

COMPREHENSIVE GUIDE TO INSOLVENCY AND BANKRUPTCY CODE, 2016

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BACKGROUND OF INSOLVENCY CODE

1.1 Objective of Insolvency Code

The vision of law (as given in press release of Government of India) is to encourage entrepreneurship and innovation. Some business ventures will always fail, but they will be handled rapidly and swiftly. Entrepreneurs and lenders will be able to move on, instead of being bogged down with decisions taken in the past.

Insolvency Code is not a substitute for recovery forum - Wherever there is existence of real dispute, provisions of Insolvency Code cannot be invoked. Insolvency code is not intended to be substitute to recovery forum - *Mobilox Innovations v. Kirusa Software* (2018) 1 SCC 353 = 144 SCL 37 = 85 taxmann.com 292 (SC) - quoted with approval in *Transmission Corporation of Andhra Pradesh v. Equipment Conductors* (2018) 150 SCL 447 = 98 taxmann.com 375 (SC).

1.1-1 Purpose of Insolvency and Bankruptcy Code, 2016

As per preamble to the Insolvency Code, the purpose of this Act is as follows—

- ◆ Consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals
- ◆ In a time bound manner

- ◆ For maximisation of value of assets of such persons
- ◆ To promote entrepreneurship
- ◆ Availability of credit
- ◆ Balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues
- ◆ Establish an Insolvency and Bankruptcy Board of India (IBBI)

Insolvency code is a complete code (and decisions in other Acts will not apply) - Insolvency code is a consolidating Act. It is complete and exhaustive in the matters dealt with therein. The Code is Parliamentary law that is exhaustive code on the subject matter of insolvency. It is covered in Entry 9 List III of Seventh Schedule, which reads as follows - Bankruptcy and Insolvency. *Innoventive Industries v. ICICI Bank* (2018) 1 SCC 407 = 143 SCL 625 = 84 taxmann.com 320 (SC).

1.1-2 Amendments to Insolvency Code made *vide* Insolvency and Bankruptcy (Amendment) Act, 2020 w.r.e.f. 28-12-2019

Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 was issued on 28-12-2019. This has been converted into Insolvency and Bankruptcy (Amendment) Act, 2020 w.r.e.f. 28-12-2019.

The purpose is to give the highest priority in repayment to last mile funding to corporate debtors to prevent insolvency, in case the company goes into corporate insolvency resolution process or liquidation, to prevent potential abuse of the Code by certain classes of financial creditors, to provide immunity against prosecution of the corporate debtor and action against the property of the corporate debtor and the successful resolution applicant subject to fulfilment of certain conditions, and in order to fill the critical gaps in the corporate insolvency framework.

The major amendments are as follows—

- ◆ Immunity from prosecution of corporate debtor for offence committed prior to CIRP, if there is change of management [section 32A(1)]
- ◆ Protection to property of corporate debtor in relation to offence committed prior to CIRP, if there is change of management [section 32A(2)]

- ◆ Scope of 'interim finance' enhanced to provide for last mile funding to prevent insolvency [section 5(15)]
- ◆ Minimum number of applicants under section 7(1) in case of numerous small financial creditors (like holders of public deposits or debentures or home buyers).
- ◆ Licenses, quotas, essential supplies cannot be cut during period of moratorium, so long as current dues are paid [section 14]
- ◆ Corporate debtor can file CIRP against another corporate debtor [section 11]
- ◆ Insolvency Professional must be appointed on the insolvency commencement date itself [section 16(1)]

The details are summarized in write-up on front pages of this book.

1.1-3 The Insolvency and Bankruptcy Code (Second Amendment) Act, 2020

In view of difficulties created on account of lockdown duty to Covid-19 (Corona) virus, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 was issued on 5-6-2020. The changes are discussed on front pages and also discussed at appropriate places in this book.

No application for CIRP if default occurs during 25-3-2020 to 24-9-2020 - Section 10A of Insolvency Code, as introduced w.r.e.f. 5-6-2020 reads as follows —

Notwithstanding anything contained in sections 7, 9 and 10 of Insolvency Code, no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after 25-3-2020 for a period of six months or such further period, not exceeding one year from such date, as may be notified in this behalf.

Further, no application shall *ever be* filed for initiation of corporate insolvency resolution process of a corporate debtor for the said default occurring during the said period.

For the removal of doubts, it is hereby clarified that the provisions of this section shall not apply to any default committed under the said sections before 25-3-2020 - *Explanation* to section 10A of Insolvency Code.

Thus, no application for CIRP can be filed, if default occurs during 25-3-2020 to 24-9-2020. This period can be increased by Central Government for further six months, by issuing a notification.

Penalty for carrying on business fraudulently to defraud traders

- If during the corporate insolvency resolution process or a liquidation process, it is found that any business of the corporate debtor has been carried on with intent to defraud creditors of the corporate debtor or for any fraudulent purpose, the Adjudicating Authority may on the application of the resolution professional pass an order that any persons who were knowingly parties to the carrying on of the business in such manner shall be liable to make such contributions to the assets of the corporate debtor as it may deem fit – Section 66(1) of Insolvency Code, 2016.

Protection if default occurs during lockdown period i.e. after 25-3-2020 and upto 24-9-2020

- Notwithstanding anything contained in section 66 of Insolvency Code, no application shall be filed by a resolution professional under section 66(2), in respect of such default against which initiation of corporate insolvency resolution process is suspended as per section 10A of Insolvency Code – Section 66(3) of Insolvency Code, introduced w.r.e.f. 5-6-2020.

1.1-4 Insolvency Code applies to personal guarantors of corporate debtors

Insolvency Code was made applicable to personal guarantors of corporate debtors w.e.f. 23-11-2017. However, there was no specific provision to conduct insolvency resolution process or bankruptcy process if the personal guarantor does not pay up. Now, this gap has been filled up w.e.f. 1-12-2019.

Provisions relating to Insolvency Resolution and Bankruptcy for individuals and partnership firms (section 78 to section 187 of Insolvency Code) have been made partially effective on 15-11-2019 ***only for personal guarantors of corporate debtors (not for other individuals and partnership firms).***

Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules, 2019 and Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process

for Personal Guarantors to Corporate Debtors) Rules, 2019 have been made effective from 1-12-2019.

IBBI (Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Regulations, 2019 and IBBI (Bankruptcy Process for Personal Guarantors to Corporate Debtors) Regulations, 2019 have also been notified w.e.f. 1-12-2019.

NCLT will be 'adjudicating authority' for this purpose. NCLAT will be appellate authority.

1.2 Overall scheme of the Insolvency and Bankruptcy Code

An Insolvency and Bankruptcy Board of India (IBBI) will be established. This Board (IBBI) will oversee the work of insolvency and bankruptcy of corporate persons, firms and individuals. [The Board (IBBI) has been established on 1-10-2016, *vide* Notification No. 3110(E) dated 1-10-2016].

Actual work relating to insolvency and bankruptcy will be handled mostly by 'Insolvency Professionals' (IP). They will be members of 'Insolvency Professional Agency' (IPA) which will ensure that the members have sufficient knowledge and expertise in these matters. IPA will also regulate the profession of IP.

The basic idea of Insolvency Code is that when an enterprise (individual, firm or corporation person) defaults in payment of its dues, the control shifts to Committee of Creditors (CoC) of financial creditors. Actual work is handled by IP. There are specified time limits to evaluate proposals for resuscitating (rehabilitating) the enterprise or taking it to liquidation. IP has control over the debtor under supervision of CoC.

Decisions are required to be taken in a time bound manner so that there are greater chances that the enterprise is saved as a going concern and productive resources of economy can be put to best use.

Insolvency of corporate persons - Part II of Insolvency Code, 2016 [sections 4 to 59] deals with insolvency resolution and liquidation for corporate persons.

The actual work will be mostly handled by 'resolution professional' (who will be registered 'insolvency professional') under supervision of Adjudicating Authority (NCLT).

At first instance, corporate insolvency process will be initiated. This will be initiated by (a) secured creditor/s (b) operational creditor/s or (c) corporate person itself.

Insolvency professional will form a Committee of Creditors (CoC) of financial creditors and with their concurrence, efforts will be made to evolve and finalise plan to revive the corporate person.

Plan for rehabilitation of corporate debtor will be prepared by Resolution Applicant (RA) and will be submitted to Insolvency Professional for approval by Committee of Creditors (CoC).

This process will last for 180 days, extendable by further maximum 90 days. During this period, efforts will be made to evolve a 'resolution plan' to rehabilitate the ailing corporate.

A Fast Track Corporate Insolvency Resolution will be available to small corporate persons.

If the efforts fail, the corporate person will be liquidated in time bound manner.

NCLT will be Adjudicating Authority and NCLAT will be appellate authority for corporate persons.

DRT will be Adjudicating Authority for non-corporate persons (individuals, firms and HUF). DRT will be Appellate Authority.

Winding up of companies - In most of the cases, liquidation (winding up) of companies will be through the Insolvency Code only. Direct winding up process under Companies Act, 2013 may be used very rarely.

Bankruptcy of personal guarantors - Personal guarantors of corporate debtors have been treated as a separate class. The provisions of Insolvency Code have been made applicable to personal guarantors of corporate debtors (often directors of the company) w.e.f. 23-11-2017. The application for bankruptcy of individual personal guarantor will have to be filed before NCLT (and not before DRT) as per section 60(2) of Insolvency Code, 2016.

Bankruptcy of individuals and firms - Part III of Insolvency Code 2016 (sections 78 to 187 of Insolvency Code) deals with insolvency

resolution and liquidation for individuals and firms. For individuals and firms, there are two distinct processes - fresh start and insolvency resolution. These are followed by bankruptcy order.

These provisions are notified w.e.f. 15-11-2019 only in respect of personal guarantors to corporate debtors (*not for other individuals and partnership firms*).

NCLT will be the Adjudicating Authority and not DRT.

The 'fresh start' will apply to individuals whose income is below Rs. 5,000 per month and debt amount does not exceed Rs. 35,000. In their case, work of insolvency resolution will be handled mostly by 'insolvency professional'. Appellate Authority (DRT) will have only supervisory role. This amount is so meagre that there will be very few individuals who will be eligible and in fact, for them, even this process is beyond their means.

In case of other individuals and firms, the process is similar to that applicable to corporate persons.

The process will be handled by 'resolution professional' under supervision of 'Adjudicating Authority'.

Insolvency Resolution Process will be initiated. Efforts will be made to finalise 'repayment plan' with concurrence of debtor and Committee of Creditors (CoC).

If the efforts succeed and repayment plan is successfully implemented, the individual or firm will get a discharge order.

If efforts fail, the person will be declared 'bankrupt'. The resolution professional will take over estate of the bankrupt. He will sell or dispose it off and satisfy repayments of creditors to the extent possible.

After that, the bankrupt will get a 'discharge order'.

The discharge order will be registered with Board (IBBI) in a register maintained under section 196 of Insolvency Code, 2016.

1.2-1 Persons to whom the Insolvency Code applies

The provisions of Insolvency and Bankruptcy Code (Insolvency Code, 2016) apply to following, in relation to their insolvency, liquidation, voluntary liquidation or bankruptcy, as the case may be (section 2 of Insolvency Code, 2016).

Clauses (a) to (d) of section 2 except with regard to voluntary liquidation or bankruptcy, were notified and brought into effect on 15-12-2016. Clauses (a) to (d) of section 2 with regard to voluntary liquidation have been brought into effect on 1-4-2017. However, provisions have been made applicable to all persons notified in clauses (a) to (g) w.e.f. 23-11-2017:

- (a) Companies incorporated under Companies Act
- (b) Companies governed under special Act (so far as of Insolvency Code, 2016 is consistent with those special Acts i.e. provisions of Special Act will prevail over of Insolvency Code, 2016)
- (c) Limited Liability Partnership (LLP)
- (d) Other body corporates as may be notified by Central Government
- (e) personal guarantors to corporate debtors
- (f) partnership firms and proprietorship firms; and
- (g) individuals, other than persons referred to in clause (e).

1.2-2 Insolvency Code not applicable to financial service providers unless specifically notified

The Code is not applicable to corporates in finance sector. Section 3(7) of Insolvency Code, 2016 states that “Corporate person” *shall not include any financial service provider.*

Thus, the Code does not cover Bank, Financial Institutions, NBFC, Insurance Company, Asset Reconstruction Company, Mutual Funds, Collective Investment Schemes or Pension Funds.

“Financial service provider” means a person engaged in the business of providing financial services in terms of authorisation issued or registration granted by a financial sector regulator – section 3(17) of Insolvency Code, 2016.

Government can notify financial service providers for purpose of insolvency and liquidation proceedings – Central Government can notify financial service providers for purpose of insolvency and liquidation proceedings, which may be conducted under the Insolvency Code, in consultation with appropriate financial sector regulator – section 227 of Insolvency Code, notified and effective from 1-5-2018.

Insolvency Code made applicable to NBFC (including housing finance companies) with assets Rs. 500 Crore or more - The provisions of Insolvency Code have been made applicable to NBFC (which include housing finance companies) with asset size of Rs. 500 crore or more as per last audited balance sheet, *vide* Notification No. S.O. 4139(E) dated 18-11-2019. RBI will be the 'Appropriate Financial Regulator' for this purpose.

Under these provisions, Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 have been notified.

1.3 Insolvency Code has overriding effect

The Insolvency and Bankruptcy Code, 2016 has overriding effect over other laws - section 238 of Insolvency Code, 2016.

Limitation Act applies to proceedings before NCLT or NCLAT - The provisions of the Limitation Act, 1963 shall, as far as may be, apply to the proceedings or appeals before the Adjudicating Authority, the National Company Law Appellate Tribunal, the Debt Recovery Tribunal or the Debt Recovery Appellate Tribunal, as the case may be.

Approved Resolution plan binding on Central/State Government and local authority even in respect of statutory dues - Provisions of Insolvency Code will prevail over provisions under Employees Provident Funds Act, ESIC Act etc. Section 31(1) of Insolvency Code specifically provides that resolution plan will be binding on Government in respect of statutory dues like tax dues.

Section 238 of Insolvency Code provides for overriding effect to provisions of Insolvency Code over other laws.

Thus, provisions of Insolvency Code will prevail over provisions under Employees Provident Funds Act, ESIC Act etc.

Section 82 of CGST Act and SGST Act states that notwithstanding anything to the contrary contained in any law for the time being in force, *save as otherwise provided in the Insolvency and Bankruptcy Code, 2016*, any amount payable by a taxable person or any other person on account of tax, interest or penalty which he is liable to pay to the Government shall be a first charge on the property of such taxable person or such person.

Thus, CGST Act and SGST Act provides for priority as per Insolvency Code.

Section 178 of Income-tax Act does not have any specific provision in this regard. Further, since Insolvency Code is later legislation, it will prevail over provisions of Income-tax Act.

Section 31(1) of Insolvency Code specifically provides that resolution plan will be binding on Government in respect of tax dues.

The statutory wording is as follows.

The resolution plan so approved shall be binding on the corporate debtor and its employees, members, creditors, *including the Central Government, any State Government or any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed*, guarantors and other stakeholders involved in the resolution plan - section 31(1) of Insolvency Code, 2016.

1.4 Insolvency and Bankruptcy Board of India (IBBI)

An Insolvency and Bankruptcy Board of India (IBBI) has been established by Central Government under section 188(1) of Insolvency Code, 2016 on 1-10-2016.

Address - Insolvency and Bankruptcy Board of India, 7th Floor, Mayur Bhawan, Shankar Market, Connaught Circus, New Delhi - 110001 Telephone: +91 11 2346 2900, office hours : 09:30 AM to 06:00 PM (Monday to Friday), except closed holidays.

CS Madhusudan Sahoo has been appointed as first Chairperson of IBBI w.e.f. 1-10-2016.

Function of the Board (IBBI) is to exercise regulatory oversight over Insolvency Professionals (IP), Insolvency Professional Agencies (IPA) and Information Utilities (IU).

The Board (IBBI) will have powers of civil court in respect of issuing summons, discovery and production of books, inspection of books/registers and issue of commissions for examination of witnesses - section 196(2) of Insolvency Code, 2016.

1.5 Financial Sector Regulators

There are various regulators to regulate financial sector.

“Financial Sector Regulator” means an authority or body constituted under any law for the time being in force to regulate services or transactions of financial sector and includes the Reserve Bank of India, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority of India, the Pension Fund Regulatory Authority and such other regulatory authorities as may be notified by the Central Government - section 3(18) of Insolvency Code, 2016.

IBBI is also a Financial Sector Regulator. NFRA (National Financial Reporting Authority) (which is being constituted) is also a ‘Financial Sector Regulator’

1.6 Adjudicating Authority (AA) and appellate authorities

NCLAT is Adjudicating Authority and NCLAT is Appellate Authority under Insolvency Code for corporates.

Adjudicating and Appellate Authorities for individuals and firms - Debt Recovery Tribunal (DRT) will be adjudicating authority for individuals and firms - section 179(1) of Insolvency Code, 2016.

1.7 Insolvency Professional

Insolvency Professional is required to play a key role in implementation of Insolvency Code. This profession will be regulated by IBBI through Insolvency Professional Agency (IPA).

Work relating to insolvency resolution is expected to be handled by ‘Insolvency Professionals’ (IP). These professionals are required to be registered with ‘Insolvency Professional Agency’ (IPA).

The Insolvency Professional Agencies (IPA) will develop professional standards, code of ethics and be first level regulator for insolvency professionals members. This will lead to development of a competitive industry for such professionals.

Provisions relating to registration as Insolvency Professional and Insolvency Professional Entity have been made in Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016.