

Insolvency and Bankruptcy Code and the question of distribution of proceeds

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Why in news?

- The Ministry of Corporate Affairs has released a discussion paper that proposes several changes to the Insolvency & Bankruptcy Code (IBC), 2016.

Insolvency and Bankruptcy Code (IBC)

What is the Insolvency and Bankruptcy Code (IBC)?

- **About**

- In 2016, at a time when India's Non-Performing Assets and debt defaults were piling up, the Insolvency and Bankruptcy Code (IBC) code was introduced through an act of the Parliament.
- It was introduced to overhaul the corporate distress resolution regime in India and consolidate previously available laws to create a comprehensive time-bound mechanism.
 - Insolvency resolution in India took 4.3 years on an average.
 - In comparison, countries such as UK and USA took 1 year and 1.5 years, respectively.
- The Code aims to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders.

- **Timeframe**

- Companies have to complete the entire insolvency exercise **within 180 days** under the IBC.
- The deadline may be extended if the creditors do not raise objections on the extension.
- For smaller companies including startups with an annual turnover of Rs 1 crore, the whole exercise of insolvency must be completed within 90 days.

- **Regulation of the IBC Proceedings**

- **Insolvency and Bankruptcy Board of India (IBBI)** has been appointed as a regulator and it can oversee these proceedings.
- IBBI has 10 members; from Finance Ministry, Law Ministry and the Reserve Bank of India.

News Summary: Insolvency and Bankruptcy Code and the question of distribution of proceeds

- The Ministry of Corporate Affairs has released a discussion paper that proposes several changes to the Insolvency & Bankruptcy Code (IBC), 2016.
- One of the proposals is about the distribution of proceeds to different classes of creditors.

What are the existing provisions of IBC dealing with the distribution of proceeds?

- Under the IBC, a resolution applicant submits a plan to deal with the outstanding debts of a company by bringing proceeds under the plan.
- A committee of financial creditors votes on the financial viability & feasibility of the resolution plan.

- The quantum & manner of distribution under the Code has long been an issue of discontent for unsecured & junior creditors.

How are proceeds distributed among creditors under the IBC?

• Categorisation of creditors

- A company may have various creditors — public sector banks, private lenders, non-banking financial companies, trade creditors etc.
- The Code puts these creditors into different categories based on the nature of debt.
 - Banks, bond issuers, and lenders are classified as financial creditors.
 - Trade creditors & vendors are classified as operational creditors.
 - Financial creditors are further categorised as secured and unsecured creditors, based on the security furnished by the borrower company.

• Priority in which proceeds will be distributed

- The Code prescribes an order of priority in which proceeds will be distributed to the creditors based on the liquidation value.
 - E.g., secured financial creditors rank the highest in the order of priority.
- The creditors receive proceeds (even if in surplus over the liquidation value) under the resolution plan in order of the mentioned priority.
 - As a result, proceeds may be extinguished at the level of financial creditors itself, leaving almost nothing for other creditors in the waterfall mechanism.

What does the discussion paper propose?

- The discussion paper acknowledges concerns among creditors regarding inequitable distribution.
- It says there is a need to devise an objective formula so that the distribution is fair and equitable for all creditors.

What is the impact of this proposal?

• Inter-creditor distribution gets impacted

- As of now, a secured financial creditor is statutorily entitled to have his claim satisfied in priority to an unsecured financial creditor.
- The proposal seeks to dilute that statutory entitlement.

• Partially undo what the Supreme Court held in the Essar Steel case

- In this case, the Supreme Court upheld the idea of paying secured creditors amounts based on their value of the security in preference to other creditors.
- Hence, the current proposal seeks to partially undo this judgement.

- **Resolution vs. liquidation**

- The Code was seen as promoting resolution over liquidation.
- However, in the proposed scenario, it will be more beneficial for the secured creditors to push the company towards liquidation.
- This will enable these creditors to realise the full value of their security rather than sharing it with other junior creditors or creditors having inferior security interests under a resolution process.

Q1) What is Insolvency in Business?

Insolvency is a state of financial distress in which a person or business is unable to pay their debts. Insolvency in a company can arise from various situations that lead to poor cash flow. When faced with insolvency, a business or individual can contact creditors directly and restructure debts to pay them off.

Q2) What is liquidation of assets as per IBC, 2016?

Liquidation of assets under the Insolvency and Bankruptcy Code (IBC), 2016 is a process where the assets of a debtor company are sold to repay the outstanding debts to the creditors. Liquidation is the last resort when other options for insolvency resolution have failed or are not feasible. The liquidation process under IBC is initiated when the resolution process fails to achieve a workable solution. It can also be initiated if the creditors decide to directly go for liquidation instead of initiating the resolution process.

Source: [An Expert Explains: In IBC discussion paper, question of distribution of proceeds among creditors](#) | [Hindu](#)

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