COMPARATIVE STUDY OF IBC CODE IN INDIA AND INSOLVENCY ACT, 1986 UK AND CORPORATE INSOLVENCY AND GOVERNANCE ACT 2020: TOWARDS A VIBRANT ECONOMY THROUGH ROBUST FINANCIAL LAWS

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Reforms in Insolvency Law for Corporate

Over the last two decades the Indian financial system has undergone a tremendous transformation. Various financial sector reforms have been initiated aimed at promoting an efficient well diversified and competitive financial systems with the ultimate objective of improving the allocative efficiency of the sources so as to accelerate economic development. As Indian swiftly moves to the center stage of the world economy there has been a consistent of effort by the policy makers to undertake comprehensive reforms in the laws and systems to bring them at par with international standards and incentivize the foreign investors to invest in the Indian economy.

Government Committees on Bankruptcy Reforms

Various Committees were constituted from time to time to renew the existing bankruptcy and insolvency laws in India. These committees analyzed the laws and suggested reforms to bring the law in time with ever-evolving circumstances.

Based on the recommendations of the Bankruptcy Law Reforms Committee constituted on 22/ 8/ 2014 under the chairmanship of Mr. T K Viswanathan, a bill relating to Insolvency and Bankruptcy Code was introduced in the parliament in December 2015, which was passed by Lok Sabha on 28/4 /2016 and by Rajya Sabha on 11th May 2016.

Ministry of Finance issued a Press Release on 11/5/2016 which observed:

"Today is a historical day for economic reforms in India, when the Rajya Sabha passed the major economic reform bill mood by the government, i.e., "Insolvency and Bankruptcy Code 2016". This is considered as biggest economic reform next only to GST…. The Insolvency and Bankruptcy Code is thus a comprehensive and systematic reform, which will give a quantum leap to the functioning of the credit market. It would take to India from among relatively weak insolvency regime to becoming one of the world's best insolvency regimes. It lays foundation for the development of the corporate bond market, which would finance the infrastructure projects of the future. The passing of this Code and implementation of the same will give a big boost to ease of doing business in India."

The Code was modified on 28th May 2016 (Inscript-1). The statement of objects and reasons appended to the said Bill succinctly puts the rationale behind the code as under-

"There is no single law in India that deals with insolvency and bankruptcy. Provisions relating to insolvency and bankruptcy for companies can be found in the Sick Industrial Companies (Special Provisions) Act, 1985, the Recovery of Debt due to Banks and Financial Institutions Act, 1993, The securitization and reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the Companies Act 2013. These statutes provide for creation of multiple fora such as Board of Industrial and Financial Reconstruction (BIFR), Debt Recovery Tribunal (DRT) and National Company Law Tribunal and their respective Appellate Tribunal. Liquidation of Companies is handled by the High Courts, individual bankruptcy and insolvency is dealt with under the Presidency Towns Insolvency Act, 1909, and the Provincial Insolvency Act, 1920, and is dealt with by Court. The existing framework for insolvency and bankruptcy is inadequate, ineffective and results in undue delays in resolutions, therefore, the proposed legislation."

The Code consolidates the laws relating to insolvency of the companies and limited liability entities including Limited Liability Partnership (LLP) and other entities with limited liability, unlimited partnerships and individuals, earlier contained in several legislations, into a single legislation. The aim of the consolidation was to provide for greater clarity in law and facilitate the application of consistent and coherent provisions to different stakeholders affected by business failures or inability to pay debt. For this purpose, the Code provided for repealing the Presidency Towns Insolvency Act, 1909, and the Provincial Towns Insolvency Act, 1920 and made amendment to 11 legislations, including the Companies Act 2013, RDDBF 9 and the

SARFAESI to give effect to its provisions. The provisions of the code override other laws to the extent such other law is inconsistent with the Code.

Salient Features of The Court Related to Corporate Insolvency

(a) Objective: As stated is long title, the objective of the code, is re-organization and insolvency resolution of Corporate Reasons, Partnerships Firms and individuals, in a time bound manner, for maximization of value of assets of the form concerned, to promote entrepreneurship and availability of credit and balance the interests of all its stakeholders.

(b) Applicability: The Code consolidates laws on insolvency and applies to the Companies, LLP firms, other body Corporate, Personal guarantors, Partnership firms, proprietorship firms and individuals. However, it is not applicable to finance service providers except those that are specifically notified as being covered by processes.

(c) Institutional Framework: A key innovation of the Code is the fourth pillar of the institutional infrastructure that it established, first of these pillars is a class of regulated persons, IP’s (Insolvency Professionals) They play a key role in the efficient working of the insolvency, liquidation and bankruptcy processes.

The second pillar is the new industry of the IUs (Infrastructure Utilities). These stores facts about lenders and the terms of lending in the electronic databases and eliminate delays and disputes about facts when defaults take place.

The third is the Adjudicating Authority (AA), namely the National Company Law Tribunal (NCLT) acting as the forum where corporate insolvency is heard and Debt Recovery Appellate Tribunal (DRAT) where individual insolvency are heard.

The fourth pillar is the Regulator, namely the IBBI which has regulatory oversight over the IP’s, IPA’s and IU’s and has the responsibility for specifying the regulations for various processes under the code.

Some of the Other Salient Features of the Code are:

(d) Processes: The Code establishes a linear collective process which is binding on the debtor, creditor and all other stakeholders. In case of corporate insolvency, it provides creditors a chance to assess the viability of the Corporate Debtors (CD), CIRP (Corporate Insolvency Resolution Plan) ends with a resolution plan rehabilitating the failing CD or commencement of liquidation of the CD.

Individual insolvency proceedings can proceed either through a fresh start process that results in the write off of qualifying debts or through the insolvency resolution process, which would provide debtor a chance to negotiate payments. A bankruptcy process, entailing sale of the assets of the debtor, can arise on failure of the insolvency resolution process.

(e) Time times: The Code establishes a timebound process for the resolution of insolvency. By way of illustration, the insolvency resolution process for corporate persons been mandated to be concluded within 330 days including the one-time extension of up to 90 days. Similarly, insolvency resolution process for personal guarantors, Partnership and Proprietorship concerns and individuals (Individual Insolvency) is to be included within 180 days.

(f) Control: Once CIRP is initiated, the management of the CD vests in the hands of the IP, who exercises the powers of the Board of Directors. This ensures information symmetry, enables fair evaluation of the viability of the CD and help preserve the nature of the CD as a going concern during the pendency of CIRP.

(g) Offences and Penalties: The Code lays down certain offences and penalties, and the Special Court for trial of offences upon a complaint by IBBI or the Government for contraventions of Provisions of the Code.

Corporate Insolvency Process

The Provisions relating to the Corporate Processes came into force on 1st December, 2016. The Code provides broadly three corporate insolvency process

i. CIRP
ii. Corporate Liquidation Process and
iii. Voluntary Liquidation Process

The Code provides for the divesting thing erstwhile management of its powers and vesting it in an independent professional to continue the business of firm as a going concern until a resolution plan is drawn up. Then, the management is handed over, under the approved resolution plan, so that the firm can get back on its feet and pay back its debt. All this is done within a period of 180 days with a onetime extension of up to 90 days or else the liquidation begins.

The Code is a comprehensive and systematic reform with the aim to change the landscape of the insolvency in the country.

Corporate Insolvency Resolution Process (CIRP)

The Provisions with regard to CIRP Liquidation Process and Voluntary Liquidation Process came into force in 2016-17 and the Regulation thereto were notified by IBBI at that time.

CIRP

The failure of some business plans is integral to the process of the market economy. When business failure takes place, the best outcome for society is to have a rapid renegotiation between the financiers, to finance the going concern using a new arrangement liability and with new management team. If this cannot be done, the best outcome for the society is a rapid liquidation. When such arrangements can be put into place, the market process of creative destruction will work smoothly, with greater competitive vigor and greater competition.

The Code read with the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. (CIRP Regulations) and Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 govern the CIRP.

Broadly, a threshold amount of default which (was Rs 1 Lac initially) is at Present Rs 1 Crore. It entitles an FC, an OC or the CD itself to file an application to initiate CIRP of the CD and if the said application is admitted, the CIRP commences. It means that

(a) The CD moves away from 'debtor in possession' to 'creditor in control'
(b) management of CD and its assets vest in an Interim Resolution Professional (IRP), who runs the CD as a going concern, and
(c) there is a moratorium prohibiting the institution or continuation of suits and proceedings against the CD.

The IRP makes a public announcement inviting submission of claims. After verification of claims, he constitutes a COC (Committee of Creditors), which in its first meeting appoint as IP as RP. While running the CD, as a going concern, the RP needs approval of the COC for certain matters. He invites feasible and viable resolution plans from eligible and credible RAs for resolution of insolvency of the CD. He issues an information memorandum (IM) and provides complete, correct and timely information about the CD to prospective RAs to enable them to design resolutions plans. On receipt of the resolution plans, he examines each of them to confirm if they comply with requirements laid down in the Code and the Regulations and submits the compliant plans for consideration of the COC approves a resolution plan within a stipulated time with 66% Amendment majority, the RP, submits the approved plan for approval by the AA. If the AA approves, a resolution plan, the CD continues as a going concern. If the COC does not approves the resolution plan with the required majority. Within this period or the AA does not approve the resolution plan, the CD mandatorily undergoes liquidation.

It is evident from the above that the Code has a strong focus on prevention of default/ failure. It enables everyone to submit a resolution plan for resolution of insolvency of the defaulting CD.

The existing Promoters and management may not submit the most competitive resolution plan or the COC may opt for liquidation. In such cases existing promoters and management may lose the firm for ever with the Code in place, ownership of firm is no more a divine right.

The credible threat of a CIRP that the control and management of the firm may move away from the existing promoters and management, most probably, forever, deters the management and promoters of the firm from operating below the optimum level of efficiency and motivates them to make the best efforts to avoid default. Further, it encourages debtors to settle default with the creditors at the earliest, preferable outside the Code. The Code would bring in significant behavioral changes and thereby redefine the debtor-creditor relationship with the Code in place, repayment of loan is no more an option, it is an obligation.

On the other hand, the creditor knows the consequences of default by a debtor, of insolvency proceeding is not initiated or the insolvency is not resolved. It is motivated to resort to more responsible (meritocratic) lending to reduce incidence of default. Further, although the creditor has the right to initiate a proceeding under the code as soon as there is a default of the threshold amount, it is not obliged to do so at the first available opportunity, if it has reasons for the same. It cannot, however, defer the initiation of proceeding indefinitely, allowing ballooning of default. It may not always be possible to prevent failures/defaults in the face and in such cases, the Code envisages a market mechanism to rescue a failing, viable in such cases.

Salient Features of CIRP

(a) The Code endeavors revival and continuation of the CD by protecting it from its own management and from liquidation

(b) The Code enables resolution of insolvency of the earliest, preferably at the very first default, to prevent it from ballooning

(c) The Code mandates resolution in a time bound manner, and undue delay is likely to reduce the enterprise value of the CD
(d) The Code envisages resolution of the CD as a going concern, as closure of the CD destroys organizational capital and renders resources idle till reallocation to alternate uses and make the possibility of resolution remote
(e) The Code envisages a collective mechanism for resolution of insolvency
(f) The Code provides for the best sustainable resolution
(g) The Code segregates commercial aspects of insolvency resolution from judicial aspects and empowers the stakeholders of the CD and the AA to decide matters within their domain
(h) The Code balances the interests of the stakeholders in the resolution process
(i) The Code requires the resolution plan to be in the compliance with the all the applicable laws of the land, and it was be implementable

Insolvency Laws In UK

The 1982 Report of the Insolvency Laws Renew Committee, insolvency laws and practice commonly known as Cork Report, recommended the adoption in the United Kingdom of Unified Insolvency Legislation. Ultimately, the Insolvency Act, 1986 (UK) was enacted and this encompasses both types of insolvency administration including corporate restructuring.

The existing UK insolvency framework is defined by the Insolvency Act, 1986. According to the Act, failing companies are either liquidated or submitted to an insolvency process that may allow them to be rescued as going concern.

The Insolvency Act, 1986, deals with the Insolvency of individuals and companies. The Act is divided into three groups and 14 schedules.

Group 1 deals with Companies insolvency, whereas Group 2 delas with insolvency of individuals and Group 3 delas with miscellaneous matters bearing on both Company and Individual Insolvency.

Basically, a company in financial difficulties may be made subject to any five statutory procedures and they are:

i. Administration
ii. Company Voluntary Arrangement (CVA)

iii. Scheme of Arrangement
iv. Receivership (including administrative receivership)
v. Liquidation (winding up) with the exception of (iii) scheme of arrangement, which fall within the ambit of the Companies Act 2006, these are formal insolvency procedures governed by the Insolvency Act, 1986.

The (i) above administration procedure was introduced by the Insolvency Act, 1986 and substantially revised by the Enterprise Act, 2002 to include a streamlined procedure allowing the company or (more often) its directors to appoint an administrator without the involvement of the Court subject to conditions.

Firms are in fact liquidated if they become the subject of a compulsory liquidation order obtained from the Court by a creditor, shareholders or director. Alternatively, the company may itself decide to pass a liquidation resolution subject to approval of a creditors' meeting- for the company to be wound up (a creditors Voluntary liquidation). Either way, the result of both these Procedures is the winding-up of the company. Neither process makes any attempt to rescue or sustain the company as a legal entity.

The Insolvency Act ,1986, also introduced three new procedures that held out the possibility of a company being brought back to life as a viable entity. These measures represented an attempt to emulate the 'rescue culture' that characterized the corporate sectors in the US.

The first of these procedures "Company Voluntary Arrangement (CVAs)"- provide a way in which a company in financial difficulty can come to a binding agreement with its creditors.

The second procedure- 'administration'- offers companies a breathing space during which creditors are restrained from taking action against them. During this period, an administrator is appointed by a Court to put forward proposals to deal with the Company's financial difficulties.

A third option- 'administrative receivership' permits appointment of a receiver by certain creditors normally the holders of the floating charge with the objective of ensuring repayment of secured debts.

In addition, the Act explicitly established a 'hierarchy of purposes' for the administrative process. The Primary duty of administrators was defined as rescuing the Company as a going concern a duty that does not exist for an administrative receiver. Only if this is not practicable or not in the interest of creditors as a whole is the administrator allowed to consider other options, such as realizing the value of property in order to make a distribution to creditors. The Enterprise Act 2002, attempted to embed a rescue culture by creating entry routes with administration that did not require a court order, and simplified the means by which a company could ‘emerge’ from administration. It also prohibited- with certain exceptions- the right of creditors to appoint an administrative receiver which had previously blocked a company's ability to opt for administration.

It may be noted that the English Bankruptcy System was the model for bankruptcy laws in the English colonies in America and in the Americans States after independence in 1776.