

## Rights of Investors Insolvency Resolution



The most significant legislation of 2016 is the Insolvency and Bankruptcy code, which has been described by finance minister Arun Jaitley as the most important economic reform next to GST since independence. After the adoption of Globalization and liberalization in the 1990s, some of the commercial laws have become inadequate to deal with the cases arising in the present scenario. In this shrinking world, it has become necessary the convergence of commercial and economic laws. Bankruptcy of the firms and individuals and the legal procedures to deal with the same have huge implications for an economy.

The Insolvency and Bankruptcy Code 2016 (hereinafter the Code), is a comprehensive law which covers the entire subject matter of corporate as well as individual insolvency under a single umbrella eliminating multiple judicial fora.

The new Code has created a situation in which entrepreneurs can raise money from the market and need not depend upon banks for finance. Therefore it is said that the Code is the channel through which India will come out with substantial share in the Global economy, especially in the digital revolution.

In a corporate entity investment can be made through a number of ways such as convertible or non-convertible debentures, preference shares, bonds, deposits, and equity shares. In the day to day management of the company equity shareholders are given more rights. However, in the insolvency resolution debenture holders, bondholders and depositors stand on the higher footing when it comes to the priority in insolvency resolution or liquidation.

### Order of priority for distribution of assets under the Code

Under the new Code, the order of priority of the application of assets of a company is as follows

- Insolvency related costs
- Secured creditors and workmen dues upto 24 months
- Other employee's salaries/dues up to 12 months
- Financial debts (unsecured creditors)
- Government dues (up to 2 years)
- Any remaining debts and dues
- Preference Shares
- Equity

The following persons can file application for initiating insolvency proceedings

- Financial creditors
- Operational creditors (including government & employees or workmen)
- Corporate debtor, member, partner, person in charge of operations or finance

It is in the light of these two lists that we may ascertain the position of investors vis a vis insolvency resolution process.

### **Rights of Debenture/ Bond Holders**

The term 'financial creditor' is defined under the Bankruptcy Code as any person to which the financial debt is owed. In turn, the term 'financial debt' includes any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any similar instrument.

Therefore, a holder of debentures or bonds will be considered a financial creditor for the purpose of the Bankruptcy Code and will be entitled to initiate the insolvency resolution process.

However, the term debenture is given a very wide connotation in the Companies Act, 2013. Section 2 (30) of the **Companies Act, 2013** define inclusively **debenture** as "**debenture**" includes **debenture** stock, bonds or any other instrument of a **company** evidencing a debt, whether constituting a charge on the assets of the **company** or not. Generally, debentures are not secured by any physical assets of the company. Therefore, it comes under the category of unsecured financial debts would be fourth in the order of priority in the application of the assets in liquidation. On the other hand, if debenture creates charge over the assets of the company, the charge applies to any physical asset of the company which is not specifically mortgaged or charged to any other debt. Such a debenture holder will enjoy priority in liquidation.

In some Western States such as Canada, a debenture refers to a secured loan instrument where security is generally over the debtor's credit, but security is not pledged to specific assets. Like other secured debts, the debenture gives the debtor priority status over unsecured creditors in a bankruptcy; however debt instruments where security is pledged to specific assets (such as a bond) receive a higher priority status in a bankruptcy than do debentures.

The new legislation alone has created a positive outlook for the bond market in India, as this will allow holders of debentures and bonds to initiate the insolvency resolution process in the most efficient manner.

### **Debenture Trustee's Right to Initiate Proceedings**

Under the Companies Act, 1956 debenture trustees were entitled to initiate proceedings for winding up. However, the Bankruptcy and Insolvency Code does to authorise the debenture trustee to initiate insolvency proceedings. Although this may create confusion in situations where the trustee is entrusted with powers to seek enforcement of bonds, keeping in mind various court precedents on trustees' authority to initiate winding-up proceedings on behalf or at the instructions of holders under the existing regime, the courts are likely to interpret the term 'financial creditor' to include a trustee of the holders.

### **Rights of Shareholders**

Preference shares whether convertible or non convertible are second last in the order of priority and then come the equity shares. Nonetheless, shareholders being the members of a corporate debtor are entitled to initiate insolvency proceedings.

## Role of Investors in the Insolvency Resolution Plan

Once an Interim Insolvency Professional is appointed, he constitutes a Committee of creditors to put forward a resolution Plan. The Committee is to consist of financial creditors including debenture holders. Shareholders and Operational Creditors may be allowed to participate in the committee meetings: but, they will not have voting power.

In spite of this, the shareholders may play a major role in implementing the resolution plan, especially when it involves restructuring.

Almost all significant decisions — such as offering preference shares to infuse funds into a defaulting company, selling properties and assets, floating convertibles, and declassifying the promoter following a dilution of shareholding – have to be approved by shareholders of the company in question; and some key decisions have to be cleared by a special resolution, requiring the support of 75% shareholders.

The regulations enacted under the Code provide that a resolution plan can be approved even if the consent of shareholders as required under the Articles of Association has not been obtained, the regulations do not dispense with the compliance with any applicable provisions of law. Hence, if the companies' law requires shareholders' approval for any provision or step provided in the Resolution Plan, the same will have to be obtained. Shareholder nod is essential for the sale of assets exceeding 10% of the turnover of the company; reclassification of a 'promoter' as 'public shareholder' cannot be carried out without shareholders giving the go-ahead. Therefore, in the insolvency resolution plan, investors particularly shareholders will have a significant say.

The present regime is one which invokes investor confidence .A foreign lender or investor can also cause a quick liquidation of the investee/ borrower company in case of default of the terms of the Shareholders Agreement/ Loan Agreement and pull back his investment/ loan, which will be a huge confidence booster while making the investment/ lending. The same will result in higher foreign investment/loans in the country.