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IBC Amendment Ordinance – Immediate Impact on Operational Creditors

Introduction:

With the advent of the amendment made to Section 4 of the Insolvency &Bankruptcy Code, 2016 vide Notification No SO 120 (E) the threshold limit to initiate Corporate Insolvency Resolution Process was increased from Rupees One Lakh to Rupees One Crore with effect from 24.03.2020. This had put the Creditors and more specifically the operational creditors on a back foot as the

amounts owed to them by corporate entities in a majority of cases likely to be less than one crore.

Threshold Increase in initiation of the Corporate Insolvency Resolution Process:

The increase in threshold to initiate Corporate Insolvency Resolution Process ("CIRP") has come down has a definite harsh blow on all the smaller creditors to whom defaulted amount/ debt owed is less than a crore.

The implementations of the Insolvency & Bankruptcy Code ("IBC" or "Code") had been very effective, though not implemented with the purpose of using the Code as a mechanism of money recovery it had in one way or the other served the purpose of a money recovery mechanism and the operational creditors have largely benefitted ever since the inception of the code. This is hugely because of the threat that it possesses, (i.e.) the probability of admitting the defaulting debtor company into Corporate Insolvency Resolution Process by which the promoters and directors of the defaulting company get to lose the control and management.

The Notification had however left out a loop hole that could have been used by the litigants/creditors wherein though it has raised the threshold to initiate the proceedings under the Code, it had failed to categorically state that the principle claimed before the Hon'ble National Company Law Tribunal ("NCLT" or "Tribunal") by way of an Application should be minimum of one crore rupees. This could pave the way for the creditors to add on interests to the principal amount till the date of filing and ensure the same is above the threshold limit and file the Application for its adjudication.

What is the flip side of such Applications that get filed which otherwise do not satisfy the threshold criteria:

It is to be noted that adding of interests to the Principal amount is per se not illegal or arbitrary if the parties have already at the time of transacting agreed to the same. In such a case the Tribunals would be obliged to entertain the interest portion and adjudication on the total defaulted amount, provided the same is in accordance with the law. The problem so arises if there exists no prior payment commitment of an interest on delayed payments or if the Creditor arbitrarily charges more interest than what was actually agreed between the parties. The Benches would construe the additional amount of interest as a "default" and with the threshold increase in place they are unlikely to be inclined to proceed with the matters for want of pecuniary jurisdiction and the Applications of such nature could face dismissals.

The National Company Law Tribunal, Chennai Bench recently in the matter of ***Arrow line Organic Products Private Limited*** ***[2020] ibclaw.in 18 NCLT*** vide its order dated 02.06.2020 once again clarified that the increase in threshold to initiate CIRP from Rupees One Lakh to Rupees One Crore is prospective in nature and will only apply to the new filings and will not be imposed on the adjudication of any ongoing cases unless the legislation clearly mentions the same is retrospective. In the absence of such an intention in the amendment the Hon'ble NCLT Chennai Bench went to confirm that the amendment made to increase the threshold is prospective in nature and does not in any way affect the matters that were already filed, being heard or been reserved for orders prior to the Notification dated 24.03.2020.

The Insertion of Section 10A:

The promulgation of the Ordinance dated 05.06.2020 has resulted in the insertion of a new Section, 'Section 10A' into the Insolvency and Bankruptcy Code, 2016. The said clause is extracted below for the purpose of convenience:

> *"10A. Suspension of initiation of corporate insolvency resolution process.*
>
> *Notwithstanding anything contained in Sections 7, 9 and 10, no application for initiation of corporate insolvency process of a corporate debtor shall be filed, for any default arising on or after 25th March, 2020 for a period of 6 months or such further period, not exceeding 1 year from such date, as may be notified in this behalf:*
>
> *Provided that no application shall ever be filed for initiation for corporate insolvency resolution process of a corporate debtor for the said default occurring during the period.*
>
> ***Explanation:*** *For the removal of doubts, it is hereby clarified that the provisions of this section shall not apply to any default committed under the said sections before 25th March, 2020."*

On bare reading of the aforementioned Section, one can infer that no application can be filed under Sections 7, 9 and 10 of the I&B Code, 2016 for initiation of Corporate Insolvency Resolution Process of a Corporate Debtor for a default that had occurred during the said period from 25.03.2020 to a minimum of 6 months and not exceeding one year from the date of Notification.

However, this insertion of Section 10A gives raise to ambiguities as to practical aspects of interpreting period of initiating of the process of Corporate Insolvency Resolution Process of a Corporate Debtor in the context of Operational Creditors ("OC"). Hence, we attempted to categorize it under the 2 scenarios;

- **Scenario 1** – If default is under the threshold limit of Rs.1 Crore had occurred before 25.03.2020 for which a Demand Notice (Form 3) has been sent out by the Operational Creditor and an Application under Section 9 of the Code has been filed with the Adjudicating Authority.
- **Scenario 2** – If default above the threshold limit of Rs.1 Crore had occurred before 25.03.2020 for which a Demand Notice (Form 3) has been sent out by the Operational Creditor. But an Application under Section 9 of the Code has not yet been filed with the Adjudicating Authority.
- **Scenario 3** – If default has occurred before 25.03.2020 and the amount that is due for the Creditor is below Rs. 1 Crore for which a Demand Notice (Form 3) has been sent out by the Operational Creditor. But an Application under Section 9 of the Code has not yet been filed with the Adjudicating Authority.
- **Scenario 4** – If default above the threshold limit of Rs.1 Crore had occurred after 25.03.2020 and during the COVID 19 default period, a Demand Notice (Form 3) has been sent out by the Operational Creditor and the Corporate Debtor has replied to the same quoting Section 10A of IBC whereby stating the said Notice is not maintainable under the law.

Connotation of the word "Initiation Date" under IBC:

The Term Initiation date is defined under the Code under Section 5 (11) and a perusal of the same clearly gives out the intention of the drafters of the Code,

Section 5 (11) is reproduced here for easy reference.

> ***"Section 5:***
>
> *(11) initiation date – means the date on which a financial creditor, corporate applicant or operational creditor, as the case may be, makes an application to the Adjudicating Authority for initiating corporate insolvency resolution process."*

The definition of 'Initiation date' clearly states that process to initiate CIRP shall start from the date on which a financial creditor, or operational creditor, or the corporate applicant himself makes an application to the Adjudicating Authority for initiating CIRP and the said CIRP shall commence from the date of admission of the application.

On holistic reading of Section 10A which has been inserted vide Ordinance dated 05.06.2020 with Section 5(11), we can infer that the process of initiation of CIRP is said to have kicked in only when an Application under Section 7, 9, 10 as the case may be is moved before the Adjudicating Officer and the issuance of Demand Notice shall not be construed as the date on which the process to initiate CIRP has been commenced for the purpose of interpreting the said new Section 10A inserted vide the instant Ordinance. However this aspect is likely to be litigated upon since the Demand Notice under Section 8 of the IBC is a mandatory procedure and hence one is likely to argue that they had initiated the process upon issuance of such demand notice. However once again; since the wordings of the ordinance expressly state that no new applications can be filed; it is likely that the tribunals' would go by filing of the application as the benchmark rather than issuance of demand notice per se.

Therefore, **in response to Scenario-1** contemplated earlier, it can be understood that the Adjudicating Authority will entertain the hearing of the Application. It is however has to be understood that the initiating date definition clearly suggests that an Application has to be filed before the Registry and merely sending demand notice under Section 8 is not sufficient. Given the fact that the amendment dated 24.03.2020 has raised the threshold limit to 1 Crore and the same is prospective in nature, this debt that fell due and subsequently the application under section 9 was also filed before the threshold changes were made. .

Further the Ordinance dated 05.06.2020 has inserted Section 10A suspending the initiation of CIRP for a debt that fell due during the specified period, the Operational Creditor Application will be not be barred from hearing before the Tribunal under the Code in this scenario as the insertion made under Section 10A is not applicable for the instant scenario.

In response to Scenario-2, the Adjudicating authority will take cognizance of the application as the 'default' is above 1 crore and the said 'default' had also occurred before 25.03.2020. The instant situation qualifies and passes the twin criteria to file new Applications before the National Company Law Tribunal under the IBC, 2016.

In response to Scenario-3, the Section 10A per se does not provide a blanket ban on filing

an Application to initiate CIRP against the Corporate Debtor. However, as per the facts given under the instant scenario it is evident that the debt has fell due before 24.03.2020 and the total amount of debt is below the threshold limit of Rupees One Crore as on the date of filing which is post the introduction of the threshold. The Registry at the Hon'ble NCLTs are not bound to accept the same due to want of pecuniary jurisdiction.

In response to Scenario-4, the proviso clause to Section 10 A under IBC clearly and categorically states that no application shall ever be filed for initiation of CIRP of a Corporate Debtor for the default occurring during the period of 6 months (subject to be extended to one year) from 24.03.2020. This proviso clause seemingly puts a blanket ban on all Applicants from filing any application on the defaults that occurred during the above time frame. Even if the Creditor chooses to proceed with the filing of the Application, the NCLT will not entertain such Applications as it goes against the intention of the instant Ordinance and the said Application will be dismissed.

However, this section under the Code does not prevent the Creditor from approaching other jurisdictions or forums and file complaints/ petitions against the Corporate Debtor in a bid to get back the Operational Debts that are due. The Creditors may approach the Hon'ble High Courts/City Civil Courts under Order VII /Order XXXVII of the Civil Procedure Code, 1906 and file a money recovery suit or approach the Commercial Division of the Hon'ble High Courts and file a Commercial Suit for recovery of the amounts due from the Corporate Creditor. These alternative options though available are considered most likely as time consuming and not as quick and effective as the proceedings under the IBC wherein time lines are followed much stringently.

Conclusion:

The Ordinance therefore clarifies that for any Application to be filed and heard for the period of next six months or twelve months as the case may be, the default must have occurred (i.e.) the date of default by the Corporate Debtor has to be on or prior to 24.03.2020 and the default amount is to be more than One Crore failing which any Application under Section 7, 9 and 10 shall not be entertained. Further with respect to the Notification dated 24.03.2020 increasing the threshold it is clear that the same is prospective in nature and any filing being made after its introduction the default amount must be more than Rupees One Crore and the debt must not have fallen due during the suspension period in order to file an Application seeking initiation of CIRP.

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