Anticipating the Function and Impact India's New Personal Insolvency and Bankruptcy Regime

Adam Feibelman*

Abstract

In May of last year, India adopted a regime for personal insolvencies and bankruptcies as part of a comprehensive new Insolvency and Bankruptcy Code. The Code was drafted and enacted in a very short amount of time, and the personal insolvency and bankruptcy provisions received considerably less attention during the lawmaking process than the provisions that relate to corporate debtors. Therefore, many fundamental questions about the purpose and likely impact of these provisions remain largely unaddressed. The Code's provisions for individual debtors have not yet gone into force, and the regulatory agency charged with implementing it has recently constituted an advisory committee, which has drafted some proposed regulations and rules and will presumably advise the agency on potential reforms. The advisory group's project of review and counsel will inevitably spur more public discussion and debate about the purpose and function of personal insolvency and bankruptcy law in India.

This Article contributes to that discussion by describing India's new personal insolvency and bankruptcy regime in some detail; analyzing the likely goals of policymakers who drafted and enacted the regime; assessing the design of the regime in light of those goals; and anticipating the function and impact of the law as enacted. It observes that the regime represents something of a legal shock, providing heretofore unavailable tools to both creditors and debtors in India. On paper, it significantly expands the availability of relief and protection available to individuals and households. It has the potential to transform aspects of Indian society related to consumer and household borrowing, especially regarding the stigma associated with financial distress and debt relief. Yet, there is a

* Sumter Davis Marks Professor of Law, Tulane Law School; Visiting Scholar, Center for Law and Policy Research, Bangalore; Fulbright-Nehru Scholar, National Law School of India Univ., Bangalore, fall 2016. Thanks to Melissa Jacoby, Jason Kilborn, Pamela Foohey, Renuka Sane and to participants of the monthly talk series at Center for Law and Policy Research, Bangalore, 2016; the Roundtable Stakeholder Consultation on Insolvency Resolution at the National Law School, Delhi, 2017; the public lecture series at National Institute for Public Finance and Policy, Delhi, 2017; and the 8th Emerging Markets Finance Conference sponsored by Indira Gandhi Institute of Development Research in collaboration with Vanderbilt Law School, Mumbai, 2017. Comments welcome: afeibelm@tulane.edu

significant possibility that the regime will, at least initially, function primarily as a creditor's remedy and provide suboptimal insurance for individual and household debtors. If so, this would reduce the regime's utility in helping individual debtors – including entrepreneurs – recover from financial distress and would exacerbate some of the social costs of consumer over-indebtedness. It could also distort the development of consumer financial markets in India by promoting the expansion of lending without effectively insuring against systemic household over-indebtedness.

Introduction

India's new insolvency and bankruptcy regime for individual debtors is part of a broad, comprehensive reform set forth in the Insolvency and Bankruptcy Code of 2016. The Code consolidates pre-existing elements of a bankruptcy and insolvency system. It preempts other legal regimes within its scope and designates exclusive jurisdiction for insolvency and bankruptcy cases in the National Company Law Tribunals for corporate cases and Debt Recovery Tribunals for personal cases. The Code also introduces numerous institutional innovations, many of which are modeled on approaches in other jurisdictions, redesigned for the Indian context. These include an Insolvency and Bankruptcy Board; an occupational class of insolvency professionals; insolvency professional agencies; and financial information utilities. At the same time, the Code's substantive regime is designed to reduce and constrain the role of courts and judges within the system by, among other things, simplifying rules on eligibility; allocating most procedural functions to insolvency professionals; setting strict deadlines for most actions required of those professionals and judges; and generally encouraging negotiation among parties.[1]

The provisions of the new Code that apply to corporate debtors, which have gone into force, have received a significant amount of attention within India and abroad. Those

[1] *Report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design*, at 6.2, available at http://dea.gov.in/sites/default/files/BLRCReportVol1_04112015.pdf ("As with legal entities, what is visualized for individuals is to enable a negotiated settlement between creditors and debtor[s] without active involvement of the court.").

provisions were expressly designed to improve the speed and predictability of allocating losses from commercial ventures, either through restructuring of debts or liquidation. This reflects two underlying goals, both ultimately related to a perceived need to increase the amount of credit, especially unsecured credit, available to commercial ventures in the country. First, policymakers intend the new insolvency and bankruptcy system will improve or at least clarify lenders' expected insolvency-state returns,[2] in part by facilitating the rehabilitation of firms with significant going concern value and by expediting necessary liquidations. Among other things, they hope that this will promote the development of a domestic corporate bond market and help attract more foreign capital to the country. Second, and of more acute concern, policymakers aimed to provide a tool for reducing the amount of existing non-performing assets in the country's banking system by enabling the long-needed resolution or rehabilitation of the banks' debtors who are counter-parties to those assets.[3]

In contrast, there has been little if any public discussion or commentary within India or elsewhere about the personal insolvency and bankruptcy provisions of the Code, which will apply either directly or indirectly[4] to over 1.2 billion individuals when they go into force.[5] Furthermore, there is relatively little in the public record about the precise goals that policymakers had in mind in adopting the personal insolvency and bankruptcy provisions of the Code. An initial interim report[6] of the Bankruptcy Law Reforms Committee that was charged by the Indian Parliament to propose and draft the new Code

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[2] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1, at Chapter 3.

[3] In fact, the Reserve Bank of India has begun to force banks to resolve large non-performing accounts by filing insolvency proceedings against their debtors. *See, e.g.*, *Resolve 55 Accounts In Six Months Under Bankruptcy Code: RBI to Banks*, Economic Times, June 22, 2017, available at http://economictimes.indiatimes.com/industry/banking/finance/banking/resolve-55-accounts-in-six-months-under-bankruptcy-code-rbi-to-banks/articleshow/59271821.cms.

[4] The total population of the country is around 1.2 billion, but the population of individuals above 24 years of age is roughly half of this. Thus, the Code will apply indirectly to children in households of adult individuals who are potential debtors in the system.

[5] *See infra* note 26 (explaining notification).

[6] *Interim Report of the Bankruptcy Law Reform Committee*, February 2015, available at http://www.finmin.nic.in/sites/default/files/Interim_Report_BLRC_0.pdf

briefly noted the need for changes to the personal insolvency laws to address the financial distress of micro, small, and medium enterprises, most of which are sole proprietorships or benefit from personal financial guarantees.[7]

The Committee did include broadly applicable provisions for personal insolvency and bankruptcy in its draft legislation, but its final report did not explain the underlying motivation for its work in this area or the social or economic need for the new provisions. It noted only "the importance of such borrowers in the economy," and that, under the preexisting framework, creditors often had difficulty recovering from individuals and often resorted to "coercive practices," which compounded the social costs of indebtedness.[8] It appears that, to the extent that policymakers considered non-business debtors in drafting and enacting the Code, their primary goal was to promote increased consumer lending in the economy and, secondarily, to provide some degree of protection to individuals in financial distress, especially from aggressive debt collection.[9]

Thus, unlike the provisions for corporate debtors under the new Code, the provisions for personal insolvency and bankruptcy do not appear to have been driven by acute or particular economic or social conditions in India. This is noteworthy because countries that have adopted or reformed their consumer insolvency regimes in recent decades have tended to so in the wake of consumer financial crises or dramatically expanding consumer financial markets.[10] While the amount of consumer debt in India has

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[7] *Interim Report*, *supra* note 6, at 125. Furthermore, the Interim Report proposed a separate statutory administrative regime for MSME's.

[8] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1, at 114.

[9] *See also*, Siva Ramann, Renuka Sane & Susan Thomas, *Reforming Personal Insolvency Law in India*, Indira Gandhi Institute of Development Research working paper, Dec. 2015, available at http://www.igidr.ac.in/pdf/publication/WP-2015-035.pdf (prepared for the Bankruptcy Law Reform Committee).

[10] Countries across Europe and elsewhere -- including Hong Kong, South Korea, Israel, and Indonesia -- have adopted or reformed their personal insolvency regimes under such circumstances in the last two decades include *See* IAIN RAMSAY, PERSONAL INSOLVENCY IN THE 21ST CENTURY: A COMPARATIVE ANALYSIS OF THE US AND EUROPE, 3-6 (HART, 2017); JASON KILBORN, COMPARATIVE

increased significantly in recent decades, and instances of household over-indebtedness appear to be growing, it has not reached levels that suggest systemic vulnerability or a looming threat of household financial crisis.[11] Aside from the ongoing financial travails of farmers in certain regions, a spike in financial distress in some sectors due to the recent demonetization, and a generally acknowledged problem of aggressive debt collection practices across the country, there does not appear to be an emerging crisis of intractable over-indebtedness among individuals and households in India. It seems very unlikely that the Indian parliament would have endeavored to reform the country's personal insolvency laws if it were not otherwise overhauling the insolvency system for commercial debtors.

The new Indian Code thus appears to represent a rare instance of a country adopting or modernizing a personal insolvency or bankruptcy regime at the relatively early stages of the development of a consumer financial market, before one is acutely necessary. Doing so avoids costs of responding too late, after consumer financial markets have over-heated. It may also have a beneficial effect on the development of those markets in the first place. Especially since the recent global financial crisis of 2008-10, there is arguably an emerging consensus that a personal insolvency or bankruptcy regime is "a significant market institution and ground rule for credit markets."[12] If properly designed and

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CONSUMER BANKRUPTCY, 5-6 (CAROLINA, 2007); JOHANNA NIEMI-KIESILAINEN, IAIN RAMSAY & WILLIAM C. WHITFORD, EDS., CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE (2003).

[11] India's household debt to GDP has increased from around 2% to 10% over the last 20 years. *See, e.g.*, https://www.ceicdata.com/en/indicator/india/household-debt--of-nominal-gdp. For countries with some of the largest economies, that figure tends to be 50% or higher. *See* http://www.slate.com/articles/business/the_united_states_of_debt/2016/05/the_rise_of_household_debt_in_the_u_s_in_five_charts.html. Furthermore, the incidence of indebtedness of Indian households in 2013 was around 22.4% in urban areas and 31% in rural areas. *See* NSS Survey of Household Indebtedness in India, 70th Round, 2013, at 18, available at http://www.mospi.gov.in/sites/default/files/publication_reports/nss_577.pdf. The overall incidence of indebtedness was up modestly from around 19% of urban households in 1991. *Id.* at 22. The incidence of household indebtedness varies significantly by region, however, reaching between 30-47% of urban households and over 50% in rural households in some states. *Id.* at 24. Of urban households with debt in 2013, the average amount was 378000 rupees. *Id.* Most household debt in India is secured. *Id.* at 40 (where "personal security" means unsecured, *see id.* at 16).

[12] RAMSAY, *supra* note 10, at 2. *See id.* at 153-73 (discussing the IMF's post-crisis embrace of consumer bankruptcy reforms and the World Bank's *Report on the Treatment of the Insolvency of*

operated, such a regime can help promote a stable market for consumer credit, making creditors more willing to lend and individuals more willing to borrow, disciplining both, reducing the social costs of consumer financial distress and perhaps the amount of household over-indebtedness in the economy as well.[13]

But such potentially beneficial effects likely depend on a system that improves or accelerates creditors' insolvency state returns, or at least makes their losses relatively predictable, and that effectively insures individuals against the risk of over-indebtedness without creating incentives for them to act opportunistically or recklessly. It is not clear how well the provisions for personal insolvency and bankruptcy under the Code as enacted will serve these functions, and there are some causes for concern. Certain aspects of the institutional design may exacerbate inter-creditor conflicts, for example, by enabling individual creditors to easily initiate a case and by requiring majority votes among creditors to approve repayment plans. The regime's reliance on negotiated repayment plans may also limit the predictability of outcomes.

While the fresh start process for individuals with low incomes, few assets, and relatively little debt, is designed to provide a robust insurance function, the insolvency provisions that apply to all other debtors provide much more limited protection for individual debtors. To the extent that there is an effort to target fresh start relief to debtors who need it most, i.e., those who genuinely cannot repay a significant amount of their debt, it is done rather bluntly through the narrow eligibility requirements for the fresh start provisions. The insurance function of insolvency or bankruptcy law can be particularly important to debtors, including those with business-related debts, who have income and assets to protect or who have significant amounts of debt, most of whom would ineligible

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Natural Persons, 2014, available at http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf).

[13] *See* World Bank, *Report on the Treatment of the Insolvency of Natural Persons*, *supra* note 12; RAMSAY, *supra* note 10, at 6 (citing post-crisis, IMF, ECB, and EU Commission pushed countries to adopt/reform laws).

for a fresh start. The bankruptcy chapter of the new Code promises to provide some meaningful debt relief to such debtors, but they must first go through the insolvency process, which requires a plan of repayment subject to creditor approval, during which the debtor is allotted only a minimum budget, and which formally ensures only a minimum level of relief or protection. It is possible, therefore, that a significant portion of debtors in financial distress will not voluntarily use the new insolvency and bankruptcy regime and that it will primarily be employed as a debt collection tool for creditors. If so, the scope of the insurance function of the new system may not end up providing sufficient relief to individual debtors who become mired in debt, may not promote risk-taking entrepreneurial activity, and may not provide a meaningful safety valve to developing consumer financial markets.[14]

This Article proceeds as follows. Part I describes the India's new personal insolvency and bankruptcy provisions, highlighting changes from the pre-existing landscape.[15] Readers who are familiar with the provisions of the new Indian Insolvency and Bankruptcy Code that pertain to individual debtors may want to turn directly to Part II. Part II.A. describes the goals that appear to have motivated drafters and policymakers who designed and adopted these provisions, drawing both on the public record and from the substance of the Code as enacted. Part II.B. assesses certain design features of the new personal insolvency and bankruptcy system in light of these goals. Part II.C. anticipates how the new system may function and what role it may play in the Indian economy, raising questions for further research once the system becomes operational. It concludes that the new personal insolvency and bankruptcy regime may, at least in the short- to medium-term, function primarily, if imperfectly, as a creditor's tool or remedy and secondarily as a form of social insurance. If so, this could have a modest beneficial effect on the supply side of developing markets for consumer finance. On the other hand, there are risks that the

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[14] *See generally*, Katharina Pistor, *A Legal Theory of Finance*, 41 J. COMP. ECON. 315 (2013) (advancing a theory that predicts the increased need and use of safety valves in the financial system).

[15] For other descriptions of the Code and the institutional framework it creates, *see* APARNA RAVI, THE OF INSOLVENCY IN INDIA BY DINSHAW F. MULLA (Sixth ed. 2017); SUMANT BATRA, CORPORATE INSOLVENCY (2017); V.S. WAHI, TREATISE ON INSOLVENCY AND BANKRUPTCY CODE (2017).

system will exacerbate some of the personal and social costs of household over-indebtedness debt and fail to realize its potential to improve the stability of consumer financial markets as they develop.

I. The New Regime

India's new Insolvency and Bankruptcy Code is widely viewed as one of the most significant financial and economic reforms in that country in recent years.[16] The new Code is, with a few notable exceptions,[17] comprehensive, covering both commercial and household debtors and displacing all preexisting regimes within its scope. It was drafted and enacted in a surprisingly short period of time for such a consequential and comprehensive legal regime. In the early fall of 2014, India's Ministry of Finance formed a Bankruptcy Law Reforms Committee to draft new legislation. The Committee published an interim report a few months later, in February 2015,[18] describing potential reforms to the country's insolvency and bankruptcy law, and setting forth a basic framework for commercial debtors. The report noted that the Committee was planning to propose reforms to the existing personal insolvency laws as well.[19]

The Committee published a final report[20] and draft bill,[21] which included provisions for individual debtors, in November 2015. After a brief period for public comments,[22] a slightly modified draft bill was introduced in the Lok Sabha, the lower house of India's

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[16] http://www.ibbi.gov.in/Press_Release_06032017.pdf

[17] The Code does not include, for example, any provisions dealing with cross-border insolvencies, and resolution of financial firms is provided for separately by the Financial Resolution and Deposit Insurance Bill, 2016, which is currently under consideration.

[18] *Interim Report*, *supra* note 6.

[19] *Interim Report*, *supra* note 6, at 31.

[20] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1.

[21] http://mof.gov.in/reports/DraftInsolvencyBankruptcyBil2015.pdf

[22] See Indira Gandhi Institute of Development Research, Finance Research Group, *Bankruptcy Law Reforms*, available at http://www.ifrogs.org/POLICY/blrc.html

Parliament that December.[23] A joint legislative committee representing both houses of Parliament reviewed the draft bill heard testimony and received additional public comments during the winter of 2016 and issued a report and a bill with some modifications in April of 2016.[24] The bill was enacted by Parliament and approved by the Prime Minister the following month.[25] Thus, it took approximately 18 months from the beginning of the Bankruptcy Law Reform Committee's work to the enactment of the Code – a short amount of time for any significant piece of legislation, especially one that impacts such a broad array of stakeholders and interests.

The provisions for business debtors were notified[26] and came into force in August of 2016; the provisions for personal insolvency and bankruptcy have not yet been notified and thus are not yet in force.[27] The chairperson of the Insolvency and Bankruptcy Board, described below, has recently stated that one of the institution's primary current goals is to "operationalise the individual insolvency regime in respect of guarantors to the corporates and the individuals having proprietary business."[28] It now appears likely that the personal insolvency and bankruptcy provisions of the Code will be put in force for that class of business-related debtors in early 2018 and for all other household debtors in the following year or so.

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[23] Lok Sabha, *Report of the Joint Committee on the Insolvency and Bankruptcy Code*, at 6, available at http://ibbi.gov.in/16_Joint_Committee_on_Insolvency_and_Bankruptcy_Code_2015_1.pdf

[24] Lok Sabha, *Report of the Joint Committee on the Insolvency and Bankruptcy Code*, *supra* note 23.

[25] http://www.indiacode.nic.in/acts-in-pdf/2016/201631.pdf

[26] As with other legislative acts, the Code provides that "It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint …." IBC, § 1.3. The Official Gazette, published by the Government of India Press, is generally used by the government to publish official notices. *See* http://egazette.nic.in/

[27] The Code provides that its different provisions can be notified at different times. IBC, § 1.3.

[28] *Individual Insolvency Norms a Priority, Says IBBI Chairman*, The Economic Times, Oct. 2, 2017, available at http://economictimes.indiatimes.com/news/economy/policy/individual-insolvency-norms-a-priority-says-ibbi-chairman/articleshow/60912706.cms

This Part describes the major institutional innovations of the Code and summarizes the substantive rules of its personal insolvency and bankruptcy provisions, highlighting some of the significant differences between the new regime and the status quo ante. The institutional innovations discussed below are part of the new framework for both personal and corporate cases. The substantive rules of the Code's personal insolvency and bankruptcy chapters apply only to individual debtors, although they are similar in many respects to the new substantive rules governing corporate cases.

A. New Institutions

The Insolvency and Bankruptcy Code creates what has been described as an ecosystem of various new institutions, institutional features, and institutional actors that will be responsible for crucial aspects of the regime.[29] Most important of these are the Insolvency and Bankruptcy Board, insolvency professionals, insolvency professional agencies, and financial information utilities, which are described below. Furthermore, the Code designates, and thus potentially transforms, existing National Company Law Tribunals and Debt Recovery Tribunals to serve as the fora and the "adjudicating authorities" for cases involving commercial debtors and personal debtors, respectively.[30]

1. <u>The Board</u>. The Insolvency and Bankruptcy Board of India is a major new regulatory entity, and it will likely grow to be an important component of the country's administrative state. The general powers of the Board[31] include regulating and supervising insolvency professional agencies, insolvency professionals, and information utilities, described in more detail below. This involves determining eligibility and registration requirements for the professionals and their agencies; in every case, approving the insolvency professional appointed by a party or appointing one for the case; supervising the operation of insolvency professional agencies and information utilities; and issuing

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[29] http://www.ibbi.gov.in/Press_Release_06032017.pdf

[30] *See infra* Part I.A.V.

[31] IBC, § 196.

regulations related to these actors and that implement numerous other substantive aspects of the Code.[32] The Board is also charged with the important if under-appreciated responsibility for gathering and disseminating data related to the new insolvency and bankruptcy system.[33] The powers of the Board are "subject to the general direction of the central government,"[34] and the central government can take over authority from the Board in an emergency or if the Board is failing to perform its functions.[35] The Code also expressly grants authority for rulemaking on certain matters to the central government.[36]

The membership of the Board must include representatives of the central government from the Ministries of Finance, Corporate Affairs, and Law, as well as a representative of the Reserve Bank of India, the country's central bank,[37] all of whom are appointed by the central government.[38] The initial Board has been designated and installed in office.[39] The Board's first chairperson, M.S. Sahoo, took office in October 2016. Prior to this position, he served as a member of the Securities and Exchange Board of India and of the Competition Commission of India, held various government positions, and practiced as an attorney.[40]

Given its regulatory and rulemaking role, the Board is essentially responsible for completing the design of the insolvency and bankruptcy system set up by the Code.[41] Since

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32 IBC, § 196, 240.

33 IBC, § 194 (requiring the Board to "collect and maintain records relating to insolvency and bankruptcy cases and disseminate information relating to such cases; [and] maintain websites and such other universally accessible repositories of electronic information as may be necessary ….").

34 IBC, § 196.

35 IBC, § 225-26.

36 IBC, § 239.

37 IBC, § 189.

38 IBC, § 188.

39 http://www.ibbi.gov.in/members.html

40 http://www.ibbi.gov.in/about-chairperson.html

41 As the Board is getting started, its powers and responsibilities can be exercised by a financial sector regulator or the central government. IBC, § 244.

the provisions of Code for commercial debtors have gone into effect, the Board has promulgated regulations on the authorization and performance of insolvency professionals[42] (including guidelines for the appointment of interim insolvency professionals[43]); the establishment and operation of insolvency professional agencies[44] (including model bylaws[45]); the operation of insolvency[46] and liquidation[47] provisions (including the voluntary liquidation provisions[48] and fast-track insolvency provisions[49]) for corporate and commercial debtors; the establishment and operation of information utilities;[50] and the inspection and investigation of insolvency professionals, entities, and agencies by the Board.[51] The Board has formally recognized two insolvency professional entities.[52]

2. Insolvency Professionals, Entities, and Agencies. Insolvency professionals are charged with managing most aspects of any insolvency or bankruptcy case under the Code. In fact, as a group, the insolvency professionals will potentially play a more consequential role within the new regime than the judges of the tribunals that will serve as adjudicating authorities. In the new insolvency and bankruptcy system, insolvency professionals will

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[42] http://www.ibbi.gov.in/Law/GAZETTEIP_professional.pdf

[43] http://www.ibbi.gov.in/Interim_Resolution_Profesional.pdf

[44] http://www.ibbi.gov.in/Law/IPA%20REGULATIONS_professional_agencies.pdf

[45] http://www.ibbi.gov.in/Law/MODEL%20BYE-LAWS.pdf

[46] http://www.ibbi.gov.in/Law/1_CIRP%20REGULATIONS301116.pdf

[47] http://www.ibbi.gov.in/Law/IBBI%20(Liquidation%20Process)%20Regulations,%202016%2015%20DEC.pdf

[48] http://www.ibbi.gov.in/IBBI%20(Voluntary%20Liquidation)%20Regulations%202017.pdf

[49] http://www.ibbi.gov.in/Insolvency_and_Bankruptcy_Board_of_India_Fast_TrackInsolvency_Resolution_Process_for_Corporate_Persons_Regulations_2017.pdf

[50] http://www.ibbi.gov.in/IU%20Regulations%2031032017%20Final.pdf

[51] http://www.ibbi.gov.in/The_Insolvency_and_Bankruptcy_Board_of_India_Inspection_and_Investigation_Regulations_2017.pdf

[52] http://www.ibbi.gov.in/Press_Release_06032017.pdf

likely initiate most cases brought on behalf of debtors or creditors under the Code.[53] Once selected and confirmed by the Board, they are generally responsible for serving as intermediaries between stakeholders – i.e., debtors and creditors – and between these stakeholders and the adjudicating authorities. As described below in more detail, they manage personal insolvency and fresh start cases, and they serve as trustees for individual debtors in bankruptcy proceedings.[54] Among other things, they are expected to ensure stakeholders obtain relevant information; to help formulate and then recommend plans to the adjudicating authorities, who appear to have limited authority to review those recommendations; and to manage and distribute estates.

The Code requires that insolvency professionals be affiliated with insolvency professional agencies and be registered and remain in good standing with the Insolvency and Bankruptcy Board. The Code itself does not, however, provide any other qualifications for these professionals. It expressly delegates to the Board authority to "specify the categories of professionals or persons possessing such qualifications and experience in the field[s] of finance, law, management, insolvency or such other field as it sees fit."[55] By regulation, the Board has required generally that insolvency professionals must take a national insolvency exam; if they have ten years of experience as an accountant, attorney, or a company secretary, they need only take a limited insolvency exam.[56] Individuals with 15 years of experience in those fields can be registered as an insolvency professional for a limited period of time,[57] presumably to work on particular cases. As of November 2017, when only the insolvency and bankruptcy provisions for corporate debtors were in force,

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[53] *See, e.g.*, IBC, §95. Debtors and creditors in both commercial and personal cases can propose their own insolvency professionals.

[54] *See infra* Part I.B.

[55] IBC, § 207(2).

[56] Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016, at § 5, available at http://ibbi.gov.in/webadmin/pdf/legalframwork/2017/Sep/23rd%20Nov%2016%20Insolvency%20and%20Bankruptcy%20Board%20of%20India%20(Insolvency%20Professionals)%20Regulations,%202016_2017-09-25%2014:29:23.pdf

[57] Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, supra note 56, at § 5.

there were nearly 2,000 registered insolvency professionals[58] and three registered insolvency professional agencies[59] in the country.

The Code also includes a "code of conduct" for insolvency professionals. It requires that individuals serving in this capacity to exercise "reasonable care and diligence;" comply with the internal rules of the insolvency professional agency he or she is affiliated with; allow the agency to examine his or her records; to submit records of each proceeding before a tribunal to that agency and to the Insolvency and Bankruptcy Board; and to act according to other conditions that may be set by the Board.[60] The Board has set forth a more elaborate code of conduct by regulation that imposes, among things, requirements regarding integrity, independence, competence, potential conflicts, transparency, timeliness, information management, confidentiality, workload, remuneration, and gifts.[61]

3. Information Utilities. Financial information utilities are charged under the Code with receiving financial information from private parties,[62] including those who "are under obligations to submit financial information under the Code;"[63] authenticating such information with input from "all concerned parties;"[64] "creating and storing financial information in a universally accessible format;"[65] and providing access to the information to entities authorized to obtain it.[66] The drafters of the Code expressed the hope that, to avoid the inefficiencies of monopoly, a number of such financial utilities would emerge.[67] If

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[58] http://www.ibbi.gov.in/register.html

[59] http://www.ibbi.gov.in/ipas.html

[60] IBC, § 208.

[61] Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, supra note 56, at Schedule 1.

[62] IBC, § 214(c).

[63] IBC, § 214(b).

[64] IBC, § 214(e).

[65] IBC, § 214(a).

[66] IBC, § 214(f).

[67] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1, 4.3.1.

so, and assuming that they do not all contain the same information, parties will need to be able to search for information from all existing utilities. The Code therefore provides that each utility must "have inter-operability with other information utilities"[68] and regulations provide that each information utility must enable users to search information held by other utilities.[69] The first information utility was formally registered in September 2017.[70]

The drafting committee recommended "that the IUs should include records of all financial liabilities, secured and unsecured"[71] and this is reflected in the regulations governing the utilities.[72] Many of the pressing time requirements for actions under the Code appear to be premised on the expectation that these utilities will provide such information rapidly and routinely. Most notably, as described below,[73] these utilities will serve the crucial function of providing evidence of a debtor's default, which is the central requirement of eligibility for insolvency.

4. Insolvency Fund. The Code also authorizes an Insolvency and Bankruptcy Fund "for the purposes of insolvency resolution, liquidation and bankruptcy of persons under the Code."[74] This intriguing provision of the Code is in one brief and very general section and so the design and operation of the Fund will presumably be determined by the Board through regulations, which it has not yet done. The Code itself simply sets two features in place. First, it authorizes the central government, private individuals and entities, and

[68] IBC, § 214(h).

[69] Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, 2017, at § 24, available at
http://ibbi.gov.in/webadmin/pdf/legalframwork/2017/Jul/IU%20Regulations%2031032017%20Final.pdf.

[70] *See*
http://ibbi.gov.in/webadmin/pdf/press/2017/Sep/IU%20Registration%20Press%20Release.pdf

[71] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1, at 4.3.3.

[72] Insolvency and Bankruptcy Board of India (Information Utilities) Regulations, supra note 69, at § 36.

[73] *See infra* note 96 and accompanying text.

[74] IBC, § 224.

"other source[s]" to contribute to the Fund.[75] Second, it authorizes any individual or entities that have "contributed any amount to the Fund" and become involved in an insolvency or bankruptcy proceeding as a debtor to apply to withdraw up to that amount "for making payments to workmen, protecting the assets of such persons, meeting the incidental costs during the proceedings or such other purposes as may be prescribed."[76] Because the Code envisions contributions from sources other than private entities, it may be authorized to disperse funds under other circumstances as well, perhaps at the discretion of a tribunal or the Board.

5. <u>Repurposed Tribunals</u>. As noted above, the Code designates the pre-existing National Company Law Tribunals and Debt Recovery Tribunals as exclusive tribunals for insolvency and bankruptcy cases. Depending on the size and scope of the caseload under the new insolvency and bankruptcy system, this new role has the potential to dramatically change the nature of these tribunals, essentially remaking them. Hundreds of millions of borrowing-age debtors will fall within the scope of the personal insolvency and bankruptcy chapters, and even a small number of cases per capita could potentially overwhelm the Debt Recovery Tribunal system.[77] It is certainly possible that insolvency and bankruptcy cases could come to dominate the workload of the tribunals, eventually requiring new administrative features as well as additional tribunals and staff devoted to those cases.

B. The New Substantive Framework

The substantive framework of India's new Insolvency and Bankruptcy Code effectively preempts a web of pre-existing laws that had provided for liquidation and restructuring of business entities and assets and for insolvency cases involving individual

[75] IBC, § 224(2).

[76] IBC, § 224(3).

[77] [citation to come]

and household debtors.[78] The Companies Act of 1956, which provided for resolution of failing corporations, was one of the most important components of the preexisting insolvency regime. It had been amended in 2013 to provide a mechanism for rescuing firms and restructuring their debt, but the relevant provisions were not subsequently notified and put into force; the 2013 amendments also created the National Company Law Tribunal and Appellate Tribunal, which replaced the Company Law Board and the Board for Industrial and Financial Reconstruction.[79] Other important components of the preexisting regime include the Sick Industrial Companies Act of 1985, which provided for restructuring of industrial companies;[80] the Recovery of Debts Due to Banks and Financial Institutions Act of 1993, which gives financial institutions advantageous rights to recover collateral from defaulting debtors – individuals as well as business debtors – and which created the Debt Recovery Tribunals for this narrow purpose;[81] and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002, which, among other things, provides for self-help enforcement by secured creditors against collateral, with appeals to the Debt Recovery Tribunal.[82] Other regimes with a narrower scope include the Joint Lending Forum and the Strategic Debt Restructuring Forum, both created by the Ministry of Finance.[83]

The provisions in the new Code for individuals and households replace two colonial-era insolvency laws, the Presidential Towns Act and the Provincial Towns Act. Until and unless the Code's provisions are notified, these Acts are still technically in force. An

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[78] Aparna Ravi, *The Indian Insolvency Regime in Practice*: An Analysis of Insolvency and Debt Recovery, Indira Gandhi Institute of Development Research working paper, 2015, available at http://www.igidr.ac.in/pdf/publication/WP-2015-027.pdf.

[79] *See, e.g.*, http://www.mondaq.com/india/x/500200/Corporate+Commercial+Law/National+Company+Law+Tribunal+NCLT+replaces+Company+Law+Board+CLB+from+June+2016

[80] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1, at 3.3.

[81] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1, at 3.3.

[82] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1, at 3.3.

[83] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1, at 3.3.

individual debtor or the debtor's creditors can initiate a case under these laws to have the debtor deemed formally insolvent in a civil court of general jurisdiction or a subordinate court within the civil court system.[84] Pursuant to the Acts, an individual debtor can , at least in theory, obtain some measure of debt relief. To do so, the court must determine that the debtor has committed an "act of insolvency," such as acting to defeat or delay one's creditors, transferring all or most of one's assets, asserting to creditors that one is not going to pay an obligation, having property sold in execution of a court decree, or failing to respond to a creditor's notice of insolvency. Courts are required to dismiss cases if they determine that the debtor has the capacity to repay his or her debts.[85] Furthermore, under this preexisting regime, courts have significant discretion in providing for the discharge of debt and in staying other actions affecting a debtor or the debtor's property.[86] Thus, under those laws, debtors in an insolvency proceeding can still be subject to other debt recovery laws.

This web of regimes for firms and individuals had created significant uncertainty for stakeholders and extended the time required to resolve or restructure the affairs of debtors in financial distress. It was not always clear when or how the scope of these different regimes overlapped, especially for corporate debtors. When they did – or might -- overlap, this provided significant opportunities for parties to shop among courts and venues before and during disputes, sometimes allowing for concurrent proceedings in different courts or jurisdictions. Furthermore, the substantive rules of many of these regimes often gave judges broad discretion over critical interventions or required judicial determinations of factual matters, which exacerbated the slow pace of cases in the system.

This Essay focuses on the provisions of the new Insolvency and Bankruptcy Code relating to personal debtors rather those covering commercial debtors, but the new Code

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[84] Adam Feibelman, *Consumer Finance and Insolvency Law in India: A Case Study*, 36 BROOKLYN J. INT'L L. 75 (2010).

[85] Feibelman, *Consumer Finance and Insolvency Law in India*, *supra* note 84.

[86] Feibelman, *Consumer Finance and Insolvency Law in India*, *supra* note 84.

adopts some general approaches that apply in all cases. In both realms, it consolidates and clarifies the substantive law that applies once a case is initiated under the Code, and it vests adjudicatory authority for cases in exclusive tribunals, one for commercial debtors and the other for individuals.[87] For both personal and commercial debtors, the Code provides insolvency or restructuring as a first-order strategy, liquidation or "bankruptcy" if the first-order approach is not successful, and a separate track for debtors with relatively low levels of debt or few assets.[88] Both regimes also utilize strict time limits for a host of actions; effectively liberalize the threshold triggers or circumstances that enable debtors and creditors to initiate cases; provide consistently robust protections for secured creditors; and require new insolvency professionals to play a central role in all cases. The following sections summarize basic aspects of the Code as it applies to personal debtors. The details in the discussion that follows, especially regarding time limits, are included to convey some of the institutional choices that policymakers made. The Supreme Court of India has held that many of the time limits for official actions under the Code's provisions for commercial debtors are not mandatory, and this will presumably apply to the similar limits under the provisions for individual debtors.

1. Insolvency. Under the Code, debtors who enter the new system will either do so through an insolvency proceeding or a "fresh start" proceeding, which is described below.[89] Broadly speaking, the personal insolvency provisions of the Code require a debtor to propose a repayment plan that meets with the approval of a majority of the debtor's creditors.

[87] As noted above, the Code designates the National Companies Law Tribunal as the exclusive venue for commercial debtors and Debt Recovery Tribunals for personal insolvency and bankruptcy cases.

[88] The Code allows commercial debtors to voluntarily seek liquidation or restructuring in an insolvency process and allows creditors to initiate a debtor's insolvency proceeding. If a debtor's insolvency case fails, then creditors can seek the debtor's liquidation. The Code also provides for a "fast track" insolvency process for small firms.

[89] *See infra* Part I.B.3.

A debtor can initiate an insolvency case under the Code if he or she "commits a default"[90] on debt of at least 1,000 rupees,[91] unless the default is on an "excluded debt."[92] Excluded debts include liabilities for court or tribunal fines; "negligence, nuisance or breach of a statutory, contractual or other legal" obligations; maintenance of any person required by law; student loans; or any other thing prescribed by regulation.[93] A default is defined in the Code as "non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not repaid …."[94] A creditor can initiate an insolvency case for any defaulting debtor if the creditor serves a formal demand and the debtor fails to pay in 14 days.[95] As noted above, information utilities are designed to play a crucial role at this point as policymakers hope and anticipate that defaults will be recorded with one or more utility in and can be almost immediately verified by the adjudicating authority. The Code provides that "[w]here the debt for which an application has been filed by a creditor is registered with [a] information utility, the debtor shall not be entitled to dispute the validity of the debt."[96]

To initiate a personal case, an individual debtor or a creditor must file an application with the Debt Recovery Tribunal in the relevant jurisdiction.[97] The filing party may do so itself or employ a resolution professional of their choosing, who will then presumably

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[90] IBC, § 94, 95.

[91] IBC, § 78. The Code further provides that the Central Government can raise this minimum but not above one lakh (one hundred thousand) rupees. IBC, § 78.

[92] IBC, § 94(3). For a discussion of excluded debts in personal insolvency cases, *see infra* note 93.

[93] IBC, § 79(15).

[94] IBC, § 3(12). Notably, this definition does not appear to encompass default of non-payment terms.

[95] IBC, § 95(4)(b).

[96] IBC, § 99(3).

[97] IBC, § 94, 95. The Code does not specify information or documents that a debtor must include with an application but provides that an application submitted by a creditor must include information about all debts owed by the debtor to the filing creditor(s), the creditor's demand for payment and the debtor's failure to do so within 14 days, and evidence of the debtor's default. IBC, § 95(4).

manage the case.[98] The Board must confirm an insolvency professional selected by the filing party or nominate an alternative professional within seven days.[99] If a party files an application directly, the Tribunal will request the Board to appoint a resolution professional within seven days[100] and the Board must appoint one within ten days thereafter.[101] A party can object to the resolution professional who initiates a case or is appointed by the Board and apply to the Tribunal to have that initial resolution professional replaced.[102]

Upon the filing of a case, an interim moratorium automatically goes into effect.[103] Such a moratorium or stay is a crucial feature of any insolvency or bankruptcy system. An interim moratorium in this context stays "any legal action or proceeding pending in respect of any debt" bars creditors of the debtor from "initiat[ing] any legal action or proceedings in respect of any debt."[104] This moratorium appears to apply to secured creditors, but it does not expressly extend to actions other than legal proceedings related to debts. This raises uncertainty about whether creditors might take actions under the moratorium other than initiate a formal action or proceeding to try to pressure their debtors to repay.[105] The Code authorizes the Central Government to include other actions within the scope of the interim moratorium.[106]

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[98] If a party files directly, they can subsequently designate a resolution professional. If they do not do so, the Debt Recovery Tribunal will request that the Insolvency and Bankruptcy Board do so. Other parties may object to a resolution professional designated by the filing party or by the Board. The Code does not provide a standard or any specific bases for removal of a resolution professional.

[99] IBC, § 97. If the proposed professional is disqualified, the Board appoints a different professional. IBC, § 97, 82 (for fresh start cases).

[100] IBC, § 97(3).

[101] IBC, § 97.

[102] IBC, § 98.

[103] IBC, § 96.

[104] IBC, § 96(1)(b).

[105] A creditor night, for example, withhold services or property from a debtor or engage in informal debt collection efforts, which might defeat the underlying purpose and spirit of the moratorium.

[106] IBC, § 96(3).

Once approved or appointed, the resolution professional must submit a report to the Debt Recovery Tribunal within 10 days recommending either approval or rejection of the application.[107] For this report, the resolution professional must determine whether the application satisfies the basic requirements for such applications set out under the Code[108] but also requires that the resolution professional "record the reasons for recommending the acceptance or rejection of the application in the report…"[109] This presumably means that the resolution professional must simply affirm that the debtor has defaulted on a debt of at least 1,000 rupees and, if required, that a demand was made and note met within 14 days. But the requirement to "record the reasons" might also be construed to invite a more active threshold gatekeeping role for resolution professionals.

The Debt Recovery Tribunal must in turn determine within 14 days after receiving the resolution professional's report whether to admit or reject the insolvency application.[110] The Code does not provide standards to govern the Tribunal's approval or rejection of applications at this stage. This presumably means that the Tribunal will simply confirm that the basic eligibility requirements stated in the Code are met or not. But, like the responsibility of resolution professional to recommend acceptance or rejection, the lack of guidance for the Tribunal here may also invite judges to consider other factors in determining whether to admit or reject applications.

If the application is admitted, the interim moratorium becomes permanent and somewhat expanded by additionally providing that the debtor "shall not transfer, alienate, encumber or dispose of any of his assets or his legal rights or beneficial interests

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107 IBC, § 99. The resolution professional can request additional information from a party, who then has seven days to provide the information. IBC, § 99(4),(5).

108 IBC, § 99(6).

109 IBC, § 99(9).

110 IBC, § 100.

therein."[111] The Debt Recovery Tribunal must issue a public notice within seven days of accepting an application inviting creditors to submit claims within three weeks.[112] The resolution professional must prepare a list of creditors from the information included in the application and from claims asserted by creditors in response to the public notice.[113]

The debtor in a personal insolvency proceeding, whether voluntary or involuntary, is responsible for preparing a repayment plan "in consultation with the resolution professional,"[114] which must provide a justification for the plan and "reasons on the basis of which the creditors may agree upon the plan,"[115] designate any fee to be paid to the resolution professional,[116] as well as other matters "to be specified."[117] The Code itself does not set forth any additional requirements or standards for a debtor's repayment plan, but does provide that a plan "may authorize or require the resolution professional to carry on the debtor's business or trade …; realize the assets of the debtor; or administer or dispose of any funds of the debtor."[118] Draft regulations released by the Board for public comment include additional requirements for repayment plans, including that a plan cannot affect excluded assets and that it must include, among other things, a duration, a schedule, a minimum budget for the debtor, and the terms of the debtor's discharge.[119]

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[111] IBC, § 101(2)(c).

[112] IBC, § 102.

[113] IBC, § 103, 104.

[114] IBC, § 105(1).

[115] IBC, § 105(3)(a).

[116] IBC, § 105(3)(b).

[117] IBC, § 105(3)(c). It is not clear if this provision envisions that other matters might be specified by an adjudicating authority on a case by case or whether they can only by specified in general by the Board through regulations.

[118] IBC, § 105(2).

[119] *See* Insolvency and Bankruptcy Board of India, *Insolvency Resolution Process for Individuals and Firms*, Draft Regulations, § 22, 2017, available at http://www.ibbi.gov.in//Draft%20Regulations%202017%20on%20Insolvency%20Resolution%20process%20for%20Individuals%20and%20Firms.pdf. The Code provides that discharge is available "in relation to the debts mentioned in the repayment plan," which does not clarify whether there is any limit on which debts can be discharged under a plan. IBC, § 119.

Neither the Code nor the draft regulations specify whether a plan might provide for discharge of debts that are otherwise non-dischargeable or whether a plan must provide any particular treatment of debts that would have priority in a bankruptcy case.[120] As discussed below, if otherwise dischargeable debts can be discharged in a repayment plan, or if the plan is not required to reflect bankruptcy priorities, this could exacerbate inter-creditor conflicts in the insolvency process.[121]

Neither the Code nor the draft regulations provide any protective limits to the terms of repayment plans beyond protecting excluded assets and providing a minimum budget. That said, the insolvency professional must submit the debtor's resolution plan and a report about the plan to the Debt Recovery Tribunal within three weeks of the deadline for creditors to submit claims.[122] The Code requires that this report must confirm that the plan complies with current law and that the plan "has a reasonable prospect of being approved and implemented."[123] It is possible that the resolution professional's authority to review for "a reasonable prospect of being … implemented" might provide a degree of discretion to police plans for especially onerous terms.

The insolvency professional's report on the debtor's repayment plan must also state whether a meeting of creditors is necessary and, if not, state why.[124] This reflects that the Code appears to assume that, in most cases, the resolution professional will convene a meeting of creditors.[125] Such a meeting must occur at least two weeks after but within 28

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[120] On the other hand, the personal insolvency regime does recognize the category of excluded debts, denying eligibility to debtors who only default on such debts. See *supra* note 92 and accompanying text. This could provide some basis for affected creditors to argue that the Code should be construed to disallow discharge of excluded debts in an insolvency case.

[121] See *infra* Part II.B.1.

[122] IBC, § 106.

[123] IBC, § 106(2)(a),(b).

[124] IBC, § 106(2)(c).

[125] IBC, § 106, 107.

days from when the resolution professional submits the debtor's repayment plan.[126] In advance of the meeting the resolution professional must distribute to creditors the debtor's repayment plan, the resolution professional's report on the plan, and a "statement of affairs of the debtor."[127] At the meeting, the creditors, other than associates of the debtor,[128] must decide whether to approve or reject the plan or modify it with the debtor's consent.[129] Approval requires "a majority of more than three-fourth in value" of the claims of creditors voting in person or by proxy.[130]

Secured creditors are entitled to vote in this process; if they do participate in the voting, however, they cannot enforce their security interests during the duration of the plan unless they are only voting the unsecured portion of their claim.[131] Thus, if a secured creditor does not participate in voting, they are presumably entitled to enforce their security interests under other legal regimes. Furthermore, a secured creditor's consent is required if the creditor does not participate in voting on a plan that affects its "right to enforce security."[132] Although the Code is not explicit on this point, this language implies that a secured creditor's consent is required if a repayment plan provides for a cure of a default to that creditor that would otherwise give rise to a right to enforce its security.

The resolution professional must prepare a report on the meeting of creditors and submit that and the repayment plan to the Debt Recovery Tribunal.[133] The Tribunal then issues an order either approving or rejecting the plan "on the basis of the report of the

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126 IBC, § 106.

127 IBC, § 107(3). *See also*, *Draft Regulations*, *supra* note 119, at § 9 (setting forth the required contents of the debtor's statement of affairs and providing that the statement be prepared by the resolution professional).

128 IBC, § 109(4)(b).

129 IBC, § 106-11.

130 IBC, § 111.

131 IBC, § 110.

132 IBC, § 110(5).

133 IBC, § 112-13.

meeting of the creditors;"[134] the Tribunal may also provide instructions for implementing the plan or require the creditors to meet to modify the plan.[135] The Code does not specify any additional standards to govern the Debt Recovery Tribunals' evaluation of the resolution professional's report or its decision on whether to approve or reject the plans. However, the fact that the Tribunal has authority under the Code to instruct on implementation or require modifications suggests a broader, more engaged role for the Tribunal at this stage than simply approving the decision of the creditors and the recommendation of the resolution professional.

The moratorium expires when the Tribunal issues its order or, in any event, within 180 days from the date of the admission of the debtor's application.[136] This effectively means that the full process of submitting and approving a debtor's plan must occur within that 180 period; the Code does not provide for an extension of this deadline.

If the Debt Recovery Tribunal approves the debtor's repayment plan, the insolvency professional is then responsible for implementing the plan through its duration[137] and applying for a discharge of the debtor's debts.[138] A debtor is generally entitled to a discharge of debts upon completion of the plan, although the Code authorizes early discharge as well.[139] The personal insolvency provisions of the Code do not specify whether any debts are non-dischargeable, as do the provision for personal bankruptcy discussed below.[140] Instead, the Code states that the resolution professional must apply for a debtor's discharge "on the basis of the repayment plan;"[141] as noted above, the Code does

[134] IBC, § 114(1).

[135] IBC, § 114(2),(3).

[136] IBC, § 101.

[137] IBC, § 116.

[138] IBC, § 119.

[139] IBC, § 119.

[140] See *infra* notes 181-93 and accompanying text.

[141] IBC, § 119(1).

not expressly preclude a repayment plan from providing that some excluded debt might be discharged.[142]

2. Bankruptcy. The personal bankruptcy chapter of the Code authorizes a Debt Recovery Tribunal to liquidate a debtor's non-excluded assets, to pay as much of the debtor's debt as possible, and to discharge the unpaid balance of certain debts. The Code provides that bankruptcy is available for individuals under three circumstances: where a debtor's application for insolvency was rejected by a Debt Recovery Tribunal because the debtor filed fraudulently; where a Debt Recovery Tribunal rejects the debtor's repayment plan; and where a debtor's repayment plan ends before complete.[143] A case must be filed within three months of one of these circumstances.[144]

A debtor or one or more of the debtor's creditors can apply to initiate a bankruptcy proceeding with a Debt Recovery Tribunal.[145] As with insolvency cases, the filing party can propose an insolvency professional,[146] and the Tribunal must within a week notify the Board of the proposed insolvency professional or, if the filing party does not propose one, request that the Board do so.[147] The Board has 10 days to approve a proposed individual

[142] *See supra* note 123 and accompanying text.

[143] IBC, § 121. *See also* IBC, § 100, 115, 118. It is not entirely clear from the Code whether a debtor might be eligible for bankruptcy if creditors do not vote to approve his or her repayment plan; this would presumably be precluded if Debt Recovery Tribunals only consider whether to approve or reject plans that have already been approved by creditors. The resolution professional must submit a report on creditors meetings regardless of whether the creditors approve the debtor's plan or not. Section 114 does not expressly prohibit the Tribunal from approving a plan that has not been approved by creditors, but the general structure and logic of the insolvency provisions does not seem designed to allow such a circumstance.

[144] IBC, § 121.

[145] IBC, § 121. A secured creditor that files an application to initiate a debtor's bankruptcy must either relinquish its security or file a statement that it is only filing "in respect of the unsecured part" of its debt. IBC, § 123(2).

[146] IBC, § 122(2), 123(4).

[147] IBC, § 125.

or nominate one if it rejects the proposed individual or if the filing party has not proposed one.[148]

An interim moratorium operates upon the filing of a bankruptcy case,[149] and the Debt Recovery Tribunal must pass a bankruptcy order or dismiss the application within two weeks of the approval of the proposed insolvency professional by the Board.[150] The Code does not provide any additional standards or requirements for issuing a bankruptcy order, so the Tribunal is presumably limited at this stage to confirming that the basic eligibility requirements are satisfied. Upon a bankruptcy order, an "estate of the bankrupt," which is eventually to be distributed among the debtor's creditors, vests in the insolvency professional[151] who, in this context, is called the bankruptcy trustee.[152] The estate is comprised of "all property belonging to or vested in the bankrupt at the bankruptcy commencement date."[153] It does not include "excluded assets," property held by the bankrupt as a trustee, money due to workmen, or any other assets designated by the central government and financial regulators.[154] Excluded assets include tools, equipment, books, and vehicles of personal or business use; basic household goods, furniture, and equipment; certain personal ornaments of religious significance; life insurance policies or pension plans; and a dwelling unit up to a value to be determined by the Board.[155] These exclusions do not defeat existing encumbrances.[156] Disposition of property by a debtor during the pendency of a bankruptcy is "void," but a bona fide purchaser cannot be

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148 IBC, § 125.

149 IBC, § 124. The interim moratorium in this context has the same scope as one that operates in a personal insolvency case under Chapter III.

150 IBC, § 126.

151 IBC, § 128(1)(a), 154.

152 The role of the bankruptcy trustee is described *infra* in text accompanying notes 164-172.

153 IBC, § 155.

154 IBC, § 155.

155 IBC, § 79(14).

156 IBC, § 79(14).

divested of the property.[157] Property acquired during bankruptcy is part of the estate unless it is an excluded asset.[158]

The issuance of a bankruptcy order also ends the interim moratorium, triggering a new moratorium enjoining creditors from initiating actions "against the property of the bankruptcy in respect of" debts owed to them or from commencing any other actions in respect of such debt without permission from the Tribunal.[159] The Tribunal must give public notice of the bankruptcy within 10 days,[160] and creditors have seven days after the public notice to register claims.[161]

Secured creditors are not barred from exercising their non-bankruptcy rights during a bankruptcy case, but they must do so within 30 days after the bankruptcy order is issued or forfeit interest on their debt.[162] During the pendency of a case, until discharge, the debtor has various disabilities. For example, he or she cannot serve as a trustee, hold public office, be a director or manager of a company, take on debt without approval, or travel overseas.[163]

In a bankruptcy case, the insolvency professional's role as "trustee"[164] appears to be a more central and active role than such professionals generally play in personal insolvency cases. As noted above, the debtor's estate vests in the trustee once the trustee is

[157] IBC, § 158.

[158] IBC, § 159.

[159] IBC, § 128(1)(c). The Code does not appear to expressly provide that pending actions continue to be stayed after the interim moratorium expires.

[160] IBC, § 130.

[161] IBC, § 131.

[162] IBC, § 128(2).

[163] IBC, § 140-41.

[164] IBC, § 125.

appointed.[165] He or she convenes a meeting of creditors,[166] administers the debtor's estate,[167] and subsequently applies for a discharge of certain debts.[168] In administering a bankruptcy case, the trustee must "investigate the affairs of the bankrupt; realise the estate of the bankrupt; [and] distribute the estate of the bankrupt."[169] Among other things, the trustee has power to hold property, make contracts, sue, sell assets of the estate, exercise rights of redemption for secured property, and collect on debts owed to the debtor.[170] Some actions by the trustee require approval of creditors, such as carrying on the debtor's business to wind it up; bringing or defending legal actions related to the estate; using property of the estate as collateral; or appointing the debtor to manage property in the estate or carrying on the debtor's business.[171] The debtor has a duty to assist the trustee in his or her performance of these functions.[172]

Notably, the bankruptcy trustee can request that the Debt Recovery Tribunal avoid various transactions that the debtor has made, including "undervalued transactions" made within two years that "caused the bankruptcy process to be triggered,"[173] preferential transfers,[174] and "extortionate credit transactions."[175] A transaction is extortionate under the Code if it requires "exorbitant payments" compared to the amount of credit extended or

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[165] IBC, § 154.

[166] IBC, § 132-35. The trustee can forego a meeting if he or she deems it unnecessary.

[167] IBC, § 136. Part III, Chapter V of the Code governs how the trustee administers and distributes the estate.

[168] See *infra* notes 181-93 and accompanying text.

[169] IBC, § 149.

[170] IBC, § 151-52.

[171] IBC, § 153.

[172] IBC, § 150.

[173] IBC, § 164.

[174] IBC, § 165. The preference period is two years for transactions with an "associate" and, otherwise, six months. To be avoidable, the bankrupt must have had "a desire" to make the other party better off, the counter-party must be a creditor or guarantor, and the transaction must put them in a position "better than … if that thing had not been done."

[175] IBC, § 167.

that are unconscionable under contract law.[176] Regulated lenders who comply with relevant law and regulations enjoy a safe harbor from the extortionate credit transaction provision.[177]

Trustees may make interim distributions to creditors[178] and make a final distribution "when the trustee has realized the entire estate or so much of it as could be realized" in the trustee's opinion.[179] The distribution is made according to the following priorities: trustee costs and expenses, in full; workmen's dues for the two years preceding the bankruptcy case and secured debts; wages to other employees for the one year preceding the bankruptcy case; government claims for the two years preceding the bankruptcy case; and all other debts.[180]

The trustee must apply to the Debt Recovery Tribunal for the debtor's discharge within one year of the commencement of the case or seven days after approval for a discharge by the creditors committee, whichever is earlier.[181] The discharge does not apply to debts incurred by fraud or "excluded debts."[182] Creditors must vote to release the trustee after he or she has administered and distributed the bankrupt's estate.[183]

3. <u>"Fresh Start"</u>. Finally, the Code provides a "fresh start process" for debtors with very modest financial profiles and who are "unable to pay [their] debt."[184] The process is

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[176] IBC, § I67(5).

[177] IBC, § 167(6).

[178] IBC, § 174.

[179] IBC, § 176.

[180] IBC, § 178.

[181] IBC, § 138. The discharge order can be withdrawn or modified. IBC, § 142.

[182] IBC, § 139. *See supra* note 93 and accompanying text (describing the definition of excluding debts under the Code).

[183] IBC, § 137, 148.

[184] IBC, § 80.

limited to individuals with annual income of 60,000 rupees[185] or less; with assets of 20,000 rupees or less; with less than 35,000 rupees in qualifying debts; who do not own a home; and who have not obtained a fresh start within the previous year.[186] Debt is qualifying if it is dischargeable (i.e., not "excluded debt"[187]), unsecured, and was not incurred within three months of applying for the fresh start process.[188] A debtor enjoys a presumption of not being able to repay debts if it appears to be the case on the face of the debtor's application.[189] A debtor can file directly or through a resolution professional,[190] but it appears that creditors cannot file involuntary fresh start cases.

As in other cases, an interim moratorium enjoining all legal actions "in respect of" the debtor's debt comes into effect when a debtor applies for relief under the fresh start chapter.[191] The Debt Recovery Tribunal must inform the Board within seven days after the debtor files an application, and the Board must approve the debtor's resolution professional or appoint one within 10 days of receiving notice from the Tribunal.[192] Thereafter, the resolution professional has 10 days to review the information provided in the debtor's application and submit a report to the Tribunal recommending either

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[185] Approximately 915 U.S. dollars. According to a recent study, the average *monthly* household income in India is around 16,800 rupees and nearly 11,500 in "underdeveloped rural areas." See ICE 360 survey, at http://www.ice360.in. These numbers reflect household, not individual, income. Furthermore, it reflects a significant amount of inequality in income between the highest and lowest earning quintiles. See Pramit Bhattacharya, *The Richest 20% Account for 45% of Income*, The Mint, Dec. 1, 2016, at http://www.livemint.com/Politics/AvHvyHVJIhR0Q629wkPS5M/Indias-richest-20-account-for-45-of-income.html (citing the ICE 360 survey). Nonetheless, the study found that the bottom quartile of households by income have a monthly average of 7,700 rupees in disposable income. *Id.*

[186] As of July 2017, 20,000 rupees roughly equals 310, and 60,000 rupees equals roughly $930. These eligibility requirements do not expressly provide for accounting for debtors who are members of households.

[187] See *infra* notes 93 and accompanying text.

[188] IBC, § 79(19)

[189] IBC, § 83(5).

[190] IBC, § 80.

[191] IBC, § 81.

[192] IBC, § 82.

acceptance or rejection of the application.[193] The report must set out debts subject to discharge[194] and the reasons for its recommendation.[195] The resolution professional may also request more information from any party, who then has seven days to furnish that information.[196] Unlike the resolution professional's report on repayment plans in the insolvency context, the Code here provides additional guidance on what may be considered at this stage. The Code provides that the resolution professional must reject the application if he or she determines that the debtor does not meet the eligibility requirements, the debtor does not have debts subject to discharge, or the debtor has "deliberately made a false representation or omission" in his or her application.[197]

Within 14 days of receiving the resolution professional's report,[198] the Tribunal must issue an order admitting or rejecting the debtor's application and stating the amount of debt determined by the resolution professional to be dischargeable.[199] The Tribunal must notify affected creditors of this decision within seven days.[200] If the debtor's application is admitted, the interim moratorium is extended for 180 days[201] and certain disabilities are extended or imposed on the debtor, including prohibitions against acting as a director of company; disposing of property; and traveling outside of the country.[202]

Creditors mentioned in the Tribunal's order admitting the application have ten days to submit objections to the resolution professional, and these objections can only relate to

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193 IBC, § 83.

194 IBC, § 83(5).

195 IBC, § (83)(7).

196 IBC, § 83(3),(4).

197 IBC, § 83(6).

198 IBC, § 84(1).

199 IBC, § 84(2).

200 IBC, § 84(3).

201 IBC, § 85(2).

202 IBC, § 85(3).

whether their debt qualify for discharge or the veracity of "details of the qualifying debt."[203] Such objections must be accepted or rejected by the resolution professional within ten days.[204] Any party can then challenge a determination made by the resolution professional within 10 days, and the Tribunal has 14 days to decide whether the challenge is meritorious.[205] Parties can also seek replacement of the resolution professional.[206] The Tribunal can revoke the debtor's application if the debtor's situation changes, the debtor misbehaves, or the debtor does not comply with their duties under the Code.[207]

The resolution professional must submit a final list of qualifying debts to the Tribunal no fewer than seven days before the moratorium period expires, i.e., 180 days after the debtor's application was admitted.[208] The Tribunal is then charged with issuing a final discharge order by the end of the moratorium period, which provides for the discharge of qualifying debts as well as penalties, interest, and contractual fees on qualifying debts since the debtor's application.[209] The order does not appear to affect the debtor's other debts or liabilities. Notably, the fresh start process does not provide for making any distributions to creditors from the debtor's property.

III. Assessing the Design

The new Indian personal insolvency and bankruptcy provisions have not yet gone into force, but the chairperson of the Board has recently stated that one of the institution's primary goals is to "operationalise the individual insolvency regime in respect of

[203] IBC, § 86.

[204] IBC, § 86(5).

[205] IBC, § 87.

[206] IBC, § 89.

[207] IBC, § 91.

[208] IBC, § 86(5), 92.

[209] IBC, § 92.

guarantors to the corporates and the individuals having proprietary business."[210] The Board has recently constituted an advisory committee on the Code's individual insolvency and bankruptcy provisions,[211] which will likely advise on regulations to implement those provisions. It is possible that this committee may also suggest changes or refinements to the Code. The Board has issued draft regulations for the insolvency provisions and plans to issue draft regulations for the bankruptcy provisions in early 2018. Although the Code and these regulations may initially only apply to individual debtors with business- and partnership-related debts, it appears that they are being designed to apply as well to consumer debtors when the force of the law is extended to them. Therefore, this appears to be a pivotal moment in the development of the personal insolvency and bankruptcy regime – a time to clarify its precise goals and to anticipate its impact on India's economy and its society. This Article is primarily concerned with the new regime as it will apply to consumer and household debtors, but much of the analysis below is relevant for business debtors and guarantors as well.

Part II.A. examines the apparent goals of policymakers who were responsible for drafting, enacting and implementing the regime, as reflected in their express statements and in its design. Part II.B assesses the design of the regime in light of those apparent goals. As with most consumer insolvency and bankruptcy regimes, it appears that the Indian regime was designed to balance three related aims: to facilitate and perhaps increase creditors' recoveries from their debtors, to provide a degree of insurance to debtors against the risk of financial distress, and to reduce the social costs of household over-indebtedness. As discussed below, there are some institutional features of the regime that potentially complicate these functions and make the operation of the regime difficult to predict.

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[210] *Individual Insolvency Norms a Priority, Says IBBI Chairman*, The Economic Times, Oct. 2, 2017, available at http://economictimes.indiatimes.com/news/economy/policy/individual-insolvency-norms-a-priority-says-ibbi-chairman/articleshow/60912706.cms

[211] http://ibbi.gov.in/webadmin/pdf/press/2017/Sep/Press%20Release-ADV%20COMM.pdf

Part II.C. considers the potential impact of the regime given its design and other background social and economic aspects of the country's consumer financial market. The new regime represents a rare example of a country adopting a comprehensive modern personal insolvency or bankruptcy regime in the absence of a crisis in consumer financial markets or destabilizing household over-indebtedness. Instead, if it goes into effect, the regime will likely be an important factor affecting the development of consumer financial markets in India. Part II.C. concludes that there are reasons to believe that, as designed, it will have some beneficial effects on that development as well as some potentially distortive effects as well. Assuming that, at least initially, the regime will function primarily as tool for creditors, it may help increase the availability of credit to the household sector. However, if it is underutilized by debtors who borrow and experience financial distress or if it fails to provide effective insurance or protection for those debtors who employ it, the regime will imperfectly allocate the risk of individuals' financial distress, inadequately address the personal and social costs of financial misfortune, and fail to provide a robust safety valve for the expanding consumer financial market.

A. Policy Goals

As a general matter, personal insolvency and bankruptcy laws tend to balance two often related foundational policy goals: providing creditors with a mechanism for facilitating their individual or collective recovery from defaulting debtors and providing debtors with a form of relief from their indebtedness and related burdens.[212] In serving these functions, insolvency or bankruptcy regimes can potentially reduce the incidence of household over-indebtedness *ex ante* and reduce the private and social costs of over-indebtedness when it occurs. Insolvency and bankruptcy regimes can pursue the first of these functions by requiring the relatively quick distribution of some portion of a debtor's assets to creditors according to some order of priorities and distributive logic, often pro

[212] The World Bank, *Report on the Treatment of the Insolvency of Natural Persons*, *supra* note 12; *See also*, KILBORN, *supra* note 10; RAMSAY, *supra* note 10.

rata within priorities.[213] They may also or alternatively provide for payment of some portion of a debtor's wage income over a period of time.[214] Many regimes enable creditors to initiate the insolvency or bankruptcy process when it is in their interest to do so; this power may also improve creditors' leverage over debtors outside of the system if they can credibly threaten to employ it.[215]

Personal insolvency and bankruptcy regimes can, and generally do, pursue the second of these functions, i.e., providing degree of relief to debtors, by staying or enjoining debt collection for some period of time; discharging or restructuring some obligations; allowing debtors to cure defaults; and providing a mechanism to enable debtors to retain certain categories of property, including property securing the debtor's obligations.

Giving creditors an effective mechanism for expeditiously recovering at least some portion of their claims against debtors can, at least in theory, be market-reinforcing, by making creditors more willing to extend credit and perhaps reducing the cost of credit. Providing relief to debtors can be market-reinforcing as well, by providing a form of insurance against the effects of over-indebtedness and allocating some related losses to creditors. If it functions effectively, the relief afforded by an insolvency or bankruptcy regime should enable over-indebted individuals to return to productive activity more

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[213] *See*, RAMSAY, *supra* note 1010, at 4-5 (noting the difference between "straight" and "repayment" regimes).

[214] *See id.* at 5 (noting that the repayment approach is ascendant) ("Liberal access to straight bankruptcy with a relatively swift discharge is increasingly a 'suppressed political alternative' for consumers, even in those jurisdictions such as England and Wales where it is available to consumers.").

[215] *See, e.g.*, Jason Kilborn & Adrian Walters, *Involuntary Bankruptcy as Debt Collection: Multi-Jurisdictional Lessons in Choosing the Right Tool for the Job*, 83 AM. BANKR. L.J. 123 (2013) (finding that creditors initiate a significant percentage of cases in many jurisdictions that allow both creditors and debtors to do so and proposing that this reflect a strategy to gain leverage over debtors outside of the insolvency or bankruptcy system).

quickly than they otherwise would. Thus, such debtor protections may help promote entrepreneurial risk-taking.[216]

Creditors will presumably pass some of the costs of such losses back to borrowers, who effectively pay a premium for their protection in the form of slightly higher rates for credit. Ideally, this credit premium, along with stigma, direct costs of the system, and other structural barriers will generally moderate any moral hazard created by the availability of relief while not discouraging individuals from borrowing responsibly in light of expected future income. In theory, the insurance function, if effectively priced, can help discipline both debtors and creditors, ideally reducing the likelihood that individuals and households will become over-indebted in the first place. Debtor protections under bankruptcy or insolvency law can also alleviate more personal costs of financial distress, like emotional and physical stress and deprivation of basic goods and services, that have significant social welfare effects but that are very hard to observe or measure.

These goals of creditor and debtor protection can sometimes push in opposite directions; yet they can also reinforce each other. At least in theory, a healthy consumer financial market is one in which creditors are motivated to lend, debtors are motivated to borrow for productive purposes, and both internalize some of the risk that the debtor will not be able to repay. In fact, most personal insolvency and bankruptcy regimes aim to balance both functions, simultaneously giving creditors useful tools to increase the speed, amount, or predictability of repayment and providing debtors with various types of debtor relief and protection. Various jurisdictions balance these functions differently, falling along a spectrum between the most creditor- and debtor-oriented ones. These goals and approaches may be explicitly addressed in the policymaking process, but in any event, they can often be deduced from the substance of the regime and the nuances of institutional design.

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[216] *See, e.g.*, Wei Fan & Michelle White, *Personal Bankruptcy and the Level of Entrepreneurial Activity*, 46 J. L. & Econ. 543 (2003); Ye Jia, *The Impact of Personal Bankruptcy Law on Entrepreneurship*, 48 CAN. J. ECON. 464 (2015).

Judging from both the law-making process that produced it and from the substance of India's new personal insolvency and bankruptcy provisions, it is difficult to clearly identify the driving motivations of the policymakers who drafted and enacted India's new personal insolvency and bankruptcy regime. While it seems clear that policymakers intended to balance creditor and debtor interests in the regime, it is not clear precisely what balance they intended to strike. Exacerbating this difficulty, there was notably little public discussion about the proposed personal insolvency and bankruptcy regime leading to its enactment; and, surprisingly, there has been even less discussion since. This section proposes a set of motivations for the various provisions of the new regime based on both the public record and the nature of the design of the regime itself and assesses key features of its design in light of these motivations.

The motivations behind the enactment of the new personal insolvency and bankruptcy regime in India are murky in large part because the project of adopting a new Code was dominated by problems related to insolvent commercial debtors. The overriding goals for reforming India's insolvency and debt-restructuring laws were to reduce the amount of time it takes to allocate losses from struggling commercial entities among various stakeholders and to reduce the degree uncertainty about the outcomes of that process. As noted above, there appear to have been two primary underlying concerns fueling these goals. First, policymakers aimed to improve background conditions for expanding the availability of credit, especially unsecured credit, to commercial ventures in the country. Policymakers appear to have been particularly concerned about the country's ability to attract foreign investors, who tend to be concerned both about the legal environment for firms or projects they invest in and about their ability to recover capital if those firms or projects fail. Discussions leading up to the enactment of the new Code frequently referred to India's very low ranking in the World Bank's Doing Business report, which is determined in part by the average time required for an insolvency proceeding in each country. India's Prime Minister, Narendra Modi, promised in campaigns leading to his elevation to significantly improve India's ability to attract foreign investment. In particular, he expressly aimed to improve the country's Doing Business ranking from its 130th place at the time to the top 50 within a few years. The Insolvency and Bankruptcy Code is one of the chief concrete actions designed to improve the environment for both domestic and international investors in India that has occurred under Modi's leadership.[217] This year, in part due to the operation of the new corporate insolvency regime, the country's ranking rose to 100.

Second, and perhaps more acutely, policymakers aimed to support the country's banks that are saddled with significant amounts of loans to troubled firms designated as non-performing assets on their balance sheets. Increasing the speed of resolution of those debtor firms would help banks determine and realize their losses on those non-performing assets, enabling them to make some progress in addressing capital-adequacy problems and perhaps improve their ability to extend new credit going forward.[218]

The scope of the initial charge to the Bankruptcy Law Reforms Committee in the fall of 2014 did not extend to individual or household debtors, and the Committee's initial report in February 2015 dealt only with business debtors. At that point, it appears that the Committee had determined that a personal insolvency regime would be necessary to resolve some business-related failures, because many firms in the country, as elsewhere, are sole proprietorships, in which the personal finances of the venturers are inextricably intertwined with those of the venture itself. These firms as well as larger ones often rely on the personal financial guarantees of owners, investors, or other stakeholders.

Subsequently, the Committee solicited a report on personal insolvency laws, which essentially became the blueprint for the provisions included in the Code.[219] This report did not distinguish between individual borrowers with business-related debts and those with personal or household debts. It discussed the UK and Australian models of personal

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[217] http://www.ibbi.gov.in/Press_Release_06032017.pdf

[218] *See supra* note [3] and accompanying text. *See also*, *e.g.*, The PRS Blog, *The Rise of Non-Performing Assets in India*, May 11, 2016, available at http://www.prsindia.org/theprsblog/?p=3652

[219] Ramann, Sane & Thomas, *Reforming Personal Insolvency Law in India*, *supra* note 9.

insolvency in detail and described a set of economic and institutional goals for a reformed system in India. It represented one of the very few express statements about the motivation for reforming India's personal insolvency laws in the public record leading to the adoption of the Code. In its introductory sections the report discussed the need for expanded access to consumer credit, especially unsecured credit that does not encumber household assets, as well as the need to address the coercive debt collecting practices of lenders in the country that increase the social costs of personal insolvency. Regarding institutional design, the report stated its view that an effective personal insolvency system must balance the interest of creditors and debtors to ensure that both parties will be willing to participate in the system and to curb the ex ante incentives on each side.

While the Bankruptcy Law Reform Committee essentially embraced the institutional approach proposed in this report, it did not expressly incorporate much of the report's background analysis or elaborate upon it. As noted above, the Committee's final report only referred glancingly to "the importance of such borrowers in the economy," and observed briefly that, under the preexisting framework, creditors often had difficulty recovering from individuals and often resorted to "coercive practices," which compounded the social costs of indebtedness.[220]

Thus, the public record of policymakers involved in drafting and enacting the Code suggests that the primary motivation in including personal insolvency and bankruptcy provisions in the Code was to ensure that Code had a comprehensive scope regarding business debtors. With regard to individual debtors who have primarily consumer and household debts, however, the goals of the regime are much less clear. Policymakers appear to have pursued various underlying goals in this regard, including both meaningful debt relief and robust creditor tools, but did not expressly articulate a particular approach to balancing these goals.

[220] *Report of the Bankruptcy Law Reforms Committee*, *supra* note 1, at 114.

To be sure, the personal insolvency and bankruptcy provisions of the Code are designed to offer significantly more relief and protection than the insolvency acts they replaced. But that is a relatively low baseline. Judging by the provisions of the Code itself, the overall regime for personal and household debtors appears designed to lean toward providing a creditors' remedy with a carve-out for a narrow subset of lower-income individuals and, at least for the near future, to serve a relatively modest social insurance function. The regime essentially contains two distinct tracks. One track, the "fresh start" chapter, is for debtors with relatively small amounts of debt or very few assets; the second track, a negotiated repayment regime with a bankruptcy back-stop, is for all other individual debtors. These two tracks roughly represent the two predominant models for individual insolvency or bankruptcy law around the globe discussed above:[221] one in which debtors repay creditors, if at all, from their available assets – i.e., "straight" or "liquidation" bankruptcy – and the other in which they repay creditors from their ongoing wage income. The fresh start chapter is essentially a straight bankruptcy regime while the insolvency process with a narrow bankruptcy back-stop is essentially a repayment approach with a liquidation process designed mostly for failed repayment plans.

Generally speaking, these two approaches tend to generate differing social insurance functions, but the choice of model alone does not determine the degree of debtor protection. The fresh start chapter in India's new Insolvency and Bankruptcy Code offers very robust relief for debtors within its scope and appears designed to function relatively straightforwardly as a generous form of social insurance. It can only be initiated voluntarily by debtors; creditors are not authorized to initiate cases under that chapter. Eligible debtors can thus file for a fresh start; trigger a broad moratorium that enjoins creditors' efforts to collect their debts; and, within 180 days, obtain a relatively generous discharge of debt without being required to distribute assets to their creditors. As it does not provide for any recovery by creditors, it is analogous to loan waiver programs that India has adopted in certain circumstances.

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[221] *See supra* Part II.A.

However, the eligibility requirements for the fresh start process purposefully limit the potential scope of the regime, excluding a large portion of the country's individual and household debtors. Given limitations in data about consumer finance, borrowing, and indebtedness in India, it would be hard to determine what portion of the population has less than 60,000 rupees in income, 20,000 rupees in assets, and some amount of burdensome household debt but less than 35,000 in qualifying debts. It is certainly possible that a significant percentage of the Indian population may meet these requirements, but the thresholds are relatively low – especially the limit on assets, which appears to include assets exempt from collection by creditors – and because homeownership rates in the country are relatively high.[222] To be sure, even if a small percentage of the population falls within this category, that would still represent large real numbers of potential cases. As discussed below, however, it is likely that a much smaller subset of the individuals who meet the eligibility requirements will actually utilize the chapter, at least for some foreseeable period of time.[223]

It is also worth noting that although the fresh start regime can only be initiated voluntarily, it is not clear if it is designed to be the exclusive regime for eligible debtors. The terms of the Code itself appear to leave open the possibility that debtors who are eligible for the fresh start process could be subject to an involuntary insolvency process if their creditors initiate it.

In contrast to the fresh start regime, the design of the insolvency and bankruptcy provisions are considerably harder to characterize. Broadly speaking, the general approach is similar in many respects to the provisions for commercial debtors, with stakeholders required first to attempt to negotiate a repayment plan with creditors. The "straight" or "liquidation," i.e., bankruptcy, provisions are available only if the insolvency process fails for particular reasons. This represents an interesting combination of the repayment and straight bankruptcy approaches. Given the narrow eligibility requirements

[222] *See* Census of India, 2011, *Houses, Household Amenities, and Assets*, available at http://www.censusindia.gov.in/2011census/hlo/Data_sheet/India/Figures_Glance.pdf
[223] *See supra* Part II.B.3.

for the bankruptcy provisions, however, it appears that the bankruptcy process is designed to be employed secondarily and perhaps somewhat exceptionally. In any event, those who do enter bankruptcy, which may promise significant relief to some debtors, will first have to go through the insolvency process and at least attempt a negotiated repayment arrangement.

This structure and the substance of the insolvency provisions available to debtors who are not eligible for a fresh start results in a balance that appears to be designed to favor creditors' interests. Perhaps most significant, unlike the fresh start provisions, creditors are authorized to initiate involuntary insolvency cases, and they may do so upon a single default. And debtors are not eligible to file if they have only defaulted on an excluded debt.[224]

Furthermore, the Code does not expressly specify or limit the possible terms of debtors' repayment plans. Draft regulations promulgated by the Board would require a minimum budget and prohibit transfer of the debtor's exempt assets.[225] These provisions would ensure at least a minimal degree of protection to debtors in the insolvency process. Beyond these limitations, it appears that a debtor can otherwise propose, and creditors can demand, whatever terms they want, which must then attract the support of two-thirds of creditors (and the consent of any non-voting secured creditor whose right to enforce its security is affected[226]). Presumably, creditors will in some circumstances voluntarily accept repayment plans that provide a greater degree of relief than a minimum budget, but there is nothing in Code to enforce such an approach if creditors do not consent. These factors, when combined, appear to give creditors significant leverage over their debtors in the insolvency process, which may also translate into significant leverage over debtors outside of the regime who fear being forced into insolvency involuntarily.

[224] *See supra* note 92 and accompanying text.
[225] *See supra* note 119 and accompanying text.
[226] *See supra* note 119 and accompanying text.

Complicating matters, however, is the fact that failure of creditors to accept a debtor's repayment plan is itself a basis for a debtor's eligibility to file a case under the bankruptcy provisions; the tribunal must ultimately approve or reject the plan "on the basis of" the creditors' decision. For cases in which the debtor may fare better in bankruptcy than in the insolvency process, or if some creditors would prefer to avoid a bankruptcy proceeding for whatever reason, this may shift the balance of negotiating power at least somewhat back toward the debtor, who can offer a repayment plan with more relief and worry less about creditors rejecting it. It is not clear whether the Code or the draft regulations limit a debtor's ability to act aggressively in this fashion by offering a plan that is unpalatable to creditors if he or she prefers to be in bankruptcy than in the insolvency process. The regulations provide for the case of a debtor who does not cooperate after the creditors have met, but that is after the plan has been offered and the creditors have met and presumably voted on it. It is possible that if the insolvency professional determines that the debtor is not acting in good faith, he or she will not submit the repayment plan to the creditors in the first place.

It is also possible that the Code provides some flexibility to the Debt Recovery Tribunals to provide additional protections to both debtors and creditors. As noted above, the Code is silent about the circumstances under which the tribunals can require modifications of repayment plans. This could be construed as authority for the tribunal judges to exercise some discretion, perhaps to police the repayment plans for strategic behavior by debtors or for unfair or burdensome terms imposed by creditors. If so, this could put a limit on any negotiating power debtors may have in the insolvency process but could also protect them from over-reaching by their creditors.

The provisions of the bankruptcy process under the Code seem to balance creditor and debtor interests more evenly than the fresh start or the insolvency provisions. On the one hand, creditors can initiate involuntary cases that meet the eligibility requirements; they get the benefit of the trustee's responsibilities to manage the estate and recover assets available to all creditors, including preferential transfers, and other claims of the estate; and they are entitled to distribution of the debtor's non-excluded assets. On the other hand, debtors enjoy a moratorium on creditors' debt collection and a relatively quick and predictable discharge of all qualifying debts, with assurance that they can retain excluded assets. Debtors with few or no non-excluded assets will be able to discharge qualifying unsecured debts by contributing little or nothing to creditors and only experience the direct and indirect costs of the process and the disabilities imposed by the Code. Nonetheless, the narrow scope of eligibility for the bankruptcy may render it a limited extension of the insolvency process.

In sum, the Code appears to be designed to provide rather generous and predictable debtor relief and protection through the fresh start provisions; to give creditors a significant amount of leverage over their debtors in the insolvency process; and to provide an insolvency backstop in the bankruptcy provisions that more evenly balance the interests of creditors and debtors. Assuming that the fresh start process will be formally available and practically useful to a narrow set of individual debtors, the Code steers most over-indebted individuals who are likely to utilize the system into insolvency proceedings. Bankruptcy may be an appealing option to some, perhaps many, debtors, but it may be an exceptional tool and, in any event, requires a trip through insolvency first. Thus, it appears that the overall system for personal debtors under the Code is designed to give creditors a good deal of leverage over most debtors and, while it provides more relief to debtors than the preexisting regimes, it deemphasizes the insurance function of the Code for most individual debtors relative to other policy goals.

B. Some Concerns

1. <u>Creditor coordination</u>. To the extent that India's new personal insolvency and bankruptcy system is designed to facilitate and expedite creditors' efforts to recover obligations from their debtors, there are features of the system that might operate in tension with that goal. Most notably, the insolvency system largely depends on creditors coordinating and cooperating in various ways, especially in voting to approve debtors' resolution plans. As an initial matter, this may significantly affect the predictability of the system for creditors, because the outcome of each case must be negotiated with relatively

few fixed variables in place. Any predictability that will arise from the system may be a product of the practice of repeat players in the system – e.g., insolvency professionals, tribunals, and institutional creditors – rather than the substance of the law.

Furthermore, the design of the Code may significantly underestimate inter-creditor tensions and adverse interests among them. Consider, for example, that any creditor can initiate an insolvency case against a debtor who is in default on any obligation. This may give a strong advantage to creditors who are in a good position to monitor their debtors and may give attentive individual creditors a greater deal of leverage over their common debtor compared to other creditors. In many cases, where a debtor defaults or nears default on a single obligation, that creditor will have private information about the debtor's eligibility or impending eligibility for insolvency, which will put the creditor at a strategic advantage over others. The Supreme Court recently upheld a decision by a National Company Law Tribunal to allow a debtor to reach a settlement with a creditor who brought a case against it under the Code and terminate the case.[227] In some cases, such a maneuver may exacerbate inter-creditor tensions by enabling individual creditors to effectively employ the insolvency and bankruptcy system to gain leverage to collect individual debts.[228]

The voting requirements for creditors to approve or reject a resolution plan may also give some creditors leverage over others if they have effective veto blocks. In some cases, it may simply give holdout creditors the ability to force a transfer of value from other creditors. If a creditor with veto power thinks it will recover more in bankruptcy, it will presumably have the power to force the debtor into that chapter, assuming that creditors' failure to approve a debtor's resolution plan makes a debtor eligible for bankruptcy.

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[227] *Lokhandwala Kataria Construction Limited v. Nisus Finance and Investment Managers, LLP*, Civil Appeal No. 9279 of 2017, available at http://ibbi.gov.in/webadmin/pdf/order/2017/Jun/LokhandwalaKatariaConstruction9279of2017.pdf

[228] Gausia Sheikh & Bhargavi Zaveri, *An Unsettling Precedent under IBC, Business Standard*, Aug. 8, 2017, available at http://www.business-standard.com/article/opinion/an-unsettling-precedent-under-ibc-117080801711_1.html

As noted above, if repayment plans can discharge otherwise non-dischargeable debts or do not have to adhere to the priorities among creditors in the bankruptcy process, this could generate some significant conflicts among creditors' interests. Consider, for example, a situation in which a debtor has one creditor with priority under the bankruptcy rules but not a large enough claim to veto a repayment plan. In such a case, the debtor's other creditors might be motivated to avoid the bankruptcy process and approve a repayment plan that impairs the priority creditor's claim.

2. Sorting. A broader concern, however, is that overall personal insolvency and bankruptcy system may not effectively balance its goals because the system is not designed to effectively steer debtors among and between its component parts. As noted above, it is not uncommon for countries to provide different types of insolvency or bankruptcy relief within a single system, combining "straight bankruptcy" or a fresh-start-type discharge with a scheme for wage-earners to repay some or all of their debts over time. But jurisdictions that attempt to divide their systems in this way must, ideally, determine a basis for steering debtors into one track or the other or for constraining debtors' ability to choose between them. The conventional and related goals in this regard are, first, to aim to sort debtors who can repay meaningful amounts from those who cannot[229] and, second, to avoid creating moral hazard, i.e., encouraging debtors to risk becoming over-indebted by insuring them from some of the potential harms of doing so.[230]

Under the new Code, to the extent that there is an effort to sort debtors, it is done rather bluntly through the eligibility requirements for the fresh start and bankruptcy provisions. Debtors eligible for the fresh start process are entitled to relatively generous, quick, and predictable debt relief, and presumably it is designed for debtors who are unlikely to be able to repay a significant amount of debt. These provisions expressly provide that, to be eligible for fresh start insolvency, debtors must be unable to repay their

[229] KILBORN, *supra* note 10, at 10.

[230] KILBORN, *supra* note 10, at 9.

debts, but it is not clear that this requirement alone will do much work: a debtor enjoys a presumption that they are unable to repay their obligations if that appears to be true from the information in their application. It is worth noting that it not clear if the requirement envisions that a debtor will be unable to repay *all* of his or her debt or *any* of the debt; requiring that a debtor be unable to pay all of his or her indebtedness would yield a narrower eligibility than requiring only that a debtor not be able to some portion of their debt.

The other eligibility requirements are based on a debtor's income, assets, and debts. It is likely that these factors are generally good proxies for ability to repay; all else being equal, low-income and low-asset debtors are probably less likely to be able to repay their debts than wealthier debtors with more assets. But the requirement that debtors have less than 35,000 rupees in qualifying debt is predictably, if slightly, over-inclusive. Because the requirement is not a floor but a ceiling, some debtors with relatively little debt, and who might reasonably be expected to repay a significant portion of their obligations, will be eligible for relief. To be clear, however, this will presumably not be a significant problem because such debtors will not have much incentive to seek relief, and the losses to creditors in such cases will be minimal.

Of greater concern is the fact that the income and asset eligibility requirements of the fresh start chapter will exclude many individual debtors who cannot repay a meaningful amount of their debts. The number of debtors who fall into this category seems likely to increase as the number of Indians earning more than 60,000 rupees per year – and their ability to incur greater amounts of debt – both increase. Such debtors will only be able to utilize the insolvency process, which is designed for debtors who can repay a meaningful amount of their debts. Ideally, those debtors who are initially limited to the insolvency process but in fact cannot repay a meaningful amount of their debts would be steered into the bankruptcy process, which, like the fresh start process, is designed largely for debtors who cannot manage a repayment plan. Given the relatively narrow eligibility requirements of the bankruptcy process, however, the Code may not be calibrated to channel appropriate cases between the insolvency and bankruptcy chapters. Even if it does succeed in steering debtors who genuinely cannot repay their obligations to the bankruptcy process, requiring them to fail in the insolvency process first may not be the most efficient means of doing so.

3. Uptake. To the extent that the various provisions of the personal and insolvency regime do offer protections and relief to debtors, this may give rise to concerns that it will lead individuals to be more reckless or opportunistic in borrowing. If so, the new system could have a destabilizing effect on the economy and Indian society by encouraging over-indebtedness and related costs of financial distress on debtors and their creditors, including the costs of the insolvency and bankruptcy system itself.

It appears more likely, however, that the system will face the opposite challenge – that debtors who could benefit from the system, for whom the system was designed, will not utilize it as intended by the policymakers who designed it and are implementing it. This is especially true with respect to the fresh start provisions, which offer the potential of generous relief to debtors who are likely to be in the greatest need of it. To begin with, there will be direct and indirect costs of seeking a fresh start, including application and professional fees, time, inconvenience, stigma, and other reputational concerns. The potential practical benefit of a fresh start to an individual must at least be greater than such costs. The ability to discharge debt would presumably be a primary benefit for most eligible debtors considering whether to utilize the fresh start provisions, but currently, it appears that much of the debt owed by people among this demographic is likely to be secured and therefore not dischargeable. Added to which, some unsecured debt may be informal to a degree that it is difficult to establish and discharge. Because the regime is not available to debtors who own their own home, these provisions will not enable debtors to use the moratorium strategically to avoid or delay the repossession of their home by secured creditors, a common benefit of personal insolvency or bankruptcy regimes for debtors in other jurisdictions.

Furthermore, debtors who are eligible for a fresh start may face significant informational and other practical challenges in learning about the relief available to them, accessing advisors or professionals to assist them, and completing the paperwork and other requirements for obtaining relief. Considering these various factors, it is possible that only a relatively small subset of eligible debtors will actually obtain any meaningful benefit from employing the fresh start process, at least until unsecured debt becomes more common in that demographic, information about the process and assistance with it becomes widely available, and the stigma associated with debt relief lessens.

Similarly, there are reasons to believe that many, perhaps most, debtors who are in financial distress would avoiding voluntarily filing for insolvency under Code. Debtors will face similar direct and indirect costs as those discussed above. They will also experience the disabilities imposed on them under the insolvency provisions of the Code. To obtain relief under the insolvency provisions, they will be need to solicit the consent of three-fourths of their creditors and then perform successfully under a repayment plan that affords them a potentially strict minimum budget. Some debtors may be motivated to file to benefit temporarily from the moratorium on creditors' debt collection activities, but it is not clear how easy it would be for them to subsequently exit the system before the rest of its machinery applies. The bankruptcy process may hold out more predictability and relief for some debtors, and filing an insolvency case is a precondition for bankruptcy. But, again, the pathway from insolvency to bankruptcy is rather narrow and it is easy to imagine that many debtors would balk at filing for insolvency simply as an initial step toward relief under the bankruptcy provisions.

C. Broader Impact

India's the new personal insolvency and bankruptcy regime represents a rare opportunity to include a functional insolvency and bankruptcy regime as part of the architecture of an emerging consumer financial market rather than prompted by a crisis. Although levels of consumer debt in India have been increasing steadily over recent decades, and are relatively high in certain regions, the Indian market for consumer finance – especially unsecured consumer credit – is still relatively modest compared to the size of its population. As noted above, the new system was not designed to fix an acute existing problem in consumer financial markets. Despite widespread concern about aggressive debt collection activities, and although individual and household financial distress is not uncommon in India, there does not currently appear to be a systemic problem of consumer over-indebtedness in the country.

A well-functioning personal insolvency or bankruptcy regime is increasingly understood to be part of the necessary infrastructure for the development and maintenance a robust and stable consumer financial market.[231] Ideally, as discussed above, it can facilitate creditors' recoveries from debtors, promoting the availability of consumer credit, and can insure debtors against the risk of financial distress, dampening the personal and social costs of their failure and perhaps making them more willing to borrow. The *ex ante* allocation of risk through pricing can also, in theory, help discipline both creditors and debtors and reduce the likelihood or extent of over-borrowing in an economy to begin with. The *ex post* allocation of losses and protections for debtors from financial distress can help keep widespread problems with household debt from creating or exacerbating a systemic financial crisis or can help resolve one if it occurs.

Yet the impact of India's new personal insolvency and bankruptcy system on developing markets for consumer finance in India and on the stability of financial system more generally depends on how the system actually functions. Given the design of India's regime and the broader context of consumer financial markets in the country, there are reasons to believe that the regime's effect on the cost and availability of credit may be modest, at least in the near-term, but that its impact on the development of the consumer financial system and the broader economy may be significant, if difficult to observe.

The broader impact of the regime on the vulnerability and stability of the country's financial system will depend in part on how it functions routinely in the coming months and years, but it will also depend on how it *might* function in the event of a financial crisis

[231] *See generally*, Adam Feibelman, *Consumer Bankruptcy as Development Policy*, 39 SETON HALL L. REV. 63 (2009).

affecting the household sector. Research on the topic has shown that the availability of consumer credit can have meaningful effects on the broader economy, although the precise nature of these effects is difficult to discern and predict. In some cases, expansion of the supply of consumer credit can have short-term positive effects on economic growth, while the longer-term effects of increasing household borrowing is more ambiguous, often negative. Thus, to the extent that a personal insolvency or bankruptcy regime affects the supply of consumer credit, it will likely have an impact on the broader economy, but one that is difficult to assess.

The effect of India's personal insolvency and bankruptcy regime on household credit markets, if any, will be a function of the pattern of creditors' and debtors' use of the system, the amount of debt discharged, and the predictability of outcomes in the system. If the regime is widely used by debtors, for example, and they are able to discharge significant amounts of debt, it is possible that this will have negative effects on the supply of credit in the economy. If, as seems likely at least in the medium term, the regime primarily functions as a creditor's remedy or a meaningful threat that creditors can use to gain leverage over debtors, this may promote the supply of consumer credit. In that case, however, it is possible that this may deter some productive borrowing or may make some individuals less likely to borrow in arms-length transactions than from familiar and familial lenders.

Related to but distinct from its impact on the supply of credit in the economy, the regime could also help determine the overall extent of household over-indebtedness in the economy. If the system effectively disciplines both creditors and debtors *ex ante*, then it could help reduce or slow the rate of household over-indebtedness. If the regime fails to improve discipline for either creditors or debtors for whatever reason – perhaps because it is under-utilized by debtors or does not provide significant debt relief or if it creates moral hazard among debtors – it might actually accelerate rates of household indebtedness, potentially increasing the vulnerability of the consumer financial system and of the broader economy.

If, in the future, household indebtedness becomes a crisis or near-crisis for whatever reason or sets of reasons, the operation of the personal insolvency and bankruptcy regime could become more acutely systemically significant. It could serve as a safety valve to expediently allocate losses, unclog the financial system, and lessen the negative effects of the crisis, such as reduced consumption in the real economy. But, again, this function will likely depend in large part on debtors actually using the system under such circumstances. If at such a moment debtors are widely reluctant or unable to utilize the regime, this would undermine the safety valve function of the regime, causing it to fail to perform its unique role in promoting the longer-term stability of the financial system. Thus, in assessing the future vulnerability and stability of the financial system and its exposure to the household finance sector, it is necessary to consider whether enough individual debtors might utilize the insolvency and bankruptcy regime when it is systemically important that they do so. Given the design of the regime and the foreseeable practical barriers for many individuals who might benefit from the regime, there are reasons to be concerned that many debtors may not do so. Creditors would presumably force some debtors into insolvency in a systemic financial crisis, but in a financial or economic downturn creditors may themselves be hesitant to trigger a wave of insolvencies.

Conclusion

[To come]