The Journey of Insolvency & Bankruptcy Code

Prior to the commencement of the Insolvency and Bankruptcy Code, 2016 (IBC, 2016 or code), the legislative framework in India to deal with the insolvency and restructuring procedures of corporate entities, partnership firms and individuals was very complex and fragmented across multiple legislations viz. the Companies Act, 1956, the Sick Industrial Companies (Special Provisions) Act, 1985, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), the Recovery of Debts due to Banks and Financial Institutions Act (RDDBFI Act), 1993, etc. The presence of multiple laws, forums and complexities resulted in delays in the timely resolution of the distressed entities, partnership firms or individuals, which further lead to the devaluation of the assets of the borrower, making insolvency negotiations redundant.

The IBC 2016 has laid down a collective mechanism for resolution of insolvencies in the country by maintaining a delicate balance for all stakeholders to preserve economic value of the process in a time bound manner.

The code empowers any creditor of a Corporate Debtor (CD), irrespective of it being a Financial Creditor (FC) or Operational Creditor (OC) or secured or unsecured creditor, or the Corporate Debtor itself, to make an application before the Adjudicating Authority (AA) to initiate Corporate Insolvency Resolution Process (CIRP) against a Corporate Debtor, at their discretion, in the event of there being a default by the Corporate Debtor in payment of their dues for an amount of INR1.00 Lakh or more.

It has shifted the focus from the 'Debtor in Possession' to a 'Creditor in Possession' regime, wherein the creditors of the Corporate Debtor, through their appointed Interim Resolution Professional/ Resolution Professional (IRP/RP), remain in control of the assets of the Corporate Debtor from the time the application is admitted by the AA. Further, until the approval of a resolution plan by the AA, the company is operated as a going concern and controlled by the Resolution Professional. The FC constitute the CoC under the provisions

of the IBC, 2016 and critical decision regarding the resolution of the CD are taken with a majority vote of 66% (which was earlier 75%) and routine decision are taken by the CoC with a majority vote of 51%.

It provides time bound resolution which should be completed within a period of 180 days from the date of admission of the application by the AA. However, if the AA is satisfied that the CIRP in a particular case cannot be completed within the specified time of 180 days, the AA may, at the request of the CoC, extend the time period by not more than 90 days which shall not be granted more than once by the AA during the CIRP. In case, the CIRP is not completed within a period of 180 days, extendable to 270 days, the AA shall make necessary orders for liquidation of the Corporate Debtor wherein the RP shall become the liquidator and shall continue to run the liquidation process. Apart from liquidation under circumstances mentioned herein, the AA may also call for liquidation of the Corporate Debtor in case the RP communicates to the AA the decision of Committee of Creditors to liquidate the Corporate Debtor even during the pendency of CIRP.

Further, to make the procedure more effective, the regulations for Insolvency and Bankruptcy Board of India (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017 was notified on 16th June, 2017 to expedite the resolution process of default in cases of small companies or start-ups or unlisted companies with total assets not exceeding INR10 million in the preceding financial year, within 90 days (as compared to 180 days in case of normal CIRP), which may be extended by 45 days once during the fast-track CIRP, if the AA is satisfied.

Under the fast-track process, a creditor or a corporate debtor may file an application, along with the proof of existence of default, to the AA for initiating the fast-track resolution process. After the application is admitted, an IRP is appointed, who, if based on the records of the corporate debtor, is of the opinion that the fast-track process is not applicable to the corporate debtor, shall file an application before expiry of 21 days from the date of his appointment with the AA requesting for an order to convert the fast-track process into a normal CIRP.

The IBC 2016 also attempted to resolve the problems of existing laws and also various conflicts that arose between debtors and creditors with respect to the gaps in the information system with the notification by Ministry of Corporate Affairs (MCA) on 1st April, 2017 pertaining to establishment and role of Information

Utilities (IUs) to act as a data storage entity that collects information from various sources and stores it in an electronic format in a safe and secure manner.

Another gap that was plugged by the MCA, related to the issue of whether a Resolution Plan requires shareholders' approval so it does not contravene any provisions of the law, as provided under Section 30(2)(e) of the IBC, 2016. In this regard, the MCA issued a clarification on 25.10.2017 that shareholder approval will not be required for Resolution Plans that have been approved by the AA. Thus the primacy of a 'Creditor in Possession' regime was further strengthened.

The code provides for admission / rejection of an application filed under section 7,9 or 10 of the Code by the AA within a period of 14 days from the date of receipt of application. However, Hon'ble Supreme Court of India in the matter of ***J.K. Jute Mills Company Limited*** held that the time limit of 14 days within which the Tribunal/NCLT has to admit / reject the application u/s 7,9 or 10 of the Code, is procedural in nature and not treated like a mandate of law and are directory. The AA has to take a decision on CIRP within 14 days as the process of admission is limited only to the question whether there is a debt or default. If these two facts are established, then, the process become faster.

Key development in the IBC was withdrawal of the cases from the AA pursuant to the settlement between the CD and its creditor(s). The provisions of the Code envisage resolution of the debt of the CD during the CIRP and do not provide for withdrawal of the application once the application is admitted by the AA. However, the Supreme Court in the matter of ***Lokhandwala Kataria Construction Private Limited Vs Nisus Finance and Investment Managers LLP*** exercised its power under article 142 of Constitution of India and permitted withdrawal of the case while recording the consent terms between the CD and its creditors. The said judgment had set a new precedent as it overrides the provisions of the code which did not provide for withdrawal of a case after the same has been admitted by the AA. Further, in the latest amendment to the IBC 2016, by the Ordinance, the provision for withdrawal of petition for CIRP has been sanctioned if the members of CoC with a majority vote of at least 90% agree to the withdrawal of the case from the CIRP process.

Another key development was with regard to the IBBI (Liquidation Process) Regulations, 2016 which were amended to allow for the sale of the entire business undertaking of a Corporate Debtor as a going concern. This change too, was to address the element of public interest as it was brought about immediately after the

AA passed a specific order in the matter of ***M/s. Gujarat NRE Coke Ltd***. allowing for sale of the entire business undertaking, in furtherance of safeguarding the livelihood of the many workers employed by Gujarat NRE Coke Ltd. This method of liquidation by sale of the CD as a going concern, was provided in addition to the existing four options for liquidation of the CD, i.e.: sale on stand-alone basis, slump sale, sale of assets in parcel, and sale of assets collectively.

One more significant development in the CIRP was the introduction of a new form 'F' by amending the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, (CIRP Regulations) of which, a person claiming to be a creditor, other than a FC/OC shall submit proof of its claim to the IRP or RP. This was a result of CIRP against one of India's biggest real estate developers, which shook the faith of around 50,000 homebuyers as they were uncertain about their position in the CIRP as they did not fall into the category of either FC or OC as defined under the IBC.

This situation turned out to be undesirable for the innumerable homebuyers, as they had nothing to recover from the real estate developer and they would lose all chances to the FC. In such a scenario, the distressed homebuyers required immediate options as to what remedy can they seek and obtain in the ongoing insolvency proceedings in order to either preserve their property or to recover their invaluable financial investment.

If a financial institution fails, the Government is there to secure its investors, but there was no such legal protection that could prima facie be made out for the homebuyers. It was the need of the hour that the homebuyers have a prorate right to recover their dues along with the FC (Banks/FIs). This determination of priority was important as without it, the payment of proceeds out of CIRP would first go to the FC, leaving nothing for the homebuyers.

After the amendment of the IBC through the ordinance of 6th June 2018, called the Insolvency & Bankruptcy Code (Amendment) Ordinance, 2018 (the Ordinance), the rights of the home buyers have found legislative recognition and offered a much needed relief. It is now concluded that the current definition of 'financial debt' is sufficient to include the amounts raised from home buyers/allottee under a real estate project, and hence, they are to be treated as Financial Creditor under the Code. Consequently, in CIRP, they shall be a part of the CoC and will be represented in the manner specified in the ordinance, and in the event of liquidation, they will fall within the relevant hierarchy of creditors in terms of section 53 of IBC.

With this status, homebuyers may get their homes or a refund of part of their investment as may be decided by the CoC, where they have representation and voting rights. However, if a resolution plan cannot be finalized and approved, and the real estate developer (RED) goes into liquidation, homebuyers may get nothing as they will be ranked as unsecured creditors and, with the staggered priority for recovery of dues under section 53 of the IBC, will lose out to creditors with security interest, who have a prior claim over the amounts that are realized from liquidating assets of the RED. Thus, banks and other financial institutions will appropriate to themselves the majority of the RED's assets, leaving little for the unsecured homebuyers.

This means that the sympathy shown by deeming homebuyers as FC is superficial and offers no actual relief, when viewed in the context of a liquidation scenario. It remains to be seen whether the recent legislative developments can achieve a delicate balance between these objectives. However, the present state of affairs serves as a compelling motivation to homebuyers to push for a viable resolution plan in order to recover their dues.

Further, in the 2018 ordinance, the existing Section 29(A) which specifically listed down the persons who were ineligible to be resolution applicants, has also been fine-tuned to exempt pure play financial entities from being disqualified on account of NPA. Similarly, a resolution application holding an NPA by virtue of acquiring it in the past under the Code has been provided with a three-year cooling-off period, from the date of such acquisition.

Taking into account the wide range of disqualifications contained in Section 29(A), the 2018 Ordinance provided that the Resolution Applicant shall submit an affidavit certifying its eligibility to bid. Moreover, a minimum one-year grace period is provided for the successful resolution applicant to fulfil various statutory obligations required under different laws was also provided.

The 2018 Ordinance also provides some reliefs for micro, small and medium enterprises (MSMEs). It does not disqualify promoter of an MSME firm from bidding for his enterprise undergoing corporate insolvency resolution process (CIRP), provided he is not a wilful defaulter and does not attract other disqualifications not related to default.

The 2018 Ordinance has clarified that the moratorium imposed under Section 14(1) (at the time of admission of an insolvency application) will not apply to guarantee contracts in relation to the corporate debtor's debt.

Additionally, Section 61(3) of the IBC was also amended to ensure that the NCLT (which has jurisdiction over the insolvency resolution of the corporate debtor) would also have jurisdiction over the insolvency resolution of the corporate guarantor.

Another important amendment brought about by the 2018 Ordinance is the introduction of a proviso to Section 434 of the Companies Act, as per which, any party to a winding up proceeding that is pending before a High Court, may file an application before that High Court for an order to transfer the proceedings before the AA, so it is dealt with as an application for initiation of CIRP under the provisions of the IBC, 2016. This helps clarify the position of law as regards the various winding up proceedings that have been pending for an inordinate period of time, before various High Courts. Their transfer before the AA will be beneficial as they will be dealt with under the time-bound process of the IBC, 2016.

The 2018 Ordinance has also introduced Section 238A, which makes the Limitation Act applicable to proceedings under the IBC, 2016. Prior to this, various time-barred claims were being filed as the Appellate Tribunal to the AA had opined that a period of limitation, if applicable, would only run from 2016, when the Code came into force.

The voting thresholds was also considered and the earlier approval of 75 % of the voting majority of the CoC members was lowered to 51% except, where the withdrawal of an insolvency application was there, a 90% voting majority was required and a 66% voting majority approval for resolutions: (i) approving extension of the corporate insolvency process beyond 180 days; (ii) relating to matters listed out under Section 28 of the IBC; (iii) approving a resolution plan; and (iv) replacing a resolution professional.

The IBC 2016 also covers certain provisions relating to cases of cross border insolvency. Cross border insolvency is one where the insolvent debtor has assets in more than one jurisdiction or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place.

When the code was introduced, provisions with respect to cross border insolvency were defined under section 234 and 235, wherein an application of provision of insolvency code in relation to assets or property of CD, including personal guarantor of a CD, situated at any place in a country outside India with which reciprocal arrangements have been made, shall be subject to such conditions as may be specified. In such a case, the AA

may issue a “Letter of Request” to a court or any other competent authority of such country to deal with its request for action on the assets of the company situated in another country.

Once the said framework comes in place, then India would be one of the most attractive investment destination for foreign creditors, given the increased predictability and certainty of the insolvency process. The Code as a whole does appear to be a move in the right direction and is likely to bring about an improvement in global perception regarding ease of doing business in India. If something goes wrong, the foreign creditors know that they are not stuck in India for the rest of their lives and can easily exit from their positions in a time bound manner. The MCA has, on 20th June 2018, called for public comments on the cross border insolvency laws.

Despite being a relatively new legislation, it has undergone several amendments within a short span of time in a bid to eradicate any loopholes and/or ambiguities that may hamper the smooth and efficient functioning of the Code. In this journey of IBC, the relevant authorities and legislative think tanks have played a crucial role by manifesting new dimensions of law within the strict time lines which further clarified the derivatives of such critical amendments. The recent Ordinance has further resolved the complexities involved in the implementation of the Code. All the stakeholders played an important role and the approach adopted by them so far has made it a success as envisaged in the code. The IBC 2016 has completely changed the entire architecture of insolvency and bankruptcy laws and proved to be a milestone in the Indian legal framework.