



SECTION VI: NON-CORPORATE INSOLVENCY

Editor's Note:

The law of insolvency is much older than the law of companies, and therefore, obviously, insolvency laws were originally made for individuals. Later, as law of corporations developed, insolvency principles, with certain modifications, were adopted by corporate laws. Before IBC made its mark, the corporate insolvency law in India too, drew inspiration from personal insolvency law, as is clearly evident from a reading of section 529 of the Companies Act, 1956. The personal insolvency law, in turn, was contained in two centenarian (even older!) laws, namely, Presidency Towns Insolvency Act, 1909 (PTIA) and Provincial Insolvency act, 1920 (PIA). PTIA covers the erstwhile presidency towns, namely, Calcutta (now Kolkata), Bombay (now Mumbai) and Madras (now Chennai), and the rest of the country is covered by PIA, though the two laws are by and large similar.

However, as discussed in Law Relating to Insolvency and Bankruptcy Code 2016, there is an essential difference in the philosophical foundations of corporate insolvency regimes, and personal insolvency regimes. The former has an overarching objective of rescue, and is, therefore, impelled by economic considerations. The latter has a larger humanitarian angle, as the objective to save an individual from being harassed by creditors, and hated societally. The objective is to provide the individual a relief, so that he can start living peacefully again. Therefore, the objective of personal insolvency laws is to provide for survival of the individual, whereas corporate insolvency laws will provide for liquidation of the failed entity.

The [26th Report of the Law Commission](#) (1964) suggested an overhaul of the individual insolvency laws. Many years later, in 2001, the [N L Mitra Committee](#) recommended a comprehensive corporate bankruptcy code, "Though it was felt that without individual insolvency system being straightened, the total system management can not be built up specially because rural and agrarian bias of the economy". Subsequently in 2014, the task before [BLRC](#) was "to create a uniform framework that would cover matters of insolvency and bankruptcy of all legal entities and individuals". The idea, as advocated by BLRC was:



"This has two distinct advantages in improving the insolvency and bankruptcy framework in India. The first is that all the provisions in one Code will allow for higher legal clarity when there arises any question of insolvency or bankruptcy. The second is that a common insolvency and bankruptcy framework for individual and enterprise will enable more coherent policies when the two interact. For example, it is common practice that Indian banks take a personal guarantee from the firm's promoter when they enter into a loan with the firm. At present, there are a separate set of provisions that guide recovery on the loan to the firm and on the personal guarantee to the promoter. Under a common Code, the resolution can be synchronous, less costly and help more efficient recovery."

Therefore, as a part of its recommendations on individual insolvency, BLRC proposed that PTIA and PIA be repealed and individual insolvency law be included in the unified code. The adjudicating authority for individual insolvency processes shall be the debt recovery tribunals.

Non-Corporate Insolvency

As such, IBC in Part III, envisages two distinct processes for individual bankruptcy law – Fresh Start Order and Insolvency Resolution Process. In fresh start process, individuals with assets and income lower than specified amounts are eligible for a discharge from their qualifying debts, subject to maximum prescribed limit. Their debts will be written off, giving them a ‘fresh start’. On the other hand, insolvency resolution process will involve a process of negotiation between the debtor and the creditors supervised by a resolution professional (akin to corporate insolvency resolution process). The debtor will prepare a repayment plan in consultation with the resolution professional to be approved by the creditors. Hence insolvency resolution process will give the debtor an ‘earned start’ – the debtor gets a ‘discharge’ but only in terms of the repayment plan. However, if the negotiations fail, the obvious outcome will be to proceed with declaration of the insolvent debtor as ‘bankrupt’. Hence, bankruptcy process is initiated led by a bankruptcy trustee appointed by the adjudicating authority (which is debt recovery tribunal). The debtor gets a discharge from bankruptcy after a specified time.

A schematic description of each of these processes is as follows –

Fresh Start Process

Fresh Start is a new and laudable concept indeed, equivalent to debt waivers, allowing a person to give a fresh start to his life. Fresh start is a once-in-life-time opportunity granted to the individual, to seek moratorium, phasing out obligations, etc. so that the individual may start his life afresh. However, the applicability of the option is greatly limited by the very narrow monetary limits laid – annual income of Rs 60,000, and assets of Rs 20,000. This largely covers the bottom-of-the-pyramid individuals who may not have qualified for any borrowing in any case.

Fresh start application may be made by the debtor himself, provided the income and asset criteria are within the thresholds referred to above, and the “qualifying debt” for which the individual seeks relief is limited to Rs 35000/- . Secured debt is not included within the definition of “qualifying debt”. Also, student loans are also excluded from the purview, as they are defined as “excluded debt. As it appears, the limits of income, assets and the debt fixed under the law are paltry. Not only should these limits be enhanced to make the provision practical, the law should not fix the limits – the limits should be left for the government or the Board to notify. It seems highly impractical that an individual seeking relief in respect of debt upto Rs 35000/- will afford the fees and expenses of the resolution process, including those of the insolvency professional, and that the institutional framework should act as Samaritan for such small value cases. The idea of the Committee may be that the **fresh start option will lead to financial inclusion, but whether the population segment covered by the provisions will at all be able to reach out to the institutional framework under the Bill will remain doubtful.**

A fresh start application may be made in a case of inability to pay the qualifying debt, for which prima facie recommendations will be made by an insolvency professional. The AA may admit the application based on the recommendations. If a fresh start application is admitted, there will be a 6-months’ moratorium against any legal action for recovery of the qualifying debt. Of course, during this period, there is an injunction on entering into several to-be notified transactions by the debtor. He may travel overseas only with the approval of the AA.

A fresh start process is akin to a one-time waiver of debt, based on the adjudication of the AA.

Insolvency Resolution Process

The insolvency resolution process is often referred to as the process of “earned start”, since there are no straight debt waivers like in the case of fresh start process. The most important ingredient in the process is a “repayment plan” which is devised by the debtor in consultation with the resolution professional. This is unlike ‘resolution plan’ in corporate insolvency resolution process where the corporate debtor cannot be a resolution applicant.

The insolvency resolution process may be initiated by the debtor or a creditor of the debtor, by making an application, either personally or through a resolution professional, to the AA. On filing of application, an interim-moratorium commences in respect of all the debts, to last till the admission or rejection of the resolution application.

The resolution professional is appointed who examines the application for initiation of insolvency resolution process, recommending whether the application shall be approved or rejected. On the basis of the recommendation made by the resolution professional, the AA approves or rejects the application. Where the application is rejected, subject to certain conditions, the creditor is entitled to file for bankruptcy order. However, where the application is admitted, the interim-moratorium ceases, while a fresh moratorium commences in relation to all the debts. The moratorium lasts for 180 days from the date of the admission of the application.

A public notice is issued inviting claims from all the creditors. The creditors register their claims with

the resolution professional, who in turn, prepares a list of creditors.

The debtor prepares a repayment plan in consultation with the resolution professional. The resolution professional prepares a report on the repayment plan for submission to the AA – also stating, whether there is a necessity of summoning a meeting

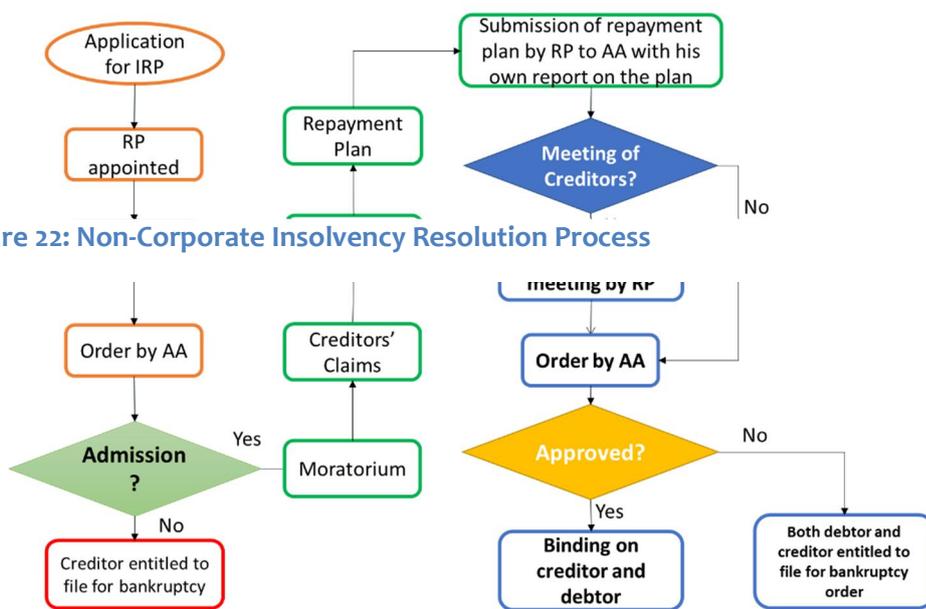


Figure 22: Non-Corporate Insolvency Resolution Process

of creditors. Where the meeting of creditors is not summoned, the AA passes an order on the repayment plan on the basis of the report on the repayment plan prepared by the resolution professional. However, where the meeting of creditors is summoned, the repayment plan has to be approved by the creditors, a report of the meeting is prepared by the resolution professional and the AA passes an order on the repayment plan on the basis of the report of the resolution professional on the meeting of creditors.

Non-Corporate Insolvency

The resolution professional supervises the implementation of the repayment plan. Once the repayment plan is completed, the resolution professional sends notice of the same to the concerned persons, and a report on implementation of the repayment plan. The resolution professional also applies to the AA for a discharge order in relation to the debts mentioned in the repayment plan and the Adjudicating Authority may pass an order accordingly. The repayment plan may provide for an early discharge or discharge on complete implementation of the repayment plan.

Bankruptcy Process

Akin to liquidation process envisaged for corporate persons as a matter of 'last resort'; where the attempts to provide an individual debtor either a "fresh start" or an "earned start" fail, the last recourse left is an application for bankruptcy. Undoubtedly, there are differences in the provisions relating to liquidation of corporate debtor and bankruptcy of non-corporate debtor.

The debtor or the creditor(s) of the debtor, both are eligible to make an application for bankruptcy order, under 3 specified circumstances – a resolution application is not admitted, a repayment plan is not approved by creditors or the adjudicating authority, or a repayment plan fails prematurely.

Once an application is filed, an interim-moratorium commences – which is similar to that under the individual insolvency resolution process. A bankruptcy trustee is appointed to manage the process. Within 14 days of confirmation of appointment of a bankruptcy trustee, the adjudicating authority passes a "bankruptcy order". This date becomes the bankruptcy commencement date, and the bankruptcy process continues to have effect till the debtor is discharged.

On the bankruptcy order being passed, these consequences follow – (a) the estate of the bankrupt vests in the bankruptcy trustee, (b) the interim-moratorium ceases and a fresh moratorium starts, and (c) the bankrupt submits a statement of financial position (if so required). The bankrupt is required to submit a statement of financial position within 7 days of the commencement date.

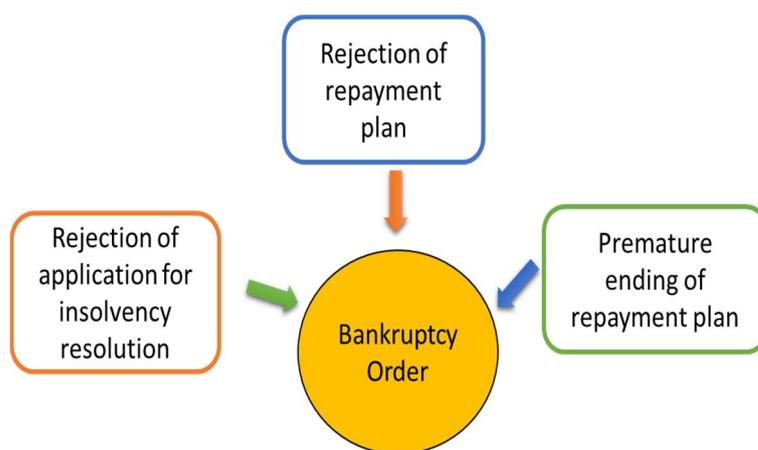


Figure 23: What leads to Bankruptcy Order

Public notice is issued inviting claim from creditors. The creditors register their claims with the bankruptcy trustee. Based on such claims, the bankruptcy trustee prepares a list of creditors, and summons a meeting of the creditors for the purpose of establishment of a "committee of creditors". The committee may, among other powers, replace the interim bankruptcy trustee.

The bankruptcy trustee administers and distributes the estate of the bankrupt in accordance with the provisions of Chapter V of Part III. The trustee takes possession and control of the bankruptcy estate, exercises powers pertaining to avoidance, vesting of after-acquired property, etc. The trustee notifies creditors to prove their claims, and values claims. The trustee makes payment of interim dividend, and before making distributing the final dividend, the trustee puts up a notice once again, requiring

creditors to have one final opportunity to prove their claims. Section 178 lists out the priority of claims of different types of creditors.

On completion of the administration, the bankruptcy trustee prepares a report of the administration and convenes a meeting of the committee of creditors for approval of the report. The bankruptcy trustee applies to the adjudicating authority for a discharge order once the approval of committee of creditors is obtained or on the expiry of 1 year from the date of bankruptcy order, whichever is earlier. That is to say, even if the administration of estate is still continuing, the bankrupt will be eligible for discharge after 1 year from the bankruptcy commencement date.

From the bankruptcy commencement date till his discharge, the bankrupt is an “undischarged insolvent” or “undischarged bankrupt” and faces several disqualifications under the Code as well as other laws; his after-acquired property is also liable to be vested in the trustee. After discharge, the once-bankrupt is a free man.

The provisions pertaining to undue preferences, fraudulent transfers, onerous contracts, extortionate credits etc., in case of non-corporate debtors are similar to those in case of corporate debtors.

Status of enforcement

Part III of IBC has not been enforced yet.

So far, the Central Government and IBBI has come up with the following **draft** rules and regulations (respectively) concerning non-corporate insolvency law contained in the Code –

- (i) [The Insolvency and Bankruptcy Board of India \(Insolvency Resolution Process for Individuals and Firms\) Regulations, 2017;](#)
- (ii) [Insolvency and Bankruptcy \(Application to Adjudicating Authority for Insolvency Resolution Process for Individuals and Firms\) Rules, 2017;](#)
- (iii) [The Insolvency and Bankruptcy Board of India \(Bankruptcy Process for Personal Guarantors to Corporate Debtors\) Regulations, 2019;](#)
- (iv) [Insolvency and Bankruptcy \(Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors\) Rules, 2019.](#)

In the Discussion Paper issued by IBBI in April, 2019, IBBI seems to suggest separate rules and regulations shall be formulated for each of the three classes of individuals (personal guarantors to corporate debtors, partnership and proprietorship firms, and other individuals). The Discussion Paper suggests that the provisions of the Code may first be notified for personal guarantors to corporate debtors. The remaining provisions of Part III of the Code applicable to individuals with business and to individuals without business may be notified in subsequent phases.