

INSOLVENCY & BANKRUPTCY CODE (AMENDMENT), 2020: A ROADWAY TO INEVITABLE MISAPPREHENSION

ABSTRACT

The article sheds light on the distress created by the recent amendment that suspends initiation of corporate insolvency resolution procedure by financial creditors, operational creditors and filing of voluntary CRIP procedure, under the Insolvency and bankruptcy code, 2016. It addresses issues that have been created by the amendment coming into force and its impact and repercussions. With the down fall of the economy, common man has been economically disturbed; the amendment sets a pathway for fraud and misrepresentation. A comparative analysis drawn with the other legislations formulated by various nations across the globe, highlight the need for adaptation and modification in the present amendment. The article critically analysis the shortcomings and lays the changes that can be brought in for a better economical future, keeping the essence of the act intact.

INTRODUCTION

In light of the distress created by the ongoing Covid-19 Pandemic, The President of India promulgated an ordinance to further amend the Insolvency and Bankruptcy Code, 2016, as on 5th June, 2020¹. The pandemic has impacted businesses, financial markets and economies all over the world, including India, and created uncertainty and stress for businesses for reasons beyond their control. The nationwide lockdown imposed by the government has disrupted normal businesses. That being said, it would be difficult for the government to find adequate number of applicants to rescue the corporate persons, who have defaulted on their payments, which may result in non-remittance of their debt obligation. In order to maximize asset value for the collective satisfaction of the creditors and to minimize the corporate deaths that could have been caused due to the low market fluctuations during lockdown, the government avers to have brought this amendment. However, the amendment being unspecific in nature has led to legal arguments and

¹Insolvency and Bankruptcy Act, 2016, No. 31 of 2016 (India)

debates in the society which may result in series of misguided consequences. Ultimately resulting in abatement of economy and there of future crises.

AMENDMENT PASSED UNDER IBC:

The scheme of the Code envisages invocation corporate insolvency resolution proceedings by suspending the operation from 25th March 2020 for a period of six months extendable to a year, of sections 7, 9, 10 that is, initiation of Corporate Insolvency Resolution Process (further referred as CIRP) by financial creditor, application for initiation of CIRP by operational creditor and initiation of CIRP by corporate applicant respectively of IBC. It incorporates two (*non-obstante provision*) Sections viz. (i) Section 10A that states that no application for CIRP shall be filed for default arising after 25th March for a period of 6 months or further not exceeding one year from such date mentioned in the amendment and that no application shall ever be filed for CIRP of a corporate debtor for the said default during period mentioned in the ordinance. (ii) 66(3) that is no application shall be filed by resolution professional under subsection (2) in respect of default against which initiation of CIRP is suspended as per section 10A in the Insolvency and Bankruptcy Code, 2016². On 1st June, 2020 prior to the amendment the government of India increased the threshold limit to file for CRIP from Rupees one lakh to Rupees one crore³.

ISSUES WITH THE AMENDMENT INTO FORCE

An amendment into force is delusive if the principal act loses its essence of accountability and transparency. The amendment into force broadens the scope for defaults and setbacks and makes way for non-feasance of the corporate debtors.

- **TERM DEFAULT ACTING AS AN ESCAPE CLAUSE:**

The term “default” under section 10A does not explicitly mention defaults due to the Covid 19 pandemic/lockdown in the nation but all defaults occurred irrespective of the reason for which amendment has come into picture, hence, leaving open boundaries to intentional defaults by corporate debtors towards the financial and operational creditors, since the recourse under IBC

²Insolvency and Bankruptcy (Amendment) Ordinance, 2020, No. 9 of 2020(India)

³Ministry of Corporate Affairs, Notification no. S.O: 1205(E), 24th Mar, 2020

has permanently been taken away. Until the interpretation by the judiciary, the term remains as an Escape Clause in the amendment.

- **PAYMENT OF INTEREST UNDER MSME ACT**

Section 9 of IBC, 2016 gives power to operational creditors to file an application for CIRP before the adjudicating authority. Most of the MSMEs (Micro, Small and Medium Enterprises) being operational creditors pursuant to this Ordinance will not be able to invoke Section 9 of IBC cases even when the default by their debtors reaches the threshold⁴. Hence, MSMEs may be subjected to voluntary defaults by their debtors. Also, there is no relaxation of section 16 of the MSME Act which calls for payment of interest to MSMEs for delay in payments⁵. So, those who owe money to MSMEs would still need to pay interest under the provisions of the MSME Act. As creditors have an alternative to file a case for interest amount to the civil court it increases the liability of the debtor who could not file for insolvency under Section 10 of IBC.

- **BAN ON VOLUNTARY INSOLVENCY DETORATING PROBABILITY OF REVIVAL**

When a debtor will not be able to repay its due to the creditors within 30 days limit and is determined to be a sick company U/s 253 of Companies Act, 2013⁶, an application for revival of the company U/s 254 of Companies Act, 2013 will not be entertained if the assets of the company are nil⁷. Section 10 of IBC, 2016 gives power to corporate debtors to file for CIRP. The ban on voluntary insolvency due to IBC(Amendment), 2020 may result in deterioration of the corporate debtor's assets as section 10 IBC resulting in lesser chances of revival of the corporate debtor and pushing it into liquidation.

⁴Ministry of Micro, small and Medium enterprises Notification, 1st June, 2020 (New Delhi, India)

⁵The Micro, Small and Medium Enterprises Development Act, 2006(India)

⁶Companies Act, 2013 (India)

⁷Commissioner of Income tax-8, Mumbai vs. The Registrar of Companies, Mumbai; TCP No.: 244(MB)/2017 (Mumbai, India)

Since there is no remedy by the government for payment of fixed assets the debtors on seeing a dead end may choose for voluntary liquidation under section 59 of IBC since section 10 has been suspended.

When a patient is in a critical health condition due to changes in the environment a doctor will treat him with appropriate medicine. He will not just leave the patient on the ventilator to suffer in pain and not allowing him to die as well. Similar is the situation of companies' u/s section 10.

- **INSERTION OF SECTION 66(3) OF IBC IMPACTING REALISABLE VALUE**

Section 66 of IBC deals with fraudulent and wrongful trading. The insertion of subsection 66(3) incites lack of due diligence by directors or partners of the corporate debtor during exemption period, leading to which them engaging in unlawful and illegal measures such as misappropriation of funds. Here, Section 66(2) has been eliminated by the amendment where the resolution professional does not have the power to file an application to the adjudicating authority anymore which further indirectly eliminates the whole of section 66. Hereby, leaving an open umbrella with no consequences under section 66. This may result in potential loss of creditors and impact their realizable value.

- **STRAIN ON ADJUDICATING AUTHORITY:**

The ordinance in force has retrospective effect and, in a sense, it affects the pending applications in between 25th March 2020 to 5th June 2020, thereof burdening the adjudicating authority with the consequences of the same.

The amendment will also strain the adjudicating authority with disputes relating to date of default between corporate debtors and creditors. Section 10A acts as a tool for regaining “defaulter’s paradise”⁸.

IMPACT OF THE DEFAULTS IN AMENDMENT

⁸Swiss Ribbon Pvt. Ltd. and others vs. Union of India, AIR 2019 SC 739.

With the said amendment coming into picture there is a high possibility of blockage of cash flow in the market. The amendment upswings the chances of money laundering, fraud and manipulation of books of accounts. Factoring in the outbreak of COVID-19, there has been substantial fall in the economy of the country and the fret of becoming non performing asset has been at the pinnacle for small and medium-sized business industry. In current situation where in the nation is facing economic crisis, employment crises, the future of business is highly contingent. There will be a mass impact on both creditors as well as debtors that is ultimately the common man. The insertion of Section 66(3) of IBC and the term “Default” being undefined acts as an opportunity for the company and its directors/partners to way out of previous debts. In such a scenario, the adjudicating authorities are handcuffed as they cannot interfere with the executive and cannot act justly as they are bound by due process of law. Every law has its repercussions directly or indirectly on the common man of the country. The BSE alone lists about 52,206,265 investors investing from various states as on 29th July 2020⁹. From this, we can construe the bare minimum number of people getting affected by the amendment. With 23 stock exchanges just in India the fraud percentage would sore skies soon. The corporate sector is a high recruiter of employees and with unemployment being one of the core issues to have risen in this pandemic, its shut down would behold much harm. Even though the initiating of insolvency process under IBC has been suspended, the creditors still have recourse under contract law. This way, the amendment does no justice to the creditors as well as the debtors. If recourse is available for recovery of default under other acts, then rationale behind of incorporation of IBC, 2016 lapses. The suspension of section 10 under IBC may lead to companies opting for voluntary liquidation under section 59 hereby countering the entire idea of the Government. Also, the resolution plans submitted but not yet voted by the committee of creditor due to the lockdown are sailing on a boat with an unknown destination. The life of the ordinance will end in the next two months and the ordinance will be put to testing in the parliament.

AMENDMENTS DUE TO COVID-19 THAT WERE KNOWN TO BE COMMENDABLE AROUND THE GLOBE:

⁹BSE Sensex, Registered investors summary (29th July, 2020, 16:00), https://www.bseindia.com/markets/keystatics/KeyStat_ClientStat.aspx?expandable%20=4

With no country spared by the pandemic there has been an increasing need for insolvency amendments not just in India, but throughout the world. A glance at the same makes one thing clear that good corporate governance can be achieved through strong laws and promotion of healthy companies.

Analyzing commendable laws around the globe such as that in Germany there was violation of obligation to file for insolvency which could result in criminal penalties and civil liabilities for the managing directors of limited liability companies and in civil liabilities for executive boards of associations¹⁰. There are two exceptions to the suspension. The accountability to file for insolvency remains in force if: (i) the reasons for insolvency are not the result of the COVID-19 pandemic, (ii) there are no possible alternatives of eliminating the inability to payment.¹¹ Creditors of a company that experienced defaults in payment may plead for opening of insolvency proceedings provided they have adequate legal interest in the same and are able to authenticate their claim to the satisfaction of the court U/s 14 German Insolvency Code. The burden of proof on whether the company is bankrupt due to Covid-19 or not lies with the creditors.

In France, the amendment passed in French insolvency law on 23rd Mar, 2020 supports creditors to file a case against the debtors if they can prove a fraudulent transaction by the debtor¹². In Romania, during COVID-19 an insolvent debtor as well as the creditor has the right to file for insolvency¹³. There are no possible alternatives of eliminating the inability to payment. Term provided under insolvency regulation is also extended by 60 days. Austria has extended its time to file for voluntary insolvency to 120 days provided they can prove that the insolvency was caused by COVID-19. In Poland the stay will only be applied to companies who have faced losses due to COVID-19. For companies that are announcing insolvency regardless of the pandemic, the general deadline to file will apply. In Croatia, protection of the homeland security, public health, environment etc. are exceptions from initiation of bankruptcy procedure.

CONCLUSION

¹⁰ German Insolvency Act, 1999 (Germany)

¹¹ COVID-19 Insolvency Suspension Act, 2020 (Germany)

¹² Ordinance no. 2020/596, 25th March, 2020 (France)

¹³ Romanian Parliament, law no. 55/2020; 18th May, 2020 (Romania)

Thus, the Insolvency and Bankruptcy code (Amendment) Act, 2020 is incoherent, when compared to the amended Insolvency provisions across the globe, it appears that Section 7, 9 & 10 of IBC needs to be partly uplifted along with clarifications being inspired from insolvency amendments of mainly Germany, France and Romania wherein the government has made it its requisite. Despite the fact that there is an influx of cases with reasonable doubts and misapprehensions in the NCLT and the Supreme Court of India, there is no proper legislation that can bind all the shortcomings of the amendment. A reasonable clarification of the term default could form basis of a clear motive of the legislation. The simplified voluntary CRIP by the debtor when insolvency isn't due to Covid-19 will stop the influx of cases under section 59 of the Act. Grant to file for cases for misapprehensions caused for reasons other than that bearing the repercussions of Covid 19 could lead to a staircase of better economic growth and financial stability. The gaping blind-spot in the amendment allows certain forbidden activities that in future may be filled by crony capitalism. While in a state of continuous crises by nature and neighboring nations, economy holds a strong stance. Considering the meticulous laws formulated by various nations, establishment of an articulate procedure for dealing with defaults and declaration of insolvency is imperative.