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Unifying Legal Framework in Debt Financing: Insolvency and Bankruptcy Code 2016

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Abstract: The study focuses on the benefits and implications of regulatory reforms emanating from Insolvency and Bankruptcy Code 2016 through repealing, amending and unifying the fourteen existing laws pertaining to insolvency in a single code. This unified code will apply to companies, partnerships, limited liability partnerships and individuals under the regulatory oversight of Insolvency and Bankruptcy Board of India. This code envisages time bound resolution process within 180 days under the supervision of Insolvency Professionals and Insolvency Professional Agencies. Information Utilities will facilitate the seamless sharing of financial information among various stakeholders in no time. The Code also seeks to establish two separate tribunals (NCLT and DRT) to adjudicate grievances related to insolvency, bankruptcy and liquidation of different entities. The Bill also proposes adequate penal provisions for malfeasance of the debtors and creditors. Overall, this legislative reform will unify the existing laws and increase the breadth and depth of debt financing in India.

Key Words: Insolvency and Bankruptcy Code 2016, Insolvency Professional, Insolvency Professional Agencies, Information Utilities, Insolvency and Bankruptcy Board of India

BACKGROUND OF INSOLVENCY AND BANKRUPTCY ACTS

The insolvency and bankruptcy issues in India are dealt with many overlapping laws namely Sick Industrial Companies Act (Special Provisions; 1985), Recovery of Debt Due to Banks and Financial Institutions Act (1993), Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (2002), and Companies Act (2013). These acts stipulate norms for the restructuring, seizure, and sale of debtors' assets in the case of insolvency issues. But the insolvency resolution of individuals and partnerships is also dealt with two archaic Acts viz. Presidency Town Insolvency Act (1909) and Provincial Insolvency Act (1920). However, creditors can also approach civil courts which are already suffering from pendency issues or low disposal rate. The insolvency resolution is delayed owing to overlapping jurisdictions of laws

and lack of qualified insolvency professionals as well. These Acts also facilitates multiple forums for resolution of insolvency with fragmented jurisdiction creating infinite uncertainty with shareholders' wealth. The Bankruptcy Law Reforms Committee (2015) has also observed that processing time of insolvency cases in India is 4.3 years , almost 3-4 times higher than that of USA (1.5 years) and UK (1 years). This committee report was tabled in both houses of the parliament and it is passed in May 2016 by both the houses of the parliament in India.

NEW DEVELOPMENTS: INSOLVENCY AND BANKRUPTCY CODE 2016

The Insolvency and Bankruptcy code 2016 attempts to consolidate the existing framework by repealing Presidency Town Insolvency Act (1909) and Provincial Insolvency Act (1920) and amending other 11 laws comprising Companies Act (2013), DRT Act (1993), and SARFAESI Act (2002). The Code has recommended following institutional structures in consolidated framework with following mandates.

<i>S. No</i>	<i>Institutional Infrastructures</i>	<i>Mandates</i>
1	Insolvency Professionals (IP)	Manage insolvency by constituting creditors' committee and take control of management and operations of the firm
2	Insolvency Professional Agency (IPA)	Conduct examinations and enforce a code of conduct on professionals
3	Information Utilities (IU)	Collection, collation, and dissemination of financial information in electronic databases
4	Insolvency and Bankruptcy Board of India	Provide regulatory oversight on IP, IPA and IU
5	Adjudicating Authorities (National Company Law Tribunal and Debt Recovery Tribunal)	Approval of initiation of resolution, appointment of insolvency professionals and also final approval on resolution plan

The Insolvency and Bankruptcy Code 2016 has simplified the resolution process for companies and individuals as below.

- *Initiation:* In the case of default, creditors or debtors will approach National Company law Tribunal (NCLT) and Debt Recovery Tribunal (DRT) for resolution initiation which is to be completed in 180 days with a maximum extension of 90 days.
- *Appointment of Interim IP:* Tribunal will appoint interim IP who will take control of management and operations of the firm and constitute creditors committee for further negotiations with debtors.
- *Creditors Committee:* It will appoint permanent IP to conduct the resolution process with 75% creditors' approval.
- *Insolvency Resolution:* After creditors' approval, creditors' committee zeros in either on restructuring or liquidation plan.
- *Approval of Adjudicating Authorities:* Resolution plan must be approved further with NCLT and DRT in the cases of companies and individuals respectively.

- *Liquidation*: Once the insolvency resolution is approved, it is restructured or liquidated in predetermined order.

BENEFITS FROM INSOLVENCY AND BANKRUPTCY CODE 2016

The Insolvency and Bankruptcy Code 2016 will yield numerous benefits to various stakeholders and entities and boost the credit market confidence. The benefits are discussed in detail as below.

- *Breadth and depth of debt financing will increase*: At present, debt financing is skewed towards collateral based financing depriving a larger portion of the market. Firms without tangible assets can't access to debt irrespective of future cash flows in the business opportunities. The Insolvency and Bankruptcy Code 2016 will inject additional confidence in the credit market for debtors as well as creditors augmenting the breadth and depth of debt financing in India
- *The overall debt distress will diminish and the shareholders' wealth will be stable*: When a firm has accessed secured credit but failed to meet obligations, creditors are bound to take control of assets of debtors leading to the disruptions in the operations of the firm. The Insolvency and Bankruptcy Code 2016 will provide a time bound resolution once the insolvency is triggered and approved. This framework has the provision of insolvency professionals protecting the interests of debtors and creditors till the resolution process is completed. Thus, shareholders are better protected with lesser erosion of values for firms.
- *Time bound resolution will reduce the uncertainty of credit market*: The earlier framework has unduly increased the load of court and DRT resolving the insolvency issues in more than five years. The Insolvency and Bankruptcy Code 2016 brings the mandate of time bound resolution in 180 days which may be extended by another 90 days. It has also the provision of fast track courts for insolvency resolution in 90 days.
- *Information symmetry will make the credit market efficient*: The earlier credit resolution framework has no provision of sharing information among different stakeholders making it lesser transparent. The Insolvency and Bankruptcy Code 2016 has the provision of Information Utilities under the regulatory oversight. Information Utilities can facilitate fast access to desired information to resolution professionals and creditors' committee for speedy and transparent insolvency resolution. Thus, uncertainty among different stakeholders will vanish, thereby making our credit market more efficient.
- *Code is unified and clear*: The Insolvency and Bankruptcy Code 2016 has common principle of resolution for various forms of organization namely individuals, partnerships, and limited liability companies. The procedural uniformities are ensured at various levels namely professionals code of ethics, Resolution Professional Agencies, Insolvency and Bankruptcy Board, and appellate tribunal for each and every process of insolvency resolution. Thus, different stakeholders are addressed under a single code.
- *Insolvency resolution has become cost effective*: In order to trigger insolvency, the Insolvency and Bankruptcy Code 2016 seeks to record the state of business entity and statement of truth from debtors' side and the evidences of default from creditors' side. It also attracts severe monetary

penalty on creditors and criminal penalty on debtors in the case of substantial misrepresentation of facts and figures from either of them. These provisions seem to make the resolution process transparent, speedy and effective. It also avoids the possibility of appeal in apex court making the overall resolution process cost effective.

- *Insolvency resolution is highly democratic, collective and participative:* As per Insolvency and Bankruptcy Code 2016, once insolvency is triggered, interim insolvency professional is appointed to constitute the creditors' committee. These committee tend to negotiate and come out with insolvency resolution in 180(270) days on 75 % approval of creditors on pro rata basis. The whole period is given for detailed negotiation among different stakeholders. They have the mandate of restructuring the debt changing the terms and conditions of financing and recovery. On the other side, if the business is unviable, creditors' committee will go for mandatory liquidation and distribution of recovery proceeds in defined order.
- *Code is at par with global standard:* Insolvency and Bankruptcy Code 2016 has most of the clauses at par with the developed economies. In US, insolvency is administered by US Trustee or Government employee, where as in Indian context this code has delegated this responsibility to Insolvency Professional working under the regulatory oversight of Insolvency Professional Agency and Insolvency and Bankruptcy Board of India. Indian code has made extra provision of reporting financial information via Information Utilities which is not prevalent in US and UK. Some of provisions of the code like control of debtor's assets in the hands of insolvency professionals are similar to UK code. This code will ensure out of the court settlement most of the times with few exceptions. Thus, this code will bring confidence in business firms as well as lenders in the market without undue erosion of value of shareholders wealth.
- *Code will ensure competitive growth of insolvency professionals and information utilities.* Under the regulatory oversight of Insolvency and Bankruptcy Board, there will be three layers of institutional infrastructures namely Insolvency Professionals (IP), Insolvency Professional Agencies (IPA), and Information Utilities (IU). The Insolvency Professionals will discharge their duties either as interim or permanent under the guidance of Insolvency Professional Agencies (IPA). IPA will furnish performance bonds equivalent to the assets of the company for the surety of the conduct of IP. IP will take control of the management and operations of the firm for controlling further erosion of shareholders' wealth for a maximum period of 270 days and to facilitate insolvency resolution constituting creditors committee. IUs will facilitate a seamless network of all financial information in least possible time. Simultaneously, multiplicity of IUs and IPAs will ensure fair competitions within the framework to evolve with better information system and insolvency resolution mechanism respectively. Thus, the competitive structures of various pillars of this code will evolve perpetually with better procedures, systems and mechanism.
- *Code has stated clearly the priority of distributing claims in insolvency resolution:* The Insolvency and Bankruptcy Code 2016 has mentioned the order of payment in case of liquidation. First receivables right lies with insolvency professional fees followed by secured creditors, workers dues, employee wages, unsecured creditors, Government dues and shareholders. Thus, it avoids any sort of conflict among various stakeholders arising out of liquidation.

- *Code mandates the provision of bailout by Insolvency and Bankruptcy Fund:* This fund has three different sources: (1) deposits by Central Government, (2) deposits by various entities and (3) Interest earned on investments made from the fund. This will act as cushion in emergency or bail out as cases are deemed fit in the economy.
- *Code has adequate penal provisions for malfeasance:* The new framework has the provisions of monetary penalty up to Rs 5 crore and Rs 5 lakhs for corporate entities and individuals respectively for substantial evidences of fraud or misrepresentation of facts and figures. Additionally, it may also attract imprisonment up to five years depending upon case.
- *Code has also addressed the cross boarder insolvency problems:* It is expected that the incumbent Government will go for agreement with various countries to handle insolvency issues of entities operating in India and abroad. Thus, cross country treaty or legal framework will help to resolve these issues.

LIMITATIONS OF INSOLVENCY AND BANKRUPTCY CODE 2016

Both the houses of the parliament have passed the code and it has also got the presidential consent. Despite all these, the code may face following issues in implementation.

- *Provision of Interim Regulator (Clause 188, 195) may not be effective:* The Code envisages the Insolvency and Bankruptcy Board of India as an overall regulator of IP, IPA and IU. The Code has proposed an interim regulator till the board is constituted. There is no time frame made available for the constitution of the board, so the functioning of interim regulator and insolvency management will not be effective.
- *Sources of funds for Insolvency and Bankruptcy Fund are not clear (Clause 224).*
- *Monetary limit of Fresh Start Process is unrealistic (Clause 80):* The Code promotes Fresh Start Process for individuals with debt waiver up to Rs 35000 subjected to annual income limit of Rs 60000 with no house ownership. These conditions of Fresh Start Process may be argued on the quantum of limits and debt waiver afresh.
- *IPA need to furnish performance bond equal to the value of assets of debtors:* The Code envisages that the IP will work under the aegis of IPA and the IPA will furnish the performance bond for the guarantee of professional and ethical behaviour of IP. The mandate of the Code seems to impose severe economic burden on IPA which may deter smaller entities to qualify for IPA. It is also likely that none of the entities may come forward for IPA. In UK and USA, insolvency laws have limit on the value of performance bond. Thus, the Government need to make it more realistic.

CONCLUSIONS

The Insolvency and Bankruptcy Code, 2016 has successfully unified the existing legal framework bringing structural reforms in debt financing. It envisages four additional institutional pillars namely Insolvency Professional, Insolvency Professional Agency, Insolvency and Bankruptcy Board of India and Information Utility. The Code sets the limit for time bound insolvency resolution in 180 days which may be extended to 270 days in exceptional cases at par with global standards. This Code will bring structural reform in debt

financing transforming India from weaker and delayed insolvency regime to one which is more robust and time bound. With the implementation of this code, innovations will continue, better price discovery will take place, and shareholders' wealth won't erode irrationally at firm's levels.

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