



KHAITAN  
& CO

*Advocates since 1911*

# AN OVERVIEW OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016

- *Kumar Saurabh Singh (Partner, Khaiitan & Co.)*



# Table of Contents

- **Introduction to the new Code?**
  - Why we needed a new Code
  - Ecosystem per the Code
- **Understanding the Code and the new Borrower- Lender relationship**
  - Corporate insolvency: Trigger
  - Corporate Insolvency Process Flow
  - Moratorium
  - Understanding resolution professionals and Committee of Creditors
- **Liquidation**
- **Cross Border Insolvency**
- **Initial Orders under the Code**
- **Key Structural Differences between India, UK and US**
- **Questions**



KHAITAN  
&CO

*Advocates since 1911*

## Introduction to the Code



# Why we needed a new Code?

## Problem of too many yet too little

Erstwhile Regime	Criticism
The SARFAESI Act, 2002	Non-inclusive regime Designed for enforcement and not revival
The Recovery Of Debts Due To Banks and Financial Institutions Act, 1993;	Overburdened DRTs
Sick Industrial Companies (Special Provisions) Act, 1985	Prescribed revival of a sick company under the same management often ineffective  Moratorium provision used to delay. No time bound process meant that moratorium often continued indefinitely  BIFR route used to delay legal action by banks for debt recovery even upon failure of CDR loan restructuring.
Corporate Debt Restructuring under RBI Guidelines	Voluntary regime  Too little too late
Strategic Debt Restructuring under RBI Guidelines	Voluntary regime, with effective Bank management (not natural for Banks)
S4A	Sustainability study challenges, valuation challenges



**Need for a comprehensive Code**



# Ecosystem per the Code



## Adjudicating Authority

Exclusive jurisdiction to deal with insolvency matters e.g. NCLT/NCLAT, DRT/DRAT

## Creditors



### Financial



### Operational



### Corporate



## Insolvency and Bankruptcy Board

Ensure transparency and governance by regulating IU/IP appointment and functioning



## Information Utilities (IU)

Maintain data on Debtors to overcome information asymmetry amongst Creditors



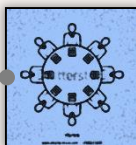
## Insolvency Professionals Agency (IPA)

Disciplinary body for Insolvency Professionals



## Insolvency Professionals (IP)

IPA-approved licensed professionals to take on role of Resolution Professional (RP)



## Committee of Creditors (CoC)

RP appoints CoC to discuss and decide resolution in best interests of all creditors



KHAITAN  
&CO

*Advocates since 1911*

# Understanding the Code and the new Borrower- Lender relationship



# Corporate Insolvency Resolution Process - Trigger

**\*FINANCIAL CREDITORS** are those creditors who have extended credit for time value of money';  
**OPERATIONAL CREDITORS** are those creditors who have extended credit in exchange for goods and services and other debt payable to the Central or State Government.

<b>Who</b>	Any Financial Creditor (Including ARCs) or Operational Creditor
<b>When</b>	<b>Financial Creditor*:</b> Upon default > INR 1,00,000 (GoI can increase up to INR 1,00,00,000) <b>Operational Creditor*:</b> Upon default > INR 1,00,000 (GoI can increase upto INR 1,00,00,000) + Non-payment by Corporate Debtor for a period of 10 days after issue of Demand Notice.
<b>New Infrastructure</b>	Intent to introduce Information Utility infrastructure to streamline information asymmetry, reduce time taken to determine actual financial health of corporate debtor.

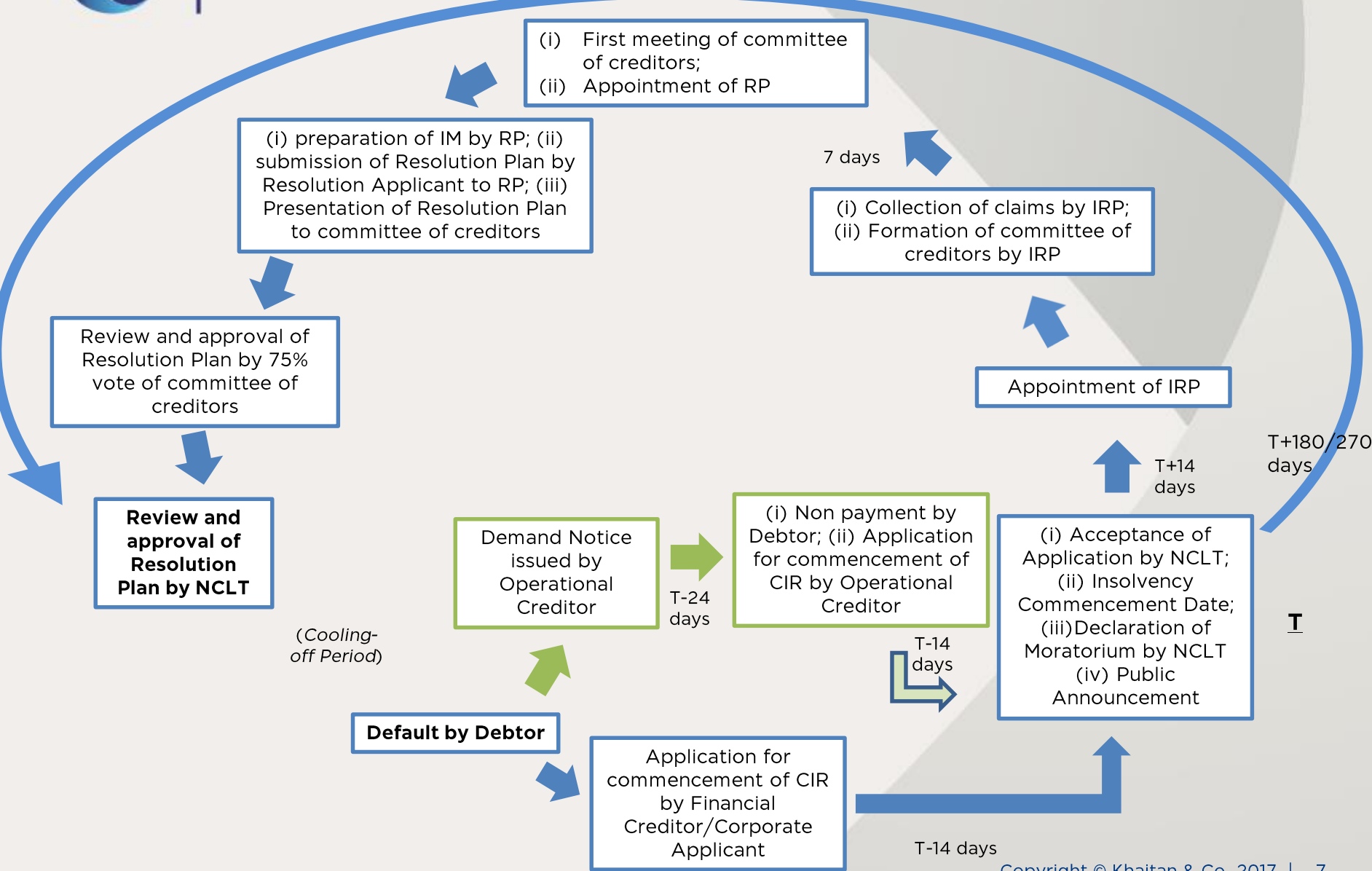
## **Key Takeaways:**

*Move away from complicated court driven "balance sheet test Operational Creditors can bring down the house of cards.*

**Food for thought:** *Are defaults other than payment defaults a trigger under the Code?*



# Corporate Insolvency Resolution ("CIR"): Process Flow







# CIR - Moratorium

To be declared by the NCLT on the insolvency commencement date

Institution of suits/continuation of pending suits or proceedings (including execution of any judgements/decrees/orders in any court of law / tribunal / arbitration panel/ other authority) against the Debtor

Termination, suspension or interruption of the supply of essential goods or services to the Debtor (limited to electricity, water, telecom and IT services)

Moratorium

Transferring, encumbering, alienating or disposing off assets (including legal rights and beneficial interests in relation to such assets) by the Debtor

Recovery of any property by an owner/lessor occupied by or in possession of the Debtor

Any action to foreclose, recover or enforce any security interest in respect of the property of the Debtor (including actions under the SARFAESI Act, 2002)\*



**Key Takeaway:** Restriction on **SARFAESI Lenders** as well as on **Debtor**.

Multilateral netting and setting-off may be permitted. GOI notification required

Supply of essential services to Debtor not stopped

Rules clarify that essential services will be part of insolvency costs

**Food for thought: The transfer of debt from a bank to an ARC is legitimized through Section 5 of SARFAESI Act. Is that also stayed once the moratorium kicks in?**



# Understanding Resolution Professionals and Committee of Creditors



## Who is an insolvency professional?

Any person who is:

- Enrolled with an insolvency professional agency;  
**and**
- Registered with the Insolvency and Bankruptcy Board as an insolvency professional



# Who can be a resolution professional?: 'Independence' test

**If the insolvency professional, and all partners and directors of the insolvency professional entity (IPE) of which he is a partner or a director are independent of the corporate debtor.**

Factors to determine independence:

- eligible to be appointed as an independent director for the corporate debtor as per provisions of the Companies Act 2013
- not a related party to the corporate debtor
- in the last 3 financial years, he or she has not been an employee or a proprietor or partner of (A) any firm of auditors, company secretaries of the corporate debtor; or (B) any legal or consulting firm that has or had any transaction with the corporate debtor as its client amounting to 10% or more of the gross turnover of such legal or consulting firm.

The resolution professional who is a director or a partner of an IPE, shall not continue as a resolution professional, if the IPE or any of its partner or director represents any other stakeholders.

**This test is also applicable at the time of appointment of 'liquidators' under the Code.**

Further, the Code prescribes that there must be no disciplinary proceedings against such person proposed to be appointed as the resolution professional.



# Powers of the Interim Resolution Professional/ Resolution Professional

- Management of the affairs of the corporate debtor shall vest
- Powers of the board shall stand suspended and be exercised by IRP
- Officers and managers of the corporate debtor shall report to the IRP and provide access as may be required
- Financial institutions maintaining accounts of the corporate debtor shall act on the instructions of the IRP
- Right to access IU records of the corporate debtor
- Avoidance Powers
- Take control over assets of the Debtor including those that are situated outside India
- Can appoint consultants, lawyers other professionals
- Enter in to or amend contracts
- Raise Super Sr. Finance (incl. secured w/o consent if 2x cover is met) Vs Raise Super Sr Finance but subject to CoC approval

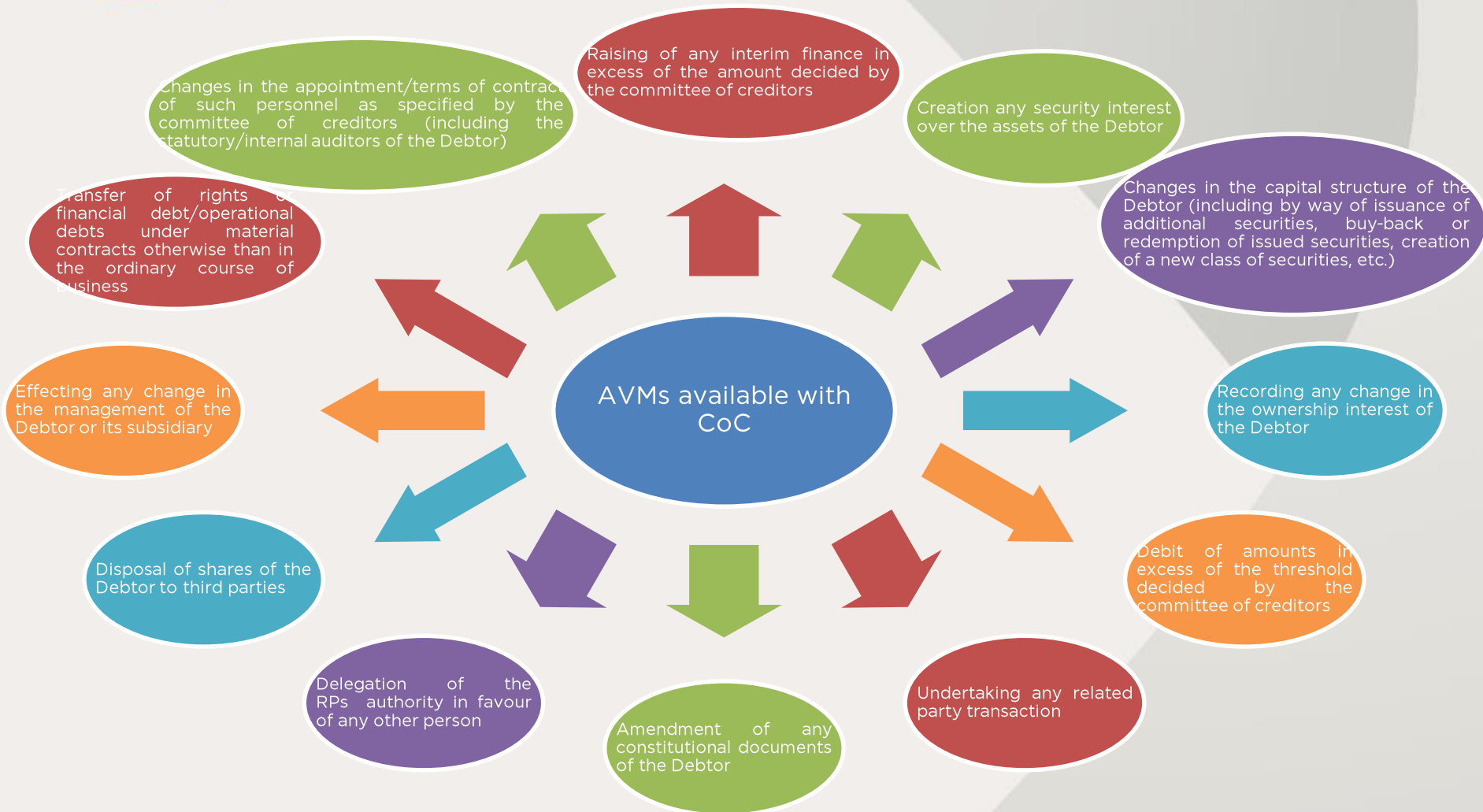


# Duties of the Interim Resolution Professional / Resolution Professional

- Limited Board oversight; Manage the entire CIR process
- Collect all claim information and set claim process and timeline
- Prepare IM which will form the basis of the Resolution Plan
- Manage Resolution Plan process (Code allows multiple Resolution Applicants)
- Constitute CoC
- To protect and preserve the value of the property of the corporate debtor and manage the operations as a going concern



# Powers of the Committee of Creditors



**Food for thought:** Is the CoC/IP also subject to the liabilities that the board of directors would ordinarily be subject to?



KHAITAN  
& CO

*Advocates since 1911*

## Liquidation





# Initiation of liquidation

Circumstances under which liquidation of a company is initiated:

- If the NCLT does not receive a resolution plan before expiry of the insolvency resolution process period (i.e. 180 days/ 180 + 90 days)
- If the NCLT rejects the resolution plan submitted to it on account of reasons such as contravention of applicable law, non-conformity with requirements specified by the board, if the plan does not provide for:
  - (a) requisite repayment of the debts of operational creditors
  - (b) for meeting the insolvency process costs
  - (c) management of the corporate debtor



# Liquidation Waterfall

In case of liquidation, the assets of the corporate debtor will be sold and the proceeds will be distributed amongst the creditors in the following order of priority:

- ↓
  - ↓
  - ↓
  - ↓
  - ↓
  - ↓
  - ↓
- cost of the insolvency resolution process and liquidation;
  - secured creditors (who choose to relinquish their security enforcement rights and workmen's dues relating to a period of 24 (twenty four) months preceding the liquidation commencement date);
  - wages and unpaid dues of employees (other than workmen) for a period of 12 (twelve) months preceding the liquidation commencement date;
  - financial debts owed to unsecured creditors;
  - statutory dues to be received on account of consolidated Fund of India or consolidated Fund of a State (relating to a period of whole or part of 2 (two) years preceding the liquidation commencement date) and debts of secured creditors (remaining unpaid after enforcement of security);
  - remaining debts and dues;
  - dues of preference shareholders
  - dues of equity shareholders or partners

## Key Takeaways

- ✓
- ✓
- ✓
- *Super Senior Finance ranks along with IRP costs*
- *Government taxes rank lower!*
- *Unsecured portion of secured creditors rank lower than other unsecured creditors*
- *Liquidation assets do not include netting/setting of multilateral clearing collaterals*



KHAITAN  
&CO

*Advocates since 1911*

# Cross border insolvency



# Cross border insolvency - Highlights

The Code stipulates a two pronged solution:

- The Central Government entering into agreements with other countries for enforcing the provisions of the Code
- Giving the NCLT the authority to write a letter to the courts and/or authorities of other countries (as may be relevant) for seeking information or requesting action in relation to the assets of the debtor situated outside India.

## Observations:

- Issues relating to Insolvency/liquidation of Indian companies with assets located in several jurisdictions outside India and vice-versa cannot be achieved without having a mechanism like adoption of the UNCITRAL Model Law on Cross Border Insolvency.
- In case of bilateral agreements suggested by the Code presently, it will not only be difficult but will also take a very long time to negotiate an agreement with each country.
- In addition, several countries may refuse to divulge any information about the assets located in their country upon receipt of a letter envisaged under the Code.



KHAITAN  
&CO

*Advocates since 1911*

# Initial Orders under the Code



# Initial Orders under the Code: Innoventive Industries

The NCLT (Mumbai) has, on 17 January 2017, passed an order in the matter of **ICICI Bank v Innoventive Industries Limited** *inter alia* admitting the application under the Code filed by ICICI Bank for initiating the corporate insolvency resolution process.

## Key Highlights from the Order:

- First NCLT order under the Code granting moratorium and appointing resolution professional.
- Code is subsequent to the Maharashtra Relief Undertaking (Special Provisions) Act (MRU Act), therefore non-obstante clause under Section 238 of the Code prevails.
- Suspension of liability under the MRU Act inconsistent with the Code.
- Order notes declaration of moratorium keeps business as usual for employees and their interest does not get affected.



# Initial Orders under the Code: Synergies

NCLT (Hyderabad) has on 23 January 2017, passed an order in the matter of Synergies - Dooray Automative Limited (SDAL) *inter alia* admitting the application filed by the corporate debtor itself under the Code for initiation of the corporate insolvency resolution process. The NCLT has admitted the application.

## Key highlights from the Order:

- The NCLT, while admitting the application made in accordance with the provisions of the SICA Repeal Act and the Code, has granted moratorium against all proceedings including SARFAESI action which was initiated by some of the creditors of the corporate debtor.
- While the NCLT has admitted the application of SDAL for CIR Process, it has not given any decision on the continuation of the orders passed by BIFR against which appeals were pending before Appellate Authority for Industrial and Financial Reconstruction prior to the notification of the SICA Repeal Act.

***Food for thought*** - *Whether the distribution arrangement arrived under SARFAESI may be amended/ challenged by the parties to the resolution plan?*



# Can Operational creditors bring down the house of cards?

The definition of 'dispute' \*\* under the Code has resulted judicial vagaries and it is yet to be seen as to which interpretation of the word would eventually prevail.

## **Essar Projects India Limited v. MCL Global Steel Private Limited**

The National Company Law Tribunal (Mumbai Bench) has clarified what constitutes a 'disputed debt. The NCLT has held:

- The Code requires a pre-existing dispute (i.e existing before the receipt of the demand notice) to be able to challenge a petition by an Operational Creditor.
- No civil suit or other proceedings were initiated against the Operational Creditor, therefore, a 'dispute in existence', i.e. a dispute in a court of law or an arbitral tribunal before the receipt of the demand notice - as is required under the Code - could not be established in the facts and scenario of this case.

\*\* 'dispute' includes a suit or arbitration proceedings relating to—

- (a) the existence of the amount of debt;
- (b) the quality of goods or service; or
- (c) the breach of a representation or warranty;





## Cntd... 2

### **Ambience Private Limited v. One Coat Plaster and Shivam Construction Company**

The NCLT (Principal bench, New Delhi) has held:

- *“This Tribunal has the power, inter alia also to reject the Application of the Operational Creditor under Section 9(5)(d) in case of notice of dispute has been received by the operational creditors or there is record of dispute with the information utility.”*
- *The definition of ‘dispute’ is not an exhaustive definition but an illustrative one. It becomes evident from the expression ‘includes’ which immediately succeeds the word ‘dispute’.*

*Food for thought: In the event that no advance has been paid to an operational creditor and there exists a dispute (for eg: as to quality of good delivered), what is the cause of action for the company in receipt of the faulty goods?*



KHAITAN  
&CO

*Advocates since 1911*

# Key Structural Differences between India, UK and USA



**KHAITAN  
& CO**

*Advocates since 1911*

## Key structural differences between India, UK and USA

**India**

Insolvency & Bankruptcy Board



Insolvency Professional Agencies



Insolvency Professionals



Creditors Committee  
(Comprising all financial creditors and operational creditors with no vote)



Debtor

NCLT/Court specific supervisory role

**UK**

Insolvency Service



Insolvency Professional Agencies



Administrator (with wide prescribed powers which have evolved through court process)



Creditors Committee comprising key creditors



Debtor

**USA**

Bankruptcy Court (Active) Involvement



Debtors (in possession)



Committee of Creditors (with key creditors)



KHAITAN  
&CO

*Advocates since 1911*

# Questions



THANK  
YOU

[www.khaitanco.com](http://www.khaitanco.com)

Khaitan & Co asserts its copyright as the author of this presentation.

The contents of this presentation are for informational purposes only. Khaitan & Co disclaims all liability to any person for any loss or damage caused by reliance on any part of this presentation.