

Proposed Suspension of fresh initiation of Insolvency Proceedings for up to one year

BACKGROUND

As a part of a series of relief measures in response to the current pandemic situation, the Finance Minister of India has announced on May 17, 2020 (“**Announcement**”) a proposed suspension of fresh initiation of insolvency proceedings up to one year. In addition, it has been announced that the Central Government will be empowered to exclude COVID-19 related debt from the definition of “default” under the Insolvency and Bankruptcy Code, 2016, as amended (“**IBC**”).

It is envisaged that an ordinance will be issued to give effect to the above measures. In connection with such an ordinance, there are a few points for consideration.

SUSPENSION PERIOD

The Announcement mentions a suspension period of up to one year. Given the far-reaching implications of any suspension and a fast evolving pandemic situation, a shorter period of suspension (perhaps until September 30, 2020) could be considered in the first instance. This could be extended at a later date as appropriate.

INITIATION OF INSOLVENCY BY FINANCIAL OR OPERATIONAL CREDITORS

A blanket suspension of initiation of insolvency proceedings by financial or operational creditors may not be a sensible approach since it will then include within its scope defaults which have occurred, and companies which became insolvent, even before the emergence of the COVID-19 pandemic. This will have numerous unintended consequences. Accordingly, any suspension must be targeted and focus on the issue at hand. Such a suspension must be restricted to situations where the reason for default is based on the COVID-19 pandemic.

If the definition of “default” under the IBC is proposed to be amended to exclude COVID-19 related default, then a suspension of initiation of insolvency proceedings

may not even be required. This approach would however burden the NCLTs with considering in each case whether the default is a COVID-19 related default or not. It could potentially give rise to a spate of litigation on this preliminary question itself.

An alternative approach is to prescribe a cut off date. For initiation of insolvency by financial or operational creditors, the default must have occurred prior to a specified cut off date. The suspension will apply only in respect of situations where the default has occurred on or after such specified date.

Possible dates which could be considered in this regard are: (a) the date from which the Reserve Bank of India's moratorium on loan repayments is effective (March 1, 2020), or (b) the date on which COVID-19 was declared a global pandemic (March 11, 2020), or (c) the date on which a national lockdown became effective in India (March 25, 2020).

VOLUNTARY INITIATION OF INSOLVENCY

It has been proposed that the suspension also extend to the voluntary initiation of insolvency under the Section 10. However, there is an inherent issue in suspending the operation of Section 10.

Section 10 provides that where a corporate entity has committed a default, it *may* (emphasis supplied) file an application for initiating insolvency subject to certain conditions. While Section 10 is written as a right, it is more akin to an obligation in certain cases in view of Section 66(2) which provides for wrongful trading.

In terms of Section 66(2), the directors of a corporate entity may be held personally liable if before the insolvency commencement date, (a) they knew or ought to have known that there was no reasonable prospect of avoiding the commencement of insolvency proceedings, and (b) they did not exercise due diligence in minimising the potential loss to the creditors of the corporate entity.

Essentially, if the directors allow a corporate entity to trade after the point at which they knew or ought to have known that the company had no reasonable prospect of returning to solvent trading, they can be held personally liable.

An alternative approach in relation to voluntary initiation of insolvency is to suspend operation of Section 66(2) for a temporary period and allowing Section 10 to continue to remain in force¹. This would reduce the threat of directors incurring personal liability if they fail to initiate insolvency. At the same time, it would continue to remain open for

¹ In this regard, the approach followed by the United Kingdom is relevant. In the United Kingdom, the Government has proposed a temporary suspension (to the end of June 2020) of Section 214 of the UK Insolvency Act, 1986 in relation to wrongful trading, subject to passage of the Corporate Insolvency & Governance Bill through the UK Parliament.

a corporate entity to make an informed assessment that it is unable to continue as a going concern, and to initiate insolvency proceedings under Section 10 on that basis, without an obligation under Section 66(2) to do so. Preserving this ability for a corporate entity to voluntarily elect to initiate insolvency proceedings even during any temporary period would be important for an efficient market. It is noteworthy that there need not be any relaxation to directors' fiduciary duties (Section 166 of the Companies Act, 2013) or to the provision regarding fraudulent trading (Section 66(1) of the IBC)) so that appropriate checks remain in place.

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