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CS PROFESSIONAL
For June 23/Dec 23 Attempt

(Module-III)

INSOLVENCY LAWS & PRACTICES

CS Vaibhav Chitlangia

HIGHLIGHTS

- Sample Answer Writing Formats
- Summarised Case Laws

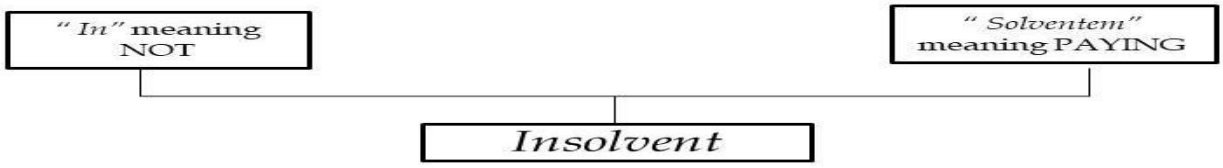
INDEX

CH-1 Insolvency – Concepts and Evolution

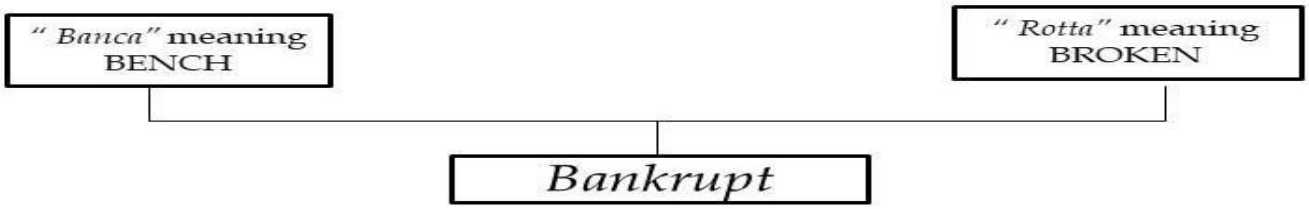
INSOLVENCY AND BANKRUPTCY – CONCEPTS

Insolvency is a state when an individual, corporation, or other organization cannot meet its financial obligations for paying debts as they become due. Bankruptcy is not exactly the same as insolvency. Technically, bankruptcy occurs when a court has determined insolvency, and given legal orders for it to be resolved. Bankruptcy is a determination of insolvency made by a court of law with resulting legal orders intended to resolve the insolvency. Insolvency describes a situation where the debtor is unable to meet his/her obligations. Bankruptcy is a legal scheme in which an insolvent debtor seeks relief. In case of insolvency, one cannot pay off the debts, whereas in the case of bankruptcy, a court order states as how an insolvent person or business has to pay off their debts – by way of selling their assets or erasing the debt that cannot be paid.

WHAT IS INSOLVENCY? HOW IS IT DIFFERENT FROM BANKRUPTCY

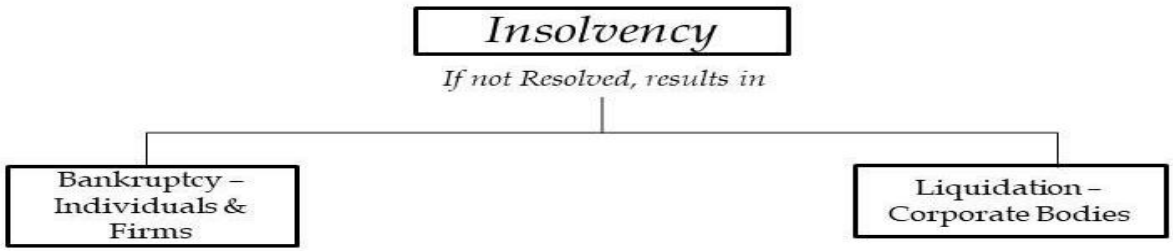


Insolvent means a person who is unable to pay his/her/its debts as they become due in the ordinary course of business. Insolvency is "the state of one whose assets are insufficient to pay his debts."



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.

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



Bankruptcy	Liquidation
Section 79(4) of the Insolvency and Bankruptcy Code, 2016 defines the term "bankruptcy" as the state of being bankrupt. Under the IB Code, 2016, "bankrupt" means a debtor who has been adjudged as bankrupt under section 126 each of the partners of a firm, where a bankruptcy order under section 126 has been made against a firm any person adjudged as an undischarged insolvent.	Liquidation means closure or winding up of a corporation or an incorporated entity through legal process. In liquidation process, the assets of the corporate body are sold and its liabilities are discharged Liquidation results in the dissolution of the company by virtue of which, the company ceases to exist.

HISTORICAL DEVELOPMENTS OF INSOLVENCY LAWS IN INDIA

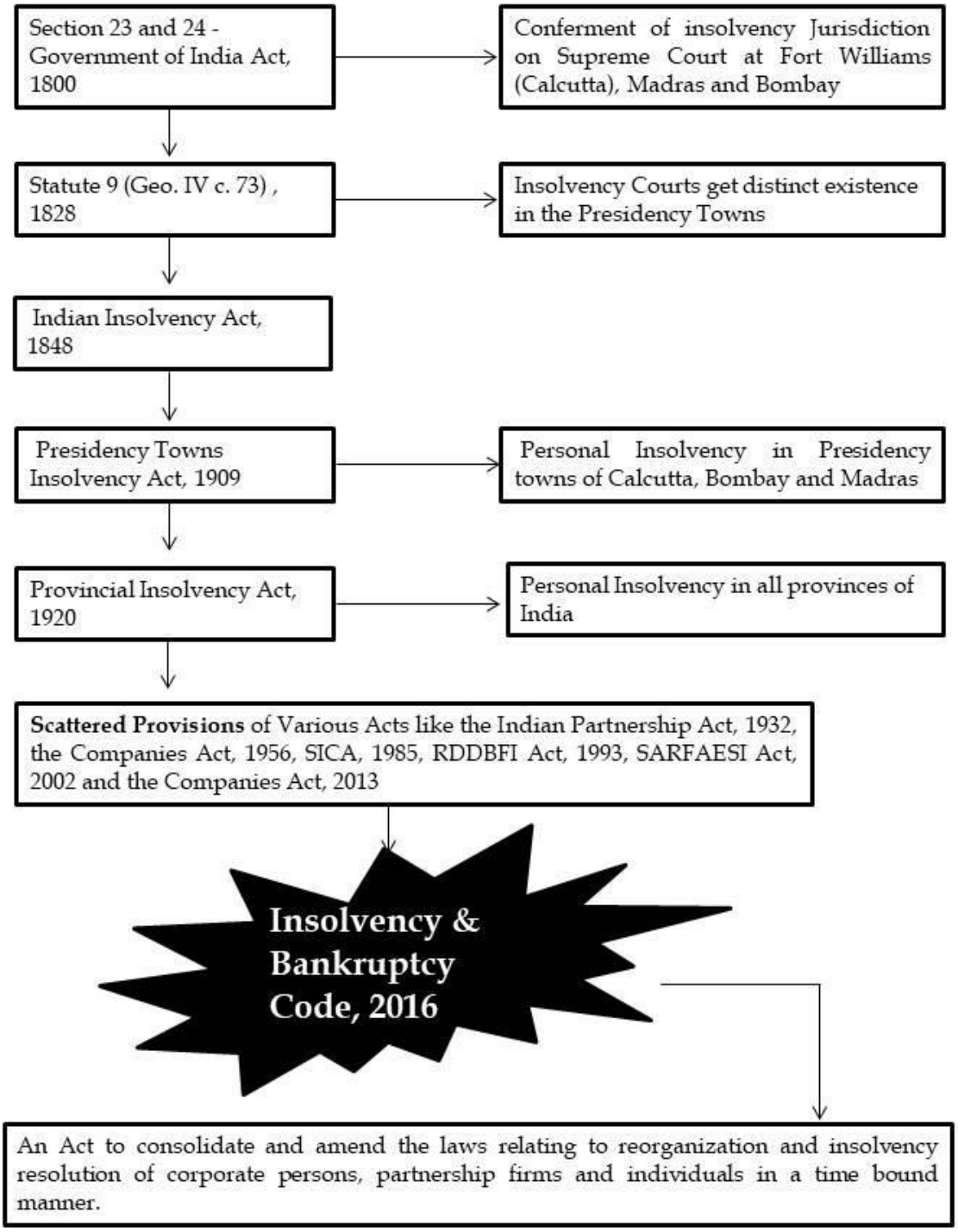
India, being a common law country and a British Colony in the past, has its law influenced to a great extent by the laws prevailing in the United Kingdom. Accordingly, a lot of influence of the English legal system can be seen in the history of the Insolvency laws in India.

The law of insolvency in India owes its origin to the English law. Before the British came to India there was no law of insolvency in the country. The earliest insolvency legislation can be traced to sections 23 and 24 of the Government of India Act, 1800 (39 and 40 Geo III c 79), which conferred insolvency jurisdiction on the Supreme Court. The passing of Statute 9 in 1828 (Geo- IV c 73) can be said to be the beginning of the special insolvency legislation in India. Under this Act, the first insolvency courts for relief for insolvent debtors were provided in the Presidency-towns. A step further in the development of insolvency law was taken when the Indian Insolvency Act, 1848 was passed. The provisions of the Indian Insolvency Act, 1848,

were, however, found to be inadequate to meet the changing conditions. However, the Act of 1848 was in force in the Presidency-towns until the enactment in 1909 of the Presidency-Towns Insolvency Act, 1909. The Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920 are two major enactments that deal with personal insolvency and have parallel provisions and their substantial content is also similar but the two differ in respect of their territorial jurisdiction. While Presidency Towns Insolvency Act, 1909 applied in Presidency towns namely, Kolkata, Mumbai and Chennai, Provincial Insolvency Act, 1920 applied to all provinces of India. These two Acts are applicable to individuals as well as to sole proprietorships and partnership firms.

Insolvency law usually has a two-fold purpose—
(i) to give relief to the debtor from the harassment of creditors whose claims he is unable to meet, and
(ii) to provide a machinery by which creditors who are not secured in the payment of their debts are to be satisfied. Under the Constitution of India 'Bankruptcy and Insolvency' is provided in Entry 9 list Concurrent list, (Article 246 – Seventh Schedule to the Constitution) i.e. both Center and State Governments can make laws relating to this subject. The major legislations governing Corporate insolvency were:
- Companies Act, 1956, relating to winding up of companies.
- The Sick Industrial Companies (Special Provisions) Act, 1985.

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

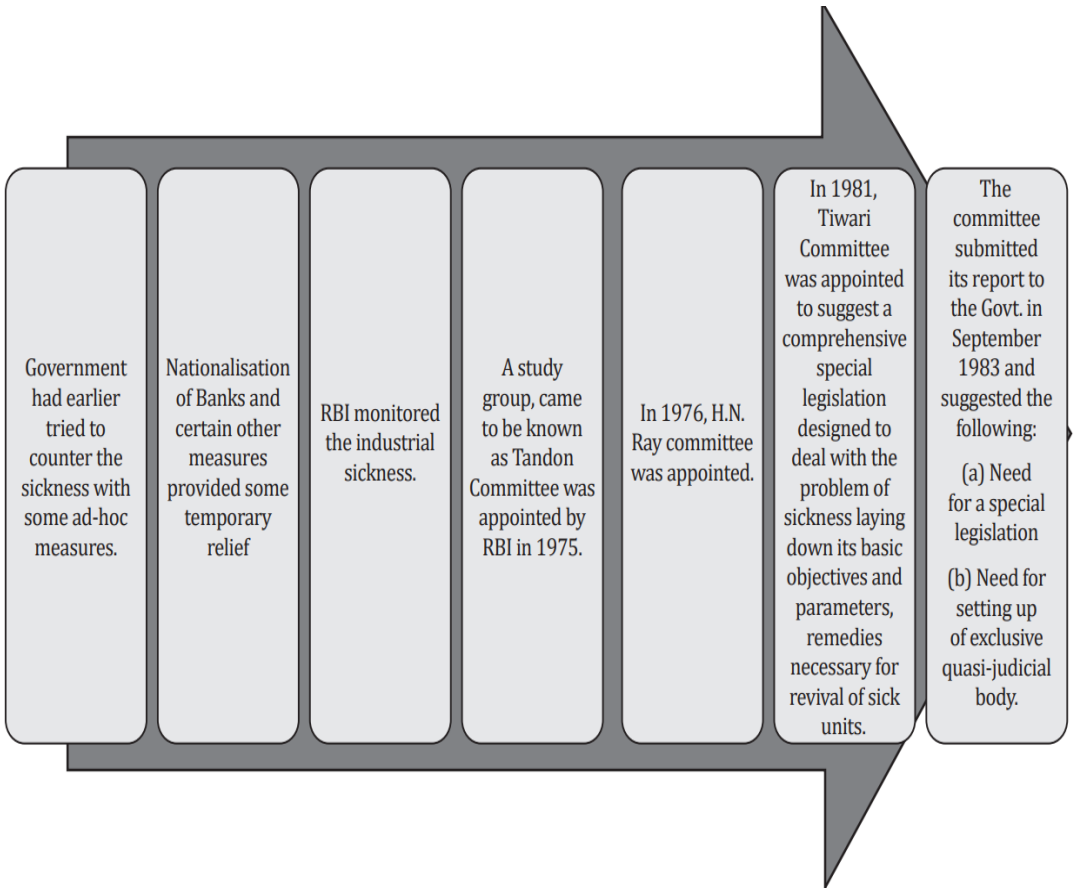


GOVERNMENT COMMITTEES ON BANKRUPTCY REFORMS

Over the last two decades, the Indian financial system has undergone tremendous transformation. Various financial sector reforms have been initiated aimed at promoting an efficient, well-diversified and competitive financial system with the ultimate objective of improving the allocative efficiency of resources so as to accelerate economic development. As India swiftly moves to the center stage of world economy there has been a consistent effort by the policy makers to undertake comprehensive reforms in the laws and systems to bring them at par with international standards and incentivise the foreign investors to invest in the Indian economy

Some earlier regulatory initiatives are as discussed below: the Genesis

(I) Industrial sickness had started right from the pre-independence days.



Thus the SICA came into existence in 1985 and BIFR started functioning from 1987.

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 –

Committee	Year	Recommendation
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)
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

ERADI COMMITTEE –

THE BEGINNING (1999) In the year 1999, the Government of India set up a High level Committee headed by Justice V.B. Eradi, to examine and make recommendations with regard to the desirability of changes in existing law relating to winding up of companies so as to achieve more transparency and avoid delays in the final liquidation of the companies. The Committee recognized after considering international practices, that the law of insolvency should not only provide for quick disposal of assets but in Indian economic scene, it should first look at the possibilities of rehabilitation and revival of companies (as mentioned in paragraph 3 of the Preface). The Committee also recognized the fact that differences in national laws and procedures have important consequences in case of enterprise with assets and liabilities in different countries, thereby, there was an urgent need to streamline the existing insolvency laws in India with that of the international law. The Committee also recommended that the jurisdiction, power and authority relating to winding up of companies should be vested in National Company Law Tribunal instead of the High Court as at present. The Committee strongly recommended appointing Insolvency Professionals who are members of Institute of Chartered Accountant of India (ICAI), Institute of Company Secretaries of India (ICSI), Institute of Cost and Work Accountants of India (ICWAI), Bar Councils or corporate managers who are well versed in Corporate management on lines of U.K. Insolvency Act.

The Committee addressed and recommended the following key points:–

(i) The Committee recognized after considering international practices that the law of insolvency should not only provide for quick disposal of assets but in Indian economic scene, it should first look at the possibilities of rehabilitation and revival of companies.

(ii) The Committee noted that there were three different agencies namely,

· The High Courts, which had powers to order winding up of companies under the provisions of the Companies Act, 1956. the High Courts were not able to devote exclusive attention to winding up cases which was essential to conclude the winding up of companies quickly;

· The Company law Board to exercise powers conferred on it by the Companies Act,

1956 or the powers of the Central Government delegated to it; and

· Board for Industrial and Financial Reconstruction (BIFR) which dealt with the references relating to rehabilitation and revival of sick industrial companies. However, the experiment with BIFR was not so encouraging.

· In order to overcome the said issues and to avoid mulplicity of fora, the Committee recommend the need for establishing National Company Law Tribunal as a specialized agency to deal with matters of rehabilitation, revival and winding up of companies. (iii) The committee brought out the dismal time taken to wind up a company in India – which ran on an average upto 25 years.

RECOMMENDATIONS BY N L MITRA ADVISORY GROUP (2001)

The Advisory Group examined the details of conflicting decisions on tribunalisation of justice. Tribunalised justice is a special character of civil law system. in a common law culture, there is an emphasis on judicial form and formalities. The conflict between the two systems is nothing new in India. Both the systems, that is the common law and the civil law systems, are now coming closer, common law systems adopting structure of administrative authority including administrative justice for the management of various state functions; and the civil law system on the other hand, incorporating the principles of accusive system and judicial process. In India, we have under the present constitutional paradigm partially adopted tribunalised form of justice under Article 323 A and 323 B20. But there are also judicial observations. It is true that in L. Chandrakumar 21, Supreme Court finally gave its nod in favour of tribunalised system of justice. But the reservation of judiciary against the erosion of judicial power especially at the High Court level is quite evident. It is not possible to oust the jurisdiction of the High Court under Articles 226 and 227 without amending the provision of Article 323B. The advisory Group discussed in details the possibility of avoiding the dualism in the system so that the whole process can be put into a straight line to avoid delay. In that context the following two methods have been discussed.

Constituting a National Tribunal with benches at the jurisdiction of each High Court to receive and deal with all petitions for bankruptcy, restructuring and finally for insolvency with an appeal lying to the High Court and Special Leave Petition to the Supreme Court; and

Having a completely dedicated bench in each High Court dealing with the entire matter of bankruptcy; reorganisation (similar to reorganisation under Chapter 11 of the US Code); and insolvency proceedings ensuring fast track liquidation, the only appeal being by way of a special leave petition to the Supreme Court.

The advisory group had also observed that an introduction of a professional expert agency to handle bankruptcy proceeding shall strengthen the existing court system. The bankruptcy court shall provide predictability and certainty to the whole system of bankruptcy proceedings. This will meet the basic objective of professional expediency and quick judicial process.

J J IRANI COMMITTEE RECOMMENDATIONS (2005)

The Ministry of Corporate Affairs constituted an expert committee on December 2, 2004 to advise the government on proposed revisions to the Companies Act, 1956, which submitted its' re be able t port in May 2005. The objective of this exercise was to have a simplified compact law that will o address the changes taking place in the national and international scenario, enable adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever- changing business models. It was a welcome attempt to provide India with a modern Company law to meet the requirements of a competitive economy. Few of its recommendations were as follows:

The Insolvency Tribunal should have a general, non-intrusive and supervisory role in the rehabilitation and liquidation process. Greater intervention of the Tribunal is required only to resolve disputes by adopting a fast track approach. The Tribunal should adopt a commercial approach to dispute resolution observing the established legal principles of fairness in the process.	The Tribunal should set standards of high quality and be able to meet requisite level of public expectations of fairness, impartiality, transparency and accountability. Selection of President and Members of the Tribunal should be such so as to enable a wide mix of expertise for conduct of its work.	The Tribunal will require specialized expertise to address the issues referred to it. The law should prescribe an adequate qualification criterion for appointment to the Tribunal as well as training and continuing education for judges/ members.
Rules should be made in such way that ensure ready access to court records, court hearings, debtors and financial data and other public information.	Standards to measure the competence, performance and services of the Tribunal should be framed and adopted so that proper evaluation is done and further improvements can be suggested.	The Tribunal should have clear authority and effective methods of enforcing its judgments. It should have adequate powers to deal with illegal activity or abusive conduct.

BANKRUPTCY LAW REFORMS COMMITTEE (2014)

The Hon'ble Finance Minister in his Budget Speech of 2014-15 announced that an entrepreneur friendly legal bankruptcy framework would be developed for SMEs to enable easy exit. Pursuant to the above announcement, Bankruptcy Law Reforms Committee (BLRC) was set up under Shri TK Viswanathan, former Secretary General, Lok Sabha and former Union Law Secretary, on 22.8.2014 to study the corporate bankruptcy legal framework in India and submit a report

Highlights of Committee Report

· The objectives of the Committee were to resolve insolvency with: lesser time involved, lesser loss in recovery, and higher levels of debt financing across instruments.

· The Committee had recommended a consolidation of the existing legal framework, by repealing two laws and amending six others. It had proposed to repeal the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920. In addition, it had proposed to amend:

(i) Companies Act, 2013,

(ii) Sick Industrial Companies (Special Provisions) Repeal Act, 2013,
(iii) Limited Liability Partnership Act, 2008, (iv) Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, (v) Recovery of Debts due to Banks and Financial Institutions Act, 1993 and
(vi) Indian Partnership Act, 1932.

- The Committee had proposed to establish a creditors committee, where the financial creditors will have votes in proportion to their magnitude of debt.
- The creditors committee would undertake negotiations with the debtor, to come up with a revival or repayment plan.

- The report outlined the procedure for insolvency resolution for companies and individuals. The process may be initiated by either the debtor or the creditors.
- At that time, only secured financial creditors (creditors holding collateral against loans), could file an application for declaring a company sick. The Committee had proposed that operational creditors, such as employees whose salaries are due, be allowed to initiate the insolvency resolution process (IRP).
- The entire IRP would be managed by a licensed insolvency professional. During the IRP, the professional would control and manage the assets of the debtor, to ensure that they are protected, while the negotiations take place.
- The Committee had proposed to set up Insolvency Professional Agencies. The agencies would admit insolvency professionals as members and develop a code of conduct.
- The report recommended speedy insolvency resolution and time bound negotiations between creditors and the debtors. To ensure this, a 180 day time period for completion of the IRP was recommended. For cases with high complexity, this time period could be extended by 90 days, if 75% of the creditors agree.
- The Committee had proposed to establish information utilities which would maintain a range of information about firms, and thus avoid delays in the IRP, typically caused by a lack of data.
- The Committee had proposed to establish the Insolvency and Bankruptcy Board of India as the regulator, to maintain oversight over insolvency resolution in the country. The Board would regulate the insolvency professional agencies and information utilities,

in addition to making regulations for insolvency resolution in India.

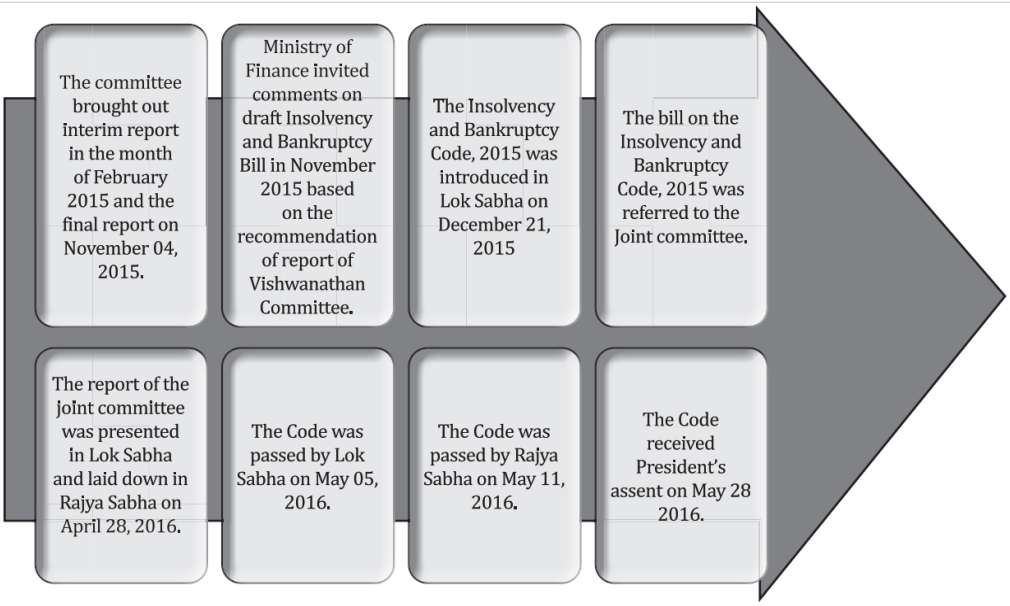
· The Committee proposed two Tribunals to adjudicate grievances under the law:

(i) the National Company Law Tribunal would continue to have jurisdiction over insolvency resolution and liquidation of companies and limited liability partnerships; and

(ii) the debt recovery tribunal would have jurisdiction over insolvency and bankruptcy resolution of individuals.

The Timelines

The Code shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint. Different dates may be appointed 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



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

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

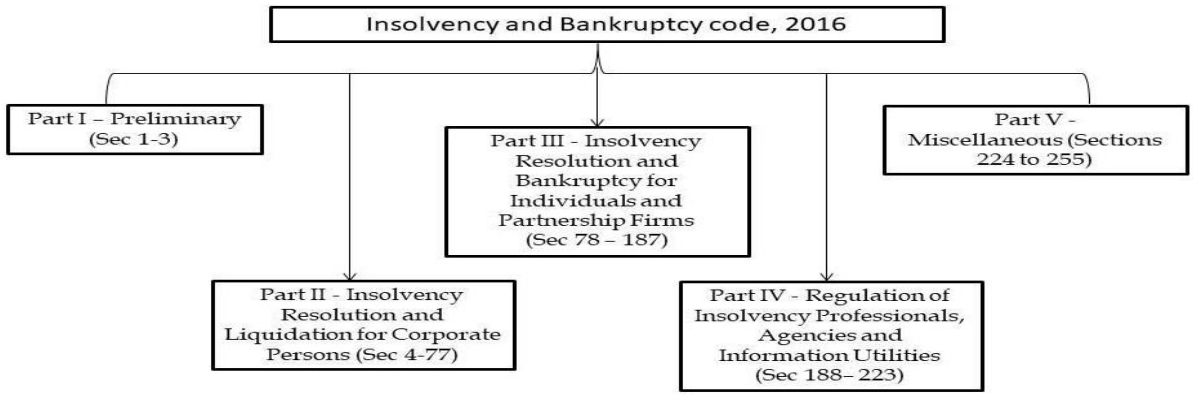
"consolidate and amend the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner."

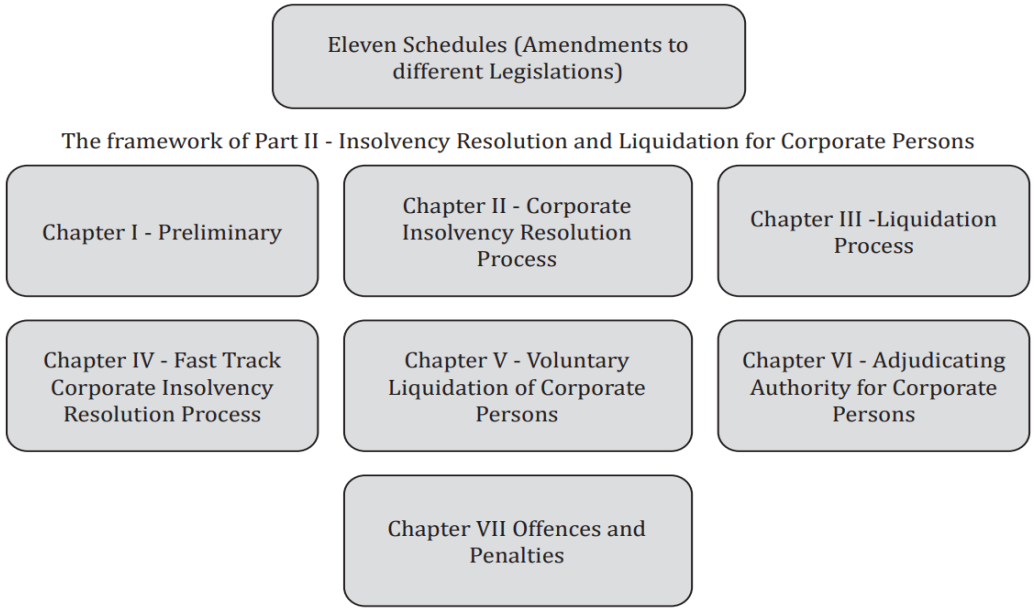
Note - Under the Constitution of India 'Bankruptcy & Insolvency' is provided in Entry 9 of List III (Concurrent List) in the Seventh Schedule to the Constitution. Hence both the Centre and State Governments are authorised to make laws on the subject.

Highlights of the Insolvency and Bankruptcy Code, 2016 in the context of Corporate Insolvency

- The preamble of the Code reads as under: to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, and for matters connected therewith or incidental thereto.
- The Code covers insolvency of individuals, unlimited liability partnerships, limited liability partnerships (LLPs) and companies.
- The Insolvency Resolution Process (IRP) for individuals and unlimited liability partnerships varies from that of companies and llPs. The Debt Recovery Tribunal ("DRT") shall be the Adjudicating Authority with jurisdiction over individuals and unlimited liability partnership firms. Appeals from the order of DRT shall lie to the Debt Recovery Appellate Tribunal ("DRAT"). The National Company Law Tribunal ("NCLT") shall be the Adjudicating Authority with jurisdiction over companies, limited liability entities. Appeals from the order of NCLT shall lie to the National Company Law Appellate Tribunal ("NCLAT").
- The Code proposes to established an insolvency regulator (the Insolvency and Bankruptcy Board of India) to exercise regulatory oversight over — Insolvency Professionals, — Insolvency Professional Agencies and — Information Utilities.
- The Code regulates insolvency professionals and insolvency professional agencies. Under regulator's oversight, these agencies will develop professional standards, codes of ethics and exercise a disciplinary role over errant members leading to the development of a competitive industry for insolvency professionals.
- The Code laid down the provision for information utilities which would collect, collate, authenticate and disseminate financial information from listed companies and financial and operational creditors of companies. An individual insolvency database is also proposed to be set up with the goal of providing information on insolvency status of individuals.

- The Code lays down a swift process and timeline of 180 days for dealing with applications for corporate insolvency resolution. This can be extended for 90 days by the Adjudicating Authority only one time extension. During insolvency resolution period (of 180/270 days), the management of the debtor is placed in the hands of an interim resolution professional/resolution professional. Corporate insolvency resolution process shall mandatorily be completed within a period of three hundred and thirty days from the insolvency commencement date, including any extension of the period of corporate insolvency resolution process and the time taken in legal proceedings in relation to such resolution process of the corporate debtor.
- Further, an insolvency resolution plan prepared by the resolution applicant and duly examined by the resolution professional confirming that the resolution plan contains the mandated provisions as per the Code, has to be approved by a majority of 66% of voting share of the financial creditors. Once the plan is approved, it would require sanction of the Adjudicating Authority. If an insolvency resolution plan is rejected, the Adjudicating Authority will make an order for liquidation.
- The Code lays down fast track insolvency resolution process for companies with smaller operations. The process will have to be completed within 90 days, which may be extended upto 45 more days, if 75% of financial creditors agree. Extension shall not be given more than once.

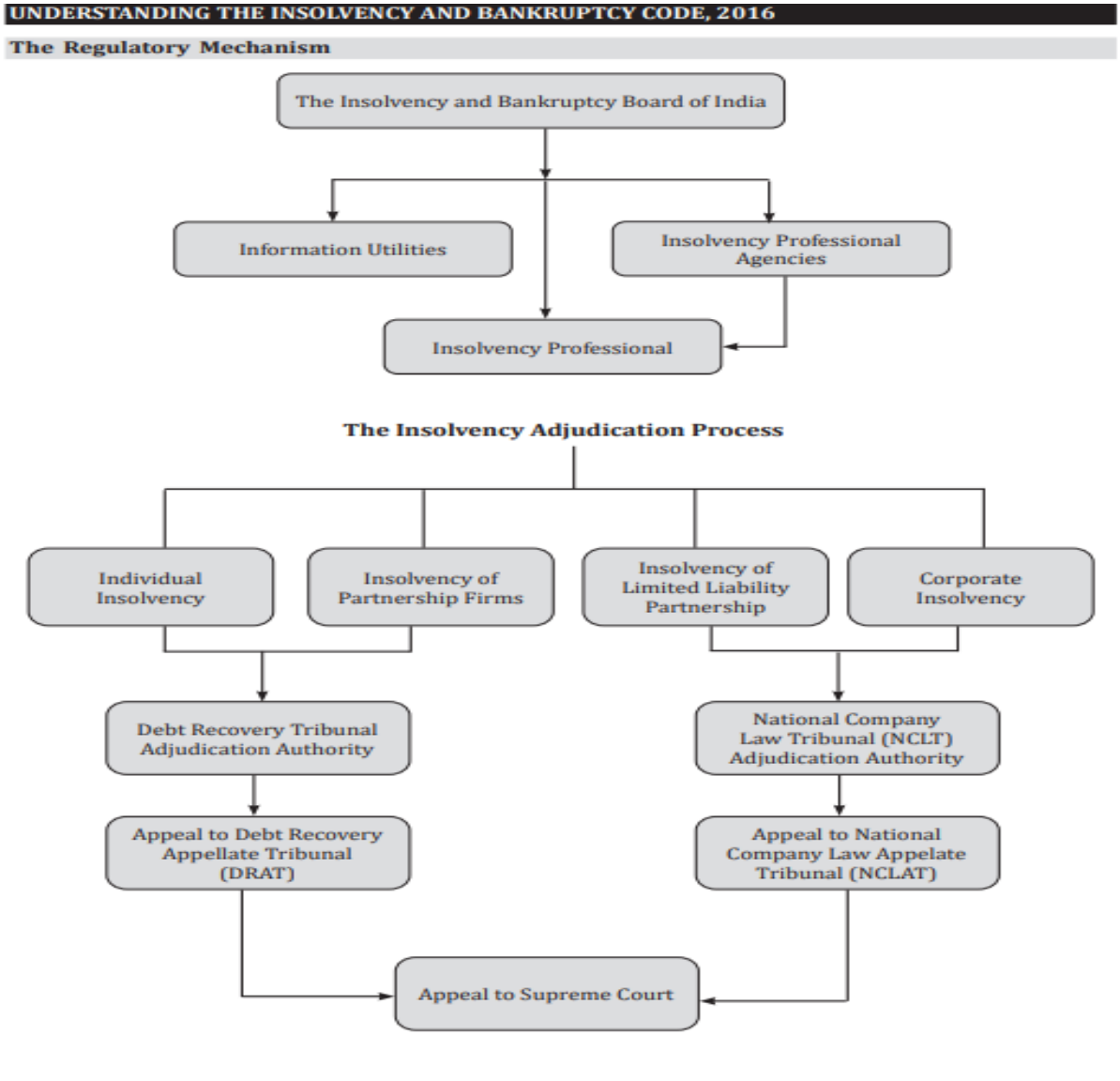




Impact of the Code on other legislations.

- The Code seeks to repeal the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920.
- The Code seeks to amend the following 11 legislations:

1. The Indian Partnership Act, 1932
2. The Central Excise Act ,1944
3. The Income Tax Act, 1961
4. The Customs Act, 1962
5. Recovery of Debts Due to Banks and Financial Institutions Act, 1993
6. The Finance Act, 1994
7. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
8. Sick Industrial Companies (Special Provisions) Repeal Act, 2003
9. The Payment and Settlement Systems Act, 2007
10. The Limited Liability Partnership Act, 2008
11. The Companies Act, 2013



THE INSOLVENCY AND BANKRUPTCY CODE 2016 – AN INTERNATIONAL COMPARISON WITH REFERENCE TO CORPORATE INSOLVENCY RESOLUTION PROCESS

The Insolvency and Bankruptcy Code, 2016 – An international Comparison (Sources: Interim Report of the Bankruptcy Law Reforms Committee).

Sl. no.	Particulars	Section	Details	International practice

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"

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