

# Insolvency and Bankruptcy Code 2015: Economic Principles and Legal Imperatives

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## Part I

# Economic principles

## Problems with the current processes

- Misplaced emphasis on secured credit
- Value destruction in corporate distress
- Corporate bond market development
- Credit for individuals
- Recovery rate estimated at 20%, capital and labour interminably stuck.

## Principles of the design

- The Code will ensure a time-bound process to better preserve economic value.
- The Code will facilitate the assessment of viability of the enterprise by private individuals.
- This protects organisational capital, in a sensible way: a commercial decision.
- The Code will provide for a calm period: entity is immune to the claims of creditors
- The Code will enable symmetry of information between creditors and debtors
- The Code will ensure a collective process
- When the negotiations fail to establish viability, the outcome of bankruptcy is binding.
- Liquidation: Clear waterfall of priorities.
- The Code will provide the correct ex-ante incentives

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## Design

- A unified code
- Insolvency trigger that places least cost on the adjudicating authority
- Role of the Adjudicator focused on matters of procedure
- A strong base of information utilities to support implementation
- A regulated industry of insolvency professionals
- A regulator to ensure malleability and efficiency.

## Firms: Three distinct processes

**Insolvency Resolution Process (IRP)** will involve a process of negotiation between debtors and creditors, outside the court through the Resolution Professional (RP), leading up to a repayment plan.

**Liquidation** is a process led by the Adjudication Authority, once the IRP has failed.

**Fast track IRP** A truncated version of IRP for smaller firms or those with simpler debt structures.

## Individuals: Three distinct processes

**Fresh Start** is a process by which individuals with debts lower than a specified amount (arrived at using NSSO and Planning Commission data) will have their debts written off, and be given a “fresh start”.

**Insolvency Resolution Process (IRP)** will involve a process of negotiation between debtors and creditors, outside the court through the Resolution Professional (RP), leading up to a repayment plan. Discharge will be possible only as per the terms of the negotiation giving the debtor an “earned start”.

**Bankruptcy procedure (BP)** is a process led by the Adjudication Authority, once the IRP has failed. Discharge in the form of “discharge-from-bankruptcy”

## Part II

# Legal framework

## Problems with the current legal framework

- Arbitrage: secured / unsecured; domestic / foreign lenders; banks / non banks
- Trigger is either too early or too late
  - SICA: 50% of net worth
  - Winding up: INR 500 default
  - SARFAESI: 90 days of NPA declared
  - Companies Act: 50 per cent of secured creditors
- No collective action process
- "Sick companies but no sick promoters"- divine right
- "Liquidation bias"
- Distribution waterfall complex and unclear

## How is the IBC different?

- Distinction between financial and operational creditors
- Trigger: Operational creditor, financial creditor, debtor
- Moratorium
- Debtor not in control during IRP
- Business Decisions by a Creditor Committee
- Insolvency resolution through managed, time-bound negotiations
- Liquidation:
  - Failure of the creditors' committee to reach an agreement during the period stipulated above;
  - A decision of the creditors' committee to proceed with liquidation during the IRP; or
  - Failure of the debtor to adhere to terms of the resolution plan approved by the NCLT.
- Distribution waterfall
- Penalties

## Enabling infrastructure

- A competitive industry of Information Utilities
- A private competitive industry of Insolvency Professionals
- Efficient and well functioning tribunals
- A well governed regulator



## What next?

- Careful review of the law in order to achieve extreme precision of drafting
- Full machinery for the pillars of infrastructure are explicitly provided for in the law.

## Questions for discussion

- Should infrastructure building precede the implementation of the law to ensure better capacity; or develop organically?
- Is the requirement to force a decision within a defined timeframe likely to lead to sub-optimal resolution (to meeting the deadline); or excessive liquidation?
- In corporate resolution, is the balance of power between operational and financial creditors appropriate? How will it affect debt and equity finance?
- Is the treatment of secured creditors fair? What are some additional possible safeguards: Adequate protection clauses? Numerosity in addition to value of debt?
- Should we consider a Fast track IRP for MSMEs?