KHAITAN &CO
Advocates since 1911

NEWSLETTER

ERGO
Analysing developments impacting business

Second Ordinance to amend Insolvency and Bankruptcy Code 2016: From structural changes to provisions to streamline the process

26 June 2018

The President of India promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance 2018 on 6 June 2018 (Ordinance) to amend the Insolvency and Bankruptcy Code 2016 (IBC). In the short history of around one and half years since the provisions relating to corporate insolvency resolution process under IBC came into force in December 2016, the Ordinance marks the second amendment to IBC.

The first amendment to IBC (by way of an ordinance in November 2017, which was ratified by the Parliament in January 2018) primarily dealt with an amendment to introduce Section 29A to IBC which set out the grounds for ineligibility of the resolution applicants to submit a resolution plan under IBC.

The second amendment by way of this Ordinance introduces primarily three changes to IBC, as also stated in one of the objectives of the Ordinance:

a. balancing interests of home buyers and micro, small and medium enterprises;
b. promoting resolution over liquidation of corporate debtor by lowering the voting threshold of committee of creditors; and
c. streamlining provisions relating to eligibility of resolution applicants.

Apart from the changes mentioned as above, the Ordinance also addresses some of the practical issues as experienced in the journey of IBC so far.

A brief snapshot of the changes introduced by the Ordinance is given below:

Amendment	Particulars	Khaitan Viewpoint
Homebuyers recognised as Financial Creditor		
Definition of Financial Debt	▪ A deeming fiction has been created such that any amount raised from an allottee under a real estate project is deemed to be having commercial effect of borrowing.	This would give right to homebuyers to initiate insolvency process in case of default as well as seat in the committee of

	▪ Accordingly, the due owed to a homebuyer by the corporate debtor recognised as financial debt	creditors with other financial creditors. Considering the approach of deeming fiction, the clause would be interpreted strictly. As such, its application will have to be seen in scenarios where the money is raised from homebuyers in one entity and the project development is housed in another group entity. However, this is an important shift in position on insolvency of real estate developers and would further strengthen the position of home buyers after RERA which puts strict obligations on developers for timely construction of projects.
Representation of Homebuyers	▪ An authorised representative shall be appointed for a class of creditors (exceeding such numbers as may be specified) ▪ Such authorised representative will be appointed by the Adjudicating Authority (NCLT) upon an application by the interim resolution professional (IRP) ▪ Authorised representative is required to be an insolvency professional ▪ Appointment shall be prior to the first meeting of the Committee of Creditors (CoC) ▪ Such authorised representative shall attend the meetings of CoC and vote on behalf of such financial creditors (homebuyers) to the extent of his voting share	▪ The finer details will be provided by way of changes to the Insolvency and Bankruptcy Board of India (Corporate Insolvency Resolution Process) Regulations 2016 (CIRP Regulations) ▪ The changes to CIRP Regulations will, *inter alia,* provide the number of creditors in a class (including a class of homebuyer-creditors) that can represent themselves and upon crossing such prescribed number, an authorised representative will have to be appointed.

Manner of voting in COC by the authorised representative of homebuyers (financial creditors)	▪ Authorised representative shall cast his vote in respect of each financial creditor in accordance with prior instructions received from each financial creditor he represents, to the extent of their respective voting share ▪ Authorised representative to circulate the agenda and minutes of the meeting of CoC to the financial creditors he represents ▪ Authorised representative is duty bound to not act against the interest of the financial creditor he represents ▪ If any financial creditor (homebuyer) fails to give prior instructions to the authorised representative, he shall abstain from voting on behalf of such financial creditor ▪ Authorised representative is required to file with CoC any instructions received by way of physical or electronic means from the financial creditor he represents – to ensure that the voting is correctly recorded for such financial creditors.	▪ The system of appointing authorised representative for a class of creditors has been worded generally and is not specific to homebuyers leaving the flexibility to recognise other classes of creditors for the purposes of voting and representation in CoC ▪ The electronic means of procuring prior voting instructions are expected to be notified as part of CIRP Regulations by the Insolvency and Bankruptcy Board of India (IBBI).
Section 29A Amendments: Relaxation in its scope and applicability		
Related party in relation to an individual	▪ The definition, *inter alia,* covers relatives leading up to the fourth generation of an individual (i.e upto sons and daughters of grandchildren) and maternal side of an individual (i.e upto grandparents of an individual), including respective spouses of each such individual ▪ The definition also provides situations when private companies, public companies, trustees of a trust, partnerships, LLPs would be related party of an individual	▪ Earlier, the term 'related party' in the definition of 'connected persons' under Section 29A was primarily read to be in the relation to a 'company' in terms of the definition under Section 2(76) of the Companies Act 2013 (Companies Act) ▪ For related party in relation to individual, the definition of 'relative' under Section 2(77) of Companies Act was referenced which was narrower than the new definition as introduced by the Ordinance

		▪ The new definition widens the scope of the 'connected persons' significantly, thereby making the sweep of ineligibility wider.

Disqualification due to a person being a promoter or in management or control of a non-performing account (NPA) and one year has lapsed as being NPA
 	
Clause (c) of Section 29A
	▪ The opening sentence of the clause has been amended to specifically provide that a person shall have the NPA account or shall be promoter or in management or control of an NPA account '*at the time of submission of the resolution plan*'
	▪ Exemptions:
	  ▪ A financial entity which is not a related party of the corporate debtor shall not be subjected to this disqualification
	  ▪ If a resolution applicant has an NPA account where such account was acquired pursuant to a resolution plan under IBC – it shall be exempt from this disqualification for a period of 3 years
	  ▪ Anyone submitting resolution plan for Micro, small and medium enterprises (MSMEs), has been exempted from this disqualification
		▪ Pursuant to this amendment, a person would now be tested for ineligibility at the time of submission of resolution plan rather than at the time of commencement of insolvency.
		▪ The exemption to financial entity is a welcome step as it addresses their concerns relating to the possibility of them actually having an NPA account for instance where such financial entity was already in the business of investing in stressed assets or the shares were acquired as part of the resolution through a scheme permitted by RBI, amongst others
		▪ The relaxation for MSMEs comes in the wake of growing realisation that the market for stressed assets in MSMEs sector has not matured as it has seen very less bidders. Accordingly, to avoid liquidation of these MSMEs, not only the promoters of MSMEs (if they do not suffer from other disqualifications such as being wilful defaulter) have been allowed to bid for their own companies even though they had

		become NPA but also any bidder for MSMEs who is otherwise disqualified on account of its account being NPA.
Disqualification due to being convicted for a criminal offence **Clause (d) of Section 29A**	▪ Earlier the disqualification attached to a person where he was convicted for an offence punishable with imprisonment of 2 years or more ▪ Now the disqualification attaches where the person is convicted for an offence publishable with imprisonment of 7 years or more other than certain prescribed statues in which case the threshold remains 2 years or more ▪ The list of prescribed acts includes those relating to economic offence under securities law, central tax law, environment law, foreign exchange laws, anti-corruption laws, etc. ▪ Exemptions: • Holding company, subsidiary company, associate company and related parties of the resolution applicant would no longer be subjected to this disqualification – applicable to the promoter and persons in management or control of the resolution applicant • Disqualification not applicable to a person where 2 years have lapsed from the date of release of such person.	▪ The proposed changes recognise the personal nature of this disqualification and rightly limits the scope of its applicability by no longer being applicable to the wider group of 'connected persons' ▪ It also clarifies that a person is not disqualified forever due to a past conviction ▪ By classification of disqualification thresholds basis the nature of laws, the provision has been rationalised which helps in addressing issues around this clause being arbitrary.
Disqualification for being disqualified to be appointed as a director under Companies Act **Clause (e) of Section 29A**	▪ Exemption: Holding company, subsidiary company, associate company and related parties of the resolution applicant would no longer be subjected to this disqualification – applicable to the promoter and persons in management or control of the resolution applicant.	▪ The amendment recognises the personal nature of this disqualification which should not attach to all the 'connected persons'

Disqualification due to avoidance transactions **Clause (g) of Section 29A**	▪ This disqualification is applicable if a person is a promoter of or in management or control of a corporate debtor where a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has been found by NCLT ▪ Exemption: it has been clarified that where such avoidance transactions have taken place prior to the acquisition of the corporate debtor pursuant to IBC or pursuant to a scheme approved by a financial sector regulator or a court, the acquirer shall not be subjected to this disqualification.	▪ The amendment is in line with the principle that the acquirer of a corporate debtor pursuant to a resolution plan shall not be punished for avoidance transactions taken place prior to the acquisition
Disqualification due to being a guarantor to a corporate debtor undergoing insolvency under IBC **Clause (h) of Section 29A**	▪ Earlier the disqualification attached merely on the ground of having provided a guarantee and the beneficiary-creditor of such guarantee having initiated insolvency against the principal borrower-corporate debtor ▪ The amendment also adds a requirement that such guarantee should have been invoked and remains unpaid in full or part, to attach this disqualification ▪ Exemption: Anyone submitting resolution plan for MSMEs has been exempted from this disqualification.	▪ This amendment is in line with the NCLT (Kolkata Bench) judgment in MBL Infrastructure Limited where NCLT held that merely because a guarantee has been provided by the promoter of the corporate debtor he cannot be disqualified, if such guarantee has not been invoked ▪ In line with the exemption to MSMEs from NPA related disqualification, resolution applicants for MSMEs including the promoters of such MSMEs are also exempted even if they have provided guarantees that have been invoked by the lenders.
Scope of Connected Persons for financial entities	▪ Where a financial entity is the resolution applicant – the holding companies, subsidiary companies, associate companies and related parties of such financial entity or its promoter, or persons in management or	▪ While a financial entity (which is not a related party of the corporate debtor) has entirely been exempted from the disqualification due

	control would not be put to test under Section 29A ▪ Further, financial entity has been defined to include: • a scheduled bank; • any entity regulated by a foreign central bank or a securities market regulator or other financial sector regulator of a jurisdiction outside India (which is FATF compliant); • any investment vehicle, registered FII, registered FPI, or a foreign venture capital investor; • asset reconstruction companies; • alternate investment funds; • such categories as may be notified by the Central Government ▪ The exemption available to financial entity to not subject all its group entities to the test under Section 29A would not be applicable to those financial entities which are related parties of the corporate debtor itself ▪ However, it has further been clarified that a financial entity which has become related party of the corporate debtor due to conversion of its debt into equity can avail this exemption.	to NPA accounts, this exemption helps narrow down the list of connected persons of a financial entity which would be subjected to the test under Section 29A ▪ Earlier only AIFs, ARCs and scheduled banks in India were able to avail such exemption. ▪ The expanded definition of financial entity will enable even foreign investors to avail this exemption of reduced exposure of its investments and portfolio companies as they would be exempt from being put to test under Section 29A.
Prospective application of the changes introduced to Section 29A	▪ Newly introduced Proviso to section 30(4) specifically provides that the eligibility criteria in Section 29A as amended by the Ordinance shall apply to those resolution applicants who have not submitted resolution plan as on the date of commencement of the Ordinance, i.e. 6 June 2018	▪ Section 29A being a disqualification provision (penal in nature) cannot be applied retrospectively and thus will be applied prospectively for resolution plans to be submitted after 6 June 2018.
Voting Thresholds for Decisions by CoC		
Default voting requirement of 51%	▪ All decisions of the CoC shall be taken by a vote of not less than 51% of voting share of the financial creditors, except where	▪ Earlier all the decisions of CoC were required to be taken by 75% votes in

	otherwise provided elsewhere in IBC	favour of such decisions ▪ The items for 51% voting requirement would include residual items for which the voting threshold has not been provided specifically under IBC.
Items that require 66% voting	▪ Approval of a resolution plan; ▪ Actions under Section 28 of IBC, including raising interim financing, issuance of additional securities, undertake any related party transactions, make any change in the management of the corporate debtor or its subsidiary, etc.; ▪ Appointment or replacement of resolution professional; ▪ Decision by CoC to liquidate the corporate debtor.	▪ The voting requirement has been reduced from 75% to 66% in view of the experiences in many cases where the resolution of could not be achieved due to the requirement of 75% votes. ▪ The reduced requirement is aimed at promoting resolution over liquidation.
Item that require 90% votes – Withdrawal of insolvency process	▪ NCLT may allow withdrawal of insolvency commencement application upon application made by the applicant with the approval of 90% voting share of CoC, in such manner as may be prescribed	▪ This amendment is in view of the challenges faced by NCLT and NCLAT in setting aside insolvency process even when the applicant and the corporate debtor have reached a settlement. ▪ In most of the cases, Supreme Court had to exercise its inherent powers under Article 142 of the Constitution of India to set aside insolvency process basis settlement between parties, as IBC did not have any provision that provided for settlement between the parties ▪ While an enabling provision to

		recognise the settlement with CoC has been introduced by the Ordinance which may be of significance for the promoters of corporate debtor in giving them a second chance to negotiate a settlement with its creditors, the framework under which settlement can be worked out is awaited as part of the rules to be notified by the Central Government.
Moratorium not applicable to Personal or Corporate Guarantors		
Amendment to Section 14 (Moratorium Provision)	▪ Section 14 has been amended to specifically provide that the moratorium on instituting any suit against the corporate debtor or its property is not applicable to *'a surety under a contract of guarantee to corporate debtor'*	▪ The last judicial position on this was that the moratorium provision is also applicable to the guarantors and accordingly, the guarantees could not be invoked during the insolvency process, which was under challenge before Supreme Court ▪ This amendment settles this long-debated question and would allow initiation of proceedings against guarantors during insolvency process of the corporate debtor.
Clubbing of insolvency proceedings against guarantors	▪ Section 60 deals with the jurisdiction of NCLT ▪ While the chapter relating to bankruptcy of individuals under IBC i.e. applicable in case of personal guarantees has not yet been notified, the erstwhile Section 60(2) and (3) provided for initiation / of bankruptcy	▪ This is a significant amendment in as much as insolvency proceedings against the corporate guarantor of a corporate debtor can be clubbed with the same NCLT.

	proceedings against the personal guarantor to the NCLT dealing with the insolvency /liquidation of the corporate debtor ▪ The amendment to Section 60(2) and (3) now also provides for insolvency proceedings against the corporate guarantor (in addition to the personal guarantor) to the corporate debtor to be initiated with or transferred to the NCLT which is dealing with the insolvency / liquidation process of the corporate debtor.	▪ This may be a step towards efforts to streamline the resolution of insolvency of the group
Amendments to Streamline the Process		
Certain Clarificatory Amendments	▪ Meaning of Dispute: In an application by the operational creditor to initiate insolvency against the corporate debtor, the language has been clarified to indicate that dispute regarding the liability to the operational creditor need not necessarily be demonstrated by a suit in a court – in line with the judgment of the Supreme Court in Mobilox Innovations Private Limited vs Kirusa Software Private Limited ▪ Waived the requirement to procure certificate from a financial institution regarding amount due and claimed against the corporate debtor: The courts faced question in this regard as to whether a foreign bank certifying non-payment by corporate debtor is in compliance of this requirement. While the courts did read this provision liberally and allowed the certificates issued by foreign banks to also be considered, this amendment waives this as a mandatory requirement ▪ Interim resolution professional (IRP) to continue till the appointment of the resolution professional (RP) and not till the expiry of 30 days of his appointment ▪ RP to continue managing the affairs of the corporate debtor	▪ Each of these amendments have been introduced following the various issues arising in relation to the subject matter of these amendments. ▪ While judicial precedents had clarified positions to some extent, the Ordinance gives legislative certainty in resolution of these issues.

	until the resolution plan is approved by NCLT. Earlier, NCLT had to pass specific orders to vest RP with the powers to manage the affairs of the corporate debtor pending decision with NCLT regarding the resolution plan submitted to it by the RP ▪ Compliance with Laws: IRP/RP responsible for complying with the requirements under any law for the time being in force on behalf of the corporate debtor. IBBI had earlier vide its circulars cast a similar responsibility on the RP ▪ Shareholder Approval: Any requirement for approval of shareholders under the Companies Act or any other law for taking any actions under a resolution plan has been specifically waived. Earlier, Ministry of Corporate Affairs vide its circular dated 25 October 2017 had waived the requirement of shareholders' approval for any actions under resolution plan ▪ Limitation Act to be applicable: Following various conflicting judgments and views on the applicability of provisions of Limitation Act to the cases under IBC, the amendment has clarified that Limitation Act 1963 shall be applicable. This implies that *inter alia* a person to whom time-barred debt is owed by the corporate debtor would not be able to initiate insolvency proceedings against such corporate debtor.	
Special Resolution for initiation of insolvency process by corporate debtor on its own	▪ As part of the application by a corporate debtor to initiate insolvency resolution process for itself under Section 10, an additional requirement of special resolution by its shareholders or a resolution by 3/4th of its partners in case of an LLP approving the initiation of insolvency proceedings for itself has been added.	▪ This amendment is aimed to ensure that the borrowers initiate insolvency process only with approval of shareholders as Companies Act does not prescribe this as a separate approval requirement from shareholders.

One year period for implementation of a resolution plan	▪ The resolution applicant is required to obtain necessary approval required under any law within a period of one year from the date of approval of the resolution plan by NCLT.	▪ This amendment reinforces that a resolution plan cannot waive the requirement to comply with mandatory applicable laws, such as competition law and other sectoral regulatory laws, as may be applicable ▪ Such a provision also begets the question if the resolution plan may be made conditional to receipt of approvals under applicable law ▪ The amendment also creates uncertainty regarding the question if approval of schemes of merger / demerger, capital reduction, etc. can be granted by NCLT as part of the resolution plan. Such schemes otherwise have separate processes under the Companies Act to be followed before NCLT.
Central Government may modify applicability of any provisions to MSMEs	▪ In terms of Section 240A, Central Government has been given power to exempt MSMEs from the applicability of any of the provisions under IBC or to apply any of the provisions with such modifications as it may specify ▪ Central Government may exercise this power in the public interest by way of a notification ▪ A draft of such notification is required to be placed before Parliament for 30 session days before being issued.	▪ This approach gives the Central Government flexibility to swiftly respond to the changing requirements for MSMEs and to cater to their specific needs without following the legislative amendment route.

With the experience of first 18 months of the working of IBC where the law was applied in the largest cases of default through RBI intervention and lot of small and mid-sized borrowers were pushed into liquidation, the amendments introduced through the Ordinance is intended to streamline the process of resolution further. It also pushes a very important objective of IBC i.e. resolution over liquidation which is expected to

guide all the stakeholders involved in the process of resolution going forward. The efforts to strengthen the position of homebuyers and permitting withdrawal of insolvency proceedings post admission are again a timely response to the challenges faced by the stakeholders in the initial cases and would provide further maturity and direction to the insolvency resolution process.

- *Kumar Saurabh Singh (Partner)*

For any queries please contact: editors@khaitanco.com

Mumbai
One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru
Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com