

**A CRITICAL ANALYSIS OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016**

**Swapna S.J.<sup>1</sup>**

**Chaitra L<sup>2</sup>**

**Santosh kumar K<sup>3</sup>**

**ABSTRACT:**

The current study attempts to analyse The Insolvency and Bankruptcy Code, 2016. It assesses the Insolvency and Bankruptcy Code impacts actions on the corporate restructuring. The research methodology of the current study relied on the internet-based investigation, review of literature. The Code intends to rationalize the processes and procedures for bankruptcy and insolvency, improve the recovery rates of debt and increase creditor confidence in India, and it should hopefully go some way to address the rights of lenders to enforce security in a distress situation, potentially bringing down the rate of non-performing loans.

The Insolvency and Bankruptcy Code, 2016 provides for the constitution of a new insolvency regulator i.e., the Insolvency and Bankruptcy Board of India (Board). Its role includes: (i) overseeing the functioning of insolvency intermediaries i.e., insolvency professionals, insolvency professional agencies and information utilities; and (ii) regulating the insolvency process. Insolvency and Bankruptcy Board of India (IBBI) will be the regulatory body responsible for framing the rules, code of conduct and registration of the above agencies.

The study concludes that Insolvency and Bankruptcy Code is regarded as a significant corporate issue of Companies in India irrespective of sector, business goal and size. This paper will highlight the key parts of the Code and assess its likely impact on the Indian debt market as well as an effort to highlight the importance of the Insolvency and Bankruptcy Code as a tool to make better corporate restructuring.

**KEYWORDS:** Insolvency, Bankruptcy.

**INTRODUCTION**

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<sup>1</sup> Assistant Professor at JSSLC

<sup>2</sup> Studying II Sem LL.M. at JSSLC

<sup>3</sup> Studying II Sem LL.B. at JSSLC

It's no secret that the Indian banking industry has a rather large number of loans outstanding that have simply gone wrong. With non-performing loans estimated at just over INR 8.3 trillion markets. In this context, the new Insolvency and Bankruptcy Code (the "Code") passed by Parliament promises to address the structural problems hampering the efficient recycling of capital and rebalance the rights of creditors, giving them much needed recourse to take timely and effective action against defaulting borrowers. In India, insolvency and bankruptcy are terms that are common with many other jurisdictions. However, they are not synonymous and should not be confused to mean the same thing.

Insolvency refers to a situation where any person or a body corporate is unable to fulfill its financial obligations (often occurring due to several factors such as a decrease in cash flow, losses and other related issues).

Bankruptcy on the other hand is a situation whereby a court of competent jurisdiction has declared a person or other entity insolvent, having passed appropriate orders to resolve it and protect the rights of the creditors.

To put it otherwise, the difference is that one comes before the other i.e. insolvency is a state of affairs, which triggers the legal process of bankruptcy.

### **OBJECTIVE OF THE STUDY:**

To critically analyse The Insolvency and Bankruptcy Code, 2016

### **METHODOLOGY OF THE STUDY:**

Comprehensive review of literature regarding the concepts and topic has been done. The present study was done with the main objectives of understanding and highlight of The Insolvency and Bankruptcy Code, 2016. The study is mainly based on secondary sources of information collected from Bare Act and Internet.

### **APPLICABILITY:**

The Code applies to companies, limited liability partnerships, partnership firms, other corporate persons, and individuals, and any other body specified by the Government.

### **BACKGROUND:**

The I&B Code was a much-needed legislation in India especially in the wake of rising NPAs. The laws governing insolvency and bankruptcy in India were not consolidated. Insolvency of individuals was dealt with under the Presidency Towns Insolvency Act, 1909 (the “Presidency Act”) and the Provincial Insolvency Act, 1920 (the “Provincial Act”). Insolvency for companies was dealt with under a number of pieces of legislation including the Companies Act, 2013 (the “Companies Act”); the Sick Industrial Companies Act, 1985 (the “SICA”), the Recovery of Debt Due to Banks and Financial Institutions Act, 1993 (the “Recovery Act”) and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (“SARFAESI”).

As a result of this overlap, several institutions had jurisdiction over the insolvency and bankruptcy process. The Company Law Board, the High Courts, the Debt Recovery Tribunals and the Board of Industrial and Financial Reconstruction dealt with the insolvency of entities they govern, which led to the problem of concurrent jurisdiction, systemic delays and other related complexities. To avoid this, the Insolvency and Bankruptcy Code has been introduced in India and tried to cover all the laws relating to insolvency and bankruptcy in India.

The **Insolvency and Bankruptcy Code, 2016(IBC)** is the bankruptcy law of India which seeks to consolidate the existing framework by creating a single law for insolvency and bankruptcy. The Insolvency and Bankruptcy Code, 2015 was introduced in Lok Sabha in December 2015. It was passed by Lok Sabha on 5 May 2016<sup>4</sup>. The Code received the assent of the President of India on 28 May 2016. Certain provisions of the Act has come into force from 5 August and 19 August 2016. The bankruptcy code is a one stop solution for resolving insolvencies which at present is a long process. The code will be able to protect the interests of small investors and make the process of doing business a cumbersome-less process.

The Code seeks to consolidate and amend the existing laws on bankruptcy and insolvency matters and creates a unified legal framework for resolution of insolvency/bankruptcy issues in a time bound manner. The Code will therefore merge the insolvency related provisions under the Companies Act, SARFAESI, the SICA, and the Recovery Act. Furthermore, the Presidency Act and Provincial Act stand repealed.

### **OBJECTIVES OF THE CODE:**

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<sup>4</sup>The Insolvency and Bankruptcy Code 2016

- (a) To create a new institutional framework consisting of The Insolvency and Bankruptcy Board of India, Insolvency Resolution Professionals, Information Utilities, Insolvency Professional Agencies (IPAs), Adjudicatory authorities for offering uniform and comprehensive legislation.
- (b) To facilitates time bound insolvency resolution process and liquidation
- (c) To improve ease of doing business in India and also to set up faster debt recovery mechanism in India.

### **MAJOR PROVISIONS OF THE CODE:**

One of the fundamental features of the Code is that it allows creditors to assess the viability of a debtor as a business decision and agree upon a plan for its revival or a speedy. The Code creates a new institutional framework, consisting of a regulator, insolvency professionals, information utilities and adjudicatory mechanisms, that will facilitate the formal and time bound insolvency resolution process and liquidation.

### **Corporate Debtors: Two-Stage Process:**

To initiate an insolvency process for corporate debtors, the default should be at least

INR 100,000 (USD 1495) (which limit may be increased up to INR 10,000,000 (USD 149,500) by the Government). The Code proposes two independent stages:

**Insolvency Resolution Process**, during which financial creditors assess whether the Debtor's business is viable to continue and the options for its rescue and revival; and

**Liquidation**, if the insolvency resolution process fails or financial creditors decide to Wind down and distribute the assets of the debtor.

### **CORPORATE INSOLVENCY RESOLUTION PROCESS (CIRP)<sup>5</sup>:**

Who can not initiate CIRP?

- CIRP cannot be initiated unless there is a default which is beyond the Minimum threshold. CIRP can be initiated only when any corporate debtor commits default. The minimum default thresholds for initiation of CIRP is Rupees One lakh or such higher

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<sup>5</sup>under Part II Chapter II of the Insolvency and Bankruptcy Code, 2016

amount as may be notified the Central Government which shall not exceed Rupees one Crore.

- CIRP cannot be initiated against the financial service provider as per Section 3(8) of IBC corporate debtor means a corporate person who owes a debt to any person. As per Section 3(7) “corporate person” means a company as defined in clause (20) of section 2 of the Companies Act, 2013, a limited liability partnership, as defined in clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008, or any other person incorporated with limited liability under any law for the time being in force but shall not include any financial service provider.

As the definition of corporate person excludes financial service provider, CIRP cannot be initiated against financial service provider.

The major provisions of the Code include establishment of an Insolvency regulator i.e. Insolvency and Bankruptcy Board of India (IBBI), creation of a new class of professionals (i.e. Insolvency Professionals) and Insolvency Professional Agencies (to develop professional standards, code of ethics and to exercise disciplinary role over IPs) and setting up of Information Utilities (who will collect, collate and disseminate information from companies and creditors). The cases in respect of corporate shall be adjudicated by NCLT and in respect of individuals and unlimited partnerships by DRTs and that the Appellate Jurisdiction shall be with NCLAT and DRATs respectively

### **THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (BOARD)<sup>6</sup>:**

The Code establishes the Insolvency and Bankruptcy Board of India (IBBI), it is a Regulatory Authority which regulates the law and registered entities under it and to bring Rules and Regulations, amendments, notifications in the Code. The Board will consist of 10 members, including representatives from the Ministry of Corporate Affairs, Ministries of Finance and Law, and the Reserve Bank of India. IBBI would regulate the appointment of insolvency professionals, information utilities and promote transparency in governance. The board will also make model bye laws for regulating insolvency professionals.

Its role includes:

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<sup>6</sup>Sec.188 of IBC, 2016

- Overseeing the functioning of insolvency intermediaries i.e., insolvency professionals, insolvency professional agencies and information utilities; and
- Regulating the insolvency process.

### **INSOLVENCY RESOLUTION PROFESSIONALS:**<sup>7</sup>

The Code provides for insolvency professionals as intermediaries who would play a key role in the efficient working of the bankruptcy process. The Code provides that the insolvency professionals are private professionals having minimum standards of professional and ethical conduct. In the resolution process, the insolvency professional verifies the claims of the creditors, constitutes a creditors committee, runs the debtor's business and helps the creditors in reaching a consensus for a revival plan. In liquidation, the insolvency professional acts as a liquidator and bankruptcy trustee.

### **INFORMATION UTILITIES:**<sup>8</sup>

One of the features of the Code is the creation of information utilities to collect, collate, authenticate and disseminate financial information of debtors in centralised electronic databases. The Code requires creditors to provide financial information of debtors. Such information would be available to creditors, resolution professionals, liquidators and other stakeholders in insolvency and bankruptcy proceedings.

### **INSOLVENCY PROFESSIONAL AGENCIES (IPAS):**<sup>9</sup>

Insolvency professional agency means any person registered with the Board under section 201 as an insolvency professional agency. These agencies are required to get registered and obtain certificate of registration from the Board. The Board shall have regard to the following principles while registering the insolvency professional agencies, namely:

1. Promote the professional development of and regulation of insolvency professionals.
2. Promote good professional and ethical conduct amongst insolvency professionals.
3. Protect the interests of debtors, creditors etc.
4. Promote the services of competent insolvency professionals to cater to the needs of debtors, creditors etc

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<sup>7</sup>Section 3 (19) of IBC, 2016

<sup>8</sup>Section 3 (19) of IBC, 2016

<sup>9</sup>Section 3 (20) of IBC, 2016

5. Promote the growth of insolvency professional agencies for the effective resolution of insolvency and bankruptcy processes under this Code.

### **ADJUDICATORY AUTHORITIES:**

The adjudicating authority for corporate insolvency and liquidation is the NCLT. Appeals from NCLT orders lie to the National Company Law Appellate Tribunal and thereafter to the Supreme Court of India. For individuals and other persons, the adjudicating authority is the DRT, appeals lie to the Debt Recovery Appellate Tribunal and thereafter to the Supreme Court.

The Insolvency and Bankruptcy Code, 2016 has made drastic changes with regard to winding up of companies. The Companies Act all along provided for winding up of companies on the ground of inability to pay debts. This ground for winding up has since been deleted from the Companies Act, 2013. It has been tagged with first compulsory resorting to corporate insolvency resolution process before going for liquidation on this ground under the Code. Such a provision shall also be applicable to Limited Liability Partnerships and other entities incorporated with limited liability under any other law for the time being in force. The Code has also shifted the provisions regarding voluntary winding up of companies from the Companies Act to the Code with some modifications, particularly doing away with members' voluntary winding up and approval of creditors compulsory for voluntary winding up of corporate debtors.

### **FAST TRACK CORPORATE INSOLVENCY RESOLUTION PROCESS:<sup>10</sup>**

The fast track corporate insolvency resolution process has been introduced which shall be completed within a period of ninety days (90) from the insolvency commencement date and there can be only one extension of forty-five days (45). The adjudicatory authority will have the power to extend the process only if an application is filed by the resolution professional on the instructions of the creditors by a resolution passed at a meeting with seventy-five per cent (75%) votes of the committee of creditors. With the implementation of the Insolvency and Bankruptcy Code, the problem of delay has been reduced since the quick disposal of

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<sup>10</sup>Chapter IV of Part II of Insolvency and Bankruptcy Code, 2016

cases have maximized the recovery amount because of the strict timelines within which the case has to be disposed of.

### **OFFENCES AND PENALTIES:**

The Code imposes punishment and penalties for offences committed by an officer of the Corporate Debtor, such as concealment of property of a CD; undergoing transactions to defraud the creditors; misconduct during the course of insolvency resolution process; falsification of books, papers, securities; for willful and material omissions from statements relating to CD; misrepresentations to creditors and etc.

- Such officer can be punishable with imprisonment of not less than three years but which may extend to five years, or with fine of not less than one lakh rupees, but which may extend to one crore rupees, or with both. That said, this doesn't render a person liable to any punishment if he proves that he had no intent to defraud or to conceal the state of affairs of the CD.
- For offences committed under individual insolvency (such as providing false information), the imprisonment varies based on the offence.
- Further, if anyone initiates the insolvency process with a fraudulent intention, a penalty ranging from Rupees One Lakh to Rupees One Crore may be imposed upon such applicant
- Number of Creditors – The I&B Code provides for a committee of creditors comprising of all the financial creditors. This is without any restriction on their number and as such it may comprise of even a thousand financial creditors. This may lead to invariable difficulties in conducting meetings, taking decisions and balancing the interests of all creditors. Therefore, there should be some cap on the number of financial creditors in a committee as in the case of operational creditors wherein the maximum number of creditors in a committee (of operational creditors) is limited to (18) eighteen. In other jurisdictions, there are restrictions on the number of creditors in a committee or there is a provision for different committees for different creditors. Such practice may be followed.
- Limitation Period – The I&B Code is silent on the applicability of the Limitation Act to the proceedings held there under. The NCLAT in *Black Pearl Hotels Pvt. Ltd. v. Planet M*

Retail Ltd dealt with the question of applicability of the Limitation Act. The aforesaid appeal arose from the decision of NCLT, Mumbai rejecting an application for initiation of insolvency proceedings by an operational creditor on the ground that the debt was barred by limitation. The NCLAT ruled that even if it is accepted that the Limitation Act is applicable to the I&B Code for initiation of Corporate Insolvency Resolution process, the period of limitation would only start running from 1st December, 2016 (i.e. the date on which the I&B Code came into force).

### **CONCLUSION:**

The Insolvency and Bankruptcy Code 2016, a vital reform that will make it much easier to do business in India. The IBC will lead 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 corporate persons, partnership firms and individuals and for maximization of value of assets of such persons. This Law promises to make it easier to wind up a failing business and facilitate a better and faster debt recovery mechanism in the country.

The IBC, 2016 is a revolutionary step as it proposes to transform the credit market in India, which hitherto was malfunctioning due to various problems and malpractices. The practice of defrauding the creditors and enjoying others money needs to be curbed because it is ultimately detrimental to the society at large. The law will implement it through NCLTs and DRTs and their machinery will have to take apart to meet the new challenges.

Justice V. R. Krishna Iyer observed<sup>11</sup>: ‘Law is a practical instrument, a working tool in a work-day world and where, the affected fraction of the community is the common official, the commercial man and ordinary folk, the wiser rule of construction follows commonsense, not casuistry, context, not strictness and not subtle nuance but plain sen.’

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<sup>11</sup>Trustees of port of Bombay v. Premier Automobiles Ltd., (1974) 4 SCC 710, Para 39