Ruling the Roost: The Shift from Debtor Rights to Creditor Rights in India's Insolvency and Bankruptcy Code

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Abstract

The Insolvency and Bankruptcy Code (IBC) 2016 introduced a significant shift from debtor right to creditor right in India's insolvency laws. This article provides an overview of this shift, its implications, and the challenges it poses.

After a brief historical background on India's insolvency laws and the need for reform, the article explains the key provisions and objectives of the IBC 2016. It then delves into the shift from debtor right to creditor right, which is driven by various factors such as the need to balance the interests of stakeholders and promote efficient resolution of distressed assets. The article examines the impact of the shift on secured and unsecured creditors, debtor obligationsand liabilities, and the role of the Committee of Creditors.

While the shift to creditor right has been lauded for empowering creditors and improving recovery rates, it also poses several challenges and criticisms. The article discusses some of these, including the potential negative impact on small and medium-sized enterprises, the risk of misuse or abuse by creditors, and the need for effective regulation and oversight.

Keywords

Insolvency and Bankruptcy Code, Debtor rights, Creditor rights, Distressed assets, Securedcreditors, Unsecured creditors, Committee of Creditors, Recovery rates.

Introduction

The Insolvency and Bankruptcy Code (IBC), 2016, emerged as a watershed moment in the history of India's insolvency framework. A much-needed reform, it sought to address the shortcomings and inefficiencies of the previous legal landscape. Before IBC, insolvency proceedings were marred by prolonged delays, low recovery rates, and an overwhelmingly debtor-centric approach. The fragmented legislative landscape included the Board for Industrial and Financial Reconstruction (BIFR) and the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), among others. However, these mechanisms proved largely inadequate in addressing the issue of corporate insolvency in India.

The introduction of the IBC marked a paradigmatic shift from the erstwhile debtor-driven insolvency regime to a more creditor-centric approach. This change aimed to expedite the insolvency resolution process, maximize the value of assets, and balance the interests of all stakeholders. The new framework placed the reins of the resolution process in the hands of creditors, thereby empowering them to make crucial decisions pertaining to the fate of a financially distressed company.

This significant alteration in the power dynamics has had far-reaching implications on the Indian insolvency ecosystem. With creditors at the helm of the insolvency resolution process, the ease of doing business in India has markedly improved, boosting investor confidence and fostering an environment conducive to economic growth. The IBC has also facilitated higher recovery rates, which has positively impacted the health of the financial sector.

However, the transition to a creditor-centric approach has not been without its fair share of challenges and criticisms. Issues pertaining to the rights of operational creditors, the management of dissenting creditors, and legal and procedural delays have emerged. Striking the right balance between the interests of domestic and foreign creditors has further complicated the insolvency resolution process.

In response to these challenges, the government has introduced several amendments to the IBC, addressing the concerns of various stakeholders and streamlining the insolvency resolution process. Initiatives such as the pre-packaged insolvency resolution process and the introduction of a cross-border insolvency framework have been instrumental in refining the existing legal landscape.

As the IBC continues to evolve, it is imperative to closely monitor its impact on the insolvency ecosystem in India. By fostering a creditor-centric approach, the IBC aims to create a more robust and efficient insolvency framework, capable of driving economic growth and bolstering investor confidence. However, the journey toward striking the perfect balance between the rights of creditors and debtors, while ensuring a fair and transparent insolvency resolution process, remains an ongoing endeavour.

The Pre-IBC Insolvency Regime: A Fragmented and Inefficient Landscape

Prior to the introduction of the Insolvency and Bankruptcy Code (IBC) in 2016, India's insolvency framework was characterized by a myriad of statutes and regulatory bodies that resulted in a disjointed, inefficient, and debtor-centric approach to resolving corporate insolvency. Two of the key legal provisions governing insolvency at that time were the Board for Industrial and Financial Reconstruction (BIFR) and the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA).

The BIFR, established under SICA, was responsible for overseeing the rehabilitation and revival of financially distressed industrial companies. While the intention behind the creation of BIFR was laudable, it was plagued by numerous shortcomings, which undermined the effectiveness of the insolvency resolution process. Some of the most glaring deficiencies of the BIFR regime included its protracted and cumbersome procedures, an overwhelming focus on the revival of companies rather than resolution, and the inability to adequately address the needs of both creditors and debtors.

SICA, on the other hand, was primarily aimed at identifying and addressing the issues faced by sick industrial companies. However, it soon became a haven for unscrupulous promoters who exploited the loopholes in the legislation to shield their companies from creditors. Furthermore, SICA's emphasis on the protection of sick companies often led to the neglect of creditors' interests and the perpetuation of non-performing assets (NPAs) in the banking system.

In addition to BIFR and SICA, other legislations such as the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDBFI) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) governed debt recovery and enforcement of security interest. These legislations, however, operated independently of each other, resulting in a fragmented and uncoordinated insolvency regime.

This pre-IBC insolvency landscape was marred by a protracted resolution process, with cases often taking several years to reach a conclusion. The World Bank's Ease of Doing Business Report 2015 ranked India 136th out of 189 countries in terms of resolving insolvency, with an average time of 4.3 years and a recovery rate of a mere 25.7 cents on the dollar.

In light of these inadequacies, the need for a comprehensive and consolidated insolvency framework became increasingly apparent. The introduction of the IBC in 2016 aimed to address these issues by overhauling the existing insolvency regime and ushering in a new era of creditor-centric insolvency resolution, thereby promoting efficiency, transparency, and a more balanced approach towards the interests of all stakeholders.

IBC 2016: Inaugurating a New Epoch of Creditor Empowerment

The Insolvency and Bankruptcy Code (IBC) 2016 heralded a transformative phase in the Indian insolvency landscape, eschewing the erstwhile debtor-centric approach in favour of a more balanced and empowering framework for creditors. This seminal legislation consolidated and amended existing laws relating to insolvency and bankruptcy, thereby streamlining the resolution process, accelerating the recovery of dues, and fostering an environment of transparency and accountability.

A cornerstone of the IBC 2016 is the establishment of the Committee of Creditors (CoC), which is comprised of financial creditors, and in certain cases, operational creditors as well. The CoC plays a pivotal role in driving the insolvency resolution process, enabling creditors to actively participate in decision-making and ensuring their interests are adequately safeguarded. This marked departure from the previous regime, wherein debtors were predominantly in control of the resolution process, has engendered greater confidence among creditors and facilitated swifter resolutions.

The IBC 2016 further empowers creditors by instituting a time-bound resolution process, which mandates the completion of the Corporate Insolvency Resolution Process (CIRP) within a period of 180 days, with a one-time extension of 90 days. This expeditious framework, in stark contrast to the protracted proceedings that characterized the pre-IBC era, has resulted in higher recovery rates, and significantly reduced the burden of non-performing assets on the financial system.

Another salient feature of the IBC is the distinction it draws between financial creditors and operational creditors. While both classes of creditors are accorded the right to initiate the insolvency resolution process against defaulting corporate debtors, financial creditors hold a more influential position within the CoC. This delineation underscores the importance of safeguarding the interests of financial creditors, who are often key stakeholders in the economic viability of distressed companies.

Moreover, the IBC 2016 introduced Section 29A, which bars defaulting promoters and related parties from bidding for their own insolvent companies. This provision, aimed at preventing unscrupulous promoters from regaining control of their companies at a discounted price, ensures that creditors are not short-changed in the resolution process and that the overall integrity of the insolvency framework is upheld.

The advent of the IBC 2016 has engendered a paradigmatic shift in the Indian insolvency landscape, placing creditors at the forefront of the resolution process and promoting an equitable balance of power among stakeholders. By fostering a creditor-centric approach, the IBC has not only imbued confidence among domestic and foreign investors, but has also contributed to the improvement of India's standing in global ease of doing business rankings, ultimately paving the way for a more robust and efficient insolvency regime.

Key Provisions in IBC that Empower Creditors

The Insolvency and Bankruptcy Code (IBC) 2016 revolutionized the insolvency landscape in India, transforming it into a more creditor-centric framework that sought to expedite resolution and safeguard the interests of creditors. Several key provisions within the IBC have been instrumental in empowering creditors, enabling them to play a proactive role in theinsolvency resolution process.

1.Section 7 - Initiation of Corporate Insolvency Resolution Process (CIRP) by Financial Creditors: Section 7 of the IBC empowers financial creditors to initiate the CIRP against a corporate debtor in the event of a default. This provision allows financial creditors to take swift action when their dues remain unpaid, thereby ensuring the timely recovery of their outstanding claims. The initiation of the CIRP under Section 7 places the control of the resolution process firmly in the hands of the creditors, marking a significant departure from the debtor-driven framework that preceded the IBC.

2.Section 9 - Application for Initiation of CIRP by Operational Creditors: Section 9 of the IBC extends the right to initiate the CIRP to operational creditors, granting them the ability to pursue their claims against defaulting corporate debtors. While the extent of their participation in the resolution process differs from that of financial creditors, this provision still represents a considerable enhancement of the rights of operational creditors, enabling them to actively protect their interests.

3.Committee of Creditors (CoC) and Their Powers: The IBC establishes the Committee of Creditors (CoC), a body composed primarily of financial creditors, and in certain instances, operational creditors as well. The CoC is granted extensive powers, including the authority to approve or reject resolution plans, decide on the liquidation of the corporate debtor, and even replace the existing management with a resolution professional. The formation of the CoC represents a significant empowerment of creditors, allowing them to drive the insolvency resolution process and ensure that their interests are duly protected.

4.Section 29A - Ineligibility of Defaulting Promoters and Related Parties: Section 29A of the IBC disqualifies defaulting promoters and related parties from bidding for their own insolvent companies during the resolution process. This provision serves to protect creditors from unscrupulous promoters who might attempt to regain control of their companies at a reduced price, ensuring that the resolution process remains transparent and equitable.

5.Time-Bound Resolution Process: One of the most notable features of the IBC is the time-bound nature of the resolution process, which mandates the completion of the CIRP within a period of 180 days, extendable by 90 days in exceptional circumstances. This expeditious framework safeguards the interests of creditors by preventing the erosion of asset value and promoting a swift resolution of insolvency cases.

These key provisions within the IBC have significantly empowered creditors, enabling them to actively participate in the insolvency resolution process and ensure that their interests are adequately protected. By shifting the balance of power from debtors to creditors, the IBC has fostered a more efficient, transparent, and equitable insolvency regime in India.

Impact of the Shift on the Insolvency Ecosystem

The Insolvency and Bankruptcy Code (IBC) 2016, with its transition to a creditor-centric approach, has had profound implications on the insolvency ecosystem in India. This fundamental shift has not only streamlined the resolution process but has also substantially improved the ease of doing business in the country. A meticulous examination of the impact of this transition reveals several key areas of improvement and growth within the insolvency ecosystem.

1.Improvement in the Ease of Doing Business Rankings: The IBC's creditor-centric approach has contributed significantly to enhancing India's position in the World Bank's Ease of Doing Business rankings. By expediting the insolvency resolution process and safeguarding the interests of creditors, the IBC has created a more conducive environment for domestic and foreign investment. As a result, India's ranking in the Ease of Doing Business Report has witnessed a considerable improvement, bolstered investor confidence and fostering economic growth.

2.Increase in Debt Recovery Rates: The shift to a creditor-centric framework has led to a marked increase in debt recovery rates. By empowering creditors to initiate the insolvency resolution process and ensuring their active participation in decision- making, the IBC has facilitated the efficient recovery of outstanding dues. Consequently, the recovery rate has risen significantly, positively impacting the health of the financial sector, and reducing the burden of non-performing assets on the economy.

3.Reduction in the Time Taken for Resolution: The IBC mandates a time-bound resolution process, which requires the completion of the Corporate Insolvency Resolution Process (CIRP) within 180 days, with a one-time extension of 90 days. This expeditious framework is in stark contrast to the protracted proceedings that characterized the pre-IBC era, where insolvency cases often took several years to conclude. The reduction in the time taken for resolution has helped preserve the value of assets, ensured a swift resolution of insolvency cases, and minimized the overall economic impact of corporate distress.

4.Balancing the Interests of Stakeholders: The IBC's creditor-centric approach has brought about a more balanced distribution of power among stakeholders. By empowering creditors, particularly through the formation of the Committee of Creditors (CoC), the IBC has ensured that their interests are duly protected, while still preserving the rights of debtors within the resolution process. This balanced approach promotes transparency, fairness, and a more equitable insolvency regime.

The shift from a debtor-centric to a creditor-centric approach under the IBC 2016 has had a far-reaching impact on the insolvency ecosystem in India. The enhancements in the ease of doing business rankings, increased debt recovery rates, and a reduction in the time taken for resolution all point towards a more robust, efficient, and equitable insolvency framework. As the IBC continues to evolve, it is crucial to closely monitor its impact on the insolvency ecosystem and strive for further improvements that foster economic growth and safeguard theinterests of all stakeholders.

Challenges and Criticisms of the IBC

Despite the numerous improvements brought about by the Insolvency and Bankruptcy Code (IBC) 2016, the legislation has faced its fair share of challenges and criticisms. Various stakeholders have expressed concerns about the implementation and impact of the IBC on the insolvency ecosystem, highlighting areas that require further refinement and amendment. A detailed examination of these challenges and criticisms reveals several key areas of concern.

1.Treatment of Operational Creditors: One of the most significant criticisms of the IBC pertains to the treatment of operational creditors. While the legislation empowers operational creditors to initiate the insolvency resolution process, their participation in the Committee of Creditors (CoC) is limited, placing them in a less influential position compared to financial creditors. This disparity has raised concerns about the equitable treatment of operational creditors and the adequacy of safeguards in place toprotect their interests.

2.Management of Dissenting Creditors: The IBC has also faced criticism regarding the management of dissenting creditors within the insolvency resolution process. The current framework allows for the approval of a resolution plan even if a minority of creditors dissent, provided the plan receives the requisite majority support from the CoC. This has led to concerns about the rights of dissenting creditors and the potential for coercive tactics within the resolution process.

3.Legal and Procedural Delays: Although the IBC mandates a time-bound resolution process, several cases have experienced delays due to legal and procedural issues. Lengthy litigation and challenges to the insolvency resolution process in various judicial forums have contributed to delays, undermining the objectives of the IBC, and eroding the value of assets. These delays highlight the need for a more streamlined and efficient legal framework to support the IBC's objectives.

4.Cross-Border Insolvency: The IBC has faced challenges in addressing cross-border insolvency cases, as the legislation currently lacks a comprehensive framework to deal with such situations. This has resulted in difficulties in the resolution of cases involving multinational corporations and foreign creditors, necessitating the development of a robust cross-border insolvency framework that is aligned with international best practices.

5.Implementation and Capacity Building: The successful implementation of the IBC requires adequate capacity building among various stakeholders, including insolvency professionals, the National Company Law Tribunal (NCLT), and Information Utilities (IUs). The lack of sufficient infrastructure, resources, and skilled professionals has posed challenges in the effective implementation of the IBC, underlining the importance of ongoing capacity building initiatives

Recent Amendments and Developments in IBC

The Insolvency and Bankruptcy Code (IBC) 2016 has been subject to several amendments and developments since its inception, reflecting the ongoing efforts to fine-tune the legislation and address the challenges and criticisms that have emerged. These recent amendments and developments showcase the dynamic nature of the IBC and the commitment of the Indian government to ensure a more efficient and effective insolvency regime.

1) Insolvency and Bankruptcy Code (Amendment) Act, 2021: This amendment introduced several key changes to the IBC, with the primary aim of addressing issues arising from the COVID-19 pandemic and further streamlining the insolvency resolution process.Notable provisions of this amendment include:

a.Pre-Packaged Insolvency Resolution Process (PPIRP): The introduction of the PPIRP as an alternative resolution mechanism for micro, small, and medium enterprises (MSMEs) seek to expedite the insolvency resolution process, minimize costs, and preserve the value of assets. This new mechanism allows debtors to propose a resolution plan in collaboration with financial creditors, subject to the approval of the Committee of Creditors (CoC).

b.Threshold for Initiation of Insolvency Proceedings: The amendment raised the minimum threshold for the initiation of insolvency proceedings from INR 1 lakh to INR 1 crore, aiming to reduce the burden on the National Company Law Tribunal (NCLT) and protect MSMEs from insolvency proceedings during the pandemic.

2.Suspension of Initiation of Fresh Insolvency Proceedings: In response to the unprecedented economic challenges posed by the COVID-19 pandemic, the Indian government suspended the initiation of fresh insolvency proceedings under Sections 7, 9, and 10 of the IBC for a period of six months, effective from March 25, 2020. This suspension, which was later extended by another three months, aimed to provide temporary relief to financially distressed companies and protect them from being pushed into insolvency during the crisis.

3.Cross-Border Insolvency Framework: The government has been working towards the development of a comprehensive cross-border insolvency framework, which is expected to be incorporated into the IBC in the near future. This proposed framework, which is likely to be based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, seeks to address the complexities of cross-border insolvency cases, and ensure that the IBC is aligned with international best practices.

These recent amendments and developments in the IBC demonstrate the proactive efforts of the Indian government to address the evolving needs of the insolvency ecosystem and ensure that the legislation remains effective and responsive to the changing economic landscape. As the IBC continues to mature, it is crucial to closely monitor its impact on the insolvency ecosystem and implement further amendments and developments as necessary to maintain a robust, efficient, and equitable insolvency regime in India.

Conclusion

In conclusion, the Insolvency and Bankruptcy Code (IBC) 2016 has been a monumental piece of legislation that has significantly altered the insolvency landscape in India. By shifting the focus from a debtor-centric to a creditor-centric approach, the IBC has fostered a more efficient, transparent, and equitable insolvency regime, empowered creditors and promoting a balanced distribution of power among stakeholders. This transformation has had far-reaching implications on the insolvency ecosystem, improving India's ease of doing business rankings, increasing debt recovery rates, and reducing the time taken for resolution.

Nevertheless, the IBC has encountered several challenges and criticisms, highlighting areas that necessitate further refinement and amendment. Addressing these concerns, the Indian government has undertaken numerous amendments and developments to ensure the legislation remains effective and responsive to the changing economic landscape.

As the IBC continues to evolve, it is imperative to closely monitor its impact on the insolvency ecosystem and strive for further improvements that foster economic growth and safeguard the interests of all stakeholders. By refining the legislation and addressing the challenges and criticisms that arise, the IBC can serve as a powerful instrument in the development of a more robust, efficient, and equitable insolvency regime in India.

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