RESPONSE TO COVID 19 AND IMPACT ON INSOLVENCY LAW IN INDIA

The passage and the working of the Insolvency and Bankruptcy Code, 2016 (**Code**) is an important landmark in India's tryst with insolvency and debt restructuring laws. Further, the interpretation provided by the courts, from holding that the Code is not a means for recovery of dues to reinforcing the primacy and commercial wisdom of the committee of creditors, along with appropriate and timely amendments by the legislature in line with the object of the Code has certainly aided in the successful implementation of the Code. Thus, the quantum of realisations under the Code for the financial creditors and time taken for such realisations are relatively efficient when compared to other laws for resolving distressed assets in the country (*Economic Survey of the Government of India 2019-20*).The present article discusses the measures brought forth by the Government of India (**Government**) in response to the ongoing pandemic.

Measures

Due to the effects of the ongoing COVID 19 pandemic, the Government has taken major steps to contain the disease, including enforcing lockdowns throughout the country, which have been extended till 31 July 2020 in certain parts of the country. Many businesses, especially businesses categorized as micro, small and medium enterprises, have been severely affected due to the outbreak and ensuing lockdown.

Keeping in mind the changing business environment in India brought about by the pandemic, several changes were introduced by the Judiciary and the Executive in India, such as excluding the period of the lockdown for the purpose of timelines stipulated under the Code, closure of filing counters except for unavoidable matters, extension of dates to make the requisite filings and an increase of the threshold default amount for initiating the resolution process to INR 10,000,000 (Indian Rupees Ten Million) from INR 100,000 (Indian Rupees One Hundred Thousand) (**Trigger Amount**).

Suspension

Considering the economic uncertainty and stress created by the pandemic, the Government passed an ordinance on 5 June 2020 (**Ordinance**) suspending the initiation of corporate insolvency resolution processes (**CIRP**) for a period of six months starting from 25 March 2020 (which may be extended up to one year, if deemed necessary by the Government) (**Suspension Period**) to prevent corporates, which are experiencing distress on account of the pandemic, from being pushed into insolvency proceedings under the Code. The chairman of the insolvency regulator, Insolvency and Bankruptcy Board of India, has indicated during a public interaction that the non-availability of enough interested parties to rescue a firm in distress is one of the main reasons for suspending the Code during this pandemic.

The Code distinguishes creditors into two types – a) financial creditor which has extended a financial debt for time value of money to the debtor and b) operational creditor which has extended a debt in relation to supply of goods, services, employment and governmental dues. Insolvency proceedings against a corporate debtor under the Code can be initiated by such financial and operational creditor or the corporate debtor itself, in case of a minimum default of the Trigger Amount. The Ordinance has suspended the initiation of CIRP by the financial creditor, operational creditor and the corporate debtor for any default arising on or after 25 March 2020 for a period of six months (or as extended). It further provides that CIRP cannot be initiated for any defaults occurring during the Suspension Period.

Further, under the Code, if it is found during the CIRP that any business of the corporate debtor has been carried on with the intent to defraud creditors of the corporate debtor or for any fraudulent purpose, the National Company Law Tribunal may pass an order for the director or partner of the corporate debtor to make contributions to the assets of the corporate debtor on an application by the resolution professional managing the corporate debtor. In this regard, the Ordinance has incorporated a provision prohibiting the resolution professional from making such application in case of default during the Suspension Period.

Concerns

Amongst developed jurisdictions that have announced changes to their insolvency laws in response to the ongoing pandemic, none have suspended completely, the ability of debtor companies to submit themselves to the insolvency process while they may have restricted creditors' ability to initiate insolvency. However, the suspension of initiation of CIRP by the debtor company itself denies the very freedom to exit an unfavourable market, which is fundamental for efficient markets.

On a bare reading of the Ordinance, it is ascertainable that no CIRP can be initiated against a corporate debtor if such default has occurred during the Suspension Period. The suspension of CIRP under the Code, one of the most efficient mechanisms for insolvency resolution, has left the creditors no choice but to seek recovery of their outstanding dues through time consuming enforcement mechanisms such as taking recovery measures under the Securitization and Reconstruction of Financial Assets And Enforcement Of Security Interest Act, 2002 (**SARFAESI**) or filing suits. Further, as seen from various cases including Jet Airways, the creditors are in no rush to trigger the provisions of the Code and have the maturity to use the Code only as the weapon of last resort to rescue the defaulting corporate. Accordingly, suspending the rights of the creditor under the Code will make the creditor apprehensive against giving any further assistance to a stressed corporate to overcome the COVID-19 situation. Further, the Code has been designed to take into account rescuing a distressed company in this situation. If due to COVID-19 a corporate entity is facing financial difficulties, the corporate entity itself, could have triggered the Code and initiated the moratorium period as stipulated in the Code.

Another concern with the Ordinance is the bar on the resolution professional, who manages the affairs of the corporate debtor during the CIRP, from filing any application seeking contribution of assets from the former management of the corporate debtor on account of historic fraudulent transactions. This gives ample opportunity to the individuals owning and / or controlling the defaulting entities to divert assets of the company which may adversely affect the "going concern" status of the defaulting entity.

Track record of the Code and the way forward

The data backing the implementation and effectiveness of the Code is impressive aided by the big-ticket matters such as the resolution of Essar Steel by ArcelorMittal in partnership with Nippon Steel Corporation (INR 420 billion) and the resolution of Bhushan Steel by Tata Steel (INR 350 billion). Out of the total 3774 CIRPs admitted, only 221 have been approved with a resolution plan whereas 914 have proceeded towards liquidation. However, it needs to be considered that among the corporate debtors under liquidation, three-fourth were either defunct or brought into the system under the erstwhile insolvency regime and therefore, their economic value had eroded even before they were admitted into CIRP. Thus, a large number of entities under liquidation had no scope of resolution under the Code since its admission into CIRP. Further, around 64% of the admitted claims of the financial creditors were realised in the period between January-March 2020 and overall, 45.96% of the admitted claims have been realised till March 2020. This recovery rate is far better than the recovery rates of other legislations such as SARFAESI. Keeping the above in view, it is submitted that the Government may re-consider the Ordinance and leave it to financial creditors and the corporate debtors to take an informed decision on whether a corporate debtor will need additional efforts to continue doing business or whether it is in the best interest of the economy that the corporate debtor is allowed to be liquidated.

Further, it is submitted that alternative modes of insolvency resolution such as recognising pre-packs and giving pre-packs the legitimacy under the Code is the need of the hour. Pre-packs provide an informal set-up for the resolution of the corporate debtor involving negotiation and finalisation with the creditors as a pre-cursor to the rigorous process stipulated under the Code. This will reduce the time taken to arrive at the resolution of the distressed entity and result in higher returns for the creditors which would be approved by the insolvency courts. The role of the insolvency courts in approving a pre-pack is limited to compliance of the pre-pack process without questioning the business judgement of the creditors. Further, the limited role of the insolvency courts, will ensure that during these uncertain times when courts and tribunals in India are not operating on a regular basis, the resolution process continues without any further delay and reduce the backlog. The guidelines for pre-packs should be detailed taking into account the interests of all secured as well as unsecured financial and trade creditors and prevent fraudulent transactions.

The Code has brought about a tremendous amount of discipline and governance in the Indian corporate world as compared to the pre-Code era. Stakeholders are recognizing contractual liabilities, keeping its creditors informed, paying trade creditors on time, among others. The Code in its infancy has become the “key” to unlock the benefits arising out of efficient use of capital. Keeping the above in mind, it is strongly recommended that rather than the suspension of the Code, it could have been preferable to initiate some of the steps mentioned above to ensure that India has a stronger insolvency resolution regime which will be able to deal with the anticipated increase in business failures at the end of this pandemic.

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