Interpreting the Code

Corporate Insolvency in India

January 2017
Interpreting the Code: Corporate Insolvency in India
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Foreword

This is the year of landmark reforms: GST and the Bankruptcy Code (Code). While the former has been subject to much discussion and debate, the latter is just beginning to be scrutinized. Both are expected to get implemented around the same time and both have a high potential to change the way we do business – if implemented with the intent with which they have been drafted.

Since 2014, the Reserve Bank of India (RBI) has cracked down significantly on the bad loans situation accumulated in the banking system over time through an AQR process, bringing to light the seriousness of the problem. This has been supplemented by very progressive and constructive initiatives such as the Joint Lenders Forum (JLF), Strategic Debt Restructuring (SDR) – with and without change in control – and S4A. These frameworks, though unable to address all situations, are a step forward toward a resolution culture. Default resolution is and will always remain unique to each situation. The Code, from that respect, is timely as it focusses on a turnaround plan with a deadline, which, if not met, results in liquidation. This forces creditors to act in unison or face consequences (one of the significant drawbacks of the earlier schemes) and avoids arbitrages available due to multiple regulations. While the Code is hailed as one of the best, the devil lies in the detail. Timely action by all stakeholders and dealing with owner-managers would underpin the success of the Code.

Timely resolution

No timely action by lenders is considered appropriate in an Indian environment, which destroys the overall value for most creditors. The law has provisions for such situations, but there are enough and more issues to deal with, including creditors taking quick decisions during the moratorium period, appeals to NCLT being resolved amicably and NCLT relying more on the insolvency professional (IP) to run the process for quicker disposition. The law is more an operational turnaround than a legal battleground. If that is understood by all the participants, it would solve problems than create them.

Dealing with owner-managers

The presence of owner-managers is a situation unique to developing economies such as India. In recent times, though, we have seen creditors take significant action to work with promoters in the best interest of the enterprise. The firmness of creditors supported by good execution can result in a win-win situation for enterprises and creditors. The Code further empowers this action, and there has been an increasing awareness among owner-managers to cooperate in the process.

While there is a long way to go in terms of filling all the holes, the Code is one of the best we have seen given our circumstances, and I am sure the law will amend itself as we gain maturity in behavior and experience unique situations that can be generalized. A good start with the right intent and a good infrastructure is half the battle won.

Abizer Diwanji
Partner & Head - Financial Services, Restructuring & Turnaround Services
EY
1 Why is the Code imperative today?
The Insolvency and Bankruptcy Code, 2016 (the Code) is, undoubtedly, a significant reform. The speed at which the legislation was enacted and then made operational (alongwith finalisation of detailed rules and regulations) has surprised many.

**How have banks dealt with stress commercially in the past?**

**Joint Lenders Forum (JLF)/Corporate Debt Restructuring (CDR)**

Traditionally, banks have preferred to restructure the debt of stressed borrowers through the CDR or JLF mechanisms. While the CDR mechanism was used extensively, the objective seems to have been to provide temporary relief to the borrower rather than make active efforts to revive businesses. CDRs have met with limited success (only 17% exits as of June 2016) in reviving stressed assets due to poor evaluation of business viability and the lack of effective monitoring.

**Strategic Debt Restructuring (SDR)**

Until the introduction of the SDR in June 2015, the Reserve Bank of India (RBI) had largely stayed away from devising a mechanism that enabled the banks/lenders to play a direct role in the turnaround of stressed borrowers. SDR is a tool for lenders to acquire majority ownership in a borrower by converting a part of the outstanding loan (including overdue interest) into equity. At a later date, it can transfer the control to a new promoter. The SDR scheme (along with variations introduced in February 2016) provides banks significant relaxation from the RBI income recognition and asset classification norms.

Most importantly, SDR aimed to provide the lenders an option to initiate a comprehensive turnaround by taking control, giving them a fair shot at reviving these companies by partnering with a more capable promoter. There has been limited will, though, from banks to take on management of companies through the SDR route. Along with an apprehension that the existing legal system would not allow a change of management to take place smoothly, banks were skeptical of lack of protection from existing and imminent litigations. Lack of willingness of the banks to “right size” the debt and provide the “new” buyer with an appropriate capital structure to turn around the assets has also impacted the success of SDR.

**Scheme for Sustainable Structuring of Stressed Assets (S4A)**

The lack of a positive response to SDR from banks have led the RBI to devise other measures such as S4A in June 2016. S4A is a reversal from the “creditor in control” stance taken by the RBI. Under S4A, control may remain with the existing promoter as long as 50% of their debt is “sustainable.” While the efficacy of the S4A is yet to be evaluated, it has found limited eligibility as it prescribes a short-term cash flow visibility and does not allow change in repayment terms. Even as these challenges are being addressed, the lack of emphasis on a comprehensive turnaround could possibly result in the problem just being postponed.

Corporate stress needs a quick and decisive revival strategy rather than an indefinite deferral of the problem. If comprehensive turnaround plans had been implemented in a timely manner, the size of the problem could have been mitigated. Limited will from lenders to engender such a strategy and a judicial framework that did not entirely support them have hampered the efforts in this direction.

**The current judicial framework**

Until the Code, there was no single legislation that governed corporate insolvency and bankruptcy proceedings in India. Lenders had limited muscle when faced with default and promoters stayed in control. Only one element of a bankruptcy framework has been put into place to a limited extent: banks are able to repossess fixed assets which were pledged with them.

According to the Bankruptcy Law Reforms Committee (BLRC), Corporate bankruptcy and insolvency is covered in a complex of multiple laws, some for collective action and some for debt recovery. These are:

1. **Companies Act, 2013** – Chapter on collective insolvency
   1. Companies Act, 2013 – Chapter on collective insolvency resolution by way of restructuring, rehabilitation, or reorganization of entities registered under the Act. Adjudication is by the NCLT. This chapter has not been notified.
   2. **Companies Act, 1956** – Deals with winding up of companies. No separate provisions for restructuring except through Mergers and acquisitions (M&A) and voluntary compromise. Adjudication is under the jurisdiction of the High Court.
   3. **SICA, 1985** – Deals with restructuring of distressed ‘industrial’ firms. Under this Act, the Board of Industrial and Financial Reconstruction (BIFR) assesses the viability of the industrial company, and refers an unviable company to the High Court for liquidation. SICA 1985 stands repealed w.e.f. 25 November 2016.
The significant number of legislations and the complex interplay between them have made the recovery of debts cumbersome for lenders. Different acts define the powers of lenders and borrowers in the case of an insolvency. The lack of clarity on jurisdiction and lack of commercial understanding have allowed stakeholders to manipulate the situation and stall progress.

The average life of cases recommended for restructuring in 2002 was 7 years and the average life of cases recommended for winding up to the court was 6.5 years. Even as of 31 October 2015, only about 955 (out of 4,636) and 163 (out of 545) cases of court and voluntary winding up had been resolved within 5 years. A significant number of such cases had been pending for more than 20 years - 1,274 and 205, respectively. In this environment, the outcomes are poor. For instance, the average time taken for insolvency proceedings in India is about 4.3 years, while it is only 1.7 years in high-income OECD countries. The recovery rate (cents on the dollar) is 71.9 in high-income OECD countries as opposed to 25.7 in India. Therefore, there is an immediate need to overhaul the insolvency framework.

How can the Code help?

The Code makes a clear distinction between insolvency and bankruptcy — the former is a short-term inability to meet liabilities during the normal course of business, while the latter is a longer term view on the business. As all businesses cannot succeed, it is perfectly normal for some businesses to fail, making it important to emphasize on corrective action.

The Code amply clarifies that insolvency or bankruptcy is a commercial issue, backed by law to enforce transparency and objectivity. It is not another law behind which the inevitable can be delayed.

As per the BLRC, the Code set out the following objectives to resolve insolvency and bankruptcy:

1. Low time to resolution
2. Higher recovery
3. Higher levels of debt financing across a wide variety of debt instruments

The Code ensures certainty in the process, including what constitutes insolvency, the processes to be followed to resolve the insolvency, and the process to resolve bankruptcy once it has been determined.

Such a framework can incentivize all stakeholders to behave rationally in negotiations toward the determination of viability, or in bankruptcy resolution. In turn, this will result in shorter recovery timeframes and better recovery, and greater certainty on lenders’ rights, leading to the development of a robust corporate debt market and unlocking the flow of capital.
Why is the Code imperative today?

Why was the Code needed?
1. Reduce the time taken to resolve insolvency
2. Develop investor confidence
3. Eliminate confusion caused by a complex judicial framework
4. Address the NPA situation decisively
5. Develop the credit and bond market

What does the code intend to change?
1. Create a single insolvency and bankruptcy framework
   Set up a clear and unambiguous process to be followed by all stakeholders in a time-bound manner
2. Provide a commercial solution to a commercial issue
3. Allow genuine business failures a second chance
4. Clear and unambiguous process to be followed by all stakeholders in a time-bound manner
5. Provide confidence to lenders of their rights and their enforcement

What does it change for the lenders?
1. Right to control the borrower upon default and maximize recovery
2. Option to initiate the process even if the default is in respect of the debt of another lender
3. Need for more robust monitoring systems to enable judicious exercise of powers
4. Lack of lender consensus on resolution plan can push the borrower into liquidation
5. Clear priority of distribution (waterfall) upon liquidation; government dues subservient to those of secured creditors and unsecured financial creditors
What does it change for the borrowers?

1. Any creditor can file an insolvency petition on a default of INR1 lakh or more
2. Insolvency professional (IP) to take over the management and operations of the borrower during the Corporate Insolvency Resolution Process (CIRP)
3. Borrowers to focus on liquidity - ensure tight cash flow forecasting and monitoring to stay current on payments
4. Need to be proactive in identifying issues, communicating with lenders and developing/implementing a turnaround plan
5. In case of fraudulent diversion of assets, personal contribution can be sought; imprisonment possible

How can the Code help fast-track resolution?

1. Lender inertia during the CIRP would mean liquidation – invariably an economically inferior outcome as compared to resolution
2. Clarity on the insolvency framework will attract investors to invest into stressed/distressed situations
3. Moratorium clause to ensure smooth insolvency-resolution process
4. An “open floor” for submission of resolution plans should facilitate the approval of the best plan
5. The framework defines the role of the judiciary and leaves limited scope for a legal delay/deferral of the problem
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About the Code

- What are the highlights of the Code?
- How does the Code change the legal landscape?
What are the highlights of the Code?

Changes after legislation

Key existing legislation, regulations and non-statutory guidance amended

- Companies Act, 1956/2013
- Recovery of debts due to banks and financial institutions act, 1993 (RDBDRI Act, 1993)
- SICA Act, 1985
- Other enactments for partnerships and individual insolvencies
- Non-statutory guidelines/out of court mechanism

Objective section of the Code

- Consolidate and amend laws relating to insolvency and bankruptcy
- Maximization of value
- Time-bound resolution
- Promote entrepreneurship and availability of credit
- Alteration of priority of payment of government dues
- Capitalize as Insolvency and Bankruptcy Board in India

The insolvency and bankruptcy ecosystem

Insolvency and Bankruptcy Board of India (IBBI)

- Insolvency professional agencies (IPAs)
- Information utilities (IUs)

Insolvency professionals (IPs)

Committee of creditors (CoC)

Insolvent entity

IBBI - apex body for promoting transparency & governance in the administration of the Code; will be involved in setting up the infrastructure and accrediting IPs and IUs

IUs - centralized repository of financial and credit information of borrowers; would validate the information and claims of creditors vis-à-vis borrowers, as needed

IPAs - professional bodies registered by the Board to promote and regulate the insolvency profession; these bodies will enrol IPs

IPs - licensed professionals regulated by the IBBI; will conduct resolution process; to act as liquidator: appointed by CoC and will assume the powers of board of directors

Adjudicating Authority (AA) - would be the NCLT for corporate insolvency; to entertain or dispose any insolvency application, approve/reject resolution plans and decide in respect of claims or matters of law/ facts thereof

CoC - consists of financial creditors who will appoint and supervise the actions of IPs; need to approve the resolution plan
## Corporate Insolvency Resolution Process

<table>
<thead>
<tr>
<th>Default</th>
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<tbody>
<tr>
<td>Failure to pay whole or any part or instalment of the amount of debt or interest due (minimum INR1 lakh)</td>
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<table>
<thead>
<tr>
<th>Who can file the application?</th>
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<tbody>
<tr>
<td>➤ Financial creditors</td>
</tr>
<tr>
<td>➤ Operational creditors (including Government and employees/workmen)</td>
</tr>
<tr>
<td>➤ Corporate debtor</td>
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<thead>
<tr>
<th>Interim resolution professional/resolution professional (IRP/RP)</th>
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<tbody>
<tr>
<td>Financial creditor and/or corporate applicant shall propose the name of an IRP in the application</td>
</tr>
<tr>
<td>It is optional for the operational creditor to propose the name of an interim IP</td>
</tr>
<tr>
<td>All powers of the board and management shall vest with the IRP/RP</td>
</tr>
<tr>
<td>RP is responsible to run the company as a going concern during CIRP</td>
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<tr>
<th>Moratorium</th>
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<tbody>
<tr>
<td>NCLT to declare moratorium from the insolvency commencement date until the completion of insolvency</td>
</tr>
<tr>
<td>Moratorium shall prohibit:</td>
</tr>
<tr>
<td>➤ Institution of suits</td>
</tr>
<tr>
<td>➤ Transfer of assets</td>
</tr>
<tr>
<td>➤ Foreclosure, recovery or enforcement under SARFAESI</td>
</tr>
<tr>
<td>➤ Recovery of assets</td>
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<thead>
<tr>
<th>Resolution process</th>
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<tbody>
<tr>
<td>Default</td>
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<tr>
<td>Appointment of a resolution professional</td>
</tr>
<tr>
<td>Moratorium period (180/270 days)</td>
</tr>
<tr>
<td>Formation of Committee of Creditors</td>
</tr>
<tr>
<td>75% of the creditors to approve resolution plan</td>
</tr>
<tr>
<td>Implement the resolution plan</td>
</tr>
<tr>
<td>Goes into liquidation</td>
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<tr>
<th>CoC</th>
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<tbody>
<tr>
<td>➤ Consists of financial creditors only, excluding related parties</td>
</tr>
<tr>
<td>➤ Will confirm or replace IRP as RP</td>
</tr>
<tr>
<td>➤ To approve several actions of RP</td>
</tr>
<tr>
<td>➤ CoC can replace IP during CIRP by 75% approval</td>
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<tr>
<th>Resolution plan</th>
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<tr>
<td>The resolution plan must provide for:</td>
</tr>
<tr>
<td>➤ Payment of insolvency resolution process costs</td>
</tr>
<tr>
<td>➤ Pay liquidation value to operational creditor in 30 days and to dissenting financial creditor before other financial creditors</td>
</tr>
<tr>
<td>➤ Management of the affairs of the borrower after the plan is approved</td>
</tr>
<tr>
<td>➤ Implementation and supervision of the approved plan</td>
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<tr>
<th>Voting power</th>
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<tr>
<td>➤ Only financial creditors have voting power in the committee in the ratio of debt owed</td>
</tr>
<tr>
<td>➤ All decision of the committee shall be approved by 75% of financial creditors</td>
</tr>
<tr>
<td>➤ If all members are not present at a meeting, a vote shall not be taken at the, and the RP can seek vote by an electronic vote system.</td>
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<tr>
<td>➤ Directors and operational creditors can attend the meeting but would not have any voting rights</td>
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<tr>
<th>Fast track insolvency</th>
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<tr>
<td>For debtors with:</td>
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<tr>
<td>➤ Assets and income below a level</td>
</tr>
<tr>
<td>➤ Such class of creditors</td>
</tr>
<tr>
<td>➤ Other categories</td>
</tr>
<tr>
<td>as may be notified by the central government (completed in 90 days)</td>
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**Liquidation Process**

**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 (refer Waterfall chart alongside)
- Dissolution of debtors (to be completed within 2 years)

**Operations under liquidation**
Liquidation order shall be deemed to be a notice of discharge to the officers, employees and workman of the debtor
Unless, the liquidator continues the business for a limited period during the liquidation process

**Liquidator**
The RP shall act as the liquidator unless replaced by NCLT powers of BoD to vest with the RP
Liquidator shall:
- Form liquidation estate
- Take into custody and control all assets
- Consolidate, verify, admit and determine the value of creditors’ claims.
- Carry on the business for its beneficial liquidation

**Priority Waterfall of claims**
- Insolvency resolution process and liquidation costs
- Secured creditor and 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 debt and dues
- Preference shareholders, if any
- Equity shareholders or partners, as the case may be

**Remuneration of liquidator**
Per regulations:
- To be based on a scale of value realized and distributed by the liquidator.
- Scale is highest for first six months and reduces for 6 to 12 months and further reduces for 12 to 24 months and thereafter.

**Remuneration of liquidator**
- Preliminary report - within 75 days from the date of the order
- Progress report - within 15 days after end of every calendar quarter
- Final report- as part of the application for the dissolution of the corporate debtor to the NCLT

**Insolvency and liquidation cost**
- Insolvency cost includes interim funding, cost of running the debtor as a 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 the rights of different classes of secured creditors (first vs. second charge and fixed vs. floating charge) is not clarified in the Code or regulations
**Key aspects of the CIRP regulations:**

1. **Public announcement**
   - It has to be made within 3 days of the appointment of the IRP.
   - It should be published in one English and one regional language newspaper.
   - It should invite creditors for submission of proof of claims (PoC) and give them 14 days from the date the IRP is appointed.

2. **Moratorium**
   - Supply of specified essential goods or services will not be terminated or suspended during the moratorium period. The Board has specified electricity, water, telecommunication and IT services as essential supplies.
   - It will not apply to such transactions as may be specified by CG.

3. **Appointment of valuers**
   - The IRP should, within 7 days, appoint two registered valuers (in accordance with the Companies Act) to determine the liquidation value.
   - The IRP/RP may appoint a third valuer if two estimates are significantly different.
   - No time limit is specified for the report of the valuers; however, liquidation value is part of the final information memorandum, which is to be prepared within 14 days of the first Committee of Creditors (CoC) meeting.

4. **Submission of PoC**
   - Separate forms have been specified for submission by operational creditors, financial creditors and workmen employees.
   - Financial creditors should submit the PoC electronically, while other creditors can submit it by post or electronically.
   - A creditor can file the PoC till approval of the plan by the CoC if the creditor failed to submit it within the date stipulated in the public announcement.

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**Corporate resolution process timeline**

<table>
<thead>
<tr>
<th>No. of days</th>
<th>Day –ve</th>
<th>14</th>
<th>17</th>
<th>21</th>
<th>35</th>
<th>44</th>
<th>51</th>
<th>65</th>
<th>150</th>
<th>180</th>
</tr>
</thead>
<tbody>
<tr>
<td>Filing of application to NCLT</td>
<td>Admission of application</td>
<td>Public announcement</td>
<td>Verification of claims by IRP</td>
<td>IRP to constitute CoC and file a report</td>
<td>Appointment of resolution professional</td>
<td>Submission of resolution plan</td>
<td>Approval of resolution plan by NCLT</td>
<td></td>
<td></td>
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*The Code proposes a time-bound resolution process, and provides aggressive timelines for each activity in the resolution process.*
5. **CoC**: If there are no financial creditors other than related parties, the CoC may consist of only operational creditors with:

- 18 largest such creditors by value
- One representative elected by all workmen other than workmen included in the top 18 operational creditors
- One representative elected by all employees other than employees included in the top 18 operational creditors

6. **Meeting of the CoC**

   - **First meeting of the CoC**
     - The IRP has to convene the first meeting within 7 days of filing the report certifying constitution of the committee. The first meeting is to be held within 7 days of the constitution of the committee.
   
   - **Any other meeting of the CoC**
     - The RP can convene a meeting of the CoC as and when necessary or on a request made by members of the CoC representing 33% of the voting rights.
   
   - **Quorum**
     - It should have members of the committee representing at least 33% of the voting rights.
     - The CoC, however, may modify the percentage of voting rights required for quorum.

7. **Voting by the CoC**

   - The resolution professional will take a vote of the members of the CoC when all the members are present in the meeting. If all members are not present at a meeting, the resolution professionals will circulate the minutes of the meeting and seek vote by electronic means within 24 hours.
   
   - All matters listed in section 28 (1) of the Code would need a positive vote of 75% of the creditors by voting share.

8. **Approval of resolution plan**

   - The resolution applicant should submit a resolution plan 30 days before the expiry of the maximum period for insolvency resolution – i.e., 180 + 90 days, as the case may be.
   
   - The resolution plan should mandatorily identify specific source of funds to pay the insolvency resolution process cost, and the liquidation value of operational creditors and dissenting financial creditors.
   
   - Liquidation value is the estimated realizable value of the assets of the corporate debtor if the corporate debtor were to be liquidated on the insolvency commencement date.
   
   - The resolution plan should provide for the implementation and supervision of the plan.
How does the Code change the legal landscape?

The Code consolidates and amends the laws relating to the reorganization and insolvency of corporations, partnerships and individuals. It seeks to achieve reorganization and, failing that, liquidation of the concerned entity. The Code makes some fundamental changes to the existing insolvency resolution process, procedurally as well substantively.

Shift from balance sheet to cash flow test

Unlike the SICA, which relied on the test of erosion of net worth to determine sickness, the Code prescribes an objective test – that of payment default in respect of a debt. In effect, it applies a cash flow approach to insolvency. Under the Code, an application for CIRP can be filed upon the occurrence of a payment default in respect of a debt of at least INR1 lakh (or a higher amount as prescribed) before the NCLT. Though winding up proceedings could also be initiated upon a default on the ground of inability to pay debt under the Companies Act, the process was not efficient and was aimed for liquidation rather than resolution of insolvency.

New institutional framework

One of the distinguishing features of the Code is that it relies heavily on processes and administrative setup to ensure flow of information and resolution of issues in a time-bound manner. The Code envisages the establishment of a new institutional framework including IUs, IBBI, IPAs and IPs. The IBBI administers the entire institutional framework including registration and regulation of each of these entities. IUs are entities registered with the IBBI. Financial creditors are required to submit financial information and information relating to secured assets, as specified by the regulations, to the IUs. Further, along with an application for CIRP, financial creditors have to furnish evidence of default recorded through the IUs (or such other evidence or record as prescribed) which the NCLT shall also refer to ascertain the existence of such default. A financial creditor can submit a claim to the liquidator by providing a record of such a claim with the IU. Therefore, records of Information Utilities will play a significant part in establishing default and help in minimizing disputes relating to default or security.

Initiation of CIRP

A financial creditor can file for CIRP even if the default is in respect of debt of another financial creditor. An operational creditor is required to deliver a notice of demand on the corporate debtor and the CIRP application can be filed only if the corporate debtor does not dispute the debt within 10 days of the delivery of such notice of demand. The corporate debtor can also file for CIRP. In each case, NCLT shall within 14 days of filing, admit or reject (after allowing 7 days for rectification of defects) the petition.

The CIRP has to be completed within a period of 180 days from the date of admission, which may be extended by a further period of 90 days by an order of the NCLT, upon application of a CoC by resolution. The timelines, the requirement of notice for operational creditors and the ability of a financial creditor to file for CIRP even if the default is in respect of another financial debt are new features incorporated under the Code. Earlier, a statutory notice was required in the context of winding up. It is debatable whether in a two stage process for insolvency resolution and, thereafter, liquidation such notice and right of representation by the corporate debtor or the other creditors should also be required.

Moratorium

Upon the admission of application for CIRP, the NCLT shall by an order declare a moratorium in respect of the corporate debtor including, among others, in respect of institution/continuation of suits or proceedings or execution of any judgement or order against the corporate debtor; any transfer,
disposal or encumbrance of its assets by the corporate debtor; and any foreclosure or enforcement of security interest including those prescribed under the SARFAESI Act. Though SICA also had moratorium provisions, SICA applied only to industrial undertakings (while the Code applies to all companies) and it had no finite end for such a moratorium. It may be noted that the moratorium starts from the date of admission of application. Internationally, legislations typically provide for moratorium from the date of application itself rather than the date of admission to protect the assets of the debtor in the interim.

CIRP

NCLT will appoint an IRP within 14 days of admission of an application. The IRP will have the power of management of the corporate debtor and take control of the assets of the corporate debtor. The powers of the board of directors will be suspended. The IRP will constitute the CoC (comprising all financial creditors of the corporate debtor), which will, in turn, appoint an RP, who for certain decisions such as interim finance, change in capital structure etc. will require prior approval of the CoC. Its meetings may be attended by representatives of the operational creditors (holding at least 10% of debt), directors and partners of the corporate debtor and the RPs is required to notify them of the meetings.

The decisions of the CoC will be taken with a 75% voting share. The corporate resolution plan pursuant to CIRP is required to be approved by the CoC. If in compliance with the applicable laws, NCLT will approve such a plan and it will be binding on all parties. The appointment of RP and vesting of powers with the CoC is a marked departure from the concept of the “debtor in possession” during the insolvency process under the existing regime.

Liquidation

If the corporate resolution plan is rejected or not approved/received in a time-bound manner, if the resolution plan is not complied with or if the CoC so recommends, NCLT shall order for the liquidation of the company and make a public announcement. In the current regime, the reorganization and winding up of corporate debtors are dealt with under separate laws. Once a liquidation order is passed by NCLT, the RP appointed for CIRP shall act as the liquidator (unless NCLT replaces the RP). The liquidator shall have the powers of the board and management. The liquidator has wide powers to act on behalf of the corporate debtor, including, among others, to verify and settle claims of creditors, evaluate and sell assets of the corporate debtor, take measure to protect and preserve the assets and properties of the corporate debtor as he deems
Interpreting the Code: Corporate Insolvency in India

What constitutes insolvency
Inability to pay debt/erosion of net worth

Class of creditors
Secured and unsecured - separate classes recognised

Management during CIRP
Liquidator

Preferential payments
Certain government dues had priority over secured debt

Exclusions from liquidation estate
N/A

Institutional framework
Fragmented. Spread across various authorities and forums.

Avoidance of transactions
The Code provides for avoidance of undervalued transactions and preferential transactions, which can be set aside upon application of the liquidator or resolution professional. Under the Code, the suspect period for such transactions with the related party is two years, while that of an unrelated party is one year. The Companies Act instead had the concepts of “fraudulent preference” and floating charges before winding up, where the look-back period was six months and one year, respectively. The Code also introduces the concept of extortionate credit transactions, which can be set side upon an application of the liquidator or the resolution professional.

Key legal differences between the Code and the current regime

<table>
<thead>
<tr>
<th>Topic</th>
<th>Current regime</th>
<th>The Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>What constitutes insolvency</td>
<td>Inability to pay debt/erosion of net worth</td>
<td>Default of amount higher than INR1 lakh</td>
</tr>
<tr>
<td>Class of creditors</td>
<td>Secured and unsecured - separate classes recognised</td>
<td>Financial and operational - no subclasses. Committee of creditors consists of financial creditors only.</td>
</tr>
<tr>
<td>Management during CIRP</td>
<td>Liquidator</td>
<td>RP under supervision COC</td>
</tr>
<tr>
<td>Preferential payments</td>
<td>Certain government dues had priority over secured debt</td>
<td>Government dues rank after financial unsecured debt. Trade creditors rank below financial creditors</td>
</tr>
<tr>
<td>Exclusions from liquidation estate</td>
<td>N/A</td>
<td>Netting and set-off recognised on financial collateral</td>
</tr>
<tr>
<td>Institutional framework</td>
<td>Fragmented. Spread across various authorities and forums.</td>
<td>Amends and consolidates laws relating to insolvency and reorganization of companies, partnerships and individuals. NCLT is the AA for CIRP. Also envisages establishment of information utilities.</td>
</tr>
</tbody>
</table>

Preferential Payments
Under the Code, government dues and dues of secured creditors (for unpaid amounts after enforcement of security) rank after the financial debts owed to unsecured creditors. Government dues had higher priority under the Companies Act. Further, any contractual arrangement between the parties that are equally ranked will be disregarded by the liquidator if it disrupts the order of priority laid out in Section 53 of the Code.
Transfer of proceedings under various acts

Post the formation of NCLT, the office CLB is no more operational. Also for insolvency and winding up cases, NCLT shall be the appropriate adjudicating authority. Consequently several proceedings under the companies act, 1956/2013 and SICA, 1985 would be transferred to appropriate adjudicating authorities as below:

1. Transfer of proceedings under SICA-

“Appeal, reference, inquiry, or any proceeding of whatever nature pending before the Appellate Authority or the Board under SICA, 1985 shall stand abated. The company in respect of which such proceedings stands abated, may make reference to the NCLT under IBC within 180 days from the commencement of the IBC

2. Transfer of proceedings under Companies Act, 1956-

All proceedings including proceedings relating to arbitration, compromise, arrangements and reconstruction and winding up of companies, pending immediately before such date before any District Court or High Court

Cases other than winding up

Cases relating to voluntary winding up

Cases relating to winding up on the ground of inability to pay debts

Cases relating to winding up matters on the grounds other than inability to pay debts

Transferred to the NCLT

Continue with High Court till 1 April 2017

Petition served to the respondent

Yes

Yes

Petition served to the respondent

No

No

Transferred to NCLT post 1 April 2017

Transferred to NCLT, except where BIFR has forwarded its opinion to high court, and where no appeal is pending

To continue with High court

Transferred to NCLT

This article has been contributed by Piyush Mishra. Piyush is a partner in Projects and Finance Practice Group of Cyril Amarchand Mangaldas. Besides being admitted to the Bar Council of Delhi, he is also a Solicitor (Nonpracticing), England & Wales. He is recognized by international publications such as IFLR 1000 (leading infrastructure lawyer). His publications include contributions in PFI India Report and PLC (Securitization Multijurisdictional Guide – India).
The Code on the ground

- How should lenders and borrowers adapt to the new Code?
- What are the potential challenges for Insolvency Practitioners?
- How does cross-border insolvency get impacted?
- What should be expected in the near-term
Interpreting the Code: Corporate Insolvency in India

The Code and its stakeholders

The Code establishes some very basic principles of borrowing and corporate insolvency resolution:

- It recognizes that all businesses cannot succeed; therefore, it emphasizes on decisive corrective action instead – on the part of all its stakeholders.
- Until now, multiple laws had often protected promoters and enabled “debtor in possession” to continue. The Code now unifies the legal framework to deal with insolvency.
- It also establishes that insolvency is a commercial issue and the law should not be left to decide if a business should be liquidated or revived – after it is insolvent. It is the creditors’ prerogative to decide. To this end, the Code prescribes a “creditor in control” regime with creditors exercising timely control in the event of a default in the repayment of any debt (including interest).
- The intended benefits of the Code, however, will be realized only when all stakeholders contribute to creating an ecosystem conducive to an effective, fair and expeditious implementation of the Code.

How should lenders and borrowers adapt to the new Code?

How should the lenders gear up to the Code?

The Code unambiguously states that the trigger for an insolvency petition is a single default (more than INR1 lakh) which, if approved, will result in the lenders taking over the management of the defaulter through an IP.

Significant value can be preserved even in distressed situations, if the lenders act swiftly with a clear intent.

When to invoke the CIRP

- A key issue that banks would need to address as the Code becomes operational is to determine if and when to invoke the CIRP, which would entail ascertaining the nature and cause of the default. Banks will have to assess whether the default is on account of temporary problems or if there is probability of further default, and whether the entire loan outstanding should be recalled and an insolvency petition should be filed. If the default is likely to be rectified, it may not be worthwhile to commence the CIRP. For assessing when to invoke CIRP, it may be necessary to define certain norms that take into consideration the following circumstances (only illustrative):

  - Whether the default is one-off for valid and satisfactory reasons or recurring coupled with delays/defaults in the payment of other dues/ liabilities
  - Whether the default is despite the capacity to pay and/or there are indications of diversion of funds and willful default
  - Whether the default is on account of delays in payment for supply of goods/services to government departments, other public authorities and public sector enterprises or large undertakings
  - Whether the default is on account of some accident or force majeure, requiring a different treatment of default, including grant of debt relief
  - Whether CIRP would result in a better realization for the creditors as compared to other options such as CDR, SDR and direct liquidation
  - Whether invoking CIRP would have a negative impact on the borrower’s market image and potentially impact the going concern
  - The cost implications of putting the borrower through CIRP (cost of IP, lawyers, new management etc.)
  - The possibility of getting interim funding during the moratorium period to continue to run the borrower as a going concern
  - The probability of 75% of the creditors approving the resolution plan
  - The probability of reviving the business, or the creditors directly going into liquidation.

One size does not fit all; the Code cannot be looked upon as a single solution for all non-performing assets. Case-by-case commercial evaluation would be critical in finding the best solution.

The answers are not straightforward and would require a detailed set of internal policies and directives, which could be used as guidelines by banks when evaluating specific situations. In addition, banks would also need to develop a sharp commercial outlook and a deeper understanding of their borrowers’ economic environment before arriving at the appropriate
solution. This would need a significant strengthening of their credit monitoring and the development of early warning mechanisms.

In more developed economies, bankers specify a range of critical covenants linked to profitability and cash flows that are monitored rigorously and periodically. Any breach of such covenants leads to an immediate and independent business review (IBR) of the borrower by a specialized agency, resulting in an assessment of the short-term and long-term viability of the business. The outcome of such an IBR would provide banks an evaluation of various options – i.e., (a) allow the borrower to work out a revival, (b) agree with the borrower on an operational restructuring, (c) negotiate a financial restructuring or (d) pull the trigger on the CIRP.

A few other matters that the banks and the RBI would need to consider include the following:

- What are the categories of loan accounts where the CIRP should be invoked? In cases of loans to small entities, it may not be feasible. Banks may consider restructuring the debt in these cases, if viable, and recover the debts via debt recovery laws, as required.
- The current provisioning norms as defined by the RBI may need to be aligned with the Code. One of the possibilities could be that the RBI continues with the existing classification norms such that for the first 90 days after default, the account can be treated as an SMA and after 90 days as an NPA. After approval of the resolution plan, the borrower can be classified as standard.
- Alternatively, a new category can be created for assets under the insolvency process and the provisioning can be stopped till the time a resolution plan is either approved or rejected by 75% of the creditors.
- Appropriate covenants would also need to be determined and included for each case in loan documents, empowering the bank to conduct an IBR when there is a breach. It should be incumbent on the borrower to inform the bank the reasons for default and the plan to mitigate it as soon as it realizes a likelihood of a loan default.

Appointment of IPs as RPs

Lenders (through the CoC) have to recommend the appointment of RPs under the Code.

During the CIRP, the powers of the Board of Directors of the corporate borrower will be vested with the RP. The RP would be responsible for administering the corporate borrower as a going concern during this period and for evaluating the resolution plans submitted.

Considering the criticality of RPs to the process, the lenders should evolve appropriate processes and exercise professional judgement in appointing an RP. Such an appointment should consider, among other factors, the experience of the IP in working in similar stressed/distressed situations as chief restructuring officer/interim management in driving turnaround plans and his reputation of professional integrity. Adequacy of staff, availability of technical/sector experts and geographical presence could also be factors in choosing an IP commensurate with the size and complexity of the situation.

Along with competent IPs, lenders would also need to empanel experts across sectors that can assist the IPs in managing defaulting borrowers.

Approval of resolution plans

The plan would need to be holistic. It should not deal with just one aspect (financial re-engineering) but should follow a multi-faceted approach that brings back the company to good health.

A resolution plan submitted by the RP to the CoC needs to be approved by a vote of at least 75% of the financial creditors. If no resolution plan is approved and submitted to the NCLT within the period of 180 days (or 270 days if extended), the NCLT shall order the liquidation of the corporate borrower.

Traditional resolution mechanisms (CDR, SDR etc.) have not succeeded, partly because of the lack of willingness and consensus of the banks to “right size” the debt and provide an appropriate capital structure to turn around the borrower.

The Code would require lenders, based on a recommendation from the RP, to evaluate the resolution plan rationally with a focus on “maximizing recovery through turnaround and revival,” not on “minimizing provisioning.” Accordingly, lenders should develop internal norms to enable the approval of resolution plans on a timely basis.

The Code bestows tremendous powers to the lenders and a responsible exercise of these powers will require a complete transformation of their outlook. In addition, credit monitoring systems and loan recovery procedures in the Indian banking system would need to be overhauled.
Borrowers need to identify problems in advance and focus on a comprehensive turnaround

The Code envisages a “creditor in control” regime with lenders exercising control upon a single default. This can be effected without any notice and the law is very stringent as compared to the existing laws.

This is a significant shift from a legal system that was heavily supportive of promoters and delayed recovery/revival under the cover of public interest or saving organizational capital. As a result, bad (and badly run) businesses continued to operate to the benefit of their owners. On the other hand, the Code imposes jail terms of up to five years if “asset-stripping” is noticed within 12 months before the default. It is, therefore, inevitable for stressed businesses and their owners to proactively devise and implement a timely and effective turnaround plan to ensure that there are no defaults that trigger the Code. Such a turnaround plan should focus on operational improvement, cash conservation and sale of non-core assets, as much as on right-sizing the capital structure.

Borrowers should also have a strong IT, finance and cash flow monitoring system to report any delayed payment or default.

Avoidance of historical transaction, which can be set aside by NCLT

<table>
<thead>
<tr>
<th>Section</th>
<th>Details</th>
<th>Time limit</th>
<th>Consequences</th>
</tr>
</thead>
<tbody>
<tr>
<td>43</td>
<td>“Preferential transaction: If any person is given a preference in any transaction by the borrower with the effect of putting that person in a beneficial position”</td>
<td>“Related party - In the last two years Unrelated party - In the last one year”</td>
<td>NCLT can pass an order to make the borrower or the person given preference to restore, repay or account for any profit from such a transaction</td>
</tr>
<tr>
<td>45</td>
<td>“Undervalue transaction: If the borrower enters a transaction with any persons which were undervalued; and such a transaction did not take place in the ordinary course of business”</td>
<td>“Related party - In the last two years Unrelated party - In the last one year”</td>
<td>NCLT can pass an order to make the borrower or the person benefited from such a transaction to restore, repay or account for any profit from such transaction</td>
</tr>
<tr>
<td>49</td>
<td>“Transaction defrauding creditors: If any transaction is deliberately entered by the borrower to defraud a creditor”</td>
<td>No time limit</td>
<td>NCLT can pass an order to make the borrower or the person benefited from such a transaction to restore, repay or account for any profit from such a transaction</td>
</tr>
<tr>
<td>50</td>
<td>“Extortionate credit transaction: If the borrower has been party to an extortionate credit transaction and which is not in compliance with the law, and such that involved receipt of financial or operational debt”</td>
<td>In the last two years</td>
<td>NCLT can pass an order to restore the position, set aside the whole transaction, modify the term etc.</td>
</tr>
</tbody>
</table>

Conclusion

Most regulations, be it winding down under the Companies Act 2013, SDR, SICA or SARFAESI, were well-meaning to find a resolution in a systematic manner as much as the Code does. However, they were misused by making the processes prescribed in the regulation a mere formality to achieve the desired objective. If this is done with the Code, it will become just another piece of comprehensive legislation.

Positive involvement and participation of the key stakeholders – the borrower and the lender – and how they gear up for and contribute to the effective and intended functioning of the Code would be a critical factor for the success of the Code.
Interpreting the Code: Corporate Insolvency in India

What are the potential challenges for Insolvency Practitioners?

An IP is defined by Section 3(19) of the Code as a person enrolled under Section 206 with an IPA as its member and registered with the IBBI as an IP under Section 207. Section 2(20) of the Code defines an “IPA” as any person registered with the Board under Section 201 as an IPA. If these provisions are compared with the Companies Act, 2013, there is a clear reference to names of company secretaries, chartered accountants, cost accountants and such other professionals notified by the Central Government, from a databank maintained by any institute or agency notified by the Government (Refer Section 259(1) and 275(2) of the Companies Act, 2013). The Company Law, therefore, permits the recognition of existing institutes of professionals as IPAs. The regulations under the Code, however, contemplate the establishment of a not for profit Section 8 company with capital of INR5 crores and net worth of INR10 crores, which should apply for registration as an IPA. Three IPAs have already been registered – ICAI, ICAI (Cost) and ICSI – with over 365 IPs registered under the “registration for a limited period” provisions as on 30 December 2016, with a validity of 6 months from the date of registration.

The first challenge for the prospective IPs in India will be to develop the competency of the newly formed IPAs to enroll, regulate and monitor working of IPs. Also, it is important that the members who are grandfathered set up the best precedent for the implementation of the law.

Professionals in India have been operating in an environment that protects industrial undertakings and large commercial enterprises from closure in spite of losses and inability to pay debts, by laws such as SICA or State Relief Undertakings Acts, which are still operative. From the freedom to pay the debts or other liabilities as and when you are able to do so, the law is changing to declare you insolvent if you have no money to pay the debt when it falls due for payment. The focus of the professionals advising business enterprises has to shift to prudent cash flow forecasting and management practices.

Although the definition of IP under the Code makes no reference to chartered accountants, cost accountants, company and lawyers, it is clear, now from the regulations, that only such professionals (and other eligible professionals) will have to undertake the tasks of insolvency resolution and liquidation of corporates. The task of IPs will relate to the following categories of enterprises:

1. All companies with debt of INR1 lakh and above
2. Industrial undertakings and large commercial enterprises
3. Infrastructure projects
4. Medium, small and micro enterprises
5. Individuals and partnership firms (debts of INR1,000 and above)
6. Fresh start cases of individuals with annual income of INR60,000 or less

IPs will have to pick the category of insolvents from among these to focus on. If individual insolvencies and fresh start cases are to be taken up, it will require a different kinds of enterprise and manpower to handle such cases. The Code provides that if there is no IP suggested by the creditor, the IBBI will nominate the IP. It is presumed that a panel of IPs to be maintained by the IBBI will be for different locations and types of insolvents, otherwise the system will be difficult to operate. In any case, IPs will have to decide their respective areas of operation and indicate them in their application for registration as IPs.

In certain economies (such as the US), the insolvency law has the concept of “debtor in possession” and on commencement of insolvency, a moratorium becomes operative and the debtor is allowed to remain in possession, formulate a resolution plan and obtain approval from all stakeholders. The Indian law prescribes a concept of “creditor in control,” and the IP is required to take possession of all assets and take over the management of the enterprise. This part of IPs’ responsibilities is the most challenging and could be eased if the insolvent
Interpreting the Code:

Corporate Insolvency in India

Eligibility of resolution professional or liquidator

- An IP is eligible to be appointed as a resolution professional or liquidator of a corporate debtor if that individual and all partners and directors of the IPE of which that individual is a partner or director are independent of the corporate debtor.

- A person will be considered independent of the corporate debtor if that person:
  - Is eligible to be appointed as an independent director u/s 149 of the Companies Act, 2013
  - Is not a related party of the corporate debtor
  - Is not an employee or proprietor or a partner of:
    - A firm of auditors or company secretaries in practice or cost auditors of the corporate debtor, or
    - A legal or a consulting firm that has or had any transaction with the corporate debtor amounting to 10% or more of the gross turnover of such firm, in the last three financial years.

Be that as it may, IPs are entrusted with the following tasks under the Code, either as IRP, resolution professional or liquidator:

- Manage the affairs of the corporate debtors as a going concern
- Constitute the CoC, convene its meetings and conduct such meetings
- Conduct the CIRP
- Discharge various duties necessary to operate the enterprise as a going concern as listed out in Section 25 of the Code

One important aspect of undertaking responsibility as an insolvency resolution professional is that the responsibility for operating the enterprise is of the IP and not the creditors at whose instance the IP is appointed. Hence, if there is a loss due to lack of timely sales of goods with a limited shelf-life or environmental damage as a result of leakage, the liability will be of the IP as the person in charge of the business enterprise. IPs will, therefore, need to empanel managerial experts in different fields who can be entrusted with the functions of a business enterprise.

Insolvency and Bankruptcy Board of India (Insolvency resolution process for corporate persons) Regulations, 2016 Draft regulations on registration of IPs

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    - A legal or a consulting firm that has or had any transaction with the corporate debtor amounting to 10% or more of the gross turnover of such firm, in the last three financial years.

Prepare the information memorandum
- Submit a resolution plan to the adjudicating authority as approved by the CoC
- Verify and determine the claims of stakeholders
- Carry on the business of the corporate debtor for its beneficial liquidation
- Examine and file for avoidance of transactions that are preferential, undervalued, fraudulent to creditors and extortionate
- Conduct the liquidation process if the resolution plan is rejected or fails after approval

Enterprise extends cooperation to the IP and facilitates the takeover of assets and management. IPs will have to decide how possession of assets will be taken: whether each and every item will be included by making an exhaustive inventory or symbolic possessions will be taken, trusting the existing personnel of the enterprise. Since there is a possibility of liquidation of the enterprise if a resolution plan is not worked out, it is expected that the company management will cooperate with the IP, and ensure that all assets are accounted for, preserved and protected, that no valuable assets are concealed or disposed of without the knowledge of the IP, and that the enterprise is allowed to be operated as a going concern.

Prepare the information memorandum
When an insolvency resolution application is admitted and an IP is appointed, it is necessary that a CoC is constituted at the earliest so that the lenders providing working capital take a view on how and to what extent working capital funds will be provided and if they are not willing to continue to lend, whether loans are required to be raised from other lenders. It would be for the IP to make a quick assessment of the business and convince the lenders to continue lending limits so that the option of disposal of the enterprise as a going concern is explored or otherwise a resolution plan is worked out.

Lastly, the IPs need to note that the Code at every stage of the appointment of an interim or final IP or approval of change of IP requires that the IBBI certify that there are no disciplinary proceedings pending against the IP and give specific approval for appointment of IP. Further, disciplinary proceedings may be initiated against the liquidator or resolution professional based on an application made by a creditor in cases where undervalued transaction are not reported by them. These provisions indicate a concern that IPs may deal with assets of the business enterprise for gaining pecuniary or other advantage for themselves or for other third parties to the detriment of other claimants and stakeholders. Professionals planning to undertake assignments as an insolvency resolution professional will have to ensure that the officials selected are independent persons with no relationship with or interest in the business enterprise and are efficient, competent and honest with good reputation and character and integrity beyond any doubt.

Introduction of the Code in India involves total transformation of the mind-sets of the business community, judiciary and the professionals advising them. Smooth transition to the new norms will be a major challenge.

The article has been contributed Mr. M. R. Umarji, Consultant, IBA. He was a member of the Bankruptcy Law Reforms Committee constituted by the Government of India to draft the Insolvency & Bankruptcy Code, 2016. Mr. Umarji has more than 45 years of experience in law, specifically with respect to the banking sector. He has worked as Legal Assistant in the Law & Judiciary Department of Government of Maharashtra and as Law Officer in Bank of Baroda, and has worked on various committees and working groups set up by the Government.
Interpreting the Code: Corporate Insolvency in India

Why has cross-border insolvency not been covered in the Code?

The Code has been widely acknowledged as a blend of some of the best practices across the world, but it just falls short of being truly global. Cross-border insolvency has not been adequately covered in the Code. While it accords the power to the Central Government to enter into an agreement with foreign countries for enforcing the provisions of the Code, the international community would have expected more.

Most of the previous law-reform committees had recommended that the UNCITRAL Model Law on Cross-Border Insolvency, which has already been adopted by over 41 countries, should be adopted in India. The Corporate Bankruptcy and Winding up Code, 2001 proposed by the NL Mitra Committee laid out detailed provisions relating to the subject of cross-border insolvency, but it did not see the light of day. The BLRC, in its interim report, was of the opinion that “Further thought and consideration is required before implementing the UNCITRAL Model Law. Such adoption should ideally take place only after the adoption of the Insolvency Code.” It also noted that some other international approaches may also need to be considered while framing the cross-border insolvency laws, including EC Regulation on Insolvency Proceedings, American Law Institute’s NAFTA Transnational Insolvency Project and the International Bar Association Cross-Border Insolvency Concordat.

Given the complexity involved in cross-border cases and the absence of an effective domestic insolvency framework, it is probably prudent to take one step at a time. Even while focusing on domestic insolvency, the BLRC acknowledged in its final report the need for cross-border insolvency.

How does cross-border insolvency get impacted?

Applicability of cross-border insolvency

Foreign creditors

Foreign assets

Insolvency proceedings in foreign country

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Limited cross-border provisions in the Code

Cross-border insolvency has not been defined in the Code, but in general it may be understood as insolvency of borrowers who have assets or creditors in different jurisdictions, or are subject to insolvency proceedings in multiple jurisdictions.

The Joint Parliamentary Committee on the Code, while deliberating on the Code, conceded that not incorporating provisions relating to cross-border provisions will lead to an “incomplete code,” and accordingly added two new enabling sections: “Agreements with foreign countries (Sec 234)” and “Letter of Request to a country outside India in certain cases (Sec.235).”

Agreements with foreign countries: The Central Government is empowered to enter into bilateral agreements with foreign governments. It may also apply the Code in relation to assets or property of a corporate debtor (including a personal guarantor of a corporate debtor), situated at any place in a country outside India with which reciprocal arrangements have been made.

It is to be seen how effective the bilateral agreements turn out to be, since it would be contingent on long-drawn negotiations with each country; and agreements with each country would vary, resulting in chaos and litigation.

Letter of request to a country outside India in certain cases: The NCLT may, on receipt of an application from an RP, request a competent authority of a foreign country to seek evidence or action in relation to the foreign assets of the corporate debtor.

There are no specific provisions in the Code on how Indian authorities would give or seek assistance to or from foreign authorities, or how Indian authorities would recognize and deal with debtors that are undergoing insolvency proceedings in multiple proceedings.

Other provisions in relation to foreign assets/creditors:

- The RP may take control over the assets belonging to the corporate debtor but located in a foreign country.
- The Code does not make any distinction between domestic and foreign creditors, and therefore creditors of both categories would have equivalent rights. However, it is not explicitly mentioned whether the representatives of foreign insolvency proceedings and creditors would have a right of access to the courts, as envisaged in the UNCITRAL Model Law.

“The next frontier lies in addressing cross-border issues. This includes Indian financial firms having claims upon defaulting firms which are global, or global financial persons having claims upon Indian defaulting firms.

Some important elements of internationalisation – foreign holders of corporate bonds issued in India, or borrowing abroad by an Indian firm – are dealt with by the present report. However, there are many other elements of cross-border insolvency which are not addressed by this report.”

Final report of BLRC: Volume I
The government has moved at an unprecedented pace to operationalize the Code. The key activities that have been completed that would fast-track the implementation of the Code include:

- Notification of final regulations on IP, IPAs, CIRP, and liquidation process.
- Notification of sections in the Code relating to Corporate Insolvency and Liquidation
- Relevant amendments to the companies act, 2013 relating to winding up provisions, and transfer of judicial proceedings
- Constitution of the IBBI as chairman and four other members
- Grandfathering of IPs and Commencement of Limited Insolvency Examinations for IPs

**What should be expected in the near-term?**

- Notification of the constitution of the NCLAT and NCLT along with their locations (the NCLT has 11 functional benches already) in June 2016
- The enactment of the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016 in August 2016, which has amended provisions of the SARFAESI and RDBFI
- Constitution of the IBBI as chairman and four other members in October 2016; three whole-time members and two other members are yet to be appointed
- Grandfathering of IPs and Commencement of Limited Insolvency Examinations for IPs

**Events timeline of the Code**

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>BLRC formed</td>
<td>August 2014</td>
</tr>
<tr>
<td>Bill referred to Joint Committee by Parliament</td>
<td>December 2015</td>
</tr>
<tr>
<td>Code passed by Parliament</td>
<td>May 2016</td>
</tr>
<tr>
<td>Sections pertaining to IBBI, powers to make regulation etc. notified</td>
<td>August 2016</td>
</tr>
<tr>
<td>Six draft rules and regulations issued for public comments</td>
<td>October 2016</td>
</tr>
<tr>
<td>Six regulations notified, and first application for CIRP filed with NCLT</td>
<td>December 2016</td>
</tr>
<tr>
<td>Draft bill submitted by BLRC</td>
<td>November 2015</td>
</tr>
<tr>
<td>Report of Joint Committee presented to Lok Sabha</td>
<td>April 2016</td>
</tr>
<tr>
<td>Responsibility for implementation given to MCA</td>
<td>June 2016</td>
</tr>
<tr>
<td>IBBI members appointed</td>
<td>October 2016</td>
</tr>
<tr>
<td>Last date to submit public comments on draft regulations</td>
<td>31 October 2016</td>
</tr>
</tbody>
</table>
Interpreting the Code: Corporate Insolvency in India

Key challenges to the implementation of the Code

- Expecting the Code to be an immediate answer to all the malaises related to insolvency resolution and NPAs in the country may be a little presumptuous. Significant uncertainties and challenges would have to be surmounted before the Code could be a success on the ground.

- **Mind-set of existing stakeholders: lenders, borrowers and judiciary**
  - A complete transformation of the banking system is needed. Specifically, aspects related to the development of early warning mechanisms, astute credit monitoring, proactive commercial decision-making with respect to the way forward and elimination of inter-creditor conflicts would need to be overhauled.
  - Banks would also need to exercise professional judgement in the selection of appropriate IPs/advisors and not follow a “lowest cost” policy without consideration of technical credentials and experience commensurate with the complexity and magnitude of the situation.

- **Stressed/distressed business owners/managers should** acknowledge and focus on the inefficiencies in their current business models in a timely manner and communicate any liquidity issues to financial creditors and other stakeholders well in advance – along with a turnaround plan.

- Funds availed from lenders (or other sources) by business owners should be utilized for the purpose for which they were granted/intended.

- Dues should be paid off on time as against using operational creditors as a source of working capital financing by inordinately delaying payments.

- Government authorities (local, state and central) need to ensure that all commitments made (land allocation, approvals etc.) are completed as per scheduled/reasonable timelines and dues payable are paid on time to the business community.

- The Code is very clear that insolvency or bankruptcy is a commercial issue, backed by law to enforce transparency and objectivity. It is not another law behind which the inevitable can be delayed. The judiciary should support the implementation of the law as intended.

The Board has notified the following regulations to provide more clarification on the operational implementation of the Code:

- Insolvency and Bankruptcy Board of India (Insolvency resolution process for corporate persons) Regulations, 2016
- Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016
- Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016
- Insolvency and Bankruptcy Board of India (Insolvency Professional agencies) Regulations, 2016
- Insolvency and Bankruptcy Board of India (Model Bye-Laws and Governing Board of IPA) Regulations, 2016
- Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016.
Legal matters

- There are numerous matters (such as sale of part of an organization and carve-out of business) that may need the approval of shareholders as per constitutional documents, shareholder agreements and other similar documents. The resolution plan will take effect notwithstanding such approval. However, the Code and regulations are silent on whether such actions contemplated in the resolution plans (or otherwise) can be completed without specific approvals as required under the Companies Act.

- The exclusion of security collateral held by a financial services provider from the liquidation estate is a welcome statutory recognition of netting and set off arrangements. However, it is more broadly worded than that envisaged under the international legislative instruments or in the context of netting arrangement for financial collateral under the ISDA framework. There may be some creative structuring around this exemption. It will be good to have some of these issues clarified in the rules and regulations.

- The regulations have stipulated a minimum payment to the operational creditors and dissenting financial creditors to the extent of the estimated liquidation value, i.e., the amount payable to them in the event of a liquidation. The liquidation value due to operational creditors should be paid within 30 days of the date of approval of the resolution plan by NCLT.

- The Code and the regulations are silent about the treatment of creditors who abstains from voting in the CoC meeting.

Other matters

- There is a view that the current 180-day (plus 90 days) period may not be adequate to nail down a resolution plan, especially in complex/large cases. While this is a consideration, various stakeholders can work constructively together to address many of the matters, including building a feasible resolution plan (pre-packs) even before the commencement of the insolvency resolution process such that the process could be completed efficiently.

- Development of professionals who have the integrity and skills to perform the onerous tasks of an IP in insolvency and bankruptcy cases is critical. Lenders may have to insist on such IPs producing a “personal” or “surety” bond to protect the fiduciary nature of the work and ensure that committed individuals become IPs.

- Development of IUs as an institution is critical for evidencing the PoC/default. The lack of a robust IU structure may lead to legal interventions and delays.

- A key aspect of the Code is that it helps make the distinction between “malfeasance” and “business failure.” Malfeasance should lead to prevention from participation in the resolution plan. Practical implementation of this aspect would be a challenge.

- There is currently no cross-border insolvency framework.

- The current provisioning norms, as prescribed by the RBI, may need to be aligned with the Code. Also, existing schemes of restructuring outlined by the RBI (CDR, 5/25, SDR, S4A etc.) would also have to be synchronized with the Code.

Next steps

Now that the Code is operational, the key activities that would need to be undertaken to facilitate its smooth implementation are as follows:

- Appointment of the additional five members of the IBBI
- Framing regulation for the formation and functioning of IUs
- Introducing the National Insolvency Examination
- Notifying the voluntary winding up process and related regulations, which are expected to be finalized by 1 April
- Notify fast track corporate insolvency resolution process
- Notifying insolvency resolution and bankruptcy of individuals and partnership firms, and the related regulations

The Code has started an interesting journey and is a step in the right direction. The success of the Code would, however, be measured upon implementation, which hinges primarily on a tectonic shift in the mind-set of its stakeholders.
4 Insolvency regime in other geographies

- How does the Code compare with other geographies?
- How does the Code measure with the UK?
## How does the Code compare with other geographies?

### A comparison of key provisions

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Details</th>
<th>India*</th>
<th>UK</th>
<th>Brazil</th>
<th>Canada</th>
<th>Australia</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>What triggers the process?</td>
<td>Default and voluntary</td>
<td>Default, insolvency and voluntary</td>
<td>Default, insolvency and voluntary</td>
<td>Default, insolvency and voluntary</td>
<td>Default, insolvency and voluntary</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>What amount of default triggers the process?</td>
<td>INR100,000</td>
<td>GBP750</td>
<td>USS</td>
<td>CAD 1000</td>
<td>NA</td>
<td>S$10,000</td>
</tr>
<tr>
<td>3.</td>
<td>Regime – debtor or creditor control?</td>
<td>Creditor</td>
<td>Creditor</td>
<td>Debtor</td>
<td>Mix of both</td>
<td>Creditor</td>
<td>Creditor</td>
</tr>
<tr>
<td>4.</td>
<td>During the insolvency process, who is in charge of the company?</td>
<td>IP</td>
<td>IP</td>
<td>BoD if debtor sponsored, and Receiver if creditor sponsored proceeding</td>
<td>IP</td>
<td>IP</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>Who can recommend the appointment of IP?</td>
<td>Creditor, debtor or court</td>
<td>Creditor, debtor or court</td>
<td>NA</td>
<td>Creditor, debtor or court</td>
<td>Creditor, debtor or court</td>
<td>Creditor, debtor or court</td>
</tr>
<tr>
<td>6.</td>
<td>Who can be the IP?</td>
<td>Individual or firm</td>
<td>Individual</td>
<td>NA</td>
<td>Corporate</td>
<td>Individual</td>
<td>Individual</td>
</tr>
<tr>
<td>7.</td>
<td>How many regulators (IPA)?</td>
<td>Four</td>
<td>Seven</td>
<td>One</td>
<td>Two</td>
<td>Three</td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Who fixes the remuneration – insolvency process?</td>
<td>Market forces, approved by creditor</td>
<td>Market forces, approved by creditor</td>
<td>Market forces, approved by court</td>
<td>Market forces, approved by creditor</td>
<td>Market forces, approved by creditor</td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td>Who fixes the remuneration – liquidation process?</td>
<td>Scale of value realized</td>
<td>Market forces, approved by creditor</td>
<td>Market forces, approved by creditor</td>
<td>Market forces, approved by creditor</td>
<td>Market forces, approved by creditor</td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Is the IP required to provide a surety bond or professional insurance?</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>11.</td>
<td>Does an IP get protection under the law?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>12.</td>
<td>Is there a moratorium period?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>13.</td>
<td>How long is the moratorium period for the company under the insolvency process?</td>
<td>180 days</td>
<td>Entire period till plan is approved</td>
<td>Entire period till plan is approved</td>
<td>180 days for BIA proposals, and longer in CCAA</td>
<td>Entire period till plan is approved</td>
<td></td>
</tr>
<tr>
<td>14.</td>
<td>Is it compulsory to form a credit committee?</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>15.</td>
<td>Are there specialized courts to deal with insolvency?</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>16.</td>
<td>Who runs the liquidation process?</td>
<td>IP</td>
<td>IP</td>
<td>IP</td>
<td>IP</td>
<td>IP</td>
<td></td>
</tr>
<tr>
<td>17.</td>
<td>Who does the IP report to during liquidation?</td>
<td>Court</td>
<td>Court</td>
<td>Creditor and court</td>
<td>Creditor</td>
<td>Creditor</td>
<td></td>
</tr>
<tr>
<td>18.</td>
<td>Period of antecedent transaction?</td>
<td>Up to two years</td>
<td>Up to two years</td>
<td>Up to five years</td>
<td>Up to 10 years</td>
<td>Up to five years</td>
<td></td>
</tr>
<tr>
<td>19.</td>
<td>Is there a licensing/examination process to become an IP?</td>
<td>Yes</td>
<td>Yes</td>
<td>N/a</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>20.</td>
<td>Are the licenses renewed?</td>
<td>Life membership</td>
<td>Annually</td>
<td>Life membership</td>
<td>No, but have to satisfy certain conditions</td>
<td>Once in three years</td>
<td></td>
</tr>
</tbody>
</table>
Interpreting the Code: Corporate Insolvency in India

As per the Doing business index 2016 released by World Bank, India continues to fare the worst amongst the BRICS nation. And with 136th rank, India is far behind the developed economies such as UK, US, and others.

Among several requisites of an effective insolvency regime, recovery is one of the most important parameters. At 25.7 cents per dollar, India is ahead only of Brazil amongst BRICS nation.
How does the Code measure with the UK?

A vast majority of the legal systems in the Commonwealth countries are founded on English common law. Hence, it is not a surprise that the Code closely mirrors the UK Insolvency Regime. The BLRC decided to move away from the existing “debtor in possession” regime to a “creditor in control” regime; the UK’s “creditor in control” regime is one of the most established and recognized globally.

Although the Code is based on the UK structure, the BLRC has identified key aspects of the legislation that may not work in an Indian scenario, and therefore appropriately customized it for India.

Some of the key similarities and differences between the Insolvency Law in the UK and the Code are detailed below:

**Key similarities:**

1. **Creditors drive the process; licensed IPs run the process:** In the UK, all creditors (except secured creditors to the extent of the value of their security), including operational (trade) creditors, have voting power in the creditor committee in the ratio of the amount outstanding – particularly for the approval of a resolution plan. However, in India, only financial creditors (secured or unsecured) can vote in a creditor committee. They need to ensure, though, that a minimum of “liquidation value” is provided to the operational creditors in a creditor committee. They need to ensure, though, that a minimum of “liquidation value” is provided to the operational creditors in the UK.

2. **Performance security/bond to be provided by the IP:** In the UK, IPs are required to provide a general and a specific bond based on the value of assets involved under the case. The bond is to cover any act of fraud by the IP. The provision for a bond was initially specified in the draft of the Code submitted to the JPC but removed in the final draft that was enacted. Further, while only an individual can be an IP in the UK, as per the draft regulations in India, individuals and partnership firms (with unlimited liability) can take IP appointments.

3. **Voting rights of creditor classes:** In the UK, all creditors (except secured creditors to the extent of the value of their security), including operational (trade) creditors, have voting power in the creditor committee in the ratio of the amount outstanding – particularly for the approval of a resolution plan. However, in India, only financial creditors (secured or unsecured) can vote in the creditor committee. They need to ensure, though, that a minimum of “liquidation value” is provided to the operational creditors in the UK.

4. **Deadline for the completion of the insolvency resolution process:** The Code specifies that if a resolution plan is not approved by the creditors within 180 days (or as extended to 270 days) of the CIRP, the liquidation process would automatically be triggered. In the UK, no such timeline has been specified under the law.

5. **Remuneration of liquidator:** In the UK, remuneration for the IP in liquidations is generally decided based on discussion between the creditors and the IP, taking into account the time spent, assets realized, complexity of the case etc. If a consensus cannot be reached, the court can fix the remuneration. In India, the liquidation remuneration could be decided by the creditors in certain circumstances, while, in other cases it would be decided based on the scale of realization and distribution (the court might consult the creditors or the IP while fixing the remuneration).

In India, as per the draft regulations, the liquidator is required to liquidate the assets within a period of two years. Extension can be granted in exceptional cases. There is no such requirement in the UK for the liquidator.

**Key differences:**

1. **Creditors’ involvement during the insolvency process:** In the UK, the IP is an officer of the court and once the appointment and remuneration are approved by the creditors, the IP is generally not required to take any further approvals from the creditors with respect to the management of operations of the corporate debtor during the insolvency period. However, under the Code (Section 2B), there are multiple actions for which the IP needs prior approval from the creditors. There is a greater involvement of creditors in India during the insolvency process.

2. **Performance security/bond to be provided by the IP:** In the UK, IPs are required to provide a general and a specific bond based on the value of assets involved under the case. The bond is to cover any act of fraud by the IP. The provision for a bond was initially specified in the draft of the Code submitted to the JPC but removed in the final draft that was enacted. Further, while only an individual can be an IP in the UK, as per the draft regulations in India, individuals and partnership firms (with unlimited liability) can take IP appointments.

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5 Case studies

- Insolvency resolution process
- Liquidation process
Facts of the case:
ABC Limited (the Company), which commenced operations in 2001, is a 100% holding company for four different companies operating in the healthcare sector. The Company has eight operating hospitals across India. In addition, there are two more hospitals under construction, with more than 50% work completed but on hold due to funding challenges. Four of the eight operating hospitals were acquired in the last three years. All the acquired hospitals are run by independent management with overall reporting to the central management team.

Based on the latest consolidated financial information available for the year ended June 2016, the Company had a top-line of INR7,500 million, with EBITDA of INR1,000 million and net loss of INR1,500 million. The Company had:

- Term loans of INR6,000 million
- Working capital loan of INR1,200 million
- Unsecured financial debt of INR1,000 million
- Operational creditors of INR1,200 million (mainly trade and capex suppliers and employee dues).

A term loan of INR1,200 million is due for repayment in the next 12 months. The majority of the debt is in the holding entities. Total financial debt is provided by a syndicate of six banks, with the lead banker holding 37.5% and the balance divided equally among the other banks, with each holding 12.5%.

The Company has around 3,500 employees and workmen, and the employee cost has significantly increased over the last few years. Apart from the employee cost, rental cost is the other significant expense, with 7 of the 10 properties on a long-term lease.

ABC Limited has been breaching covenants for the last few quarters and has defaulted on the repayment of its quarterly installment for the last three quarters. However, it has managed to make payments on a delayed basis to avoid NPA classification.

The promoter (holding majority shareholding) has proposed a plan with the following key points to deal with the situation:

- Disbursal of additional INR500 million to expedite the construction of two hospitals that they believe will be high-cash-generating assets, based on a feasibility study report.
- Additionally, the term loan repayable in the next 24 months should be deferred and a revised repayment schedule should be agreed upon. A cash flow statement for the next three years has been submitted by the Company to support the proposal.
- Interest rate should be reduced by 50% for the next six quarters and then reset at a higher rate to cover the loss.
- Personal guarantee and additional security will be provided on the personal assets of the promoter.
- Banks can charge a one-time fee of INR75 million to agree to the proposal.
- To improve the operational cash flow from the business, the promoter would also make changes in headcount and procurement cost.

Options available to banks:
ABC Limited was in a difficult financial position and required a clear strategy and open communication between all the stakeholders for revival. As far as the banks are concerned, they had three options:

a) Do nothing and ask the promoter to infuse capital to revive the Company first
b) Accept the promoter’s proposal on debt restructuring (everything else business as usual)
   - The bankers could have accepted the proposal of the promoter. If the plan was successfully implemented, it would have resulted in the recovery of debt in the long term by the banks.
   - However, in case the plan was not successful, it would have deteriorated the value of the asset, possibly facilitated asset-stripping and negligible value would have been realized via delayed liquidation for all external stakeholders including secured creditors, unsecured creditors, employees and suppliers.

c) Act proactively to rescue and revive the business
To choose an option with the objective of maximization of benefit to all stakeholders, the banks had to evaluate deeper and make an independent assessment of business viability. They needed to answer the following questions:

1. What were the reasons for the current distress in the Company? How much of that could have been changed?
2. What was the cash flow-generation capability of the Company in the short, medium and long term?
3. What was the confidence level in the existing management? Were there any indications of diversion of funds or willful default?
4. What support or restructuring was required to revive the business? How much more money might have been required to revive the Company? What was the possibility of getting additional equity or debt funding from the market?
5. What could have been the strategy from the other classes of lenders, creditors, management etc.?

Commissioning of IBR to assess viability

Option A was not an option as it would have only delayed the inevitable with a risk of the assets being stripped of any residual value.

To answer the questions noted above, the banks in their core committee (combining the debt of the entire Company) decided to get an IBR done. They expected the IBR to help in assessing the viability of the business and validating the promoter’s assertions. In four weeks, the banks received an IBR report. Some of the key facts included in the report were as follows.

(i) On an as is basis, EBITDA from business would only be able to service part of the interest in the next 12-18 months and no principal payment would be possible. Principal repayment could only start after 18 months.

(ii) All the four greenfield hospitals had optimal utilization levels and were cash flow positive; however, margins had been either flat or declining in the last three years.

(iii) From the four operating hospitals acquired by the group, two would be free cash flow positive only in 2019 and the other two in 2022.

(iv) The report identified a list of non-core assets that could be liquidated to realize cash of up to INR500 million. Also, there were assets worth INR500 million that were not yet pledged against any loan and could be provided as additional security against a loan.

(v) There was a benchmarking study done with other hospitals in the same geography and the report identified a few measures to save annual costs in the range of INR200 million to INR300 million. The report also provided details of the potential of consolidating some functions such as finance, procurement and HR into a single unit for all the hospitals.

(vi) The report indicated the potential of improving the working capital cycle by 10 days.

(vii) The expected capex to complete the under-construction hospital was approximately INR1,000 million.

(viii) An estimate of the liquidation valuation (if put into liquidation today) vs. the going concern valuation (as is) was provided in the IBR report.

Please refer to the chart below
What did the banks do?

Based on the IBR report, the bankers concluded that the business was viable and they wanted to support it. Else, they ran the risk of taking the Company into liquidation, which would result in significant loss of value to all class of creditors. Further, a delayed liquidation would result in further deterioration of value.

However, the banks also recognized the need for operational and financial restructuring along with close monitoring and therefore all the stakeholders should cooperate in the turnaround strategy to minimize their losses.

Accordingly, the banks decided to appoint an external agency to perform the role of monitoring the business closely (to prevent loss of value) and develop a comprehensive resolution plan.

The resolution plan developed by the external agency suggested the following:

(i) Bank debt be converted to equity to the extent of 26% (of equity) - INR2,000 million

(ii) A financial investor be brought in to fund the completion of one under-construction project (equity and priority debt)

(iii) A part of the debt (INR1,000 million) be converted to a long-term instrument carrying a nominal rate of interest with repayment being made over five years starting in 2021.

(iv) Two hospitals be sold at the earliest and timelines to be stipulated for this to bring down debt.

(v) An operational turnaround plan be implemented, including consolidating the back office function, consolidating the supply chain and rationalizing the employee base.

(vi) Key cash flow and profitability covenants agreed on going forward.

The resolution plan was discussed with all the key stakeholders – banks, promoters and potential investors. Based on the comments received, the plan was modified and an in-principle agreement was reached.

Code vs. outside the Code

Under the current circumstances, the banks decided to invoke the Code to get an approval on the resolution plan. The following benefits could be realized upon invoking the Code.

1. There would be a moratorium period of 180 (or 270) days where no proceedings can be started against the Company – a time that can be utilized to refine the resolution plan and seek requisite approvals.

2. There would be an independent IP running the process. The IP would be a registered professional with rights and duties defined under the law.

3. The plan approved by the creditors under the Code will also be approved by NCLT. The transparency of the process would have legal sanctity and would not subject the bankers to scrutiny or investigation.

4. The plan approved would be binding on all classes of creditors and no further action can be taken for the next 12 months if the plan is implemented as approved. If a plan outside the Code is agreed upon, any financial or operational creditor could still file for insolvency under the Code.

5. Under Section 14 (2), the supply of essential goods or services shall not be terminated, hence, supporting the going concern of the company till the time a plan is approved.

Conclusion

In summary, the banks could help revive the Company because of the following:

- The banks acted on a timely basis (rather than postpone the problem) and they based their decision-making on an IBR.
- They appointed an independent agency to monitor operations (and arrest loss of value) and develop a comprehensive resolution plan.
- The resolution plan was discussed and modified based on the views of various stakeholders - before triggering the 180-day deadline specified under the Code.
- The Code was then invoked to benefit from the legal protection available - after which the resolution plan could be approved and implemented.
Liquidation process

Facts of the case:
Refer below a balance sheet for XYZ Limited. Based on the balance sheet and the additional information provided, give a working for the outcome to different classes of creditors.

<table>
<thead>
<tr>
<th>Liability</th>
<th>“Amount (INR million)”</th>
<th>Assets</th>
<th>“Amount (INR Million)”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity share capital</td>
<td>1,600</td>
<td>Land and building</td>
<td>4,500</td>
</tr>
<tr>
<td>Preferential share capital</td>
<td>1,200</td>
<td>Fixtures and fittings</td>
<td>800</td>
</tr>
<tr>
<td>Term loan</td>
<td>1,400</td>
<td>Stock</td>
<td>435</td>
</tr>
<tr>
<td>Working capital loan</td>
<td>1,000</td>
<td>Debtors and prepayments</td>
<td>540</td>
</tr>
<tr>
<td>Unsecured financial creditors</td>
<td>800</td>
<td>Cash</td>
<td>125</td>
</tr>
<tr>
<td>Government dues</td>
<td>120</td>
<td>Accumulated losses</td>
<td>1,155</td>
</tr>
<tr>
<td>Workmen dues</td>
<td>240</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee liability</td>
<td>380</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational creditors</td>
<td>1,240</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,980</strong></td>
<td><strong>Total</strong></td>
<td><strong>7,980</strong></td>
</tr>
</tbody>
</table>

Additional information

Secured creditors:
1. Term loan is secured against fixed charge on land and building and fixtures and fittings. Bank A with an INR1,000 million term loan outstanding has first charge on the assets and Bank B with INR400 million outstanding has second charge on the assets.
2. Working capital loan is provided by Bank B and secured against a floating charge on stock, debtors and other current assets of the Company.

Other Liabilities:
1. Workmen dues include amount payable for up to the last 15 months
2. Employee liability includes provision for bonus payable of INR50 million, which was discretionary based on the performance of the company and not yet announced to the employees. Also, INR25 million is outstanding for employees for more than 12 months.

3. Last three years of tax assessment pending and total demand raised by the department is INR1,200 million. This has not been included in the balance sheet. However, the liquidator has managed to get an assessment completion certificate and agreed to a final liability of INR400 million.

Fixed assets and other assets:
1. Land and building realized 65% of book value and there would be a cost of INR100 million in realizing the assets.
2. Fixtures and fitting would realize 25% of book value, net of any realization cost. Stock, debtors and other current assets would realize 60% of book value.

Other information:
1. There was a pending insurance claim filled by the Company for a quality breach by a supplier, which was not recorded in the books. The liquidator has managed to recover INR150 million from the insurance company. Lease for the office premises had a lock in period of 10 years, out of which three years have expired. The landlord has submitted a claim of INR120 million for the remaining seven years of the lease period.
2. Based on the amount realized and distributed, the cost of liquidation is computed to be INR175 million.
3. The pending insolvency period cost was INR75 million, mainly including interim funding, remuneration of the IP, unpaid cost for running the company during the period etc.
4. The secured creditors have decided to relinquish their security interest to the liquidation estate and receive proceeds from the sale of assets by the liquidator in the manner specified in Section 53.

Response:

Table 1: Total value realized by liquidator

<table>
<thead>
<tr>
<th>Assets</th>
<th>“Book value (INR million)”</th>
<th>%</th>
<th>“Amount realised (INR Million)”</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and building</td>
<td>4,500</td>
<td>65%</td>
<td>2,925</td>
</tr>
<tr>
<td>Fixtures and fittings</td>
<td>800</td>
<td>25%</td>
<td>200</td>
</tr>
<tr>
<td>Stock</td>
<td>435</td>
<td>60%</td>
<td>261</td>
</tr>
<tr>
<td>Debtors and prepayments</td>
<td>540</td>
<td>60%</td>
<td>324</td>
</tr>
<tr>
<td>Other current assets</td>
<td>425</td>
<td>60%</td>
<td>255</td>
</tr>
<tr>
<td>Cash</td>
<td>125</td>
<td>100%</td>
<td>125</td>
</tr>
<tr>
<td>Insurance claim</td>
<td></td>
<td>150</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>6,825</strong></td>
<td></td>
<td><strong>4,240</strong></td>
</tr>
</tbody>
</table>

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### Table 2: Order of priority

<table>
<thead>
<tr>
<th>Section reference</th>
<th>Order of priority</th>
<th>Note</th>
<th>“Amount (INR million)”</th>
<th>“Amount (INR million)”</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total value realized during liquidation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Realized from secured assets</td>
<td></td>
<td>4,090</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Less: Cost of realising secured assets</td>
<td>1</td>
<td>-100</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Collection from insurance claim</td>
<td>2</td>
<td>150</td>
<td></td>
</tr>
<tr>
<td><strong>Distribution of assets as per Section 53 of the IBC</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>53 (1)(a)</td>
<td>Insolvency resolution process costs</td>
<td>1</td>
<td>-75</td>
<td></td>
</tr>
<tr>
<td>53 (1)(a)</td>
<td>Liquidation process costs</td>
<td>1</td>
<td>-175</td>
<td>-250</td>
</tr>
<tr>
<td><strong>Amount available for workmen and secured creditors</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>53 (1)(b) (i)</td>
<td>Workmen’s dues for the period of up to 24 months</td>
<td>3</td>
<td>-240</td>
<td></td>
</tr>
<tr>
<td>53 (1)(b) (ii)</td>
<td>Debts owed to a secured creditor</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Term loan Bank A</td>
<td>3</td>
<td>-1,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Term loan Bank B</td>
<td>3</td>
<td>-400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Working capital loan and shortfall</td>
<td>3</td>
<td>-1,000</td>
<td>-2,640</td>
</tr>
<tr>
<td><strong>Amount available for distribution to employees</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>53 (1)(c)</td>
<td>Wages owed to employees</td>
<td>4</td>
<td>-305</td>
<td>-305</td>
</tr>
<tr>
<td><strong>Amount available for distribution to financial unsecured creditors</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>53 (1)(d)</td>
<td>Financial debts owed to unsecured creditors</td>
<td></td>
<td>-800</td>
<td>-800</td>
</tr>
<tr>
<td><strong>Amount available for distribution to government dues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>53 (1)(e)</td>
<td>Central government and state government dues</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Recorded in balance sheet</td>
<td></td>
<td>-120</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tax claim settled for open assessment</td>
<td></td>
<td>-400</td>
<td>-520</td>
</tr>
<tr>
<td><strong>Amount available for any remaining debt and dues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>53 (1)(f)</td>
<td>Any remaining debt and dues</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Operational creditor</td>
<td></td>
<td>-1,240</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Employee claim for more than 12 months</td>
<td>4</td>
<td>-25</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Rent claim for unexpired lease period</td>
<td>5</td>
<td>0</td>
<td>-1,265</td>
</tr>
<tr>
<td><strong>Amount available for preference shareholder</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>53 (1)(g)</td>
<td>Preference shareholders</td>
<td></td>
<td>-1,200</td>
<td>-1,200</td>
</tr>
<tr>
<td><strong>Amount available for equity shareholder</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>53 (1)(h)</td>
<td>Equity shareholders</td>
<td></td>
<td>-1,600</td>
<td>-1,600</td>
</tr>
<tr>
<td></td>
<td>Net (Shortfall) /excess</td>
<td></td>
<td></td>
<td>-4,440</td>
</tr>
</tbody>
</table>
Interpreting the Code:
Corporate Insolvency in India

Note 1:
- INR100 million of cost for realizing fixed assets has been deducted from the amount realized. Alternatively, it could also be included in the liquidation cost.
- In case the value realized is less than the insolvency and liquidation cost, the amount realized would be distributed between all the cost pari passu.

Note 2:
- Claim recovered from insurance company of INR150 million has added to the total value realized. It could be argued to use this realization against unsecured creditors, since this is not realized from secured assets.

Note 3:
- Workmen dues and secured creditors have pari passu claim on the amount available after liquidation and insolvency cost.
- Bank A has a first charge on the secured fixed assets. In case the amount realized from secured fixed assets was less than the total outstanding of term loan of INR1,400 million, Bank A with first charge should be given preference over Bank B. To the extent Bank B was not paid under Section 53 (1) (b) (ii), it should be paid under Section 53 (1) (d).
- In case of working capital loan, Bank B has charge over the floating assets – i.e., stock, debtor and other current assets – of the Company. In the current situation, floating assets realized INR965 million. The shortfall of INR35 million is set off against the excess realization from the secured fixed assets. However, it could be argued to treat the shortfall as unsecured financial creditor under Section 53 (1) (d).

Note 4:
- Employee liability for more than 12 months has been included under Section 53 (1) (f) as other debts.
- Bonus of INR50 million is not included in the employee liability as it is not declared and hence not due to the employees.

Note 5:
- Rent claim for unexpired lease period has been included under Section 53 (1) (f) as other debts at nil value. As based on draft Regulation 36, payment of periodic nature can only be claimed till the time order for liquidation is passed under Section 33 of the IBC. This may, however, be subject to further clarification by appropriate authorities.

Table 3: Outcome to different class of creditors

<table>
<thead>
<tr>
<th>Currency</th>
<th>INR million</th>
<th>Amount outstanding</th>
<th>Amount realized in liquidation</th>
<th>% realized</th>
</tr>
</thead>
<tbody>
<tr>
<td>Workmen</td>
<td>240</td>
<td>240</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>380</td>
<td>305</td>
<td>80.3</td>
<td></td>
</tr>
<tr>
<td>Secured creditors</td>
<td>2,400</td>
<td>2,400</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Unsecured creditors</td>
<td>800</td>
<td>800</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>Government dues</td>
<td>520</td>
<td>145</td>
<td>27.9</td>
<td></td>
</tr>
<tr>
<td>Any remaining debt and dues</td>
<td>1,265</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Preference shareholder</td>
<td>1,200</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Equity shareholder</td>
<td>1,600</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8,405</strong></td>
<td><strong>3,890</strong></td>
<td><strong>46.3</strong></td>
<td></td>
</tr>
</tbody>
</table>
Interpreting the Code: Corporate Insolvency in India

Question - What is the impact of the Code on the existing legislations such as SARFAESI Act, SICA and Companies Act?

Response - The Code consolidates and amends the laws relating to the reorganization and insolvency of corporations, partnerships and individuals.

It may be noted that existing judicial proceedings under the Companies Act will be transferred from CLB to NCLT for all cases, and from High Court to NCLT in specific cases as presented on page no. 19. Also, all proceedings under SICA will abate, with the option for the company to make a reference to NCLT within 180 days of the commencement of the Code. Further, on declaration of moratorium, all actions under the SARFAESI Act will be prohibited till the insolvency resolution process under the Code.

Besides, there are numerous matters (such as sale of part of an organization and carve-out of business) that may need the approval of shareholders as per constitutional documents, shareholder agreements and other similar documents. The resolution plan will take effect notwithstanding such approval. However, the Code and regulations are silent on whether such actions contemplated in the resolution plans (or otherwise) can be completed without specific approvals as required under the Companies Act.

Question - Can the Code be triggered in case of non-payment of dues by government-owned companies?

Response - The Code shall apply to:

- Any company incorporated under the Companies Act, 2013
- Any other company governed by any special act for the time being in force
- Any limited liability partnership incorporated under the Limited Liability Partnership Act, 2008
- Such other body incorporated under any law for the time being in force, as the Central Government may, by notification, specify in this behalf
- Partnership firms and individuals

There is no specific exclusion of any company owned by the Government and the Code shall apply to such companies.

Question - What has been the response of the RBI to the Code? Specifically, how does this impact bank provisioning guidelines?

Response - The current provisioning norms as defined by the RBI may need to be aligned with the Code. For instance, one of the possibilities could be that the RBI continues with the existing classification norms such that for the first 90 days after default, the account can be treated as an SMA and after 90 days as an NPA. After approval of the resolution plan, the borrower can be classified as standard.

FAQs

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Further, the existing schemes of restructuring outlined by the RBI (CDR, 5/25, SDR, S4A, etc.) would also have to be synchronized with the Code.

The RBI could also play a pivotal role by developing a better early warning system for banks based on a robust covenant framework. With better early warning reporting, the RBI could preempt the banks to take appropriate action in a timely manner, thereby acting as a virtual information utility.

**Question** - How does the Code help avoid litigations that may delay revival?

**Response** - The Code provides a moratorium during the CIRP that protects the borrower from any suits or recovery actions during that period. Besides, a resolution plan approved by the NCLT during CIRP would be binding on all parties.

**Question** - Should creditors trigger the insolvency process upon every default? Or should they evaluate other options outside the framework?

**Response** - No situation is the same and a one-size-fits-all approach may not make sense. An objective evaluation has to be done on a regular basis by the creditors, along with evolving a strong early warning mechanism based on robust covenant framework. Upon a default, the creditors should evaluate their options based on an IBR before charting their course of action. Please refer to pages 18 to 19 and the section on case studies for a detailed discussion on this.

**Question** - Does the Code provide immunity to the financial creditors to take hard measures (including haircuts) without fear of undue vigilance? What are the consequences of lack of consensus or lack of action?

**Response** - The Code does not, explicitly, provide any immunity to the lenders for their actions. However, inaction or lack of consensus among the financial creditors during the CIRP would mean liquidation – mostly an economically inferior outcome as compared to resolution.

The resolution plans could be developed by anyone who intends to and can submit it to the RP. Upon receipt of all the resolution plans, the RP will recommend the appropriate plan to the CoC. Upon approval of a resolution plan by the CoC with a voting of 75% majority, it would need to be approved by the NCLT. The plan so approved becomes binding on all creditors including the dissenting creditors.

The transparency of the process of development and approval of the resolution plans and the lack of a more beneficial alternative should address the concerns of the creditors.

**Question** - What are the rights of foreign creditor vis-à-vis domestic creditors?

**Response** - The Code does not make a distinction between domestic and foreign creditors. Any creditor, operational or financial, could exercise the rights available under the Code.

**Question** - What are the powers to minority creditors, operational creditors and unsecured creditors? Can they block the resolution or liquidation process?

**Response** - 75% of the financial creditors (secured and unsecured) would vote on the resolution plan. In the resolution plan, payment to operational creditors and dissenting financial creditors must be provided for their liquidation value – i.e., to the extent to what they would receive in a liquidation scenario. The liquidation value due to operational creditors should be paid within 30 days of the date of approval of the resolution plan by NCLT.

Operational creditors and shareholders do not have any voting rights on the plan. However, where there are no financial creditors or the financial creditors are related party, the CoC should be formed by the operational creditors. Also, the Code does not restrict any class of creditors or shareholders to propose a resolution plan.

**Question** - How would personal guarantees of the promoters be enforced?

**Response** - The Code allows the creditors to invoke the CIRP of both the corporate debtors and its personal guarantors. This would mean that the Code shall override proceedings to enforce personal guarantees under SARFAESI, Indian Contracts Act etc. with respect to the CIRP. There are no other changes to the rights of the creditors to enforce personal guarantees.

**Question** - How would the ranking between the first charge secured creditor, second charge secured creditor and workmen compensation dues be decided?

**Response** - As per the reading of the Code, workmen compensation dues and secured creditors would rank pari passu. Also, as per the Code, you need to relinquish security before participating in the distribution. Both first charge and second charge secured creditors would rank pari passu with respect to the distribution under Section 53(1). Therefore, as a first charge creditor, you are expected to take a commercial call if you want to enforce security under existing means available or relinquish it for distribution under Section 53.
However, Regulation 45 of the liquidation process states that the contractual arrangement between recipients with equal ranking under Section 53 (1), if disrupting the order of priority, the liquidator can make the payment to one of the recipients nominated by all the recipient parties to the contractual arrangement. The practical application of such distribution will evolve over a period of time.

**Question** - Consider a situation where there are two secured creditors, one with a fixed charge and another with a floating charge, and the amount realized from the fixed charge assets is more than the fixed charge debt and the amount realized from floating charge assets is less than the floating charge debt. Then, would there be a set off between shortfalls of the floating charge debt with the excess of fixed charge assets or floating charge shortfall will be treated as an unsecured claim?

**Response** - Under Section 53, you relinquish your security to be part of the liquidation distribution. Therefore, the source of realization should not impact the distribution specified under Section 53 - these would be distinct from each other.

**Question** - If amount is realized from unsecured assets, will they still be available to secured creditors first (as per order of priority in Section 53) or will they be equally available to all classes of creditors (secured or unsecured)?

**Response** - All collections - irrespective of the source of realization - should go into a common pool of the liquidation estate. The distribution from this liquidation estate should happen as per Section 53 of the Code.

**Question** - Definition of employee’s dues - Will this include any discretionary bonus? In case of an employee car lease foreclosure, who would pay the foreclosure cost?

**Response** - As per the Code, only unpaid dues for the last 12 months can be paid to employees. Besides, any legal and contractual dues should be included as liabilities. If a car lease is a contractual liability of the borrower, the resulting foreclosure cost should be included under unsecured liabilities (and not employee liability).

**Question** - Supply of essential goods or services: Can a supplier ask for change in the terms and condition of the trade during CIRP?

**Response** - The regulations define a list of essential supplies so as to include supplies of electricity, water, telecommunication and IT services to the extent these are not a direct input to the output produced or supplied by the corporate debtor. Such supplies cannot be suspended or terminated during the moratorium period.

Dues of such suppliers are part of the insolvency resolution process cost and therefore will have priority for payments over any other dues.

However, there is nothing in the regulation stopping the supplier from renegotiating payment terms with the RP during the CIRP. Besides, the regulator can specify other goods or services as essential in the future.

**Question** - What will happen to future unexpired warranty given by the Company on the products sold in case of liquidation? Will that claim be included in unsecured claims?

**Response** - It would depend upon the contractual arrangement between the customer and the debtor. Any liability that is not due on the insolvency commencement date may not be included in the claims.

**Question** - Can the IP take control of the assets in a subsidiary?

**Response** - As per Section 18 of the Code, one of the key responsibilities of the IP is to take control and custody of the assets of the borrower. However, the IP cannot take control over the assets of a subsidiary of the borrower. With respect to the subsidiary, the IP can only act in the capacity of a shareholder (i.e., step in to the shoes of the borrower).

**Question** - Can IRP’s tenure end before the appointment of Resolution professional in the first CoC meeting?

**Response** - The IRP tenure shall end within 30 days of his appointment. Also the CoC shall be constituted within 30 days of his appointment. The first CoC meeting, however, may happen after the end of 30 days, since it is to be held within 7 days of the constitution of the committee. It is in the first CoC meeting, that IRP shall be replaced or appointed as final Resolution professional. Therefore, it is not clear if IRP shall continue to enjoy powers during the intervening period, i.e from end of 30 days of his appointment to first CoC meeting. In light of this, it is recommended that the IRP should try to hold CoC meeting before end of his tenure so that final IP can be appointed within 30 days of his appointment.
For further information, please contact

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