

How the Government's approach towards IBC will affect the Stakeholders – Deciphering the recent announcements by the Finance Minister

(By Aakash Batra, Year III, B.A LLB. (Hons.), Symbiosis Law School, Pune)

Amidst the upsurge of COVID-19 in India, Prime Minister Narendra Modi announced an economic stimulus package worth 20 lakh crore INR on 12th May 2020. This package is intended to bring relief to various sectors of the society and economy and as the basic objective behind this is to make India self-reliant, hence it is also known as “*Atmanibhar Bharat Yojana*”. The package has been divided into five tranches and as a part of the fifth tranche, certain policy reforms have been announced by the Finance Ministry in the Insolvency and Bankruptcy Code 2016 (*hereinafter* referred as ‘IBC’) sector. The Finance Minister, Nirmala Sitharaman addressed the nation on 17th May 2020 and proclaimed certain measures with respect to the IBC sector considering them important for the ease of doing business.

IBC is one of the most crucial and significant reforms in the legal and financial setting of India. It has not only consolidated the laws related to reorganization and insolvency resolution while recognizing the interests of all the stakeholders, but also has helped in identifying India at the global economic forefront. Its objective is to provide resolution in a time bound manner and maximize the availability of credit in the Indian market. The code has been successful in recognizing India as a decent investment destination (considering the jump in ease of doing business index).

Whether the government has misconstrued the purpose of IBC and has approached it in a wrong manner or not via the recent announcements is something which needs to be understood by critically analyzing the impact of these announcements on various stakeholders and economy.

POLICY REFORMS ANNOUNCED BY THE GOVERNMENT

The following are the key measures which have been announced by the Finance Minister:

- The minimum threshold to initiate insolvency proceedings under IBC has been raised to 1 crore INR from 1 lakh INR, which largely insulates MSMEs.
- For MSMEs, a special insolvency resolution framework will be notified soon u/s 240A of IBC.
- Fresh initiation of insolvency proceedings under IBC has been suspended for 1 year, depending upon the pandemic situation in the country.
- ‘COVID-19 related debt’ has been excluded from the definition of ‘default’ under IBC for the purpose of triggering insolvency proceedings.

CRITICAL ANALYSIS

After the announcement, the stock market took a dip and confidence of investors was shaken. With respect to MSMEs, there exists an exemption for these entities under the code, with respect to the application of Sec. 29A of the IBC which deals with disqualification of the resolution applicant. The current announcement regarding MSMEs is to insulate them as this sector is already stressed and has been affected the most due to COVID-19. The share of this sector in the gross domestic product of the country is somewhere around 1/3rd according to the previous two years data. The Finance Minister also said that this has been done so that companies are not dragged to the tribunals at a time when they are facing a huge crisis and when they are trying to get back on their feet. What the insolvency framework will be for these enterprises is yet to be seen and the picture will be clear only after the ordinance in this regard comes out.

Suspension of the code is the most serious announcement regarding this sector and is a very bold move. The announcement has left certain ambiguities in this regard and the intention of the government is not clear. First of all, it is not known whether proceedings u/s 7 which deals with financial debt and proceedings u/s 10 which deals with operational debt have been suspended only or whether proceedings u/s 10 which is voluntary initiation of the resolution process by the corporate debtor, have also been suspended. Suspension of proceedings u/s 10 might be problematic because one of the basic objectives of IBC is to enable the firms to survive even after they default, that is why liquidation under the code is only the secondary and last resort and the CIRP is centered on benefiting both, the debtor as well as the creditor by focusing on maximization of assets. A delay in voluntary initiation because of the suspension will lead to deterioration in value. Although the position regarding this has not been clarified but when the cabinet proposed Sec. 10A in April 2020, the suspension was intended for Sec. 7, Sec. 9 as well as Sec. 10. In the midst of a crisis, if these stressed firms are not provided an option to voluntarily trigger the resolution process, the object of the code will be defeated and the government has failed to consider that. India hasn't faced the real effects of the pandemic yet and the situation is likely to worsen in the next few months so this suspension of IBC might as well be extended in future. As debts cannot stay hidden for too long, eventually the businesses will not be able to survive in an indebted condition for such a long duration. Also, the burden of repaying the loans is always present in the minds of the borrower and not taking a borrower to IBC might not be an adequate relief because their credit rating will be downgraded.

A big enigma is that when the government has already decided to suspend the initiation of proceedings under IBC for 1 year altogether, what is the use of excluding COVID-19 related debts from the definition of 'default'? But as they have propounded for a distinction between COVID-19 related debts and NON-COVID-19 debts, the intent of the government appears to be a 'limited suspension' for only defaults related to the pandemic. Distinguishing between COVID-19 and NON-COVID-19 debts will be a grey area and further clarity is needed in this regard. Moreover, what will happen to proceedings related to defaults which occurred before the pandemic has not been cleared by this announcement.

What will be the impact of this on the lenders is something that the government has failed to consider in this announcement and as the lenders have heavily relied on IBC for recovery mechanism, this is surely going to affect their confidence. This might take a toll on the lending ability and the credit availability in the country. IBC was succeeding in creating an atmosphere where debtors had begun to realize that the old ways are not going to continue, just when the pandemic hit the world and took our nation to pre-IBC days.

It is true that this announcement may seem to be a 'good news' for some corporates but the proposed reforms will be unfair to the aggrieved party and will give unscrupulous borrowers, a chance to defeat the purpose of IBC. Furthermore, this will increase the stressed debt levels for banks and especially the units which are already stressed such as PSUs. We might see more merging of these units in near future. Also, the recovery of these debts post-COVID-19 period will see a lot of slippages and will be comparatively lower. Unscrupulous borrowers might as well take undue advantage of these measures in respect to debts which were already bad and were doubtful before the pandemic situation. Also, this could be a '*business stimulus measure*' by the government because the largest bad debts (NPAs) are with public sector banks and as this will increase the losses for these units, the government will have to refinance them. Due to this refinancing, the public will have bear the burden via government taxation to compensate for these public sector bank losses.

There could be several positive impacts as well because this will reduce the burden on NCLTs and the tribunals will get a chance to focus on other important matters which are pending such as the oppression and mismanagement cases under company law, cases related to mergers and acquisitions etc.

The recent announcements have failed to address this sector properly and have created confusion in the minds of stakeholders. An ordinance will definitely give more clarity in this regard.

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