



BALANCING INTERESTS OF STAKEHOLDERS UNDER IBC, 2016 AND IMPACT OF COVID-19

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ABSTRACT

The Insolvency & Bankruptcy Code, 2016 (IBC) was enacted to bring all the troubles and shortcomings which existed in the staggered insolvency laws in India under one Umbrella. The main objectives behind the Insolvency and Bankruptcy Code (IBC) is to maximise the value of assets of insolvent corporate person, reassure entrepreneurship and obtainability of credit, and balancing the interests of all stakeholders. The value of an assets of insolvent entity *ipso facto* depreciates with time. Hence, the best way to preserve its value is by resolving the entity's insolvency at the earliest. But while the course of resolution, it is significant to balance the interests of all stakeholders, which certainly demands a fair and justifiable obligation of the dynamics between stakeholders and the entity. The focus during the whole resolution and liquidation process also highlights the objective to minimise the loss to the stakeholders.

This paper studies distinguish feature of the IBC, 2016 in order to safeguard/balance the interest of stakeholders. The study is descriptive in nature to depict the *modus operandi* during the resolution process with the help of case to case analysis and to describe the brief objectives which an IRP has to keep in mind to reduce the loss during the Liquidation process. This paper also deals with the impact of COVID-19 as a global pandemic on the Insolvency and Bankruptcy proceeding in India.

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INTRODUCTION

The Insolvency and Bankruptcy Code, 2016¹ (hereinafter IBC, 2016) is the only law in India which deals with the insolvency and bankruptcy. Banking Sector in India has always faced the problems due to indebtedness, insolvency and bankruptcy. Safeguarding an ideal flow of cash is the key factor to the smooth and proper functioning of the banking sector and sustaining numerous stakeholders. This is one of the foremost reasons behind the idea that why it is necessary to have the monetary soundness and reliability in the economic market which contain the weed of the insolvency. Although there were many codified Acts and laws which used to govern and regulate the recovery of debt in India like SARFAESI Act², RDBFI Act³, SICA⁴ etc. Also, during the British Rule in India, there were Acts⁵ codified to deal with the insolvency process while for the individual insolvency there were provisions under the Code of Civil Procedure, 1908 but the mechanism of dealing with the matters related to insolvency and bankruptcy went through a most significant reform due to enactment of the IBC, 2016.

The IBC, 2016 is a landmark development in the dynamic world of resolution of stressed assets laws in India by repealing and amending several legislations and creating a single comprehensive law to deal with the insolvency and bankruptcy in India. Insolvency can be defined as the financial and accounting concept wherein the entities liability exceeds its assets whereas bankruptcy is a legally declared inability of an organization or an individual to pay off his debt to the creditors.

Indian Economy is with no doubt, straddled with massive Non-Performing Assets or NPAs in the financial sector and the false balance sheets deficit problem is distressing the banking sector and looking at current scenario, the country's banking sector is going through a difficult time. IBC, 2016 has ensured the resolution and revival of the companies in a justified and time bound manner. It is apt to say that this Code, since its inception i.e. in its

¹ Insolvency & Bankruptcy Code, 2016, No. 31 Act of Parliament, 2016.

² Securitization and Reconstruction of Financial Asset and Enforcement of Security Interest Act, 2002.

³ Recovery of Debts Due to Banks and Financial Institutions Act, 1993.

⁴ Sick Industrial Companies Act, 1985.

⁵ Provincial Insolvency Act, 1920 & Presidency Towns Insolvency Act, 1909.

short time span has shown the reliability, credibility on the law by fulfilling and justifying the purpose of its enactment and provided a ray of hope amongst the various stakeholders.

The basic thinking behind the code is to keep financially distressed corporates as going concern and provide maximum benefit to all the creditors embracing both the financial as well as operational creditors and to safeguard the interests of stakeholders in the distressed company. The failure in business or the corporate failure affects the entire the hierarchy of the stakeholders of the company. This failure inclusively affects the financial lenders & creditors, operational creditors, suppliers, stakeholders, workers, customers, and also the state and central government. That is why it is necessary to safeguard their interests by optimizing the total value and assets of the company in the profitable manner.

In the matter of Prowess International Pvt. Ltd. Vs. Parker Hannifin India Pvt. Ltd.⁶, the Hon'ble NCLAT held:

“...in the circumstances, instead of interfering with the impugned order, we remit the case to the Adjudicating Authority for its satisfaction whether the interest of all stakeholders have been satisfied and whether one or other creditor has not raised any claim like Punjab National Bank, after giving notice to individual claimant and taking into consideration of Insolvency Resolution plan and report of the Insolvency Resolution Professional as may be prepared, the Adjudicating Authority may close the proceedings”⁷.

⁶Company Appeal (AT) No. 89 of 2017

⁷ Id.

INSOLVENCY AND BANKRUPTCY CODE: “PURPOSE”

The IBC 2016 was enacted with several objectives. The objectives laid down under the code are intended with following most important points:

1. Resolution or revival of the companies making default⁸ in discharging liabilities or corporate debtor.
2. Maximisation of value of assets of the corporate debtor so as to provide maximum benefit to all the creditors.
3. Promotion of entrepreneurship.
4. Availability of credit balancing the interests of all the creditors.

MODUS OPERANDI FOR INSOLVENCY & BANKRUPTCY

The following are the modes of operation defined under IBC, 2016 to suffice the purpose:

(a) Corporate Insolvency Resolution Process (CIRP): A corporate has mainly two sources of funds, namely equity and debt, provided that if the corporate is not financial service provider. Usually, the equity owners' controls and run the corporate. If the owners of equity fails to service the debt, the default will lead the corporate to undergo through the process of CIRP, for which a professional, known as Insolvency Professional carries on the business of the corporate until the Committee of Creditors draws up a resolution plan so that the business shall flourish and the corporate doesn't have to stop functioning. During the process, it is the responsibility for the Insolvency Professional as well as the Committee of Creditors to not only ensure the maximisation of the value of the assets of a corporate but to also bring the balance and equilibrium in the interests of all the stakeholders of that corporate.

As per section 13 & section 15 of the IBC, 2016, there shall be a requirement of a public announcement making a call for the submission of claims. While the Section 18 clause 1 of IBC, 2016 requires the appointed IRP to collect all the claims submitted by creditors. IBC

⁸ Section 3(12) of Insolvency & Bankruptcy Code, 2016 defines “default” as *non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not repaid by the debtor or the corporate debtor, as the case may be.*

separates the profitable aspects of Insolvency Resolution from legal aspects and hence, permits stakeholders and adjudicating authority to resolve matters within their sphere efficiently and effectively at the soonest.

After the approval of resolution plan by the Committee of Creditors, it is then submitted to the adjudicating authority for their approval as per the section 31 of IBC, 2016. As soon as the Adjudicating Authority approves the plan, it is binding in nature on the employees, creditors, guarantors, members, and other stakeholders along with the corporate debtor in the plan. Keeping the preamble of IBC in the mind, as NCLAT stated which has been mentioned before, it is a dire need for Adjudicating Authority to satisfy themselves regarding the balancing of the interest of all stakeholders, before the approval of resolution plan, which if not satisfied may dismiss the plan and set out the corporate for the liquidation. Thus, CoC plays a vital role and are obliged to reflect their welfares in the resolution plan up to such necessary measures for balancing the interests of stakeholders.

But if a corporate debtor goes for liquidation, then the clause 2 of section 35 of IBC, 2016 sanctions the liquidator to take advice or consult with any of the stakeholders permitted to a dispersal of proceeds as per section 53 of IBC, 2016. However, the IBC, 2016 allows the Board to provide higher protection for the stakeholders. There are several instances where the tribunal added the meaning and widen the ambit of the word stakeholders and also the home buyers were recognised as the stakeholders⁹. This showed that the home buyers are also the stakeholders, now it is upto the IRP to decide whether he will fall in the category of Financial, Operational or other creditor, based on circumstances.

Previously the corporate debtors who were defaulting since long would come up with the idea of resolution for which the value of liquidation most of the cases were insignificant for the Operational Creditors, enabling the creditors to lose much during the CIRP. Hence, during the consideration of the decision of the Financial Creditors, which also constitutes the Committee of Creditors, the Board seek the apt impact to provide the protection to the other stakeholders as per the section 30(2)(b) of IBC and choses whatever deems fit to maximise the asset value, whether it is resolution process or liquidation.

Generally, it is more convenient to envisage the resolution within the concerned corporate defaulter, as shutting of the firm ends the working capital and reduce sassets and resources

⁹ Prabodh Kumar Gupta vs. Jaypee Infratech Limited and Othrs., Co. Pet. No. (IB)68/Ald/2017 (NCLT, Allahabad)

idle till rearrangement to their substitute uses. The legal framework of IBC, permits and enables the stakeholders to complete the resolution process within time period and supposes the top possible resolution. Hence, IBC permits anyone and everyone, counting the shareholders (including promoters) and the corporate debtor, to suggest the best resolution plans and also authorizes the Committee of Creditors to choose the best out of them. This may lead to boundless opportunities of resolution. A resolution plan, regardless of its method and content, signifies a maximised value for all stakeholders of concern debtor. As it is the main objective of each resolution plan to maximise the cumulative worth, which is generally expressed in financial terms.

Issues to focus upon for value maximisation:

1. It depends upon the number of partners or applicants in the resolution. As it is directly proportional to the price maximisation. Hence, it requires to welcome the as much as possible participation by all potential resolution applicants.
2. There shall be legal certainty as a resolution applicant may bid the best value if it is entitled with clean rights upon the regulation, control and assets of the corporate debtor, leading it to be in a situation to use the resolution plan effectively.
3. Implementation of resolution plan may require further consents and approvals as per the law from stakeholders or adjudicating authorities.
4. The prevailing promoters as in their advantageous position as they are aware of the accurate situation of the corporate debtor and may derive a better and realistic resolution plan as per their knowledge.
5. Generally, the big CIRP transactions and businesses consist a number of consultants and advisers, they involved with the resolution professional and with financial creditors.
6. The cost under IBC shall be cost effective because if it is not then the stakeholders may not like and deny using the plan, especially when they have further choices to attain the same result through a different resolution plan.

(b) Corporate Liquidation Process (CLP): The initial stage in an insolvency resolution of a corporate is to make every possible effort to revive and restart the corporate. For this, an effective resolution plan must be enforced, else, liquidation shall come into process. In certain cases, where the resolution is not possible, and the corporate debtor is declared insolvent and it may need to go out with the minimum disruption cost while leaving and releasing the resources in proper manner for new allocation for the better and efficient uses. IBC, 2016 states a procedure for liquidation and make sure to avail a liquidator to conduct the procedure. IBC, 2016 authorizes the liquidator to sell off the movable and immovable properties and unlawful claims of the corporate debtor in liquidation through bidding, public auction or private contract. The regulations by IBC, 2016 empowers the liquidator to either sell an asset on a separate basis or sell off the assets in a slump sale. It is essential and required to enable the expansion of a market mechanism enabling the competitive bids, tenders or offer to purchase assets and the sale of the asset to some highest buyer, so that the main objective shall be fulfilled of getting the maximum realisation for the stakeholders.

During the process of liquidation, the official liquidator has to keep in mind that if the value of claims of customers is substantial or higher than those of Operational or Financial Creditors than such corporate debtors should not be permitted to be liquidated, which prima facie means, that the corporate debtor has to fulfill his obligation towards his customers before getting into liquidation.

Asset Memorandum:

The IP or Liquidator prepares a list of stakeholders, on the basis of claims as per the proofs submitted and accepted. After this, at the initial stages, they shall prepare the asset memorandum in accordance with the regulations of Insolvency and Bankruptcy Code, 2016.

The asset memorandum shall provide the following details in respect of the assets which are intended to be realized by way of sale:

- a. value of the asset,
- b. value of the business.
- c. intended manner of sale.

- d. the intended mode of sale.
- e. expected amount of realization from sale.
- f. any other information that may be relevant for the sale of the assets.

Stakeholders do have certain rights and privileges in these processes. Financial creditors although have a right to prompt a CIRP and join the Committee of Creditors (CoC), which approves the resolution plan¹⁰. In certain circumstances, operational creditors also have a right to prompt a CIRP, as well as a right to join the CoC, along with a right to attend but not vote in the meetings of the CoC, and a right to the repayment of their debts which shall not be less than the amount which is to be paid to them in the event of a liquidation of the corporate debtor.

IBC, 2016 make best use of the value by protruding an equilibrium between Resolution and Liquidation. It reassures and eases resolution in most cases where creditors would obtain at least as much as the liquidation.

IMPACT OF COVID-19 ON PROCEEDINGS UNDER IBC, 2016

The world has seen of the greatest pandemic in recent times. As soon as there was outburst of the pandemic Novel Coronavirus or COVID-19, Indian Government announced a nationwide lockdown on 24th March 2020. The Ministry of Home Affairs, through its order dated 24th March 2020 has issued certain directions which followed the closure of majority of Government and private offices and other commercial establishments barring a few essential services. As a result of this country wide lockdown, Corporates and all the co-related stakeholders and creditors faced the imminent threat of financial crisis.

Impact of Coronavirus not only pushed the government to deal with medical and health fringe but also at the financial back foot. To battle with the financial crisis faced due to the COVID-19 there were several steps taken such as increasing the threshold of default to the start the insolvency and resolution process against companies under the IBC, 2016. Considering to suspension of filing of fresh applications filed by creditors or companies under Section 7, Section 9 and Section 10 of the IBC, 2016 so that the companies shall not

¹⁰Arcelor Mittal India Private Limited v. Satish Kumar Gupta (2019) 2 SCC 1.

face the and forced into insolvency during such tough times.¹¹National Company Law Appellate Tribunal took a *suo moto* action and ordered on 30th March 2020 providing the directions about the exclusion of the time period of lockdown from the mandatory period of CIRP¹².

In view of this severe pandemic, the IBBI amended the regulations governing IBC, 2016 by announcing the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Third Amendment) Regulations, 2020 (the "Amended CIRP Regulations, 2020") w.e.f. March 29, 2020. These regulations states that this period of the nation-wide lockdown shall not be counted in calculating the limitation period for any activity for a corporate insolvency resolution process. IBBI also excluded the said period of lockdown from counting the limitation period for liquidation process through amendment in the Regulations in Liquidation Process.

On 12th May 2020, Indian PM announced a whopping amount of 10% of India's GDP to tackle the situation amidst the upsurge of Coronavirus in India. The said package of almost Rs. 20 Lakh crores is intended to bring aid and relief to various sectors and economy as well as protecting the interest of the stakeholders. The following are some key measures announced by the Indian Finance Minister:

- Announcement of special framework for insolvency resolution for MSME sector under section 240 of IBC, 2016.
- Suspension of fresh insolvency proceedings for 1 year.
- Exclusion of "COVID-19 related debt" from the definition of default under IBC, 2016.

After this, the confidence of investors and stockholders was shaken. Insulating the MSME sector has mostly affected the medium & small enterprises as this sector shares the 1/3rd of the total GDP of the country. In view of Finance Minister, these steps have been taken so that the corporates shall not be dragged into tribunals at such time of huge health & economic crisis.

¹¹ The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, No. 9 of 2020.

¹²*Suo Moto* - Company Appeal (AT) (Insolvency) No. 01 of 2020.

Suspension of proceedings under section 10 of IBC, 2016 may face new challenges as it violates the basic idea behind the Code which is to enable the corporates to survive and revive even after they default benefiting both the debtors as well as the creditors by focusing on the maximisation of the assets.

Just when the debtors realised that the old ways are not going to continue for the default, when the Insolvency and Bankruptcy Code, 2016 was begun to succeed, this pandemic situation happened and the Government was forced to rely again on the corporate sector, hence providing several relaxation now may affect the confidence of the lenders. This may lead to the increase in the level of stressed debt for the banking sectors as unscrupulous borrowers may take the undue advantage of these relaxation. These announcements and relaxation by the government has promulgated the fear and confusion in the minds of stakeholders. This has created a dilemma in the minds of investors about their stressed money as it may further delay the process of getting the credited amount back.

Furthermore, in view of the ambiguity triggered by the global pandemic, the companies that are currently going through the CIRP would perhaps find it problematic to gain interest of resolution applicants. In cases, where a resolution plan has been submitted by the resolution applicant and is awaiting for the approval of the Committee of Creditors or the Adjudicating Authority, the resolution applicant may pursue or look for certain amendment of the resolution plans which has been duly submitted or annulment of the process of submission/finalisation as the assessments and feasibility of businesses is likely to be harshly affected due to the COVID-19 outbreak.

Though the recent announcements have being welcomed by certain sectors as it may reduce the burden of the NCLTs throughout the country and also possible alternative to protect MSMEs from these worries and the outbreak of COVID-19 is making the notification applicable only for the prescribed time of crisis as has been done by Singapore in their urgent legislation brought into immediate effect titled COVID-19 (Temporary Measures) Act, 2020¹³. Not only in Singapore but almost every country which has been affected by COVID-19 took several relief measures just like Singapore and India. The U.S. Government has signed into the statutes regarding the Coronavirus Aid, Relief, and Economic Security (the CARES Act), which will provide the effective bankruptcy relief to majorly small

¹³ COVID-19 (Temporary Measures) Act, 2020 (Singapore).

businesses and individuals, as the threshold for filing for insolvency seems to have increased.¹⁴ Australian Parliament on the other hand passed a Response Act¹⁵ amending various laws subject to temporary in nature for the COVID-19 situation. These amendments have made their ways to provide the aid and relief by increasing the threshold for initiation and increasing the deadline from 21 days to 6 months for a company to respond to a creditor's initiation of bankruptcy.

CONCLUSION

While providing relaxation to the corporate debtors by the Government and giving protection to the viable business from being fallen in to insolvency, there were few measures which were not considered and measured by the Government in the various niceties.

After the relaxation or lifting up the suspension, the government need to make sure that the rights of creditors are interestingly taken care of and the consequences of the suspension shall be dealt with, in a proper manner or else, it may defeat the core objectives of the IBC for which it has come into its initial existence. As several adjudicating authorities not functioning, the stakeholders are powerless to approach any tribunal or forums for any instant relief, also there is no remedial procedure for the stakeholders to seek extension of CIRP, Resolution Plan's approval, liquidation of the corporate defaulters, or for any genuine aid in prolongation of the CIRP. There are several appeals by resolution applicants looking for more time in proposal of resolution plans, as outstanding thoroughness, several site visits and investor summits are all harshly obstructed.

In relation to the concerns in the mind of stakeholders', the insolvency regulatory authority i.e. the Insolvency and Bankruptcy Board of India, has recently through amendment, provided that this timeline of lockdown will not be calculated to determine the timeframe of any motion in the CIRP prescribed under the regulations.

As in adherence to this, the Appellate Tribunal took a *suo moto* action and ordered on 30th March 2020 providing the directions about the exclusion of the time period of lockdown from the mandatory period of CIRP. Now, this has put several concerns in the minds of

¹⁴ Coronavirus Aid, Relief, and Economic Security Act or the CARES Act, 2020 (United States of America).

¹⁵ Coronavirus Economic Response Package Omnibus Act, No. 22 of 2020 (Australia).

stakeholders regarding their share of recovery. At this time of crisis, there is an utter need for the flag bearers to take the up the call and necessary action as per the law to ensure the best interest of all the stakeholders. Right now, the corporates are battling with the economic crisis and the struggle to balance the interests of stakeholders and companies will remain constant. The need of hour is a legal framework and proper execution of the regulations which shall caters to the creditors and corporate debtors on the same page and bring out the balance and equilibrium among various stakeholders.

