**Editorial**

# Bankruptcy Code to Help the Bankers and Borrowers

The Narendra Modi-government has finally succeeded in getting cleared the Bankruptcy Code from the Lok Sabha to enhance ease of doing business in the country and facilitate timely debt recovery in cases of default. The Bill would effectively unlock the assets stuck up with bankrupt borrowers. On becoming a law, it would enable banks to push for resolution/recovery of the money from a troubled company within a period of 180 days, with a grace period of another 90 days only if majority (75 per cent) of creditors would agree to it. If the recovery doesn't happen even then, the company will be liquidated automatically. The Insolvency and Bankruptcy Code, 2016 passed by the Lok Sabha (LS) on 5 May, 2016 and the Rajya Sabha on May 11, would indeed ensure time-bound settlement of insolvency, enable faster turnaround of sick businesses and create a database of serial defaulters.

The new code will replace the existing bankruptcy code of the country by doing away with at least 12 different legislations in existence hitherto. Some of these legislations are centuries old. It will cover individuals, companies, limited liability partnerships and partnership firms. The bill also includes provisions to address cross-border insolvency through bilateral agreements with other countries.

The new code proposes to repeal the Presidency Towns Insolvency Act, 1909, the Provincial Insolvency Act, 1920 of British time, along with amending the other 11 legislations, including the Companies Act, 2013; Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; Limited Liability Partnership Act, 2008, etc. Policy-related aspects are being addressed in the code itself and vaious procedural aspects will be dealt under delegated legislations for the sake of flexibility. The code is unique in its approach as it has drawn the positive attributes of the bankruptcy systems of the US and the UK, like providing for a moratorium period during the resolution process, time-bound insolvency process, etc. But it is yet to address certain important aspects such as lifting of moratorium in cases of fraud, option for management of affairs by the corporate debtor under supervision, etc. Another deviation is with respect to chapter 11 of the US Bankruptcy Code which provides for debtor in possession concept, i.e. the debtor continues to manage the affairs of the company during the insolvency resolution process. The new code proposes the management of affairs by an insolvency resolution professional similar to the UK bankruptcy laws.

One of the important features of the new Code is that it empowers both the corporate debtor and the creditor to initiate corporate resolution process on the trigger of a loan default. On the initiation of bankruptcy, an Insolvency Resolution Professional (IRP) will assume control of the corporate debtor's management, displacing the incumbents. But, merely enabling stakeholders to move for insolvency resolution does not mean they will be motivated to move.

Counter-intuitively, the only stakeholders that have adequate information about the solvency risk of a firm are the management of the borrowing unit. But, because the probability of the management surviving in case of bankruptcy under the current Code is zero after moving for the same, it is most unlikely that they will move for the insolvency resolution process at all.

The insolvency resolution process could be initiated by a corporate debtor who has defaulted in payment of his dues or by creditors, on either case, whether it is financial or operational. When the process is triggered on, the creditors' claims will be frozen for 180 days, during which time they will hear proposals for revival and decide on the future course of action. As per the new code within those 180 days, 75% of financial creditors must agree to such a revival plan. If this minimum threshold is not met, the defaulting firm would automatically go into liquidation. But, if three-fourths of the financial creditors consider the case complex and feel it cannot be addressed within 180 days, the adjudicator could grant a one-time extension of up to 90 days on the process. Thus, it has to be resolved within 180+90=270 days.

The model that Chapter 11 of the US Bankruptcy Code offers is instructive and appears to have better flexibility in this regard. Under Chapter 11 of the US code, the management retains its job during the bankruptcy process except that the creditors and the ourt are empowered to appoint a trustee. The Court can also appoint an examiner to investigate the affairs of the debtor. Thus, in the US, the management retains management control in bankruptcy, except they manage "in the shadow of a trustee" appointed as aforesaid and as such, the risk that they will indulge in asset stripping during the process appears substantially mitigated.

As the new code now attempts to create a formal insolvency resolution process (IRP) for businesses, either by coming

up with a viable survival mechanism or by ensuring speedy liquidation, it will effectively curb the number of long-pending cases of default substantially. The code now envisages a new regulator also for bankruptcies—the Insolvency and Bankruptcy Board of India—while introducing professionals who will handle insolvency cases and insolvency professional agencies to oversee the overall supervision of the Insolvency Board. The code also proposes for information utilities to collect, collate, authenticate and disseminate financial information from listed companies and financial and operational creditors of companies. This will help make the IRP smoother, transparent and dependable by maintaining a range of financial information about companies. Currently, four different forums—High Courts, Company Law Board (CLB), Board for Industrial and Financial Reconstruction (BIFR) and Debt Recovery Tribunal (DRT)—have overlapping jurisdictions, which gives rise to systemic delays and complexities in the process. The code helps overcome these challenges and would help reduce the burden on the courts as all litigations will be filed under the code before the National Company Law Tribunal (NCLT) for corporate insolvency and insolvency of LLPs, and before DRT for individual insolvency and insolvency of unlimited partnership firms. So, the burden on the judiciary would reduce considerably. This model offers incentive for the management to move the insolvency resolution process at the earliest. Besides, the commentary to the Code also highlights the need to distinguish corporate failure from corporate malfeasance. Yet, a blanket rule for replacing the management with IRP also appears repulsive as well as internally incoherent.

But, inspite of some minor limitations, the code is the most desired and awaited. Because the Present mode for recovering money from a defaulted corporate borrower is nightmarish for bankers, and it takes years for the Debt Recovery Tribunals (DRTs) to overcome the litigations. Defaulters typically drag the banks to various courts on one or the other pretext to delay their payments. By the time the whole process gets over, there remains nothing for the banks to recover. The underlying value of the assets gets eroded sharply by then. It is not yet clear whether the new bankruptcy law would also allow a defaulted debtor to move to a higher court against the lenders or not. If it is yes then, things aren't going to be different, even now. Therefore, even when the new law is in place, its success would depend on how conducive our legal system would be to support the execution of the new Law and how fast banks would be able to exercise their rights. Otherwise in Vijay Mallya's-Kingfisher case the banks have been fighting this case with this liquor baron in different courts (DRTs, High Courts and Supreme Courts), and even after 4 years of default, there has been no meaningful progress on recovery. Even he has left the country.

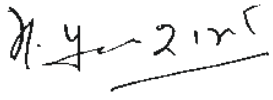
With this new code, the time-frame to resolve bankruptcy in India would at least get shortened to one year. It will help creditors to recover the debt faster and will also help to improve India's position in World Bank's ease of doing business ranking.

So, it is true that the proposed bankruptcy law, on replacing the Presidency Towns Insolvency Act, 1909, would come handy for the banks to deal with future cases of default. However, a big question that emerges is whether the existing stock of bad loans, where recovery from corporations is pending for several years, the new code would be applicable or not which are currently in DRTs.

Another praiseworthy attribute incorporated in the new code is for protecting workers' interest. The code will allow the money due to workers and employees from the provident fund, the pension fund and gratuity fund would not be included in the estate of the bankrupt company or individual. Further, workers' salaries of up to 24 months will get the first priority in case of liquidation of assets of a company, ahead of secured creditors.

Howerver, Corporate democracy requires that each class of creditors under the proposed resolution plan vote separately on it. So merely enabling each of them to attend the creditor committee meetings as "observer" as the bill (as passed by the Lok Sabha) has sought to do appears inconsistent with corporate democracy. Indeed, Chapter 11 of the US Bankruptry code provides for class voting to ensure that the sanction of the resolution plan is truly representative.

Finally, since the Code provides a hard deadline of 180/270 days for completing corporate insolvency resolution process and failing which, the Code mandates the "Adjudicating Authority" to order liquidation (Section 33 (2) of the Code, the Code offers a much smooth process for recovery of debt from defaulters.



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