

## **The Insolvency and Bankruptcy Code 2016 – An Overview**

The Insolvency and Bankruptcy Code, 2016 (the “Code”) received the President’s assent on May 28, 2016 and was notified in the official gazette soon after, towards establishing a much-needed modern framework for dealing with the insolvency and bankruptcy of corporate entities and natural persons in India and for creating a hospitable environment for investment and restructuring.

Prior to the adoption of the Code, the bankruptcy and insolvency scenario in India was governed by a slew of legislations – (i) The Companies Act, 1956 (as related provisions of the Companies Act, 2013 are yet to be notified); (ii) The Recovery of Debts Due to Banks and Financial Institutions Act, 1993; (iii) The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; (iv) The Presidency Towns Insolvency Act, 1909; (v) The Provincial Insolvency Act, 1920; (vi) The Partnership Act, 1932 dealt with by forums such as the Debts Recovery Tribunal and company courts. The erstwhile legal framework was saddled with jurisdictional and interpretation issues making the debt recovery process a virtual nightmare.

The introduction of the Code seems to be a step in the right direction towards streamlining bankruptcy and insolvency laws into one comprehensive and unified law for all debtors, including companies, unlimited liability partnerships, limited liability partnerships (LLPs), individuals and other entities, as and when notified by the central government. Towards this objective, the Code will have the effect of amending many of the other aforementioned existing statutes and repeal the archaic ‘The Presidency Towns Insolvency Act, 1909’ and ‘The Provincial Insolvency Act, 1920’.

Set out below are some of the highlights of the Code:

### **Corporate Insolvency:**

**Process:** The Code prescribes a 180-day time period for the resolution of insolvency proceedings and an extension of 90 days for the same only on the agreement of more than 75% of the creditors by debt owed. The creditors and the debtors on application have the ability to fast track an insolvency application to 90 days. The insolvency process prescribed under the Code involves: a) the filing of the insolvency application by the debtor(s) or the creditor(s) before the National Company Law Tribunal (“NCLT”) where the minimum amount of default is Rs. 1,00,000/-; b) public announcement; c) appointment of interim licensed insolvency professionals (“IPs”) whose appointment is confirmed by a committee of creditors; d) submission of a resolution plan by the debtors with a roadmap including the repayment schedule; and e) acceptance or rejection of the resolution plan by the adjudicating authority.

Till such time as the NCLT is established the insolvency applications shall be handled by the company court bench(es) of the respective high courts. With the issue on the constitutional validity of the NCLT being put to rest by the Constitutional Bench of the Hon’ble Supreme Court in the case of *Madras Bar Association vs. Union of India & ANR (AIR2015SC1571)*, it is just a matter of time before the NCLT is constituted.

**Distribution of Proceeds:** If the debtor's resolution plan is rejected, the adjudicating authority shall order the liquidation of the debtor and appoint a liquidator to take charge of the debtor's assets and affairs. The liquidator shall form a liquidation trust comprising of all of the debtor's assets and act as the fiduciary trustee of the trust for the benefit of the creditors. After an extensive valuation of all the claims against the debtor, the following waterfall of the liquidation proceeds has been prescribed by the Code: (i) insolvency resolution process costs; (ii) dues owed to secured creditors; (iii) dues owed to workers for a 24-month period preceding the date on which liquidation was commenced (on par with dues owed to secured creditors); (iv) dues owed to other employees who are not workers for a 12-month period preceding the date on which liquidation was commenced; (v) dues owed to unsecured creditors; (vi) dues owed to any state government or central government; (vii) dues owed to a secured creditor for any unpaid amount following enforcement of the security (on par with dues owed to any state government or the central government); (viii) any remaining debts; (ix) preference shareholders; and (x) equity shareholders or partners. This is a remarkable shift from the erstwhile regime, under which some of the dues owed to the government and statutory dues took precedence over the dues owed to secured creditors and preference shareholders.

### **Individual and Partnership Insolvency:**

**Process:** The insolvency process prescribed by the Code involves: a) the filing of the insolvency application by an individual, partnership firm or a creditor before the Debts Recovery Tribunal (“DRT”); b) the application will have to be admitted by the DRT; c) on admission the DRT shall appoint an IP, who shall submit a report to the DRT either accepting or rejecting the debtor’s application; e) the IPs shall request the creditors to meet and vote on the repayment plan submitted by the debtor; f) the IP shall then submit a report to the DRT based on basis of which DRT may implement the repayment plan as approved by the creditors; and g) the DRT may on the basis of the repayment plan pass an order for early discharge of the debtor from the proceedings or for discharge on complete implementation of the repayment plan.

**Fresh Start:** As part of the insolvency process only individuals and partnerships firms exclusively enjoy these pre-cursors to the bankruptcy processes, by applying to be discharged from liability to repay debts. Some of the key parameters for successfully applying for a ‘fresh start’ is that the debtor's (i) gross annual income should not exceed Rs. 60,000; (ii) aggregate value of the assets should not be less than Rs. 25,000/-; and (iii) aggregate value of the qualifying debts should not exceed Rs. 35,000/-. In the insolvency resolution process, the creditors and the debtors shall engage in negotiations to arrive at an agreeable repayment plan, supervised by an IP.

**Bankruptcy:** In the event that the DRT does not accept an insolvency resolution process or fresh start proposal, or if the debtor fails to adhere to its repayment schedule, the debtor or creditor may jointly or individually apply to have the debtor declared bankrupt before the adjudicating authority. In which case the DRT will appoint a bankruptcy trustee, issue a public notice inviting claims subsequent to which a list of creditors and claims shall be prepared and the DRT shall pass the bankruptcy order. Once the bankruptcy order is passed, the estate shall vest with the bankruptcy trustee who shall administer and distribute the proceeds to the creditors as follows: (i) costs and expenses incurred by the bankruptcy

process; (ii) dues owed to workers for a 24-month period preceding the date on which bankruptcy was commenced (on par with dues owed to secured creditors); (iii) dues owed to other employees who are not workers for a 12-month period preceding the date on which bankruptcy was commenced; (iv) dues owed to any state government or central government; and (v) all debts and dues owed by bankrupt including unsecured debts.

#### Professional and Bodies created under the Code:

The Code shall create the following set of professionals and bodies for its smooth implementation:

- new class of licensed IPs, who will have to be members of Insolvency Professional Agencies (IPAs);
- Information Utilities (IUs), who shall collect, collate and disseminate financial information about debtors to prevent serial defaulters from abusing the system and to facilitate insolvency resolution. As of now there is no clarity on the functioning mechanism of the IUs as the Code does not specify whether the IUs will maintain a centralized database where all the information in relation to a particular debtor can be sought at one go. That said the existence of IPs and IPAs shall definitely add professionalism and expertise to the proceedings by administering the resolution process, assets of the debtors and thereby ensuring that valuation information is provided to creditors in order to facilitate them in decision making.
- NCLT for the adjudication of corporate insolvency matters with appeals lying to the National Company Law Appellate Tribunal.
- DRT for the adjudication of individuals and unlimited liability partnership with appeals lying to the Debt Recovery Appellate Tribunal. The erstwhile process and system shall be required to be completely overhauled in order to ensure speedy adjudication of matters.
- The Insolvency and Bankruptcy Board of India (“**Board**”) will be established to regulate the functioning of IPs, IPAs and IUs and will consist of representatives from the Reserve Bank of India, and Ministries of Finance, Corporate Affairs and Law. Till the Board is set up, the central government will exercise the powers of the Board or designate any financial sector regulator with the powers and functions of the Board. The establishment of the Board shall strengthen the system, since it will act as a regulatory oversight body, supervising the functioning of IP, IPAs and IUs, and holding them accountable.
- An Insolvency and Bankruptcy Fund shall be set up and will receive grants from the central government, deposits from any person or any other source and shall be available to contributors if they face bankruptcy proceedings (up to the extent of their contribution). The Code is however not clear as to how the Fund will work and the manner in which the funds shall be utilized.

**ARA LAW View:** The streamlining of procedures, simplification of the insolvency process and fast-tracking of recovery is expected to have a positive effect on India's lending climate and the ease of doing business in India. The Code allows investors to exit from failing investments in a time-bound manner and without freezing funds in long drawn legal battles. The Code can also help in resolving India's bad debt problem, which has crippled bank lending and positioned India at rank 130 in the World Bank's Ease of Doing Business Index. In the wake of the Vijay Mallya's case, the importance of the Bankruptcy Code is paramount, as it provides for entering into cross-border treaties to confiscate overseas assets of willful defaulters and recover dues of banks. The Code will also strengthen the government's 'Make in India' initiative and growth campaigns as it reinforces investors' trust.

The most significant aspect of the Code is substituting the Official Liquidator's role with Insolvency Professionals and Agencies and NCLTs and DRTs. This move has drastic implications on the transparency and accountability of the system, thus repositioning it in entirety. The Official Liquidator route has proven to be a tedious and cumbersome one, with cases taking as long as 4 to 5 years at the very least, and easily stretching to a decade and more.

While the Code is ambitious in nature, with its vision of timely procedures, the success of the same depends on how well the regulators and parties adhere to the Code itself. It is a welcome legislation for investors and entrepreneurs alike, and has the potential to boost investments in India.