

RESOURCE PAPER - 21



INDO-JAPAN CHAMBER OF COMMERCE & INDUSTRY

Insolvency and Bankruptcy Code 2016

by
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PREFACE

India is fast developing. In the context of doing business with ease among BRICS countries India has come to 77th position (from 100 last year), next to China. India's score on a number of key parameters has improved; dealing with construction permits (from 181 to 52) , trading across borders (from 146 to 80), implementation of GST etc. are contributing to a great extent. However, in areas such as starting a business , enforcing contracts, registering property, paying taxes and resolving insolvency matters still require attention.

This Resource Paper on Insolvency and Bankruptcy Code 2016 and the subsequent Resource Paper to be published in December 2018 is an attempt to answer many of the questions raised by our Japanese businessmen when the IJCCI delegation was in Japan in September 2018. A careful analysis on the subject by experts in A.K. Mysamy & Associates LLP in this regard is highly appreciated. The authors, Mr. K K Balu, a Corporate Lawyer and Senior Advisor at A.K. Mysamy & Associates LLP, Attorneys-At-Law with over 50 years of Legal, Teaching and Judicial experience. He was Formerly Vice-Chairman [Judge] of the Company Law Board for over 12 years. He acts as an Arbitrator, Conciliator and Mediator. He has obtained training in India and Abroad on matters relating to Banking, Housing, Micro-Finance and Tax planning. He has held senior positions in the National Housing Bank and Syndicate Bank between 1978 and 1996 and was a Legal Advisor for various Banks while practicing law.

Ms. Josephine Shreela G. is a Bachelor of Commerce and Bachelor of Law, and is an Associate at A.K. Mysamy & Associates LLP.

I am confident that our readers would find this Resource Paper highly informative and useful. IJCCI would deem it a pleasure and a great privilege to assist the Japanese business community in understanding matters relating to ease of doing business with their Indian counterparts.

31st October 2018

Suguna Ramamoorthy
Secretary General

INSOLVENCY AND BANKRUPTCY CODE 2016
A Crucial Factor in Strengthening Trade & Investment
Relationship between India and Japan

Introduction

India and Japan have shared decades long cordial trade and investment relationship. From April 2000 to March 2016, India has received USD 20.97 billion as cumulative FDI inflow from Japan. This accounts for 7.27% of total inflows into India and as of March 2016, Japan was the 4th largest contributor to India's FDI inflows. Also, there are about 1229 Japanese Companies registered in India.

Strengthened by decades long cooperation between the two economies, the India -Japan Cooperation today is forging new frontiers in bilateral trade and investment cooperation.

India made a significant effort to improve its ease of doing business rankings by introduction of the Insolvency and Bankruptcy Code in 2016. The Code was introduced to ensure a time bound resolution, promote entrepreneurship, availability of credit and also balance the interests of relevant stakeholders. In the revised ease of doing business rankings by the World Bank

released in the year 2018, India has been positioned in the top 100 with the Code operating as an important factor in the move upward.

There are plethora of benefits that insolvency reforms bring in improving the investment climate in an economy. This crucial link is well ascertained and enforced by the Code. This resource paper is intended to be an introduction to the major features to the Code and also to highlight the potential role that the Code has in strengthening the economic relationship between India and Japan. The legal framework in India pertaining to insolvency reforms prior to the introduction of the Code was characterized by overlapping legislations and absence of time bound resolution. The introduction of the Code brought along with it a system of consolidation of existing legislations and a time bound resolution. The Code in its practice has proven to be highly beneficial for Indian businesses and is being widely utilized by Indian and Foreign creditors.

Framework of the Insolvency and Bankruptcy Code 2016

Resolution and Not Recovery

The Code places a strong emphasis on resolution and not recovery and also by ensuring that the company continues as a going concern. This resolution and not recovery-oriented nature of the Code establishes the collective process of insolvency resolution which is highly beneficial than individual recovery processes.

Time Bound Resolution

The objective of the Code as already stated is to ensure time bound resolution by the fixation of clear timelines for every part

of the corporate insolvency resolution process. The entire corporate insolvency resolution process is required to be completed within 180 days. The detailed timelines are mentioned below.

Equality between Creditors

By ensuring a collective process, the Code ensures the treatment of all creditors alike including within its ambit domestic and foreign creditors. Foreign creditors can file an application to initiate the insolvency resolution process in the same manner as domestic creditors.

Adjudicating Authority

The Code provides that the authority responsible for adjudication of all matters under the Code is the National Company Law Tribunal (NCLT). The appeal from the orders of the NCLT shall lie to the National Company Appellate Tribunal. High Court and Civil Courts jurisdiction are ousted under the Code. Appeal from the orders of the National Company Law Appellate Tribunal lie to the Supreme Court.

Role of various Professionals

The Code envisages the establishment of various professionals for efficient execution of the insolvency resolution process. The appointment of various mechanisms such as the Insolvency Resolution Professional, the Insolvency and Bankruptcy Board of India (hereinafter referred to as the Board), Information Utilities and their specialized functions, are intended to facilitate the objectives of the Code.

The Code makes a departure from the erstwhile insolvency legislations in defining the period within which an application for initiation of insolvency resolution process can be made. The

Code by adoption of the liquidity test of insolvency, has enabled the creditor to initiate an insolvency proceeding in a case of a default without the need to make an inquiry into whether the debtor is unable to pay debts.

The Code envisages three persons who can file an application for initiation of corporate insolvency resolution process.

- Financial Creditor
- Operational Creditor
- Corporate Applicant

Financial Creditor

The Code defines the Financial Creditor as any person to whom a financial debt is owed and it includes a person to whom such debt has been legally assigned or transferred. The following are defined as financial debt under the Code namely:

- a) Money borrowed against payment of interest.
- b) Any amount raised by acceptance under any acceptance credit facility or its dematerialized equivalent.
- c) Any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument.
- d) Amount of liability in respect of any lease or hire purchase contract which is deemed as finance or capital lease under the Indian Accounting Standards.
- e) Receivables sold or discounted other than any receivables sold on non-recourse basis.
- f) Any amount raised under any transaction including any forward sale or purchase agreement having the commercial effect of borrowing, this also includes any

amount raised from an allottee under a real estate project.

- g) Any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price.
- h) Any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit or any other instrument issued by bank or financial institution.

Operational Creditor

Operational Creditor is defined as a creditor to whom an operational debt is owed and it includes a person to whom such debt has been legally assigned or transferred. Operational debt is defined as a claim in respect of the provision of goods including employment or a debt in respect of payment of dues arising under any law for the time being in force and payable to the Central Government, State Government or any local authority.

Corporate Applicant

The Code also provides for initiation of insolvency resolution process in case of a default by the Corporate Debtor.

Differences in Application Process by the Financial Creditor and Operational Creditor

As already stated above, the Code provides for initiation of insolvency proceedings on a single case of default. The term default is defined in the Code as non-payment of debt when the whole or part or instalment of debt becomes due and payable. The Code prescribes differential application procedure for financial creditors and operational creditors.

The Financial Creditor on the occurrence of default by corporate debtor, can file an application to the Adjudicating Authority in the

following manner:

- The Financial Creditor shall along with the application furnish a record of the default recorded with the Information Utility.

The **Information Utility** is the mechanism established under the Code to store financial information which includes debt information and also information relating to the default of the debt. The information utility currently registered with the Insolvency and Bankruptcy Board of India is the National E-Governance Services Limited (NESL).

- The Financial Creditor is also required to mandatorily name a Resolution Professional to act as the Interim Resolution Professional

The **Resolution Professional** is an insolvency professional appointed under the Code to conduct the corporate insolvency resolution process.

The Adjudicating Authority within a period of 14 days from the receipt of the application shall on the fulfillment of the requirement either admit or reject the application. The Corporate Insolvency Resolution Process begins from the date of admission of application.

The application procedure is different for an operational creditor who on the occurrence of default must first deliver a demand notice demanding the defaulted amount. The Corporate debtor on receipt of the demand notice must bring to notice of the Operational Creditor the existence of dispute, if any.

Dispute includes a suit or arbitration proceedings relating to the existence or amount of debt, the quality of goods or service and the breach of representation or warranty. The Supreme Court in

the case of *Mobilox Innovations Private Limited v. Kirusa Software Private Limited*, held that any plausible contentions giving rise to further dispute also qualifies as dispute.

The operational creditor after the expiry of ten days from the date of delivery of the demand notice if is not in receipt of the payment from the corporate debtor or does not receive a notice of the dispute, can file an application before the Adjudicating Authority.

The Operational Creditor is required to file the application in the following manner:

- The Operational Creditor shall along with the application furnish a copy of the invoice demanding payment or the demand notice.
- An affidavit to the effect that there is no notice of dispute given by the Corporate Debtor.
- Copy of the certificate from financial institution maintaining the accounts of the Operational Creditor confirming that there is no payment of an unpaid operational debt, if any.

The term **Financial Institution** is defined in the Code as a scheduled bank, financial institution as defined in section 45 I of the Reserve Bank of India Act 1934, public financial institution as defined in clause (72) of section 2 of the Companies Act 2013, such other financial as the Central Government may by notification specify.

The above requirement is made not mandatory in view of the Insolvency and Bankruptcy Code (Amendment) Ordinance 2018. The amendment gave effect to the decision of the Supreme Court in the case of *Macquaire Bank Limited v. Shilpi Cable*

Technologies, wherein the Supreme Court considered the circumstances in which the foreign supplier or an assignee who has a foreign bank may find it difficult to fulfill the above-mentioned condition.

- Copy of any record with the information utility confirming that there is no payment of unpaid operational debt, if any.

The operational creditor is not mandatorily required like the financial creditor to propose a resolution professional as an interim resolution professional, but may do so.

Corporate applicant is defined in the Code as a Corporate Debtor and persons authorized to represent the Corporate Debtor. The Corporate applicant on committing a default, may file an application for initiating corporate insolvency resolution process, accompanied with the prescribed fee, The application should also contain the following:

- Information relating to the books of account and such other documents for such period as may be specified.
- Information relating to the resolution professional proposed to be appointed as an interim resolution professional.
- Special resolution passed by shareholders of the Corporate debtor or the resolution passed by at least three-fourths of the total number of partners of the Corporate debtor as the case may be approving filing of the application.

As already stated above, the Corporate Insolvency Resolution process begins from the date of admission of the application by the Adjudicating Authority.

The Code stipulates that the after admission of the application,

the entire corporate insolvency resolution process has to be completed within 180 days. The Code also provides for the completion of the insolvency resolution process in a fast track manner which can be completed within 90 days.

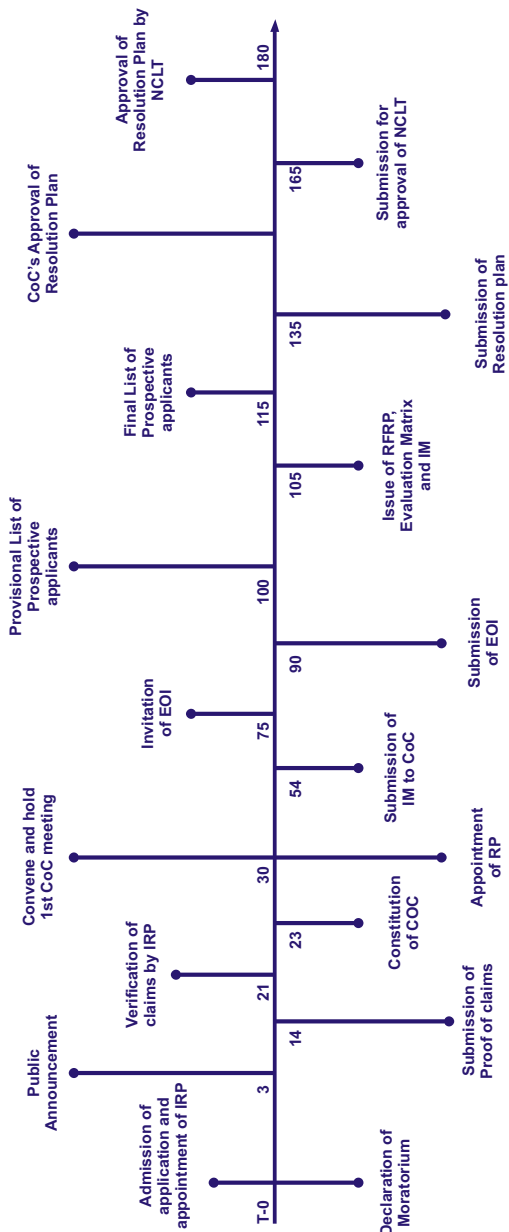
Moratorium

On admission of the application, the Adjudicating Authority shall declare the moratorium. The moratorium prohibits the institution of the following suits during the continuance of the corporate insolvency resolution process namely:

- Institution or Continuance of suits against the Corporate Debtor.
- Transferring, encumbering, alienating or disposing off by the Corporate Debtor any of its assets any legal right or beneficial interest therein.
- Any action under the SARFAESI Act 2002.
- The recovery of any property by an owner of lessor where such property is occupied by or in possession of the Corporate Debtor.

The Code was amended to exclude a surety in a contract of

POST ADMISSION: CIRP TIMELINE



guarantee from the operation of the moratorium.

Resolution of Distressed Assets under the Code An opportunity for Foreign Investors

After the declaration of the moratorium and the public announcement, the resolution professional is required to convene the Committee of Creditors. The Committee shall comprise of only the financial creditors of the Corporate debtor. The Code also provides through the regulations that in circumstances where Corporate Debtor has only operational creditors to have a committee comprising of such operational creditors.

The Committee of Creditors in their first meeting is required to appoint the interim resolution professional as a resolution professional or resolve to replace the interim resolution professional with another resolution professional.

Information Memorandum:

The resolution professional is required to formulate the information memorandum, on the basis of which the resolution applicants are required to submit the resolution plans. The Information Memorandum shall contain details of the corporate debtor such as its assets and liabilities.

Evaluation Matrix:

The evaluation matrix consists of such parameters which every resolution plan is required to fulfill. The evaluation matrix also contains the manner of applying the parameters. The parameters and the manner of application of such parameters are decided by

the Committee of Creditors.

Resolution Plan: The prospective resolution applicants are required to submit resolution plans on the basis of the information memorandum. The resolution plan should contain the following particulars:

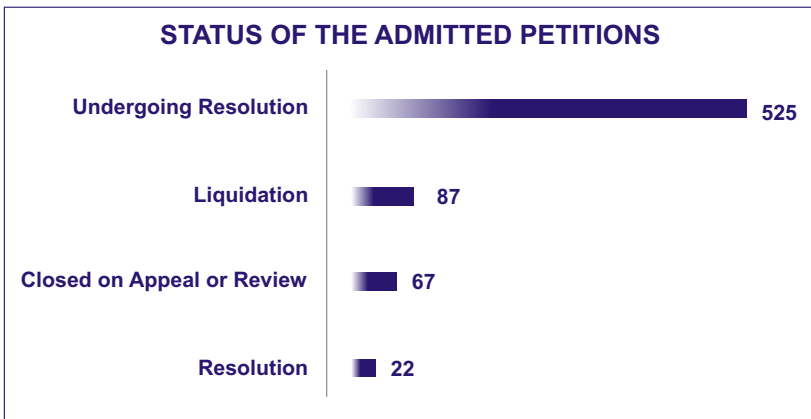
- Payment of the Insolvency resolution process costs in the manner provided by the Insolvency and Bankruptcy Board of India and in priority to the payment of the other debts of the Corporate Debtor.
- Payment of the debts of the operational creditor in such manner as specified by the Board.
- Management of the affairs of the Corporate Debtor after the approval of the resolution plan.
- The Implementation and supervision of the resolution plan.
- The Plan should not contravene any of the provisions of the law for the time being in force.
- The resolution plan also confirms to the other requirements specified by the Board.

The operation of the Code in adherence to the strict timelines prescribed has provided an opportunity for many investors to participate in the resolution process of various distressed assets. Foreign companies who are ready to bring forth the necessary management and expertise, consider the opportunity to participate in the resolution of distressed assets under the Code as

a tremendous opportunity to enter into the Indian market.

This was facilitated by the recent notification from the Reserve Bank of India (RBI) dated 12.02.2018 which has provided that the route under the Code as the mode of restructuring the stressed assets. The RBI vide the notification mentioned above, has withdrawn the existent debt restructuring schemes such as the Strategic Debt Restructuring (SDR), Scheme for sustainable restructuring of stressed assets (S4 A), Corporate Debt Restructuring (CDR) etc. The RBI has also stated a specific timeline within which the resolution of stressed assets should occur, failing which action under the Code will have to be initiated.

By providing equality with the domestic creditors and facilitated by the recent RBI notification, the Code plays a significant role in facilitation of investment by foreign investors.



As of March 2018, of the 701 corporates admitted into resolution process, 67 were closed on appeal or review. 22 resulted in resolution, while 87 yielded liquidations and 525 are undergoing resolution process.

Cross Border Insolvency

Cross Border Insolvency plays an important role in strengthening the insolvency framework. Cross Border Insolvency occurs when a debtor's assets or liabilities are located in more than one state or if the debtor is subject to the jurisdiction from two or more states. There is plethora of benefits that an effective cross border insolvency framework can ensue. The existence of a framework for cross border insolvency enables the achievement of an essential objective of insolvency laws namely creation of effective and predictable rules for foreign direct investment.

The current framework for cross border insolvency incorporated under the Code follows the bilateral route. According to the current framework, the operation of the same depends upon the entering of bilateral agreements with Countries by the Central Government. The limitations of the current framework have been recognized and the Ministry of Corporate affairs in a recent notification dated 20.6.2018 which stated that the Government intends to adopt the UNCITRAL Model Law on Cross Border Insolvency (UNCITRAL Model Law).

The UNCITRAL Model Law has been adopted by major jurisdictions in establishing their cross-border insolvency framework. The objectives of the UNCITRAL Model Law as stated in the preamble are: “1) Cooperation between Courts and competent authorities of the State and foreign states involved in cross border insolvency 2) Greater certainty for trade and investment 3) Fair and efficient administration of cross border insolvencies that protect the interests of all the creditors and other interested persons including the debtor 4) Protection and maximization of the value of the debtor's assets 5) Facilitation of the rescue of financially troubled business, thereby protecting

investment and preserving employment.”

Some of the benefits that the adoption of the UNCITRAL Model Law can entail are the recognition of foreign insolvency proceedings and also providing a framework of commencement of domestic insolvency proceedings when a foreign insolvency proceeding has already commenced. The Model Law is also flexible in nature and therefore it can be adopted to suit domestic requirements.

The adoption and incorporation of the UNCITRAL Model Law under the Code will enable to bring forth an efficient and reliable framework for foreign investors which will also help achieve the objective of the Code namely improve India's Ease of Doing Business.

Conclusion

The Code in its operation so far, has proven to be extremely beneficial for both Indian and Foreign Companies alike. The legislative framework of the Code also through timely amendments to suit changing requirements has facilitated the operation of the Code. The effective functioning of the Code in the coming future will play a crucial role in strengthening the trade and investment relationship of both India and Japan.





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