

INFOLEX

NEWSALERT

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THE INSOLVENCY AND BANKRUPTCY CODE, 2016

1. Introduction

The Insolvency and Bankruptcy Code, 2016 (the “Code”) passed by the *Lok Sabha* on 5th May, 2016¹ seeks to provide a framework for time-bound settlement of insolvency by formulating a survival mechanism or by ensuring speedy liquidation by a formal insolvency resolution process (“IRP”).

According to World Bank data, the average amount of time required to resolve insolvency is just over 4 years in India.

The proposed law aims to increase confidence for creditors in the Indian market.

The Code requires passage before the *Rajya Sabha* before becoming law.

2. Present regime

The Code will amend the existing laws governing bankruptcy and liquidation in India which *inter alia* include the Companies Act, 2013, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the Sick Industrial Companies Act, 1985 and the Recovery of Debt Due to Banks and Financial Institutions Act, 1993.

Further, the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920 shall stand repealed.

3. New regime

3.1 The Board

The Code provides for the setting up of an Insolvency and Bankruptcy Board of India (the “Board”)² with 10 members including representatives from the Reserve Bank of India and the Central Government to regulate insolvency procedures in India.

The Board will have the power to oversee the functioning of insolvency professionals (“IPs”)³ who are defined to be a specialized class of professionals appointed to deal and manage the IRPs, their agencies and information utilities (which are agencies collating information from companies with the intention to identify those with insolvency risk).

¹ See the following link for the full text <http://www.prsindia.org/administrator/uploads/media/Bankruptcy/Bankruptcy%20Code%20as%20passed%20by%20L.S.pdf>

² See Section 188, the Code.

³ See Section 199, the Code.

3.2 Adjudicating Authorities

The Debt Recovery Tribunals (“DRTs”)⁴ will adjudicate the IRPs of individuals and partnership firms. Any person aggrieved by the order of DRT may appeal to the Debt Recovery Appellate Tribunal.

The National Company Law Tribunal (the “NCLT”)⁵ will have jurisdiction over the IRPs for companies and Limited Liability Partnerships. Any person aggrieved by the order of the NCLT may appeal within 30 days.

An appeal from the order of the respective appellate tribunals may be filed before the Supreme Court of India.

3.3 Insolvency Resolution Process

The Code provides for separate IRPs for individuals and companies. A resolution process can be initiated by either debtors or creditors.

3.3.1 Individuals

In case of individuals, the Code provides for two different methods for solving disputes, namely:

- (a) a fresh start; and
- (ii) IRP.

Under the fresh start process, an individual will be eligible for a debt waiver of up to INR 35,000 on fulfilling certain conditions.

In case of IRP, the parties will engage in negotiations under the supervision of the IP to make a plan for repayment of debts.

Such plans will require an approval of 75% of the creditors.

Bankruptcy can be initiated only after the failure of the IRP.

An individual held to be bankrupt will be disqualified from holding public office.

3.3.2 Companies

In case of companies or limited liability partnerships, the Code prescribes a limit of 180 days from the date of admission of the application (extendable to a period of 90 days with approval of 75% of the creditors) within which the IRP should be completed.

A resolution applicant may submit a plan to the IP containing the necessary details. The resolution plan will be approved only if 75% of the creditors have voted in favor of the plan. Once approved the IP shall submit the resolution plan to the adjudicating authority.

If such adjudicating authority is satisfied, it shall by order approve the plan which shall then be binding or it may reject the plan.

Liquidation can be initiated, *inter alia* in the following cases:

⁴ Section 179, the Code.

⁵ Section 60, the Code.

- on the expiry of maximum period permitted for IRP;
- on rejection of the resolution plan by the adjudicating authority; or
- in the event a committee of creditors decide to liquidate.

If the process cannot be resolved within the 180 day period mentioned above (or as extended) the assets of the company may be sold to repay the creditors.

The Code further makes provision for a *fast track* insolvency process for companies with smaller operations. The process will have to be completed within 90 days from the insolvency commencement date unless extended for a further period of 45 days with the approval of 75% of creditors.

3.4 Liquidation

In relation to corporate entities, the Code provides for an *order of priority* for distribution of assets during a liquidation, set out in section 53 (*Distribution of assets*) of Chapter III (*Liquidation Process*) of Part II (*Insolvency Resolution and Liquidation for Corporate Persons*) of the Code.

On accepting the claims, the liquidator shall determine the value of the claims in a manner that may be specified by the Board. If the liquidator rejects any claim, the creditor may apply to the adjudicating authority within the specified time period.

The order of priority is set out below:

- (a) insolvency resolution costs;
- (b) workman's dues (for the preceding 24 months) ranking equally with debts owed to a secured creditor;
- (c) wages and unpaid dues to employees other than workmen for the preceding 12 months;
- (d) financial debts owed to unsecured creditors;
- (e) amounts due to the Central Government and the State Government (including amounts owed to a consolidated fund) ranking equally with debts due to a secured creditor for any unpaid amount;
- (f) remaining debts and dues;
- (g) preference shareholders; and
- (h) equity shareholders.

It remains unclear as to why unsecured creditors have priority over trade creditors.

It should also be noted that amounts owed to the government will be repaid *after* unsecured creditors.

It should be noted that, *inter alia*, monies owed to employees through a provident fund, pension fund or gratuity shall be excluded from distributable assets to the creditors.

Generally, it should be noted that bankruptcy applications for individuals and partnership firms will need to be filed within 3 (three) months (previously, it was 6 (six)) from the date the order sanctioning bankruptcy is passed by the adjudicating authority.

3.6 Preferential transactions and undervalued transactions

The Code provides for treatment of preferential transactions and transactions that are undervalued in nature. In case of undervalued transactions, the adjudicating authority may declare such transactions to be void and reverse the effect of such transactions.

3.7 Penalties

The Code provides penalties for offences committed by a corporate entity under corporate insolvency.

Officers of the company can be penalized for not declaring assets and property owned by it or for willfully concealing any property.

In such cases, the officer shall be penalized with imprisonment of up to 5 (five) years or with a fine of up to INR 10 (ten) million or both. However, he shall not be punished if it is proved that he had no *intent* to defraud.

The Code also penalizes individuals for offences including the provision of incorrect information and the punishment will vary based on the offence committed by an individual.

For the majority of the offences, the fine is specified to be up to INR 500,000 or imprisonment for up to 1 year or both.

3.8 Fund

The Code provides for the creation of the Insolvency and Bankruptcy Fund with amounts contributed from the Central Government or from other sources. It is not clear however, how these funds will be utilized.

Any person who has contributed to the fund may in case of proceedings initiated in respect of such person withdraw funds (not exceeding the amount of contribution).

IndusLaw View:

The Code intends to rationalize the processes and procedures for bankruptcy and insolvency and improve the recovery rates of debt and increase creditor confidence in India.

It should hopefully go some way to address the rights of lenders to enforce security in a distress situation and bring down the rate of non-performing loans.

However, it should be noted that the orders from the NCLT and the DRT can be further challenged before the respective appellate tribunals and then before the Supreme Court of India.⁶

Much work will need to be done to make the work of IPs coherent under the regulatory authority of the Board.

Arguably, the penalties for not declaring assets are not stringent enough (and we assume that those penalties will fall under the amounts owed to the government in the insolvency waterfall).

Generally, the provisions for appeals could prove to be a set-back for the effective implementation for insolvency resolution.

⁶ Sections 32, 42, 61, 62, 181, 182, 202, the Code.

With avenues for appeals and disputes, it remains to be seen to what extent IPs can essentially take control over distressed assets and sideline promoters of companies in default scenarios.

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