From Chairperson's Desk

Leveraging Behavioural Change

The Insolvency and Bankruptcy Code, 2016 (IBC/Code) was enacted to provide for insolvency resolution of distressed entities in a time bound manner. To keep the unprecedented reform abreast with the upcoming challenges, the Government has amended the Code six times during the last six years. The Insolvency and Bankruptcy Board of India (IBBI), the Regulator, has also made 84 amendments to its 18 regulations made under the Code, out of which around 22 amendments have been made in the past one year alone. The Code has led to behavioural change in the debtor-creditor relationship. The fear of losing control of the firm on initiation of corporate insolvency resolution process (CIRP), is nudging debtors to settle their dues with the creditors as soon as possible. Till September, 2022, 23,417 applications for initiation of CIRPs, having underlying default of ₹ 7.31 lakh crore were resolved before their admission. This is attributed to the behavioural change effectuated by the Code.

However, there is a concern that the Code is losing its sheen due to excessive delays and loss of value in the resolution process. The performance of the Code during the past six years has been better than the previous regimes, but there is a great scope for improvement. We need to learn from our experience in the last six years and make the Code more effective in terms of processes and more result oriented. The Government and the Regulator are working in tandem, to roll out next generation reforms in the insolvency space.

It has to be borne in mind that amendments in the Code and/or regulations may not suffice. The performance of the Code is based on the collective participation of all stakeholders in a non-adversarial manner. From early identification of distress to value maximizing insolvency resolution, each stage and activity in the processes under the Code needs constant engagement, willingness and commitment of all the stakeholders. There is a need to ensure that all stakeholders keep their respective act for the successful implementation of the Code.

Let us take admission of a CIRP as an example to understand the importance of behavioral aspects in the Code. Section 7 of the Code provides initiation of CIRP by a financial creditor (FC) when a default has occurred. Banks declare an account as non-performing asset (NPA) in ninety days after occurrence of default in repayment obligations/ persistent irregularities as per Income Recognition and Asset Classification norms set by the Reserve Bank of India (RBI). It is perhaps in the interest of banks to file CIRP applications as soon as default occurs. However, it is noticed that more than a year is being taken by FCs in filing CIRP applications post occurrence of default. This delay leads to erosion in value of assets. Thus, the creditors need to change their behaviour and submit the CIRP application early as soon as default has occurred. They invariably have the option to withdraw the application before it is admitted. Even where the application has been admitted, in case they arrive at a satisfactory settlement with the corporate debtor (CD), FCs still have the option of withdrawal under section 12A of the Code.

Further, for the Adjudicating Authority (AA) to expeditiously verify the existence of such default, the Report of the Bankruptcy Law Reforms Committee had envisaged that the CIRP application should rely on information of default furnished by registered Information Utility (IU). This will allow for the speedy commencement of insolvency proceedings, owing to the undisputed information that is made available by the IU. The provisions under section 7(3), *inter alia,* obligates the FC to furnish a record of default of an IU as part of their application for initiation of CIRP. Section 7(4) requires the AA to ascertain the existence of a default from the records of an IU. However, it is observed that substantial time of the AA is consumed in ascertaining 'existence of debt' and 'occurrence of default' due to examination of voluminous and at times irrelevant documents. Therefore, it is necessary that the creditors must adapt to mandatory submitting the record of default as a proof of existence of default so that the AA can accept the same as sufficient proof of default.

Furthermore, it has also been observed that interlocutory applications are filed during the admission process on grounds of principle of natural justice not being followed, the application being barred by limitation, inaccuracy of default amount etc. There are numerous documents exchanged between the FC and the CD regarding restructuring/settlement etc. before taking a recourse under the Code. The IU is also mandated to send at least three notices to the CD before issuing record of default. The CIRP application by banks are generally within limitation period of three years and are filed after several notices extended by the creditors to the debtors. These documentary evidences establish that the principle of natural justice is inbuilt and rigorously followed to establish existence of default. Additionally, there is no requirement of determination of the exact amount of default or adjudication of dispute at admission stage provided that the threshold default amount of ₹ 1 crore is met. Thus, the creditors need to file their applications in time, enclosing certificate of record of default issued by the IU, pre-exchanged correspondences with debtor along with the CIRP application so that the examination by AA is facilitated and thereby, time taken in admission is reduced. This requires behavioural change at all levels.

To sum up, mere amendments in the Code/regulations may not suffice and it is necessary for all the stakeholders to take actions in a time bound manner in accordance with the spirit of the Code that reduces delays and maximises the value of the CD.

(Ravi Mital)