

# CORPORATE RESTRUCTURING, INSOLVENCY, LIQUIDATION & WINDING-UP

CS Vaibhav Chitlangia





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## SANDESH



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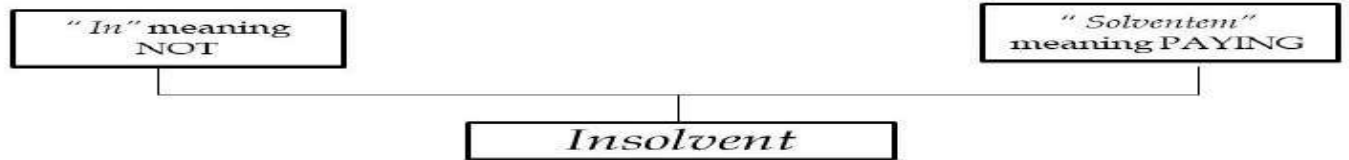
On behalf of **TEAM YES**

**CS Vikas Vohra    CA CS Harish A. Mathariya**  
**Founders**



## CH 14 - INSOLVENCY

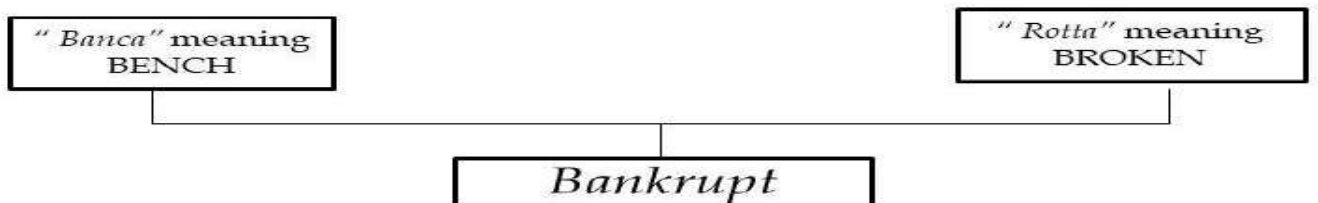
### WHAT IS INSOLVENCY? HOW IS IT DIFFERENT FROM BANKRUPTCY



Insolvent means a person who is unable to pay his/her/its debts as they become due in the ordinary course of business. Insolvency is "the state of one whose assets are insufficient to pay his debts."

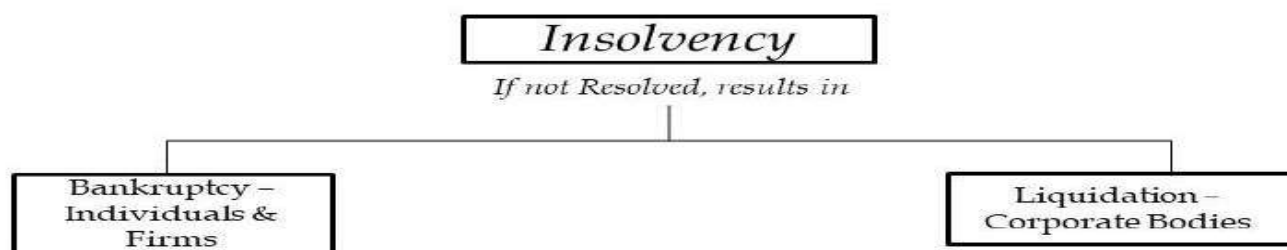
Other than cases of outright fraud, the debtor may be insolvent because of the following cases-

- **Financial failure** - a persistent mismatch between payments by the enterprise and receivables into the enterprise, even though the business model is generating revenues, or
- **Business failure** - which is a breakdown in the business model of the enterprise, and it is unable to generate sufficient revenues to meet payments. Often, an enterprise may be a successful business model while still failing to repay its creditors.



The word *Bankruptcy* has its roots in the trade that was carried out on **Ponte Vecchio**, a medieval segmental arch bridge, in Florence, Italy. In medieval Italy, if a banker, who conducted his marketplace transactions on a bench, was unable to meet business obligations and was in debt, his bench was broken in a symbolic show of failure and his inability to continue.

<b>Insolvency</b>	<b>Bankruptcy</b>
<p>Insolvency is the State of not being able to repay one's debts</p> <p>It is merely a situation and can be used in respect of individuals as well as corporates.</p>	<p>Bankruptcy is the legal status accorded to such people</p> <p>It is a formal declaration of insolvency in accordance with the law of the land</p>



<b>Bankruptcy</b>	<b>Liquidation</b>
<ul style="list-style-type: none"> <li>• Section 79(4) of the Insolvency and Bankruptcy Code, 2016 defines the term "bankruptcy" as the state of being bankrupt.</li> <li>• Under the IB Code, 2016, "bankrupt" means               <ul style="list-style-type: none"> <li>✓ a debtor who has been adjudged as bankrupt under section 126</li> <li>✓ each of the partners of a firm, where a bankruptcy order under section 126 has been made against a firm</li> <li>✓ any person adjudged as an undischarged insolvent.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Liquidation means closure or winding up of a corporation or an incorporated entity through legal process.</li> <li>• In liquidation process, the assets of the corporate body are sold and its liabilities are discharged</li> <li>• Liquidation results in the dissolution of the company by virtue of which, the company ceases to exist.</li> </ul>

The bankruptcy process begins with filing of a petition in a court or before an appropriate authority designated for this purpose. The debtor's assets are then evaluated and used to pay the creditors in accordance with law.

## INSOLVENCY FRAMEWORK IN UK, USA AND INDIA

### United Kingdom - Historical Development

In England, the Act of Parliament of 34 & 35 Henry VIII, c4 is regarded as the first legislation on the subject. Promulgated in 1542 under the reign of Henry VIII, it was a strict and creditor supportive legislation enacted mainly for the benefit of creditors. This Act of 1542, was in fact akin to a criminal statute directed against men who indulged in wasteful expenditures and then refused to pay off debts incurred during the course of extravagance. The 1542 Act looked upon the debtors as offenders. There was no provision for the discharge of debtors and even future earnings of the debtors were not exempt from execution for the debt.

In the beginning of the eighteenth century, these strict and creditor supportive medieval laws began to lose its punitive nature. That is why a few authors maintain that the first real bankruptcy laws in England were 4 Anne, c. 17(1705), and 10 Anne, c.15(1711) as unlike earlier statutes which looked upon debtors as offenders. The highlighting feature of the Statutes of Anne was the discharge of the bankrupt who conformed to the provisions of the law. While the additional rights given to the bankrupt under the 1705 Act were significant yet the Act was passed for the sole benefit of the creditors.

### Current Scenario

In contrast to the above, the primary focus of modern insolvency laws is not elimination of insolvent entities but on their rehabilitation and continuation of their business. The Current Regulatory Framework in UK The Insolvency Act, 1986 and the Insolvency Rules, 1986 regulate the insolvency framework in the United Kingdom. The Insolvency Act, 1986 was



enacted on the recommendation of the Cork Review Committee Report on Insolvency Law and Practice (1982). Prior to the enactment of the Insolvency Act, 1986, the law relating to insolvency in the UK was fragmented and was contained in the Bankruptcy Act, 1914, the Deeds of Arrangement Act, 1914, the Companies Act, 1948 and parts of the County Courts Act, 1959. These Acts were supplemented by the principles of common law and equity.

### **Features of the Act of 1986**

The Act of 1986 consolidated the following -

- enactments relating to company insolvency and winding up,
- enactments relating to the insolvency and bankruptcy of individuals, and
- all other enactments bearing on these two subject matters, including the functions and qualification of insolvency practitioners, the public administration of insolvency, the penalisation and redress of malpractice and wrong doing, and the avoidance of certain transactions at an under value.

The Insolvency Act, 1986 deals with the insolvency of individuals and companies and is divided into the following three groups.

- Group 1 deals with Company Insolvency;
- Group 2 deals with Insolvency of Individuals; and
- Group 3 deals with Miscellaneous Matters Bearing on both Company & Individual Insolvency.

Further, the Insolvency Act, 1986 introduced the following three new procedures in order to explore the possibility of bringing a burdened company back to life as a viable entity -

1. **Company Voluntary Arrangements' (CVAs)**- It provides a way where a company in financial difficulty can come to a binding agreement with its creditors. It is a negotiation by a company of the payments due to all of its creditors, or other form of financial restructuring, and is subject to creditors meeting and approval of 75% of the creditors present and voting.



2. **'Administration'** - In this second option, an administrator is appointed by a court to suggest proposals to deal with the company's financial difficulties. This option offers companies a breathing space as the creditors are restrained from taking any action during this period. It is designed to hold a business together while plans are formed, either to put in place a financial restructuring plan to rescue the company, or to sell the business and assets, to produce better results for the creditors, than a liquidation.
3. **'Administrative Receivership'** - This third option permits the appointment of a receiver by certain creditors (normally the holders of a floating charge).

### United States of America - Historical Development

America followed the English bankruptcy system and like the UK system, American bankruptcy laws involved imprisonment until debts were paid or creditors agreed for the release of the debtor. There was no uniform law in America as bankruptcy laws differed from State to State. Some of these American states became famous as debtor's havens because of their unwillingness to enforce commercial obligations.

Article 1, Section 8, Clause 4 of the United States Constitution as adopted in the year 1789, made provision for the grant to Congress the power to establish uniform bankruptcy law through out the United States. The Congress enacted temporary bankruptcy statutes in 1800, 1841 and 1867 to deal with economic recessions. The Acts of 1800 and 1841 vested jurisdiction in the federal district courts. The district court judges were given the power to appoint commissioners or assignees to take charge of and liquidate a debtor's property. However, these laws were temporary measures and were repealed as soon as economic conditions stabilized.

There was not a permanent bankruptcy law in the United States of America until 1898, when the National Bankruptcy Act was enacted. This Act of 1898 was later amended in 1938 to provide for the rehabilitation of a debtor as an alternative to liquidation of assets. The National Bankruptcy Act, 1898 governed bankruptcy in the United States for 80 years

until 1978, when after a thorough review of the then existing law and practice, the Bankruptcy Reform Act, 1978 was enacted. The Bankruptcy Reform Act, 1978 superseded the National Bankruptcy Act, 1898 and established bankruptcy courts in each district and made provisions for the appointment of separate bankruptcy judges.

### ***Current Scenario***

"Bankruptcy Code", a federal law, governs bankruptcy in the United States of America. It is a uniform federal law that governs all bankruptcy cases in America. The Bankruptcy Code was enacted in 1978.

The procedural aspects of the bankruptcy process are governed by the Federal Rules of Bankruptcy Procedure (Bankruptcy Rules). Six basic types of bankruptcy cases are provided for under the Bankruptcy Code.

1. **Chapter 7 titled "Liquidation"** - In Chapter 7 Bankruptcy, a court-appointed trustee or administrator takes possession of non-exempt assets, liquidates these assets and then uses the proceeds to pay creditors. He shall be accountable for all the property received and has the right to investigate the financial affairs of the debtor. He shall also file accounts of the administration of the estate with the United States Trustee and the Court.
2. **Chapter 9 titled "Adjustment of Debts of a Municipality"** - Chapter 9 Bankruptcy proceedings provides for reorganization which is available to municipalities. In Chapter 9 Bankruptcy proceedings a municipality (which includes cities, towns, villages, counties, taxing districts, municipal utilities, and school districts) get protection from creditors and a municipality can pay back debt through a confirmed payment plan.
3. **Chapter 11 titled "Reorganization"** - Unlike Chapter 7 where the business ceases operations and a trustee sells all of its assets, under Chapter 11 the debtor remains in control of its business operations and repay creditors concurrently through a court-approved reorganization plan. Generally, it is a debtor in possession regime. Section

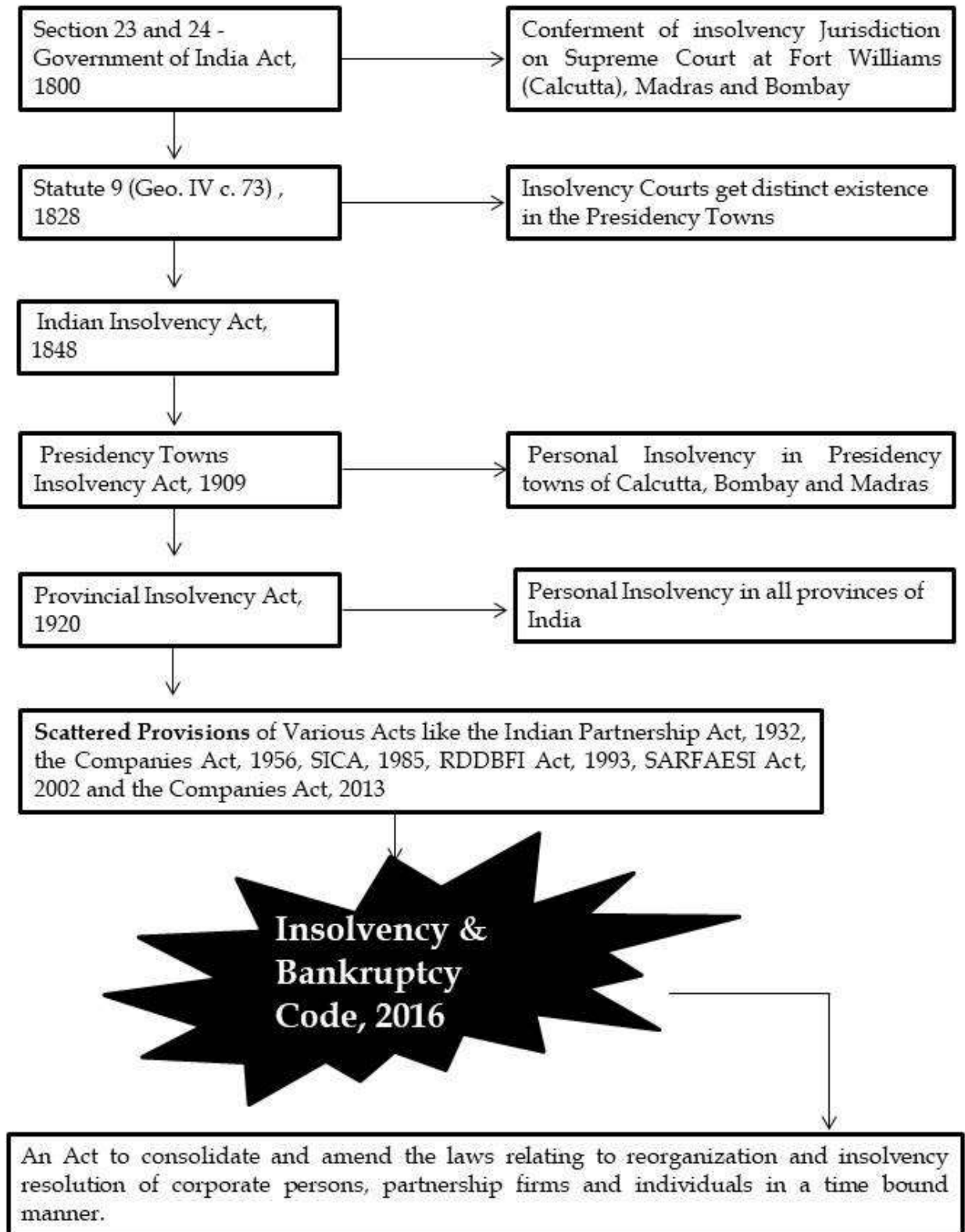
1106 of the Bankruptcy Code requires the trustee, where appointed, to file a plan "as soon as practicable" or, alternatively, to file a report explaining why a plan will not be filed or to recommend that the case be converted to another chapter or dismissed.

4. **Chapter 12** – This chapter added to the Bankruptcy Code in 1986. It allows a family farmer or fisherman to continue to operate the business while the plan is being carried out.
5. **Chapter 13** – This chapter enables individuals with regular income to develop a plan to repay all or part of their debts.
6. **Chapter 15** – This part was added to the Bankruptcy Code in 2005. It provides mechanism for dealing with insolvency cases involving debtors, claimants and other interested parties involving more than one country. Under Chapter 15 a representative of a corporate bankruptcy proceeding outside the country can get access to the United States courts.

### **HISTORICAL DEVELOPMENTS OF INSOLVENCY LAWS IN INDIA**

India, being a common law country and a British Colony in the past, has its law influenced to a great extent by the laws prevailing in the United Kingdom. Accordingly, a lot of influence of the English legal system can be seen in the history of the Insolvency laws in India.

The following chart traces the history of the development of insolvency laws in India –



### GOVERNMENT COMMITTEES ON BANKRUPTCY REFORMS

Over years, various Committees were formed by the Government to look into the laws related to banking and insolvency and suggest measures for the same. These Committees have all contributed in some way or another in the formulation of the Insolvency and Bankruptcy Code, 2016. Some of these important Committees were -

<b>Committee</b>	<b>Year</b>	<b>Recommendation</b>
Tiwari Committee	1981	Enactment of the Sick Industrial Companies (Special Provisions) Act, 1985, (SICA)
Narsimha Committee I	1991	Enactment of the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993
Narsimha Committee II	1998	Enactment of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002
Justice Eradi Committee	1999	Recommended setting up of a National Company Law Tribunal (NCLT)
N L Mitra Committee	2001	Proposed a comprehensive bankruptcy code
J J Irani Committee	2005	Proposed significant changes to make the restructuring and liquidation process speedier, efficient and effective and accordingly amendments were made to (RDDBFI) Act, 1993 and (SARFAESI), 2002
Bankruptcy Law Reform Committee	2014	Reviewed the existing bankruptcy and insolvency framework in the country and proposed the enactment of Insolvency and Bankruptcy Code as a uniform and comprehensive legislation on the subject

## WHY NEW LAW?

*It is not true to say that India did not have any law dealing with Insolvency before the enactment of the Insolvency and Bankruptcy Code, 2016. However, the legal framework in that respect was scattered and extremely inefficient.*

*Following are the reasons that can be attributed to the need of a new law for insolvency in India-*

- ✓ *There were multiple overlapping laws and adjudicating forums dealing with financial failure and insolvency of companies and individuals*
- ✓ *The framework did not provide the lenders an effective and timely way of recovery or restructuring of defaulted assets and caused undue strain on the Indian credit system.*
- ✓ *Individual bankruptcy and insolvency was dealt with under the Presidency Towns Insolvency Act, 1909, and the Provincial Insolvency Act, 1920, which are both about a century old legislations.*
- ✓ *The liquidation of companies was handled under various laws and different authorities.*
- ✓ *None of the laws provided for a strict time frame within which the process to resolve insolvency was to be completed*

*As per World Bank data in 2015, insolvency resolution in India took 4.3 years on an average, which was way higher when compared to other countries such as United Kingdom (1 year) and United States of America (1.5 years). These delays were caused due to time taken to resolve cases in courts, and confusion due to a lack of clarity about the current bankruptcy framework.*

*Keeping in mind these shortcomings of the previous legislation, the Insolvency and Bankruptcy Code, 2016 was enacted with an objective to*

***"consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner."***



Note - Under the Constitution of India 'Bankruptcy & Insolvency' is provided in Entry 9 of List III (Concurrent List) in the Seventh Schedule to the Constitution. Hence both the Centre and State Governments are authorised to make laws on the subject.

### INSOLVENCY AND BANKRUPTCY CODE, 2016 - AN INTRODUCTION

The Ministry of Finance had constituted a Committee called the "Bankruptcy Law Reform Committee" which drafted the Insolvency and Bankruptcy Code, 2016.

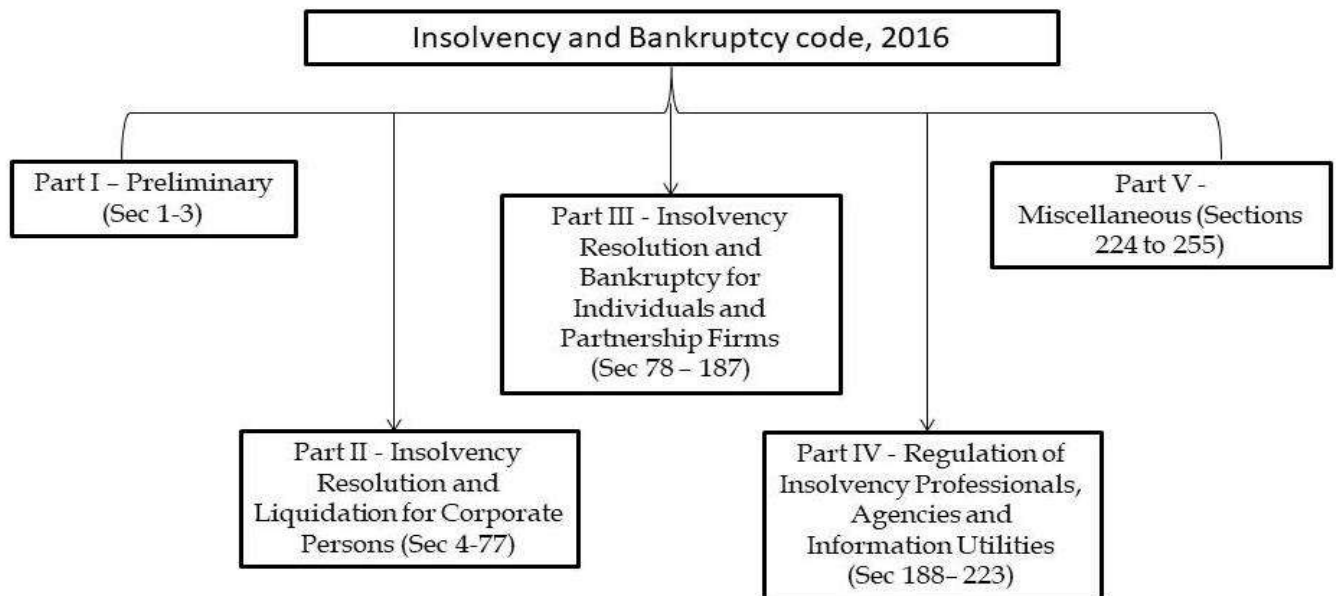
The Code was introduced in the Lok Sabha on 21 December, 2015 and was subsequently referred to a Joint Committee of Parliament. The Committee submitted its recommendations and the modified Code was passed by the Lok Sabha on 5 May, 2016. The Code was passed by Rajya Sabha on 11 May, 2016 and it received the presidential assent on 28 May 2016. The Code was notified in the Official Gazette on 28 May, 2016.

#### Key Objectives of the Insolvency and Bankruptcy Code, 2016

- ✓ To consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals
- ✓ To provide for a time bound insolvency resolution mechanism
- ✓ To ensure maximisation of value of assets
- ✓ To promote entrepreneurship
- ✓ To increase availability of credit
- ✓ To balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues
- ✓ To establish an Insolvency and Bankruptcy Board of India as a regulatory body
- ✓ To provide procedure for connected and incidental matters

## ORGANISATION OF THE CODE

The Insolvency and Bankruptcy Code, 2016 consists of total **255 sections** organised in **5 Parts**.



Section 1 of the Code provides that the Central Government may appoint different dates for different provisions of this Code and any reference in any such provision to the commencement of this Code shall be construed as a reference to the commencement of that provision.

## APPLICABILITY OF THE CODE

Section 2 of the Code provides that the provisions of the Code shall apply to :

- ✓ Any company incorporated under the Companies Act, 2013;
- ✓ Any other company governed by any special Act;
- ✓ Any Limited Liability Partnership;
- ✓ Such other body incorporated under any law, as the Central Government may by notification specify;
- ✓ Personal guarantors to corporate debtors;

- ✓ Partnership firms,
- ✓ Individuals.

*It may be noted that as per Section 238, Insolvency and Bankruptcy Code, 2016 has overriding effect over other laws.*

*"It always seems impossible unless it is DONE!"*

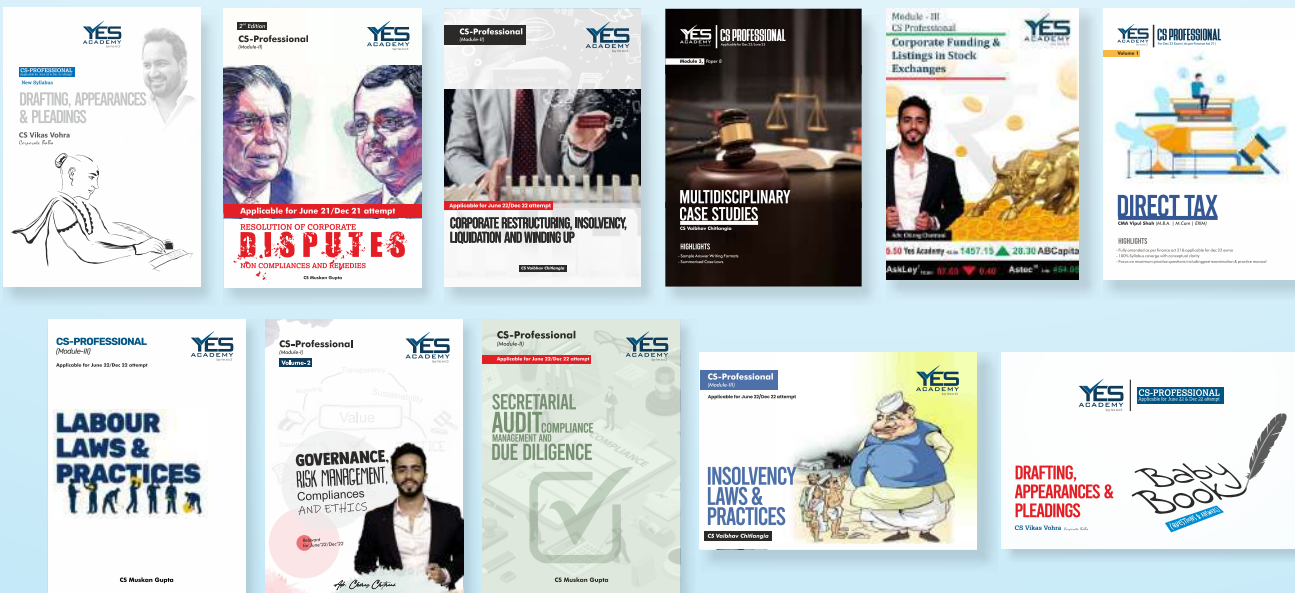


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**CS Vaibhav Chitlangia**

**CS Vaibhav Chitlangia** is a law graduate from ILS Law College, Pune and a Company Secretary with All India Ranks at all the three levels. He got All India Rank 15 in Foundation Programme (June 2016), All India Rank 22 in Executive Programme (June 2017) and All India Rank 04 in the Professional Programme (June 2018).

Vaibhav has an experience of working with one of India's best law firms for over 1.5 years where he dealt with the practical implications of corporate laws. He has also been guiding company secretary students since 2018 and has had an opportunity of teaching a number of students from across the country. His interests include Mergers and Amalgamations, Competition Laws and Insolvency and Bankruptcy Code, amongst others. He also has prior experience in teaching subjects like Corporate Restructuring and Resolution of Corporate Disputes to the students of CS Professional Programme. He believes that

"the only impediment in the path of success is a person's own mindset; if that is controlled, every feat is achievable"