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Solving Insolvency in India?

The insolvency and bankruptcy regime in India has historically been fragmented, involving a number of regulations implemented by several regulatory authorities and adjudication forums. The introduction of the Insolvency and Bankruptcy Code, 2016 (Insolvency Code) is a significant development aimed at a comprehensive, centralized regime and an efficient procedural framework.

The Insolvency Code is intended to integrate the regulatory framework provided under:

- Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), which established the Board for Industrial and Financial Reconstruction (BIFR) for sick companies. The SICA has been repealed, with effect from December 1, 2016;
- Various provisions within the Companies Act, 2013 (and its predecessor, the Companies Act, 1956) relating to insolvency for corporations;
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act), 2002 relating to secured lending;
- The Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 relating to bankruptcy of individuals (which have been repealed in entirety as the Insolvency Code came into effect); and
- Chapter XIII of the Limited Liability Partnership Act (LLP Act), 2008 relating to limited liability partnerships.

In addition, the insolvency resolution infrastructure also included various out-of-court mechanisms such as bilateral restructuring, one-time settlements, corporate and strategic debt restructuring and buyout of loans by asset reconstruction companies.

The absence of a comprehensive insolvency and bankruptcy regulatory framework resulted in lack of clarity and certainty, delay in closure of unviable businesses and confusion on the priority order of creditor claims having competing rights. This was further complicated by the absence of any centralized information system relating to assets and indebtedness of debtors.

Insolvency and Bankruptcy Code, 2016

The Insolvency Code has consolidated the regulatory framework relating to restructuring and liquidation of corporations, other unincorporated entities as well as individuals. It was approved by the President of India in May 2016. Various parts of the Insolvency Code have been and are proposed to be implemented in a phased manner.

Important Features of the Insolvency Code

Debtor in Possession to Creditor in Control Regime

The Insolvency Code classifies creditors into a number of categories, including financial creditors, operational creditors, employees, regulatory authorities and other creditors and specifies their respective and relative rights. Either the debtor or any class of creditors may initiate a resolution process under the Insolvency Code in case of non-payment of or inability to pay (as the case may be) a valid claim equal to or more than ₹100,000.

Within 14 days of the date of admission of the application, the board of directors and the promoters of the debtor company will cease to have control over the operation of the debtor company and an interim resolution professional will be appointed by the respective adjudicating authority. This interim resolution professional will manage the affairs of the debtor company for a maximum of 30 days until a committee of creditors is constituted to vote on the appointment of the resolution professional.

The Insolvency Code contemplates the formation of a committee of creditors to approve all material decisions in the insolvency process. Matters relating to the sale of assets, interim funding, creation of security interest and other related matters are required to be approved by this committee. The voting rights of the creditors are proportionate to the respective outstanding amounts owed to them. The debtor is entitled to a non-voting membership in the committee. Any decision by the committee requires the vote of more than 75% of the financial creditors, by value of the outstanding debt to such creditors.

On the first meeting of the committee of creditors, which is to be held within seven days of its constitution, the committee will vote to either confirm the existing interim resolution professional as the resolution professional for the course of the insolvency procedure or make an alternate appointment which shall then be confirmed by the respective adjudicating authority and the Insolvency and Bankruptcy Board of India. The resolution professional thus appointed will then manage the affairs of the debtor company throughout the course of the insolvency procedure.

The Insolvency Code contemplates a strictly time-bound, objective framework for insolvency resolution where the creditors, rather than the courts, are entitled to determine whether the business operations of the debtor should be revived and continued, or whether such entity and its assets should be liquidated.

Clear Waterfall Mechanism

The proceeds from the sale of liquidation of assets are required to be distributed in the order of claims specified by the Insolvency Code:

1. Process costs associated with insolvency and liquidation procedure
2. Secured creditor claims and workmen dues (capped at 24 months prior to liquidation) ranking pari passu
3. Other employees' salaries (capped at 12 months prior to commencement of liquidation)
4. Unsecured creditors
5. State and Central Government dues (capped at 24 months prior to commencement of liquidation) and unpaid dues to unsecured creditors after enforcement of security interest ranking pari passu
6. Any remaining debts and dues
7. Preference shareholders, if any
8. Equity shareholders or partners, as the case may be

The waterfall mechanism contemplated in the Insolvency Code is comparable to those applicable in Singapore and certain other developed insolvency law regimes. The relatively lower claim ranking for regulatory payments in the priority of claims is a notable concession by the government to other classes of creditors.

Transparency and Effective Resolution

The Insolvency Code contemplates a specified time period within which the viability of the debtor is required to be assessed and a resolution process is required to be agreed. The Insolvency Code contemplates an automatic moratorium of 180 days for any debt recovery actions by the creditors, during which the debtor may continue operations as a going concern under the interim resolution professional. The moratorium period may be extended by an additional 90 days under exceptional circumstances only. The likelihood of abuse of the moratorium period has been addressed by ensuring that any application for an extension of the moratorium period is strictly examined. The Insolvency Code also envisions the development of a comprehensive information system relating to indebtedness level, security creation and asset base of the relevant debtor to ensure transparency in the insolvency process.

Cross-border Insolvency

Although the Insolvency Code has not adopted the UNCITRAL model of cross-border insolvency addressing cooperation and coordination among various jurisdictions, it envisages various measures for the enforcement of cross-border insolvency. In the event that enforcement procedures under the Insolvency Code are initiated on assets located outside India in a reciprocal action jurisdiction, the adjudicating authority may issue a request to a competent court.

The Insolvency Code also contemplates that the government of India may enter into bilateral or multilateral arrangements in order to ensure enforcement of the Insolvency Code.

Conclusion

The new insolvency regime introduced in May 2016 contemplates a pragmatic cash-flow based insolvency assessment, which may assist in early identification of potential insolvency signs compared to the existing net worth or balance sheet based assessment. The Insolvency Code also provides for various safeguards to ensure that the collateral and other assets are not siphoned off by the debtor. It also provides for investigation and cancellation of antecedent transactions with third parties and related parties to prevent any illegal diversion of assets by the debtor or transactions benefitting a certain set of creditors. The introduction of the Insolvency Code is expected to provide a relatively efficient procedural framework for bankruptcy and insolvency laws in India.

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