UPSC PREPARATION

Insolvency And Bankruptcy Code (IBC) – IBC Amendment Bill 2021 [UPSC Notes GS III]

What is Insolvency And Bankruptcy Code?

Definition of Bankruptcy:

The legal status of an entity or a person where the debt owed to the creditors cannot be repaid is known as Bankruptcy. A court order imposes bankruptcy in most of the jurisdictions. It is mostly initiated by the debtor. It is important to note that bankruptcy is not synonymous with insolvency. It is not the only legal status that could be applicable to an insolvent individual or an entity. In countries like the UK, bankruptcy is exclusive to individuals. Liquidation, administration and other such insolvency proceedings are applicable to entities and companies.

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.

Objectives of IBC

- To consolidate and amend all existing insolvency laws in India.
- To simplify and expedite the Insolvency and Bankruptcy Proceedings in India.
- To protect the interest of creditors including stakeholders in a company.
- To revive the company in a time-bound manner.
- To promote entrepreneurship.
- To get the necessary relief to the creditors and consequently increase the credit supply in the economy.
- To work out a new and timely recovery procedure to be adopted by the banks, financial institutions or individuals.
- To set up an Insolvency and Bankruptcy Board of India.
- Maximization of the value of assets of corporate persons.

IBC – What does the Code aim to do?

The 2016 Code provides for a time-bound process to resolve insolvency. When a default in repayment occurs, creditors gain control over the debtor's assets and must make decisions to resolve insolvency within 180 days. To ensure an uninterrupted resolution process, the Code also provides immunity to debtors from resolution claims of creditors during this period. The Code also consolidates provisions of the current legislative framework to form a common forum for debtors and creditors of all classes to resolve insolvency.

Who facilitates the insolvency resolution under the Code?

- The Insolvency Professionals: These professionals will administer the resolution process, manage the assets of the debtor, and provide information for creditors to assist them in decision making.
- Insolvency Professional Agencies: insolvency professionals will be registered with insolvency professional agencies. The agencies conduct examinations to certify insolvency professionals and enforce a code of conduct for their performance.

- Information Utilities: Creditors will report financial information of the debt owed to them by the debtor. Such information will include records of debt, liabilities and defaults.
- Adjudicating authorities: The proceedings of the resolution process will be adjudicated by the National Companies Law Tribunal (NCLT), for companies; and the Debt Recovery Tribunal (DRT), for individuals. The duties of the authorities will include approval to initiate the resolution process, appoint the insolvency professional, and approve the final decision of creditors.
- Insolvency and Bankruptcy Board: The Board will regulate insolvency professionals, insolvency professional agencies and information utilities set up under the Code.
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What is the procedure to resolve insolvency in the Code?

The Code proposes the following steps to resolve insolvency:

1. Initiation: When a default occurs, the resolution process may be initiated by the debtor or creditor. The decision to resolve insolvency: A committee consisting of the financial creditors will take a decision regarding the future of the outstanding debt owed to them. They may choose to revive the debt owed to them or sell (liquidate) the assets of the debtor to repay the debts owed to them. If a decision is not taken in 180 days, the debtor's assets go into liquidation.
2. Liquidation: If the debtor goes into liquidation, an insolvency professional administers the liquidation process. Proceeds from the sale of the debtor's assets are distributed in the already established order of precedence.

The Insolvency and Bankruptcy Code (Amendment) Bill, 2021

- The Insolvency and Bankruptcy Code (Amendment) Bill, 2021 was introduced in the Lok Sabha to amend the insolvency law and provide for a prepackaged resolution process for stressed Micro, Small and Medium Enterprises.
- The bill will replace the ordinance that was promulgated on April 4 this year. It proposed 'pre-packs as an insolvency resolution mechanism for MSMEs.
- under this mechanism, main stakeholders such as creditors and shareholders come together to identify a prospective buyer and negotiate instead of a public bidding process.

Provisions of the Bill:

- It specifies a minimum threshold of not more than Rs 1 crore for initiating the pre-packaged insolvency resolution process
- It provides for disposal of simultaneous applications for initiation of the insolvency resolution process and pre-packaged insolvency resolution process, pending against the same corporate debtor.
- Penalty for fraudulent or malicious initiation of pre-packaged insolvency resolution process or with intent to defraud persons, and for fraudulent management of the corporate debtor during the process.
- Punishment for offences related to the pre-packaged insolvency resolution process.

What are 'pre-packs?

- A pre-pack is an agreement for the resolution of the debt of a distressed company. It is an agreement between secured creditors and investors instead of a public bidding process.
- The scheme allows only the debtor to trigger its own bankruptcy process with the approval of financial creditors.
- In general bankruptcy provisions, the proprietors or major shareholders of a small business lose operational control of the enterprise to lenders.
- In a pre-pack insolvency scheme, the shareholders or proprietors do not lose control over the enterprise.
- The creditors will agree to terms with the promoters or a potential investor, and seek approval of the resolution plan from the NCLT..
- The approval of at least 66 per cent of financial creditors that are unrelated to the corporate debtor would be required before a resolution plan is submitted to the NCLT.
- The NCLTs either accept or reject the application for a pre-pack insolvency proceeding before considering a petition for a CIRP.
- According to analysts, this scheme would yield resolution faster than the corporate insolvency resolution process (CIRP).

The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018

- The Ordinance amends the Insolvency and Bankruptcy Code, 2016 to clarify that allottees under a real estate project should be treated as financial creditors.
- The voting threshold for routine decisions taken by the committee of creditors has been reduced from 75% to 51%. For certain key decisions, this threshold has been reduced to 66%.
- The Ordinance allows the withdrawal of a resolution application submitted to the NCLT under the Code. This decision can be taken with the approval of 90% of the committee of creditors.

Issues with IBC 2016

- **Missing the deadline:** IBC mandates that an insolvent asset must be resolved in 270 days. Out of the 12 big accounts initially referred to IBC, five cases are pending for more than 600 days due to continuous litigation by some party or the other. Among the most prominent examples of this chequered journey for the IBC is the Essar Steel insolvency. It has been more than 600 days since the Rs 50,000-crore account entered the IBC.
- **Lack of benches and judges:** India has 14 NCLTs, and two are yet to start functioning. The government had a couple of years back announced to set up 24 bankruptcy courts. The NCLT judge roster shows 27 members have been sharing the workload against the target of appointing 60 judicial and technical members. Delhi and Kolkata are sharing the workloads of Jaipur, Chandigarh, Guwahati and Cuttack benches. Recently the government highlighted that it has been taking steps to increase the capacity of National Company Law Tribunal (NCLT) and increased its benches from 10 to 15. Also, 26 new members have been added taking the total strength to 52.
- **Haircuts:** It is the extent of write off that banks undertake as part of a resolution plan to get the company back on track. So far financial creditors have got 43 per cent of their claims and 188 per cent of the liquidation value. Steps should be taken so that haircuts are reduced.

- All these factors are raising concerns that IBC will meet the same fate as DRT and SARFAESI and banks will eventually lose confidence in IBC
- The recent Supreme Court order setting aside RBI's decision to send all power companies to the NCLT has also set a wrong precedent.

Parliament has recently passed the **Insolvency and Bankruptcy Code (Amendment) Bill 2019** to resolve a few of the issues:

Insolvency and Bankruptcy Code (Amendment) Bill 2019

- The Code provides a time-bound process for resolving insolvency in companies and among individuals. Insolvency is a situation where individuals or companies are unable to repay their outstanding debt.
- Under the Code, a financial creditor may file an application before the National Company Law Tribunal (NCLT) for initiating the insolvency resolution process. The NCLT must find the existence of default within 14 days. Thereafter, a Committee of Creditors (CoC) consisting of financial creditors will be constituted for taking decisions regarding insolvency resolution. The CoC may either decide to restructure the debtor's debt by preparing a resolution plan or liquidate the debtor's assets.
- The CoC will appoint a resolution professional who will present a resolution plan to the CoC. The CoC must approve a resolution plan, and the resolution process must be completed within 180 days. This may be extended by a period of up to 90 days if the extension is approved by NCLT.
- If the resolution plan is rejected by the CoC, the debtor will go into liquidation. The Code provides an order of priority for the distribution of assets in case of liquidation of the debtor. This order places financial creditors ahead of operational creditors (e.g., suppliers). In a 2018 Amendment, homebuyers who paid advances to a developer were to be considered as financial creditors. They would be represented by an insolvency professional appointed by NCLT.
- The Bill addresses three issues. First, it strengthens provisions related to time-limits. Second, it specifies the minimum payouts to operational creditors in any resolution plan. Third, it specifies the manner in which the representative of a group of financial creditors (such as home-buyers) should vote.

Insolvency & Bankruptcy Code (Second Amendment) Act 2020

1. Rajya Sabha recently passed an Insolvency & Bankruptcy Code (2nd amendment) Act 2020. The IBC Bill 2020 came into force on June 5th, 2020.
2. After section 10 of the Insolvency and Bankruptcy Code, 2016 the following section shall be inserted –
    - Section 10 A – Suspension of initiation of the corporate insolvency resolution process. As per Section 10 A, 'Notwithstanding anything contained in sections 7, 9 and 10, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after 25th March, 2020 for a period of six months or such further period, not exceeding one year from such date'. Fresh insolvency proceedings will not be initiated for at least six months starting from March 25 amid the COVID-19 pandemic. Default on repayments from March 25, the day when the nationwide lockdown began to curb COVID-19 infections, would not be considered for initiating insolvency proceedings for at least six months.
3. Amendment of section 66. In section 66 of the principal Act, after sub-section (2), the following sub-section shall be inserted –

- ” Section 3 – “Notwithstanding anything contained in this section, no application shall be filed by a resolution professional under sub-section (2), in respect of such default against which initiation of the corporate insolvency resolution process is suspended as per section 10A.”

4. The ordinance suspends sections 7, 9, and 10 on grounds that the pandemic has created uncertainty and stress for business for reasons beyond their control, the nationwide lockdown has added to disruption of normal business operations in such circumstances it would be difficult to find an adequate number of resolution applicants for a distressed/defaulting business.

Conclusion

A lot many things have been settled through repeated amendments but still, a lot needs to be done. Not only do the new amendments plug loopholes in the Insolvency and Bankruptcy Code (IBC), which some promoters had used to stall resolution of their bankrupt companies, but the changes also seek to ensure time-bound resolution of insolvency cases. There has been a marked improvement in the recovery process which is already leading to billions of dollars being invested in the country due to the protection of creditor rights. Compared to other markets, the pace at which we have achieved this is also noteworthy. In the US, for example, it took 10 years (from 1978) for the bankruptcy law to attain some stability. The progress in India has been remarkable by global standards