

SAMVĀD: PARTNERS

INSOLVENCY AND BANKRUPTCY CODE, 2016

THE TRANSFORMATION PROCESS

Ekta Bahl

23 March 2017

Context

- Insolvency and Bankruptcy Code, 2016 came into effect for insolvency resolution and liquidation of corporate persons as of December 1, 2016.
- Additional provisions were brought into force on December 15, 2016
- Some provisions are yet to be notified/ Rules yet to be framed (e.g. Information Utilities, Individuals and Partnerships)

What does the Code Replace?

➤ **Sick Industrial Companies (Special Provisions) Act, 1985**

- repealed with effect from December 1, 2016 and all proceedings under SICA stand abated.
- SICA proceedings are not automatically transferred for consideration under the Code, but company whose proceeding stands abated may file an application within 180 days of the Code coming into effect.

➤ **Winding up Proceedings under the Companies Act**

- *Creditors can no longer file new winding up petitions under the Companies Act on the grounds that a company is unable to pay its debts.*
- Other grounds for filing under amended Section 271 of Companies Act, 2013 will continue.

➤ **What happens to pending winding up proceedings?**

- *Companies (Transfer of Pending Proceedings) Rules, 2016* – All winding up petitions relating to winding up on grounds of inability to pay debts pending before a high court and where notice has not yet been served on the respondent, will be transferred to the bench of the NCLT having territorial jurisdiction and shall be considered an application under the Code.

➤ **Voluntary Winding up -**

- Part II, Chapter V of the Code deals with Voluntary liquidation of corporate persons, but yet to be notified.
- Until then, voluntary winding up petitions will continue to be dealt with in accordance with the Companies Act, 1956

And what continues as before...

- **Debt Recovery Proceedings in DRTs under Recovery of Debt Due to Banks and Financial Institutions Act, 1993** – debt recovery mechanism available to banks and financial institutions
- **Security enforcement actions under SARFAESI** – allows secured creditors to enforce security without intervention of a court.
- **Non-statutory mechanisms – Credit Debt Restructuring, Strategic Debt Restructuring, etc.**

Brief Overview

- Any creditor or the corporate debtor itself may file an application for insolvency resolution under the IBC.
- The trigger for filing an application is the occurrence of a payment default (defined as non-payment of a debt on its due date) of an amount of not less than INR 1,00,000. In the case of individuals and partnership firms, the minimum default amount is limited to INR 1,000.
- In the case of financial debt, a financial creditor, such as a bank, a non-banking financial institution or a debenture trustee, may file an application immediately upon a default occurring, provided that the information on the default is available in the records of an information utility or the applicant provides some other acceptable proof of non-payment.
- In the case of operational debt – debt owed to suppliers, vendors, payments owed to employees, etc. – the operational creditor will need to deliver a demand notice to the debtor. If the debtor fails to either pay the unpaid dues or prove the existence of a dispute on the debt payment within 10 days of the demand notice, the operational creditor may file an application for insolvency resolution.

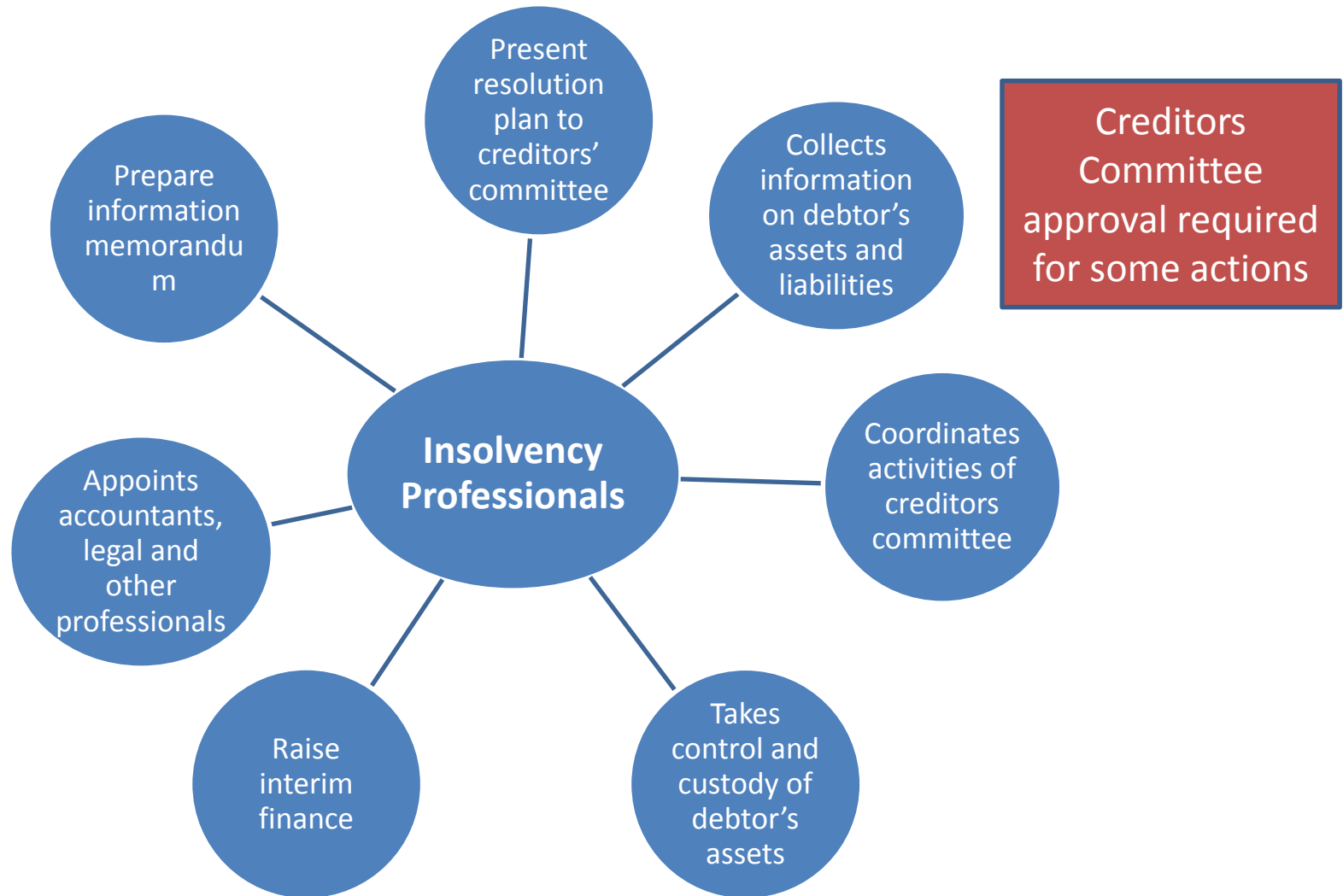
However, these provisions that allow for early detection could potentially result in triggering insolvency resolution in situations where a corporate entity has inadvertently failed to satisfy a liability or if the same was on account of external factors that would be remedied in the near future.

Brief Overview

Once an application for insolvency resolution has been filed and accepted by the NCLT, two things happen:

- **Moratorium**: A 180-day moratorium comes into place during which time all pending actions against the debtor are stayed and no new actions may be initiated. During the moratorium period, the debtor will also be prevented from disposing of its assets out of the ordinary course. The idea behind this moratorium is to provide a calm period for the debtor and creditors to discuss their future course of action, without having to deal with individual enforcement actions by creditors, which could lead to asset stripping and chaos. The impact of such a provision on creditor rights is still to be examined and ascertained. An important point to note is that Section 14(1)(c) of the IBC makes it clear that during the IRP, the IBC takes precedence over debt recovery laws and security enforcement actions under SARFAESI. In other words, no new SARFAESI actions may be commenced and any existing ones would have to be suspended during the moratorium period.
- **Appointment of an Insolvency Professional**: The control of the business shifts to the committee of creditors. An insolvency resolution professional is appointed to manage the business of the debtor on behalf of the committee of creditors with a view to preserving its assets to the maximum extent possible and to coordinate the actions of the committee of creditors. The resolution professional will also need to prepare an information memorandum on the debtor's business and financial condition to assist creditors in drawing up a resolution plan. The success of this approach will rest on the effectiveness and experience of insolvency professionals in performing these functions as well as the ability of the Insolvency Professional to manage conflicts of interest.

Corporate Insolvency Resolution Process



Brief Overview

- One of the key features of the IBC is the time-bound process that it offers for insolvency resolution. Subject to a one time 90-day extension in exceptional cases, the IRP must end in 180 days. By the end of the 180-day period, the committee of creditors needs to have approved the resolution plan for the debtor, failing which the company goes into liquidation. Approval of the resolution plan requires the vote of 75% in value of the financial creditors (both secured and unsecured).

Date of Filing of the Application	0
Admission/Rejection of Application	[0+14] = T1
Appointment of IRP	[T1+14] = T2
Public Announcement	[T2+3] = T3
Appointment of Registered Valuer	[T2+7] = T4
Creditors to submit claims	[T4+15] = T5
IRP to constitute creditors committee and submit report	[T2+30] = T6
Creditors Committee Meeting	[T6+7] = T7
Preparation of Information Memorandum	[T7+14] = T8
Submission of Resolution Plan	[T1+150] = T9
Approval by Creditors Committee	-
Submission of Resolution Plan to NCLT	-
Approval/Rejection of the Resolution Plan	T1+180

- However, it remains to be seen whether the strict timelines stipulated in the IBC will be followed by all parties concerned, including the NCLT. Given the work load of the NCLT, one can already see the stretching of the timelines.

Brief Overview

- Another feature to note is the IBC's attempt to limit the discretion and role of the NCLT in the insolvency resolution process. The contents of the resolution plan are left entirely up to the business decision of the committee of creditors, with the NCLT's role being limited to ensuring that the process for approval was followed and that the resolution plan does not violate the provisions of the IBC or other laws.
- If 75% in value of the financial creditors **do not approve** the resolution plan or if they vote affirmatively to put the debtor into liquidation, **the NCLT is required pass a liquidation order**. It remains to be seen as to whether the NCLT would give more time for approving a resolution plan. NCLT also has the power to reject a resolution plan on a technicality.
- If certain preferential transactions have been entered into with creditors, sureties or guarantors, or if undervalued transactions have been entered into other than in the ordinary course of business within 1 year prior to the Insolvency Commencement Date (2 years prior for related party transactions), the transactions can be set aside or . NCLT can require the buyer to pay additional consideration. Extortionate credit transactions involving the receipt of financial or operational debt 2 years before the Insolvency Commencement Date can also be avoided if the terms of such transactions require the debtor to make exorbitant payments.

Brief Overview

- If during the corporate insolvency resolution process or a liquidation process, it is found that any business of the corporate debtor has been carried on with intent to defraud creditors of the corporate debtor or for any fraudulent purpose, the NCLT may on the application of the IRP pass an order that any persons who were knowingly parties to the carrying on of the business in such manner shall be liable to make such contributions to the assets of the corporate debtor as it may deem fit. (S. 66). Further, the NCLT may direct a director or partner to be **“liable to make such contribution to the assets of the corporate debtor as it may deem fit, if –**
 - (a) Before the insolvency commencement date, such director or partner knew or ought to have known that there was no reasonable prospect of avoiding the commencement of a corporate insolvency resolution process in respect of such corporate debtor; and**
 - (b) Such director or partner did not exercise due diligence in minimising the potential loss to the creditors of the corporate debtor.”**
- Piecemeal implementation of the IBC and failure to make necessary amendments to the other laws could result in delays or finding loopholes in the IBC.

Brief Overview

- The biggest challenge in getting the IBC off the ground would be to develop robust institutional framework and a strong cadre of insolvency professionals required to implement the new law. However, there are also some areas that the law fails to address:

(a) Cross-Border Insolvency: The IBC does not adequately address the issues that would arise when a debtor has assets or creditors in jurisdictions outside India. The IBC does not discriminate between domestic and foreign creditors, and creditors who may be resident outside of India are permitted to commence and participate in proceedings under the IBC. However, the IBC does not provide any mechanisms by which an insolvency resolution professional or liquidator may access a debtor's assets located abroad other than to state that the Central Government may enter into bilateral agreements with other countries to deal with cross border insolvency issues. The new law also fails to address what happens if insolvency proceedings against a debtor are commenced concurrently in more than one jurisdiction.

(b) Inter-play with Debt Recovery Laws and the Corporate Debt Restructuring Process (“**CDR**”): The interplay of the IBC with debt recovery laws such as SARFAESI and the RDDBFI Act have not been fully addressed. There is an inherent tension between a statute that provides for collective insolvency resolution such as the IBC and debt recovery laws that enable individual creditors to enforce their security interests or recover their debt. However, for an insolvency regime to function effectively, there needs to be a clear delineation between these two types of laws. Amendments to the SARFAESI and RDDBFI Acts⁶ are currently being considered by the same Joint Parliamentary Committee that considered the IBC and it is hoped that these amendments would make the relationship between the IBC and debt recovery laws more seamless. Another issue on which the IBC is silent is the relationship of the IBC to out-of-court restructuring mechanisms such as CDR. For example, does an ongoing CDR process get suspended if an application for IRP is filed?

Conclusion

- Notification of the remaining provisions of the Code and amending all the other related laws
- Plugging in loopholes/Judicial interpretation
- Increasing the number of benches of the NCLT
- Capacity and skillset of the Insolvency Professionals
- Establishment of the Information Utilities
- Approach of the disputing parties (financial vs. operator)
- Identification of roadblocks for sticking to timelines
- Harshness of the outcome
- Past Transactions
- Cross-Border Transactions
- Personal liability

THANK YOU