

## INSOLVENCY AND BANKRUPTCY LAWS IN INDIA

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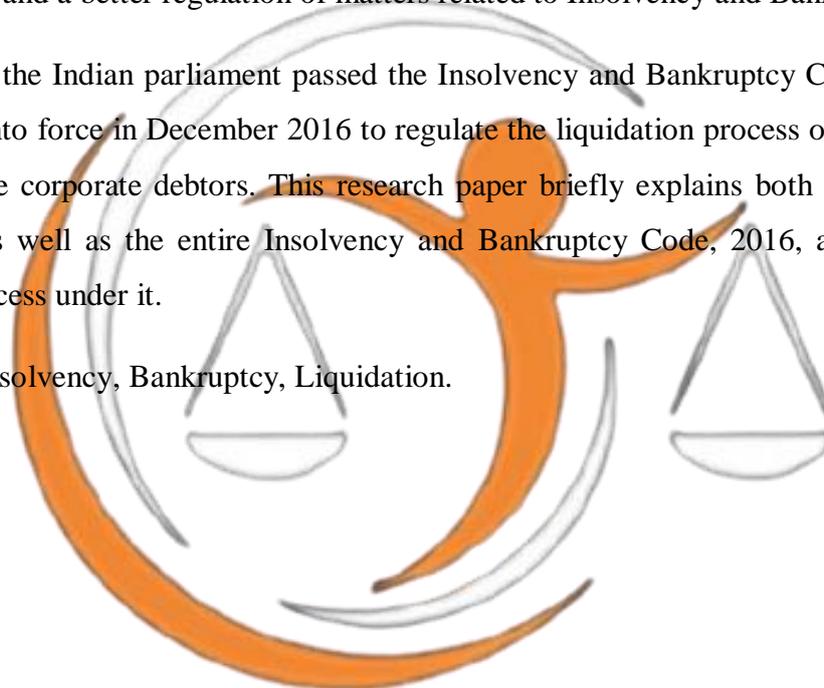
### ABSTRACT

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Pursuing business as a company has always been the best option as it gives members the ability to limit their responsibilities. The Corporate Personality Doctrine gives the company certain rights and obligations, but if the obligations on the company's assets exceed its income, then the company can sometimes even collapse. There were several laws for these companies to give an opportunity to revive themselves, but a single law was required for a proper revival and a better regulation of matters related to Insolvency and Bankruptcy.

In May 2016, the Indian parliament passed the Insolvency and Bankruptcy Code (IB Code), which came into force in December 2016 to regulate the liquidation process of individuals as well as for the corporate debtors. This research paper briefly explains both Insolvency and Bankruptcy as well as the entire Insolvency and Bankruptcy Code, 2016, and what is the resolution process under it.

**Keywords:** Insolvency, Bankruptcy, Liquidation.



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## WHAT IS BANKRUPTCY?

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An organization usually opts for bankruptcy if it fails to pay back the money of its clients. It declares itself bankrupt in order to get out of any debt-related obligation. It's considered a legalized process. However, creditors can move court and file a petition and after measuring the outstanding liabilities of the company clients are paid through the assets of the company.

Non-payment of these debts creates a level of chaos in the firm which needs to be fixed as quickly as possible so that future proceedings of the firm don't get affected. It is a Federal court procedure.

## WHAT IS INSOLVENCY?

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Insolvency is a condition of the financial crisis in which an individual or company is unable to cover their loans or, in other words, satisfy their financial commitments to lenders. Before entering into such proceedings, any insolvent corporation or person is likely to have made informal agreements with lenders (creditors), such as putting up alternate payment mechanisms.

Insolvency can arise due to the poor decisions taken by the firm's management which may lead to poor cash management, poor cash inflow, or a sudden increase in expenses.

## FACTORS CONTRIBUTING TO INSOLVENCY

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There are various factors that can play a major role in a person or a company becoming insolvent:

- 1. The hiring of inappropriate Accounting or Human resource management-**

Insolvency can result from a company's hiring of insufficient and unqualified accounting and human resource management. For example, an inexperienced accounting manager can misuse the company's budget, resulting in financial resource overspending. Expenses will mount up almost as quickly as revenue will pour out in excess of what is coming in.

## 2. **Rising Vendor cost-**

When a business needs to offer higher rates for products and services, the premium is passed down to the customers. Rather than pay the higher costs, many customers go to other businesses where products and services are sold at lower prices, and losing customers means less revenue for the business, making it impossible to repay debts.

## 3. **Lawsuits from Consumers as well as Business associates-**

Such kind of lawsuits also raises the risk of insolvency of a firm as the business may end up paying a large amount as settlement cost of these cases instead of using it for further operations. When further operations get restricted, it will lead to less or no income generation of the firm, ultimately increasing the burden of debts on the firm.<sup>1</sup>

## 4. **Unable to meet the changing consumer needs-**

Any businesses go bankrupt when they struggle to adapt their products and services to satisfy changing market demands. As customers are buying a range of goods and services from other companies, the business begins spending money and incurring costs, which is bad for the company's financial security.

## **INSOLVENCY VS. BANKRUPTCY**

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An insolvency is a form of financial hardship in which a company or individual is unable to pay their debts or meet other financial obligations. The Internal Revenue Service (IRS) defines insolvency as whether a person's total liabilities outweigh his or her total assets.

Bankruptcy, on the other side, is a court decision that specifies how an insolvent party can repay their creditors, or how they can use their properties to do so.

And if it's just for a short time, an individual or company may be insolvent without going bankrupt. If the case continues, it can result in bankruptcy.

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<sup>1</sup> Insolvency, <https://corporatefinanceinstitute.com/resources/knowledge/finance/insolvency/>  
[www.juscorpus.com](http://www.juscorpus.com)

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“The **Insolvency and Bankruptcy Code, 2016**<sup>2</sup> came into force on May 5, 2016, as notified in the ‘**Gazette of India**’. It was introduced on 21 December 2015 by our former finance minister **Late Arun Jaitley Ji** in the lower house of the parliament i.e., Lok Sabha with a view to give benefits to the businessman as well as different firms in our country.” The main objective of this law was to provide a proper legal system where all the small investors, owners of the firms, as well as the businessman feels safe and they can improve their earning without being worried.

“The first case related to Insolvency was raised by the **National Company Law Tribunal (NCLT)** in August 2017. It was the case of **Synergy Dooray Automotive limited**, in which they filed for insolvency on 23 January 2017 and the order appeared on the National Companies Law Assembly website on 14 August 2017. It provides a limited time to settle or resolve the issue. The Insolvency and Bankruptcy Code, 2016 contains 255 sections and 11 schedules.”

### **The Insolvency and Bankruptcy law has four main features:**

- **Insolvency Resolution-**

Individuals, corporations, and collaboration firms all have separate insolvency settlement mechanisms defined by the code. Either the borrower or the debtor will start the process. The implementation of this insolvency settlement phase has also been given a deadline. Firms would have 180 days to conclude the procedure, which may be expanded by 90 days if the majority of creditors consent. The phase would take about 90 days for small businesses or firms (with assets under Rs. 1 crore) which may be prolonged by 45 days.

“According to **The Insolvency and Bankruptcy (Amendment) Act, 2019**<sup>3</sup>, the mandatory maximum time limit of 330 days including the time spent in the legal process has been increased.”

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<sup>2</sup> IBC ,2016

<sup>3</sup> Insolvency and Bankruptcy (Amendment) Act, 2019

- **Insolvency Regulator-**

The code creates a different board, the Insolvency and Bankruptcy Board of India, to oversee the country's insolvency proceedings and to govern all companies registered under it. The board is made up of ten members, including officials from the Ministry of Finance and Law and the Reserve Bank of India (RBI).

- **Insolvency Professionals-**

The insolvency operation will be overseen by qualified practitioners, and it will be their responsibility to safeguard the debtor's properties in the insolvency phase.

- **Insolvency and Bankruptcy Adjudicator-**

“The bankruptcy code proposes the setting up of two separate tribunals to look after the insolvency process for individuals and firms.

1. The National Company Law Tribunal for Companies and Limited Liability Partnership firms
2. Debt Recovery Tribunal for individuals.”

**Insolvency Law has a two-fold purpose:**

- To provide a proper process from which borrowers that are not protected in the settlement of loans will be repaid
- To provide relief to debtors from creditors whose demands they are unwilling to satisfy.

It is founded on the Roman theory of 'Cessio Boborum,' which entails the debtor surrendering all of his assets to his creditors in exchange for protection from legal proceedings. The liquidation, insolvency, and bankruptcy of any corporation, entity, or person are both governed by these rules.

### **PROCEDURE UNDER INSOLVENCY AND BANKRUPTCY CODE, 2016**

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The settlement mechanism can be started by either operating or financial claimant, as well as the debtor itself, according to the Insolvency and Bankruptcy Code of 2016. In the case of a

corporation, the debtor must also submit a permission document from the Board of Directors along with the application order. The Liquidation and Corporate Insolvency Resolution Processes are two separate systems or practises covered by this code. In the Corporate Insolvency Resolution Phase, creditors must determine the viability of the company and see whether there is even a remote possibility that it will be resurrected. When the Resolution mechanism fails, the creditors attempt to liquidate the company's properties to reclaim their debts, although the default must be greater than 1 lakh rupees.

## **INSOLVENCY RESOLUTION PROCESS**

**Financial Creditors-** When a corporate debtor fails to pay its obligations, a financial creditor can initiate the Corporate Insolvency Resolution Process under Section 7 of the Insolvency and Bankruptcy Code. The financial creditor shall apply the record of the default or all other proof of the default, as well as the name of the resolution specialist proposed to serve as an interim resolution professional, while submitting an application on his or her own or jointly with other financial creditors.

Within 14 days after receiving the complaint, the Adjudicating Authority will estimate the default depending on the IU's reports or any information provided by the financial creditors.

**Operational Creditors-**When the default occurs, the Operational Creditor may serve the debtor with a notice of unpaid operational debt or a copy of an invoice requesting payment of the sum involved in the default. The Debtor must notify the OC within 10 days of any ongoing lawsuit, conflict, or settlement proceedings in connection with the dispute. If the Operational Creditor may not collect the pending balance within 10 days, he will file a CIR application with the National Company Law Tribunal.

**Moratorium-** A moratorium may be declared by the adjudicating authority after submitting an application for CIRP. At this period, no court action against the debtor may be started. During this period, no wealth transfers are permitted, and the debtor is not entitled to any recovery. This moratorium may be extended before the conclusion of the CIRP.

**Committee of the Creditors (COC)-** The Insolvency Professional would be responsible for determining the creditors and forming a committee known as the "Committee of the Creditors." This Committee of Creditors includes financial creditors. Operational creditors

with claims in excess of the requirement would be entitled to attend meetings but will have no voting power. The COC must accept the debtor's company revival proposals/plans and, if they are not viable, proceed to asset liquidation within 180 days + 90 days. A 66 per cent majority vote is needed for the decision to be revived.

**Liquidation** - If 66 per cent of the overall creditors do not accept the plan, or if the IBC provisions are not followed, or if the debtors ignore the settlement, liquidation is requested. An official liquidator can be named by the Insolvency Professional. His job would be to check the statements of borrowers, accept them, and allocate the money recovered for debt repayment.

**Fast Track Process** - The Code often has a Fast Track CIR for start-ups to ensure that the procedure is done quickly and that regular company operations will resume as soon as possible. The procedure must be finished in 90 days, although it may be prolonged by 45 days if necessary.

**Voluntary Liquidation of the Corporate Person**-Section 59 of the Insolvency and Bankruptcy Code, 2016 states that any corporate person who has not committed any default but wishes to liquidate himself can do so voluntarily, subject to the submission of an affidavit by the majority of Directors stating that they have conducted all inquiries and that either no debt is pending or that the debt is settled.

## **MAJOR AMENDMENTS IN THE INSOLVENCY AND BANKRUPTCY CODE, 2016**

### **1. Insolvency and Bankruptcy (Amendment) Act, 2017**

In an ongoing attempt to improve ease of doing business, the government is experimenting with various methods to smooth the position of the RP in the CIRP mechanism so that ineligible debtors or creditors are unable to intervene with the insolvency process. The provision was made to keep some individuals out of the settlement phase and the company's revival. "In the case of **Sanjeev Shriya v. State Bank of India**, it was held by the court if there is a personal guarantor of the corporate, which may involve the promoter will be covered under Section 14 of the code."<sup>4</sup>

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<sup>4</sup> Sanjeev Shriya v. State Bank of India WRIT - C No. - 30285 of 2017

## **2. Insolvency and Bankruptcy (Amendment) Ordinance, 2018**

The inclusion of homebuyers in the description clause was one of the most significant changes introduced to the code. Home sellers will also be considered financial creditors, and they will be entitled to reclaim the balance charged in advance as a result of this provision. Previously, they were advised to file a complaint with COPRA, which was a long and time-consuming legal procedure through which the buyers generally lost money.

“In the case of **Chitra Sharma v. Union of India**, it was stated that the amount that is paid by the home buyers as an advance was more than the bank dues of the seller (real estate). Even though the dues of the home buyers were more they were not given preference and the bank was in a favourable position because the home buyers were not the financial creditor under this case.”<sup>5</sup>

## **3. Insolvency and Bankruptcy (Second Amendment) Bill, 2018**

Since there was no direct mention of homebuyers' status, the lower house, the Lok Sabha, made it clear on August 10, 2018, that they would be considered as financial creditors as well. When the creditors finalise the settlement agreement, they would still need approval from the Competition Commission of India. The aim of this provision was to minimise the likelihood of a CIRP extension submission, i.e., a request for a 90-day extension.

The ultimate objectives, as specified in the declaration of artefacts and purposes, are laudatory and crucial for reforming the resolution, insolvency, and bankruptcy system that governs corporations, individuals, and partnership firms. As a result of the volatile situation and corporate gridlock, the parliament will have to make changes in order to address business failure if it occurs.

## **4. Insolvency and Bankruptcy Code (Amendment Bill), 2019**

The Union Cabinet approved the proposal of introducing a Bill dated 19th July 2019 in the Parliament to make amendments to the Insolvency and Bankruptcy Code, 2016.

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<sup>5</sup> Chitra Sharma v. Union of India WP (C) No. 744 of 2017

These amendments are done to fill the gap in the Corporate Insolvency Resolution Framework as aggrandized in the code, simultaneously maximizing the value from the CIRP.<sup>6</sup> The government intends to maximize the value of a corporate debtor within the strict deadlines of the Code.

## CONCLUSION

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The 2016 Insolvency and Bankruptcy Code is a significant move forward toward providing a proper and well-structured regulatory framework for bankruptcy, liquidation, and insolvency settlement involving both entities and corporations. Since there were too many different laws relating to insolvency and bankruptcy, each of which had different remedies with different stakeholders, parliament introduced a new Code into the market to include protection for debt-ridden corporations and bank failure. With the ever-changing market, frauds and crimes would be regulated and meet the genuine needs of creditors, employees, and all other stakeholders. The fall of India's capital market has been attributed to the Punjab National Bank fraud, the Sahara scam, and numerous other corporate failures, as well as a decline in international investors who were previously able to invest in the market.

The Insolvency and Bankruptcy Code, 2016, has many goals, including reviving the corporate debtor, repaying creditors and other lenders, and indirectly increasing foreign direct investment in the Indian market. The 2016 Insolvency and Bankruptcy Code seeks to prevent any “discriminatory and neutral settlement plan” from being implemented. It, therefore, establishes a well-defined regulatory structure for the allocation of debts owed to creditors, and only non-discriminatory resolution applicants are accepted.

However, the Insolvency and Bankruptcy Board's willingness to operate with the pace and timeliness required by the code is a source of concern.

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<sup>6</sup> IBC,2016 Amendments ,<https://taxguru.in/corporate-law/insolvency-bankruptcy-code-2016-amendments.html>  
[www.juscorpus.com](http://www.juscorpus.com)