ONE YEAR OF INSOLVENCY AND BANKRUPTCY CODE, 2016:

AN ANALYSIS

The Insolvency and Bankruptcy Code, 2016 ("IBC") was enacted to provide the much-needed speedier resolution of insolvency proceedings and debt restructuring for the benefit of operational and financial creditors.

Prior to IBC enactment, the earlier legal regime pertaining to insolvency and debt restructuring was fragmented into various legislations and had been delivering poor outcomes for years for creditors and distressed businesses seeking an exit. The IBC manifested the government's attempt to consolidate and create a uniform framework governing and regulating insolvency proceedings in India. This code created time bound process for insolvency resolution.

The Preamble to the IBC characterizes it as "An act to consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto."

IBC was thus enacted on May 28, 2016 with an aim to inter alia address and resolve these issues in addition to providing for an effective mechanism for resolution of insolvency and bankruptcy matters in India. The new bankruptcy law was envisaged as a useful tool for the benefit of international creditors and investors from the perspective of PE funds which are continuing to grow their investments and exposure in India. IBC seeks to address the issues faced currently in the context of insolvency and winding up.

However, IBC's journey so far has not been free from obstacles. It has come under the scanner during the past year for various concerns. We discuss some key challenges that plague the IBC and would put forth some recommendations to overcome these challenges.

Major Challenges

Debt recovery in India has been a challenge with creditors and debtors disputing rights and obligations in legal wrangles under various provisions under applicable laws making the process time consuming and costly. Some of the major challenges being faced by IBC are:

Priority given to Resolution over Liquidation

The IBC has created a priority system wherein the first attempt is to rescue the company from bankruptcy and if such an attempt fails then the company goes into liquidation. Though, such a system is commendable, it puts creditors on a backseat. Creditors who are in a hurry to recover their money from a sinking ship, have to wait for at least 180 days before the liquidation proceedings can commence. This might deter foreign investors from becoming financial creditors and may make future creditors wary.

Committee of Creditors

Section 21 of the IBC provides for the setting up of committee of creditors. This committee would comprise of all the financial creditors of the company and would meet to vote on the resolution process. Even though, this move sounds democratic, a meeting of all the financial creditors of a company may not be practically feasible. This is so because financial creditors may range from one in number to thousands. Hence, this provision though theoretically ideal may not prove to be useful in reality.

Period of Limitation

IBC does not provide any limitation period for the raising of claims. This issue came under the judicial purview recently in the Black Pearl Hotels Pvt. Ltd. v. Planet M Retail Ltd. The NCLAT on an appeal against the decision of the NCLT, ruled that the Limitation Act would be applicable to cases under the IBC, however, the limitation period shall begin from December 1, 2016 that is the date when the IBC came into effect. Such an interpretation may be unfair to debtors and provide an unjust advantage to creditors who have not exercised their right for long.

The 75% Rule

Section 21 of the IBC mandates that all decisions taken by the committee of creditors shall be by a vote of not less than 75% of voting share of financial creditors. Making decisions dependent on voting share may be a cause for concern. This is so because even a minority shareholding creditor may stall the decision-making process or a majority shareholding creditor may impose his whims and fancies. Such a mechanism is undemocratic and thwarts the very purpose of having a committee of creditors.

Interim Finance

The IBC has provided the concept of interim finance which is the financial debt raised for the resolution of insolvency of the company. Once again, this concept does sound theoretically correct but if tested against practical situations, it sounds like a dilatory tactic. Firstly, it is highly unlikely that any creditors (existing or new) would provide loans to a company undergoing the insolvency resolution process. Secondly, the raising of funds from a new lender requires the approval of the committee of creditors. The committee of creditors would in all probability be against approving the interim finance as this may lead to further delay in their payouts. Hence, interim finance may be difficult to obtain under the current rules.

Recovery by Operational Creditors

The IBC provides that the operational creditors send a demand notice for repayment and if this demand notice is not acknowledged or repayment is not done within 10 days of sending the notice then they may file a petition for insolvency resolution. One of the grounds of rejection of this petition is the repayment of debt by the corporate debtor. However, the IBC is silent on what is the rule as to part- payment. If a debtor partly repays the debt would that constitute as repayment and would that lead to rejection of the petition. Such ambiguities pose a grave concern to the efficacy of the IBC.

Cross-Border Insolvency

The IBC does not explicitly mention if its provisions are applicable to cross border insolvency proceedings. This may not be a very attractive aspect for foreign creditors.

Flooding of NCLT

A major challenge for the IBC could be the tidal flow of cases to NCLT. The first step of insolvency resolution process has led to a massive flow of such petitions to NCLT. This may create backlogs and cause delays in recovery.

Deadline for insolvency resolution process

The deadline for insolvency resolution process is 180 days with a leeway of extending up to another 90 days. This means that the creditors would not be able to initiate liquidation for at least 6 months. This may propel them to take legal action and resort to courts.

Despite the aforementioned challenges, the IBC endeavors to ensure finality in the recovery process. Promoters have to cooperate with the committee of creditors and the insolvency resolution professionals.

Judicial Interpretation of IBC

Owing to the ambiguities embedded therein, IBC has become subject to myriad judicial interpretations. We have discussed a few key case laws dealing with the interpretation of the provisions of the IBC.

- Lokhandwala Kataria Construction Private Limited v. Nisus Finance and Investment Managers LLP

In this case, the SC considered whether NCLAT, the appellate body under the IBC, could allow withdrawal of insolvency application after admission on the basis of the consent terms agreed between the parties. Rule 8 of Insolvency and Bankruptcy (Application to Adjudicating Authority Rules 2016) Rules allows the parties to withdraw the application prior to admission of the application by National Company Law Tribunal ("**NCLT**"), the adjudicating authority under the Code. However, there is no provision for withdrawal of application after admission.

- Surendra Trading Company Vs. Juggilal kamlapat jute mills Company Limited and others[1967 37CompCas 20 All]

In this case, the question before the Court was whether time limit of 7 days prescribed under the Code for rectifying or removing defects in the application filed by an operational creditor for initiating corporate insolvency resolution is mandatory or not. Section 9 of the Code deals with initiation of corporate insolvency resolution process by operational creditor. The section grants 14 days period to NCLT to accept or reject an application after the receipt of the application. However, before rejecting an application on the ground of any defects, NCLT has to give a notice to the applicant to rectify the defects and seven days period is given to the applicant to remove the defects.

- Macquarie Bank Limited Vs. Shilpi Cable Technologies Limited [Decided on 15 Dec, 2017]

In this case, the SC brought clarity to two crucial issues pertaining to the Code. The first question was whether, in relation to an operational debt, the provision contained in Section 9(3)(c) of the Code is mandatory. Section 9(3)(c) requires that while initiating insolvency proceeding under the Code, operational creditor shall submit a certificate from a financial institution maintaining accounts of the operational creditor confirming that there is no payment of the unpaid operational debt by the corporate debtor. The SC held that the requirement under Section 9(3)(c) regarding the certificate from the financial institution is not a condition precedent to trigger the insolvency process under the Code but can only be considered as a piece of evidence. The second issue under consideration was whether lawyer could issue demand notice under the Code on behalf of operational creditor. The issue is significant due to the earlier decisions of lower adjudicating authorities that only a creditor himself or person holding position with the creditor can issue demand notice. Since lawyers often do not hold position with the creditor, this means that he could not issue demand notice. The Court analyzed the provisions of the Code and categorically concluded that not only the creditor and his authorized agent but lawyers are also entitled to issue demand notice under the Code on behalf of creditors.

Impact of IBC on bank's NPAs

Non-performing assets or NPAs as they are popularly called are at the heart of the entire discourse pertaining to IBC. One of the major reasons behind revamping of the insolvency regime and creation of the IBC was to reduce the NPAs plaguing the country. In June, 2016, gross NPAs of listed banks stood at Rs. 6.7 trillion or 9.1% of their advances, a jump from 4.3% of advances in March 2015. With the commencement of IBC boasting of a robust insolvency resolution process, it was expected that the quantum of NPAs would reduce.

As per the Economic Survey, 2017-18, the IBC has been instrumental in reducing bad loans. The twin pronged approach of having an insolvency resolution process in place and providing recapitalization packages to public sector banks has significantly contributed to

the reduction of NPAs. However, despite enabling the reduction of bad loans, the contribution by IBC can only be characterized as `baby-steps'.

RBI had referred 12 accounts now known as the dirty dozen for insolvency resolution to start with. These account for almost 25% of the extant NPAs in the country. While the identification and referral of these accounts for insolvency resolution is laudable, there has been significant delay in the resolution process.

The current framework of IBC is grappling with certain practical flaws and this delay may be attributed to these flaws. Firstly, the lack of a bidder contributes to timely resolution. Secondly, the recently added section 29A has made the bidding process tougher and hence has contributed to delayed resolution.

To sum up, though the IBC has made a significant headway in curbing NPAs, it still has a long way to go before it can be characterized as being `significantly successful'.

A year after its enactment, IBC still faces certain operational and practical concerns. However, it would be fallacious to categorize it as ineffectual. IBC has made a sizeable dent in the quantum of NPAs. It has provided a systematic process and a bedrock for our earlier fragmented insolvency laws. However, certain improvements in the IBC may lead to it being more efficient. Some of the recommendations we suggest are as follows:

The decision-making process of the committee of creditors should be revamped. Instead of voting based on shareholding, one creditor one vote system should be followed.

There are a lot of ambiguities embedded in the IBC currently. Issues such as what does repayment encompass, proper provisions for resolution of cross border insolvency etc. should be addressed.

Bidding system should be made wider and not dependent upon the approval of the committee of creditors. A screening process may be brought in place to avoid flooding of NCLT with insolvency petitions.