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Individual Insolvency- The Next Big Thing

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ABSTRACT

In the 4 years of the enactment of the Insolvency and Bankruptcy Code 2016, the government has not only chosen to notify legislation relating to corporate insolvency but sure has come a long way in putting forward laws relating to individual insolvency and it is expected that more parts of personal insolvency will be notified in the near future making it the next big thing and drawing the focus away from corporate insolvency.

In this context the paper describes the Indian credit market and presents an argument for the need of personal insolvency law being more clear and transparent in nature. It also lays down the laws and legislation relating to personal insolvency and an overview of the process of insolvency and bankruptcy code involving fresh start process and the insolvency resolution process. The paper also draws back a line to the history and the evolution of insolvency infrastructure in India and the problems and the criticism faced in coming forward with a codified set of laws.

I. BACKGROUND OF INDIVIDUAL INSOLVENCY LAW IN INDIA

Before the British raj came to India, there weren't any insolvency laws that prevailed in India. It was only after the Government of India Act, 1800 that came into being which laid down the provisions for Insolvency laws in India. Further, in the year 1828, a statute was passed which marked the commencement of special insolvency legislation in India and this statute applied to Presidency towns namely Bombay, Madras and Calcutta.

It was originally meant to be in effect for a span of 4 years however, was extended until 1843. In 1848 another statute of insolvency law called the Indian Insolvency Act, 1848 was passed that created a major distinction between traders and non-traders. Insolvency jurisdiction under the statute was transferred to High Courts. Its jurisdiction was conjointly restricted to presidency towns. In 1909, the current prevailing Presidency Towns Insolvency Act 1909 was passed.

Later the provincial Insolvency Act, 1907 was passed which repealed the current legislation of Provincial Insolvency Act, 1920. Recently in 2016, the Insolvency and Bankruptcy code, 2016 was passed with the key purpose of the enactment to consolidate and amend the laws and

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legislation relating recognition and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons/entities and also to deal with the increasing level of Non-performing loans in India, in a better way.

Prior to the enactment of the Insolvency and Bankruptcy code, 2016 there was no single legislation in the country to deal with insolvency and bankruptcy. There were multiple imbrication of laws and adjudicating forums dealing with financial non-accomplishment and insolvency of companies and individuals in India. The framework for insolvency and bankruptcy was incompetent, ineffective and resulted in undue delays in resolution. The legal and institutional framework did not assist lenders in effective and timely recovery or restructuring of defaulted assets and caused undue strain on the Indian credit system.

The elements within the Code, that involve the individual insolvency matters are yet to be notified. However, the Central Government vide gazette notification dated 15.11.2019^[2] stated that the provisions of this part that relate to the Personal Guarantors to the corporate Debtors shall come into being from 01.12.2019, save and except provisions associated to the fresh start method.

Earlier the individual insolvency framework was primarily enacted under two acts, namely, the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 as stated above. These acts had synchronous provisions and their substantial content was conjointly similar however the two differed in respect of their territorial jurisdiction. While Presidency Towns Insolvency Act, 1909 applied in presidency towns specifically, Kolkata, Mumbai and Chennai, the Provincial Insolvency Act, 1920 applied to any or all provinces India. The Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920 law further allowed an application to be filed either by the creditor or the debtor, to begin insolvency process, if the debtor is unable to pay his, debts amounting to 500 rupees or more. More so in the case of a petition by a creditor, he had to show that the insolvent had committed an act of insolvency including the debtor transferring his property to a third person, taking action to defeat or delays his creditors filing a petition for insolvency, failing to get back to a creditor's notice of insolvency with a reply, etc, In a period of three months before the presentation of the petition.

² Ministry of Corporate Affairs notification, Gazette of India part II, section 3, sub section(I), (nov 15th 2019) ,http://www.mca.gov.in/Ministry/pdf/BankruptcyRulesPGCD_15112019.pdf

(A) ISSUES AND CHALLENGES FACED WHILE FRAMING THE INDIVIDUAL INSOLVENCY FRAMEWORK

There were various issues faced during framing of the legislation, some of the significant issues have been mentioned below-

1. The old insolvency laws had become obsolete and quiescent.

The legal framework dealing with the individual insolvency was driven from age old laws which had been weathered down and did not see any significant change for a long period. Due to the lack of amendment in the legislation it had become largely ineffective and considered inadequate and outdated. Also the paucity of case laws under these acts were used very rarely and had turned dormant and obsolete in practice.

2. The procedure under the old insolvency act were complex and time consuming.

This was one of the major reasons for the set back of these acts. The acts prescribed for the provisions of the Civil Procedure Code 1908 to be followed under the legislation which at times made the provisions overlapping and hence complicated and this caused delay in the entire process. There were also major interventions by the court under these laws which made it less captivating and less desirable for the people who wanted to opt for an insolvency process.

As a result this method was rarely used by creditors as a mode for recovery of debts and loans. The creditors started using other methods for recovery of their debts and loans which were more convenient and less time consuming such as the outside court settlement method which resulted in partial or no recovery at all or the Negotiable Instrument act 1881, which could only be used in check bounce cases. Although these other processes were easy to understand for a creditor who is dealing with the process of insolvency and recovery of debts for the first time but it also resulted in a broad category of creditors finding themselves with no constructive mechanism for recovery at all. These unproductive and profitless methods led for the creditors to recover their loans and debts using intimidating tactics.

3. Restricted ambit for filing insolvency petition against the debtor

Under both the legislation mentioned above the creditor could file insolvency petition only under few grounds and the ambit of these laws were very limited. Hence if a creditor was dealing with a issue related to insolvency outside the preview of these legislation he was barred from doing so. This further discouraged the creditor from having a recourse through these old insolvency laws.

4. No provision for participation of creditors and debtors

The old insolvency laws limited the participation of the debtors and the creditors. For the successful resolution of the company, asset maximization and limitation on the liability and for the company to accelerate it was important for the both the creditors and the debtors to actively participate and hold negotiation.

5. Impact of the credit market.

The incompetent insolvency regime led to a very low credit recovery which had an deleterious impact on the credit market. Credit markets are extremely important from the perspective of economic growth and acceleration and insolvency laws play an important role in assisting the growth of credit markets.

Due to this the urgency of putting forth a new set of insolvency regime was felt. This further led to the framing of the code which majorly focused on coping up with the non-performing loans in India in a much more systematic and organized way.

6. No separate provision for the bankruptcy of an individual

The old insolvency laws only provide for the insolvency of an individual whereas it does not lay down any provisions for dealing with the bankruptcy of an individual. This bars an individual under debt to not only initiate a bankruptcy process but let alone making the exit process challenging.

7. There was no separate adjudicating authority dealing specifically with insolvency matters.

The effectiveness of these laws were categorically hampered by the Indian Judicial system. The jurisdiction of these cases were handed to the district courts under these acts. Since there were no separate adjudicating authority dealing with the insolvency cases, the entire process became a rather time consuming process due to the slow functioning of the courts and the piling up of the cases. This was on account of the quantity of the judges in these courts and the quality of the process wherein a large number of judges dealt with the administrative matters which left very little time that could be invested in the judicial matters. The quantity of the judges adjudicating these matters plays a key role in the insolvency process so as to assure that a large number of people from different parts of the country can access the system. Therefore weak institutional infrastructure of the lack of adjudicating authority posed another dilemma in the implementation of the legal framework dealing with individual insolvency.

Whereas if we look at the present code the jurisdiction is vested with a separate adjudicating authority called the National Company Law Tribunal and the National Company Law Appellant Tribunal. Additional measures are also taken by the government to keep a check and make the current code even more efficient.

8. Absence of a unified insolvency law.

Another problem with the previous insolvency legislation was that there was no unified insolvency law covering all the provisions and aspects in one single place. Also there were a lot of individual state amendments imposed which made the code even more complicated and ambiguous in nature. Thus having a need for a unified insolvency code was considered the need of the hour which led to the enactment of Insolvency and Bankruptcy code 2016.

II. CRITICAL APPRECIATION OF THE INSOLVENCY AND BANKRUPTCY CODE 2016.

The code has brought a huge difference and change in the insolvency regime in India.

The Insolvency and Bankruptcy Board of India (“IBBI”) constituted a Working Group under the chairmanship of Mr. Amarjit Singh Chandiok, Senior Advocate and President, INSOL India by an office order dated 13th June, 2017 to recommend the strategy and approach for implementation of the provisions of the Insolvency and Bankruptcy Code, 2016 (“Code”) dealing with insolvency and bankruptcy in respect of

- (i) guarantors to corporate debtors i.e. personal guarantors, and
- (ii) individuals having business, and submit a report along with the draft rules and regulations.[³]

There are certain issues in the code dealing with the individual insolvency that are yet to be notified which need to be addressed for a strengthened and eminent insolvency resolution. Some of which are:

(A) The eligibility threshold for filing of insolvency application is low

According to the provisions of the code, both the debtors and the creditors can file for an insolvency application if the amount of the default is not less than one thousand rupees. This would only suggest that on a single default of one thousand rupees the either of the creditor or the debtor can bring an action against the other which would result in huge number of insolvency cases being filed with the Debt Recovery Tribunal(DRT) even for a default of such

³ Report of the Working Group on Individual Insolvency, The Insolvency and Bankruptcy Board of India, (17th august, 2017), https://ibbi.gov.in/uploads/resources/Final-Report_of_WG_on_Indiv_Insol-Aug_2017.pdf

a small amount.

(B) Weak institutional infrastructural

Unlike the corporate insolvency, in case of individual insolvency the the code provides that the DTR will have the jurisdiction over these cases. Now, since the DTR is already overburdened with cases, every other individual insolvency process initiation would just result in piling up of cases with the DTR. There is no proper or separate adjudicating authority formed for the matters for individual insolvency, so that these methods can be handled with proper efficiency.

(C) Wider role of the DTR in the insolvency process

There is a high involvement of the DTR in these cases as approval of the DTR is required in various stages of the insolvency process. Now this process can be time consuming and inefficient as the body is already overburdened with cases. This may adversely affect the individual insolvency regime set up under the code.

The working group under the chairmanship of Mr. Amarjit Singh Chandiok, Senior Advocate and President, INSOL India noted that in case where the of corporate insolvency process is pending against the personal guarantor of corporate debtor the jurisdiction for the same will lie with the National Company Law Tribunal in case where the corporate insolvency process has been initiated or is pending and cases where a corporate insolvency process is not pending against the corporate debtor, the jurisdiction in respect of Insolvency and Bankruptcy of personal guarantor is Debt Recovery Tribunal. For other individuals and partnership firms, the jurisdiction is also vested with the Debts Recovery Tribunal.[⁴]

III. INDIVIDUAL INSOLVENCY UNDER THE CODE

The code has been enacted and brought into force to strengthen the legislation relating to restructuring and insolvency resolution process of companies, partnership firms, individuals.

The Insolvency and Bankruptcy Code 2016 is divided into IV parts.

Here, while the provisions contained in part I and II were notified and brought into effect from 1.12.2016, whereas the provisions as contained in part III which relates to Fresh Start Process and Insolvency and Bankruptcy process and regulation for partnership firms and individuals where the amount of default is not less than One Thousand Rupees which is resolved by the

⁴ Report of the Working Group on Individual Insolvency, The Insolvency and Bankruptcy Board of India, (17th august, 2017), https://ibbi.gov.in/uploads/resources/Final-Report_of_WG_on_Indiv_Insol-Aug_2017.pdf

Debt Recovery Tribunal (DRT).[⁵]

Part III of the act is applicable to the following, namely-

- I. Personal guarantor to corporate debtor
- II. Partnership firms and individuals

The Insolvency and Bankruptcy Code 2016 involves 2 kinds of process-

(A) Fresh start process

A debtor, who is not able to pay his debt, is therefore qualified and eligible to make an application to the Adjudicating Authority (AA), either personally or through a Resolution Professional (RP), for a fresh start for discharge of his qualifying debt if he effectuates the following conditions[⁶]:

1. the gross annual income of the debtor does not exceed sixty thousand rupees;
 2. the aggregate value of the assets of the debtor does not exceed twenty thousand rupees;
 3. the aggregate value of the qualifying debts does not exceed thirty-five thousand rupees;
 4. he is not an undischarged bankrupt;
 5. he does not own a dwelling unit, irrespective of whether it is encumbered or not;
 6. a fresh start process, insolvency resolution process or bankruptcy process is not subsisting against him; and
 7. no previous fresh start order has been made in relation to him in the preceding twelve months of the date of the application for fresh start.
- After an application is filed and initiated by a debtor for a fresh start, an interim-moratorium period shall commence on the date of filing of the said application in relation to all of his debts. It shall cease to have effect on the date of admission or rejection of such application as the case may be.⁷
 - If the following application has been filed by the debtor himself, the Adjudicating Authority (AA) shall within seven days of the initiation/filing of an application, direct the Board to nominate a Resolution Professional(RP) for the fresh start process and if the said application is filed by the debtor through a RP, the AA shall ask the Board to

⁵ Section 78 of Insolvency and bankruptcy code, 2016(India)

⁶ Section 80 of Insolvency and bankruptcy code, 2016(India)

⁷ Section 81 of Insolvency and bankruptcy code, 2016(India)

confirm within seven days of the application initiation to affirm that there are no disciplinary proceedings against the RP.⁸

- The RP appointed by the Board shall examine the said application within ten days of his appointment, and submit a report to the AA, either suggesting either acceptance or rejection of the application.

The RP shall reject the application, if in his opinion:

1. the debtor does not satisfy the conditions specified under section 80; or
2. the debts disclosed in the application by the debtor are not qualifying debts; or
3. the debtor has deliberately made a false representation or omission in the application or with respect to the documents or information submitted.⁹

The AA may within fourteen days from the date of submission of the report by the RP, pass an order either admitting or rejecting the said application.¹⁰

If the Resolution Professional appointed by the AA admits the application, the moratorium period shall begin in reference to all debts and shall cease to have effect at the end of the period of one hundred and eighty (180) days which commences at the date of the admission of the application. During the moratorium period any kind of legal proceedings in respect with any debt shall be deemed to have been put on hold and the creditors are restricted to initiate any proceedings in respect of any debt.

During the moratorium period, the debtor shall¹¹:

1. not act as a director of any company, or directly or indirectly take part in or be concerned in the promotion, formation or management of a company;
2. not dispose of or alienate any of his assets;
3. inform his business partners that he is undergoing a fresh start process;
4. be required to inform prior to entering into any financial or commercial transaction of such value as may be notified by the Central Government, either individually or jointly, that he is undergoing a fresh start process;
5. disclose the name under which he enters into business transactions, if it is different from the name in the said application;

⁸ Section 82 of Insolvency and bankruptcy code, 2016(India)

⁹ Section 83 of Insolvency and bankruptcy code, 2016(India)

¹⁰ Section 84 of Insolvency and bankruptcy code, 2016(India)

¹¹ Section 85 of Insolvency and bankruptcy code, 2016(India)

6. not travel outside India except with the permission of the AA.
- Under the order of the AA, any creditor under section 84 of the code to whom the debt is owed may file for an objection by way of an application within 10 days of the order through the RP only on the grounds of inclusion of a debt as a qualifying debt or incorrectness of the details of the qualifying debt specified in the order. Further the RP shall either accept or reject the order on his discretion, within 10 days of the date of the application
- Again, the debtor or the creditor whosoever is the aggrieved party who is unhappy with the decision taken by the RP may file an application to the AA challenging the same order. The RP shall prepare and submit a final list of qualifying debts to the AA at least seven days before the moratorium period comes to an end. The AA shall pass a discharge order at the end of the moratorium period for discharge of the debtor from the qualifying debts thereof.

The AA shall also discharge the debtor from the following liabilities:

1. penalties in respect of the qualifying debts from the date of application till the date of the discharge order;
2. interest including penal interest in respect of the qualifying debts from the date of application till the date of the discharge order; and
3. any other sums owed under any contract in respect of the qualifying debts from the date of application till the date of the discharge order.¹²
4. The discharge order shall only discharge the debtor from the liabilities that are categorically mentioned under the order and nothing beyond what is mentioned in it.

The RP may submit an application to the AA seeking revocation of its order passed under section 84 on the following grounds:

1. if due to any change in the financial circumstances of the debtor, the debtor is ineligible for a fresh start process; or
2. non-compliance by the debtor of the restrictions imposed under section 85; or
3. if the debtor has acted in a mala fide manner and has willfully failed to comply with the provisions of this Chapter.

¹² Section 92 of Insolvency and bankruptcy code, 2016(India)

- The AA shall, within fourteen days of the receipt of the said application, either admit or reject the application and on passing of the order admitting the said application, the moratorium and the fresh start process shall cease to have effect.^[13]

Insolvency resolution process

Another process that the code in relation to Individual insolvency deals with and has to offer to the aggrieved parties is the Insolvency Resolution Process. This is more convenient and a widely accepted method than the Fresh start process.

The process was introduced under the code to allow the debtors and the creditors an easy and relatively convenient passage through the insolvency process.

The insolvency resolution process is initiated either by the debtor or the creditor through a RP or personally to the AA by making an application.

Steps that are to be followed for the resolution process

- On filing of the above mentioned application either personally or through an RP, the interim- moratorium period shall commence in respect of all the debts and shall cease to have effect on the acceptance or rejection of the application. During this period no person can bring an action related to any of those debts that have been ceased under the interim moratorium process.
- If the said application has been filed by the creditor or the debtor personally then within 7 days of the application the the AA shall direct the Insolvency and Bankruptcy Board (IBBI) to appoint an RP for the insolvency Resolution Process, whereas if the application has been filed through a RP, the AA may direct the board within 7 days of the receipt of the application to confirm that there are no disciplinary actions pending against the RP.
- The resolution professional when appointed shall examine the application within 10 days of in appointment and further submit a report to the AA giving his recommendations as to weather accept or reject the said application on his discretion.
- Now, the AA within 14 days after the report has been submitted by the resolution professional pass an order as to giving accent or quashing the order on its discretion.
- If the application has been rejected by the AA on the basis of the report submitted by the RP or on believing that the application has been made with the intention to deceive

¹³ Section 91 of Insolvency and bankruptcy code, 2016 (India)

or defraud the creditor or and the RP, the creditor may then have the authority to file for a bankruptcy order.

- If the application has been accepted by the AA then the moratorium period shall begin in reference to all the debts and shall cease to have effect at the end of 180 from the date of admission or on the date of the order passed by the AA.
- Here from and legal proceeding against the debts shall not comply with, meaning that the creditor may not be allowed to bring any action and the debtor may be barred from discharging any of his assets, or transferring, alienating, obstructing or disposing of his legal rights or beneficial interest therein.
- The AA within 7 days of the order issue public notice and invite creditors to put forth their claims and submit it within 21 days. The creditors shall also register its claim with the RP and further the RP will make a list within 30 days of all the said creditors.
- Then the debtor in reference with the list prepared by the RP shall come forward with a repayment plan, which may comprise of proposals of restructuring of his debts or affairs in consultation with the RP

The repayment plan may authorise or require the RP to:

1. carry on the debtor's business or trade on his behalf or in his name; or
 2. realise the assets of the debtor; or
 3. administer or dispose of any funds of the debtor.
- The RP in furtherance to this will submit a repayment plan combined with a report on such plan to the AA within a period of 21 days from the last day on which the creditors submitted their respective claims.
 - If the RP is of the opinion that a meeting of the creditors should be summoned he may mention in the report submitted to the AA the date, time and place of where such a meeting shall be held.
 - The RP shall then issue a notice to all the creditors that are mentioned in the list who have made submission for claims atleast 14 days prior to the date of the meeting.
 - In the meeting it is upon the discretion of the creditors weather to approve, modify or reject the proposal made by the RP on behalf of the debtor.
 - Now if the creditors collectively decide to accept and modify the plan presented by the RP, it will be the duty of the RP to ensure the consent of the debtor in reference to the modifications made by the creditors.

- Creditors are entitled to vote in the meeting in accordance to the voting share assigned to each of the creditor. A creditor shall be barred from a voting right in case his claim to the debt is of an unliquidated amount.
- He shall also have no voting share if his name is not present in the list of creditors made by the RP or if he is an associate of the debtor.
- When modification in the repayment plan is being made it has to be approved by more than 3/4th of the total creditors present in the meeting in person or through proxy.
- The RP will prepare a detailed report of the meeting held with the Creditors and submit a copy of the same to the creditors as well as the AA.
- The AA may by presenting an order give assent or quash the repayment plan presented by the RP on the basis of the meeting of creditors being held under section 112 of the code and if the meeting of the creditors was not held then the AA shall pass the order under section 106 of the code on the basis of the report prepared by the RP
- The approval order by the AA will also put forth the directions in which the repayment plan shall be implemented.
- If the AA is of the opinion that the repayment plan should undergo some changes and modifications it may direct the RP to re-summon the meeting of the creditors and make necessary changes in the repayment plan.
- When the AA is of the opinion for the rejection of the repayment plan, the debtors and the creditors may then file an application for bankruptcy.
- The RP will administer the implementation of the repayment plan and submit a closure notice and a report within 14 days to the persons who may come under the purview of the repayment plan and to the AA .
- The RP shall apply to the AA for a discharge order in reference to the debts mentioned in the repayment plan from which the claims are to be realised and the AA shall pass the order as stated.
- The repayment plan may ask for an early discharge or discharge on complete implementation of the plan.
- If the repayment plan comes to an end earlier than it was originally supposed to be (I.e without being fully implemented in respect of each and every person who comes under its purview), RP may submit the report to the AA mentioning the same and the AA shall pass an order for non-compliance and non-completion of the implementation plan.

- The persons whose claims have yet not been fully realised shall be eligible for a bankruptcy order.
- On failure of any of the mentioned above a bankruptcy process can be initiated.

Thus, a bankruptcy process can be initiated in the following three circumstances:

1. on the rejection of application for insolvency resolution process;
2. on rejection of repayment plan; and
3. on premature ending of the repayment plan.

IV. CONCLUSION

The Insolvency and Bankruptcy Code, 2016, is considered to be one of the most thoughtful and important reforms in India as it was the need of the hour. Before the enactment of this particular legislation there were a number of different scattered and blur laws in relation to IBC. This code envisages a drastic change in the insolvency laws as it is more compact and petite.

These individual insolvency laws under this code are archaic and are not yet lined up with the economic and global standards. It still stands at a place where a lot is yet to be identified and informed to the individual debtors and the creditors looking for a smooth insolvency resolution process. These laws should be aligned in a manner where it does not put undue stress in the capital market. With so much left to come our way we can only think of Individual Insolvency as the next big thing.