



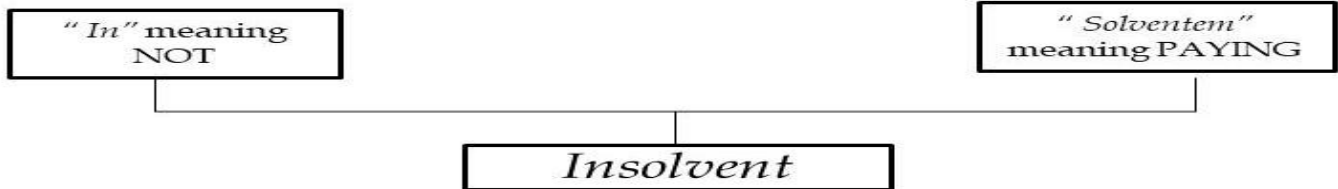
CS-Professional
(Module-II)

Part II - Insolvency

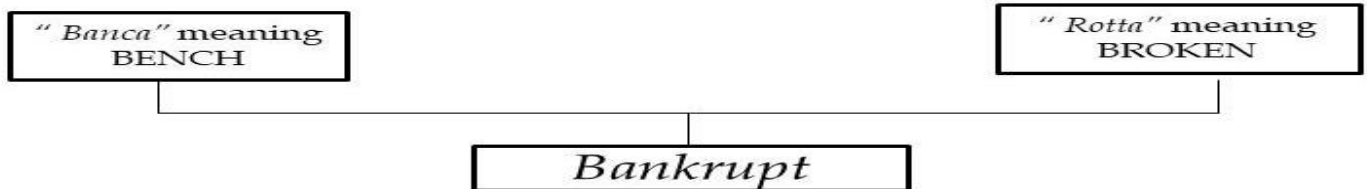
CS Vaibhav Chitlangia

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."



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
<ul style="list-style-type: none"> • Insolvency is the State of not being able to repay one's debts • It is merely a situation and can be used in respect of individuals as well as corporates. 	<ul style="list-style-type: none"> • Bankruptcy is the legal status accorded to people • It is a formal declaration of insolvency in accordance with the law of the land

Insolvency

If not Resolved, results in

**Bankruptcy –
Individuals &
Firms**

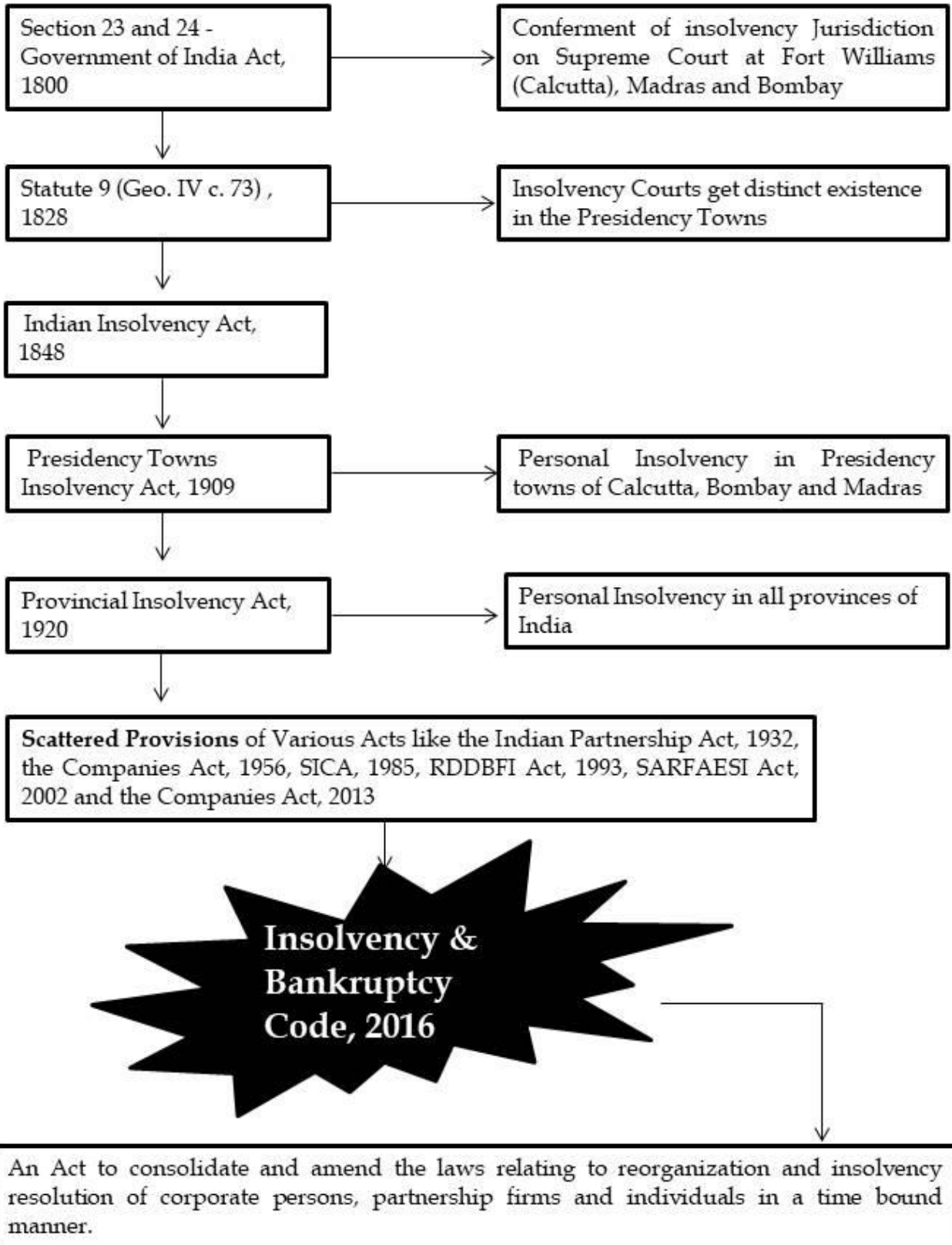
**Liquidation –
Corporate Bodies**

Bankruptcy	Liquidation
<ul style="list-style-type: none">• 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<ul style="list-style-type: none">✓ 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.	<ul style="list-style-type: none">• 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 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 –

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

➤ 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.”**

➤ 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.

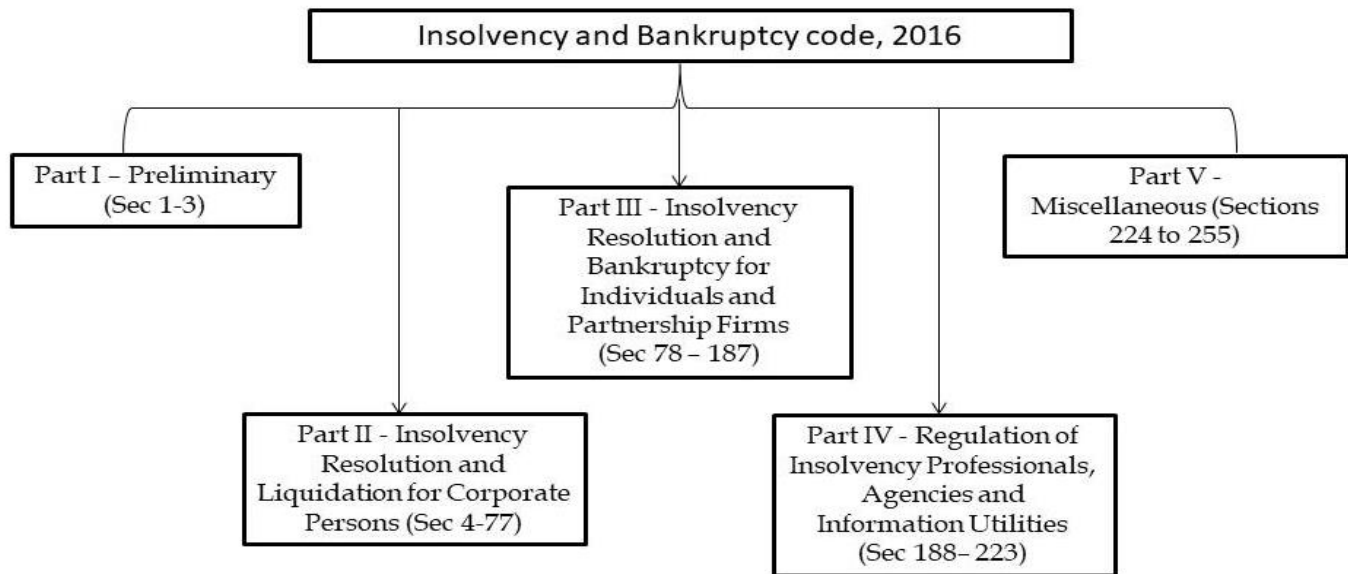
The Code was introduced in the Lok Sabha on 21 December, 2015 and was subsequently referred to a Joint Committee of Parliament. The Committee submitted its recommendations and the modified Code was passed by the Lok Sabha on 5 May, 2016. The Code was passed by Rajya Sabha on 11 May, 2016 and it received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

The Insolvency and Bankruptcy Code, 2016 extends to the whole of India. However, Part III of the Code does not extend to the State of Jammu and Kashmir.

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

➤ WHAT SETS THE CODE APART?

The following are some of the distinguishing factors which have led to the recognition of IB Code, 2016 as one of the most successfully drafted legislations in India –

1. Who may initiate the resolution process -

In case the defaulter is a Corporate Person, the Insolvency Resolution process can be initiated by –

- a. The Financial Creditors
- b. The Operational creditors
- c. The Corporate Applicant

If the defaulter is an individual or a firm, the Resolution Process can be initiated by –

- a. The Debtor
- b. Any of the Creditors

2. Threshold to initiate Insolvency resolution process-

For Corporate Debtors (Including LLPs) – **Minimum Default of Rs. 1,00,000/-**

For Individuals/ Firms – **Minimum default of Rs. 1,000/-**

3. Processes envisaged in the Code for the resolution of insolvency -

For a Resolution Process under Part II of the Code (i.e., of a Corporate Person) –

- a. **Insolvency Resolution Process**, during which the creditors assess the viability of debtor's business and the options for its rescue and revival
- b. **Liquidation**, in case the insolvency resolution process fails or financial creditors decide to wind up and distribute the assets of the debtor

For a Resolution Process under Part II of the Code (i.e., of an individual / firm) –

- a. Automatic Fresh Start
- b. Insolvency Resolution

4. Time Limit for completion of the resolution process –

The Insolvency Resolution Process as envisaged under the Code is required to be completed within **180 days (subject to a one-time extension by 90 days)** from the date of acceptance of application by the NCLT.

However, the **Insolvency and Bankruptcy Code (Amendment) Act, 2019** has laid down that the corporate insolvency resolution process shall mandatorily be completed within a period of 330 days from the insolvency commencement date. This shows that an overall limit of 330 days has been imposed for the completion of the Resolution process.

5. Priority of claims for distribution of proceeds –

The Code envisages that the claims of different creditors / stakeholders shall be discharged in the following order of priority –

- a. fees of insolvency professional and costs related to the resolution process,
- b. workmen's dues for the preceding 24 months and secured creditors,
- c. employee wages,
- d. unsecured creditors,

- e. government dues and remaining secured creditors (any remaining debt if they enforce their collateral),
- f. any remaining debt,
- g. shareholders.

This shows that there has been a significant change in the order of priority in which claims are discharged under the Code.

6. Other Provisions –

The Code specifies stringent penalties for certain offences such as concealing property in case of corporate insolvency. The imprisonment in such cases may extend up to five years, or a fine of up to one crore rupees, or both.

Further, in case of cross-border insolvency proceedings, the central government has been given the power to enter into bilateral agreements and reciprocal arrangements with other countries to enforce the provisions of the Code.

➤ DIFFERENT FUNCTIONARIES UNDER THE CODE

The IB Code, 2016 provides for the establishment of a completely new Institutional Framework for the smooth functioning of the Code. This includes the Insolvency and Bankruptcy Board of India (IBBI), Adjudicating Authorities (AAs), Insolvency Professionals (IPs), Insolvency Professional Agencies (IPAs) and Information Utilities (IUs)

➤ THE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (IBBI)

The Insolvency and Bankruptcy Board of India was established on 1st October 2016. It is a unique regulator which regulates a profession as well as processes under the Code.

IBBI is a body corporate having perpetual succession and a common seal, with power, subject to the provisions of this Code, to acquire, hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or be sued.

Composition - The Board shall consist of the following members who shall be appointed by the Central Government, namely:

- a. A Chairperson
- b. Three members not below the rank of joint Secretary or equivalent, one of each to represent the Ministry of Finance, the Ministry of Corporate Affairs and Ministry of Law, ex-officio.
- c. One member to be nominated by the Reserve Bank of India, ex-officio.
- d. Five other members to be nominated by the Central Government, of whom at least three shall be the whole-time members.

The term of office of the Chairperson and members (other than ex officio members) is of five years or till they attain the age of sixty-five years, whichever is earlier, and they are eligible for reappointment.

Removal of Members – The Central Government has the power to remove a member from office, after giving an opportunity of being heard to the member, if he /she -

- a. is an undischarged bankrupt as defined under Part III;
- b. has become physically or mentally incapable of acting as a member;
- c. has been convicted of an offence, which in the opinion of the Central Government involves moral turpitude;
- d. has, so abused his position as to render his continuation in office detrimental to the public interest.

Powers and Functions of the Board -

- a. Regulation of Information Utilities;
- b. Regulation of Insolvency Professional Agencies and Insolvency Professionals;
- c. Regulation making in specific areas about procedural details in the insolvency and bankruptcy process & data collection, research and performance evaluation;

- d. Regulating all matters related to insolvency and bankruptcy process.
- e. Setting out eligibility requirements of insolvency intermediaries i.e., Insolvency Professionals, Insolvency Professional Agencies and Information Utilities.
- f. Regulating entry, registration and exit of insolvency intermediaries.
- g. Making model bye laws for Insolvency Professional Agencies.
- h. Setting out regulatory standards for Insolvency Professionals.
- i. make model bye-laws to be adopted by insolvency professional agencies etc.

➤ **INSOLVENCY PROFESSIONALS (IP)**

Insolvency Professionals (IPs) are required to act as intermediaries in the insolvency resolution process. They are a class of *regulated but private professionals* having minimum standards of professional and ethical conduct.

Under the Act, a resolution professional has to –

- a. Be a member of any Insolvency Professional Agency (IPA)
- b. Be registered as an Insolvency Professional with the IBBI

The IBBI has framed the **IBBI (Insolvency Professional) Regulations, 2016** to regulate the working of Insolvency Professionals

Functions and obligations of insolvency professionals –

To take such actions as maybe necessary and required in the following matters –

- a. fresh start order process under Part III
- b. individual insolvency resolution process under Part III
- c. corporate insolvency resolution process under Part II
- d. Individual bankruptcy process under Part III
- e. liquidation of a corporate debtor firm under Part II.

Code of Conduct of the Insolvency Professionals –

- a. To take reasonable care and diligence while performing his duties

- b. To comply with all requirements and terms and conditions specified in the bye-laws of the insolvency professional agency of which he is a member
- c. To allow the insolvency professional agency to inspect his records
- d. To submit a copy of the records of every proceeding before the Adjudicating Authority to the Board as well as to the insolvency professional agency of which he is a member
- e. To perform his functions in such manner and subject to such conditions as may be specified

➤ **INSOLVENCY PROFESSIONAL AGENCIES (IPA)**

Insolvency Professional Agencies are designated to regulate Insolvency Professionals. Their main function is to conduct examinations to enrol Insolvency Professionals and enforce a code of conduct for their functioning.

Currently, there are 3 IPAs registered with the IBBI. They are -

- a. ICSI Insolvency Professional Agency.
- b. Insolvency Professional Agency of Institute of Cost Accountants of India.
- c. Indian Institute of Insolvency Professional of ICAI.

Functions of IPAs -

- a. grant membership to persons who fulfil all requirements set out in its byelaws on payment of membership fee
- b. lay down standards of professional conduct for its members
- c. monitor the performance of its members
- d. safeguard the rights, privileges and interests of insolvency professionals who are its members
- e. suspend or cancel the membership of insolvency professionals who are its members on the grounds set out in its bye-laws

- f. redress the grievances of consumers against insolvency professionals who are its members, and
- g. publish information about its functions, list of its members, performance of its members and such other information as may be specified by regulations.

To regulate the working of Insolvency Professional Agencies, IBBI has framed the following Regulations -

- a. **The Insolvency and Bankruptcy Board of India (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016**
- b. **The Insolvency and Bankruptcy Board of India (Insolvency Professional Agencies) Regulations, 2016.**

➤ **INFORMATION UTILITIES**

The main duty of the Information Utilities (IUs) is to collect, collate, authenticate and disseminate financial information. The purpose of such collection, collation, authentication and dissemination financial information of debtors is to facilitate swift decision making in the resolution proceedings.

Obligations of Information Utility -

- a. create and store financial information in a universally accessible format
- b. accept electronic submissions of financial information from persons who are under obligations to submit financial information
- c. accept, in specified form and manner, electronic submissions of financial information from persons who intend to submit such information
- d. meet such minimum service quality standards as may be specified by regulations
- e. get the information received from various persons authenticated by all concerned parties before storing such information

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- f. provide access to the financial information stored by it to any person who intends to access such information in such manner as may be specified by regulations
- g. publish such statistical information as may be specified by regulations and
- h. have inter-operability with other information utilities.

The Insolvency and Bankruptcy Board of India has framed the **IBBI (Information Utilities) Regulations, 2017**.

➤ **ADJUDICATING AUTHORITY**

The IB Code, 2016 provides for two Adjudicating Authorities. They are –

- a. For Corporate Persons – National Company Law Tribunal
- b. For Individuals and Firms – Debt Recovery Tribunal

The Jurisdiction of the Civil Court have been explicitly excluded by virtue of Section 63 as well as Section 180 of the Code.

➤ **INSOLVENCY AND BANKRUPTCY FUND**

The Code provides for the creation of an Insolvency and Bankruptcy Fund.

The Code provides that the following amounts should be credited to the fund-

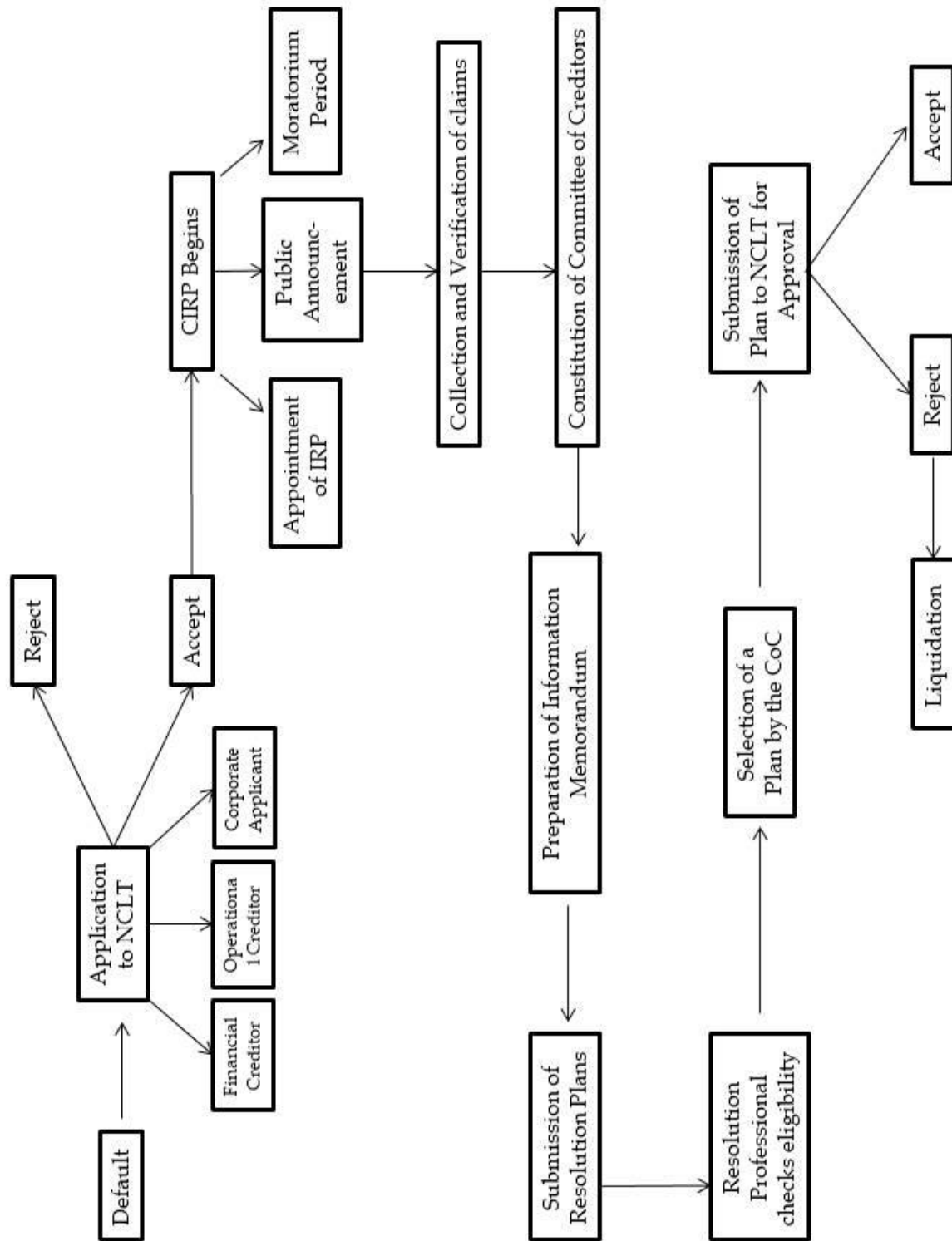
- a. Grants made by the Central Government for the purposes of the Fund
- b. Amount deposited by persons as contribution to the Fund
- c. Amount received in the Fund from any other source
- d. Interest or other income received out of the investment made from the Fund.

It is further provided in the Code that a person who has contributed any amount to the Fund may, in the event of proceedings initiated in respect of such person under the

Code, make an application to such Adjudicating Authority for withdrawal of funds not exceeding the amount contributed by it, for making payments to workmen, protecting the assets of such persons, meeting the incidental costs during the proceedings or such other purposes as may be prescribed.

CS Vaibhav Chitlangia

CORPORATE INSOLVENCY RESOLUTION PROCESS



CH 15 - PETITION FOR CORPORATE INSOLVENCY

RESOLUTION PROCESS

➤ **WHAT IS A CIRP?**

The Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 defines the expression "corporate insolvency resolution process" as "*the insolvency resolution process for corporate persons under Chapter II of Part II of the Code.*"

A Corporate Insolvency Process means a process where –

1. the financial creditors assess the viability of debtor's business; and
2. the seek options for its revival and rehabilitation.

The failure of a CIRP results in the Liquidation of the Company.

Liquidation is the process by which the assets of the debtor are realised and distributed by the liquidator in order to discharge its debts.

➤ **PERSONS WHO MAY INITIATE A CIRP**

Section 6 of the IB Code, 2016 provides for three categories of people who may initiate a CIRP against a Corporate Debtor. They are –

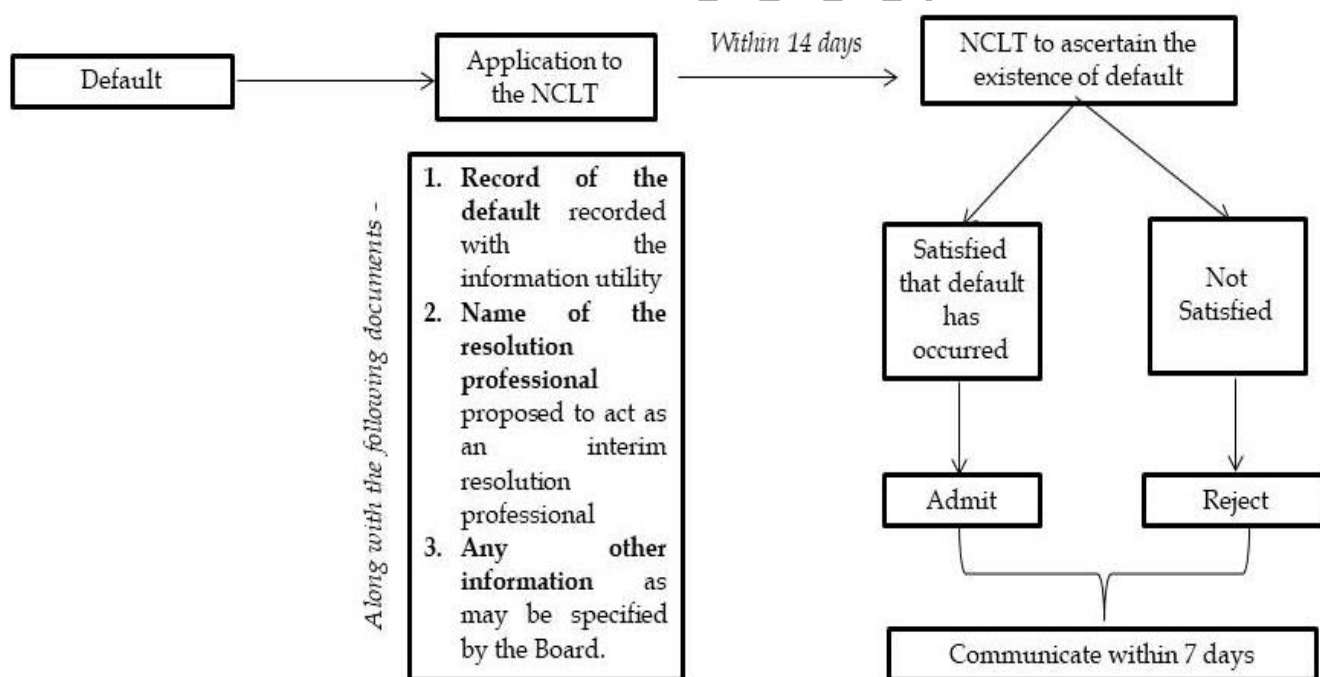
1. Financial Creditors
2. Operational Creditors
3. Corporate Applicant

➤ PROCEDURE FOR MAKING APPLICATION

The IB Code, 2016 has envisaged the procedure for initiation of CIRP by different sets of people in different sections. These are -

1. Section 7 - Financial Creditors
2. Section 8 - Operational Creditors
3. Section 9 & 10 - Corporate Applicant

▪ Initiation of Corporate Insolvency Resolution Process by Financial Creditors (Section 7)



The Application u/s 7 of the IB Code, 2016 can be filed by -

1. A financial creditor by itself;
2. A financial creditor jointly with other financial creditors;
3. Any other person on behalf of the financial creditor.

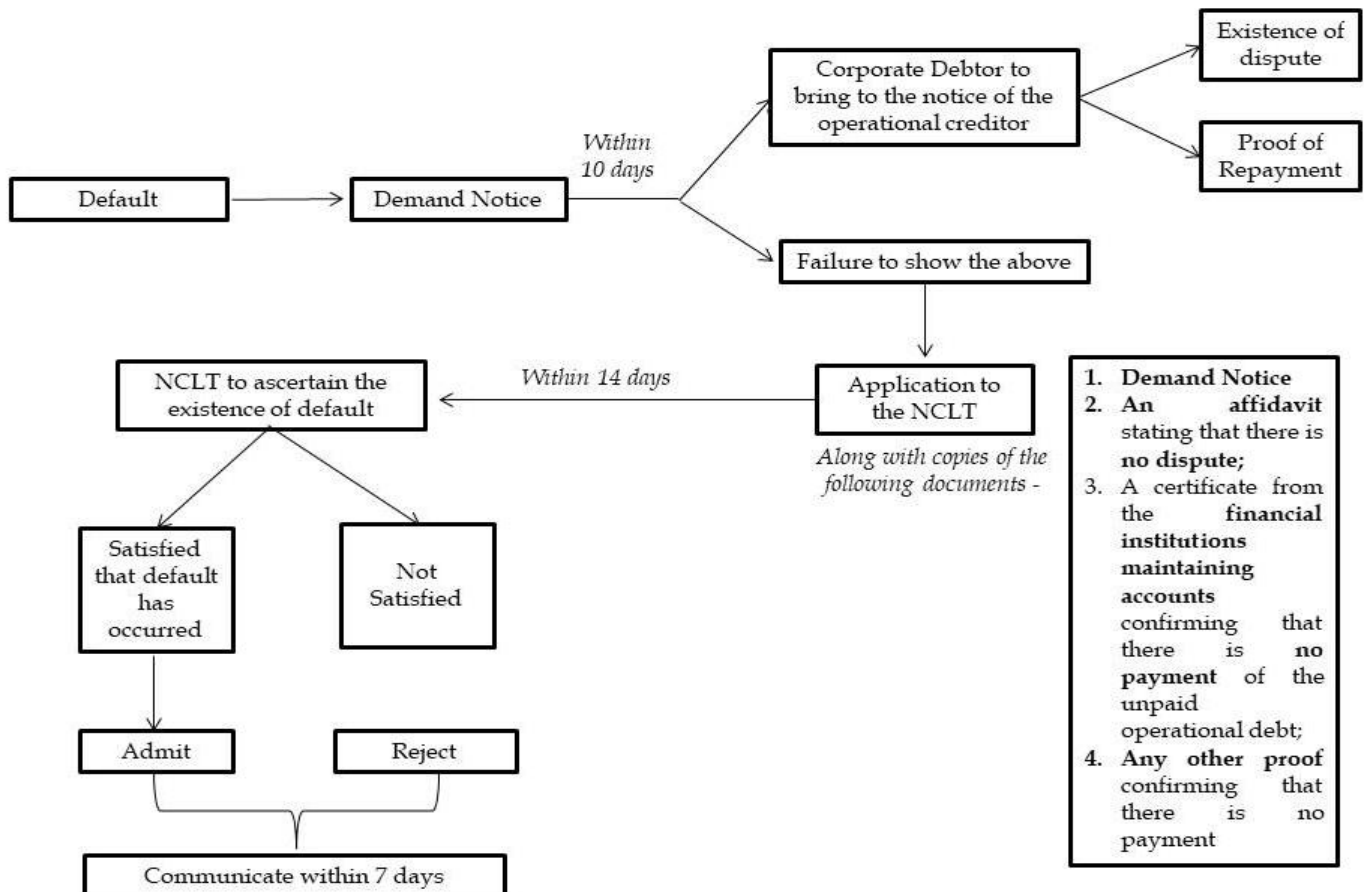
NOTE - A financial creditor can file an application for corporate insolvency resolution process even if the default is in respect of debt of another financial creditor.

If the NCLT finds that -

1. The Application is incomplete, or
2. The Resolution Professional whose name is suggested is not eligible, or
3. Default has not occurred;

it may return the application to the applicant. The applicant has a duration of **7 days** to rectify the mistakes and resubmit the application to the NCLT.

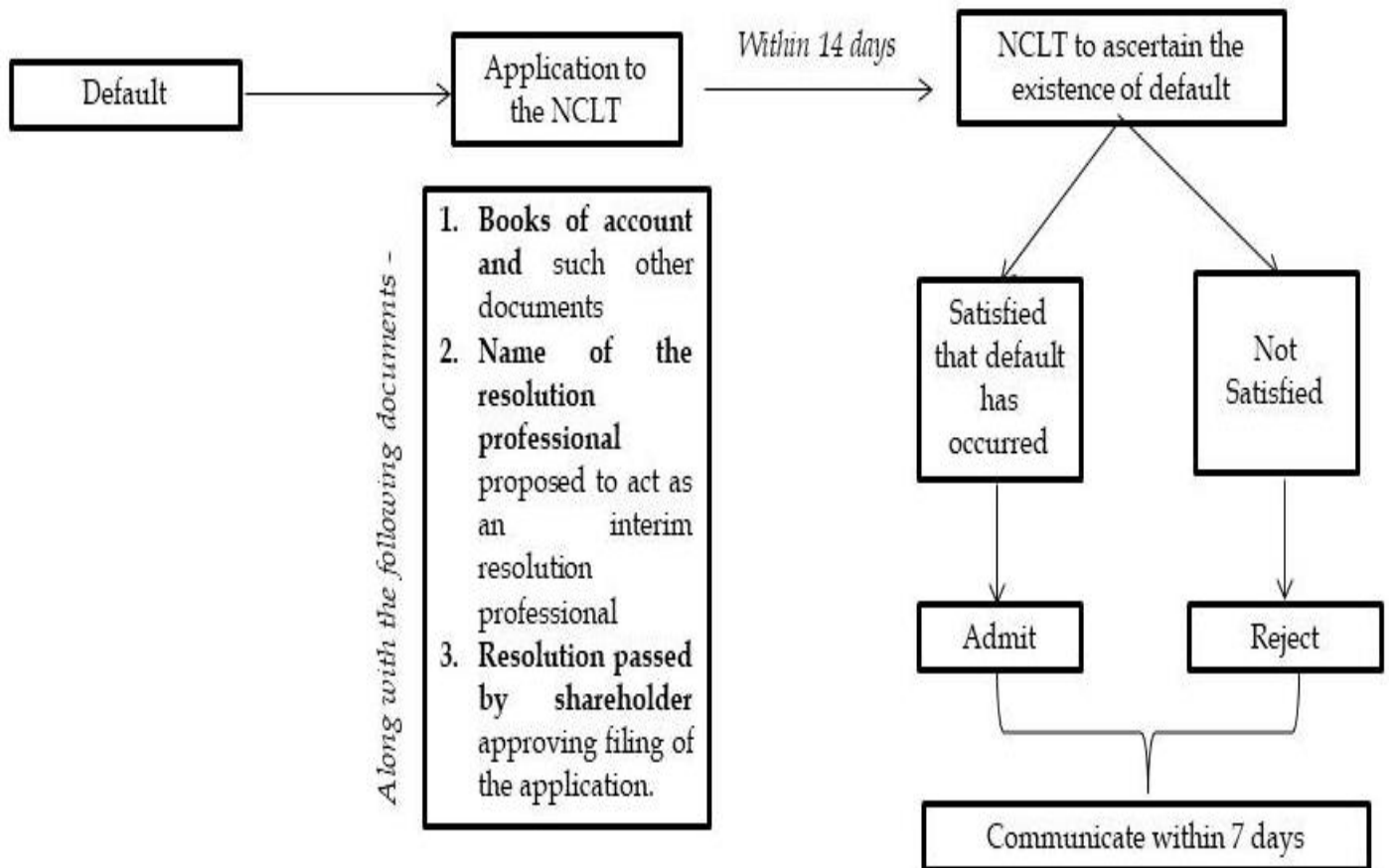
▪ **Initiation of Corporate Insolvency Resolution Process by an Operational Creditor (Section 8 and 9)**



NOTE -

- ✓ The Applicant under section 9 is not required to mandatorily suggest the name for the interim Resolution Professional.

▪ **Initiation of Corporate Insolvency Resolution Process by the Corporate Applicant (Section 10)**



NOTE - The Corporate Applicant can only initiate the corporate insolvency resolution process upon the occurrence of a default and not on mere likelihood of inability to pay debts.

➤ **DEFAULT BASED TEST**

The Insolvency and Bankruptcy Code, 2016 provides a default based test for initiating the corporate insolvency resolution process. A **default based test** for initiating the insolvency resolution process means proper action is taken at the earliest instance showing signs of financial distress. It permits early intervention which helps in timely resolution of insolvency.

➤ **PERSONS NOT ENTITLED TO MAKE APPLICATION - SECTION 11**

The following persons are disentitled from making an application for the initiation of CIRP against a Corporate Debtor -

1. a corporate debtor undergoing a corporate insolvency resolution process;
2. a corporate debtor having completed a CIRP twelve months preceding the date of making of the application;
3. a corporate debtor or a financial creditor who has violated any of the terms of resolution plan which was approved twelve months before the date of making of the application;
4. a corporate debtor in respect of whom a liquidation order has been made.

➤ **TIME-LIMIT FOR COMPLETION OF INSOLVENCY RESOLUTION PROCESS - SECTION 12**

Time Limit - The Corporate Insolvency Resolution Process shall be completed within a period of **180 Days** from the **date of admission of the application** to initiate such process.

Extension of time– The Resolution Professional shall file an application to the NCLT to extend the abovementioned period if authorised by a resolution passed at a meeting of the committee of creditors by a vote of 66% of the voting shares. This extension can be granted only once for a maximum period of 90 days.

However, the **Insolvency and Bankruptcy Code (Amendment) Act, 2019** has laid down that the corporate insolvency resolution process shall mandatorily be completed within a period of **330 days** from the insolvency commencement date.

➤ **WITHDRAWAL OF APPLICATION - SECTION 12A**

- ✓ This Section was added by the **Insolvency and Bankruptcy Code (Second Amendment) Act, 2018**.
- ✓ It provides that the Adjudicating Authority may allow the withdrawal of application admitted under section 7 or section 9 or section 10, on an application made by the Applicant.
- ✓ The application for withdrawal needs the approval of **90%** voting share of the committee of creditors.



CS Vaibhav Chitlangia is one of the very few people to have completed the Company Secretary Course at the age of 21 with All India Ranks at all the three levels. He got the 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).

Apart from teaching, Vaibhav is currently in the final year of ILS Law College, Pune. 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 mind; if that is controlled, every feat is achievable"



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