



# A COMPARATIVE STUDY OF BANKRUPTCY LAWS WITH SPECIAL REFERENCE TO INDIA AND USA

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## ABSTRACT:

This paper investigates a comparative relationship of United States and Indian insolvency and bankruptcy laws from individual and corporate viewpoint and examines the relevant legislative regime. This study demonstrates major replacements and adjustments made to earlier relevant laws in order to implement the brand-new bankruptcy code, which includes a mechanism for resolving insolvency and liquidating assets, as well as a brief history of bankruptcy.

**Keywords:** Insolvency, bankruptcy, IBC, US bankruptcy code.

## INTRO:

To be insolvent is to be unable to pay one's debts. It relates to both corporate failure and personal bankruptcy. However, the insolvency is more commonly used to refer to corporate failure or company failure. The terms "insolvency" and "indebtedness" refer to a person's condition in which their assets and resources are insufficient to satisfy their debts when they fall due in the normal course of business. No matter if the benefits were mortgaged or sold, it is the condition of having more commitments (liabilities) than all of the resources that may be available to pay them. Corporate insolvencies occur as a result of a company's high debt levels. Cash flow insolvency and balance sheet insolvency are the two categories into which insolvency is typically divided.

The terms "cash flow insolvency" and "lack of ability to satisfy commercial commitments deriving from day-to-day business transactions with third parties" have different meanings; the second is a broader term that refers to situations in which a company's liabilities exceed its assets. The primary issue in that scenario would not be the company's long-term viability, but a short-term cash flow delay that may be resolved using a variety of strategies. Sometimes, the terms "insolvency" and "bankruptcy" are used synonymously. Legally, the two terms do not, however, have the same meaning everywhere.

Bankruptcy is a legally recognized process by which a debtor is relieved of whole accountability for its debts by a court order for their partial payment. It is also a legal process for the recovery of unpaid debts by creditors. People and businesses who are unable to meet their financial obligations, can file for bankruptcy to avoid having to pay back some or all of their debt. Additionally, it defends people whose debts have gotten out of control. National and common law principles control the rules and procedures for declaring bankruptcy. Although individual or corporate insolvency or bankruptcy may appear very awful, there may be a benefit to both parties in bankruptcy. If a debtor is unable to pay creditors the full amount,

the creditor seeks to recover unpaid debts as quickly as feasible, before the debtor becomes totally unable to pay any of their dues/debts.

From the perspective of the debtor, bankruptcy enables debt relief. Following are the main objectives of bankruptcy laws:-

- (a). fair division of the borrower's assets among creditors of comparable standing.
- (b). a method by which a borrower is relieved from all of his debts, giving him a fresh start.
- (c). to look into the circumstances that led to the insolvency, thereby disseminating the required information which might guide others from accumulating debts that they are unable to pay off.

The purpose of bankruptcy processes, which are punitive in nature, is to ensure that people who are unable to meet their financial responsibilities are barred from participating in business decisions and professions other than those in which they are employed as employees.

This is the main goal of the establishment of a bankruptcy regime and the reason that the Bankruptcy Laws were passed. Despite the aforementioned, bankruptcy proceedings may be effectively used by creditors to recover debts owed to them by borrowers if certain prerequisites are met and one of the acts of bankruptcy permitted by the Act is committed.

## **HISTORICAL BACKGROUND**

The rights of creditors and insolvent debtors who are unable to pay their debts are governed by bankruptcy law. In a broader sense, bankruptcy deals with the seizure of the debtor's possessions and the distribution of those possessions among the debtor's numerous creditors. The phrase is derived from an Italian merchant practices from the Renaissance who operated from benches in public markets. An unpaid merchant's "bench" was figuratively "broken" by his creditors. Thus, failures in business became referred to as "banco rotta."

## **SCENE IN USA**

In the United States, the first bankruptcy legislation was created in 1800. The Act of 1841 replaced this law after it was revoked in 1803 The Act of 1867, which had been revised in 1874 and had been repealed in 1878, replaced the 1841 statute, which had been repealed in 1843. The Nelson Act of 1898 became the nation's first contemporary bankruptcy law. In 1978, the Bankruptcy Reform of 1978 became the second piece of contemporary bankruptcy legislation. The most recent modification to the 1978 law is the Bankruptcy Abuse Prevention and Consumer Protection Act (2005).

## **SCENE IN INDIA:**

The Companies Act of 1956 ("Companies Act"), the Sick Industrial Companies (Special Provisions) Act of 1985, and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002 all governed bankruptcy prior to the implementation of the Insolvency and Bankruptcy Code of 2016. (SARFAESI).

## **PRESENT LEGAL OBLIGATIONS FOR INDIA AND USA:**

**USA:** In USA , The US Bankruptcy Code is divided into six chapters under Title 11: For businesses and individuals seeking relief, the Bankruptcy Code chapters 7, 9, 11, 12, 13 and 15 may be used to file a petition.

### *Chapter 7: Liquidation*

It covers the liquidation procedure and entails the bankruptcy court appointing a trustee to gather the debtor's non-exempt assets. The trustee is responsible for selling the property and allocating the money to the creditors in accordance with their order of priority. In the US, both businesses and people can declare bankruptcy. With the passage of "the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005," the bankruptcy law was altered. The provision was designed to restrict consumer

borrowers generally from declaring bankruptcy. The move, according to the amendment's proponents, would shield some creditors, such as credit card firms, from losses brought on by insolvent clients.

### *Chapter 9: Reorganization of Municipalities*

This section of the bankruptcy code addresses municipalities and how to assist them in reorganising their debt. It must have legal authorisation from the state, a public official, or a body designated by the state as having the authority to provide such authorizations. Prior to the passage of this Chapter of the Bankruptcy Code, the only option for creditors of the financially challenged municipalities was to file a lawsuit and obtain a court order compelling the municipality to increase taxes. Municipalities were added to the bankruptcy code through a 1934 change to the Bankruptcy Act. Numerous municipal bankruptcies were ultimately caused by the 2008 financial crisis, including six in 2010, thirteen in 2011, and twelve in 2012. Detroit, Michigan, filed for bankruptcy on July 18, 2013, becoming the largest municipality to do so.

### *Chapters 11, 12, and 13: Reorganization*

"Chapters 11, 12, and 13 deal with the reorganisation of the debtor's assets, whereas Chapter 7 deals with the process of liquidation. The insolvency court will typically allow the account holder to retain some or all of the benefits and utilise them to satisfy debts to creditors. Businesses, whether sole proprietorships, partnerships, or corporations, can file under Chapter 11.

### *Cross-Border Insolvency, Chapter 15*

Chapter 15 permits collaboration in cross-border liquidation proceedings between American courts, foreign courts, and other authorities.

### **India:**

The "Insolvency and Bankruptcy Code, 2016" (hereafter IBC) seeks to enact changes to the legislation governing the resolution of bankruptcy cases involving partnerships, individuals, unlimited and limited liability firms, and other entities. This law's primary goal is to provide resurrection and resolution in a condensed amount of time in order to maximize the value of the debtor's assets. The Code has established a fundamental structure to assist failing businesses in either closing down or creating a revival plan, as well as to allow investors to withdraw their money.

The fact that the Code does not distinguish between the rights of local and international creditors or between different types of financial organizations is another crucial aspect of the Code. The Code aimed to strike a balance between the interests of all parties involved, changing the priority order, commonly called as 'water fall', for paying off government debts among other things.

The Code has amended 11 laws, including the "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," and "Sick Industrial Companies (Special Provisions) Repeal Act 2003," and repeals the "Presidency Towns Insolvency Act, 1909" and "Provincial Insolvency Act, 1920."

The Code takes precedence over all other laws in bankruptcy proceedings in order to prevent any future litigation. It is expressly stated that civil courts or other authorities do not have the power to issue any injunctions. Having put into practice after its passing by the Parliament and creation of the necessary infrastructure, the IBC has proved to be most crucial step in advancing the process of recovering bad debts. The following are the main highlights of the insolvency resolution process:

### **Resolution of Personal and Partnership Insolvencies:**

The provisions in the Insolvency Code in respect of insolvency resolution and Bankruptcy for Individuals and partnership firms have been notified and made effective from 1-12-2019 only for personal guarantors of corporate debtors (not for other individuals and partnership firms).



**Automatic fresh start procedure:** The Code permits discharge of admissible obligations, assisting the debtor in beginning all over again. In this case, the creditors evaluate the viability of the debtor's business and its alternatives for rescue and revival during the insolvency resolution process.

**Bankruptcy:** It is identical to a liquidation process. If the insolvency process fails, creditors may apply to have the assets of the debtor distributed in order to pay off debts.

### **Resolving insolvency**

By putting the onus of starting the bankruptcy resolution process against the corporate debtor on the creditor, the law significantly departs from the previous resolution mechanism. According to the current legal framework, the debtor has the primary responsibility for starting the settlement process, and creditors may take independent actions for recovering, enforcing security rights, and reforming debt.

### **Corporate Insolvency Resolution and Liquidation**

The creditor has the right to start the insolvency resolution process if the default is to the tune of Rs. 1 crore or more. The Code suggests two distinct phases:

Resolution- Financial creditors evaluate the viability of the debtor's firm and the possibilities for its rescue and revival throughout the insolvency resolution process; or

Liquidation- If the insolvency process is unsuccessful or a creditor decides to liquidate the debtor's assets.

### **The Process of Resolving Insolvency**

If a corporate debtor defaults, a financial creditor may start the procedure to resolve corporate insolvency. An application to start the resolution process has to be made to the "National Company Law Tribunal" (hereinafter NCLT). Before submitting a claim to the NCLT, operational creditors are required to provide the corporate debtor a 10-day notice.

The NCLT is required to complete this process within 180 days of receiving the application. Following receipt of an application by NCLT, creditors' claims will be put on hold for 180 days while NCLT considers revival ideas. Thus, until the resolution plan is approved or until the liquidation procedure is started, no coercive proceedings may be brought against the corporate debtor under any other law.

With the recommendation of the Insolvency and Bankruptcy Board (hence, "the Board") within 14 days of application acceptance, NCLT appoints an interim "Resolution Professional" (RP), who remains as interim IP only for 30 days. Interim IP seizes control of the debtor's property and business operations and gathers financial data on the debtor from data sources. The NCLT announces the start of the corporate insolvency proceedings to the public and requests claims from any additional creditors.

### **Liquidation**

Liquidation is ordered when the resolution plan is not submitted to the NCLT within the prescribed period, or when it is rejected because it does not comply with the Code, or when the creditors' committee decides based on a majority vote, or when the debtor violates the resolution plan. No other actions may be taken by or against the debtor during this process, except for those taken by the liquidator on behalf of the corporate debtor, with NCLT approval.

### **Fast Track Process for Resolving Bankruptcies**

For corporate debtors, the Code provides a fast-track insolvency resolution process. The process must be finished in 90 days, though the time may be extended by NCLT for another 45 days.

### **Voluntary Liquidation of a Corporate Person**

The Code allows for voluntary liquidation procedures where the company has the intention to do so on its own. The NCLT issues a directive for its dissolution after the debtor has been fully wound up and its assets have been sold.

## **Fresh Start Process**

As per this procedure, qualified debtors may apply to the Debt Recovery Tribunal (DRT) for a discharge from certain debts up to a particular amount, allowing them to start again.

Corporate entities are not eligible for the fresh start procedure. A specialist that the DRT has designated will review the application, collect claims from creditors, accept or reject the application, and then submit a report to the DRT with justifications. The DRT will decide whether to accept or reject the application based on the report.

## **Resolution in Fresh Start Process**

Under Fresh Start process, the debtor must prepare a repayment plan and submit it for the creditors' approval as part of the bankruptcy resolution procedure. "The DRT passes an order binding the debtor and creditors to the repayment plan," if it is accepted. The debtor or creditors may submit an application for a bankruptcy order if the plan is rejected or fails. Upon receiving approval from the Board, DRT nominates a resolution specialist. After reviewing the insolvency application, the resolution professional reports to DRT with a recommendation to accept or reject it.

DRT is required to accept or reject the application within 14 days. Within 21 days of such notice, DRT has to publish a notice soliciting claims from all creditors. Creditors must file claims with a Resolution Professional. A list of creditors must be created by the resolution professional. By a vote of more than 75%, the creditors may adopt, alter, or reject the repayment plan at a meeting called by the Resolution Professional. A meeting report is written by the Resolution Professional and forwarded to DRT.

## **BANKRUPTCY**

The procedure of bankruptcy is comparable to corporate liquidation. The creditor or the debtor himself may apply to the DRT for bankruptcy of the debtor. DRT may reject the application for insolvencies, if the repayment plan is not submitted on time or it fails to meet the criteria of the Code, or the Code is violated. The only way to withdraw the application is with the tribunal's permission. The DRT will issue an order, signaling the start of the bankruptcy process.

## **SETTLEMENT BODY UNDER THE CODE:**

Prior to the notification of IBC, for debt recovery and restructuring, the High Courts, the Company Law Board (CLB), the Board for Industrial and Financial Reconstruction (BIFR), and the Debt Recovery Tribunal (DRT) had overlapping jurisdiction. As a result, the procedure was complicated and subject to systemic delays. The National Company Law Tribunal (NCLT), which is now made the Adjudicating Authority (AA), for insolvency resolution and liquidation of companies and limited liability partnerships under Part II, Chapter VI of the Code, aims to overcome these obstacles and lessen the burden on the courts by requiring that all litigation be brought under the Code.

## **CONCLUSION:**

Both the Indian Insolvency and Bankruptcy Code and the US Bankruptcy Code have distinct provisions for both individual and corporate debtors. The Indian Code however, says nothing about municipalities. As we've already seen in this article, the USA used to have a law of this kind, but India didn't. Instead, India was relying upon the "Companies Act," "SICA," "SARFAESI," and other similar pieces of legislation. To implement the IBC, the Indian government has made several changes to the relevant laws already in place, as we've seen in this article. Though many teething problems have been faced in implementing the provisions of the IBC, Overall, the outcome has been good and it has instilled a new legal ecosystem for ease of doing business and resolution of insolvency, which has positively impacted the growth of Indian economy and world bank ranking on ease of resolution.

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