

# Processes under India's new bankruptcy law

Renuka Sane

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# Problems with the current processes

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

# Dealing with failure

- ▶ Failure of business is a normal thing.
- ▶ In failure
  - ▶ Limited liability should be respected.
  - ▶ Individuals must be given a “second chance”.
- ▶ Speed of resolution
  - ▶ Capital and labour can be put back to work quickly.
  - ▶ Individuals can move on and resurrect their ventures.

# How do we deal with failure?

Four principal goals (Warren 1993):

- ▶ To enhance the value of the failing debtor
  - ▶ Preserve the going concern value of the business
  - ▶ Design and implement collective creditor action
  - ▶ Provide effective relief or release from the financial liabilities and obligations of the insolvent
- ▶ To distribute value according to multiple normative principles
  - ▶ Determine priority
  - ▶ Treat those with no legal rights to assets - employees, suppliers, tax authorities

# How do we deal with failure?

- ▶ To internalise the costs of the business failure to the parties dealing with the debtor
  - ▶ Constrain externalisation of business / personal losses
  - ▶ Provide public goods: courts, information etc
  - ▶ Do we give precedence to the state over creditors?
- ▶ To create reliance on private monitoring
  - ▶ How do we give managers the right ex-ante incentives to avoid bankruptcy?
  - ▶ Should we put ultimate decision making power in the hands of the claimants rather than in the hands of the judiciary or experts?

# Design

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

# Insolvency and Bankruptcy Code, 2016

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- ▶ What is new: When an entity is in distress, IBC has the process to:
  - ▶ resolve insolvency as Step 1, and
  - ▶ resolve bankruptcy as Step 2
- ▶ The Step 1 process to resolve insolvency is called the *Insolvency Resolution Process (IRP)*.
- ▶ The IRP is a combination of Trigger, Process, Limits
- ▶ For individuals below a certain threshold, debt waiver in the form of a *Fresh Start*.



# The IRP – trigger

- ▶ Anyone with an *undisputed credit claim* can trigger.
- ▶ Benefits?
  - ▶ Difficult to create a carefully coordinated effort to hide distress.
  - ▶ Comforts creditors about future performance on their credit contracts.
  - ▶ Makes for an easier environment for creditors to then lend more readily.
- ▶ Frictions?
  - ▶ Need capacity to deal with frivolous claims?

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2. Debtor loses control. A regulated insolvency professional – called the Resolution Professional is in charge. May displace management, if necessary.
3. The Creditor's Committee has responsibility of all decisions that have a material effect on the enterprise.
4. Litigation against the outcome (of resolution or liquidation) has to be on failure of procedure, and not the business decision.

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## Liquidation – trigger

- ▶ Failure of the creditors' committee to reach an agreement during the IRP
- ▶ Liquidation decision by the creditors' committee to proceed with liquidation during the IRP
- ▶ Failure of the debtor to adhere to terms of the resolution plan approved by the NCLT
- ▶ In the case of individuals, have to file separately

## Liquidation – waterfall

1. Costs of IRP (including any interim finance raised) and liquidation
2. Secured creditors AND workmen dues (capped up to 24 months from the start of liquidation), pari passu
3. Employees' salaries (capped up to 12 months from the start of liquidation)
4. Financial debts of unsecured creditors
5. Central or State Government dues pertaining to 2 year period prior to start of liquidation AND unpaid dues of secured creditors after enforcement of security, pari passu
6. Any remaining debt
7. Preference shareholders
8. Equity shareholders

All distributions as per the above waterfall will be net of the liquidator's fees, which will be deducted proportionately from each stage of the waterfall.

# Fast track IRP

- ▶ A simpler form of IRP.
- ▶ Time – 90 days.
- ▶ Starts as a regular IRP. Creditors' committee can vote to make it fast track.

# Fresh Start Process

- ▶ Fresh Start
  - ▶ Complete debt forgiveness.
  - ▶ Thresholds coded in the law.
  - ▶ Recorded for a short period of time.
- ▶ Discharge
  - ▶ Quick discharge in IRP: negotiable between creditors and debtors.
  - ▶ Twelve months to discharge in bankruptcy
  - ▶ Recorded for a short period of time.

# Penalties

- ▶ Frivolous triggers
- ▶ Concealment of property
- ▶ Defrauding creditors, fraudulent trading
- ▶ Falsification of books, material omissions, false representation
- ▶ Preferential transactions, voidable transactions, extortionate transactions
- ▶ Contravention of moratorium
- ▶ Contravention of resolution plan.

# Appeals

- ▶ To NCLAT, within 30 days (+15 if permitted).
- ▶ Only on procedural grounds.
- ▶ To the SC, on questions of law, within 45 days (+15 if permitted).
- ▶ Writ jurisdiction.

## How is the IBC different?

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

# How to make this work

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## New institutions in the IBC:

1. Regulated *information utilities* to record indisputable evidence.
2. Regulated professionals to mediate a rational and honest negotiation between creditors and debtors in distress, with as little conflict of interest as possible.
3. A strong regulator who has a legislative, executive and judicial role over these two new industries (IUs and IPs) AND monitors three outcomes expected from better bankruptcy laws:
  - ▶ Shorter time to resolve insolvency and bankruptcy
  - ▶ Higher recovery rates
  - ▶ Deeper and liquid credit markets, both secured and unsecured, from private and public markets.
4. Courts which are involved only in ensuring procedural correctness.

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# What's the status of IBC now

- ▶ MCA has notified the IBBI, IPA and IP related provisions.
- ▶ The IBBI has notified regulations on: IPA, IPs, IRP and liquidation regulations.
- ▶ 4 IPAs (?)
- ▶ Limited Insolvency Exam in place. National Exam soon. Around 1000 IP licenses given (970 grandfathered 30 through the exam).
- ▶ 11 cases filed: 1 by creditor, 1 by operational creditor, 9 by debtors
- ▶ Personal insolvency sections yet to be notified