



Insolvency and Bankruptcy Ordinance 2020- An Overview Regarding Benefaction and Inconsiderateness

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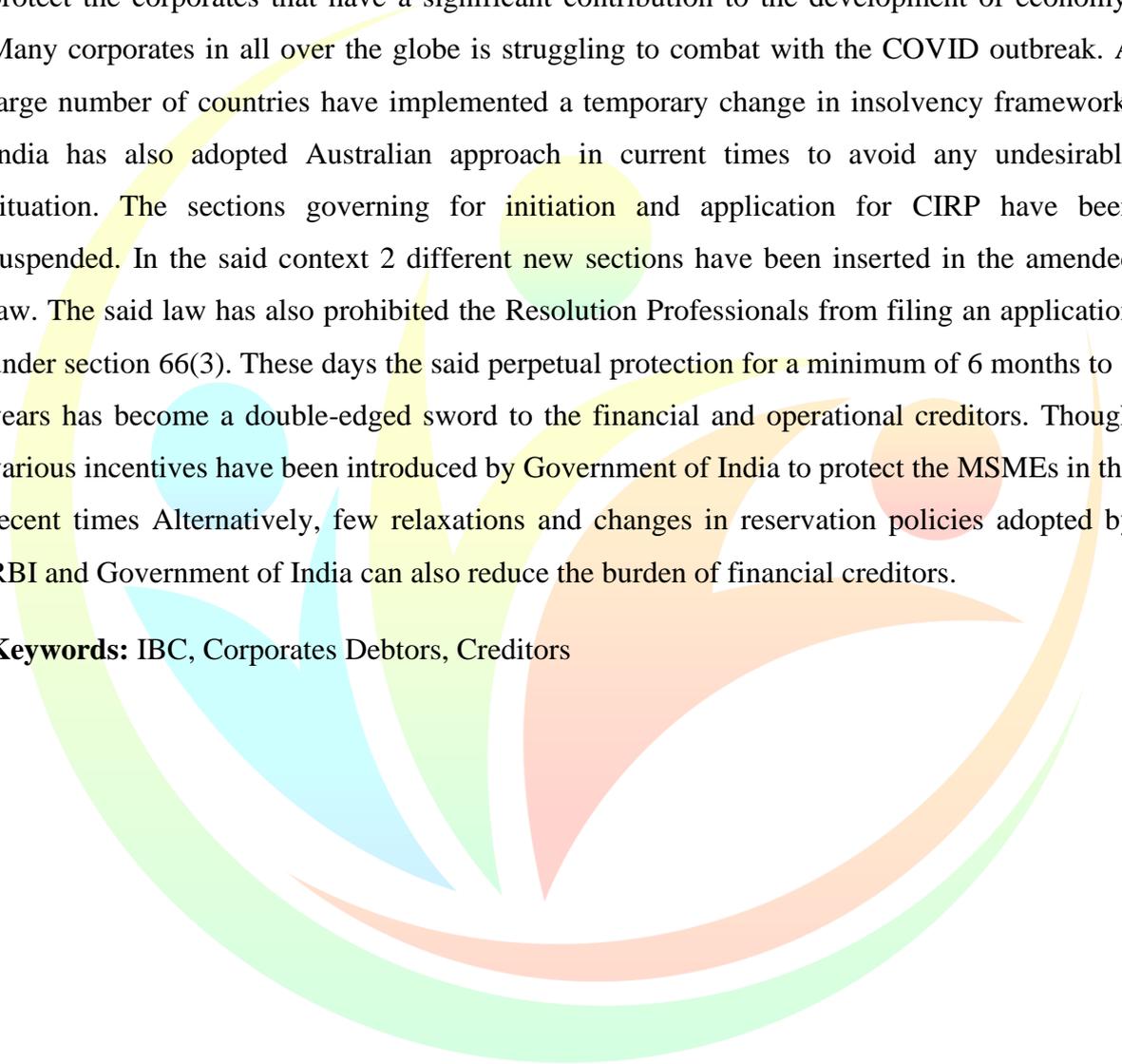


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ABSTRACT

Insolvency and Bankruptcy ordinance 2020 is amongst the recent amendments of Government of India. The ordinance is enacted by president of India on 5th June 2020 to protect the corporates that have a significant contribution to the development of economy. Many corporates in all over the globe is struggling to combat with the COVID outbreak. A large number of countries have implemented a temporary change in insolvency framework. India has also adopted Australian approach in current times to avoid any undesirable situation. The sections governing for initiation and application for CIRP have been suspended. In the said context 2 different new sections have been inserted in the amended law. The said law has also prohibited the Resolution Professionals from filing an application under section 66(3). These days the said perpetual protection for a minimum of 6 months to 1 years has become a double-edged sword to the financial and operational creditors. Though various incentives have been introduced by Government of India to protect the MSMEs in the recent times Alternatively, few relaxations and changes in reservation policies adopted by RBI and Government of India can also reduce the burden of financial creditors.

Keywords: IBC, Corporates Debtors, Creditors

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INTRODUCTION

COVID pandemic and nationwide lockdown has forced the governments of all over the world to take some necessary steps to tackle the threat. Insolvency and Bankruptcy Ordinance 2020 is said to be such an initiative to protect the corporates of the nation. Insolvency and bankruptcy act 2016 have been amended as IBC ordinance 2020 by president of India on 5th June 2020. The economic conditions, social wellbeing etc. of the country ceased to grow for a certain period. The companies are also suffering due to decline in sales. They are unable to meet the obligations of the creditors at the current times. In the said economic condition, there is a high need to protect the firms from undesired insolvency. The IBC code is not a recovery resolution forum rather it is an utmost effort for the company's survival through restructuring of the corporates. Section 10A and 66(3) are the recent addition of the ordinance that has made a temporary suspension of initiation of corporate insolvency resolution process. It is expected that the law can minimize the property demolition due to poor economic realized value in current distressed situation. The promulgation of IBC ordinance has focused for the protection of strength of financial system. Suspension of any proceedings for

corporate insolvency has been enacted for a minimum of 6 months that can be extended upto 1 year. The protection of firms operating in the economy has become very crucial as there is high possibilities of default in current times. It would be very difficult to endeavor the perpetual succession of any corporate due to the expectancy of high-resolution applicants. On the other hand, this amendment has prevented both the operational creditors and financial creditors to proceed against their claims. Around Rs.303 lakh crore fund of MSME sectors have been blocked with large corporates. M/s Kuntal Construction Pvt. Ltd. Versus M/s Bharat Hotels Ltd is a case for default of amount of Rs. 14,89,966. Alchemist Asset Reconstruction Company Ltd Versus Manoj Garg. & Anr. is a case of claim for Rs. 65,81,74,830. Jet Airways, Dewan Housing finance Ltd are the two major default cases pending under IBC act. All these categories of defaults have squeezed the creditors of the firms in current times. In the said context the present study has been undertaken.

REVIEW OF LITERATURE

There are extensive number of literatures on different issues regarding Insolvency and Bankruptcy code. Few articles of the very recent times have been discussed

here. **Agrawal, A. 2020.** in his article “Liquidation as Going Concern Under Insolvency and Bankruptcy Law” has discussed about the process of liquidation of going concern under Insolvency and Bankruptcy code 2016. In the said article it is expressed that the conversion of liquidation into resolution has fulfilled the objectives of balancing the interest of stakeholders. **Gurrea-Martínez, A. 2020.** in the article “Insolvency Law in Times of COVID-19” has explained about the insolvency law in different countries across the globe at the times of COVID 19. The author has suggested for a comprehensive package of legal, financial, tax and economic responses. **He, D., Yu, K., & Wu, J. 2020.** in their paper “Industry characteristics, court location, and bankruptcy resolution” both theoretically and empirically investigated the determinants of formal bankruptcy resolution. Based on the industry characteristics large firms are suggested to be reorganised. **Homonoff, T., Spreen, T. L., & Clair, T. S. 2020.** in article titled “Balance sheet insolvency and contribution revenue in public charities” has discussed about the insolvency of non-profit organisation that cannot be forced into bankruptcy. The authors have documented bunching that lead to increase revenue contribution of the non-profit organizations at the threshold for

insolvency. In an article titled “Formulating an Effective Cross-Border Insolvency Framework under the Indian Insolvency and Bankruptcy Code”, few recommendations have been made by the author **Kurpad, M** for establishing an effective cross border insolvency regime under IBC. In the said article the author has argued for the adoption of UNCITRAL model law and any bilateral or cross border insolvency law without modification. **McGregor, S. L. (2020).** in his article “Tailoring Bankruptcy Insolvency Education to Ensure Solvency Literacy” has proposed for bankruptcy counselling and education for attaining solvency literacy. **Parker, A. (2020).** in his paper titled “Corporate Insolvency Resolution Process Under IBC 2016” has discussed in detail about the corporate insolvency process under IBC 2016. An article titled “Differential Treatment Among Creditors Under India's Insolvency and Bankruptcy Code, 2016: Issues and Solutions” has been analysed by the author **Pryor, C. S., & Garg, R. in 2020.** The author has analysed the results of an examination of the implementation of India's IBC, 2016. **Singh, H. (2020).** in his article “Pre-packaged Insolvency in India: Lessons from USA and UK” has elaborated about the pre-packaged bankruptcy rooted in USA or UK that could be find integrated in India's

bankruptcy regime. The author has highlighted specific challenges to the introduction of pre packs and presented a holistic overview. **Stef, N., & Dimelis, S. (2020)**, in a paper “Bankruptcy regime and the banking system” have studied samples of 87 countries to investigate the influences of legal rights of banks for private credit, bank lending deposit spread and foreign banks presence. The association between Systemic risk, economic policy uncertainty and firm bankruptcies have been studied by **Stolboy, M., & Shchepeleva, M. (2020)** in their article “Systemic risk, economic policy uncertainty and firm bankruptcies: Evidence from multivariate causal inference”. Based on the studies of the above literatures it is found that no such literature has considered the effects and consequences of Insolvency and Bankruptcy ordinance 2020 for analysis and evaluation. In the present context the following objectives have been considered for the study.

OBJECTIVES OF THE STUDY

The present study is conducted to fulfill the underlying objectives -

- i) To Understand the role of Insolvency and bankruptcy ordinance 2020 in light of COVID-19 crisis.

- ii) To evaluate the challenges and threats of the creditor under the current regulation.

UNDERSTANDING THE ROLE OF INSOLVENCY AND BANKRUPTCY ORDINANCE 2020 IN COVID-19 CRISIS

IBC ordinance 2020 has been enacted by the president of India to protect the companies from being forced into insolvency proceedings occurred due to COVID 19 crisis. Before the enactment of IBC 2016, the matter of insolvency was a very complex as it was governed by multiple laws like Companies Act 1956 or Industrial Companies Act 1985 and many more. IBC code 2016 has outlined the framework of the resolution process for individuals, companies and partnership firms separately. For the supervision of insolvency proceeding and monitoring the regulation of entities registered under it, the IBC code has established the Insolvency and Bankruptcy Board of India.

Usually the licensed professionals used to manage the insolvency process. These licensed professionals usually govern the assets of the debtors during the insolvency process. The National company Law Tribunal and Debt Recovery Tribunals are two different tribunals proposed by the code to administrate the process of insolvency resolution, for individuals,

companies and partnership firms. Initially an appeal has to be submitted to adjudicating authority by financial or operational creditors governed by section 7,9 and 10 under IBC act 2016. Section 7 of the IBC authorised financial creditors to initiate corporate insolvency resolution process. Section 9 of the said act deals with application of insolvency by an operational creditor, while Section 10 is for initiation of insolvency resolution proceedings by a corporate applicant. All the above sections have been suspended to cease the right of creditors or corporate applicant to initiate and apply for CIRP. Therefore, a new section, section 10A has been inserted in the current amendment. The current IBC regulation 2020 has changed the scenario in multiple ways. Several facets have kept in consideration before the enactment of the IBC ordinance. **Firstly**, the right of creditors for initiation of corporate resolution process has suspended which temporarily can protect the companies from undesired dissolution. In the current pandemic and lockdown situation, the production and turnover of the firms have been reduced tremendously. Therefore, it becomes difficult for firms to meet its current obligation. **Secondly** the value of the firm's assets will be destroyed due to poor economic condition if dissolution occurs. It is expected such undesirable situations can be overcome if

proper mechanism is being adopted & followed. **Thirdly**, the bankruptcy of firms will hamper the economic stability as well as generate more unemployment which lead to individual financial distress and indebtedness. **Fourthly**, the suspension of section 10 for a minimum of 6 months will obliged the creditors to meet their claims in a coordinated, systematic and rational way. This becomes healthy for the economy of any country. **Finally**, IBC ordinance has granted few months for the restructuring of company's capital both internally and externally. Currently the law has allowed the corporate debtors to take breath freely for minimum of 6 months from 25.03.2020 that can be extended up to 1 year if necessary. In short, the ordinance will help to rejuvenate the confidence of corporate debtors. Insertion of section 66(3) of the principal Act thereby has prohibited the Resolution Professionals from filing an application under sub-section (2) of Section 66 of the Code. It has allowed the directors and partners of any firm to act in a manner on the interest of corporate debtor for its revival and maximization of its value. This ultimately boost the confidence of managers or directors of corporates.

CHALLENGES AND TREATS TO CREDITORS

The challenges that are being faced by the creditors can be discussed in two different parts i.e. from the end of financial creditors and from the view point of operational creditors.

a) Challenges and threats to Financial creditors

Section 5(7) of IBC act 2016 has outlined the definition of financial creditors. As per Section 5 (7) "financial creditor means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to". Basically, financial creditors are money lenders like banks and financial institutions that used to circulate funds to the corporate houses. Such money lenders used to supply credit to corporate debtors in different forms. Firstly, funds are being supplied to corporate debtors against payment of interest. Financial Institutions including banking and non-banking institutions provide different credit facilities on account of acceptance of payables. Issue of bonds, debentures, loans or any similar instrument is the third way of borrowing from financial creditors. But at the time of realization of such debt priority becomes an

important parameter. The realized value of asset is utilized to pay off the debt as the first charge holder is paid off first and then the next holder of second ranking paid off and so on. In other words, priority of charge is significant while determining which creditor will be paid of first. No equivalent clause was existing in any of the previous acts under which the 'first charge' can be initiated in favour of financial institutions, banks, non-banking financial institutions, or any of the secured creditors. The banks or any other financial institutions cannot demand for the first charge despite of having mortgage over the immovable property. The priority was available to the secured creditor under the amended provisions of Section 31-B of the Recovery of Debts Due to Banks and Financial Institutions Act only applicable for Government dues, and not to statutory dues payable under the EPF and MP Act, 1952. The current amendment of IBC ordinance 2020 has made the situation more challenging. Suspension of section 7 and 9 have ceased the right of financial creditors for any proceedings against corporate debtors. Substantially the inclusion of section 10 A certify *that no appeal should be granted for the said default occurring after 25.03.2020*. A large no

of banks is struggling for a long time to manage the non-performing assets that results in merger of few banks at recent times in Indian economy. Instead of having huge debts outstanding, banks and other financial institutions find no options to manage their claims and non-performing assets. It may also happen that such corporate debtors can still escape the clause by accounting for the default after this period. It is not difficult for unscrupulous borrowers to take shelter under the blanket of section 10(A) for perpetual protection.

b) Challenges and threats to Operational Creditors

An operational creditor is "any person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred as per Section 5(20) of the IBC 2016". Usually these are the entities provide raw material, goods or services to the corporate debtors. Most of the cases these operational creditors are Micro Small and Medium Enterprises. Due to the insertion of section 10A, operational creditors specially the MSMEs are in great trouble. They will not be able to proceed against corporate debtors to demand their claims under the

stipulated time period of 6 months from 25.03.2020 to maximum 1 year if situation arises. This time frame may be a reason of shortness of breath for operational creditors now a days. Again, the threshold limit has already been raised to 1 lakh to 1 crore in section 4 of IBC 2016 for any default that arises to corporate debtors. This has more an adverse effect on operational creditors. Now the amendment of IBC might lead to a high possibility of MSMEs not being able to invoke Section 9 of the Code even if the default arises above the minimum prescribed threshold of Rupees 1 crore. Now the question arises that will the businesses be allowed to claim their dues, once the corporate debtors recover from the financial distress? The answer is no, that the creditors cannot claim the dues even after the disruption period is over. This will have an unwelcoming impact on the MSME sector. This may result in a deliberate default by the corporate debtors that would go against unadjudicated proceedings due to insertion of Section 66(3).

CONCLUSIONS

Insolvency and bankruptcy law is such an initiative of Ministry of law and Justice that could prove itself to be a stabilizer of

economy specially in the corporate sector with its all amendments from time to time. IBC has become a tool for releasing the money from non performing corporates. The IBC ordinance 2020 is basically for the survival of corporate debtors which is important for maintaining the stability of economy. Though it has challenged the smooth functioning of operational and financial creditors. The potential losses of financial creditors may be adjusted through different financial reforms to boost the economy. Again, RBI on its official disclosure on **April 17th 2020** and **23rd May 2020** has permitted a relief of 180 days to its distressed borrowers due to COVID pandemic from their accounts being pronounce as non-performing assets. After the completion of 180 days, such defaulting accounts can still be taken to the bankruptcy court where reasons of default are not in connection to COVID-19. Thus, such financial creditors can initiate for recovery process through section 19 of Recovery of Debts Due to Bank and Financial Institution Act or under section 13 and 14 of the SARFEASI Act. Similarly, operational creditors can go for the same process under the Commercial Courts Act for recovery. For the recoveries of debts,

SMEs can proceed under Samadhan Scheme. Section 16 of the MSMED Act, 2006 has specified the date from which interest is payable, has not been subjected to the Ordinance. Thus, a debtor committing a default will have to pay the specified interest regardless of the Ordinance passed. Thus, a corporate debtor owing repayment to MSMEs will not be capable to exempt itself from the Ordinance. Again, to protect the MSMEs in these hard times, the Ministry of Micro, Small and Medium Enterprises has amended the definitions of MSME through the Gazette Notification dated June 01, 2020 to ensure that more enterprises fall within the ambit of the Micro, Small and Medium Enterprises Development Act 2006. In the recent times various incentives has also been introduced by Government of India to protect the MSMEs like approval of equity infusion of Rupees 50,000 crores from the Fund of Funds, Rupees three lakh crore of collateral free loans to the MSMEs for their operational needs from the package of Aatmanirbhar Bharat.

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