

Insolvency and Bankruptcy Law in India

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Week 03

Lecture 11

Welcome, everyone. Let us recap what we discussed in the previous class. In the previous class, we discussed the concepts of insolvency, bankruptcy, and liquidation, as well as the differences between bankruptcy and liquidation. Then we discussed the objectives of the IBC. Then we discussed the IBC structure, how many parts there are in the IBC, how many sections there are in the IBC, and the terms that are not defined under the IBC. So, in the IBC, we have definitions in Section 3 and Section 5.

But if any word is not defined in the IBC, where do we need to refer? We have other legislation here. The list is provided under the IBC. We discussed it in the previous session. Then we discussed the applicability of the IBC.

Today, we are discussing the topic “Introduction to IBC,” and under that, we will discuss the definitions section. So let us discuss a few important definitions today. So, the first important definition is “board.” What is the meaning of the word? The term “board” is defined in Section 3, subsection 1. So here, if you look at the definitions, I have given the number 1; it refers to board Section 3, subsection 1, subsection number.

So, subsection 3 of subsection 1 defines the term “board.” Board means the Insolvency and Bankruptcy Board of India, established under Section 188, subsection (1) of the legislation. So, as we discussed in yesterday’s class, we discussed that one of the objectives of the IBC is to establish the IBBI (Insolvency and Bankruptcy Board of India). So, under Section 188 of the IBC, a board has been established. Then, the next definition is a claim.

What is the meaning of the claim? Subsection 6, Section 3. So, what is the meaning of a claim? Claim means a right to payment, whether or not such right is reduced to judgment, fixed, disputed, undisputed, legal, equitable, secured, or unsecured. So, whenever I have a right to payment, I have the right to receive that payment from someone. Maybe such a right is due to the judgment; that means I have already received some judgment. The court of law has given the judgment, and now I am entitled.

Maybe it is fixed already, maybe it is disputed or undisputed, maybe legal, maybe equitable based on equity, or secured or unsecured. So, whenever I have a right to

payment, that is called a claim. Then, I have the right to a remedy. Whenever I have the right to a remedy, what is the right to a remedy for breach of contract? We both entered into the contract, I imagine. So, whenever I breach, you have a remedy against me.

So, the right to remedy for breach of contract under any law in force at the time, if such breach gives rise to a right to payment, is important. Please remember that this breach should give rise to a right to payment; unless you have a right to payment, the right to remedy is of no use. So, whether or not such right is reduced to a judgment-fixed measure—mature, disputed, undisputed, secured, or unsecured—more or less, if you observe these two paragraphs, the last two lines are repetitive in nature. Whether such a right is reduced to a fixed mature judgment or an immature disputed one, all of them are already present. In simple language, I can say, “What do you mean by a claim?” A claim means it is a right to payment and a right to remedy.

So, you have the right to payment, and you also have the right to a remedy. Whenever you satisfy these two conditions, the right to payment and the right to remedy, it is called a claim. The next definition is for a corporate entity. So, section three, subsection seven of the Act defines the term “corporate person.” A corporate person means a company, an LLP, or any other person incorporated with limited liability, as defined under the Companies Act.

Please remember these corporate persons. In the subsequent lessons, we will discuss who is eligible to file a petition under this legislation. A corporate person is also one of the persons who are eligible to file a petition or an application under this legislation. So, a corporate person means a company as defined under the Companies Act 2013, an LLP, or any other person incorporated with limited liability; however, it shall not include any financial service providers. So, financial service providers are not covered under corporate personhood because they are regulated by the Reserve Bank of India.

We have separate legislation and a separate set of schemes that are also regulated by the Reserve Bank of India. Because these are all very sensitive in nature, they are important to the economy. So, that is why we have a separate set of rules and regulations. Now, let us see who the financial service providers are. Because a corporate person does not include a financial service provider, we should understand what a financial service provider is.

So, who is the financial services provider? Subsection 17 of Section 3 defines a financial services provider. A financial service provider is a person engaged in the business of providing financial services in accordance with the authorization issued and the registration granted by the financial sector regulator. What is the meaning of a financial service provider? A financial service provider is a person; thus, when you look at the word “is,” it indicates that it is an inclusive definition; it is not an exhaustive definition.

Whenever you look at the definitions part of any legislation, there are two categories: inclusive and exhaustive. Here, “financial service provider” is an inclusive definition.

So, they have given the image ABCD, but that does not mean that the definition includes only ABCD; other than that, anyone or anything that has the characteristics of ABCD is also included in the definition. Financial service means a financial service provider, which is any person engaged in the business of providing financial services. So, we have to understand the meaning of financial services in terms of authorization issues; you cannot provide financial services unless you have authorization from the concerned authority or registration granted by the financial sector regulator. So, from this definition, you can understand that any person who provides financial services is regulated by a financial sector regulator. Then, we have to understand the meanings of financial services and financial sector regulation.

When I say that financial services are defined under subsection 16 of Section 3, I mean only subsection 16 of Section 3. So, what is the meaning of financial services? Financial services mean accepting deposits. Generally, banking institutions accept deposits for the purpose of lending. That is the basic definition of banking services as defined under the Banking Regulation Act, which includes accepting deposits. Any person who accepts deposits and is registered is considered to be providing financial services.

Then, safeguarding and administering assets consisting of financial products belonging to another person, or agreeing to do so, is important. Whenever you are selling assets that belong to others, I can refer you to asset management companies. So, if there are asset management companies and portfolio managers, they administer the assets that belong to other people. Even so, it is considered a financial service. Then it affects the insurance contracts.

Any person who provides insurance policies or contracts of insurance and offers to manage or agrees to manage assets consisting of financial products belonging to another person is offering or managing those financial products. If someone is managing financial products that belong to another person, I am not actually investing; someone else is investing, and I am managing. I am managing or offering such products to another person. In such cases, these services are called financial services. Again, we have to refer to the definition of financial products.

So that’s why the term “financial product” is highlighted in the PPT. Okay, then, what else is included in financial services? Rendering or agreeing to render advice on, or soliciting for, the purpose of buying, selling, or subscribing to financial products is prohibited. In subsequent lessons, we will discuss the meanings of financial products. Whenever someone renders services for the purpose of buying, selling, or subscribing to

financial products, Generally, financial products include securities. I'm offering the sale; I'm offering shares.

Otherwise, I am selling the shares, offering to subscribe to the shares, availing myself of financial services, or exercising any rights associated with financial products or services. Whoever renders these services by receiving some consideration—maybe you can think of them as stockbrokers—is considered to be providing financial services. Establishing or operating an investment scheme involves maintaining or transferring records of ownership of a financial product, so whoever establishes or operates an investment scheme is providing financial services. Let us take the example of a mutual fund, which is an investment scheme. Okay, so mutual funds—what is the basic concept of a mutual fund? The investor and the mutual fund company have already invested.

So, the investment as a whole is divided into units that are sold to retail investors. That is why they are managing the investment scheme. So, whoever establishes or operates the investment scheme, or maintains or transfers the records of ownership of the financial product is responsible. So, who can be included in maintaining and transferring the records here, deposit participants? If you look at the deposit system, the depository participants, and the deposit systems in India, we have NSDL and CDSL, along with other depository participants. They are maintaining and transferring the records of ownership, so whoever renders the services mentioned in Clause F is considered to provide financial services.

Then, underwriting the issuance or subscription of a financial product is required. So, whoever is underwriting the issue of subscription, whenever you are going for an initial public offering or possibly a further public offering, the company will generally seek underwriters. What is the meaning of “underwriter”? Underwriters mean that if you fail to receive the minimum subscription, these underwriters will subscribe; it is as if you are reducing the risk. Whoever underwrites the issuance or subscription of a financial product is also considered to render financial services. Then, providing or issuing stored value or payment instruments is providing payment services.

So, who is providing the payment services, or who is issuing stored value or payment instruments? Maybe you are a UPI. So, maybe I am providing some debit and credit card services; all these things are considered financial services. You have to consider who renders the financial services; therefore, this legislation is not applicable. Then, key service terms for the financial sector are regulated. In the previous definition, a corporate person does not include a company, LLP, or other persons, but shall include a financial services provider.

So, who is a financial services provider? A financial service provider is a business that provides financial services, and registration is granted by the financial sector regulator.

Now, are you clear on the definition of financial services? Who is the financial regulator? Let us look at the financial regulator as defined under subsection 18, section 3, subsection 18. The financial sector regulator includes, in its inclusive definition, the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and the Pension Fund Regulatory and Development Authority (PFRDA), as well as any other authorities that may be notified. That's why I told you it is an inclusive definition. The central government has the power to notify any other authority.

If any authority is notified by the central government as a financial sector regulator, then it is also included. Now, let us look at the definition of a financial product. What is the meaning of a financial product? Because in the previous definitions, whenever we discuss the terms financial product and financial services, we refer to whoever is offering the financial products. What is included in the definition of a financial product? Section 3, subsection 15 defines the term "financial product".

"First one: Securities. What is the meaning of security? The term "securities" is not actually defined in this legislation. Securities are defined under the Securities Contracts (Regulation) Act. If I want to discuss the definition of securities, that in itself is a one-hour lesson. In simple language, securities can mean any shares, bonds, or debentures; perhaps you are converting the shares or debentures into stocks. That is stock of debentures or equity stock, perhaps your deposits, units issued by the mutual fund, and units issued by the collective investment scheme.

These are all the various categories that exist. These all include security receipts; for example, security receipts issued under the SARFAESI Act. These are all the various categories included in the definitions of securities. So, a financial product includes securities. Your insurance contract states that whenever I avail myself of insurance services, the insurance company will provide me with one contract.

That contract of insurance and deposits states that if any banking institution accepts deposits, it is also included within the meaning of financial products. Credit arrangements, including loans and advances by banks and financial institutions, are also included. If financial institutions are providing any credit arrangements, they may be in the form of loans, an overdraft facility, or advances; all of these are included in financial products. Then, retirement benefit plans—okay, we have various retirement benefit plans. Then, small savings instruments, if there are any, are also included among the financial products.

Then, foreign currency contracts are contracts for exchanging one currency for another. So, whenever you have foreign currency contracts, suppose you have options, and derivatives are involved, imagine there are derivatives; there can be a possibility of a derivative based on the foreign currency. So, a derivative is an instrument whose value is

derived from an underlying asset. So, this underlying asset can be a foreign currency. So, whenever you have foreign currency contracts other than contracts to exchange one currency, If you are entering into an agreement to exchange one currency, it is not regulated.

So, other than one currency, if you have any agreement in which foreign currency contracts are present, it is included in the definition of a financial product or any other instrument that may be prescribed. These are all the various products included in the definition of a financial product. Then the next definition is Section 3, Subsection 11. Debt. What is the meaning of debt? Debt means a liability.

So, you have to underline the word “liability”: liability or obligation in respect of a claim. What is required? What is the meaning of debt? Debt means a liability, obligation, or claim. The keyword is important. I am highlighting or stressing the words liability, obligation, and claim, which are due from any person and include financial and operational debts. So, if you observe the definition of debt, you must underline the words liability, obligation, claim, financial liabilities, and operational debt.

Liability means I am liable, and obligation means I have some obligation. Liability and obligation are synonymous; we will use them accordingly. There is also a definition for claim: financial debt and operational debt. Subsequently, we will discuss the meaning of claim in the following lessons. Then, what is the meaning of financial debt? It is defined in part two.

So, part one is a preliminary section. In part two, it is defined in section five, subsection eight. Section five, subsection eight defines the term “financial debt.” What is the meaning of financial debt? Financial debt refers to a type of debt that includes interest. Whenever I include the debt, it is along with the interest, principal plus interest, and the principal amount plus interest, if any, and includes money borrowed against the payment of interest. Any amount raised by acceptance under any acceptance credit facility or its dematerialized equivalent, and any amount raised pursuant to the issuance of bonds, is included.

Suppose I issue the bonds; by issuing the bonds, I receive some money. Or maybe I have issued some notes, debentures, loan stock, or similar instruments. So, whenever I issue something—maybe debentures, loans, bonds, etc.—I am raising debt capital.

So, that is called a financial debt. The amount of any liability in respect of any lease or hire-purchase contract. So, if I am liable to pay some rent, an amount—maybe take the example that I have taken one property on a lease basis—I am supposed to pay the rent. So that amount is called financial debt, and receivables sold are discounted, other than any receivables sold. Then, any amount raised under any other transaction, including forward sale purchase agreements having a commercial effect, means that any money

raised under other transactions is also included within the definition of financial allotment. But for the purpose of this clause, this is added after that; in the subsequent lessons, we will discuss how allottees are considered financial creditors in the real estate sector, as certain judgments by the Honorable Supreme Court of India have addressed this matter.

Previously, they treated them as operational creditors; however, the Supreme Court subsequently issued a judgment that financial creditors include allottees in real estate as well. So, that is why it is included. For the purpose of this clause, any amount raised from the allottees under the real estate project shall be deemed to be an amount having a commercial effect on borrowing. Because, in the case of a real estate project, what happens is that in the majority of cases, the builders first start allotting the flats and then raise the money. This money is used in the project, so when they are using it in the project, it is nothing but finance for them.

So, they are borrowing money, though they are not borrowing in a technical sense. Strictly speaking, they are taking the money from the allottees, and this money is invested in constructing the real estate project. So that's why they are treated as financial creditors. The expressions "allottee" and "real estate project" shall have the meanings defined in the respective legislation. We have separate legislation, namely the Real Estate (Regulation and Development) Act of 2016.

So, under section 2, classes Z and D of the legislation, we have definitions; therefore, we must observe the same definitions here as well. Then, enter into any derivative transaction in connection with the production against or benefiting from fluctuations in any rates or prices and for calculating the value of any derivatives. So, what is the meaning of a derivative? Derivative means any instrument that derives its value from an underlying asset. So, what is this underlying asset? This underlying asset can be foreign exchange, crude oil, or any product for which I am hedging my risk to reduce it. I am purchasing the derivatives because the prices may fluctuate, so I have entered into the agreement.

Suppose we take the example of you selling one derivative to me. The agreement is that you have to exchange the foreign currency; maybe take the dollar. One dollar is equal to 82 rupees. After three months, I will have the option to purchase from you for a certain number of dollars at 82 rupees. Suppose in the market, if the dollar price increases or decreases the rupee price, bringing the dollar value to around 85 rupees, then I can exercise this right and get the dollar at 82 rupees.

So, obviously, these 3 rupees are profit. So, these are called derivative transactions: futures and options are various categories that exist. So, any derivative transaction entered into in connection with the production against or benefit from the fluctuations is

generally used to hedge our risk because these things are fluctuating in nature, such as oil prices, crude oil prices, pulses, and foreign exchange. To protect against fluctuations, you generally tend to purchase derivatives. For any derivative transaction, only the market value of the transaction shall be taken into consideration. Then, what else is included? Any counter indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit, or any other instrument issued by the bank or financial institution is applicable.

Is there an indemnity obligation in respect of the guarantee? The guarantee is given by a bank or financial institution, okay? These are all obligations because I am liable, okay? Suppose I have taken a letter of credit or any other instrument issued by the bank. Then, obviously, I am liable to pay in the near future; I am supposed to pay. Okay, so all of this is included in the definition of financial debt. Then, any amount of liability in respect of the guarantee or indemnity for any of the items referred to in subclauses a to h shall be specified. Suppose we take the example of all these things: whatever we have discussed from A to H—money borrowed and money raised.

We have A, B, C, D, E, F, G, and H. If I have given a guarantee for the above transactions, from A to H, or I have given any indemnity, then all of these are considered financial debts.

However, in the case of Orator Marketing Pvt. Ltd. v. Samtex Design Pvt. Ltd., the Honorable Supreme Court held that the list given in this section, Section 5, Subsection 8, is inclusive. The list is inclusive but not exhaustive because it has not used the word “includes.” Okay, so it is inclusive but not exhaustive.

Then, let us look at other definitions of operational debt. What is the meaning of operational debt? Operational debt means a claim in respect of the provision of goods or services, including employment or debt in respect of the repayment of dues arising under any law for the time being in force and payable to the central government, any state government, or any other local authority. What is the meaning of operational debt? Let me tell you in simple language. Financial means it is a liability; debt is a liability for sure. Financial means whenever I have any debt for the purpose of finance, that is to do business, that is called financial debt.

It is like a capital expenditure. Operational means I am selling the goods. For example, I am selling the goods or purchasing the goods. It is a day-to-day activity, nothing to do with my main business. When I purchase the goods, I am supposed to pay the amount.

This is called operations. This is relating to the operations, your operations. Whenever I perform some operations, if any liability arises, then it is called operational debt. So operational debt means a claim in respect of the provision of goods or services. I am selling some goods, I suppose. Let us take the example: I am purchasing the goods, or

someone else is rendering services to me. Then, I am supposed to pay something, so this liability is called operational debt.

In respect to the rendering of services or goods, this is called operational debt. So let us discuss another important definition: the term “default” is defined under section 3, subsection 12. Default means non-payment of debt when the whole or any part of an installment of the amount of the debt has become due and payable and is not repaid by the debtor or the corporate debtor, as the case may be. So, what is the meaning of “default”? Does default mean non-payment? It can be operational debt, as we have just discussed, or financial debt. So, non-payment of debt, whether in whole, in part, or in installment, may mean that the whole amount is pending, part is pending, or some installment of the debt has become due.

Please remember that you have to underline the words “due” and “payable.” Okay, why? Because this is one of the essential elements to be satisfied whenever you want to file an application before the NCLT, it is important to understand it fully. Whenever the debt has become due or whenever it is payable, and it has not been repaid by the debtor, or possibly the corporate debtor, as the case may be, we will call it a default.

Let us recap what we have discussed today. Today, we discussed some important definitions under the IBC. We have discussed the definitions of a claim and a corporate person, as well as who is considered a corporate person.

Then we discussed the definition of a financial service provider. The person who provides financial services is called a financial services provider. Then what are financial services? We have discussed this. Then we discussed the definition of a financial-sector regulator. Then, we discussed the definitions of financial products, debt, and financial liabilities.

Then, there is the definition of operational debt. The definition of debt includes financial debt and operational debt. We have discussed the definition of debt, as well as financial debt and operational debt, in today’s lesson.

Thank you.