

THE INSOLVENCY AND BANKRUPTCY CODE (AMENDMENT) ORDINANCE, 2020

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI



Highlights of the Ordinance

- The Insolvency and Bankruptcy Code allows a corporate debtor as well as its creditors to initiate an insolvency resolution process. The Ordinance prohibits the initiation of insolvency proceedings for defaults arising during the six months from March 25, 2020 (extendable up to one year).
- A director or a partner may be held liable if despite knowing that insolvency proceedings cannot be avoided, he did not exercise due diligence in minimising the potential loss to the creditors. The Ordinance removes this provision for defaults in the above period.

Key Issues and Analysis

- The suspension of the insolvency resolution process raises several issues. First, it prohibits resolution even in cases where that may be the best way to preserve the value of assets. Second, it removes the option of a debtor to avail of the insolvency process for restructuring. Third, it is unclear why insolvency proceedings against specified defaults have been prohibited forever.
- It may be questioned whether a personal guarantor to a corporate debtor should undergo insolvency proceedings for defaults for which insolvency proceedings are not allowed against the debtor

PART A: HIGHLIGHTS OF THE ORDINANCE

Context

The Insolvency and Bankruptcy Code, 2016 provides a time-bound process to resolve insolvency among companies and individuals. Insolvency is a situation where an individual or company is unable to repay their outstanding debt. In light of the COVID-19 crisis, the World Bank identified two key challenges for an insolvency framework: (i) need to prevent otherwise viable firms from prematurely being pushed into insolvency and (ii) increase in the number of firms that will not survive the crisis without resolution of insolvency.^[1] In India, the threshold of default for initiation of insolvency proceedings was raised from one lakh rupees to one crore rupees.^[2] Further, regulations were amended to provide that the lockdown period will not be counted in the timeline for ongoing proceedings for certain activities.^[3] In this context, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 was promulgated on June 5, 2020.^[4] The Ordinance notes that COVID-19 has created uncertainty and stress for businesses for reasons beyond their control and it is difficult to find an adequate number of resolution applicants to rescue the corporate debtor who may default in discharging their debt.⁴

Key Features

- **Prohibition on the initiation of insolvency proceedings for certain defaults:** The Code allows the corporate debtor as well as its creditors to initiate insolvency resolution process. The Ordinance provides that for defaults arising during the six months from March 25, 2020 (extendable up to one year), no insolvency proceedings can ever be initiated by either the corporate debtor or its creditors.
- **Liability for wrongful trading:** A director or a partner of the corporate debtor may be held liable to make personal contributions to the assets of the company in certain situations. This liability will occur if despite knowing that the insolvency proceedings cannot be avoided, the person did not exercise due diligence in minimising the potential loss to the creditors. The resolution professional may apply to the NCLT to hold such persons liable. The Ordinance prohibits the resolution professional from filing such an application in relation to the defaults for which insolvency proceedings have been prohibited.

PART B: KEY ISSUES AND ANALYSIS

Bar on the initiation of insolvency resolution process for certain defaults

The Insolvency and Bankruptcy Code, 2016 (IBC) allows the corporate debtor as well as its creditors to initiate the insolvency resolution process. The Ordinance provides that for defaults arising during the six months (extendable up to one year) from March 25, 2020, no insolvency proceedings can ever be initiated by either the corporate debtor himself or any of its creditors. We discuss some related issues below.

Need for the complete suspension of the corporate insolvency resolution process

The Ordinance prohibits initiation of insolvency proceedings against defaults arising during the specified period. This raises the question whether a complete suspension is required. On one hand, there is a need to safeguard companies, which were viable before the pandemic and whose insolvency is temporary, from being prematurely pushed into insolvency.¹ On the other hand, a complete suspension of insolvency proceedings may take away a distressed company's opportunity to seek recourse under the IBC framework. For certain companies, the deferral of insolvency proceedings may lead to further deepening of their financial stress and the resultant loss in value.

The Ordinance also states that it is difficult to find an adequate number of resolution applicants during this period.⁴ This may increase the risk of liquidation of a company which could have been rescued by sale as a going concern in a normal situation. However, another possible outcome of an insolvency resolution process is debt restructuring where debt obligations are reorganised to resolve insolvency, but the company is not sold to a third-party buyer. In United Kingdom, for instance, the insolvency law was amended in June 2020 to provide certain new types of restructuring options for companies facing financial difficulty.^[5]

Further, it raises a question whether all defaults during the specified period need to be treated in the same manner. There may be defaults which were not induced due to COVID-19 related disruptions but are a result of distress in companies before the pandemic. That said, whether a default is induced by COVID-19 or not will be subject to interpretation and may lead to disputes which can result in increased litigation.

Corporate debtor is prohibited from initiating insolvency proceedings

The Ordinance prohibits the initiation of insolvency proceedings by the corporate debtor. The question is whether the corporate debtor should be prohibited from initiating insolvency proceedings. The corporate debtor may be better placed to assess whether the recourse under the insolvency framework is warranted. A voluntary and timely initiation of insolvency proceedings by an insolvent debtor could maximise the benefits for the debtor as well as creditors. Note that in countries such as Spain, Germany, and France, while creditor-initiated insolvency proceedings were restricted and the duty of the debtor to file for insolvency were relaxed, voluntary insolvency proceedings by the debtor have been allowed.¹^[6]

Insolvency proceedings against the specified defaults are prohibited forever

The Ordinance states that no insolvency proceedings can ever be initiated against defaults occurring during the specified period. This could result in a scenario where creditors are unable to hold the company liable for these defaults even after the company's ability to repay has been restored. It is unclear why a debtor should be protected from the liability for these defaults even after its temporary adverse situation has been resolved.

Initiation of insolvency proceedings against the personal guarantor to a corporate debtor

Under the Code, insolvency proceedings can be initiated against the personal guarantor of a corporate debtor.^[7] This is an individual who provides a guarantee for the debt of a corporate debtor. While the Ordinance prohibits insolvency proceedings against the corporate debtor for the defaults occurring during the specified period, it does not disallow such action against the personal guarantor. The question is whether the personal guarantor should be held liable for defaults for which the original debtor's liability itself has been relaxed.

[1]. [COVID-19 Outbreak: Implications on Corporate and Individual Insolvency](#), World Bank, April 13, 2020.

[2]. [“Aatma Nirbhar Bharat Package – Progress So Far”](#), Press Information Bureau, Ministry of Finance, July 12, 2020.

[3]. [“IBBI amends CIRP Regulations to provide relief in corporate insolvency resolution process due to COVID-19 outbreak”](#), Press Information Bureau, Ministry of Corporate Affairs, March 30, 2020.

[4]. [The Insolvency and Bankruptcy Code \(Amendment\) Ordinance, 2020](#).

[5]. [The Corporate Insolvency and Governance Act 2020](#), United Kingdom.

[6]. [“COVID-19: An international guide to changes in insolvency law”](#), DLA Piper, June 22, 2020.

[7]. [The Insolvency and Bankruptcy \(Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors\) Rules, 2019](#).

group. This document has been prepared without regard to the objectives or opinions of those who may receive it.

END

Downloaded from **crackIAS.com**

© **Zuccess App** by crackIAS.com

crackIAS.com