

IBC 2016: To watch out for Disciplinary Committee's Orders



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*The Insolvency and Bankruptcy Board of India (IBBI or the Board) has been monitoring the assignments handled by Insolvency Professionals (IPs) under the Insolvency and Bankruptcy Code, 2016 (IBC or the Code) by creating a system with robust checks and balances. Under the existing regulatory framework, IBBI is empowered to initiate disciplinary actions against IPs for any contraventions found in any assignment. The Disciplinary Committee (DC) of IBBI may impose penalty or suspend/ cancel the registration of the IPs/ Insolvency Professional Agencies (IPAs)/ Information Utilities (IUs), as the case may be. In this article, the author has presented an analysis of various orders of the DC of IBBI from January 2022 to June 2023 based on contraventions committed by IPs. This analysis would provide insights into the common mistakes made by IPs thereby helping fellow IPs to avoid them in future. **Read on to know more...***

1. Introduction

The IBBI has been empowered under Section 196 of Chapter II titled 'Powers and Functions of Board' under Part IV of the IBC titled 'Regulation of Insolvency Professionals, Agencies, and Information Utilities' of the Code to carry out inspection and investigations on IPs,

Insolvency Professional Agencies (IPAs) and Information Utilities (IUs) and pass orders, if any abnormalities are found in compliance with the provisions of the Code.

Sections 217 - 220 of Chapter VI titled 'Inspection and Investigation' of Part IV of the Code lays down the framework for IBBI to carry out inspection and

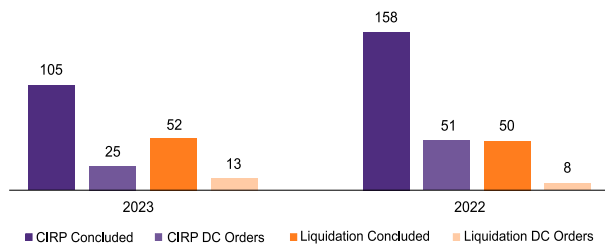
investigation. The Board can, upon receipt of any complaint under Section 217 of the Code or if there are reasonable grounds to believe that any IP, IPA or IU has contravened any of the provisions of the Code or the rules or regulations or directions, direct an Investigation Authority (IA) to inspect and investigate such person and/or agency.

Upon completion of inspection/investigation laid down under Section 218 of the Code, the IBBI may issue a show cause notice to such IP/IPA/IU, allowing them to file its reply under Section 219 of the Code. Thereafter, the Board shall constitute a Disciplinary Committee (DC) under Section 220 of the Code to consider and examine the report of the IA. The primary function of the DC is to examine reports of IA and form an opinion on the same. The DC may impose penalty or suspend/ cancel the registration of the IP/ IPA/ IU, as the case may be.

2. The Report Card: Orders passed by the DC

From FY 2017-18 to June 2023, the DC passed 167 orders against IPs including 97 orders passed during the period of analysis i.e., from January 2022 to June 2023. Comparison of number of DC orders passed with number of cases wherein Corporate Insolvency Resolution Process (CIRP) or Liquidation was concluded during the above-mentioned period are depicted in the chart below:

Fig. 1 : Concluded cases vis-a-vis DC Orders



*Calendar Year wise. 2023 – To be read until 30 June 2023

3. Analysing the Orders

On analysis of the above 97 orders passed by DC, major contraventions can be summarised as under:

(a) **In CIRP:** In terms of (i) delay in IBBI/statutory compliances, deviation from model timelines and contravention in Committee of Creditors (CoC) formation; (ii) anomalies in implementation of Resolution Plan, claims admission process and payment of pre-CIRP dues by IP; (iii) outsourcing of responsibility by IP.

(b) **In Liquidation process:** In terms of (i) delay in IBBI/ statutory compliances, deviation from model timelines; (ii) issues in conducting E-auction process; (iii) error in calculation of liquidator’s fee.

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The DC has taken stringent actions in certain cases varying from suspending the registration of IPs for periods ranging between six months to three years, imposing monetary penalties ranging between ₹50 thousand to ₹5 lacs or percentage of fee earned by IPs basis the gravity of the contraventions and the interest of stakeholders. In some cases, the DC has also taken lenient view by issuing directions to IPs to remain extra-vigilant on future assignments and to undergo educational courses conducted by IPA.

4. News from the UK

Under the UK Insolvency Act 1986¹ — the Secretary of State declares a Recognised Professional Body (RPB), which in turn, regulates Insolvency Practitioners. Disciplinary Rules framed by RPBs govern the disciplinary process. We analysed the rulings by the Regulation and Conduct Committee of Insolvency Practitioners Association (one of the RPB), for the calendar year 2022, and found 12 instances wherein the IPs were pulled up for issues similar to the ones faced in India — failure to file timely compliances, drawing excess remuneration, operational deficiencies, errors in admitting claims of creditors, independence issues and failure to retain records. On the face of it, these appear to be simple matters and one would wonder why the IPs are unable to comply with the regulations. However, in reality, the underlying issues are infused with practical complexities coupled by varying interpretation of law

¹ Section 391 - <https://www.legislation.gov.uk/ukpga/1986/45/section/391>

and regulation. Interestingly, the UK being a matured jurisdiction, has developed a Common Sanctions Guidance² laying down a uniform evaluation matrix to determine disciplinary outcomes. Under Common Sanction Guidance — common contraventions committed by an IP are split into three categories depending upon its seriousness.

- (a) Very serious
- (b) Serious and
- (c) Less serious

In cases of very serious contraventions such as criminal offences, fraud, etc., there is a high probability of suspension of license. Conversely, in serious and less serious cases, the contraventions may be less severe such as reprimands and penalties.

5. Key Issues in India

In this article, we have tried to cover the contraventions made by IP and DC’s view on the orders passed during the period January 2022 till June 2023.

5.1. Payment of pre-CIRP dues: Moratorium levied under Section 14 of the Code prohibits the Corporate Debtor (CD) from transferring, encumbering, alienating or disposing of any of the assets or any legal right or beneficial interest therein, of the CD. However, the DC has observed instances wherein the IPs make the payment of dues pertaining to pre-CIRP period to run the operations of the CD as a going concern, violating the above-stated provision.

During CIRP, running the operations of the CD as a going concern is a challenging task. While Section 14(2) and 14(2A) of the Code provide for unrestricted supply of essential goods and services, which are critical to protect and preserve the value of the CD and manage the operations as a going concern, provided the dues for such services during the moratorium period is paid. However, the Code does not permit the IPs to pay the pre-CIRP dues.

But there is a practical challenge where the essential service providers are creditors

themselves and are reluctant to provide further services until their older dues are paid. In such case, it is advisable that the IPs seek directions from Adjudicating Authority (AA) in order to safeguard the interest of CD and IPs.

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Practically though, approaching AA and obtaining directions is a time-consuming process and the IP can make efforts to negotiate business terms with existing critical goods/service providers by offering cash discounts, operate on advance payment basis, etc., to manage this challenge.

(a) In the case of IBBI/DC/136/2022 order dated 28 Oct 2022³, the RP had made payment of ₹3.89 crores for pre CIRP period expenses. When the matter reached before the DC, the RP submitted that payments were made only towards expenses, which were critical and necessary to maintain the CD as a going concern and maximise the value of its assets. It was the only reason that the CoC did not object against the said payments. The only assets of the CD were its existing projects and its employees and therefore, it was imperative to keep the said projects running, to complete them and to retain the employees.

The DC observed that there cannot be an exception to the rule. Under the existing laws, once CIRP is initiated against a CD and a moratorium is imposed, the provisions of the Code take precedence over all other laws of the country. In

² <https://www.gov.uk/government/publications/disciplinary-sanctions-against-insolvency-practitioners/common-sanctions-guidance>

³ IBBI/DC/136/2022 Dated 28 October 2022: <https://ibbi.gov.in/uploads/order/96b0d9910a2c1459d324bd444ebd8274.pdf>

the instant case, preferential payment of pre-CIRP dues to the employees and vendors of the CD had the effect of causing disturbance in the moratorium as envisaged in the provisions of Section 14 of the Code. The resolution process becomes meaningless if the assets of the CD are allowed to be disintegrated during the process. The DC imposed a penalty of ₹5 lacs and issued a strict warning to avoid such contravention in future.

- (b) In the case of IBBI/DC/135/2022 order dated 20 Oct 2022⁴, the IP made payments of pre-CIRP dues to six vendors in one of the projects, in order to maintain the CD as going concern, wherein DC laid the same principle that preferential payment of pre-CIRP dues to few creditors over others had the effect of causing disturbance in the moratorium and imposed monetary penalty of ₹5 lacs.

5.2. Non-Cooperation by CD's Personnels:

Cooperation from suspended Directors/Promoters and the management of the CD is imperative to effectively discharge duties of IPs, to take control of the assets, to manage the operations as a going concern and also to ensure compliance with several laws and regulations. However, quite often, this support is not readily extended to the IPs which act as an impediment to the Resolution process.

The IPs in such circumstances may choose to hold discussions with the personnels of the CD and explain the process or issue letters to management personnel describing the duties/responsibilities of an IP as envisaged under Section 17 and 18 of the Code and also highlight their role as described under Section 19(1) of the Code.

Despite these efforts, if the non-cooperation continues, the Code empowers the IPs under Section 19(2) to make an application to the AA to obtain necessary directions against non-cooperating stakeholders.

- (a) In the matter of IBBI/DC/106/2022 order dated 21 June 2022⁵, IP failed to take control of assets including the cash lying with the CFO and to make timely payment of renewal charges for cloud data storage, resulting into loss of data on cloud storage, by stating that there was status quo order from the Supreme Court. He did not approach AA u/s 19(2) of the Code for taking necessary directions. Considering the facts of the case, the DC observed that status quo cannot be construed as CIRP been halted or IP will not continue as RP. The scheme of running the CD as a going concern is an onerous responsibility of the IP. Moreover, Section 19(2) of the Code provides for discretion in hands of RP to approach the AA considering the situation of CD and such discretion is to be used for the benefit of CD. The DC took a lenient view as there was no significant bearing on the process.

Section 19(2) of the Code provides for discretion in hands of RP to approach the AA considering the situation of CD and such discretion is to be used for the benefit of CD.

- (b) In the matter of IBBI/DC/147/2023 order dated 30 Jan 2023⁶, the IP, in good faith reposed by CD officials, decided to not take control of certain assets or appoint separate security agency for safeguarding the assets of CD. The primary reason given by IP was that ex-management of the CD were also management of the Resolution Applicant and they were cooperative all along. However, such laxity and negligence in taking control and custody of the assets of CD resulted in the movement of the assets of the CD by the ex-management. The DC observed that reasons of cooperation by the ex-

⁴ IBBI/DC/135/2022 Dated 20 October 2022 : <https://ibbi.gov.in/uploads/order/009c53f7017b3618fd6dc712a8025789.pdf>

⁵ IBBI/DC/106/2022 Dated 21 June 2022: <https://ibbi.gov.in/uploads/order/28ab6572ffa44be20f53cdc98e64ad0f.pdf>

⁶ IBBI/DC/106/2022 Dated 21 June 2022: <https://ibbi.gov.in/uploads/order/28ab6572ffa44be20f53cdc98e64ad0f.pdf>

management and resulting good faith of IP for not taking physical control of the assets of the CD are not tenable. The IP even chose not to employ separate security personnel to safeguard the assets. It shows negligence, carelessness and abdication of duty by IP which resulted in siphoning of the assets of CD by promoters during the period of CIRP. Accordingly, DC found the IP to be violation of the IBC.

5.3. Operational Creditors (OCs) to be included in the CoC: Section 24(3)(c) of the Code on including OCs to the CoC states that RP shall give notice of each meeting of the CoC to OCs or their representatives if the amount of their aggregate dues is not less than 10% of the debt. This poses several challenges in terms of appointing an authorised representative and dealing with several creditors.

In the case of IBBI/DC/137/2022 order dated 02 Nov 2022⁷ the IP failed to serve notice to OCs. As per the understanding of IP, notice of CoC meeting needs to be given only to those individual OCs, whose aggregate dues exceed 10% of the total debts. However, it was clarified by DC that the notice of CoC meeting is required be sent to all OCs or their representatives, when the aggregate dues of all OCs combined exceed 10% of the total debt. Accordingly, the DC imposed penalty of ₹5 lacs on IP for the above violation.

5.4. Excess Remuneration drawn by the Liquidator: Regulation 4 of the IBBI Liquidation Process Regulations, states about the Liquidators' fee which shall be either fixed by CoC or Stakeholders Consultation Committee (SCC) in its First Meeting or should be the fee as mentioned in the schedule of fee under Regulation 4(2)(b) which is based on percentage of the amount realised net of other liquidation costs, and of the amount distributed, for the balance period of liquidation. It is important to interpret these rules appropriately as there have been instances wherein incorrect interpretation has led to excess fee being drawn by the liquidator.

“ Regulation 4 of the IBBI Liquidation Process Regulations, states about the Liquidators' Fee which shall be either fixed by CoC or SCC in its First Meeting or fee as mentioned in the schedule of fee under Regulation 4(2)(b). ”

- (a) In the matter of IBBI/DC110/2022 order dated 5 July 2022⁸, it was noted that IP withdrew excess fee by applying incorrect percentages under Regulation 4(2)(b) IBBI Liquidation Process Regulations.

In this case, the IP realised an amount of ₹61.10 crore from the sale of assets of CD. Out of which, ₹56.51 crore was realised in the first six months and ₹4.59 crore in the next six months. It was observed that IP calculated his fee for realising an amount of ₹4.59 crore under the category of “next six months” by applying 3.75% on ₹1.00 crore and @ 2.80 % on remaining ₹3.59 crore. Similarly for distribution, IP applied @ 1.88% for ₹1.00 crore and 1.40% for the remaining amount under the category of “next six months”. As the realisation amount of ₹4.59 crore falls under the category of next ₹50 crore and in the next six months category, the rate applicable on realisation as per prescribed table should have been 0.94%. Likewise, rate applicable on distribution should have been @ 0.48%. By wrong application of the rate, IP had drawn excess fee of ₹13.69 lacs. Since, RP has remitted the excess fee to the account of the CD, the DC took a linnet view by advising him to be more careful in the future.

In the matter of IBBI/DC/124/2022 order dated 18 Aug 2022⁹ excess fee amounting ₹ 8.3 lacs was withdrawn due to wrong calculation and IP engaged a related entity

⁷ IBBI/DC/137/2022 dated 02.11.2022: <https://ibbi.gov.in/uploads/order/09c7e08271040550421a7907d1029e10.pdf>

⁸ IBBI/DC110/2022 dated 5 July 2022: <https://ibbi.gov.in/uploads/order/d23f8c5aa27e2be1b15a5ae3c7f07e79.pdf>

⁹ IBBI Order no. IBBI/DC/124/2022: <https://ibbi.gov.in/uploads/order/fc509576137d2f5a4c9f5c55321cc9e0.pdf>



for helping him in the liquidation process of the CD on vague terms and conditions and without specifying the amount of fee payable to such entity. The DC suspended the registration for 3 years and instructed to deposit an amount equivalent to payments made to related party.

5.5. Outsourcing of Duties: IBBI vide its Circular dated 03 January 2018¹⁰, had directed that an IP shall not outsource any of his duties and responsibilities as mentioned under Section 18 of the IBC. However, there are instances wherein an IP may appoint a process advisor to assist him run the process and operations, but the ultimate control and responsibility always lie with the IP, which cannot be delegated. The IP should ensure that the engagement letter executed with such professionals clearly defines the scope of work for which the professional is engaged.

- (a) In the case of IBBI/DC115/2022 order dated 20 July 2022¹¹ the DC observed that a person was appointed as CIRP Advisor in 5th CoC Meeting at a fee of ₹6 lacs per month (fee equal to fee of the RP) which was w.e.f. from CIRP initiation date. Clause 27 of Code of Conduct under First Schedule of IP Regulations states that an

IP shall disclose all process related costs, as applicable, to all relevant stakeholders, and must endeavour to ensure that such costs are not unreasonable. The DC was of the view that appointment of a process advisor at a fee equal to the fee of RP without clearly defined scope of work is against the provision the Code and Regulations. The DC further observed that RP had followed an unprofessional approach in taking decisions on hiring professionals and other support services. The RP was suspended for six months.

- (b) In the matter of IBBI/DC/164/2023 order dated 10 May 2023¹², the DC reinforced the supremacy of independence of IP. During the inspection it was noted that the terms on engagement of IRP/RP had been negotiated with financial creditors solely by an Insolvency Professional Entity (IPE) (wherein the RP was a Partner). Also, the fee sharing ratio between IPE and IP was structured in such a fashion, which as per DC, had hampered the independence of IP. Furthermore, in the absence of proper scope of work of IPE justifying higher fee share — the IA was of the prima facie view that IP had, inter alia, violated provisions of the IBC and Code of Conduct. The IP submitted that an IP as per the laws in force can be a member of an IPE, who can provide support services to IPs who are its partners or directors.

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The DC stated that Clause 5 of the Code of Conduct clearly provides that an IP

¹⁰ IBBI Circular No. IP/003/2018 dated 03 January 2018: https://ibbi.gov.in/webadmin/pdf/legalframework/2018/Jan/CIRP%203_2018-01-03%2018:42:38.pdf

¹¹ IBBI/DC115/2022 dated 20 July 2022: <https://ibbi.gov.in/uploads/order/0006bc581fac95ab66e4729d57dfa236.pdf>

¹² IBBI/DC/164/2023 dated 10 May 2023: <https://ibbi.gov.in/uploads/order/3f6d-f7b98f2bbc7ea649a579e10a6653.pdf>

¹³ IBBI/DC/147/2023 30 January 2023: <https://ibbi.gov.in/uploads/order/16952e-3c21a84c82387bdd36f7544080.pdf>

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should maintain complete independence and should conduct the processes, independent of external influences. The DC found IP to be in violation and levied penalty of ₹2 lacs.

5.6. Incorrect Implementation of Resolution

Plan: Section 31 of the IBC states that approval of Resolution Plan by AA will make it binding on the CD and its stakeholders, including Government or any local authority to whom a debt with respect to payment of dues arising under any law.

- (a) In the matter of IBBI/DC/147/2023 order dated 30 Jan 2023¹³, the CoC approved Resolution Plan for the CD had provisions for an upfront payment of ₹60 lacs at the time of submission of offer, which was credited in the CDs bank account. The RP utilised the amount for payments towards statutory dues upon the request of the Resolution Applicant. Later the Resolution Plan was rejected by AA and the CD was directed for liquidation.

The RP submitted that he believed that the procedures prescribed within the Resolution Plan can be performed until the AA rejects the Plan. The DC observed that Section 31 of the IBC clearly states that a Resolution Plan needs to be approved by the AA to become binding on the stakeholders. Therefore, the implementation of any provision of Resolution Plan cannot happen without the approval of AA. Accordingly, the registration of IP was suspended for period of one year.

6. Conclusion

With the evolving changes, many instances occurred where IPs faced challenges in interpreting the Code and Regulations. The IBBI intervenes from time to time to maintain the balance in the eco-system in order to achieve the purpose of enactment of the Code. The dynamics of everchanging law, its amendments and clarifications issued by the IBBI from time-to-time including the orders of the Disciplinary Committee helps to constantly guide us. It also helps the IBBI to understand the need of providing the clarifications and educating the IPs to understand the intent of the enactment. Such learnings enable us to know what to watch out for.

