CORPORATE INSOLVENCY RESOLUTION PROCESS: A CRITICAL ANALYSIS

Arya Krishnakumar[*] & Ann Thomas[**]

ABSTRACT

In 2016, parliament passed the insolvency and bankruptcy code in order to improve the business environment and to alleviate distressed credit markets. The code offers a uniform, comprehensive insolvency legislation comprising all companies, partnerships and individuals. In the absence of a bankruptcy law, a firm's assets would be sold as a scrap and its value would be lost. Now the situation has changed. This law helps to rescue business through speedy liquidation process without any further depletion in the value of assets. The code consists of a regulator, insolvency professionals, information utilities and adjudicatory mechanisms to facilitative a speedy insolvency resolution process and liquidation, thus resulting in a new institutional frame work

[*] 8th Semester Student, B.Com, LL.B (Hons.), School of Legal Studies, CUSAT

[**] 8th Semester Student, BBA, LL.B (Hons.), School of Legal Studies, CUSAT

compared to earlier one. It is the responsibility of the creditor to initiate insolvency resolution process against the corporate debtor.

In this paper, we will be dealing mainly with corporate insolvency resolution process. To initiate an insolvency process for corporate debtors, the default should be at least INR 100000. At first comes insolvency resolution process where the creditors assess the debtors business and takes a decision whether to wind up or rescue. If the decision is to wind up then comes the liquidation stage .Either a financial creditor or an operational creditor can initiate an insolvency resolution process against a corporate debtor at National company law tribunal (NCLT).The NCLT orders a moratorium on debtors operations for the period of insolvency resolution process. Then NCLT appoints an insolvency professional or resolution professional to administer the insolvency resolution process. The resolution professional identifies the financial creditors and constitute a committee. Their decisions are binding on the corporate debtors and all its creditors. They consider proposal for the revival of debtor and must take decision regarding it within a period of 180 days.

Our paper would like to throw light in the minds of the reader by raising the following questions:

1. What is the root cause of developing the code?
2. How has the corporate resolution process helped in uplifting the standard of business?
3. What are the challenges faced in the corporate insolvency process?

India has a distressed state of credit markets .It is due to a weak insolvency regime, its inefficiency and systematic abuse. Due to this Act an early identification of financial failure is possible thus helping to maximise the asset value of insolvent firms. The goal of this paper is to address, in detail, the concept of corporate insolvency resolution process, the various steps involved in it, its impact on business and the challenges faced.

INTRODUCTION

Earlier bankruptcy resolution mechanism in India was highly shattered .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. Introduction of Insolvency and Bankruptcy Code 2016 is a step taken to address insolvency and bankruptcy related challenges the country is facing. Recognizing the reforms in the bankruptcy and insolvency regime it seems critical for improving the business environment and alleviating distressed credit markets, so the Government introduced the Insolvency and Bankruptcy Code Bill in November 2015, drafted by a specially constituted 'Bankruptcy Law Reforms Committee' (BLRC) under the Ministry of Finance. After a public consultation process and recommendations from a joint committee of Parliament, both houses of Parliament have now passed the Insolvency and Bankruptcy Code, 2016 (Code).The government is propounding a separate framework for bankruptcy resolution in failing banks and financial sector entities. One of the most fundamental features of the code is that it allows creditors to assess the feasibility of a debtor as a business

decision and agree upon a plan for its revival or a speedy liquidation. The code creates a new institutional framework comprising of a regulator, insolvency professionals ,information utilities and adjudicatory mechanisms that will facilitate formal and time bound insolvency resolution process and liquidation. The Code makes a significant departure from the existing resolution regimen by shifting the responsibility onto the creditor to pioneer the insolvency resolution process against the corporate debtor. Under the existing legal framework, the primary onus to initiate a resolution process lies with the debtor and creditor may pursue separate actions for recovery, security enforcement and debt restructuring.

BACKGROUND OF THE CODE

The Insolvency and Bankruptcy Code, 2016 (IBC) is the law in India which helps to reframe the existing framework by creating uniform law for insolvency and bankruptcy. The code aims to revoke the Presidency towns insolvency act, 1909 and sick industrial companies (special provision) repeal act, 2003. The Government then bought into existence the

Insolvency and Bankruptcy Code Bill in November 2015, made by a specially constituted 'Bankruptcy Law Reforms Committee' (BLRC) under the Ministry of Finance. After a public consultation process and recommendations on this regard from a joint committee of Parliament, both houses of Parliament have approved the Insolvency and Bankruptcy Code, 2016. National Company Law Tribunal (NCLT) passed the first insolvency resolution order that comes in this code in the issue of Synergies-Dooray Automotive Ltd on 14 August 2017. NCLT Okays first insolvency resolution scheme under IBC.[1] Company gave the claim for insolvency on 23 January 2017. The resolution plan was given to NCLT within a period of 180-day period as needed by the code, and the approval for the same was received on 2 August 2017 from the tribunal. The final order was uploaded on 14 August 2017 on the NCLT website.

INSOLVENCY AND BANKRUPTCY: THE CONCEPT ELUCIDATED

Insolvency is a situation where an individual organisation is not able to meet its outstanding debt to the lender and thus

[1] Live mint, 16th August 2017

it becomes due. We can succeed over this problem by changing repayment technique of loans or writing off a part. If these methods cannot be employed then a legal action will be initiated and its assets will be sold to finish off the debts.

Bankruptcy is a condition where a person without any other force declares himself as an insolvent and proceed to court. On declaring bankrupt the court is responsible to liquidate personal property of insolvent and hand it over to the creditors.

INSOLVENCY AND BANKRUPTCY CODE

India is a fast emerging start up hub. [2]The Code offers a uniform, comprehensive insolvency legislation containing every companies, partnerships and individuals. It's a different framework for bankruptcy resolution in failing banks and financial sector entities. It contains a regulator, insolvency professionals, information utilisers and adjudicatory mechanisms that will help in a formal and time

[2] According to study conducted by ASSOCHAM India in association with 'Thought Arbitrage Research Institute' http:// www. assocham. org/ newsdetail.php?id=5874

bound insolvency resolution process and liquidation.[3] The code makes a clearly distinguishes between insolvency and bankruptcy. The former is a short term inability to meet liabilities during the normal happening of business. Whereas the latter is a long term view on the business. The code says that insolvency or bankruptcy is commercial issue backed up by law to have transparency and objectivity. The objectives of the act include:

1. Short time to resolution
2. Greater recovery
3. Higher level of debt financing across a wide variety of debt instruments.

WHY DO WE NEED THE CODE?

Statistics shows that there are 11% bad debts in business and the rate is increasing day by day. The time needed for resolution is also more when compared to other developed countries. Let us also bring it into consideration that there are thousands of pending litigations for recovery of money. In current setup, it takes minimum of four years to stop a

[3] Gazette of India. Retrieved 31st May 2016

company in India. Before the commencement of this act the recovery was through contract act or any other similar acts which was held not practical. This made government to bring into force an 2alternate plan to substitute the existing insolvency which leads to the enforcement of the code.

INSOLVENCY RESOLUTION PROCESS

The IRP provides a tool to handle the overall distressed position of a debtor. We can see that there is a significant departure from existing legal framework. The creditor starts the insolvency resolution process.

INSOLVENCY RESOLUTION PROCESS FOR CORPORATES

If the default is above Rs 1 Lakh which can be increased up to one crore, the creditor may start the resolution process.

Insolvency resolution process

Insolvency resolution is the process where creditors decide whether the debtor's business is ready and able to continue and the options to save. The Insolvency and Bankruptcy

Board of India Regulations, 2017[4] have laid down important definitions and procedure to carry out the resolution process.

Liquidation

It is when the above said process fails and then the creditors decide to wind down and distribute the assets of the debtor.

The Insolvency Resolution Process

When Benjamin Franklin said, "Time is Money[5]" he certainly meant that time is a valuable asset and we must make it count. A financial creditor, an operator or corporate debtor can start the resolution process. An application to be made before NCLT for the start of process. Operational creditor should give demand notice of 20 days to corporate debtor before approaching the NCLT. The process shall be finished within 180 days of admission by

[4] http:// www. ibbi. gov. in/ Insolvency_ and_ Bankruptcy_ Board_ of_India_Fast_TrackInsolvency_Resolution_Proc ess _for_Corporate_ Persons_Regulations_2017.pdf

[5] Advice to a young tradesman (1748)

NCLT. Then the creditor's claim will be frozen for 180 days during which NCLT will hear proposals for revival. NCLT appoints interim insolvency professionals (IP) within a duration of 14 days of acceptance of application. NCL causes public announcement to be made and committee. They shall meet within first seven days and decide by 75% votes whether to replace or confirm interim IP. Then resolution professional shall be appointed by NCLT. The creditor's committee has to then take a decision by 75% majority voting .RP shall place an information memorandum before the creditor's committee for its approval .Once the resolution is passed then creditors committee has to decide on the restructuring process .The resolution plan will be sent to NCLT for final approval and then implemented once approved.

LIQUIDATION

Liquidation process commences when

a. There is failure to submit resolution plan to NCLT within prescribed period.
b. Rejection of resolution plan for non-compliance with requirements of code.

c. Decision of creditor's council based on vote of majority.
d. Contravention of resolution plan by debtor.

During liquidation, no suit or other proceedings shall institute by or against the corporate debtor; except through liquidation on behalf of corporate debtor with permission of NCLT. Liquidation shall receive, verify and admit or reject the claims of creditors. Creditor may apply within 14 days .A secured creditor may either relinquish its security interest to the liquidation estate and receive on first priority the proceeds in accordance to law as applicable to secured interest. Any surplus amount so received shall be tendered to liquidation. Assets will be distributed in the manner of priority of debts laid in the code. All sums due to any workmen or employee will be considered as priority dues. Upon the assets of the corporate debtor completely liquidated and liquidator making an application, NCLT shall pass an order dissolving the corporate debtors.

FAST TRACK INSOLVENCY RESOLUTION PROCESS

The code has provided for a fast track insolvency resolution process in respect of corporate debtors, for which the qualification to be given by government. The process shall be finished within 90 days and an additional 45 days can also be granted. Provisions of insolvency can also be applied to fast track insolvency. This enables new companies to complete resolution process quickly and move on. Lok Sabha passed the bill to fast track debt recovery[6] for a speedy insolvency process.

VOLUNTARY LIQUIDATION OF CORPORATE PERSON

The court provides an option for voluntary liquidation proceedings by corporate persons themselves who intends to liquidate it and has not committed any default and can pay off its debts wholly from proceeds of liquidation of assets. The law requires a declaration to that effect from majority of directors of that company also stating that the company is not being liquidated to defraud any person. Creditors representing two-thirds value of the company's debts shall approve a resolution passed to this effect. Then

[6] The Economic Times, 2 August 2016

voluntary liquidation commences .Once the debtor is completely wound up and assets liquidated the NCLT passes an order for its dissolution.

ORDER OFPRIORITY OF PAYMENT OF DEBTS

a. Insolvency resolution cost and liquidation cost
b. Workers' dues (for 24 months before commencement) and debts to secured creditor (who have relinquished their interest.
c. Wages and unpaid dues to employees other than workmen for 12 months before commencement.
d. Financial debts to unsecured creditors and workers' dues for earlier period.
e. Crown debts and debts to secured creditor following enforcement of security interest.
f. Remaining debts
g. Preference share holders
h. Equity share holders

MORATORIUM

It is one of the most special characteristic feature of the code. It is not automatic and thus to be granted by

adjudicating authority at the time of admission of corporate insolvency application. It will be there until the end of the resolution process. During the period of filing of application, an interim moratorium period shall automatically commence and shall be effective until insolvency or liquidation. The supply of essential goods and services to debtor shall not be interrupted during this period.

ADJUDICATING AUTHORITY UNDER THE CODE

At present the high courts, the Company law board and board for industrial and financial reconstruction and debt recovery tribunal are having overlapping or in other words similar jurisdiction in the matter of debt recovery and restructuring. This paves way to systematic delays and complexities in the process .Under part 2 chapter six of the code NCLT would be adjudicating for insolvency resolution and liquidation of companies. An appeal can be preferred from orders of NCLT to National Company Law Appellate Tribunal within 30 days. Orders of NCCAT are appealable on a question of law to Supreme Court within 45 days. In

keeping with the broad philosophy, that insolvency resolution must be commercially and professionally driven the role of adjudicating authority is limited to ensure due process rather than adjudicating on merits of insolvency resolution.

IMPACT OF THE CODE IN BUSINESS

The Insolvency and Bankruptcy Code, 2016 was implemented with the intention of improving the ease of doing business in India, a country perceived to have a weak insolvency framework and where defaulting debtors abuse the law. At the outset, the Code appears to have the interests of business at heart: it aims to rectify laws relating to reorganization and insolvency resolution of corporate persons, partnership firms, and individuals; attempts to ease the process of recovery of money by operational and financial creditors in a timely manner; and places the liability on professionals to put forth resolution plans within 180 days. It seeks to ensure that there is neither scope for any further claims by the creditors, except through the Code's mechanisms, nor for the corporate debtor to challenge the claims made by the creditor.

However, the Code has enough loopholes to close down businesses instead of assisting entrepreneurs. As explained subsequently, it fails to provide adequate safeguards to protect the rights of the company before handing over the management in its entirety to the resolution professional.

THE FLAWS

The Code rides mainly on the unquestionable word of the creditors. Neither does the corporate debtor have an opportunity to put forth his/her case nor is there any scope of discretion provided to the adjudicating authority itself. At various stages — of admission of the insolvency proceedings, of appointing the insolvency professional, of finalizing the resolution plan — the Code fails to give any opportunity to the corporate debtor to make a representation, at the very least. In this manner, the Code ignores rights enshrined in the Constitution. (In *Maneka Gandhi v. Union of India*[7], 1978, the Supreme Court observed that it is the duty of the authority to give reasonable opportunity to be heard, even where there is no specific

[7] 1978 AIR 597

provision for showing cause when a proposed action affects the rights of the individual.)

The Code is also inadequate in providing a yardstick for the qualification of the interim and of the final insolvency resolution professionals. It allows for any person to access the information memorandum propounded by the insolvency professional without restricting competitors or imposing any confidentiality obligations. This allows for any person to access proprietary information of the corporate debtor and misuse the same, given that there is no law safeguarding confidentiality and vitiates the fundamental right to business under Article 19(1)(g).

It is also shocking that the Code prohibits withdrawal of the application once the same has been admitted. This means that there is no scope for settlement. This is despite the recent ruling of the Supreme Court in *Lokhandwala Kataria Construction (P) Ltd. V. Nisus Finance and Investment Managers LLP* (2017), wherein a settlement proposal was taken on record and the appeal was disposed of. However, this cannot be considered as a precedent.

Further, the unrestricted access of any person without mandatory contractual obligations in relation to confidentiality vitiates the fundamental right to business under Article 19(1)(g).

All this shows that the Code still requires a lot of hand-holding by the judiciary to put in place adequate safeguards and guidelines to ensure its smooth, effective, and fair enforcement. The Code may have teething troubles, such as infrastructure facilities, but there is no excuse at all for basic constitutionality flaw.

Challenges in Insolvency Resolution Process

The SARFAESI Act, under Section 17, empowers debtors to file an appeal against any action taken by creditors with the Debt Recovery Tribunal; and the Debt Recovery Tribunal is required to decide such applications within 4 months. To expect that the 2016 Code will turn around things in a way that will make insolvency resolution a smooth and time-effective stroll to recovery or liquidation is impossible.

The minimum single default for triggering the insolvency proceedings is merely a sum of Rs. 100,000/-. This can be a caution, especially under a corporate regime, as any employee for non-payment or late payment of salary (temporary turbulence in company's cash flows) or any small vendor for unexpected non-payment of dues, will be in a position to trigger insolvency proceedings although the default is meagre due to temporary disturbance in cash flows.

According to some experts, there is not any significant evidence that confirms that, stowing entire faith in creditors will accelerate the recovery process or will improve the chances of efficient restructuring; that is, by axing the equity-holders from the entire decision making process will eventually result them to be more uncertain and less supportive of viable insolvency resolution mechanism.

The Insolvency and Bankruptcy Code, 2016 is applicable to both corporate and non-corporate persons. As per Section 6 of the Code, where any corporate debtor commits a default, then- financial creditor, operational creditor or the corporate debtor by itself, can initiate the "corporate

insolvency resolution process" in respect of such corporate debtor. According to the 2016 Code, any creditor: financial or operational, will be able to start the insolvency resolution process by giving the proof of default. If the adjudicating-agency, that is, the National Company Law Tribunal or the Debt Recovery Tribunal, gives a clean-gosignal, then, the entity will be taken over by the 'Committee of Creditors' and 'Insolvency Professionals'.

The applicant creditor will prepare a resolution plan and will submit it to the Insolvency Resolution Professional. The plan will then have to be approved by 75% of the creditors (by value) in the Committee of Creditors (operational creditors will not be the part of the committee). There is no certainty that 75% of the creditors will agree to the resolution plan. Thus, as it will not be easy to get 75% creditors on board, much likely, the resolution/revival plan will be in doldrums and there will be eventual rise of litigation.

Necessarily, as the operational creditors are denied seat in the Committee of Creditors as per the 2016 Code, thus, the

NCLT while reviewing the resolution plan will have to make sure that the operational creditors are treated fairly.

The insolvency resolution mechanism has to be completed within 180 days of the takeover by the insolvency professionals; though in some situation 90 additional days can be provided. If the plan provides for action to ensure the "continuation of corporate debtors as a going concern", and the same is accepted by the adjudicating agency, the debtor shall survive, provided it complies with its all provisions. If the revival plan is rejected, then the entity will go into liquidation process. There is no time limit specified for the liquidation.

As far as the mechanism of 'fresh start' is taken, the same is applicable to those individuals whose monthly income is below Rs. 5000/- and the debt amount is not more than Rs.35, 000/-. This amount is so insufficient that very few individuals able to take benefit of this mechanism. No qualification per se has been prescribed for the Insolvency Resolution Professionals in the 2016 Code. Looking into their scope of work and the responsibilities they shall be shouldering, an Insolvency Resolution Professional needs

multiple skills i.e. to require skills of a lawyer, a chartered accountant, a management professional, a company secretary and a cost accountant, which by itself not an easy standard to meet.

Section 224 of the 2016 Code laid down that a fund, namely, the Insolvency and Bankruptcy Fund is to be created for the purposes of insolvency resolution, liquidation and bankruptcy of persons under the 2016 Code, and any person can voluntarily make contributions to the fund and in any event of insolvency proceedings been initiated against such person, such person can withdraw funds not exceeding the amount contributed by him to the fund to make payments to the workmen or for protecting his assets or to meet the incidental costs incurred during the insolvency proceedings and for any other purpose. However, the basic question is this, that, if a person will get only that which he has contributed to the fund, then why at all a person will make contributions of the fund and not deposit the amount he has in a bank-account over which he will earn interest as per the specified rates.

CONCLUSION

The objective of this paper is to analyse the corporate insolvency resolution procedures of India, as per Insolvency and Bankruptcy code 2016. The underlying motivation of this exercise is to highlight the impact of the process and its challenges. The fragmentations of the existing legal framework and the delays in enforcement in India have created incentives for rent seeking by various participants in the insolvency process. If a robust market for credit is to develop in India, the corporate insolvency process must give clarity to all debtors as well as all classes of creditors about the procedures and rules to deal with in an event of insolvency.

Only then, will a credit market without concentration of any one class of debtors or creditors can develop. The presence of multiple laws and adjudication flora has created opportunities for the debtor firms to exploit the arbitrage between the systems to frustrate the recovery efforts of creditors and to adversely impact the timeliness of the resolution process. Thus, it is imperative to consolidate the multiple laws and flora in India, a strategy that seems to

work well for both UK and Singapore. There is thus an urgent need to consolidate the laws in India including the individual enforcement as well as informal procedures.

The formal process for insolvency resolution is essentially a judicial process and the courts and judiciary form an integral part of it. Countries have chosen to deal with this in their own ways. For instance, the UK law has devolved large portion of the responsibilities to the insolvency practitioners thereby minimizing the role of the judiciary, which is now involved primarily in dispute resolution and for setting guidelines for the parties involved. Furthermore, mechanisms need to be built at every stage of the law to create sufficient disincentives for strategic behaviour by the parties involved.

Likewise, the insolvency practitioners system must also be a strong one such that their objectives are aligned with those of the insolvency resolution system. While the corporate insolvency resolution law can lay out clear and well-defined provisions governing the procedures at each stage, effective and timely resolution of an insolvency case will depend largely on the efficiency with which those provisions and

rules are enforced. Hence the success of the new law proposed by a committee in any country including India will depend critically on the extent to which existing institutions can also be reformed and made more effective, new enabling infrastructure can be set up and adequate State capacity can be created.