CHAPTER- 7

INTERNATIONAL SCENARIO ON LAWS OF INSOLVENCY
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INTERNATIONAL SCENARIO ON LAWS OF INSOLVENCY

This chapter shall consist of:

- Insolvency laws of US
- Insolvency laws of UK
- A Comparative Study Between US and UK Insolvency Regime
- A Comparative Study Of UK Insolvency Regime And The IBC, 2016 Of India
INTERNATIONAL SCENARIO ON LAW OF INSOLVENCY

At this juncture, it is pertinent to examine the practice in other jurisdictions for some guidance in bringing about reform in Indian insolvency regime. The corporate insolvency laws of most legal systems are widely categorized as either debtor-friendly or creditor-friendly. The regimes of United States (“US”), France and Italy are perceived as benefiting the debtors more than the creditors, whereas those of United Kingdom (“UK”), Sweden and Germany are seen as favouring the creditors.\(^{540}\) Reorganization or rescue provisions of an insolvency regime are generally considered to favour the debtors. Liquidation on the other hand is largely assumed to be a process that primarily protects the creditors. Nevertheless, studies have shown that the success or failure of an insolvency regime is not a function of which side of the ‘friendliness spectrum’ a given systems falls in, but is rather dependent on the legal institutions within which the system operates, as well as the nature of the firms that the law services and their capital structure. The Indian reorganization and liquidation regime, as proposed in Chapters XIX and XX of CA 2013 subscribes to the philosophy of giving primacy (at least in the law ‘on the books’) to the interests of the creditors over that of the shareholders and other stakeholders.\(^{541}\)

In US there is no requirement of proving insolvency in order for a company to undergo rescue procedures under Chapter 11 of the Bankruptcy Code. On the contrary, the UK uses the insolvency or likelihood of insolvency of a company as a trigger to invoke administration (the formal process for revival and rehabilitation of companies under financial distress). Since doubtful solvency is often an indicator of impending financial troubles, such a test is best suited for determining whether steps for rehabilitating the company are to be taken.\(^{542}\)

\(^{540}\) A.V. Pavlova, The Organizational and Legal Mechanism of Control of the Insolvency and Bankruptcy Institution as an Economic Growth Factor, Studies on Russian Economic Development, Pleiades Publishing Ltd. (2008)

\(^{541}\) Interim Report of The Bankruptcy Law Reform Committee(February2015); available at:<http://www.finmin.nic.in/sites/default/files/Interim_Report_BLRC_0.pdf> accessed on 24\(^{th}\) November 2016

\(^{542}\) Ibid.
In the UK, an administration order is made by the court only if it is satisfied that the company (a) ‘is unable to pay its debts’ or ‘is likely to become unable to pay its debts’ and (b) that the administration order is reasonably likely to achieve the purpose of administration.\textsuperscript{543}

The term “likely” has not been defined anywhere in IA 1986) or the rules, and therefore it becomes relevant to look at the judicial development on this aspect. The analysis of this term in the context of the first ground came up specifically in issue in the case of In the matter of \textit{Highberry Limited v Colt Telecom Group plc.}\textsuperscript{544} A company called Highberry claimed in a petition for administration order that Colt Telecom (“Colt”) is or is likely to become insolvent due to the dramatic fall in its share price since the year 2000, and also due to its substantial operating losses and negative cash-flows and also on the basis of the report of an auditing firm. The noteholders of Highberry who were keen on forcing Colt into administration argued that though there was no risk of cash flow insolvency till 2006, however post 2006, Colt would be unable to repay a substantial amount of the capital due on the notes when it becomes payable (which was 4 years later from the date of the petition) as it was not clear it will be generating enough cash flow from its assets or anyone would be willing to re-finance the company in 2006. The issue framed was “must a petitioner prove that the company is “likely to be unable to pay its debts” on a balance of probabilities or is it sufficient for it to prove that that there is a real prospect of that being so” and therefore, Jacob J. considered it necessary to examine the meaning of the term “likely” as it appeared in the IA 1986.

A reference was made to the judgment of \textit{Re Primlaks (UK) Ltd}\textsuperscript{545} wherein it has been observed that the plain grammatical meaning of the word “likely” is not always used to convey the speaker's belief that it will probably happen, and such a meaning is not what is intended to be attributed to the word “likely” under the IA 1986. Jacob J. further observed – “To put a company into administration is a serious matter. Creditors, as well as the company itself, can apply. To expose the company to all the expense, danger, and problems associated with administration is a serious matter. It is most unlikely that Parliament intended this when there was only a real prospect of insolvency rather than where insolvency was more probable than not. The experience of this case fortifies my view that it is not enough merely to show a

\textsuperscript{543} Schedule B1, para 11, IA 1986 - Conditions for making order - The court may make an administration order in relation to a company only if satisfied— (a) that the company is or is likely to become unable to pay its debts, and (b) that the administration order is reasonably likely to achieve the purpose of administration.

\textsuperscript{544} [2002] EWHC 2815 (Ch).

\textsuperscript{545} (1989) 5 B.C.C. 710.
‘real prospect’ of insolvency as opposed to insolvency being more likely than not. I cannot think Parliament intended that companies should be exposed to this kind of hostile proceeding where it is more likely than not that the company is not insolvent.”

ALLOWING UNSECURED CREDITORS TO INITIATE RESCUE PROCEEDINGS

Currently, the Companies Act 2013 permits the following parties to file an application before the NCLT for a declaration that the company is sick- (a) the company, (b) any secured creditor, (c) the Central Government, (d) the Reserve Bank of India, (e) State Government, (f) public financial institution, (g) a State level institution, (h) a scheduled bank. Unsecured creditors are not permitted to initiate rescue proceedings under the Companies Act 2013. This may reduce the incentives of unsecured creditors to provide credit. The recent global financial crisis has shown that a market for bank loans may not be available at all times and alternative sources of finance need to be put in place to prevent widespread liquidity crunch when the banks are under distress. A right to initiate rescue proceedings is particularly important for unsecured bond investors, who expose themselves to a high risk in such investments.  

Moreover, there may be companies which only have unsecured creditors. It may also be noted that in the UK, any creditor can apply to the court for an administration order in relation to the company. In the US, a Chapter 11 proceeding may be commenced on the filing of a petition under Chapter 11 by three or more entities, each of which is either a holder of a claim against the company that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such non-contingent, undisputed claims aggregate at least $10,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims. Thus, international practice is in favour of permitting even unsecured creditors to file for the initiation of rescue proceedings in relation to the company.

547 Ibid.
MORATORIUM

The CA 2013 provides for a moratorium on enforcement proceedings to be granted on an application to the NCLT, and for a fixed duration of 120 days. The provisions on the moratorium suffer from the following problems: (i) wide discretion to the NCLT to determine whether a moratorium should be granted or not; (ii) no provision for lifting or modifying the terms of the moratorium once it has been granted; (iii) no express requirement for consideration by the NCLT of creditor interests in making the decision to grant the moratorium; (iv) no provision for an interim moratorium while the NCLT is hearing an application for grant of the moratorium. Many countries provide for an automatic moratorium on other proceedings once the company enters formal insolvency proceedings. The possibility of abuse of the moratorium by the debtor company arising in such a case is prevented through the incorporation of suitable safeguards for secured creditors. For example, Section 362 of the US Bankruptcy Code provides for an automatic moratorium on the enforcement of claims against the company and its property upon the filing of a Chapter 11 petition. The moratorium covers judicial and administrative proceedings, enforcement of judgments against the company or its estate, acts to obtain possession/control of estate property, acts to create, perfect or enforce liens, acts to collect claims, exercise of right of set off, tax court proceedings etc.

However, secured creditors can apply to the court to lift the stay under certain circumstances. The moratorium may be lifted for appropriate cause, including if, in the opinion of the court, the debtor company has not ‘adequately protected’ the property interests of the creditor during the period of the moratorium. Similarly, the moratorium may also be lifted with respect to an action against property of the debtor’s estate, if the debtor does not have any equity in the property and such property is not required for the effective reorganisation of the debtor.

Schedule B1 of the IA 1986 (UK) provides for an interim moratorium applicable during the period between the filing of an application to appoint an administrator or giving of notice of intention to appoint an administrator and the actual appointment of such administrator. Further, the IA 1986 provides for an automatic moratorium on insolvency proceedings. The

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548 Sections 253(2)-(3), Companies Act 2013.
549 Rodrigo Olivares-Caminal et al, Debt Restructuring, (1st edn, Oxford University Press 2011) (hereinafter referred to as “Olivares-Caminal et al”)
550 Ibid.
moratorium on insolvency proceedings is broad in nature. Further, there is an automatic moratorium on enforcement of security over the company’s property, repossession of goods in the company’s possession under a hire-purchase agreement (defined to include retention of title arrangements), exercise of a right of forfeiture by a landlord by peaceable re-entry and institution of legal proceedings against the company. The moratorium in these cases can be lifted with the approval of the administrator or the consent of the court.

It is evident that in these jurisdictions, an automatic moratorium (coupled with an interim moratorium in the case of the UK) has been used to prevent a race to collect by the creditors, precipitating the liquidation of the company. Specific safeguards for protection of the interests of secured creditors and others with a proprietary interest in the assets in the possession of the firm (e.g. under hire purchase and retention of title arrangements) have been incorporated through express stipulation of circumstances under which a moratorium may be lifted in the US, and in the case of the UK, through provision for lifting of moratorium with the approval of the administrator or the consent of the court.

PRINCIPLES GOVERNING THE MORATORIUM

As discussed above, the US provides for an automatic stay on the enforcement of claims against the company and its property upon the filing of a Chapter 11 petition. The court may grant relief from a moratorium under Section 362(a) of the US Bankruptcy Code by terminating, annulling, modifying or imposing conditions on such moratorium. Such relief may be granted for cause, including where the debtor has not adequately protected the interests of the concerned secured creditor in the property.

Similarly, with respect to a moratorium on an act against property, if the debtor does not have equity in the property and the property is not necessary for the effective reorganisation of the debtor company, the court may grant relief from the moratorium. Relief may be granted from the moratorium on an application by a creditor having an interest in the real property of the company if the court finds that the filing of the petition was part of a scheme to hinder, delay or defraud creditors that involved multiple bankruptcy filings affecting the property or transfer of ownership (either in part or whole) or other interest in the property without the

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551 Ibid.
552 Schedule B1, para 43, IA 1986.
554 Section 362(d), US Bankruptcy Code.
consent of the secured creditor or approval of the court. The court may also grant relief from the stay, with or without a hearing if such relief is necessary to prevent irreparable damage to the interest of an entity in the property of the company and if such interest will suffer such damage before a notice and hearing can be held.\textsuperscript{555}

In the UK, case law on the moratorium provisions under the IA 1986 provides useful guidance as to the exercise of the discretion by the administrator/court in lifting the moratorium. In \textit{Re Atlantic Computer Systems plc},\textsuperscript{556} the court laid down some guidance for the cases where leave is sought to exercise proprietary rights (including security rights) against a company in administration. The court held that if the grant of leave is unlikely to hinder the achievement of the purpose for which the administration order was made, then the creditor should be given leave to take enforcement action. In other cases, the court has to conduct a balancing exercise between the legitimate interests of the particular creditor and the legitimate interests of other creditors. Such a balancing exercise attaches great significance to the proprietary interests of the creditor:

“…The underlying principle here is that an administration for the benefit of unsecured creditors should not be conducted at the expense of those who have proprietary rights which they are seeking to exercise, save to the extent that this may be unavoidable and even then this will usually be acceptable only to a strictly limited extent…”

Thus, the court will have to take into account the loss (any kind of financial or non-financial loss, whether direct or indirect) caused to the creditor on account of a refusal of leave, and weigh it against the loss caused to others due to the grant of leave. In conducting this exercise, the court will have to consider circumstances such as the financial position of the company, its ability to pay rental arrears as well as continuing rentals, the proposals put forth by the administrator, the time for which the administration order has been in force and the time period for which it will remain in force, the effect on the administration if the court were to grant leave, the effect of refusal of leave on the creditor applying for leave, the end result to be achieved by the administration, the prospects of such a result being achieved and the history of the administration till date. It must be noted that other considerations may also apply, depending on the circumstances of each case. Thus, in \textit{Bristol Airport v Powdrill},\textsuperscript{557} the court considered the conduct of the parties as an important factor in not granting leave-

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\textsuperscript{555} \textit{Supra} n.553
\textsuperscript{556} [1990] BCC 859.
\textsuperscript{557} [1990] Ch 744.
\end{flushleft}
the creditors had in this case obtained the benefit of the administrator’s actions through most of the administration period and were subsequently seeking to exercise their security interests.

While many countries provide for an automatic moratorium, given the past experience under the SICA wherein the automatic moratorium was widely abused by debtor companies, the present provision in the CA 2013 may be retained. However, the law must at minimum lay down clear principles to guide the exercise of discretion by the NCLT on whether the moratorium should be granted or not, and it does not seem optimal to leave this fundamental question to be developed on a case by case basis in the NCLT. Further, a provision may be made for an interim moratorium applicable automatically till the NCLT decides on the application for grant of moratorium or for a maximum period of 30 days, whichever is earlier. Given the possibility of the displacement of management under the rescue mechanism under CA 2013, it seems unlikely that debtor companies will initiate rescue proceedings only with the intention of taking advantage of the interim automatic moratorium.\(^{558}\)

**TAKEOVER OF MANAGEMENT OR ASSETS BY THE ADMINISTRATOR**

As indicated earlier in the Report, “The main drawback of the SICA scheme” was that it left “the debtor company in possession of the assets which creates an asymmetry and imbalance between the debtor company and its creditors conferring on the inefficient or inept management an unmerited advantage…The debtor in possession allows the promoters to leverage informational advantages and to create tailor made delays in the proceedings by taking recourse to [the moratorium]…” (Eradi Committee Report as cited in van Zwieten). In order to address this concern, the CA 2013 provides that an interim administrator or the company administrator appointed as part of the rescue process can take over the management of the debtor company.\(^{559}\) However, like most other powers envisaged in CA 2013, such takeover of management can take place only after the NCLT directs the administrator to take over the management (under Section 256 (1) or Section 258 (3)). In all other cases, the incumbent management continues to be in possession of the company. Moreover, CA 2013 does not provide any guidance on the circumstances in which the management or assets may be taken over. Even where the administrator has been directed to take over the management, CA 2013 provides no clarity on what role the existing management will play after such

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559 Ibid.
takeover of management. The provision relating to takeover of management by the interim administrator provides that when such interim administrator has been directed to take over the management, the directors and the existing management shall extend all reasonable cooperation to him manage the affairs of the company (S 256(2)). However, the provision relating to the takeover of management by the company administrator (who is appointed only after the NCLT has ruled that the company should be rescued) is silent on the role of the existing directors and management. Contrast this to Section 15 of the SARFAESI Act that includes detailed provisions on the manner and effect of the takeover of management for the purpose of debt recovery.\(^{560}\) Presently in India, Insolvency and Bankruptcy Code, 2016 has replaced the existing “debtor in possession” regime to a “creditor in control” regime.

**International practices**

In the UK, the administrator, once appointed, takes over the management of the company. The administrator plays a central role in the rescue process and has the power to do anything ‘necessary or expedient for the management of the affairs, business and property of the company.’ The administrator has the power to carry on the business of the company.\(^{561}\) Most significantly, it may be noted that a company in administration or an officer of a company in administration may not exercise a management power without the administrator’s consent.\(^{562}\) Once appointed, the administrator shall manage the company’s affairs, business and property.\(^{563}\) The power of the court to give directions to the administrator is limited to those instances where none of the administrator’s proposals have been approved by the creditors’ meeting, or where its directions are consistent with such proposals/revisions, or if the court thinks the directions are required in order to reflect a change in circumstances since the approval of proposals/revisions.\(^{564}\) Further, an administrator has the power to remove a director of the company or to appoint a director of the company.\(^{565}\) Most significantly, a company in administration or an officer of a company in administration may not exercise a management power without the administrator’s consent. However, this does not mean that the entry into administration terminates board appointment ipso facto. But the board’s power to exercise managerial powers is limited- if the administrator is of the opinion that the board is competent, he/she may permit them to remain in office and exercise managerial powers. In

\(^{560}\) Ibid.

\(^{561}\) Para 14, Schedule 1, IA 1986.

\(^{562}\) Para 64(1), Schedule B1, IA 1986.

\(^{563}\) Para 68, Schedule B1, IA 1986.

\(^{564}\) Para 68(3), Schedule B1, IA 1986.

\(^{565}\) Para 61, Schedule B1,IA 1986
order to ensure that the board cooperates with the administrator, Section 235 of the IA 1986 imposes an obligation on the management of the company (including officers of the company) to give the administrator such information concerning the company and its promotion, formation, business, dealings, affairs or property that the administrator may at any time after the entry into administration reasonably require, and to attend on the administrator at such times as the latter may reasonably require. This requirement is similar to the obligation under Section 256(2) on the directors to cooperate with the interim administrator.\textsuperscript{566}

In contrast, the US follows a debtor-in-possession regime wherein the management remains in control of the debtor company even after Chapter-11 proceedings have been initiated.\textsuperscript{567} It has been suggested that in the case of a debtor-in-possession regime as under Chapter 11 of the US Bankruptcy Code, the management would be encouraged to make a timely reference for early resolution of financial distress as they would not fear the loss of control in the event of entry into insolvency proceedings.\textsuperscript{568} However, such a system has been criticized because it leaves the management (which may be responsible for the company’s failure) in charge of managing the rescue proceedings.\textsuperscript{569} It could also increase risks of fraudulent activity by the management, including the siphoning away of the company’s assets. However, the US bankruptcy law provides an important safeguard against the abuse of the debtor-in-possession regime by permitting the appointment of a trustee in certain circumstances. Section 1104(a) of the Bankruptcy Code permits the appointment of a trustee to take over the management of the debtor company on two grounds. A trustee shall be appointed for cause, including fraud, dishonesty, incompetence or gross mismanagement of the debtor company’s affairs by the present management, either before or after the commencement of the Chapter 11 case, or for a similar cause.\textsuperscript{570} It must be noted that the grounds mentioned in Section 1104(a)(1) are not exhaustive.\textsuperscript{571} Further, a trustee shall also be appointed if such appointment is necessary in the interests of the debtor company’s creditors, any equity shareholders, and other interests of the estate. The trustee may be appointed by the court on the request of an interested party or

\textsuperscript{566} Supra n.553
\textsuperscript{567} Although in practice the scope of management power in Chapter 11 may be severely limited by the control that some creditors have over the company’s cash flow inter alia (Ayotte and Morrison).
\textsuperscript{568} Sefa Franken, Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited, European Business Organization Law Review (2005)
\textsuperscript{569} John Armour, The Rise of the 'Pre-Pack': Corporate Restructuring in the UK and Proposals for Reform, RP Austin and Fady JG Aoun (eds.), Restructuring Companies in Troubled Times: Director and Creditor Perspectives, 43-78. (Sydney: Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2012)
\textsuperscript{570} Section 1104(a)(1), US Bankruptcy Code.
the trustee at any point of time after the commencement of Chapter 11 proceedings but before a plan has been confirmed. Once the trustee is appointed, unless the court orders otherwise, the trustee takes control of the assets and business operations of the debtor.572 The trustee steps into the shoes of the debtor and has fiduciary obligations to all the parties. The trustee’s duties are set out in Sections 1106 and Section 704. They include: (i) investigating the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor’s business and the viability of continuing the business, any other matter relevant to the case or to the formulation of a plan; (ii) file a plan under Section 1121 or recommend conversion of the case to a case under chapter 7, 12, or 13 of this title or dismissal of the case; and (iii) post-confirmation of the plan, file such reports as are necessary or in accordance with the court orders, etc.573

POWERS AND FUNCTIONS OF THE COMPANY ADMINISTRATOR

In the UK, the functions of the administrator are set out expressly in Schedule B1, IA 1986. Paragraph 59 (1) of Schedule B1 vests a wide discretion in the administrator by empowering him/her to do anything ‘necessary or expedient for the management of the affairs, business and property of the company.’ Paragraph 60 states that the powers of the administrator are as specified in Schedule 1, IA 1986, which contains a list of 23 powers of the administrator.574 It may be noted that a UK administrator takes over the management of the debtor on its appointment unlike CA 2013 which envisages takeover of the management or assets by the company administrator only under directions of the NCLT. Therefore, most powers of administrator under IA 1986 are relevant in the Indian context only after the administrator has been directed to take over the management or the assets.575

SCHEME OF REHABILITATION

In order for the scheme for the rehabilitation of the company to be sanctioned, Section 262 (2) of CA 2013 requires that it has to be approved by (a) secured creditors representing 75% in value of the debts owed by the company to such creditors and (b) unsecured creditors representing 25% in value of the amount of debt owed to them. This provision requiring consent from both secured and unsecured creditors for approval of a scheme of revival seems

572 Section 1108, US Bankruptcy Code.
574 Para 64(1), Schedule B1
575 Supra n.573
well founded. In relation to industrial units, such unsecured creditors will typically consist of suppliers of raw materials and other services such as maintenance of the plant and machinery. Other unsecured creditors may include bond holders and trade creditors. If the scheme is approved with the consent of all such stakeholders, it reduces the possibility separate legal actions by such creditors for recovery of their dues.\footnote{Ibid.}

It is useful to see how this issue is addressed in some other jurisdictions:

**US**

In Chapter 11 proceedings in the US as each class of creditors that are impaired by the plan need to consent to it through a vote of two-thirds of that class in volume and half the allowed claims of that class. Any class of creditors that are not impaired by the plan are automatically deemed to have accepted the plan and any class that does not receive any property or claims under the plan are deemed to have rejected the plan. The US Bankruptcy Code provides for “cram down” of dissenting creditors as long as certain conditions are satisfied.\footnote{Ibid.}

**UK**

In UK administration proceedings, acceptance of the proposal requires a simple majority in value of the creditors present and voting.

**Germany**

The plan needs to be approved by each class of creditors. For each class, approval requires majority vote in number of creditors voting on the plan, provided that this represents the majority of claims by aggregate amount. The plan may be “crammed down” on any nonapproving class of creditors if (i) the plan does not make that class any worse than they would be in the event of liquidation, (ii) the plan provides that the creditors of such class will participate fairly in the economic value to be distributed to creditors and (iii) the plan has been approved by the majority of classes.\footnote{Ibid.}

**France**

In French sauvegarde proceedings, two committees of creditors plus a bond holders’ committee are established. One committee consists of all institutions that have a claim against
the debtor (financial institutions creditors’ committee) and the second committee consists of all the major suppliers of the debtor (trade creditors’ committee). Consent must be given by each committee and requires approval of two-thirds in value of those creditors who exercise their voting rights. Creditors of each committee and bondholders vote as a single class regardless of the security interest they may hold against the debtor.  

RESCUE FINANCING AND GRANT OF SUPER-PRIORITY

If a financially distressed company is to be able to successfully pull itself out of rescue proceedings, continued trading during the course of rescue proceedings is to be facilitated. For this purpose, a financially distressed company often needs access to external finance. However, once a company enters the rescue proceedings, it would find it extremely difficult to obtain credit as few lenders would be willing to lend to a troubled company. Therefore, lenders need to be encouraged to come forward to lend through measures such as giving super-priority to such finance, increased governance rights, safeguards for protection of creditor interests etc.

The CA 2013 does not contain provisions which encourage lenders to extend credit to a financially troubled company. While a proposal for provision of super-priority for rescue financing was considered by the Committee on Financial Sector Reforms, the Committee ultimately favoured a position where the debtor would work towards a consensual solution with its largest secured creditor so that, in most cases, that creditor would be the one providing the additional financing in restructuring. The experience in other jurisdictions points towards the grant of super-priority for rescue financing, either through specific legislative provisions or judicial interpretation. For example, in the US, bankruptcy courts give several benefits, including super priority to a lender who agrees to provide finance to the company under reorganization, a process known as Debtor-in-Possession financing.

One of the primary issues which lead to the breakup of economically valuable businesses is the debt overhang problem which entails that any fresh capital (which is needed to bolster the working capital needs of the distressed company and kick start its recovery) is not forthcoming as it will almost entirely be siphoned off in debt payments to the existing creditors. In order to address this issue, the Bankruptcy Code of US contains provisions

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579 Ibid.
580 Ibid.
581 Ibid.
which provides (subject to various safeguards) for the possibility of “super priority” being
granted to creditors who provide finance to companies in distress (in the US, context,
companies which have filed for Chapter 11 protection) – i.e., the rescue finance providers
will rank ahead of all existing creditors. Any free cash flows generated as a result of the
injection of fresh capital will first go toward the Debtor-in Possession financiers and not the
existing creditors thereby avoiding the debt overhang problem. The buy-in of the existing
creditors is achieved by allowing them to participate in the Debtor-in-Possession financing or
with equity positions in the distressed companies. This regime has proven to be reasonably
robust in practice in the US (although several lessons need to be learnt from the US
experience) and some of the biggest bankruptcies in the recent past including those of
Chrysler and General Motors included portions of Debtor-in-Possession financing in their
structures.\textsuperscript{582}

In the UK where the idea of super-priority funding was considered in great detail, the
Enterprise Act 2002 (which made significant amendments to the IA 1986) did not provide for
such priority. The Government was of the opinion that the decision to lend to a company in
financial trouble was to be left to the commercial judgment of the market. However, a
reading of Section 19(5) and Schedule B1, para 99, IA 1986 indicate that there is a possibility
that super-priority for rescue funding may be permitted under these provisions, super-priority
(over the administrator’s statutory charge for his remuneration and expenses) is given for
debts incurred under contracts entered into by the administrator in the carrying out of his
functions. This has been expansively interpreted in \textit{Bibby Trade Finance Ltd v McKay},\textsuperscript{583}
where the High Court permitted the administrator’s liability to a lender who had advanced
funds during administration to be characterized as a legitimate administration expense (and
therefore enjoying super priority). This indicates that English courts are willing to permit
super-priority funding even in the absence of a specific legislative provision in this regard.
Note however that expenses are payable only out of the company’s unsecured assets and, to
the extent these are insufficient, those subject to a floating charge. Assets subject to fixed
security interests are not, to the extent of the security interest, available for discharging
expenses. The result of this is that one can’t grant ‘super priority’ above the holders of fixed

\textsuperscript{582} Ibid.
\textsuperscript{583} 130[2006] EWHC 2836 (Ch).
security interests, and these secured creditors may have fixed security over much of the company’s assets.584

Provision for super-priority financing has now been recognised as an integral part of insolvency law reform. The European Bank for Reconstruction and Development’s 10 Core Principles for an Insolvency Law Regime states that super-priority new financing should be permitted in cases of corporate restructuring (Core Principle 8). Similarly, the UNCITRAL Legislative Guide on Insolvency Law 2004 also recognises that giving priority for post-commencement finance is essential for continued trading and consequently, for a successful rescue.585 Thus, it is evident that internationally, there is recognition that provision of super-priority for rescue finance is crucial for a successful rescue. Having said that, the crucial issue is whether such financier can get priority over existing secured creditors, given that the company may have no unencumbered assets. This is possible under the US regime (whereas in the UK, fixed charge holders cannot be subjected to such a super priority result without their consent), but the US rules are subject to significant safeguards for existing secured creditors. The application of these safeguards requires significant judicial expertise, including in the adjudication of complex valuation disputes.586

585 Ibid.
586 Ibid.
A COMPARITIVE STUDY OF UK INSOLVENCY REGIME AND THE IBC, 2016 OF INDIA

A vast majority of the legal systems in the Commonwealth countries are founded on English common law. Hence, it is not a surprise that the Code closely mirrors the UK Insolvency Regime. The Bankruptcy Law Reforms Committee (BLRC) decided to move away from the existing “debtor in possession” regime to a “creditor in control” regime; the UK’s creditor in control regime is one of the most established and recognized globally.  

KEY SIMILARITIES BETWEEN IBC, 2016 AND UK INSOLVENCY REGIME

1. Creditors drive the procedure; authorized IPs run the procedure: If a borrower is in default, a creditor can record file an application to the court and begin the indebtedness procedure. The creditors are in charge in deciding the future strategy. An authorized IP will run the procedure.

2. Any creditor or the debtor can initiate the process: In the event of default, a creditor can initiate the insolvency process. The debtor can also initiate the process by making an application to the court. The process is broadly similar irrespective of whether the application is filled by a creditor or debtor.

3. Moratorium provided during the insolvency period: Upon commencement of the insolvency resolution process, a moratorium will be available to the corporate debtor during which period no suits can be instituted or recovery action can be initiated.

4. Clear waterfall of payments outlined during liquidation: Under both the UK and the India regime, the legislation provides a clear waterfall of payments during liquidation, giving priority of payment to secured and preferential creditors. During liquidation, the liquidator pays the liquidation costs first before making payment to any preferential/secured creditors.

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588 Ibid.
589 Ibid.
590 Ibid.
591 Ibid.
5. Multiple IPAs (or equivalent) regulated by a Board: In the UK, there are multiple self-regulating bodies including ICAEW, ACCA and ICAS. Any professional who intends to become an IP needs to register with such a body and pass an exam (besides putting in minimum hours of practical training). There is a common board, which oversees the functioning of all the self-regulating bodies and brings in consistency in their functioning. In India as well, the draft regulations provide for multiple IPAs to be formed under the IBBI.\(^\text{592}\)

KEY DIFFERENCES

1. Creditors' inclusion amid the bankruptcy procedure: in the UK, the IP is an officer of the court and once the arrangement and compensation are endorsed by the creditor, the IP is by and large not required to take any further approval from the creditor regarding the administration of operations of the corporate indebted person amid the indebtedness time frame. In any case, in under the Code (Section 28), there are different activities for which the IP needs earlier approval from the creditor. There is a more noteworthy involvement of creditors in India in the bankruptcy procedure.\(^\text{593}\)

2. Performance security/bond to be provided by the IP: In the UK, IPs are required to provide a general and a specific bond based on the value of assets involved under the case. The bond is to cover a situation if any fraudulent act is committed by the IP. The provision for a bond was initially specified in the draft of the Code submitted to the JPC but removed in the final draft that was enacted. Further, while only an individual can be an IP in the UK, as per the draft regulations in India, individuals and partnership firms (with unlimited liability) can take IP appointments.\(^\text{594}\)

3. Voting rights of creditor classes: In the UK, all creditors (except secured creditors to the extent of the value of their security), including operational

\(^{592}\) Ibid.
\(^{593}\) Ibid.
\(^{594}\) Ibid.
(trade) creditors, have voting power in the creditor committee in the proportion of the outstanding sum especially for the resolution of a resolution design. Be that as it may, in India, just financial creditors (secured or unsecured) can vote in creditor committee. They have to guarantee, however, that at least 'liquidation value' is given to the operational creditors in any resolution design. In India, 75% of the financial creditors (in value) need to approve the resolution design proposed amid the bankruptcy procedure. In the UK, creditors with a minimum majority affirm the plan. 595

4. Deadline for the completion of the insolvency resolution process: The Code specifies that if a resolution plan is not approved by the creditors within 180 days (or as extended to 270 days) of the CIRP, the liquidation process would automatically be triggered. In the UK, no such timeline has been specified under the law.596

5. Remuneration of liquidator; timeline for completion of liquidation: In the UK, remuneration for the IP in liquidations is generally decided based on discussion between the creditors and the IP, taking into account the time spent, assets realized, complexity of the case etc. If a consensus cannot be reached, the court can fix the remuneration. In India, the liquidation remuneration could be decided by the creditors in certain circumstances while in other cases, it would be decided based on the scale of realization and distribution (the court might consult the creditors or the IP while settling the remuneration). In India, according to the draft regulations, the liquidator is required to liquidate the assets within a time span of two years. Extension can be allowed in exceptional cases. There is no such necessity in the UK for the liquidator.597

595 Ibid.
596 Ibid.
597 Ibid.