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NO FRESH INSOLVENCY CASES FOR A YEAR:

A narrow escape for companies

The global spread of the virus is persistent despite mitigation efforts. Faced with the stark reality of sweeping shutdowns of almost entire economies worldwide, the International Monetary Fund acknowledged that the current "crisis is like no other". While India is grappling with the deadly virus, there is another battle of nerves that that needs to be dodged by the bullet. Amid high tension, the Reserve Bank of India and the Union Cabinet finally rolled out its big guns to stop the Damocles sword of insolvency hanging on the head of companies that might end up defaulting in the wake of a pandemic.

Recent decisions by the Reserve Bank of India (RBI) and Union Cabinet

To mitigate the burden of debt arising due to disruption of cash inflows, the first move was witnessed on March 27, 2020, when the Reserve Bank of India (RBI) imposed a moratorium of 3 months on all term loans outstanding as on March 01, 2020, to curb defaults in repayment of loans[1] and for another 3 months on May 22, 2020. Under this scheme, the original repayment period would get extended by 90 days. Thereafter on April 22, 2020, the Union Cabinet cleared the ordinance which was proposed way back by the Union Finance Minister on March 24, 2020, thus providing relief to the companies from insolvency for the next six months.[2] The Amendment seeks to introduce Section 10A, which will suspend Section 7, 9, and 10 of the Insolvency and Bankruptcy Code, 2016 ("Code"). Thereafter the government also released a statement, "The mandatory requirement of holding meetings of the Board of the companies within prescribed interval provided in the Companies Act (120 days), 2013, shall be extended by a period of 60 days till next two quarters i.e., till 30th September,"[3] and further to ease the burden on companies and auditors, the government announced that Companies (Auditor's Report) Order, 2020 would be made applicable from the financial year 2020-2021 instead from 2019-2020.

Further, to de-stress real estate regulators, on 13 May 2020 the Finance Minister provided 6 months extension to the all real estate projects registered under the Real Estate Regulatory Authority expiring on or after March 25 and further directed the Ministry of Housing and Urban Affairs to treat COVID-19 as "force majeure" under RERA.[4] In the fifth and last tranche of 20-lakh crore-package announcements on 17 May 2020, it was declared that any debt incurred during the

Covid-19 crisis for a company will be excluded from the default category under IBC and no fresh insolvency will be initiated for one year, which paves a major relief to SME and MSMEs. Additionally, to benefit the MSMEs, the minimum threshold limit for initiation of insolvency proceedings has been raised to 1 crore from 1 lakh, however, an ordinance in this regard is awaited. A special insolvency framework for MSMEs will be notified under Section 240A of the Code.

Introduction of Section 10A

There have been reports claiming that the Central Government while exercising its power under Section 242 of the Code, will introduce a new section, 10A, which would suspend Section 7, 9, and 10 for up to a year.

Section 242 states:

Power to remove difficulties

> 1. If any difficulty arises in giving effect to the provisions of this Code, the Central Government may, by order, published in the Official Gazette, make such provisions not inconsistent with the provisions of this Code as may appear to be necessary for removing the difficulty:
>
> Provided that no order shall be made under this section after the expiry of five years from the commencement of this Code.
>
> 2. Every order made under this section shall be laid, as soon as may be after it is made, before each House of Parliament.

The proposed Section 10A will suspend Section 7, 9, and 10 of the Code. Section 7 of the Code deals with the initiation of Corporate Insolvency Resolution Process (CIRP) by the financial creditor, Section 9 of the Code deals with the application for initiation of CIRP by the operational creditor and Section 10 allows the Corporate Applicant to approach the National Company Law Tribunal (NCLT) for initiation of its Insolvency.

Impact of Introduction of Section 10A

Due to the cessation of businesses and economic activities on account of an outbreak of this novel COVID-19, a large amount of cash flow has been affected, thus adversely impacting the already disrupted chain in the country as well as globally. To prevent the micro, small and medium enterprises (MSMEs) being dragged into insolvency proceedings in force majeure clauses of default, the Cabinet's move is the need of the hour and I could safely state that they could not have done anything better.

However, the issue then arises of whether the introduction of Section 10A, will let the Code achieve its objectives?

The proposed Section would grab the powers imparted to financial and operational creditors under Section 7 and 9 respectively. Further, it would also take away the privilege provided to the corporate debtor under Section 10 to voluntarily file for CIRP. But the objective of Section 7 & 9 and Section 10 operates on quite a different footing of the Code. In addition to it, the lenders also differ as to operational and financial creditors. With the suspension of Section 7 & 9, the companies would try to

secure finances and relief from NBFCs and Bank, renegotiating loans, one-time settlement (OTS), etc., while in cases of irretrievable financial distresses, the Corporate Applicant can file for its insolvency under Section 10.

The year 2020 is a dark phase for financial creditors due to inadequate liquidity in the market and banks will be unable to look for a new buyer for the stressed company on the contrary operational creditors would also struggle due to bad debts owing to goods and services provided to the companies. Thus blocking the lenders' right to recourse to the most timely and efficient debt resolution would defeat the very purpose of Code and result in stress on the financial system of the nation.

Due to suspension, there will be very limited remedies available to the lender in case of default, as the recourse to IBC would be completely closed and they would have to resort to alternate, commercial or civil remedies, which takes years to resolve, as a result of the prolonged result, the businesses would be closed. Thus, a blanket ban over the suspension of the cases will not solely lead to the objective sought to be achieved; hence, it calls for an alternative mechanism.

Alternative Mechanism

Let's go back to the pre-IBC era!!

No doubt IBC is considered as a landmark reform by the government as a measure by companies to recover its lost glory and continue as a going concern, but the much-relieved scheme will result in a slew of IBC cases flooding the court's post-1-year window. Also, due to deterioration in the business valuations, by the time a 1-year window will be lifted, the valuation would have dropped considerably and may not be in sync with the earlier reports and nobody would be in a condition to pay more than the current valuation. Hence, the creditors to effectuate their claims will resort to Summary suits under Order XXXVII of the Code of Civil Procedure, 1908 (CPC), or a commercial suit under Commercial Courts Act, 2015, or a civil suit and few may also take recourse under the Companies Act, 2016 for winding up of the companies or the SARFESI Act, 2002.

The dilemma:

IBC *vis-a-vis* Summary suits under Order XXXVII of CPC

The creditor who seeks to recover the debt can opt for summary suits entailed under Order XXXVII of the CPC, which is not an ordinary suit and the defendant has to apply for leave to defend within the stipulated period, however, if the defendant fails to use his right, the plaintiff will be entitled to claim the judgment. The whole process entails speedy and efficient disposal of suits, which are commercial in nature, and it often takes lesser time than IBC proceedings. *Then why do creditors prefer IBC over summary suits?*

IBC is not intended to be substituted to a recovery forum and wherever there is the existence of a real dispute, IBC cannot be invoked.[5]

Thus, it is apposite to see the motive of the creditor, recovery, or insolvency.

IBC *vis-a-vis* Commercial suit under Commercial Court Act, 2015

In the light of the definition of commercial dispute, defined in Section 2(1)(c)(i) and Section 2(1)(c)(xviii) of the Commercial Court Act, 2015, financial and operational debt can be proved.

Section 2(1)(c) commercial dispute– means a dispute arising out of––

> (i) ordinary transactions of merchants, bankers, financiers and traders such as those relating to mercantile documents, including enforcement and interpretation of such documents;
>
> (xviii) agreements for sale of goods or provision of services;

However, the creditors will be too cautious in adopting this alternate remedy for the requirement to pay '*ad valorem*' court fees on the amount claimed, which is approximately 1% of the claimed amount. The term '*ad valorem*' is derived from the Latin *ad valentiam*, meaning 'to the value.' On the contrary, the Code mandates a fixed court fee of Rs. 2,000/- and Rs. 25,000/- for operational and financial creditors.

Another important ingredient is the 2018 amendment to the Commercial Court Act, 2015, which makes it mandatory for a party to exhaust the remedy of mediation before the institution of a commercial suit. Thus, given Section 12A of the Act, the mandatory obligation of mediation rests with the discretion of the opposite party, and on failure to mediate, it would take around 2-3 years on an average to complete the proceedings.

Conclusion

The coronavirus outbreak and the nationwide lockdown to curb the infection have significantly affected the economy. Since the lockdown is in force, a move to suspend cases under Section 7, 9 and 10 was in the cards of the government but a blanket ban over the cases is not the solution and the government should come up with a nuanced policy with certain exemptions & guidelines and a distinction should be made based upon the stage and type of the case, failing with there will be a flood of cases post 1-year window, hence the Code will lose its ornament of disposal of cases in a fixed, speedy and efficient manner.

The amendment will soon come up as to the enactment of Section 10A, thereby protecting the MSMEs against the harsh actions, however, once the dust settles, the government should ensure that the rights of the creditors against the wilful defaulters do not go undressed.

Also, it is expected that along with the amendment, answers to open-ended questions such as status of cases where demand notice was served before the amendment and status of cases under Section 7, 9, and 10 were not admitted and pending adjudication before the tribunals, are provided.

Therein lies a ray of hope.

Reference

[1]https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/0RBIBULLETINMAY2020E677E0A6FAC94ED8A77D1E76424F49A1.PDF

[2] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1607942

[3] https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1607942

[4] https://pib.gov.in/PressReleasePage.aspx?PRID=1623858

[5] https://www.mondaq.com/india/insolvencybankruptcy/661280/mobilox-innovations-private-limited-vs-kirusa-software-private-limited

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