



IBC Reform: Distribution of Proceeds

For Prelims: Non-Performing Assets (NPA), Liquidation value, National Company Law Appellate Tribunal (NCLAT), United Nations Commission on International Trade Law (UNCITRAL).

For Mains: Insolvency & Bankruptcy Code (IBC), Proceeds Distributed Among Creditors Under the IBC.

Why in News?

The **Ministry of Corporate Affairs** has proposed several changes to the [Insolvency & Bankruptcy Code \(IBC\), 2016](#).

What are the Suggested Changes in IBC?

- The Ministry recognizes that **some creditors are worried about not receiving a fair share of the money** when a company's debts are resolved.
 - To address this, it suggests creating a **fair system for dividing the money among creditors**.
- This would involve using a **specific formula to divide the money based on the size of each creditor's claim**.
 - Any surplus over the liquidation value shall be pro-rated amongst all the creditors in ratio of their unsatisfied claim.

What is Insolvency & Bankruptcy Code, 2016?

- The **Government implemented the IBC, 2016 to consolidate all laws related to insolvency and bankruptcy and to tackle [Non-Performing Assets \(NPA\)](#)**, a problem that has been pulling the Indian economy down for years.
 - **Insolvency** is a situation where **individuals or companies are unable to repay their outstanding debt**.
 - **Bankruptcy**, on the other hand, is a situation whereby a court of competent jurisdiction has **declared a person or other entity insolvent, having passed appropriate orders to resolve it and protect the rights of the creditors**. It is a legal declaration of one's inability to pay off debts.
- The IBC Covers all **individuals, companies, Limited Liability Partnerships (LLPs)** and partnership firms.
 - Adjudicating authority:
 - **National Company Law Tribunal (NCLT)** for companies and LLPs.
 - **Debt Recovery Tribunal (DRT)** for individuals and partnership firms.

How are Proceeds Distributed Among Creditors Under the IBC?

- A company has various creditors — **public sector banks, private lenders, non-banking financial companies, trade creditors, vendors**, workmen, employees, governments, etc.
 - The Code puts these creditors into different categories based on the [nature of debt](#).

- **Banks, bond issuers, and lenders** are classified as financial creditors. Financial creditors are further **categorised as secured and unsecured creditors**, based on the security furnished by the borrower company.
- **Section 53** of the Code prescribes an order of priority in which proceeds will be distributed to **the creditors based on the liquidation value**.
- As per this waterfall mechanism, secured financial creditors rank the highest in the order of priority. They are **followed by unsecured financial creditors, government dues and, finally, operational creditors**.
 - Hence, financial creditors like banks have the first claim until exhaustion. **Proceeds may be extinguished at the level of financial creditors itself**, leaving almost nothing for other creditors in the waterfall mechanism.

What is the Jurisprudence on the Subject of Proceeds Distribution?

- The **Supreme Court** ruled on a case involving how to pay back **creditors in the Essar Steel India Limited case**.
 - The **National Company Law Appellate Tribunal (NCLAT)** had said that all creditors should be paid equally, regardless of whether they had security or not.
 - However, the **Supreme Court disagreed with the NCLAT and said that secured creditors should be paid back first** because their security interest needs to be protected.
- **Section 30(4) of the Code allows for the Committee of Creditors** to consider the value of security interest when approving a resolution plan.
- The **United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law** says that **secured creditors can receive payment based on the value of their security**, while unsecured and junior creditors may not receive anything.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Q. Which of the following statements best describes the term 'Scheme for Sustainable Structuring of Stressed Assets (S4A)', recently seen in the news? (2017)

- (a)** It is a procedure for considering ecological costs of developmental schemes formulated by the Government.
- (b)** It is a scheme of RBI for reworking the financial structure of big corporate entities facing genuine difficulties.
- (c)** It is a disinvestment plan of the Government regarding Central Public Sector Undertakings.
- (d)** It is an important provision in 'The Insolvency and Bankruptcy Code' recently implemented by the Government.

Ans: (b)

Source: IE