



# Process of Corporate Insolvency and Bankruptcy

**Tulasi Thanishya.Sampara**

5th year BBA LLB ,KL (DEEMED TO BE UNIVERSITY), vaddeswaram, Andhra Pradesh,India.

## **ABSTRACT :**

Insolvency arises when individuals or business have insufficient assets to cover their debts, or are unable to pay their debts when they are supposed to pay. A company becomes insolvent if it does not have enough assets to cover its debts/ or it cannot pay its debts on or before the due dates. It is the director's responsibility to know whether the company is trading or not, while insolvent and if it can be held legally responsible for continuing to trade in that situation. The decision to appoint receivers, liquidators and administrators, is the responsibility of the appropriate funding bodies (i.e. banks and lending institutions). creditors, the courts, the directors or the company itself, depending on the procedure. In England and Wales, the term is used for the formal procedure for individuals (not companies) who are declared by the courts to be insolvent. Insolvent individuals can sometimes avoid bankruptcy by means of an Individual Voluntary Arrangement (IVA) or a Debt Relief Order (DRO).

## **Introduction**

Insolvency is a type of financial distress insolvency arises when individuals or business have insufficient assets to cover their debts ,or unable to pay their debts when they are supposed to pay when an entity or companies total liabilities exceeds total assets. It lead to insolvency proceedings,in which legal action will be taken against insolvent person or entity, and assets may be liquidated to pay off outstanding debts .it is the director's responsibility to know whether the company is trading or not ,while insolvent and if it can be held legally responsible for continuing to trade or not ,while insolvent and if it can be held legally responsible for continuing to trade in that situation. The decision to appoint receivers, liquidators and administrators,is the responsibility of the appropriate funding bodies ,creditors,the courts ,the directors or the company itself,depending on the procedure. In England and Wales,the term is used for the formal procedure for individuals who are declared by the courts to be insolvent. Insolvent individuals can sometimes avoid bankruptcy by means of an Individual Voluntary Arrangement (IVA) or a Debt Relief Order (DRO).

In India ,the Insolvency and Bankruptcy Code,2016 The code was enacted by the Indian parliament to consolidate and amend the laws relating to insolvency and bankruptcy in India it provides comprehensive

legal framework for dealing with the insolvency and bankruptcy of companies, individuals and partnerships. The code applied to both corporate and individual insolvency and establishes the Insolvency and Bankruptcy Board of India to oversee the process

Under the Code, a company is considered to be insolvent if it is unable to pay its debts as they become due. When a company is found to be insolvent, a bankruptcy process is initiated in which company's assets are sold to repay its creditors. The Code also provides for a time bound resolution process, in which a plan for resolving the company's bankruptcy must be proposed and approved within 180 days, with the possibility of 90 day extension

The code establishes the insolvency and bankruptcy board of India to oversee the insolvency and bankruptcy process in the country. The Board is responsible for regulating the insolvency professionals and insolvency professional agencies who manage the bankruptcy process for companies

Broadly speaking insolvency means inability to pay its creditors.

six different types of insolvency. Apart from the fact that it has to do with inability to pay he further distinguishes the concept as 'balance sheet insolvency', 'cash flow insolvency' and 'economic failure which represent the accounting concept of insolvency while on the other hand he talks about 'liquidation', 'reorganization' and 'insolvency proceedings i.e., bankruptcy' on the legal aspect of insolvency. When the liabilities exceed the assets, a firm becomes insolvent. Accordingly, Basel II norms define insolvency as when the scheduled payments are delayed for more than 90 days. Belcher [Bel1997] has compared the availability of assets to the payment of liabilities with a focus on cash flow. Balance sheet insolvency is when the book value of assets of a company is less than those of its liabilities whereas cash flow insolvency arises when a firm is unable to pay its dues when they fall due. This condition is also known as financial distress when a company is not able to repay its dues as and when they fall due. There is a difference between solvency and economic viability [Whi1983]. Insolvency is the relationship between a firm's asset or cash flows and amount of debt in its financial structure whereas economic viability is the function of net present value of its business as a going concern. If a business has a going concern value which is greater than the value of its asset sold on a break up basis, and also greater than zero, then it is economic value [Arm2015]. Lack of economic viability is known as 'economic distress'.

### **Economic Concept of Insolvency**

As per the economic concept of insolvency, it is a situation where a company is not able to pay its dues, dividends to shareholders' etc. which may or may not lead to a legal remedy. In this concept if management of company is suspended then it is considered to be a good step towards resolution. Some authors, as Zopounidis [Zop1995] have defined this concept very elaborately. According to them, when a company defaults in repayment, it means that it is not able to make profits, and its capital is not creating any value. The authors also reason that the company defaults as it is not able to solve social problems like unemployment etc. But this definition is too broad and it leads to focus on payment problem only. Safe companies can be

differentiated from risky companies on the basis of timely repayment of their dues. The inability to repay makes companies more risky. This definition is adopted by Ooghe and Van Wymmersch According to these authors, a company, is said to be insolvent when it cannot anymore reach its economic goals in a socially and legally constrained environment. One feature of economic concept of insolvency is that it is unable to fulfill its commitment

towards its different stakeholders. The problem of inability to pay must be analyzed and should be done continuously. The failure starts with small difficulties which are gradually transformed into more serious problems. Some works, following [Bea1966], thus tried to propose models in which the non-payment is used like the signal of failure of the company

### **Law & Finance concept of Insolvency**

Insolvency from legal point of view is defined on the basis of judicial criteria which has been laid down in the insolvency act of any country. In most countries, a firm is classified as bankrupt when the judicial authority decides that the company is not able to pay its dues [Cab1999]. Insolvent companies always conform to this mix of legal and accounting logic. At each stage of judicial process, accounting considerations are introduced to strengthen the rationality of the decision made by the judges. The legal action begins with default in payments and finishes with a resolution or liquidation plan. If a point of time is to be ascertained to tell that the company is shifting from a sound company to an insolvent company, many scholars are of the view that it is the moment when a company presents its legal documents to the court for liquidation or reorganization. The failure is then adjusted to the entry in insolvency proceedings and filing for petition has to be considered as an extreme situation, i.e., an exit from the market resulting from the mismatch between the entrepreneurial project and the market conditions

### **Initiation of Insolvency Resolution process**

Company Insolvency Resolution Process (CIRP) is commenced once a company debtor commits a default - section 4(1) of Insolvency Code,2016.

The default ought to be minimum rupees 1 Crore contribution to section 4(1) of Insolvency and bankruptcy Code,2016.

CIPR can't be initiated if quantity concerned is smaller amount than rupees one hundred thousand **Deltas pharma v life essential personal care**

When quantity concerned exceeds rupees one lakhs, adjudicating authority isn't needed to work out precise quantity defaulted . Discrepancy in calculation is settled by CoC

### **Who will initiate Insolvency Resolution Process**

When ever a corporate debtor will a default, a monetary creditor or an operational creditor or the corporate debtor itself might initiate corporate Insolvency Resolution Process in respect of such corporate debtor within the manner as provided in section 6 of Insolvency Code ,2016

### Documents Required for Financial Creditor

The prescribed documents are to be submitted along with the application form.

A record of the default recorded with the information utility or such other document or evidence of default.

The name of the resolution professional proposed to act as an interim resolution professional.

Any other information as may be specified by the board.

### Documents Required for Operational Creditor

The following documents are to be furnished at the time of making the application form.

A copy of invoice demanding payment or demand notice delivered by the operational creditor to the corporate debtor.

An affidavit stating that there is no notice given by the corporate debtor describing to a dispute of the outstanding operational debt.

A copy of the certification from the financial institutions maintaining accounts of the operational creditor confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available.

A copy of any report with information utility confirming that there is no payment of an unpaid operational debt by the corporate debtor, if available.

Any other proof is confirming that there is no payment of an unpaid operational debt by the corporate debtor or such additional information, as may be prescribed by the central government.

### Documents Required for Corporate Debtor

The following documents are to be furnished at the time of making the application form.

The information is representing its books of account and such other documents for such period as may be specified by the Board.

The information representing the resolution professional proposed to appointed as an interim resolution professional.

The special resolution is given by shareholders of the corporate debtor or the resolution adopted by at least three-fourths of the total number of partners of the corporate debtor, as the case may be, approving the filing of the application.

### **How to Apply for CIRP?**

Application To The NCLTA creditor of a corporate (financial or operational), or the company, can request to the NCLT (National Company Law Tribunal). It is used to admit that the company enters the CIRP (Corporate Insolvency Resolution Process). For this, creditors must show the failure of payment of a debt which is more than one Lakh rupees, and the NCLT has to pass an order either admitting or denying the application within 14 days.

The financial and an operational creditor have to satisfy separate requirements when making their requests before the NCLT. A financial creditor needs to furnish the report of the default. The IBC (Insolvency and Bankruptcy Code, 2016) creates a new class of record keepers known as Information Utilities.

Then the operational creditor needs first to make a demand for his unpaid debt. By an ongoing dispute, it is open to the corporate debtor to defend the claim.

### **Appointment of Interim insolvency Resolution Professional**

When a corporate debtor is accepted into the CIRP (Corporate Insolvency Resolution Process), it checks the board of directors. Further, the management is placed under an independent “interim resolution professional”. From this and till the end of the CIRP (Corporate Insolvency Resolution Process), the management ceases to have any control over the activities of the company.

### **Moratorium**

Moreover, a moratorium takes part which prohibits the following

Continuing or beginning of any legal matters on the corporate debtor

Transfer of its assets

Execution of security interest

Recovery of property as an owner

Discontinuing or termination of the supply of basic goods and services, the moratorium lasts till the corporate debtor is in CIRP process.

### **Conclusion**

India presently ranks 136 out of 189 countries within the World Bank's index on the benefit of resolution insolvencies. India's weak insolvency regime, its important inefficiencies and systematic abuse are a number of the explanations for the distressed state of credit markets in India these days. The Code guarantees to originate extensive reforms with a thrust on somebody driven Insolvency resolution. It aims at early identification of monetary failure and maximizing the plus price of insolvent corporations. The Code conjointly has provisions to handle cross border Insolvency through bilateral agreements and reciprocal arrangements with alternative countries. The unified regime envisages a structured and time-bound method for Insolvency resolution and liquidation, that ought to considerably improve debt recovery rates and revitalize the indisposed Indian bond markets.

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