Source : www.thehindu.com Date : 2020-06-11

THE FAULT IN OUR DRAFTS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Industry & Services Sector incl. MSMEs and PSUs

Hours after India went into lockdown, the Finance Minister announced a slew of measures to alleviate the economic crisis. This included proposed changes to the Insolvency and Bankruptcy Code (IBC), 2016, a law enacted to bring about smooth and quick resolutions for companies facing insolvency and bankruptcy with a view to primarily avoiding liquidation. The government, the Minister said, was considering suspension of certain provisions of the IBC which enabled creditors to file insolvency petitions against Indian companies for a year’s time beyond April 30. April 30 came and went without any announcement in this regard.

In mid-May, the Finance Minister announced that the government was planning to bring in an ordinance to suspend provisions enabling filing of fresh insolvency cases for a period of one year. This was followed by absolute silence on the modalities or mechanism of suspension of the provisions. Banks, financial institutions (FIs), and insolvency law practitioners had no idea where they stood with these announcements. Finally, on June 5, the government promulgated an ordinance which inserted Section 10A in the IBC. The government said the ordinance was promulgated because the lockdown has caused business disruptions which may lead to default on debts pushing such companies into insolvency. Therefore, it felt that suspending Sections 7, 9 and 10 of the IBC would be the right course of action.

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Towards that end, Section 10A provides that “no application for initiation of corporate insolvency resolution process of a corporate debtor shall be filed, for any default arising on or after 25th March, 2020 for a period of six months or such further period, not exceeding one year from this period, as may be notified in this behalf”. This means that these provisions shall remain suspended from March 25 till September 25, unless extended for another six months, which would extend the suspension up till March 25, 2021.

However, the proviso to the section states that no application for insolvency resolution shall ever be filed against a corporate debtor for any default occurring during the suspension period. While the main Section 10A suspends such applications for a limited period, the proviso enlarges the scope to provide complete amnesty under the IBC for any default occurring during such period. The role of a proviso in a statute is to restrict the application of the main provision under exceptional circumstances. However, the proviso here expands the substantive provision in the main section. Further, if the main provision is unclear, a proviso may be given to explain its true meaning. In this case the main provision appears clear, only to be obfuscated by the proviso. The proviso therefore does not appear to be legally tenable. As creditors can still approach courts, and as banks/FIs can still approach Debt Recovery Tribunals, the protection given by this proviso seems illusory.

Notably, Section 10A also suspends provisions of Section 10 of the IBC which enables voluntary insolvency resolution. This is difficult to understand as such voluntary insolvency resolution should have been made easier for companies facing distress.

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The ordinance appears to consider every default occurring during the suspension period to be a consequence of the pandemic. There could be cases where defaults were imminent due to other

reasons, but which will now still enjoy this protection. The ordinance should have protected only such defaults which may occur as a direct consequence of the pandemic or the lockdown and should have left this determination to the National Company Law Tribunal. Also, a company defaulting on its payment obligations on March 24 (a day before the lockdown started) would not be provided any relief under the IBC as compared to a company defaulting on or immediately after March 25 due to similar reasons. This makes the suspension, in the absence of definition of a COVID-19 default, prima facie arbitrary.

Earlier, the government increased the minimum default amount to trigger corporate insolvency resolution from 1 lakh to 1 crore. This was purportedly done to protect MSMEs from insolvency petitions. However, this also operates against such MSMEs because they will now be forced to approach civil courts to recover undisputed debts below 1 crore. The suspension of these provisions would now impact even claims above 1 crore for at least six months to a year.

The ordinance has opened itself up to a legal challenge on grounds of arbitrariness and untenability of the proviso due to the flaw in its drafting. It is unfathomable how these flaws arose despite the government having ample time to think this through.

V.V.Sivakumar and Chitranshul Sinha are Partners in Dua Associates, Advocates and Solicitors

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