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IBC (AMENDMENT) ORDINANCE, 2020: A RELIEF TO THE DISTRESSED CORPORATE SECTOR

Impact of the Amendment of Insolvency and Bankruptcy Code 2016 on the Indian MSME sector, increasing default amount for initiation of Corporate Insolvency Resolution Process (CIRP) and Insertion of Section 10-A and Section 66(3)

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The unprecedented pandemic of COVID 19 has put unprecedented pressure on the already stressed economy. The pandemic has impacted business, financial markets, and the economy and has created a state of uncertainty and disruption in the business sector. The businesses, already battling with various challenges for survival, suffered a heavy jolt due to the nationwide lockdown, which the government was forced to impose from 25th March 2020 due to the COVID 19 pandemic. As all the businesses except those related to essential commodities and services were shut down, it left the industry high and dry leading to a severe liquidity crunch. Many debtors who were erstwhile making regular payments to their financial and operational creditors started committing defaults due to lack of business and funds.

As the financial and operational creditors of the defaulting corporates were eagerly waiting for lifting up of the lockdown, so that their defaulters can be dragged to the National Company Law Tribunal (NCLT) for realising their dues, the government and the Reserve Bank of India (RBI) stepped in with a slew of measures to support the crumbling economy. Although debt recovery is not the actual objective of the Insolvency and Bankruptcy Code, 2016 (IBC), however, it cannot be denied that most of the cases are filed as a coercive measure to force the corporate debtor to come to the table for a settlement and make the payment. It is also a fact that many cases are settled out of court after the insolvency proceedings are filed in the NCLT and are subsequently withdrawn after a settlement.

Increasing the amount of default from Rs. 1 Lakh to Rs. 1 Crore for initiation of Corporate Insolvency Resolution Process (CIRP)

Initially, the government increased the minimum amount of default for initiation of CIRP against a corporate debtor from Rs. 1 Lakh to Rs. 1 Crore. This was mainly aimed at providing relief to the MSME Sector i.e. the Micro,

Small and Medium Scale Enterprises, as the corporate debtors with default amount below Rs. 1 Crore generally belong to this category and there was a demand for a long time that the limit of default for initiating CIRP should be increased. Also, this sector was worst hit by the lockdown.

Ordinance of 2020 amending the Insolvency & Bankruptcy Code, 2016: Insertion of Section 10-A and Section 66(3)

Merely increasing the amount of default for initiation of insolvency proceedings was not sufficient for protecting the corporates, as not only the MSMEs but all the industries big and small are bearing the brunt of the COVID 19 pandemic lockdown. Hence, with the intention to protect the corporates from being pushed into insolvency proceedings, the government suspended the initiating of CIRP under Sections 7, 9, and 10 of the Insolvency and Bankruptcy Code, 2016 for defaults within a certain period by amending the code. As the parliament was not in session, the amendment to the IBC was brought via the route of ordinance promulgated by the President on 5th June 2020. The ordinance inserted Section 10-A, after Section 10 in the IBC, which provides that no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after 25th March 2020, for a period of six months which can be further extended up to one year. The ordinance also says that no application shall ever be filed for initiation of the corporate insolvency resolution process of a corporate for the default occurring during the said period. The explanation to section 10-A makes it clear that its provisions shall not apply to any default committed before 25th March 2020.

While the suspension of S. 7 and 9 can be understood, the suspension of S. 10 may do more harm than good. Section 10 enables a corporate debtor, who has committed a default, to file an application for initiating corporate insolvency resolution process with the Adjudicating Authority. When it seems that the business of the corporate debtor is showing no signs of revival and the corporate debtor is unable to repay its debts, then in such a situation generally the corporate debtor itself invokes the provision for initiation of CIRP. The provision is aimed at protecting the assets of the company from being squandered away or diminish in value over time so that the interest of the creditors can be protected. If there is no business left with the corporate debtor or it is running into heavy losses, then in such a situation, not allowing such corporate debtor to file for CIRP for six months or one year may result in diminishing the value of its assets over time or even may result into wastage of the assets at the hands of directors and over time the company may not find any resolution applicant who may be interested in reviving the company.

The ordinance also inserted section 66(3) after section 66(2) that no application shall be filed by a resolution professional under sub-section 2 in respect of such default against which initiation of CIRP is suspended as per S. 10-A.

Analysis

The intention behind this ordinance is certainly noble and laudable as it was a much-needed measure to protect the business units from being dragged into insolvency due to their inability to repay their debts because of the factors beyond their control. The ordinance has brought a big relief to the corporates that were unable to repay their debts because of disruption of business due to the lockdown. It has given them a breather so that now they can invest their resources and focus on bringing their business back on the track without having to worry and fear about closing down their businesses at least for some period of time. The Reserve Bank of India had also announced a three-month moratorium on EMIs of loans which was subsequently again extended by further three months which provided much-needed relief to the corporates that were facing a liquidity crunch and protected from any action from their financial creditors for the time being.

It should be noted that the ordinance only prohibits the filing of applications for initiating insolvency proceedings under S. 7, 9 and 10 in the NCLT for defaults committed after 25th March 2020 for a period of six months which may be extended to one year and does not provide any waiver of the debt. The corporate debtor still continues to be liable to repay the dues. Though the amount defaulted during this exempted period of six months from 25th March 2020 cannot be taken into account for the initiation of CIRP against the corporate debtor, the creditors can still initiate the CIRP, if the total amount of the default before 25th March 2020 and/or subsequent to the period of expiry of six months is more than one crore. If the defaulted amount excluding the amount that falls in the exempted period is less then Rs. One crore then the creditors will not be able to file for CIRP in the NCLT but can still pursue other remedies under the law for the entire amount such as filing of the commercial suit for recovery in the commercial court.

Similarly, S. 66(2) provides to ensure that the directors and partners of the corporate debtor should exercise due care and diligence to minimise the potential loss to the creditors and holds them liable for any lack of due care in this regard and on the application of the resolution professional, the Adjudicating Authority may order them to contribute to the assets of the corporate debtor if it deems fit. S. 66(3) inserted by the ordinance prohibits the resolution professional from making such application under S. 66(2) in respect of such defaults against which the initiation of CIRP is

suspended as per S. 10-A. The disruption of business because of COVID 19 pandemic is beyond anybody's control and irrespective of any level of due care and diligence on the part of the directors and partners, they may still not be able to prevent losses to the creditors and hence some protection to them for a limited period is a welcoming step. However, S. 66(3) does not give any undue protection to fraudulent transactions carried out to defraud the creditors, which lies, in the domain of S. 66(1).

Conclusion

The corporate sector certainly needed a helping hand from the government at this critical stage and they needed to be protected rather than liquidated because of their inability to repay their debts due to disruption of their business during this critical period. However, instead of suspending the section 7, 9 and 10 for the defaults committed on or after 25th March 2020 for a period of six months or one year, it would have been better if filing of the CIRP was suspended altogether for a period of six months irrespective of the date of default. Because the companies that have committed a default prior to 25th March 2020 are also facing disruption of business and liquidity

crunch due to the lockdown and they too need time for the revival of their businesses so that they are in a position to repay their debts. Hence, suspending the filing of CIRP irrespective of the date of default would have given a breather to the entire business sector, which was a need of the hour. Suspending the filing of CIRP only when the date of default is after 25th March 2020 gives no relief to such large number of companies and CIRP can still be initiated against them even though they are facing disruption of their business due to the lockdown and hence, the objective of this ordinance has not been achieved as much as it could have been. Further, the lockdown due to COVID 19 pandemic may have hit many more companies than usual times, and hence, finding a resolution applicant for all these companies for coming up with a plan to rescue the corporate debtor is no doubt going to be a difficult task. Closing down the business units and liquidating them in the absence of resolution applicant is not a prudent solution and it will eventually hit the economy harder and on a much larger scale. In such a situation, though more efforts are needed, giving the corporate debtors some time to rebuild and recover their disrupted businesses is the need of the hour, and the IBC (Amendment) Ordinance, 2020 is one step towards it.