

When Zero Hour Strikes: The Insolvency And Bankruptcy Code As An Exit Mechanism

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Exit Mechanism Under IBC 2016

The Insolvency and Bankruptcy Code, 2016 ("Code") caused a magnanimous shift in the field of insolvency and bankruptcy laws in India. The Code has transformed the insolvency regime from a "debtor in possession" to a "creditor in control" one, providing major control to the financial and operational creditors of a corporate debtor in an insolvency or a liquidation process.[1]

The Code offers a balance of benefits to creditors, corporate debtors, and the management of corporate debtors. While on one hand, it provides a better mechanism to recover the debts of creditors, it also offers an option to run the operations of the corporate debtor while the insolvency process is in motion. Further, it also allows the management of the corporate debtor to focus on important matters other than the insolvency or liquidation process of the corporate debtor.

The Insolvency and Bankruptcy Code aims at providing an easy exit mechanism for corporate debtors by way of simplifying their insolvency or liquidation process. It also allows for an easy exit for the management of the corporate debtor by suspending them from their roles once the insolvency or liquidation process is initiated.

This article aims to provide an analysis on how the Insolvency and Bankruptcy Code helps in achieving these twin objectives, by comparing it with the erstwhile insolvency laws.

Insolvency Laws: A Brief History

Insolvency, before the implementation of the Insolvency and Bankruptcy Code, was dealt with under many laws. While the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 governed individual insolvency, for companies, it was the Companies Act, 1956, Companies Act, 2013 ("Companies Act") and the Sick Industrial Companies (Special Provisions) Act, 1985. Further, financial institutions used to initiate proceedings under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, ("SARFAESI Act") for recovering debts due to them from individuals and other entities.

Insolvency and Bankruptcy Code, which was enacted in 2016, was an attempt to

consolidate the insolvency laws and has therefore either repealed, modified or substituted these laws.

Exit Mechanism: The Code v. Erstwhile Laws

The Statement of Objects and Reasons of the Code states that it is an "act 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 maximization of value of assets of such persons." The intention of the Code is to complete insolvency processes in a timebound manner, thereby maximizing the value of the assets and balancing the interests of all the stakeholders, including the Government. The Code, through its variety of insolvency and liquidation processes, seeks to further the objectives stated by it.

A. Exit Mechanism for the Company

The Code provides that an application for initiation of a corporate insolvency resolution process (CIRP) shall be decided by the adjudicating authority, being the National Company Law Tribunal (NCLT), within 14 (fourteen) days and that the order on the admission of Corporate Insolvency Resolution Process (CIRP) shall also include the appointment of the Resolution Professional (RP) and they shall be deemed to be appointed from the date of the order by the NCLT. Further, the Code provides that the CIRP shall be completed within a maximum period of 330 days. In this regard, the Supreme Court in its recent ruling has held that the CIRP should be completed within the timeframe prescribed under the Code.^[2]

The Code provides for a Fast Track CIRP process for certain classes of corporate debtors which can be completed within a maximum period of 135 days including extensions if any.

Further, the Code has also brought in a new type of insolvency process for MSMEs, called the Pre-Packaged CIRP, where the creditors and the MSME enterprise, can enter into an arrangement/agreement, without initiating the CIRP, and sanction can be sought for the said arrangement before the NCLT. Apart, from this, the Code also provides that liquidation of corporate debtors should be completed within 1 (one) year from commencement of the liquidation process.

Comment:

Under the erstwhile laws, the time period for completion of liquidation or insolvency was either not provided or if provided, would in most cases, be a directory provision. Further, under the erstwhile laws, the process of completing the liquidation or insolvency was vague and led to further delays in completion and increased costs. Additionally, under the erstwhile laws, all entities had to go through the same process for liquidation or insolvency – regardless of the nature and size of the enterprise.

The Code, by simplifying the process and providing strict timelines and also by providing different options of insolvency/liquidation for various classes of corporate debtors, seeks to expedite the process of insolvency and liquidation.

B. Exit Mechanism for Management

The Code provides that once a CIRP or a Fast-Track CIRP (as the case may be) is initiated, the management of the corporate debtor shall be taken over by the RP or the liquidator (as the case may be) and the powers of the Board of Directors (BOD) shall stand suspended as of the date of appointment of the RP. The role of the BOD and the management shall then be limited to assisting

the RP in providing necessary information as required by the RP.

By way of suspending the powers of the BOD and the management, the Code essentially allows such persons to focus on other matters and not be apprehensive of the insolvency process of the corporate debtor.

Comment:

Under the erstwhile laws, there was no such provision and hence, while the insolvency process continued, the BOD/management would also continue managing the entity. Further, the lack of clarity on the process of insolvency or its complexity was also something that weighed the management with down additional compliances.

Concluding Notes

A look at the provisions indicates that the Insolvency and Bankruptcy Code (in theory) does fulfil its twin objectives and provides a hassle-free exit mechanism for both the management and the corporate debtor. In the earlier laws, there was no system in place that allowed a company to survive and carry on while also safeguarding the interests of the creditors. As exit mechanisms go, it is one that aims to preserve and maximise the value of the company's assets and aims to deliver practical solutions to the stakeholders in a regimented process that adheres to deadlines and a schedule.

Having said this, it needs to be noted that while the process of insolvency/liquidation has been set out in detail, there are many practical issues involved in the process that the Insolvency and Bankruptcy Code does not deal with. This is a testament to the number of amendments the Insolvency and Bankruptcy Code has undergone since its enforcement in 2016.

For example, several practical issues that arise post-initiation of CIRP regarding submission of claims, admission of claims, rejection of claims etc are not dealt with by the Code or its rules or regulations. Therefore, while theoretically, the Code does aim at providing a faster exit mechanism, only time will reveal whether the Code has achieved these objectives from a practical eye.

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- [1] Insolvency and Bankruptcy Board of India, 2020, "Understanding the IBC: Key Jurisprudence and Practical Considerations – A Handbook", Available at: <https://ibbi.gov.in/uploads/whatsnew/e42fddce80e99d28b683a7e21c81110e.pdf>
 - [2] Ebix Singapore Private Limited vs Committee of Creditors ("CoC") of Educomp Solutions Limited Civ. Appeal No. 3224 of 2020
- Contributed by Sivasubramanian N, Associate