

Corporate Insolvency Resolution Procedure under Indian Insolvency and Bankruptcy Code, 2016: A Comparative Perspective



The foremost concern of an insolvency and bankruptcy regime is to keep viable businesses operating. An ideal regime should restrain premature liquidation of sustainable businesses and should be able to turn around businesses suffering from a temporary economic strain so that investment of creditors can be recuperated. Recent research on bankruptcy reforms has shown that development of regime or major reforms in the existing one can significantly reduce the failure rates with a decrease in number of liquidation of profitable businesses and are also associated with benefits like - increased access to low-cost credit, higher credit recovery rate for creditor and higher security for employees. The Indian Insolvency and Bankruptcy Code, 2016 (IBC) is a salutation overhaul for Sick Industrial Companies Act, 1985 (SICA) that offers a homogeneous and inclusive legislation, which encircle all the companies, corporate, limited liability partnerships and individuals. In the present article, the author has deliberated upon the Corporate Insolvency Resolution Procedure under Indian Insolvency and Bankruptcy Code, 2016 vis-à-vis other jurisdictions. Read on to know more....



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1. Introduction

Organisations can, and do, perform badly for various sets of reasons that may be internal or external to the organisation. For a lender or a creditor, discovering the financial distress or a near insolvency or bankruptcy of an organisation is really important. Before a petition is filed to the governing authority, debtor

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and creditor can meet to look out for alternatives for settling the outstanding dues without going for lengthy and costly official bankruptcy procedures.

Different economies have different codes, acts or a law that governs the procedure for liquidation, restructuring/reorganisation of a distressed firm. The proceedings for resolution and implementation of code also vary with different economies. A strong code can control the financial behaviour of a borrower and a stronger legal framework along with stronger enforcement protocols will force borrowers to avoid unnecessary risks and to follow more practical approach while making financial decisions (Claessens et al., 2003). Conversely, a deficient system can make debtors to depict more risky behaviour and take adverse financial decisions leading to higher credit default rates and financially distressed economy.

2. What are the Fundamentals of an Ideal Insolvency and Bankruptcy Procedure and Why Does it Matter?

The foremost concern of an insolvency and bankruptcy regime is to keep viable businesses operating. Studies show that effective reforms in insolvency and bankruptcy procedures are associated with increased access to low-cost credit, higher credit recovery rate for creditor and higher security for employees (Armour et al., 2015). An ideal bankruptcy proceeding ensures a higher recovery for creditors' investments, and increases the credit availability for reinvesting in viable businesses and hence, improving companies' access to credit. Similarly, if an insolvency and bankruptcy code compliments the Absolute Priority Rule (APR) for all claims, it allows secured investors to continue their investment and keeps good faith (Djankov, 2009). Some examples from recent research on cases of bankruptcy reforms showing the positive economic impacts are shown in the table below.

Table 2.1: Examples of positive economic impacts

Sl. No.	Country	Impact	Study Referred
1	Belgium	Bankruptcy rates fell down by about 9 percent	Dewaelheyns & Hulle, 2006
2	Chile	Helped economy to recover much faster during a depression	Bergoeing et al., 2006

Sl. No.	Country	Impact	Study Referred
3	Colombia	Number of liquidation went down by about 15 percent	Giné & Love, 2006

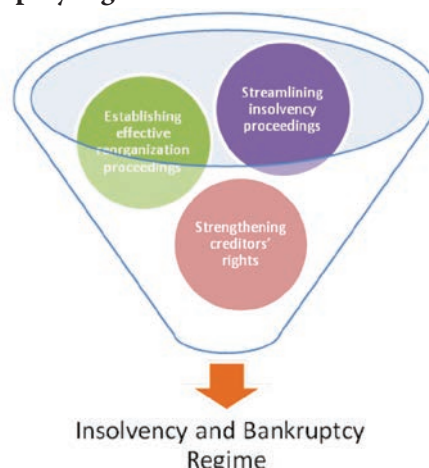
Table 2.2: Recent insolvency resolution reforms with respect to regions

Features	Economies
Introduced a new restructuring procedure	India; Benin; Brunei Darussala; Kenya; Mali; Niger; Poland; Togo; Republic of Congo; Guinea; Chad
Improved the likelihood of successful reorganisation	Brunei Darussalam; Kenya; Thailand
Improved provisions on treatment of contracts during administrators	Brunei Darussalam; Kenya; Vanuatu
Regulated the profession of insolvency administrators	Brunei Darussalam; Kenya
Strengthened creditors' right	Kazakhstan; India

Source: Doing Business (The World Bank, 2016)

The World Bank and the United Nations Commission on International Trade Law set forth a unified international good-practice standard on creditor and debtor regimes and insolvency. Good practices are aimed at improving both the efficiency and the outcome of insolvency proceedings. These include streamlining insolvency proceedings, establishing effective reorganisation proceedings and strengthening creditors' rights.

Figure 2.1: Good practices for insolvency and bankruptcy regimes

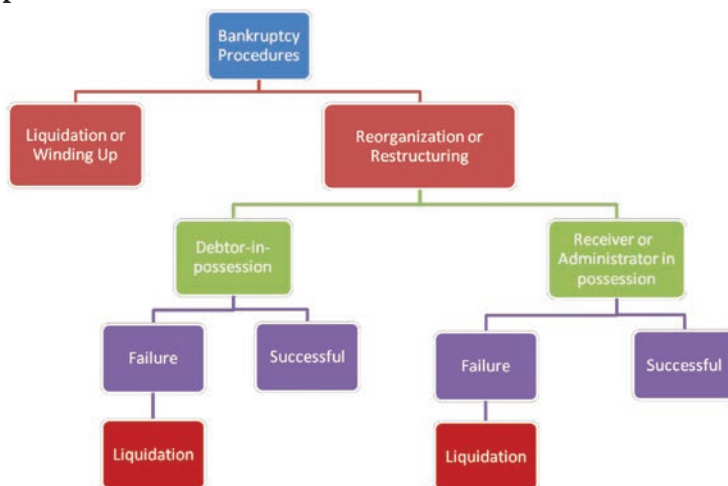


3. Insolvency and Bankruptcy Resolution Procedures

Bankruptcy resolution procedures take two distinct approaches:

1. Debt collection by sale of assets to satisfy the creditors' claims
2. Re-organisation of the firm's debt to maintain it as a going concern

Figure 3.1: Approaches for bankruptcy resolution procedures



Indian, United Kingdom's, and United States' insolvency and bankruptcy procedures are discussed below to cover both approaches with a comparative perspective.

3.1 Indian insolvency and bankruptcy resolution procedures

Indian bankruptcy procedures are covered under two segments: (1) SICA; and (2) IBC

Sick Industrial Companies Act, 1985 (SICA)

In India, the overall legal framework for restructuring/reorganisation or liquidation of financially distressed or sick units is laid down under SICA. SICA was legislated as a key economic reform to deal with the long and widespread distress in Indian industries and has been in operation since January, 1986. One of the goals of SICA was to unlock the investment by winding up the unviable businesses.

Two quasi-judicial bodies were established under SICA

- Board for Industrial and Financial Reconstruction (BIFR)

- Appellate Authority for Industrial and Financial Reconstruction (AAIFR)

BIFR was the governing authority for rehabilitating/reorganisation and reviving viable but sick industrial units and process the liquidation of the non-viable units and AAIFR was created for dissatisfied stakeholder to file an appeal against orders issued by BIFR.

Insolvency and Bankruptcy Code, 2016 (IBC)

The Parliament of India passed Insolvency and Bankruptcy Code in December 2016 (Legislative Department, 2016). The new code promises a better and painless procedure for restructuring or reorganisation of firm's debt and also speed up the liquidation of a failing business and efficient recovery of creditor's investment. IBC introduces the much awaited and much-needed creditor driven procedure for resolving insolvency and bankruptcy. While the introduction of new code is a historical reform in the country's economy, its effect will be seen in years to come and will depend on the infrastructure support and capacity of the implementing authorities and newly formed protocols.

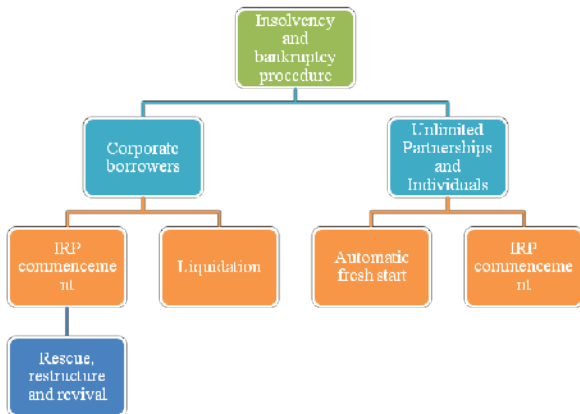
Consolidation of the current framework with the fangled institutional structure is expected to take place under IBC. The new code will construct an institutional framework, consisting of:

- (1) IBBI (Insolvency & Bankruptcy Board of India) as the regulating authority,
- (2) Insolvency professionals (to act as intermediary and help sick units and financial institutions including banks with a smooth takeover or liquidation process),
- (3) Information utilities (credit information storing units), and
- (4) Adjudicatory mechanisms, to facilitate a time-bound insolvency resolution procedure and liquidation if necessary.

The IBC appoints two different authorities to make the procedure for insolvency resolution smoother. The NCLT (National Company Law Tribunal) to deal with cases related to companies and LLP's and the DRT (Debt Recovery Tribunal) for partnership firms and individual.

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Figure 3.5: Insolvency and bankruptcy procedure under IBC



a) Corporate borrowers (min. default value INR 100,000)

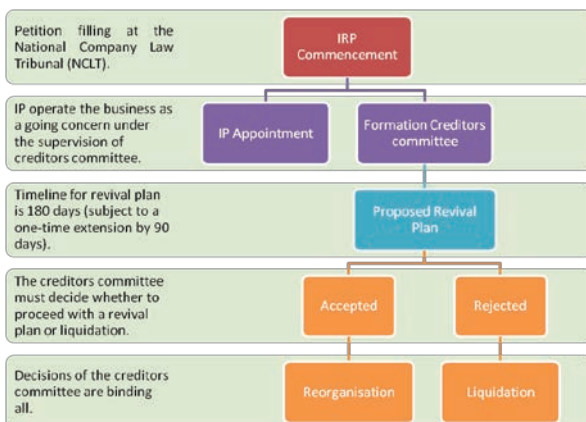
A two-stage independent procedure is proposed under new code:

- IRP: Insolvency Resolution Process
- Liquidation: if IRP fails and creditors take a decision to liquidate.

IRP

Commencement of IRP begins with a moratorium ordered from NCLT which remains in effect throughout the procedure. This operates as a 'calm period' during which no judicial proceedings can take place against the debtor. Under IBC, IRP transfers the rights to creditors and allows them to go for own assessment to analyse the potential and the viability of running the business as a going concern or to go for liquidation. This is a momentous procedural departure from SICA, which followed a debtor-in-possession bankruptcy procedure.

Figure 3.6: IPR under IBC:



Liquidation

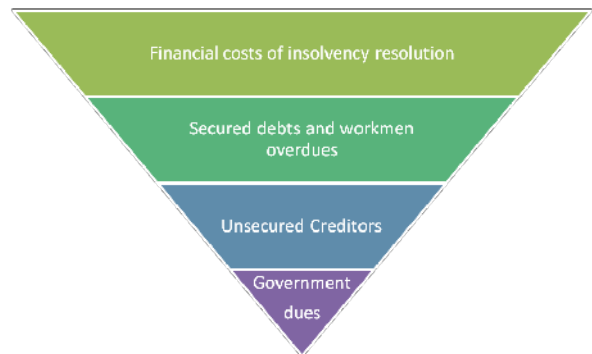
If IPR fails and no mutual agreement is reached, liquidation comes into play. Liquidation is imposed if:

1. Creditor's committee approves liquidation (with 75 percent majority);
2. Debtor is not able to propose a resolution plan (180 days timeline with a one-time extension of 90 days);
3. The proposal if rejected by creditor committee or by NCLT on technical grounds; or
4. Petition is submitted for liquidation to NCLT by any affected person.

All the ongoing legal proceedings come to a halt following the liquidation orders from NCLT.

Under IBC there are significant changes with respect to SICA in the priority for distribution of liquidation proceeds.

Figure 3.7: Priority of claims under IBC:



b) Unlimited Partnerships and Individuals (minimum default value INR 1000)

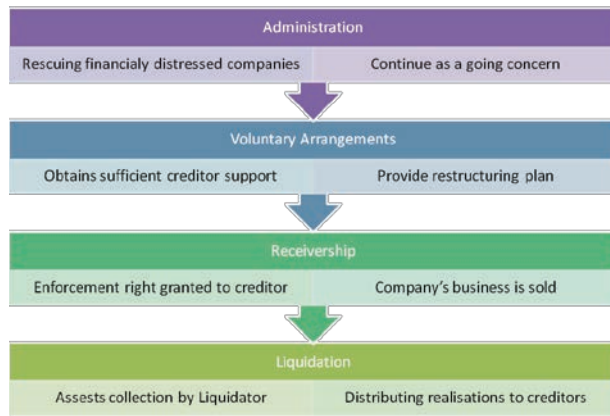
IRP under the new code are as below:

- i. Automatic fresh start: emancipation from debts to start afresh.
- ii. Insolvency resolution: New repayment plan is proposed.

3.2 United Kingdom insolvency and bankruptcy resolution procedure

With number of amendments since its realisation, The Insolvency Act, 1986 (Insolvency Act 1986: Chapter 45, 1986) can be taken as the primary source for British and Wales insolvency law. The most important feature of this procedure is that, once the bankruptcy is filed, firm's promoters, board members, managers and other officials immediately lose all control over the firm.

Figure 3.2: United Kingdom insolvency and bankruptcy resolution procedure



Administration

Administration: A “rescue method” for companies that are already into bankruptcy or are likely to go insolvent. Three routes are known to take an entry into administration: (1) by any order issued by court, (2) by notice or petition filed at the court by the creditor, and/or (3) by notice or petition filed at court by the company itself or its board members. The administrator once appointed takes over the control of the company. An administrator must ensure that anyone out of three objectives mentioned below must be satisfied (first being the top priority):

- Maintaining the company as a going concern;
- Achieve better value for creditors in case of liquidation;

- Distribution to creditors by realisation of company assets.

Voluntary arrangements

Under this, the bankrupt company puts a debt restructuring proposal to its creditors without altering any rights of its secured and preferential creditors. The decision needs to be approved with a majority of 75 percent or more. After the restructuring plan is accepted and approved by creditors, the terms and conditions are to be ratified by the court before implementation to ensure fair practices.

Receivership

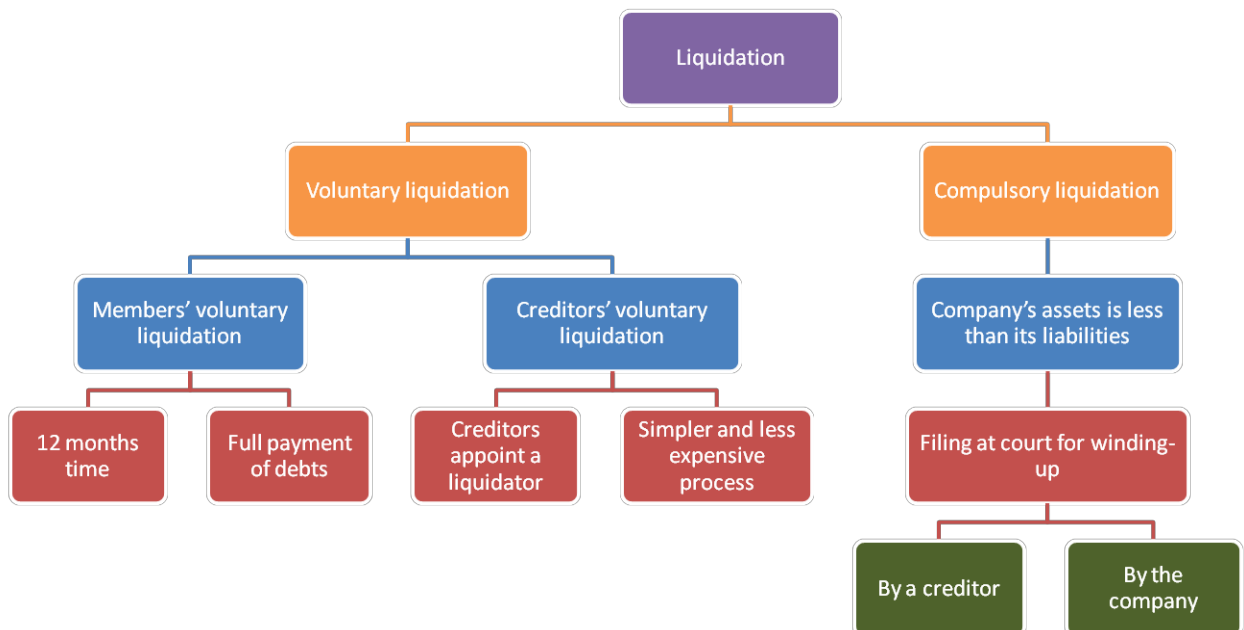
Receivership is not a collective remedy; it is enforcement rights granted to secured creditors. The primary duty of an appointed receiver is to execute the liquidation of company’s assets and distribute the proceeds from the sale amongst creditors on basis of priority.

Liquidation

The process of liquidation can take two paths:

- (1) Voluntary
- (2) Compulsory

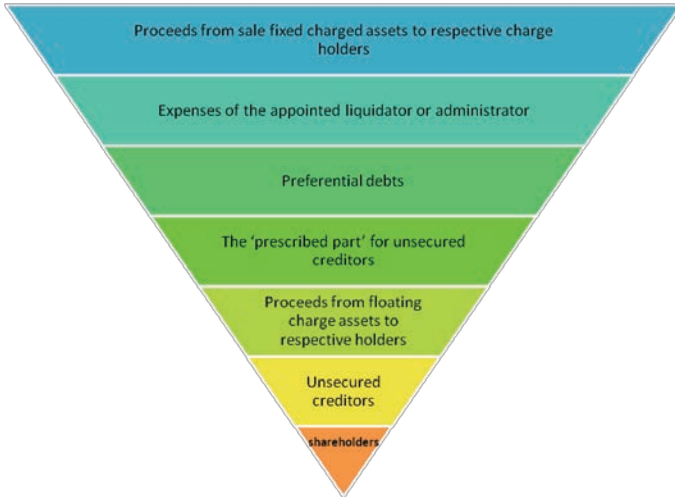
Figure 3.3: Liquidation under United Kingdom insolvency and bankruptcy resolution procedure



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In case of liquidation, both administrator and liquidator are under a duty to distribute the proceeds among creditors in a constitutional order of priority.

Figure 3.4: Priority of payment under United Kingdom bankruptcy procedure

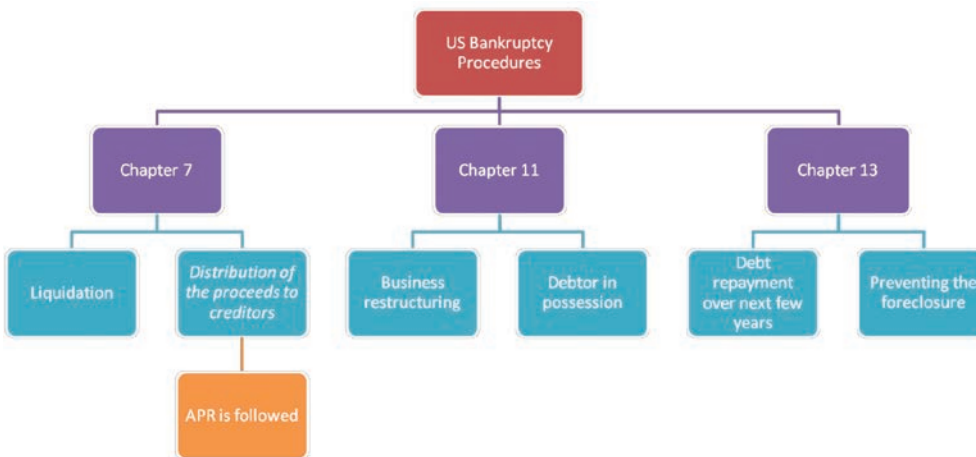


3.3 United States insolvency and bankruptcy resolution procedures

The United States Bankruptcy procedures are discussed under three different chapters:

1. Chapter 7,
2. Chapter 11, and
3. Chapter 13.

Figure 3.5: United States bankruptcy procedures



Chapter 7: Liquidation

In Chapter 7 bankruptcy proceedings a company ceases all its business operations and goes out of

business completely. A trustee is appointed to realise the assets and the proceeds from the liquidation are distributed as per APR. If the firm completes bankruptcy procedure under Chapter 7 once, it cannot file for another Chapter 7 bankruptcy for next six years.

Chapter 11: Restructuring

Chapter 11 is a procedure for restructuring a financially distressed organisation. It is a procedure where the defaulting management or debtor remains in possession of all assets and controls the organisation, under supervision of court. To file a chapter 11 bankruptcy a firm need not be officially bankrupt: near future bankruptcy anticipation is sufficient to file a chapter 11 bankruptcy. Within 120 days a debt restructuring plan is prepossessed to keep the firm running as a going concern. Restructuring plan can be adopted in two ways:

1. UCP (Unanimous consent procedure)

The plan is to be approved by each-class of creditor with two-third majority of the face value of total outstanding claims within class and one-half of the number of creditors.

2. Cram-down procedure

Under the cram-down procedure, the judge crams-down an agreement keeping in mind that all creditors are treated "fair and equitably". This involves a detailed procedure and estimation and hence, is more costly than UCP. Once adopted, it is binding for all.

Chapter 13

Chapter 13 allows a person or sole proprietorship who is under debt but still has considerable source of income to prepare and submit a repayment plan to the courts. As part of the restructuring

or reorganisation, the debtor must follow the plan submitted to repay outstanding debts to creditors within a timeframe of three to five years.

Table 1: Comparative perspective (bankruptcy procedures): SICA vs. IBC vs. United Kingdom vs. United States

Entities	SICA	IBC	UK	US – Chapter-11
Implementing Authorities	BIFR and AAIFR	IBBI	Court	Court
Timeframe	Average 4 Years	180 days (extension of 90 days)	1 Year	1.5 Years
APR	Violates APR	Follows APR	Follows APR	Violates APR
Recovery(percent)	26	Higher expectations	88.6	78.6
Support Structure	2 Pillars: • BIFR and AAIFR • Adjudicatory (NCLT & DRT)	4 Pillars: • IBBI • IP's • IU's • Adjudicatory (NCLT & DRT)	2 Pillars: • Adjudicatory mechanisms (Court) • Administration or Liquidator (on appointed basis)	2 Pillars: • Adjudicatory mechanisms (Court) • Trustee (By appointment)
Supports	Debtor-in-possession	Creditors based	Creditors based	Debtor-in-possession
Ease of Liquidation	Near impossible	Easy liquidation	Easy liquidation	Liquidation under Chapter 7
Ranking	136**	103*	14*	3*
Associated Problems	<ul style="list-style-type: none"> • Huge Delay • High cost of Procedure • Low recover rate • Near impossible liquidation • APR violation • Debtor in possession • Overinvestment 	Hard deadline of 180/270 days may push otherwise salvageable firms into liquidation.	Most of the time the process result in liquidation rather than restructuring.	<ul style="list-style-type: none"> • Huge Delay • High cost of Procedure • APR violation • Debtor in possession • Overinvestment
Similarity with	Chapter 11	UK	IBC	SICA

** (The World Bank, 2016);

* (The World Bank, 2017)

SICA vs. IBC vs. United Kingdom's Bankruptcy procedure vs. United States' Bankruptcy procedure

BIFR (enacted under SICA) has remarkable similarities with Chapter 11. Both procedures follow debtor-in-possession process and create perverse incentives for debtor leading to inordinate delays and overinvestment with a serious violation to APR. Under debtor-in-possession procedures over-leveraged and distressed firm attempts to

restructure through risky investments (Goswami, 1996). Conversely IBC proposes a different procedure and is on the line of the United Kingdom's framework and follows the process of appointment of an administration (IPs) to lead the process under the supervision of a creditor committee for implementing the revival plan or the process for liquidation if IRP fails and distribution of proceeds as per APR.

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4. Concluding Remarks

SICA was surrounded by too many barriers and weaknesses; one amongst the other identified weaknesses was the definition of sickness given under the code. The definition of a sick unit under SICA identifies the sickness in an industrial unit very late and makes it very difficult for BIFR to propose a revival plan. Liquidation of an unviable business was virtually impossible and also accounted for the greatest problem in SICA. Other major issues with SICA included APR violation along with debtor-in-possession procedures, inordinate delays, and overinvestment. Currently, India is ranked much below China and Pakistan for ease of resolving insolvency with an average period of 4 years to resolve insolvency and a low recovery rate of about 25 percent.

IBC isn't a magic spell that works overnight. We need to wait and watch for the benefits to curve in after an initial building period. It takes into consideration the APR and most importantly it is a creditors based IRP, conversely to SICA which supported the debtor-in-possession bankruptcy procedure. For successful implementation of IBC an increased infrastructure support and capacity building at NCLT will be needed. A smoother and faster transition from SICA to IBC will require a hefty pool of highly qualified and competent IP's with IU's serving as a support system backing IP's. If the 180 day (270 days if extended by 90 days) timeline for the IRP is achieved; this reform will help India to perform better in World Bank's index.

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