



## INDIA AMENDS ITS INSOLVENCY AND BANKRUPTCY CODE IN VIEW OF THE COVID-19 CRISIS

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On 5<sup>th</sup> June 2020, the eagerly anticipated Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020. (“**Ordinance**”) was promulgated under Article 123(1) of the Constitution of India. The said Ordinance has been promulgated to combat the economic distress caused by COVID-19 and the resultant government lockdowns. With the insertion of Section 10A (*Suspension of Insolvency Resolution Process*) in the Code, initiation of proceedings for all defaults/debts arising under the Insolvency and Bankruptcy Code, 2016 (“**Code**”) on or after 25<sup>th</sup> March 2020 (“**cut-off date**”) for a period of 6 (six) months, or for such other period, not exceeding one year from such date, as may be notified, stand suspended. Vide the Ordinance, Section 66(3) has been inserted in the Code to prevent a Resolution Professional from filing any application under sub-section (2) of Section 66 in respect of any such default against which initiation of corporate insolvency process has been suspended as per Section 10A.

The Ordinance forms a part of the stimulus package announced by the Hon’ble Finance Minister on 17<sup>th</sup> May 2020, specifically to boost Micro Small Medium Enterprises (“**MSMEs**”), a sector which contributes 7% to India’s GDP while accounting for 45% of the total manufacturing output and 40% of the exports from India. The effect of the Ordinance and suspension of Corporate Insolvency Resolution Process (“**CIRP**”) under the Code ought to be read along with the Reserve Bank of India’s (“**RBI**”) stimulus package announced on 27<sup>th</sup> March 2020 and 17<sup>th</sup> April 2020. The RBI introduced measures to ease the financial stress on Indian businesses which *inter alia* include loan moratorium for a 6 (six) months period commencing from 1<sup>st</sup> March 2020 until 31<sup>st</sup> August 2020 (“**moratorium period**”) and stand still on asset classification (the 90-day period for classifying Non Performing Assets norm shall also exclude the extended moratorium period).

In our earlier news alert titled, [\*‘Debts, Diseases and Default- Revision of the threshold for default under the Insolvency and Bankruptcy Code, 2016’\*](#), we had *inter alia* analysed the impact of suspension of proceedings under Section 7 (Initiation of corporate insolvency resolution process by financial creditor), Section 9 (Application for initiation of corporate insolvency resolution process by operational creditor) and Section 10 (Initiation of corporate insolvency resolution process by corporate applicant) of the Code.

In this alert we attempt to examine the Ordinance in the first part and the effect of the suspension implemented on both creditors and debtors in the second part.

## 1. Section 10A - Suspension of Corporate Insolvency Resolution Process

In her address to the nation on 17<sup>th</sup> May 2020, the Hon'ble Finance Minister stated that no fresh insolvency proceedings can be initiated for up to one year. This announcement was formalised vide the Ordinance.

The text of the Ordinance clarifies that the blanket suspension of CIRP only pertains to defaults that have occurred on or after the cut-off date, i.e. 25<sup>th</sup> March 2020 for a period of 6 (six) months or for such other period, not exceeding 1 (one) year from such date, as may be notified.

### A. Rationale

The statement of objects and reasons in the Ordinance inter alia declares that the Ordinance is promulgated to combat the uncertainty and difficulty faced by businesses, *for no fault of their own*. The Ordinance also notes (i) the difficulty in finding an adequate number of Resolution Applicants who are available to salvage corporate persons defaulting in discharge of their obligations and (ii) that the nation-wide lockdown in force since 25<sup>th</sup> March 2020 has added to the disruption of normal business activities.

The Ordinance provides that it would be expedient to suspend CIRP under the Code to prevent corporate persons which are experiencing distress on account of the current unprecedented situation, from being pushed into insolvency proceedings under the Code. This shows that vide the Ordinance, the government has sought to justify the suspension not only as an economically equitable solution but also a practical one.

### B. Language

Section 10A provides for a qualified suspension of CIRP subject to the following factors:

- a) Default on or after the cut-off date,
- b) Time period of suspension: a period of 6 (six) months but not exceeding a year from the date, subject to notifications ("**suspended period**").

Interestingly, the proviso to Section 10A states that no application shall *ever* be filed for initiation of CIRP for defaults occurring during the suspended period thereby suggesting that a default during the suspended period cannot be prosecuted under the Code.

Whilst one would ordinarily expect the suspended period to serve as an extended credit period for the corporate debtor, the proviso's language provides emphatically that a default arising during the suspended period cannot be prosecuted at all under the Code. The contradictory language in Section 10A and the proviso, make it difficult to assess whether permanent suspension of 'COVID-19 related debts' is the intended effect of the Ordinance.

### **C. Effect**

Instinctively, the first cause and effect analysis of the suspension of CIRP would be in respect of corporate debtors vis-à-vis creditors. However, due consideration ought to be given to the following categories of persons (corporate and individual) as well and the effect of suspension of CIRP on them:

#### **i. Corporate debtors prior to the cut-off date:**

Distressed corporate persons prior to the cut-off date find no relief in the suspension of CIRP as they do not qualify to have 'COVID-19 related debts.' It is pertinent to note that the cut-off date is one day after the national lockdown was announced by the Hon'ble Prime Minister. However, many states imposed partial lockdowns prior to the Central Government's decision. In view of the same, Section 10A yields no relief to parties which were unable to comply with their obligations prior to the national lockdown and are equally affected by COVID-19.

#### **ii. Small Lenders**

The Ordinance is lopsided as it has failed to consider the effect of suspension of CIRP for lenders who may not survive the burden of unpaid debts. The Ordinance was also announced in the stimulus package to protect MSMEs. However, the Ordinance has failed to consider the role of MSMEs as lenders/operational creditors and other groups which are likely to be adversely affected *viz* small businesses/operational creditors.

#### **iii. Applicants under Section 10 of the Code**

Suspension of CIRP for those corporate applicants who would voluntarily want to subject themselves to CIRP are left with no recourse under the Code for debts which occurred on or after the cut-off date. Denying a debtor's freedom to exit a bad market situation maybe counterintuitive to the purpose for which the Ordinance was issued.

The effect of the suspension will also cause stress on an overburdened financial system, with financial institutions already grappling with stressed assets and an economic

slowdown. An unwarranted by-product of the Ordinance shall surely be the ‘opportunistic debtor’ as it is likely to give rise to opportunistic debtors who may well have been equipped with the ability to discharge their debt but will now seek refuge under the Ordinance and escape the CIRP process.

Whilst the intent of passing the Ordinance is certainly laudable and will effectively protect a large number of distressed corporate debtors, its one-sided nature may not be suitable for all parties who are suffering in the current economic climate. The ambiguity in the proviso also leaves scope for confusions. It is unlikely that the intent of the Ministry is to provide any permanent or blanket protection vide the Ordinance, however the same is likely to be resolved by judicial interpretation in the future.

## **2. Section 66(3) (Amendment to Section 66)**

Section 66(3) has been inserted in the Code barring Resolution Professionals from filing an application under Section 66(2) (*Fraudulent and wrongful Trading*) to supplement Section 10A. The insertion of the said section may give rise to a situation where directors of the corporate debtor are immune from any mala fide actions committed during the suspended period. The amendment effectively robs the Resolution Professional of his right to file a bona fide application under Section 66(2) and allows the Directors a free hand to act as they please. This could be counterproductive to the objective sought to be achieved through the amendment.

## **3. Remedies available to Creditors**

With the suspension of CIRP under the Code, creditors will revisit their legal options and may choose to resort to the following remedies instead of invoking the provisions of the Code:

- A. Financial Institutions such as commercial banks and non-banking financial companies etc may resort to the *Prudential Framework for Resolution of Stressed Assets* issued by the RBI on 7<sup>th</sup> June 2019. This framework *inter alia* requires banks and financial institutions in India to act promptly for resolution of accounts in ‘financial difficulty’. Further, the *Master Circulars on wilful defaulters* issued by the RBI on 1<sup>st</sup> July 2013 and 1<sup>st</sup> July 2015 will also serve as a guiding light to banks/financial institutions issuing loans or other financial facilities. These circulars comprise of guidelines to identify ‘wilful defaulters’ and report them to the RBI, the Securities and Exchange Board of India and caution other banks and financial institutions ensuring further bank finance is not made available to such defaulters restrict their access to the capital market to raise funds. However, these guidelines will be subject to the concessions provided by RBI under the moratorium period.
- B. Secured Creditors will take recourse under the provisions of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

subject to the concession provided by RBI under the moratorium period.

- C. Unsecured and other operational creditors with unpaid debt will have to resort to litigation and alternate dispute resolution for the recovery of these debts.
- D. Section 230 of the Companies Act 2013 may also aide all classes of creditors and distressed companies who cannot avail of Section 10 of the Code during the suspended period. Section 230 provides for *Power to Compromise or Make Arrangements with Creditors and Members* which also includes reorganisation of share capital of the Company. As opposed to the CIRP process of the Code which is creditor driven and time bound, the scheme under Section 230 states that compromise can be arrived at between ‘any class of creditors’ and includes the management of the Company making it an inclusive and collective process. The scheme once approved by the prescribed majority is then submitted to the National Company Law Tribunal subject to other provisions of the Companies Act 2013. The process of application and submission of a scheme arrived at under Section 230 is governed by *the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016* Though the provisions of Section 230 have largely been used in mergers and amalgamations it remains a viable option for all classes of creditors and distressed companies for debt restructuring.

#### 4. Conclusion

The provisions of the Ordinance read with the Gazette Notification dated 24<sup>th</sup> March 2020 have brought substantial changes within the framework of the Code. The minimum threshold for initiation of proceedings under the Code stands increased and the right to initiate proceedings for defaults which have occurred during the suspended period stand revoked; unless the proviso is interpreted by judicial authorities to only entail a suspension of such right.

With the suspension of CIRP under the Code, parties must adopt a practical solution for dispute resolution which ought to be cost effective and expeditious. In our opinion, parties may find it financially and commercially prudent to take aide of the forms of settlement and amicable dispute resolution mechanisms available within the civil and commercial law frameworks in India to that end.

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