



2017 Asia Pacific Restructuring & Insolvency

**INDIA'S INSOLVENCY
REGIME: AN UPDATE ON
THE INSOLVENCY AND
BANKRUPTCY CODE**





INDIA'S INSOLVENCY REGIME

AN UPDATE ON THE INSOLVENCY & BANKRUPTCY CODE

Introduction

- The insolvency and bankruptcy regime in India has undergone a **comprehensive overhaul** with the implementation of the Insolvency and Bankruptcy Code, 2016 (“**the Code**”).
- The Code is intended to “consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promoter entrepreneurship, availability of credit and balance the interests of all stakeholders...”
- The Code consolidates laws in relation to:
 - the insolvency of companies and limited liability entities such as limited liability partnerships; and
 - the bankruptcy of unlimited liability partnerships and individuals.
- Previously, laws relating to insolvency and bankruptcy in India were scattered across several statutes. The Code seeks to bring uniformity in approach and also standardizes processes.
- The provisions of the Code with respect to the corporate insolvency resolution (“**CIR**”) process were brought into effect from 1 December 2016.

Key Features of the Code

The Code sets out rehabilitation, revival and insolvency procedures for all corporate debtors, individuals and partnership firms. It does not cover financial service providers.

New features of the Code

- The establishment of a dedicated regulator (the Insolvency and Bankruptcy Board) to oversee the operation and implementation of the Code.
- A single specialised tribunal called the National Company Law Tribunal ("**NCLT**") to, among other things, hear matters pertaining to the insolvency resolution process under the Code.
- "Information utilities" to maintain records regarding debt repayment, recovery and default.
- A cadre of specialized "insolvency professionals" to manage the insolvency, rehabilitation and winding up process.
- A regulatory agency to regulate "insolvency professionals".
- A time bound, integrated, reorganisation and insolvency process.
- Creditor driven process with limited judicial intervention and a requirement to form a committee of creditors ("**CoC**") to help facilitate the reorganization and winding up process.

Mandatory Corporate Insolvency Resolution (CIR) Process

Initiation of CIR Process

- Any financial or operational creditor can file or the corporate debtor itself can initiate the CIR process under the Code upon a default of INR 100,000 (USD 1,700).
- Resolution professional nominated by the applicant is appointed as the interim resolution professional ("**IRP**").
- IRP constitutes a CoC which consists exclusively of financial creditors. CoC to confirm or replace the IRP as the resolution professional ("**RP**").

Committee of Creditors & Resolution Professional

- **RP** prepares an **information memorandum** which is required to inter alia include financials and status of disputes.
- **Any person** may propose a **resolution plan based on the information memorandum** for the corporate debtor's revival.
- RP screens proposed resolution plans. CoC may either approve a resolution plan by 75% majority or choose to liquidate the corporate debtor.
- The complete process is required to conclude within **180 days**, extendable by a maximum of 90 days with the consent of the CoC. This is however subject to appeals made against orders of the NCLT and the National Company Law Appellate Tribunal ("**NCLAT**").

Conclusion of CIR Process— Revival or Liquidation

- NCLT confirms whether the resolution plan approved by CoC complies with statutory requirements.
- If the resolution plan does not meet the specified criteria or the CoC decides to liquidate the corporate debtor, the NCLT will pass an order for liquidation.

Mandatory Corporate Insolvency Resolution (CIR) Process

Management of Company

- Upon appointment of the IRP, management of the corporate debtor immediately vests with the IRP – powers of the Board of Directors/Partners are suspended.
- IRP plays a key role in the management of the affairs of the corporate debtor and the administration of the CIR process.

Moratorium

- Moratorium during CIR process prohibiting: (a) legal proceedings against the corporate debtor; (b) transfer/encumbrance of assets; (c) enforcement of security interest; and (d) recovery of property by an owner or lessor that is occupied by the corporate debtor.
- Supply of essential goods and services to the corporate debtor are not to be suspended or terminated during the moratorium period. As per the rules notified under the Code, essentials goods and services are: (a) electricity; (b) water; (c) telecommunication services; and (d) information technology services, to the extent that these are not a direct input to the output produced or supplied by the corporate debtor.

Liquidation Process

Trigger

- No resolution plan submitted to NCLT within 180 + 90 days.
- CoC or NCLT rejects resolution plan.
- CoC decides to liquidate anytime during the CIR process.
- Corporate debtor contravenes approved resolution plan – prejudicially affected party can apply for liquidation.

NCLT

- Pass an order of liquidation and make a public announcement.
- RP to continue as liquidator, unless removed by the NCLT.
- No suit or proceedings can be instituted by or against the corporate debtor, subject to the right of a secured creditor to stand outside liquidation.
- Exclusive jurisdiction to decide all matters in relation to the corporate debtor.
- Liquidation process should be completed within 2 years from the commencement of the liquidation process.

Liquidator

- Receive claims from creditors within 30 days from commencement of the liquidation process and verify the same.
- Accept or reject the claims - determine the value of the claims.
- Form a liquidation estate.
- Apply to NCLT for the avoidance of any **preferential/undervalued/extortionate credit transactions**.
- Sell the immovable and movable property and actionable claims of the corporate debtor by public auction or private contract.
- Distribute proceeds in accordance with newly prescribed waterfall mechanism.
- Acts of the liquidator are subject to supervision by the NCLT.

Changed Waterfall Mechanism for Distribution of Liquidation Proceeds

• **CIR process** costs and **liquidation** costs

• debts owed to a **secured creditor** if that secured creditor has relinquished security; and
• **workmen's dues** for the period of 24 months before liquidation (pari passu sharing amongst the two groups)

• **wages and any unpaid dues owed to employees** other than workmen for the period of 12 months before liquidation

• **financial debts** owed to **unsecured creditors**

• **debts owed to secured creditors for unpaid amounts** despite enforcing the security interest; and
• **dues to the Governments** (pari passu sharing amongst the two groups)

• any **remaining debts**

• **preference shareholders**, if any

• **equity shareholders or partners**, as the case may be

• **liquidator's fees** to be **deducted proportionately** from proceeds payable to each class

Avoidance of Transactions

	Preferential Transactions	Undervalued Transactions	Extortionate Credit Transactions
Definition	<p>Transactions which put any person in a better position than he would have been under the waterfall mechanism if the corporate debtor had been wound up.</p> <p><u>Exclusions:</u></p> <ol style="list-style-type: none"> 1. transactions in the ordinary course of business; and 2. transactions securing new value 	<p>Transactions where the corporate debtor has either:</p> <ol style="list-style-type: none"> 1. gifted the property; or 2. transferred one or more assets for an amount which is significantly less than the value of consideration provided by the corporate debtor. <p><u>Exclusions:</u></p> <p>Transactions in the ordinary course of business.</p>	<p>Transactions where the terms of the transaction:</p> <ol style="list-style-type: none"> 1. require the corporate debtor to make exorbitant payments in respect of the credit provided; or 2. are unconscionable under the principles of law relating to contracts. <p><u>Exclusion:</u></p> <p>Any debt extended by any person providing financial services in compliance with existing laws.</p>
Look back period	<p>One year in case of transactions with any person. Two years in case of transactions with a related party.</p>		Two years
Remedy	<p>Powers of NCLT include reversal of transactions, supplanting obligations and directing payment of adequate consideration. Safeguards available for interests of persons who acquire property in good faith and for value.</p>	<p>NCLT has wide powers to remedy these transactions including directing payment of adequate consideration.</p>	<p>Powers of NCLT include modifying terms of the transaction and setting aside the entire transaction.</p>

Implementation of Infrastructure

- 11 benches of the NCLT at 10 locations across India – New Delhi, Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai.
- The Insolvency and Bankruptcy Board of India has been functional since 1 October 2016.
- Only one Information Utility has been set up, although; it is not functional yet.
- 904 Insolvency Professionals have been registered.
- 3 Insolvency Professional Agencies have been registered.

Significant Numbers

222

Total number of **cases admitted** since the Code has been enacted

64

Total number of claims by **financial creditors**

102

Total number of **claims by operational creditors**

56

Total number of **applications by corporate debtors**

Initiation of Insolvency Proceedings under RBI directions

- Ordinance issued on 4 May 2017 amending the Banking Regulation Act, 1949 – RBI was authorized to issue directions to banks to initiate insolvency proceedings under the Code in respect of a default.
- RBI constituted an Internal Advisory Committee which identified 12 accounts (totaling 25% of the GNPA) for a reference under the Code. Accounts identified based on minimum INR 5,000 crore exposure to banks of which more than 60% are NPAs.
- 13 June 2017 - RBI issued directions to banks to commence insolvency proceedings against 12 companies.
- 29 August 2017 – RBI issued directions to banks to commence insolvency proceedings against approximately 40 defaulters if the banks are unable to find a resolution for such accounts by December.

Key Issues Under the Code

Constitutional Challenges to the Code

- Multiple challenges of the Code on constitutional grounds are being resolved in judicial fora – preliminary indications suggest a judiciary that is alive to the objectives of the Code
 - Certain state statutes allow a moratorium to be imposed with respect to suits against industrial undertakings in specified circumstances. Challenge on grounds of interfering with the federal scheme of the Constitution? Rejected by the Supreme Court in *Innoventive Industries v. ICICI Bank*.
 - Provisions of the Code are not explicit in providing an opportunity to the corporate debtor when an application is filed before the NCLT. Challenge on grounds of violation of principles of natural justice. Though the NCLAT has read a requirement of limited notice under the Code in *Innoventive*, the matter is still being agitated by parties before the High Court of Madras and High Court of Karnataka.
 - Supreme Court also seized with constitutional challenge on validity of the categorization of creditors under the Code and their respective rights and status under the Code in the *Jaypee Infra matter*.

Challenge by Essar Steels against CIR process

- Proceedings under the Code against *Essar Steel* challenged before the Gujarat High Court on the ground that the referral by the RBI was arbitrary, unreasonable and manifestly unjust.
- Gujarat HC held that RBI did not discriminate against Essar Steel.
- Gujarat HC also held that a CIR process can be initiated even if a debt restructuring plan is at an advanced stage (the debt restructuring plan of Essar Steel was pending before the Joint Lenders Forum).

Understanding Financial Debt

- “**Financial Debt**” has been defined under Code as “a debt along with interest if any, which is disbursed against the consideration for the time value of money”.
- The meaning of time value of money has been examined in *Nikhil Mehta & others v. AMR Infrastructures Ltd.* where the NCLT stated that the term “**time value**” should be understood as ‘the price associated with the length of time that an investor must wait until an investment matures or related income is earned’.
- What is the benefit of classifying a debt as “financial debt”?
 - Role in the CoC
 - Priority in waterfall mechanism

Definition of Financial Debt and Hybrid Instruments

Are the following instruments financial debt?

- Compulsorily convertible debentures – debt instrument with trappings of equity
- Redeemable preference shares – capital instrument with obligation of repayment
- Optionally convertible redeemable preference shares – option with holder of the instrument to redeem or seek conversion
- Uninvoked corporate guarantees and bank guarantees

Initiation of CIR process by Operational Creditors

- Definition of **“operational creditor”** - a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred.
- Definition of **“operational debt”** - a claim in respect of provision of **goods or services** including **employment** or a debt in respect of the **repayment of dues** arising under any law for the time being in force and **payable to the Central Government, any State Government or any local authority**.

Initiation of CIR process by Operational Creditors

- On occurrence of a default, demand notice to be issued by the operational creditor to the corporate debtor.
- Corporate debtor has 10 days to bring to the notice of the operational creditor the existence of a dispute or repay the unpaid operational debt.
- If no action is taken by the corporate debtor within 10 days, operational creditor may apply to initiate the CIR process. Application must include copy of a certificate from a financial institution confirming that no payment of the debt has been made by the corporate debtor.
- Application can be rejected by the NCLT if notice of dispute has been received by the operational creditor.
- Definition of **“dispute”** – includes a suit or arbitration proceedings relating to (a) the existence of the amount of debt; (b) the quality of goods or service; or (c) the breach of a representation or warranty.

Issues faced by Operational Creditors

- NCLAT – Filing of a certificate from a financial institution maintaining accounts of the operational creditor is mandatory. In its absence, application liable to be rejected (*Smart Timing Steel v. National Steel and Agro Industries*).
- NCLAT – Financial institution giving the certification should be Indian (*Macquarie Bank Limited v. Uttam Galva Metallics*).
- NCLT Principal Bench – Dispute can be raised even after the demand notice is issued by the operational creditor to the corporate debtor (*Shivam Construction v. Ambience Private Limited*).
- NCLT Mumbai bench – Raising a dispute in reply to a demand notice does not amount to notice of an existing dispute (*DF Deutsche Forfait AG v. Uttam Galva Steel*).
- NCLAT – Mere raising of a claim for the first time while replying to a notice from the operational creditor cannot be a ground for rejection of application for admission of insolvency proceedings. The word ‘includes’ in the definition of ‘dispute’ refers to proceedings initiated or pending before the consumer court, tribunal, labor court or mediation, conciliation, etc. (*Kirusa Software v. Mobilox Innovations*).

Universe of Creditors – larger than Financial Creditors and Operational Creditors

- Only financial creditors and operational creditors can initiate a CIR process under the Code. Flat buyers held not to be either financial creditors or operational creditors (*Col. Vinod Awasthy v. AMR Infrastructures Ltd., Nikhil Mehta & others v. AMR Infrastructures Ltd.*).
- Flat buyers with assured returns from the builders, prior to handing over of flat, held to be financial creditors by the NCLAT (*Nikhil Mehta & others v. AMR Infrastructures Ltd.*).
- Lack of clarity on flat buyers ability to file claims with the RP during the CIR process. Issue was magnified when *Jaypee Infrastructure Limited* went through the CIR process.
- Regulations subsequently amended to include Form F to enable all “other creditors” to file claims in the CIR process. However, initiation of CIR process still limited to financial creditors and operational creditors.

Treatment of Foreign Creditors under the Code

- The Code makes no distinction between domestic and foreign creditors. Both domestic and foreign creditors are allowed to initiate the CIR process against a corporate debtor on occurrence of a default as specified under the Code.
- Typically, foreign creditors are in the minority in most Indian companies and are unlikely to influence the outcome of the CIR process.
- The Code is an effective tool to use as a threat against a corporate debtor to settle dues owed by a corporate debtor to a foreign creditor:
 - Powers of the board and management are suspended once the CIR process is initiated.
 - If there is no agreed resolution plan within the time period provided under the Code, the corporate debtor is required to be mandatorily liquidated.

Timelines under the Code

- Sections 7, 8 and 9 of the Code – 14 days provided to the NCLT to admit or reject an application for initiating CIR process.
- Contrasting Views on the Timelines:
 - NCLT – 14 day timeline under Sections 7, 9 and 10 is directory and not mandatory however Section 12 which prescribes the time limit for completion of CIR process within 180 days (and a further extension of 90 days which is available) is mandatory (*JK Jute Mills v. Surendra Trading, NCLAT*).
 - Supreme Court observation – The time limit of 14 days provided to the NCLT for admission/rejection of an application is mandatory (*Innovative Industries v. ICICI Bank*).

Moratorium

- Section 14(1) – Upon commencement of insolvency, moratorium is declared on institution of suits/proceedings against the corporate debtor, alienation of assets by the corporate debtor, enforcement of security interest created by the corporate debtor on its property and recovery of property by an owner/lessor where such property is occupied by or in the possession of the corporate debtor.
- Section 14(2) – Supply of essential goods and services (electricity, water, telecom and IT services) to the corporate debtor must not be terminated/suspended/interrupted during the moratorium period. Upheld by the NLCT in *Super Multicolor Printers*.
- Electricity for manufacturing held not to be an essential service (*Innovative Industries*)
- Properties of the promoter are not covered by the moratorium issued under the Code (*Schweitzer Systemtek India v. Phoenix ARC*).

Applicability of the Limitation Act to the Code – Contrasting Views

- Principal Bench of the NCLT – No specific bar in the Code to the application of the Limitation Act. Hence, Limitation Act applicable to proceedings before the NCLT (*Deem Roll-Tech v. R.L. Steel & Energy*).
- NCLAT – There is nothing on record to suggest that the Limitation Act is applicable to the Code (*Neelkanth Township and Construction v. Urban Infrastructure Trustees Limited*).
- Supreme Court (*Neelkanth case*) – Appeal dismissed keeping the question of applicability of the Limitation Act to proceedings under the Code open.

Withdrawal and Settlement of Claims

- Rules issued under the Code provide for withdrawal of an application initiating the CIR process before the admission of the application and not post admission of the application.
- NCLT – Reasoning that after admission of an application, the CIR process becomes representative in its character (*Parker Hannifin India Private Limited v. Prowess International Private Limited*).
- NCLT – Certain decisions allowed withdrawal and closure of the CIR process after admission of the application if the corporate debtor was successful in clearing all its creditors' claims as well as the CIR process costs (*Raipur Power and Steel Limited and Ors. v. M/s. Tomorrow Sales Agency Private Limited; West Bengal Essential Commodities Supply Corporation Ltd. v. Bank of Maharashtra*).
- Supreme Court – Inherent powers to permit withdrawal of application after admission not available to NCLT and NCLAT – though Supreme Court in exercise of its inherent power allowed withdrawal (*Lokhandwala Kataria Construction Pvt. Ltd. v. Nisus Finance & Investment Manager LLP*).

Resolution Plan

- A resolution plan may provide inter alia transfer or sale of assets of the corporate debtor, substantial acquisition of shares of the corporate debtor, amendment of the constitutional documents of the corporate debtor, fresh issuance of securities by the corporate debtor, satisfaction or modification of any security interest or reduction in the amount payable to creditors of the corporate debtor.
- Section 31 of the Code – Resolution plan will be **binding** on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders in the resolution plan.
- Issue – Are corporate compliance requirements (ie, shareholder approval, special resolution board approval) to implement aspects of the resolution plan obviated?

Resolution Plan

- **First resolution plan approved**
 - Resolution plan submitted in the case of *Synergies Dooray Automotive Limited* (corporate debtor) is the first resolution plan to be approved under the Code.
 - Petition for insolvency admitted in January 2017 (total claim of approximately USD 150 million).
 - Key proposals under the resolution plan included merger of the corporate debtor with one of the creditors, payment of debt and statutory dues over a period of three years and certain reliefs/concessions from stamp duty, sales tax and service tax.
 - Resolution plan approved in August 2017 (within the 180 day timeline).
 - Challenge preferred before NCLAT against the resolution plan including on the ground of lack of authority of the NCLT to modify a plan approved by the CoC.

Liquidation under the Code

- *VNR Infrastructures* – First company ordered to be liquidated under the Code. No resolution plan was ready within the 180 day limit and the CoC did not consent to an extension of 90 days proposed by the RP. NCLT ordered liquidation of the company.
- REI Agro – No resolution plan was ready within 180 days of admission of claim. NCLT ordered liquidation of the company.
- Approximately 21 companies have sought voluntary liquidation under the Code.

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