Interview with The Expert

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Q1. What are the foundational objectives of the Insolvency and Bankruptcy Code, 2016?

A. It is useful to look at the objectives of the Code as stated in its long title. It is for insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for ***maximisation of value of assets*** of such persons, ***to promote entrepreneurship, availability of credit*** and ***balance the interests of all the stakeholders***. Towards these objectives, the Code (a) endeavours to prevent insolvency; (b) provides a market mechanism for time bound for resolution of insolvency, wherever possible, and (c) promotes ease of exit, wherever required.

The Code has primarily four foundational objectives:

(i) It addressesbusiness failures and thereby ***promotes entrepreneurship.*** Consider a firm that has freedom of entry and freedom to do business. It may, however, fail to deliver as planned, for a variety of reasons. Most often it is due to competition and innovation and for no fault of the entrepreneur.Whilecompetition and innovationcontribute to growth significantly, they increase the incidence of firm failure. The failure could also arise from faulty conceptualisation of business, inefficient execution of business, change of business environment, or even malafide design in rare cases. Irrespective of the reason,it dampens entrepreneurship.Through provisions for reorganisation, wherever feasible,and exit of a firm, wherever required, the Code enables a firm / entrepreneur to get in and get out of business with ease, undeterred by failure (honest failure for business reasons).

(ii) It addresses default andthereby ***enhances availability of credit*** for business. Failure usually manifests as default in repayment obligations, indicating the firm in question in a state of insolvency. Default could arise also from a mismatch between cash inflows and outflows. It is the result of either illiquidity or insolvency and is often a legitimate outcome of business operations. It has, however, serious business consequences. In the face of risk of default, lendersare not willing to lend.As the lenders do not get back their funds, the availability of funds at their disposal reduces limiting their ability to relend even for genuinely viable projects. On the other hand, low and delayed recovery pushes up the cost of lending, and consequently, credit becomes available at a higher cost at which firms are not willing to borrow.Through provisions for resolution and exit,the Code enables lenders to recover funds from either future earnings, post-resolutionor sale of liquidations assets.They can now

distinguish and price credit risks across risk categories and offer differentiated and customized credit products across the value chain.On the other hand, the inevitable consequence of a resolution process (creditors get a right to decide the future of the firm) deters the management and promoter of the firm from committing a default and thereby minimizes the incidence of default. These increase supply of credit, reduce cost of funds, and develop debt market.

(iii) It addresses inefficiency of resource utilisation and thereby ***maximises the value of assets****. Default reflects relative under-performance (inefficiency) of a firm as compared to the most competitive firm in the industry. In other words, the resources at the disposal of afirm may not always be optimally utilised. The Code facilitates better utilisation of resources of the firm, while preserving the enterprise value. It enables the optimum utilisation of resources, all the time, either by (a) preventing use of resources below the optimum potential, (b) ensuring efficient resource use within the firm through resolution of insolvency; or (c) releasing unutilised or under-utilised resources for efficient uses through closure of the firm. It is believed thatif the resources, that are currently unutilised or underutilized or rusting for whatever reason, can be put to more efficient uses, the growth rate may well go up by a few percentage points, other things remaining unchanged, particularly when it is accompanied by availability of credit and entrepreneurship.*

(iv) It ***balances interests of all stakeholders*** *of the corporate debtor. Equity owners have complete control over a firm as long as they service debt obligations. When they fail to service debt, the Code shifts control to the creditors who get a right to decide what to do with the firm. However, the debtor has as much rights as a creditor under the Code to initiate resolution in case of default. An operational creditor has as much rights as a financial creditor to initiate resolution. The Code provides several measures, such as, payment of at least liquidation value to operational creditors, priority in waterfall for stakeholders in case of liquidation, to balance the interests of stakeholders. While running the firm and approving a resolution plan, the Committee of Creditors (CoC) and the Insolvency Professional (IP) also need to balance the interests of all stakeholders.*

The economywitnessed freedom of entry in the 1990s, led primarily by reform in securities laws, and freedom to compete in the 2000s led primarily by reform in competition laws. The Code now provides the ultimate economic freedom, freedom to exit, led primarily by reform in insolvency and bankruptcy laws. The Code has liberated resources stuck up in inefficient and defunct firms (chakravyuha) for continuous recycling, and has thereby changed the script from ***'Hopeless End' to 'Endless Hope'.***

Q2. What is the strategy underlying the Code?

A. *In the matter of Innoventive vs. ICICI, the Hon'ble SupremeCourtsummed up the Code: "The scheme of the Code, therefore, is to make an attempt, by divesting the erstwhile management of its powers and vesting it in a professional agency, to continue the business of the*

corporate body as a going concern until a resolution plan is drawn up, in which event the management is handed over under the plan so that the corporate body is able to pay back its debts and get back on its feet. All this is to be done within a period of 6 months with a maximum extension of another 90 days or else the chopper comes down and the liquidation process begins."

If a corporate defaults the threshold amount, a financial creditor, an operational creditor, or the corporate itself may initiate resolution process. It makes an application before the adjudicating authority (AA) along with the evidence of default. If default is established, the AA admits the application and appoints an interim insolvency professional (IRP). The IRP runs the operations of corporate as a going concern up to 30 days during which he collects the claims and based on the same, forms a CoC. The CoC appoints a resolution professional to run the corporate as a going concern and decides what to do with the corporate. The CoC endeavours to resolve insolvency through a resolutionplan.If it approves a resolution plan within 180 days with 75% majority, the resolution professional submits the plan to the AA for approval. If the AA does not receive a resolution plan within the scheduled time, the corporate is liquidated. The strategy thus has broadly three elements:

(i) The Code is proactive. It provides for transfer of control and management of corporate and its assets from the extant promoters and managers to an IP if an application for resolution is admitted. This seeks to bring in behavioural change on the part of stakeholders. In particular, the inevitable consequence of a resolution process (the management as well as the assets of the corporate vest in an IP) deters the management and promoter of the firm from committing a default and thereby minimizes the incidence of default. Going forward, the best use of the ***Code would be not using it at all.***

(ii) Despite the best endeavour, it may not always be possible to prevent insolvencyfor valid, obvious reasons. Where prevention is not possible, the Code envisages ***resolution through a market mechanismas*** *under:*

(a) Resolutionwithin the firm as a going concern, as closure of the firm destroys organisational capital and renders resources idle till reallocation to alternate uses. It expects the creditors to recover their defaults from future earnings of the firm rather than from sale of its assets.

(b) Collective mechanism to resolve the insolvency rather than recovery of dues by a creditor which may make the prospects of resolution difficult. It enables any financial creditor to trigger the resolution process even when the firm has defaulted to another financial creditor and does not envisage termination of the process even if default of the party concerned is satisfied. Once admitted, the nature of insolvency petition changes to representative suit and the lis does not remain only between a creditor and the corporate debtor.

(c) Team effort to resolve the insolvency. There are many players having defined, complementary roles for completion of the process. In a matter, the Hon'ble NCLT observed: "no pleading or defending party, the terminology like petitioner/ respondent or plaintiff/defendant is not present under this Code….". The process is not adversarial.

(d) Timely Resolution. It requires resolution of insolvency at the earliest, preferably at the very first default, to prevent it from ballooning to un-resolvable proportions. A stakeholder is entitled to trigger resolution process as soon as there is a default of the threshold amount. He is, however, not obliged to do so at the first available opportunity if he has reasons for the same.

(e) Resolution in a time bound manner as undue delay is likely to reduce the organizational capital of the firm. When the firm is not in pink of its health,prolonged uncertainty about its ownership and controlmay make the possibility of resolution remote, enterprise value declines, impinging on economic growth.

(f) Resolution in the best possible manner. Anybody and everybody, including the promoters of the firm, may propose resolution plans and the CoC choose the best of them. It envisages limitless possibilities of resolution – with or without the existing promoter, with or without existing products, change of technology or business model, turn-around, buy-out, merger, acquisition, takeover, and what not.

(g) Segregationof commercial aspects of insolvency resolution from judicial aspects. The stakeholders and adjudicating authority decide matters within their domain expeditiously. It empowers and facilitates the stakeholders to complete the resolution process in time.

(h) Balance the interests of stakeholders in the resolution process. A resolution plan should take care of interests of all stakeholders - operational creditor, financial creditor or any other claimant - and also balance their interests.

(i) Compliance with all applicable laws of the land. The

resolution plan needs to be consistent with the laws of the land and should be implementable.

(iii) Where resolution is not possible, the Code enables an inefficient or defunct firm to exit with the least disruption and cost, and release the idle resources in an orderly manner for fresh allocation to efficient uses.

Q 3. How is the Code unique as compared to the erstwhile regime?

A. *The Code provides a comprehensive, modern and robust insolvency and bankruptcy regime, at par with global standards and even better in some aspects. The unique features of this regime are:*

(i) There were several enactments dealing with different aspects of insolvency and bankruptcy of different persons. The Code, however, provides for a comprehensive regime dealing with all aspects of insolvency and bankruptcy of all kinds of persons.

(ii) It seeks to bring in behavioural changes to prevent insolvency.

(iii) It moves away from erosion of net worth to a more objective 'default' in payment for initiation of the insolvency process.

(iv) It moves away from the 'debtor-in-possession' regime to a 'creditors-in-control' regime where creditors decide matters with the assistance of an IP.

(v) In comparison to earlier enactments, the Code seeks to trigger insolvency resolution at the earliest and complete it in a time bound manner and empowers the stakeholders to do so.

(vi) It has separated commercial aspects of insolvency and bankruptcy proceedings from judicial aspects and empowers stakeholders and adjudicating authorities to decide the matters within their domain expeditiously.

(vii) It provides a collective mechanism to resolve insolvency rather than recovery of loan by a creditor. Recovery yields inequitable distribution of available assets to one or a few aggressive creditors to the detriment of the debtor and other creditors, while resolution maximises the value of the assets.

(viii) It requires invitation of resolution plans from market participants and approval of the best of them by CoC.

(ix) It provides several facilitators to complete the transactions, namely, an independent IP to run the debtor as going concern, continuation of essentialservices during resolution period, interim finance for continued operation of the debtor, moratorium on institution of proceedings to provide a calm period, information utilities to provide authentic information, etc.

(x) The proceedings under the Code are not adversarial.

(xi) The Code has several provisions to balance the interests of all stakeholders.

(xii) It has provisions to deal with undervalued transactions and extortionate transactions.

(xiii) In the waterfall for distribution of proceeds from sale of liquidation assets, Government dues come after unsecured creditors.

(xiv) It seeks to liquidate the corporate debtor in an orderly manner.

Q 4. Since the implementation of Code, what are the major initiatives of IBBI? What were the challenges?

A. *IBBI is a unique regulator: it regulates a profession as well as transactions. It has regulatory oversight over the IPs, Insolvency Professional Agencies (IPAs) and Information Utilities (IUs). It writes and enforces rules for transactions, namely, corporate insolvency resolution, corporate liquidation, individual insolvency resolution and individual bankruptcy under the Code. So the first initiative of IBBI was to put in place the regulatory framework and the ecosystem expeditiously to commence corporate insolvency transactions. It made regulations to govern transactions relating to corporate insolvency resolution, fast track resolution, corporate liquidation, and voluntary liquidation, and relating to service providers, namely, IPs, IPAs, and IUs. It put in place a mechanism for registration and monitoring of service providers. These enabled commencement of transactions under the Code by 1st December, 2016 within 60 days of the establishment of the IBBI on 1st October, 2016.*

Every new establishment has challenges of setting up a new organization, organizing people, and technology, andso

does the IBBI. We thank the Institute of CostAccountants of India for making premises available for immediate use by the IBBI. Ministry of Corporate Affairs extended all possibleassistance to address any and every challenge the IBBI encountered. Help came from all possible corners, including other regulators.For example, SEBI has exempted resolution plans from the requirement of public offer under the Takeover Code, preferential allotment from pricing norms, etc. RBI has allowed information utilities and IPs to access the information from credit information companies. Government issued an ordinance authorizing RBI to issue directions to any bank to initiate insolvency resolution process in respect of a default under the Code. There are early signs of markets for interim finance, resolution plans and liquidation assets developing very fast.

To commence transactions, we needed IPs. We did not have these professionals as such. We needed innovative, immediate solutions. Fortunately, we had statutorily regulated professionals, namely, chartered accountants, company secretaries, cost accountants, and advocates, who have been carrying on somewhat similar work. We allowed these professionals with 15 years' of practice experience to register as IPs, but their registration was valid for only six months. About a thousand professionals registered in this category. This gave us the time to plan a more systematic solution. We developed a Limited Insolvency Examination and allowed professionals with 10 years of experience and graduates with 15 years' managerial experience to pass the examination and then register as IPs.

Despite the best of efforts and intentions, a regulator may not always have the understanding of the ground realities, as much and as early as the stakeholders and the regulated may have, particularly in a dynamic environment. The most important initiative of the IBBI has, therefore, been seeking proactive engagement with the stakeholders and building institutional capacity, in partnership with them, to implement the insolvency and bankruptcy reform. This ensured that the regulations are informed by thelegitimate needs of those interested in andaffected by regulations.The reform witnessed exceptional cooperation from them and soon it became a reform by the stakeholders, of the stakeholders and for the stakeholders.

Q 5. What is the way forward?

A. *Two major things. First, we are looking forward to implementing a regime for individual insolvency in a phased manner. In the first phase, we would implement the insolvency regime in respect of individuals, who are guarantors to corporates undergoing resolution process. That can be done fairly quickly as the adjudicating authority for this is the NCLT. Next would be individuals who are having some kind of business - proprietorship or partnership firms. Second, we will facilitate corporate insolvency transactions. Many resolution and liquidation transactions will mature in the next few months and those may throw up some irritations and deficiencies in the regulatory framework. We would address them expeditiously. We have already invited public comments on the existing regulations. Following the due process, regulations may be modified, if considered necessary.To the extent within our purview, we would promote a conducive environment for the development of markets for interim finance, resolution plans and liquidation of assets. We would focus on building capacity of IPs and keep a close watch on their conduct. We would facilitate operationalisation of information utilities so that authentic information is available to the AA and IPs to complete the transactions expeditiously.*

Q 6. Do you think present capacity of Adjudicating Authority sufficient to handle Corporate Insolvency Resolution Process and Liquidation cases?

A. *Yes. The infrastructure needs to develop in sync with workload and it is happening. By now more than 700 applications under the Code have been disposed of by the AA, with outstanding quality and mostly within the prescribed time.*

Q 7. Many of stakeholders particularly operational creditors perceive the IBC 2016 as a debt recovery tool. Is it a recovery tool?

A. *No. The objective is reorganisation or resolution of insolvency, as stated in the long title of the Code. In the matter of Prowess International Pvt. Ltd. Vs. Parker Hannifin India Pvt. Ltd., the Hon'ble NCLAT settled this by the observation: "It is made clear that Insolvency Resolution Process is not a recovery proceeding to recover the dues of the creditors. I & B Code, 2016 is an Act relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner ...."The Code envisages insolvency resolutionprocess in time bound manner within thefirm as a going concern.It expects the creditors to get their default amounts from future earnings of the firm rather than from sale of its assets. That is why the Code prohibits any action to foreclose, recover or enforce any security interest during the resolution period and thereby prevents a creditor from rushing in to recover his dues.It also prohibits alienation*

of assets of the debtor. It enables any financial creditor to trigger the resolution process even when the firm has defaulted to another financial creditor and does not envisage termination of the process even if claim of the party concerned is satisfied. In the matter of Parker Hannifin India Private Limited Vs. Prowess International Private Limited, the Hon'ble NCLT observed that once admitted, other creditors have a right to file their claims. The nature of insolvency petition changes to representative suit and the lis does not remain only between a creditor and the corporate debtor. Therefore, they alone do not have the right to withdraw the insolvency petition because the disputes between them have been settled.

Q 8. Do you not think that the Banking Sector which is reeling under all time high NPA situation still reluctant to initiate Insolvency Process under IBBI? What may be possible reasons for such reluctance?

A. *I do not think, they are reluctant.It is just that they need a little longer time for preparation, as they need to put in place an organisation wide decision making process to deal with a large number of transactions end to end. They would trigger the process only when they are reasonably confident of arriving at resolution and they think, resolution under the Code is the best of the options available to them under the circumstances. More importantly, being financial creditors, they have the duty and obligation to approve an appropriate and implementable resolution plan. In any case, irrespective of who triggersthe process, ultimate decision remains with them. Further, generally banks are secured creditors and they have security to fall back for recovery. They have other recourses for recovery as well as resolution outside the Code.*

Q 9. One of the objectives of Code is to keep the entity "ON GOING CONCERN" so as to maximise the value of assets of corporate debtors. For this purpose the Interim Resolution Professional (IRP)/ Resolution Professional (RP) may have to arrange Interim Finance. Don't you think arranging Interim Finance by stressed businesses is difficult? Is IBBI thinking to develop market for Interim Finance to make available flow of interim finance to corporate debtors under CIRP?

A. *The Code mandates the IPs to make every endeavour to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern. For this purpose, they have authority to raise interim finances and "insolvency resolution process costs" includes the amount of any interim finance and the costs incurred in raising such finance. Resolution plan identifies specific sources of funds that is used to pay the insolvency resolution process cost. Despite these protection, it may be difficult to obtain interim finance in some cases, while IPs have succeeded in obtaining interim finance in a few cases. To the extent within its purview, IBBI would promote a conducive environment for the development of markets for interim finance, resolution plans and liquidation of assets.*

Q 10. In an Eco-system of IBC 2016, Information Utilities would play a vital role to make available financial information to creditors, resolution professionals, liquidators and other stakeholders in insolvency and bankruptcy proceedings? When IUs under the Code start their functioning?

A. *IBBI has notified regulations for information utilities. It has granted registration to one IU. It should start rendering services soon.*

Q 11. How can the Code help MSMEs?

A. *MSMEs are either creditors and or debtors. As creditors, they can trigger insolvency resolution of corporate debtors. As debtor, they can be either companies or non-companies. As corporate debtors, they can benefit from resolution under Fast Track Process, under which the process needs to be completed within a period of 90 days, as against 180 days in other cases. This process is available for insolvency resolution of: (a) a small company, as defined under clause (85) of section 2 of the Companies Act, 2013; (b) a start-up (other than the partnership firm), as defined in the notification dated 23rdMay, 2017 of the Ministry of Commerce and Industry; and (c) an unlisted company with total assets, as reported in the financial statement of the immediately preceding financial year, not exceeding Rs.1 crore. Further, IBBI is working on an insolvency resolution framework for non-corporate MSMEs. IBBI has constituted a Working Group for recommending the strategy and approach for implementation of the provisions of the Code to deal with insolvency and bankruptcy in respect of individuals having Business, and drafting related Rules and Regulations.*