

# **THE INSOLVENCY RESOLUTION PROCESS BY FINANCIAL CREDITOR UNDER THE INSOLVENCY AND BANKRUPTCY CODE 2016**

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## **ABSTRACT**

The year 2017, a year of reforms rather landmark reforms firstly the GST and then the Insolvency and Bankruptcy code (IBC), the latter is just beginning to be examined closely and thoroughly. Due to these two enactments we are to witness a lot of changes in the manner businesses are conducted. The Insolvency & bankruptcy laws were scattered in lot more enactments and could not help recovery as it were time consuming, a need was felt that new stringent laws be enacted which would take care of the existing defaulters in a time bound manner. Therefore the Government of India decided to replace all the existing insolvency laws namely the Recovery of debts due to Banks and Financial Institutions Act 1993, the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Securitizations and Reconstructions of Financial Assets and Enforcement of Security Interest Act, 2002. The IBC received the assent of the President of India on 28<sup>th</sup> May, 2016. The Parliament enacted this new law for the reorganization and insolvency resolution of LLP, corporate persons, individuals and partnership firms within a time bound manner for maximization of value of assets and to consolidate the existing framework by creating a single law for insolvency and bankruptcy. The IBC is also to facilitate a better and faster debt recovery mechanism and is surely to change the negative perception<sup>1</sup> of recovery and litigation associated with it India. The IBC provides that the insolvency process can be initiated either by the financial creditor or the operational creditor or the corporate debtor itself.

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<sup>1</sup> negative perception - that it takes more than four years on an average to resolve insolvency in India

## **INTRODUCTION**

The objective of this new law is to promote entrepreneurship, availability of credit, and balance the interests of all stakeholders by consolidating and amending the laws relating to reorganization and insolvency resolution of LLP, corporate persons, partnership firms and individuals in a time bound manner and for maximization of value of assets of such persons and matters connected therewith or incidental thereto<sup>2</sup>.

The Government of India decided to replace all the existing insolvency laws namely the Recovery of debts due to Banks and Financial Institutions Act 1993, the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Securitizations and Reconstructions of Financial Assets and Enforcement of Security Interest Act, 2002 including the Presidency Towns Act, 1909 (Presidency Act) & the Provincial Insolvency Act, 1920 (Provincial Act), today both are repealed. The Parliament enacted this new law also to consolidate the existing framework by creating a single law for insolvency and bankruptcy.

One of the most important feature of this new law is that it provides for a clear, coherent and speedy process in a time bound manner, for early identification of financial distress and resolution of companies and limited liability entities if the underlying business is found to be viable.

The object of this article is to analyze and understand the insolvency process initiated by the financial creditor and to make an attempt to address any concerns arising out of the same.

## **BACKGROUND**

The legal and institutional existing machinery in India for dealing with debt default has not been at par with global standards. As is observed by the World Bank's Ease of doing business report that it takes more than four years to resolve insolvency in India. The creditors to initiate their recovery action had recourse either through the Contract Act or through special laws namely the Recovery of debts due to Banks and Financial Institutions Act 1993, the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the Securitizations and

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<sup>2</sup> Insolvency and Bankruptcy Code-2016, Objective

Reconstructions of Financial Assets and Enforcement of Security Interest Act, 2002. These laws did not had the desired outcomes as it provided for multiple forums and was time consuming. These existing insolvency laws were not able to aid recovery for the creditors/lenders nor were able to aid restructuring of firms. As far as the individual insolvency is concerned there were placed almost a century old the Presidential Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920, both stands repealed with the enactment of the new IBC. This being the legal and institutional machinery in India naturally this hampered the confidence of the lenders and therefore diminishing the debt access to borrowers.

The restructuring of the debt of stressed borrowers was done through the Corporate Debt Restructuring (CDR)<sup>3</sup> or the Joint Lenders Forum (JLF)<sup>4</sup> mechanism, this scheme of Reserve Bank of India was preferred by Banks. Since the overall success rate of CDR was very less this led the RBI to devise other scheme namely Sustainable Structuring of Stressed Assets (S4A). These efforts on the part of RBI could not achieve the desired results, and this compelled the Government to enact a new law that is a single legislation that would govern corporate insolvency and bankruptcy proceedings in India since the lenders had limited muscle when faced with default and promoters stayed in control of the affairs of the corporate.

## **INSOLVENCY RESOLUTION PROCESS**

In case a corporate debtor makes a default in payment of dues to the financial creditor, then in this situation the financial creditor may file an application<sup>5</sup> i.e. Insolvency resolution petition before the National Company Law Tribunal<sup>6</sup> (NCLT). The petition can be filed on a default of Rs 1 lakh or more. It is to be noted here that it is not necessary that the application should be filed on default in respect of the debt owned by the financial creditor himself, but any other

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<sup>3</sup> SDR is a tool for lenders to acquire majority ownership in a borrower by converting a part of the outstanding loan (including overdue interest) into equity. At a later date, it can transfer the control to a new promoter. The CDR did not provide any active efforts or plan to revive business rather it provided for temporary relief to the borrower. Therefore the success rate is very less. The evaluation of the business viability was not upto the mark as it was very poor and there was actually no monitoring.

<sup>4</sup> Joint Lenders' Forum which is a body comprised of banks who have given loan to the concerned borrower entity. The JLF is a dedicated grouping of lender banks that is formed to speed up decisions when an asset (loan) of more Rs 100 crore or more turns out to be a stressed asset. RBI has issued guidelines for the formation of JLF in 2014 for the effective management of stressed assets. Main purpose of JLF is to revive accounts that are stressed. The JLF has to initiate Corrective Actions when an account becomes the potential of being an NPA.

<sup>5</sup> Insolvency and Bankruptcy Code, 2016, S. 7(1)

<sup>6</sup> National Company Law Tribunal is one of the Adjudicating Authorities under the IBC for corporate persons

financial creditor can also file the application for insolvency process on default committed by the corporate debtor. The applicant herein namely the financial creditor has to support the application with evidence of default<sup>7</sup> and has to propose the name of the resolution professional to act as an interim resolution professional. In the absence of a name of a resolution professional NCLT is empowered to appoint one after consulting the Insolvency and Bankruptcy Board of India<sup>8</sup> (IBBI).

The Code provides for a window of fourteen days on the receipt of the application wherein the NCLT has to ascertain the existence of default<sup>9</sup> from the records of information utilities or on the basis of evidence furnished by the financial creditor and then NCLT can either accept or reject the application. In case the application is rejected, NCLT before doing so, shall give an opportunity to the applicant to rectify the defect in his application within seven days. It is very important and must be noted that the corporate insolvency resolution process commences from the date of admission of the application by NCLT. The entire resolution process needs to be completed within a period of 180 days unless extended by an order of the tribunal. A total period allowed to complete the resolution process is a maximum of 270 days, an initial 180 days and a maximum extension of 90 days.

The effect of admission of the application by the tribunal is that firstly it has to declare moratorium<sup>10</sup>, secondly appoint interim resolution professional and then cause public announcement. It is very important that a public announcement needs to be made as the public at large needs to be informed that the insolvency resolution process of the corporate debtor has been initiated. The creditors and the stakeholders needs to furnish their claims. The public announcement also details the information of the interim resolution professional who shall be vested with the management of the corporate debtor and be responsible for receiving claims.

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<sup>7</sup> Insolvency and Bankruptcy Code, 2016, S. 3

<sup>8</sup> Insolvency and Bankruptcy Board of India is the apex body, regulator for promoting transparency and governance in the administration of the IBC. It is tasked with the responsibility in setting up the infrastructure and accrediting Insolvency Professionals (IPs), Insolvency Professional Agencies (IPAs) and Information Utilities (IUs).

<sup>9</sup> Insolvency and Bankruptcy Code, 2016, S. 7(4)

<sup>10</sup> A temporary prohibition of an activity. Under the Code moratorium is declared u/S 13(a). It prohibits firstly the institution or continuation of suits against corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority; secondly transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein; thirdly any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; and lastly the recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.

Most importantly the public announcement informs the date on which the corporate insolvency resolution process shall close, needless to state that it has to be the one hundred and eightieth day from the date of the admission of the application initiated by the financial creditor. The appointment of the interim resolution professional by the NCLT is made as proposed by the applicant in its application for initiating the insolvency resolution process. In case there is no proposal made for the appointment of an interim resolution professional then NCLT needs to make a reference to the Board<sup>11</sup> for recommendation of an insolvency professional who may act as an interim resolution professional. The Board within ten days recommends the name and accordingly interim resolution professional is appointed. It is to be noted that the term of the interim resolution professional shall not exceed thirty days<sup>12</sup>, it follows that within thirty days the Committee of Creditors needs to appoint a Resolution professional. The committee of creditors is free either to appoint the interim resolution professional as resolution professional or can appoint any other person qualified to be appointed as such.

Now this is something very innovative and new, the IBC provides that as the interim resolution professional is appointed, the entire management of the affairs of the corporate debtor is vested with the interim resolution professional<sup>13</sup>. The powers of the board of directors is completely suspended and are exercised by the interim resolution professional. The interim resolution professional is empowered to have access to all documents and records as may be required by him and for the smooth functioning all the employees, officers and managers needs to report to him, even the financial institutions of the corporate debtor to follow suit. One of the most important duties assigned to the interim resolution professional is that he shall make every endeavour to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern and to do so he has the authority to appoint accountants, legal or other professionals as may be necessary and also to enter into contracts on behalf of the corporate debtor and also to raise interim finance.

Another important duty assigned to the interim resolution professional is that after collation of all the claims received against the corporate debtor he shall constitute a committee of creditors<sup>14</sup>. This is so important because the committee of creditors in their first meeting, by a

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<sup>11</sup> Insolvency and Bankruptcy Board of India (IBBI)

<sup>12</sup> Insolvency and Bankruptcy Code, 2016, S-16(5)

<sup>13</sup> Insolvency and Bankruptcy Code, 2016, S-17(1)(a)

<sup>14</sup> Insolvency and Bankruptcy Code, 2016, S-21

majority vote of not less than seventy-five per cent of voting share of the financial creditors has to either resolve to appoint the interim resolution professional as a resolution professional or in the alternate can replace the interim resolution professional by another resolution professional as the term of the interim resolution professional is only for a period of thirty days. Thus the resolution professional conducts the entire corporate insolvency resolution process and is solely responsible for the management of the operations of the corporate debtor during the corporate insolvency resolution process.

## **RESOLUTION PLAN**

Resolution plan<sup>15</sup> is one of the key and most important area of the IBC. A very precise and multi-dimensional understanding of the concept of Resolution Plan is inevitable. The plan needs to be equipped with the details as to how the company would restructure its business operations, financial re-engineering and would include everything that would make the company prosper.

Initially an information memorandum is prepared by the resolution professional which forms the basis for preparation of the resolution plan. Preparing the resolution plan is the most difficult and tedious work that has to be undertaken by the resolution professional, it is just like walking on a tight rope taking enough care that he does not fall. Most importantly the resolution plan should be prepared cautiously and meticulously and utmost care should be taken that the resolution plan does not contravene the provisions of the law for the time being in force. To prepare a sound resolution plan the resolution professional needs a continuous support from his team in legal, financial and secretarial areas of operation and also from expert external advisors.

On preparing the resolution plan the resolution professional needs to place it before the committee of creditors. The committee of creditors needs to approve the plan by a vote of not less than seventy-five per cent of voting share of the financial creditors. It is to be noted that the operational creditors are not the members of the committee of creditors, though they can participate but have no voting rights. When the resolution plan is approved by the committee

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<sup>15</sup> Resolution plan is like a revival plan for the corporate debtor.

of creditors the resolution professional needs to submit the same to the Adjudicating authority, the NCLT for approval.

The Adjudicating authority, NCLT on satisfaction that the resolution plan has been approved by the committee of creditors and the resolution plan provides for the payment of insolvency resolution process costs; provides for the repayment of the debts of operational creditors in such manner as may be specified by the Board; provides for the management of the affairs of the Corporate debtor after approval of the resolution plan; the implementation and supervision of the resolution plan; and most importantly that the resolution plan does not contravene any of the provisions of the law for the time being in force and should conform to such other requirements as may be specified by the Board, then the Adjudicating authority needs to approve the resolution plan. It is to be noted that on approval of the resolution plan by NCLT the same shall be binding on the corporate debtor and also its employees, members, creditors, guarantors and all other stakeholders involved. In the alternate if the Adjudicating authority is satisfied that the resolution plan does not provide or confirm to the requirements as provided under the code it may reject the resolution plan.

## **EFFECT OF THE ORDER OF APPROVAL**

On approval of the resolution plan the moratorium order passed ceases to have effect. The resolution professional is required to forward all the records relating to the conduct of the corporate insolvency resolution process including the resolution plan to the Board (IBBI) so that it is recorded in its database.

## **AREA OF CONCERN**

According to Section 30(4) of the IBC, “The committee of creditors may approve a resolution plan by a vote of not less than 75% of voting share of the financial creditors.” It implies that only 26% of voting share of the financial creditors can force a corporate to go into liquidation. I think the government needs to rethink on this count. As experiences suggest that liquidation yields a very lower value for assets, it also results to job losses due to closure and it is also

accompanied with more social problems, so liquidation is definitely not the solution but revival of the company is in the best interest of all the stakeholders.

Also the time limit of initial 180 days and the extendable time by 90 days also appears to be insufficient for the entire resolution process to be completed in my view a complete package of 365 days should be provided so that all possibilities can be explored before the corporate goes into liquidation.

## **CONCLUSION**

The IBC is found to be very clear and unambiguous with respect to the insolvency resolution process as laid down under the various provisions wherein the application is made by the financial creditor to initiate such process. It definitely provides a process that is time bound but as stated in earlier paras I have a little concern that the time period of 180 days with an extendable period of 90 days needs to be reviewed by the government and an additional period of at least 60 days needs to be provided, for the insolvency process to be completed. There is also a need to revisit the provisions which accord approval of the resolution plan initiated by the financial creditors as it provides in the alternate that if 26% of voting share of the financial creditors decide then they can force the company into liquidation as the code provides 75 % of voting share of financial creditors should approve the resolution plan before it is submitted to the Adjudicating authority for approval. The IBC is definitely a comprehensive reform and also change the image of India as having weak insolvency regimes to becoming a better insolvency regime. Thus the passing and implementation of the Code will definitely strengthen the ease of doing business in India.