COMPARATIVE ANALYSIS OF THE INSOLVENCY RESOLUTION MODELS: DEBTOR-IN-POSSESSION & CREDITOR-IN-CONTROL IN IBC

Yash Parekh, UnitedWorld School of Law, Karnavati University

ABSTRACT

The IBC has been developed a lot since its inception. Since then a lot of changes have been seen from the mode of resolution from Debtor-Based to Creditor-Based and other relevant changes. This following paper aims to identify the concepts of Insolvency and Bankruptcy Code of India with its history and how it was established under the given the lack of actual insolvency resolution processes. Following its understanding, the paper further looks into the current framework of insolvency resolution which is a Creditor-Friendly model. Moreover, it keeps undergoing changes which would be highlighted in the paper, that is, the introduction of a hybrid model of insolvency resolution called the PPIRP after the widespread negative effects caused by the Covid-19 Pandemic. Given the scenario in India, the paper further aims to derive a comparative analysis of the insolvency framework models of two prominent countries which has influenced India, that is, the United Kingdom and the United States. Owing to the given analysis the paper further highlights certain shortcomings which need to be addressed for a better efficient restructuring of insolvent entities in India. It concludes with the author trying to highlight certain shortcomings of the code with an approach to solve them through the comparative analysis.

Keywords: CIRP, Insolvency Framework Models, Hybrid Framework, PPIRP

Introduction

The Corporate Insolvency Process (CIRP) in India as established under the Insolvency and Bankruptcy Code (IBC), 2016, is the procedure to resolve the insolvency of a corporate debtor, that is, a corporate person who owes a debt to any person, either in whole or any partial amount or in installments. This process can be initiated by a financial creditor, an operational creditor, and a corporate applicant of the corporate debtor by approaching the National Company Law Tribunal (NCLT) under Section 7, Section 9, and Section 10 of the Code respectively. The entire purpose of this legislation is to facilitate the smooth reorganization and insolvency resolution of the corporate entities involved within a given time limit for the utmost maximization of the value of assets and collaterals of such persons, in order to encourage businesses and maintain a balance of interest of all the stakeholders, most presumably the shareholders and the creditors[1].

Much needs to be understood about the Insolvency Resolution framework that exists in India and a comparative study of this model with foreign counterparts needs to be analyzed in order to bring out the maximum utility of our Legislation.

India's Insolvency Framework Model

History

Companies exist by a contract that clearly establishes the balance of equity and debt. The basis of control is dependent upon the obligation of debt, that is, as long as there is remaining debt by a corporate entity, the equity owners would have full control over the business. However, the controllership transfers to the creditors when such debt obligations are not handled. Therefore, if default would take place, the equity owners would have no say or control over the affairs of the company.In the Past, the act of Bankruptcy was synonymous with stealing. It was considered a derogatory and humiliating act for which the punishment was the execution of the Debtor's property to repay the outstanding Loans[2]. Even in the Dharmashastras, the act of committing a default was considered a grave and sinful act[3]. It was written that when the person

[1] *Understanding the IBC: Key Jurisprudential and Practical Considerations*, INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, https://www.ibbi.gov.in/uploads/publication/e42fddce80e99d28b683a7e21c81110e.pdf
[2] Pihu Mishra & Sushanta Kumar Das,(2021). *Social Ramifications of Bankruptcy Law,* in QUINQUENNIAL OF INSOLVENCY AND BANKRUPTCY CODE, 2016
[3] Rajiv Mani, *Debts in Ancient India,* in INSOLVENCY AND BANKRUPTCY CODE: A MISCELLANY OF PERSPECTIVES

who had defaulted on the repayment would be inflicted with draconian punishments or if the person died, then all the debtor's good deeds would be transferred over to the creditor.

However, the following framework was not evident in India before the enactment of the IBC, in 2016. The Company that had defaulted in paying its debts had always stayed in control. The Creditors would have no power over such default. The only entity that had a limited extent of control were the Banks which had the authority to repossess fixed assets that were pledged with them by the Company. Therefore, under the following arrangement, the recovery rate of debt in India was among the lowest in the world which was approximately 20% of the value of debt. This situation that was created by low recovery rates led to Creditors being reluctant to provide any financial assistance or lending. Thus, the market concentration of lending was only evident in a few large companies that had the capability to repay the debts they took.

Given the conundrum at hand, the Bankruptcy Law Reforms Committee (BLRC), after presiding over this issue and looking up at the inefficient outcome and shortcomings of our past existing legislation released a report in 2015 that gave a paradigm shift in the insolvency resolution process[4]. The committee suggested that in case of default of a company wherein the corporate person is unable to repay their debts, the control of the company would pass over from the rule of "debtors-in-possession" to the principle of "creditors-in-control" upon which the code on Insolvency and Bankruptcy is based on.[5]

"The Committee believes that there is only one correct forum for evaluating such possibilities and making a decision: a creditors committee, where all financial creditors have votes in proportion to the magnitude of debt that they hold. In the past, laws in India have brought the arms of the government (legislature, executive, or judiciary) into this question. This has been strictly avoided by the Committee. The appropriate disposition of a defaulting firm is a business decision, and only the creditors should make it."[6].

This recommendation of taken over into the picture and the enactment of the Insolvency and Bankruptcy Code, 2016 took place.

---

[4] Chatterjee, S., Shaikh, G., & Zaveri, B. AN EMPIRICAL ANALYSIS OF THE EARLY DAYS OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016. *National Law School of India Review*, *30*(2), 89-110. https://doi.org/26743938

[5] TK Viswanathan et al. Bankruptcy Law Reforms Committee. (2015). The Report of the Bankruptcy Law Reforms Committee Volume 1: Rationale and Design. https://ibbi.gov.in/BLRCReportVol1_04112015.pdf

[6] ibid.

Current Framework for Insolvency Resolution

According to the BLRC Committee report, Shareholders and Creditors are the most prominent stakeholders of a Company. When a default takes place, the control of the management should transfer to the committee of creditors. This was also held in a case ruled by the Supreme Court highlighting the fact that there has been a shift in the exclusive right to control over a company in case of a default.[7] It was held in the case that the Insolvency and Bankruptcy Code, 2016 is a "Creditor-Friendly" code and that once the "Insolvency Professional (IP)" is appointed, the incumbent directors would have no say in the affairs of their company[8]. The IP works under the supervision of the Committee of Creditors for the purpose of reorganization.

The formulation of a Committee of Creditors is based on the principle of a Collective mechanism to deal with a stressed-out company's financial situation. It is different from the mechanism of Individual Creditors claiming their debts[9]. The establishment of the Committee is in accordance with Sections 18 and 21 of the Code. Section 18(c) clearly states the power of the Interim Resolution Professional to constitute a committee of creditors after taking into consideration the claims received against the corporate debtor and his financial situation while Section 21 lays down the functions of the Committee. However, only the financial creditors would be able to participate in the committee of creditors leaving behind the operational creditors. This sparked some debate and led to discussions in the court of law. In the case of Akshay Jhunjhunwala and Anr. v. Union of India[10] it was held that financial creditors such as banks are given a different treatment merely because the monetary risks of banks outweigh those of the operational creditors. Similarly, in the case of Swiss Ribbons v. Union of India[11], Justice R.F. Nariman gave the reasoning that Financial Creditors are able to be a part of the Committee due to the fact they have the ability to engage in the restructuring of financial aid and reorganization of the corporate debtor's company whilst in financial burden, which the operational creditors are unable to do. However, the difference between financial and operational creditors does not deviate from the fact that this provision was brought into the picture to guarantee an efficient resolution of the corporate debtor's insolvency.

---

[7] Innovative Industries Ltd. v. ICICI Bank Ltd., 2017 (11) SCALE 4.
[8] Section 20(1) of the Insolvency and Bankruptcy Code, 2016, The interim resolution professional shall make every endeavour to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern.
[9] RAVI, A. (2015). Indian Insolvency Regime in Practice: An Analysis of Insolvency and Debt Recovery Proceedings. *Economic and Political Weekly*, *50*(51), 46-53. https://doi.org/44002991
[10] *Akshay Jhunjhunwala v. UOI* [W.P. No. 672 of 2017. Decided on February 2, 2018 (Calcutta)]
[11] *Swiss Ribbons v. UOI* [Writ Petition (Civil) No. 99 of 2018, decided on January 25, 2019 (SC)]

After the CIRP is initiated by the persons concerned, a “Resolution Plan” is formulated in accordance with Section 5(26) of the code which includes provisions for the restructuring of the defaulting business of the corporate debtor and suggests methods like merger, amalgamation and demerger. Due importance is placed on the resolution of the insolvent corporate person as a “Going Concern”. When all the conditions and proposals are met, the resolution plan is accepted. However, in case of the absence of acceptance of the resolution plan, the NCLT has the authority to issue a liquidation order to the corporate debtor which upon approval of the CoC, a liquidator is appointed who sells the assets of the corporate debtor and distributes it among the stakeholders.

Hybrid & Flexible Model of Insolvency Resolution Framework: The Pre-Packaged Insolvency Resolution Process (PPIRP)

In recent news, a new amendment in 2021 had to be introduced in light of the COVID-19 pandemic. It was the inclusion of a Pre-Packaged Insolvency Resolution Process (PPIRP) in the Code to serve as an alternative resolution plan for the Mico, Small, and Medium Sized Enterprises (MSMEs) to ensure that the resolution process is smoother. The given amendment came out as a result of a report by the Insolvency Law Committee[12] which elucidated the need for a hybrid resolution method of “Debtor-in-possession” and “Creditor-in-Control” in the wake of the pandemic threatening the stressed MSME sector. According to the Committee, this recommendation was based in order to provide relief to the stressed MSME sector by making the insolvency process a lot simpler, and cost-efficient.

The Pre-Packaged Process adopts the hybrid model, that is the Debtor-Creditor model, where both parties can actively and mutually decide on the resolution process. In this model, the Debtor can participate to incentivize timely decisions and bring in the relevant experience while maintaining the core element of the CIRP. With this decision, the Section 29A was relaxed in order to provide for the PPIRP[13]. However, this amendment is only applicable to MSMEs.

Section 29A of the IBC, 2016 contains conditions upon which a potential bidder would be disqualified from being a resolution applicant. This section restricts the access to the present management from actively taking part in the company's future to decide the resolution plans.

[12] Ministry of Corporate Affairs. (Issued on October 31, 2020) (India) Report of the Sub-Committee of the Insolvency Law Committee on Pre-Packaged Insolvency Resolution Process
[13] Ram Mohan, M. P., & Raj, V. (2021). Section 29A of India’s Insolvency and Bankruptcy Code: An Instance of Hard Cases Making Bad Law? https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3886464

It makes ineligible the promoters, management, or any key managerial personnel of a company who has held a non-performing asset for over a year[14].

Comparative Study of Insolvency Resolution Models with the UK and the US

In India, the resolution facilitation process was inspired by both the United States and the United Kingdom's Insolvency Laws. Both the UK and the US have contradictory laws on insolvency yet they both acknowledge the process of insolvency resolution and the need for rehabilitation. Despite their differing views and provisions, their purpose is the efficient method of resolution rather than liquidation.

The key difference in between the Bankruptcy Laws of the UK and the US is the approach of the model that may control the defaulting business. In the UK, the most prominent model is of the "Creditor-in-Control" approach whereas in the US, the "debtor-in-possession" model.

The UK's Insolvency Law is most similar to the IBC, 2016 owing to its origin from the Common Law system. It is seen as a manager-displacing piece of legislation[15], that is, although there remains a management and the board of directors, the overall function of management of assets lies in the hands of the Insolvency practitioner (Insolvency Professional in India) who is appointed by the creditors. The Insolvency Act, of 1986, the law governing insolvency in the UK has been inherently sympathetic and arching towards the Creditor's side and proactively seeking out for their rights. The process of resolution is similar to that in India. Instead of a Resolution Professional, the UK has its counterpart called the Administrator who handles the resolution process on behalf of the creditors. It is the administrator who assumes control of the defaulter's company and carries out the important managerial functions. Similarly, A Company Voluntary Arrangement (CVA) is formed which acts like the Committee of Creditors in the Indian Context. The CVA decides and accepts a certain amount of the debts due to them or comes into an agreement with the company that their debt would be transferred into equity.

Unlike the UK's creditor-centric policy on insolvency, the US follows a more Debtor-in-Possession model for resolving such issues. The Insolvency process of the Defaulting Companies in the US is duly conducted in accordance with Chapter 11 of the US Bankruptcy

[14] Section 29(c) of IBC, 2016
[15] McCormack, G., & Paterson, S. (2007). Control and Corporate Rescue: An Anglo-American Evaluation. *The International and Comparative Law Quarterly*, *56*(3), 515-551. https://doi.org/4498088

Code[16]. According to its Judiciary, the people who are investors or creditors in the US prefer the defaulter, that is, the business owner in the resolution decisions. The whole basis of this reasoning is that the Defaulter has prior experience and knowledge of the functioning of the company more than that of the Creditor, therefore It would be wiser for the Corporate Debtor to keep having control over the management of the Company. The provisions of the reorganization process are very much in alignment with the Company's favour and are seen as an assisting instrument[17]. As per Chapter 11, the management of the company can have control over its functions while the Bankruptcy proceedings are going on. The Corporate Debtors would be given ample time of 120 days to come up with a resolution plan while having having control over the affairs of their business to initiate a much smoother reorganization plan. The governing body for these procedures is overtaken by the US Department of Justice offer who is better known as the US Trustee.

It is important to note that both these differing methods of resolution, that is, the Debtor-based and the Creditor-based method are equally meritorious in their given respective jurisdiction and situations. Having a Debtor-in-possession method could benefit the resolution process due to the vital experience held by the key managerial personnel, however, could also be treated as a negative covenant when the decisions of such debtors are based on a "nothing to lose" principle where the decisions would not only recklessly lose their company but also not be able to pay the creditors the same. This may lead to fraudulent activities on the pretext that the company is in bankruptcy proceedings.

Even the Creditor-in-Control method of resolution has its own benefits and drawbacks. It enables the role of an Insolvency Professional who takes charge of the management of the company and has relevant experience in this particular field of law. The process of resolution would be able to smoothly conduct its operations with almost no room for appeals from the debtors of the company, which would result in better outcomes for the creditors and a just result. It is the influence of the creditors who put their perspective in place that would directly impact the resolution process. Yet, this method has its own shortcomings as the creditors would

[16] Chapter 11 - Bankruptcy Basics. (n.d.). Retrieved from https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics#:~:text=This%20chapter%20of%20the%20Bankruptcy,seek%20relief%20in%20chapter%2011.

[17] V.Anantha Nageswaran and Aakanksha Arora. (2022) *Insolvency and Bankruptcy Code: A Path Well Travelled,* IBC IDEA, IMPRESSIONS AND IMPLEMENTATION, INSOLVENCY & BANKRUPTCY BOARD OF INDIA https://ies.gov.in/pdfs/IBBI-annual-publication1-32.pdf

have arbitrary powers over the debtor's business wherein the decision would not create a balanced plan of resolution as it would only favour the Creditors of the Company. This would only aggravate further imbalance when the Committee of creditors would not be able to come up with a resolution plan within the stipulated time given in accordance with the code[18]

Shortcomings of the Code and Way Forward

Much evident shortcoming in the "Creditor-in-possession" model of our IBC is the lack of experience and clarity among the Creditors. The multi-layered process of Insolvency resolution has led to inefficiencies that are backed by delays. A combination of winding up petitions and its counter of debt recovery petitions haze the understanding of the overall position of the Insolvent Person and the decision-making process of the Committee of Creditors. This goes against the very essence of the Insolvency Resolution Process stipulated by this Code[19] In the case of *Kritika Rubber Industries v. Canara Bank*[20] the creditors had initiated an action in the Debt Recovery Tribunal whereas another group of debtors filed for winding up petition in the same court. The interesting fact of this case is that while the parties to the DRT were unaware of the winding up petition claimed no knowledge of its existence. This case served as a precedent to show the confusion created by the multiple processes of resolution and the numerous conflicts it brought between the stakeholders. These conflicts not only jeopardize the whole insolvency resolution process but also waste the precious time of the court of law.

Arbitrariness of Creditors is also one of the few dilemmas being faced by our Corporate Debtors. It grants almost complete and arbitrary power over the whole CIRP. Such authority could reflect an inequitable distribution among the Committee of Creditors and would rather strike as a retributive legislation rather than a resolving legislation[21].

Moreover, the IBC has remained strict upon withdrawal of the resolution applications. According to the NCLT, the application by a corporate debtor would not be withdrawn once the resolution plan is drawn by the CoC and was held in the case of *Ebix Singapore Private Limited v. Committee of Creditors of Educomp Solutions Limited*[22]. While maintaining a time-bound insolvency process is certainly the main objective of our Code, certain uncontrollable

[18] Section 12 of IBC, 2016
[19] *Supra* Note 9
[20] Kritika Rubber Industries v. Canara Bank (Karnataka High Court), CA No. 190/2008 in Co P No. 167/1999, decided on 7 November 2008
[21] Pryor, C. S., & Garg, Dr. R. (2020). Differential Treatment Among Creditors Under India's Insolvency and Bankruptcy Code. Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3676489
[22] MANU/SCOR/39578/2020

situations should permit the withdrawal of the application. Certain exigencies should be put into place which would provide reasonable time for the withdrawal and avoid the risk of losing the company's financial condition.

Given the shortcomings of the code, it should be considered that the introduction of PPIRP, which has been initially introduced to aid the MSME sector, provides a much better recourse than our only Creditor-Based friendly model of resolution. It involves the flexibility that is required, that is, giving the Corporate Debtors the option to voice their opinions coming out of their experience in operating the insolvent company and the mutual decision of creditors in a way to fix the best restructuring method which is devoid of any one-sided approach of benefits. If regulations can permit such changes, then it would be an optimum and effective solution in addressing the insolvency resolution processes.

Conclusion

Therefore, this paper tries to bring into the picture the Insolvency and Bankruptcy Law in India while dwelling over its history, the shift from a debtor-centric model to a creditor-centric and in the recent trend the hybrid structure of CIRP. It considers the comparative analysis of both the model and its respective place of origin (the UK and the US) and tries to frame all the nuances that make our IBC function. The pivotal role of the Creditors and Debtors have been made into understanding and their need for an appropriate legislative framework. The paper also dwells into the shortcomings of our Code which can be redefined to prevent any unjust situation among the corporate debtors or the creditors. Striking a balance between both the party's need whilst maintaining the very objective of the code. Thus, navigating these complexities, continuous evaluation and amendments would be essential in providing a robust and equitable solution in the CIRP.

REFERENCES

Journal Articles

1.	*Understanding the IBC: Key Jurisprudential and Practical Considerations*, INSOLVENCY AND BANKRUPTCY BOARD OF INDIA, https://www.ibbi.gov.in/uploads/publication/e42fddce80e99d28b683a7e21c81110e.pdf
2.	Pihu Mishra & Sushanta Kumar Das,(2021). *Social Ramifications of Bankruptcy Law,* in QUINQUENNIAL OF INSOLVENCY AND BANKRUPTCY CODE, 2016
3.	Rajiv Mani, *Debts in Ancient India,* in INSOLVENCY AND BANKRUPTCY CODE: A MISCELLANY OF PERSPECTIVES
4.	Chatterjee, S., Shaikh, G., & Zaveri, B. AN EMPIRICAL ANALYSIS OF THE EARLY DAYS OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016. *National Law School of India Review*, *30*(2), 89-110. https://doi.org/26743938
5.	RAVI, A. (2015). Indian Insolvency Regime in Practice: An Analysis of Insolvency and Debt Recovery Proceedings. *Economic and Political Weekly*, *50*(51), 46-53. https://doi.org/44002991
6.	Ram Mohan, M. P., & Raj, V. (2021). Section 29A of India's Insolvency and Bankruptcy Code: An Instance of Hard Cases Making Bad Law? https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3886464
7.	McCormack, G., & Paterson, S. (2007). Control and Corporate Rescue: An Anglo-American Evaluation. *The International and Comparative Law Quarterly*, *56*(3), 515-551. https://doi.org/4498088
8.	V.Anantha Nageswaran and Aakanksha Arora. (2022) *Insolvency and Bankruptcy Code: A Path Well Travelled,* IBC IDEA, IMPRESSIONS AND

	IMPLEMENTATION, INSOLVENCY & BANKRUPTCY BOARD OF INDIA https://ies.gov.in/pdfs/IBBI-annual-publication1-32.pdf
9.	Pryor, C. S., & Garg, Dr. R. (2020). Differential Treatment Among Creditors Under India’s Insolvency and Bankruptcy Code. Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3676489

Government Reports

1.	TK Viswanathan et al. Bankruptcy Law Reforms Committee. (2015). The Report of the Bankruptcy Law Reforms Committee Volume 1: Rationale and Design. https://ibbi.gov.in/BLRCReportVol1_04112015.pdf
2.	Ministry of Corporate Affairs. (Issued on October 31, 2020) (India) Report of the Sub-Committee of the Insolvency Law Committee on Pre-Packaged Insolvency Resolution Process