

The Concept of Corporate Insolvency and Resolution Process- An overview of IBC 2016

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Abstract: *The Insolvency and Bankruptcy Code (IBC) of 2016 indeed marked a significant shift in India's approach to handling insolvency and bankruptcy matters, streamlining and modernizing the process. The aim of this research is to scrutinize the effectiveness and efficiency of the CIRP framework. This could involve examining aspects such as:*

By critically analyzing these and other aspects of the CIRP framework, it can be contributed to a deeper understanding of its strengths, weaknesses, and areas for refinement or reform. This type of analysis is crucial for the ongoing evolution and improvement of insolvency and bankruptcy laws, ensuring they meet the needs of all stakeholders in an ever-changing economic landscape. The economic and legal landscape prior to the implementation of the Insolvency and Bankruptcy Code (IBC) has also been discussed in this research. The economic rationale behind having an effective insolvency regime, emphasizing concepts such as efficient allocation of resources, creditor protection, and fostering a conducive environment for entrepreneurship and investment and a detailed examination of the CIRP and liquidation processes as outlined in the IBC is also included.

It is also identified and analyzed key challenges that hinder the smooth functioning of the CIRP, such as procedural bottlenecks, judicial capacity constraints, stakeholder coordination issues, and regulatory complexities.

Keywords: Insolvency and Bankruptcy Code, IBC, Corporate Insolvency Resolution Process, Corporate Insolvency Resolution Process, Liquidation Process

I. INTRODUCTION

Inadequate Accounting or Human Resources Management: Poor financial management practices, such as inaccurate accounting records or inefficient human resources management, can contribute to financial instability and ultimately lead to insolvency. Without proper oversight and resource allocation, companies may struggle to manage their expenses and maintain profitability.

Rising Vendor Costs: Increasing costs from suppliers or vendors can put pressure on a company's cash flow and profitability, especially if these costs are not adequately managed or negotiated. If a company is unable to pass on these increased costs to customers or find alternative suppliers, it may face difficulties in meeting its financial obligations.

Failure to Adapt to Changing Consumer Needs: Businesses that fail to innovate and adapt to evolving consumer preferences or market trends risk losing relevance and market share. This can lead to declining sales and revenue, making it challenging to cover operational expenses and debt obligations, ultimately resulting in insolvency.

By understanding these contributing factors, businesses can proactively address financial vulnerabilities and implement strategies to mitigate the risk of insolvency. This may involve improving financial management practices, optimizing cost structures, and prioritizing innovation and customer-centric strategies to ensure long-term viability and sustainability. The importance of discharging debts and transactions in the ordinary course of business in a timely manner. This is indeed essential for the smooth functioning of business activities and to prevent financial unrest that could have cascading effects on various stakeholders. The Insolvency and Bankruptcy Code (IBC) of 2016, enacted by the Government of India, seeks to address these concerns by consolidating and amending various laws related to insolvency resolution across different entities into a single legislation. Its primary objective is to provide a time-bound

resolution process for maximizing the value of a debtor's assets, thereby aiming to revive distressed companies or facilitate their orderly winding up. By establishing a comprehensive mechanism, the IBC aims to assist not only sick companies but also operational creditors, investors, and other stakeholders in achieving resolution or exit in a structured manner. This includes providing avenues for operational creditors to participate in the resolution process, thereby empowering them in the insolvency resolution framework.

The role of adjudicating bodies, such as the National Company Law Tribunal (NCLT), becomes crucial in overseeing the implementation of the resolution process and ensuring its effectiveness. However the ultimate goal is to prevent larger financial unrest by identifying and addressing issues at the grassroots level, thereby emphasizing the importance of early intervention and resolution in the insolvency framework. Overall, the IBC represents a significant step towards streamlining and modernizing India's insolvency resolution framework, with the aim of promoting economic stability, protecting stakeholders' interests, and facilitating the efficient allocation of resources. It's evident that the Insolvency and Bankruptcy Code (IBC) of India draws inspiration from the bankruptcy laws of countries like the US and UK, incorporating several key features to enhance the effectiveness and efficiency of the insolvency resolution process. Let's delve into some of these aspects:

Moratorium: The provision of a moratorium during the insolvency process prevents creditors from taking individual actions against the debtor, allowing for a breathing space to facilitate negotiations and restructuring efforts. This concept is borrowed from the US and UK bankruptcy laws and helps in maintaining the status quo during the resolution process.

Time-Bound Process: Implementing a time-bound insolvency process, including provisions for the takeover of management and powers of creditors, ensures that resolution efforts are conducted promptly and efficiently. This approach aims to minimize delays and maximize the chances of successful resolution or restructuring, aligning with international best practices.

Regulatory Oversight: The introduction of a regulatory body, the Insolvency and Bankruptcy Board of India, provides oversight and regulation of insolvency proceedings, ensuring adherence to legal frameworks and standards. This regulator plays a crucial role in maintaining the integrity and effectiveness of the insolvency resolution process.

Information Utility: The concept of an Information Utility serves as a centralized database of credit information, facilitating the insolvency resolution process by providing access to crucial data needed for decision-making. This addresses one of the main challenges faced in the restructuring and liquidation process, namely the lack of readily available credit information.

By adopting these features from established bankruptcy systems and introducing innovative concepts like the Information Utility, the IBC aims to modernize and streamline India's insolvency resolution framework. These provisions not only enhance transparency and efficiency but also contribute to creating a conducive environment for resolving insolvency cases and promoting investor confidence in the Indian market.

II. NEED FOR A PROPER INSOLVENCY AND BANKRUPTCY MECHANISM

The challenges and inefficiencies outlined in India's legal and institutional framework for dealing with business failures and insolvency are significant and have real implications for the country's economic health and competitiveness. Let's break down some of the key points:

Multiple Jurisdictions and Delayed Resolution: The jurisdiction to handle issues arising from insolvency and business failures was dispersed among various courts and tribunals, leading to systematic delays and complexities in the resolution process. This fragmented approach not only prolonged the resolution process but also added to the burden of pending cases in civil courts, exacerbating the backlog of legal proceedings.

Rising Bad Debts and Inefficient Resolution: The statistics highlight the growing problem of bad debts in India, which account for a significant portion of total lending. Corporate bad debts, in particular, constitute a substantial portion of nationalized banks' bad debts. The prolonged time taken to wind up a company in India, averaging around 4 years, further underscores the inefficiencies in the current resolution process.

Global Competitiveness and Ease of Doing Business: The inadequate institutional and legal framework for dealing with debt defaults and insolvency contributes to India's lower ranking in global indices such as the World Bank's ease of

doing business index. The lengthy resolution process, coupled with the lack of specialized courts or tribunals dedicated to insolvency cases, poses challenges for businesses operating in India and may deter foreign investment.

Addressing these challenges requires comprehensive reforms aimed at streamlining the insolvency resolution process, enhancing judicial capacity, and strengthening the institutional framework for handling business failures. The introduction of the Insolvency and Bankruptcy Code (IBC) in 2016 was a step in the right direction, aiming to consolidate and modernize insolvency laws in India. However, ongoing efforts are needed to ensure effective implementation of the IBC and address remaining gaps in the insolvency resolution ecosystem.

By improving the efficiency and effectiveness of the insolvency resolution process, India can enhance its attractiveness as a destination for investment, foster entrepreneurship, and promote economic growth and stability. The introduction of the Insolvency and Bankruptcy Code (IBC) in May 2016 reflects a recognition by the Indian government of the critical need for reforms in the bankruptcy and insolvency regime to improve the business environment and address challenges in credit markets. By consolidating and amending laws related to reorganization and insolvency resolution for corporate entities, partnership firms, and individuals, the IBC aims to achieve several key objectives:

Timely Resolution: The IBC emphasizes the importance of resolving insolvency cases in a time-bound manner to maximize the value of assets and minimize disruptions to business operations. By providing a structured framework for insolvency resolution, the IBC aims to expedite the process and mitigate delays.

Promotion of Entrepreneurship: By facilitating a more efficient resolution of distressed businesses, the IBC seeks to promote entrepreneurship and encourage risk-taking in the business community. By offering a clearer path for businesses to navigate financial challenges, the IBC aims to foster a more dynamic and competitive economic environment.

Availability of Credit: A well-functioning insolvency framework is essential for maintaining the stability and confidence of credit markets. By establishing clearer rules and procedures for handling insolvency cases, the IBC aims to enhance the availability of credit by reducing uncertainty and risk for lenders.

Balancing Stakeholder Interests: The IBC seeks to balance the interests of various stakeholders involved in the insolvency resolution process, including creditors, debtors, employees, and government authorities. By prioritizing the maximization of asset value and promoting transparency and fairness in the resolution process, the IBC aims to ensure equitable outcomes for all parties involved.

Establishment of Regulatory Body: The creation of the Insolvency and Bankruptcy Board of India (IBBI) provides a dedicated regulatory body tasked with overseeing and regulating insolvency proceedings. The IBBI plays a crucial role in ensuring compliance with the provisions of the IBC and promoting effective implementation of insolvency resolution mechanisms.

Overall, the introduction of the IBC represents a significant step towards modernizing India's insolvency framework and addressing longstanding challenges in credit markets. By providing a clearer and more efficient process for handling insolvency cases, the IBC aims to promote economic growth, entrepreneurship, and financial stability in the country.

III. A CRITICAL ANALYSIS ON CORPORATE INSOLVENCY RESOLUTION PROCESS

The Insolvency and Bankruptcy Code, 2016 captures its key objectives and features effectively. Let's break down some of the highlights:

The IBC aims to streamline and simplify the insolvency resolution process by consolidating and amending laws related to insolvency resolution across different entities, including companies, limited liability entities, partnerships, and individuals. By creating a single legislation, the IBC provides a cohesive framework for addressing insolvency issues in a comprehensive manner.

The primary focus of the IBC is to facilitate the resurrection or resolution of distressed companies in a time-bound manner, with the aim of maximizing the value of the debtor's assets. This approach emphasizes the importance of timely intervention to address insolvency issues and minimize disruptions to business operations.

A notable feature of the IBC is the empowerment of operational creditors, such as workmen and suppliers, to initiate the insolvency resolution process in the event of a default. This provision ensures that all stakeholders, including those with operational claims, have a role in the resolution process and can take proactive steps to protect their interests.

The IBC does not make any distinction between the rights of international and domestic creditors or between classes of financial institutions. This ensures fairness and equality in the treatment of creditors, regardless of their origin or type of institution.

The IBC seeks to balance the interests of all stakeholders involved in the insolvency resolution process, including creditors, debtors, employees, and government authorities. This includes altering the order of priority of payment of government dues to ensure equitable outcomes for all parties involved.

The IBC is guided by the philosophy that insolvency resolution must be commercially and professionally driven, rather than court-driven. This approach emphasizes the importance of efficient and effective resolution mechanisms, with adjudicating authorities playing a limited role in ensuring due process rather than adjudicating on the merits of the resolution.

Overall, the IBC represents a significant reform in India's insolvency framework, aimed at promoting transparency, efficiency, and fairness in the resolution process while balancing the interests of all stakeholders involved.

This provides a clear understanding of the distinction between business failure and financial failure, as well as the importance of a sound bankruptcy process in addressing both scenarios. Here's a breakdown of the key points you've outlined regarding the Insolvency and Bankruptcy Code (IBC) of 2016 and the corporate insolvency resolution process (CIRP):

The IBC marks a significant departure from the previous resolution regimen by shifting the responsibility to initiate the insolvency resolution process from the debtor to the creditor. If the default amount is above Rs.1 crore, the creditor has the right to initiate the process, streamlining the resolution process and empowering creditors to take proactive steps in addressing defaults.

Provisions for Corporate Insolvency Resolution Process (CIRP): Sections 4 to 77 of Part II of the IBC contain provisions for the CIRP and liquidation for corporate persons. The CIRP can be initiated by financial creditors, operational creditors, or the corporate debtor itself through application to the National Company Law Tribunal (NCLT) under specified conditions.

Key Steps in CIRP:

Intimation of admission or rejection of application by NCLT within seven days.

Declaration of moratorium and appointment of an Interim Resolution Professional (IRP) by NCLT.

Public announcement containing essential information about the CIRP process.

Constitution of a Committee of Creditors comprising all financial creditors.

Suspension of management powers of the corporate debtor and their transfer to the IRP.

Consideration by the Committee of Creditors to appoint the IRP as the Resolution Professional (RP) or replace the IRP with another RP.

The Insolvency Commencement Date starts from the date of admission of the application and must be completed within 180 days, with the possibility of a one-time extension of up to ninety days by the NCLT. This ensures that the resolution process is conducted in a time-bound manner to maximize the value of the debtor's assets and minimize disruptions to business operations.

Overall, the provisions outlined in the IBC and the CIRP aim to provide a structured and efficient framework for resolving corporate insolvency issues, empowering creditors, and promoting the rehabilitation of distressed companies as a going concern.

This outlines the key steps involved in the formulation and approval of a resolution plan within the Corporate Insolvency Resolution Process (CIRP). Here's a breakdown of the process:

Preparation of Information Memorandum: The Resolution Professional (RP) is responsible for preparing an Information Memorandum, which contains essential information about the corporate debtor's financial position, assets, liabilities, and other relevant details. This document serves as a basis for potential Resolution Applicants to formulate their resolution plans.

Formulation of Resolution Plan by Resolution Applicant: Based on the information provided in the Information Memorandum, Resolution Applicants prepare their resolution plans outlining how they intend to resolve the insolvency of the corporate debtor and maximize the value of its assets.

Submission and Examination of Resolution Plan: The Resolution Applicant submits the formulated resolution plan to the RP, who examines its feasibility and compliance with the requirements of the Insolvency and Bankruptcy Code (IBC). The plan must be approved by at least 75% of the voting share of financial creditors to proceed further.

Submission to NCLT for Approval: Once approved by the financial creditors, the RP submits the resolution plan to the National Company Law Tribunal (NCLT) for final approval. The NCLT reviews the plan and either approves it or rejects it. In case of rejection, the NCLT may order for liquidation of the corporate debtor.

Binding Nature of Approved Plan: If the resolution plan is approved by the NCLT, it becomes binding on the corporate debtor and all its stakeholders, including employees, members, creditors, guarantors, and other parties involved in the resolution process.

Appeal Process: In case of rejection of the resolution plan by the NCLT, an appeal can be made to the National Company Law Appellate Tribunal (NCLAT) for reconsideration.

End of Moratorium: The moratorium period, which suspends legal actions against the corporate debtor, ends on the date of approval of the resolution plan.

Overall, this structured process ensures transparency, creditor participation, and judicial oversight in the resolution of corporate insolvency cases, aiming to achieve the best possible outcome for all stakeholders involved.

Secured creditors are considered financial creditors under the IBC.

Financial Creditor Initiation: A financial creditor, including a secured creditor, can initiate the Corporate Insolvency Resolution Process (CIRP) by filing an application to the National Company Law Tribunal (NCLT) under Sections 6 and 7 of the Code. A financial creditor is defined as any person to whom a financial debt is owed, including those with security interest in the debt.

Operational Creditor Initiation: An operational creditor can also initiate the CIRP by filing an application to the NCLT under Sections 8 and 9 of the Code. An operational creditor is defined as a person to whom an operational debt is owed, which includes claims related to the provision of goods or services, including employment, and debts payable to governmental authorities.

Corporate Applicant Initiation: Additionally, a corporate debtor itself can initiate the CIRP process by filing an application to the NCLT under Section 10 of the Code. This provision allows the corporate debtor to take proactive steps to address its financial distress and seek resolution through the insolvency process. These provisions ensure that various stakeholders, including financial creditors, operational creditors, and corporate debtors, have the ability to initiate the CIRP process, thereby promoting transparency and enabling swift resolution of insolvency cases in accordance with the objectives of the Insolvency and Bankruptcy Code.

IV. LIQUIDATION PROCESS

Section 33 of the Insolvency and Bankruptcy Code (IBC) delineates the circumstances under which the National Company Law Tribunal (NCLT) must order the liquidation of a corporate debtor. These circumstances include:

Failure to Receive or Reject a Resolution Plan: If the NCLT does not receive a resolution plan within the prescribed period of 180 days, as per Section 12 of the Code, or if it rejects the plan received under Section 31(2), it shall order liquidation.

Non-Approval of Resolution Plan by Committee of Creditors: If the Committee of Creditors does not approve a resolution plan and decides to opt for liquidation of the corporate debtor, the NCLT shall order liquidation.

Contravention of Approved Resolution Plan: If the corporate debtor contravenes the approved resolution plan, and an aggrieved party applies for liquidation, the NCLT shall order liquidation.

The Code mandates that once any of these grounds are satisfied, the NCLT must pass an order for liquidation without discretion.

Once a liquidator is appointed, the mechanism outlined in Chapter III of the Code takes effect. This includes provisions similar to those in the Companies Act, with some distinctions. Notably, appeals against liquidation orders are limited to grounds of material irregularity or fraud.

The Code introduces the concept of a liquidation estate comprising assets specified in Section 36(3) of the Code, which the liquidator manages as a fiduciary to creditors. Certain assets, such as beneficial interests and trust ownership, are excluded from the liquidation estate.

The liquidator is empowered with special informational powers to access information systems for claim admission and asset identification, aiming to prevent unwarranted claims and expedite the process. Statutory appeal to the NCLT is provided against liquidator's orders rejecting claims, a departure from the previous regime.

Additionally, the liquidator can make applications to annul extortionate credit transactions made within two years before the insolvency commencement date. The NCLT may order restitution, modification, or other actions if it deems the transaction to be extortionate, though such powers should be exercised judiciously to avoid undue interference in legitimate transactions.

V. CHALLENGES TO CORPORATE INSOLVENCY RESOLUTION PROCESS AND LIQUIDATION PROCESS IN INDIA

This paper provides a comprehensive analysis of the challenges faced by insolvency professionals in carrying out corporate insolvency resolution processes (CIRP) and liquidation processes under the Insolvency and Bankruptcy Code, 2016 (IBC). Here's a breakdown of the challenges as under :

Time-bound Process: The strict 180-day timeline for CIRP poses challenges in collating credit information, preparing information memorandums, setting up information utilities, and adjudicating resolution plans within the stipulated timeframe. Additionally, there's a need for infrastructure strengthening and availability of insolvency professionals.

Absence of Timelines for Disposal of Appeals: While Section 12 sets a time limit for CIRP, there are no prescribed timelines for NCLT to approve or reject resolution plans or dispose of appeals, potentially leading to prolonged resolution processes.

Infrastructure Establishment: Adequate IT and other infrastructure are required at adjudicating authorities' offices to handle the influx of CIRP and liquidation cases.

Capacity Building of Insolvency Professionals: Capacity building of insolvency professionals is crucial, considering the newness of the code and the qualifications and experience required for them.

Expiration of IRP Tenure: Regulations regarding the tenure of Interim Resolution Professionals (IRP) need clarity to avoid situations where the tenure expires before convening the first meeting of the creditors' committee.

Shortage of NCLT Benches: Limited NCLT benches and resources pose challenges in managing the transition of pending cases and ensuring effective disposal of insolvency cases.

High Cost of Bankruptcy Resolution: Adoption of the UK bankruptcy regime may lead to increased costs of bankruptcy resolution, which may not significantly improve creditor recoveries.

Cross-Border Insolvency: The current code lacks explicit provisions for cross-border insolvency, which is crucial for a comprehensive and effective insolvency law.

Risk of Fraudulent Initiation: The stringent nature of the law may lead to fraudulent initiation of CIRP by competitors, posing a challenge in distinguishing genuine cases from frivolous ones.

Impact on Entrepreneurship: The threat of losing control over management and facing liquidation may deter entrepreneurship and risk-taking, impacting corporate growth and development.

Professional Standards: Variations in licensing, renewal requirements, and professional standards between India and countries like the UK pose challenges in maintaining uniformity and ensuring high standards among insolvency professionals.

These challenges highlight the complexity and nuances of implementing the IBC effectively and underscore the need for continuous refinement and adaptation to ensure its success in addressing corporate insolvency issues.

VI. CONCLUSION

The enactment of the Insolvency and Bankruptcy Code, 2016 marks a pivotal moment in India's legal and economic landscape. By consolidating various aspects of insolvency and recovery processes into a single comprehensive code, the IBC has ushered in a new era of efficiency, transparency, and accountability in handling financial distress.

With a primary focus on corporate insolvencies, the IBC addresses longstanding issues of fragmented legal frameworks and inefficient institutional setups. Its time-bound resolution process aims to maximize the value of distressed businesses, benefiting creditors, debtors, and the overall economy by facilitating quick redeployment of capital and resources.

However, as with any significant legislative reform, challenges abound. From the need for infrastructure strengthening to capacity building of insolvency professionals, and from ensuring timely disposal of appeals to addressing cross-border insolvency issues, there are numerous areas that require attention and refinement.

Despite these challenges, the IBC represents a historic development for India, signaling a shift towards a more robust and effective insolvency regime. As the implementation of the code progresses and stakeholders adapt to its provisions, it is hoped that the IBC will fulfill its objectives of promoting entrepreneurship, availability of credit, and balanced interests of all stakeholders involved in the insolvency resolution process.

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