 ISSN: 2581-8503

VOLUME 2 : ISSUE 4

|| August 2020 ||

Email: editor@whiteblacklegal.co.in

Website: www.whiteblacklegal.co.in

 ISSN: 2581-8503

DISCLAIMER

EDITORIAL TEAM

ABOUT US

WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal provide dedicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

WHITE BLACK LEGAL: THE LAW JOURNAL

IBC AMENDMENT 2020 – MORE THAN IT MEETS THE EYE

(By Devika Bhadbhade[1])

ABSTRACT

With the passing of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020[2] (Ordinance), there has been an ongoing debate over the interpretational issues attached to it. This article primarily aims at delving into the issues related to the prohibition over the insolvency proceedings. In addition to this, it casts a light upon the development of the insolvency laws in India. Even though, the Ordinance is gladly received by the business houses as it has suitably taken into account the current economic condition due to the pandemic, there are certain deficiencies which outweigh the advantages offered by the Ordinance. Firstly, the Ordinance provides for a blanket suspension for the initiation of the Corporate Insolvency Resolution Process for any defaults within the suspension period. Secondly, it takes away the power of corporate debtors to initiate the voluntary insolvency proceedings. Thirdly, it leaves a window for wilful default by the debtors. Fourthly, its ambiguous about the defaults that are phased over a time frame. Fifthly, it suffers from a few drafting flaws by not defining the 'date of default', not explicitly mentioning that the Ordinance will have retrospective effect and not clarifying the treatment of defaults that are spread over a time frame. Lastly, it excuses directors/partners from intentional default. This article aims to discuss the above deficiencies in detail and concludes with the need to modify the Ordinance.

Keywords- Insolvency and Bankruptcy Code (Amendment) Ordinance 2020, Pandemic, shortcomings.

I. EVOLUTION OF IBC:

The introduction of the Insolvency and Bankruptcy Code, 2016 (Code) was a boon for the creditors in the financial market in India. Earlier there were dime a dozen legislations dealing with insolvency and bankruptcy in India. There was a need for a holistic legislation dealing with Bankruptcy in India. A number of legislations were in place to tackle problem of bankruptcy but none of them succeeded in addressing the issue of non-performing assets crisis. Beginning with The Sick Industrial Companies (Special provisions) Act, 1985 to The Code of Civil Procedure, 1908, The Presidency Towns Insolvency Act, 1909, The Provincial Insolvency Act, 1920 and The Securitisation and Reconstruction of Financial Assets and

[1] Final year student of Indian Law Society's Law College, Pune.
[2] With effect from 5th June 2020.

Enforcement of Securities Interest Act, 2002 (also known as the SARFAESI Act) the journey was crammed with loopholes. The legislations failed to adhere to the purpose for which they were introduced. Hence, there was a call for a consolidated legal framework to provide the Corporate debtor with a resolution plan in a time bound manner and to allow free flow of credit in the economy. These shortcomings were addressed by the introduction of The Insolvency and Bankruptcy Code in the year 2016 by the late Finance Minister Arun Jaitley. The Code was introduced in the Lok Sabha in December 2015 and was passed by both the houses in May 2016. Subsequently, it received the assent from President Pranab Mukherjee and was notified in The Gazette of India on 28th May 2016.

Earlier in one of the World Bank's ranking variable, 'Resolving Insolvency' India was ranked 108 out of the 190 countries but as per the recent statistics India is now ranked at 52[3]. The credit for this huge leap is associated with the introduction of The Insolvency and Bankruptcy Code, 2016.

II. THE INSOLVENCY AND BANKRUPTCY CODE (AMENDMENT) ORDINANCE 2020:

In the wake of novel Coronavirus an indefinite nationwide lockdown was announced in India from 25th March 2020 as a result the economy was disrupted. This caused uncertainty and strain on businesses for reasons beyond their control. Due to the Coronavirus infused economic disruption, many small and medium size businesses were unable to keep at their obligations under the contracts and make payments. Considering the poor performance of these businesses, it was a foregone conclusion that proceedings under The Insolvency and Bankruptcy Code, 2016 i.e. under section 7 – application for default against financial creditor, section 9 – application and default against operational creditor would be initiated against the defaulting borrowers[4]. Thus, in an effort to combat these legal proceedings the Hon'ble Finance Minister of India announced the suspension of the Corporate Insolvency Resolution Process (hereinafter referred to as CIRP) under Code[5]. Since then there have been speculations as to the nature and extent of the proposed suspension and it's implications. These speculations were put to rest by

[3] Pallavi Nahata, World Banks's Ease of Doing Business Index: Where India Gained And Lost, Bloomberg Quint (Oct 24, 2019, 02:13 PM), https://www.bloombergquint.com/business/world-banks-ease-of-doing-business-index-where-india-gained-lost.
[4] The Insolvency and Bankruptcy Code, 2016.
[5] PIB Delhi, Finance Minister announces Government Reforms and Enables across Seven Sectors under Aatma Nirbhar Bharat Abhiyaan, Press Information Bureau, (May 17, 2020, 03:11 PM), pib.gov.in/PressReleasePage.aspx?PRID=1624661.

the promulgation of the amendment ordinance to Code, however it has given rise to a new set of issues.

By exercising the power granted under clause (1) of Article 123 of the Indian Constitution, the Hon'ble President promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 on 5th June 2020[6]. This Ordinance primarily bought about two important alterations in the Code, namely:

a) *It inserted section 10A to the Code stating that no application can ever be filed for the initiation of the corporate insolvency resolution process against a corporate debtor for a debt arising on or after the 25th March, 2020 (specified date) for a period of six months or such longer period as may be specified, not exceeding one year. In other words, it provides for the suspension of the initiation of the insolvency proceedings under the Code.*
The explanation to the provision explicitly states that the provision of section 10A shall not apply to defaults committed prior to the specified date.

b) *It inserted sub-section (3) to section 66, which deals with liability of any persons who were aware of such practices and the directors, in case of fraudulent or wrongful trading. The new sub-section has provided a blanket protection to these persons.*

III. SHORTCOMINGS OF THE ORDINANCE:

At the first glance, the ordinance is a move in the right direction by the government providing businesses with the much-required respite. It is also in line with the recent blog of World Bank wherein it advised the governments to modify its insolvency structure to adapt to the unique circumstances[7]. However, a detailed inspection of the Ordinance reveals that are quite a few limitations which tend to overshadow the benefits which the ordinance aims to provide. Following are some of the limitations which the Ordinance has come with:

1. NON-LINKAGE OF THE DEFAULT WITH THE PANDEMIC:

The Finance Minister in her announcement explicitly indicated the exclusion of the debts which primarily arise due to the pandemic from the definition of 'default'. However, the Preamble of the Ordinance merely reflects the unfortunate consequence of the pandemic on the business and financial markets and the economy as a whole and also the difficulty in recruiting

[6] The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020.
[7] Ceyla Pazarbasioglu & Alfonso Garcia Mora, Strengthen insolvency frameworks to save firms and boost economy recovery, World Bank Blogs (May18, 2020), http://www.blogs.worldbank.org/voices/strengthen-insolvency-frameworks-save-firms-and-boost-economy-recovery.

resolution professionals to save the corporate debtor who may default in repayment of debts, nowhere does it define the word 'default' thereby linking the default with the pandemic. Further, section 10A of the Code uses the 'any default' this necessarily implies that there need not be a close nexus between the default and the pandemic. Therefore, 'any default' which occurs during the suspension period is presumed to be due to the pandemic. Thus, it provides for a blanket suspension of the initiation of the CIRP for any defaults within the suspension period. The ordinance has been promulgated entirely disregarding the following two circumstances:

a) *Firstly, there could be businesses who could be circling the drain for quite some time before the pandemic broke out and hence were on the verge of insolvency due to its extended poor performance. However, as the default occurred on or after the specified date no insolvency proceedings can ever be initiated against such corporate debtor.*

b) *Secondly, there could be businesses whose businesses might have been affected due to the pandemic prior to the specified date. Since the default occurs prior to the specified date these businesses are not insulated from insolvency proceedings.*

2. SUSPENSION OF VOLUNTARY INSOLVENCY:

In addition to the prohibition of initiating the CIRP process by the financial and operating creditors under section 7 and 9 of the Code (respectively) the Ordinance also suspends the voluntary initiation of the CIRP by the corporate debtor. The Ordinance seems to have entirely ignored the following:

a) *There could be organizations whose debt would have snowballed due to its poor performance in the past and are circling the drain for quite some time and due to this suspension, they are unable to initiate an insolvency process.*

b) *The situation of the creditors who genuinely need to assess the realizable value of their debtors. By prohibiting the voluntary initiation of the insolvency proceedings, it leads to the further deterioration of the assets of these business houses and thereby it becomes onerous for these crippling organizations to sustain and thereby pushing them into liquidation.*

3. EVERLASTING BAN ON INITIATION OF CIRP PROCESS AND PREMEDITATED DEFAULTS:

The proviso to section 10A of the Code stresses on the fact that no corporate insolvency resolution process (CRIP) can *ever* be initiated against a corporate debtor for a default occurring on or after the specified date for a period of six months or such other period as may be specified, not exceeding one year. Similarly, the preamble of the Ordinance considers it pragmatic to exclude defaults arising out of extraordinary situations from the purview of the Code. Therefore, both the above provisions lead us to conclude that there is an everlasting exclusion to initiate the CIRP against the defaulting corporate debtors. This brings in the issue of intentional default under consideration. There are high probabilities of corporate debtor making an intentional default against the financial or operating creditors and even toward the workers and employees of the company since they can never initiate CIRP against the corporate debtor under section 7 and 9 of the Code.

4. DEFAULTS THAT ARE PHASED OVER A TIME FRAME:

Sub-section 12 of section 3 of the Code defines the term 'default'. It means nonpayment of debt when a whole or part of the debt has become due and payable and is not repaid by the corporate debtor. Such a default continues unless and until it has been remedied or waived off. The Ordinance fails to address the issue where the part of the default is continued post the suspension period. Correspondingly, it also fails to clarify whether both these defaults can be combined to meet the threshold of INR 1 crore and initiate the insolvency proceedings under the Code.

For instance, if a corporate debtor defaults twice, first during the suspension period for an installment of INR 60,00,000 which continues even after the suspension period is over; and another when the suspension period is over for an installment of INR 40,00,000. Here the first question that arises is whether section 10A of the Code will be applicable in case of defaults occurring during the suspension period or will it continue to get attracted in case of defaults taking place post the suspension period? Secondly, here the sole installment of INR 40,00,000 does not fulfill the threshold requirement but both the installments combined fulfills the threshold requirement, so can both these installments be combined to meet the threshold? Due to an absence of clarity in both these issues, the Ordinance remains unclear.

5. WHAT IS THE DATE OF DEFAULT?

As far as the applicability of section 10A of the Code is concerned, 'date of default' plays an important role. There could be differences arising between the creditors and the corporate

debtor as to the determination of 'date of default' since the Ordinance has failed to caste light upon it and hence is a contentious question of fact requiring an adjudication by the adjudicating authority. However, due to the insertion of section 10A to the Code the creditors are barred from filing applications before the adjudicating authority under section 7 and 9 of the Code. The effect of such an omission would be unfolded in the coming days.

6. PROSPECTIVE OR RETROSPECTIVE APPLICATION?

The Ordinance fails to explicitly mention about its retrospective effect on applications filed before it was notified i.e. between 25th March 2020 and 5th June 2020. This drafting flaw gives rise to a dilemma about the application of this Ordinance. This dilemma was set aside by the Chennai bench of the National Company Law Tribunal (NCLT) in Siemens Gamesa Renewable Private Limited v Ramesh Kymal[8]. The NCLT interpreted the Ordinance in the light of its Preamble and held that the Ordinance would have a retrospective effect. The NCLT said "The date of filing cannot determine the rights of the parties in view of the prevalent extraordinary situation which will wholly defeat the object of the promulgation of the Ordinance in protecting the interest of the corporate persons". Such a flaw could have been easily done away with thoughtful drafting which would have saved the precious time of the judiciary.

7. EXCUSING INTENTIONAL FRAUD:

Section 66 of the Code which deals with 'Fraudulent trading and wrongful trading'. The Ordinance inserts sub-section (3) to section 66 prohibiting the resolution professionals from filing an application against the directors/partners for wrongful trading in respect of default under section 10A of the Code. This provides an escape window for the directors for fiddling and siphoning off money without facing consequences under section 66 of the Code by virtue of sub-section (3).

IV. CONCLUSION:

The intent of the Ordinance is to aid corporation to survive through the troubled waters. However, it is necessary to be vigilant to ensure that corporate debtors do not take any undue advantage of the drafting flaws of the ordinance. Further, the adjudicating authority has to ensure the smooth implementation by setting away the hindrances which may arise on account of prohibition on the initiation of voluntary insolvency proceedings by the corporate debtor,

[8] Siemens Gamesa Renewable Private Limited Vs Ramesh Kymal, order dated Jul 9, 2020, IA/395/2020 in IBA/215/2020.

disqualification of the creditors for initiation of the insolvency proceedings against willful defaults, limitation on filing an application for wrongful/fraudulent trading by the resolution professionals, etc. Judicial intervention might help in clearing a few confusions. Nevertheless, there is need to make a few changes in the Ordinance to help the businesses in true sense and at the same time keep the interests if the creditors.