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Insolvency and Bankruptcy laws – A look into the position of foreign countries

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Insolvency and Bankruptcy laws – A look into the position of foreign countries

INTRODUCTION

The last quarter of 2016 saw lots of movements in the corporate regimen of India. With the commencement of provisions of compromise and arrangements, mergers and amalgamations of the Companies Act, 2013; the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "the Code"). With this, much of the Code pertaining to corporate persons has now been notified. For the remaining part of the Code, recently the draft regulations on the Information Utilities were released for public comments, which were based on the report[1] of the recommendations of Working Group 4 set up by the Ministry of Corporate Affairs on regulation for Information Utilities. Also, the Insolvency and Bankruptcy Board of India has issued the draft Insolvency and Bankruptcy Board of India (Voluntary Liquidation) Regulations, 2017[2] for public comments.

The Insolvency & Bankruptcy Board of India has registered six cases including one involving UB Engineering Limited to begin insolvency resolution process against the company, ushering in a new era in India's dealing with sick businesses. ICICI Bank's application for insolvency resolution against Innoventive was the first to be registered by the Board. Among other registered cases are Srei Equipment Finance's application against Sree Metaliks, insolvency filing by Nicco Corporation and Bhupen Electronics Ltd.

In our previous article, we analysed the critical areas of the Code wherein further evaluation and examination was required for attaining the motive for which the code was notified. Now, we go a step further and then intend to analyse the foreign counterparts of the Code. The objective of the article is analyzing the implementation and effectiveness of the Insolvency Code in certain western and Asian countries, thereby analyzing its probe with their Indian counterpart and identify the key areas of implementation accordingly.

UNITED STATES OF AMERICA

To begin with, USA has different law for each of its state. There are separate courts dealing with that of bankruptcy matters. Clause 4 of Section 8 of Article I of the Constitution of United States[3] empowers the government to enact uniform laws on this subject (Bankruptcy) throughout all the States. The power has been exercised quite frequently during last 216 years. Significant changes in the laws were enacted in the year 1978 and thereafter in 2005 through the Bankruptcy Abuse Prevention and Consumer protection Act of 2005 respectively. The law there also defines concept of 'Bankruptcy

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[1] http://www.ibbi.gov.in/wg-04report.pdf

[2] http://www.ibbi.gov.in/IBBI%20(Voluntary%20Liquidation)%20Regulations%202017.pdf

[3] Clause 4 of Section 8 of Article I of the Constitution of United States. The same can be viewed at: http://constitutionus.com/

Crimes', tax implications upon bankruptcy and thereby integrates the bankruptcy law with other laws.

In United States of America[4], separate Bankruptcy courts were created for each district under Article I of the United States Constitution. These courts were additional to the District courts for each district. The Federal Rules of Bankruptcy Procedure (FRBP) govern procedure in the U.S. bankruptcy courts. The overwhelming majority of all proceedings in bankruptcy are held before a United States bankruptcy judge, whose decisions are subject to appeals to the district court. In some judicial circuits, appeals may be taken to a Bankruptcy Appellate Panel (BAP). Bankruptcy courts appoint a trustee to represent the interests of the creditors and administer the cases. Bankruptcy courts appoint a trustee to represent the interests of the creditors and administer the cases. The U.S. Trustee appoints Chapter 7 trustees for a renewable period of 1 year, Chapter 13 trustees are "standing trustees" who administrator cases in a specific geographic region. Decisions of the Bankruptcy Courts are not collected and published in an official reporter produced by the government. Instead, the de facto official source for opinions of the Bankruptcy Courts is West's Bankruptcy Reporter, published privately by Thomson West.

In US bankruptcy petition can be filed by Individual as also corporates. Petitions are filed in District Level Courts known as US Bankruptcy Court. The law also deals with bankruptcy proceedings in foreign forums. Under Chapter 9, the Courts consider how the foreign jurisdiction treats creditors and whether US creditors are protected against prejudice to the proceedings of their claims. There are separate protective provisions for adjustment of debts of family farmer, fishermen or individual with regular annual income. Separate provisions for debts of a municipality also have been made.

The model that Chapter 11 of the US Bankruptcy Code employs is instructive. Under Chapter 11, the management retains its job during the bankruptcy process but the creditors and the Court are empowered to appoint a trustee. The Court can also appoint an examiner to investigate the affairs of the debtor. In other words, while the management retains control in bankruptcy, they manage "in the shadow of a trustee" and as such, the risk that they will indulge in asset stripping during the process appears substantially mitigated.

UNITED KINGDOM

In UK, the Insolvency Act of 1986 deals with the cases of individuals and companies. The Act deals with at length on receivers and their powers, administrative orders, voluntary arrangement by companies, members voluntary winding up, creditors voluntary winding up, winding up by the

[4]https://en.wikipedia.org/wiki/United_States_bankruptcy_court

court and dissolution of companies, liquidators and their powers, winding up of unregistered companies. It covers registered friendly societies.

The procedure involves filing of bankruptcy petitions, and orders for bankruptcy being passed. Provisions for protection of bankrupt's estate and investigation of his affairs also have been made. Separate provisions for trustees in bankruptcy and administration by trustee have been made. A separate Chapter deals with effect of bankruptcy on certain rights and transactions and powers of court in bankruptcy. Bankruptcy offences have been separately defined. Role of new professionals called 'insolvency practitioners' has been recognized and their qualifications have been laid down.

Provisions against debt avoidance and preferential debts laying down priority to be given among creditors/ claimants have been separately provided for company and individual under insolvency.

It is open for directors of the company to take a proposal to the company or its creditors for voluntary arrangement and the proposal shall provide for appointment of trustee for its implementation. The proposal may also be submitted to the court and the court can appoint trustee.

Borrowing from the United Kingdom, the Code proposes to catalyze an industry of Insolvency Professionals that will be regulated by the Board. Thinking through an economic prism, an Insolvency Professional acts as an agent of creditors as a class and its presence ensures the inter-creditor agency costs are minimized. Empirical studies conducted on the UK bankruptcy regime, however, reveal that while adoption of the IRP model resulted in higher realizations, they also correspondingly increased costs of bankruptcy and thus did not materially improve creditor recoveries. In the light of this evidence, the adoption of the Insolvency Professional model warrants careful scrutiny. Moreover, the emergence of a well-functioning Insolvency Professional market will be critical to the success of the Code.

CHINA

China has been the world leader in economic growth during last thirty years and hence their legislation deserves closer attention. In China, Ministry of Commerce is the regulator. The cases are dealt by Peoples Courts. The judge appoints an administrator and a moratorium applies preventing further civil law recovery action by any creditor. In response to the growing demand of private entity bankruptcies, China has enacted the Enterprise Bankruptcy Law of 2006 (2006 EBL) that became effective in 2007. The current Chinese bankruptcy regime consists of the 2006 EBL, various administrative regulations, and judicial interpretations promulgated by the Supreme People's Court of the People's Republic of China.

Who are covered?

Specifically, Chinese courts have overly broad power because (1) only limited debtors can file for reorganization, (2) the standards of accepting a case are vague under the 2006 EBL are minimal, and (3) the automatic stay regime does not work as well in China given the fifteen-day window between a filing and the court's final acceptance of a case.

The 2006 EBL applies to corporate entities, financial institutions, or other organizations as against its erstwhile counterpart which only applied to state owned enterprises. However, as the 2006 EBL only applies to organizations, natural persons who do not qualify for organization status cannot avail themselves of bankruptcy law's protections. EBL 2006 regime also provides bankruptcy procedures for financial institutions.

Financial institutions vis-à-vis others

According to Article 134, financial institutions include commercial banks, securities companies, and insurance companies, etc. According to U.S. Bankruptcy Code, only a person who resides in, or has a domicile, a place of business, or property in the United States may file for bankruptcy. Such "persons" include individuals, partnerships, and corporations, but not a government unit.

Our Code also draws a demarcation between the financial institutions and others. Furthermore, a natural person can also invoke bankruptcy law in the India under Part III of the Code. However, the provisions pertaining to the same are yet to be notified. The decision to separate the treatment of corporate and individual bankruptcy in the United States, however, does not imply that one is more important than the other. Rather, the division is in response to different policies and practices in these two categories.

Because human beings cannot be terminated the way corporate entities can, individual bankruptcy cases are oriented more towards the economic rehabilitation of the debtor than that of their corporate counterparts. In this sense, our Code applies to a broader group of people, with fewer restrictions, than the 2006 EBL in China. This affords courts with less power to filter out reorganization cases at its discretion.

In addition to the fact that only a selective group of people can file for bankruptcy, Chinese courts also have substantive power because debtors are given less opportunity to reorganize through the court system. This is due to the fact that conversion from complete liquidation to reorganization is more difficult in China once a creditor files for liquidation because of the judicial courts having more intervention than the Indian Tribunal.

Voluntary Liquidation

According to Article 7 of the 2006 EBL, both debtor and creditor may file for complete liquidation. A debtor may file for liquidation in two situations: (1) when the debtor cannot pay off the current debts due, and the assets are unavailable to pay off all of the debts, taking into account both the debts currently due and those that will become due in the future; and (2) when the debtor apparently lacks the ability to pay off his or her debts now or in the future, regardless of the debtor's actual ability to pay.

It is difficult to tell the difference between the two situations, though the second is easily met once a creditor has evidence to support a reasonable belief that the debtor cannot pay off his or her debts, even if the debtor is still generating income. The two tests for liquidation filings appear to be very vague, and the 2006 EBL provides no guidance on how to differentiate them. This is opposite to the Indian mechanism wherein a corporate debtor is only allowed to file an application for voluntary winding up when he is in a position to pay its creditors.

A creditor may also file for involuntary liquidation against the debtor if the debtor fails to file for bankruptcy. A creditor may file these involuntary bankruptcy applications if the debtor cannot pay off his or her debts when they become due. Thus, unlike in the United States, there is no requirement that liabilities actually exceed assets in order to file for bankruptcy in China. Once again, there is stark difference between our Code and its Chinese counterpart as under our Code, creditors voluntary winding up has been done away with. However, if corporate debtor goes for voluntary winding up than in such case approval of 2/3 of the total value of creditors is necessitated for the processes to commence. This approval is in addition to the members approval by way of passing a special resolution or ordinary resolution, as the case may be.

Bankruptcy Administrator

After a bankruptcy case is initiated, a Chinese court will appoint an "administrator" similar to a Insolvency Professional in India. An administrator cannot resign without justifiable reasons and the resignation of an administrator is subject to approval by the Chinese court. Given the administrator's substantial involvement and influence in the liquidation and reorganization process, there are detailed rules on the appointment of administrators in China. On one hand, the administrators appointed by the court are often local persons or entities tasked with ensuring that they are familiar with the local situation. They are also expected to have close ties to the company to render effective management. On the other hand, if the debtor is a commercial bank, securities company, or insurance company, the administrators will often be a non-local entity in order to ensure fairness. This also applies to cases with complicated legal issues or nationwide impact. The administrator is appointed

through a random drawing to avoid manipulation of the appointment or a potential conflict of interest.

The administrator, rather than the debtor, dominates 2006 EBL proceedings. During the reorganization process, the debtor may, through his application and upon court approval, manage his property and business operations on his own under the supervision of an administrator. However, the debtor's power is still limited in three ways: (1) when the court accepts the reorganization application, it will also appoint an administrator; (2) even if the court decides to grant the debtor control over operations, such a decision usually takes time and the administrator retains the power to run the business during the interim; and (3) the debtor in control is still subject to the administrator's supervision. Given that 2006 EBL proceedings are administrator-oriented and the court has the exclusive power to appoint administrators, approve its resignation, and determine their fees, the court more or less controls the operation of the debtors throughout the process. Under the 2006 EBL, an administrator must manage the operations of the debtor and perform his duties according to the provisions of the law, report his work to the court, and is subject to supervision by the creditors' meeting and the creditors' committee.

SINGAPORE

Singapore is a major hub for business all over the globe. The bankruptcy related proceedings are regulated by insolvency and public trustees office. Similar to India, the erstwhile laws in Singapore dealt with individual bankruptcy under Chapter 20 of Bankruptcy Act and corporate insolvency was dealt with under Chapter 50 of the Companies Act.

Singapore's insolvency process has three options:

(i) scheme of arrangement;
(ii) appointment of judicial manager; and
(iii) winding up of the company under which a secured creditor has an option of appointing a receiver and manager for the secured property.

In Singapore, when an application to place the company under judicial management is made, an interim moratorium automatically comes into effect, with the aim of preserving the assets until the application is finally disposed of. The court may appoint an interim judicial manager, who may, if the court sees fit, be the person nominated in the application for a judicial management order.

In Singapore, the moratorium period is decided by the court and may be lifted with consent of the judicial manager or leave of the court. During the moratorium period, no steps can be taken to enforce security over the company's property and no other proceedings can be commenced.

In Singapore, a lender that holds a floating charge over the entire undertaking of the company will usually have the power to appoint a receiver and manager rather than just a mere receiver, because of the all-encompassing nature of the security. In relation to mortgages, the mortgagee is entitled to continue with its foreclosure action against the mortgagor even though the mortgagor is in liquidation.

Singapore has evolved jurisprudence on the *pari passu* rule and anti-deprivation rule, and one cannot contract out of insolvency proceedings.

CANADA

The proceedings are regulated by office of the superintendent of Bankruptcy. Various stages of bankruptcy appear to be dealt with by separate legislations.

The statutory framework for liquidation of the assets of an insolvent, whether individual, partnership or corporate and its distribution in fair and orderly way is dealt with under Bankruptcy and Insolvency Act (BIA). The trustee appointed under the Act takes charge of the assets, sales them and distributes the proceeds. The bankruptcy can be avoided by negotiation arrangement with their creditors for compromise of the debts or reorganization of financial affairs.

An insolvent company can seek a court for stay in creditors action while it negotiate an arrangement with them for re-schedulement or compromise under Companies' Creditors Arrangement Act (CCAA.) For liquidation of major financial institutions, including banks, insurance companies, trust and loan companies who cannot be liquidated under BIA separate law called Winding Up and Restructuring Act (WURA) is applicable.

CONCLUSION

As we have observed that process of the afore selected countries are different in their own ways due to the operational differences among other criteria's. Also, our Insolvency and Bankruptcy Code, 2016 have been adopted basis the European Law.

After deep examination, there are concern areas that are prevalent in the systems of law and therefore it is imperative that proper care must be taken while compliance, adherence and execution of the same. Under the Insolvency and Bankruptcy Code, 2016, the insolvency professional or the resolution professional has been bestowed with the responsibility to ensure that interest of all the stakeholders is safeguarded and the principle of natural justice is taken due care of. Therefore, the responsibility of

the insolvency professional or resolution professional is immense considering the technicalities and modalities involved and the aforestated areas under the previous law needs to be taken care of while such professional is incharge.