The report of the
Bankruptcy Law Reforms Committee
Volume I: Rationale and Design

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BANKRUPTCY LAW REFORMS COMMITTEE

New Delhi

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Shri Arun Jaitley
Finance Minister
Government of India
New Delhi 110001

Respected Finance Minister,

The Bankruptcy Law Reform Committee presents its Report to the Government of India. The Report is in two parts: Volume I –text of the findings and recommendations and Volume II – draft Insolvency and Bankruptcy Code.

Yours sincerely

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1 — Acknowledgements

As Chairman of the Committee on bankruptcy law reforms, I have had the privilege of overseeing the design and drafting of a new legal framework for resolving matters of insolvency and bankruptcy. This is a matter of critical importance: India is one of the youngest republics in the world, with a high concentration of the most dynamic entrepreneurs. Yet these game changers and growth drivers are crippled by an environment that takes some of the longest times and highest costs by world standards to resolve any problems that arise while repaying dues on debt. This problem leads to grave consequences: India has some of the lowest credit compared to the size of the economy. This is a troublesome state to be in, particularly for a young emerging economy with the entrepreneurial dynamism of India.

Such dynamism not only needs reforms, but reforms done urgently. The Committee was seized of this, and focused on a two-phase mandate over its tenure. The first phase was to examine the existing bankruptcy framework, and whether there were policy and legal changes that could yield immediate effect. The focus here was on the problems of insolvency and bankruptcy under the Companies Act, 2013. The outcome of the deliberations of the Committee led to the Interim Report of the Committee that was put out for public comments at the end of February, 2015 (Ministry of Finance, 2015). The team at the Vidhi Centre for Legal Policy, led by Debanshu Mukherjee, did a wonderful job to deliver the richly detailed report within the hard limitations on time.

The Committee then embarked on the second phase of its mandate. Here, the task was to create a uniform framework that would cover matters of insolvency and bankruptcy of all legal entities and individuals, save those entities with a dominantly financial function. This shifted the mandate to a much wider problem that included micro, small and medium enterprises, sole proprietorships and individuals. This also meant demands on a much wider and deeper base of knowledge, on both matters of the economics of the problem as well as the legal framework. Fortunately for the Committee, we had ample help from various sources to tackle both of these issues.

A sub-group of the Committee including Aparna Ravi, Sudarshan Sen, Susan Thomas, Madhukar Umarji and Bahram Vakil led the charge, devoting immense time to contribute the knowledge of their experience, distil research inputs and the wisdom of various market participants into our deliberations. Research contributions and real world knowledge on the economics and the legal framework were gathered from the many policy papers, workshops and a conference that was conducted during the period of the Committee's working. These discussions captured knowledge of the intricacies of the insolvency and bankruptcy processes on the ground in India today, and engaged with economists, lawyers and the financial market participants from banks, the asset reconstruction companies and fund managers. This knowledge base was used to think about how the insolvency process should be redesigned.

The Committee is thankful for conversations with Raghuram Rajan of Reserve Bank of India, Amitabh Kant of Department of Industrial Policy and Promotion, S. K. Amarnath of ARCIL, Sanjay Banerjee of the University of Nottingham, Clive Barnard, Kevin Pullen, John Whiteoak and Soumya Rao of Herbert Smith Freehills LLP, Sumant Batra of Kesar Dass B. and Associates, Sharad Bhatia and Saugata Bhattacharya of Axis Bank, Ashwin Bishnoi and Tarang Shashisekhar of Khaitan & Co., A. K. Choudhary of the Reserve Bank of India, Bhagwan Chowdhry of University of California Los Angeles, Janak Dalal and Sridhar Srinivasan of Deutsche Bank, Maneesha Dhir of Dhir & Dhir Associates, Amardeep Singh Bhatia and Puneet Duggal of the Ministry of Corporate Affairs, Diwakar Gupta now of Asian Development Bank, Sapan Gupta of Bajaj Financial Services Ltd., Jayesh H of Juris Corp., Monika Halan of The Mint, Saurabh Jaywant, Gaurav Kumar and Irfan Mohammed of IFMR Capital, Teresa John, Rahul Matthan, Harsh Pais and Upasana Rao of Trilegal, Shaktikanta Das, Ajay Tyagi, C. K. G. Nair and Manoj Joshi of the Department of Economic Affairs, Pramod Kabra, Vikram Nirula and Santhanam Rajgopalan of India Value Fund Associates, Chief Justice Sanjay Kaul of the Madras High Court, K. P. Krishnan of the Dept. of Land Resources, Sankar Krishnan and Nikhil Shah of Alvarez & Marshal, P. K. Malhotra, S. D. Kelkar and M. M. Pathak of State Bank of India, Rajiv Mehrishi then of the Ministry of Finance, Debanshu Mukherjee and Arghya Sengupta of Vidhi Centre for Legal Policy, Badri Narayan of Third Eye Capital, Venky Panchepagesan of IIM Bangalore, Suyash Rai, Shubho Roy and Bhargavi Zaveri of the Macro / Finance Group at NIPFP, Raghuram Rajan of the Reserve Bank of India, A. K. Ralhan of CERSAI, Shailendra Singh and Ravinder of the Dept. of Industrial Policy and Promotion, M. S. Sahoo of Competition Commission of India, U. K. Sinha of SEBI, S. Ramann of the Comptroller and Auditor General, Justice Srikrishna, Surendra Nath Tripathi of the Ministry of MSME, Mahesh Uttamchandani and Sagar Shiv Shankar of the World Bank, Harsh Vardhan of Bain Capital, Mukulita Vijayawargiya at the Ministry of Law and Justice, Dina Wadia of J. Sagar Associates and Pradeep K. Yadav of the University of Oklahoma.

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and Anjali Sharma of the Finance Research Group at IGIDR.

The Committee would like to acknowledge the benefit of suggestions from various experts outside of India, including Kristin van Zweiten of the University of Oxford, Clive Barnard and Kevin Pullen of Herbert Smith Freehills LLP, Pramod Rao of Citigroup, and during meetings supported by the British High Commission and organised by Angela Lynch, Anita Nandi and Frederick Packham of the City of London. The Committee is also thankful to the British High Commission, the City of London, and the India-UK Financial Partnership chaired by Uday Kotak and Sir Gerry Grimstone for their support of the research which fed into this work.

All this yielded a rich accumulation of knowledge and information that has been synthesised into the two volumes that form the report of the Committee. This was translated into drafts for the two volumes by a team of young economists and lawyers, who came together driven by their conviction about the need of a robust insolvency and bankruptcy legal framework for India. The Committee owes tremendous thanks to the ceaseless enthusiasm and tireless efforts of Debanshu Mukherjee, Anirudh Burman, Ashika Dabholkar, Pratik Dutta, Shreya Garg, Richa Roy, Renuka Sane, Rajeswari Sengupta, Suharsh Sinha, Anjali Sharma, Priyadarshini Thyagarajan, and Shivangi Tyagi. Shubho Roy provided the principles of quality drafting of law, and Chirag Anand and Nikhil Saboo provided the support of technology to facilitate their work in designing and drafting the structure and form presented in the reports of the committee. The Committee is also grateful for the diligent work of Ms. Mukulita Vijayawargiya and her team at the Legislative Department of the Ministry of Law and Justice for further building on these drafts.

Finally, I would like to thank the silent and efficient administrative support from the team at the Ministry of Finance. Without the efforts of C.K.G. Nair, Gaurav Masaldan, Praveen Trivedi, Mrityunjay Jha, A. K. Sinha, and Revant Gupta, our work would have been a lot less smooth and a lot more tiresome.

The drafting of a single, comprehensive, and internally consistent bankruptcy law was a complex undertaking, with few precedents in India's history. Without the immense efforts of all the persons named above, it could not have been done at the required level of quality. I am grateful for the selfless dedication to the project that came from everyone who came in contact with it.

Dr. T. K. Viswanathan

2 — Executive summary

Difficulties of the present arrangements

The limited liability company is a contract between equity and debt. As long as debt obligations are met, equity owners have complete control, and creditors have no say in how the business is run. When default takes place, control is supposed to transfer to the creditors; equity owners have no say.

This is not how companies in India work today. For many decades, creditors have had low power when faced with default. Promoters stay in control of the company even after default. Only one element of a bankruptcy framework has been put into place: to a limited extent, banks are able to repossess fixed assets which were pledged with them.

While the existing framework for secured credit has given rights to banks, some of the most important lenders in society are not banks. They are the dispersed mass of households and financial firms who buy corporate bonds. The lack of power in the hands of a bondholder has been one (though not the only) reason why the corporate bond market has not worked. This, in turn, has far reaching ramifications such as the difficulties of infrastructure financing.

Under these conditions, the recovery rates obtained in India are among the lowest in the world. When default takes place, broadly speaking, lenders seem to recover 20% of the value of debt, on an NPV basis.

When creditors know that they have weak rights resulting in a low recovery rate, they are averse to lend. Hence, lending in India is concentrated in a few large companies that have a low probability of failure. Further, secured credit dominates, as creditors rights are partially present only in this case. Lenders have an emphasis on secured credit. In this case, credit analysis is relatively easy: It only requires taking a view on the market value of the collateral. As a consequence, credit analysis as a sophisticated analysis of the *business prospects* of a firm has shriveled.

Both these phenomena are unsatisfactory. In many settings, debt is an efficient tool for corporate finance; there needs to be much more debt in the financing of Indian firms. E.g. long-dated corporate bonds are essential for most infrastructure projects. The lack of lending without collateral, and the lack of lending based on the prospects of the firm, has emphasised debt financing of asset-heavy industries. However, some of the most important industries for India's rapid growth are those which are more labour intensive. These industries have been starved of credit.

Problem statement

While lending to limited liability companies is particularly important, lending also takes place to individuals, sole proprietorships, partnerships, limited liability partnerships, etc. A comprehensive and consistent treatment of bankruptcy and insolvency for all these is an essential ingredient of India's rise into a mature market economy. The draft 'Indian Financial Code', by Justice Srikrishna's Financial Sector Legislative Reforms Commission, covers the failure of financial firms. The present Committee has taken up the task of drafting a single unified framework which deals with bankruptcy and insolvency by persons other than financial firms.

At present, there are multiple contradictory elements in the legal arrangements. The Committee has chosen the strategy of repealing many existing laws on bankruptcy and insolvency, and writing a clean modern law which is a simple, coherent, and effective answer to the problems under Indian conditions.

The key economic question in the bankruptcy process

When a firm (referred to as the corporate debtor in the draft law) defaults, the question arises about what is to be done. Many possibilities can be envisioned. One possibility is to take the firm into liquidation. Another possibility is to negotiate a debt restructuring, where the creditors accept a reduction of debt on an NPV basis, and hope that the negotiated value exceeds the liquidation value. Another possibility is to sell the firm as a going concern and use the proceeds to pay creditors. Many hybrid structures of these broad categories can be envisioned.

The Committee believes that there is only one correct forum for evaluating such possibilities, and making a decision: a creditors committee, where all financial creditors have votes in proportion to the magnitude of debt that they hold. In the past, laws in India have brought arms of the government (legislature, executive or judiciary) into this question. This has been strictly avoided by the Committee. The appropriate disposition of a defaulting firm is a business decision, and only the creditors should make it.

The Insolvency Resolution Process (IRP)

For some firms, the right answer after default is to take the firm into liquidation. But there may be many situations in which a viable mechanism can be found through which the firm is protected as a going concern. To the extent that this can be done, the costs imposed upon society go down, as liquidation involves the destruction of the organisational capital of the firm.

Currently, the Companies Act 2013 permits the following parties to file an application before NCLT for a declaration that company is sick- (a) the company, (b) any secured creditor, (c) the Central Government, (d) the Reserve Bank of India, (e) State Government, (f) public financial institution, (g) a State level institution, (h) a scheduled bank. Even under the SARFAESI, 2002, debt enforcement rights are available for secured creditors only. However, the Committee proposes that any creditor, whether financial or operational, should be able to initiate the insolvency resolution process (IRP) under the proposed code. It may be noted that operational creditors will include workmen and employees whose past payments are due. The Committee also recommends that a resolution plan must necessarily provide for certain protections for operational creditors. This will empower the workmen and employees to initiate insolvency proceedings, settle their dues fast and move on to some other job instead of waiting for their dues for years together as is the case under the existing regime**.**

The strategy proposed by the Committee runs as follows, when default takes place an Insolvency Resolution Process (IRP) can be initiated and run for as long as 180 days. The IRP is overseen by an 'Insolvency Professional' (IP) who is given substantial powers.

The IP makes sure that assets are not stolen from the company, and initiates a careful check of the transactions of the company for the last two years, to look for illegal diversion of assets. Such diversion of assets would induce criminal charges.

While the IRP is in process, the law enshrines a 'calm period' where creditors stay their claims. This gives a better chance for the firm to survive as a going concern. For the 180 days for which the IRP is in operation, the creditors committee will analyse the company, hear rival proposals, and make up its mind about what has to be done.

When 75% of the creditors agree on a revival plan, this plan would be binding on all the remaining creditors. If, in 180 days, no revival plan achieves support of 75% of the creditors, the firm goes into liquidation.

In limited circumstances, if 75 % of the creditors committee decides that the complexity of a case requires more time for a resolution plan to be finalised, a one-time extension of the 180 day period for up to 90 days is possible with the prior approval of the adjudicator. This is starkly different from certain present arrangements which permit the debtor / promoter to seek extensions beyond any limit.

This approach has many strengths:

- Asset stripping by promoters is controlled after and before default.
- The promoters can make a proposal that involves buying back the company for a certain price, alongside a certain debt restructuring.
- Others in the economy can make proposals to buy the company at a certain price,

alongside a certain debt restructuring.

- All parties knows that if no deal is struck within the stipulated period, the company will go into liquidation. This will help avoid delaying tactics. The inability of promoters to steal from the company, owing to the supervision of the IP, also helps reduce the incentive to have a slow lingering death.
- The role of the adjudicator will be on process issues: To ensure that all financial creditors were indeed on the creditors committee, and that 75% of the creditors do indeed support the resolution plan.

Liquidation

Firms go into liquidation through one of two paths. Sometimes, the creditors committee can quickly decide that the right path is to go into liquidation. Alternatively, 180 days can go by and no one plan is able to obtain the required supermajority in the creditors committee. In this case also, liquidation is triggered.

Liquidation will be led by a regulated insolvency professional, the liquidator. In this process, the assets of the company are held in trust. The rights of secured creditors are respected: they have the choice of taking their collateral and selling it on their own. The recoveries that are obtained are paid out to the various claimants through a well-defined waterfall.

The Committee has recommended to keep the right of the Central and State Government in the distribution waterfall in liquidation at a priority below the unsecured financial creditors in addition to all kinds of secured creditors for promoting the availability of credit and developing a market for unsecured financing (including the development of bond markets). In the long run, this would increase the availability of finance, reduce the cost of capital, promote entrepreneurship and lead to faster economic growth. The government also will be the beneficiary of this process as economic growth will increase revenues. Further, efficiency enhancement and consequent greater value capture through the proposed insolvency regime will bring in additional gains to both the economy and the exchequer.

Bankruptcy and insolvency for persons

Firms can be liquidated, but individuals cannot. Many concepts in the IRP, such as obtaining a new owner with a revival plan, are not applicable for individuals. Hence, a simplified process is envisaged for default by individuals. This includes a concept of a 'Fresh Start' where specified loans of a limited class of borrowers can be waived, but this information about individual bankruptcy will reflect in the records of the individual.

Speed is of essence

Speed is of essence for the working of the bankruptcy code, for two reasons. First, while the 'calm period' can help keep an organisation afloat, without the full clarity of ownership and control, significant decisions cannot be made. Without effective leadership, the firm will tend to atrophy and fail. The longer the delay, the more likely it is that liquidation will be the only answer. Second, the liquidation value tends to go

down with time as many assets suffer from a high economic rate of depreciation.

From the viewpoint of creditors, a good realisation can generally be obtained if the firm is sold as a going concern. Hence, when delays induce liquidation, there is value destruction. Further, even in liquidation, the realisation is lower when there are delays. Hence, delays cause value destruction. Thus, achieving a high recovery rate is primarily about identifying and combating the sources of delay.

This same idea is found in FSLRC's treatment of the failure of financial firms. The most important objective in designing a legal framework for dealing with firm failure is the need for speed.

Identifying and addressing the sources of delay

Before the IRP can commence, all parties need an accurate and undisputed set of facts about existing credit, collateral that has been pledged, etc. Under the present arrangements, considerable time can be lost before all parties obtain this information. Disputes about these facts can take up years to resolve in court. The objective of an IRP that is completed in no more than 180 days can be lost owing to these problems.

Hence, the Committee envisions a competitive industry of 'information utilities' who hold an array of information about all firms at all times. When the IRP commences, within less than a day, undisputed and complete information would become available to all persons involved in the IRP and thus address this source of delay.

The second important source of delays lies in the adjudicatory mechanisms. In order to address this, the Committee recommends that the National Company Law Tribunals (for corporate debtors) and Debt Recovery Tribunals (for individuals and partnership firms) be provided with all the necessary resources to help them in realising the objectives of the Code.

The need for a regulator

Globally, insolvency professionals (IPs) are an important component of a well-functioning insolvency and bankruptcy system. This requires the construction of a regulated industry. The Committee envisions the establishment of multiple private self-regulatory IP agencies functioning under the oversight of a regulator. These IP agencies would oversee the functioning of IPs and help in the development of the industry.

Information utilities would be a competitive industry. Their oversight would also require a regulator.

Many procedural details about the working of the bankruptcy process should not be encoded into the primary law, as they need to evolve rapidly based on experience and based on changes in the economy. The draft law envisages regulations which spell out these details. These regulations would be drafted by a regulator.

Finally, there are certain statistical system functions which would also be performed by a regulator.

The Committee recommends the establishment of an Insolvency and Bankruptcy Board of India (referred to as the Board/Regulator in this report) which would perform the abovementioned functions.

From ideas to implementation

The Committee has drafted a Volume 1, which is a committee report showing rationale and arguments, and a Volume 2 which is a draft law. The legislative track of the implementation will comprise taking this draft law through the consultative process, and public debate, prior to its being tabled in Parliament. The Committee recognises that setting up the institutions contemplated in this report may require some time. Therefore, the Committee recommends that until such time as the regulator is not established, its powers and functions may be exercised by the Central Government. This can be addressed by providing for appropriate transitional provisions in the Code.

Domestic versus international perspective

The Committee has taken up, and attempted to comprehensively solve, the question of bankruptcy and insolvency insofar as it is a purely domestic question. This is an important first milestone for India.

The next frontier lies in addressing cross-border issues. This includes Indian financial firms having claims upon defaulting firms which are global, or global financial persons having claims upon Indian defaulting firms.

Some important elements of internationalisation – foreign holders of corporate bonds issued in India, or borrowing abroad by an Indian firm – are dealt with by the present report. However, there are many other elements of cross-border insolvency which are not addressed by this report. Examples of these problems include thousands of Indian firms have become multinationals, and Indian financial investors that lend to overseas persons.

The Committee proposes to take up this work in the next stage of its deliberations.

Conclusion

The failure of some business plans is integral to the process of the market economy. When business failure takes place, the best outcome for society is to have a rapid re-negotiation between the financiers, to finance the going concern using a new arrangement of liabilities and with a new management team. If this cannot be done, the best outcome for society is a rapid liquidation. When such arrangements can be put into place, the market process of creative destruction will work smoothly, with greater competitive vigor and greater competition.

India is in the process of laying the foundations of a mature market economy. This involves well drafted modern laws, that replace the laws of the preceding 100 years, and high performance organisations which enforce these new laws. The Committee has endeavored to provide one critical building block of this process, with a modern insolvency and bankruptcy code, and the design of associated institutional infrastructure which reduces delays and transaction costs.

We hope that the implementation of this report will increase GDP growth in India by fostering the emergence of a modern credit market, and particularly the corporate bond market. GDP growth will accelerate when more credit is available to new firms including firms which lack tangible capital. While many other things need to be done in achieving a sound system of finance and firms, this is one critical building block of that edifice.

3 — Economic thinking

3.1 Why reforms?

Financial sector reforms have given a transformation of the equity, currency and commodity markets. However, despite considerable policy efforts, the credit markets continue to malfunction (Banerji et al., 2012; Sane and Thomas, 2012; Rajan, 2008; Percy Mistry Committee Report, 2007). One key factor that holds back the credit market is the mechanism for resolving insolvency, or the failure of a borrower (debtor) to make good on repayment promises to the lender (creditor). The existing laws have several problems and are enforced poorly.

Table 3.1 shows that numerous government committees have worked on this subject, for many decades. The present project builds on their work and thinking. There is, however, a key difference between this project and its predecessors. In the past, bankruptcy reforms had involved treating the broad landscape of the bankruptcy process as given, and undertaking certain incremental changes. The present Committee has the mandate of comprehensive reform, covering all aspects of bankruptcy of individuals and non-financial firms. Here the term "non-financial firms" includes but is not restricted to limited liability corporations. The only element which is not covered in the present work is the recent work of the Financial Sector Legislative Reforms Commission (FSLRC), which has a comprehensive solution for the failure of financial firms.

In this chapter, we go back to the basics to understand the problem of resolving insolvency, and from there to design an approach to solve it in India. Section 3.2 articulates economic principles for a sound set of arrangements of bankruptcy and insolvency resolution. In Section 3.3, we describe the working of present arrangements in India, and the difficulties faced with these present arrangements. Section 3.5 shows the benefits for India from undertaking bankruptcy and insolvency reform.

Table 3.1: Government committees on bankruptcy reforms

Year	Committee	Outcome
1964	24th Law Commission	Amendments to the Provincial Insolvency Act, 1920.
1981	Tiwari Committee (Department of Company Affairs)	SICA, 1985.
1991	Narasimham Committee I (RBI)	RDDBFI Act, 1993.
1998	Narasimham Committee II (RBI)	SARFAESI Act, 2002.
1999	Justice Eradi Committee (GOI)	Companies (Amendment) Act, 2002, Proposed repeal of SICA.
2001	L. N. Mitra Committee (RBI)	Proposed a comprehensive bankruptcy code.
2005	Irani Committee (RBI)	Enforcement of Securities Interest and Recovery of Debts Bill, 2011. (With amendments to RDDBFI and SARFAESI).
2008	Raghuram Rajan Committee (Planning Commission)	Proposed improvements to credit infrastructure.
2013	Financial Sector Legislative Reforms Commission (Ministry of Finance)	Draft Indian Financial Code which includes a 'Resolution Corporation' for resolving distressed financial firms.

3.2 The role that insolvency and bankruptcy plays in debt financing

Creditors put money into debt investments today in return for the promise of fixed future cash flows. But the returns expected on these investments are still uncertain because at the time of repayment, the seller (debtor) may make repayments as promised, or he may *default* and does not make the payment. When this happens, the debtor is considered *insolvent*. Other than cases of outright fraud, the debtor may be insolvent because of

- Financial failure – a persistent mismatch between payments by the enterprise and receivables into the enterprise, even though the business model is generating revenues, or
- Business failure – which is a breakdown in the business model of the enterprise, and it is unable to generate sufficient revenues to meet payments.

Often, an enterprise may be a successful business model while still failing to repay its creditors. A sound bankruptcy process is one that helps creditors and debtors realise and agree on whether the entity is facing financial failure and business failure. This is important to allow both parties to realise the maximum value of the business in the insolvency.

As an example, consider a risky business venture which is financed using Rs.50 of equity and Rs.50 of debt. Once the project is built out, it proves to have a net present value, or NPV, of future cash flows of Rs.40 only. A sound bankruptcy process would work as follows. The equity value of the enterprise would be wiped out and the existing shareholders would lose control. If a new equity investor can be found who is willing to pay Rs.40, this could be paid to the debt investors. At Rs.40, they would face a relatively small loss of Rs.10 and get an 80% recovery rate. The new equity shareholder would

get a debt-free enterprise with an NPV of future cash flows worth Rs.40.

The above steps describe a creditors and debtors agreeing on a *financial rearrangement* to preserve the economic value of the business. In the conventional understanding, the enterprise in the above example would be treated as a 'failed business model' and be closed down. The value that could have been earned of keeping it as a going concern is lost. Through a financial rearrangement, the enterprise remains a going concern.

Such outcomes are particularly important for enterprises that provide services and have little built up assets which can be sold by the creditor to recover value. For example, the procedure in the above example was used after many telecom firms, worldwide, bid values which were too high for spectrum allocation. Sound bankruptcy processes induced a financial rearrangement, but the business models of the firms ran uninterruptedly through the entire rearrangement, preserving economic value for their creditors despite defaulting on promised payment.

3.2.1 Assessing viability

The economic problem presented above is called the assessment of viability of an enterprise or a project. An enterprise that is facing financial failure is considered a viable enterprise: there is a possible financial rearrangement that can earn the creditors a higher economic value than shutting down the enterprise. On the other hand, where the cost of the financial arrangement required to keep the enterprise going will be higher than the NPV of future expected cash flows. In this case, the enterprise is considered unviable or *bankrupt* and is better shut down as soon as possible.

However, the assessment of viability is difficult. There is no fixed or unique approach to answer this question. In an ideal environment, the assessment will be the outcome of a collective decision. Here, creditors and debtor will negotiate a potential new financial arrangement. Each of them will balance all available information, including all future possibilities of the economic environment under which the enterprise will operate, as well as all alternative investment opportunities available to the creditors as well as the debtor.

In the negotiation, the debtor is likely to request that creditors restructure their liabilities so as to ease the liquidity stress of future repayments. The proposal may contain the need for fresh financing, either from existing creditors or from new financiers. In exchange, the debtor may offer to reorganise the operations of the enterprise by giving up some rights in management or to change the size of operations. Creditors will evaluate the proposal and offer modifications on their own. If both sides see the possibility of value in the enterprise, these negotiations will settle on a new financial arrangement. On the other hand, if they cannot agree on a solution, it will be optimal for the creditors to sell the assets available and shut down the enterprise.

3.2.2 Conflicts in creditor-debtor negotiation

The outcome of such a negotiation is optimal when the interests of the debtor and creditors are aligned to maximise economic value of the enterprise. However, there are

several elements in the negotiation that increase rather than prevent conflict between the two.

One conflict arises because the asymmetry of information between the creditor and the debtor. Since the debtor will always have more information about the enterprise than the creditor, they tend to have the upper-hand in the negotiation. Another conflict arises in the approach of the creditors and debtor to preserving the time value of their own investment. The creditor has the incentive to close out her investment quickly so as to avail of alternative investment opportunities. The debtor has the incentive to hold on to the assets, either to benefit from potentially higher returns by deploying the assets in more risky ventures or to benefit by stripping asset value.

Conflicts tend to be exacerbated when there are multiple levels and types of liabilities in an enterprise. In addition to the conflict between creditor and debtor, there can be conflict between different types of creditors as well. Enterprises have financial creditors by way of loan and debt contracts as well as operational creditors such as employees, rental obligations, utilities payments and trade credit. When the debtor contracts these liabilities, there is an understanding about a priority structure of payout to the claims. While this will not be disputed when the debtor is solvent, multiple claims will give rise to conflict during insolvency.

3.2.3 What can a sound bankruptcy law achieve?

Improved handling of conflicts between creditors and the debtor

The previous section lays out the types of conflicts between creditors and the debtor. The role of the law, in a formal bankruptcy process, is to lay down rules of procedure into which the conflict is channeled, and results in a solution. A sound legal framework provides procedural certainty about the process of negotiation, in such a way as to reduce problems of common property and reduce information asymmetry for all economic participants.

Avoid destruction of value

A sound legal process also provides flexibility for parties to arrive at the most efficient solution to maximise value during negotiations. If the enterprise is insolvent, the payment failure implies a loss which must be borne by some of the parties involved. From the viewpoint of the economy, some firms undoubtedly need to be closed down. But many firms possess useful organisational capital. Across a restructuring of liabilities, and in the hands of a new management team and a new set of owners, some of this organisational capital can be protected. The objective of the bankruptcy process is to create a platform for negotiation between creditors and external financiers which can create the possibility of such rearrangements.

Drawing the line between malfeasance and business failure

Under a weak insolvency regime, the stereotype of "rich promoters of defaulting entities" generates two strands of thinking: (a) the idea that all default involves malfeasance

and (b) The idea that promoters should be held personally financially responsible for defaults of the firms that they control. However, the following perspectives are useful in the context of enterprises:

1. *Some business plans will always go wrong*. In a growing economy, firms make risky plans of which some plans will fail, and will induce default. If default is equated to malfeasance, then this can hamper risk taking by firms. This is an undesirable outcome, as risk taking by firms is the wellspring of economic growth. Bankruptcy law must enshrine business failure as a normal and legitimate part of the working of the market economy.
2. *Limited liability corporations are an important mechanism that fosters risk taking.* Historically, limited liability corporations were created with the objective of taking risk. If liability was unlimited, fewer risky projects would be undertaken. With limited liability, shareholders have the ability to walk away, allowing for greater exploration of alternative business models. Since exploration benefits society through risk taking, it is important to protect the concept of limited liability, which bankruptcy law must aim to do.
3. *Control of a company is not divine right.* When a firm defaults on its debt, control of the company should shift to the creditors. In the absence of swift and decisive mechanisms for achieving this, management teams and shareholders retain control after default. Bankruptcy law must address this.
4. *The illegitimate transfer of wealth out of companies by controlling shareholders is malfeasance*. When a company is sound, corporate governance ensures that the benefits obtained by every share are equal. When a company approaches default, managers may anticipate this ahead of time and illicit transfers of cash may take place. The bankruptcy process must be designed with a particular focus on blocking such behavior, which is undoubtedly malfeasance.

Above all, bankruptcy law must give honest debtors a second chance, and penalise those who act with mala fide intentions in default.

Clearly allocate losses in macroeconomic downturns

Bankruptcy reforms are particularly important in avoiding extreme problems in a business cycle downturn or a financial crisis. A business cycle downturn or a financial crisis will lead to certain firms failing. With a sound bankruptcy framework, these losses are clearly allocated to some people. Loss allocation could take place through taxes, inflation, currency depreciation, expropriation, or wage or consumption suppression. These could fall upon foreign creditors, small business owners, savers, workers, owners of financial and non-financial assets, importers, exporters. In turn, this creates *predictability* about the allocation of the losses.

Without this predictability, events of downturns and crisis lead to greater instability in the economy. The sectors or groups that fear such loss allocation will politically mobilise to place the losses upon someone else. Responses to this uncertainty can include capital flight, reduced investment because of increased saving, shorter credit lending and higher interest rates.

This political economy is eliminated by the creation of two institutional mechanisms: the bankruptcy Code proposed by this Committee and the Resolution Corporation which covers the losses of potential failure of all financial firms recommended by the FSLRC. The predictability generated by these two institutional arrangements will increase the robustness of the economy when faced with a downturn. In turn, downturns will become shorter and shallower. The ability of the economy to sustain high levels of credit, safely, will be enhanced and the economy can move on faster after a downturn or a crisis.

3.3 Present arrangements in India

The present structure of the bankruptcy and insolvency process in India is elaborate and multi-layered (Sharma and Thomas, 2015). The legislative process is covered over multiple laws, and adjudication takes place in multiple fora. For example, Sengupta and Sharma, 2015 notes that while the Companies Act, 1956, contains the main legal provisions for corporate insolvency, the legislative framework is completed through three major laws, two ancillary laws and one special provision.

Individual bankruptcy and insolvency

The Presidency Towns Insolvency Act, 1909, covers the insolvency of individuals and of partnerships and associations of individuals in the three erstwhile Presidency towns of Chennai, Kolkata and Mumbai. The 1861 Indian High Courts Act led to the setting up of the High Court system in place of the Presidency towns Supreme Courts, which also has jurisdiction over insolvency related matters in the Presidency towns.

The Provincial Insolvency Act 1920, is the insolvency law for individuals in areas other than the Presidency towns, deals with insolvency of individuals, including individuals as proprietors. Section 3(1) of the Provincial Insolvency Act, 1920, allows the State Government to empower subordinate courts to hear insolvency petitions, with district courts acting as the court of appeal.

Corporate bankruptcy and insolvency

Companies are registered under the Companies Act, 2013. Limited liability partnerships are registered under the Limited Liability Partnership Act, 2008. The Micro, Small and Medium Enterprise Development Act, 2006, registers MSMEs but does not yet have provisions for resolving insolvency and bankruptcy.

Partnership firms are registered under the Indian Partnerships Act, 1932, which is administered by the Ministry of Corporate Affairs. But, like for sole proprietorships, insolvency and bankruptcy resolution of partnership firms is treated the same as under individual insolvency and bankruptcy law.

The present bankruptcy and insolvency framework is knit together from debt recovery laws as well as collective action laws to resolve insolvency and bankruptcy (Ravi, 2015).

Debt recovery

A civil court of relevant jurisdiction is the basic mechanism that is available to any creditor for debt recovery. If the loan is backed by security, this is enforced as a contract under the law.

The Recovery of Debt Due to Banks and Financial Institutions Act (RDDBFI Act) 1993 gives banks and a specified set of financial institutions greater powers to recover collateral at default. The law provides for the establishment of special Debt Recovery Tribunals (DRTs) to enforce debt recovery by these institutions only. The law also provides for the Debt Recovery Appellate Tribunals (DRATs) as the appellate forum.

Under certain specified conditions, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) 2002 enables secured creditors to take possession of collateral without requiring the involvement of a court or tribunal. This law provides for actions by secured creditors to take precedence over a reference by a debtor to BIFR. The DRT is the forum for appeals against such recovery.

Collective resolution of bankruptcy and insolvency

Companies Act 2013 contains provisions for rescue and rehabilitation of all registered entities in Chapter XIX, and Liquidation in Chapter XX. However, these provisions have not been notified.

The law for rescue and rehabilitation remains the Sick Industrial Companies (Special Provisions) Act (SICA), 1985, although it applies exclusively to industrial companies. Under SICA, a specialised Board of Industrial and Financial Reconstruction (BIFR) assesses the viability of the industrial company. Once it has been assessed to be unviable, BIFR refers the company to the High Court for liquidation. The SICA was repealed in 2003, but the repealing act could not be notified as the National Company Law Tribunal proposed by a 2002 amendment to the Companies Act, 1956 got entangled in litigation.

The current legal framework for bankruptcy resolution (called *winding up* of a company on inability to pay debt) continues to be the Companies Act 1956, pending provisions in Companies Act 2013 which are yet to be notified.

Out-of-court mechanisms set up after 2000 for banks to restructure loan contracts with debtors include Corporate Debt Restructuring (CDR) and more recently, the Joint Lending Forum and the Strategic Debt Restructuring Forum (Ministry of Finance, 2015).

3.3.1 Difficulties of the present arrangement

The current state of the bankruptcy process for firms is a highly fragmented framework. Powers of the creditor and the debtor under insolvency are provided for under different Acts. Given the conflicts between creditors and debtors in the resolution of insolvency as described in Section 3.2.2, the chances for consistency and efficiency in resolution are low when rights are separately defined. It is problematic that these different laws are implemented in different judicial fora. Cases that are decided at the tribunal/BIFR

often come for review to the High Courts. This gives rise to two types of problems in implementation of the resolution framework. The first is the lack of clarity of jurisdiction. In a situation where one forum decides on matters relating to the rights of the creditor, while another decides on those relating to the rights of the debtor, the decisions are readily appealed against and either stayed or overturned in a higher court. Ideally, if economic value is indeed to be preserved, there must be a single forum that hears both sides of the case and make a judgement based on both. A second problem exacerbates the problems of multiple judicial fora. The fora entrusted with adjudicating on matters relating to insolvency and bankruptcy may not have the business or financial expertise, information or bandwidth to decide on such matters. This leads to delays and extensions in arriving at an outcome, and increases the vulnerability to appeals of the outcome.

The uncertainty that these problems gives rise to shows up in case law on matters of insolvency and bankruptcy in India. Judicial precedent is set by "case law" which helps flesh out the statutory laws. These may also, in some cases, pronounce new substantive law where the statute and precedent are silent. (Ravi, 2015) reviews judgments of the High Courts on BIFR cases, the DRTs and DRATs, as well as a review of important judgments of the Supreme Court that have had a significant impact on the interpretation of existing insolvency legislation. The judgments reviewed are those after June 2002 when the SARFAESI Act came into effect. It is illustrative of both debtor and creditor led process of corporate insolvency, and reveals a matrix of fragmented and contrary outcomes, rather than coherent and consistent, being set as precedents.

In such an environment of legislative and judicial uncertainty, the outcomes on insolvency and bankruptcy are poor. World Bank (2014) reports that the average time to resolve insolvency is four years in India, compared to 0.8 years in Singapore and 1 year in London. Sengupta and Sharma, 2015 compare the number of new cases that file for corporate insolvency in the U.K., which has a robust insolvency law, to the status of cases registered at the BIFR under SICA, 1985, as well as those filed for liquidation under Companies Act, 1956. They compare this with the number of cases files in the UK, and find a significantly higher turnover in the cases that are filed and cleared through the insolvency process in the UK. If we are to bring financing patterns back on track with the global norm, we must create a legal framework to make debt contracts credible channels of financing.

This calls for a deeper redesign of the entire resolution process, rather than working on strengthening any single piece of it. India is not unusual in requiring this. In all countries, bankruptcy laws undergo significant changes over the period of two decades or more. For example, the insolvency resolution framework in the UK is the Insolvency Act of 1986, which was substantially modified with the Insolvency Act of 2000, and the Enterprise Act of 2002. The first Act for bankruptcy resolution in the US that lasted for a significant time was the Bankruptcy Act of 1989. This was followed by the Act of 1938, the Reform Act of 1978, the Act of 1984, the Act of 1994, a related consumer protection Act of 2005. Singapore proposed a bankruptcy reform in 2013, while there are significant changes that are being proposed in the US and the Italian bankruptcy framework this year in 2015. Several of these are structural reforms with fundamental implications on resolving insolvency.

Box 3.1: The present legislative framework for bankruptcy and insolvency

- Individual bankruptcy and insolvency is legislated under two acts: the Presidency Towns Insolvency Act, 1909, and the Provincial Insolvency Act, 1920.
  High courts have the jurisdiction over insolvency related matters in the erstwhile Presidency towns of Chennai, Kolkata and Mumbai. Subordinate courts hear cases of individual insolvency in all other areas, with the district court being the court of appeal.
- Corporate bankruptcy and insolvency is covered in a complex of multiple laws, some for collective action and some for debt recovery. These are:
  1. Companies Act, 2013 – Chapter on collective insolvency resolution by way of restructuring, rehabilitation, or reorganisation of entities registered under the Act. Adjudication is by the NCLT. This chapter has not been notified.
  2. Companies Act, 1956 – deals with winding up of companies.
     No separate provisions for restructuring except through Mergers & Acquisitions (M&A) and voluntary compromise.
     Adjudication is under the jurisdiction of the High Court.
  3. SICA, 1985 – deals with restructuring of distressed 'industrial' firms.
     Under this Act, the Board of Industrial and Financial Reconstruction (BIFR) assesses the viability of the industrial company, and refers an unviable company to the High Court for liquidation.
     SICA 1985 stands repealed, but the repealing enactment is yet to be notified.

Principles for a new Code

What are the principles on which to base a new design of bankruptcy and insolvency resolution? One useful benchmark is the UNCITRAL *Legislative Guide on Insolvency*, which states the following objectives for a collective insolvency resolution regime (UNCITRAL, 2005):

1. Provision of certainty in the market to promote efficiency and growth.
2. Maximisation of value of assets.
3. Striking a balance between liquidation and reorganisation.
4. Ensuring equitable treatment of similarly situated creditors.
5. Provision of timely, efficient and impartial resolution of insolvency.
6. Preservation of the insolvency estate to allow equitable distribution to creditors.
7. Ensuring a transparent and predictable insolvency law that contains incentives for gathering and dispensing information.
8. Recognition of existing creditor rights and establishment of clear rules for ranking priority of claims.
9. Establishment of a framework for cross-border insolvency.

These principles are derived from three core features that most well developed bankruptcy and insolvency resolution regimes share: a linear process that both creditors and debtors follow when insolvency is triggered; a collective mechanism for resolving insolvency within a framework of equity and fairness to all stakeholders to preserve economic value in the process; a time bound process either ends in keeping the firm as a going enterprise, or liquidates and distributes the assets to the various stakeholders. These features are common across widespread differences in structure and content, present either through statutory provisions or their implementation in practice (Mukherjee, Thyagarajan, and Anchayil, 2015; Ravi, 2015; Sengupta and Sharma, 2015).

These features ensure certainty in the process, starting from what constitutes insolvency, and the processes to be followed to resolve the insolvency, or the process to resolve

bankruptcy once it has been determined. Done correctly, such a framework can incentivise all stakeholders to behave rationally in negotiations towards determination of viability, or in bankruptcy resolution. In turn, this will lead to shorter times to recovery and better recovery under insolvency, and a greater certainty about creditors rights in developing a corporate debt market.

3.4 Features of the proposed Code

The Committee deliberated on the objectives and the design for a new insolvency and bankruptcy framework.

3.4.1 Objectives

The Committee set the following as objectives desired from implementing a new Code to resolve insolvency and bankruptcy:

1. Low time to resolution.
2. Low loss in recovery.
3. Higher levels of debt financing across a wide variety of debt instruments.

The performance of the new Code in implementation will be based on measures of the above outcomes.

3.4.2 Principles driving the design

The Committee chose the following principles to design the new insolvency and bankruptcy resolution framework:

I. *The Code will facilitate the assessment of viability of the enterprise at a very early stage.*

1. The law must explicitly state that the viability of the enterprise is a matter of business, and that matters of business can only be negotiated between creditors and debtor. While viability is assessed as a negotiation between creditors and debtor, the final decision has to be an agreement among creditors who are the financiers willing to bear the loss in the insolvency.
2. The legislature and the courts must control the process of resolution, but not be burdened to make business decisions.
3. The law must set up a calm period for insolvency resolution where the debtor can negotiate in the assessment of viability without fear of debt recovery enforcement by creditors.
4. The law must appoint a resolution professional as the manager of the resolution period, so that the creditors can negotiate the assessment of viability with the confidence that the debtors will not take any action to erode the value of the enterprise.

The professional will have the power and responsibility to monitor and manage the operations and assets of the enterprise. The professional will manage the resolution process of negotiation to ensure balance of power between the creditors and debtor, and protect the rights of all creditors. The professional will ensure the reduction of asymmetry of information between creditors and debtor in the resolution process.

II. *The Code will enable symmetry of information between creditors and debtors.*

5. The law must ensure that information that is essential for the insolvency and the bankruptcy resolution process is created and available when it is required.
6. The law must ensure that access to this information is made available to all creditors to the enterprise, either directly or through the regulated professional.
7. The law must enable access to this information to third parties who can participate in the resolution process, through the regulated professional.

III. *The Code will ensure a time-bound process to better preserve economic value.*

8. The law must ensure that time value of money is preserved, and that delaying tactics in these negotiations will not extend the time set for negotiations at the start.

IV. *The Code will ensure a collective process.*

9. The law must ensure that all key stakeholders will participate to collectively assess viability.
   The law must ensure that all creditors who have the capability and the willingness to restructure their liabilities must be part of the negotiation process. The liabilities of all creditors who are not part of the negotiation process must also be met in any negotiated solution.

V. *The Code will respect the rights of all creditors equally.*

10. The law must be impartial to the type of creditor in counting their weight in the vote on the final solution in resolving insolvency.

VI. *The Code must ensure that, when the negotiations fail to establish viability, the outcome of bankruptcy must be binding.*

11. The law must order the liquidation of an enterprise which has been found unviable. This outcome of the negotiations should be protected against all appeals other than for very exceptional cases.

VII. *The Code must ensure clarity of priority, and that the rights of all stakeholders are upheld in resolving bankruptcy.*

12. The law must clearly lay out the priority of distributions in bankruptcy to all stakeholders. The priority must be designed so as to incentivise all stakeholders to participate in the cycle of building enterprises with confidence.
13. While the law must incentivise collective action in resolving bankruptcy, there

must be a greater flexibility to allow individual action in resolution and recovery during bankruptcy compared with the phase of insolvency resolution.

3.4.3 Design of the proposed Code

A unified Code

The Committee recommends that there be a single Code to resolve insolvency for all companies, limited liability partnerships, partnership firms and individuals.

In order to ensure legal clarity, the Committee recommends that provisions in all existing law that deals with insolvency of registered entities be removed and replaced by this Code.

This has two distinct advantages in improving the insolvency and bankruptcy framework in India. The first is that all the provisions in one Code will allow for higher legal clarity when there arises any question of insolvency or bankruptcy. The second is that a common insolvency and bankruptcy framework for individual and enterprise will enable more coherent policies when the two interact. For example, it is common practice that Indian banks take a personal guarantee from the firm's promoter when they enter into a loan with the firm. At present, there are a separate set of provisions that guide recovery on the loan to the firm and on the personal guarantee to the promoter. Under a common Code, the resolution can be synchronous, less costly and help more efficient recovery.

Insolvency trigger that place least cost on the adjudicating authority

The Committee recommends that both the debtor and creditors must have the ability to trigger insolvency. In either case, the key principle driving the form of the trigger is for least cost of determination on the bankruptcy and insolvency Adjudicator. The Committee recommends that the debtor can trigger the process after default using detailed disclosure about the state of the entity, accompanied by a Statement of Truth. The creditor can trigger using evidence of a default. Any misrepresentation in the trigger can result in severe monetary penalties for the creditors, and may also result in criminal penalties for debtors.

A strong base of information utilities to support efficient implementation

The Committee recognises that asymmetry of information is a critical barrier to fair negotiations, or ensuring swiftness of the process. The Committee recommends the creation of a regulated information utility that will make available all relevant information to all stakeholders in resolving insolvency and bankruptcy.

Role of the Adjudicator focused on matters of procedure

The Committee recommends that the role of the Adjudicator needs to be carefully laid out so as to both minimise undue burden on the judiciary while simultaneously ensure the fairness and efficiency of insolvency resolution.

This is done through two sets of recommendations from the Committee. The Committee recommends that the Adjudicator will focus on ensuring that all parties adhere to the process of the Code. For matters of business, the Committee recommends that Adjudicator will delegate the task of assessing viability to a regulated Insolvency Professional (Burman and Roy, 2015). The Adjudicator will be more directly involved in the resolution process once it is determined that the debt is unviable and that the entity or individual is bankrupt.

A regulated industry of insolvency professionals

The Committee recommends that an industry of regulated professionals be enabled under the Code (Burman and Roy, 2015). These *Insolvency Professionals* will be delegated the task of monitoring and managing matters of business by the Adjudicator, so that both creditors and the debtor can take comfort that economic value is not eroded by actions taken by the other. The role of the professional is also critical to ensure a robust separation of the Adjudicator's role into ensuring adherence to the process of the law rather than on matters of business, while strengthening the efficiency of the process.

A regulator to ensure malleability and efficiency

The Committee recognises that it is not possible, at present, to fully design every last procedural detail about the working of the bankruptcy process. Further, the changing institutional environment in India will imply that many procedural details will need to rapidly evolve in the future. Hence, the Committee has taken the strategy of establishing a regulator to be called the Insolvency and Bankruptcy Board which will be given clear regulation-making powers about certain elements of procedural detail. The Code will be careful to not engage in excessive delegation of legislative power. In each case where regulation-making power is given to the Board, there will be a clear statement of objectives, which would create a natural accountability mechanism in the future.

The Board will establish an information system through which data about the performance of the bankruptcy process will be continuously collected. The data so collected may be used to identify areas where regulations need refinement, and will generate evidence about the extent to which modifications of the regulations result in improvements of the bankruptcy process.

The Committee envisages two regulated industries: an industry of information utilities, and an industry of insolvency professionals. In these areas, the Board will perform legislative, executive and quasi-judicial functions.

All in all, the Committee visualises that the Board will perform four functions: (a) Regulation of information utilities; (b) Regulation of insolvency professionals and insolvency professional agencies; (c) Regulation-making in specific areas about procedural detail in the insolvency and bankruptcy process and (d) data collection, research and performance evaluation.

Resolution phase I: A calm period for insolvency resolution

The Committee recommends two phases of resolution, once a procedure of default resolution has been triggered. The first phase is a collective negotiation

to rationally to assess the viability of the debt. The Committee recommends that the assessment must be ensured a calm period where the interests of the creditors can be protected, without disrupting the running of the enterprise.

This calm period is implemented in two orders passed by the Adjudicator. One is an order passing a moratorium on all recovery actions or filing of new claims against the enterprise. The other is by putting in place an insolvency professional who has the powers to take over the management and operations of the enterprise.

Resolution phase II: Bankruptcy as an outcome of insolvency resolution

The Committee recommends that bankruptcy is an outcome of resolving insolvency. If the debtor and creditors agree to change the terms of their contract during the negotiations to keep the enterprise as a going concern, then the enterprise is viable, and the insolvency resolution process is closed. If the negotiations fail to deliver a solution, then the enterprise is unviable, and is deemed bankrupt. The Code then specifies that bankruptcy resolution is immediately triggered.

Swift and efficient bankruptcy resolution

Since bankruptcy comes as an outcome of transparent and supervised negotiations, the Committee recommends that the liquidation is protected against appeals to stay for all but exceptional cases of fraud. In continuation of the principle of not burdening the judiciary unduly, the process will be managed by a regulated Insolvency Professional called the Liquidator. The Adjudicator will have oversight over the process, as well as the role of adjudicating on matters of conflicts in the distribution of the recoveries, or any other appeal during the process.

3.5 How India will benefit from reforms of the bankruptcy process

A better functioning bankruptcy process would yield benefits in numerous directions:

Misplaced emphasis on secured credit At present, many lenders are comfortable giving loans against (some) collateral. The concept of looking at the cash flows of a company and giving loans against that is largely absent. This has created an emphasis on debt financing for firms who have fixed assets. Many important business opportunities, which do not have much tangible capital, tend to face financing constraints.

Value destruction in corporate distress when a firm has secured credit, and fails on its obligations, the present framework (SARFAESI) emphasises secured creditors taking control of the assets which were pledged to them. This tends to disrupt the working of the company. The present frameworks do not allow for the possibility of protecting the firm as a going concern while protecting the cash flows of secured creditors.

Poor environment for credit While SARFAESI has given rights to creditors on

secured credit, the overall recovery rates remain low particularly when measured on an NPV basis. This creates a bias in favour of lending to a small set of very safe borrowers, and an emphasis on using more equity financing which is expensive. This makes many projects unviable. Better access to credit for new entrepreneurs will create greater economic dynamism by increasing competition.

Industrial disease The lack of rapid resolution of corporate distress leads to slow multi-year processes of industrial disease. Bankruptcy reform would allow a faster process through which society would put capital and labour to work in a business, and rapidly change course when that business did not work. This will foster more risk taking and better use of capital. The capital and labour that is blocked in industrial disease will be reduced.

Problems of infrastructure developers The example above (of firms being protected as a going concern, with equity capital being wiped out, and being sold at a lower firm value to a new equity shareholder) applies to many situations in the field of infrastructure in India today.

Failure of auctions At present, in many public sector settings, auctions tend to go wrong because some bidders propose values which are *too low*. The bidders know that in the absence of an efficient bankruptcy process, they will not be displaced from their concession agreement, and they will have the ability to renegotiate terms from a position of strength. An efficient bankruptcy code would yield a better answer: When a project gets into trouble, it would be resolved using the formal bankruptcy process.

Corporate bond market development The natural financing strategy in all countries is for large companies (e.g. the top 500 firms) to obtain all their debt financing from the bond market. This channel has been choked off in India, partly owing to the fact that corporate bond holders obtain particularly bad recovery rates under the present arrangements. Bankruptcy reform would yield higher recovery rates for corporate bond holders, and remove one barrier that impedes the corporate bond market. It is important to emphasise, however, that this is not the only barrier which holds back the corporate bond market.

4 — Institutional infrastructure

4.1 Insolvency and Bankruptcy Board of India

4.1.1 The case for a regulator

The case for the establishment of the Insolvency and Bankruptcy Board of India (referred to as the Board) rests on four strands of work that are required to be done.

Malleability

The insolvency and bankruptcy process must, at all times, be stated precisely so that all participants are confident in their expectations. This requires detailed rules of procedure. At the same time, India faces an important issue of malleability. Alongside the evolution of the Indian economy, and as experience is obtained in the early years of the new law, there is a role to modify many of the details of the process.

Legal precision can be obtained by encoding all procedural details into the primary law. However, this implies that every modification requires amending the law in Parliament. This may introduce delays in the process of adapting the law in response to changing conditions. Alternatively, malleability can be obtained by encoding high level principles into the primary law, and creating a regulator which is given the power to write regulations which express questions of detail.

On the issue of malleability, there is a legislative function (issuing regulations). However, there is no executive or quasi-judicial function.

Two regulated industries

The framework envisaged by the Committee involves two regulated industries: information utilities and insolvency professionals and agencies. In each of these areas, there is a role for a regulator (akin to the Securities and Exchanges Board of India, SEBI) which combines legislative, executive and quasi-judicial functions, and has

a close engagement with the working of the industry. This profile of work is best placed in a regulator rather than in a department of government.

Statistical system

Fine grained data about the working of the bankruptcy process in India needs to be captured, released into the public domain. This task can also be placed upon the regulator. This data should, in turn, be used as an input for the work of the regulator on drafting of regulations about details of the bankruptcy process, and the regulation of information utilities and of insolvency professionals.

4.1.2 Establishing the Insolvency Regulator

As with all regulators, the Committee believes that the Code and the delegated legislation made under it must address two sets of questions with respect to the functioning of the Board. Thus the drafting instructions in this chapter relate both to the Code and the delegated legislation thereunder.

On substantive content, the questions are:

1. What are the objectives of the Board?
2. What are the functions of the Board?
3. What powers would it have in order to pursue these objectives and functions?
4. How can accountability be achieved?

On regulatory governance, the following are the questions:

1. What is the governance arrangement in terms of the composition and the management of the Board?
2. How will the legislative function of the Board work?
3. How will the executive function of the Board work?
4. How will the quasi-judicial function of the Board work?
5. What is the framework for penalties which will be utilised when orders are issued?
6. What will be the forum/process for appeals against the regulation making process or appeals against the orders of the Board?
7. How will the Board be financed? How will oversight of the budget come about?

Clarity on these questions is required in order to draft a law that induces a high performance agency. We now turn to these questions. The strategy adopted here draws upon the best practices for the working of regulators, along the lines that have been designed in Srikrishna, 2013.

4.1.3 Objectives of the regulator

The objective of the Board is to utilise all legislative, executive and quasi-judicial functions so as to achieve a well functioning bankruptcy process in India. This would include features of:

1. High recovery rates in an NPV sense;
2. Low delays from start to end;

Box 4.1: Drafting instructions for the research and advisory functions of the Board

1. The Board will develop standardised process for collecting, storing and retrieving records on bankruptcy and insolvency resolution.
2. The Board will have the power to require that information be submitted into these systems. All information filings will be electronic only.
3. The Board will form independent advisory councils for ongoing discussions on issues related to bankruptcy and insolvency resolution, which will recommend policy actions for improving the functioning of the bankruptcy and insolvency resolution system.

3. Sound coverage of the widest possible class of claims e.g. bank loans, corporate bonds, etc.;
4. A perception in the minds of persons in the economy that India has a swift and competent bankruptcy process.

4.1.4 Functions of the regulator

The functions of the Board lie in four areas:

1. At various points in the remainder of this report, and at various points in the proposed draft law, procedural details are to be specified by the regulations. It is the responsibility of the Board to create the intellectual capabilities for understanding these questions, and operating a formal regulation-making process that results in high quality regulations. Through this, malleability in the operation of the bankruptcy and insolvency process will be achieved.
2. With regard to the two regulated industries (information utilities and insolvency professionals/agencies), the Board will have legislative, executive and quasi-judicial functions.
3. The Board will create and publicly release a fine-grained database about the working of every bankruptcy and insolvency transaction in the country. This will include case histories of every transaction, and the working of each insolvency professional.

4.1.5 Statistical and research functions

Comprehensive case the Board will be the record-keeper of all cases of insolvency and bankruptcy resolution. histories will be maintained for all cases, and comprehensive information about the working of insolvency professionals will be maintained. Towards this, the Board will create systems for data collection, storage and retrieval. The Board will have the power to require filings of information. Subject to confidentiality requirements, the Board will make this data available for research activities, with the aim that this will feed back into the discussion on policy on the legal framework for bankruptcy and insolvency over time. This will then build fact based motivation for ongoing reforms to this framework that will keep track of the changes in the economic and business environment.

Box 4.2: Drafting instructions on the availability of closed insolvency and bankruptcy records of legal entities

1. The records of insolvency and bankruptcy of all legal entities covered under the Code will be maintained and recorded by the Board after the cases are closed.
2. The Board will make available a part of this information to the public as a record of the state of insolvency and bankruptcy in India. The format and content of the public information may be specified by the Board by regulations, and will at least include the following:
   (a) The date on which information is first entered;
   (b) The name of the presiding member of the Tribunal;
   (c) Information about the debtor;
   (d) Information about the financial creditors of the debtor;
   (e) The type of process: insolvency or liquidation;
   (f) The start date of the proceeding;
   (g) The end date of the proceeding;
   (h) The current status of the proceeding;
   (i) The details of the insolvency professional;
   (j) The solution for an insolvency resolution case; and
   (k) The details of the liquidation outcome.

One of the bottlenecks to understanding the state of insolvency and bankruptcy resolution in India has been a pervasive lack of information even about historical cases. The basic information about the event of default of any generic firm is not readily accessible, let alone instances of insolvency or bankruptcy resolution. Given the current fragmented legal framework, this is scattered across multiple tribunals and courts, with no centralised point of access.

The Committee visualises that an important output from the new Code will be that all records of insolvency and bankruptcy events will be stored and maintained to be used as a measure of the state of insolvency and bankruptcy resolution in India.

Once the cases handled by the adjudicator are closed, the Committee recommends that the full documentation of the cases are transferred for use, storage and maintenance to the Board .This will be critical for the Board in its role as the supervisor of the industry of insolvency professionals, as well as the regulator for the overall insolvency and bankruptcy processes in the country.

The Committee recommends that the content as well as the manner of access about these records be specified by the Board. Further, the Committee states that the access to these records should be made publicly available, with clear channels and formats through which it can be accessed. Drafting instructions for the availability of records of past cases are presented in Box 4.2.

4.1.6 Accountability mechanisms

Accountability of the regulator will be achieved through the following elements:

1. The rule of law. The establishment of sound processes for the legislative, executive and quasi-judicial functions will establish an environment of the rule of law, which creates accountability in and of itself.

The formal steps required of the regulation-making process will create checks and balances and avoid the abuse of power.
2. Judicial review of the orders of the regulator will create checks and balances.
3. Reporting of statistical information, in particular about the four objectives defined in Section 4.1.3, will create accountability.

In performing its reporting function, the Board should periodically report to the government and to the public on suitable measures (such as the time taken for granting an approval, measurement of efficiency of internal administration systems, costs imposed on regulated entities and rates of successful prosecution for violation of laws) that demonstrate the fulfillment of *Regulatory objectives* or the assessment of the Board's *performance*. To this effect, the Board will set up measurement systems for assessing its own performance. This will create greater transparency and accountability in the Board's functioning. The measurement of activities of the Board also needs to be tied with the financial resources spent by the Board to carry out those activities.

Box 4.3: Drafting instructions for rules on performance reporting by the Board

The allocation of resources by the Board is intrinsically tied to the performance of the Board. Therefore the Committee recommends the following principles for the measurement of the Board's performance and financial reporting:

1. The Board should create two annual reports:
   (a) Audited report which is comparable to traditional financial reporting; and
   (b) Performance report which incorporates global best practice systems of measuring the efficiency of the regulatory system.
2. The performance report should use modern systems of measuring each activity of the Board as objectively as possible.
3. Performance systems must require the Board to create and publish performance targets.
4. All performance measures must be published in the annual report.
5. Performance measurement system should be reviewed every three years to incorporate global best practices.
6. Every three years, an expert review of the overall working of India's insolvency and bankruptcy process should take place.

4.1.7 Governance arrangement

The Committee believes that there are sound reasons for favouring financial and operational independence in regulatory agencies. It allows the regulator to create capacity and capability to perform its functions. It also reduces the scope for political interference in the actual *transactions* of the regulator. With this in mind, the Committee recommends that the Board be set up as a statutory body.

4.1.8 Process for legislative functions

Regulation-making must follow a structured process that allows all stake-holders to be fully informed of and participate in the regulation-making process. The Committee has therefore identified the process that the Board should follow while making regulations and the mechanisms for the judicial review of legislative powers exercised

by regulators.

Box 4.4: Drafting instructions for the provisions on the structure of the Board

1. The Code will set out the legal entity, form and organisational structure of the Board.
2. The Code will define the composition of the Board and the roles and responsibilities of the Board. The Code will set out the process for selection of the board of the Board. This will be done to ensure that the board is comprised of experts who are selected in a transparent manner.
3. The Code or delegated legislation may define the terms of appointment of the members of the Board including conditions of service, duration of employment, terms of resignation, removal and suspension of such members.
4. Rules made under the Code may define the minimum standards for the functioning of the Board. This may include principles governing conduct of board meetings, frequency of board meetings, method of taking and recording decisions, legitimacy of decisions and conflicts of interest.
5. A mechanism for monitoring the compliance of the Board may be laid down in rules made under the Code. This will be through a special committee of the board, *a review committee*.
6. The process for setting up advisory councils to advise the Board will also need to be prescribed. This will include the composition, and functions of such councils.

The Code or delegated legislation made under the Code must determine the process to be followed for the formulation of regulations, starting with the manner in which the drafting of regulations is to be initiated. The Committee recommends that the regulation-making process should be directly overseen by the board of the Board. Effective public participation in the regulation-making process is necessary to ensure that subsidiary legislation are responsive to the actual requirements of the economy. It will also help to check and improve the information and analysis done by the Board. The Committee recommends that the process to be followed to carry out consultations and receive public comments should be prescribed by rules framed under the Code. The expected overall impact is that regulations will become more responsive to the needs of the financial system.

In a system of principles-based provisions that are to be interpreted and applied by the Board, there is a genuine need for clarifications and explanations. This would require the Board to have the power to publish general guidelines to insolvency professionals and information utilities explaining laws and regulations. The Committee believes that allowing the Board to publish guidelines of this nature will constitute an important step in reducing uncertainty about the approach that the Board may take. The mechanism of publishing guidelines should not be used to (in effect) to make regulations without complying with the procedural requirements laid down for regulation-making. For this reason, guidelines will be deemed to be clarificatory in nature. Violations of guidelines alone will not empower the Regulator to initiate enforcement action against regulated entities.

4.1.9 Process for executive functions

The executive function includes inspections, investigations, enforcement of orders

and processing of complaints. The exercise of supervision and monitoring powers is fundamental to effective enforcement. The Committee believes that the overall approach of the Code should be to provide for strong executive powers, balanced with greater transparency and accountability, to prevent abuse. This will reduce allegations of possible bias and scope of arbitrariness to the minimum.

It is also important to ensure that there is no overlap in the legislative and executive functions of the Board. The executive should not be allowed to issue instructions of a general nature to all regulated entities or a class of regulated entities. Such instructions should only be possible after the full regulation-making process has been followed.

Box 4.5: Issuing regulations and public consultations by the Board

1. The process for issuing regulations may be set out in rules made under the Code. This will include:
   (a) The process for issuing regulations, the details to be captured in the regulations and a cost-benefit analysis;
   (b) The process for public consultation, specifying a designated time for receiving comments from the public;
   (c) The process for incorporating public comments in regulation making; and
   (d) The process for issuing final regulations.
2. There must be a process for emergency regulation making where the Board may be temporarily exempted from some of the requirements of the due process of regulation making. This will include the conditions, as well the process and time lines for the Board to comply with when issuing regulations in such cases.

4.1.10 Process for quasi-judicial function

In exercise of their supervisory and enforcement powers, regulators need to assess whether or not regulated entities have adequately complied with the provisions of the law and in case of any detected breach, they have the power to impose appropriate penalties. These wide ranging executive powers given to regulators necessarily need to be balanced with proper systems governing the application of administrative law. Therefore, the Committee recommends that the exercise of quasi-judicial (administrative law) functions by the Board needs to be carried out within the bounds of a sound legal framework that ensures the separation of administrative law powers from other powers of the Regulator.

The Committee recognises that actions taken by regulators can impose significant penalties and burden on regulated entities. Therefore, the *rule of law* requires that a clear judicial process be available to persons who seek to challenge regulatory actions.

Box 4.7: Drafting instructions for rules on the exercise of executive functions by the Board

The Code will define the process for exercise of the executive functions of the Board. These include the process for:

1. Disposal of applications;
2. Grant of approvals, including licensing or registration;
3. Inspections, which may be routine or special;
4. Investigation of violations of regulations;
5. Proving violation of regulations to the judicial officers (by leading evidence);
6. In the case of successful prosecution before the administrative law department, suggesting enforcement actions; and
7. Compounding of offences with the involvement of the administrative law department.

Box 4.8: Drafting instructions for rules on the exercise of administrative law functions by the Board

1. The Board will designate one of its members as an administrative law member.
2. The Board may create a special class of officers called administrative law officers.
3. The Code will define the process to be followed by the Board to exercise its administrative law function including the process to be followed in investigations.
4. The Board may, through regulations. lay down the procedure to be followed for the discharge of administrative law functions by the Board.

4.1.11 Framework for penalties

When the Board is convinced that the accused is guilty of a violation, he needs a framework through which punishments can be imposed. The Code provides that the Board may impose monetary penalties or cancel or suspend the registration of the insolvency professional, insolvency professional agency or information utility as the case may be.

4.1.12 Appeals against actions of the regulator

The Committee deliberated on which forum would be better equipped to decide appeals from the Board's orders. The Committee concluded that appeals from the Board's orders should lie before the NCLAT. An aggrieved party should have a statutory right to appeal to the Supreme Court from the order of the NCLAT.

4.1.13 Obtaining resources and spending them

Insolvency and bankruptcy regulation, especially for individuals, is likely to be a resource intensive function. The Board should be equipped with the capability and the resources required to perform a wide range of functions and is responsible for building and maintaining the credibility of the bankruptcy and insolvency resolution process. There is need for financial independence which allows the Board to have the required flexibility and human resources that are more difficult to achieve within a traditional

government setup. This will enable the Board to hold assets independently and to develop its own recruitment criteria and processes, which are necessary for mobilising required human resources.

The Committee believes that as a good practice the Board should fund itself from the fees collected from its regulated entities. However, the industry of regulated professionals and entities focused on bankruptcy and insolvency will develop over time, while the Board will require to perform its supervisory functions from the start. As a result, there will be a period in which the Board will need to be funded by the government.

In the light of this, the Committee recommends that the Board be funded through a mix of government support and fees collected from regulated entities for the first five years after it comes into being.

The Committee also believes that government involvement in the financial matters of the Board should be minimal. Government must only control the salary and perquisites of the members of the Board.

Section 4.1.3 has defined the four objectives of the Board. Under the oversight of the board, each of these should be numerically measured. The budget process for each year should consist of a process between the management and the board, where the board proposes a set of targets and the management estimates the scale of expenditure required to achieve these targets.

Box 4.9: Judicial review of the administrative law functions of the Board

1. The substantive content of regulations should not be subjected to judicial review.
2. Process violations in the issuance of regulations should be the subject of appeal.
3. Orders against regulated persons (either information utilities or insolvency professionals) should be subject to appeal.
4. This appeal should lie before National Company Law Appellate Tribunal (NCLAT).

Box 4.10: Finances of the Board

1. The Board will be funded through a mix of fees levied on the IPs and IUs and Central Government grants. However, apart from this, the involvement of the Central Government in the financial matters of the Board should be minimal.
2. The Board will specify, through regulations, the scale of fees it will levy and collect as well as the manner of collection.
3. The Board should base its budget, on performance of the Board for the previous year in fulfilling its objectives, and the desired targets for the coming year.

4.2 The Bankruptcy and Insolvency Adjudicator

Resolution under the Code involves two different phases, for both firms or individuals. The first phase is where insolvency is resolved, and is referred to as the Insolvency Resolution Process or IRP. If a solution is not reached within a specified time, the second phase of resolving bankruptcy or insolvency is triggered. It referred to as liquidation for entities and bankruptcy for individuals. In both these phases, insolvency professionals are involved in managing the processes although their roles differ from one phase to another. The Code provides various powers to the insolvency professional at each stage which can be used subject to approval from the adjudicator. The adjudicator is akin to a bankruptcy judge whose main objective is to ensure that the insolvency or bankruptcy resolution is being performed within the framework laid down by the law. Chapters 5 and 6 explain this entire process in detail, along with the role of the adjudicator. The following section describes the institutional arrangement necessary for the proper functioning of this adjudication institution.

4.2.1 Tribunals

Jurisdiction on firm insolvency and liquidation Under Companies Act, 2013, the National Company Law Tribunal (NCLT) has jurisdiction over the winding up and liquidation of companies. NCLAT has been vested with the appellate jurisdiction over NCLT. Similarly, the Limited Liability Partnership Act, 2008 also confers jurisdiction to NCLT for dissolution and winding up of limited liability partnerships, while appellate jurisdiction is vested with NCLAT. The Committee recommends continuing with this existing institutional arrangement. NCLT should have jurisdiction over adjudications arising out of firm insolvency and liquidation, while NCLAT will have appellate jurisdiction on the same.

Jurisdiction on individual insolvency and bankruptcy Current Indian laws on individual insolvency are archaic and do not treat individual insolvency at par with corporate insolvency in this regard. Jurisdiction over these matters are vested with High Courts (for Calcutta, Madras and Bombay) or District Courts (for the rest of India).

In the proposed Code, the goals of bankruptcy laws for individuals overlap considerably with the goals of corporate insolvency and liquidation. Therefore, there are economies of scale in having the same judicial institution adjudicating the resolution process for firms and individuals. However, unlike firm insolvency and liquidation, the physical infrastructure of the adjudication institutions for individual insolvency need to be much more wide spread across the entire country to facilitate access to justice for the common Indian. Currently, NCLT is a work in progress and it may take some time for NCLT benches to have a wide scale presence at national level. In contrast, at present Debt Recovery Tribunal (DRT) benches have much wider presence across the country. Therefore, the Committee recommends that DRT should be vested with the jurisdiction over individual insolvency and bankruptcy matters.

Jurisdiction on insolvency regulator The Code establishes an insolvency regulator (the Board) for regulating insolvency professionals, insolvency professional agencies and information utilities. This regulator may have an administrative law wing to perform the quasi-judicial functions of the regulator. These orders are envisaged to be in the nature of regulatory orders vis-a-vis regulated entities. Aggrieved persons should be able to appeal against such orders. A statutory right to appeal is consequently necessary for this purpose. The Committee recommends that the NCLAT should have appellate jurisdiction over orders passed by the insolvency regulator.

4.2.2 Territorial jurisdiction

The jurisdiction of NCLT and DRT could be determined based on the place where the cause of action arose or the location of the debtor. The current Indian law on corporate bankruptcy has caused much confusion on this issue. Under the Companies Act, the location of the registered office of the debtor company determines which company court will have jurisdiction. In contrast, under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the DRT within whose jurisdiction the cause of action arises, wholly or in part, may also have jurisdiction. Since a part of the cause of action arises at the location of the bank branch where the loan transaction had taken place, the DRT which has jurisdiction over the bank branch is an eligible forum for an original application by the bank. This has lead to much cross-litigation and conflicting orders between the company court and the DRT. To avoid this confusion it is essential that in corporate bankruptcy matters the jurisdiction of the NCLT should be determined according to the location of the registered office of the debtor firm. In individual insolvency matters, the jurisdiction of the DRT must be determined according to the place where the debtor actually and voluntarily resides or carries on business or personally works for gain.

The proposed Code envisages the NCLT as an exclusive forum for firm insolvency and liquidation adjudication, while DRT is envisaged as an exclusive forum for individual insolvency and bankruptcy adjudication.

The jurisdiction of any civil court or authority should be specifically barred where NCLT or DRT has jurisdiction. No injunction can be granted by any court or authority in respect of any action that the NCLT/NCLAT or DRT/DRAT is empowered to take under the Code.

Further, following from current law, once a liquidation or bankruptcy order has been made, leave of the NCLT or DRT would be necessary to proceed with any pending suit or proceeding or to file any fresh suit or proceeding by or against the debtor firm or individual. This will ensure the sanctity of the liquidation or bankruptcy process. The NCLT or DRT should also have jurisdiction to entertain and dispose of any pending or fresh suit or legal proceeding by or against the debtor company or individual; question of priorities or any other question, whether of law or facts, in relation to the liquidation or bankruptcy. By bringing all litigations that may have a monetary impact on the

Box 4.11: Drafting instructions on jurisdiction of the Tribunals

1. The DRT having territorial jurisdiction over the place where an individual actually and voluntarily resides or carries on business or personally works for gain can entertain an application under this Code regarding such individual.
2. The NCLT having territorial jurisdiction over the place where the registered office of a firm is located can entertain an application under this Code regarding such firm.
3. No civil court or authority will have jurisdiction to entertain any suit or proceedings in respect of any matter on which the NCLT/NCLAT or DRT/DRAT has jurisdiction.
4. No injunction must be granted by any court or authority in respect of any action taken or to be taken by the NCLT/NCLAT or DRT/DRAT pursuant to the Code.
5. Once a bankruptcy order has been made, the DRT will have jurisdiction to entertain or dispose of:
   (a) any suit or proceeding by or against the individual debtor;
   (b) any claim made by or against the individual debtor;
   (c) any question of priorities or any other question whatsoever, whether of law or facts, arising out of or in relation to bankruptcy of the individual debtor.
6. Once a liquidation order has been made, the NCLT will have jurisdiction to entertain or dispose of:
   (a) any suit or proceeding by or against the firm;
   (b) any claim made by or against the firm, including claims by or against any of its branches in India;
   (c) any question of priorities or any other question whatsoever, whether of law or facts, arising out of or in relation to the firm.
7. The NCLAT will have jurisdiction to hear appeals arising from an order passed by the insolvency regulator.
8. An appeal from an order of the insolvency regulator under this Code must be filed within forty five days before the NCLAT.
9. The NCLAT may, if it is satisfied that a person was prevented by sufficient cause from filing an appeal within forty five days, allow the appeal to be filed within a further period not exceeding fifteen days.

economic value of debtor firm or individual's assets within the jurisdiction of the NCLT, the liquidation or bankruptcy process will be made streamlined and efficient. However, proceedings before the Supreme Court or the High Court must not be within the purview of this clause.

4.2.3 Procedural rules

The Central Government must issue procedural rules governing the proceedings before the NCLT and the DRT. These rules should also include provision for charging fees. The scale of fees may be decided taking into account the budgetary requirements of the institution without compromising with the ease of accessibility to the adjudication system. A procedure committee with representation from the users of the adjudication mechanism should review the functioning of these rules and provide feedback to the tribunals every year based on which the Central Government may consider improving them. The President, the Presiding Officer or the Chairperson, as the case may be, may

also issue practice directions to supplement the working of the rules of their respective tribunal. Ideally, with time, these practice directions should be incorporated into the rules to make the rules more comprehensive and detailed.

Delegated legislation relating to the NCLT and the DRT may provide for some procedural matters aimed at improving the transparency and accountability of the tribunals. These include allowing audio-visual recording of all proceedings, publishing of records of the proceedings and all other necessary information.

4.2.4 Essential features

In this section, the Committee lays down best practices, which may be followed by the NCLT and the DRT ("Tribunals") to ensure efficient case management and adjudication. These may be codified through suitable delegated legislation.

Maximising efficiency of the Tribunals would require maximum use of technology and minimum human intervention. This should start with the filing process itself. Currently, most courts and tribunals have a physical paper-based filing system. Even those which have moved to 'e-filing' have merely computerised the present processes.[1] Consequently, a lot of time is wasted at the registry at the filing stage because of formatting defects, errors in payment of fees etc. Instead of computerising the present filing process, the Tribunals should re-engineer the entire filing process with a view to making it a paperless system. Essentially, this would require an e-filing software which will provide a web-based format for the drafting and filing of petitions and applications before the tribunal along with features for online payment of the necessary fees. The web-based e-filing formats should be continuously updated to improve standardisation of the petitions and applications filed as well as impose strict page or word limits to ensure better drafting quality of the pleadings.[2] Softcopies of the necessary annexures could also be uploaded through the e-filing system.[3]

[1]Simply computerising the existing processes of courts will not give us better functioning courts. Projects must start with the mandate of building a world class court, not a mandate of computerising the court. See, Datta and Shah, 2015.

[2]Limitations on number of pages and words that can be used in pleadings are found in procedural rules of foreign courts. For example, see Rules 28.1(e), 32(a)(7) United States Supreme Court, 2013.

[3]In US, most bankruptcy courts permit or require documents to be filed electronically, except those filed by pro se debtors. See, Sobel, 2007; in Australia, the County Court of Victoria allows for e-filing of

On final submission of any petition or application through the e-filing system, a text-searchable portable document format of the petition or application should be generated along with a unique case number. The ultimate objective of the e-filing system should be to allow parties to file their petitions, applications and supporting documents online 24x7 from any location without any physical interaction with the tribunal and its staff. Figure 4.1 and Figure 4.2 show the log-in pages of the e-filing systems of the Dubai International Financial Centre (DIFC) court and the Federal Court of Australia respectively.

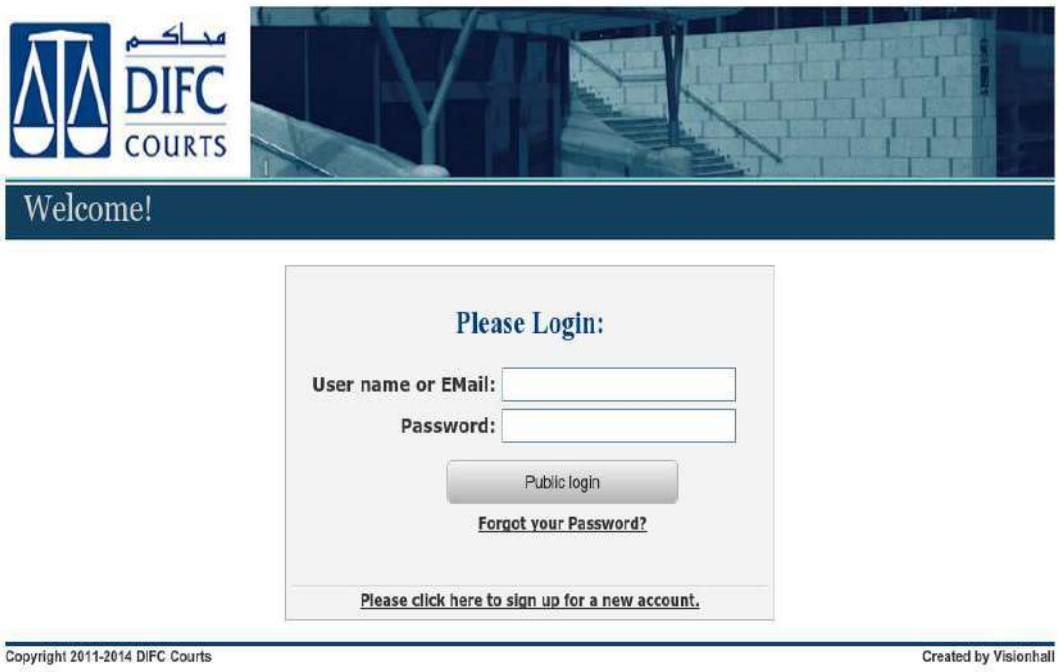

Figure 4.1: DIFC Court log-in page

After filing of a matter, the status, relevant documentation, schedules of hearings etc. should be automatically managed by a case management software. No matter should be placed before the judge unless the predefined prerequisites are satisfied. For example, judicial time should not be used unless pleadings necessary for the judicial hearing are complete.[4] The Tribunal administration must ensure this with the aid of the case management system.

The rules of the Tribunal should also provide for pre-hearing conferences to help ascertain if all the prerequisites for a judicial hearing have been met.[5] A judicial hearing should focus on the exact disagreement on facts and the legal arguments mentioned in the

most documents via electronic submission. The County Court Rules of Procedure in Civil Proceedings 2008 expressly provide for the same. For details, see, County Court of Victoria, 2014.

[4]The Supreme Court has observed that 'pleadings are foundation of the claims of parties. Civil litigation is largely based on documents. It is the bounden duty and obligation of the trial judge to carefully scrutinize, check and verify the pleadings and the documents filed by the parties. This must be done immediately after civil suits are filed.' See, Supreme Court of India, n.d.

[5]Reportedly, the Law Ministry is considering introduction of the system of pre-trial hearings on the lines of the UK and the US pursuant to deliberations of the National Mission for Justice Delivery and Legal Reforms. See, Press Trust of India, 2015.

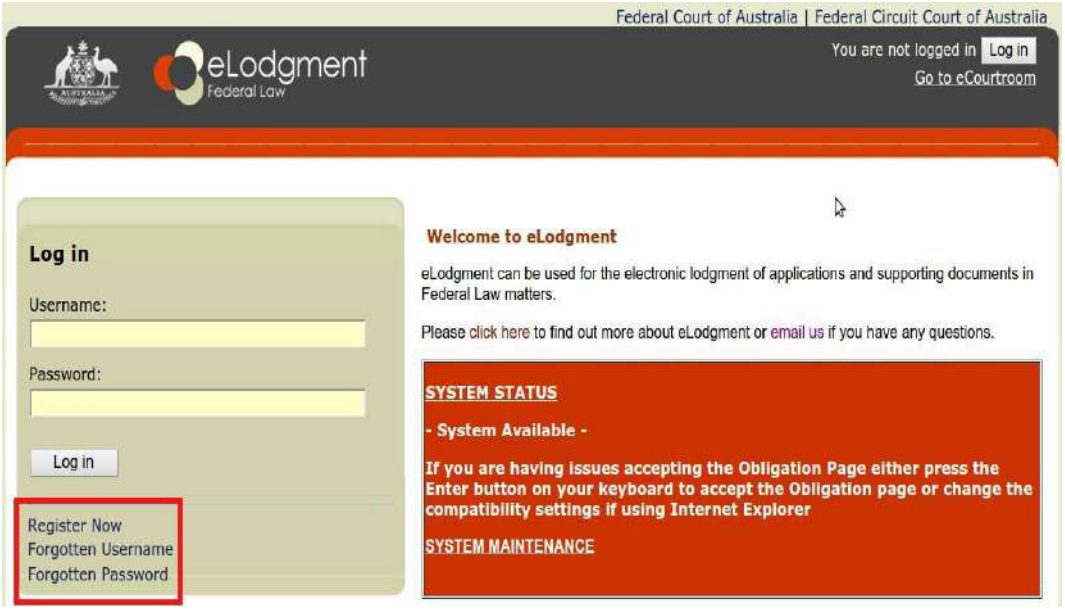

Figure 4.2: Federal Court of Australia log-in page

pleadings.[6] Each judge should have a dedicated research team to adequately brief the judge for each hearing.[7] The Tribunal should enable hearing through video conferencing mechanism.[8] This will allow parties to present their cases from a hearing center at a city before a bench sitting in another city.

Oral arguments should be time bound and confined to the pleadings only.[9] The procedural rules of the Tribunal may also provide for only paper based hearing in appropriate circumstances.[10] A matter taken up for final hearing must be finished off and not left

[6]The Supreme Court has suggested that 'at the time of filing of the plaint, the trial court should prepare complete schedule and fix dates for all the stages of the suit, right from filing of the written statement till pronouncement of judgment and the courts should strictly adhere to the said dates and the said time table as far as possible. If any interlocutory application is filed then the same be disposed of in between the said dates of hearings fixed in the said suit itself so that the date fixed for the main suit may not be disturbed.' See, Supreme Court of India, n.d.

[7]In US, many appellate judges require their law clerks to prepare a memorandum on each case (a 'bench memo') for the judge to review before hearing oral arguments. In some circuits, the law clerk for one judge may prepare a memorandum to be circulated among the three judges on the panel prior to oral argument. The judges will study the memos in advance of oral argument. See, Sobel, 2007; the US laws specifically allow each bankruptcy judge to appoint a secretary, a law clerk, and such additional assistants as the Director of the Administrative Office of the United States Courts determines to be necessary. See 28 USC §156, Law Revision Counsel, 2015.

[8]As an example, the Federal Court of Australia has online courtrooms which are used by Judges and Registrars to assist with the management and hearing of some matters before them. Such matters include ex parte applications for substituted service in bankruptcy proceedings and applications for examination summonses; however eCourtroom may also be used for the purpose of the giving of directions and other orders, in general Federal Law matters. The eCourtroom is integrated with eLodgment, providing parties with a link between eCourtroom and eLodgment to facilitate the electronic filing of documents. For details, see, Federal Court of Australia, 2015.

[9]Procedural rules of some foreign courts allow the time for oral hearing to be pre-fixed. Longer arguments can be allowed only on filing of a motion reasonably in advance. See Rule 34(b), United States Supreme Court, 2013.

[10]Right of hearing need not always include right to 'oral' hearing. Advanced common law jurisdictions

part heard. Every judicial hearing must be audio-visually recorded and published.[11] Every order of the tribunal must be immediately made available online. After the final disposal of a matter, all petitions, applications and orders pertaining to that matter must be made available online on a single web-page publicly accessible free of charge. All such web-pages must be arranged in a systematic manner to allow anyone to search for a specific matter by is unique number, parties' name etc. Figure 4.3 shows the summary page of a recently decided matter before the UK Supreme Court.

Figure 4.3: UK Supreme Court case details web page format

The Tribunal must develop a case-load forecasting model. The financial budgeting of the Tribunal must be based on the forecasted case-load. Based on the estimates, resources need to be allocated in advance to ensure that the disposal rate of the tribunal is not hampered due to resource constraint. However, potential tendencies of mismanagement of judicial budget should also be curbed by making the tribunal administration accountable for the expenditure. To enhance accountability the law must require the tribunal to publish an annual report at the end of every financial year. The rules of annual reporting must require an audited financial statement of the tribunal along with a performance report. The performance report must clearly show the level of performance achieved by the tribunal against the targets under various parameters during the assessment year

allow for dispensing with oral hearing in certain matters. For example, see Rule 34(a)(2), United States Supreme Court, 2013; also see Rule 32, Lord Chancellor, 2014.

[11]Most jurisdictions have started moving towards audio-visual recording of court proceedings. The High Court of Australia publishes audio-visual recordings of full court hearings; UK Supreme Court publishes audio-visual recording of all current and decided cases; US Supreme Court publishes audio recordings of proceedings before it. For details, see, Stepniak, 2012; recently, in India, Calcutta High Court for the first time allowed audio-visual recording of a court proceeding. See, High Court at Calcutta, n.d.

against the budget spent. All performance statistics like pendency rate, disposal rate etc must be published and the entire data set must be made available in proper format. Every instance of matters not being disposed off within a reasonable time frame must also be reported.

4.3 Bankruptcy and Insolvency Information Utilities

Before the process of resolution can begin, an essential step required is to correctly establish the facts about what are the assets available, who the claimants are, and what contracts are in force. Traditionally, this has involved paper based processes, and comes with its own problems, such as the need to ensure that the documents are in hand are true copies. Advances in technology and computational power of recent decades have created an opportunity to dramatically reduce the cost and complexity of managing information. In turn, this allows using the information to eliminate delays and frictions in resolving insolvency and bankruptcy: drastically reducing delays and reducing costs.

India has been a late starter in building the institutional infrastructure for a liberal democracy and a market economy. At many steps in this journey, progress has been made by 'leapfrogging' – utilising contemporary computer technology to design aspects of the government and of the economy which were not feasible at the time when mainstream solutions in advanced countries fell into place. Examples of this include electronic voting and the Aadhaar system (Shah, 2006; Claessens, Glaessner, and Klingebiel, 2001). The Committee believes a similar 'leapfrogging' opportunity exists in the field of insolvency and bankruptcy. There is a possibility to go to the top decile of countries of the world, by utilising computer technology, and often doing things in ways which are not seen even in advanced countries as of 2015.

This section focuses on this 'information infrastructure' for a sound insolvency and bankruptcy resolution process. In many cases, the initiatives proposed here have value over and above this process. In the following text, we note these other benefits in passing and for sake of completeness, while primarily focusing on the requirements for a high quality resolution of insolvency and bankruptcy. The attempt of this section is to create an information infrastructure which will put India in the ranks of the top decile of the world by way of information management both before and after insolvency is underway.

4.3.1 Bankruptcy and insolvency information utilities

The information infrastructure required for the insolvency and bankruptcy process that is proposed in this report consists of two sets of rules: rules that govern information submission and rules that govern information access and release during insolvency. The operations of the process require a class of "bankruptcy and insolvency information utilities" (referred to as IUs): firms which stand ready to receive information filings that are required under this Code, and stand ready to deliver information when requested. As a caveat, it must be added that the provisions relating to IUs contained in the Code are enabling provisions to facilitate the development of an industry of IUs that will happen over time.

The Board will license and regulate the working of the IUs. There is the possibility of a market failure developing in the form of market power where a small number of firms reap monopoly profits. Hence, this is intended to be an open competitive industry with exactly one tariff (the price charged upon the person submitting information). If the first set of pioneers earn a particularly high return on equity, nothing should prevent

additional players from entering the business. Interconnection regulation would ensure interoperability between multiple players, all of whom would support the identical APIs for electronic access. This pro-competitive environment would ensure that supernormal profits will not arise.

In the course of resolving insolvency and bankruptcy, many players would access information from these IUs. They would use a standard API to obtain information from multiple utilities, thus assembling the full information set upon demand. The charges imposed here would only be the telecom charges.[12]

From the viewpoint of the end-use of information, centralisation of information is desirable. At the same time, centralisation involves problems associated with the elevated profit, and low quality work, of monopolies. The Committee has chosen the strategy of information that is distributed across multiple utilities. A full view of any one case (e.g. one firm bankruptcy) will be assembled in real time by querying all the IUs that exist. Queries will take place at a negligible cost. Competition will drive down the user charge for filing.[13]

IUs are essential for the process of filing information. However, they are not central to the large scale decentralised process of accessing and utilising this information. Further dissemination or processing or value added services would come about through a variety of access mechanisms which can include the media, information companies and research organisations. All such entities would be able to easily access data from all IUs at telecom charges, and then resell or redistribute this information, with or without value added. The access of these entities are subject to rules of privacy specified by the Regulator.

Drafting instructions for rules governing the industry of IUs are placed at Box 4.13.

[12]Persons involved in the insolvency process attach a very high value upon *comprehensive* information. Hence, they will always run a query on each information utility, in order to assemble the full picture. This raises the possibility of a small information utility charging very high prices for access to information. Hence, the Committee favours a tariff structure where revenues are obtained through a simple flat tariff structure at the point of mandatory *submission* of data to a information utility chosen by the entity that is doing the submission.

[13]Distributed information utilities have many other interesting implications. As an example, it may be cheaper to require filers to submit information to *two* distinct information utilities, and thus reduce the costs of high availability and disaster recovery at any one utility.

Box 4.13: Drafting instructions for rules governing bankruptcy and insolvency information utilities

1. The Board will license entities who will perform the role of information utilities.
2. All information utilities will satisfy the following characteristics:
    (a) They will accept electronic submission of data from persons who are obliged, under the Code, to submit information.
    (b) A fee will be charged for the submission of data.
    (c) The Board will regulate interconnection to ensure free entry, and interoperability, between all information utilities.
    (d) All information utilities will exhibit identical APIs for submission of information and access to database.
    (e) The Board will prescribe minimum service quality standards including uptime, disaster recovery, latency, etc.
    (f) The price charged for information access will be the cost of transmission of the information.
    (g) No restrictions will be placed upon the use of information that is given out by information utilities, subject to applicable laws.
4. The Board will regularly run sample studies to assess the accuracy and completeness of information obtained from information utilities, and take remedial steps when the level of gaps and errors is large enough to materially hamper the insolvency resolution process.
5. The Board will specify statistical information which must be regularly released by all information utilities.

4.3.2 Information requirements for insolvency and bankruptcy resolution

The Committee debated on what categories of information must be available to all participants in order to ensure that a resolution process is swift and efficient. While all information is important, certain parts of the information becomes critical at different parts of the resolution process. For example, in order to trigger a case of insolvency against an entity, the creditor will need to demonstrate proof of (a) having a liability against the entity, and (b) the entity having failed on a promised payment. Without this evidence, the adjudicator will refuse to register the insolvency case, or defer the matter until the insolvency can be proved. If, on the other hand, the record of the liability is readily accessible from a registered IU, and the instance of default is also recorded within, the time taken and the cost to trigger the case of insolvency can be reduced. Thus, it is important to identify what are the information requirements that are critical to a swift resolution of insolvency and bankruptcy, and who can access the information at what point of the process.

The Committee defined categories of information as follows:

1. Reliable and readily accessible records of liabilities of a solvent entity.
2. Clear evidence of the instance of default.
3. Records of assets that are pledged as collateral against secured credit contracts.
4. Reliable and readily accessible records that comprise the balance sheet and cash-flow statements of the entity.

4.3.3 Information about the liabilities of a solvent entity

A solvent entity has a certain structure of liabilities. The terms of all contracted liabilities are relevant for valuing liabilities. As an example, the presence of debt, and the terms on which the debt is contracted, is relevant for the pricing of equity. While the identities of counterparties should remain private, the existence of all financial contracts along with the terms and conditions, is relevant for all financial analysis related to the health and status of the entity.

Liabilities fall into two broad sets: liabilities based on financial contracts, and liabilities based on operational contracts. Financial contracts involve an exchange of funds between the entity and a counterparty which is a financial firm or intermediary. This can cover a broad array of types of liabilities: loan contracts secured by physical assets that can be centrally registered; loan contracts secured by floating charge on operational cash flows; loan contracts that are unsecured; debt securities that are secured by physical assets, cash flow or are unsecured. Operational contracts typically involve an exchange of goods and services for cash. For an enterprise, the latter includes payables for purchase of raw-materials, other inputs or services, taxation and statutory liabilities, and wages and benefits to employees.

Given the importance of such information to the access to finance for enterprise, several efforts have been implemented over the last decade, particularly with the development of technology, such as the MCA21 at the Registrar of Companies, which acts as a repository of balance sheet information. However, despite mandating disclosure and making non-compliance a criminal offence, existing information registration systems have not had good compliance records. One reason for a lack of compliance is the lack of sound enforcement. An advantage of the information systems in the Bankruptcy and Insolvency process is that the Code places the information as a critical lever in the hands of the debtor or the creditor. The Code specifies that if the Adjudicator is able to locate the record of the liability and of default with the registered IUs, a financial creditor needs no other proof to establish that a default has taken place.

The Committee recommends that the IUs should include records of all financial liabilities, secured and unsecured, and proposes a two part framework:

1. Centralised databases about the full set of liabilities of all entities that are entered into by financial firms. These will be obtained through filings of contracts and securities from the financial firms and intermediaries.
2. Public disclosure norms about the liabilities by the IU will vary depending upon whether the entity has listed securities or not. This will be as follows:
   (a) *For all entities that have at least one listed security*, there will be public disclosure of the terms and conditions of these contracts, but not identities of the sources of financing. The reasoning for this is that investors are likely to require information about the full structure of liabilities in order to value the listed security.
   (b) *For entities that do not have even one listed security*, access to the terms and conditions of these contracts will be made available even but in a limited manner.

Access to information about all contracts will be available to all existing financial firms and intermediaries which are creditors to the entity. It can also be temporarily enabled by the entity to a financial firm which is a potential creditor.

This mechanism ensures comprehensive capture of the activities of financial firms in establishing the liabilities of all entities. For listed entities only, anonymised information about the contracts that make up the liabilities will be available in the public domain at all times. This will assist the valuation of all securities issued by these entities, and acts as an incentive for all financial firms to file the records of their liability. So that entities that are not listed can also

benefit from superior valuation, the Code enables access to this information in the IU to both existing creditors as well as potential creditors to the entity.

The second set of liabilities are operational liabilities, which are more difficult to centrally capture given that the counterparties are a wide and heterogeneous set. In the state of insolvency, the record of all liabilities in the IUs become critical to creditors in assessing the complexity of the resolution required. Various private players, including potential strategic acquirers or distressed asset funds, would constantly monitor entities that are facing stress, and prepare to make proposals to the committee of creditors in the event that an insolvency is triggered. Easy access to this information is vital in ensuring that there is adequate interest by various kinds of financial firms in coming up to the committee of creditors with proposals.

It is not easy to set up mandates for the holders of operational liabilities to file the records of their liabilities, unlike the case of financial creditors. However, their incentives to file liabilities are even stronger when *the entity approaches insolvency*. The Code provides that the electronic filing of their transactions can act as easily accessible proof of claims using the Adjudicator will accept the application by the creditor to trigger an insolvency resolution process. With a competitive industry of IUs, even operational liabilities can be readily recorded as long as the cost of the filing can be balanced against the certainty of being counted in the priority of payment if the entity falls into bankruptcy. The need for a variety of IU offering services at different costs for different users becomes one more reason why the Board must ensure that the industry of the IUs remains competitive (Box 4.13).

Drafting instructions for regulations that may enable the ongoing tracking of the transactions that make up the financial liabilities of all entities, while they are going concerns, are placed in Box 4.14.

4.3.4 Information about operational creditors

While the Committee considered that it is fair to empower the operational creditor to trigger the resolution processes, the difficulty lies in the implementation of an efficient mechanism to enable such creditors to do so. The Committee considered that one approach could be for the operational creditor to present an *undisputed invoice demanding payment or notice delivered by such creditor to the debtor* as a document as joint proof of an existing liability and a default by the debtor on this liability. This is similar to the *statutory demand* of the U.K. as described in Box 4.15.

In a similar manner in India, the operational creditor can serve a notice to the debtor demanding payment of debt within specified number of days and confirm that debtor has not disputed the demand. .

This can be filed online at a regulated IU using the unique identifier of the registered entity that is available on the registration authority, such as the Registrar of Companies for entities under Companies Act 2013. For an individual, these may be done through credit information systems on individuals such as credit bureaus. Below a threshold value of the bill specified by the Board, the filing system can be set up to serve the invoice or notice electronically to the entity. Once the invoice or notice is served, the debtor should be given a certain period of time in which to respond either by disputing it in a court, or pay up the amount of the invoice or notice. The debtor will have the responsibility to file the information about the court case, or the repayment

record in response to the invoice or notice within the specified amount of time. If the debtor does not file either response within the specified period, and the creditor files for insolvency resolution, the debtor may be charged a monetary penalty by the Adjudicator. However, if the debtor disputes the claim in court, until the outcome of this case is decided, the creditor may not be able to trigger insolvency on the entity. This process will act as a deterrent for frivolous claims from creditors, as well as act as a barrier for some types of creditors to initiate insolvency resolution.

A debtor, who is filing for insolvency resolution, must file a comprehensive list of all operational liabilities over the previous two years into a registered IU. This includes liabilities for purchase of goods or services, and will result in the Adjudicator charging a penalty to the debtor if new liabilities with clear evidence surface during the insolvency resolution process.

Box 4.14: Drafting instructions for the Code and the regulations thereunder for information capture about the liabilities of financial creditors

1. Financial firms who are the counterparties to, or the arrangers of the transaction where a registered entity obtains financing on its balance sheet, must do an electronic filing about the transaction to a registered IU. The format and period within which the filing must be done will be specified by the Board, and must be co-signed with the counterparty to the contract.
2. The electronic filing must be done at the initiation of the transaction, at any and all subsequent modifications, and at the closeout of the transaction. The form for the modifications will be specified by the Board. This will ensure that the information about the liability remains current at all times.
3. The filing must be consistently done: all subsequent information about the transactions must be filed at all the databases where the initial filing was done. At all times, it should be possible to query the database(s) and obtain the full picture of the liabilities of all entities on any day.
4. If the filing does not satisfy regulatory specifications, the IU will have to remove the record, and send notices to both counterparties about the failure in filing within 24 hours.
5. The class of transactions which require filings by financial firms will be specified in regulations.
6. For all entities who have even one listed security, this data should be publicly accessible. The full set of outstanding contracts, in their updated form, which make up the liabilities of all listed entities should be available to any financier of the entity. The content of the information that is to be made available and the manner of access will be specified by the Board.
7. The liabilities of an entity that does have not even one listed security, while all this information is present with registered IUs, will not be publicly accessible as long as the entity is solvent. The information will be available to existing creditors of the entity where the content and manner of access will be specified by the Board. The entity will also be able to allow temporary access to any financial firm with whom it is in discussion for a credit transaction. The manner of the access will be specified in regulations.
8. The information that is publicly released should not show the *identities* of the persons who are supplying financing; what should be shown is only the terms and conditions of the financial contract.

Box 4.15: Statutory demand as evidence to initiate a bankruptcy proceeding in the U.K.

If a creditor in the UK wants to initiate a bankruptcy proceeding and needs to produce a clear evidence that she has an undisputed amount due, she files a *statutory demand* on the debtor.

- This done through a standardised demand form titled *Form 6.07: Creditor's Bankruptcy Petition on Failure to Comply with a Statutory Demand for a Liquidated Sum Payable Immediately* which is available from *The Insolvency Service* of the U.K. Government.
- These can be presented to the debtor, either in person, through registered post or through a solicitor.
- On receiving a statutory demand, the debtor has the right to dispute it in the Bankruptcy court within a specified period (say 21 days).
- If the debtor does not do so, this demand can be used as a basis for initiating a bankruptcy or insolvency.
- If the debtor does dispute it, she has to then be party to the case for deciding the status of the statutory demand.

Box 4.16: Drafting instructions for the Code and regulations for information capture about liabilities of operational creditors

1. An operational creditor in India wants to initiate insolvency resolution with a clear evidence that she has an undisputed amount due files a record of *undisputed bill* against the debtor. The form and manner of the filing will be specified by the Regulator.
2. For bills above a threshold value specified in Regulation, the record must contain information about the liability and evidence of having been served to the debtor.
3. For bills below a threshold value specified in Regulation, the IU will serve the bill to the debtor at a nominal cost.
4. On receiving the bill, the debtor can either
   (a) File a dispute case with the Adjudicator, where she is then party to the case for deciding the status of the bill, or,
   (b) Make the due payment to the Adjudicator who will pay the creditor and send an order to the IU to remove the record of undisputed bill

   within a period specified in regulations.
5. If the debtor does not do neither, the record can be treated as an undisputed bill and used as a basis for initiating a bankruptcy or insolvency.

4.3.5 Information of default or restructuring

A critical gap in the existing information infrastructure is the lack of information about default. Unlike existing definitions of default today which is substituted by definitions of non-performing assets, the Committee took the view that the sooner the stress was known to the creditor community, the more swift would be the resolution of insolvency. Thus, it is important that the event of default is visible to creditors as soon as it takes place. In order to ensure this, the Committee was of the view to draw upon the transmission of cash flows to securities holders to provide the event of default.

For entities that issue securities such as equity, bonds, preference shares, the Committee believes that a single electronic mechanism should exist, through which all cash flows to the holders of their securities are transmitted in a frictionless manner. The logical place where this work should take place is in the depositories, who maintain the title on all securities (equity or debt). For ordinary solvent entities, this would remove transactions costs from the process of delivering cash flows to all owners of securities.

This system has numerous advantages for the securities markets as a whole, and for corporate bonds in particular. For all investors, it gives a frictionless mechanism for transmission of cash flows from issuers to beneficiaries. It removes the possibility of issuers who selectively default on payments to powerful investors while reneging on less powerful investors. It eliminates the delays associated with establishing the fact that default took place when a bondholder desires to force the entity into the insolvency resolution process: the depositories would be able to rapidly produce definitive proof that the required amount of cash was not sent to them on the appointed date.

With this framework in place, the event of default to the creditors then becomes a failure of transmission of the promised cash flow into the account. The depository can forward the information about the failure to the IU in a manner specified by the Board, and the IU records it as a failure against the relevant liability. Since financial creditors can query and observe the record of a failed payment against any of the liabilities of the entity, the diligent financial creditor can take appropriate action. This may be in the form of seeking information from the management, or starting a negotiation to understand the state of health of the entity.

The Committee also considered the importance of making public information about default, which could be addressed through three elements.

When an entity has even one listed security, the event of default on a loan or a bond is a material disclosure that should be available to all security holders. For example, when a bank has a borrower where the exposure exceeds 0.1% of the total assets of the bank, default ought to be released by bank to the investing public. Another approach could be a public signal from the depository itself. Since all cash flows from issuers would be processed by depositories, a depository seeing inadequate cash coming into it when compared with the obligations on a bond could publicly announce default.

4.3.6 Information about secured assets

Information about secured assets become even more important if the resolution leads to an outcome of liquidation. In liquidation, lenders with secured assets are most likely to want to retrieve their security and carry out debt recovery by themselves so as to minimise the cost of the liquidation and maximise their loss given enterprise default. The Committee believes that secured lenders to an enterprise will be incentivised under the provisions of the Code to ensure that accurate records are filed with the IU. Since the records can be easily verified from the IUs, the Liquidator can easily release the security to the creditor. On the other hand, if the creditor has not filed the record, this imposes an additional cost on the Liquidator, who will have to verify both the assets as well as the claims of the creditor. The Code or delegated legislation thereunder will provide that creditors who fail to register their secured assets will have to separately pay the verification charges and costs of the Liquidator and the Adjudicator. These will not be included in the costs of the liquidation resolution process.

As with the registration of the liabilities in Box 4.14, the documentation, format and the manner in which the record of the secured asset needs to be filed may be specified by the Board. For example, at the time of submission, the Board can specify that the record must be signed off by both counterparties to the transaction. If both counterparties have not signed within 48 hours of the security being filed, the Board will specify that the record be rejected by the IU. The Committee believes that a similar approach can be adopted for all manner of secured assets, whether it is physical collateral or floating charge against receivables. In the case of the latter, the secured asset will be recorded as cash flows expected during the term of the contract.

Leveraging the existing Information Systems

As a consequence of policy recommendations on the need for better systems of information management for credit markets (Rajan, 2008), as well as the rapid advance of technology in financial systems in India, there are pockets of information management firms that can be useful bases on which to start the bankruptcy and insolvency information utilities.

For example, there have been several efforts on building registries for secured assets. For example, a fully electronic registry provides for registration of charges on secured assets headed by the Registrar of Companies (RoC). State governments run land registries that serve as a source of information for land as collateral and other state registries for registration of certain kinds of motor vehicles. The Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) was established under

the SARFAESI Act, 2002, which registers a category of security interests to financial credit contracts that are secured by an underlying asset. In a recent report, (Umarji, 2013) has proposed a more comprehensive range of categories of secured assets that can be registered at CERSAI. Once this becomes operational, CERSAI could be an important part of the IUs for swifter liquidation under the Code. The securities markets depositories have information about all securitised debt contracts.

The Committee considered that the existing systems serve as the starting point for access to filings on secured assets during the insolvency resolution process, once these systems register with the Board as a IU. However, at present several of these systems have developed under different laws and regulatory agencies, which may mandate a different manner and type of disclosure made into these systems. These mandates also involve restrictions on access to all parties who may be involved in an insolvency and bankruptcy resolution case. An enabling framework may require amending respective laws to enable access of the information to the relevant parties during the resolution processes under the Code.

4.3.7 Rules about privacy of information in an IU

There is a tension between legitimate concerns about privacy, and the gains to society from more open release of information. The position of the Committee on these questions favours partial public access to information about liabilities without identities at all times for listed entities, temporary access enabled by permission about liabilities without identities for unlisted entities, and complete release of information to participants of the insolvency resolution process when the process commences.

4.3.8 Rules on revealing creditor identities

Through the systems proposed in Section 4.3.3, IUs would have comprehensive information about *who* the financial creditors of the entity are (whether for loans or bonds), and the terms and conditions associated with all elements of debt from financial firms.

For a subset of firms (firms with at least one listed security), a subset of the information (the terms associated with all liabilities, but not the identities of the owners) would be publicly released at all times.

The insolvency resolution process can come about at the instance of the debtor entity, or it can be triggered by a creditor. When a resolution professional takes the case, she must have complete access to the identities of lenders (or bondholders) and the terms at which all credit has been given to the firm so that she can propose the creditors committee to the adjudicator. Similarly, if an entity goes into liquidation, access to the similar information about the financial creditors and a larger access to the operational creditors must be made available to the liquidator. The mechanism and the rules to certify the access of a given insolvency professional will be specified by the Board.

4.3.9 Open industry-standard APIs

Application Programming Interfaces ("APIs") are the mechanism by which a user system accesses a resource. Once an API has been designed and placed into the public domain, a large industry of software developers can create innovative applications by having access to the resource through published APIs.

As an example, consider an IU which accepts a certain kind of data filing and supports querying for that information. The public would have access to the full documentation to the APIs through which these operations are done. This would make possible third party software development without requiring any coordination, permission, empanelment or authorisation by the IU.

As an example, accounting or back office software running at user organisations would be able to use these APIs to submit information to a registered IU. The software would submit cryptographic credentials, in order to identify the legal person for whom information is being submitted. The software would submit proof of having paid the requisite user charges. After this, the software would submit a parcel of data. The IU would perform hygiene checks upon the data, confirm receipt, and give the sender a token of proof that this data was indeed received.

When data *access* is required, users (e.g. the software running on the laptops belonging to insolvency professionals) will query all IUs in existence and assemble a full picture.

APIs are best designed by loose coalitions of technologists. As an example, the APIs that underlie the Internet are drafted by the Internet Engineering Task Force (IETF) which is neither a government organisation nor a for-profit corporation nor a industry association (Hoffman, 2012). Similar structures need to be created to design, and oversee the evolution of, the open standards envisaged for IUs.

4.3.10 An information-rich environment

Asymmetric information has the ability to undermine the resolution of insolvency and bankruptcy. In addition, while a country may (in principle) offer information access to persons involved in the resolution, there may be a long drawn process for obtaining all the relevant information and establishing its veracity. The previous sections lay the foundations for the working of infrastructure with the creation of information utilities, databases about liabilities, and centralisation of cash flows associated with all liabilities, as the critical elements of information access that can improve the efficiency of the resolution of insolvency and bankruptcy in India.

The elements of the law of this section are aimed at transforming the information infrastructure surrounding the process to resolve insolvency and bankruptcy. The following key elements are put into place:

1. A competitive industry of IUs would exist (Box 4.13).

2. At all times, for all entities, IUs (put together) would have comprehensive information about the transactions which make up the liability structure of any given entity (Box 4.14). In the case of a loan, they would have the record of the identity of the lender(s). In the case of a bond, they would have a record of the ISIN of the bond, and the depositories would have the record of the bondholders at all times. IUs would have records of the terms and conditions of all loans and bonds issued by all firms.
3. For entities which have at least one listed security (either debt or equity), at all times, the terms and conditions of all loans and all bonds would be visible to the public.
4. For entities which do not have even one listed security, at all times, the terms and conditions of all loans and all bonds would be visible to their existing creditors. Further, any potential creditor would be enabled access to this information by the entity.
5. Cash flows associated with all securities (whether equity or debt) would go from firms to depositories, who would send this cash onwards to beneficial owners with the minimum possible delay.
6. Information about default would come out through three channels: requirements of disclosure by listed firms, listed banks and depositories .
7. When the insolvency resolution process or the liquidation process is triggered, the IUs and the depositories would submit a packet of information to the insolvency professional appointed by the adjudicator. This information would include the identities of all creditors and the terms and conditions of all liabilities, as well as assets registered.
8. While all this *information* would be distributed at multiple distinct IUs, there would be a set of standard APIs through which software at the command of all end-users would be able to marshal all this information on demand. This would yield the full benefits of obtaining information from one central database, without the difficulties induced by centralisation.

This would create an information-rich environment that will significantly reduce practical frictions that has, and would otherwise, bedevil the resolution of insolvency and bankruptcy in India.

4.3.11 Analogies with FSLRC's treatment of resolution

In recent years, the work on financial sector reforms has emphasised the 'resolution' capability. A Resolution Corporation has been proposed by the Financial Sector Legislative Reforms Commission (FSLRC), which will intervene in the working of financial firms when they are distressed but still solvent (Srikrishna, 2013).

In the international experience, the importance of resolution rose sharply after the failures of Bear Stearns and Lehman Brothers in 2008. In both these cases, handling their failure was difficult owing to the complex information about

obligations and contracts of the failing firms and the subsidiaries of the failing firms.

After the global financial crisis, a key response by policy makers worldwide in improving resolution capabilities is that of improving information infrastructure. The US Treasury has built an 'Office for Finance Research' (OFR) which holds a comprehensive live database about the activities of all financial firms. In the future, when a financial firm may approach failure, this database will yield complete and up to date information about liabilities, exposures and counterparties.

FSLRC has proposed that a statutory Financial Stability and Development Council (FSDC) be tasked with systemic risk regulation. This will be a council of regulators chaired by the Finance Minister. FSDC will contain a database, named the 'Financial Data Management Centre' (FDMC) which will be a comprehensive database about the activities of all financial firms. This database will be used by the Resolution Corporation in its ordinary activities, and FSDC when faced with systemic crises.

There is an analogy between the FSLRC proposal about FDMC, and the proposals embedded above on strengthening information infrastructure. In both cases, the creation and management of live databases is the route to reducing uncertainty and delay in the insolvency resolution process. FSLRC has recommended a statutory database, the FDMC, which is a shared data facility for all financial agencies. The proposal here is somewhat different in having a industry of multiple competing information utilities. However, in both cases, the end result is the same: complete facts in electronic form with negligible delay, when required in the insolvency process.

4.4 The Insolvency Professionals

Insolvency professionals play a vital role in the insolvency and bankruptcy resolution process as envisaged by the Committee and as detailed in chapters 5 and 6. As mentioned in these chapters, insolvency and bankruptcy resolution under the Code will proceed in two phases, for registered entities as well as for individuals. The first phase of the insolvency and bankruptcy process is the period of insolvency resolution during which insolvency is assessed and a solution is reached within a stipulated time period. In case a solution is not reached within the specified time limit, the second phase of the process begins wherein the entity is declared bankrupt. At this point a registered entity enters into Liquidation whereas a individual enters into bankruptcy resolution.

This entire insolvency and bankruptcy process is managed by a regulated and licensed professional namely the Insolvency Professional or an IP, appointed by the adjudicator. In an insolvency and bankruptcy resolution process driven by the law there are judicial decisions being taken by the adjudicator. But there are also checks and accounting as well as conduct of due process that are carried out by the IPs. Insolvency professionals form a crucial pillar upon which rests the effective, timely functioning as well as credibility of the entire edifice of the insolvency and bankruptcy resolution process.

An IP may hold any of the following roles under the Code:

1. Resolution professional (RP) to resolve insolvency for a firm or an individual;
2. Bankruptcy Trustee in an individual bankruptcy process;
3. Liquidator in a firm liquidation process;

In administering the resolution outcomes, the role of the IP encompasses a wide range of functions, which include adhering to procedure of the law, as well as accounting and finance related functions. The latter include the identification of the assets and liabilities of the defaulting debtor, its management during the insolvency proceedings if it is an enterprise, preparation of the resolution proposal, implementation of the solution for individual resolution, the construction, negotiation and mediation of deals as well as distribution of the realisation proceeds under bankruptcy resolution. In performing these tasks, an IP acts as an agent of the adjudicator. In a way the adjudicator depends on the specialized skills and expertise of the IPs to carry out these tasks in an efficient and professional manner.

The role of the IPs is thus vital to the efficient operation of the insolvency and bankruptcy resolution process. A well functioning system of resolution driven by IPs enables the adjudicator to delegate more and more powers and duties to the professionals. This creates the positive externality of better utilisation of judicial time. The worse the performance of IPs, the more the adjudicator may need to personally supervise the process, which in turn my cause inordinate delays. Consumers in a well functioning market for IPs are likely to have greater trust in the overall insolvency resolution system. On the other hand, poor quality services, and recurring instances of malpractice and fraud, erode consumer trust.

The following sections describe the mandates for the IPs and delineate a framework for regulating IPs.

Box 4.17: Mandates for IPs

1. An IP will act independently, objectively, and with impartiality;
2. An IP will carry outs his tasks diligently;
3. An IP will treat the assets of the debtor with honesty, and transparency;
4. An IP will avoid all possible conflicts of interest and if he comes to know of any such conflict, he will disclose the same immediately to the creditor committee;
5. An IP will maintain confidentiality of information acquired as a result of professional relationships;
6. An IP will act in a fiduciary capacity towards the debtor, and the creditors as a whole, when appointed in any capacity in an insolvency and bankruptcy resolution proceeding;
7. An IP will not commit fraud or abuse, or exert undue influence on, or on behalf of his clients.

4.4.1 Mandates for IPs

In the case of insolvency resolution, a failure of the process may result from two main sources: collusion between the parties involved and poor quality of execution of the process itself. Hence, it is important that the professionals responsible for implementing the insolvency resolution process adhere to certain minimum standards so as to prevent failures of the process and

enhance credibility of the system as a whole.

In India today, there are professionals and intermediaries that offer services to resolve financial distress of both registered entities as well as individuals. These include lawyers, accountants and auditors, valuers and specialist resolution managers. However, given the critical role that the Code envisages for these entities in the resolution process, the Committee believes that the Board should set minimum standards for the selection of these professionals, along with their licensing, appointment, functioning and conduct under the Code.

To this end, the Code empowers the Board to lay down the minimum professional standards and the code of conduct to be followed to by IPs at each stage of the insolvency and bankruptcy resolution process. Mandates for IPs, which may be prescribed through delegated legislation are described in Box 4.17 .

4.4.2 Entry Requirements for IPs

Well designed entry barriers benefit both customers and service providers. Minimum qualifications and professional standards enable those authorised to carry on such professions with the ability to charge a better price for their services.

Entry barriers in any regulated profession may be categorised into licensing, registration, certification and accreditation. Granting license to start practicing a profession is a core function of a regulator. Licensing ensures that it is unlawful to perform certain activities without meeting the specified criteria. Occupational licensing may raise the average skill levels in the profession, thereby improving the quality of services.

While individual professionals are usually required to register with the relevant regulatory body by filing specified information before carrying out a certain activity, certification is a voluntary mechanism whereby professionals may apply to be certified as competent by a relevant regulatory body upon suitable demonstration of competence. Certification,

Box 4.18 - Entry Requirements for IPs

The Committee recommends that the regulatory framework imposing entry barriers on IPs be based on registration:

1. Any person or individual who wants to practice as an IP will need to obtain membership of an approved, professional IP agency. Once the IP is the member of a professional IP agency, he will need to apply to be registered with the Regulator.
2. No one will be allowed to perform the activities that an IP may perform, without being registered with the Regulator.
3. Only "fit and proper" individuals who clear the IP exam and satisfy an IP agency's entry requirements will be issued membership certificates.
4. An individual who acts as an IP at a time when he is not qualified to do so is liable to imprisonment or a fine, or to both.

in turn, is different from accreditation where professionals may apply for a formal recognition of their competence by a professional body or an industry

association. The criteria and process of accreditation depends entirely on the professional body.

Entry requirements for IPs are described in Box 4.18 . These can be prescribed by the Board.

4.4.3 IP Regulatory Structure

There is concern that starting with a strong regulatory regime may be inimical to the development of the IP profession. The Committee deliberated on the question of regulation versus development. The Indian experience on self-regulating professional bodies (such as Institute of Chartered Accountants of India (ICAI), Bar Council of India and Institute of Company Secretaries (ICSI)) has been reasonably positive in the development of their respective professions and professional standards. However, the experience on their role in regulating and disciplining their members has been mixed. In comparison, financial regulators (such as SEBI and RBI) have had greater success in preventing systemic market abuse and in promoting consumer protection.

Thus, the Committee believes that a new model of "regulated self regulation" is optimal for the IP profession. This means creating a two tier structure of regulation. The Regulator will enable the creation of a competitive market for IP agencies under it. This is unlike the current structure of professional agencies which have a legal monopoly over their respective domains. The IP agencies under the Board will, within the regulatory framework defined, act as self-regulating professional bodies that will focus on developing the IP profession for their role under the Code. They will induct IPs as their members, develop professional standards and code of ethics under the Code, audit the functioning of their members, discipline them and take actions against them if necessary. These actions will be within the standards that the Board will define. The Board will have oversight on the functioning of these agencies and will monitor their performance as regulatory authorities for their members under the Code. If these agencies are found lacking in this role, the Board will take away their registration to act as IP agencies.

4.4.4 The role of the IP agencies

The IP agencies will be formed according to the guidelines laid out by the Board. The agencies must be given legal powers to ensure they are financially autonomous. This must be done by ensuring that the agencies have the power to collect fees from their members for supporting their operations. The Committee is also of the opinion that the regulatory structure be so designed such that competition is promoted amongst the multiple IP agencies to help achieve efficiency gains. Greater competition among the IP agencies will in turn lead to better standards and rules and better enforcement.

Within this framework, regulation must ensure that IPs are competent to perform the variety of tasks they may be hired for and also that IPs are fair and impartial, and conflicts of interest are minimised. To this end, the Committee recommends that the professional IP agencies establish rules and standards for their members through bye-laws, create and update relevant entry

barriers, and have mechanisms in place to enforce their rules and standards effectively.

The Code specifies the necessary regulatory governance processes to be followed by the professional IP agencies in carrying out the following functions:

1. Regulatory functions - drafting detailed standards and codes of conduct through bye-laws, that are made public and are binding on all members;
2. Executive functions - monitoring, inspecting and investigating members on a regular basis, and gathering information on their performance, with the over arching objective of preventing frivolous behavior and malfeasance in the conduct of IP duties;
3. Quasi-judicial functions - addressing grievances of aggrieved parties, hearing complaints against members and taking suitable actions.

Through these three types of functions, a clear and well-defined statutory framework enabling the IP agencies to enforce their rules on all members can be established. There is a need for clear separation of these functions, and in performing these functions, the IP agencies must at all times follow the regulations and guidelines laid out by the Board.

The Committee recognises that there are existing professional agencies or self-regulated organisations (SROs) that will want to be licensed as IP agencies. The Committee observes that while this may be permitted, existing SROs applying for the IP registration must satisfy all criteria and entry requirements laid out by the Board. All professional IP agencies must abide by the two main objectives of ensuring quality and ensuring fidelity in their members carrying out their functions as IPs under the Code.

Regulatory functions of IP agencies

The primary function of the professional IP agencies is to set minimum standards of behaviour expected from all IPs. The process for framing of bye-laws is outlined in Box 4.19

Box 4.19: Framing of bye-laws by IP agencies

1. An IP agency will make detailed bye-laws governing the conduct of its member IPs, during the insolvency and bankruptcy resolution process.
2. The bye-laws of an IP agency must adhere to the objectives and principles as laid out by the Board.
3. The board of an IP agency will approve draft of every bye-law proposed to be made by that agency.
4. The IP agency will make an application to the Board for approval of every proposed bye-law.
5. The application must contain:
   (a) A draft of the proposed bye-law; and
   (b) A statement setting out the objectives of the proposed bye-law and the issue the proposed bye-law seeks to address.
6. In the event of modifications proposed by the Board, the IP agency after making the necessary changes, will get the final version of the bye-law approved both by the board of agency and by the Board.
7. Upon receipt of the Board's approval, the IP agency will publish the bye-law along with the date on which such bye-law takes effect.
8. IP agencies will exercise minimal discretion in framing bye-laws, especially in the process of granting licenses to IPs.

Multiple regulatory instruments with similar outcomes might have different regulation-making processes thereby resulting in undesired confusion among the parties affected. Hence the Committee recommends that the IP agencies should be empowered to issue only bye-laws. The Committee believes that the process of framing bye-laws should be directly overseen by the board of the IP agency, to ensure that issues that require regulatory intervention are discussed and approved at the highest level within the agency's organization. Further, once a bye-law is formulated by an IP agency, it should be sent to the Board for approval.

In a system governed by the rule of law, no action should be judged against unknown standards. Hence, before the IP agencies can carry out any supervision or adjudication function, they have the responsibility to lay down, in clear and unambiguous terms, the behaviour they expect from member IPs. In doing so, the agencies need to follow a standardised, and structured framework such that all stake-holders are fully informed of the process which in turn would help establish credibility and confidence in the overall IP system.

Thus, IP agencies specify bye-laws governing specific areas of IP conduct. These are described in Box 4.20.

Executive functions of IP agencies

A major responsibility of the IP agencies involves the exercise of executive functions. This includes inspections, investigations, enforcement of orders and processing of complaints. The exercise of supervision and monitoring powers is fundamental to the effective enforcement of bye-laws by an authorised IP agency. The Committee observes that all professional IP agencies should have adequate governance and monitoring mechanisms and should follow a structured process for supervising the conduct of IPs at

Box 4.20: Bye-laws governing IPs

IP Agencies will use bye-laws to:

1. Specify that IPs licensed by them are 'fit and proper'.
2. Explain what constitutes 'fit and proper'.
3. Explain how member IPs are expected to comply with each of the obligations stated in Box 4.24. Agencies may also make standards of conduct over and above the obligations stated in Box 4.24.
4. Lay out all standards of conduct expected from IPs in clear and unambiguous terms through a detailed manual prepared by each IP agency. In doing this, each agency must adhere to the broad guidelines laid out by the Regulator.
5. Define the minimum qualification criteria and experience requirements for granting membership to IPs over and above the entry-level exam.
6. Require all IPs to furnish professional indemnity insurance and insolvency bond against fraud or defalcation.
7. Set clear standards governing the relationships between IPs and members of the debtor company and creditors.
8. Require all IPs to furnish information about their performance at regular intervals;
9. Impose limits on remuneration that IPs may charge for providing insolvency and bankruptcy resolution services;
10. Require IPs to provide services at concessional rates or for no remuneration for specific classes of persons;
11. Specify sanctioning of non-compliant IPs. Each agency will set unambiguous benchmarks for non-compliance, and lay down a clear mechanism for awarding and enforcing penalties.
12. Specify the conditions under which an IP might lose his professional license and be expelled from the agency.

regular intervals, and enforcing their rules and standards through the bye-laws.

There is also a need for IP agencies to exercise strong executive powers balanced with greater transparency and accountability. Executive functions of IP agencies are described in Box 4.21. Their powers of investigation and enforcement should be carried out in the least arbitrary and most effective manner.

Quasi-judicial functions of IP agencies

In exercise of their supervisory powers, IP agencies need to assess whether or not an IP has adequately complied with the provisions of the bye-laws. In case of any detected breach, the agency has the power to impose appropriate penalties.

The Committee therefore recommends that each professional IP agency will have an independent quasi-judicial wing that will be responsible for hearing complaints against IPs of that specific agency. In their quasi-judicial jurisdiction, IP agencies will have the power to impose penalties for non-compliance on IPs and will perform this function impartially. Quasi-judicial functions of IP agencies are described in Box 4.22 .

Box 4.21: Executive functions of IP agencies

Each professional IP agency will carry out some general executive functions on a routine basis. These include:

1. Having its own internal mechanisms to ensure that all IPs adhere to its standards and code of conduct.
2. Conducting an entry-level IP exam. Different IP agencies can conduct their own exams as long as these are within the broad guidelines laid out by the Regulator.
3. Granting IP membership certificates to applicants who clear the entry-level exam, as well as satisfy agency-specific entry-requirements.
4. Submitting names and other details as required by the Regulator, in the database maintained by the Board.
5. Evaluating and updating the syllabus and requirements from the examinations from time to time, to ensure that these remain abreast of contemporary market requirements.
6. Organising regular training sessions and conducting exams for existing member IPs, at least at the frequency specified by the Board, to ensure they are up to date with the changing market conditions and industry requirements.
7. Conducting regular inspections and audits on member IPs wherein inspections will be treated as an instrument for checking compliance with the Code, and also for providing inputs for corrective action.
8. Obliging IPs to co-operate with such inspections.
9. Requiring randomly chosen IPs to be audited by independent third-parties on a periodic basis.
10. Finishing all investigations and audits in a time-bound manner and carrying them out with least disruption to the function or reputation of the overall IP industry.
11. Proving violation of regulations to the judicial wing of the agency by leading evidence.

Box 4.22: Drafting instructions for regulations setting out the quasi-judicial functions of IP agencies

1. Each IP agency will put in place an effective system of handling complaints and grievances against IPs from aggrieved parties such that the system of grievance redressal is transparent and publicly accessible.
2. Each agency will put in place a transparent and impartial system for imposing penalties on member IPs.
3. IP agencies will have the flexibility to impose a graduated system of penalties, where minor non-compliances will result in monetary fines, and major violations will result in expulsion from the agency, leading to the member losing his/her IP membership and registration.
4. Each agency will publish the list of disciplinary actions taken against its members on its own websites. In the event of an IP getting de-registered the relevant IP agency will update his details accordingly in the database maintained by the Board.

Box 4.23: Drafting instructions for the Code and the regulations thereunder role of the Board in regulating IP agencies

1. The Board will define the criteria for fit and proper entities to be registered as IP agencies.
2. The Board will set the minimum standards of functioning for IP agencies.
3. The Board will clearly define the roles and responsibilities of the IP agencies in regulating their member IPs. This will include:
   (a) The minimum requirements for registering IPs;
   (b) The minimum standards of functioning of IPs and their code of ethics;
   (c) The minimum standards to be followed for auditing and monitoring the functioning of member IPs;
   (d) The process for hearing and investigating complaints against the members IPs; and
   (e) The process for imposing sanctions, including the types of offenses and the penalties imposed for each type of offense.
4. The Board will receive performance reports by IP agencies on their functioning.
5. The Board will specify the kind of information about the function of IP agencies that is required to be furnished, the form and manner in which the information is to be provided and the frequency in which the agencies are required to submit these reports to the Board.
6. The Board will require an IP agency to release statistics about all the complaints that it has processed. The number of complaints must be reported as number of complaints per unit IP and as per unit insolvency resolution. The number of complaints must also be reported per billion rupees of NPV recovered. In addition, there must be data for the number of complaints where the IP was found guilty by the IP Agency.
7. The Board will monitor and audit the functioning of the IP agencies. The Board will carry out inspections and review the executive and quasi-judicial functions of the IP agency.
8. The Board will hear complaints against IP agencies, investigate these complaints and impose sanctions and penalties on them, including monetary penalties and de-licensing. It will draft regulations clearly defining the offenses and the types of sanctions/penalties that might be imposed.
9. In case the Board deregisters an IP agency, it will define the process by which the members of that agency can become members of another IP agency.

4.4.5 The role of the Board with regard to IP agencies and IPs

The Board will frame regulations governing the executive and the quasi-judicial functions of the IP agencies with regard to their member IPs. These are described in Box 4.22.

However, there is an additional role of the Board which comes in the form of the Board being the point of hearing complaints against IPs who are involved in a case of insolvency or bankruptcy resolution. There are three places in the Code at which the complaints against an IP may come before the Regulator:

1. A complaint during an insolvency resolution process or bankruptcy resolution, seeking a removal of the IP.
2. A complaint may be raised against an IP on a case from which he has been discharged in his role as an RP either after insolvency is resolved or it has moved to liquidation.
3. The Board may find that a given IP has a statistically large number of recorded

complaints or has records of poor performance in insolvency or bankruptcy resolution.

5 — Process for legal entities

Chapter 3 identifies that the objective of the bankruptcy reform is to improve the following set of outcomes:- lower time to resolution and lower loss given default by a legal entity, to reach a higher level of debt in enterprise financing, which comes from all sources and not just secured credit.

In their deliberations, the Committee identified both a lack of clarity in the law as well as problems of implementation. The Code proposed by the Committee aims to reduce both. A central assumption is that rational creditors and debtors want to maximise economic value, and are willing to negotiate to realise this value. The legal framework comes into force to resolve conflict in these negotiations, either between the creditors and debtor or between different creditors. With conflict, each party acts to ensure their rights are upheld as an immediate response, which inevitably affects the affect economic value of an entity adversely. The proposed Code aims to create a legal framework that shifts the incentive of either party from actions of individual recovery to collective action to realise as high an economic value as possible of the entity under default.

Elements of the design

There are some key elements that evolved during the Committee discussions. These are listed below.

Consolidation into a single Code

The Code provides resolution for all entities other than those with a dominantly financial function which are covered in the Indian Financial Code proposed by the Srikrishna, 2013. The Code applies to all creditors, whether they are domestic or international in origin.

A calm period for negotiations

The Code provides for the creation of a *calm period* for creditors and debtors to negotiate the viability of the entity. In the calm period a regulated insolvency professional controls the assets under the supervision of an adjudicating authority. The regulated insolvency professional manages the entity. During insolvency resolution, there is a time bound moratorium against debt recovery actions and any new cases filed. During bankruptcy resolution, the assets are in a trust managed by a regulated insolvency professional. This helps assure creditors and debtor that assets are protected while they negotiate.

An adjudicating authority ensures adherence to the process

At all points, the adherence to the process and compliance with all applicable laws is controlled by the adjudicating authority. The adjudicating authority gives powers to the insolvency professional to take appropriate action against the directors and management of the entity, with recommendations from the creditors committee. All material actions and events during the process are recorded at the adjudicating authority. The adjudicating authority can assess and penalise frivolous applications. The adjudicator hears allegations of violations and fraud while the process is on. The adjudicating authority will adjudicate on fraud, particularly during the process resolving bankruptcy. Appeals/actions against the behaviour of the insolvency professional are directed to the Regulator/Adjudicator.

Managed by a regulated professional

An insolvency professional who is registered by the Bankruptcy and Insolvency Board (Section 4.4) is explicitly appointed by the Adjudicator during the bankruptcy and insolvency resolution process. This person is called the *Resolution Professional* when she manages the insolvency resolution process, and *Liquidator* when she manages the process during liquidation. This professional is given the power by the Adjudicator to effectively run and manage the entity (when it is a going concern), and the assets of the entity at all times during the process of insolvency and bankruptcy resolution. The Code gives the power of registering these professionals to the Regulator who in turn creates regulations for qualifications, reporting, and performance monitoring. The Regulator is also in charge of hearing appeals against these registered insolvency professionals, and can take enforcement action against them.

Business decisions by a creditor committee

All decisions on matters of business will be taken by a committee of the financial creditors. This includes evaluating proposals to keep the entity as a going concern, including decisions about the sale of business or units, retiring or restructuring debt. The debtor will be a non-voting member on the creditors committee, and will be invited to all meetings. The voting of the creditors committee will be by majority, where the majority requires more than 75 percent of the vote by weight.

Insolvency resolution through managed, time-bound negotiations

The first phase of the insolvency and bankruptcy process is the *period of the Insolvency Resolution Process*, or IRP. The assessment of insolvency is through documentary proof, triggered either by the debtor or the creditor. The Resolution Professional is appointed by the Adjudicator, on recommendation either by the creditor, the debtor or the Regulator. When the negotiations conclude on a solution to keep the entity as a going concern, the Adjudicator will close the case of insolvency. If there is no agreement on a solution, or if there is a solution that contravenes any applicable law or does not meet the criteria prescribed in the Code, the Adjudicator orders that the entity is bankrupt, and orders the start of bankruptcy resolution, which is *period of Liquidation*.

No prescriptions on solutions to resolve the insolvency

The choice of the solution to keep the entity as a going concern will be voted on by the creditors committee. There are no constraints on the proposals that the Resolution Professional can present to the creditors committee. Other than the majority vote of the creditors committee, the Resolution Professional needs to confirm to the Adjudicator that the final solution complies with three additional requirements. The first is that the solution must explicitly require the repayment of any interim finance and costs of the insolvency resolution process will be paid in priority to other payments. Secondly, the plan must explicitly include payment to all creditors not on the creditors committee, within a reasonable period after the solution is implemented. Lastly, the plan should comply with existing laws governing the actions of the entity while implementing the solutions.

An irreversible, time-bound liquidation with defined payout prioritisation

If creditors cannot agree on a solution within a defined time, the Adjudicator automatically passes a liquidation order on the entity with accompanying orders: to appoint a Liquidator on recommendation of the Regulator; to move assets into a liquidation trust, which is managed by the Liquidator; to change the name of the entity in the registration records to include the phrase "in-liquidation" to the original name. The board of this entity in liquidation is replaced by the creditors committee. In this setting, there is clear accountability on the Liquidator, who is free to maximise the value of assets in the most efficient manner of disposal. All realisations from these sales go to the liquidation trust, and are distributed to creditors according to waterfall defined in the Code. In the waterfall, after the costs of the insolvency resolution process and liquidation, secured creditors share the highest priority along with a defined period of workmen dues. All distributions will be net of liquidator's fees which will be deducted proportionately from each stage of the payout in order to incentivise the liquidator to ensure recovery to each class of recipient. The liquidation process is an irreversible process from within a fixed period after the liquidation order is passed. An appeal to stay the liquidation will not be considered by the Adjudicator.

The Committee believes that with the insolvency institutions described in Chapter 4, the implementation of the proposed Code are likely to achieve the objectives laid out in Section 3.4. The details of this proposed Code are presented in the following sections.

Box 5.1: Applicability of the Code

1. The Code will cover all individuals, companies, LLPs, partnerships firms and other legal entities registered in India as may be notified, except for those with a dominantly financial function. These are covered under the Indian Financial Code, proposed by the Financial Sector Legislative Reforms Commission.
2. The Code requires that the provisions and laws related to resolving insolvency and bankruptcy for all these legal entities must be repealed, and replaced by the provisions under this Code.

5.1 A single Code for all legal entities

The Committee recommends that there is a single Code to resolve insolvency for all legal entities. The Code will not cover entities that have a dominantly financial function, whose resolution is covered by the Resolution Corporation in the draft Indian Financial Code, proposed by the Financial Sector Legislative Reforms Commission. In order to ensure legal clarity, the Committee recommends that provisions in existing law that deals with insolvency of all registered entities be replaced by this Code (companies and limited liability partnerships to begin with). Then, all questions related to insolvency of any legal entity in India will find an answer in a single Code.

5.2 The calm period of the Insolvency Resolution Process, IRP

As described in Section 3.2.2, several conflicts arise between the debtor and creditors when the debtor defaults on payments. While it is optimal for both parties to negotiate to maximise value, the difference in their objectives lead them to take individual action to protect their investments. The Code provides legal recourse to both the debtor and the creditor for a calm period where these negotiations can take place in an orderly, non-conflicted manner, managed by a neutral third party professional.

The Insolvency Resolution Process, or IRP, is the period during which viability is assessed in the Code proposed by the Committee.

5.2.1 Who can trigger the IRP?

The Committee considers that both the debtor and the creditors should have the power to trigger insolvency resolution. However, the manner in which the two parties can trigger the IRP will differ. The trigger for each party is such that it creates an even balance of power for the negotiations in the IRP.

Since debtors have the advantage of better information, and the IRP offers a calm period for creditors and debtors to meet as equals in negotiations, the Code puts the onus on debtors to reduce the information asymmetry as a part of triggering the IRP. Thus, the debtor can be the management or the majority shareholder, who has access to the degree of information that is required by the Code.

In the case of the creditors, the Code places the power of the outcome of negotiations with creditors, where a majority decide on whether the entity can continue as a going

Box 5.2 – Trigger for IRP

1. The IRP can be triggered by either the debtor or the creditors by submitting documentation specified in the Code to the adjudicating authority.
2. For the debtor to trigger the IRP, she must be able to submit all the documentation that is defined in the Code, and may be specified by the Regulator above this.
3. The Code differentiates two categories of creditors: *financial creditors* where the liability to the debtor arises from a solely financial transaction, and *operational creditors* where the liability to the debtor arises in the form of future payments in exchange for goods or services already delivered. In cases where a creditor has both a solely financial transaction as well as an operational transaction with the entity, the creditor will be considered a financial creditor to the extent of the financial debt and an operational creditor to the extent of the operational debt is more than half the full liability it has with the debtor.
4. The Code will require different documentation for a debtor, a financial creditor, and an operational creditor to trigger the IRP. These are listed Box 5.3 under what the Adjudicator will accept as requirements to trigger the IRP.

concern or must be liquidated. Therefore, the Code requires that the creditor can only trigger the IRP on clear evidence of default.

Here, the Code differentiates between financial creditors and operational creditors. *Financial creditors* are those whose relationship with the entity is a pure financial contract, such as a loan or a debt security. *Operational creditors* are those whose liability from the entity comes from a transaction on operations. Thus, the wholesale vendor of spare parts whose spark plugs are kept in inventory by the car mechanic and who gets paid only after the spark plugs are sold is an operational creditor. Similarly, the lessor that the entity rents out space from is an operational creditor to whom the entity owes monthly rent on a three-year lease. The Code also provides for cases where a creditor has both a solely financial transaction as well as an operational transaction with the entity. In such a case, the creditor can be considered a financial creditor to the extent of the financial debt and an operational creditor to the extent of the operational debt.

While both types of creditors can trigger the IRP under the Code, the evidence presented to trigger varies. Since financial creditors have electronic records of the liabilities filed in the Information Utilities of Section 4.3, incontrovertible event of default on any financial credit contract can be readily verifiable by accessing this system. The evidence submitted of default by the debtor to the operational creditor may be in either electronic or physical form, since all operational creditors may or may not have electronic filings of the debtors liability. Till such time that the Information Utilities are ubiquitous, financial creditors may establish default in a manner similar to operational creditors.

5.2.2 How can the IRP be triggered?

In most other jurisdictions, the trigger to start insolvency resolution procedures against an entity requires evidence that is based on a test of insolvency. The outcome of the tests are taken by the adjudicating authority as evidence to consider the entity to be insolvent.

The Committee observes that there is no standardised, indisputable way to establish insolvency. Several jurisdiction have balance sheet tests as one element to determine

insolvency. Another is the presentation of reasoned arguments for why the entity should be considered insolvent. These too are based on performance in balance sheets and cash-flow statements of the entity. The balance sheet test is vulnerable to the quality of accounting standards. India suffers from having both a low average standard of accounting quality as well a wide variation across single entities. Therefore, the Code does not prescribe fixed balance sheet variables or parameters as critical to triggering insolvency.

The proposed Code assumes that, under situations of stress in the entity, the debtor and creditors have already have gone through negotiations to reach a solution to keep the entity as a going concern. The IRP is considered as a last course effort to resolve conflicts in the negotiations. Then triggering the IRP can be assumed to be a considered step, after deliberation and preparation. Thus, the Code specifies that insolvency can be triggered when the application for insolvency resolution to the adjudicating authority is accompanied by appropriate documentation. The documentation requirement to trigger insolvency differs for debtors and creditors.

The Code requires that the documentation that the debtor provides with the application to trigger the IRP must help reduce the information asymmetry faced by creditors. The debtor must include statements of the audited balance sheet of the entity at the time of application, with all assets and liabilities, as well as the audited balance sheet for the two years prior to the application, and the cash-flow status of the entity during the same period. The Code also requires that these documents are submitted with a "Statement of Truth" document signed by the debtor applicant. The Code requires that the debtor propose a registered Insolvency Professional to manage the IRP.

An application from a creditor must have a record of the liability and evidence of the entity having defaulted on payments. The Committee recommends different documenta-tion requirements depending upon the type of creditor, either financial or operational. A financial creditor must submit a record of default by the entity as recorded in a registered Information Utility (referred to as the IU) as described in Section 4.3 (or on the basis of other evidence). The default can be to any financial creditor to the entity, and not restricted to the creditor who triggers the IRP. The Code requires that the financial creditor propose a registered Insolvency Professional to manage the IRP. Operational creditors must present an "undisputed bill" which may be filed at a registered information utility as requirement to trigger the IRP. The Code does not require the operational creditor to propose a registered Insolvency Professional to manage the IRP. If a professional is not proposed by the operational creditor, and the IRP is successfully triggered, the Code requires the Adjudicator to approach the Regulator for a registered Insolvency Professional for the case.

When the Adjudicator receives the application, she confirms the validity of the documents before the case can be registered by confirming the documentation in the information utility if applicable. In case the debtor triggers the IRP, the list of documentation provided by the debtor is checked against the required list. The proposal for the RP is forwarded to the Regulator for validation. If both the documentation and the proposed RP checks out as required within the time specified in regulations, the Adjudicator registers the IRP.

In case the financial creditor triggers the IRP, the Adjudicator verifies the default from the information utility (if the default has been filed with an information utility, tit such be incontrovertible evidence of the existence of a default) or otherwise confirms the existence of default through the additional evidence adduced by the financial creditor, and puts forward the proposal for the RP to the Regulator for validation. In case the operational creditor triggers the IRP, the Adjudicator verifies the documentation. Simultaneously, the Adjudicator requests the Regulator for an RP. If either step cannot be verified, or the process

verification exceeds the specified amount of time, then the Adjudicator rejects the application, with a reasoned order for the rejection. The order rejecting the application cannot be appealed against. Instead, application has to be made afresh. Once the documents are verified within a specified amount of time, the Adjudicator will trigger the IRP and register the IRP by issuing an order. The order will contain a unique ID that will be issued for the case by which all reports and records that are generated during the IRP will be stored, and accessed.

Box 5.3: Drafting instructions for how the IRP can be triggered.

1. The Adjudicating authority will accept the application to start an IRP under the following conditions:
   (a) If the application contains the required documentation; and
   (b) If these can be verified by the Adjudicator.
   If there are gaps in the documentation or challenges while verifying the submitted material, the Adjudicator will reject the application and not register the IRP.
2. The documentation required depends upon who triggers and varies as follows:
   (a) If the debtor has applied, the application contains:
      i. Audited record of business operations for the previous two years. If such information has been filed at a registered information utility, then the documentation must be consistent with the filling at the Information Utility;
      ii. Audited record of financial and operations payments for the previous two years. If such information has been filed at a registered information utility then the documentation must be consistent with the filling at the Information Utility;
      iii. Audited statement of list of assets and list of liabilities at the time of application for the IRP. If such information has been filed at a registered information utility then the documentation must be consistent with the filling at the Information Utility;
      iv. A signed Statement of Truth document;
      v. A proposed Resolution Professional; and
      vi. Any other documentation specified by the Regulator.
   (b) If the financial creditor has applied, the application contains:
      i. Record of existing liability with the debtor and where applicable, information of such liability as filed at a registered information utility;
      ii. Record of default from credit contract and where applicable, information of such default as filed at a registered information utility ;
      iii. A proposed Resolution Professional; and
      iv. Any other documentation specified by the Regulator.
   (c) If an operational creditor has applied, the application contains:
      i. Record of an undisputed bill against the entity, and where applicable, information of such undisputed as filed at a registered information utility.
3. The Adjudicator will seek verification from the Regulator about the Insolvency Professional proposed by the debtor or the financial creditor before registering the IRP.
4. The Regulator can issue regulations to add to the documentation that is required to trigger IRP from time to time.
5. If the Adjudicator cannot verify the required documentation or the credentials of the Insolvency Professional within a specified period, the application will be rejected with a reasoned order. The Code does not allow an appeal against the rejection of the IRP application. A fresh application can be made to trigger the IRP, without any restrictions.

5.3 Process flow of the IRP

The registration of the case for the IRP acts as the first public announcement about the entity being in stress.

Box 5.4: Drafting instructions for the maximum period allowed for the IRP at registration

1. The Code will define a default maximum IRP period within which to conclude the negotiations to find a solution to the insolvency of the entity. The period does not include the date of registration of the IRP.
2. The Code permits that the maximum period of insolvency resolution can be *less* than the default maximum period for special cases that are defined under the Fast-track IRP as defined in Section 5.4. However these can not be longer than the default maximum IRP period.
3. At the successful trigger of an IRP, the registered case is recorded with a unique case number as well as the date beyond which the IRP will be considered closed.

The Code defines a *default maximum time* allowed as the duration of the calm period to be 180 days. The period is calculated from the start of the IRP, not including the date of registration. The Committee had discussions with the stressed asset managers at financial firms as well as asset reconstruction specialists, who suggested that 180 days is a reasonable time to evaluate a stressed entity and propose a solution to keep it as a going concern, for even the more complex cases of insolvency. In the event 75% of the committee of creditors vote that a debtor's information is especially opaque or the resolution is complex, they may apply to the Adjudicating Authority for a single extension of another 90 days. A debtor or a smaller number of creditors shall in no event be entitled to ask for an extension of the IRP period.

Often, for cases of smaller entities with simpler liability structures, questions of insolvency can be resolved in a much shorter time than the default maximum IRP period. Thus, the default maximum IRP period is an upper threshold: the RP can submit to the Adjudicator that the insolvency has been resolved at anytime within the default maximum period. The Committee acknowledges the need to set the maximum period for special cases, such as small and medium entities, to be lower than the default maximum set in the Code to cover any entity. These are provided for separately in the Code as Fast-track IRPs. These are described in Section 5.4.

At the registration of the IRP, the Adjudicator assigns a unique case number and the maximum date after which the IRP is considered closed, which is calculated depending upon the type of the IRP.

Once the case is registered, there are three distinct parts to the IRP: the steps at the start, the period in between managed by the Resolution Professional (referred to as the RP) and the steps at the close of the IRP.

5.3.1 Steps at the start of the IRP

In order to ensure that the resolution can proceed in an orderly manner, it is important for the Adjudicator to put in place an environment of a "calm period" with a definite time of closure, that will assure both the debtor and creditors of a time-bound and level field in their negotiations to assess viability.

The first steps that the Adjudicator takes is put in place an order for a moratorium on debt recovery actions and any existing or new law suits being filed in other courts, a public announcement to collect claims of liabilities, the appointment of an interim RP and the creation of a creditor committee.

Box 5.5: Drafting instructions for the moratorium order at the start of the IRP

1. The Adjudicator will issue an order for a moratorium from the time that the IRP case is registered against the debtor entity.
2. The moratorium will cover all debt recovery cases by existing financial creditors or operational creditors, and new cases filed to establish fresh claims after the start of the IRP.
3. The moratorium will be come to an end under one of the following conditions:
   (a) the Adjudicator receives a submission from the RP with a signed statement from the creditors with an agreement to keep the entity as a going concern;
   (b) the period of the IRP reaches the default maximum period days; or

1. Moratorium on debt recovery action

The motivation behind the moratorium is that it is value maximising for the entity to continue operations even as viability is being assessed during the IRP. There should be no additional stress on the business after the public announcement of the IRP. The order for the moratorium during the IRP imposes a stay not just on debt recovery actions, but also any claims or expected claims from old lawsuits, or on new lawsuits, for any manner of recovery from the entity.

The moratorium will be active for the period over which the IRP is active.

2. Public announcement of IRP and collection of claims

The Adjudicator issues an order for the public announcement of the IRP. The announcement will include a location where all creditors can file claims of liability against the entity, as specified in regulations. The manner of filing must afford the opportunity to all creditors to submit their claim to be considered while resolving insolvency, and be counted in the priority of claims during liquidation if the negotiations fail.

The announcement for the filing of liabilities must be carried out in a manner as specified by the Regulator. For example, regulations will be issued which define the information that must accompany a liability claim, such as the name of the claimant, address at which they can be reached, the size and nature of the liability. The Regulator will also define the format in which it must be submitted, and the penalties that will be imposed on false or misleading claims. The announcement will include the date up to which the claims can be filed.

The information will be collected and maintained by the interim RP, appointed by the Adjudicator.

3. Appoint an interim Resolution Professional

The Adjudicator appoints an interim RP at the start of the IRP. The interim RP has the following responsibilities: the collection of claims, the collection of information about the entity from the debtor in the case of a creditor triggered IRP, the creation of the creditor committee and taking over the management of the operations and monitoring the assets of the entity in IRP.

Box 5.6: Drafting instructions for the public announcement for filing creditor claims at the start of the IRP

1. The Adjudicator will issue an order for public announcement of the IRP. This announcement must at least include:
   (a) Name of the entity;
   (b) Address of the entity;
   (c) Name of the registration authority; and
   (d) Date by which the IRP will be automatically closed.
2. This announcement will be available at defined locations as specified by the Regulator, as well as at the website of the Adjudicator.
3. The office of the Adjudicator will also issue a public announcement calling for the submission of claims against the entity. This announcement will have the following details.
   (a) The date on which the window for submissions will be closed;
   (b) The details of the information that is required to be submitted, and the format in which it is to be submitted
   (c) The details of the interim RP who will be responsible for collecting such claims;
   (d) The penalties for submitting false or misleading claims.
4. The filings of the liabilities will be collected and compiled by the interim RP appointed by the Adjudicator.

How is the interim RP selected? If the IRP has been triggered by the debtor or financial creditor, the interim RP appointed will be the IP proposed in the application. If no RP has been proposed, then the Adjudicator will apply to the Regulator to provide an interim RP for the case. The appointment process will be as specified by the Regulator.

In order to assure the creditors that the assets of the entity will be protected, the Adjudicator will give the interim RP the power to run the entity as a going concern. This includes the power to take over management of the business and the property of the entity, as well as to bring in working capital and fresh funds by granting security over the property of the entity if required. The term of the fresh financing sourced will be constrained to be within the term for which the IP will be the interim RP. The costs of the financing will be counted as IRP costs.

The Adjudicator will also give the interim RP the responsibility of collecting and collating liability claims. This includes access to the electronic records of liabilities of the entity that are filed in a registered IU. The information about the financial creditors will be used to form the creditors committee.

Finally, where the IRP has been triggered by a creditor, the Adjudicator will give the interim RP the responsibility of collecting the information about the entity that is equivalent to the information that would be present in a debtor triggered IRP. This involves getting access to the information, and filing it in a registered IU if required. If the debtor does not respond to the requests for the information, the interim RP can file a complaint with the Adjudicating Authority.

4. Creation of the creditors committee

The creditors committee will have the power to decide the final solution by majority vote in the negotiations. The majority vote requires more than or equal to 75 percent

Box 5.7: Drafting instructions for appointing the interim RP at the start of the IRP

1. The Adjudicator will pass an order appointing an interim RP at the start of the IRP.
2. The interim RP will either be the registered Insolvency Professional proposed in the IRP application of the debtor or the financial creditor, or proposed by the Regulator if the IRP application does not propose an RP.
3. The interim RP has the responsibility to collect and collate the information about the creditors, both financial and operational. The Adjudicator will enable access for the interim RP into the IU records of the entity for this purpose.
4. The interim RP has the responsibility to collect and collate the information about the assets, finances and operations of the entity to the same depth as will be available to the Adjudicator under a debtor triggered IRP. The Adjudicator will enable access for the interim RP into the records of the entity at the relevant IUs for this purpose.
5. If the debtor is non-cooperative, the interim RP can appeal to the Adjudicator against the management. The Code specifies that the Adjudicator will issue an order to the debtor for release of the information. If the debtor continues to be non-cooperative, the Adjudicator will issue an order to the RP to replace management, and impose a monetary penalty as specified in regulations.
6. The interim RP is given the power to do all the things that are necessary for the entity to continue as a going concern. This includes taking over the management of the business and the assets of the entity, appointing accountants and legal staff to verify liabilities and assets and issue legal notices if required.
7. The interim RP has the power to raise fresh finances to keep the entity as a going concern. The term of the financing is restricted to the period till the creditors committee is formed. The cost of financing actions of the interim RP will be considered as the cost of the IRP.

of the creditors committee by weight of the total financial liabilities. The majority vote will also involve a cram down option on any dissenting creditors once the majority vote is obtained. The Adjudicator enables the RP to clarify matters of business from the creditors committee during the course of the IRP. For example, if the RP needs to raise fresh financing during the IRP, she may seek approval from the creditors committee rather than the Adjudicator. The list of these matters which fall in the responsibility of the creditors committee will be specified in the Code.

The Committee deliberated on who should be on the creditors committee, given the power of the creditors committee to ultimately keep the entity as a going concern or liquidate it. The Committee reasoned that members of the creditors committee have to be creditors both with the capability to assess viability, as well as to be willing to modify terms of existing liabilities in negotiations. Typically, operational creditors are neither able to decide on matters regarding the insolvency of the entity, nor willing to take the risk of postponing payments for better future prospects for the entity. The Committee concluded that, for the process to be rapid and efficient, the Code will provide that the creditors committee should be restricted to only the financial creditors.

Then, in order to create the creditors committee, all financial creditors of the entity have to be identified. This information is expected to be readily available in the registered IUs described in Section 4.3. The Adjudicator gives the interim RP the power to access information about the financial creditors of the entity in the IUs or any other registry or database where information regarding creditors will be recorded. The interim RP has the power to obtain information from the debtor to validate the set and weight of the financial creditors if required. The definition of a financial creditor will be stated in

Box 5.8: Drafting instructions for creating the creditors committee at the start of the IRP

1. The creditors committee will contain all the financial creditors to the entity. (See Box 5.2 for the definition of the financial creditor.)
2. The debtor must be invited to all meetings of creditors committee as a non-voting member. He can be present for discussions on matters of business, but does not have a vote in deciding any outcome.
3. A member of the creditor committee may designate an Insolvency Professional to represent them in the creditors committee, whose fees will be paid directly by the creditor and not be included in the costs of the IRP.
4. The interim RP will identify the set of all financial creditors from the information utilities, and submit the proposed creditors committee to the Adjudicator within fifteen days from the start of the IRP. A failure to do this within the stipulated period will be taken as a failure to adhere to the processes of the IRP.
5. The final choice of solution to keep the entity as a going concern, or whether it should be liquidated, will be decided by majority vote in the creditors committee. The majority vote will be more than or equal to 75 percent of the votes of the creditors committee by weight of their liability. If a creditor chooses not to participate in the vote, the votes and the majority will be counted without their vote.
6. The creditors committee also has the responsibility to take decisions on questions relating the matters of business raised by the RP during the IRP which affects the economic value of the entity.
7. The interim RP will continue to be the RP for the remainder of the IRP, unless the creditors committee applies to the Adjudicator to appoint a fresh RP.

the Code. The calculation of the weight of the financial creditor will be specified in regulations.

Once the verification has been completed, the interim RP will apply to the Adjudicator to send notices to the financial creditors informing them about their voting rights, duties and responsibilities on the creditor committee for the IRP case. The creditors have to acknowledge the receipts of these notices. A creditor can appoint an insolvency professional as their representative on the creditors committee. However, the fees of this professional will be borne by the creditor and not counted as part of the IRP costs.

The voting right of each creditor will be the weight of their liability in the total liability of the entity from financial creditors. The calculation for these weights will need to take into account all the contractual agreements between the creditor and debtor, so that the weight is the net of all these positions. The rules to calculate the weights of the creditors will be specified by the Regulator. If a creditor chooses not to participate in the negotiations, despite having been so informed, the vote of creditors committee will be calculated without the vote of this creditor.

The Committee concludes that the debtor will be present at all the meetings of the creditors committees, but can have no voting rights. Thus, the debtor becomes a non-voting member on the creditors committee.

5.3.2 The role of the Resolution Professional

The first phase of the IRP is completed when the creditors committee is formed, and the window to submit claims is closed. The creditors committee can apply to the Adjudicator to appoint a new RP to replace the interim RP. The RP must be chosen by a majority vote in the creditors committee for the Adjudicator to accept the application.

With a creditor committee in place, the RP has a wider role, in addition to monitoring and supervising the entity, and controlling its assets. In carrying out this role, if there are questions of business that arise, she can call on the creditors committee to give clarification or guidance on how she can proceed. For example, if there is evidence of fraudulent practice in the existing management, the RP can hire legal services to prepare a case of fraud against the management. She has the power to convene the creditors committee, present the evidence before them and ask for a vote to ratify a proposed change in the management, as well as to proceed to bring the case of fraud for adjudication to the Bankruptcy and Insolvency Adjudicator.

The RP becomes the manager of the negotiation between the debtor and the creditors in assessing the viability of the entity. In this role, she has the responsibility of managing all information so that debtors and creditors are equally informed about the business in the negotiations. Finally, she is responsible for inviting and collecting proposals of solutions to keep the entity going. In this role, she is responsible for managing the process through which to invite proposals from the overall financial market, rather than just the creditors and debtor. The Committee discussed that this could include other potential market participants, such as other financial institutions, asset reconstruction companies, foreign financiers, strategic investors, other firms and minority shareholders in the entity. Part of the task of the RP is to ensure as much equality of information about the entity to all participants in the negotiations as is possible.

Thus, the RP needs to ensure several features in the IRP, giving first priority to the need to preserve time value and equality in negotiations in the process.

1. The RP must provide the most updated information about the entity as accurately as is reasonably possible to this range of solution providers. In order to do this, the RP has to be able to verify claims to liabilities as well as the assets disclosed by the entity. The RP has the power to appoint whatever outside resources that she may require in order to carry out this task, including accounting and consulting services.
2. The information collected on the entity is used to compile an information memorandum, which is signed off by the debtor and the creditors committee, based on which solutions can be offered to resolve the insolvency. In order for the market to provide solutions to keep the entity as a going concern, the information memorandum must be made available to potential financiers within a reasonable period of time from her appointment to the IRP. If the information is not comprehensive, the RP must put out the information memorandum with a degree of completeness of the information that she is willing to certify.
   For example, as part of the information memorandum, the RP must clearly state the expected shortfall in the coverage of the liabilities and assets of the entity

presented in the information memorandum. Here, the asset and liabilities include those that the RP can ascertain and verify from the accounts of the entity, the records in the information system, the liabilities submitted at the start of the IRP, or any other source as may be specified by the Regulator.

3. Once the information memorandum is created, the RP must make sure that it is readily available to whoever is interested to bid a solution for the IRP. She has to inform the market (a) that she is the RP in charge of this case, (b) about a transparent mechanism through which interested third parties can access the information memorandum, (c) about the time frame within which possible solutions must be presented and (d) with a channel through which solutions can be submitted for evaluation. The Code does not specify details of the manner or the mechanism in which this should be done, but rather emphasises that it must be done in a time-bound manner and that it is accessible to all possible interested parties.

Finally, the RP is responsible for calling the creditors committee to evaluate the submitted proposals. She has a role to play in discussing and ranking the proposals in terms of how to maximise enterprise value. As a first stage filter, she must ensure that all the proposals have clarity on how the IRP costs and the liabilities of the operational creditors will be treated and that all parts of the proposed solutions are consistent with the relevant laws and regulations. But she must leave the choice of final solution to selection by the majority vote from the creditors committee.

Fees charged by the RP

The Committee is of the view that there should be no constraints on RP fees. In a competitive market for the insolvency professionals, the fees for managing the insolvency resolution process will converge to the fair market value for the size of the entity involved. While the market is evolving, the Code tries to ensure that there is as much transparency about the behaviour and the performance of individual insolvency professionals that the professional, creditors and debtors are incentivised to behave optimally. For example, the fees charged by the professional is collected as part of the records of the IRP, which is maintained in a public database by the Regulator. Since this will be recorded and disseminated for all professionals across all resolution cases, the potential customers can compare fees across professionals, along with all the other performance measures that are also maintained. This includes size of the insolvency being resolved, the days taken for resolution, the frequency with which entities are resolved and turn out to be successful turnarounds and the frequency with which entities are resolved but eventually turn up for liquidation. Then, customers will be able to carry out a fee-performance when choosing among professionals to engage for other cases.

The Committee feels it is prudent to allow the market to develop and competition to drive charges of the RP rather than setting these in the Code, or in regulations. In any competitive market, we expect that there will be a range of services available for a range of problems. However, there is one case that will require intervention. When the insolvency is brought for resolution well within time, there is typically a sizeable amount of assets that support the fees of insolvency resolution. On the other hand, this is not the case for an insolvency that is discovered at a late stage. In a typical situation,

Box 5.9: Drafting instructions for the role of the Resolution Professional (RP)

1. The interim RP can continue to be the RP for the rest of the IRP.
2. The creditors committee can apply to the Adjudicator to appoint a new RP with a majority vote from the creditors committee.
3. The RP has the following responsibilities:
   (a) To take control over all the assets entitled to the entity;
   (b) To manage the entity so that it remains a going concern during the IRP;
   (c) To call meetings of the creditors committee for guidance on how to resolve matters related to keeping the entity as a going concern if required.
   (d) To verify accounts and liabilities as is required;
   (e) To raise finances to carry on operations;
   (f) To create an information memorandum about the entity on the basis of which solutions can be proposed to keep it as a going concern;
   (g) To provide the information memorandum to whoever wishes to make a proposal, and to provide a visible channel through which proposals can be submitted for evaluation;
   (h) To ensure that all submitted proposals provide for the payment of the liabilities of the operational creditors within a reasonable period as specified by the Regulator;
   (i) To call meetings of the creditors committee for evaluation of proposals; and
   (j) To ensure that all actions are taken in a time-bound and transparent manner.
4. The RP has the power to:
   (a) Take any action required to manage the entity so that it remains a going concern during the IRP;
   (b) Remove any director of the company and to appoint a replacement if required;
   (c) Issue notices against fraudulent behaviour for the purposes of recovery if required, and bring such cases for adjudication to the Adjudicator;
   (d) Issue public announcements about the availability of the information memorandum and a mechanism through which proposals to keep the entity as a going concern can be submitted for evaluation by the creditors committee; and
   (e) Call any meeting of the members or creditors of the company when required.
5. The charges and costs incurred by the RP will be part of the resolution costs.

Box 5.10: Drafting instructions for the fee of the Resolution Professional (RP)

1. The fees charged by the RP will be as an outcome from market forces, and not set in the Code or provided in regulations.
2. The Regulator will require that any registered insolvency professional will offer her services at a nominal charge for a certain minimum number of cases a year. The fees will be paid by the Regulator in this case. The same requirement will hold for all registered professionals. The manner in which the Regulator will select the professional for the case will be specified in regulations.

there will have been a build up of the leverage by the entity borrowing at higher rates to make payments. Or assets may have been sold or pledged for cash to make payments. Experience from other jurisdictions suggest that there will be cases of low or no asset entities which come to the Adjudicator for resolution. In this case, the Adjudicator can approach the Regulator to recommend an RP who will be appointed with the condition that her services will be offered at a minimum charge, paid for by the Regulator. The requirement to offer to serve in a minimum number of such cases will be part of the requirements of continuing registration for the insolvency professional.

5.3.3 Obtaining the resolution to insolvency in the IRP

The Committee is of the opinion that there should be freedom permitted to the overall market to propose solutions on keeping the entity as a going concern. Since the manner and the type of possible solutions are specific to the time and environment in which the insolvency becomes visible, it is expected to evolve over time, and with the development of the market. The Code will be open to all forms of solutions for keeping the entity going without prejudice, within the rest of the constraints of the IRP. Therefore, how the insolvency is to be resolved will not be prescribed in the Code. There will be no restriction in the Code on possible ways in which the business model of the entity, or its financial model, or both, can be changed so as to keep the entity as a going concern. The Code will not state that the entity is to be revived, or the debt is to be restructured, or the entity is to be liquidated. This decision will come from the deliberations of the creditors committee in response to the solutions proposed by the market.

There are three aspects of this process that the Code does state. The first is that the *process* of obtaining solutions is provided with all information as can be reasonably expected at the time, is transparent and is time-bound.

The second is that any proposed solution must explicitly account for the IRP costs and the liabilities of the operational creditors within a reasonable period from the approval of the solution if it is approved. The Committee argues that there must be a counterbalance to operational creditors not having a vote on the creditors committee. Thus, they concluded that the dues of the operational creditors must have priority in being paid as an explicit part of the proposed solution. This must be ensured by the RP in evaluating a proposal before bringing it to the creditors committee. If there is ambiguity about the coverage of the liability in the information memorandum that the RP presents to garner solutions, then the RP must ensure that this is clearly stated and accounted for in the proposed solution.

Box 5.11: Drafting instructions for solutions to an IRP

1. As stated in Box 5.9, the RP must ensure as comprehensive an information memorandum as possible about the state of the entity as of the time of the IRP.
2. As stated in Box 5.9, the RP must create a universally visible process through which to gather and collect proposals to resolve the IRP.
3. For all the proposals received, the RP must apply the following two filters before it can be considered ready for submission to the creditors committee:
   (a) The RP must ensure that all proposals must include timely payment to verified liabilities of operational creditors and others not represented on the creditors committee, within time frames that are specified by the Regulator.
   (b) The RP must verify that the solutions proposed are consistent with relevant laws that govern corporate actions of the given entity.
4. The RP must ensure that the collection and presentation of the proposed solutions to the creditors committee is done keeping in consideration the time limit available for the IRP.
5. The RP must ensure that the solution agreed upon by majority vote in the creditors committee is presented as a binding contract signed by the majority to the Adjudicator within the time limit available.
6. If the solution involves the exercise of the cram-down choice, the RP can apply to the Adjudicator for a moratorium against debt recovery action during the time period required for the solution.

The third is that any solution that is presented must recognise restrictions and requirements from related laws. This holds particularly for corporate actions, which have provisions in Act governing the form of the given entity. For example, if the entity is a listed firm and the solution involves a merger of the entity with another, the solution must include awareness of the rules and regulations governing the merger of firms under Companies Act 2013, and SEBI (Substantial Acquisition of Shares and Takeover) Regulations if the firm is listed on an exchange.

The remaining mechanics of the process to acquire solutions and communicating these to the creditors committee is left to the management by the RP as described in Box 5.9. The Code states how the RP can call the creditors committee, and what constitutes majority vote. Once the majority is obtained as stated in the Code, the RP will have to obtain a signed agreement to the solution by the creditors committee, and submit it to the Adjudicator before the end of the maximum period for the IRP. This solution will be the outcome of the IRP.

5.3.4 Rules to close the IRP

The Committee agrees that it is critical for the Code to preserve the time value of the entity by ensuring that negotiations in the IRP are time bound. The Code states that the IRP has a default maximum time limit that is strictly adhered to, regardless of whether the creditors committee has identified a solution. On the other side, the Committee is also of the view that, if a solution can be identified within a shorter time frame, the process must accommodate closing the IRP in a shorter time period also.

The Committee proposes that the IRP can come to a close in either of two ways. Either the RP is able to get a binding agreement from the majority of the creditors committee or the calm period reaches the default maximum date set by the Adjudicator at the start

of the IRP. If either condition is met, the Adjudicator will issue an order to

Box 5.12: Drafting instructions for closing the IRP case

1. The IRP will come to an end when any of the following conditions is reached:
   (a) the Adjudicator receives a submission from RP with a signed agreement of a solution with a majority from the creditors committee; or
   (b) the period of the IRP has reached the default maximum IRP period.
   This is referred to as the *outcome* of the IRP.
2. The Adjudicator will pass an order closing the IRP case. The order will be of one of two types depending upon the :
   (a) An order closing the case, if the RP submits a binding agreement from the majority of the creditor committee to a proposed solution.
   (b) An order closing the case and an order of liquidation of the entity, if the calm period has reached the end of 180 days and the RP has not submitted a binding agreement from the majority of the creditor committee. If 75% of the creditors think that the resolution will require additional time, the resolution professional (on the instructions of the committee of creditors) may make an application to the Adjudicating Authority for another 90 days. The debtor or other creditors will not be entitled to make an application for extension of time.
3. The Adjudicator will simultaneously pass orders to:
   (a) Lift the moratorium;
   (b) Release the RP from the case if required; and
   (c) Release the records of the IRP to the Regulator.

close the IRP. However, the orders will vary depending upon the condition.

If the RP submits a binding agreement to the Adjudicator before the default maximum date, then the Adjudicator orders the IRP case to be closed. If the Adjudicator does not receive a binding agreement by this date, the Adjudicator issues an order to close the IRP case along with an order to liquidate the entity.

When the IRP case is closed, the Adjudicator will also issue following set of orders:

1. To lift the moratorium put in place for the IRP,
2. To release the RP as required; and
3. To release the IRP records to the Regulator.

In the case where the IRP resolves that the entity cannot be kept as a going concern and the Adjudicator issues an order for liquidation, the Adjudicator may order the RP to continue managing the assets of the entity during the Liquidation.

5.4 Fast-track IRP

By default, each IRP must be carried out within the default maximum period set in the Code (Box 5.4). However, this is the time taken for the resolution of a very complex entity, where complexity may come in the structure of liabilities and assets, or size of operations. Most entities are likely to have a less complex structure in these aspects. Their insolvency is also likely to take a

shorter time to resolve. For example, the time taken to resolve a conflict for an entity with a single secured creditor who has more than 80 percent of the financial liability is likely to take a shorter time to resolve than one with multiple creditors where the maximum exposure is 20 percent. Another example is that of an insolvent entity where the debtor or the majority of the creditors have a robust argument for liquidation as the most efficient outcome.

While it is likely that the creditors and debtors themselves chose to wind down negotiations in a shorter period than the default maximum period allowed, the Committee view is that there is merit in creating explicit provisions for cases where the IRP to be necessarily carried out in shorter time periods than the most complex case. These cases will be called the Fast-track IRP. The Code will specify three types of fast-track cases: for entities with small scale of operations, for entities with low complexity of creditors and for such other categories of corporate debtors as may be prescribed. In the first two, definitions of what constitutes such entities will be issued by the Central Government.

In Fast-track cases, the process flow of the IRP will be the same in order to retain the principles of transparency and collective action. Since the resolution is expected to be done in a shorter period, there will be greater onus on the process at trigger. The entity who triggers the Fast-track process must submit documentation with the application to support the case for the Fast-track IRP. The Adjudicator will seek validation from the other parties involved before issuing the order for a Fast-track IRP. For example, if the creditor triggers the small entity Fast-track IRP, the application must include audited statements that the entity is eligible for this process. The Adjudicator will forward these to the debtor for validation. If there is no dispute from the debtor on the eligibility documents within a specified amount of time, the Adjudicator will issue the order for the Fast-track IRP.

With the registration of the case, a process similar to that at the start of an IRP will commence. There will be an interim RP who is in charge of collection of claims, monitoring the entity and the creation of a creditors committee. Once the creditors committee is formed, the RP will verify the submitted liabilities to the best of her ability. She will have the same responsibilities as defined in Box 5.9, but a shorter time period within which to resolve the insolvency. The Committee recommends that this time period should be at least half the time taken for the complex cases, or within 90 days. Similar to the provision for IRP, in a fast-track process, if more than 75% of the creditors are of the view that more time is required to resolve the stress, they may apply to the Adjudicating Authority for an extension. The debtor or any other creditor will not be entitled to seek an extension. While these are the cases that have been visualised at the start, the Committee feels that the Regulator can issue regulations to create more cases for Fast-track IRP as the case history builds under this Code.

5.5 A time-bound, efficient Liquidation

Liquidation is the state the entity enters at the end of an IRP, where neither creditors nor debtors can find a commonly agreeable solution by which to keep the entity as a going concern. In India, it is widely accepted that liquidation is a weak link in the bankruptcy process and must be

strengthened as part of ensuring a robust legal framework. The process flow in liquidation shares some objectives in common with that of resolving insolvency. Preservation of time value is the most important, and efficient outcomes under collective action is the next, both of which are important principles driving the design. However, this is not straightforward in implementation, particularly in an environment where different creditors have different rights over the assets of the entity, information is asymmetric, and governance and enforcement has been traditionally weak.

The Committee presents some principles that the provisions of the Code must hold in

Box 5.13: Drafting instructions for Fast-track IRP

1. The Code and the regulations thereunder will have provisions for Fast-track IRP.
2. The Fast-track IRP differs from the default in two ways:
   (a) If the order for the Fast-track IRP is passed, the interim RP and RP are informed of the shorter time period within which they have to carry out their responsibilities.
   (b) In order to trigger the Fast-track process:
      i. The entity who is triggering the IRP must submit a separate application for the fast-track process.
      ii. The fast-track application must contain a statement with evidence supporting the case for Fast-rack that is signed by an Insolvency Professional.
      iii. The Adjudicator will forward the application for the Fast-track to the entity that did not trigger the IRP.
      iv. If there is no objection raised to the fast-track within two days of the Adjudicator sending out the application, the Adjudicator will issue an order to register the IRP as a fast-track process.
      v. If there is an objection, the following process must be followed:
         A. An objection must be submitted with evidence of why the triggering application is incorrect, and it must be signed off by an Insolvency Professional.
         B. On receiving such an objection, the Adjudicator will confirm that due process has been followed and forward it to the Insolvency Professional proposed by the triggering entity for a rebuttal.
         C. If there is no response from the triggering entity by the end of the next day, the Adjudicator will reject both the application for the IRP and the Fast-track process, and ask the triggering entity to submit the IRP application without the Fast-track application.
         D. If a response is received that is signed off by the RP within the designated time, the Adjudicator will accept the Fast-track application and register the Fast-track IRP.

Liquidation:

1. Only assets that are owned by the entity, as it was in place before the IRP, is available for liquidation.
2. The entity loses beneficial ownership on the assets. The ownership is moved to a liquidation trust and the liquidator manages this trust. The assets are taken over as is – with all encumbrances.
3. Secured creditors can choose to enforce their security interest after the liquidation order is passed.
4. Liabilities that were in place before the IRP are unaffected by the liquidation. Only liabilities that are written before liquidation can have a right to distribution under liquidation.
5. Creditors have no direct interest in the realisation or distribution of liquidation. They can only charge the liquidator to carry out her statutory duties.
6. Under liquidation, all liabilities that are fully earned are accelerated to the time of the liquidation. Liabilities that are not earned can only demand what has already fallen due.
7. Members of a limited liability firm are not liable for its dues. Exceptions include: where the entity is registered as an unlimited liability firm; where the entity acts as the agent of the members; or where they undertake a collateral liability such as a guarantee or other such contracts. Individual members can also be liable for instances of explicit fraud.
8. Foreign creditors are treated on par with domestic creditors.

With these principles, the Code states the process of liquidation as following the following process flow: well defined triggers – who can trigger and how the trigger can be accepted; the process flow once liquidation is triggered as first steps, the actions after and the closure of the process.

5.5.1 What can trigger Liquidation?

The Code describes four ways in which liquidation can be triggered:

a. By rejection of resolution plan by the adjudicator if it fails to meet the necessary conditions.

b. By failure to reach an agreement in the committee of creditors during the stipulated period.

c. By a decision of the committee of creditors during the IRP.

d. By the failure of adherence to terms of a resolution plan.

Box 5.14: Drafting instructions for triggering Liquidation

1. There are four ways to trigger Liquidation:
   a. Rejection of resolution plan by the adjudicator if it fails to meet the necessary conditions.
   b. Failure to reach an agreement in the committee of creditors during the stipulated period.
   c. Decision of the committee of creditors during the IRP.
   d. Failure to adhere to terms of a resolution plan.
2. The Code will also provide for voluntary liquidation of corporate persons who have not defaulted on any debt.

5.5.2 Rules to accept the trigger to Liquidation

a. **As an outcome of on-going IRP**

Liquidation triggered as an outcome of the IRP is automatic; the RP will apply to the Adjudicator to create an order either when the creditors sign off on liquidation or the Adjudicating Authority will order a liquidation when the period of the IRP comes to an end and no proposal for resolution has been submitted or where the resolution plan does comply with the required conditions.

b. **Failure to comply with the terms of the resolution plan**

Where the resolution plan approved by the Adjudicating Authority is contravened by the concerned firm, then any person other than such firm, whose interests are prejudicially affected by such contravention, may make an application to the Adjudicating Authority for a liquidation order.

c. **As an application for voluntary liquidation**

Where a firm has not defaulted on any debt (or where a firm has no debt), it may make any application to be liquidated voluntarily in such manner as may be specified by the Board.

5.5.3 Steps at the start of the Liquidation

A liquidation order is accompanied by a set of other orders issued by the Adjudicator to:

a. **Create a trust for the assets of the entity**
During the liquidation process, a trust is created which becomes the owner of the assets of the entity. The trust will hold the assets on behalf of the entity. Further, once the assets start being sold, the trust will receive realisations from the sales. The trust will distribute the dividends as per the payout provisions of the Code. These are described in Section 5.5.8. The trust will be managed by the insolvency professional appointed by the Adjudicator, who has the role of managing the assets, asset sales and the distribution of the realisations.

While the trust is being created and before it can take over, the Adjudicator will order the RP of the IRP to continue as manager of the assets of the entity. Even after the trust is in place, the RP can continue as the manager of the trust until a liquidator is appointed.

All transactions done by the trust as sale of assets or distribution of dividends must be treated as pass-through. The realisations must only be taxed in the hands of the recipients.

b. **Appoint a Liquidator**

The RP from the IRP may continue as the liquidator as long as the Regulator raises no objection to her continuing in this role.

If there is a complaint against the RP at any stage during the IRP or after the liquidation order is passed, the Adjudicator must apply to the Regulator for an alternative RP as a replacement.

The roles of the liquidator is described in detail in Section 5.5.9.

c. **Liquidating the legal entity**

The Committee recommends that the Adjudicator will pass the following orders to liquidate the legal entity:

(a) An order to the relevant registration authority to rename the entity by adding the phrase "-in-liquidation" to the original name. This will increase the visibility of the Liquidation order and ensure that the entity cannot assume a business-as-usual manner in transactions with counterparties. It will also protect and safeguard the assets of the entity from fraudulent action by the erstwhile managers and owners.

(b) An order to cease all powers of the board and the management and vest them with the liquidator.

Box – 5.15 - Drafting intstructions voluntory liquidation

An application for voluntary liquidation of a corporate person registered as a company shall meet the following conditions:
(a) a special resolution of the shareholders of the company requiring the corporate debtor to be liquidated voluntarily; or a resolution of the shareholders of the company in a general meeting requiring the company to be wound of voluntarily as a result of expiry of the period of its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company, as the case may be;
(b) a declaration from majority of the directors of the company verified by an affidavit stating that –
(i) they have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full from the proceeds of assets sold in the voluntary liquidation; and
(ii) the company is not being liquidated to defraud any person;
(c) audited financial statements and record of business operations of the company for the previous two years; and
(d) a report of the valuation of the assets of the company, if any prepared by a registered valuer.

Box 5.16 – Drafting instructions for certain orders in realtion to the liquidation order

The Adjudicator will issue these orders as soon as a liquidation order is passed:

1. An order to appoint the liquidator following the process described in Box 5.17.
2. An order to the relevant registration authority to change the name of the entity by adding the phrase "-in-liquidation" to the original name.
3. An order to cease all powers of the the board and the management and vest them with the liquidator.

Box 5.17: Drafting instructions for the appointment of a Liquidator

1. The liquidator can be selected through any of the following ways:
   (a) The RP of the IRP can continue as the liquidator.
   (b) The Regulator can recommend, with reason, a new liquidator to replace the RP to the Adjudicator.
   (c) The Adjudicator can apply to the Regulator for a replacement liquidator.
2. The Adjudicator will either issue an order for the RP to continue as a liquidator, or the Adjudicator will issue an order to appoint the liquidator recommended by the Regulator.

Box 5.18: Drafting instructions for establishing the irreversibility of Liquidation

1. The Code will provide for a period beyond which the outcome of Liquidation cannot be reversed by appeal in any other court. This does not refer to appeals against the behaviour of the RP or the failure to adhere to process during the IRP, which is directed to the Regulator for redressal.
2. The period of irreversibility for Fast-track Liquidation will be less than that set in the Code for Liquidation. This period will be specified by the Regulator.

5.5.4 Establishing the irreversibility of Liquidation

The Committee argues for clarity on what can be appealed once a Liquidation order has been issued. The Liquidation outcome is a matter of business that is managed by a regulated professional, under a reasonably well-defined set of rules of process. In that case, appeals are likely to be placed against the behaviour of the Resolution Professional, or about failure of following the process.

Appeals against the outcome can be entertained if there is evidence of fraud or material irregularity. These must be presented and resolved, within a reasonable window of time. If resolution of the case requires more than this period of time, then the Liquidation of the entity becomes irreversible, and will hold irrespective of legal action in any other court of the land.

5.5.5 Establishing assets in Liquidation

The Committee debated what assets of the entity must be available for realisation in liquidation. Not all assets that are present within the entity, from the start of the IRP, can be considered for Liquidation. The Committee agrees that the following sets of assets must be kept out of the liquidation process:

a. Assets held by the entity in trust (such as employee pensions).
b. Assets held as collateral to certain financial market institutions (such as clearing corporations or similar financial transactions to either creditors or non-creditors). In other jurisdictions, these may be referred to as “assets subject to netting and set-off in multi-lateral trading or clearing transactions”.

In defining these assets, the Code will take cognisance of the assets that are used as collateral to ensure counterparty guarantees in financial transactions where clear legal documentation is available as proof of transaction (Reference to IFC). These funds and assets cannot be used for recovery in Liquidation.

c. Assets held as part of operational transactions where the entity has rights over the asset but is not the owner of the title of the asset. For example, there could be goods belonging to third parties given to the debtor for processing or value addition. The entity only has rights over goods held in inventory. But these are

Box 5.19: Drafting instructions for establishing the assets of the entity in Liquidation

1. Only assets where the entity is a beneficial owner before the start of the IRP can be considered as available to realisation during Liquidation.
2. The assets that are not owned by the entity include:
   (a) Assets held in trust. An example are funds and securities held for employees pensions programs.
   (b) Assets that are held as security by financial market institutions that are laid out in the Indian Financial Code. These include collateral posted to the clearing corporation.
   (c) Assets held as part of operational transactions which have been provided to the entity with reservation of title. These include goods in inventory where the title of the goods belongs to a trade creditor or a wholesale distributor.

   All such assets cannot be used by the liquidator to realise recoveries for creditors.
3. Access to security in contracts that were entered into prior to the IRP and Liquidation will not be changed as a consequence of Liquidation.

owned by the producer or a wholesale distributor of these goods. These can be claimed back by the owner, and cannot be sold to realise value in liquidation.

5.5.6 Right of the secured creditors to withdraw from collective Liquidation

Once the moratorium is lifted at the closure of the IRP, the secured creditors can initiate debt recovery action on the assets of the entity. As recognised in other jurisdictions and in the IRP under the Code, the Committee argues that there are likely benefits to collective action in liquidation just as there is in assessing viability during the IRP (Mukherjee, Thyagarajan, and Anchayil, 2015).

However, at the close of the IRP, the Committee appreciates that the secured creditor must be able to enforce their interest and act to maximise their loss given default through sale of the security without the costs of the Liquidation process under the Code. Thus, the Code provides that the secured creditor can withdraw the asset against which they hold security interest.

Drafting instructions for provisions in the Code enforcing the rights of secured creditors in Liquidation is presented in Box 5.20

5.5.7 Realisation in Liquidation other than through sale of assets

The Committee drew on the liquidation experiences both in India as well as other countries, and listed two other ways in which higher economic value can be realised other than just sale of assets.

Box 5.20 – Realization of the security of secured creditors

1. Secured creditors can withdraw the asset against which they have security interest from the liquidation trust subject to the following conditions:
   (a) Existence of records establishing their claim on the asset present in a registered IU or proved in a manner as may be specified; and
   (b) Payment instruction for their share of the IRP costs.

Treating proposals to sell the business as a whole, or parts of the business, in Liquidation

In this form of maximising value recovered, the distinction is made between the business and the entity. The business is the underlying structure whose operations generate revenue, either as a whole or in parts. The entity includes the management, the ownership and the financial elements around this core business. In the liquidation phase, the liquidator can coordinate proposals from the market on sale of the business, in parts or even as a whole. The evaluation of these proposals come under matters of business. The selection of the best proposal is therefore left to the creditors committee which form the board of the erstwhile entity in liquidation.

However, a different set of principles guide what is defines the best solution in the liquidation phase, unlike the IRP. In the IRP, the financial creditors had the power to choose the best solution to keep the entity as a going concern, with the condition that the liabilities of the other creditors will be fully met within a reasonable period in the implementation of the solution.

In liquidation, such a condition cannot be applied. The interests of both the financial and the operational creditors will be served on a best efforts basis. Under the waterfall of liabilities provided in the Code, secured creditors who have the priority in the waterfall, will have the best recovery while all other creditors, both financial and operational, will face a lower recovery. It is important for the Code to retain a sense of fairness in how the solutions in Liquidation should preserve the rights of all creditors, so that they are incentivised to continue providing credit to other entities. Thus solutions in Liquidations must be evaluated on the long-term incentives of both secured creditors and non-secured creditors.

This suggests a two-filter approach to evaluating the proposals that the liquidator receives on how to optimally liquidate the business, before she presents it to the creditors committee. The first is to maximise the value expected under realisation. The second is to evaluate the impact on the non-secured creditors. If two proposals are reasonably similar in the expected realisation, then the proposal which minimises the adverse impact on non-secured creditors should be ranked higher in the presentation to the creditors committee. On the other hand, if a proposal has a significantly higher expected realisation among all other proposal, this proposal may have the highest ranking even if the other proposals may have a lower adverse impact on non-secured creditors.

The liquidator will be responsible for recording the rankings of various proposals, along with the arguments, in the presentation to the creditors committee. These records will be available publicly through the Regulator within as short a period as is reasonably possible. They can be used in appeals to the Adjudicator against outcomes selected

by the creditors committee in liquidation, but cannot be used as an appeal against the liquidation itself.

Treating recoveries from vulnerable transactions

The Committee discussed the possibility of identifying and recovering from *vulnerable transactions*. These are transactions that fall within the category of wrongful or fraudulent trading by the entity, or unauthorised use of capital by the management. There are two concepts that are recognised in other jurisdictions under this category of transactions: of fraudulent transfers, and fraudulently preferring a certain creditor or class of creditors. If such transactions are established, then they will be reversed. Assets that were fraudulently transferred will be included as part of the assets in liquidation.

The Committee recommends that all transactions up to a certain period of time prior to the application of the IRP (referred to as the "look-back period") should be scrutinised for any evidence of such transactions by the relevant Insolvency Professional. The relevant period will be specified in regulations. At any time within the resolution period (or during the Liquidation period if the entity is liquidated) the relevant Insolvency Professional is responsible for verifying that reported transactions are valid and central to the running of the business. There should be stricter scrutiny for transactions of fraudulent preference or transfer to related parties, for which the "look back period" should be specified in regulations to be longer.

The Code will give the Liquidator the power to file cases for recovery. Some jurisdictions set such recoveries aside for payment to the secured creditors. Given the extent of equity financing in India, all recoveries from such transactions will become the property of the trust, and will be distributed as described within the waterfall of liabilities.

Drafting instructions for realisation of value in Liquidation other than through sale of assets are presented in Box 5.21.

5.5.8 Establishing priority of payout in Liquidation

In the principles about the rights of claimants in Liquidation, the core principle is that the order of liabilities that were in place before Liquidation, must be retained after Liquidation. Therefore, the Code visualises that no new claims can be submitted on the assets of the entity beyond those that are registered in the financial and operational

Box 5.21: Drafting instructions for regulations on realisation in Liquidation other than through sale of assets

a. There could be two sources of additional value in Liquidation other than sale of assets. These include:
   (a) Proposals for sale of the business as a whole or in parts.
   (b) Value recovered from vulnerable transactions.
b. In proposals for sale of the business:
   (a) The liquidator will call for proposals to buy the business, either in parts or as a whole, to maximise economic value.
   (b) The proposals in Liquidation will be evaluated on both:
      i. Value offered, and
      ii. Ranking of the proposal in terms of impact on non-secured creditors, including operational creditors.
   (c) The creditors committee as the board of the erstwhile entity will select the best of the proposed solutions.
   (d) All the solutions will be recorded in the Liquidation case, and will be available from the Regulator in as short a time as is reasonably possible.
   (e) The liquidator will conduct the sale and the trust will receive the proceeds for distribution.
   (f) The distribution of these proceeds will be made according to the waterfall of payments provided by the Code (Section 5.5.8).
c. Recoveries from vulnerable transactions are carried out in the following manner:
   (a) These transactions are identified by an insolvency professional, either in IRP or in Liquidation, as those which are wrongful or fraudulent trading, unauthorised use of capital by the management.
   (b) The period over which the transactions are scrutinised is specified in the Code.
   (c) Once these are identified, the Liquidator will file an appeal to the Adjudicator against the party that carried out the transaction to revoke the transaction, if possible, and recover the lost value.
   (d) When the case is resolved in favour, the recovered value is deposited with the trust for distribution.
   (e) The cost incurred by the Liquidator for recovery in these cases is covered by the general realisations from in Liquidation up to a threshold that is specified by the Regulator. Beyond this threshold, the costs will be recovered from the value recovered from the case.

liabilities information systems of Section 4.3 (or by other specified means), and those that are submitted at the start of the IRP. The only claims that can be admitted after the start of the IRP are claims arising from transactions registered with, or by, the RP in charge of the IRP. These are likely to have been transactions for temporary financing or working capital arrangements that are considered critical to keep the entity as a going concern. Rather than fresh creditor claims, these will be considered on par with the costs of the IRP, and be treated as such.

The Committee also agrees that a creditor with claims that is backed by proof of beneficial ownership of the security can automatically apply to the liquidator to retrieve the security from the Liquidation trust. This includes assets underlying transactions of hire-purchase and financial lease assets, and secured creditors who can exercise their rights over assets where they have security rights as described in Section 5.5.6. Such creditors can apply to the Adjudicator with proof of the ownership, and payment for the IRP costs as specified in regulations. The Adjudicator will then issue an order to the Liquidator to release the asset from the Liquidation Trust.

For the remaining creditors who participate in the collective action of Liquidation, the Committee debated on the waterfall of liabilities that should hold in Liquidation in the new Code. Across different jurisdictions, the observation is that secured creditors have first priority on the realisations, and that these are typically paid out net of the costs of insolvency resolution and Liquidation. In order to bring the practices in India in-line with the global practice, and to ensure that the objectives of this proposed Code is met, the Committee recommends that the waterfall in Liquidation should be as follows:

1. Costs of IRP and liquidation.
2. Secured creditors and Workmen dues capped up to three months from the start of IRP.
3. Employees capped up to three months.
4. Dues to unsecured financial creditors, debts payable to workmen in respect of the period beginning twelve months before the liquidation commencement date and ending three months before the liquidation commencement date;
5. Any amount due to the State Government and the Central Government in respect of the whole or any part of the period of two years before the liquidation commencement date; any debts of the secured creditor for any amount unpaid following the enforcement of security interest
6. Remaining debt
7. Surplus to shareholders.

There was some debate in the committee on whether the priority given to workmen[14] in the *Companies Act, 2013* should be retained in the proposed Code as well.

5.5.9 The role of the liquidator

The swiftness with which the Liquidation phase can be completed in the most efficient way has always rested on the liquidator. One of the central problems identified in the

[14]Where workmen is defined as per *Industrial Disputes Act, 1947*.

Box 5.22: Drafting instructions for the priority of payout in Liquidation

1. The Code will state that the priority of payout of the dividends from the Liquidation trust will be as follows:
   (a) Tier 0: Costs of IRP and liquidation costs.
   (b) Tier 1: Secured creditors and Workmen dues capped up to three months from the start of IRP.
   (c) Tier 2: Employees wages and unpaid dues capped up to three months.
   (d) Tier 3:
      i. Dues to unsecured financial creditors,
      ii. workmen's dues in respect of the nine month period beginning twelve months before the liquidation commencement date and ending three months before the liquidation commencement date.
   (e) Tier 4:
      i. Any amount due to the State Government and the Central Government in respect of the whole or any part of the period of two years before the liquidation commencement date;
      ii. any debts of the secured creditor for any amount unpaid following the enforcement of security interest.
   (f) Tier 5: any remaining debt
   (g) Tier 6: surplus to shareholders/partners.
2. At each point in the waterfall, there will be no differentiation between domestic and international creditors.

poor implementation of bankruptcy systems in India has been the liquidator.

Responsibilities include verification of all claims made on the assets of the entity. Here, the full list of claims needs to be identified and verified, so that any recovery can be made to these creditors in all fairness. In addition, the liquidator has the responsibility to identify the assets of the entity that is available for realisation under Liquidation.

The Liquidator applies to access the records of liability verification of the IRP from the Regulator. The Liquidator also independently is given the power to access all the information systems required to verify claims of liabilities, assets that are security, audited balance sheets and cash flow transaction records of the entity. Finally, claims of liability that were submitted at the start of the IRP and that are not included in the rest of the information system are included as liabilities against the erstwhile entity for recovery. The principle of collective action requires that all assets are held in the Trust by the Liquidator, who also carries out all realisations and adds it to the cash assets in the trust.

Fees charged the Liquidator

The recovery from assets are paid out to creditors net of the insolvency resolution and Liquidation costs.

Like in the case of fees for the Resolution Professional, the Code has very few provisions on the costs of Liquidation or the fees that the Liquidator has charged. The Committee is of the view that the costs incurred and the fees charged by the professional in carrying out their role should be the market price from a competitive market. However, while the IRP is designed as a time-bound process, there can be no such externally imposed, general time limit on the Liquidation process that can lead to optimal Liquidation outcomes.

Box 5.23: Drafting instructions for the Code and the regulations thereunder on the role of the Liquidator

a. The responsibilities of the Liquidator include:
   (a) Account for, and verify, all legitimate claims to the distribution from the value realised from Liquidation. These must done at least as good as the reporting standards specified by the Regulator.
   (b) Account for, and establish all assets where the entity was the beneficiary owner. Ascertain their presence as registered with the Liquidation trust. These must done to reporting standards specified by the Regulator.
   (c) At a regular frequency specified by the Regulator, the Liquidator will report the estimated value of the assets held in the Liquidation trust. Where the assets do not have regularly updated and transparent market price, the Liquidator will also make available the methodology using which the estimated value was arrived at. The methodology must be audited by the Regulator.
   (d) Ensure full transparency and good governance practices in the management of the assets of the Liquidation trust. These must be at least as good as specified by the Regulator.
   (e) The Liquidator is responsible to each creditor to ensure swift distribution of the maximum realisation, and to the Regulator for compliance with the standards of good practice and no conflict of interest in this distribution.
   (f) The Liquidator manages the Liquidation trust and must adhere to the provisions, rules and regulations applicable under the relevant law.

b. The powers of the Liquidator include:
   (a) The Liquidator has the power to access all the records related to the entity that is available in the information systems. This includes:
      i. the credit information systems;
      ii. the records submitted to the relevant registration authority;
      iii. the information systems for financial liabilities and those for non-financial liabilities;
      iv. the information systems for securities and assets posted as collateral;
      v. the IRP records for the case at the Regulator; and
      vi. any other system that is specified as relevant by the Regulator from time to time.
   (b) The Liquidator is registered as the manager of the Liquidation trust.
   (c) The Liquidator can call for bids, run auctions, hire the services of third party valuation experts in order to assess the value of the assets in the Liquidation trust while creating valuation reports to the Regulator.

Box – 5.24 – Drafting instructions for regulations on liquidator's fee.

1. The liquidator fees will be a function of the realised value in Liquidation, which will earn lower revenues for later recoveries. The regulations will specify that the maximum fraction that is permitted of the value that is realised in the first year of Liquidation. In subsequent years, the fraction that is permitted as liquidator fees of the realised value will continuously decrease.
2. The form of the function will be specified by the Regulator subject to the condition that it satisfies the provisions in the Code.
3. The fees that can be charged while recovering from vulnerable transactions will have a different structure. Here, the Regulator will specify a threshold value for the fees charged. All costs incurred above this threshold value has to be recovered from the case filed for recovery from the vulnerable transactions.
4. As in the case of the IRP for low or no asset cases, the Regulator will specify that a Liquidator offer her services free of charge for a certain miniumum number of cases as part of requirements of registration.

In fact, it has been found that often the Liquidator has the incentive to prolong the Liquidation process purely as a mechanism to seek rents from the creditors. They earn rents either by deploying the capital realised, or differentiating payouts to those who can pay for it. The Committee agrees that the Code and the regulations thereunder should incentivise good behaviour by the Liquidator by imposing a structure on fees charged in Liquidation. An ideal structure will be one that incentivises the Liquidator to preserve time value of transactions in Liquidation.

The fees that the Liquidator can charge must be a decreasing function of time. Under such a fee structure, the same realisation obtained in the second year will mean a smaller fee for the liquidator than the fee for the realisation in the first year. The precise function can be specified by the Regulator, and can vary from case to case in regulations. However, irrespective of the variations, because fees earned must be lower in a later year than in an earlier year, the Liquidator is motivated to realise value sooner rather than later.

Lastly, in order to ensure greater distribution certainty to creditors in Liquidation, the Code differentiates the fees that can be charged for verified and quantified assets and for uncertain recoveries (such as those from lawsuits to recover value from vulnerable transactions). When there is surety about the assets, the Liquidator is incentivised to maximise the payout for the creditors when her fees are a fraction of the realisations. However, when there is uncertainty on the possibility of any recovery or the time at which it can be realised (as in a lawsuit against directors or management), the costs of recovery will become surely very high while the realisation is uncertain. In such cases, the Code directs the Regulator to set a threshold value for the fees that the Liquidator can charge. All the fees beyond that threshold will be recovered from the recoveries at a higher rate than is used for charges when realisations are sure.

5.5.10 Rules to close the Liquidation

The end of Liquidation requires complete dissolution of the entity. One indicator is that the assets held in the Liquidation trust have been sold and the realisations paid out

Box 5.25: Drafting instructions for closing the Liquidation case

1. The Liquidator can apply to the Adjudicator to close the Liquidation case at any point after the clear assets held in the Liquidation trust has been realised, and the value has been distributed to creditors.
2. The Adjudicator will hear the case based on the probability of realisations expected from vulnerable transactions and disputed assets.
3. If the Adjudicator accepts the application, then an order is issued to close the Liquidation case. This is accompanied by the following orders:
   (a) An order to the registration authority to remove the name of the entity from the register;
   (b) Release the Liquidator from the case, but retain management of the Trust; and
   (c) Release the records of the Liquidation case to the Regulator. Details of the submitted records will be consistent with those specified by the Regulator.
4. The Liquidator continues to manage the cases for vulnerable transactions. Whatever recoveries are made are deposited into the Trust are paid out as dividends, net of legal fees.

to satisfy as much of the liabilities within the prioritisation of the waterfall in Section 5.5.8. At this stage, there are possible recoveries of the assets of the entity in the future. These are most likely to come from lawsuits to recover from identified vulnerable transactions and cases of fraudulent actions carried out by the directors of the erstwhile entity. However, these are highly uncertain. The tradeoff is to keep the case open and accrue costs of Liquidation from Liquidator fees on one hand and on the other, to close the case, dissolve the entity, but retain the Liquidation trust, so that whatever recoveries are made can be deposited into the trust net of the Liquidator costs of managing these lawsuits.

The Liquidator may apply to the Adjudicator to close down the case with estimates of the time to recovery and possible value of recovery from the vulnerable transactions. If the Adjudicator rules in favour of the application, an order to close the Liquidation case will be issued. This will trigger a set of accompanying orders as follows:

1. An order to the relevant registration authority to remove the name of the entity from its register.
2. An order releasing the Liquidator from the case.
3. An order to submit all records related to the case to the Regulator.

If the Adjudicator does not rule in favour of the application, the Liquidation case remains open. The Code permits the Liquidator to apply for the closure again after a reasonable period of time has passed.

Removal of the RP during the resolution process

The Code makes provision for the removal of the RP during the resolution process. This can be done either during an insolvency or a bankruptcy resolution process. An application can be made to the Adjudicator by the creditors committee for the removal of the RP at any time during the IRP, or by the board during the Liquidation process. In either case, this must be supported with a majority vote. Any other application for the

Box 5.26: Drafting instructions for removing an during an IRP or a Liquidation

1. The creditors committee can apply to the Adjudicator for the removal of an IP at any time during a live insolvency or bankruptcy resolution case. The application has to be accompanied with a majority vote.
2. The Adjudicator will admit an application for the removal of either the RP or a Liquidator during the resolution process, from any other party with cause shown.
3. The Code does not permit the removal to be accompanied by a new recommended replacement candidate.
4. The Code provides that the Adjudicator must apply to the Regulator for a replacement RP, and that the Regulator must respond within under 48 hours of the Adjudicator application.
5. If the application for removal is made during an active IRP, there is no extension permitted to the period of the IRP as a consequence of the removal of the RP. The date of closure of the IRP case remains the same as on the order registering the IRP case.

removal of the RP can be made to the Adjudicator with cause shown. The Adjudicator must apply to the Regulator for a replacement RP as soon as the application is made. The Regulator must recommend a replacement RP within not more than 48 hours. In case the application is to remove an RP during the IRP, the removal of the RP does not allow for an extension in the window of time permitted for the IRP: there final date of closure for the IRP remains the same as in the order registering the IRP.

5.6 Actions against fraud, malpractice and other wrongs

In the deliberations of the Committee, there are two categories of offences/wrongs against which actions can be initiated: fraud and malpractice. Further, depending upon the perpetrator of the act or omission, actions are further differentiated based on whether they can be heard by the Adjudicator, courts or the Regulator.

In the view of the Committee, bankruptcy is a legal process that is designed to give honest people a chance for a better financial future. It is therefore important that all participants in the bankruptcy and insolvency resolution processes act honestly in disclosing their true state of affairs. This approach leads to principles that guide the identification of offences/wrongs under the Code.

The first principle that the Code seeks to ensure is better symmetry of information between the creditors and the debtor. The onus of honest behaviour in this respect typically sits with the debtor who has the information advantage over the creditor. Thus, it is crucial that the debtor is honest in all disclosures and does not make false representation or conceal facts about the assets or transactions in these disclosures. If the debtor triggers the IRP, the Adjudicator will admit the case only if these records are accompanied by a signed Statement of Truth document. For example, the records of the operations and the finances of the entity are expected to be presented to the Resolution Professional managing the IRP.

The Code expects that creditors adhere to the principle of honest disclosure as well. False and frivolous claims at the time of triggering the insolvency, misrepresentation

or false claims during the negotiations in the creditors committee, false representation about claims on the assets of the entity in liquidation are all subject to appeals at the Adjudicator.

Once the IRP is admitted, the types of actions that can be made are divided into those that can be admitted during the IRP, appeals on the outcome of the IRP and those during the Liquidation Process.

5.6.1 Actions during the IRP

It may be useful to think about legal actions during the IRP as being categorised under actions made to the Adjudicator against the RP or by the RP. In any of the cases, it is important to note that:

1. The hearing of the petition and the subsequent actions taken in remedy will not cause a change in the date of closure of the IRP.
2. The charges of such petitions will not automatically become part of the IRP costs. This can vary depending upon the outcome of the appeal.

Actions against the RP

Since the RP manages the resolution process, the Adjudicator can hear petitions against the behavior of the RP. The wrongs can range from failure to adhere to processes, to misrepresentation of facts to the creditor's committee on behalf of the debtor, misrepresentation of facts to the Adjudicator on behalf of the debtor or on behalf of the creditors or the creditors committee, fraudulent action on dealing with the assets of the entity. The wrongs/offences will be specified in the Code, along with those over which the Regulator have quasi-judicial power and those which will be adjudicated in the Courts. The Code will also specify the board framework of penalties that will be applicable for each of the offences.

Action by the RP against the debtor

There are two specific instances where the RP can petition the adjudicator against the debtor, which has a material impact on the process flow of the IRP. These are actions by the RP against the debtor for a lack of cooperation of the debtor. This has often been cited as a problem by both the judges as well as the intermediaries who negotiate the settlement between the creditors and the debtor of defaulting entities in India. The current proposal seeks to mitigate this problem partly by using electronic filing of information in the information utilities. However, there will be instances where the RP will need to seek clarifications or greater detail from the debtor, who will always have the best information available about the entity.

If the debtor does not cooperate with the RP, the RP can file a petition to the Adjudicator. The Adjudicator can hold a hearing with the debtor, and either issue an order to the debtor to cooperate with the RP. If the RP does not report that the debtor has cooperated with the RP within the specified time, the Adjudicator can close the IRP case, withdraw the moratorium against debt recovery and new cases filed against the entity, ban the debtor from triggering

an IRP for a specified period, and issue an order for the debtor to pay all the costs incurred during the IRP.

The Adjudicator can also hear petitions by the RP against fraud by the debtor entity. If the Adjudicator finds sufficient evidence of fraudulent transactions on the part of the management, or the promoter, or the directors, it can pass appropriate orders.

5.6.2 Appeals/Actions after the IRP

- The following of appeals/actions that can be visualized at the end of the IRP:

1. If the outcome is liquidation, there is a window of time when appeals can be heard to change this outcome. The Code provides the period of time within which the Adjudicator must finalise her judgment on the matter. If the period of time passes without resolution of the appeal, then the Adjudicator will automatically pass the order of irreversibility of the Liquidation of the existing entity.
2. There can continue to be petitions to the Regulator on failure of the RP to adhere to processes during the IRP. These will be filed by individuals, and may attract monetary penalty in the case of failure of adherence to processes or collusion with one party in the process, or criminal liability in the case of fraudulent practices involving theft of property.
3. Actions on fraud during the IRP, with or without the collusion of the RP. Depending upon the magnitude of the fraud, the outcome of the IRP may be declared as voided by the adjudicator.
   In the case of liquidation, the appeal must be resolved before the time at which the liquidation is considered irreversible.

5.7 Penalties

The code provides for both civil and criminal liability for wrongdoing.

6 — Process for individuals

The focus of bankruptcy reform so far has been legal entities, i.e. firms registered under the Companies Act, 1956 (and 2013), as well as the Limited Liability Partnership Act, 2008. However, large parts of the credit market consists of loans to individuals, and loans to small and medium enterprises (SMEs) which are in the form of sole proprietorships. These enterprises are a large and important component of the Indian economy. According to reports by the SMB Chamber of Commerce and the Ministry of Micro, Small and Medium Enterprises, India currently has more than 48 million SMEs. These SMEs contribute more than 45% of India's industrial output, 40% of the country's total exports and create 1.3 million jobs every year. Indian SMEs employ close to 40% of India's workforce.

India has a weak record on recovery of loans to individuals and to SMEs. Either recovery is difficult and leads to creditors incurring losses, or recovery takes place through the use of coercive practices which leads to debtors incurring losses. Given the importance of such borrowers in the economy, the Committee believes that a fresh approach to individual bankruptcy is an important goal.

The goals of the process for individual insolvency and bankruptcy presented in the Code include:

- Providing a fair and orderly process for dealing with the financial affairs of insolvent individuals.
- Providing effective relief or release from the financial liabilities and obligations of the insolvent.
- Providing mechanisms that enable both debtor and creditor to participate with the least possible delay and expense.
- Providing the correct ex-ante incentives so that individuals are not able to unfairly strategise during the process of bankruptcy.

These goals overlap considerably with goals of the resolution for legal entities. There are two differences: First, in the bankruptcy process, where unlike a legal entity, the

Box 6.1 – Drafting instructions for creating a code for individuals

1. The Code will cover individuals and partnership firms.
2. The Code requires that the provisions and laws related to resolving bankruptcy and insolvency for these entities must be repealed, and replaced with provisions under this Code.

individual cannot be liquidated. Second, the Code provides for debt relief for a certain section of debtors where the chances of recovery are so low that the cost of resolving the insolvency would only become an additional burden to either the debtor or the creditor or the State.

6.1 The applicability of the Code

The Committee considers the following categories of entities to whom the individual insolvency and bankruptcy provisions shall apply:

- Sole proprietorships where the legal personality of the proprietorship is not different from the individual who owns it.
- Personal guarantors
- Consumer finance borrowers
- Student loan borrowers
- Credit card borrowers
- Farmers
- Micro-finance borrowers
- Partnership firms

When individuals encounter financial distress, it is likely that they are unable to make payments to entities, such as landlords and operational creditors. It is likely that, for small individuals, such non-financial creditors bear the costs of individual financial distress. Jurisdictions such as the UK allow for individuals to declare insolvency if they cannot pay arrears with rent, utility bills, telephone bills, council tax and income tax, as well as hire purchase agreements.

A similar question of what type of credit should be in the list of "qualifying debts" for which an individual may seek relief under the Code. While there are difficulties in verifying information surrounding these claims, the Committee agreed that non-financial creditors should not be excluded, as it is likely that without resolution of debts of non-financial creditors, insolvency resolution will not be complete.

Finally, in the existing legal framework, individuals are geographically divided across the respective Acts, Presidency Towns Insolvency Act, 1909 (PTIA) for Calcutta, Bombay and Madras and the Provincial Insolvency Act, 1920 (PIA) for the rest of India, respectively. These will need to be repealed.

6.2 Overall procedure

A sound bankruptcy and insolvency framework requires the existence of an impartial, efficient and expeditious administration. This is more likely to be possible for individual insolvency when administrative proceedings are placed outside the court of law. As with legal entities, what is visualised for individuals is to enable a negotiated settlement between creditors and debtor without active involvement of the court. The principle is to allow greater flexibility in the repayment plans, and a time to execute the plans, that can be acceptable to both parties. If creditors and debtors can settle on such a plan out of court, what matters for the system is that there is a record of this settlement and that it can affect the premium of future credit transactions. Economies across the world are increasingly placing administrative proceedings outside of the courts. This seems to be a natural way forward for India as well.

The Committee proposal for an individual bankruptcy law envisages two distinct processes as can be seen from Figure 6.1. The first is the "Fresh Start Order" (henceforth referred to as FSO) is a process by which individuals with assets and income lower than specified amounts will be eligible for a discharge from their qualifying debts (the aggregate of which must not exceed the prescribed amount). Their debts will be written off, giving the debtor a "fresh start". Both the default and the FSO will be recorded in the individual's credit history.

The second is the "Insolvency Resolution Process" (IRP), which will involve a process of negotiation between debtors and creditors supervised by a Resolution Professional (RP). The formal oversight of the process of negotiation by the RP under the shadow of the law with no long term adversarial effects to the debtor is a critical step towards a modern insolvency framework. If the negotiation succeeds, it will lead to a repayment plan which the RP will execute. This gives the debtor an "earned start". The debtor gets a discharge but only as per the terms of the negotiation. However, if negotiations fail, then the matter will proceed to "bankruptcy resolution process" which is led by a Bankruptcy Trustee appointed by the Adjudicating Authority. In bankruptcy resolution, the debtor will get a discharge from bankruptcy after a specified time.

The Committee debated on the course of action in the event of disability or death of the debtor during any of the processes. The Committee agreed that at no point should any external event lead to a deviation from the repayment plan as this precludes the possibility of foul play by either party to turn the plan to their unfair advantage. The parties may choose to purchase life insurance as part of the repayment plan to provision for such a possibility. This is reflected in the choices described in the following sections.

6.3 Triggering insolvency

6.3.1 Who can trigger insolvency?

As with insolvency of legal entities, the Committee observes that there is no standard, indisputable way to establish insolvency for an individual. The Code prescribes different

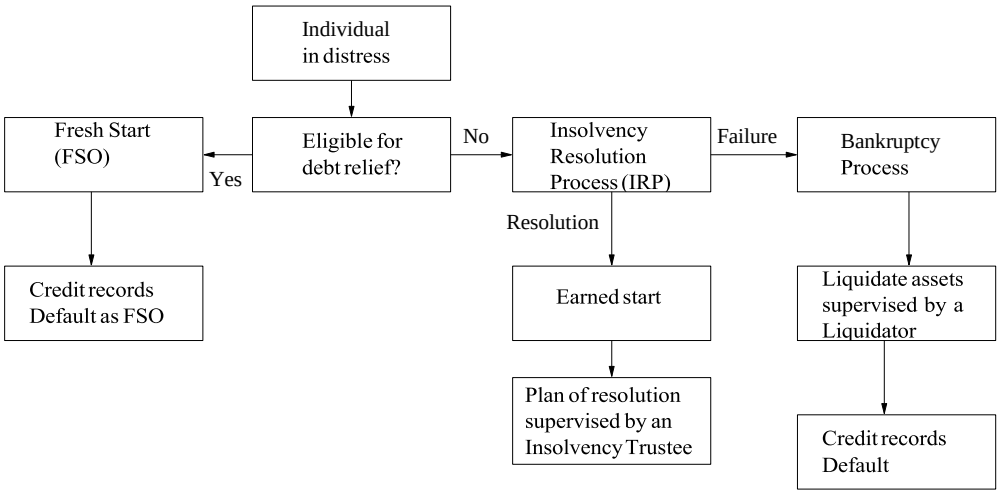

Figure 6.1: The process flow of individual insolvency

rules for who can trigger insolvency for the FSO and the IRP, and different processes on how the trigger can be accepted in each case.

Fresh Start Order, FSO

The FSO is a process of discharge of the qualifying debts of the debtor if the assets and income of a debtor are below a specified amount . Thus, debtors who have assets and income below this specified level, and do not own their home, are eligible for an FSO. Hence, only the debtor can file for a FSO. The proposed thresholds in the Code have been provided taking into account the relevant data and the Central Government shall have the power to revise the relevant assets and income test from time to time. These should ideally be increased at regular intervals in line with inflation measured by the Consumer Price Index (CPI). The home-ownership clause is important, because if the debtor owns a home, then this should be available for sale, the proceeds of which can be used to repay the full (or partial) amount due to the creditor. Further, the Code shall also specify the maximum amount of qualifying debts for which an application can be made.

The FSO application cannot be made for debts specifically excluded from the FSO. These include secured debts, court fines, child support payments, student loans, money owed under a criminal charge, and debts resulting from certain personal injury claims against the debtor. All other debts qualify for an FSO. An indicative list includes, but is not restricted to, credit card debt, unsecured bank overdrafts and loans, unsecured loans from finance companies, credit from money-lenders, employers, friends and family, and debts to customers who have paid for goods or services that the debtor was unable to supply.

The debtor should not be under another FSO, or IRP prior to the application. The debtor cannot jointly make an FSO application with a spouse (or de facto partner). Each individual has to make an individual application.

Insolvency Resolution Process, IRP

The application for an IRP can be made both by the debtor and the creditor. The IRP application cannot be made for debts specifically excluded from the IRP. These include court fines, child support payments, student loans, money owed under a criminal charge,

Box 6.2: Drafting instructions for who can trigger the individual resolution process

1. The Fresh Start Order (FSO) Process can be triggered by the debtor by submitting documentation specified in the Code to the Adjudicating authority.
2. The FSO cannot be made jointly with a spouse (or de facto partner). Each debtor must make an individual application.
3. The Insolvency Resolution Process can be triggered by either the debtor or the creditors by submitting documentation specified in the Code to the Adjudicator.
4. The Code specifies who is a debtor or a creditor for the purposes of triggering the insolvency resolution process (IRP).
5. The debtor should not be under another FSO, or IRP, or should not be an undischarged bankrupt prior to the application.
6. The Code specifies the debts that qualify for resolving individual insolvency.

and debts resulting from certain personal injury claims against the debtor. All other debts qualify for an IRP. The debtor should not be under another FSO, or IRP, or be an undischarged bankrupt prior to the application.

6.3.2 What is the process for triggering insolvency?

As the debtor has more information about the entity than the creditor, a debtor application to trigger the process must include information so as to reduce the asymmetry that the creditor has in evaluating insolvency. This requires disclosure of all information pertinent to the insolvency. The debtor may hire an RP to help with the application. The application must contain:

1. A list of all debts, secured and unsecured, owed by the debtor on the date of the application.
2. The amount of each debt, secured and unsecured, owed by the debtor on the date of the application.
3. The names of creditors to whom each debt is owed.
4. Details of security (collateral) held in respect of any of the debts.
5. Other financial information w.r.t to assets and cash flow status of the debtor for upto two years prior to the application date.

Since it is difficult to verify each claim made by the debtor, she will have to also submit a "Statement of Truth", which implies that if any part of the information in the application is found to be fraudulent, or to have been deliberately hidden, the applicant will be liable for criminal penalties. The Adjudicator will charge a monetary penalty for a frivolous application.

In the event that the creditor has evidence of default on payments, the creditor can trigger insolvency. The creditor may appoint an RP to trigger the process.

The Committee debated on whether the criterion of "reasonable prospect" of inability to pay debts should be valid for triggering legal proceedings by a creditor. On the one hand, such a clause can help with early detection of bankruptcy and lead to saving of asset value of debtors. On the other, ambiguity around the definition of reasonable prospect

Box 6.3: Drafting instructions for triggering the Insolvency Resolution Process

1. There are different requirements for a debtor and for a creditor to trigger the insolvency resolution process.
2. The debtor will have to submit proof of failure to pay debts when they are due. The application must contain
   (a) A list of all debts, secured and unsecured, owed by the debtor on the date of the application.
   (b) The amount of each debt, secured and unsecured, owed by the debtor on the date of the application.
   (c) The names of creditors to whom each debt is owed.
   (d) Details of security (collateral) held in respect of any of the debts.
   (e) Other financial information w.r.t to assets and cash flow status of the debtor.
3. The debtors' application must contain a "Statement of Truth" which implies that if any part of the information in the application is found to be fraudulent, or to have been deliberately hidden, the applicant will be liable for criminal penalties.
4. The application of the creditor must contain
   (a) The most recent information regarding the debtor that the creditor has in possession
   (b) Record of debts owed by the debtor to the creditor submitting the application
   (c) Record of default on payments by the debtor and evidence substantiating such default.
5. The application for an FSO and IRP must be accompanied by a non-refundable fee.

can induce delays into the process. It is possible that, in situations where the balance of power is tilted in favour of the creditor, the clause may get used to harass debtors. The Committee took the view, therefore, to exclude the clause. This may be allowed when the information systems support the creditors ability to reliably support such a claim.

The application of the creditor should contain evidence of default on payments by the debtor that is filed in a registered information utility. In case the evidence is not present in the information utility, the creditor will have to provide other relevant evidence of default. In case of loans to individuals, especially between family and friends, it may be difficult to mandate registration in an information utility as a prerequisite for making an application. The hope, however, is that the ease of presenting evidence from the records in the information utility incentivise debtors as well as creditors to register the same voluntarily.

The application must be accompanied by a non-refundable fee to cover the costs of the procedure.

6.3.3 Effect of filing an application at the Adjudicator

The application for IRP will be made to the relevant Adjudicator. A key element in any process is to evaluate the veracity and validity of the application. However, given that records in the case of individuals may be difficult to verify in a short span of time, the application will only be checked for adhering to the specified format. As described earlier, the Statement of Truth filed by the debtor will imply that if any information in the application is found to be fraudulent, or to have been deliberately hidden, the

Box 6.4: Drafting instructions for effect of filing an application at the Adjudicator

1. If the application confirms to the required format, the Adjudicator will accepted it immediately.
2. A moratorium will commence as soon as the application is filed. This moratorium will end once the application is accepted.
3. During this period no creditor will be permitted to take any action to recover debts or to initiate any other legal proceedings against the debtor.
4. If the applicant has proposed a RP the Adjudicating Authority will seek confirmation from the Regulator within a specified period of time that the proposed RP has relevant expertise to act as one, and that no disciplinary proceedings exist against her.
5. If the Regulator confirms that the proposed RP has the relevant expertise and that there are no disciplinary proceedings against her, the Adjudicating Authority will appoint the RP.
6. If the application is made without an RP, the Adjudicator will request the Regulator to appoint an RP to the case.
7. The Regulator must do so within a specified time period.

applicant will be liable for criminal penalties.

If the application meets the format requirements, it will be accepted. A moratorium will commence as soon as the application is filed, to avoid the possibility of action against the debtor between the filing and acceptance of the application.

If the application is made with the help of a RP, the Adjudicator will check the database of the Board for any disciplinary proceedings against the RP. If there are no disciplinary proceedings, the Adjudicating Authority will appoint the RP.

If the application is made without the help of a RP, or if the Adjudicator finds disciplinary proceedings against the RP chosen by the debtor, the Adjudicator will request the Board to appoint an RP to the case.

6.3.4 The process for acceptance of the Application

Once an RP is appointed, the RP will evaluate the application within a specified period of time. If the application is for FSO, the RP will determine if the applicant is indeed eligible for the FSO. The RP may raise queries to the applicant of the receipt of the application. If the application does not meet specific requirements, or if the queries of the RP are not answered within a specified time period, the RP will recommend refusal of the application. On receipt of the recommendation of acceptance of the application by the RP, the Adjudicator will register the FSO or IRP as the case may be.

If at any point till the conclusion of the FSO or the IRP, the appointed RP is unable to function in her role, the Adjudicator will record the failure and request the Board for another RP. The details of the RP will be changed in the details of the individual resolution case.

Box 6.5 – Drafting instructions for the acceptance of the application by the adjudicator

1. The RP will evaluate the application within a specified time period.
2. The RP will present either an approval or a rejection report.
3. The RP may recommend refusal if the application does not meet all the specific requirements, or if the information provided is not satisfactory. The RP may also recommend refusal if queries raised are not answered within a specified time period.
4. On receipt of recommendation of acceptance by the RP, the Adjudicating authority will accept the application within a specified period of time.
5. The Order must be communicated to the debtor as well as the creditors within a specified time period.
6. On receipt of recommendation of refusal by the RP, the Adjudicating authority will refuse the application within a specified period of time.
7. If the application is refused, the Adjudicating Authority will pass an Order refusing the application. The Order will permit the debtor and creditors to file a separate application for bankruptcy.
8. If the application is refused, the applicant will not be able to file an FSO or an IRP as the case may be again in the next twelve months.
9. If at any point the appointed RP is unable, or unwilling to function in her role, another RP may be appointed. The Adjudicator will record the failure of the original RP and change the details of the RP in the records of the individual resolution case.

6.4 The process after acceptance of the application

6.4.1 Moratorium period

One of the goals of having an insolvency law is to ensure the suspension of debt collection actions by the creditors, and provide time for the debtors and creditors to re-negotiate their contract. This requires a moratorium period in which there is no collection or other action by creditors against debtors. The moratorium period will have the following characteristics:

1. **Applicability of the moratorium** The Code envisages two kinds of moratoriums. The first is the moratorium that takes effect at the time of application as discussed in the previous section. The second commences once the FSO or the IRP application is accepted by the Adjudicator.
   A creditor can object to the inclusion of his particular debt in the list of debts eligible for the FSO within a specified time frame that falls within the moratorium period. The RP will evaluate this request. If the creditors objection is accepted by the Adjudicating authority after investigation by the RP, that particular debt may be struck off the list of "qualifying debts".[15]
   During the period of the moratorium, all creditors, including secured creditors who may not be part of the list of "qualifying debts" for which an FSO or IRP is sought, will not be permitted to take any action to recover debts or initiate any other legal proceedings against the debtor. In effect, the creditor will not have any

[15] As described earlier, an indicative list includes, but is not restricted to, credit card debt, unsecured bank overdrafts and loans, unsecured loans from finance companies, credit from money-lenders, employers, friends and family, and debts to customers who have paid for goods or services that the debtor was unable to supply.

remedy in respect of the debt.

2. **Public announcement of IRP and collection of claims**
   The Adjudicator will issue an order for public announcements of the IRP registered for the entity, with a location where all creditors can submit any credit claims against the entity. This ensures that all creditors have the opportunity to lodge their claim into the process of resolving insolvency, and realisation during bankruptcy proceedings if negotiations fail.
   The claims collection announcement includes publishing the announcement of the IRP in newspapers, and other public media. The claims will be collected and maintained by the RP in the records of the individual resolution case.
3. **Time period of the moratorium**
   In the case of the FSO, the moratorium will remain for six months from the date of the acceptance of the application. This ensures that debt relief is not without its costs, as certain restrictions apply to the debtor in the moratorium period.
   In the case of an IRP, it is important to ensure that the debtor is incentivised to offer a repayment plan to the creditor. In order to ensure that incentives are aligned, the moratorium should before a clearly defined, and fixed period of time. The moratorium will, therefore, remain for six months or till the debtor and creditor agree on a repayment plan, whichever is earlier. In this context, it is presumed that the debtor does intend to make a proposal to the creditor regarding a repayment plan, and that all negotiations have to necessarily take place within this moratorium period.
4. **Preparation of the repayment plan**
   During the moratorium period, the debtor, in consultation with the RP needs to prepare a repayment plan. The proposal should include not only the balance sheet of the individual, but also details of how the debtor proposes to repay creditors, and should also provide reasons why the creditors may accept the plan. In addition, the RP should submit a report on the repayment plan, stating that the plan is legally valid, and has a reasonable prospect of being approved by the creditors, and propose a date for the meeting of the creditors. The plan and the report prepared by the RP should be submitted to the Adjudicating Authority. In addition, this proposal should be sent to every creditor by the RP, along with the date for the proposed meeting between the debtor and creditors.
5. **Changes in the application**
   In order to ensure that there is no fraud, the debtor should be required to notify the Adjudicator (through the RP) if she is aware of any error or omission in the information supplied in the application for insolvency, or if there is any change in her financial circumstances since the date on which the insolvency trigger was made, and before the moratorium period ends. This includes information such as an increase in income, or acquiring of property.

6.4.2 The process of negotiation

The goal of the IRP is to facilitate all types of repayment plans that are acceptable to the debtor and creditors by placing the proceedings that lead to an agreement of such a plan outside the court of law. This makes the stage of negotiation an important one in

Box 6.6: Drafting instructions for the moratorium period during the IRP

1. A moratorium period will first commence from the date of application, and then a second moratorium will commence from the date that the insolvency resolution application is accepted. The moratorium will apply to all creditors, including those whose debt is not part of the application.
2. The moratorium period for both FSO and IRP will be six months. In the case of the IRP, the moratorium period may end before six months if the debtor and creditor agree on a repayment plan.
3. During this period no creditor will be permitted to take any action to recover debts or to initiate any other legal proceedings against the debtor.
4. A creditor can object to the inclusion of a particular debt in the list of debts eligible for the FSO within a specified time frame that falls within the moratorium period. The Adjudicator will request the RP to evaluate this objection. If the creditors objection is accepted after investigation by the RP, that particular debt may be struck off the list of qualifying debts.
5. All creditors will have the opportunity to lodge their claim into the IRP.
6. The debtor will make a proposal of a repayment plan to the creditors for with the help of an RP.
7. The proposal should contain
   (a) The balance sheet of the debtor, include assets and cash-flows for the past two years.
   (b) A proposal with the details of the repayment plan.
   (c) The repayment plan must include fees to be paid towards the IRP.
8. The RP should prepare a report on the plan proposed by the debtor. This report should state that the plan is legally valid, and likely to be accepted by the creditors. Both the plan, and the report should be submitted to the Adjudicating Authority, along with a proposed date for the creditors meeting.
9. The proposed repayment plan should also be sent to the creditors by the RP.
10. The debtor will be required to notify the Adjudicating Authority if she becomes aware of any error or omission in the information supplied in her application for insolvency, or if there is any change in her financial circumstances since the date on which the insolvency trigger was made, and before the moratorium period ends.

the insolvency process.

Once the repayment plan has been lodged with the Adjudicating Authority and sent to all creditors, the latter will be summoned to a meeting. The details of the creditor meeting, including the names of creditor, the name of the debtor and the location of the meeting must be placed in the records of the resolution case. Secured creditors may choose to not be a part of the meeting.

In the case of negotiations between an individual debtor and creditors, it is possible that the balance of power tilts in favour of the creditor. The creditor may threaten the debtor with a court-led bankruptcy unless she refuses to part with essential items of livelihood. To avoid such an event, the Committee agreed that the meeting should be conducted in accordance with rules specified by the Code. This should include documentation of a list of debts, income and assets that cannot be claimed through negotiations, unless voluntarily offered by the debtor. These include necessary clothing and household items, tools of trade to an indexed amount, financial assets in pension and provident funds (below a specified amount), and child support payments. The debtor also has to be present at the meeting. The creditors may propose modifications, but these can become part of the repayment plan only on the consent of the debtor.

The final arrangement has to have a majority vote of creditors with 75% in value. Creditors absent at the meeting will have to accept the decision of those present. If the secured creditor chooses to vote in the creditors meeting, she will have to give up her right to enforce security during the period of the repayment plan. She will then be bound by the terms of the repayment plan. If the secured creditor chooses to not vote in the creditors meeting, the final arrangement cannot affect the right of a secured creditor to appropriate or enforce her security, unless the secured creditor consents to the same. The repayment plan must include fees to be paid towards the IRP. Once a decision on the repayment plan has been made, the same must be reported to the Adjudicator.

The entire process of negotiation should be concluded within the moratorium period of six months. In the event of the death of the debtor during the period of negotiations, the legal representative of the debtor may assume responsibility for the same.

Once a consensus has been reached, the Adjudicator should accept the agreement without any modification, and give the stamp of approval which will give effect to the agreement. Failure to reach a consensus, or refusal by the next-of-kin to participate in the negotiation process will lead to the failure of the IRP.

6.4.3 Implementation of the repayment plan

A critical feature of orderly resolution is the actual implementation of the repayment plan agreed to by both the debtor and creditors. This requires an impartial authority to oversee the process of repayment, either through the sale of assets, or through the transfer of part of future income of the debtor to creditors. The terms of the agreement will bind all parties affected by it.

The parties concerned may choose to continue with the same RP, or appoint a new RP

Box 6.7: Drafting instructions for the process of negotiation

1. The repayment plan proposal should be sent to all creditors, and all creditors should be summoned to a creditors meeting.
2. The details of the creditor meeting, including the names of creditor, the name of the debtor and the location of the meeting will be recorded in the resolution case.
3. The proposal may be modified, but the final proposal must have full consent of the debtor.
4. The Code shall specify the rules of negotiation which will include a list of debts, income and assets that cannot be claimed through negotiations, unless voluntarily offered by the debtor.
5. If the secured creditor chooses to vote in the creditors meeting, she will give up her right to enforce security during the period of the repayment plan and will be bound by the terms of the repayment plan.
6. If the secured creditor chooses to not vote in the creditors meeting, the final arrangement will not affect rights of secured creditors without her consent.
7. The final decision will be reported to the debtor, creditors and the Adjudicator. It should contain
   (a) The repayment plan, or the failure to agree to a repayment plan
   (b) The resolutions that were discussed at the meeting and the decision on such resolutions
   (c) List of creditors who were present (or represented) at the meeting and their respective voting records
8. The Adjudicating Authority will pass a written Order on the basis of the final decision reported.
9. The entire process of negotiation should take place within the moratorium period of six months.

to oversee the implementation of the plan. The time-frame for the implementation will be a function of the terms of agreement of the plan. However, the terms of agreement of the plan will prohibit creditors from taking any action against the debtor, except as agreed in the plan. If the debtor is found in violation of the agreement in the repayment plan, the Adjudicator may revoke the voluntary agreement.

If the debtor becomes disabled during the implementation of the plan, the debtor and creditors may once again re-negotiate on a new plan. If the debtor dies during the implementation of the plan, then the legal representative of the debtor can choose to continue with the repayment plan, or request for an Adjudicator led bankruptcy process which will lead to the sale of the deceased debtors assets up to the value of debt owed to creditors at that point in time. This ensures that the next-of-kin continues to bear the cost either through period cash flow payments to creditors, or some loss of inheritance through the sale of the debtors assets.

Once all the repayments have been made, the RP should send a notice to the effect to both the Adjudicating Authority, as well as all persons who are bound by the repayment plan. If the repayment plan comes to an end prematurely, i.e. before all repayments have been made, the RP should notify the Adjudicating Authority of the same. The Adjudicating Authority should then pass an order stating that the IRP was not completed, and the debtor or the creditors may apply for bankruptcy.

Box 6.8: Drafting instructions for implementing the repayment plan

1. Once the repayment plan is lodged with the Adjudicator, the terms of the agreement will bind all parties affected by it.
2. The parties concerned may choose to continue with the same RP, or appoint a new RP to oversee the implementation of the plan.
3. The time-frame for the implementation will be defined in the terms of agreement of the plan.
4. The terms of agreement of the plan will prohibit creditors from taking any action against the debtor, except as agreed in the plan.
5. If the debtor is found in violation of the agreement in the repayment plan, the Adjudicator may revoke the voluntary agreement.
6. If the debtor becomes disabled during the implementation of the plan, the debtor and creditors may once again re-negotiate on a new plan.
7. If the debtor dies during the implementation of the plan, then the legal representative of the debtor can choose to continue with the repayment plan, or request for an Adjudicator led bankruptcy process which will lead to the sale of the deceased debtors assets up to the value of debt owed to creditors at that point in time.
8. Once all the repayments have been made, the RP will send a notice to the effect to both the Adjudicating Authority, as well as all persons who are bound by the repayment plan.
9. If the repayment plan comes to an end prematurely, i.e. before all repayments have been made, the RP will notify the Adjudicating Authority of the same. The Adjudicating Authority will then pass an order stating that the IRP was not completed, and the debtor or the creditors may apply for bankruptcy.

6.4.4 Restrictions on the debtor

For the processes under the Code for individuals to be effective, it is imperative that there are restrictions on what actions the debtor can undertake during the fresh start process. The restrictions also serve to incentivise debtors to manage debts such that they minimise the possibility of an insolvency. Such restriction are not imposed on the debtor under the insolvency resolution process, as this process is for bonafide negotiations between the debtor and the creditors for the purposes of repayment of debt by the debtor.

The Code will specify restrictions on the debtor from the period of acceptance of application till the debtor is awarded a "fresh start" (at the end of the fresh start process). Specifically, the debtor will not be able to participate as a director of any company, will have to inform other trading partners that she is undergoing such process, will have to make all assets, and financial statements available, including those of associated entities such as companies and trusts to the RP. The debtor will have to inform any potential lender about the pending process before borrowing fresh amounts. The debtor will not be permitted to travel overseas without the permission of the Adjudicating Authority.

6.4.5 Replacement of the resolution professional

As the RP plays a key role in the life-cycle of the insolvency resolution process - from the time of the acceptance of the application, the design and agreement of the repayment plan, to the final execution of the plan, it is possible that unfair conduct of the RP jeopardises the interests of either party. If the debtor or the creditor have the ability to request for a replacement of a RP, then this serves as another deterrent to bad behaviour. The Code, therefore, allows for both the debtor and the creditor to apply to the Adjudicating Authority requesting for replacing the RP. The Code will

specify the grounds on which

Box 6.9: Drafting instructions for restrictions on the debtor

1. The Code will specify restrictions on the debtor till the debtor is awarded a fresh start.
2. The restrictions will include:
   (a) The debtor will not be permitted to dispose assets.
   (b) The debtor will have to specify to other trading partners that the debtor is under the process of the FSO.
   (c) The debtor will have to inform all parties about the on-going FSO before entering commercial or financial transactions.
   (d) The debtor will have to make all assets, and financial statements available, including those of associated entities such as companies and trusts.
   (e) The debtor will not be permitted to travel without the permission of the Adjudicating Authority.

Box – 6.10 – Drafting instructions for replacement of the insolvency professional

1. The debtor or creditor may apply to the Adjudicating Authority requesting the replacement of the RP.
2. The Code will specify the grounds on which such an application may be made.
3. In addition, the creditors may request for a different RP for the implementation of the repayment plan.
4. The Adjudicating Authority must form a *prima facie* opinion on whether to accept or reject the application within a specified time frame.
5. If the Adjudicating Authority accepts the application, it should check the basic credentials of the proposed RP with the Board.
6. The Board should send a response to the Adjudicating Authority recommending or rejecting the appointment of the proposed RP within a specified time period.
7. On the receipt of the recommendation approving the appointment of the RP from the Board, the Adjudicating Authority should appoint the new RP.
8. The Board should commence an enforcement action if the replacement was requested on grounds that the RP was not performing as per the code of conduct.
9. If, however, the Board finds that the request for replacement was made with an intent to defraud or to delay the IRP, the applicant may be directed to compensate the RP.

a replacement can be requested, and the procedure to be followed by the Adjudicating Authority and the Board for finding a replacement.

6.5 Bankruptcy proceedings

It is widely recognised that the bankruptcy process must be strengthened as part of ensuring a robust legal framework. The Committee recommended that once the bankruptcy process has started, it should be established as irreversible as quickly as possible, and be concluded in as short a time as is reasonably possible. One way to ensure this is to provide as much clarity about the steps of bankruptcy as is possible in the design of the relevant provisions of the Code. These are discussed in the following sections.

6.5.1 Bankruptcy application

The process flow drawn by the Committee envisages an Adjudicator-led bankruptcy procedure in the event of failure of the IRP. This failure could be at the time of the application, at the time of negotiations around the repayment plan, or at the time of the actual implementation of the repayment plan. There are two differences w.r.t legal entities. First, there is no provision for a fast-track IRP to bankruptcy. Second, the failure of IRP does not lead to automatic bankruptcy - it only makes it possible for either the debtor or creditor to make a separate application for bankruptcy. This is because the Committee believed that in the case of individual insolvency, there should be greater effort at the possibility of voluntary negotiations such that personal assets of the debtor remain with her to the extent possible. The stigma of bankruptcy is higher for individuals, hence failure of an IRP should not automatically lead to bankruptcy proceedings. The Code describes three ways in which bankruptcy can be triggered for individuals:

1. **By the failure of the acceptance of the application of the IRP by the Adjudicating Authority-**
   If at the time of application the IRP is rejected by the Adjudicating Authority due to the non disclosure of information requested by the RP, or if the application was made with the intention to defraud creditors or the RP, the creditors can trigger a bankruptcy.
2. **By the failure of negotiations during the IRP.**
   If the process of negotiation of an on-going IRP fails, or if the IRP cannot conclude with a plan within a specified time period, either the debtor or the creditor can apply for a bankruptcy.
3. **By the failure of adherence to terms agreed to in negotiations in a previous IRP.**

Creditors can also apply for bankruptcy when the debtor failed on terms that were part of the solution of a previous IRP. Here, the main objective is to minimise the time to bankruptcy and maximise value. Such an application is permitted if this is triggered within a reasonable period of the previous IRP having been resolved.

Once a bankruptcy petition is filed, it cannot be withdrawn without the leave of the Adjudicating Authority.

6.5.2 Effect of the application

There is likely to be a period of time between the application of bankruptcy and the acceptance of the application. This makes it important to have provisions for a moratorium period even before the application has been accepted. This is also the period where a professional playing the role of a "bankruptcy trustee" needs to be appointed. The Committee proposes a moratorium period at the time of the application and also makes recommendations regarding the appointment of the bankruptcy trustee.

6.5.3 Effect of the bankruptcy order

Once the bankruptcy order is passed, the estate of the bankrupt will vest with the Trustee, and become divisible among the creditors. To expedite the process of the sale of assets,

Box 6.11: Drafting instructions for triggering bankruptcy

1. There are three reasons to trigger bankruptcy:
   - **(a) Failure by the debtor or creditor to get the IRP application accepted by the Adjudicating Authority**
     The failure can be due to the non disclosure of information requested by the RP, or if the application was made with the intention to defraud creditors or the RP.
   - **(b) Failure by creditors and debtors to negotiate a solution in an ongoing IRP.**
     The failure can be either an explicit failure to agree on a solution, or that the ongoing IRP has hit the time limit permitted in the Code.
   - **(c) Application by financial creditors for a bankruptcy on a failure to adhere to terms solution of a previous IRP.**
     The previous IRP should have been resolved within a *reasonable time* as specified in regulations issued by the IRB from time to time from the application to trigger bankruptcy.
2. The application may be made by creditors of the debtor (singly or jointly with other creditors), or by the debtor.
3. If the debtor has deceased at the time of the bankruptcy application, the notice should be served to the legal representative of the deceased debtor.
4. The applicant may nominate a resolution professional as the bankruptcy trustee for the purposes of the bankruptcy application.
5. The application of the debtor must include:
   (a) Proof of application of the IRP.
   (b) The records of the IRP, and the proof of failure of the IRP.
   (c) The order passed by the Adjudicating Authority allowing for the application of bankruptcy
   (d) Particulars of the creditors of the debtor
   (e) Particulars of debts owed to the creditors
   (f) Particulars of securities held in respect of the debt
   (g) Audited statement of list of assets and list of liabilities of the debtor
   (h) Information of the debtor
6. The application of the creditor must include:
   (a) Records of the previous IRP, and the negotiation solution
   (b) The order passed by the Adjudicating Authority allowing for the application of bankruptcy
   (c) Details of the debts owed by the debtor to the creditor as on the date of the bankruptcy application
   (d) Information about the individual that is necessary to complete the bankruptcy application
   (e) If the applicant is a secured creditor, she should provide a statement that she is willing, in the event of a bankruptcy order being made, to give up his security for the benefit of all the creditors of the bankrupt, or that the application is made only in respect to the unsecured part of the debt.
   (f) If the secured creditor makes an application only in respect to the unsecured part of the debt, then she should provide an estimated value of the unsecured part of the debt.
7. The bankruptcy application must be submitted along with a prescribed non-refundable fee.

Box 6.12: Drafting instructions for the effect of filing of application

1. A moratorium will commence as soon as the application for bankruptcy is filed. This moratorium will end once the application is accepted.
2. During this period no creditor will be permitted to take any action to recover debts or to initiate any other legal proceedings against the debtor.
3. If the applicant has proposed a bankruptcy trustee the Adjudicating Authority will seek confirmation from the Board within a specified period of time that the proposed bankruptcy trustee has relevant expertise to act as one, and that no disciplinary proceedings exist against her.
4. If the Board confirms that the proposed bankruptcy trustee has the relevant expertise and that there are no disciplinary proceedings against her, the Adjudicating Authority will appoint the bankruptcy trustee.
5. If the application is made without a bankruptcy trustee the Adjudicator will request the Board to appoint an RP to the case. The Board must do so within a specified time period.
6. The Adjudication Authority should pass a bankruptcy order within a specified time period of receiving the confirmation from the Board regarding the bankruptcy trustee.
7. The order should provide for the appointment of the bankruptcy trustee. The Trustee can be changed during the process of bankruptcy.
8. The Code will provide provisions on resignation, replacement or vacancy in the office of the Trustee.
9. A copy of the order should be sent to the debtor as well as the creditors.

the following steps need to be taken:

1. **Estate of the trust** The Code will enumerate on what constitutes the estate of the bankrupt. This is important so as to provide clarity on all that is available for realisation in the process of bankruptcy.
2. **Statement of affairs** The bankrupt will be required to submit his statement of affairs to the bankruptcy trustee within a specified time period from the bankruptcy commencement date. The statement of affairs should provide information on the creditors of the debtor, the debts, assets and liabilities, and other information as may be necessary.
3. **Notice inviting claims from creditors**
   The bankruptcy proceedings should give an opportunity to all creditors to lodge their claims. This involves dispatching notices to all the creditors listed in the application, as well as putting up a public notice giving details of the bankruptcy order for those creditors who may have been missed in the application.
4. **Registration of claims and final list of creditors**
   The creditors will be required to register their claims with the bankruptcy trustee in a specified format within a specified period of time. Secured creditors who realise their security will have to prove the balance due after deducting the net amount realised. They can prove the whole claim if they surrender the security to the trust. Once the date for registration of claims has passed, the bankruptcy trustee should prepare a final list of creditors of the bankrupt, also within a specified period of time.
5. **Meeting of creditors**
   Once a final list of creditors has been made, all the creditors should be summoned for a creditors meeting. The meeting notice should be issued within a specified

Box 6.13: Drafting instructions for effect of the bankruptcy order.

1. The Code will enumerate on what constitutes the estate of the bankrupt.
2. The bankrupt will be required to submit his statement of affairs to the bankruptcy trustee within a specified time period from the bankruptcy commencement date. The statement of affairs should provide information on
   (a) creditors of the debtor
   (b) debts owed to the creditors
   (c) property owned by the debtor and his immediate family
   (d) books of accounts of the debtor
   (e) legal proceedings pending against her or her immediate family, to his knowledge.
3. The bankruptcy trustee will dispatch notices to all the creditors listed in the application.
4. The bankruptcy trustee will put a public notice giving details of the bankruptcy order for those creditors who may have been missed in the application.
5. The creditors will be required to register their claims with the bankruptcy trustee in a specified format within a specified period of time.
6. Secured creditors who realise their security will have to prove the balance due after deducting the net amount realised. They can prove the whole claim if they surrender the security to the trust.
7. The bankruptcy trustee will prepare a final list of creditors of the bankrupt within a specified period of time.
8. The bankruptcy trustee will summon the creditors for a creditors meeting. The meeting notice should be issued within a specified period of time from the date of the bankruptcy order.
9. All creditors summoned to the meeting (or their proxies) will be entitled to vote in respect of the resolutions in the meeting.
10. Votes will be calculated according to the value of debt owed to the creditor at the bankruptcy commencement date.
11. A creditor who is a member of the immediate family or who is an associate, of the bankrupt will not be entitled to vote.

period of time from the date of the bankruptcy order. All creditors summoned to the meeting (or their proxies) will be entitled to vote in respect of the resolutions in the meeting. Votes will be calculated according to the value of debt owed to the creditor at the bankruptcy commencement date. Since the vote of the immediate family members or associates of the bankrupt may be biased, such a creditor will not be entitled to vote.

6.5.4 Restrictions on the bankrupt

For the process of bankruptcy to be effective, it is imperative that there are restrictions on what actions the bankrupt can undertake and that she is also subject to certain disqualifications, from the date of acceptance of the application for bankruptcy till the passing of the discharge order. The restrictions / disqualifications are of a nature similar to the restrictions as enumerated for the fresh start process.

6.5.5 Functions of the Trustee

In being appointed by the Adjudicator, the Trustee is vested with the rights and powers that the debtor would have had if she had not become bankrupt. In addition, the Trustee has recovery powers that the debtor would not have. Any property of the debtor automatically vests in the Trustee, who is not required to take any action for this 'vesting'

Box 6.14: Drafting instructions for restrictions on the bankrupt

1. The Code will specify restrictions on the bankrupt from the date of the bankruptcy commencement. The bankrupt will:
   (a) not be permitted to be a director of any company, or directly or indirectly take part in or be concerned in the promotion, formation or management of a company
   (b) be required to inform his business partners that he is undergoing a bankruptcy process
   (c) prior to entering into any financial or commercial transaction of a pre-scribed value, either individually or jointly, inform all the parties involved that he is undergoing a bankruptcy process
   (d) be incompetent to maintain any action, other than an action for damages in respect of an injury to his person, without the previous sanction of the Adjudicating Authority
   (e) be permitted to travel overseas only with the permission of the Adjudicating Authority

to occur.

The function of the Trustee is to preserve and protect the value of the assets until a formal order of bankruptcy is passed, at which time the Trustee has to maximise the value in sale. In undertaking this role, the Trustee verifies all claims made on the assets of the debtor. The full list of claims needs to be identified and verified, so that any recovery can be made to these creditors in all fairness. The Trustee may investigate the affairs of the debtor, admit debts, examine the debtor, and identify the assets of the debtor that are available for realisation under bankruptcy. Finally, the Trustee may sell assets of the debtor.

6.5.6 Assets in bankruptcy

The Committee debated what assets of the individual must be available for realisation in bankruptcy, who will control the sale of the assets – whether the sale has to be done by the Trustee, or whether the secured creditor can take charge instead – and to whom the value can be paid out. Assets acquired by the bankrupt, or devolved to the bankrupt, after the commencement of the insolvency process and before discharge will also vest in the Trustee when they are acquired. Items held in trust, or loaned to the bankrupt do not vest in the Trustee.

The Trustee will usually invite the co-owner of the property (usually the family home) to either buy the bankrupt's interest or join in selling the property. If the co-owner will not cooperate with the Trustee or they cannot agree on a satisfactory arrangement, the Trustee can force the sale of joint property. In that case, however, the Trustee will share the surplus with the non-bankrupt co-owner on the basis of the legal entitlement as shown on the title deed.

There was clarity that the following unencumbered assets must be kept out of bankruptcy:

Box 6.15: Drafting instructions for functions and rights of the Trustee

1. The estate of the bankrupt shall vest in the bankruptcy trustee immediately on the appointment of the trustee
2. The Trustee will have the following functions:
   (a) Investigate the affairs of the bankrupt
   (b) Realise the estate of the bankrupt
   (c) Distribute the estate of the bankrupt
3. The Trustee will have the right to:
   (a) Hold property of every description,
   (b) Make contracts,
   (c) Sue and be sued,
   (d) Enter into engagements binding on himself and, in respect of the bankrupt's estate
   (e) Employ an agent
   (f) Execute any power of attorney, deed or other instrument,
   (g) Do any other act which is necessary or expedient for the purposes of or in connection with the exercise of those powers.
4. The Trustee will have the power to:
   (a) sell any part of the estate of the bankrupt
   (b) give receipts for any money received by him
   (c) prove, rank, claim and draw a dividend in respect of such debts due to the bankrupt as are comprised in her estate
   (d) exercise the right of redemption in respect of any property of the bankruptcy held by any person by way of pledge or hypothecation.
   (e) exercise the right to transfer the property of the bankrupt which is transferable in the books of a person to the same extent as the bankrupt might have exercised it if she had not become bankrupt.
   (f) deal with any property comprised in the estate of the bankrupt to which the bankrupt is beneficially entitled in the same manner as the bankrupt might have dealt with it.
5. The Code will specify actions that will require creditors approval before the Trustee can act on them.

Box 6.16: Drafting instructions for the assets realisable in bankruptcy

1. All assets owned by the bankrupt can be used in realising value.
2. Assets acquired by the bankrupt, or devolved to the bankrupt after the commencement of the insolvency process and before discharge will also vest with the Trustee when they are acquired.
3. Items held in trust, or loaned to the bankrupt do not vest in the Trustee.
4. The following assets will be exempted:
   (a) Assets held as collateral to certain financial market institutions.
   (b) Necessary clothing and household items.
   (c) Tools of trade to an indexed amount.
   (d) Financial assets (and interest earned on the financial assets) in pension and provident funds (up to a specified amount).
   (e) Any right to recover damages or compensation for personal injury or wrong doing or in respect of the death of the spouse or member of family of the debtor.
   (f) The dwelling unit (family home) of the bankrupt (up to a specified amount).
   (g) Funds earmarked for maintenance of children, spouse and elderly parents.
5. The Trustee will invite the co-owner of the property to either buy the bankrupt's interest or join in selling the property. The Trustee can, however, force the sale of joint property if the co-owner chooses to not co-operate.
6. In that case, however, the Trustee will share the surplus with the non-bankrupt co-owner on the basis of the legal entitlement as shown on the title deed.

1. Assets held as collateral to certain financial market institutions subject to protection available regarding secured assets (such as clearing corporations or similar financial transactions to either creditors or non-creditors).
2. Necessary clothing and household items
3. Tools of trade to an indexed amount,
4. Financial assets in pension and provident funds (under an specified amount)
5. Any right to recover damages or compensation for personal injury or wrong doing or in respect of the death of the spouse or member of family of the debtor.
6. The dwelling unit (family home) of the bankrupt (up to a specified amount)
7. Funds earmarked for maintenance of children, spouse and elderly parents.

6.5.7 Administration of the estate

Administration and distribution of the estate of the bankruptcy are critical elements of the bankruptcy procedure. There are several transactions that can compromise the process. For example, disposition of property by the bankrupt, or onerous property such as unprofitable contracts, or property that may actually give rise to a liability to the estate may lead to fewer realisable assets to the detriment of the creditors.

There was additional discussion around the recoveries of wrongful or fraudulent trading or unauthorised use of capital. The Committee recommended that all transactions undertaken during a specified time period prior to the application of the bankruptcy should be scrutinised for any evidence of such fraudulent practices. From the start of the IRP, the RP who is managing the relevant process is responsible for scrutinising and verifying that the reported transactions are valid and central to the running of the business. Those that can be classified as fraudulent and/or unauthorised will become evidence in a case of

Box 6.17: Drafting instructions for administration of the estate

1. The Code will specify provisions related to the following
   (a) Restrictions on disposition of property
   (b) Treatment of after acquired property
   (c) Treatment of onerous property
   (d) Disclaimer of leaseholds
   (e) Challenge against disclaimed property
   (f) Treatment of transactions at an undervalue
   (g) Treatment of transactions giving preference
   (h) Bona-fide purchasers
   (i) Treatment of extortionate credit transactions
   (j) Treatment of contracts
   (k) Administration of the estate of a deceased debtor

alleged fraud made to include such assets as part of the estate of the insolvent, through an order of the court. During the bankruptcy phase, the Code will give the Trustee the power to file lawsuits to recover lost value by canceling those transactions where they are able to, or to recover value from the accused party. These are referred to as vulnerable transactions, carried out in the lead up to, and during, insolvency resolution as well as after bankruptcy.

Some jurisdictions set such recoveries aside for payment to the secured creditors. Given the extent of equity financing in India, all recoveries from such transactions will become the property of the enterprise, and so will be distributed as described within the waterfall of liabilities. Also particular to Indian conditions are transactions made in relation to marriage. It was recommended that vulnerable transactions may include the case of a settlement made in consideration of marriage where the settlor is not at the time of making the settlement able to pay all his debts without the aid of the property comprised in the settlement and it appears to the Adjudicator that the settlement, covenant or contract was made in order to defeat or delay creditors, or was unjustifiable having regard to the state of the settlor's affairs at the time when it was made.

The Code will specify provisions related to all such transactions.

6.5.8 Priority of payout

The Committee debated on the waterfall of liabilities that should hold in bankruptcy in the new Code. In order to uphold the objectives of preserving the rights of creditors in bankruptcy, the Committee agreed that the optimal waterfall should be as follows:

1. Costs and expenses incurred by the bankruptcy trustee for the bankruptcy process.
2. The second priority will be to
   (a) Secured creditors.
   (b) Workmen dues for the period of three months prior to the date of the bankruptcy commencement

   3.Employee dues for the period of three months prior to the date of the bankruptcy commencement.

Box 6.18 – Drafting instructions for the distribution of proceeds in bankruptcy

The optimal waterfall should be as follows:

1. Costs and expenses incurred by the bankruptcy trustee for the bankruptcy process.
2. The second priority will be to
   (a) Secured creditors,
   (b) Workmen dues for the period of three months prior to the date of the bankruptcy commencement.
3. Employee wages and unpaid dues for the period of three months prior to the date of the bankruptcy commencement
4. The next priority will be to
   (a) amounts due to the Central and State Government in respect of the whole or any part of two years before the bankruptcy commencement date.
   (b) dues payable to workmen of the bankrupt for whole or any part of the nine month period beginning from twelve months before the bankruptcy commencement date and ending three months before the bankruptcy commencement date;
   (c) wages and unpaid dues payable to employees of the bankrupt for whole or any part of the three month period beginning from six months before the bankruptcy commencement date and ending three months before the bankruptcy commencement date
5. Lastly all other debts payable by the bankrupt.
6. Debts of the same class will rank equally between themselves
7. Any surplus remaining after the payment of the debts will be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the bankruptcy commencement date.
8. Interest payments will rank equally irrespective of the nature of the debt.

3. The next priority will be to
   (a) Amounts due to the Central and State Government in respect of the whole or any part of two years before the bankruptcy commencement date.
   (b) dues payable to workmen of the bankrupt for whole or any part of the period beginning from twelve months before the bankruptcy commencement date and ending three months before the bankruptcy commencement date;
   (c) dues payable to employees of the bankrupt for whole or any part of the period beginning from six months before the bankruptcy commencement date and ending three months before the bankruptcy commencement date.

4. lastly, all other debts owed by the bankrupt, including unsecured debts.

6.5.9 Rules to close bankruptcy

When the Trustee has realised all of the bankrupt's estate, or is of the view that the costs of realising additional amounts outweigh benefits, the Trustee will give a notice of closing the bankruptcy to the Adjudicating authority. The notice will propose a final date by which all the claims against the bankrupt will be closed off. The Trustee will defray any outstanding expense of the bankruptcy out of the bankrupt's estate. Any surplus amount will belong to the bankrupt.

The Trustee will also propose a final meeting with all creditors in which, the Trustee all creditors will receive a report of the administration of the bankrupt's estate. At this point, the Trustee will be released from duty, and the bankruptcy will come to a close.

Box 6.19: Drafting instructions for the close of bankruptcy

1. After the Trustee has realised all of the bankrupt's estate, she will give a notice
   (a) of her intention to declare a final dividend or
   (b) inform that no further dividend will be declared
2. The notice will propose a final date by which all the claims against the bankrupt will be closed off.
3. After the final date the Trustee will
   (a) defray any outstanding expenses of the bankruptcy out of the estate of the bankrupt
   (b) declare and distribute that dividend
4. All creditors will receive a report of the administration of the bankrupt's estate
5. If a surplus remains after payment in full and with interest of all the creditors of the bankrupt and the payment of the expenses of the bankruptcy, the bankrupt will be entitled to the surplus
6. The Trustee will be released from duty, and the bankruptcy will come to a close.

Box 6.20: Drafting instructions for the annulment of the bankruptcy order

1. The Adjudicating Authority may annul a bankruptcy order if it appears that
   (a) on any ground existing at the time the bankruptcy order was made, the bankruptcy order ought not to have been made
   (b) both the debts and the expenses of the bankruptcy have all, since the making of the bankruptcy order, either been paid or secured for to the satisfaction of the Adjudicating Authority
2. If the bankruptcy is annulled, any action duly taken by the bankruptcy trustee in the process of bankruptcy will be valid except that the property of the bankrupt will vest in a individual appointed by the Adjudicating Authority or revert to the bankrupt on terms stated by the Adjudicating Authority.
3. The Adjudicating Authority must notify the following of the annulment
   (a) the Board;
   (b) the insolvency professional agency
4. An annulment will bind all the creditors so far as it relates to any debts due to them which forms a part of the bankruptcy debts.

6.5.10 Annulment

An annulment is the cancellation of the bankruptcy and reinstatement of the affairs of the debtor as if no bankruptcy had occurred. The Adjudicating Authority may annul a bankruptcy order if it appears that the order should actually not have been made, or if all the debts have been paid since the making of the order. Annulment is an important clause as the record of the bankruptcy forever stays on the record of the debtor. If there is reason to believe that the bankruptcy order should not have been made, then the debtor should not have to go through the entire process.

6.6 Discharge

Discharge relates to the relief offered to the debtor. The world has adopted one of two measures - an "earned" start where the duration of the repayment plan lasts for between three to seven years. This is the system prevalent in most European countries. The other is that of a "fresh" start where debt relief is granted with a year. In the US, fresh start

Box 6.21: Drafting instructions for discharge

1. When the moratorium period ends and an FSO is issued, the debtor is discharged from all debt specified in the Order. The record will permanently stay on the credit history of the debtor.
2. The discharge under the IRP will be granted in accordance with the repayment plan. It is possible that discharge is granted before full repayment, as negotiated in the plan, is complete. The successful IRP will be recorded in the credit history of the debtor and will permanently stay.
3. The debtor will be granted a "discharge from bankruptcy" at the end of one year. This record will stay on the credit history permanently.
4. The bankruptcy procedure may continue. The discharged bankrupt will be required to co-operate with the relevant authority to conclude the bankruptcy process.
5. The discharge does not release the debtor from liabilities specified by the Code.

underlies the policy of small-business insolvency legislation. The UK has also moved towards a system of discharge within twelve months. The choice for India seems to be a combination of debt relief and earned relief given the design of two procedures: the FSO and the IRP.

6.6.1 FSO

The debtor will get discharge from her qualifying debts at the end of the moratorium period. The Adjudicating authority will issue an Order which will discharge the debtor from all the debt specified in the Order. This would also include all the interest and penalties that may have become payable since the date of application of the FSO. The record will remain permanently on the credit history of the debtor.

6.6.2 IRP

The discharge under the IRP will be granted in accordance with the repayment plan. It is possible that discharge is granted before full repayment, as negotiated in the plan, is complete. The debtor will be required to co-operate with the relevant authority to conclude the repayment process. The successful IRP will be permanently recorded in the credit history of the debtor.

6.6.3 Bankruptcy

In the case of an Adjudicator-led bankruptcy, the debtor will be granted a "discharge from bankruptcy" at the end of one year from the date of being adjudged a "bankrupt" i.e the bankruptcy order. This record will stay on the credit history permanently. The bankruptcy proceedings may continue. The discharged bankrupt will be required to co-operate with the relevant authority to conclude the bankruptcy process. The discharge does not release the debtor from any liability in respect of a fine imposed, or liability to pay damages from negligence, nuisance or breach of a statutory, contractual or other duty.

6.7 Offences

In disputes regarding insolvency, howsoever settled or disposed, the debtor stands in a position of strength with regard to information of assets held by him. All known creditors put together may not be able to obtain a full picture of revenue flows and assets over which the debtor has a beneficial control or exercises a power over its disposition. This information asymmetry has, at least in part, attempted to be restored by creating provisions in the law that capture all possible violations that an insolvent may engineer or commit to maintain opacity over his assets and deny creditors' access to assets that legally fall within the ownership of the insolvent or over which it exercises a power of disposition.

An individual is not guilty of the offence if he proves that, at the time of the conduct constituting the offence, he had no intent to defraud. The indicative list of offences by an insolvent debtor /bankrupt may be of three kinds:

1. Fraud
   (a) Fraudulent disposal of property i.e. makes or causes to be made or caused to be made, any gift or transfer of, or any charge on his property.
   (b) Making a false representation or omits material information in the application.
2. Absconding
   (a) Absconding which carries the meaning of the bankrupt who leaves in the 6 months before petition, or in the initial period, or attempts or makes preparations to leave the country.
3. Malpractice
   (a) Bankrupt attempts to account for any part of her property by fictitious losses or expenses.
   (b) Non-disclosure of all the property comprised in his estate or disposal of any such property.
   (c) Contravention of the restrictions or disqualifications imposed on the debtor.
   (d) Concealment of property i.e. when an insolvent conceals any debt due to or from him or conceals any property.
   (e) Concealment of books and papers, falsification - does not deliver possession to the Trustee or conceals destroys, mutilates or falsifies, books, papers and other records of which he has possession or control and which relate to his estate or his affairs.
   (f) Obtaining credit; engaging in business - either alone or jointly with any other person, he obtains credit to the extent of the prescribed amount or more without giving the person from whom he obtains it the relevant information

about his status; or he engages (whether directly or indirectly) in any business under a name other than that in which he was adjudged bankrupt without disclosing to all persons with whom he enters into any business transaction the name in which he was so adjudged.

6.8 Appeals

Appeals shall be heard against the following:

1. The fresh start order.
2. Fraud in an agreement under the IRP or final order under the IRP process.
3. The bankruptcy order.
4. The final discharge order of the Adjudicator in the case of bankruptcy.

7 — Repeals and savings

There are four types of existing laws (both central and state) that the proposed Code will interface with. These are:

1. Laws dealing with matters of insolvency and bankruptcy of persons and legal entities.
2. Laws dealing with recovery of dues from persons and legal entities and disputes associated with the same.
3. Laws whose provisions can impact the procedures and the creditors waterfall in the proposed Code.
4. Subordinate legislation, both rules and regulations, in each of the above.

For the Code to be implemented effectively, these interfaces will need to be defined and made clear. Such clarity will ease the transition to the Code and also ensure that its robustness and credibility are maintained over time. Some of the existing laws will need to be repealed in entirety, some in part and in others amendments that either introduce new provisions or change existing provisions will need to be enacted to ensure that the existing provisions do not adversely impact the functioning of the proposed Code.

From a constitutional perspective, a parliamentary law on and insolvency and bankruptcy can over-ride other laws on this subject matter. However, there are two points of specific concern. First, certain categories of secured creditors and the tax authorities have special powers granted to them under extant laws. Second, the number of adjudicating authorities (specialised tribunals) under the various laws is large and appears to be growing. The adjudicating authority under the Code needs to have the requisite jurisdiction to deal with conflicts that may arise due to this.

In the following sections, an attempt is made to identify the various statutes and regulations that will need repeal or amendment in the context of their interface with the proposed insolvency and bankruptcy Code. In practice, however, defining all possible interfaces with an exhaustive list of relevant laws is impossible. These will be the subject matter of case law and will evolve over time.

7.1 Laws dealing with bankruptcy and insolvency

These are central or state laws that have provisions on reorganisation, restructuring and winding up of entities under their respective jurisdictions, including under conditions of financial distress, insolvency or bankruptcy.

1. Companies Act, 1956 or Companies Act, 2013 (whichever is relevant)
2. Sick Industrial Companies Act, 1985
3. Limited Liability Partnership Act, 2008
4. Indian Trusts Act, 1882
5. Various state laws on state cooperative societies
6. Multi-state Cooperative Societies Act, 2002
7. Trade Union Act, 1926
8. Laws governing incorporation of statutory corporations (whether created by parliament or by state legislative assemblies)
9. Presidency Towns Insolvency Act, 1909
10. Provincial Insolvency Act, 1920

7.2 Laws dealing with recovery of dues

These laws have provisions dealing with recovery of dues, either by financial and non-financial creditors.

1. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
2. Recovery of Debts Due to Banks and Financial Institutions Act, 1993
3. Recovery provisions of the Income Tax Act 1961
4. Enforcement provisions of the Contract Act, 1872
5. Laws related to tort dues.

7.3 Laws that may impact procedures under the proposed Code

These include the non-insolvency or non-recovery provisions of various laws that may impact the procedures or creditors' waterfall under the proposed Code. These could be provisions with regard to procedural matters, dispute resolution or primacy over other laws. Some of these are:

1. Companies Act, 1956 or Companies Act, 2013 (whichever is the extant law at that time)
2. Limited Liability Partnership Act, 2008
3. Indian Trusts Act, 1882
4. Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
5. Recovery of Debts Due to Banks and Financial Institutions Act, 1993
6. Income Tax Act 1961
7. Contract Act, 1872

8. Transfer of Property Act, 1882
9. Registration Act, 1908
10. Stamp Act, 1899 (and the various state laws)
11. Various indirect tax laws in the states
12. The Bombay Shops and Establishments Act, 1948 (and equivalent legislation in other states, if any)
13. Criminal, civil or personal laws relating to payment of maintenance (for example Section 125 of the Code of Criminal Procedure, 1973)
14. Laws dealing with employees and workmen such as: Employees State Insurance Act, 1948, Employees' Provident Fund and Miscellaneous Provisions Act, 1952, Workmen's Compensation Act, 1923, Payment of Wages Act, 1936, Payment of Bonus Act, 1965, Payment of Gratuity Act, 1972, Bombay Industrial Relations Act, 1946 (and equivalent legislation in other states, if any) and any other laws relating to employment and welfare
15. Industrial Disputes Act, 1947

7.4 Subordinate legislation that interface with the Code

These include rules made by government departments or regulations by financial sector or other regulatory bodies that may impact the effective implementation of the Code. Some of these are:

1. RBI norms on corporate debt restructuring (CDR) and strategic debt restructuring (SDR).
2. Government and RBI norms for self help groups (SHG) and joint liability groups (JLG).
3. RBI norms for functioning of asset reconstruction companies (ARCs).
4. RBI prudential norms and asset classification guidelines.
5. SEBI Substantial Acquisition of Shares and Takeovers Regulation.
6. SEBI Issue of Capital and Disclosure Requirement Regulation.
7. SEBI Issue and Listing of Debt Securities Regulation.
8. SEBI Public Offer and Listing of Securitised Debt Instruments Regulation.
9. Companies Rules under the Companies Act.
10. MSME guidelines on various matters.

7.5 Interfaces with the draft Indian Financial Code

In addition to the extant laws, the proposed Code is also interconnected with the draft Indian Financial Code through the following elements:

1. The Resolution Corporation envisaged in the draft Indian Financial Code is the primary mechanism for the insolvency of financial firms. The work of the Committee addresses all non-financial firms.
2. The resolution process of the Resolution Corporation takes place in an information-rich environment partly owing to the working of the statutory Financial Data

Management Centre. The approach taken in this report is to obtain an information-rich environment through a competitive industry of 'information utilities'.

3. The principles of consumer protection, as envisaged in the draft Indian Financial Code, limit and shape the methods adopted for individual bankruptcy. The proposals made in this report are fully compatible with these principles.
4. It is expected that under the proposed insolvency law, financial advisors will emerge who will advise and guide consumers who are under credit stress. This business, of credit counseling, would be a financial service and would be regulated by the draft Indian Financial Code.

8 — Implementation

In order to carry this report from a proposal to complete implementation, the following areas of work are required:

1. The legislative track: obtaining feedback from the public and refining the draft law;
2. Constructing the regulator;
3. Constructing the adjudication infrastructure;
4. Initiating the information utilities;
5. Initiating the insolvency profession.

Alongside all work on the legislation, careful thinking is required about the executive and judicial aspects also. Advance planning is required on the construction of State capacity on all aspects that is required for the proper functioning of the law. This will include institutional infrastructure in the form of the regulator, information systems, administrative arrangements for courts, and the insolvency profession.

8.1 Constructing the regulator

The Committee has proposed the creation of a regulator which will be integral to the working of the bankruptcy process. While many countries do not have a specialised regulator for the field of insolvency, the Committee believes that the construction of a non-departmental public agency, which fuses certain legislative, executive and quasi-judicial functions, is of essence in achieving the desired outcome. The desired outcomes, however, hinge on the construction of a high performance government agency which will perform the roles anticipated in this law.

Many times, in the Indian experience, when there is low *institutional capacity*, the performance of a government agency critically depends on the individuals present therein. This puts an undue emphasis on the appointments process, which may or may

not always deliver remarkable outcomes. In a situation where institutional capacity is low, the performance of a government agency varies greatly with the identities of its key personnel. The working of the agency is not predictable; it fluctuates depending on staffing changes. India's quest for State capacity lies in achieving consistent *institutional capacity*, where high performance is obtained consistently for decades, and staffing changes are routine.

In the past, most government agencies have been setup in an informal manner, by recruiting a few people. Many years elapse before the agency is fully working, and in many aspects, it has been difficult to achieve high performance. In recent years, the Ministry of Finance has adopted a new approach to this question, which comprises of the following elements.

Every government agency is composed of: (a) Office facilities (b) Organisation design (c) Process manuals (d) IT systems which encode the process manuals. A formal process is required, of constructing these four elements. The Ministry of Finance has adopted the practice of setting up 'Task Forces' which support it in procuring IT and consulting companies to assist in the construction of these four elements. Large teams and resources are brought into play in a short time, so as to construct world class capabilities in these four dimensions.

This approach is being used by the Ministry of Finance in building the institutional landscape envisioned in the draft Indian Financial Code: the Financial Sector Appellate Tribunal (FSAT), the Resolution Corporation (RC), the Financial Data Management Centre (FDMC), the Public Debt Management Agency (PDMA) and the Financial Redress Agency (FRA). As constructing State capacity is a slow and complex process, the Ministry of Finance has embarked on this work prior to the enactment of the Indian Financial Code as law. Similar methods are also being used by the Department of Food for building the Warehouse Development and Regulatory Authority (WDRA).

Drawing on these experiences, the Committee recommends:

1. The government must immediately create a 'Task Force/Committee for Construction of the Indian Bankruptcy and Insolvency Resolution Authority' which will set about creating the requisite State capacity. This would ensure that the Regulator is fully ready to perform the roles required of it by the time the law is enacted.

8.2 Information utilities

The strategy envisaged in this report is that an industry of multiple competing information utilities will come about. However, on day one this does not exist.

The first task for Government is to collaborate with academics and technical organisations to draft a set of industry standard APIs (Section 4.3.9) which will be used all through the information utility industry. These standard APIs will serve as a coordination point for a large number of software developers all across the economy: those building information utilities, and those building applications which will be used by insolvency

professionals and others in the insolvency industry in accessing this information.[16]

There are already many organisations in India who could potentially play the role of the 'information utilities' as envisaged in this report and draft law. To the extent that a consultation process is established, and Government proactively reaches out to these firms and clarifies open questions, this will yield a more rapid initiation of projects at these information utilities.

Information utilities will necessarily have incomplete coverage at the start. They have to first reach a certain critical mass so that there are incentives for insolvency professionals to always use them. There are, of course, strong incentives for economic agents to use information utilities, as this would eliminate delays and disputes in the insolvency process. The Government and the Board/Regulator will have to manage a calibrated process through which at first there is a hybrid system involving paper-based records for legacy activities coupled with newer information in the information utilities, and coverage in the information utilities becomes increasingly pervasive.[17]

Drawing on this reasoning, the Committee recommends:

1. A project should be immediately initiated, in collaboration with academics and technical organisations, to draft a set of standard APIs, and provide reference implementations. The standards-making process utilised here should be similar to that adopted by the Internet Engineering Task Force (IETF). These will become an organising framework for the entire automation of the insolvency industry.
2. Government must immediately initiate a consultation process where prospective entrants into the information utility industry have an opportunity to better understand what is envisaged, and thus refine their plans.
3. After the law is enacted, Government and the Board/Regulator must first ensure that information utilities are used even when the amount of information in them is small. Gradual steps should be undertaken over a period of roughly five years to create a complete straight- through-processing environment where most firm failure is processed without recourse to any physical paper records.

8.3 Insolvency profession

The strategy proposed in this report is one where multiple competing private self regulatory organisations will emerge, under the oversight of the Board/Regulator. Private persons will play a leadership role in creating a profession that addresses the requirements of insolvency in India. The Board/ Regulator will have oversight over these organisations from the

[16]The best example in India, thus far, of open standards which are being used by diverse players in the software industry is the set of standards which have been released by UIDAI.

[17]For an analogy, when dematerialisation of shares on the equity market began, at first, the fraction of shares that were dematerialised was necessarily tiny. At this time, the role of the Government and the Regulator lay in insisting that if a person chose to dematerialise shares, the full processes of the equity market *were* available to him. When the depositories achieved a certain minimum critical mass, the Government and the Regulator started a gradual process of making demat delivery *mandatory* on the equity market. Over a seven year period, the use of demat shares in settlement on the equity market went from 0 to 100%. A similar transition has to be navigated for the information utilities in the frictionless insolvency process that is envisaged.

viewpoint of ensuring that standards are maintained, and enforcement actions are being taken appropriately.

On day one, such SROs do not exist. Activities must be initiated, before the new law is enacted, which induce the requisite capacity building and transitioning into the new insolvency profession.

Drawing on this reasoning, the Committee recommends:

1. The Government should begin consultations with public minded citizens who may like to play a leadership role in establishing these SROs.
2. The Government and the Board/Regulator will need to establish a framework for grandfathering, where persons with expertise in insolvency are rapidly accepted as SRO members, and a first set of insolvency practitioners is available in the market.
3. The Government and the Regulator should initiate human capital building activities all across the country so as to build up the first wave of expertise for this field.

8.4 Adjudication infrastructure

A critical element of the insolvency process is well functioning adjudication infrastructure. The working of courts or tribunals is a business process, and comprehensive workflow redesign is required, as part of business process re-engineering, in order to obtain smooth functioning of courts. The Committee recommends that international best practices on modern tribunal management be followed in resolving insolvency related disputes.

8.5 Transition provision

Given that setting up of a Regulator, and the development of entities like Insolvency Professionals and Information Utilities will take time, the Committee recommends a transition provision during which the Central Government shall exercise all the powers of the Regulator till the time the Regulator is established. Under these powers, the Central Government may *inter-alia*:

1. Prescribe the categories, qualifications, experience and expertise of persons to act as insolvency professionals;
2. Prescribe the qualification of entities to act as information utilities; and
3. Frame regulations for the conduct of the insolvency resolution process, liquidation and bankruptcy.

8.6 Summary

The ultimate objective is for India to have an efficient bankruptcy and insolvency framework. This involves navigating the legislative track and going from the draft law to a Parliamentary legislation. This also involves many other elements of building State capacity. Establishing a sound insolvency framework for India should be seen as a project which encompasses five things: (a) The legislative track; (b) Establishing the Regulator; (c) Initiating the industry of information utilities and phasing-in comprehensive adoption of these utilities; (d) Initiating the insolvency profession; and (e) Establishing world class adjudication infrastructure.

Given that establishing a regulator is likely to take time, the Committee recommends that till then the Central Government may exercise all powers of the regulator.

9 — Annexures

Office Order Constituting the BLRC

F. No. 7/2/2014-FSLRC
Government of India
Ministry of Finance
Department of Economic Affairs
(FSLRC Division)

North Block, New Delhi
22.8. 2014

OFFICE ORDER

The Hon'ble Finance Minster in Para 106 of his Budget Speech 2014-15 has announced that an "Entrepreneur friendly legal bankruptcy framework will also be developed for SMEs to enable easy exit".

2. Pursuant to the above announcement, it has been decided to set up a Committee with the following composition to study the corporate bankruptcy legal framework in India and to submit a report within a period of six months; ie, by 28.2.2015.

i. Shri TK Vishwanathan,- Chairperson
ii. Representative of the Department of Financial Services -Member
iii. Representative of the Ministry of Corporate Affairs –Member
iv. Representative of the Ministry of Law(Legislative Deptt) –Member
v. Additional Secretary(Investment), DEA- Member
vi. Representatives of RBI and SEBI- Permanent Invitees

The Committee will have the option to invite experts in the field and representatives of other Ministries/Departments concerned as Special Invitees.

3. The detailed Terms of Reference (ToRs) of the Committee and the Technical Support required will be decided by the Committee in its first meeting and will be issued separately.

4. This issues with the approval of the Hon'ble Finance Minster.

22/8/14

(Gaurav Masaldan)
Director(FSLRC)
23092247/23095038

1. Shri TK Vishwanathan, Chairperson
2. Secretaries of the Department of Financial Services, Ministry of Corporate Affairs, Legislative Department, Ministry of Law; with the request to nominate Senior Officers conversant with the subject to attend the meetings of the Committee, as Members.
3. Governor, RBI, Mumbai; with the request to nominate a Senior Officer conversant with the subject to attend the meetings of the Committee.
4. Chairman, SEBI, Mumbai; with a request to nominate a Senior Officer conversant with the subject to attend the meetings of the Committee.

Copy for information to:-

1. PS to Hon'ble Finance Minster
2. PS to MoS(Finance)
3. PPS to FS, Ministry of Finance
4. PS to AS(Investment)/AS(EA), DEA, Ministry of Finance
5. JS(FM)/Adv(CM)/Adv(FSDC), DEA, Ministry of Finance

Office Order Revising Composition of the BLRC

F. No. 7/2/2014-FSLRC
Government of India
Ministry of Finance
Department of Economic Affairs
(FSLRC Division)

North Block, New Delhi
10.11. 2014

OFFICE ORDER

In partial modification of the Ministry of Finance Office Order No 7/2/2104-FSLRC dated 22.8.2014, setting up the Committee to study the corporate bankruptcy legal framework in India, the composition of the Committee is revised as follows:-

i.	Shri TK Vishwanathan,	- Chairperson
ii.	Representative of the Department of Financial Services	-Member
iii.	Representative of the Ministry of Corporate Affairs	–Member
iv.	Representative of the Ministry of Law(Legislative Deptt)	–Member
v.	Additional Secretary(Investment), DEA	–Member
vi.	Representatives of RBI	-Member
vii.	Representatives of SEBI	-Member
viii.	Dr. Ajay Shah, NIPFP	–Member
ix.	Prof. Susan Thomas, IGIDR	–Member
x.	Mr. P.Ravi Prasad, Tempus Law Associates	–Member
xi.	Mr. Bahram Vakil, AZB & Partners	–Member
xii.	Mr. B.S. Saluja, ICADR	–Member
xiii.	Mr. M.R.Umarji, Alliance Corporate Lawyers	–Member
xiv.	Ms. Aparna Ravi, Centre for Law and Policy Research	–Member
xv.	CEO & MD, IFCI, New Delhi	Permanent Invitee

Legal research and writing for the Committee will be provided by M/s Vidhi Centre for Legal Policy, New Delhi.

2. The Committee will have the option to invite experts in the field and representatives of other Ministries/Departments concerned as Special Invitees.

3. The Committee will submit its report in 2 phases:-

a) Interim Report for immediate action, pending legislation of the Bankruptcy Code; by Feb 2015.
b) Final Report within 12 months thereafter, recommending a Bankruptcy Code.

This issues with the approval of the Hon'ble Finance Minster.

10/11/14

(Gaurav Masaldan)
Director (FSLRC)
23092247/23095038

1. Shri TK Vishwanathan, Chairperson
2. All Members of the Committee
3. CEO & Managing Director, IFCI, New Delhi.
4. M/s Vidhi Centre for Legal Policy, New Delhi.
5. **Copy for information to:-**
   - i. PS to Hon'ble Finance Minster
   - ii. PS to MoS(Finance)
   - iii. PPS to Secretary(EA) Ministry of Finance
   - iv. PS to AS(Investment), DEA, Ministry of Finance
   - v. Adv(CM)/ DEA, Ministry of Finance

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