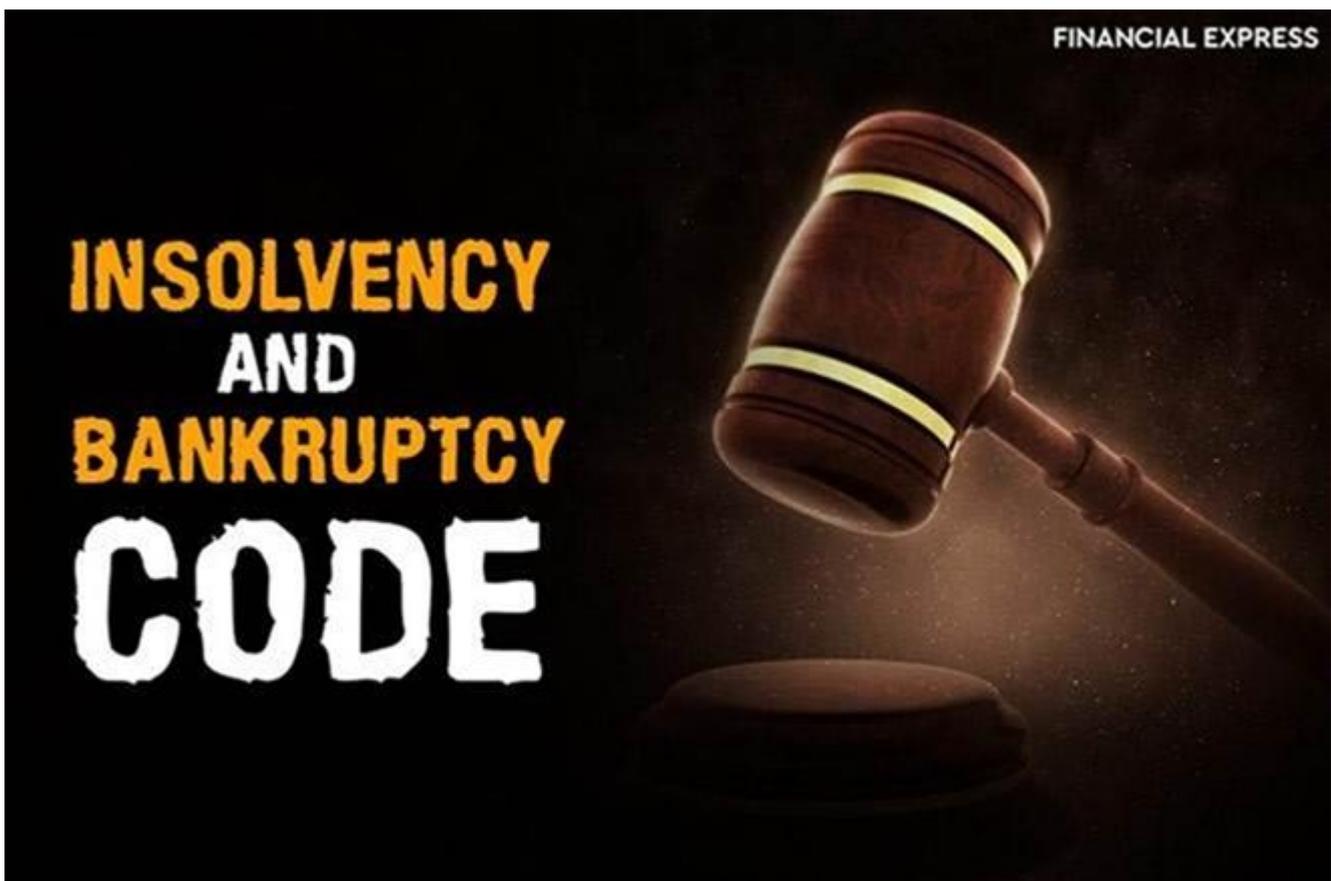


Operating without a code: Suspension of IBC okay, but there's scope for further fine-tuning

Published: June 23, 2020 6:01 AM

In anticipation of the suspension of the Insolvency Code, the stakeholders had already voiced their opinion against taking away the ability of a company to initiate insolvency proceedings.



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On June 5, an Ordinance was promulgated barring initiation of the corporate insolvency resolution process for defaults committed within six months (extendable up to one year) from March 25. The Ordinance also clarifies that no application can ever be filed in respect of such defaults, thereby, giving a permanent immunity to such defaulting companies under the Insolvency Code.

First, the threshold for default under the code was extended from Rs 1 lakh to Rs 1 crore as soon as the lockdown was imposed, to ensure that insolvency proceedings are not initiated for smaller defaults. At the time of increasing the default threshold the FM had given hints that if the global pandemic situation does not improve, the code may be suspended. More recently, the FM specifically announced that initiation of fresh insolvency proceedings on Covid-19 related debts would remain suspended. There was much speculation with regard to this announcement. The Ordinance is on expected lines, but one would have expected a more detailed framework to suspend the operation of the Insolvency code, rather than blanket time-specific embargo.

The Insolvency and Bankruptcy Code has been fairly successful since its inception in 2016. It has led to resolution of 221 cases with a 44% recovery rate. Instead of identifying a criterion based on which relaxations could have been granted, the government has completely suspended the system.

The absence of criteria and its linkage to the suspension of the insolvency resolution process may actually cause more harm to the businesses, as the Insolvency Code will no longer remain available for restructuring. In the absence of a moratorium, the corporate debtor will be more vulnerable against the creditors, who will look into initiating other legal recourse to claim their debt.

The pandemic has already caused debtors to face financial stress, which may lead to defaults. The time-specific approach also raises doubts: First, if a business heavily relied on global demand and consequently faced pandemic-related stress prior to the lockdown, then there will be no immunity for such a company.

Conversely, if an entity was already under stress and started making defaults in ordinary course after March 25, they will be able to take shelter under the newly instituted Ordinance even when the root cause of the default may not relate to the global pandemic. The government could have considered providing an effect- or impact-based immunity.

In anticipation of the suspension of the Insolvency Code, the stakeholders had already voiced their opinion against taking away the ability of a company to initiate insolvency proceedings. The SC, in its judgments, has categorically stated that the ability to start and end business is a constitutional right, and, therefore, it cannot be taken away. Still, the Ordinance takes away the right of a company to initiate insolvency proceedings against itself, while allowing the same company to

initiate voluntary liquidation proceedings under the Insolvency Code which can also be a consequence of pandemic-related stress.

What would be the real impact of the suspension? And, can the impact be structured? The inability to pay automatically leads to a default under the Insolvency and Bankruptcy Code, and hence lenders may grant a moratorium to ensure that the obligation to pay and the consequent default does not arise till the operation of the Ordinance. Such moratoriums have also been advised by Reserve Bank of India, initially for three months, with another three months extension.

We should also be mindful that creditors can still take recourse to other methods and means to recover dues or prosecute the defaulting companies, like enforcement of a security interest under laws like Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) or initiation of arbitration or other legal proceedings. Therefore, the government should also consider enacting special pandemic legislation through which an immunity akin to the moratorium granted under the Insolvency Code is afforded to businesses that can prove pandemic-related stress.

Nevertheless, it was important for the government to provide relief to businesses which have been severely impacted by the pandemic and continue to reel under the global crisis. Therefore, it is a step in the right direction. However, there is scope for further fine-tuning, impact-based clarifications, and objective oriented stimulus or immunity.

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