

Legislative Brief

The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017

The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 was promulgated on November 23, 2017. It amends the Insolvency and Bankruptcy Code, 2016.

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Vatsal Khullar

vatsal@prsindia.org

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Highlights of the Ordinance

- ◆ The Ordinance amends the Insolvency and Bankruptcy Code, 2016 to prohibit certain people from submitting a resolution plan (specifying details of restructuring a defaulter’s debt). These persons include: (i) wilful defaulters, (ii) disqualified directors, (iii) promoters or management of the defaulting company, and (iv) any person who has committed these activities abroad.
- ◆ The Ordinance bars an insolvency professional from selling the property of a defaulter to any such person during liquidation.

Key Issues and Analysis

- ◆ The Ordinance prohibits certain persons from submitting resolution plans as it may be considered undesirable to let them take charge of the company. However, this may reduce competition among applicants seeking to resolve the company and result in lower recoveries for creditors.

PART A: HIGHLIGHTS OF THE ORDINANCE

Context

The Insolvency and Bankruptcy Code, 2016 was enacted to consolidate insolvency-related laws and provide a time-bound process to resolve insolvency among companies and individuals.¹ Insolvency refers to a situation where a person is unable to repay its debt.

The Code is in its early stages of implementation with the first case resolved in August 2017.² Institutions under the Code, such as information utilities (to handle financial information related to debtors) are being set up and insolvency professionals (IPs) are being trained.³

Over the last two years, 300 cases have been registered under the Code, some of which have been challenged in courts.⁴ In November 2017, a committee was set up to review the Code, identify issues in its implementation, and suggest changes.⁴ The committee has been given two months to submit its report. The Ordinance was promulgated on November 23, 2017 to prohibit certain persons from submitting resolution plans to resolve defaulting companies. The government stated that the Ordinance seeks to prevent these persons from misusing the Code.⁵

Process under the 2016 Code:

- Upon default, the insolvency professional manages the defaulter’s assets and constitutes a creditors committee.
- Creditors committee decides to either: (i) approve a resolution plan to restructure the defaulter’s loans, or (ii) liquidate (sell) its assets to recover the outstanding amount.
- If no decision is taken within 180 days (extendable by 90 days), the defaulter’s assets will be liquidated.

Key Features

The Ordinance amends provisions related to corporate default to prohibit: (i) certain persons from submitting resolution plans, and (ii) sale of the defaulter’s assets to such persons in case of liquidation. A resolution plan contains details which include: (i) the manner of repaying debts of the defaulting company, and (ii) management of the company after the resolution plan is approved.¹

- **Resolution applicant:** Under the Code, any person submitting a resolution plan to an IP is known as a resolution applicant. These resolution applicants may include lenders or investors, among other persons. The Ordinance amends this provision to specify that a resolution applicant may submit a resolution plan only after receiving an invite by the IP to do so.

- **Ineligibility to be resolution applicant:** The Ordinance inserts a provision prohibiting certain persons from submitting a resolution plan. A person will be ineligible to submit a plan if: (i) he is an undischarged insolvent (individual unable to repay his debt), (ii) he is a wilful defaulter, (iii) his account has been identified as a non-performing asset for more than a year, (iv) he has been convicted of an offence punishable with two or more years of imprisonment, (v) he has been disqualified as a director under the Companies Act, 2013, (vi) he has been prohibited from trading in securities by SEBI, (vii) he has indulged in undervalued, preferential, or fraudulent transactions, (viii) he has given guarantee on a liability of the defaulting company undergoing resolution or liquidation, (ix) he is connected to any person mentioned above (including promoters, management, or any person related to them), or (x) he has indulged in these activities abroad.
- **Approving resolution plan:** The Ordinance prohibits the committee of creditors from approving a resolution plan submitted before the Ordinance was promulgated, if the plan was submitted by a person ineligible to be a resolution applicant as per the Ordinance.
- **Liquidation:** The Code allows the IP to sell the property of the defaulter in case of liquidation. The Ordinance prohibits the sale of this property to any person ineligible to be a resolution applicant.

PART B: KEY ISSUES AND ANALYSIS

Restricting certain persons from submitting a resolution plan

Ordinance:
Clause 5

The Ordinance prohibits certain persons from submitting resolution plans to resolve a defaulting company. These include: (i) promoters, management of the company, or any person related to them, (ii) persons who have given a guarantee on a liability of the defaulting company undergoing resolution or liquidation, (iii) persons who have indulged in preferential or undervalued transactions, or (iv) any person who has committed any of the specified activities abroad. We discuss some issues which may arise out of the provisions of the Ordinance.

Excluding persons from the process may reduce competition among applicants for the defaulting firm

The Ordinance prohibits certain persons from submitting a resolution plan for resolving a defaulting company. It may be argued that this may reduce the number of plans submitted before the committee of creditors. One argument to exclude such persons may be that these people have not complied with laws in the past, and therefore could be undesirable candidates to restructure a failing company. Further, promoters and management of a firm may have been responsible for its failure and it may be improper to allow them to regain control of the company.

However, on the other hand excluding certain people (including persons related to the promoters or management) may result in lower competition among applicants seeking to resolve a company, which may lead to lower recoveries for creditors. Further, in case of some small and medium enterprises, the promoter may be the only person submitting a plan to revive the company. In such cases, the defaulting firm will go into liquidation even if there could have been a viable resolution plan.

Rationale for barring certain persons who have given a guarantee on a liability of the defaulting company

The Ordinance prohibits a person from submitting a resolution plan if he has given a guarantee on a liability of the defaulting company undergoing resolution or liquidation. For example, A lends Rs 1,000 to B. This amount is guaranteed by C, implying that if B is unable to repay this amount, then C will repay it on B's behalf. There may be a case for prohibiting C from submitting a resolution plan if he does not honour the guarantee. However, there may be instances where C honours the guarantee and the resolution process is triggered by defaults on other debts of B. The question is whether a guarantor who honours his guarantee should be barred from submitting a resolution plan for any company.

1. The Insolvency and Bankruptcy Code, 2016, <http://ibbi.gov.in/webadmin/pdf/legalframework/2017/Jul/IBC%202016.pdf>.
2. Quarterly Newsletter for Jul-Sept 2017, Insolvency and Bankruptcy Board of India, http://ibbi.gov.in/IBNNOV2017_13.pdf.
3. "NCLT might have more benches for faster NPA resolution: M S Sahoo", The Indian Express, June 16, 2017.
4. 'Constitution of Insolvency Law Committee', Order, Ministry of Corporate Affairs, November 16, 2017, http://mca.gov.in/Ministry/pdf/constitutionOrder_17112017.pdf.
5. 'Ordinance to amend the Insolvency and Bankruptcy Code, 2016 promulgated', Press Information Bureau, Ministry of Corporate Affairs, November 23, 2017.

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