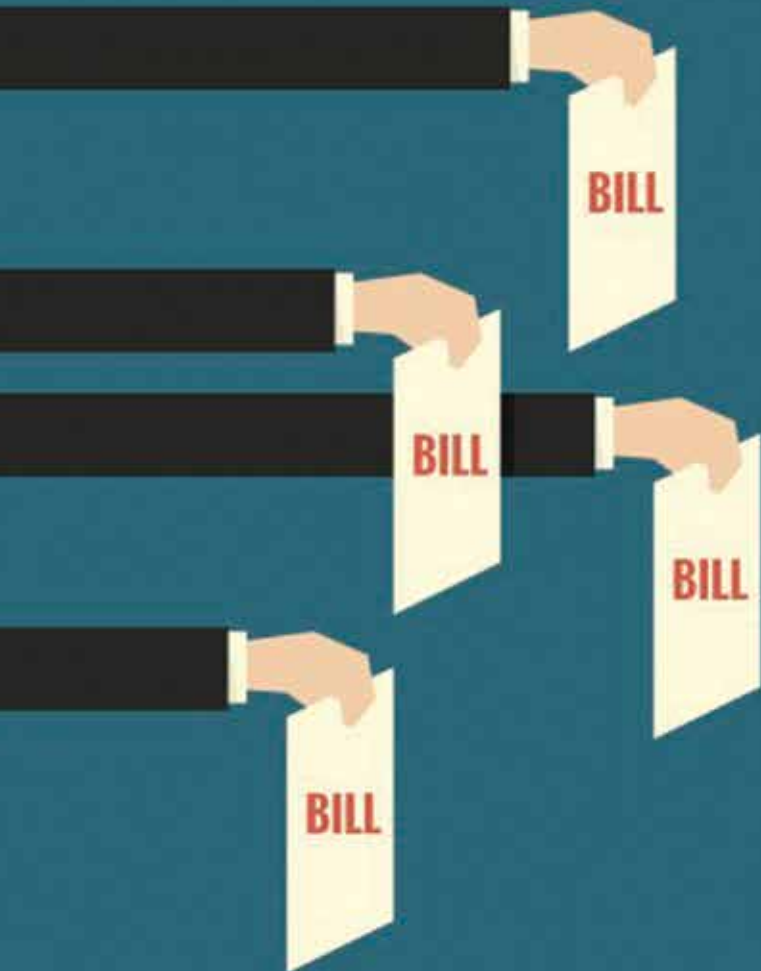


The Insolvency and BANKRUPTCY Code 2015





The Code is a long due overhaul of the insolvency and bankruptcy laws in India, and it comes as a timely encouragement for creditors and investors looking to explore opportunities to do business in India. On the flipside, perhaps the Code proposes far too many changes at the same time, which raise concerns on whether such drastic changes in practices, laws and procedures would be effective in a setup such as India's where changes to the legal system are predominantly hard to enforce.



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The introduction of the Insolvency and Bankruptcy Code, 2015 (the Code) in the Lok Sabha by Finance Minister Arun Jaitley on December 21, 2015 was greeted by unanimous applause and a sigh of relief from all stakeholders. The Code first surfaced over a year ago when the Finance Minister announced that the government hoped to overhaul the present setup of insolvency and bankruptcy laws in the country. Since then, the Bankruptcy Law Reforms Committee chaired by Dr. TK Viswanathan has worked tirelessly to put together the Code in its present form, and submitted its final report on November 4, 2015.

Although the introduction of the Code in the Lok Sabha is only the first step towards a simpler and faster recovery of debts for creditors, the Code has created much excitement amongst many quarters of the industry.

Present Predicament of Insolvency/Bankruptcy Laws In India

The problems stemming from the present legal regime for insolvency/ bankruptcy proceedings in India are multi-fold, some of which are as follows:

Fragmented System

The lack of consolidation and the complex inter-workings and incompatibilities between various statutes such as the Companies Act, 2013 (**Companies Act**); the Sick Industrial Companies (Special Provisions) Act, 1985 (**SICA**); Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (**RDDB Act**); Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (**SARFAESI Act**); the Presidency Towns Insolvency Act, 1909; the Provincial Insolvency Act, 1920 has resulted in a highly fragmented system which has led to complex issues of how the various statutes and the judicial forums these statutes have setup reconcile with one another. The result has been a slew of often conflicting judgements by various High Courts and the Supreme Court of India interpreting these statutes and how they interact with one another.

Outdated Procedures

The existing legal regime is also painfully out of sync with present day market realities, noticeably ineffective, laborious, long drawn; and ultimately hampers the ability to do business in India. Although secured creditors such as banks and financial institutions appear to have a safety net under the present legal regime in the form of the RDDB Act and the SARFAESI Act, it is also a fact that unsecured creditors comprise a large (if not larger) chunk of the lending in India when compared to secured creditors. The existing legal machinery and forums for even secured creditors such as banks and financial institutions does not work with any commendable degree of efficiency or success rate. Put together, such factors have resulted in India having one of the worst recovery rates in the world.

Outdated Bankruptcy Laws for Individuals

While the insolvency laws dealing with companies and institutional creditors such as banks and financial institutions have been revisited from time to time, the bankruptcy laws relating to other debtors such as individuals, unlimited liability partnerships and sole proprietorships has remained unchanged for nearly a hundred years. This has so often resulted in a scenario where the creditor can pursue a stronger action against the borrowing company but is left to resort to archaic methods and remedies against the individual promoters or the management of the company.

Ineffectiveness

It has not been the case that law makers have ignored the issue of more effective insolvency laws, but more a case of piecemeal additions to an already fragmented setup that has rendered the system ineffective when compared to recovery laws in other jurisdictions. For instance, the SICA was passed with the intent of providing failing industries

a last gasp chance to bail themselves out of insolvency proceedings so as to reduce the death of the companies facing credit crunch. However, the SICA has since been one of the most misused of the insolvency statutes as a flurry of references have been filed with the Board of Industrial and Financial Reconstruction seeking a stay on recovery and insolvency proceedings before other judicial forums. The SARFAESI Act came to be passed with the view of remedying the mischief that SICA was allowing for, but seeks to alleviate the problems only for banks and securitisation companies leaving scores of other creditors including unsecured creditors high and dry.

Paradigm Shift

The Code is touted as and is expected to be a game-changer in dealing with India's mounting arrears of recovery cases nationwide. The Code is also an important part of the incumbent NDA government's Ease of Doing Business in India narrative and introduces a number of changes to the present setup.

One Size Fits All

The consolidation of the present legal regime dealing with insolvency and bankruptcy proceedings in India under a single overarching legislation is arguably the greatest contribution of the Code. The Code is a comprehensive legislation and would govern the rights and liabilities of debtor entities including companies, limited liability partnerships (**LLP**), individuals and such other entities as may be notified by the Central Government of India from time to time. At the other end of the table, the Code would govern the rights and liabilities of all creditors – secured or unsecured, institutional or otherwise.

The Code also seeks to repeal the Presidency Towns Insolvency Act, 1909; the Provincial Insolvency Act, 1920 and make amendments to many of the existing statutes that govern insolvency proceeding such as the Companies Act, the RDDB Act and SICA and relevant rules and regulations passed under these statutes.

Dedicated Adjudicating Authorities

The Code designates and allocates insolvency proceedings to different judicial forums based on who the debtor is. The Adjudicating Authority (**AA**) for each kind of debtor is as follows:

- The National Company Law Tribunal (**NCLT**) as proposed to be constituted under Section 408 of the Companies Act for body corporates such as companies and limited liability partnerships; and
- The Debts Recovery Tribunals (**DRT**) constituted under Section 1A of the RDDB Act for individuals and unlimited liability partnerships.

Time-bound Corporate Recovery and Fresh Start

The Code proposes to introduce Corporate Insolvency Resolution Process (**CIRP**) for companies and LLPs, which

processes aim to consolidate the entire mechanism from filing of the proceedings for recovery of dues till dissolution of assets in the event the debtor is determined insolvent or bankrupt. In what is an unprecedented introduction to the recovery process, every CIRP is required to be decided by the concerned AA, which in case of corporate debtors would be the NCLT, in 180 days from the date of admission of the application to initiate CIRP, and extendable by another 90 days if more than 75% of the creditors agree to the extension of time. In addition, the Code also provides a fast-track option to complete the CIRP even faster in a span of 90 days.

In the case of individuals and unlimited liability partnership firms, a creditor may initiate the insolvency resolution process by filing an appropriate application before the concerned AA, i.e. the DRT. Particularly in the case of individual debtors, they have a right to what is termed as a “fresh start” under the Code. A fresh start is essentially an application by an individual debtor seeking to be discharged from the liability to repay the debts. However, the fresh start option is restricted to case where the gross annual income of the debtor does not exceed ₹60,000/- and the aggregate value of the qualifying debts of the debtor does not exceed ₹35,000/-.

Re-prioritisation in Liquidation

In the event the CIRP of a corporate debtor is unsuccessful and the AA is forced to bring the affairs of the corporate debtor to a close, a liquidator may be appointed to take charge of the assets and affairs of the corporate debtor. The liquidator shall then form a liquidation trust comprising of all assets of the corporate debtor and act as the fiduciary trustee of the liquidation trust for the benefit of the creditors.

In what is one of the most remarkable changes proposed by the Code, the age-old prioritisation of creditors for distribution of assets of a body corporate in liquidation has undergone a complete overhaul. Under the Code, the creditors would queue up in line for distribution of assets of the corporate debtor in the following order:

- Insolvency resolution process costs;
- Dues of secured creditors;
- Workmen's dues for a period of twelve months preceding the liquidation commencement date (at par with dues of secured creditors);
- Dues of other employees who are not workmen for a period of twelve months preceding the liquidation commencement date;
- Dues of unsecured creditors;
- Dues of any State Government or Central Government of India; and dues owed to a secured creditor for any unpaid amount following enforcement of security;
- Any remaining debts;
- Preference shareholders; and
- Equity shareholders or partners.

Insolvency Resolution Professional

The Code keenly involves “insolvency resolution professionals” and “insolvency resolution agencies”, who are engaged by the AAs in the insolvency resolution process (for body corporates, individuals and partnerships alike) to assist the AAs in making an accurate assessment of the health and status of the debtor before passing necessary orders. The insolvency resolution professional is required to prepare and submit a report on a meeting of the debtor's different creditors to the AA, and is required to co-ordinate and work with the creditors to assist in preparing the repayment/resolution plan.

Where do we go now?

The Insolvency and Bankruptcy Code, 2015 is long due overhaul of the insolvency and bankruptcy laws in India and it comes as a timely encouragement for creditors and investors looking to explore opportunities to do business in India. The Code addresses key concerns such as the long delay between initiation of recovery action and the liquidation or bankruptcy process which makes India a negative environment to do business in. Credit and investment are areas where trust and belief in the workings of the system play a crucial role and the Code looks to break new ground here.

The Code proposes to introduce novel changes to procedure and law to ensure that the present average creditor return rate of 20%¹ of the total dues increases to levels at par with other jurisdictions. The introduction of insolvency resolution professionals and agencies is yet another novel change proposed by the Code. Apart from closely working with creditors to try and arrive at a workable solution for recovery of the dues, the insolvency resolution professionals would also ensure that the existing assets of the debtor are not dissipated by alienation during the pendency of the insolvency resolution process.

On the flipside, the Code perhaps proposes far too many changes at the same time, which raise concerns on whether such drastic changes in practices, laws and procedures would be effective in a setup such as India's where changes to the legal system are predominantly hard to enforce. While one may argue for a piecemeal modernisation of the present regime, such an approach is bound to lead to hangovers of the previous regime, incorrect and ineffective application of the amendments, and ultimately further dilution of public trust in the system. While it is an admitted fact that the passing of the Code will also mean myriad amendments and repeal acts, once fully implemented, the Code is no doubt going to be among the more talked about initiatives of the legislature for years to come.

¹Please see “Executive Summary”, The Report of the Bankruptcy Law Reforms Committee Volume 1: Rationale and Design, available at http://www.finmin.nic.in/reports/BLRCReportVol1_04112015.pdf. Last visited January 19, 2015



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