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**UNDERSTANDING THE INSOLVENCY AND BANKRUPTCY CODE,  
2016: A COMPREHENSIVE OVERVIEW**

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**ABSTRACT**

*A business is said to be insolvent or bankrupt when its debts are due and there aren't enough assets to pay them. It is said that a company is insolvent if it does not have sufficient cash on hand or if its assets are worth less than its debts. It portends serious financial difficulties and the inability to settle bills. Bankruptcy and insolvency affect financial institutions and, consequently, the entire economy, regardless of whether the debtor is an individual or a corporation. When insolvency or bankruptcy impacts banks and other financial intermediaries, such as the biggest unsecured debtors, non-bank financial organizations, and term supply companies, a legislative framework must be put in place to address these issues. It is wise to look for alternatives to liquidation when temporary financial incapacity occurs, including when liquidity constraints are to blame. Rescheduling loans, injecting cash, replacing management, and merging or amalgamating are all examples of such actions.*

*Insolvency and Bankruptcy Code, 2016 (IBC) is to protect and preserve the life of the corporate debtor "as a going concern" by yearning for the resolution of its insolvency through restructuring, keeping liquidation as last resort. The concept of "rescue financing", also known as "bridge financing" or "interim financing", lends a helping hand in fulfilling the said objective of the Code. It refers to the infusion of new funds by rescue financiers into the ailing corporate debtors so as to help them sail through the process of insolvency, safeguarding the value of the company.*

*The Insolvency and Bankruptcy Code, 2016 aims at protecting the corporate debtors as going concerns as well as at maximizing the value of their assets. In pursuance of this objective, the Code has incorporated the provision of interim finance to facilitate the rescue of distressed*

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*debtors, and consequently, has stimulated the overall growth of the Indian economy. A healthy interim finance market lends a helping hand in promoting insolvency resolution while averting the possibilities of resorting to liquidation. It examines the historical background, key features of the IBC, its impact on the Indian economy. The study aims to provide insights into the development and effectiveness of the IBC in India.*

**Key words:** Corporate Insolvency, Resolution, Insolvency Bankruptcy Code 2016

## **EVOLUTION OF IBC IN INDIA**

With the implementation of the IBC, the Companies Act of 1956 and the Companies Act of 2013 no longer allow for the initiation of winding up proceedings due to an inability to repay debts. Nevertheless, the firms Act, 2013 allows for the compulsory liquidation of firms due to causes unrelated to insolvency, such as failure to submit financial statements or annual returns for five consecutive financial years.

The Companies Act, 2013 includes provisions for voluntary schemes of financial reconstruction, which are approved by the National Company Law Tribunals. These schemes involve arrangements and compromises with creditors and/or shareholders and are usually separate from the insolvency regime, although they can also be applied during liquidation.

The Sick Industrial Companies (Special Provisions) Act of 1985 served as the main legislation for the rehabilitation of financially distressed industrial companies. It provided a framework for such companies to proactively commence a rescue and rehabilitation procedure if their net value had significantly declined. The failure of the system can be attributed to two primary factors: the continuous and unrestricted moratorium protection, which was occasionally exploited by the debtors in possession, and the lack of a defined and time-limited resolution process.<sup>2</sup>

The Reserve Bank of India (RBI), the banking regulator in India, developed several voluntary mechanisms for debt restructuring. These mechanisms were communicated to banks through instructions or circulars. They include corporate debt restructuring, the joint lenders' forum mechanism, strategic debt restructuring, outside strategic debt restructuring, and the Scheme for Strategic Structuring of Stressed Assets.

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<sup>2</sup>Shreyanshiit-The Evolution of Corporate Insolvency Laws in India, <https://www.legalserviceindia.com/legal/article-8526-the-evolution-of-corporate-insolvency-laws-in-india.html>, Last visited 4<sup>th</sup> March 2024.

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India has multiple means for enforcing debt and security. While the individual debt and security enforcement mechanisms remain in place, their effectiveness is limited once insolvency resolution or liquidation proceedings begin under the IBC. For banks and financial institutions, the two primary legislations that hold significance are the Recovery of Debts Due to Banks and Financial Institutions Act and the SARFAESI Act.

The Code repeals the Presidency Towns Insolvency Act, 1909, and Provincial Insolvency Act, 1920, as well as amends 11 legislations, including<sup>3</sup>:

- 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

In order to prevent any additional legal disputes in bankruptcy cases, the Code will take precedence over all other legislation. It is explicitly stipulated that civil courts or authorities do not have jurisdiction and are also prohibited from granting any injunction. Implementing the Code as a replacement for many laws, after establishing the necessary infrastructure, will be a crucial measure in advancing the system for recovering unpaid debts. Furthermore, the strict timeline outlined in the Code for resolving insolvency and liquidation cases would lead to a clear increase in economic growth.

The introduction of the Insolvency and Bankruptcy Code (IBC), 2016 aimed to enhance the creditor-debtor relationship. To alleviate the growing load of non-performing assets, many types of reforms were essential. Nevertheless, it was crucial to promptly implement alterations to the Insolvency and Bankruptcy Laws. Thus, in 2014, the Ministry of Finance created the Bankruptcy Law Reforms Committee (BLRC), chaired by Dr. T. K. Viswanathan, to advocate for comprehensive bankruptcy reform. This committee's report had two parts: logic and design/recommendations and a comprehensive draft Insolvency and Bankruptcy Bill for all corporations. The study suggested major structural changes. The Insolvency and

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<sup>3</sup> Summarizing the Insolvency of Bankruptcy code, 2<sup>nd</sup> August 2016, <https://www.indialaw.in/blog/commercialcorporate/summarising-insolvency-bankruptcy-code-2016/>, Last visited 3<sup>rd</sup> Feb 2024.

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Bankruptcy Code 2016 is the result of these recommendations.<sup>4</sup> Considering the proposal to introduce an Indian Bankruptcy Code that would replace the current legislation and apply to both non-financial corporations and people. The initial version of the Insolvency and Bankruptcy Code was presented in 2015. It comes into effect in December 2016.

Insolvency and Bankruptcy Code, 2016 was passed by Lok Sabha on May 5 and Rajya Sabha on May 11. The President of India gave his assent in 2016, and after six months in December 2016, IBC became active. On June 1, 2016, the government established the National Company Law Tribunal (NCLT) and its appellate body under the Companies Act, 2013, to adjudicate company and limited liability partnership disputes. The Debt Recovery Tribunal (DRT), formed under the Recovery of Debts owed to Banks and Financial Institution Act, 1993, shall adjudicate individual and partnership debts.<sup>5</sup>

The Insolvency and Bankruptcy Code (IBC), 2016 was implemented to consolidate the previously existing legislation pertaining to insolvency and bankruptcy. Insolvency refers to a condition in which a company's financial troubles are severe enough to prevent it from operating its business.

Insolvency can be applied for by both individuals and companies. Individuals refer to the state of financial failure as bankruptcy, while corporations use the term corporate insolvency to describe the same condition. Insolvency refers to a scenario when an individual or corporation lacks the ability to repay their debt in the immediate or foreseeable future, and the total value of their assets is lower than their liabilities.

The IBC 2016 has established a comprehensive framework for resolving insolvencies in the country, ensuring that all parties involved maintain a careful equilibrium to safeguard the economic worth of the process within a specified timeframe.

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<sup>4</sup> Anjali Krishna- A historical evaluation of Insolvency and Bankruptcy Laws in India, Published on 8<sup>th</sup> Feb 2023, <https://lawbhoomi.com/a-historical-evaluation-of-insolvency-and-bankruptcy-laws-in-india/>, (Last visited 25<sup>th</sup> Jan 2024)

<sup>5</sup>Girijesh- All you need to know about insolvency and Bankruptcy code, Published on 4<sup>th</sup> Sept 202, [https://blog.ipleaders.in/all-need-know-about-insolvency-bankruptcy-code/#Who\\_can\\_file\\_application\\_for\\_corporate\\_insolvency\\_resolution\\_and\\_how](https://blog.ipleaders.in/all-need-know-about-insolvency-bankruptcy-code/#Who_can_file_application_for_corporate_insolvency_resolution_and_how), Last visited 27<sup>th</sup> Jan 2024.

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**CORPORATE INSOLVENCY RESOLUTION: WHO CAN INITIATE AND HOW?**

Financial creditors, operational creditors, and corporate debtor applicants can begin CIRP under Code sections 7, 9, and 10.<sup>6</sup>

**Financial creditor**

According to section 5(7)<sup>7</sup> of the Insolvency and Bankruptcy Code of 2016, financial creditors refer to creditors who provide monetary funds to the promoters. Banks, home buyers, and other entities are classified as promotional creditors. Debtors adhere to the subsequent procedures in the event of a default.

- The financial creditors have the ability to submit an application before the adjudicating authority.
- Upon providing the facts, the adjudicating authority must determine the occurrence of default within a period of 14 days. If default is confirmed, the application is accepted.
- If there has been no default, the application will be refused.
- The adjudicating body must notify the financial creditors of the application's admission within 7 days. Following this, the corporate insolvency resolution process commences.

**Operational Creditor**

An operational creditor refers to a party who has provided goods or services to a company and is owed payment for those goods or services.

According to section 5(20)<sup>8</sup> of the Insolvency and Bankruptcy Code of 2016, operational creditors are creditors who do not offer money or cash to the promoters, but instead provide goods and services to them. As an illustration, there is a firm called 'X' that specializes in car manufacturing, while another company, 'Y', supplies machinery to company 'X' for the purpose of automobile production. Both companies have entered into an agreement stipulating that after the machines are delivered to company 'X', company 'X' would promptly transfer the funds to company 'Y' within a period of 20 days. In this scenario, firm 'Y'

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<sup>6</sup> Insolvency and Bankruptcy Board of India, <https://ibbi.gov.in/uploads/faqs/CIRPFAQs%20Final2408.pdf>, Last visited 27<sup>th</sup> Jan 2024.

<sup>7</sup> Insolvency and Bankruptcy Code 2016, section 5(7)

<sup>8</sup> Insolvency and Bankruptcy Code 2016, section 5(20)

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assumes the role of the operational creditor, while company 'X' acts as the debtor. The procedure unfolds in the following manner:

- Upon the incidence of default, the operational creditor dispatches a demand notice to the corporate debtor.
- The debtor notifies the creditor within 10 days of receiving notice regarding the repayment of outstanding operational expenses or the notification of disputes.
- Should the payment for the disagreement remain outstanding after a period of 10 days, it is necessary to submit an application to the adjudicating authority.
- Subsequently, the operational creditors have suggested the appointment of a resolution expert, and the adjudicating body must make a decision to accept or reject the application within a period of 14 days.
- Initiation of insolvency resolution proceedings.

### **Corporate debtor**

Under section 5(a)<sup>9</sup> of IBC 2016, corporate debtors are the promoters who take loans or money from financial creditors or take goods or services from operational creditors as a debt.

The process is as follows<sup>10</sup>:

- Corporate debtors file an application with the adjudicating authority upon default.
- After providing information, the authority makes a decision within 14 days.
- If accepted, the insolvency resolution process begins. If denied, the adjudicating body sends notice to address flaws.

### **NEED FOR INSOLVENCY AND BANKRUPTCY CODE (AMENDMENT), 2020**

The Rajya Sabha received the Insolvency and Bankruptcy Code (Second Amendment) Bill, 2020 on September 15, 2020. The Insolvency and Bankruptcy Code, 2016 is modified by it. The Code offers a time-limited procedure for addressing insolvency in both corporate entities and individuals. Insolvency refers to the state in which individuals or corporations are unable of fulfilling their due debt obligations. The Bill aims to temporarily halt the commencement

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<sup>9</sup> Insolvency and Bankruptcy Code 2016, section 5(a)

<sup>10</sup>Girijesh- All you need to know about insolvency and Bankruptcy code, Published on 4<sup>th</sup> Sept 202, [https://blog.ipleaders.in/all-need-know-about-insolvency-bankruptcy-code/#Who\\_can\\_file\\_application\\_for\\_corporate\\_insolvency\\_resolution\\_and\\_how](https://blog.ipleaders.in/all-need-know-about-insolvency-bankruptcy-code/#Who_can_file_application_for_corporate_insolvency_resolution_and_how), Last visited 27<sup>th</sup> Jan 2024.

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of the corporate insolvency resolution process (CIRP) under the Code. It supersedes the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 that was issued on June 5, 2020.

**Salient features<sup>11</sup>:-**

- CIRP initiation is restricted for certain defaults, but creditors or the company can initiate it by filing an application with the National Company Law Tribunal (NCLT). The Bill prohibits the company or its creditors from initiating CIRP for defaults occurring within six months of March 25, 2020. However, the central government may extend this period to one year through notification. The Bill allows CIRP to be initiated for defaults before March 25, 2020.
- Corporate debtors are now permitted to initiate CIRP against other corporate debtors: An explanation II has been added to Section 11 of the Code through the Amendment Act, allowing corporate debtors referred to in clauses (a) to (d) of Section 11 to initiate CIRP against other corporate debtors, which was previously not allowed.
- No suspension or termination of licenses, permits, etc., issued by the Government during the moratorium: An explanation has been added to Section 14 of the Code to clarify that licenses, permits, registrations, etc., issued by the Central Government or any other authority shall not be suspended or terminated due to insolvency, provided there is no default in payment of current dues for the use or continuation of such licenses, permits, etc., during the moratorium period. These changes aim to ensure the continuity of business operations and maximize the value of a corporate debtor.
- Continuation of the supply of goods/services critical to Corporate Debtor: With the new amendment, sub-section (2A) has been inserted into Section 14(2) of the Code. It states that if the Interim Resolution Professional (IRP) or Resolution Professional (RP) considers the supply of goods/services critical to protecting and preserving the value of the corporate debtor and managing its operations as a going concern, such supply shall not be terminated or interrupted during the moratorium, except in cases where the corporate debtor has not paid dues arising from such supply during the moratorium.

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<sup>11</sup>Faranaaz G Karbhari- Salient Features of the Amendment to the IBC Code, 4<sup>th</sup> March 2020, <https://hsalegal.com/article/salient-features-of-the-amendment-to-the-ibc-code/>, Last visited 28<sup>th</sup> Jan 2024.

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- Appointment and tenure of IRP: Amended Section 16(1) mandates the appointment of the IRP on the date the insolvency commences, eliminating the previous requirement for the Adjudicating Authority to appoint the IRP within 14 days from the insolvency commencement date.
- Liability for prior offences: Section 32A, introduced by the Act, stipulates that the corporate debtor will not be liable for offences committed before the commencement of CIRP from the date the resolution plan is approved by the Adjudicating Authority, provided the approved resolution plan results in a change in the management or control of the corporate debtor as prescribed in Section 32A. This section also absolves the corporate debtor from prosecution instituted against it during the CIRP upon approval of the resolution plan, but the officer in default (in the case of a company) and the designated partner (in the case of an LLP) remain liable for any such offence committed by the corporate debtor. Additionally, this section protects the property of the corporate debtor from actions such as attachment, seizure, retention, or confiscation.

### **INSOLVENCY AND THE BANKRUPTCY CODE, 2016 AND THE RESCUE CULTURE**

The Insolvency and Bankruptcy Code, 2016 (IBC) is a comprehensive law that specifically deals with insolvency. The IBC introduced the resolution plan as a solution for struggling enterprises and corporate creditors. It was a source of relief for many people. Section 5(26) of the Code provides the definition of the word "resolution plan."

The Insolvency and Bankruptcy (Second Amendment) Act clarified the inclusion of corporate resolution plans in the resolution plan, emphasized the importance of financial creditors in asset distribution proposed by the resolution applicant, and specified the impact of the resolution plan on all legal aspects. A major achievement for the Corporate Debtors and Resolution Applicants was when the amendment specified that if the resolution plan considers restructuring the corporate debtor through merger, amalgamation, or demerger, the corporate debtor is not obligated to comply with the Merger Framework outlined in the Companies Act 2013 and its associated Rules. One major concern in implementing Resolution Plans is dealing with conflicting financial creditors. According to Section 30(4) of the Code, a goal plan must be approved by sixty-six percent of the democratic fraction of the financial creditors to be accepted by the Adjudicating Authority.

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The Insolvency and Bankruptcy Board of India's regulations from 2016 defined "dissenting financial creditors" as financial lenders who have voted against the resolution plan approved by the committee of creditors. The Insolvency and Bankruptcy Board of India amended the Insolvency Resolution Process for Corporate Persons Regulations, 2016 to include financial creditors who abstained from voting in support of the resolution plan as dissenting financial creditors. The Insolvency and Bankruptcy Board of India, through its circular dated September 14, 2018, clarified that financial creditors who are not part of the Committee of Creditors do not have voting rights. Therefore, they cannot be classified as either opposing or dissenting creditors when it comes to approving a resolution process. All specialists, including the Adjudicating Specialists (NCLT/NCLAT), the regulatory authority (IBBI), and the members, aim for a seamless approval and implementation of the Resolution Plan. The latest IBBI bulletin states that IBC operates as a market system where global entities compete to provide the highest value for the company through a resolution plan. The goal plans have produced approximately double the liquidation value.

To comprehend the rescue culture in India, one must grasp the Corporate Insolvency Resolution Process (CIRP) outlined in Sections 6-32 of Chapter II of the Code<sup>12</sup>. If a corporate debtor fails to pay a debt that is due and payable, the corporate resolution process can be commenced according to Chapter II of the Act. The Act highlights the importance of promptly identifying financial difficulties for quick resolution. It specifies that the resolution process can be initiated by a financial creditor, an operational creditor, or the corporate debtor. The financial creditor can file an application with the National Company Law Tribunal, together with evidence of default and the designation of a resolution expert who will act as an interim resolution professional. Once the adjudicating body confirms the presence of a default, it will then go on. The method for an operational creditor differs from that of a financial creditor due to the smaller and recurrent nature of operational obligations compared to financial debts. After a default, the operating creditor must provide a demand notice or an invoice for payment of the debt in default. This prevents operational creditors with lower debt claims from prematurely triggering the insolvency resolution process or doing so for unrelated reasons.

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<sup>12</sup> Insolvency Bankruptcy code, Sections 6 to 32

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The chapter specifies a time restriction of 180 days, which can be extended by an additional 90 days for completing the corporate insolvency process. Within fourteen days of receiving the application, the adjudicating body selects an interim resolution expert who plays a crucial role in the corporate resolution process. He performs several functions such as collecting claims, obtaining information on the corporate debtor, organizing a committee of creditors, managing the company's activities temporarily, and monitoring assets until a resolution expert is chosen. Once the resolution professional is appointed, they may create an information memorandum to help a resolution applicant develop a resolution plan. An information memorandum will be prepared to help market participants find strategies for resolving the insolvency of the corporate debtor. Anyone can initiate a resolution application as long as they follow the relevant legislation. The resolution expert must present every filed resolution plan to the creditors' committee for approval or disapproval. If authorized, it will be sent to the adjudicating body for final approval. If not approved, the firm will proceed with liquidation.

The resolution plan in the Insolvency and Bankruptcy Code, 2016 is a strategy designed to assist a struggling firm in returning to financial stability. The resolution applicant, who is not disqualified under Section 29A, submits the plan to the resolution professional. The resolution professional ensures that the plan does not violate any requirements and complies with Section 30(2) of the Code. The court in the case of *Binani Industries Limited v Bank of Baroda & Anr*<sup>13</sup> established several regulations that must be adhered to in a resolution plan.

- a) The Resolution Plan focuses on resolving the Corporate Debtor as a viable entity, rather than through methods like sale, auction, recovery, or liquidation.
- b) The primary goal of the Resolution plan is to mitigate the danger of insolvency by maximizing earnings and enhancing the equitable interests of debtors and creditors.
- c) The resolution strategy must be distinguished from the concept of recovery. The Insolvency and Bankruptcy Code restricts recovery but promotes the resolution plan.
- d) The resolution strategy necessitates significant consideration and must be distinguished from the concept of liquidation. A resolution strategy must support a continuously expanding economy.
- e) The resolution plan must treat all parties equally. If it shows favoritism towards any

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<sup>13</sup> Company Appeal(AT) (Insolvency) No. 82 of 2018

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financial or operational creditor, it would violate the fundamental purpose of Section 5(26) of the Code.

## CONCLUSION

The Insolvency and Bankruptcy Code (IBC) is a crucial legal framework governing insolvency proceeding in the country. As a relatively recent law, it is continuously evolving, necessitating a close examination of its amendments and court rulings to understand its complexities fully. The Corporate Insolvency Resolution Process (CIRP) outlined in the IBC serves the dual purpose of facilitating creditors' debt recovery while protecting the interests of the company. The Code specifies three categories of individuals who can initiate the CIRP process. Despite facing limitations and challenges, the IBC is being refined through legal proceedings and adjudications to fulfill its obligations effectively. It offers comprehensive solutions for both creditors and businesses involved in insolvency and bankruptcy proceedings.

A notable feature of the IBC is its provision allowing interim insolvency professionals to assume control of a company's administration, irrespective of whether the debtor is capable of managing it. However, certain hurdles and disincentives exist within the current framework for initiating the resolution process, which are under continuous evaluation and discussion for enhancement.

The Government of India has been responsive to recommendations and has made numerous amendments to strengthen the IBC since its inception, ensuring timely resolution, value maximization, and protection of stakeholders' interests. The IBC covers insolvency resolution for various entities, including corporates, limited liability partnerships, partnership firms, and individuals. However, certain aspects related to partnership firms and individuals are yet to be enforced.

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