STUDY OF THE INSOLVENCY AND BANKRUPTCY CODE 2016

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Abstract

India has been riddling since decades with the problem of insolvency and bankruptcy issues. Several public sector banks, financial institutions and operational creditors were facing severe credit default risk. Various laws and codes have been passed as a corrective measure, but have proved to be inefficient and failed to provide any kind of relief to the creditors.

There was thus a need for reform in insolvency and bankruptcy laws. The Insolvency and Bankruptcy code 2016 (IBC) has been instrumental in creating a shift in the way the bankruptcy process of defaulting firms has been dealt with. The IBC 2016 promises to bring about transparency, method and infrastructure in the entire system of liquidation. Changing up core aspects of the insolvency process, it gives companies a well-deserved chance at revival. Despite the recent amendments to the code and regulation changes by the Insolvency and Bankruptcy Board of India, there are still few grey areas in the code. This paper aims to thus test the effectiveness of the IBC 2016 since its introduction in 2016 and whether it resolves lags in the previous system. Hence, the paper dwells into the various components of IBC to critically analyse its sustainability and scalability. The research paper is purely based on secondary research through different news articles and reports from reliable sources.

Though it is too early to comment on the impact of the IBC 2016, the researchers have tried to study the code and conclude whether it will be successful in fixing the problems and will keep up to its promise in the long run.

Keywords: Insolvency, Bankruptcy, IBC Code 2016
Introduction

The Indian economy had growth rates which were among the highest globally in the year 2000 because of the internet boom. This kick started a phase where enormous amounts of investments were made by companies that over-leveraged themselves in the fear of losing opportunities which looked very lucrative. The Investment-GDP ratio had soared by 11% reaching 38% in 2007-08. The Global Financial Crisis in the year 2007-08 ended high growth levels. The reduced growth rates led to low revenues, while high inflation levels led to the RBI increasing the interest rates. All this culminated into creation of NPA’s at an exponential rate in the Financial Sector. In a survey done between 2014 and 2017, gross NPAs of public sector banks rose to Rs 7,23,513 crore from 2,24,542 crore. Banks reported that the amount of bad loans exceeded the total interest they earned as ‘operating earnings’. Over a period of 30 years, India implemented 12 Debt resolution mechanisms but all the laws failed to meet the purpose for which they were implemented. The borrowers used ambiguity in the judiciary to delay resolutions, avoid liquidation, retain control and deteriorate the value of the company. The creditors ended up seeing massive cuts in their debt recovery when these cases saw any form of conclusion. The World Bank in 2015 estimated that it took 4.6 years on average to resolve insolvency in India contrary to UK & US which took 1 & 1.5 years respectively. This one of the major reasons India was ranked 142 out of 189 countries by the World Bank for ease of doing business in 2015.

According to a study by The Ministry of Finance, if one would go at the rate of disposal at which insolvency cases were being resolved in the year 2015 it would take us another 324 years just to complete the backlog. Thus the new government felt an urgent need for an efficient, effective and speedy framework to curb the increasing number of NPA’s.

Therefore, The Insolvency and Bankruptcy Code (IBC) 2016 was introduced as one solution for all the above problems.
Birth of the Insolvency and Bankruptcy Code

The Insolvency and Bankruptcy Code, 2016 (IBC), passed on 26th May, 2016, is a landmark reform for India in the insolvency and bankruptcy ecosystem. The code has been put together by amending previous debt resolution mechanisms. IBC solidifies different statutory guidelines declared before and focuses on a time-bound resolution combined with maximization of value. This gives borrowers a second chance at reviving their failing businesses and lenders a hope of recovering their money. Hence, the Code aims at stabilizing the debt market and catalyzing growth in India. It has amended previous guidelines like:-

- Companies Act, 1956/2013
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act, 2002)
- Sick Industrial Companies Act, 1985 (SICA Act, 1985)

In all 2 laws were repealed and 11 laws were amended and redrafted under IBC.
A gist of the Infrastructure to support the implementation of IBC was set up in under a year of its inception, which are as follows:

1] **Insolvency and Bankruptcy Board of India (IBBI)**- Apex authority in charge of regulating the Corporate Insolvency Resolution Process. Its primary job is to create and amend laws relating to reorganization and insolvency.

2] **National Companies Law Tribunal (NCLT)/ Debt Recovery Tribunal (DRT)** - These are the adjudicating authority for the IBC 2016. They look into the matters of insolvency resolution. NCLT deals with corporates, companies and LLPs, whereas DRT is for individual bankruptcies.
3] **Information Utilities (IUs)**- These bodies keep all financial and credit records of the borrowers which becomes useful during the CIRP.

4] **Insolvency Professional Agencies (IPAs)**- These are registered bodies that matriculate the Insolvency Professionals.

5] **Resolution Professionals (RPs)/ Insolvency Professionals (IPs)** - RPs are appointed by the Adjudicating authority to replace the board of directors and look after the daily operations of the company. They work towards formulating a resolution plan for Committee of Creditors (CoC).

**Corporate Insolvency Resolution Process (CIRP) Under IBC 2016**

The Corporate Insolvency Resolution process (CIRP) is a set of guidelines and workflow that is carried out after a complaint is filed. The defined process of the IBC 2016 is as follows:

**Step 1**: Default of above INR 1 Lakh leading to CIRP application filed by financial creditors or homebuyers.

**Step 2**: Appointment of Resolution Professional (RP) who will undertake the working of the business by dissolving and replacing the board of directors.

**Step 3**: Moratorium Period of 180-270 days where no third party will be able to take action against the defaulting entity.

**Step 4**: Formation of Committee of Creditors (CoC) i.e. A collection of all financial creditors who will review the resolution plan prepared by the RP and decide whether it is feasible.

**Step 5**: Implementation of resolution plan if accepted by 66% of CoC; liquidation of company if otherwise. Liquidation will take place on the basis of the Priority waterfall of Claims method, which defines order of priority.
Benefits of IBC

( 1 ) Creditor in control (vs) Debtor in possession

IBC gives power to any financial, operational creditor or corporate debtor to file a complaint to the Adjudicating Authority whereas earlier, only the defaulters were in control of initiating the resolution processes. Certain exceptions include wilful defaulters, promoters/management of the company with non-performing debt for more than a year and disqualified directors. Moreover, it prohibits the sale of property of the defaulter to such parties during liquidation. The decision to accept or reject a resolution plan rests with the CoC, which is a major shift from the previous processes. NCLT has restrained the suspended directors of the defaulting companies from using the companies’ brand name and trademarks as it may affect the business. For example, on 25th January, 2019 the NCLT prohibited several entities such as Precious Power Technologies, SaveAWatt Power Technologies, Tushara Energy Ventures, etc from using the brand name and trademarks of Servomax India Limited, which is currently under CIRP with debt amounting to Rs. 8.77 crores.

( 2 ) Speedy resolution

Before IBC, it took 4.5 years on an average to complete insolvency proceedings. IBC has created a time bound process to tackle the endless extensions that used to be given earlier. It allows only 90 days extension over the prescribed 180 days of moratorium period. According to Corporate Affairs Secretary Injeti Srinivas, up till now IBC has recovered a sum of over 3 lakh crore of total debt, 60,000 crore from non-performing assets and 1.2 lakh crore at pre-admission before the insolvency petition was admitted.

( 3 ) There are no sources in the current document.

There were several laws governing bankruptcy and insolvency, a common case went on with different judicial bodies creating unnecessary delays and complexity. For example, cases went on in different forums like High Court, Company Law Board, Board for Industrial and Financial
Reconstruction, Debt Recovery Tribunal etc. Therefore, IBC formed a single law and only two adjudicating authorities to govern all aspects relating to the insolvencies.

(4) Well defined institutional framework

Prior to IBC 2016, the insolvency proceedings would take place in an unorganised manner due to lack of proper infrastructure. Different organisations i.e. IBBI, IUs, IPAs and IPs and a well defined process (CIRP) have been established under IBC to streamline the insolvency and bankruptcy process. Currently, India has more than 1800 Insolvency Professionals registered with IBBI.

(5) Early detection

Since Information Utilities function as ready reserves for every financial record of an entity, early detection of stressed assets is possible, thereby preventing defaults from taking place in the first place. In case of operational creditors such as suppliers, vendors, employees, they can file an application for insolvency resolution if the debtor is not successful in paying their unpaid dues beyond 10 days of demand notice. Due to the existence of IBC, around Rs. 1.2 lakh crores worth loan defaults have been resolved, even before they have been admitted. Out of 9000 cases transferred to the NCLT, 3,500 cases have been resolved pre-admission.

(6) Homebuyers as financial creditors

Homebuyers were not treated as financial creditors and so their dues were not cleared from the proceeds of liquidation. However, under IBC homebuyer’s interests are protected as they are treated as financial creditors. For example, in the case of the insolvency proceedings against Jaypee Infratech, home buyers were unable to address their concerns to the developer. However, after the amendment to the IBC in 2018, homebuyers were given a 62.2% representation in the CoC. The Supreme Court has ordered Jaypee Infratech’s parent company Jaiprakash Associates Limited to pay the homebuyers a sum of Rs. 600cr.
(7) Focuses on turnaround

Unlike before, Board of directors/Promoters are replaced by an insolvency professional (IP). IP curates a resolution plan most suitable for the operational turnaround of the business. The average recovery of insolvency resolution cases have been been 46% under the IBC as compared to 26% under the Board for Industrial and Financial Reconstruction.

(8) Central Repository of Information about Debtors

An absence of a central repository of information made it challenging for lenders to recover dues. There was considerable loss of time in gathering necessary information from various bodies under acts such as Indian Evidence Act 1872, Bankers’ Books of Evidence Act 1891, Information Technology Act 2000, etc. To address this delay, Information Utilities were formed. One of the very first information utilities to be registered with the IBBI was the The National E-Governance Services Limited (NeSI). It’s function is to collect critical and verified information regarding any debt, claim or default to facilitate a time bound resolution.

Negatives of IBC.

(1) Significant delays in resolution

In many cases the 270 days fixed timeframe was broken due to wasteful procedural aspects and insufficiency of framework. Every delay in judgment cause lenders to lose out on interest by the day. Thus far only 5 of the prescribed 12 main insolvency cases have come to a conclusion with an average of 333 days taken to solve them.

- Amtek Auto Ltd. - Acquired by Liberty House
- Bhushan Steel Ltd. - Acquired by Tata Steel. Ltd.
- Electrosteel Steels Ltd. - Acquired by Vedanta Ltd.
- Lanco Infrastructure Ltd. - Headed for liquidation
- Monnet Ispat Ltd. - Acquired by JSW Steel Ltd.

An average more than 415 days have passed since these the remaining cases came to IBC, and so far there is no end in sight.
(2) Concerns of Operational Creditors

Operational creditors cannot file a complaint with the NCLT in case of any defaults on payments due. They get very low representation on the CoC. Due to low liquidation worth and inadequacy to pay financial creditors, the incentive due to operational creditors remains at Nil. For Example, Close to 30 operational creditors of Essar Steel are seeking payment of dues worth over Rs 600 crore. While the total admitted claims of operational creditors is Rs 4,995 crore, the resolution applicant, Arcelor Mittal, has offered to settle only Rs.214 crore of these. Orissa Stevedores, an operational creditor claimed that the financial creditors are getting lesser haircuts on their dues when compared to the operational creditors.

(3) No legal framework to enforce cross border insolvencies

(4) Single bidder--Liquidation vs Resolution

In most of the cases lenders have agreed to liquidate the company as the liquidation value is much higher than any bids. But the actual value realised later on could be much lower due to rising operational costs and inefficient cash flows.

(5) Dealing with contingent liabilities

Most companies have varied pending liabilities like - tax, statutory dues, government dues, labour litigation and other commercial disputes, which makes it difficult to ascertain to what extent the liabilities will be discharged under CIRP, and what should be the true value of the company.

(6) Alignment with other laws and exemptions

The resolution process should be in synchronization with all other laws at the time. The bidder/resolution applicant does not get any exemption for taking over the management of the company, for example - Income tax is not exempted for tax accrued on book profits, which were generated by writing off liabilities.
There are not enough number NCLT benches and Judges in comparison to the quantum of case filed for resolution.

Conclusion

Since the day it was rolled out, IBC has successfully recovered around 3 lakh crores, directly or indirectly, from various default cases as quoted by the Mr. Injeti, Secretary, Corporate Affairs. The average recovery rate in the sixty-odd insolvency cases, which have seen a resolution, in the past two years is 46% contrary to the 26% which existed under the Board for Industrial And Financial Reconstruction (BIFR) regime. India's ranking for Ease of Doing business has bumped up to 70 from 142 in 2015 which is a big leap.

Although the new code has been facing some hiccups and challenges, the government is improving it by rolling out new reforms. Any kind of opinion on the nature of the code, quality of performance, level of relevance and the working of IBC would be premature, considering it is merely 3 years old.

But after looking at the numbers and the way it is being acknowledged, not only in India, but around the world, IBC is proving to be the silver lining that India needed in the dark clouds of rising NPAs and lethargic growth rate.
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