Impact of COVID-19 on Proceedings under the Insolvency and Bankruptcy Code, 2016

In the light of the economic upheaval on account of the COVID-19 pandemic and the resultant restrictions on economic activity, the Indian Government announced[1] the possibility of suspension of the right to initiate insolvency resolution proceedings against corporate debtors[2] under the Insolvency and Bankruptcy Code, 2016 (the "**Insolvency Code**") on March 24, 2020, and May 17, 2020. While this measure was finally implemented on June 5, 2020, the Government introduced several other measures relating to the Insolvency Code in the interim.

I. INCREASE IN PAYMENT DEFAULT THRESHOLD

Pursuant to a notification[3] dated March 24, 2020, the amount of payment default constituting the threshold for initiating insolvency resolution proceedings under the Insolvency Code was increased from INR 1 lakh to INR 1 crore. This move is expected to benefit micro, small and medium enterprises ("**MSMEs**") and is also otherwise welcome by corporate debtors given that the earlier threshold of INR 1 lakh was relatively low. Unlike the suspension of insolvency proceedings described below, *there is no end-date for this measure*, i.e., the notification does not restrict the applicability of the increased threshold to the period of the pandemic or any other time period.

II. EXCLUSION OF LOCKDOWN PERIOD FROM TIMELINES

In March-April 2020, regulations under the Insolvency Code were amended to provide that the period of lockdown would not be counted for any activity/task in the Corporate Insolvency Resolution Process ("**CIRP**") or liquidation process, as applicable, that could not be completed due to such lockdown. While this

[1] http://www.mca.gov.in/Ministry/pdf/IBCAmedBill_05062020.pdf
[2] Unless specified otherwise, this post discusses insolvency proceedings in respect of corporate debtors.
[3] https://ibclaw.in/wp-content/uploads/2020/03/Sec.-4-of-IBC.pdf

amendment did not extend the statutory timeline of 180 days (which may be extended to up to 270 days) for completion of the CIRP specified under Section 12 of the Insolvency Code, the National Company Law Appellate Tribunal ("**NCLAT**") issued an order[4] dated 30 March 2020, pursuant to which the period of lockdown was required to be excluded from such statutory period in respect of cases where the CIRP was pending.

III. SUSPENSION OF INSOLVENCY PROCEEDINGS

On June 5, 2020, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020[5] (the "**Insolvency Ordinance**") became effective. The Insolvency Ordinance inserted a new Section 10A (*Suspension of Initiation of Corporate Insolvency Resolution Process*) in the Insolvency Code and modified Section 66 (*Fraudulent Trading or Wrongful Trading*) of the Insolvency Code.[6]

Section 10A of the Insolvency Code prohibits the filing of applications under Sections 7, 9 and 10 of the Insolvency Code (i.e., by financial creditors, operational creditors and corporate debtors themselves) for the initiation of CIRP of a corporate debtor in respect of defaults arising during the six (6) month period from and including March 25, 2020 (the date of commencement of the national lockdown) which may be extended up to one (1) year ("**Restricted Period**"). Section 10A of the Insolvency Code also prohibits in perpetuity the filing of applications for the initiation of CIRP of a corporate debtor in respect of any such default.

However, Section 10A of the Insolvency Code will not be applicable in respect of defaults committed by the corporate debtor prior to March 25, 2020.

IV. SUSPENSION OF LIABILITY FOR WRONGFUL TRADING

Under Section 66(2) of the Insolvency Code, during the CIRP of a corporate debtor and upon an application filed by the resolution professional with the relevant National Company Law Tribunal ("**NCLT**"), the directors or partners (in case of a limited liability partnership) of the corporate debtor can be ordered to personally contribute to the corporate debtor's assets if the director or partner knew or ought to have known that there was no reasonable prospect of avoiding CIRP and did not exercise due diligence to minimize potential losses to creditors. The Insolvency Ordinance now inserts sub-section (3) to Section 66 of the Insolvency Code, which prohibits

[4] https://nclat.nic.in/Useradmin/upload/5186278465e81baf8ac471.pdf
[5] http://www.mca.gov.in/Ministry/pdf/IBCAmedBill_05062020.pdf
[6] Under Article 123 of the Constitution, an ordinance will be on par with an Act of the Parliament and will cease to operate upon the expiry of six (6) weeks from the date of reassembly of the Parliament unless it is approved by the Parliament. An ordinance will cease to operate earlier if both Houses of the Parliament pass resolutions disapproving the ordinance or if it is withdrawn by the President.

making any applications under Section 66(2) in respect of any default for which initiation of CIRP has been suspended under Section 10A.

V. SPECIAL INSOLVENCY FRAMEWORK FOR MSMES

On May 17, 2020, the Indian Government announced[7] the introduction of a special insolvency framework for MSMEs – this is still awaited.

There is no doubt that the recent changes to the Insolvency Code, taken together with the moratorium and other measures announced by the Reserve Bank of India ("**RBI**"), will provide some relief to stressed businesses. However, the Insolvency Ordinance also extends to voluntary initiation of insolvency under Section 10 of the Insolvency Code. 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 considering Section 66(2) of the Insolvency Code, which provides for wrongful trading. Given that the operation of Section 66(2) has been suspended, Section 10 should have been permitted to continue to remain in force, particularly given that it requires a shareholders' resolution by 75% vote, the CIRP invites a scrutiny of the company's past dealings, including with related parties, and the CIRP could result in a change in ownership and management. It would then continue to remain open for 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.

A blanket prohibition on initiation of the CIRP in respect of defaults arising during the 'Restricted Period' poses some risk of misuse – e.g., some companies may choose to default on operational payments during the 'Restricted Period' even if they can pay since operational creditors would never have recourse to the Insolvency Code in respect of such default, even after the pandemic subsides, and they would also not be eligible to use the RBI's mechanisms which are available to banks and financial institutions. The suspension of Section 66(2) of the Insolvency Code may also be subject to misuse. However, it is noteworthy that there is no relaxation to directors' fiduciary duties (Section 166 of the Companies Act, 2013) or to the provision regarding fraudulent trading (Section 66(1) of the Insolvency Code)) so that appropriate checks remain in place.

Further, the above measures are focused primarily on new insolvency proceedings, however, the pandemic has also had a significant impact on ongoing insolvency proceedings. For example, the NCLT and the NCLAT have been hearing urgent matters

[7] https://www.ibbi.gov.in/uploads/resources/70fcd5225f17f6a85ab362bec76e0798.pdf

through video-conferencing, however, this has caused delays in pending insolvency proceedings; and the assumptions and valuations in resolution plans submitted prior to the pandemic may not be appropriate in the current circumstances.

Lenders, debt investors and borrowers will now need to consider alternative out-of-court enforcement/restructuring options, such as under the Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019[8] ("**RBI Directions**") and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002,[9] ("**SARFAESI Act**") or in-court restructuring through schemes under Sections 230–232 of the Companies Act, 2013. On August 6, 2020, the RBI announced[10] that a window would be provided under the RBI Directions to enable lenders to implement a resolution plan in respect of eligible corporate exposures, without a change in ownership, as well as personal loans, while classifying such exposures as standard assets, subject to specified conditions. It remains to be seen whether stakeholders will use these mechanisms effectively without diminishing value or if courts will be inundated with insolvency resolution proceedings in respect of prior defaults and defaults occurring after the expiry of the 'Restricted Period'.

In these circumstances, a greater focus is required on enhancing the efficacy of existing out-of-court and in-court restructuring mechanisms and introducing new mechanisms to preserve value, such as the pre-packaged insolvency resolution process, which would provide statutory approval to a mutually agreed resolution plan in a cost-effective manner.

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[8] https://ibclaw.in/rbi-prudential-framework-for-resolution-of-stressed-assets-directions-2019/
[9] http://www.drat.tn.nic.in/Docu/Securitisation-Act.pdf
[10] https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=11941&Mode=0