Insolvency and Bankruptcy Code 2016: Redrawing the Economic Reforms Landscape in India

By

Devyani Bhushan

Anubha Shrivastava

Dr. Syama Prasad Mookerjee Research Foundation

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Vikas Saini

Dr. Syama Prasad Mookerjee Research Foundation

9, Ashoka Road, New Delhi-110001

Web : www.spmrf.org, E-Mail : office@spmrf.org, Tel : 011-23005850

The Context

The National Democratic Alliance (NDA) Government introduced The Insolvency and Bankruptcy Code 2015, in Lok Sabha in December 2015.The draft Code was based on the inputs provided in the report of the committee headed by Dr T.K. Vishwanathan, which had given its report to the Government in November 2015.[1] A modified code, incorporating the suggestions of the Joint Parliamentary Committee (JPC), which had submitted its report in April 2016) was considered and passed by Lok Sabha on 5 May 2016. Most of the ruling alliance ministers have hailed this Code as a historic and game changing economic reform

The Insolvency and Bankruptcy Code 2016, comprehensively redraws the economic reforms landscape in the country by providing easy exit from the business market and by restricting debt. The Code would positively impact the ease of doing business in India, which is one of Asia's largest economies and would also prove to be a panacea, over long term, for banks that have been over burdened by Non Performing Assets (NPA). This Code should be seen and appreciated as a part of the package of economic reforms ushered in by the NDA Government which strives to make India more business friendly, particularly for foreign investors. The Insolvency and Bankruptcy Code, 2016, prescribes the procedure and creates a framework to wind up a failing business and recover debts in a simplified and time bound manner.

The Code which repeals dated financial laws like Presidency Towns Insolvency Act 1909, Provincial Insolvency Act ,1920 and makes major amendments in 11 laws including the iconic Companies Act, 2013 and the Recovery of Debts due to Banks and Financial Institutions Act, 1993,. The Code will apply to companies, partnerships, limited liability partnerships, individuals and any other entity, specified by the Central Government.

"Insolvency" is a situation where individuals or organisations are unable to meet their financial obligations. "Bankruptcy" is a legal status usually imposed by a court, on a firm or an individual (unable to meet debt obligations.) Upon successful completion of the bankruptcy proceedings, the debtor is relieved of the debt obligations incurred prior to filing for bankruptcy.[2] The Insolvency and Bankruptcy Code 2016, creates an institutional mechanism a insolvency resolution process for businesses operated by companies, individuals or any other entities, either by coming up with a viable survival mechanism or by ensuring their prompt liquidation.

Main Features and Benefits

At present individuals and entities wanting to do business in India have to deal with multiple laws. While in the past two decades, successive national Governments have done away with some laws and simplified many others, to facilitate the entry of individuals and companies into Indian markets, the present NDA Government has realised that the Ease of Doing Business is not limited only to convenient entry into the market.

Providing easy and transparent procedures of exit from the market and restricting debt is equally, if not more important. Therefore a need was felt to introduce one law to deal with bankruptcy in transparent and efficient manner. Hence the Bankruptcy and Insolvency Code ,2016.

The Code seeks to achieve certainty for recovery of debts and prescribes transparent as well as time bound enforcement proceedings for the same. Hence the Code is of great value to both domestic and international creditors and investors in such companies and businesses, which have become bankrupt. Investments by multinational companies and global financial institutions, in India, are growing and their exposure to Indian markets is also growing. These global institutions have repeatedly raised concerns on the issue of timely resolution of bankruptcy cases and certainty in recovery of dues. At times, these country risks have prevented investment from international investors. The present Code fully addresses these concerns. It is important to note that the Code does not make any distinction between the rights of international and domestic creditors or between classes of financial institutions. The Code seeks to achieve certainty for recovery and enforcement proceedings and would appeal specially to interventional creditors and investors from Private Equity Funds which are increasing their exposure to Indian markets and Indian business entities in-terms of investment.

The Code provides a level playing field and ensures that in cases of insolvency and bankruptcy, everyone would get their dues.[3] The Code also lays down an order of priority for everyone to get their due. It prescribes that in case of liquidation, to resolve insolvency, the assets will be distributed in the following order:-

1. Cost of insolvency process
2. Workers , secured creditors
3. Employee wages
4. Unsecured creditors
5. Government dues and remaining secured creditors
6. Any remaining debt
7. Shareholders

The Code requires an "Insolvency Plan", to be approved by 75% of creditors entitled to vote on the plan, as well as the approval of the relevant authority (The authorities are detailed later in the article)

The Code also seeks to ensure ease of recovery of debts as well as sets up strict timelines for resolution of insolvency and liquidation proceedings. The Code will hopefully ensure that there are no deadlocks in insolvency proceedings. The Code prescribes that bankruptcy is to be resolved within prescribed time, if not resolved in time, assets are to be sold to pay debtors.

The Code lays down a time bound process with 180 days to resolve insolvency. There is also a fast track option with a 90 days limit and a single extension of 45 days if needed. The Code also has provisions for force majeure and one time extension of

90 days, if three fourths of the creditors agree that the case is complex and cannot be addressed within 180 days, a onetime extension of 90 days can be granted. Hence the maximum time provided for resolving insolvency in some circumstances is 270 days in the Code.

As per, World Banks Ease of Doing Business Report, 2016,[4] currently, it takes an average of 4.3 years to resolve insolvency in India. This compares quiet unfavourably with United States where it takes 1.5 years, Finland where it takes 0.9 years and Japan where it takes 0.6 years. Even in case of China, it takes on an average 1.7 years to resolve bankruptcy. It is hoped that the Insolvency and Bankruptcy Code, 2016, would go a long way in correcting this imbalance, and would cut down the time to less than a year in India. Such a substantial change would also be a giant step to change the negative perception of long drawn out recovery and extremely complex litigation process in India.

One of the most important reforms that the Code seeks to trigger is substantive consequential changes/ amendments in various existing economic legislations and repeal of some of the existing economic legislations. India currently has multiple laws to deal with the problem of insolvency. These multiple laws lead to substantial delays in winding up a company. The Code repeals two acts going back to early 20th century and substantially amends 11 acts.

The Code ushers in key reforms by creating two authorities to deal with insolvency. First is the National Company Law Tribunal which will adjudicate cases for companies and limited liability partnerships. The second is The Debt Recovery Tribunal, which will adjudicate cases for individuals and partnerships firms. The Code also provides for Insolvency Regulator. The Insolvency and Bankruptcy Board of India will be establishes as a regulator to oversee the functioning of the Insolvency Professionals (IPs), related agencies and information utilities. This regulator will have 10 members including representatives from the Central Government and the Reserve Bank of India.

The Code introduces a new concept, for the first time in India, that of Insolvency Professionals (IPs). These are professionals, who will be specialising in dealing with matters of insolvency, liquidation and bankruptcy. These professionals will ensure efficient, effective and professional handling of repayment of debt. Insolvency Professionals will control the assets of the debtors during the process of resolution of insolvency. This provision of the Code triggered intense debate in the parliament. Members of the house raised concerns on the Code’s reliance on this new category of professionals and how such professionals, in adequate numbers would be made available. The role of the IPs may in the short to medium term, have to be filled by similar professionals from the field of law and business management. Insolvency Professional Agencies will also be created, under the Code, to regulate IPs. These agencies will conduct examinations to enrol IPs and enforce a code of conduct for their functioning.

The Code proposes to protect workers and employees of a company in case the company suffers from insolvency/ bankruptcy. The Code specifically provides for

workmen's dues for 24 months and wages and unpaid dues to the employees (other than workmen) for 12 months to be paid in priority during the liquidation process. To protect workers interests, the Code has provisions to ensure that the money due to the workers and employees from the Provident Fund, the Pension Fund and Gratuity fund should not be included in the estate of the bankrupt company or individual. Hence it is hoped that the code would provide relief to such workers and employees who are left unpaid by defaulting companies

The Code also visualises an institutional architecture to collect and maintain financial information related to a debtor. This architecture is based on setting up of "Insolvency Information Utilities". The Code proposes setting up of Information Utilities which would collect, collate, authenticate and disseminate financial information from listed companies as well as financial and operational creditors of companies. The Code also proposes an individual insolvency data base. Setting up such utilities would prove to be a critical intervention if these utilities harmonise and synergise their activities and data base with existing financial registries in the country ie. Central Registry of Securitisation, Asset Reconstruction and Security Interest of India, Central Repository of Information on Large Credits etc .

The Code also addresses the issue of cross-border insolvency. It has a provision of enabling the Central Government to enter into bilateral agreement with other countries for enforcing the provisions of the Code and notify its applicability from time to time. The Code also provides that the assets of the debtor located outside the country (in countries with which India has such bilateral agreement) can also be included for insolvency resolution process/ litigation before the adjudication authority.

The critics of the Insolvency and Bankruptcy Code 2016 point out that UNICETRAL model law on cross border insolvency, should have been adopted/ incorporated in the Code.[5] It was in May 1997, that the secretariat of the United Nations Commission on International Trade Law (UNICETRAL) issued the aforesaid model law to assist States in resolution of Corporate Insolvency. So far only 23 countries (including UK, USA, Japan and Australia), have substantially implemented the model law into their domestic legislation. India however has opted for signing bilateral agreement with sovereign countries.

Some commentators have suggested that the Code may help the country's banking sector, which is currently suffering from Non Performing Assets (NPA) / bad debts and prolonged insolvency litigation, the prime and latest example being US $ 1.3 billion debt of the now extinct Kingfisher Airlines and its promoter Vijay Mallaya, declared a "wilful defaulter" by the banks, who has left the country. According to a report of ASSOCHAM, the stressed assets (gross NPA plus restructured assets) of banks in India, were to the tune of Rs 10 trillion (US $150 billion), at the end of 2015-16[6].One must, however keep in mind that it would take a minimum of at least one year to put the required institutional framework in place for the Code to be implemented. The resolution of NPAs/ bad debts therefore would have to be addressed both by initiating

immediate steps like clean and fully provisioned bank balance sheets as well as curbing disproportionate exposure of banks to large corporate and long term steps like the effective implementation of the code.

The Bankruptcy Code 2016, by facilitating quick resolution of business failures would also push up India's ranking in Ease of Doing Business Index as well as World Bank Insolvency Ranking. India's present ranking in the category of- starting a business is 155 (in 2015 it was 164), India's present ranking in resolving insolvency is 136 (in 2015 it was 136).[7] In World Banks 2016 report India has been ranked 130 out of 189 countries (in 2015 India's ranking was 142), in ease of doing business. The stated objective of the NDA Government is that by 2019 India should be in the top 50 countries, in ease of doing business rankings.

Banks and assets reconstruction companies stand to gain from the Code in immediate future. The Code and the institutional mechanism that it puts in place would strengthen the comfort level of lenders. This in turn, it is hoped, will lead to greater investments. Locked up assets worth millions will be freed. Thus the Code will improve the ease of doing business in India by facilitating a better and faster debt recovery mechanism in the country and by changing the negative perception of recovery and prolonged litigation associated with such recovery in India. Experts like David. A. Skeel, Professor of corporate law at the University of Pennsylvania Law School feels that an effective bankruptcy system can make a significant difference and have a positive effect on growth of gross domestic produce (GDP).[8]

One should however not be placing all our eggs in the basket of the Insolvency and Bankruptcy Code 2016. The Code, though an important intervention, should not and must not be seen as the ultimate panacea for all the ills plaguing the businesses that go bankrupt in India. What is perhaps equally if not more important is better corporate governance and risk mitigation measures. ❍

(Devyani Bhushan is a Visiting Research Associate at SPMRF and has worked in the field of public policy. Anubha Shrivastava is with the Amity University)

(Endnotes)

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