CHAPTER 19 · COMPLIANCE MANUAL · 2024 EDITION

INSOLVENCY AND BANKRUPTCY CODE, 2016

*This chapter is an extract from **The RST Compliance Manual**, a regulator-mapped reference for Indian business entities curated by the partners of R S T & Co.*

Insolvency and Bankruptcy Code (IBC) was enacted by the Parliament with the intention of bringing uniformity to bankruptcy laws in 2016.

IBC is an all encompassing law that deals with the bankruptcy of corporations, partnerships and individuals. IBC has established the Insolvency and Bankruptcy Board of India as the nodal agency to regulate all matters relating to insolvency and bankruptcy with an intent to complete insolvency resolution process in a fast and transparent manner.

19.1 Objectives of the Code

The primary objective of IBC is to provide a balance between an interest of all the stakeholders of the company to enjoy the availability of credit and the loss that a creditor might have to bear on account of default. Other key objectives are:

Consolidate and amend the laws relating to re-organization and insolvency resolution of corporate persons, partnership firms and individuals.

Fix time periods for execution of the law for time-bound settlement of insolvency (180 days).

Maximize the value of assets of interested persons.

Promote entrepreneurship and increase the availability of credit.

Balance all stakeholder’s interest, including alteration, in the order of priority of payment of Government dues.

Establish an Insolvency and Bankruptcy Board of India as a regulatory body for insolvency and bankruptcy law.

Establish higher levels of debt financing across a wide variety of debt instruments.

Provide painless revival mechanism for entities.

Deal with cross-border insolvency.

Resolve India’s bad debt problem by creating a database of defaulters.

19.2 WHO DOES IT APPLY TO?

Any Company incorporated under the Companies Act, 2013

Any other company incorporated by any special statute

Any Limited Liability Partnership firm registered under Limited Liabilities Partnership Act, 2008

Any Partnership registered under the Partnership Act, 1932

Any Individual person

Exception: IBC shall not apply to corporate persons who are regulated financial service providers like banks, financial institutions and insurance companies.

19.3 WHEN WILL AN INSOLVENCY RESOLUTION PROCESS TRIGGER?

An insolvency resolution process under the IBC can be initiated by a creditor when there is a minimum default of Rs. 1,00,000 of debt by the corporate debtor and Rs. 1,000 in case of individuals and unlimited partnerships. Central Government by placing a notification may specify the minimum amount of default of higher value which shall not be more than Rs. 1 crore.

Application can be filed by a creditor before the National Company Law Tribunal (NCLT) or Debt Recovery Tribunal (DRT). The NCLT will consider the following elements before admitting the application:

Existence of a debt

Existence of default, and

Notice of default (if the application is filed by an operational creditor).

A **creditor** can be an operational creditor or a financial creditor. A **debtor** is any entity or an individual who owes any liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt.

Default is defined as non-payment of debt when whole or any part or installment of the amount of debt has become due and payable but has not been repaid by the debtor.

19.4 CATEGORIES OF CREDITORS UNDER THE IBC

19.4.1 Financial Creditor

Financial creditor is any person to whom a financial debt is owed. The relationship between the financial creditor and the debtor is a pure financial contract, such as a loan. A financial debt is a debt along with interest which is disbursed against the consideration for the time value of money.

Examples of **financial debt:**

Money borrowed against repayment of interest.

Money raised against any accepted credit facility.

Money raised through instruments like bonds, notes, debentures or similar instruments.

Any amount raised through transactions like forward sale or purchase agreements.

Financial creditors may either be **secured creditors or unsecured creditors**. In the event of liquidation and asset distribution proceedings, secured creditors are given a higher priority than unsecured creditors. Secured financial creditors are given the same priority of repayment as workmen and employee dues and are given a higher priority than other operational creditors, who are treated as unsecured creditors for the purposes of liquidation.

Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 has **included home buyers** within the definition of financial creditor.

19.4.2 Operational Creditors

Operational creditor is a person to whom operational debt is owed or to whom such debt has been assigned. Operational debt is a claim in respect of the provision of goods or services, including employment or dues payable to any governmental authority.

19.5 HOW DOES THE CORPORATE INSOLVENCY RESOLUTION PROCESS WORK?

(For Companies and Limited Liability Partnerships)

Step 1: Corporate Insolvency Resolution Process (CIRP)

During this process, the financial creditors investigate the corporate debtor to determine whether it is viable to continue its business. The creditors also come up with a plan to restructure the corporate debtor.

Application to the NCLT: The creditor has to file an application with the NCLT for initiating insolvency resolution proceedings. The NCLT will be required to either accept or reject the application within 14 days of filing the application.

Initiation of the insolvency process and suspension of management: Once the application has been accepted by the NCLT, the management of the debtor is suspended and the intermediate authority, appointed by the NCLT referred to as Interim Insolvency Resolution Professional takes over the management of the corporate debtor. A moratorium takes effect on the corporate debtor, which prohibits the continuation or initiation of any legal proceedings against the debtor, the transfer of its assets, or the enforcement of any security interest.

Appointment of the committee of creditors: The interim resolution professional investigates the claims made by the creditors and constitutes the committee of creditors within 30 days of the NCLT admitting the application.

Appointment of the resolution process: The committee of creditors appoints an independent person as the resolution professional, referred to as Insolvency Resolution Professional (IRP) to take over the management of the corporate debtor.

Approval of the resolution plan: Within 180 days of the initiation, the IRP is required to draw up a resolution plan for the revival of the corporate debtor. The plan needs to be approved by creditors holding at least 75% of the debt of the corporate debtor.

Step 2: Liquidation Process

If the CIRP fails, the financial creditors have the option to wind up the corporate debtor, liquidate and distribute its assets in the order of liquidation preference prescribed under IBC.

Priority of Claims

After the costs of insolvency resolution including any interim finance, secured debt together with workmen dues for the preceding 24 months rank highest in priority.

Central and state Government dues stand below the claims of secured creditors, workmen dues, employee dues and other unsecured financial creditors.

Upon liquidation, a secured creditor may choose to realise his security and receive proceeds from the sale of the secured assets in first priority.

If the secured creditor enforces his claims outside the liquidation, he must contribute any excess proceeds to the liquidation trust.

In case of any shortfall in recovery, the secured creditors will be junior to the unsecured creditors to the extent of the shortfall.

19.6 Insolvency Resolution Process for Individuals/Unlimited Partnerships

Step 1: Automatic Fresh Start

Eligible debtors on the basis of gross income can apply to the Debt Recovery Tribunal (DRT) for discharge from certain debts which do not exceed the specified threshold, allowing them to start afresh.

Step 2: Insolvency Resolution

This process consists of preparation of a repayment plan by the debtor, for approval of creditors. If the plan is approved, the DRT passes an order binding the debtor and creditors to the repayment plan. If the plan is rejected or fails, the debtor or creditors may apply for a bankruptcy order.

19.7 Institutional Infrastructure

19.7.1 The Insolvency Regulator

IBC provides for the constitution of insolvency regulator, the Insolvency and Bankruptcy Board of India. Its role includes -

overseeing the functioning of insolvency intermediaries (insolvency professionals, insolvency professional agencies and information utilities), and

regulating the insolvency process.

19.7.2 Insolvency Resolution Professionals

IBC provides for insolvency professionals as intermediaries who play a key role in the efficient working of the bankruptcy process. IBC contemplates insolvency professionals as a class of regulated but private professionals having minimum standards of professional and ethical conduct.

In the resolution process, the insolvency professional verifies the claims of the creditors, constitutes a creditors committee, runs the debtor's business during the moratorium period and helps the creditors in reaching a consensus for a revival plan.

In liquidation, the insolvency professional acts as a liquidator and bankruptcy trustee.

19.7.3 Information Utilities

IBC has created information utilities to collect, collate, authenticate and disseminate financial information of debtors in centralised electronic databases.

IBC requires creditors to provide financial information of debtors to multiple utilities on an ongoing basis. This information would be available to creditors, resolution professionals, liquidators and other stakeholders in insolvency and bankruptcy proceedings.

19.7.4 Adjudicatory authorities

The adjudicating authority for corporate insolvency and liquidation is NCLT. Appeals from NCLT orders lie to the National Company Law Appellate Tribunal and thereafter to the Supreme Court.

For individuals and other persons, the adjudicating authority is the DRT, appeals lie to the Debt Recovery Appellate Tribunal and thereafter to the Supreme Court.

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End of Chapter. *For the complete Compliance Manual, additional chapters, or a tailored briefing for your finance and compliance teams, contact **info@rstandco.co.in**.*