

# Inter alia...



**AZB & PARTNERS**  
ADVOCATES & SOLICITORS

MAY 2016 • SPECIAL EDITION • STRICTLY FOR PRIVATE CIRCULATION

## The Insolvency and Bankruptcy Code, 2016

*Inter alia...* is a legal newsletter published each quarter by AZB & Partners for a select list of clients and colleagues. Each issue aims to provide a snapshot of the recent legal developments in certain critical areas: infrastructure, foreign direct investment, securities law, exchange control regulations, corporate law, media and entertainment, intellectual property and banking. We hope you will find the content informative and useful. If you have any questions or comments, please email us at: [editor.interalia@azbpartners.com](mailto:editor.interalia@azbpartners.com) or call AZB & Partners.



**AZB & PARTNERS**  
ADVOCATES & SOLICITORS

**MUMBAI:** AZB House | Peninsula Corporate Park | Ganpatrao Kadam Marg | Lower Parel | Mumbai 400013 | India | TEL +91 22 66396880 | FAX +91 22 66396888 | E-MAIL [mumbai@azbpartners.com](mailto:mumbai@azbpartners.com)

**MUMBAI:** Sakhar Bhavan | 4th Floor | 230 Nariman Point | Mumbai 400021 | India | TEL +91 22 66396880 | FAX +91 22 49100699 | E-MAIL [disputeresolution.mumbai@azbpartners.com](mailto:disputeresolution.mumbai@azbpartners.com)

**DELHI:** AZB House | Plot No. A8 | Sector 4 | Noida 201301 | National Capital Region Delhi | India | TEL +91 120 4179999 | FAX +91 120 4179900 | E-MAIL [delhi@azbpartners.com](mailto:delhi@azbpartners.com)

**GURGAON:** Unitech Cyber Park | 602 Tower-B | 6th floor | Sector 39 | Gurgaon 122001 | National Capital Region Delhi | India | TEL +91 124 4200296 | FAX +91 124 4038310 | E-MAIL [gurgaon@azbpartners.com](mailto:gurgaon@azbpartners.com)

**BANGALORE:** AZB House | 67-4 4th Cross | Lavelle Road | Bangalore 560001 | India | TEL +91 80 42400500 | FAX +91 80 22213947 | E-MAIL [bangalore@azbpartners.com](mailto:bangalore@azbpartners.com)

**PUNE:** Onyx Towers | 1101-B | 11th floor | North Main Road | Koregaon Park | Pune 411001 | India | TEL +91 20 67256666 | FAX +91 20 67256600 | E-MAIL [pune@azbpartners.com](mailto:pune@azbpartners.com)



AZB & PARTNERS  
ADVOCATES & SOLICITORS

*Inter alia...*

## The Insolvency and Bankruptcy Code, 2016

The Lok Sabha and Rajya Sabha, on May 5, 2016 and May 11, 2016 respectively, passed the Insolvency and Bankruptcy Code, 2016 ('Bankruptcy Code'). The Bankruptcy Code now awaits Presidential assent and notification.

### Legislative Background of the Bankruptcy Code

The Finance Minister, Mr. Arun Jaitley, in his Budget Speech 2015-16, had identified 'Bankruptcy Law Reforms' as a key priority for improving the ease of doing business and had announced that a comprehensive bankruptcy code, meeting global standards and providing necessary judicial capacity, will be brought in. Consequently, the Government constituted a Bankruptcy Law Reforms Committee under the Chairmanship of Dr. T. K. Viswanathan to look into various bankruptcy related issues. Bahram Vakil, Founding Partner, AZB & Partners was appointed as a member to the Bankruptcy Law Reforms Committee.

The Bankruptcy Law Reforms Committee submitted its report on November 4, 2015 ('BLRC Report'), which has been prepared in two parts - Volume I of the BLRC Report sets out the "Rationale and the Design" and Volume II of the BLRC Report contains a comprehensive Draft of the Insolvency and Bankruptcy Bill, 2015 ('Bankruptcy Bill').

The Bankruptcy Bill was referred to a Joint Parliamentary Committee ('JPC') comprising members of both Houses of Parliament on December 23, 2015. The JPC submitted its report to the Parliament on April 28, 2016 and the Government accepted all changes recommended by the JPC.

Further to the *Inter Alia...Special Edition* dated December 10, 2015, this edition sets out a summary of the Bankruptcy Code, as it was passed by the Lok Sabha and the Rajya Sabha pursuant to the changes made to the Bankruptcy Bill.

### Brief Overview of the Bankruptcy Code

The Bankruptcy Code replaces the entire gamut of extant corporate insolvency laws by introducing a single comprehensive law that: (a) empowers all creditors (whether secured, unsecured, domestic, international, financial or operational) to trigger resolution processes; (b) enables the resolution process(es) to start at the earliest sign of financial distress; (c) provides for a single forum to oversee all insolvency and liquidation proceedings; (d) enables a calm period where new proceedings do not derail existing ones; (e) provides for replacement of the existing management during insolvency proceedings while maintaining the enterprise as a going concern; (f) offers a finite time limit within which the debtor's viability can be assessed; and (g) lays out a linear liquidation mechanism.

### Institutional Infrastructure

The process of insolvency resolution and liquidation under the Bankruptcy Code is predicated on the following institutional infrastructure: (a) a regulator namely, the Insolvency and Bankruptcy Board of India ('Regulator'); (b) a cadre of regulated insolvency professionals and regulated information utilities; and (c) the adjudicating authorities, namely the National Company Law Tribunal ('NCLT') which governs corporate entities and the Debt Recovery Tribunals which govern individuals. Thus, the Bankruptcy Code proposes to cover not only corporate entities and limited liability partnerships, but also individuals, and prescribes processes for dealing with bankruptcy related issues for each of the aforesaid entities.

### Key Features

We have set out below the key features of the corporate insolvency resolution process ('IRP') and liquidation as contemplated in the Bankruptcy Code:

1. **Distinction between Financial and Operational Creditors:** The Bankruptcy Code makes a distinction between financial creditors (both secured and unsecured, who have extended credit for interest, instead of goods and services in exchange) and operational creditors (creditors who have extended credit in exchange for goods and services). This distinction has been made in order to: (i) treat both, the secured and unsecured creditors at par, for the purposes of initiating an IRP and providing an opportunity to participate in the decision making process; (ii) empower an operational creditor to trigger an IRP, and attend all meetings of the creditor committee but not have any voting rights, since such operational creditors would be paid the liquidation value, at the least.



2. **Trigger:** The primary principle of the Bankruptcy Code is to detect distress at the earliest and resolve it. To this end, it enables the IRP to be triggered by the occurrence of a single default. The process is slightly varied for debtors, financial creditors and operational creditors and is briefly explained below:

- (i) **Financial Creditor Trigger:** A financial creditor may trigger the IRP by filing an application with the NCLT upon the occurrence of a payment default for amounts owed to them or any other financial creditor.
- (ii) **Operational Creditor Trigger:** An operational creditor may trigger the IRP by issuing a notice to the debtor upon the occurrence of a payment default. Following the issuance of such notice, the debtor may either repay or demonstrate existence of a genuine dispute. If the debtor has not repaid or demonstrated the existence of any dispute after the lapse of 10 days from the issuance of the notice, the operational creditor will be entitled to file an application with the NCLT for initiating the IRP.
- (iii) **Debtor:** Significant shareholders, management personnel and any other employee or service providers of a company, who are capable of producing detailed audited financial information, may file for an IRP upon the occurrence of a default.

The Bankruptcy Code prescribes penalties for false and frivolous triggers in order to disincentivise creditors triggering IRP for extraneous reasons.

3. **Debtor Not in Control During IRP:** An insolvency professional, who is registered with the Regulator, can be appointed by the adjudicator during the IRP (**Resolution Professional**). Such Resolution Professional is empowered to effectively run and manage the entity, including its assets, as a going concern during the period that the IRP is pending, thereby addressing concerns of asset-stripping or siphoning during the IRP period. The Bankruptcy Code also provides for the powers of the board of directors or the partners of the corporate debtor, as the case may be, to stand suspended upon the appointment of a Resolution Professional, and requires the suspended management of such entity to cooperate with the Resolution Professional. Under the Bankruptcy Code, the Regulator is responsible for registering Resolution Professionals, prescribing qualifications and the reporting requirements for Resolution Professionals as well as performance monitoring of such Resolution Professionals.
4. **Moratorium:** During the IRP, there is a time bound moratorium of 180 days against any debt recovery actions and new cases filed against the debtor. The moratorium can only be extended by a further period of 90 days in exceptional circumstances. This helps address concerns in respect of protection of assets in course of the IRP. During such moratorium, a regulated insolvency professional controls the assets under the supervision of the NCLT.
5. **Business Decisions by a Creditor Committee:** All business decisions of the company, during the IRP, are to be taken by a committee of financial creditors (**Creditor Committee**). The matters on which decisions can be taken by the Creditor Committee include evaluating proposals to continue operations of the entity as a going concern, decisions about the sale of business or units and retiring or restructuring of existing debt. The debtor, though invited to all meetings, will be a non-voting observer on the Creditor Committee. The decisions of the Creditor Committee will be by way of a majority of 75% of the creditors and will be calculated on the basis of the value / proportion of the financial debt owed to them by the debtor.
6. **Super Priority for Raising Interim Finance:** Any interim finance raised during the IRP period will have super-priority, both in the resolution plan and during liquidation. If the Resolution Professional proposes to raise interim finance, prior to the formation of the Creditor Committee, approval of the existing secured creditors would be required if the value of property over which security is proposed to be created is equal to or more than twice the amount of the debt. Post the formation of the Creditor Committee, any interim finance raised up to a prescribed threshold will require the prior approval of the Creditor Committee.
7. **Insolvency Resolution through Managed Negotiations:** When an agreement has been reached in respect of maintenance of the company as a going concern, the NCLT will close the case for insolvency. If there is no agreement upon conclusion of negotiations, or if the conclusion of such negotiations contravenes any applicable law or does not meet the criteria prescribed in the Bankruptcy Code, the NCLT may pass an



**AZB & PARTNERS**  
ADVOCATES & SOLICITORS

*Inter alia...*

order declaring the entity insolvent and notifying the period within which the liquidation will be deemed to have commenced.

8. **No Prescriptions on Solutions to Resolve the Insolvency:** As set out above, the Creditor Committee is tasked with making business decisions of the entity. The Resolution Professional is tasked with putting together an information memorandum and facilitating discussions amongst parties to make proposals to the Creditor Committee. Other than the majority vote of the Creditor Committee, the Resolution Professional is also required to confirm to the NCLT that the final solution voted on by the Creditor Committee complies with the following five requirements:
  - (i) the proposed solution must explicitly require the repayment of any interim finance availed of by the entity during the course of the IRP. Further, costs of the IRP are required to be paid in priority over other payments;
  - (ii) the plan must explicitly include payment to all creditors that are not members of the Creditor Committee, within a reasonable period after the solution is implemented;
  - (iii) the plan must provide for the management of the affairs of the debtor after approval of the resolution plan;
  - (iv) the plan must provide for the manner of the implementation and supervision of the resolution plan; and
  - (v) the plan must comply with existing laws applicable to the entity while implementing the solution.
9. **Triggers for Liquidation:** The Bankruptcy Code sets out the following triggers for liquidation:
  - (i) rejection of a resolution plan by the NCLT, if it fails to meet the necessary conditions set out above;
  - (ii) failure of the Creditor Committee to reach an agreement during the period stipulated above;
  - (iii) a decision of the Creditor Committee to proceed with liquidation during the IRP; OR
  - (iv) failure of the debtor to adhere to terms of the resolution plan approved by the NCLT.
10. **An Irreversible, Time-Bound Liquidation with Defined Payout Prioritization:** If any of the conditions set out in paragraph (9) above are met, the NCLT will pass a liquidation order along with accompanying orders to: (i) appoint a liquidator recommended by the Regulator; (ii) move assets into a liquidation trust, which will be managed by the liquidator; and (iii) to change the name of the entity reflected in the registration records to include the phrase “in-liquidation” to its original name. The board of such entity is to be replaced by the Creditor Committee. Under the Bankruptcy Code, the liquidator continues to be responsible for maximising the value of the assets of the entity in the most efficient manner of disposal. All realisations from such sales will be made to the liquidation trust, and will be distributed to creditors according to the prescribed waterfall mechanism set out in the Bankruptcy Code and briefly described in paragraph (11) below.
11. **Distribution Waterfall:** The brief particulars of the distribution waterfall set out in the Bankruptcy Code are set out below:
  - (i) costs of IRP (including any interim finance raised) and liquidation;
  - (ii) secured creditors and workmen dues (capped up to two years from the start of IRP);
  - (iii) employees’ salaries (capped up to one year);
  - (iv) dues to unsecured financial creditors;
  - (v) any amount due to the relevant State Government and/or the Government of India in respect of the whole or any part of the period of two years prior to the date of commencement of liquidation;
  - (vi) any debts of secured creditors for any amount unpaid following the enforcement of security interest;
  - (vii) any remaining debt; and
  - (viii) remaining surplus to be distributed to shareholders.

All distributions as per the above waterfall will be net of the liquidator’s fees, which will be deducted proportionately from each stage of the waterfall in order to incentivise the liquidator to ensure quicker recovery for each class of recipient. The liquidation process is an irreversible process after the expiry of a specified period

from the passing of a liquidation order. An appeal to stay the liquidation may be considered by the National Company Law Appellate Authority only on very limited grounds.

12. **Penalties:** As a first, the Bankruptcy Code prescribes penalties for fraudulent and wrongful trading by the promoters of the entity for the period leading upto liquidation.
13. **Cross-border Application:** The Bankruptcy Code contains provisions to empower the Central Government to enter into agreements with foreign countries for enforcing the provisions of the Bankruptcy Code, including making reciprocal arrangements to apply the provisions of the Bankruptcy Code to a country where the property or personal guarantor of the debtor may be situated. The NCLT is also authorized to issue a letter of request to such country, with whom the Central Government has established reciprocal relations, for the purposes of seeking evidence, if assets of a debtor or personal guarantor are located in that country.



**AZB & PARTNERS**  
ADVOCATES & SOLICITORS

*Inter alia...*

---



**AZB & PARTNERS**  
ADVOCATES & SOLICITORS

*Inter alia...*

---

FOR FURTHER INFORMATION RELATING TO THIS SPECIAL EDITION, PLEASE CONTACT:



MUMBAI

**ZIA MODY** [zia.mody@azbpartners.com](mailto:zia.mody@azbpartners.com)

**BAHRAM N. VAKIL** [bahram.n.vakil@azbpartners.com](mailto:bahram.n.vakil@azbpartners.com)

**ASHWIN RAMANATHAN** [ashwin.ramanathan@azbpartners.com](mailto:ashwin.ramanathan@azbpartners.com)

**RICHA ROY** [richa.roy@azbpartners.com](mailto:richa.roy@azbpartners.com)



NEW DELHI

**AJAY BAHL** [ajay.bahl@azbpartners.com](mailto:ajay.bahl@azbpartners.com)

**GAUTAM SAHA** [gautam.saha@azbpartners.com](mailto:gautam.saha@azbpartners.com)



BANGALORE

**SRINATH DASARI** [srinath.dasari@azbpartners.com](mailto:srinath.dasari@azbpartners.com)



AZB & PARTNERS  
ADVOCATES & SOLICITORS

*Inter alia...*

---

❖  
Law Firm of the Year  
VC Circle, 2016

❖  
Best National Corporate Law Firm | Best Overall National Law Firm of the Year  
Legal Era Awards, 2016

❖  
M&A Law Firm of the Year | Arbitration Law Firm of the Year  
Commercial Dispute Resolution Law Firm of the Year | Competition Law Firm of the Year  
Corporate INTL, 2016

❖  
Ranked No. 1 in APAC ex Japan Mid-Market by Deal Count (up to US\$ 250m)  
Bloomberg's Global M&A, Legal Rankings, Q1 2016

❖  
Ranked No. 1 in Asia-Pac buyouts by Deal Count  
Mergermarket's Global and Regional M&A League Tables of Legal Advisors, Q1 2016

❖  
Ranked No. 1  
for the Indian M&A Announced League Table by Deal Count  
Ranked No. 1 for India involved  
Mid-Market M&A Rankings by Deal Count and Deal Value (up to US\$ 500m)  
Ranked No. 1 for India involved  
Small Cap M&A Rankings by Deal Count and Deal Value (up to US\$ 50m)  
Thomson Reuters' Emerging Markets M&A Review, Legal Advisors, Q1 2016

❖  
Law Firm of the Year | Best Overall Law Firm  
Firm of the Year for categories of Banking & Finance, Capital Markets,  
Competition & Antitrust, Mergers & Acquisitions, Private Equity & Venture Capital,  
Restructuring & Insolvency and Structured Finance & Securitization  
India Business Law Journal, 2015

❖  
Ranked No.1  
by Deal Count and Deal Value for the Indian M&A Announced Deals League Table  
Thomson Reuters' Emerging Markets – M&A Review, 2015

❖  
Ranked No.1  
by Deal Count and Deal Value for India League Tables  
Mergermarket Global & Regional M&A League Tables of Legal Advisors, 2015

v  
Ranked No.1  
in APAC ex Japan Mid-Market by Deal Count (up to US\$ 500m) and  
Ranked No.1 in APAC ex Japan Mid-Market by Deal Count (up to US\$ 250m)  
Bloomberg Global M&A Mid-Market M&A Ranking, 2015

**Disclaimer** For private circulation to the addressees only and not for re-circulation. Any form of reproduction, dissemination, copying, disclosure, modification, distribution and/or publication of this Special Edition is strictly prohibited. This Special Edition is not intended to be an advertisement or solicitation. The contents of this Special Edition are solely meant to inform and is not a substitute for professional advice. Legal advice should be obtained based on the specific circumstances of each case, before relying on the contents of this Special Edition or prior to taking any decision based on the information contained in this Special Edition. AZB & Partners disclaim all responsibility and accept no liability for the consequences of any person acting, or refraining from acting, on such information.

If you have received this Special Edition in error, please notify us immediately by telephone +91 22 6639 6880.

**Copyright** © AZB & Partners. All rights reserved. Replication or redistribution of content, including by caching, framing or similar means, is expressly prohibited without the prior written consent of AZB & Partners. Any queries on this Special Edition may be addressed to: editor.interalia@azbpartners.com