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Suspension of Proceedings under IBC, 2016 vis-à-vis IBC Ordinance,

2020- A Critical Analysis

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This article is written with an intention to analyze the consequences of the decision taken by the Government of India, to suspend IBC proceedings initially for a period of six months, which may be extended by a year¹ which has been enforced vide Ordinance dated June 4, 2020, notified on 5.6.2020. The intention behind the Ordinance, is definitely to grant some relaxation to the Corporate Debtors/small scale businesses, which might have suffered severe economic downfall due to the pandemic (Covid-19).

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Legislative-intent vis-a-vis the Ordinance

One should examine the provisions already existing in order to get a better understanding of what may be the outcome, which in all probability would be against the very object behind the Insolvency and Bankruptcy Code, 2016 (*hereinafter as “the Code”*) as enacted by the Parliament.

The admission of a petition under the Code, in a general practice is triggered against the corporate debtor who was ‘unable to pay debt,’ either “financial” or, “operational,” to the creditor within a prescribed time limit as per the terms of an agreement/understanding entered upon between the parties.

Now, let us analyze the direct impact on the stakeholders in particular, and the mechanism of the relationship between a debtor and creditor in general while the

¹ Section 10A IBC, 2016 inserted vide Ordinance dated 5.6.2020.

economy is reeling due to the lockdown because of the wide-spread pandemic (Covid-19).

The Ordinance dated June 4, 2020 passed by the Union Government in the present scenario where the relief granted to the corporate borrowers i.e. Debtors will be two-fold, namely:

- Minimum payment default threshold for triggering bankruptcy proceedings to be raised to Rs. 1 crore.
- To have provisions in the law to exclude all debt associated with pandemic from defaults covered under IBC for the next one year.

Therefore, there shall be no bankruptcy proceedings against the corporate debtors for 6 months and if the suspension is extended then extended till 1 year for not having paid the debt owed by them to the corporate lenders for business related transactions so that they are not dragged to the judicial tribunals and have to face the wrath at the hands of the law whilst trying to revive their losses and step on their feet. It was further announced that it is not only the high-stake corporates that might incur the benefit, rather it is the small-scale businesses namely Micro, Small and Medium Enterprises (*hereinafter as 'MSME'*) who are going to incur the benefit under this new umbrella provision.

It has further been said that in order to qualify as a 'default' under IBC, the amount has been increased from Rs. 1 lakh to Rs. 1 crore for a company, which is an added leverage given as one of the economic boost to the company². The intention of the executive government to enact the Ordinance seems to stem from the necessity to protect the financial sector and business houses from the wrath of IBC. The triggering factor behind this major announcement was that "many businesses got severely affected by the lockdown and the coronavirus pandemic. Any debt which is incurred or a situation (of payment default) comes up for companies because of the Covid-19 on or after

² Notification dated 24.3.2020.

25.3.2020 for a period of six months extendable for a period of another six months (One Year in total), then they shall not be included in the category of defaults (under IBC).

Examination of the Ordinance

In an attempt to critically examine the Ordinance dated June 4, 2020 by the Hon'ble FM, we need to gauge the idea that though the proceedings under the Code have been suspended for minimum 6 months and maximum 1 year, but such an act in haste is not two-dimensional at all. In order to substantiate the above statement, we would like to pull out certain ambiguities that might result in unintended consequences.

1. There is a need of certain guidelines to create a better understanding as to what constitutes debt related to the Covid-19 crisis and whether the suspension of proceedings also covered existing insolvency cases referred to the National Company Law Tribunal (*hereinafter as 'NCLT'*) but could not be taken because of the nation-wide lockdown across the country.
2. The other probable interpretation could be that default on loans taken under the Covid-19 relief measures will not be counted as 'default', and if the former is true, extension of the suspension of fresh insolvency proceedings beyond a year would be an obvious outcome.

Illustration

Let us consider A, a company owes an Operational debt amounting to Rs. 3 crores on 18th April to B, an Operational creditor which he has promised to pay by the end week of June positively.

So, in case of failure of repayment of the loan amount by A to B, the latter will be left with an option of approaching the NCLT, in normal course, i.e. initiate the proceedings.

Now, firstly, the Ordinance will not let B initiate any proceedings against A and secondly, the count of a year would only begin once there is a default by the month of

July and might stretch beyond the cap of 1 year as granted by the Ordinance recently brought into force, further bringing ambiguity in the implementation of the said provision.

Conclusion

On an in depth analysis of the situation caused by the Covid-19 crisis *vis-a-vis* the falling GDP, we have arrived at the conclusion that there was absolutely no need of passing an ordinance on suspension of IBC proceedings for six months. It is to be further noted that that on 29th March, IBBI inserted a new Regulation 40C in CIRP Regulation, 2016 to exclude only the time of activities prescribed under Regulation 40A and other CIRP regulations .i.e. the entire period of lockdown shall not be counted for the purposes of calculation of timeline (limitation, in other words) for any activity that could not be completed due to such lockdown, in relation to a CIRP.

The ordinance would jeopardize the object and purpose of the IBC since the ultimate consequences are catastrophic. Undoubtedly, this would obviously incentivize the loans taken by the companies, but it will further overburden the economy with concentration of money within the group of entities and stall the process of 'movement' of money within the market since it is a well established market economics that if Inflation was a monetary phenomenon, then controlling the supply of money was the route to low inflation.

Secondly, this process will discourage the debtors to pay back the amount that they owe to the debtors for one reason that *their* inaction will not attract any prescription under IBC and they can purposefully cause the delay and make good the losses caused to them, in isolation to the effect that it might cause otherwise.

Thirdly, since the proceedings can only be initiated when only after a year, it might lead to plethora of cases being filed against the company immediately after this protection cease to exist, and this will further burden the tribunals and courts and create pressure

on them for them to decide on a company's liabilities and it being a 'going concern'. Further, it might further instill the fear amongst the creditors to support any small/big businesses and this will hamper the economy for long.

The best possible way to implement such ordinance would be to do it in brackets, and not make it an umbrella provision for all, for the reason being, it has to be done with an intention to save the economy. In our view, this step taken by the government amongst other relief measures are a company-centric approach and may not be much appreciated by the creditors and will not be able to 'flatten the curve'.

The legislative framework of Insolvency and Bankruptcy Code, 2016 and the Ordinance passed to address the extraordinary situation of a pandemic-induced lockdown are not in consonance with each other. In the absence of a well-established framework for the limitation of such proceedings, creditors are vulnerable to the repayment of the default amount and has to forgo their rightful entitlements.



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