

Insolvency and Bankruptcy Code, 2016



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Ease of Doing Business is an initiative of World Bank that provides objective measure of business regulations and their enforcement across 190 countries.

India's rank in World Bank – Ease of Doing Business, 2017



India ranks 136th among 190 countries in resolving insolvency parameter due to low recovery rate and time consuming insolvency resolution process.

Indicators	India	South Asia	OECD Countries
Recovery Rate	26%	33%	73%
Time (Years)	4.3	2.6	1.7

World Bank uses 10 objective parameters to measure the ease of doing business in respective countries. India fares poorly in most of them.

Parameter1	2017 Ranking	2016 Ranking
Overall	130	131
Starting a Business	155	151
Dealing with Construction Permits	185	184
Getting Electricity	26	51
Registering Property	138	140
Getting Credit	44	42
Protecting Minority Investors	13	10
Paying Taxes	172	172
Trading across Borders	143	144
Enforcing Contracts	172	178
Resolving Insolvency	136	135

Source: Ease of doing Business, World Bank Group

India aims to join top 50 in World Bank's Ease of Doing Business ranking and Government of India is addressing the parameters proactively on which the ranking is based. Introduction of Insolvency and Bankruptcy Code, 2016 is a step taken to address the insolvency and bankruptcy related challenges the country is facing.

The current Bankruptcy resolution mechanism in India is highly fragmented. Lack of clarity and certainty due to large number of legislations and non statutory guidelines have made recovery of debt a complex and time consuming process.

The Insolvency and Bankruptcy Code, 2016 seeks to consolidate the existing framework by creating a single law for bankruptcy and insolvency.

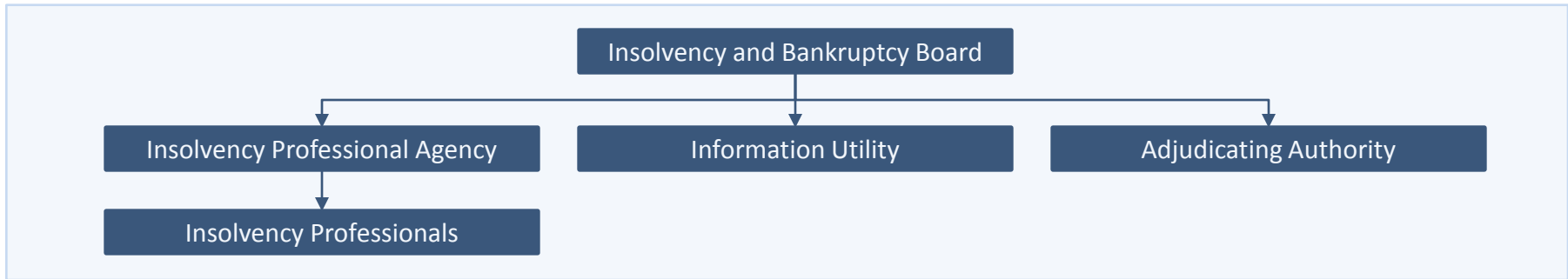
Existing Mechanisms

Companies Act, 2013
Companies Act, 1956
The recovery of debts due to banks and financial institutions act, 1993
SARFAESI Act, 2002
The Sick Industrial Companies (Special Provisions) Act, 1985
The Presidency Towns Insolvency Act, 1909
The Provincial Insolvency Act, 1920
CDR/SDR/S4A
ARC

New Mechanisms

The Insolvency and Bankruptcy Code, 2016

The Insolvency and Bankruptcy Code, 2016 will replace the existing laws pertaining to Insolvency and Bankruptcy



Insolvency and Bankruptcy Board (IBB)

- IBB is an apex body governing Insolvency and Bankruptcy Code.
- It will set up the necessary infrastructure and accredit Insolvency Professionals (IPs) and Information Utilities (IUs)

Insolvency Professionals (IPs)

- IPs are licenced professionals registered with Insolvency Professional Agencies who would act as resolution professional/ liquidator/bankruptcy trustee in an insolvency resolution process

Information Utilities

- Information Utilities would collect, store and distribute information related to the indebtedness of Companies

Insolvency Professional Agency

- Insolvency Professional Agencies (IPAs) would admit insolvency professionals as members
- Currently there are three IPAs
 - Indian Institute of Insolvency Professionals of ICAI
 - ICSI Insolvency Professional Agency
 - Insolvency Professional Agency of Institute of Cost Accountants of India

Adjudicating Authority

- Adjudicating Authority (AA) would have exclusive jurisdiction to deal with insolvency related matters.
- National Company Law Tribunal (NCLT) would be AA for Corporate and LLP insolvency
- Debt Recovery Tribunal (DRT) would be AA for individual or partnership insolvency



Exclusive Jurisdiction of Adjudicating Authority

Adjudicating Authority (NCLT and DRT) will have exclusive jurisdiction in insolvency related matters. No injunction can be granted by any court, tribunal or authority in respect to action taken by Adjudicating Authority.



Moving from “Erosion of net worth” to “Payment Default”

- The Sick Industrial Companies (Special Provision) Act, 1985 relied on erosion of net worth to determine sickness, the code prescribes payment default of more than INR 1 Lakh to assess the insolvency.
- New mechanism allows early detection of insolvency trend.
- Lender can initiate the process even if the default is in respect of the debt of another lender.



Who can file corporate insolvency resolution?

- Lenders
- Creditors
- Corporate Debtor: Shareholder, management of the entity



Creditor in Possession Approach

The board of directors are suspended and creditor approved resolution professional is appointed to manage the Company.



Time-bound Resolution Process

The entire process should be completed in 180 days (270 days in case of extension).

Default

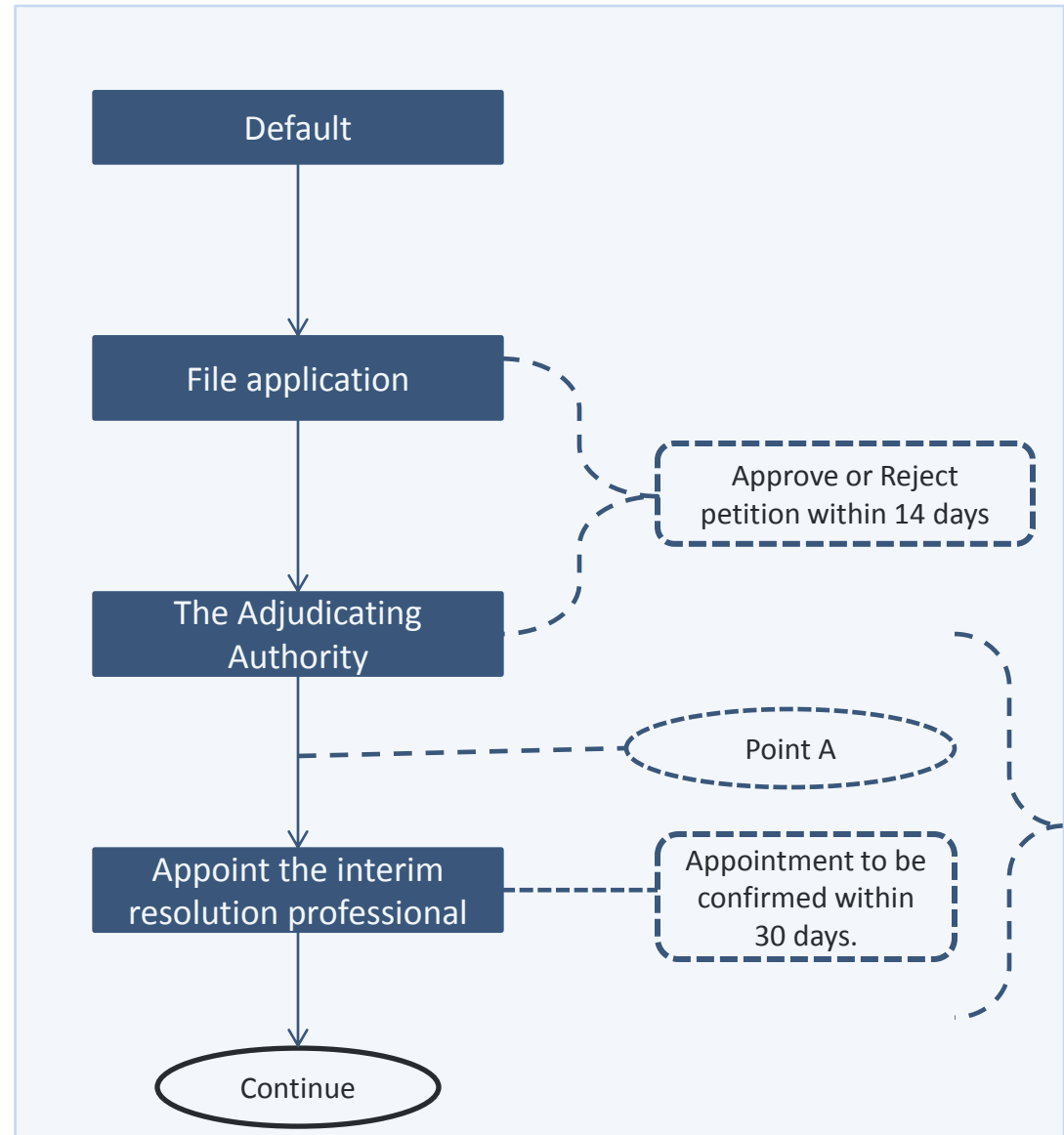
Failure to pay whole or any part or instalment of the amount of debt or interest due (min INR 1 Lakh) may be increased to one crore rupees by central government notification

Who Can File the Application

- Financial creditors
- Operational creditors (including government & employees or workmen)
- Corporate debtor, member, partner, person in charge of operations or finance

Interim Resolution Professional / Resolution Professional (IRP/RP)

- Financial creditor and/or corporate applicant shall propose the name of an IP in the application
- It is optional for the operational creditor to propose the name of an interim IP
- All powers of the board and management shall vest with the IRP/IP
- IP is responsible to run the Company as a going concern during CIRP



Corporate Insolvency Resolution Process (CIRP)

Committee of Creditors

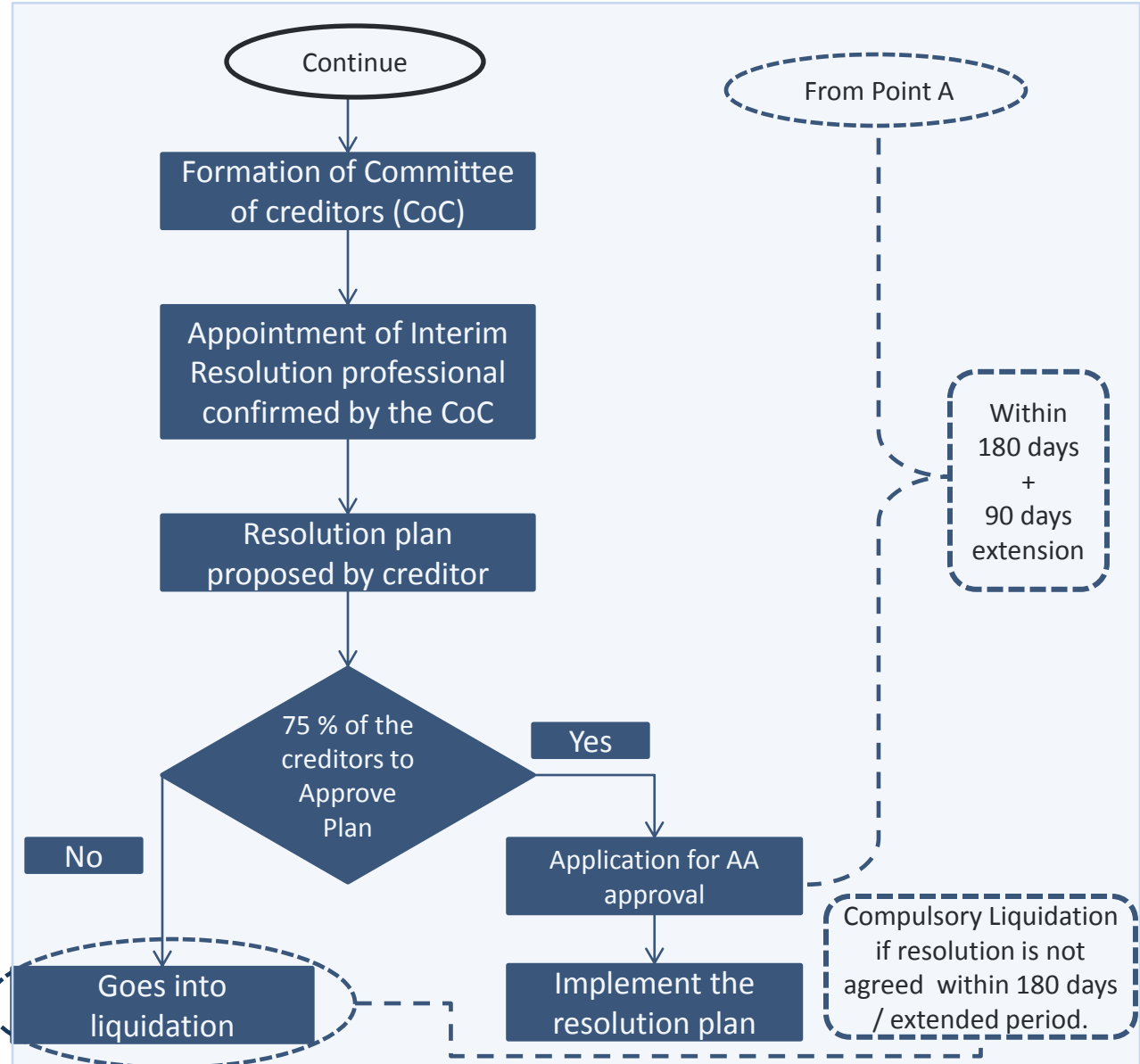
- Usually consists of financial creditors
- Operational creditors to constitute committee when there are no financial creditors or all of them are related to corporate debtor
- Will confirm or replace IRP as RP
- To approve several actions of RP

Resolution Plan

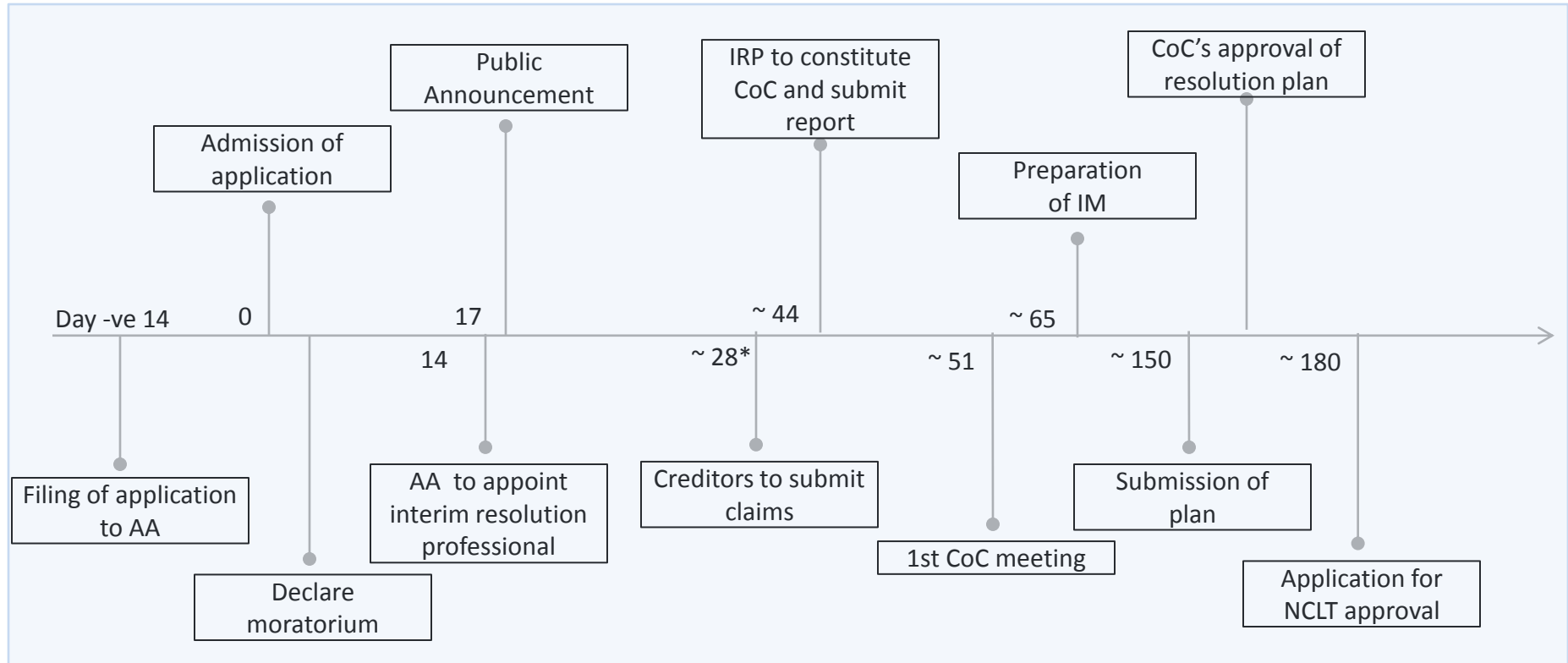
- The resolution plan must provide for Operational creditors (including government & employees or workmen)
- payment of insolvency resolution process costs
 - repayment of the debts of operational creditors
 - management of the affairs of the borrower after the plan is approved
 - implementation and supervision of the approved plan

Voting Power

- Only financial creditors have voting power in the committee in the ratio of debt owed, unless operational creditors constitute the committee
- All decisions of the committee shall be approved by 75% of financial creditors/Operational creditors, as the case may be



Corporate Resolution - Process Time Line*



- Approximate timeline based on the Code
- If a creditor fails to submit proof on or before the last date mentioned in PA, creditor has time to submit such proof to IRP till the approval of the resolution plan by the COC, but cannot be a member of the CoC till admission of claim



Initiation:

Failure to approve resolution plan within specified days will cause initiation of Liquidation. Corporate Debtor can also opt for voluntary liquidation by a special resolution in a General Meeting.



Liquidator

- The IP may act as the liquidator and exercise all powers of the BoD
- The liquidator shall form an estate of the assets, and consolidate, verify, admit and determine value of creditors' claims



Order of Priority for Distribution of Assets

- Insolvency resolution process and liquidation costs
- Secured creditors and workmen dues up to 24 months
- Other employees' salaries/dues up to 12 months
- Financial debts (unsecured creditors)
- Government dues (up to 2 years)/amounts remaining unpaid following enforcement of security interest by secured creditor
- Any remaining debts and dues
- Preference
- Equity



Duties of RP

- To collect all information relating to the assets, finance and operations of the corporate debtor to determine its financial position
- To receive and collate all the claims submitted by creditor to him/ her
- To constitute a committee of creditors
- Take custody of assets and monitor the assets

In a Nutshell : RP has to drive the process of Insolvency as prescribed in the code.



Resolution Plan

There are no guidelines on what the Resolution plan consists of; however the resolution plan should at least consist of

- Payment of costs of RP/IRP/cost of supply of essential goods/ amounts due to persons affected by moratorium and costs directly related to CIRP in priority of repayment of other debts of corporate debtors.
- Repayments to operational creditors, which should not be lesser than the amount to be received by them in case of liquidation of the corporate debtor
- Provide for management of corporate debtor, implementation and supervision of the resolution plan after its approval
- Does not contravene any of the provisions of the law for the time being in force
- The resolution plan must comply with applicable requirements as specified by the Board

The Liquidator must try to maximise the value of the assets in the most efficient manner of disposal and create a liquidation trust for distribution.

The primary responsibilities of the Liquidator are:

- to verify claims of all the creditors
- to take into his custody or control all the assets, properties, effects and actionable claims of the corporate debtor
- to evaluate the assets and properties of the corporate debtor in the manner as may be specified by the Board and prepare a report
- to take such measures to protect and preserve the assets and properties of the corporate debtor as he considers necessary
- to carry on the business of the corporate debtor as he considers necessary
- 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
- institute or defend any suit, prosecution or other legal proceedings, civil or criminal, in the name of or on behalf of the corporate debtor
- to investigate the financial affairs of the corporate debtor to determine undervalued or preferential transactions





Expiration of Tenure of IRP Professional

Regulation 17(1) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 provides that the IRP shall file a report certifying constitution of the committee to the adjudicating authority on or before the expiry of 30 days from the date of his appointment. Regulation 17(2) provides that the IRP shall convene the first meeting of the committee within 7 days of filing the report under regulation 17(1). Under section 16, the tenure of the IRP shall not exceed 30 days from the date of his appointment.

Therefore there could be instances where the tenure of IRP has already expired at the time of convening the first meeting of the committee of creditors.



No Timeline for Disposal of Appeals

While section 12 provides a period of 180 days for the corporate resolution insolvency process there are no timelines prescribed within which the NCLT is required to approve or reject a resolution plan. Similarly there are no timelines prescribed for disposal of appeals. Therefore, the ultimate resolution could still be a long drawn process.



Absence of Information Utilities

The absence of information utilities, can also cause inordinate delays especially if the NCLT gets involved in evaluating whether a default has indeed taken place.



Shortage of NCLT benches

The NCLT has only 11 benches and limited judicial and technical members, which is highly inadequate compared to the huge number of cases already pending at BIFR and DRT which are expected to be transferred to NCLT.

A report states that the total number of insolvency and bankruptcy cases pending would be around 25,000 and the NCLT even with an increased number of judicial members of up to 50 would take approximately 7 years to adjudicate upon 25,000 pending cases, assuming all of them moved to NCLT.

Furthermore the NCLT's are also required to adjudicate compromises and mergers and oppression mismanagement cases. Unless there are dedicated benches to hear insolvency cases, the number of benches are significantly increased and are well equipped, and the transition is better managed, effective and expeditious disposal may be a distant dream.



Shortage of Skilled Professionals

The Code departs from the erstwhile framework of 'debtor in possession' to the new framework of 'creditor in possession'. Whilst this shift may be recommended, a lot would depend on the efficiency of the IP's as managers especially since the management is transferred to their hands. At present three agencies i.e. chartered accountants, cost accountants and company secretaries are recognised and in excess of 1,000 individuals enrolled with these agencies, have been licensed and are able to take on appointments as insolvency professionals.

These professional will have a challenging task ahead; they have very limited knowledge and experience in running the businesses (as the promoters will be forced to step back), in setting up independent management, assessing the financial viability and preparing a resolution plan or evaluating the resolution plans. Until an efficient infrastructure of insolvency professionals who are efficient managers is put in place, effective implementation of the Code would seriously be prejudiced.



Non Co-operative Management

The formulation of a resolution plan would depend on the quality and sufficiency of information contained in the information memorandum (“IM”). The ability of the IRP/RP to prepare a detailed IM would depend on the co-operation of the management as they would alone be privy to the management and operations of the company.

Whilst the Code contains provisions whereby the IRP may seek the assistance of the adjudicating authority in instances where the management is non-co-operative, any such action would only reduce the time available for the preparation of the IM and hence may affect the quality and sufficiency of information provided and the restructuring process. However, this may not be an issue in cases of pre-pack arrangements i.e. where a restructuring plan is agreed in advance of a company declaring its insolvency. Generally, such pre-pack arrangements are popular abroad.



Lack of Consensus among Lenders

A resolution plan submitted by the RP to the CoC needs to be approved by a vote of 75% of the financial creditors. If no resolution plan is approved and submitted to the NCLT within the period of 180 days (or 270 days if extended), the NCLT shall order the liquidation of the corporate borrower. The Code therefore vests a lot of power on the lenders. Past experience demonstrates lack of willingness and consensus on the part of banks at arriving at a consensus in such matters. The implementation of the Code is therefore dependent on the lenders acting in a timely manner and adopting a holistic approach of turnaround and revival rather than focussing merely on minimising provisioning.



High Cost of Bankruptcy Resolution Process

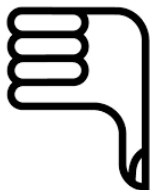
The IBC adopts the UK bankruptcy regime. Studies conducted in the UK on their bankruptcy regime reveal that while adoption of the IRP model resulted in higher realizations, they also correspondingly increased costs of bankruptcy and may not materially improve creditor recoveries.



Dilution of rights of Secured Creditors

In so far as a constitution of creditors committee is concerned, the Code does not distinguish between a secured and an unsecured creditor as voting rights are only dependent on the amount owed to the creditor. Thus an unsecured financial creditor with same levels of exposure as a secured financial creditor in a company will have same voting rights in the CoC, though the position of the unsecured creditor to recover dues at the time of liquidation is at a much weaker footing. This dilutes the position of a secured creditor.

Further it is not clear if the CoC/resolution plan can be challenged if all the financial creditors however insignificant, do not constitute a part of the committee.



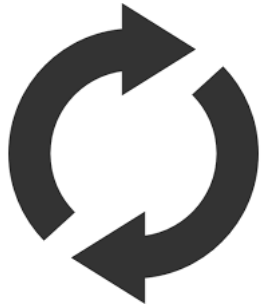
Disadvantageous to Trade Creditors

Trade creditors will receive their dues after the unsecured financial creditors during liquidation in order of priority. It may be contended that the financial creditors extend credit after higher level of risk assessment whereas the same opportunity may not be available to trade creditors considering the exigencies of business. The suggested therefore prejudicially affects the interest of the trade creditors.



Need for better Monitoring of IP's

Further, the IBBI also needs to ensure adequate mechanism to monitor the IP's is in place so as to ensure transparency and avoid unethical practices. This would entail significant capacity building both in terms of human resources and IT capabilities.



Synchronization of Current Restructuring Schemes with the Code

In terms of the applicable RBI regulations, the restructuring schemes such as JLF, SDR and S4A and sale of distressed assets do not require the involvement of the foreign lenders as they are not RBI regulated, hence not part of those processes. This would be an unsatisfactory situation vis-à-vis the foreign lender as these restructuring processes may not resolve the issues of the foreign debt. Under IBC, if the conditions are met, the offshore creditor can bring everyone to the table, and undermine any ongoing onshore process. The RBI needs to suitably align these restructuring schemes with the Code.



Potential Higher Provisioning for Banking Sector

Further, under the applicable restructuring guidelines, the domestic creditors have incentive to undergo the processes of JLF, SDR or S4A and take benefit of the reduced provisioning norms for the NPA's on their books. However, the triggering of a resolution process under the Code would undermine that approach in that the debtor is now subject to a clearly defined resolution process with a hard end date that may result in liquidation if consensus cannot be reached on the restructuring proposal. Such provisioning norms under the existing restructuring schemes needs to be reconsidered by RBI, as the same shall be subject to the IBC resolution process.

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