

“CORPORATE MISGOVERNANCE, NON PERFORMING ASSETS AND INSOLVENCY AND BANKRUPTCY CODE 2016

Corporate governance

- The Companies Act, 1956 (“1956 Act”)
 - Ineffective at handling some of the present-day challenges
- The Companies Act, 2013
 - Enacted with a view to meeting the present-day challenges of corporate governance arising from stakeholders’ expectations.
- The 2013 Act ushered
 - In a new era of corporate governance
 - Increasing the roles and responsibilities of the Board,
 - Protecting shareholders' interests
 - Bringing in a disclosure based regime and
 - Built in deterrence through self-regulation.
- Measures
 - Enhancing the duties and liabilities of directors
 - Imposition of stringent penal provisions in case of breach of any statutory provisions.
 - New requirements under the 2013 Act

National Company Law Tribunal

- Headed by President who is a retired Chief Justice of High Court.
- Judicial Members
- Technical Members
- Presently 11 Benches at 10 Stations
 - Ahmedabad
 - Allahabad
 - Bengaluru
 - Chandigarh
 - Chennai
 - Guwahati
 - Hyderabad
 - Kolkata
 - Mumbai
 - New Delhi

Companies Act, 2013

- More stringent provisions to ensure better Corporate Governance
- Reporting requirements
- Duties of Directors
- Regular meetings of the Board
- Provisions to protect minority shareholders
- Oppression and mismanagement
- Amalgamation and Merger
- Winding Up
- Class action suit

Majority-minority shareholder imbalance

- Major corporate governance issue
- Possibility of under-representation of minority shareholders' views and interests
- Likelihood of domination of majority shareholders' opinion due to the conferment of significant authority upon the directors appointed (or nominated) by majority shareholders.
- This issue of imbalance of power among the board's members can largely be resolved by promoting the participation of smaller investors in company's decision-making (at least on major matters), specifically by way of their participation in company's resolutions.
- Corporate governance literacy also needs to be enhanced among retail investors to enable them to take informed decisions for the company.

Corporate Winding Up

- Time involved in getting winding up order from a Company Court is very high and during this time promoters retain control of management often leading to deterioration in corporate governance.
- Priority of payments
- Statutory dues get priority over other creditors.
- Secured creditors may not find this route providing the best recovery ratio.

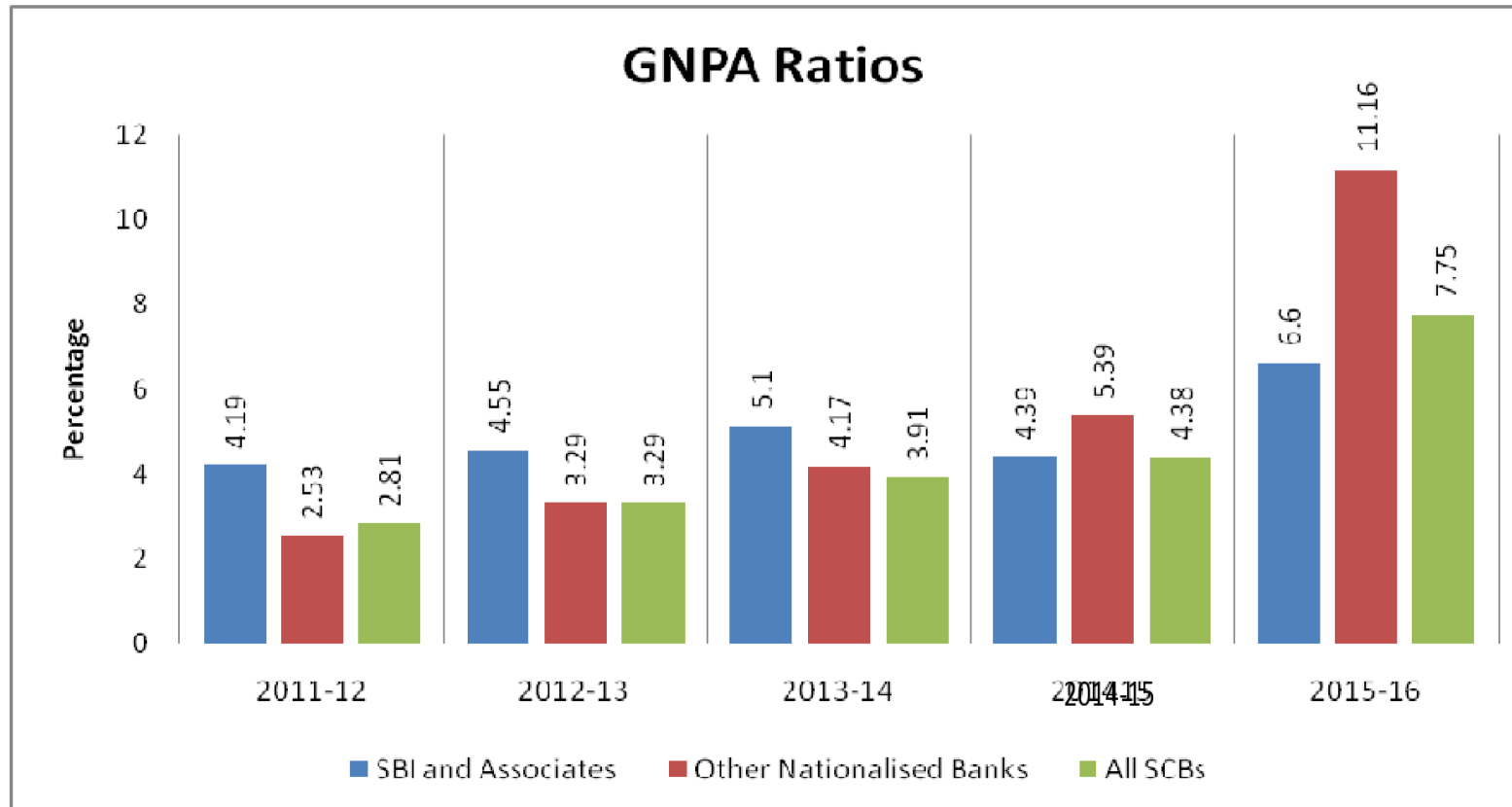
Non-performing Assets

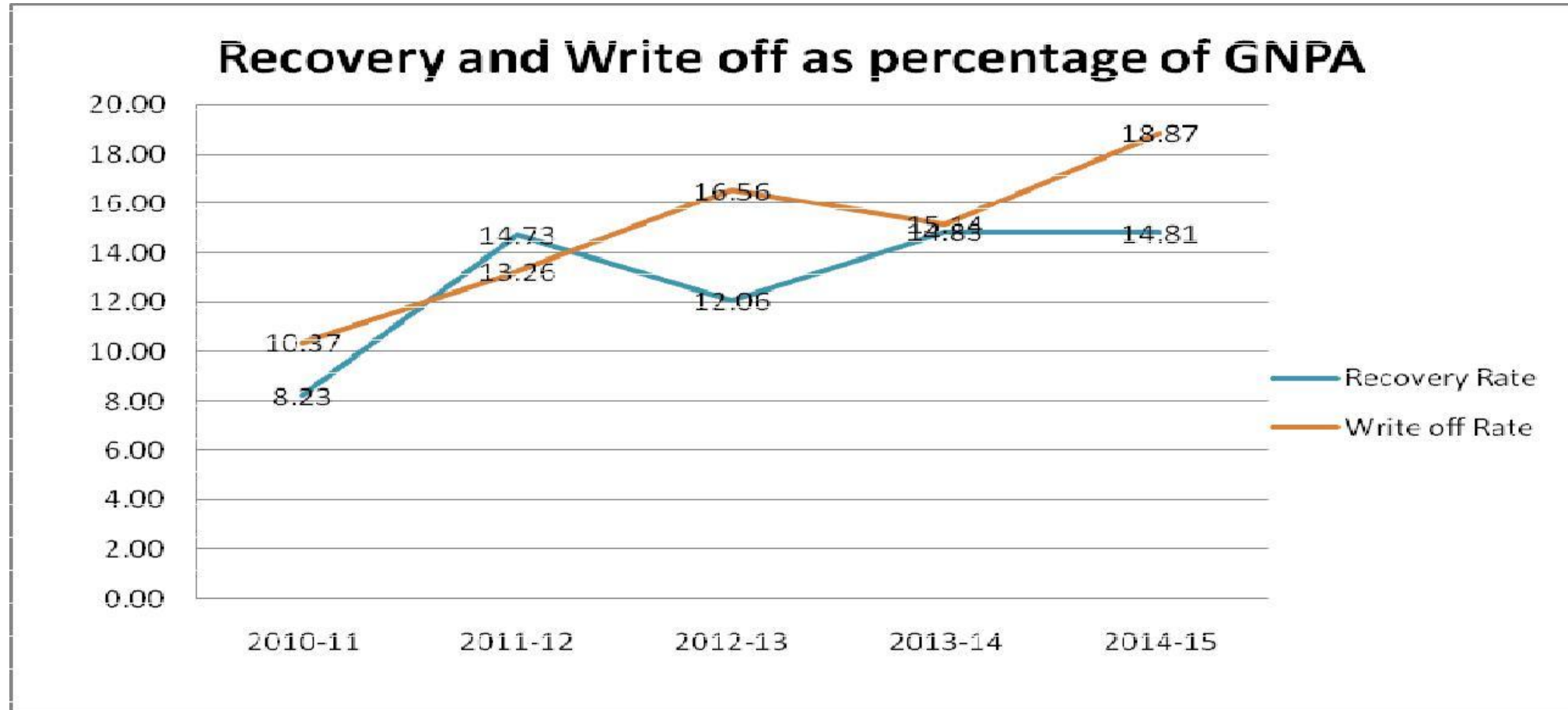
- An asset, including a leased asset, becomes nonperforming when it ceases to generate income for the bank.
- NPA is a loan or an advance where:
 - interest and/ or instalment of principal remains overdue for a period of more than 90 days in respect of a term loan,
 - the account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC),
 - the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
 - the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops,
 - the instalment of principal or interest thereon remains overdue for one crop season for long duration crops,
 - the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.

RBI, the NPA and Banks:

- The B.R. Act 1949 RBI is used to regulate and supervise banks but never before RBI was asked to assess the quality of commercial loans and advise banks the steps to recover the loan, which was hitherto exclusively the functions of the lending banks, their administration and Boards of Directors. The responsibility is now being shifted to the RBI, the Central Bank of the country.
- Nearly 11 trillion rupees (viz. 11 lakh crore of rupees) is the stressed asset of banks
- Gross NPA of banks is now about 15% of total lending.
- Politicization of lending decisions
- Wilful default by big borrowers
- Downturn in economy in several sectors like steel, cement, textile, power, infrastructure, gems and jewellery, some areas of exports.
- Laxity in Banks' recovery mechanism and Misgovernance.
- Make Adequate provisioning of losses
- Hence, the desperate remedy of asking RBI to intervene to put the banks on rails. Hence, the mechanism of RBI sponsored Oversight Committee, National Company Law Tribunal (NCLT), action under Insolvency and Bankruptcy Code *et al* under RBI directives.

GNPA Ratios for Public Sector Banks





Existing Laws Relating to Recovery of Debt and Revival of Borrowers

- **CPC:** A creditor may file a money recovery suit against a defaulting debtor under the Civil Procedure Code, 1908 (CPC) with jurisdictional Civil Court. However, owing to high backlog of cases and slow adjudication process, it may take decades to obtain a decree against the debtor through this route.
- **SICA:** The Board of Industrial & Financial Reconstruction (BIFR) was set up under Sick Industrial Companies (Special Provisions) Act, 1985 ('SICA').
- **SARFAESI Act**
 - Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
 - Banks utilize this Act as an effective tool for bad loans (NPA) recovery

Addressing NPAs of Bank: Insolvency & Bankruptcy code to play major role in resolution

- With the government and the Reserve Bank of India (RBI) deciding to first tackle the top-50 large stressed assets into the banking universe, corporate insolvency will emerge as a credible solution for resolution of bad assets.
- Highlights:
- Insolvency code has been ranked at 136th position by World Bank in 2017, now 103 in 2018.
- Three banks have applied under IBC so far .
- RBI is expected to bring in some clarity on accounting treatment of assets under IBC.
- Though there has been very slow response in the Insolvency & Bankruptcy Code currently, yet it is expected to play a major role in addressing the Non-Performing Assets of Indian Banks coming ahead.
- With the government and the Reserve Bank of India (RBI) deciding to first tackle the top-50 large stressed assets into the banking universe, corporate insolvency will emerge as a credible solution for resolution of bad assets.
- On May 05, 2017, when the cabinet gave more power to RBI – the apex body is now in position to direct banks to initiate insolvency proceedings with respect to a specific account.

How IBC will play major role in the NPA resolution

- It is expected that IBC will result in rise in debt restructuring by a creditor with the new owner or even with existing owner of the business rather than liquidation.
 - Fear of investigation made banks reluctant to undertake debt re-structuring earlier.
- World Bank too had pointed out few measures that India follow. They are – increase the number of benches of NCLT for speedy disposal, quick transfer of cases from high courts, shut down of official liquidator offices and proper monitoring of the work of tribunals appointed.

IBC a misnomer

- IBC is the short form for Insolvency and Bankruptcy Code, 2016.
- It appears that this is a law to provide a company to be insolvent and bankrupt
 - Thereby indicating the death of the company, with no chance of revival or rehabilitation
 - And the remaining assets are distributed among the creditors, employees, government dues and other stake-holders
- Actually, the IBC provides for an attempt to resolve the issues between the creditors and the corporate debtor
 - Detailed procedure for resolution process is laid down
- Only when the resolution process fails, then the company goes into liquidation

Scheme of IBC

- Applicable to
- Corporates and limited liability partnerships (LLP)
 - Adjudicating Authority is NCLT
- Individuals or partnership firms
 - Administered by Debt Resolution Tribunal (DRT)

Scheme of IBC for Corporates

1. Application to Adjudicating Authority that is NCLT by
 1. Financial Creditor
 2. Operational Creditor
 3. Corporate Debtor
2. NCLT to give notice to Corporate Debtor
In the case of application by Corporate Debtor to the Financial Creditors
3. Insolvency commencement date to start from the date of admission of application
4. Interim Resolution Professional to be appointed within 14 days of admission of application
5. IRP to invite claims by paper publication within 3 days of appointment and constitute a Committee of Creditors
6. COC to confirm IRP as Resolution Professional or apply to AA for replacement of IRP

Scheme of IBC for Corporates

(continued)

- Application to Adjudicating Authority by
 - Financial Creditor u/s 7 of IBC
 - Financial Creditor means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to
 - May be filed jointly also
- Application to include
 - Record or default
 - Name of Interim Resolution Professional proposed
- AA to ascertain existence of default within 7 days and if satisfied admit the application or reject the same
 - Before rejection AA to give notice to the applicant to rectify the defect within 7 days

Scheme of IBC for Corporates

(continued)

- Application to Adjudicating Authority by
 - Operational Creditor u/s 9 of IBC
 - Operational Creditor means any person to whom an operational debt is owed and includes a person to whom such debt has been legally assigned or transferred to
- “Operational Debt” means a claim in respect of the
 - provision of goods or services
 - including employment or
 - a debt in respect of the repayment of dues arising under any law for the time being in force and payable to the Central Government, any State Government or any local authority;
- A prior demand notice is required u/s 8 by the OC to the CD
 - CD to reply within 10 days
 - Stating existence of dispute, if any, and record of the pendency of suit or arbitration proceedings filed before receipt of such notice
 - Repayment of unpaid Operational Debt

Scheme of IBC for Corporates

(continued)

- Application by Operational Creditor to include
 - Copy of the invoice demanding payment or demand notice delivered by the OC to the CD
 - An affidavit to the effect that there is no notice given by the CD relating to a dispute of the unpaid Operational Debt
 - A copy of the certificate from the financial institutions maintaining accounts of the OC confirming that there is no payment of an unpaid Operational Debt by the CD
- AA to ascertain existence of default within 7 days and if satisfied admit the application or reject the same
 - Before rejection AA to give notice to the applicant to rectify the defect within 7 days
- OC may propose name of Interim Resolution Professional in the application to AA
 - Or AA shall make a reference to the IBBI for recommendation of an Insolvency Professional who may act as an IRP

Scheme of IBC for Corporates

(continued)

- Application to Adjudicating Authority by
 - Corporate Debtor u/s 10 of IBC
 - Corporate Debtor means any person who owes a debt to any person
 - And has committed a default
- Application to include
 - Its books of accounts and such other document relating to such period as may be specified
 - Name of Interim Resolution Professional proposed
- AA to ascertain existence of default within 7 days and if satisfied admit the application or reject the same
 - Before rejection AA to give notice to the applicant to rectify the defect within 7 days

Persons not entitled to make application to initiate Corporate Insolvency Resolution Process

- CD undergoing CIRP
- CD having completed CIRP, 12 months preceding the date of making an application
- CD or a FC who has violated any terms of the Resolution plan which was approved 12 months preceding the date of making an application
- CD in respect of whom a liquidation order has been made

Time limit for completion of Insolvency Resolution Process

- CIRP to be completed within 180 days from the date of admission of application to initiate such process
- RP may apply for extension of CRP by maximum of 90 days, if so, instructed by a Resolution passed at a meeting of COC by a vote of 75% in voting shares
- Maximum time for resolution is 180+90 days

Declaration of Moratorium

- After admission of application u/s 7/9/10, AA shall by an order
 - declare a moratorium, and
 - cause a public announcement of the initiation of CIRP, and
 - appoint an IRP

Section 14 of IBC - Moratorium

- *Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:*
 - (a) The institution of suits or continuation of pending suits or proceedings against the corporate debtor, including execution of any judgment, decree, or order in any court of law, tribunal, arbitration panel, or other authority;*
 - (b) Transferring, encumbering, alienating, or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;*
 - (c) Any action to foreclose, recover, or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);*

Section 14 of IBC – Moratorium

(Continued)

- *2. The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.*

- 3. The provisions of sub-section (1) shall not apply to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.*

- 4. The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:*
 - *Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of Section 31 or passes an order for liquidation of corporate debtor under Section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be.*

Management of Affairs of CD by IRP

- From the date of appointment of IRP
 - Management of affairs of CD shall rest in the IRP
 - IRP shall act and execute in the name and on behalf of the CD, all deeds, receipts and other documents
 - Take such actions as may be specified by the Board
 - Have the authority to access the electronic record of CD
 - Have authority to access books of accounts etc. of CD available with Government Authorities, Statutory Auditors, Accountants
 - Powers of Board of Directors of the CD shall stand suspended and be exercised by the IRP
 - Officers and managers of CD shall report to IRP and provide him access to such documents and records of the CD as required by him
 - Financial Institution maintaining accounts of the CD shall act on the instructions of the IRP and furnish him information relating to CD available with them

Committee of Creditors

- To be constituted by IRP
- To comprise of all Financial Creditors of CD
 - Related parties of CD shall not have right of representation, participation or voting in a meeting of COC
 - All decisions of the COC shall be taken by a vote of not less than 75% of voting share of the Financial Creditors
 - RP to make available any financial information required by the COC within 7 days
- COC to confirm continuation of IRP as Resolution Professional, or file an application before AA for his replacement

Submission of Resolution Plan

- A resolution applicant may submit resolution plan to the RP
- RP to examine each resolution plan to confirm that such plan
 - Provides for payment of CIRP costs in priority to the repayment of other debts
 - Payment of debt of OC
 - Provides for management of the affairs of CD after approval of Resolution Plan
 - Implementation and supervision of Resolution Plan
 - Does not contravene any provision of law
- Committee of Creditors to examine Resolution Plan and may approve the same
- Resolution Plan to be submitted before AA for approval

Liquidation Process

- Adjudicating Authority
 - Before expiry of CIRP period, or
 - On rejection of Resolution Plan for non-compliance of the requirements
- To pass an order for liquidation of CD u/s 33 of IBC
- To issue a public announcement stating that the CD is in liquidation, and
- Such order to be sent to the authority with which the CD is registered
- AA may appoint RP as liquidator or replace him and appoint new liquidator

Distribution of Assets on Liquidation (sec.-53)

- The proceeds from sale of liquidation assets shall be distributed in the following order of priority
 - Costs of CIRP and liquidation costs to be paid in full
 - Debts to rank equally between and among the following
 - Workmen dues for 24 months preceding the liquidation commencement date
 - Debts owed to a secured creditor if such secured creditor has relinquish security as per Section 52
 - Wages and any unpaid dues owed to employees other than workmen for 12 month preceding liquidation commencement date
 - Financial debts owed to unsecured creditors
 - Debts to rank equally between and among the following
 - Any amount due to Central/State Government in respect of 2 years preceding the liquidation date
 - Debts owed to a secured creditors for any amount unpaid following enforcement of security interest
 - Any remaining debts and dues
 - Preference shareholders, if any
 - Equity shareholders or partners as the case may be

- Application by liquidator to AA for dissolution of CD whether assets of the CD have been completely liquidated
- AA to order dissolution of CD from the date of the order

Fast track CIRP

- In cases where
 - CD has assets and income below notified level, or
 - CD with such class of Creditors or amount of debt as may be notified or
 - Such other category of Corporate persons as may be notified
- Fast Track Corporate Insolvency Process to be completed within 90 days

Section 238

- The provisions of this Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of such law.

Thank You