

National Programme on Insolvency and Bankruptcy Code

Corporate Insolvency Resolution Process: Challenges and Issues

15 July 2017

Objectives of the Code

The Insolvency and Bankruptcy Code, 2016 is a law that seeks to protect value of businesses under stress and provides for a transparent and time bound resolution process

Why was the code needed?

- ü Reduce time taken to resolve insolvency
- ü Develop investor confidence
- ü Eliminate confusion caused by complex judicial framework
- ü Address NPA situation decisively
- ü Develop credit and bond market

The code provides for a distinction between bankruptcy and insolvency. It seeks to provide a time bound chance for viable businesses to turnaround and liquidate businesses where no resolution is possible

Overview of CIRP (1/2)

Default

min INR 1 lakh; even a single day

Who can file the application?

- Financial & Operational creditors (including Government & employees/workmen), and Corporate debtor

Resolution Professional (IRP/ RP)

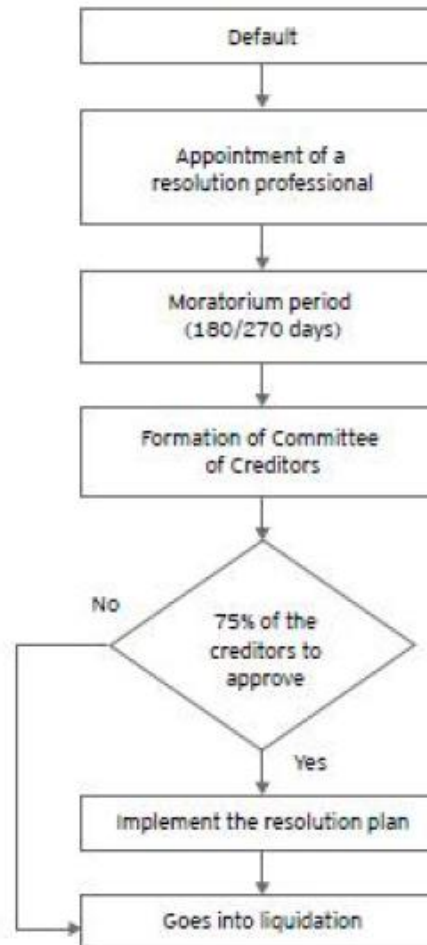
- Financial creditor and/ or corporate applicant shall propose the name of an IRP in the application
- All powers of the board and management shall vest with the IRP/ RP

Moratorium

Moratorium shall prohibit:

- Institution of suits
- Transfer of assets
- Foreclosure, recovery or enforcement under SARFAESI
- Recovery of assets

Resolution process



Committee of creditors (CoC)

- Consists of financial creditors only, excluding related parties
- To approve several actions of RP

Resolution plan

The resolution plan must provide for:

- payment of insolvency resolution process costs
- repayment of the debts of operational creditors
- management of the affairs of the borrower after the plan is approved
- implementation and supervision of the approved plan

Voting power

- Only financial creditors have voting power in the committee in the ratio of debt owed
- All decision of the committee shall be approved by 75% of financial creditors

Fast track insolvency

For debtors as may be notified by the central government (completed in 90 days)

Overview of CIRP (1/2)

Liquidation order

Liquidation order will be passed if:

- CIRP ends
- Plan not submitted to NCLT
- Plan not approved
- Decided by CoC
- Plan not properly implemented

Liquidation steps

- Appointment of liquidator
- Formation of liquidation estate
- No legal proceeding by or against the debtor
- Consolidation of claims
- Distribution of assets
- Dissolution of debtors (to be completed within 2 years)

Liquidator

Liquidator shall:

- Form liquidation estate
- take into custody & control all assets
- consolidate, verify, admit and determine value of creditors' claims
- Carry on the business for its beneficial liquidation

Priority Waterfall of claims

Insolvency resolution process and liquidation costs

Secured creditor & workmen dues (upto 24 months)

Other employee dues (upto 12 months)

Financial debts of unsecured creditors

Government dues (upto 2 years) and unpaid secured creditors

Any remaining debts and dues

Preference shareholders, if any

Equity shareholders or partners, as the case may be

Reporting

Preliminary report – within 30 days from the date of the order

Progress report – within 15 days after end of every period of 3 months from the date of order

Insolvency and liquidation cost

- Insolvency cost include interim funding, cost of running the debtor as going concern (eg rent or salary of employees), cost of IP etc
- Liquidation cost include any cost incurred by liquidator during liquidation period

Secured creditor in liquidation

Secured creditor has the option to:

- enforce and realise the security outside the Code or
- relinquish its security interest and receive proceeds as defined in the priority of claim
- Distinction between rights of different class of secured creditors (first vs second charge, fixed vs floating charge) is not clarified in the Code or regulations

Role of a Resolution Professional

- Ø Take over management of the corporate debtor and run business as going concern
- Ø Collation and verification of claims
- Ø Constitute and report to Committee of Creditors (CoC)
- Ø Prepare information memorandum
- Ø Receive resolution plans from resolution applicants and place before CoC for approval
- Ø Raise interim finance if required

The resolution professional plays a key role in running the CIRP and is empowered along with responsibilities to the CoC

Planning for CIRP - By RP and by the Company

Know your company

Get your team in place - competence and integrity

Impact of IBC and organization stabilization

Market research

Day 1 and Week 1 Plans

Checklists

Communication plan

Day 1 Agenda - Do's and Don'ts

Action	Considerations
Key employees on board	<ul style="list-style-type: none">• It is imperative to get key employees on board to ensure business is run smoothly with minimal disruption• Employee town halls may be considered to convey messages and objectives, avoid concerns and gain confidence
Transparency with stakeholders including promoters and directors	<ul style="list-style-type: none">• Maintain transparency with all stakeholders• Take help/ assistance of promoters where possible and needed
Taking control	<ul style="list-style-type: none">• Review/ revise authority matrix• Ensure control over assets is established (physical assets, IT assets and data, records and documents)
Delegating authority	<ul style="list-style-type: none">• Delegation of routine organizational functions after assessing critical areas and available employees• Implement adequate monitoring mechanism
Management by collaboration	<ul style="list-style-type: none">• Working along with all stakeholders is necessary to run business as going concern

Issues faced in CIRP - issues/ ambiguities in the Code

No precedence or standards to follow

Lack of adequate judicial pronouncements by courts and precedence of completed cases will pose challenges for several provisions

Pending harmonisation with other laws

Clarity on provisions of companies law - certification of financial statements, audit committee requirements etc.

Control on key subsidiaries (business related - i.e. forward or backward integrated) not available

Cases where there are significant trading transactions with subsidiaries may not provide adequate control over business

Process of inviting resolution plan

There is no defined process for inviting and considering resolution plans which can lead to disputes and challenges

What constitutes resolution process costs

Do business expenses incurred to run business expenses get classified as resolution process costs

Disregard of priority of charges

There is no clarity if the provision requiring the IP to disregard priority of charges, removes the priority of creditors in case they choose to relinquish their security

Challenges faced in CIRP - implementation issues

Indemnity for actions taken in good faith, no insurance products

Technical and operational capabilities to run complex businesses

Extremely tight liquidity crunch may not allow business to be run as going concern. In case of operating losses all liabilities during CIRP may not get discharged leading to business shut down

Adherence to timelines - so much to achieve in 180/ 270 days - going concern, IBC procedures, invite resolution plans etc.

Resistance from employees / promoters due to various concerns and uncertainty

Loss of confidence of employees, vendors, customers. Fear of liquidation may lead to employee attrition, loss of business and lack of support from vendors

Costs of changes in capital structure - costs such as increased in authorized share capital may add challenges to implementation of resolution plan

Tax impact of haircut on liabilities
