. On dissolution, the company ceases to exist as a separate entity and becomes incapable of keeping property, suing or being sued. Thus in between the winding up and dissolution, the legal status of the company continues and it can be sued in the court of law.

The terms "Winding up" and "Dissolution" are sometimes erroneously used to mean the same thing. But, the legal implications of these two terms are quite different and there are fundamental differences between them as regards the legal procedure involved.

The entire procedure for bringing about a lawful end to the life of a company is divided into two stages i.e., 'winding up' and 'dissolution'. Winding up is the first stage in the process whereby assets are realized, liabilities are paid off and the surplus, if any, distributed among its members. Dissolution is the final stage whereby the existence of the company is withdrawn by the law. Dissolution brings about an end to the legal entity of the company.

### Important Changes brought about by the Insolvency and Bankruptcy Code, 2016

The Insolvency and Bankruptcy Code, 2016 was passed with the objective of consolidating and amending the laws relating to reorganisation and insolvency resolution in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for other matters connected.

The Ministry of Corporate Affairs has notified section 255 of the Insolvency and Bankruptcy Code, 2016. Section 255 of the Insolvency and Bankruptcy Code, 2016 amends the Companies Act, 2013, in accordance with the Eleventh Schedule of the Insolvency and Bankruptcy Code, 2016.

The Central Government has appointed the 15 November, 2016 as the date on which the provisions of the section 255 of the Insolvency and Bankruptcy Code, 2016 shall come into force.

The Insolvency and Bankruptcy Code, 2016 has made significant amendments to provisions relating to winding up in the Companies Act, 2013. The important ones are discussed below:

**"Winding up"** – The expression "winding up" was not defined in the Companies Act, 2013 or in the erstwhile Companies Act of 1956. The Eleventh Schedule has added sub-section (94A) to section 2 of the Companies Act, 1956. The definition of "winding up" reads as follows:

"Winding up" means winding up under the Companies Act, 2013 or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable." [Section 2(94A)]

**Voluntary winding up** – Provisions relating to voluntary winding up in the Companies Act, 2013 i.e., sections 304 to 323 have been omitted by the Insolvency and Bankruptcy Code, 2016. Voluntary liquidation is now dealt with under section 59 of the Insolvency and Bankruptcy Code, 2016.

**Inability to pay debts** – Insolvency and Bankruptcy Code, 2016 has substituted section 271 of the Companies Act, 2013. Section 271 of the Companies Act, 2013, before its substitution by the Insolvency and Bankruptcy Code, 2016, provided the following seven grounds for winding up by Tribunal:

- (a) if the company is unable to pay its debts;



- (b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
- (c) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
- (d) if the Tribunal has ordered the winding up of the company under Chapter XIX;
- (e) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;
- (f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
- (g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

Now after its substitution, section 271 provides the following five grounds where a company may be wound up by a Tribunal:

- “(a) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
- (b) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
- (c) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;
- (d) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
- (e) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.”

The following two grounds have been deleted from section 271:

- “(a) if the company is unable to pay its debts;
- (d) if the Tribunal has ordered the winding up of the company under Chapter XIX”

Thus, if a company is unable to pay its debts, creditors can't file petition in tribunal in for winding up of the Company. However, the Companies Act, 2013 shall continue to govern winding up of companies on various other grounds excluding inability to pay debts.

### **Winding up by Tribunal under the Companies Act, 2013**

The Companies Act, 2013 continues to govern winding up of companies on various other grounds excluding inability to pay debts. Sections 270 to 288, Sections 290 to 303, Section 324 and Sections 326 to 365 of Chapter XX of the Companies Act, 2013 contain the provisions relating to winding up of a company.

The Ministry of Corporate Affairs has notified these sections on 7 December, 2016 and these sections have come into force with effect from 15 December 2016.

### **Circumstances in which Company may be Wound up by Tribunal**

Section 271 of the Companies Act provides that a company may, on a petition under section 272, be wound up by the Tribunal, –

- (a) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
- (b) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
- (c) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;
- (d) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
- (e) if the Tribunal is of the opinion that it is just and equitable that the company should be wound-up.

### Who may file Petition for Winding up

Section 272 lays down that a petition to the Tribunal for the winding up of a company shall be presented by –

- (a) the company;
- (b) any contributory or contributories;
- (c) all or any of the persons specified in clauses (a) and (b) ;
- (d) the Registrar;
- (e) any person authorized by the Central Government in that behalf; or
- (f) in a case falling under clause (b) of section 271, by the Central Government or a State Government.

### Powers of Tribunal

According to section 273(1), the Tribunal may, on receipt of a petition for winding up under section 272 pass any of the following orders, namely: –

- (a) dismiss it, with or without costs;
- (b) make any interim order as it thinks fit;
- (c) appoint a provisional liquidator of the company till the making of a winding up order;
- (d) make an order for the winding up of the company with or without costs; or
- (e) any other order as it thinks fit:

Provided that an order under this sub-section shall be made within ninety days from the date of presentation of the petition:

Provided further that before appointing a provisional liquidator under clause (c), the Tribunal shall give notice to the company and afford a reasonable opportunity to it to make its representations, if any, unless for special reasons to be recorded in writing, the Tribunal thinks fit to dispense with such notice:

Provided also that the Tribunal shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged for an amount equal to or in excess of those assets, or that the company has no assets.

Where a petition is presented on the ground that it is just and equitable that the company should be wound up, the Tribunal may refuse to make an order of winding up, if it is of the opinion that some other remedy is available

to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing the other remedy. [Section 273(2)]

### **Filing Statement of Affairs of the Company**

Section 274 lays down that in case, where the Tribunal is satisfied that on a petition that the winding up of the company is to be made out, he may by an order direct the company to file its objections along with a statement of its affairs within thirty days of the order which can be allowed a further period of thirty days in a situation of contingency or special circumstances.

In case, where the Company fails to file the statement of affairs, the tribunal shall forfeit the right of the company to oppose the petition and right of such directors and officers of the company as found responsible for such non-compliance.

Further, the director or the officer of the company who is in default will be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both. The complaint may be filed in this behalf before the Special Court by Registrar, provisional liquidator, Company Liquidator or any person authorized by the Tribunal.

### **Company Liquidators and their Appointments**

For the purposes of winding up of a company by the Tribunal, the Tribunal at the time of the passing of the order of winding up, shall appoint an Official Liquidator or a liquidator from the panel maintained under sub-section (2) as the Company Liquidator. [Section 275(1)]

The provisional liquidator or the Company Liquidator, as the case may, shall be appointed by the Tribunal from amongst the insolvency professionals registered under the Insolvency and Bankruptcy Code, 2016.] [Section 275(2)]

Where a provisional liquidator is appointed by the Tribunal, the Tribunal may limit and restrict his powers by the order appointing him or it or by a subsequent order, but otherwise he shall have the same powers as a liquidator. [Section 275(3)]

The terms and conditions of appointment of a provisional liquidator or Company Liquidator and the fee payable to him or it shall be specified by the Tribunal on the basis of task required to be performed, experience, qualification of such liquidator and size of the company. [Section 275(5)]

On appointment as provisional liquidator or Company Liquidator, as the case may be, such liquidator shall file a declaration within seven days from the date of appointment in the prescribed form disclosing conflict of interest or lack of independence in respect of his appointment, if any, with the Tribunal and such obligation shall continue throughout the term of his appointment. [Section 275(6)]

While passing a winding up order, the Tribunal may appoint a provisional liquidator, if any, appointed under clause (c) of sub-section (1) of section 273, as the Company Liquidator for the conduct of the proceedings for the winding up of the company. [Section 275(7)]

**“Company Liquidator”**, means a person appointed by the Tribunal as the Company Liquidator in accordance with the provisions of section 275 for the winding up of a company under this Act. [Section 2(23)]

### **SECRETARY DEPT OF COMMERCE AND INDUSTRIES VS KARNATKA STATE TEXTILE LTD (2005 58 SCL 287)**

In this case appointment of liquidators has been discussed .

An Appeal is filed before Karnataka High Court praying for permission of the Court to be granted in favour of the applicant to appoint Additional Director, Department of Disinvestment, to be the Independent Liquidator of

the company for the purpose of discharging her duties and functions as Liquidator under the provisions of the Companies Act, 1956 and under the supervision of the Court.

High Court in Para 13 held that, while there is to be one Official Liquidator attached to each High Court and he is appointed by the Central Government, the Central Government may also appoint one or more Deputy or Assistant Official Liquidator to assist the Official Liquidator in the discharge of his functions. Except for such appointments, there is no provision for appointing an independent person or a third party as an Official Liquidator in liquidation proceedings under the supervision of the Court.

This precedent will not apply under section 275 (2) of the Companies Act, 2013 as it provides for appointment of provisional liquidator or company liquidators from panel of by the Tribunal from amongst the insolvency professionals registered under the Insolvency and Bankruptcy Code, 2016.

### **Removal and Replacement of Liquidator**

Section 276 lays down that in case where the reasonable cause being shown and for reasons to be recorded in writing, the tribunal may remove the provisional liquidator or the Company Liquidator, on any of the following grounds:

- (a) misconduct;
- (b) fraud or misfeasance;
- (c) professional incompetence or failure to exercise due care and diligence in performance of the powers and functions;
- (d) inability to act as provisional liquidator or as the case may be, Company Liquidator;
- (e) conflict of interest or lack of independence during the term of his appointment that would justify removal.

Further, in the event of death, resignation or removal of the liquidator the Tribunal may transfer the work assigned to him or it to another Company Liquidator for reasons to be recorded in writing.

### **Intimation for Winding Up**

According to Section 277, upon the order for appointment of provisional liquidator or for the winding up of a company, the tribunal shall within a period not exceeding seven days from the date of passing of the order give intimation of the appointment to the Company Liquidator or provisional liquidator and the Registrar.

The Registrar on receipt of the copy of order of appointment of provisional liquidator or winding up order shall make an endorsement to that effect in his records relating to the company and notify in the Official Gazette that such an order has been made and in the case of a listed company, the Registrar shall intimate about such appointment or order, to the stock exchange or exchanges where the securities of the company are listed.

Such winding up order shall be deemed to be a notice of discharge to the officers, employees and workmen of the company, except when the business of the company is continued.

### **Effect of Winding up Order**

The order for the winding up of a company shall operate in favor of all the creditors and all contributories of the company as if it had been made out on the joint petition of creditors and contributories. [Section 278]

### **Stay of Suits on Winding up Order**

When a winding up order has been passed or a provisional liquidator has been appointed, no suit or other legal proceeding shall be commenced, or if pending at the date of the winding up order, shall be proceeded with, by or against the company, except with the leave of the Tribunal and subject to such terms as the Tribunal may impose:

Provided that any application to the Tribunal seeking leave under this section shall be disposed of by the Tribunal within sixty days. [Section 279(1)]

Nothing in sub-section (1) shall apply to any proceeding pending in appeal before the supreme Court or a High Court. [Section 279(2)]

### **Submission of Report by Company Liquidator**

According to section 281(1), where the Tribunal has made a winding up order or appointed a Company Liquidator, such liquidator shall, within sixty days from the order, submit to the Tribunal, a report containing the following particulars, namely:

- (a) the nature and details of the assets of the company including their location and value, stating separately the cash balance in hand and in the bank, if any, and the negotiable securities, if any, held by the company:

Provided that the valuation of the assets shall be obtained from registered valuers for this purpose;

- (b) amount of capital issued, subscribed and paid-up;
- (c) the existing and contingent liabilities of the company including names, addresses and occupations of its creditors, stating separately the amount of secured and unsecured debts, and in the case of secured debts, particulars of the securities given, whether by the company or an officer thereof, their value and the dates on which they were given;
- (d) the debts due to the company and the names, addresses and occupations of the persons from whom they are due and the amount likely to be realized on account thereof;
- (e) guarantees, if any, extended by the company;
- (f) list of contributories and dues, if any, payable by them and details of any unpaid call;
- (g) details of trademarks and intellectual properties, if any, owned by the company;
- (h) details of subsisting contracts, joint ventures and collaborations, if any;
- (i) details of holding and subsidiary companies, if any;
- (j) details of legal cases filed by or against the company; and
- (k) any other information which the Tribunal may direct or the Company Liquidator may consider necessary to include.

The Company Liquidator shall include in his report the manner in which the company was promoted or formed and whether in his opinion any fraud has been committed by any person in its promotion or formation or by any officer of the company in relation to the company since the formation thereof and any other matters which, in his opinion, it is desirable to bring to the notice of the Tribunal. [Section 281(2)]

The Company Liquidator shall also make a report on the viability of the business of the company or the steps which, in his opinion, are necessary for maximizing the value of the assets of the company. [Section 281(3)]

The Company Liquidator may also, if he thinks fit, make any further report or reports. [Section 281(4)]

Any person describing himself in writing to be a creditor or a contributory of the company shall be entitled by himself or by his agent at all reasonable times to inspect the report submitted in accordance with this section and take copies thereof or extracts therefrom on payment of the prescribed fees. [Section 281(5)]

### **Directions of Tribunal on Report of Company Liquidator**

The Tribunal shall, on consideration of the report of the Company Liquidator, fix a time limit within which the entire proceedings shall be completed and the company be dissolved:

*Provided that* the Tribunal may, if it is of the opinion, at any stage of the proceedings, or on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, that it will not be advantageous or economical to continue the proceedings, revise the time limit within which the entire proceedings shall be completed and the company be dissolved. [Section 282(1)]

The Tribunal may, on examination of the reports submitted to it by the Company Liquidator and after hearing the Company Liquidator, creditors or contributories or any other interested person, order sale of the company as a going concern or its assets or part thereof:

*Provided that* the Tribunal may, where it considers fit, appoint a sale committee comprising such creditors, promoters and officers of the company as the Tribunal may decide to assist the Company Liquidator in sale under this sub-section. [Section 282(2)]

Where a report is received from the Company Liquidator or the Central Government or any person that a fraud has been committed in respect of the company, the Tribunal shall, without prejudice to the process of winding up, order for investigation under section 210, and on consideration of the report of such investigation it may pass order and give directions under sections 339 to 342 or direct the Company Liquidator to file a criminal complaint against persons who were involved in the commission of fraud. [Section 282(3)]

The Tribunal may order for taking such steps and measures, as may be necessary, to protect, preserve or enhance the value of the assets of the company. [Section 282(4)]

The Tribunal may pass such other order or give such other directions as it considers fit. [Section 282(5)]

### **Custody of Company's Properties**

Upon the winding up order made by the tribunal the Company Liquidator or the provisional liquidator take into his or its custody or control all the property, effects and actionable claims to which the company is or appears to be entitled to and take such steps and measures, as may be necessary, to protect and preserve the properties of the company which shall be deemed to be in the custody of the Tribunal from the date of the order for the winding up of the company. [Section 283]

### **Advisory Committee**

The Tribunal may, while passing an order of winding up of a company, direct that there shall be, an advisory committee to advise the Company Liquidator and to report to the Tribunal on such matters as the Tribunal may direct. [Section 287(1)]

The advisory committee appointed by the Tribunal shall consist of not more than twelve members, being creditors and contributories of the company or such other persons in such proportion as the Tribunal may, keeping in view the circumstances of the company under liquidation, direct. [Section 287(2)]

The Company Liquidator shall convene a meeting of creditors and contributories, as ascertained from the books and documents, of the company within thirty days from the date of order of winding up for enabling the Tribunal to determine the persons who may be members of the advisory committee. [Section 287(3)]

The advisory committee shall have the right to inspect the books of account and other documents, assets and properties of the company under liquidation at a reasonable time. [Section 287(4)]

The provisions relating to the convening of the meetings, the procedure to be followed thereat and other matters relating to conduct of business by the advisory committee shall be such as may be prescribed. [Section 287(5)]

The meeting of advisory committee shall be chaired by the Company Liquidator. [Section 287(6)]

### **Powers and Duties of Company Liquidator**



Section 290 of the Companies Act, 2013 lays down that subject to directions by the Tribunal, if any, in this regard, the Company Liquidator, in a winding up of a company by the Tribunal, shall have the power –

- (a) to carry on the business of the company so far as may be necessary for the beneficial winding up of the company;
- (b) to do all acts and to execute, in the name and on behalf of the company, all deeds, receipts and other documents, and for that purpose, to use, when necessary, the company's seal;
- (c) to sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels;
- (d) to sell the whole of the undertaking of the company as a going concern;
- (e) to raise any money required on the security of the assets of the company;
- (f) to institute or defend any suit, prosecution or other legal proceeding, civil or criminal, in the name and on behalf of the company;
- (g) to invite and settle claim of creditors, employees or any other claimant and distribute sale proceeds in accordance with priorities established under this Act;
- (h) to inspect the records and returns of the company on the files of the Registrar or any other authority;
- (i) to prove rank and claim in the insolvency of any contributory for any balance against his estate, and to receive dividends in the insolvency, in respect of that balance, as a separate debt due from the insolvent, and rateably with the other separate creditors;
- (j) to draw, accept, make and endorse any negotiable instruments including cheque, bill of exchange, hundi or promissory note in the name and on behalf of the company, with the same effect with respect to the liability of the company as if such instruments had been drawn, accepted, made or endorsed by or on behalf of the company in the course of its business;
- (k) to take out, in his official name, letters of administration to any deceased contributory, and to do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate which cannot be conveniently done in the name of the company, and in all such cases, the money due shall, for the purpose of enabling the Company Liquidator to take out the letters of administration or recover the money, be deemed to be due to the Company Liquidator himself;
- (l) to obtain any professional assistance from any person or appoint any professional, in discharge of his duties, obligations and responsibilities and for protection of the assets of the company, appoint an agent to do any business which the Company Liquidator is unable to do himself;
- (m) to take all such actions, steps, or to sign, execute and verify any paper, deed, document, application, Petition, affidavit, bond or instrument as may be necessary, –
  - (i) for winding up of the company;
  - (ii) for distribution of assets;
  - (iii) in discharge of his duties and obligations and functions as Company Liquidator; and
- (n) to apply to the Tribunal for such orders or directions as may be necessary for the winding up of the company.

### **Professional Assistance to Company Liquidator**

The Company Liquidator may, with the sanction of the Tribunal, appoint one or more chartered accountants or company secretaries or cost accountants or legal practitioners or such other professionals on such terms and



conditions, as may be necessary, to assist him in the performance of his duties and functions under this Act. [Section 291(1)]

Any person appointed under this section shall disclose forthwith to the Tribunal in the prescribed form any conflict of interest or lack of independence in respect of his appointment. [Section 291(2)]

### **Exercise and Control of Company Liquidator's Power**

Sub-section (1) of section 292 lays down that subject to the provisions of this Act, the Company Liquidator shall, in the administration of the assets of the company and the distribution thereof among its creditors, have regard to any directions which may be given by the resolution of the creditors or contributories at any general meeting or by the advisory committee.

Any directions given by the creditors or contributories at any general meeting shall, in case of conflict, be deemed to override any directions given by the advisory committee. [Section 292(2)]

The Company Liquidator –

- (a) may summon meetings of the creditors or contributories, whenever he thinks fit, for the purpose of ascertaining their wishes; and
- (b) shall summon such meetings at such times, as the creditors or contributories, as the case may be, may, by resolution, direct, or whenever requested in writing to do so by not less than one-tenth in value of the creditors or contributories, as the case may be. [Section 292(3)]

Any person aggrieved by any act or decision of the Company Liquidator may apply to the Tribunal, and the Tribunal may confirm, reverse or modify the act or decision complained of and make such further order as it thinks just and proper in the circumstances. [Section 292(4)]

### **Books to be kept by Company Liquidator**

The Company Liquidator shall keep proper books in such manner, as may be prescribed, in which he shall cause entries or minutes to be made of proceedings at meetings and of such other matters as may be prescribed. [Section 293(1)]

Any creditor or contributory may, subject to the control of the Tribunal, inspect any such books, personally or through his agent. [Section 293(2)].

### **Audit of Company Liquidator's accounts**

The Company Liquidator shall maintain proper and regular books of account including accounts of receipts and payments made by him in such form and manner as may be prescribed. [Section 294(1)]

The Company Liquidator shall, at such times as may be prescribed but not less than twice in each year during his tenure of office, present to the Tribunal an account of the receipts and payments as such liquidator in the prescribed form in duplicate, which shall be verified by a declaration in such form and manner as may be prescribed. [Section 294(2)]

The Tribunal shall cause the accounts to be audited in such manner as it thinks fit, and for the purpose of the audit, the Company Liquidator shall furnish to the Tribunal with such vouchers and information as the Tribunal may require, and the Tribunal may, at any time, require the production of, and inspect, any books of account kept by the Company Liquidator. [Section 294(3)]

When the accounts of the company have been audited, one copy thereof shall be filed by the Company Liquidator with the Tribunal, and the other copy shall be delivered to the Registrar which shall be open to inspection by any creditor, contributory or person interested. [Section 294(4)]

Where an account referred to in sub-section (4) relates to a Government company, the Company Liquidator shall forward a copy thereof –

- (a) to the Central Government, if that Government is a member of the Government company; or
- (b) to any State Government, if that Government is a member of the Government company; or
- (c) to the Central Government and any State Government, if both the Governments are members of the Government company. [Section 294(5)]

The Company Liquidator shall cause the accounts when audited, or a summary thereof, to be printed, and shall send a printed copy of the accounts or summary thereof by post to every creditor and every contributory:

Provided that the Tribunal may dispense with the compliance of the provisions of this sub-section in any case it deems fit. [Section 294(6)]

### **Payment of Debts by Contributory and Extent of Set-off**

The Tribunal may, at any time after passing of a winding up order, pass an order requiring any contributory for the time being on the list of contributories to pay, in the manner directed by the order, any money due to the company, from him or from the estate of the person whom he represents, exclusive of any money payable by him or the estate by virtue of any call in pursuance of this Act. [Section 295(1)]

The Tribunal, in making an order, under sub-section (1), may, –

- (a) in the case of an unlimited company, allow to the contributory, by way of setoff, any money due to him or to the estate which he represents, from the company, on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit; and
- (b) in the case of a limited company, allow to any director or manager whose liability is unlimited, or to his estate, such set-off. [Section 295(2)]

In the case of any company, whether limited or unlimited, when all the creditors have been paid in full, any money due on any account whatever to a contributory from the company may be allowed to him by way of set-off against any subsequent call. [Section 295(3)]

### **Power of Order Costs**

The Tribunal may, in the event of the assets of a company being insufficient to satisfy its liabilities, make an order for the payment out of the assets, of the costs, charges and expenses incurred in the winding up, in such order of priority inter se as the Tribunal thinks just and proper. [Section 298]

### **Power to Summon Persons Suspected of having Property of Company**

The Tribunal may, at any time after the appointment of a provisional liquidator or the passing of a winding up order, summon before it any officer of the company or person known or suspected to have in his possession any property or books or papers, of the company, or known or suspected to be indebted to the company, or any person whom the Tribunal thinks to be capable of giving information concerning the promotion, formation, trade, dealings, property, books or papers, or affairs of the company. [Section 299(1)]

The Tribunal may examine any officer or person so summoned on oath concerning the matters aforesaid, either by word of mouth or on written interrogatories or on affidavit and may, in the first case, reduce his answers to writing and require him to sign them. [Section 299(2)]

The Tribunal may require any officer or person so summoned to produce any books and papers relating to the company in his custody or power, but, where he claims any lien on books or papers produced by him, the

production shall be without prejudice to such lien, and the Tribunal shall have power to determine all questions relating to that lien. [Section 299(3)]

The Tribunal may direct the liquidator to file before it a report in respect of debt or property of the company in possession of other persons. [Section 299(4)]

If the Tribunal finds that –

- (a) a person is indebted to the company, the Tribunal may order him to pay to the provisional liquidator or, as the case may be, the liquidator at such time and in such manner as the Tribunal may consider just, the amount in which he is indebted, or any part thereof, either in full discharge of the whole amount or not, as the Tribunal thinks fit, with or without costs of the examination;
- (b) a person is in possession of any property belonging to the company, the Tribunal may order him to deliver to the provisional liquidator or, as the case may be, the liquidator, that property or any part thereof, at such time, in such manner and on such terms as the Tribunal may consider just. [Section 299(5)]

If any officer or person so summoned fails to appear before the Tribunal at the time appointed without a Reasonable cause, the Tribunal may impose an appropriate cost. [Section 299(6)]

Every order made under sub-section (5) shall be executed in the same manner as decrees for the payment of money or for the delivery of property under the Code of Civil Procedure, 1908 (5 of 1908). [Section 299(7)]

Any person making any payment or delivery in pursuance of an order made under sub-section (5) shall by such payment or delivery be, unless otherwise directed by such order, discharged from all liability whatsoever in respect of such debt or property. [Section 299(8)]

### **Examination of Promoters, Directors, etc.**

Upon the report of the Company stating that in his opinion a fraud has been committed by any person in the promotion, formation, business or conduct of affairs of the company since its formation, the Tribunal may, after considering the report, direct that such person or officer shall attend before the Tribunal on a day appointed by it for that purpose, and be examined as to the promotion or formation or the conduct of the business of the company or as to his conduct and dealings as an officer thereof. [Section 300]

(2) The Company Liquidator shall take part in the examination, and for that purpose he or it may, if specially authorised by the Tribunal in that behalf, employ such legal assistance as may be sanctioned by the Tribunal.

(3) The person shall be examined on oath and shall answer all such questions as the Tribunal may put, or allow to be put, to him.

(4) A person ordered to be examined under this section—

- (a) shall, before his examination, be furnished at his own cost with a copy of the report of the Company Liquidator; and
- (b) may at his own cost employ chartered accountant or company secretaries or cost accountant or legal practitioners entitled to appear before the Tribunal under section 432, who shall be at liberty to put to him such questions as the Tribunal may consider just for the purpose of enabling him to explain or qualify any answers given by him.

### **Arrest of Person trying to Leave India or Abscond**

The Tribunal, if satisfied that a contributory or a person having property, accounts or papers of the company in his possession is about to leave India or otherwise to abscond, or is about to remove or conceal any of his property, for the purpose of evading payment of calls or of avoiding examination respecting the affairs of the company, the Tribunal may cause the contributory to be detained until such time as the Tribunal may order; and

his books and papers and movable property to be seized and safely kept until such time as the Tribunal may think fit. [Section 301]

### Dissolution of Company by Tribunal

When the affairs of a company have been completely wound up, the Company Liquidator shall make an application to the Tribunal for dissolution of such company. [Section 302(1)]

The Tribunal shall on an application filed by the Company Liquidator under sub-section (1) or when the Tribunal is of the opinion that it is just and reasonable in the circumstances of the case that an order for the dissolution of the company should be made, make an order that the company be dissolved from the date of the order, and the company shall be dissolved accordingly. [Section 302(2)]

A copy of the order shall, within thirty days from the date thereof, be forwarded by the Company Liquidator to the Registrar who shall record in the register relating to the company a minute of the dissolution of the company. [Section 302(3)]

If the Company Liquidator makes a default in forwarding a copy of the order within the period specified in sub-section (3), the Company Liquidator shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues. [Section 302(4)]

### Case Law

In *Mathew Phillips v. Malayalam Plantation Ltd* Court, two companies, Malayalam Plantations (India) Ltd. and Harrisons and Crossfield (India) Ltd. evolved a scheme of amalgamation. They filed petitions in this court under Section 391 of the Companies Act, 1956, for a direction to convene separate meetings of the shareholders of the companies. Court differentiated between amalgamation and dissolution. Court held that the position in dissolution need not be identical as in amalgamation. The word “dissolution” as used in the Companies Act has a perceptible connotation. Section 481 of the Companies Act, 1956 contains what is “dissolution of company”. It reads thus :

**“481. Dissolution of company.”**—(1) When the affairs of a company have been completely wound up or when the court is of the opinion that the liquidator cannot proceed with the winding up of a company for want of funds and assets or for any other reason whatsoever and it is just and reasonable in the circumstances of the case that an order of dissolution of the company should be made, the court shall make an order that the company be dissolved from the date of the order, and the company shall be dissolved accordingly.”

There are three contingencies for dissolution of company:

- 1) When company has been completely wound-up.
- 2) When the court is of the opinion that liquidator cannot proceed with the winding up of company for funds and assets.
- 3) When court is of the opinion that liquidator cannot proceed with the winding up for any other reason. In such contingency court can order dissolution of company.

### Fraudulent Preference

Section 328 of the Companies Act, 2013 deals with fraudulent preference. Sub-section (1) of section 328 provides that where a company has given preference to a person who is one of the creditors of the company or a surety or guarantor for any of the debts or other liabilities of the company, and the company does anything or suffers anything done which has the effect of putting that person into a position which, in the event of the company going into liquidation, will be better than the position he would have been in if that thing had not been done prior to six months of making winding up application, the Tribunal, if satisfied that, such transaction is a fraudulent preference may order as it may think fit for restoring the position to what it would have been if the company had not given that preference.

According to sub-section (2), if the Tribunal is satisfied that there is a preference transfer of property, movable or immovable, or any delivery of goods, payment, execution made, taken or done by or against a company within six months before making winding up application, the Tribunal may order as it may think fit and may declare such transaction invalid and restore the position.

### **Liabilities and Rights of certain Persons Fraudulently Preferred**

Where a company is being wound up and anything made, taken or done after the commencement of this Act is invalid under section 328 as a fraudulent preference of a person interested in property mortgaged or charged to secure the company's debt, then, without prejudice to any rights or liabilities arising, apart from this provision, the person preferred shall be subject to the same liabilities, and shall have the same rights, as if he had undertaken to be personally liable as a surety for the debt, to the extent of the mortgage or charge on the property or the value of his interest, whichever is less. [Section 331(1)]

(2) The value of the interest of the person preferred under sub-section (1) shall be determined as at the date of the transaction constituting the fraudulent preference, as if the interest were free of all encumbrances other than those to which the mortgage or charge for the debt of the company was then subject. [Section 331(2)]

(3) On an application made to the Tribunal with respect to any payment on the ground that the payment was a fraudulent preference of a surety or guarantor, the Tribunal shall have jurisdiction to determine any questions with respect to the payment arising between the person to whom the payment was made and the surety or guarantor and to grant relief in respect thereof, notwithstanding that it is not necessary so to do for the purposes of the winding up, and for that purpose, may give leave to bring in the surety or guarantor as a third party as in the case of a suit for the recovery of the sum paid. [Section 331(3)]

(4) The provisions of sub-section (3) shall apply *mutatis mutandis* in relation to transactions other than payment of money. [Section 331(4)]

### **Companies (Winding-Up) Rules, 2020**

Ministry of Corporate Affairs notified Companies (Winding-Up) Rules, 2020 through Notification No. G.S.R. 46(E) on 24th January, 2020. These rules shall apply to winding-up under the Companies Act 2013. These rules will come into force from 1st April, 2020.

The Rules are applicable to companies going into winding-up for the circumstances mentioned under section 271 as well as summary procedure for liquidation under section 361 of the Companies Act, 2013. The Rules have been divided into 6 parts comprising of 191 rules and 95 forms.

'Winding-up Rules' among other things provide for summary procedure for winding-up of companies having specified thresholds. The winding-up of companies falling within the specified thresholds will henceforth require the approval of the Central Government instead of the National Company Law Tribunal (NCLT).

Notification of these rules is expected to reduce the burden at the level of NCLT as summary procedure for liquidation can now be filed with the Central Government.

Currently, the proceedings pertaining to voluntary winding up and winding up on the grounds of inability to pay debts are governed by the Insolvency and Bankruptcy Code 2016, which provides for time-bound speedy dissolution of a company.

However, winding-up proceedings on the ground other than inability to pay debts continued to be governed by the Companies (Court) Rules, 1959 which were notified nearly 60 years ago by the Supreme Court and required suitable amendments in view of the notification of the Companies Act, 2013 and the Insolvency and Bankruptcy Code, 2016.

An important feature of these rules is the summary procedure for liquidation introduced through Part V. An important factor for such summary winding-up is that the Central Government will provide required approvals to such companies for the normal winding-up process which is otherwise undertaken through the NCLT, thereby reducing the burden on NCLT and greatly shortening the overall winding-up timelines.

### Summary Procedure for Liquidation

These rules allow following classes of companies to close their business by making a winding-up application to Central Government without going to NCLT.

Companies accepting deposit and having total outstanding deposits	Upto ₹25 Lacs*
Companies having total outstanding loan including secured loan	Upto ₹50 Lacs*
Companies having total turnover	Upto ₹50 Crores*
Companies with paid-up capital	Upto ₹1 Crore*

\*based on latest audited balance sheet

- In addition, Companies having book value of assets upto ₹1 Crore (currently specified under section 361(1)(i)) of the Companies Act, 2013, can also approach Central Government for liquidation.
- The provisions of the Rules related to filing and audit of the Company Liquidator's accounts and its procedure (Rule 91 to 99 of the Rules) and disposing of assets (Rule 165 to 167 of the Rules) shall be applicable to above class of companies with modification that the word 'Tribunal' shall be considered as 'Central Government'.

Other procedural aspects are as under:

- The Rules lay down the process for meeting of creditors and contributories of the company, and specify the scenarios in which creditors can vote.
- The Rules make it necessary for all the money lying in the bank account of Company Liquidator which is not immediately required for the purposes of winding up, to be invested in government securities or in interest bearing deposits in any scheduled bank.
- The Rules lay down the procedure for maintenance of registers and books of accounts by the Company Liquidator.
- The Rules also outline the procedure for creditors to prove their debts and claims against the company and if the proof of such debt gets rejected by the Company Liquidator, there is also a provision and process for creditor to make an appeal to Tribunal.

### LESSON ROUND UP

- The main purpose of winding-up of a company is to realize the assets and pay the debts of the company expeditiously and fairly in accordance with the law.
- The Insolvency and Bankruptcy Code, 2016 has made significant amendments to provisions relating to winding-up in the Companies Act, 2013.
- Winding-up means winding-up under Companies Act, 2013 or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable.
- The Companies Act, 2013 shall continue to govern winding-up of companies on various other grounds excluding inability to pay debts, which shall be dealt under the Insolvency and Bankruptcy Code, 2016.



(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

- [illegible]



**PROFESSIONAL PROGRAMME**

**CORPORATE RESTRUCTURING, INSOLVENCY,  
LIQUIDATION & WINDING-UP**

**PP-CRILW**

**TEST PAPER**

**WARNING**

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

“27. Suspension and cancellation of examination results or registration.

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as student, or debar him from re-registration as a student, or take such action as may be deemed fit.

## PROFESSIONAL PROGRAMME

### CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

*(This Test Paper is for recapitulation and practice for the students. Students need not to submit responses/ answers to this test paper to the Institute.)*

*Time Allowed: 3 hours*

*Maximum Mark: 100*

#### PART II (50 Marks) (Insolvency, Liquidation and Winding-up)

4. (a) Describe in brief the need and objective for enacting the Insolvency and Bankruptcy Code, 2016. Mention salient features of the Code. (5 marks)
- (b) Explain in brief the institutional set-up under the Insolvency and Bankruptcy Code, 2016. (5 marks)
- (c) What do you understand by Committee of Creditors (CoC)? State the modalities for conducting meetings of the CoC. (5 marks)
- (d) Insolvency and Bankruptcy Code, 2016 has prescribed Insolvency Resolution Process for corporate persons for the resolution of insolvency in a time bound manner. Explain the steps involved in brief. (5 marks)
5. (a) There are certain events that trigger initiation of Liquidation Process for corporate persons under the Insolvency and Bankruptcy Code, 2016. Discuss.
- (b) Explain in brief 'Voluntary Liquidation' of corporate persons under the Insolvency and Bankruptcy Code, 2016?
- (c) State the circumstances under which a company may be wound-up by the Tribunal (NCLT) under the Companies Act, 2013. (5 marks each)
6. (a) What is an Asset Reconstruction Company (ARC)? What measures it can take for the purpose of asset reconstruction under the SARFAESI Act, 2002?
- (b) What are the elements identified as key to conduct of cross-border insolvency cases under the UNCITRAL Model Law on Cross Border Insolvency?
- (c) Resolution Professional (RP) under the Insolvency and Bankruptcy Code, 2016 has onerous responsibility to balance the interest of all parties involved in the insolvency resolution process. State the duties of RP under the Code. (5 marks each)

OR

- 6A.(i) What is securitisation? How has the SARFAESI Act, 2002 empowered the banks and financial institutions?
- (ii) Describe six basic types of bankruptcy situations dealt with under the US Bankruptcy Code.
- (iii) What is Fresh Start Process? State the eligibility conditions for making an application for fresh start process. (5 marks each)