IBC Amendment 2019: Slow & Sure Steps to Resolution

1. Introduction

In May 2016, the Indian Government introduced a radical legislation called Insolvency and Bankruptcy Code (**"IBC"**) which is now the stand-alone statute on insolvency and bankruptcy. It was primarily enacted to help banks recover bad loans i.e., those that remained unpaid beyond 90 days or more. It applies to companies, partnership firms and limited liability partnerships. Through this law, creditors are empowered to seek time-bound resolutions to get their money back from a company on bad debts. With 255 sections, it repeals some ancient laws and amends the liquidation provisions of companies, debt recovery and asset reconstruction processes.[1] It took a few months to put together the procedural rules which were notified on December 1, 2016 and apply to corporate insolvency resolution process (**"CIRP"**). The new regulator, Insolvency and Bankruptcy Board of India, was established on October 1, 2016 and with 35 different officers fulfilling varied functions, it is responsible for successful IBC implementation. The adjudicating authority is National Company Law Tribunal (**"NCLT"**). According to media reports,[2] since its enactment in the last three years 21,000 cases have been filed out of which nearly 10,000 cases have been settled. Of this, 8,500 cases were resolved after filing, but before admission and about 1,500 cases resolved thereafter. 1,500 cases are under process.

After it was introduced in 2016, IBC has been amended thrice; twice in 2018 and the latest amendments came into effect from August 16, 2019 through IBC Amendment Act, 2019. This newsletter examines key provisions focusing on the latest changes which ought to clear various hurdles in the resolution process.

2. CIRP Process Overview

IBC envisages two types of creditors – financial & operational. Under section 5(7), the former is any person to whom a financial debt is owed and includes a legal assignee or transferee. The financial creditor can be secured (usually banks) or unsecured (other lenders). In contrast, operational creditors are unsecured, often are suppliers of good or services, include employees claims, trade debts and dues payable to the Central or any State Government or any local authority.

Under section 6 of IBC, if a corporate debtor defaults in payment of INR 100,000 (about USD 1,400)[3] or more, then a financial or operational creditor or even the corporate debtor can initiate CIRP. This does not necessarily mean that the company will be shut down; rather, the focus is to find a resolution which can include steps to raise fresh funds so operations can continue. However, the threshold of INR 100,000 is quite low, empowers a creditor who is owed a low figure to take extreme steps and file an application to launch the insolvency resolution process and, therefore, the government is contemplating enhancing the minimum sum. A single *financial creditor* can file an application to launch CIRP with NCLT or join forces with others. NCLT has to

[1] These are Recovery of Debts due to Banks & Financial Institutions and SARFAESI Acts
[2] See, https://economictimes.indiatimes.com/news/economy/policy/government-mulls-raising-rs-1-lakh-default-threshold-for-invoking-ibc-srinivas/articleshow/71583287.cms?from=mdr, last accessed on Oct 15, 2019
[3] 1 USD = INR 71 and rounded off

either admit or dismiss the application within 14 days. If admitted, the resolution process is initiated. The process for *operational creditors is* somewhat different. They have to issue a demand notice along with supporting invoice on the corporate debtor who, upon receipt and within 10 days, can either pay up or respond and notify the existence of a dispute. Under section 5(6), dispute must be pre-existing, in court or arbitration relating to the existence of quantum of debt, quality of goods service or breach of representation or warranty. If the company either fails to pay or neglects to notify the existence of a dispute, operational creditor can move NCLT and file an application to launch CIRP with evidence of proof of default and non-payment coupled with an affidavit affirming absence of notice regarding existence of a dispute of the claimed amount. If NCLT is satisfied that all the relevant criterion is fulfilled, it will admit the application in 14 days or reject.

Once an application is admitted, NCLT appoints an insolvency resolution professional (**"IRP"**) to take charge of the company and the moratorium period begins. The IRP is responsible for formulating the CIRP plan. Such plan must include steps to revive the company, such as raising fresh funds for operation, looking for new buyer(s) to sell the company as going concern. The outstanding debts may be satisfied if, as part of the resolution plan, someone takes over the corporate debtor and pays-off the remaining debts. If a resolution plan is not submitted or not approved by the committee of creditors[4] (**"COC"**) the CIRP process is deemed to have failed. In such a case, liquidation commences and corporate debtor is liquidated.

3. The Timing Issue

Section 12 of IBC provides 180 days to complete the entire resolution process, computed from the date of admission of application by NCLT. The aforesaid period of 180 days was never sacrosanct and IRP could (and did) seek extensions for an additional 90 days, which were granted provided NCLT was satisfied that the situation warranted an extension. Thus, the entire process had to be completed within 270 days. But in reality, it took much longer due to multiple factors. Usually, the NCLT took 21-30 days to determine the existence of a default before admitting or rejecting CIRP application. Additionally, presumably largely due to the backlog of pending cases CIRP could not be completed within 270 days.

Now, in civil suits where the process of Civil Procedure Code applies, courts have held that prescribed periods are directory and not mandatory. Effectively, this means courts can extend the timelines and, of course, this ability to permit innumerable extensions has been considered one of the biggest malaises of Indian dispute resolution. In the case of JK Jute Mills Co. Ltd. vs Surendra Trading Co., in May 2017 NCLAT stated time was the essence of IBC, even alluded to 270-days as being mandatory in nature. In the event the timeline is not honored, then there is a consequential cascading impact on the liquidation process, described in section 33.

4. The Amendments

4.1 *Timelines:* The legislature felt it was necessary to address the concerns surrounding the possibility of multiple extensions and, accordingly, the 2019 Amendment has introduced changes whereby (a) 14 days have to be respected i.e., NCLT must admit or dismiss the CIRP application

[4] The COC comprises of financial creditors only. Operational creditors, shareholders, board and other company officials are excluded

within that period, else record reasons for delay[5] in its own order; and (b) 270 days have been replaced by 330 days which means that the entire process cannot be extended beyond that. Clearly, the objective is to facilitate expeditious disposal. While fixing an outer time limit is laudable, there are two concerns. Firstly, the question does arise if one size fits all because there may be situations where the resolution process could take longer given the scale of debts. For instance, the situation of Jet Airways. Secondly, assuming 330 days is sufficient, then it does not factor in potential challenges to the plan which has been common in the recent past when they get mired in litigation. It would be worthwhile to draw an outer limit, including possible challenges in court so that once a plan is approved, the next step should be to implement it. Else, the prolonged periods will defeat the very purpose for which IBC was introduced.

4.2 *Restructuring:* Under the IBC, it was unclear whether resolutions could include restructuring like mergers, demergers or amalgamations. The 2019 Amendment clarifies this is possible by insertion of an explanation in section 5(26) which provides that a resolution plan may include provisions for restructuring of corporate debtor which may be carried out by way of merger, amalgamation and demerger. While it will allow options for resolution plans, there are inconsistencies between the Code and provisions of CA 2013, which is the governing law for restructuring. Firstly, CA 2013 requires special resolution of all class of creditors and shareholders for a restructuring scheme. In contrast, the IBC excludes shareholders and operational creditors from the approval process of the resolution plan. Secondly, CA 2013 states that schemes must be provided to ROC and CCI where required for their approval. But IBC makes resolution plans binding on government authorities (see next section below) without clarifying if approval is required. In view of the non-obstante provision of section 238 of IBC that it overrides other laws in case of inconsistencies, it appears that IBC will prevail unless the future brings jurisprudence to the contrary.

4.3 *Binding on Government:* Section 31(1) has been amended to clarify that the resolution plan approved by NCLT is binding on the Central or State Government or any local authority to whom statutory dues are owed by the corporate debtor. There was no such provision in IBC, as drafted originally or even in the two earlier amendments. Hopefully, this change will put an end to frivolous challenges to an approved resolution plan.

4.4 *Distribution of proceeds:* Section 53 of IBC determines the distribution manner in the event of liquidation of the corporate debtor and how the proceeds of the sale will be prioritized. In "Standard Chartered Bank Vs. Satish Kumar Gupta" i.e. Essar Steel case, financial and operational creditors were treated at par and the COC did not have a material say in deciding the distribution manner. In this case, the appellate body NCLAT had ruled that section 53 did not apply in the distribution of an approved resolution plan. A financial creditor is usually a secured one and equating them with unsecured ones caused a lot of turbulence and triggered enormous debate. In an endeavour to give the financial creditors their due, section 30(2)(b)[6] has been amended. It now provides that a resolution plan must ensure that (a) the operational creditors receive the higher of, at least, the liquidation value of their debt or the figure they would have received if the amount distributed under the resolution plan was done pursuant to the sequential order of priority described in section 53; (b) the dissenting financial creditors also receive the amount they would have received if the distribution under the resolution plan followed the prescribed waterfall

[5] This has now been added by means of a proviso in section 7(4)

[6] Section 30 deals with the resolution plan

mechanism of section 53 in case of liquidation. Furthermore, there is now a statutory mandate that the distribution shall be both fair and equitable for the creditors.

4.5 *Liquidation by COC*: By an amendment to section 33, an explanation has been inserted whereby "the COC may take the decision to liquidate the corporate debtor, any time after its constitution and before the confirmation of the resolution plan, including at any time before the preparation of the information memorandum." This means that the COC can evaluate and chose to liquidate a corporate debtor by making an application to NCLT at any time. While the change is inserted as an explanation, the question arises if there will be any scope of abusing such wide powers or appropriate checks and balances will have to be built in.

4.6 *Authorized representative*: It is possible in some cases the number of creditors could be voluminous and there may be lack of consensus amongst them. Section 25A(3A) has been inserted through the 2019 Amendment whereby an authorized representative[7] shall vote in the COC on behalf of all financial creditors he represents and in accordance with the decision of majority, i.e. in excess of 50% of those present and voting. Previously, while casting his vote the representative had to factor based on the individual instructions of the creditors or, if no instructions were given, abstain from voting. Hopefully, this will both ease and speed the decision-making process of creditors.

Conclusion

The expectation of the government and industry is that these rounds of amendments shall iron out the thorns and facilitate the process of resolution and/or liquidation, while maintaining the core spirit of the IBC – minimize liquidations and maximise resolution plans to revive stressed companies. It is premature to take a conclusive position as no law can envisage every possible situation beforehand, but the fact that corrective steps have been taken, amongst others, to ensure that timelines shall be met, distribution should be fair and equitable (as opposed to pro-rata amongst different classes of creditors), resolutions can be found via mergers and amalgamations has to be lauded as they are steps in the direction of finding resolutions.

Author
Priti Suri

[7] The amendment applies to authorized representative(s) of creditors belonging to a class, who are appointed under section 21(6A) of IBC