

## **BANKRUPTCY LAW IN INDIA AND CHINA: A COMPARATIVE STUDY**

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### **ABSTRACT**

Insolvency and Bankruptcy Code was introduced in the 2016 in India. Before the introduction of this new code, India had multiple laws laid down. Due to multiple laws prevailing in India, there had been occurred major defaults and scams which made the situation worse. So, Government of India, decided to come up with a new code. The new code is still in progress. It was reported that huge amount of money already recovered since last 2years. The study was conducted to get a clear understanding about the relevance of new code in the current scenario by comparing it with bankruptcy law prevailing in China for the last 10 years. The study concluded that China's bankruptcy law seems to be more efficient in its operation compared to bankruptcy law in India though China does not have personal insolvency system.

**Keywords:** Insolvency and Bankruptcy Code 2016, Bankruptcy, Insolvency, Reorganization process

### **INTRODUCTION**

Insolvency is a situation where in individuals and corporate are unable to pay its debts as they are unpaid. Bankruptcy is different from insolvency. Bankruptcy is a legal term used by the person or business that cannot repay outstanding debts. In most countries, bankruptcy is imposed by debtors. There are number of consequences that a person should face after declared as bankrupt. When a creditor forces a company into liquidation, all assets are sold to repay debts. The appointed liquidator may conduct an investigation and the director could be responsible for liquidation of the company.

### **Evolution of Corporate Bankruptcy Law in India**

There are different Acts and special provisions for liquidation and reorganization process. One of the acts is Companies Act 1956 which has been modeled after the British Companies Law. There are two modes that can be used to accomplish liquidation of companies: one is voluntary

liquidation by creditors and the other is involuntary liquidation by courts. The entire liquidation process will be handled by Official liquidator once the winding up order has been announced by the court. The automatic stay is not available under this act. The second Act is Sick Industrial Companies Act 1985 which has established the Board for Industrial and Financial Reconstruction (BIFR) to securely detect the sick industrial units and to provide the appropriate measures for the same. Once the application for intervention has been filed, three alternatives are available for BIFR. The first alternative is to sanction a plan that is being framed by creditor or management without any concessional financing. The second alternative is to determine the ability to survive and if the business is not financially stable, and then go for liquidation. The last and third alternative is to claim for rehabilitation of the business in the interest of general public. In the second and third alternative, the BIFR would appoint an operating agency to determine the stability of the company and put forward a plan. Under this act, an alternative act will be an automatic stay will be granted against all claims. The third major act is Recovery of Debts due to Banks and Financial Institutions 1993 which permits the financial institutions to recover the debts that is outstanding that exceeds Rs.1 million by filing a complaint before Debt Recovery Tribunal (DRT). Companies Act 1956 has been amended by passing Companies Act 2002 and repealed Sick Industrial Companies Act 1985 with a goal to matches up with international standards. There are certain provisions in relation to insolvency of individuals and unincorporated bodies. The Presidency Towns Insolvency Act 1909 and Provisional Insolvency Act 1920 are the most important acts that engage with personal insolvency in India.

### **Insolvency and Bankruptcy Code, 2016**

This law has been implemented to deal with insolvency and bankruptcy. The objective behind implementation of this Act is to bring in single law instead of multiple laws. Once the case is filed, the power of Board of Directors would be taken off and might appoint a resolution professional by the creditor to manage the company during insolvency proceedings. Adjudicating authority would be different for corporate and individuals. National Company Law Tribunal would be adjudicating authority for corporate and LLP insolvency whereas Debt Recovery Tribunal could be the adjudicating authority for individuals. The code describes the person or corporate which defaults in paying more than Rs 1 Lakh could assess the insolvency. There is a committee of creditors consist of financial creditors. It would be lead by operational creditors in the absence of financial creditors. The decision taken should be sanctioned by three fourth of financial or operational creditor. The plan for resolution is sanctioned by creditors. But in case if the plan for resolution fails to get approved then the corporate debtor has all rights to prefer voluntary liquidation. As a result of voluntary liquidation, the Insolvency Professional will turn out to be Official Liquidator of the company. There is an order to distribute the assets among the

creditors at the time of liquidation. First they pay off liquidation cost, after that they pay off secured creditors and then to the unsecured creditors.

### **History of Bankruptcy Law in China**

The Qing Dynasty Bankruptcy Law, 1906 was approved on April 1906 and commenced on July of the same year. The law applied on merchants and also applicable for joint stock companies which are suffering a loss. The deceased merchant can file a complaint to Local Chamber of Commerce by declaring him as bankrupt. The belongings of merchant would be sealed. The Chamber would choose a Trustee to administer the case and the property would be handed over to the trustee. He has the power to take the final decision either to sell the assets or to determine the creditors' claim and distribute it among them. The Kuomintang Bankruptcy Law was implemented in 1935 but extending its applicability to partnership firms, companies and defaulted debtors along with individual traders. This law was lost its applicability by the foundation of New Republic. The Bankruptcy Regulation of Shenyang in Liaoning Province was the regulation that was implemented in 1985 for industrial enterprises that would be declared as insolvent. The Civil law was implemented in the year 1986 and that was the first time bankruptcy was declared under a law. The Law of Enterprise Bankruptcy 1986 was applied to only state owned enterprises with separate legal identity. Though the law was approved in December 1986, it came into force on November 1988. The Code of Civil Procedure Law was approved on 9 April 1991 and was applicable to enterprises with legal identity and not applied to enterprises owned by whole persons. There were some state owned enterprises which had been changed to companies with frequently varying degree of ownership. The Company Law was approved on December 1993 and it became effective on July 1994. This law helps in identifying the need for the appointment of special liquidation committee for a company which had already been regarded as bankrupt. The limitation of this law is that it is applicable to state enterprises only. Enterprise Bankruptcy Law 2006 states that it would be applicable to non- state enterprises unlike Enterprise Law 1986. But the new law excludes partnership, sole proprietors and then including companies. The new law could be more beneficial by bringing in transparency and long benefit to creditors. The enterprise can file for voluntary or involuntary petition as the case may be. Under the new law, automatic stay is available. There is an order of priority for distributing assets among creditors. At first, secured claims would be met and after that unsecured claims. For the reorganization, debtor or creditor can file the application. The debtor in possession manages the company during reorganization under the supervision of administrator. The debtor in possession or administrator can put forward a reorganization plan within 180 days after the reorganization application is accepted by the court which may extend to another 90 days. All the creditors either secured or unsecured have the right to vote on reorganization plan.

## **REVIEW OF LITERATURE**

Bankruptcy reorganization is the least expensive method in converting a financially troubled firm to a state of financial stability. Debt rearrangement seems to be more flexible by giving alternatives such as taking a haircut by the creditors or to extend the date of repayment or to defer the payment of tax or change the identity of lenders or exchange debt for equity. The restructuring process totally relies on the sale of assets to repay the creditors (Lee, 2011). The debtor or creditor is empowered to file an application for reorganization or liquidation in China. The debtor could start reorganization or liquidation process if it is not able to pay the debts or if asset exceeds liabilities. (Buford, 2017). The personal insolvency system in England and Wales are more complex and five different debt relief mechanisms are available. It includes bankruptcy, an individual voluntary arrangement, an administrative order, debt relief order and private debt management plan. A distinctive feature of French personal insolvency law is the central role played by the Bank of France. In Sweden, the process is a type of repayment plan and it lasts for five years. (Ramsay, 2017). In similar lines, in case of most of the personal bankruptcies, the unsecured creditors receive nothing as compensation. (White, 2014). It is been declared that the efficiency of corporate bankruptcy regimes depends largely on effectiveness of governance structure of firms.(Franken, 2004). German civil law countries better protect the secured creditors (Fimayer, 2008). In UK, flexibility can be attained by obtaining acceptance from creditors for their plans and by offering improved returns whereas in Sweden, the position of creditors skews the opportunity though the reconstruction proceedings are creditor friendly but on the other hand, priority is given for lending which is not available in UK. (Pond, 2006). Debt finance is important than equity finance in Germany followed by France whereas in common law countries both equity and debt finance are equally important (Brouwer, 2006). The level of protection given to shareholders in Australia is high compared to US, Germany, UK, France and India. (Helen Anderson, 2012). The recovery rate is higher for Germany compared to France and UK. The recovery rate is low for France. UK and Germany are creditor friendly in contrast to France. Focusing on these three countries we could capture the main stake of debate on bankruptcy reforms that have been implemented in Europe (Regis blaze, 2010). In the UK, the assets cannot be sold without the permission of creditors and only expenses that are met before paying secured creditor is insolvency proceedings unlike France and Germany where super priority is given to those who contribute to refund the distressed firms. Debtor friendly laws give privilege to debt renegotiation and company's reorganization. (Froute, 2007). The major objective behind reorganization is to raise the value of distressed firms above its liquidation value and the firms go for reorganization if they are financially distressed temporarily. (Hashi, 1997). UK and France lie somewhere between Germany and the US in believing that the rights of creditor have to be considered above the concerns of bankruptcy (Kaiser, 1996). The goals of special resolution regime in UK include financial stability, minimization of cost in the public

interest consideration. The ultimate goal of special resolution regime in UK is to protect the confidence in banking system. Deposit confidence can be attained through deposit insurance (Lastra, 2008). In the UK, a secured creditor has exclusive right over the asset and such a lien can be used as a method to restrict a receiver from using the asset to manage the business. But in Germany, secured creditors do not have any role in liquidation proceedings and in US, debtor in possession usually manage the business throughout the reorganization proceedings (Julian R. Franks, 1996). The New Enterprise Law in China take into consideration all enterprises whether it is state owned or not (Harmer, 1996). The author states that among all group involved in the implementation of bankruptcy law in US, the Bankruptcy Professionals have strongly influenced to modify the Bankruptcy Law in US since its enactment in 1898 (Zywicki, 2003). Corporate bankruptcy is the ' crucial missing piece in understanding corporate governance. (Armour, Cheffins, & Skeel, 2002). In US, the debtor in possession can manage the business but need court approval to sell the assets during reorganization. The debtor in possession can suggest a reorganization plan only for few months but, thereafter, any creditor may do so. In UK, the company is managed by an administrator who is an outsider to the company at the time of reorganization. (McCormack, 2007). The players in the bankruptcy community have great influence in the development of bankruptcy law. (Gebbia, 2017).

### **OBJECTIVE OF THE STUDY**

- To compare the bankruptcy laws prevailing in India and China.

### **SCOPE OF THE STUDY**

The study is relevant in this current scenario because earlier India had multiple laws to deal with insolvency and bankruptcy. It was found difficult to follow multiple laws that lead to the occurrence of major defaults and scams done by major players in the market. So, Government of India has come up with single legislation that is, Insolvency and Bankruptcy Code introduced in the year 2016.

### **STATEMENT OF THE PROBLEM**

The study is relevant in this current scenario because China and India had multiple laws to deal with insolvency and bankruptcy. Since the implementation of Insolvency and Bankruptcy Code 2016 in India, no detailed study was conducted on new bankruptcy law. Further, both China and India are fastest growing economies in the world. Therefore a comparative study between bankruptcy laws in China and India will help in understanding defects and merits of new bankruptcy law implemented in India.

**Comparison between Bankruptcy Law prevailing in India and China**

<b><u>BASIS</u></b>	<b><u>INDIA</u></b>	<b><u>CHINA</u></b>
ESTABLISHMENT YEAR`	28 May 2016	June 1 2007
WHO CAN FILE APPLICATION FOR REORGANISATION/ LIQUIDATION	Financial Creditors, Operational Creditors Corporate Debtor	Creditors or Debtors (excluding sole proprietors, partnerships and individuals), commercial banks, insurance companies, securities companies.
ADOPTION	UK Bankruptcy Law	A mixture of US and UK Bankruptcy Law
MORATORIUM	Available	Available
APPROACH	Creditor in Possession Approach	Debtor in Possession Approach
APPLICABLE LAW	Insolvency and Bankruptcy code 2016	China's Enterprise Bankruptcy law of 2006
COMMITTEE OF CREDITORS	Consists of financial creditors. The operational creditors could be a member in the committee in the absence of financial creditors.	Consists of creditor and employee representatives. A maximum of nine persons.
PROPOSAL TO CREDITORS	180 days	180 days
VOTING REQUIREMENTS FOR APPROVAL OF PLAN	Voting power persists with financial creditors until and unless operational creditors become the member in the committee. The decisions taken in the committee shall be sanctioned by three fourth of financial creditors/Operational creditors, as the case may be.	Maximum in number and two thirds in value for each affected class present at the creditors meeting for resolution plan voting and cram down is applied.
APPLICABLE AUTHORITY	There are two authorities to deal with insolvency. National Company Law Tribunal (NCLT) deals with Corporate	The People's Court in the Domicile of debtor

	and LLP insolvency. Debt Recovery Tribunal (DRT) deal with individual or partnership insolvency	
ORDER OF PRIORITY	Insolvency reorganization process and liquidation costs, Secured creditors and workmen, Other employees' salaries, and then repay unsecured creditors, Government dues up to 2 years, any remaining debts.	Secured, bankruptcy expenses, priority claims, unsecured claims
WHO IS RESPONSIBLE TO RUN THE COMPANY DURING REORGANISATION PROCESS	Insolvency Professional appointed by creditors	Court appointed independent administrator
PERSONAL INSOLVENCY LAW	As if now only corporate person (companies) can declare they insolvent. IBC contains provisions for declaring insolvency of individuals as well as partnerships but these sections have not been notified. Once they get notified a person can be declared insolvent.	China do not have personal insolvency law

**CONCLUSION**

In India, Insolvency and Bankruptcy Code was introduced in the year 2016. But in China, the Enterprise Insolvency Law has been introduced a decade ago. In India, bankruptcy law is still in the implementation stage. But in China, law has been incorporated successfully and doing well. Bankruptcy law in India covers both corporate and individuals. Whereas bankruptcy law in China excludes sole proprietors, partnerships and individuals. India has been adopted bankruptcy law from UK. But in China, bankruptcy law is a mixture of US and UK bankruptcy law. In India, creditor in possession approach is followed whereas in China, debtor in possession approach is followed at the time of reorganization proceedings. In India, financial creditors and operational creditors could be the member in the committee of creditors. In China, creditors and employee

representatives constitute committee of creditors. In India, Insolvency professional appointed by creditors is responsible to manage the business during reorganization process. In China, court appointed administrator is responsible to manage the business during reorganization process. In both the countries moratorium period is available. In both the countries the resolution process should be completed within 180 days. In both the countries, order of priority is the same. Firstly, liquidation expenses will be met followed by paying off secured and unsecured claims. In India, NCLT would be applicable authority to engage with insolvency of corporate. DRT would be the applicable authority to engage with individuals. In India, as if now corporate person can only declare themselves as insolvent. IBC contains provisions for declaring insolvency of individuals as well as partnerships but these sections have not been notified. Once they get notified a person can declare him as insolvent. But in China, there is no personal insolvency law to declare individuals as insolvent.

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