

Insolvency and Bankruptcy Code 2016



Introduction

Insolvency and Bankruptcy Code, 2016 is an Indian Law governing and regulating Insolvency proceedings in India. It was passed in the Lok Sabha on 5th May 2016 and received presidential assent on 28th May 2016.

IBC is a “Code” and not an “Act”, in the sense that it consolidates and amends all existing laws (i.e. Acts) relating to reorganization and Insolvency of corporate persons, partnership firms and individuals. In simple words, “A Code” is a collection of acts already passed into law.

Need for IBC

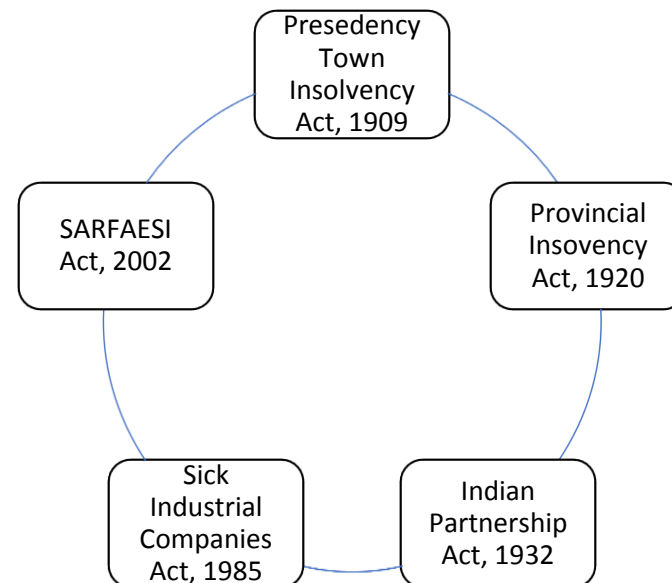
The following factors led to Introduction of IBC:-

❖ Long Resolution Processes

According to ease of doing report of the World Bank, it took on an average 4-5 years for completion of insolvency process, which ultimately eroded the returns to the creditors and other stakeholders and defeated the entire purpose of insolvency resolution.

❖ Multiplicity of Laws relating to Insolvency

Existence of overlapping provisions of bankruptcy laws led to a lot of confusion on part of creditors or lenders as to which law/act to resort to in case of imposing insolvency on any debtor. Following are the different Acts dealing with Insolvency at different levels:-



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❖ Single Window Clearance

The Jurisdiction for approving resolution plan was with multiple agencies having overlapping powers that was increasing the delay and making it more complex. Furthermore, High Court clearance was required for further step to be taken by the government appointed liquidator. High Courts being already overburdened were not able to take up the matter immediately, which ultimately halted the case.

❖ Asset Stripping by Promoters

Owing to the long Insolvency process under the erstwhile laws, it had become a common practice among the promoters of the company that was about to be declared insolvent, to sell of the assets of the company to their own relatives at prices lower than the market price. This kept the assets from being taken over by the liquidator. This practice is popularly known as "Asset Stripping". **IBC takes the powers away from the "Management" and hands it over to the "Insolvency Professionals (IPs)" appointed under the act. These IPs manage the affairs of the company till the process is over.**

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Need for IBC

❖ (Not So) Ease of Doing Business

According to the "Ease of Doing Business Report" of **2014 recovery rate was 25.6% in case of Insolvency Cases, while average time taken to resolve insolvency was a mind boggling 4.3 Years. All this only demoralized foreign big bulls** to invest their foreign funds in India. They also feared dealing with Indian business houses and getting back only 25.6% of their funds back and that too after 4.3 Years.

❖ Mounting NPA Challenge of Indian Public Sector Banks

Another major driving factor that contributed to the inception of IBC is the uncontrollably increasing Non-Performing and Stressed Assets. According to the economic survey conducted by the Economic Times, **Gross NPAs increased by almost four times from 59,972 Crores in 2010 to a whopping 2,04,209 Crores in 2014.**The major contributor to this situation being Public Sector Banks (Almost 90%). The state run banks with the intent to balloon their balance sheets, engaged in aggressive lending , not aware of the consequences that were to follow. Borrowers fraudulently applied for inflated loans and diverted money for personal use. This resulted into huge increase in willful defaulters. To their relief was the lengthy, unproductive and time consuming liquidation and recovery proceedings in India. It was time to give the wilful defaulters a bitter taste of their own medicine. This was definitely an alarming situation and something had to be done urgently and this is when Insolvency and Bankruptcy Code 2016 came into the picture.

Salient Features of the Code

❖ Quick Resolution Process

IBC claims to resolve the insolvency process within a period of **180 days** which can be further extended to **another 90 days**. This means that under IBC insolvency proceedings against a person will be completed within a **maximum period of 270 days**. This period is even shorter for Partnership firms, Start-ups and having assets worth less than 1 Crores i.e. 90 days which can be further extended for 45 days. If this claim turns out to be correct, it would be a striking break through from the erstwhile acts where it would take a mammoth 4-5 year period. Whether this claimed has proved to be correct or not, we would discuss in the latter part of our discussion

❖ Insolvency Professionals

Under the previous laws, insolvency process was managed by government appointed liquidators, who were required to take permissions from the High Court at every level. IBC hands over the powers to carry on the process to Insolvency Professionals (IPs), who would be Chartered Accountants who satisfy certain condition as listed under the code and who have cleared exam conducted by the Board set up under this Code for becoming Insolvency Professionals. IBC has given full autonomy to such IPs for quick resolution of the case.

❖ Establishment of a Separate Board

A separate board named Insolvency and Bankruptcy Board of India (IBBI) is constituted under this Code to handle cases of Insolvency and Bankruptcy. It takes a lot of burden off the already over loaded High Court and acts as a "Fast Track Court" to ensure quick resolution. It is also the governing body for the IPs which is also responsible for conducting exams for the IPs, etc.

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Salient Features of the Code

❖ Shift from “Debtor in Possession” to “Creditor in Control” regime

Corporate insolvency Resolution Process (CIRP) can be initiated even by a small financial or operational creditor to whom a minimum amount of Rs. 1 Lakh is owed. This can be effected without any notice and this code is very stringent as compared to SARFAESI, 2002. Even the IP appointed by IBBI is approved by the Committee of Creditors (CoC). Further, it is to be noted that related parties are excluded from this CoC. Thus it could be concluded that **the Code seems to shift the powers from the Debtor to the Creditor.**

❖ Order of Priority – Finally Defined!

Earlier, different laws had different order for payment to parties at the time of liquidation. As a result of which it was a lot of example regarding, which expense should be paid in priority over which expense. IBC finally clears the air.

Payments shall be made in the following order :-

- ❑ Insolvency Cost
- ❑ Secured creditors and workmen dues upto 24 months
- ❑ Other employee’s salaries up to 12 months
- ❑ Financial debts (unsecured creditors)
- ❑ Government dues (up to 2 years)
- ❑ Preference Share Holders
- ❑ Equity Share Holders

Insolvency Process under IBC – A Snapshot

❖ Application to NCLT

Application is to be made to the NCLT by any Financial or Operational Creditor to start Insolvency proceedings against the company (Corporate Debtor). The creditor has to prove that there has been a default exceeding Rs. 1 Lakh . **NCLT is supposed to pass an order either accepting or dismissing the application within 14 days.** Creditor is required to send documents evidencing default along with the application. They are also required to recommend a name of an Insolvency Professional who can act as an Interim Resolution Professional (IRP), until CoC appoints the Resolution Professional (RP).

❖ Taking over of management by IRP

Once NCLT approves the application after validating the credentials of the proposed IRP, he takes over the management of the company from the management. Henceforth management ceases to hold any control over the company. At this stage a moratorium takes effect that prohibits recovery of any property from the company by the owners. The moratorium shall last till the end of Corporate Insolvency Resolution Process (CIRP)

❖ Formation of CoC

The IRP then invites claims from the public via a public notice, classify the claims and form a CoC comprising all the financial creditors.

❖ Appointment of RP

The CoC then appoints a RP to carry forward the CIRP. The RP can be the same as IRP.

❖ Approval of Plan by CoC

A Resolution Plan for the revival of the company is prepared by the RP. The plan needs to be approved by creditors holding at least 75% of the financial debt. It shall be noted that IBC doesn't prohibit any person from proposing a plan, i.e. management, creditor or the RP himself can propose the plan however it shall be the duty of the RP to ensure that the plan is in line with IBC.

The Plan is then submitted to the board. Once the plan is approved by the board, it becomes binding on all stakeholders. However, if the plan gets rejected, there the last resort that is left is Compulsory Liquidation.

Bhushan Steel and IBC – A Case Study

Bhushan Steel being one of the largest steel producers in the country decided to ride the boom in the steel industry in 2003 by starting up new production plant in Odhisa. Looking at Bhushan Steel's strong order book, banks were eager to grant them loans. By 2010 Bhushan Steel was already shouldering loans worth Rs. 11,404 Crores. But, then came 2008! The dreadful year for a lot of industries around the globe. With the Chinese Olympics also getting over and on account of global slump steel demand and prices dropping drastically (from \$1265/tonne to \$300/tonne), Bhushan's lenders pinned their hopes on the Odisha plant reaching full capacity. But the plant never performed as expected. This led to one lending after the other and by 2014 the company was spending almost Rs. 1600 Crores a year as interest payments. It's Debt reached the pinnacle of Rs. 46,062 Crores in 2016, and this is when it became too much to handle for the management.

Finally right after the inception of IBC, RBI identified 12 Cases that covered around 25% of the Gross NPAs of the economy and referred them to IBC for starting insolvency proceedings. Bhushan Steel was one of them. New Delhi Bench of NCLT issued an order dated 26th July, 2017, ordering commencement proceedings of Bhushan Steel. An IP was appointed by the NCLT which constituted a CoC. Pursuant to the invitation published by the RP, Tata Steel Limited had submitted a resolution plan for the Company. Once the plan was approved by CoC, it was sent to the NCLT by the IP for final approval. NCLT finally approved the plan on 15th May 2018. According to the Plan Tata Steel invested in Bhushan Steel through its wholly owned subsidiary Bamnipal Steel Limited (BNPL) , a total of Rs. 35,132.58 Crores which was used to settle the existing debts of the company. Further, Loan of Rs. 14.50 crores was converted into equity shares and the balance loan was novated to BNPL for an additional aggregate consideration of Rs. 100 crores. BNPL then subscribed to 72.65% of fully paid equity share capital of the company. Bank recovered around 62% of their total lending to Bhushan Steel and this is what makes this Bhushan Steel case one of the most successful cases of Insolvency proceedings in India.

Accordingly Bhushan Steel became one of the most successful cases of IBC till date.

Dividends reaped so far

- ❖ World Bank has gone on record to say that India is one of the top 10 Nations to show a notable improvement in the “Ease of Doing Business” Sector. **India Ranked 77th in the EODB Report of 2019 as against 134th in the 2014 report, which without doubt is a monumental shift.**
- ❖ To quote Shri PiyushGoyal in his Interim Budget speech for AY 2019-20, “There were high stressed and non-performing assets (NPAs) amounting to ` 5.4 lakh crore in 2014. Many more were hidden through restructuring or otherwise which were discovered during Asset Quality Reviews and inspections carried out since 2015.....**An amount of close to 3 lakh crore has already been recovered in favour of banks and creditors (through IBC)**”.
- ❖ While IBC has been hailed as a knight in the shining armour to resolve the issue of long delays in the disposal of case, for its claim of resolving the Insolvency cases in 270 days, from the major cases that has been resolved till date under this law, it is evident that 270 days is still a long way to go. However **the average time taken to complete the Insolvency proceedings under the high profile cases of Amtek Auto Ltd, Monnet IspatItd, Electrosteel, Bhushan steel and Lanco was 333 days.** While in certain other cases even more than 400 days were also taken since the case came up to IBC. However, the situation is still better than the one existing in the Pre-IBC scenario.

Conclusion

- IBC is definitely a welcome step by the Government for the Investors, Lenders, as well as for the Business Houses. **Just like GST, IBC being a new law, is not functioning at its full potential. Challenges such as pendency of existing cases, further appeals by the rejected bidders to the High Court, no Support from the management (as they have been stripped off their powers) for timely resolution, etc. do loom over the smooth functioning of the code, but given that the code has been conceived with the right intent, it is just a matter of time before India Inc. would start yielding returns from it. Going forward, by all means Insolvency and Bankruptcy Code, 2016 is the future of Insolvency Proceedings in India.**

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