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INTERPRETATION OF INSOLVENCY AND BANKRUPTCY CODE, 2016
AND ITS CHALLENGES

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Introduction

Insolvency and bankruptcy are the two terms where Insolvency is a situation in which companies and individuals are unable to pay their outstanding debt. Whereas, Bankruptcy is a legal declaration of one's ability to pay off debts by the court by passing the appropriate order to resolve the debts as well as to secure the rights of the creditors. Bankruptcy is just the legal term of Insolvency after the person or any entity has been declared unable to pay off the debts in the Court of Law. Insolvency and Bankruptcy Code came into effect on 28th May 2016 and provisions on the corporate insolvency resolution process (CIRP) came into effect on 1st December 2016. This Code is made up to improve the relationship between creditors and debtors.

When an individual is not able to pay the debt and apply for insolvency they are known as Bankrupts. Whereas when a company is unable to pay the debt in the future also and the value of its assets is less than that of its liability it is known as corporate insolvency. The term "debt" is defined under Section 3 (11) of Insolvency and Bankruptcy Code, 2016 which means "liability or obligation with respect of a claim which is due from any person and includes a financial debt and operational debt".

This code is made by merging all the pre-existing insolvency and bankruptcy law keeping in mind the state where a company is unable to run the business further due to financial difficulties. This Code is considered the revolutionary step was taken by the Government to keep the warm relationship between debtor and creditor and also to cut down the burden of non-performing assets for the company. After this code came into existence the Companies with failed businesses can revive them in a much lesser time.

This code specifies that all failed companies or unsuccessful private individuals have to complete the resolution process in a maximum of 270 to 330 days. The provision of the Insolvency and Bankruptcy Code, 2016 apply to Individuals, Unlimited Partnership Firms, Limited liability partnership, and Companies.

Historical evolution of Insolvency and Bankruptcy Code

In 1985 government introduced the Sick Industrial Companies Act (SICA) with the intention of the revival of sick companies. In the act, the authorities that were involved in regulating the act was BIFR (Board for industrial and financial reconstruction). This act failed because of the definition of “SICK” industries as given in the act. The industries are approached only after when it is too late to revive them, and therefore the only option left is to wind up the industry, which is not the purpose of the act.

After this, the Recovery of Debts due to Banks and Financial Institution Act, 1993 (RDDBFI) was passed to establish special courts for debt recovery. Debt Recovery Tribunals and Debt Recovery Appellate Tribunals were given the authority to recover the debts of Banks and Financial Institutions. This act failed because it was difficult for banks and Financial Institutions in recovering process. After this Act, SARFESI (Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest) Act, 2002 was made up with the intention to empower banks and Financial Institutions where banks and Institutions had all the power of assets reconstructions.

This Act also failed as the main functions of banks and Financial Institutions are lending money and not the reviving companies. If the Bank and Financial Institutions focus on reviving the companies then their effectiveness will deviate from what the actual purpose of these institutions is. After failing in proper implementation of all these Acts, this Insolvency and Bankruptcy Code was passed in 2016, in which creditors are in charge. They have the option to revive the company or liquidate it.

Needs for Insolvency and Bankruptcy Code

In 1991 when Indian economy brought up economic reforms that are Liberalization, Privatization, and Globalization policies which is made to provide entry to the Companies into Indian Market. That, Competition Act was passed in 2002, and the Competition Commission of India was made in 2009 to provide a framework for the companies so that they can compete with each other. Companies had the right to enter and compete in the market but they don't have the right to exit and liquidate till 2016. Insolvency and Bankruptcy Code, 2016 was passed which gives the company the right to liquidate or exit from the Indian Market in case of Insolvency and bankruptcy. This code is made with the arrangement and collection of different existing Acts, rules, and regulations; thus, it is a wider term than Act.

This Code balance the interest of all the stakeholders including alteration in the order of payment of the government dues. The code maximized the value of an asset of each stakeholder and also promote entrepreneurship as well as innovations. After this code came into existence both individuals and organizations can apply for insolvency. Earlier company resolution takes almost 5-7 years but this code simplifies the process of liquidation of the Company as it specifies in what amount the assets will be divided among the partners and all the necessary details regarding it. It protects the rights of the investors and makes the liquidation process easy.

An amendment under the Insolvency and Bankruptcy Code

Due to the Destruction created by the spread of Novel Coronavirus disease lockdown has affected the economy so much that the cash flow in the economy has temporarily stopped. This leads to an increase in the number of non-performing assets causing default in payment for the Financial Institutions, Banks, and Creditors. Therefore, the Government of India to safeguard the interests of the debtors and rescue the financial market introduced the concept of the Pre-packaged Insolvency Resolution Process, amended by ordinance which was promulgated by the president on 4th April 2021¹. This ordinance was introduced for MSMEs (Micro, small, and medium enterprises) whose default amount should be up to 1 crore and not less than 1 lakh. It is an

¹ <https://www.moneycontrol.com/news/business/explained-all-you-need-to-know-about-the-insolvency-and-bankruptcy-code-amendment-bill-2021-7245131.html>

alternative resolution process other than CIRP. The debtor is the in-charge in the initiation of PIRP.

The resolution plan should be made up by the corporate debtor with the equal participation of creditors. The debtors need prior approval of 66% voting shares of the financial creditors for appointing a Resolution Professional (RP) and resolution plan. After setting up the whole plan the debtor can further go to NCLT (National Company Law tribunal) for initiating the final proceeding of PIRP. This fast resolution process helps in reducing the burden of NCLT as the resolution plan has already been made. PIRP also provides a big relief to the MSMEs who were going through financial stress that is caused by the pandemic.

Shortcomings of Insolvency and Bankruptcy Code

Time Limit: According to the process of Corporate Insolvency Resolution, when a company defaults in payment to the creditor, the creditor can apply to this process to initiate the recovery of action from the Company. CIRP is a time bound process under Section 12 of the Code which mandates the process to be completed within 180 days from the date of admission of such application. However, the duration of such a process may extend by adjudicating authority when a meeting between creditors passed with 66% votes. Even such an extension period has to be processed within 90 days. The process has to be completed within 330 days as per Section 4 of the Insolvency and Bankruptcy Amendment Act, 2019 which includes the extension granted, and the section provides another 90 days for the proceeding to perform in avoidable delay situations due to numerous litigation process. For the companies having a large number of creditors, it is very difficult to complete CIRP within 330 days.

Lack of NCLT Benches: There are numerous cases pending before the NCLT till today. Total number of pending cases are over 20,000² and where there is only 15 NCLT Benches³. The lack of NCLT benches leads to a lot of problems in reaching the objective of the code. As the number of cases is higher than that of the proper infrastructure it is difficult to manage. Keeping in mind

² https://www.business-standard.com/article/companies/headless-nclt-awaits-reforms-to-speed-up-resolution-of-pending-cases-121062500038_1.html#:~:text=While%20the%20government%20is%20concerned,are%20insolvency%20and%20bankruptcy%20cases.

³ <https://nclt.gov.in/national-company-law-tribunal-benches>

that the objective of this code is to get a quick resolution process, with fewer NCLT benches it is difficult to achieve.

Management of Resolution professionals: To be an insolvency professional one must either be a Charter Account, a Company Secretary, a Cost Accountant or an advocate with 10 years of experience, or a graduate with 15 years of experience in handling the matters of a company. It is also required to pass the insolvency examination conducted by the Insolvency and Bankruptcy Board of India (IBBI). These requirements make it difficult for a resolution professional to get experience in the management of a company. Due to let experience they are unable to solve the problem and therefore their management is in question.

Conclusion

The exit process from a business should be as smoother as the entering process. With this Insolvency and Bankruptcy Code of 2016, India's global ranking in resolving insolvency has improved. The World Bank is also in this view that this code provides a better prospect in the process of liquidation and asset realization⁴. However, there are still many issues that need to be resolved to let the resolution process go smoother.

Also, the time taken in the process of resolution is equally important and should not be exceeded. Bankruptcies happen for many reasons, not always it is due to corrupt promoters or bad management. Sometimes it's the government policy change, a shift in demand, higher input costs, or even competition in the market⁵. The ultimate goal of the authorities should how they can revive the company or how they derogate the assets receiving the maximum value from it. Insolvency law in India is evolving but it still needs changes related to its interpretation and understanding.

⁴ <https://www.thehindubusinessline.com/opinion/columns/understanding-ibc-facts-and-implementation-challenges/article35071282.ece>

⁵ <https://www.newindianexpress.com/opinions/2021/jul/02/why-has-ibc-failed-to-live-up-to-its-promise-2324198.html>