4. Insolvency & Bankruptcy Code (IBC), 2016

Why in News?

- The Ministry of Corporate Affairs has recently proposed several changes to the Insolvency & Bankruptcy Code (IBC), 2016.

Highlights

- The Ministry recognizes that some creditors are worried about not receiving a fair share of the money when a company's debts are resolved.
- To address this, it suggests creating a fair system for dividing the money among creditors.
- This would involve using a specific formula to divide the money based on the size of each creditor's claim.
- Any surplus over the liquidation value shall be pro-rated amongst all the creditors in ratio of their unsatisfied claim.
- The Government implemented the IBC, 2016 to consolidate all laws related to insolvency and bankruptcy and to tackle Non-Performing Assets (NPA), a problem that has been pulling the Indian economy down for years.
- Insolvency is a situation where individuals or companies are unable to repay their outstanding debt.
- Bankruptcy, on the other hand, is a situation whereby a court of competent jurisdiction has declared a person or other entity insolvent, having passed appropriate orders to resolve it and protect the rights of the creditors. It is a legal declaration of one's inability to pay off debts.
- A company has various creditors — public sector banks, private lenders, non-banking financial companies, trade creditors, vendors, workmen, employees, governments, etc.
- The Code puts these creditors into different categories based on the nature of debt.
- Banks, bond issuers, and lenders are classified as financial creditors. Financial creditors are further categorised as secured and unsecured creditors, based on the security furnished by the borrower company.
- Section 53 of the Code prescribes an order of priority in which proceeds will be distributed to the creditors based on the liquidation value.
- As per this waterfall mechanism, secured financial creditors rank the highest in the order of priority. They are followed by unsecured financial creditors, government dues and, finally, operational creditors.

- Hence, financial creditors like banks have the first claim until exhaustion. Proceeds may be extinguished at the level of financial creditors itself, leaving almost nothing for other creditors in the waterfall mechanism.
- The Supreme Court ruled on a case involving how to pay back creditors in the Essar Steel India Limited case.
- The National Company Law Appellate Tribunal (NCLAT) had said that all creditors should be paid equally, regardless of whether they had security or not.
- However, the Supreme Court disagreed with the NCLAT and said that secured creditors should be paid back first because their security interest needs to be protected.
- Section 30(4) of the Code allows for the Committee of Creditors to consider the value of security interest when approving a resolution plan.
- The United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law says that secured creditors can receive payment based on the value of their security, while unsecured and junior creditors may not receive anything.