IBC and Companies Act: The devil is in the details!

1. Introduction

India aims to have a business-friendly regime and the recent sweeping changes in the regulations, like the Goods and Service Tax, regulation on real-estate sector, enactment of Insolvency and Bankruptcy Code, 2016 (**"IBC"**) reinforce this objective. Perhaps, somewhat attributable to some of these recent regulations, India's position in World Bank's Ease of Doing Business index has improved and jumped from 77 in the previous year to 63.[1] World Bank has about a dozen criteria spanning multiple areas of business regulations and one of them is resolving insolvency, which is assessed in the overall ease of doing business score and ranking. IBC was enacted to consolidate the laws relating to reorganisation and insolvency resolution in a time bound manner. It has simplified the winding-up process for companies, which was earlier fragmented due to multiplicity of statutes as well as forums. With a defined process in place, IBC has slowly proved its significance in resolving insolvency.

Once enacted, IBC introduced changes to the Companies Act, 2013 (**"Act"**) particularly in relation to debt restructuring and winding-up. Interestingly, IBC may be seen as an encroachment into the functioning of the Act. This newsletter analyses some overlapping provisions of the Act and IBC and their probable impact.

2. Amendments to the Act

Section 238 of IBC specifically states that it shall supersede all other laws and prevail in the event of any conflict with the Act or any other law. Further, IBC has carried out amendments to 10 other statutes which are listed in its Schedules 1 to 10. These include LLP Act, Income Tax, Central Excise and the Act, amongst others.

2.1 IBC introduced 36 changes to the Act, particularly listed in its Eleventh Schedule. Most of these changes pertain to winding-up, debt restructuring, revival and rehabilitation of sick companies, functioning of liquidator and powers of the tribunal. The definition of company liquidator and winding-up under the Act has also been revised, mainly to harmonise with IBC. This newsletter shall not examine all the amendments, but selective ones which are relevant for evaluating the overlap between the two statutes.

2.2 Previously, chapter 19 of the Act dealt with the process and timeframe for revival and rehabilitation of sick companies.[2] The process of determining a company as sick would start when a secured creditor made an application to the tribunal[3] if a company failed to pay its debt on demand from secured creditors representing 50% or more. The tribunal had to come to a finding that the company was "sick" and, thereafter, a secured creditor or the company could file an application with the tribunal for determining measures for revival and rehabilitation. The tribunal would appoint an interim administrator, with power to **(a)** appoint a maximum 7 member

[1] https://www.doingbusiness.org/content/dam/doingBusiness/country/i/india/IND.pdf last accessed on Dec 20, 2019

[2] Under Sick Industrial Companies Act of 1985, a company is considered sick when has at the end of any financial year accumulated losses equal to or exceeding its entire net worth

[3] Board for Industrial and Financial Reconstruction established under Sick Industrial Companies Act, 1985

committee of creditors (**"CoC"**) representing each class of creditors; **(b)** convene meeting of creditors; and **(c)** submit a report on the possibility of revival and rehabilitation of the company. Based on the report and the approval of required majority of creditors, the tribunal could decide on revival and appoint a company administrator for furnishing a scheme, which had to be approved by unsecured and secured creditors representing one-fourth and three-fourths respectively, in value of amount owed by company to such creditors. Other criterion was also prescribed if scheme involved amalgamation with another company. Now, the entire chapter 19 of the Act stands omitted and a secured creditor can approach NCLT for initiating a corporate insolvency resolution process (**"CIRP"**). During the process, the management rests with the insolvency resolution professional (**"IRP"**) and only financial creditors are allowed to decide on the resolution plan. This is explained further in section 3. In short, a company can no longer be declared sick and, if it cannot function, it has to be either liquidated or undergo a CIRP.

2.3 Chapter 20 of the Act described winding-up and was divided into four parts. Winding-up could occur in two ways i.e., **(a)** by the tribunal, and **(b)** voluntarily. IBC has removed the entire part on voluntary winding-up and a company now needs to undergo the process mentioned in section 59 of IBC, described in section 3 below. In case of non-voluntary winding-up, the process prescribed under the Act and, as demonstrated below, the processes under the two statutes are not the same. Part III of Chapter 20 of the Act contains provisions applicable to both forms of winding-up, but in view of the need to follow IBC's process for voluntary winding-up, this chapter will apply only to court-driven closure.

2.4 IBC deleted section 325 of the Act which prescribed the sequencing of payments. In the event of liquidation, section 53 of IBC deals with waterfall mechanism, which deviates from the Act[4] in the priority order for distribution of assets. *Firstly*, the cost of CIRP and liquidation gets the top position in the waterfall mechanism under the IBC, while the Act places them at the bottom. *Secondly*, revenues and taxes payable to the Government get the priority after payment of financial debts owed to unsecured creditors. The Act gives them top position in the priority order. *Thirdly*, workmen's dues for 24 months are considered from the date of commencement of liquidation under IBC, while the Act considers the date of winding-up order for computation of 2 years. Thus, in the event of winding-up of a company for reasons other than voluntary winding-up or by a creditor, waterfall mechanism specified in the Act would apply and the mode shall determine the order of preference of claims of creditors, workmen, government and shareholders.

3. Overlapping provisions

As discussed above, there is a possibility of potential conflict between the Act and IBC. Interestingly, if a company decides to wind-up, it has a right under the Act and IBC.

3.1 *IBC driven winding-up:* The IBC allows a company to opt for voluntary liquidation if it has not committed any default, i.e. failed to pay any debt, wholly or partly, when it became due. There are several other mandatory conditions as well which may be prescribed by the Insolvency and Bankruptcy Board (**"IBB"**). Briefly, the process is as follows. At the outset, the majority of the board of directors have to declare and confirm through an affidavit that **(a)** they have examined thoroughly and the company has no debt or that it will be able to pay its debts in full from the proceeds or assets to be sold and **(b)** the liquidation is not to defraud any person. Such declaration

[4] Sections 326 and 327 of the Act provide the order of preference

and affidavit have to be substantiated with documents like audited financial statements, record of business operations and valuation report, if any. Four weeks after the declaration of the directors, the shareholders have to convene a meeting, approve and pass a special resolution for voluntary liquidation and appointment of liquidator *or* pass a resolution for liquidation as per the terms of Articles of Association and appointment of liquidator. If the company owes any debt, then within 7 days of the shareholders resolution, the creditors representing two-thirds in value of the debt have to approve the liquidation as well. Thereafter, necessary filings with the Registrar of Companies and IBB have to be done, within 7 days of the shareholders' resolution or the creditor's approval, as the case may be. Then, the liquidator takes charge, for the subsequent steps including realisation of assets, settlement of dues and distribution of proceeds to the stakeholders. Once assets are liquidated and all other affairs wound-up, the liquidator has to approach NCLT for dissolution of the company. Within 14 days of order of dissolution, the company has to file the order with the ROC.

3.2 *Act driven winding-up:* Under the amended Act, winding-up can only be done by the tribunal i.e., NCLT alone. Various persons can initiate winding-up, including the company. The broad procedure is set out in Part I of Chapter 20 and while there are over 30 sections in this part covering every aspect of closure, yet sections 271 to 274 describe the process largely. In case a winding-up petition is filed by a person other than the company, section 274 requires NCLT to direct the company to file its objections along with statement of affairs. If a company fails to do so, it will not only forfeit its right to oppose the petition, but the directors and officers who are found responsible for non-compliance shall be liable for punishment. The Act does not impose any condition upon the company regarding default in payment of its debts.

Thus, in case of default, a company cannot voluntarily liquidate under IBC, while it can apply to NCLT along with a special resolution for winding-up. The key point here is, regardless of the time and success of the petition, a remedy does exist under the Act for a company that has defaulted. And, where the process is successful it is noteworthy to remember that the payments to creditors will be handled differently and not in the order prescribed under IBC.

3.3 *IBC Resolution Plans:* Under section 6 of IBC, a financial or operational creditor or the corporate debtor can initiate CIRP, if a corporate debtor defaults in payment of INR 100,000 or more. While admitting an application, NCLT appoints an IRP who takes charge of the corporate debtor as a going concern. The IRP is the equivalent of the liquidator under the Act and is responsible for presenting a resolution plan to the CoC. Upon CoC's approval, NCLT reviews it and then conclusively decides in favour or against it, as it deems fit. A resolution plan must include steps to revive the company, which may include infusion of fresh funds for operation or settlement of dues, sale of assets of company as a going concern, arrangement with other company, amongst others.

Section 5(26) of IBC clarifies that a resolution plan may include restructuring by way of merger, amalgamation and demerger and, if these options are opted for, it may be necessary to comply with several other requirements of the Act. It is possible that there may be inconsistencies in the process laid down in IBC and the Act while approving a restructuring resolution plan. Some of the differences between the two statutes are as follows.

Firstly, IBC excludes shareholders[5] and operational creditors from approval process, while the Act requires special resolution of all categories of creditors and shareholders. *Secondly*, IBC makes the resolution plan binding on government authorities, without clarifying whether it requires their approval. In a recent case, NCLT has directed[6] that the Secretary to Ministry of Corporate Affairs be made as party to all proceedings under IBC and the Act. However, the appellate tribunal has recently stayed the operation of this order and until a final decision is made, the inconsistencies will continue to exist. *Thirdly*, IBC empowers the CoC to approve the resolution plan and NCLT has a limited role in the approval process. In contrast, the Act requires NCLT to exercise wide range of powers in approving a scheme and if deem fit, modify it too. *Fourthly*, IBC amends part of section 230 of the Act, which deals with compromise or arrangements with creditors and members. The amendment allows a liquidator appointed under IBC or the Act to file an application for compromise or arrangement and NCLT may take steps in that regard, but no process is prescribed for the liquidator. In contrast, the Act contemplates an application by a liquidator appointed under IBC and sets out the process. While section 238 of IBC provides supremacy to IBC in the event of inconsistencies, in situations where IBC does not have explicit provisions to the contrary, only jurisprudence could iron out these anomalies.

Conclusion

It appears that when IBC was enacted, the overlap of some of the foregoing provisions was not clearly visible. IBC's supremacy over other laws is explicit when there are conflicts. The devil is always in the details! The situation could be different when IBC is silent about few aspects like compliance mechanics for a resolution professional or liquidator in the event of merger or amalgamation or any arrangements under the Act. As result, the ambiguity has created room for jurisprudence to fill the gap. It is appropriate that we have codified law, rather than the uncertainty of a judicial law-making and perhaps the clarity in insolvency resolution process may, along with other indicators, help in further improving India's rank in World Bank's Ease of Doing Business index.

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[5] General Circular No.IBC/01/2017 dated October 25, 2017 issued by the Ministry of Corporate Affairs clarifies that the approval of shareholders, members or the company for a particular action required in implementation of the resolution plan is deemed to be have been given on approval by NCLT

[6] **Oriental Bank of Commerce vs. M/s. Sikka Papers Ltd. & Ors**. decided by NCLT, New Delhi, on November 22, 2019