BANKRUPTCY LAWS: A COMPARATIVE STUDY OF INDIA AND USA

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ABSTRACT

This study examines a comparative relationship of United States and Indian insolvency and bankruptcy laws from individual and corporate prospective and analysis of the legislative framework. This study shows significant amendments and replacement made in previous related Acts for implementing the all new bankruptcy code with insolvency resolution and liquidation process with brief history of bankruptcy.

Keywords: Insolvency, bankruptcy, IBC, US bankruptcy code.

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1. INTRODUCTION

Insolvency means the incapability to repay debts. It applies both to failure of business organization as well as individual person bankruptcy, but the Insolvency is normally referred to business or corporate insolvency. Again, insolvency or indebtedness implies insufficiency to pay obligations upon the date when they become due in the customary course of business; the state of a person whose property and resources are deficient to release the individual's obligations. It is the state of having more obligations (liabilities) than all out resources which may be accessible to pay them, regardless of whether the advantages were mortgaged or sold. Corporate insolvencies happen because companies become extremely indebted. Insolvency is usually classified into two, "cash flow insolvency and balance sheet insolvency". There is a difference between two the narrower concept of cash flow insolvency "not ability meet up with commercial obligations arising from day today business transaction with third parties; and the wider concept for the second one is where the liabilities of the company more than the assets of the company. The main problem in that situation would not be the long-term feasibility of the business but a short-term delay in the cash flow, which can be correct through various techniques. Sometimes insolvency and bankruptcy are used interchangeably. However, the legally both are not having same meaning globally. Although these words essentially carry the same meaning in many systems. Bankruptcy is a legal process for the recovery of unpaid debts by creditors and also It is a legally authorized process by which a debtor is relieve of total liability for its debts by decision of court for their partial payment. Bankruptcy allows individuals and business that cannot pay their financial obligations to be immune from repaying

some or all of their unpaid debt. Insolvency has been in presence since antiquated occasions. It also protects persons who have become overburden by their debts. The regulations and procedures for filing bankruptcy are governed by law of national and common law principles. Although insolvency or bankruptcy seems very bad for individual or corporate but there is a possible benefit to both parties in bankruptcy. A creditor wants to recover unpaid debts to the possible limits in a speedy manner from a debtor who is not able to pay creditors the whole amount. From the debtor's point of view, bankruptcy allows the resolution of debts. There are following objectives of bankruptcy law:

- a. An equal distribution of the borrower's assets among creditors of the equal rank.
- b. A process through which a borrower is free from his all his debts, it gives him a new chance of making a start again.
- c. To enquire into the situation accountable for the insolvency and thereby provide information which may prevent others from accumulate debts which they are not capable to liquidate.

Bankruptcy procedures are punitive in nature and are to ensure that persons who cannot pay their financial obligations are disqualified from business, decision-making position and working as professions, except they are working as an employee. This is the reason for the enactment of the Bankruptcy Laws and is the most important purpose for the institution of a bankruptcy petition. in spite of the above, bankruptcy proceedings can be advantageously employed, by creditors, to recover debts due to them by borrowers upon the compliance with certain conditions precedent and the commission of any of the acts of bankruptcy provided under the Act.

1.1. THE HISTORY OF BANKRUPTCY LAW

"Bankruptcy law governs the rights of creditors and insolvent debtors who cannot pay their debts. In broader terms, bankruptcy deals with the seizure of the debtor's assets and their allocation to the debtor's various creditors. The term derives from the Renaissance custom of Italian traders, who did their trading from benches in town marketplaces. Creditors literally "broke the bench" of a merchant who failed to pay his debts. The term *banco rotta* (broken bench) thus came to apply to business failures." (Daniel Warner, George Siedel and Don Mayer)

1.1.1. In United State of America

"The first bankruptcy law in the United States came into being in 1800. This law was repealed in 1803 and was followed by the Act of 1841. The 1841 law was repealed in 1843 and was succeeded by the Act of 1867, which was amended in 1874 and was later repealed in 1878. The Nelson Act of 1898 became the first modern Bankruptcy Act in the country. The next modern bankruptcy law was enacted in 1978 by the Bankruptcy Reform of 1978. The Bankruptcy Abuse Prevention and Consumer Protection Act (2005) is the most recent amendment to the 1978 law." (Aghion, Phillipe, Oliver Hart and John Moore, 1992)

1.1.2. In India

Before Insolvency and bankruptcy code 2016 following laws were in practiced of bankruptcy:

The Companies Act, 1956 ("Companies Act"), Sick Industrial Companies (Special Provisions) Act, 1985, and Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI).

2. PRESENT BANKRUPTCY CODE OF USA AND INDIA

In USA

The contents of US bankruptcy code is divided in six chapters under the Title 11:

The US Bankruptcy Code are allowed to file a petition under the Bankruptcy Code chapters 7, 9, 11, 12, 13 and 15 for corporates and individuals seeking relief.

2.1. Chapter 7: Liquidation

It covers the process of liquidation and involves the appointment of a trustee by the bankruptcy court to collect the non-exempt assets of the debtor. The trustee is tasked with selling the assets and distributing the proceeds to the creditors in order of preference. Businesses and individuals in the United States can file for bankruptcy. An amendment was made to the bankruptcy law in 2005 with the passing of “the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005”. The amendment was intended to limit consumer debtors from filing bankruptcy in general. Supporters of the amendment claimed that the change would protect certain creditors such as credit card companies from losses resulting from bankrupt customers.

2.2. Chapter 9: Reorganization of Municipalities

This chapter of “the bankruptcy law deals with municipalities and how to help them in the restructuring of their amount outstanding. A municipality refers to a public agency of a state. It must be authorized to be a borrower by state law, government officer, or an organization allowed by state law to give such authorizations. Before this Chapter of bankruptcy code, the only remedy for troubled municipalities was for the creditors to take an action through court order to force the municipality to raise taxes. An amendment to the Bankruptcy Act in 1934 extended the bankruptcy code to include municipalities. The 2008 financial crisis eventually led to many municipal bankruptcies, six in 2010, thirteen in 2011, and twelve in 2012. The largest municipality to file for bankruptcy was Detroit, Michigan on July 18, 2013.” (Aghion, Phillipe, Oliver Hart and John Moore, 1992)

2.3. Chapters 11, 12, and 13: Reorganization

“The Chapter 7 that deals with the process of liquidation, Chapters 11, 12, and 13 deal with the reorganization of the debtor’s assets. Usually, the insolvency court will enable the account holder to keep a few or the majority of the benefits and use them to pay obligations owed to creditors. Chapter 11 is for businesses, whether a sole ownership, partnership, or corporation. Individuals have Chapter 11. Chapter 12 of this Code is only related to family farmers and fishermen. It provides additional benefits such as higher debt ceilings that are not provided by Chapter 11 and 13.” (Retrieved from www.uscourts.gov)

2.4. Chapter 15: Cross-Border Insolvency

Chapter 15 of this code allows for the cooperation between American courts, foreign courts, and other authorities involved in cross-border liquidation cases.

3. PRESENT BANKRUPTCY CODE INDIA

The “Insolvency and Bankruptcy Code, 2016” (hereinafter IBC) aims to combine and amend the laws relating to bankruptcy resolution of unlimited and limited liability companies, partnerships and individuals. The main aim of this law is at providing revival and resolution in a limited time period for maximizing the value of debtor’s assets. The Code has put a principal framework to aid sick enterprises to either wind up their business or make a revival plan, and for investors to exit. Another important element of the Code is that it does not make any

differences between the rights of international and domestic creditors or between classes of financial institutions. The Code has sought to balance the interest of all the concerned parties including alteration in the order of priority of payment of Government dues.

The Code repeals the “Presidency Towns Insolvency Act, 1909”, and “Provincial Insolvency Act, 1920”, as well as amends 11 laws, including: “Indian Partnership Act 1932”, “The Companies Act 2013”, “Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002”, “Limited Liability Partnership Act, 2008”, “Sick Industrial Companies (Special Provisions) Repeal Act 2003”. To avoid any further litigation in bankruptcy proceedings, the Code will have superseding effect over all other laws. It is specifically provided that civil courts or authority not to have authority and also cannot grant any injunction. The IBC as a new law, substituting over a dozen laws, when applied post the infrastructure being put in place, will show to be the most important step in evolving the regimen of recovery of bad debts. The insolvency resolution process is described herein below:

4. INSOLVENCY RESOLUTION PROCESS

The law makes a noteworthy departure from the existing resolution by shifting the charge on the creditor to initiate the bankruptcy resolution process against the company debtor. Under the existing legal outline, the primary obligation to initiate a resolution process lies with the debtor, and creditor may follow separate actions for regaining, security enforcement and debt reformation.

4.1. Insolvency Resolution and Liquidation Process for Corporates

If the default is above Rs.1 Lakh to Rs.1 Cr, the creditor may initiate insolvency resolution process. The Code proposes two independent stages:

Insolvency Resolution Process: In which financial creditors assess whether the debtor’s business is viable to run and the options for its rescue and revival;

Liquidation: If the insolvency resolution process fails or creditor choose to shut down and allot the assets of the debtor.

A. The Insolvency Resolution Process

A financial creditor may initiate corporate insolvency resolution process in case a corporate debtor default. “An application can be made to the “National Company Law Tribunal” (hereinafter NCLT) for starting the resolution process. Operational creditors have to give notice of 10 days to corporate debtor before approaching the NCLT. If corporate debtor fails to repay dues then the operational creditor can approach NCLT. This process shall be accomplished within 180 days of receiving of application by NCLT. Upon receiving of application by NCLT, Creditors’ claims will be frozen for 180 days, during this time NCLT will hear proposals for revival. Thus, no coercive proceedings can be launched against the corporate debtor in any other under any other law, until approval of resolution plan or until initiation of liquidation process. NCLT appoints an interim “Insolvency Professional” (IP) upon confirmation by the Insolvency and Bankruptcy Board (hereinafter, “the Board”) within 14 days of acceptance of application. Interim IP holds office for 30 days only. Interim IP takes control of the debtor’s assets and company’s operations, collect financial information of the debtor from information utilities. NCLT causes public notice to be made of the initiation of corporate insolvency process and calls for submission of claims by any other creditors.” (Retrieved from www.ibbi.go.in)

B. Liquidation

The beginning of liquidation process takes place on failure to submit the resolution plan to the NCLT within the given period, or rejection of resolution plan for non-compliance with the

requirements of the Code, or decision of creditors' committee based on vote of majority, or contravention of resolution plan by the debtor. During this process, no other proceedings shall be instituted by or against the debtor; except through the liquidator on behalf of corporate debtor with permission of the NCLT. The Resolution Professional will act as liquidator. Creditor can appeal to the arbitrator within the time of 14 days.

C. Fast Track Insolvency Resolution Process

The Code has provision of fast track insolvency resolution process for corporate debtors. The process shall be completed in 90 days it may extendable by 45 days.

D. Voluntary Liquidation of Corporate Person

The Code offers for voluntary liquidation proceedings by corporate who intends to liquidate by own and not made any default and can pay all debts from proceeding of liquidation. Once the debtor is completely wound up and assets liquidated, the NCLT passes an order for its disbanding.

4.2. Insolvency Resolution for Individuals & Partnership Firms

For this there is no specific mandatory period specified within which the resolution decision has to be done. If the default is above Rs. One Thousand and up to Rs.1 lakh, the Code applies. The Code has following distinct processes:

Automatic fresh start process: The Code allows discharge of qualifying debts thereby helping the debtor to start afresh.

Insolvency resolution process: during the process creditors assess whether the debtor's business is feasible to continue and the options for its rescue and revival

Bankruptcy: It is same as liquidation proceeding. When insolvency process fails, creditors may apply to distribute debtor's assets for repayment of debts.

A. Fresh Start Process

Under this process, eligible debtors can apply to the Debt Recovery Tribunal (DRT) for discharge from certain debts not more than a specified threshold, permitting them to start afresh. The fresh start process is only available to and not available for corporates. A professional appointed by the DRT who will examine the application, receives claims from creditors, accepts or rejects the application and submits a report with reasons to the DRT. On the basis of the report, the DRT will take decision of accepts or rejects the application.

B. Insolvency Resolution Process

The insolvency resolution process consists of preparation of a repayment plan by the debtor, for approval of creditors. If approved, "the DRT passes an order binding the debtor and creditors to the repayment plan. If the plan is rejected or fails, the debtor or creditors may apply for a bankruptcy order. DRT shall appoint resolution professional upon confirmation received from the Board. The resolution professional shall examine insolvency application and submit his report to DRT with his recommendation to admit or reject it. DRT shall within 14 days admit or reject the application. DRT shall issue public notice inviting claims from all creditors within 21 days of such notice. Creditors shall register claims with resolution professional. Resolution professional shall prepare a list of creditors. The resolution professional shall summon a meeting of creditors to approve, modify or reject the repayment plan by a majority of more than 75% votes. The resolution professional prepares a report of the meeting and submits to DRT." (Sharma, Nakul and Vyas, Rahul)

C. Bankruptcy

The process is similar to liquidation of corporate. “When application for insolvencies rejected by the DRT or the repayment plan is not submitted in time or the repayment plan fails or does not fulfil requirements of the Code, or the repayment plan is contravened, the creditor or the debtor himself may apply to DRT for bankruptcy of the debtor. The application cannot be withdrawn except with the leave of the tribunal. The DRT will pass an order, thereby indicating commencement of bankruptcy proceeding.” (ibbi)

4.3. Adjudicating Authority under the Code

At present, the High Courts, the Company Law Board (CLB), the “Board for Industrial and Financial Reconstruction” (BIFR) and Debt Recovery Tribunal (DRT) are having overlapping jurisdiction in the matter of debt recovery and restructuring. This gives rise to systemic delays and complexities in the process. The code intends to overcome these challenges and aims to reduce the burden on the courts as all litigation will be filed under the Code as under Part II, Chapter VI of the Code, National Company Law Tribunal (NCLT) would be adjudicating authority for insolvency resolution and liquidation of Companies, Limited Liability Partnerships (LLPs).

5. CONCLUSION

The US bankruptcy code and Insolvency and bankruptcy code of India has many similarities like both codes has separate provisions for individual, corporate. But there is nothing relating to municipalizes in Indian Code. As we have seen earlier in this article, USA already has this kind of law in the past but in India we didn’t had that we relied upon “Companies Act, SICA, SARFAESI” etc. for implementing IBC Indian govt made several changes in existing relating laws as we have seen in this article. Overall this particular code is very clear and helpful for both debtors and creditors.

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