

## INSOLVENCY AND BANKRUPTCY CODE: A LEGAL REMEDIES TO LENDERS

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### ABSTRACT

*In a growing economy like India, a healthy credit flow and generation of new capital are essential, and when a company or business turns insolvent or "sick", it begins to default on its loans. In order for credit to not get stuck in the system or turn into bad loans, it is important that banks or creditors are able to recover as much as possible from the defaulter and as quickly as they can. The business can either get a chance, if still viable, to start afresh with new owners, or its assets can be liquidated or sold off in a timely manner. This way fresh credit can be pumped into the system and the value degeneration of assets can be minimised. In 2016, at a time when India's Non-Performing Assets and debt defaults were piling up, and older loan recovery mechanisms such as the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), Lok Adalats, and Debt Recovery Tribunals were seen to be performing badly, the Insolvency and Bankruptcy Code (IBC) code was introduced to overhaul the corporate distress resolution regime in India and consolidate previously available laws to create a time-bound mechanism with a creditor-in-control model as opposed to the debtor-in-possession system. As well said by our Honorable vice president of India, everything is possible in any democracy if there is a Political Will and Administrative Skill, and undoubtedly the one major political will which to make ease of business in India as well as to cater the bad debts problem of finance of an individual or small sized business as well as corporates, is come out in the form of Insolvency and Bankruptcy code. This Act provides a new legal regime for time bound payments or restructuring of Loans/Debts through a robust legal framework. This code provides a new ERA in the area of Finance and Credit with Statutory Legal Framework at Par with other Jurisdiction of the world.*

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**Keywords:** *Insolvency, Bankruptcy, Resolution Plan, Insolvency Professional, Adjudicating Authority.*

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### Introduction

In the present modern world, Loss of debt is probably the biggest problem for almost all kind of persons including corporates. This problem becomes more sever when economy encounters any pandemic such as Corona or world war. In such cases the Lender losses more than what he earned on his debt i.e. he do not losses only the interest which he could have earned but he losses his principle too. In economic terms the loss is more than the loss which is considered by lay man. Because economics also considers the opportunity loss that i.e. the other benefit that could accrue to that person by using his money if he would not have been given a debt. For example if instead of giving the loan, he had invested in Fixed Deposit, he would have earning interest on it, which he is not earning now. So the actual losses is Principle not recovered + Interest on it which he lost + Income which he could earned on it by other means. The other problem is the current legal and institutional framework of India does not at all help lenders in recovery of dues in effective and timely manner or restructuring of defaulted assets thus causing undue blockage of Indian credit system.

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When a corporate debtor (CD), or a company which has taken loans to run its business, defaults on its loan repayment, either the creditor (a bank or an entity that has lent money for operational purposes) or the debtor can apply for the initiation of a Corporate Insolvency Resolution Process (CIRP) under Section 6 of the IBC. Earlier, the minimum amount of default after which the creditor or debtor could apply for insolvency was ₹1 lakh, but considering the stress on companies amid the pandemic, the government increase the minimum amount to ₹1 crore. So, to give relief to lender or creditors from such a problem an act has been introduced known as “**Insolvency and Bankruptcy Code 2016**”.

#### **For whom this Code is Beneficial?**

This code is applicable to:

- Any company incorporated under the Companies Act 2013 or any previous companies Act,
- Any other company governed by any special Act,
- Any LLP incorporated under the Limited Liability Partnership Act, 2008,
- Such other body incorporated under any law for the time being in force, as the Central Government may, by notification, specify in this behalf,
- Personal guarantors to corporate debtors,
- Partnership firms and proprietorship firms, and
- Individuals, other than persons referred to in clause (5)
- As we saw in point 5 to 7, this code do not give relief to corporates only but also to individual lenders and creditors.

#### **What Differentiate the Insolvency and Bankruptcy**

In general sense and for understanding of a common man, the terms could mean same, however technically there is a difference in both of it. **Insolvency** is a state of affairs or a situation of financial crises in an entity and where it is not able to pay its debt. If insolvency is capable of being addressed through insolvency resolution process, the entity is not declared bankrupt. **Bankruptcy** is a legal declaration that an entity cannot repay the debts which are due to its creditors. An application for obtaining an order that a person has become bankrupt may be made by the person himself (*viz.* the debtor) or any of its creditors. Bankruptcy is the legal option if insolvency is untreatable.

#### **Parties to the Insolvency Resolution Process**

Majorly there are 4 different parties who becomes the part of the whole insolvency resolution plan (IRP). These are:

- **Insolvency Professionals:** Members registered with IBBC act as the Insolvency Professionals. They manage the IRP and liquidation process. Insolvency Professionals also act as liquidator during the liquidation process.
- **Information Utilities:** It is a kind of databank for all the debts and credits of all the business houses. It helps to keep a track on debts or credits taken by the debtors and thus, helps in initiating the insolvency resolution process in the event of any default.
- **Insolvency and Bankruptcy Board of India:** It adds the most significant value to the insolvency and bankruptcy regime. The Board registers and regulates the insolvency professionals and information utilities.
- **Adjudicating Authorities:** The Code has e following Adjudicating Authorities:
  - **National Company Law Tribunal (NCLT):** in case of companies, LLPs and enforcement of personal guarantees related to corporate debtors. An appeal against the order of NCLT may be filed with the National Company Law Appellate Tribunal (NCLAT) and then to Supreme court.
  - **Debt Recovery Tribunal:** in case of individuals and partnership firms. An appeal against the order of DRT may be filed with the Debt Recovery Appellate Tribunal and then to Supreme court.

#### **The Procedural Aspect**

IBC works in phases. First is Insolvency Resolution process and second is Liquidation Process. In the Insolvency Resolution Process Financial creditors (whom a debt is owned) assess whether the debtor's (Who owes a debt) business is viable to continue in future and whether options for its revival still exist. The **Liquidation stage however comes**, if the insolvency resolution process fails or financial creditors decide to wind down and distribute the assets of the debtor.

- **Stage First: Insolvency Resolution Process**

An insolvency Resolution process may be started by a Financial or Operational Creditor against Corporate Debtor by filing an application into NCLT. In exceptional circumstances the defaulting corporate debtor, its shareholders or employees, may also initiate voluntary insolvency proceedings. Here it should be noted that Applicant has to select Insolvency Professional from whom he want to carry IRP and need to mention the name of the same in application. The NCLT admit such application where it is satisfied that:

- A default has occurred and
- The application made as above is complete,
- There are no disciplinary proceedings pending against the proposed resolution professional.
- On acceptance of the application,

NCLT issues a moratorium order on the debtor's operations for the period of the IRP. During this moratorium period no judicial proceedings for recovery, enforcement of security interest, Transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein or termination of essential contracts can take place against the debtor. A public announcement of the same shall be made and shall contain Name and address of the corporate debtor under the corporate insolvency resolution process, Name of the authority with which the corporate debtor is incorporated or registered, The last date for submission of claims, as may be specified, Details of the interim resolution professional who shall be vested with the management of the corporate debtor and be responsible for receiving claims, Penalties for false or misleading claims, and The date on which the corporate insolvency resolution process shall close

After that NCLT appoints an insolvency professional or 'Resolution Professional' to administer the IRP. Generally the Insolvency resolution professional, whose name was given in the application by the applicant, is appointed by NCLT as Insolvency Professional. After official appointment, he takes over the management of the corporate borrower and operates the business under the instructions of committee of creditors. In this way the whole management shifts from the hands of the Debtor into the hands of Insolvency Resolution Professional (i.e. in the hands of Creditors). Here it should be noted that constitution of committee of creditors is essential. The reason behind the same is that Insolvency resolution plan is carried out on behalf of all creditors irrespective to the fact that application has been filled by any one or more creditors. The composition of committee is of financial creditors only. However committee works for both creditors and operational creditors above a particular threshold are allowed to attend the meeting of the committee. Decision of committee (Taken by 66% majority vote) is binding on the corporate debtor and all its creditors.

The applicant has to submit a proposal for revival or insolvency resolution of the debtor. The proposal is considered by the committee and after their approval it being reviewed by the Insolvency Professional. If the same is approved by the IRP, then it is being forwarded to Adjudicating Authority for their consideration and approval. Each Revival Plan must necessarily provide for payment of operational debts to the extent of the liquidation waterfall. The whole Insolvency Resolution Plan must be complete in 180 days with an extension of 180 more days on being application made by the Insolvency Resolution Professional.

Here it is worth noting that the resolution plan shall provide for payment in specified manner only i.e. first payment of insolvency resolution process costs (as specified by the Board) in priority to the payment of other debts of the corporate debtor, than payment of debts of operational creditors in such manner as may be specified by the Board which shall not be less than the amount to be paid to such creditors in the event of a liquidation of the corporate debtor, or the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority, whichever is higher, and then payment of debts of financial creditors, who do not vote in favour of the resolution plan, in such manner as may be specified by the Board, which shall not be less than the amount to be paid to such creditors in the event of a liquidation of the corporate debtor.

- **Stage Second**

If Interim resolution plan do not work, then the last option which remain with creditor to recover his dues, is to put the corporate debtor into liquidation. However as per the code, Adjudicating Authority can order liquidation only in the following circumstances:

- if Adjudicating Authority does not receive an approved resolution plan, before the expiry of the insolvency resolution process period or the maximum period permitted for completion of the corporate insolvency resolution process, or the fast-track corporate insolvency resolution process,
- if Adjudicating Authority Rejects the resolution plan,
- Where committee of creditors approves by not less than 66% of the voting share to liquidate the corporate debtor,
- If resolution plan approved by the Adjudicating Authority is contravened by the concerned corporate debtor, or by any other concerned person.
- Where the Adjudicating Authority passes an order for liquidation of the corporate debtor, the resolution professional appointed for the corporate insolvency resolution process shall be the liquidator for the purposes of liquidation.
- On being order of Liquidation the Liquidation Assets shall be distributed in the order of priority and within the order of priority as decided in section 53 of the code.
- Once the Liquidation Assets are completely distributed among the all-liability holders, the Corporate Debtor get into the Dissolution.

### **Challenges in Implementation of Insolvency and Bankruptcy Code**

According to its regulator, the Insolvency and Bankruptcy Board of India (IBBI), the first objective of the IBC is resolution - a way to save a business as a going concern, through restructuring, change in ownership, mergers and other methods. The second objective is to maximize the value of assets of the corporate debtor and the third objective is to promote entrepreneurship, availability of credit, and balancing the interests. The Code says that the order of these objectives is "sacrosanct". Keeping this order in mind, when one looks at the IBBI data for the 3,400 cases admitted under the IBC in the last six years, half or more than 50% of the cases ended in liquidation, and only 14% could find a proper resolution, which is the first objective. While the situation was better in 2016 and 2017, since 2018, a majority of the cases ended in liquidation in most of the quarters while cases for which resolution plans were approved ranged between 15% and 25%. The IBC was touted as a time-bound mechanism in the face of the often-laggard states of older mechanisms. Timeliness is key here so that the viability of the business or the value of its assets does not deteriorate further. The IBC initially stipulated a 180-day deadline to complete the resolution process, with a permitted 90-day extension.

### **Conclusion and Recommendations**

Since independence India is always ranked out of 100 from top 100 countries for ease of Business, and that has been found as major obstacle in development of Economy of India and thus became a great barrier in the line of making India one of the developed countries. Businesses always found themselves trapped into the red tapism, Complex Government Policies, Confused Tax Structure and undoubtedly non recovery of Dues due lack of a strong Code for recovery of Dues, which all together makes difficult to run a business. This code is a master stroke by the government of India in the context to Resolve at least one out of many issues and barriers and to give a free environment to businesses. The code also provides cross border insolvency regimes through the help of various bilateral Agreements.

In order to address the delays, the Parliamentary Standing Committee suggested that the NCLT should not take more than 30 days after filing, to admit the insolvency application and transfer control of the company to a resolution process. Citing the more than 50% vacancy in the Tribunal compared to the sanctioned strength, it suggested recruitment in advance based on the projected number of cases. It also recommended the setting up of dedicated benches of the NCLT for IBC cases. To reduce case loads, the Committee suggested that the pre-packs option be extended to all corporates after review. This is because, under PIRP, unlike CIRP, the debtor continues to manage company operations during the resolution process. The IBBI has also called for a new yardstick to measure haircuts. It suggested that haircuts not be looked at as the difference between the creditor's claims and the actual amount realised but as the difference between what the company brings along when it enters IBC and the value realised. It asserts that a company may have already deteriorated significantly in value by the time it comes under the Code's process, so the value realised should pertain to the company's existing assets and not previous assets.

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