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INSOLVENCY AND BANKRUPTCY AMENDMENT ORDINANCE: JUNE 2020

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Background

Ever since the Hon'ble Finance Minister of India announced the suspension of initiation of corporate insolvency under the Insolvency and Bankruptcy Code 2016 (IBC) in wake of the COVID-19 pandemic, there have been several market speculations about the nature and extent of the proposed suspension and its implications. With the promulgation of the amendment ordinance to IBC, most of these speculations have been put to rest, however owing to the language of the Ordinance, a new set of issues may have arisen.

Introduction

The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 (Ordinance) has come into force on 5 June 2020. The Ordinance envisages insertion of a '*non-obstante provision*' to Section 7, 9 and 10, by way of Section 10A of the IBC, which provides that for occurrence of any default between the period commencing from 25 March 2020 till expiry of 6 months or such further period as may be notified, not exceeding 1 year (Exemption Period), creditors/corporate applicants shall not have the right to file applications to initiate the corporate insolvency resolution process.

The *proviso* to Section 10A further clarifies that there shall be a permanent ban on filing of applications for any default which may occur during the Exemption Period. In other words, the rights available to the creditors/corporate applicants under Section 7, 9 and 10 of the IBC have been permanently taken away, so far as any default during the Exemption Period is concerned.

For abundant clarity, the Ordinance has also inserted an *Explanation* to suggest that Section 10A shall not have any application on any default that has occurred before 25 March 2020. Therefore creditors/corporate applicants are still entitled to file appropriate applications to initiate the corporate insolvency resolution process, for any default which may have occurred prior to 25 March 2020.

While the *Explanation* fails to specifically mention that Section 10A will also not have any application with respect to defaults after expiry of the Exemption Period, such an interpretation seems to be implied.

The second part of Ordinance deals with insertion of '*non-obstante provision*' to Section 66 of the IBC and provides that the Resolution Professionals are barred from filing any

application under Section 66(2), if that application relates to a default, which has occurred during the Exemption Period.

Impact of the Ordinance

- **Scope of the Ordinance**

  Applies only to defaults occurring between the period commencing from 25 March 2020 till expiry of 6 months, which may be extended up-to 1 year.

- **Blanket Ban for defaults during Exemption Period**

  The Ordinance imposes a blanket ban on use of the 'trigger provisions', for defaults occurring during the period between 25 March 2020 till the expiry of 6 months, which may be extended up-to 1 year.

  However, there is no blanket ban on filing of applications during this period or after that, for any default occurring before 25 March 2020.

Comments

- **Non-Linkage to CoVID-19**: While the preamble of the Ordinance refers to the impact of the COVID-19 pandemic on businesses, financial markets and the economy, the language appearing in Section 10A does not link defaults to the COVID-19 pandemic. This ensures that unnecessary time shall not be spent by parties proving whether the default is linked to COVID-19, before the adjudicating authority.

- **Ban of Voluntary Insolvency**: In addition to involuntary insolvency proceedings under Section 7 and 9, the Ordinance has also imposed a ban on initiation of voluntary insolvency process under Section 10, for default during the Exemption Period, which doesn't seem to be aligned with the intent of the Ordinance. The preamble of the Ordinance suggests that 'it is considered expedient to suspend Section 7, 9 and 10 to prevent corporate persons experiencing distress, being pushed into insolvency proceedings'. In our view, a prohibition on voluntary insolvency proceedings of a corporate debtor in distress, may result in further deterioration of its assets, implying lesser chances of revival of the corporate debtor and pushing it into liquidation.

- **Blanket Ban and Intentional Defaults**: Another issue for consideration is, whether exempting the defaults during the Exemption Period may lead to intentional defaults by corporate debtors towards the financial and operational creditors (including employee and workmen), since the recourse to IBC by such creditors for default during the Exemption Period has been permanently taken away.

- **Section 66(3): Excusing the Fraud**: Considering Section 66 deals with '*Fraudulent trading or Wrongful trading*', the proposed Section 66(3) seems to be ambiguous. From the current language it seems that it proposes to excuse lack of due diligence by the director or partner of a corporate debtor resulting in a potential loss to creditors of the corporate debtor during the Exemption Period. Such an exemption may result in directors/partners of corporate debtors engaging into unlawful and illegal measures such as misappropriation and siphoning off funds without facing consequences under Section 66 of IBC and may adversely impact the realisable value for its creditors.

- **Adjudication of disputes relating to date of default**: The date of default is critical as far as the applicability of Section 10A is concerned and may be a disputed

question of fact, between the creditor and the corporate debtor requiring adjudication by the adjudicating authority. However, considering that creditors are precluded from filing applications under Section 7 and 9 before the adjudicating authority, it would be interesting to see how disputes relating to date of default are decided.

Conclusion

The IBC in January 2019 was considered as a panacea for all ills plaguing the Indian financial system, which led the Honourable Supreme Court to observe as follows, in the landmark judgement of Swiss Ribbons Pvt. Ltd. and Ors. vs. Union of India (UOI) and Ors. (AIR 2019 SC 739):

a. *The flow of financial resource to the commercial sector in India has increased exponentially as a result of financial debts being repaid.*

b. *These figures (figures considered by the SC) show that the experiment conducted in enacting the Code is proving to be largely successful.*

c. *The defaulter's paradise is lost. In its place, the economy's rightful position has been regained.*

The Ordinance appears to have been promulgated with the intention of protecting companies and promoters from *no fault liability*. It is however necessary to ensure that Section 10A does not become a tool for regaining the defaulter's paradise. The legislature and adjudicating authority may also need to be mindful of ironing out certain creases in the implementation of the Ordinance, which may arise on account of ban on voluntary insolvency for Exemption Period defaults, inability of lenders to file insolvency proceedings even for intentional defaults during Exemption Periods, restriction on filing of fraudulent/wrongful trading applications by resolution professionals (with respect to defaults against which insolvency is suspended) *etc*.

On a separate note, the Ordinance may also encourage creditors to adopt alternate mechanisms, such as restructuring, one-time settlement and change in ownership etc.

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