INSOLVENCY AND BANKRUPTCY (AMENDMENT) ORDINANCE, 2020- A BOON OR A BANE?

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The Insolvency and Bankruptcy Code was enacted in the year 2016 and it was enforced with effect from December 1, 2016. The provisions of this legislation relates to Corporate Insolvency. Prior to the Insolvency and Bankruptcy Code, there were several other acts like the Companies Act of 1956, Sick Industrial Companies Act of 1985, and many others which did not provide any strong solution by itself. The main objective of this act is to make Corporate Insolvency a time-bound process and protect the creditors. It also aims to prevent corporate deaths and increase the efficiency of the business in our Country. Since the act has come into force, it has been amended so far for five times. The Recent one being the *IBC (Amendment) Ordinance, 2020* promulgated on June 5, 2020. The Impact of the Covid-19 pandemic has caused many businesses to reach the verge of disruption and has also caused a lot of loss to the financial economy of the country. In order to boost the economy and also to help small companies and MSMEs, several financial packages were announced by the Finance Minister Mrs. Nirmala Sitharaman as a part of the Government's policies to provide relief to the small businessmen and to uplift the financial conditions of the Country. The Amendment has many flaws which are discussed in this paper. The changes have raised many questions. The paper analyses all the changes that have been brought by the ordinance. It also recommends the alternative remedies for creditors and debtors.

Introduction.

The Insolvency and Bankruptcy Code was enacted in the year 2016 and it was enforced with effect from December 1, 2016. This Code deals with the nuances of Corporate Insolvency. Prior to the Insolvency and Bankruptcy Code, there were several other acts like the Companies Act of 1956, Sick Industrial Companies Act of 1985, and so on which did not provide any strong solution by itself. The objective of this act is to make Corporate Insolvency a time-bound process and protect the creditors. It also aims to prevent corporate deaths and increase the efficiency of the business in our Country. Since the act has come into force, it has been amended for five times so far.[1] The Recent one being the *IBC (Amendment) Ordinance, 2020* promulgated on June 5, 2020. As the entire world is struggling with the Global Pandemic of Covid-19, many countries like the U.S.A, UK, Australia, etc. have adopted various measures to meet the problems of Insolvency that would arise due to the pandemic.[2] Keeping in mind the same problems, <u>the Central Government of our Country Introduced the IBC (Amendment) Ordinance, 2020 to suspend the initiation of new CIRP by the financial creditors (Section</u>

[1] Shakal Bhushan, IBC (Amendment) Ordinance, 2020: A Pandemic of Bad Drafting, the leaflet.in, https://theleaflet.in/ibc-amendment-ordinance-2020-a-pandemic-of-bad-drafting/
[2] Devesh Juvekar, Dikshat Mehra and Chintan Gandhi, Decoding IBC(Amendment) Ordinance, 2020 for creditors and Corporate Debtors, Mondaq.com, https://www.mondaq.com/india/insolvencybankruptcy/952672/decoding-ibc-amendment-ordinance-2020-for-creditors-and-corporate-debtors

7), operational creditors (Section 9) or voluntary filing for Insolvency (Section 10) and also to suspend filing of an application by the resolution professional under Section 66(2) of the Code.

Major Changes Brought about by the IBC (Amendment) Ordinance, 2020.

The Impact of the global pandemic has caused many businesses to reach the verge of disruption and has also caused a lot of loss to the financial economy of the country. In order to boost the economy and also to help small traders and MSMEs, several financial packages were introduced by the Finance Minister Mrs. Nirmala Sitharaman as a part of the Government's policies to provide relief to the small businessmen and to uplift the financial conditions of the Country. The Central Government to help smaller section of the economy and the MSME's and to reduce the burden on the National Company Law Tribunal ('NCLT") and National Company Law Appellate Tribunal ("NCLAT") through powers bestowed upon it by way of the proviso to Section 4 of IBC passed a notification[3] under which it has increased the minimum amount of default for CIRP under IBC, from a sum of Rs. 1,00,000 (Rupees One Lakh) to Rs. 1,00,00,000 (Rupees One Crore). The Notification also stated that creditors cannot file an insolvency application against borrowers for default of value less than 1 Crore.

The highlight of the IBC (Amendment) Ordinance, 2020 is the insertion of a new section .i.e. Section 10A. Section 10A sanctions the suspension of Section 7 (Initiation of CIRP by financial creditor), Section 9 (Initiation of CIRP by operational creditor) and Section 10 (Initiation of CIRP by corporate applicant).

Another change brought about by the Amendment is the insertion of Sub-section (3) of Section 66. The provision of sub-section (3) under Section 66 prohibits the Resolution Professional from filing an application under sub-section (2) of Section 66 of the Insolvency and Bankruptcy Code (hereafter to be referred to as "IBC").

Critical Analysis of the Ordinance.

Increasing the threshold amount from Rs. 1 lakh to Rs. 1 Crore.

The Finance Ministry introduced this change to help the small entrepreneurs and MSMEs that might be terribly affected by the pandemic and have a greater chance of going into liquidation as they are out of business during the lockdown period. Thus, the main rationale behind increasing the limit is that the small and medium enterprises get more time to recover from this. NCLT and NCLAT would also be relaxed by this move as it would result in a lower amount of cases coming to it. But one of the issue to be considered is whether the increase in the threshold amount for initiating application under section 7, section 9 is a temporary or a permanent measure? It can be more of a permanent measure as the Union Government would definitely want to reduce the burden of low claim cases on the NCLT.

Another pertinent question that relates to this increase in threshold amount is the application of it. As the law is prospective in nature, the notification should apply only to the fresh application for initiating insolvency proceedings and not to the applications filed before 24th March 2020. This was established

[3] [3] Notification No. SO 1205(E), https://ibbi.gov.in/uploads/legalframwork/48bf32150f5d6b30477b74f652964edc.pdf

by the NCLT Chennai Bench on 2nd June 2020 in the case of ***Arrowline v. Rockwell***[4]. As there was no clarification on whether the application of the notification would be retrospective or prospective, the NCLT bench held that, the Notification would be considered to be prospective. The same was further held by the NCLT Kolkata Bench in the case of ***Foseco India Limited Vs. Om Boseco Rail Products Limited***.[5] The Hon'ble Chennai Bench in the *Arrowline Case*, while coming to this decision, analysed the concept of "vested rights" following the decision of the Hon'ble Supreme Court in ***Karnail Kaur v. State of Punjab***[6], which in turn followed ***Garikapati Veeraya v. N. Subbaih Choudry***,[7] to hold that rights vested upon a party when an application under section 7, 9 or 10 of the Code is filed and as a result of the same, rights vest in parties only upon filing of the application under Section 7, 9 or 10 and not any time prior. So basically, even if a notice under section 8 has been furnished by operational creditors, the right to invoke jurisdiction of the NCLT for IBC proceedings only occurs on the filing of the application. Consequently, it appears that even for defaults which occur prior to 24th March 2020, IBC proceedings cannot be maintained after 24th March 2020, if the default amount is not more than Rs. 1 Crore. This does not depict that the Notification dated 24th March 2020 is retrospective, but will remain prospective, although having effect on some previous facts, which was explained in ***Ramji Purshottam v. Laxmanbhai D. Kurlawala***.[8]

Increasing of the threshold amount will highly impact the operational creditors because when viewed from a commercial standpoint, operational creditors have dues of smaller value and thus were getting benefitted from the threshold limit of 1 lakh. So, if this change brought about is a permanent change, the operational creditors would face a tough time in recovering their money. Another important thing to note is that unlike financial creditors, operational creditors are not vested with the right to file a joint application for recovering of their debts from the corporate debtors in NCLT. This extinguishes the option of more than one operational creditors coming together to reach the threshold of 1 Crores so that they can file an application under Section 9 of IBC. Financial creditors won't be affected much by the increase in the threshold amount as financial creditors mostly have large exposures to corporate debtors which are more than 1 Crore and even if a financial creditor has dues which are less than 1 Crore, two or more financial creditors can file a joint application under section 7 of IBC which would help them to cross the threshold limits.

Insertion of Section 10A

The drafting of the newly inserted section 10A creates a lot of ambiguity. There are many companies that are in debts even before the pandemic existed. If these sections are suspended, the rightful interest of the creditors would also be suspended for the current period as they would not be able to raise or initiate any proceedings. Suspension of Section 10 lacks rationale, as suspending the rights of the companies voluntarily willing to go into liquidation makes no sense. There are many companies which itself wants to go for liquidation due to many reasons or

[4] IA/341/2020 in IBA/1021/2019
[5] CP(IB)/1735/KB/2019
[6] (2015) 3 SCC 206
[7] AIR 1957 SC 540
[8] (2004) 6 SCC 455

maybe because they believe that they cannot survive irrespective of the pandemic.

Article 19(1)(g) of the Indian Constitution guarantees every citizen the right to practice any profession, or to carry on any occupation, trade or business. The right to carry on a business has three facets:[9]

a) the right to start a business
b) the right to continue a business
c) the right to close a business.

The Apex Court in the landmark judgment of ***Excel Wear v. Union of India***[10] held that: the right to close down a business was an essential part of the fundamental right to carry on any business guaranteed under Article 19(1)(g). The Supreme Court has specifically stated in its judgment that the right to carry on any business also provides the inherent right to close the business as no person can be compelled to run the business in case of losses or other circumstances. So the government's move to block the way of the Corporate Debtor by Suspending Section 10 infringes the fundamental right provided to the corporate debtor under Article 19(1)(g) of the Constitution of India.

The right to shut down a business available to the Debtor is not absolute but subject to the reasonable restrictions under Article 19(6) of the Constitution. The Supreme Court in ***Narendra Kumar v. Union of India***[11] held that *"In applying the test of reasonableness, the Court has to consider the question in the background of the facts and circumstances under which the order was made, taking into account the nature of the evil that was sought to be remedied by such law, the ratio of the harm caused to individual citizens by the proposed remedy, to the beneficial effect reasonably expected to result to the general public. It will also be necessary to consider in that connection whether the restraint caused by the law is none than was necessary in the interest of the general public"*. Therefore, it can be clearly understood that the ordinance brought into effect is in violation of the fundamental rights of the Corporate Debtor. As the Apex Court had observed in the case of **Sodan Singh vs. N.D.M.C**[12] that the purpose of 'trade and business' is 'subsistence' or 'profit' and therefore taking away the same by the way of ordinance and denying the corporate debtor his right to initiate voluntary insolvency proceedings under Section 10 of the Code without keeping it under the ambit of reasonable restriction under Article 19(6) of the Constitution.

Another thing to evaluate is the suspending Section 7 in relation to the RBI circular of June 7, 2020. As per the circular, Banks are provided with 210 days' time period to produce a resolution plan for the borrowers and if such is not done, it must give 20% additional provisioning which should be over and above the provision they hold and such provisioning will go up by 35% if till 365 days no plan is made. Thus, if the Government is planning to suspend section 7, RBI must take back its circular in this regard or else banks would be at a negative end.

Covid-19 has created a great impact on the economy of our country that has forced various businesses to close down due to heavy losses incurred by them These

[9] Barsi Light Railway Company Ltd and Ors v. Joglekar (K.N.) and Ors (1957) 1 LLJ 243 SC
[10] AIR 1979 SC 25
[11] AIR 1960 SC 430 (437)
[12] (1992) 5 SCC 52

circumstances cannot be altered by the businessmen wherein it may not be possible for some of them to carry on their business and thus suspending Section 10 of the IBC not only takes away the reasonable right of the owner to shut down his business, which is essentially a fundamental right of his but also increases the troubles of already distressed debtor.

Insertion of the Sub-Section (3) of Section 66.
The Ordinance has also inserted sub-section (3) to Section 66 of IBC thereby prohibiting the Resolution Professional from filing an application under sub-section (2) of Section 66 of the Code. The introduction of this new sub-section can result in Directors/Partners of a Corporate Debtor engaging in illegal acts during the period of application of Section 10A causing defaults and still enjoy the immunity provided to a corporate debtor under Section 10A. The Insertion of the new sub-section (3) to Section 66 reduces the powers of a Resolution Professional from a chief of the process to a silent participant witnessing potential frauds.

Section 66 of the IBC basically deals with 'Fradulent trading or Wrongful trading', so the proposed Section 66(3) seems to be irrational. It appears to excuse lack of due diligence by the Corporate Debtor resulting in loses to creditors during the Exemption Period. Such an exemption may result in directors/partners of corporate debtors to engage in Fradulent transactions such as inappropriate usage of funds or extortion of money without facing actions under Section 66 of IBC and that would eventually impact the realizable value for its creditors.

Alternative remedies available with the Creditors/Debtors.
The primary idea behind the Code was re-organisation and insolvency resolution in a time-bound manner for the maximization of the value of assets. In order to not alter the same in the present economic scenario, notwithstanding the ambiguities, the Ordinance is a great move. However, Suspension may lead the creditors to seek a solution under enactments like the SARFAESI Act/RDDBFI Act, thereby, defeating the real reasons behind introducing the Code. It also contradicts the interest of a corporate debtor since there is no direct imposition of moratorium, or initiation of judicial proceedings or the option to file for voluntary bankruptcy.

Alternative remedies.
Remedies available under The Companies Act, 2013: Financial Creditors may pursue restructuring or rearrangement schemes like one-time settlement (OTS) or Scheme under Section 230 of the Companies Act, 2013. Section 230 of The Companies Act allows the Company or a member or creditor of a company in case of a windup to file an application before NCLT to obtain an sanction for a compromise or arrangement between the company and the creditors or the company, as the case may be that the company shall abide by, if sanctioned by the Tribunal. Section 231 of The Companies Act, 2013 empowers the Tribunal to enforce this compromise or arrangement. Though this alternative is considered to be the primary recourse after the Suspension of Section 7, 9 and 10 of IBC, however, the NCLAT in ***S.C. Sekaran vs. Amit Gupta and Ors.***[13] Has thrown light on its essentialness by directing the liquidator "to take steps in terms of

[13] (2019) 152 SCL 536

Section 230" for the revival of the Corporate Debtor.

RBI's Prudential Framework for Stressed Assets: RBI regulated Creditors can attempt to resolve at the bank level to push for a new start to the Corporate Debtor. RBI authorizes lenders to formulate a resolution plan if there's a case of non-payment of debt and thereafter, observe the performance of the debtor to capture any default on the ground level to secure themselves from a large amount of default. However, the Circular has a drawback. It fails to analyze that the creditor may not always be banks and NBFC and thus neglects to include other classes of Creditors like Foreign Lenders, bondholders or Mutual Funds.

RBI's one-time restructuring circular for Micro, Small and Medium Enterprises: The RBI's circular, has extended the time period for a one-time restructuring of the existing loans of the MSME's classified as 'standard asset' till December 31, 2020. However, this alternative is available only to the MSMEs who do not have an aggregate exposure of banks and NBFCs exceeding Rs. 25 crores on January 1, 2020.

Remedy under Different Legislation: The Creditors in case of a non-payment by the Corporate Debtor can resort to Recovery of Debts Due to Banks and Financial Institutions (RCCBFI) Act, 1993 wherein the creditor is a financial institution or banks. Also, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, (SARFEISI) Act, 2002, is also available to banks to recover the debt when a security is involved. Money can also be recovered by filing a money recovery suit under order 37 of the Civil Procedure Code, 1908 by an individual to recover a debt.

Conclusion.

The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 is brought into action to boost the economy and protect the MSMEs but it is going to have an ill-effect as well. The drafting of the newly inserted Section 10A and sub-section (3) to Section 66 creates a lot of ambiguity. Though the protection under the IBC (Amendment) Ordinance 2020, which provides a complete immunity to the defaulters from the debt arising during the Covid-19 pandemic may be a welcome step but it will have a lot of consequences with more questions than answers over the period of time. The Creditors and Debtors may resort to alternative options and possibilities of restructuring those debts for which no insolvency proceedings could ever be filed but the question still remains to be considered that even after the restructuring of those debts will they be continued to be treated as protected under the provisions of the Section 10A.

The temporary suspension of Section 7 and 9 of the Insolvency and Bankruptcy Code, 2016 is a good move and much needed at this time of a pandemic but the suspension of Section 10 seems to have no rationale as it would only force the Corporate Debtors and Companies in huge debts to continue when the Company believes that the best solution for it would be resolution under insolvency law. The introduction of this Code was to simplify the process of Insolvency but if the debtors have to go through the old resolution alternatives, it would defeat the very objective of this Code. Moreover, the continuance of such Debtors would further deteriorate assets that may prove to be implausible for companies that could have restructured.

Since the Covid-19 Pandemic has impacted everyone worldwide, various countries like Australia, UK have also suspended their insolvency laws. While suspending the rights of a creditor to bring about an action against the companies in case of default, certain countries have succeeded in providing voluntary insolvencies in order to safeguard the company and its stakeholders. For example, France has allowed the companies to initiate voluntary restructuring or liquidation proceedings if a company goes out of business and is unable to continue its course of action during the state of health emergency or if the financial operation of a business require it.[14] Similarly, Spain has also allowed filing of voluntary bankruptcy applications but these applications would not proceed during the state of alert.[15] Likewise, Australia has allowed voluntary insolvencies/administration under its insolvency law.[16] Pursuant to it, it witnessed Australia's second-largest airline, Air Mauritius file for Bankruptcy.[17]

The Ordinance appears to be promulgated to protect companies and promoters from no fault liability but it is necessary to ensure that Section 10A does not become a roadway for the defaulters to siphon off funds. The legislature and adjudicating authority may also need to be really careful while dealing with cases relating to the ambiguities that will arise by the implementation of the Ordinance, cases which will be a result of ban on voluntary insolvency for exemption Period defaults, cases arising due to the suspension of the rights of a lender to file insolvency proceedings during exemption Periods, restriction on the filing of Fradulent/wrongful trading applications by resolution professionals and so on.

So, overall in my opinion, though this Ordinance has been introduced in good faith and to safeguard the interest of the people in large, it is flawed in the drafting of it and creates a lot of ambiguity. It raises a plethora of questions that have no answer to it yet. So, there's a lot of scope for the Insolvency and Bankruptcy (Amendment) Ordinance, 2020 to be a bane than a boon.

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[14] https://www.restructuring-globalview.com/wp-content/uploads/sites/21/2020/04/COVID-19-Impact-of-Global-Insolvency-Laws-29.04.20.pdf

[15] Ibid

[16] https://www.law.ox.ac.uk/business-law-blog/blog/2020/04/managing-insolvency-curve-australia

[17] https://www.businesstoday.in/sectors/aviation/coronavirus-clips-air-mauritius-wings-airline-placed-under-administrators/story/401755.html