REFORMS IN THE INDIAN INSOLVENCY AND BANKRUPTCY PROCEEDINGS TO ADDRESS THE CHALLENGES IN THE POST COVID-19 ECONOMY

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ABSTRACT

The 'Wuhan virus' which has created a global pandemic claiming lives all over the world in hundreds and thousands and has not limited its destruction to human lives but has impacted the global economy in a decisive manner. Trade, business and commercial proceedings have come to a standstill due to the market forces of demand and supply being skewed. The plight of businessmen in these economic times is manifold. Difficulty in continuing business operations in a lockdown economy coupled with the challenges of financial distress have led to many small scale as well as larger business organizations to force shut and declare insolvency.

In these desperate times, it is necessary for the Government of India to cater to the needs of both loss-making creditors as well as distressed debtors. It is imperative to strategize corporate reforms to be able to breathe life into the Indian economy. While the world is rapidly edging close to a global recession, the only way one can save the staggering Indian economy is by awarding concessions and relief schemes along with changes in the legal framework. This would require careful planning as the interests of all the stakeholders must be equally safeguarded.

This article discusses the proposed reforms to the present Insolvency and Bankruptcy Code, 2016 by the Government of India in an attempt to provide a conducive business environment in India even in the midst of a health crisis. Whether increasing the threshold of debts on which one can initiate an IBC proceedings and extending the moratorium period are sufficient to save corporate houses from winding up is an important question. This article seeks to analyze the potency of the amendments and policy decisions in a post Covid-19 insolvency regime and to what extent such legal framework balances the interests of all stakeholders.

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INTRODUCTION

In January, 2020, the world was struck by a global pandemic unique in nature. When the Covid-19 virus started spreading worldwide in the early months of 2020, affecting thousands of people, it brought along with it a shroud of uncertainty and mystery. This is because researchers and experts were unable to determine the attributes and behavior of the unique virus in the human body hence both its vaccination and eradication plans seemed indefinite and the timeline for the same was unpredictable.

The global pandemic has decisively changed the fate of many futuristic agendas and plans of companies, governments and individuals. In an attempt to tackle the impact of Covid-19 on trade, business and the economy, governments and organizations had to change their plans and strategies drastically to cushion the adverse effects of this virus on businesses and its eminent economic threat. On the one hand this health crisis has acted as a catalyst to change the course of certain legislations and policies and on the other hand it has been an obstacle to many governance policies which were under construction and business strategies in the pipeline for organizations.

One such important change that is being closely observed by the legal fraternity is the impact of Covid-19 on restructuring the Insolvency and Bankruptcy Code, 2016*(hereinafter referred to as IBC)*. The Central Government in exercise of its powers under section 4 of the Act[1]altered the threshold for petitions under section 7, 9 and 10[2] to be admitted in the National Company Law Tribunal *(hereinafter referred to as NCLT)* only if the default is equal to or above Rs. 1 crore amended from the previous amount of Rs. 1 lakh or above. The lockdown period is not to be counted in the stipulated time period[3] within which previously admitted cases are required to be resolved.[4] There are about 2000 such cases which have been filed before the NCLT recently suffering from an indefinite timeline now.[5] The Finance Minister committed that the Central Government is planning to bring about a special insolvency resolution framework for small and medium businesses. Additionally, defaults

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[1] The Insolvency and Bankruptcy Code, 2016, Act No. 31 of 2016, Section 4.
[2] Insolvency and Bankruptcy Code, 2016, Act No. 31 of 2016, Sections 7, 9, 10.
[3] Insolvency and Bankruptcy Code, 2016, Act No. 31 of 2016, Section 1(14).
[4] Quinn Logistics India Pvt. Ltd. v Mack Soft Tech Pvt. Ltd. &Ors. (2018) 208 CompCas 0432.
[5] Press Trust of India Ltd. (2020), *Lockdown period to be excluded from insolvency process timeline: NCLAT,* Economic Times (March 31, 2020, 07:41), https://realty.economictimes.indiatimes.com/news/regulatory/lockdown-period-to-be-excluded-from-insolvency-process-timeline-nclat/74916846.

occurring out of Covid-19 pandemic are barred from admission up to 1 year after the pandemic is over.

All these proposed changes can be considered both as boon and bane. While India is steadily climbing the ladder on the ease of doing business index, globally, the foreseeable repercussions of these policy changes are many. This is because both the makeshift changes as well as the permanent ones in the IBC will impact business in India in a decisive manner. It is essential to map the amendments in the IBC Code of 2016 as a measure against the challenges posed by insolvency and bankruptcy proceedings in the midst of the corona virus crisis. By evaluating the impact of the proposed changes in the IBC Code on businesses operating in India and the Indian economy one can conclude on its impact on individual and groups of stakeholders. While most of the changes suggested for the Insolvency and Bankruptcy Code of 2016 are being welcomed so far by corporate India and is lauded in the present time, it may have probable detrimental effects in the times to come.

REFORMS TO INSOLVENCY LAWS IN INDIA

Covid-19 positive cases were notified in India since the beginning of March, 2020. The Central Government almost immediately made plans centric to social distancing and announced a lockdown on 25th March, 2020 known as the '*Janta Curfew'*.[6] The impact of such a lockdown on the economy was predictable. Therefore, to relieve the businessmen in India who were going to face difficulties in operating their business amidst lesser demand and hindrance to the supply chain along with financial stress and operational debts, the finance minister not only announced amendments to the existing Insolvency and Bankruptcy Code, 2016 but also relaxed various policies revolving around the insolvency procedure in India.

On 24th March, 2020 Finance Minister Nirmala Sitaraman announced the revised criteria for initiating an insolvency proceeding against a corporation.[7] The law under section 7, section 9 and section 10 of the Insolvency and Bankruptcy Code, 2016 initially stated that the threshold for the minimum amount of debt for a financial creditor, operational creditor or a corporate

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[6] Gettleman J. and Schultz K. (2020*), Modi Orders 3-Week Total Lockdown for All 1.3 Billion Indians*, The New York Times (March 24, 2020), https://www.nytimes.com/2020/03/24/world/asia/india-coronavirus-lockdown.html.

[7] Government of India, Ministry of Corporate Affairs, *Notification F. No. 30/9/2020-Insolvency,* March,2020, http://www.mca.gov.in/Ministry/pdf/Notification_28032020.pdf.

applicant respectively, to initiate an insolvency proceeding against the enterprise must be Rs. 1 lakh or more. The default amount has now been set to Rs. 1 crore or more.[8] It must be noted that there were suggestions to increase the default amount in the Insolvency Committee Report submitted earlier in February 2020[9] since the Rs. 1 lakh threshold was considered to be inadequate and resulted in clogging of the Courts and National Company Law Tribunals *(hereinafter referred to as NCLT)* with frivolous insolvency claims. However, the legislative intent behind this action is to protect the interests of MSMEs which are in financial distress due to the lopsided functioning of the economy. While the amendment received positive response, it continues to be unclear on multiple grounds such as its retrospective applicability and whether it is a permanent change.

The Finance ministry backed this alteration in existing law with another policy decision to further support businessmen in debt by declaring on 17th May, 2020 that no fresh application of insolvency would be entertained for a period of 1 year.[10] The time period that was earlier mandated in the Code[11] for disposing existing and on-going cases and applications has now been relaxed. Furthermore, the finance minister declared that a separate insolvency procedure will be formulated under section 240 A of the IBC, keeping in mind the structure of MSMEs and to cater the needs of the small industries.[12] It was declared that debts arising post the onset of the corona virus pandemic would not be included in the definition of *'default'* as is mentioned in the Code,[13] thus barring initiation of insolvency proceedings against debt accumulation in this unforeseen economic condition.[14] All these actions were taken by the finance ministry to provide the much needed safety net to small scale businesses to remain operational in these unprecedented times.

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[8] Mahajan. P, Srivastava. A and Singh. M, *India: Covid-19 Staving Bankruptcy-Recent Reforms,* Mondaq (April 7, 2020),:https://www.mondaq.com/india/financing/914458/covid-19-staving-bankruptcy-recent-reforms.

[9] Government of India, Ministry of Corporate Affairs*, Report of the Insolvency Law Committee,* February, 2020, p.5: http://www.mca.gov.in/Ministry/pdf/ICLReport_05032020.pdf.

[10] Press Trust of India Ltd, *No fresh insolvency to be initiated for one year under IBC: Finance Minister,* Economic Times (May 17, 2020, 03: 24PM),https://realty.economictimes.indiatimes.com/news/regulatory/no-fresh-insolvency-to-be-initiated-for-one-year-under-ibc-finance-minister/75787259.

[11] Insolvency and Bankruptcy Code, 2016, Act No. 31 of 2016, Section 12.

[12] ET Online, *FM provides Covid-19 relief, no fresh insolvency proceeding against MSMEs for 1 year,* Economic Times (May 17, 2020, 04:17 PM)https://economictimes.indiatimes.com/small-biz/sme-sector/fm-provides-covid-19-relief-no-fresh-insolvency-proceeding-against-msmes-for-1-year/articleshow/75785351.cms?from=mdr.

[13] Insolvency and Bankruptcy Code, 2016, Act No. 31 of 2016, Section 1(12).

[14] Butani. M, Upadhyaya. K, *IBC Suspension: Reforms that can fill the Gap, Bloomberg Quint* (May 26, 2020, 01:36PM), https://www.bloombergquint.com/opinion/ibc-suspension-filling-the-gap.

IMPLICATIONS OF THE RECENT INSOLVENCY REGULATIONS ON THE INDIAN ECONOMY- A CRITICAL ANALYSIS

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The reforms to the insolvency regime that have been introduced in the current health crisis scenario can roughly be demarcated into three categories-(a) the increase in threshold of the default limit; (b) the exclusion of covid-19 related debts from the definition of 'default' under the IBC; and (c) the suspension of provisions under the IBC for a period of one year.

While the Central Government has been vigilant, expeditious and proactive in responding to the economic crisis as a result of the global pandemic, a number of critical details have been left out in the planning and policy drafting which at best resolves the short-term problems of insolvency and debt recovery. The reforms have been drafted keeping in mind the 'ease of doing business in India' strategy in tune with the latest 'Atmanirbhar' India campaign. Therefore, the solutions largely remedy the needs of the debtors. This marks a paradigm shift from creditors' rights facilitating insolvency regime to a debtor-centric insolvency framework, in India.

Interestingly, the policies which were formulated to provide relief to the MSMEs are not specific to them. Hence, larger multinational corporate houses can reap the benefit of not having to worry about repayment of loans for an entire year now with the suspension of the IBC. Furthermore, if these corporate houses can prove that the debt accrued to them is due to the Covid-19 pandemic, they can be released from repayment of the entire sum irrespective of the amount due. This in turn will largely affect the liquidity and cash-flow in the economy if large debts accrued in the lockdown period are written off. It is unfair to the creditors whose interests are being violated as they are suffering from the defaults and have no remedies to recover the debt amount.

The notification which raises the threshold of defaults to Rs.1 crore has not accounted for the method of recovery of debts below Rs. 1 crore INR.[15] This is problematic because an amount below the sum of Rs. 1 crore is still a sizeable sum of money loss of which will be detrimental for small lenders and creditors. Without an institutionalized method of recovery of financial debts, immense pressure is placed on the creditors especially when a global recession has been predicted. The lack of safeguards for creditors to recover their money will

[15] Government of India, Ministry of Corporate Affairs, *Notification F. No. 30/9/2020-Insolvency,* March,2020, http://www.mca.gov.in/Ministry/pdf/Notification_28032020.pdf.

deter them from future investments and loaning activities which in turn will adversely affect the economy.

The new regulations fail to address whether debts which had arisen before the pandemic and accrued due to the onset of pandemic will be governed by the new provisions. If the answer is affirmative then insolvency proceedings cannot be initiated against such enterprises making the creditors suffer. Furthermore, there has been no clarity from the Government whether the policies have a retrospective application. The Supreme Court has held in a recent judgment[16] that while procedural law may have retrospective application, substantive laws are not applied retrospectively unless otherwise explicitly mentioned. The NCLT has shed some light on this matter and opined that these policies will not apply retrospectively as they alter the substantive rights of creditors and enterprises under sections 7, 9 and 10[17] to initiate insolvency proceedings.[18] However, comments from the Government on the retrospective applicability are still awaited.

The latest policies on insolvency boost business but may affect the economy in the long run by depriving creditors of purchasing power. The next problem that arises from these reforms is the ambiguity in the time frame for which it will be applicable. There is no clarity on the date of commencement of the one year suspension of the IBC or period of suspension of the prescribed time frames under the IBC for the cases which are already being heard or have been initiated before the NCLT. This lack of clarity in the timelines takes away one of the biggest achievements of the Insolvency and Bankruptcy Code of 2016 in India which was to regulate the insolvency procedure in a time bound manner and provide speedy relief to distressed parties.

This leads one to a very pertinent question as to whether suspension of the Code is a solution to the challenge posed by the pandemic to the Indian economy. This is because at a time that the economy revives and manages to bounce back to normalcy, a large vacuum of debts which is being created now is still going to remain unrecoverable and with these debts not made good the economy will be plummeted to a negative rate of recovery.

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[16] Sangyong Engineering and Construction Co. Ltd. v National Highways Authority of India *(NHAI)* AIR 2019 SC 5041.

[17] Insolvency and Bankruptcy Proceedings, 2016, Act No. 31 of 2016, Section 7,9,10.

[18] Foseco India Limited v Om Boseco Rail Products Limited (CP (IB) No 1735/ KB/ 2019).

The suspension of the IBC has resulted in aggrieved creditors opting for alternate recourses which are far more time-consuming and expensive in nature hence adding to the misery of the creditors. Furthermore, this policy burdens the already overburdened Courts of Justice in India, regressively reverting to the pre-IBC era of long drawn procedures for debt recovery. It is to be taken into account that the suspension of IBC will lead to overburdening of the NCLT by unprecedented number of applications for insolvency once such suspension is relaxed resulting in an ordeal for the economy. The NCLT is already burdened with cases arising out of breaches of Companies Act, 2013 and the Competition Act, 2020 and by adding insolvency cases, speedy recovery of debts which have already been delayed due to the pandemic, will become a distant dream.

Although this article restricts its scope to a discussion on post covid-19 reforms in insolvency laws in India, it is essential to deliberate upon whether these proposed changes to the insolvency laws are in synchronization with the latest banking regulations of the Reserve Bank of India[19] (*hereinafter referred to as RBI*). While both the Ministry as well as the RBI seeks to cushion the effect of the health crisis on the faltering economy, each have come up with policies independent of consideration of the other. This has resulted in defaulting enterprises and debtors reaping the benefits of both the banking relaxations and insolvency reforms in the present dynamic scenario. Meanwhile, lending banks and non-banking financial creditors are losing out on both accounts by having to cap the interest rates and forgoing the right to initiate an insolvency process against defaulters. This results in accumulation of double benefits to debtors at the cost of creditors.

The recent measures to restructure the insolvency laws in India lack in safeguarding the interests of creditors in its entirety. The structure of the insolvency laws in India has been designed in the present context to aid small and medium scale companies survive the financial distress as a repercussion of the lockdown imposed on the economy. However it is unfortunate that the policy-makers have not taken into account that a large number of MSMEs serve as operational creditors themselves to other corporations. By formulating such policies, these MSMEs are left with no recourse under the IBC to recover the sum of money already invested by them in the business hence being forced to shut down. This defeats the very purpose for which these regulations were put in place.

[19] Reserve Bank of India, *COVID- 19- Regulatory Package*, RBI/2019-20/186, https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11835&Mode=0.

ADAPTATION OF THE NEW INSOLVENCY REGULATIONS BY THE LEGAL FRATERNITY

In 2018, the National Company Law Appellate Tribunal *(hereinafter referred to as NCLAT)* in its landmark judgment[20] allowed the first aberration to section 12 of the IBC regarding extending the time period of the Corporate Insolvency Resolution Process *(hereinafter referred to as CIRP)* from the statutory 270 days to an additional 166 days. It was held that the Adjudicating Authority or Appellate Tribunal inherently reserved the right to exclude certain period of time for the purpose of counting the total time period for completion of the CIRP of 270 days when a genuine application was filed by the resolution professional, committee of creditors or any aggrieved person. The Appellate Tribunal had already opined that the time-related provisions of section 12[21] was not airtight and could be altered or extended in a case by case consideration. Therefore, there was no urgent need for the Ministry to devise policies extending the ambit of section 12 mandating a longer period of time for completion of CIRP.

However, with the coming into effect of the new amendments to the IBC, various NCLTs have shed light on the scope and applicability of the same. The tribunals have provided with the much needed clarity on these regulations formulated by the Ministry which was expected from the Government itself. In two recent judgments, the NCLT Chennai Bench[22] and NCLT Kolkata Bench[23] have declared that the increase in threshold of debt from Rs. 1 lakh to Rs. 1 crore vide *Notification* issued by the Central Government on 24/03/2020 will be applicable prospectively. Hence, the notification does not alter the maintainability of pending applications before the NCLTs.

NCLT Chennai stated in the case of *Arrowline,* that insolvency proceedings cannot be maintained after 24th March, 2020 against defaults which have occurred before the stipulated date of the Notification i.e. 24th March, 2020, if the default amount is not above Rs. 1 crore. This continues to maintain the prospective nature of the Notification although it does affect

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[20] Quinn Logistics Pvt. Ltd. v Mack Soft Tech Pvt. Ltd. &Ors. (2018) 208 Comp Cas 0432.
[21] Insolvency and Bankruptcy Code, 2016, Act No. 31 of 2016, Section 12.
[22] Arrowline Organic Products Pvt Ltd v Rockwell Industries *Ltd*, IA/341/2020 in IBA/1031/2019.
[23] Foseco India Limited v Om Boseco Rail Products Limited, CP (IB)/1735/KB/2019.

some antecedent facts.[24] The learned bench distinguished substantial rights from those which are vested as was upheld by the Hon'ble Supreme Court in the case of *Karnail Kaur*[25] or *Garikapati Veeraya.*[26] In the present case, the rights are vested upon a party when an application under section 7, 9 or 10 of the IBC is filed. Hence as a consequence rights vested upon the party is post filing of the petition and not prior to it.

The Courts have magnanimously simplified the implications of the Government policies to save aggrieved persons and relevant stakeholders from ambiguity and confusion. However the Ministry which has set out to restructure the insolvency regime of India, continues to delay clarifications on its rather hasty and half-baked policies and regulations.

CONCLUSION AND RECOMMENDATIONS

There is no denying that the response of the Government in a timely and efficient manner is laudable. However, these policies lack the much needed foresight and a holistic outlook to cater to the needs of all the relevant stakeholders in an insolvency proceeding.

In this regards, other countries have taken certain plausible steps which may be feasible for India too. In Germany[27], the Chancellor has announced a large sum of relief package directed specifically to aid defaulting organizations to relieve them of the burden of the debts. While large sums of money are being disbursed in India under the 'Atmanirbhar' – reliant India campaign, the exact mechanism of distributing the money to ensure that it reaches the aimed end-users is not being monitored. Therefore, whether the money originally dispatched to relief MSMEs from their debt burden is ultimately serving its purpose or getting lost in transit is unknown.

United States of America and United Kingdom are known for their practice of entering into pre-package insolvency resolution plans which serve to be very effective.[28] India too can formulate policies which result in mediation between parties (the debtor as well as the

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[24] RamjiPurshottam v Laxmanbhai D. Kurlawala, (2004) 6 SCC 455.
[25] Karnail Kaur v State of Punjab, (2015) 3 SCC 206.
[26] GarikapatiVeeraya v N. Subbiah Choudhry, AIR 1957 SC 540.
[27] Barcaba. D and Kaufman. E, *Covid-19: Legal impacts on insolvency law in Germany, Bird & Bird* (April, 2020), https://www.twobirds.com/en/news/articles/2020/germany/covid-19-legal-impacts-on-insolvency-law-in-germany.
[28] Cirmizi. E, Klapper. L, and Uttamchandani. M, (2010), The Challenges of Bankruptcy Reform, Policy Research Working Paper 5448, World Bank, Washington, DC.

creditor) to enter into an outside court settlement resolving the issue of debts through an agreement instead of having to resort to legal methods and CIRP.

All these policies are channeled to increasing the liquidity in the Indian economy by expanding the purchasing power in the hands of the people. Liquidity is an essential strategy required to have the wheels of the economy running and balance market forces of demand and supply to stabilize the economy. Excessive liquidity in the economy however, is a problem that has resulted in economic recessions in the past, such as the one suffered by the United States of America in 2008. It must be kept in mind that one of the predicted ramifications of the pandemic is of a global recession which the world is already heading towards.

Indian policy makers need to attract investors by improving the ease of doing business in India by preventing insolvency of companies when it is unable of repaying loans. However, such scenario cannot be remedied by relaxing the existing guidelines and awarding concessions. By suspending the IBC, the moratorium period which helps a company to restructure itself or chalk out an acceptable plan to settle dues with its creditors has now been negated. Creditors can straight away initiate civil proceedings against these defaulting companies in the Court. Furthermore, by suspension of section 10 of the IBC, defaulting enterprises which themselves wish to register insolvency and restructure their companies do not have that option any longer. Suspension of these measures is therefore counterproductive and regressive.

The Indian Government needs to have a macro outlook towards its economy and take into consideration the interests of all the stakeholders. Large scale permanent restructuring of insolvency laws is needed such as digitalization of insolvency proceedings, starting from its registration, to an online medium for mediation and then an online portal for uploading the resolution plan for the committee of creditors to review, etc. This must be considered as opposed to short-term, dynamic changes which may result in lack of transparency and clarity.

Meanwhile it is of utmost importance to eradicate the ambiguity around the present reforms with respect to the time-periods and scope of applicability. The ministry needs to urgently draft concrete solutions via notifications and update the same. The progress and success that was once achieved by the enforcement of the Insolvency and Bankruptcy Code, 2016 was

praiseworthy. It will be unfortunate if such progress is mitigated in an attempt to restructure insolvency laws in India through the Insolvency and Bankruptcy Code, 2020.