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IBC Amendment Ordinance- A Stitch in Time?

Insolvency Round-Up

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IBC Amendment Ordinance - A stitch in time?

There was a significant jump witnessed in India's ease of doing business rankings last year and the Insolvency and Bankruptcy code ("the Code") was regarded as a key contributor in the jump. Having acknowledged the contribution of the Code, the Government of the day is making every possible effort to make it fit for purpose. The Code was brought in force in December 2016 and has already seen two ordinances and an amendment not to mention the circulars and changes in rules and regulations.Being new, the jurisprudence around the Code is still evolving and unforeseen situations are encountered every day. However, it is encouraging to see that the Judiciary as well the Legislature are both being very proactive is making sure the Code delivers what it was intended for.

The most recent step in this direction is the Insolvency and Bankruptcy Code Amendment Ordinance promulgated on 06.06.2018. Below are the key changes brought in by way of the present ordinance and are bound to have far reaching consequences.

1. ***Home Buyers as Financial Creditors***

   To remove the existing anomaly which short changed the Home Buyers by placing them at the bottom of the pyramid in getting their claim addressed in case of liquidation, the Home Buyers have formally be given the status of a financial creditor. This has been done by inserting an explanation in section 5(8) of the Code whereby the amount raised from allottee of a real estate project is to be considered as a commercial borrowing. Till now though the home buyers under assured return projects were considered to be Financial Creditors, the humble ordinary home buyer did not get any say under the Code. In fact, the Hon'ble Supreme Court of India had to invoke their extraordinary power provided under article 142 of the Constitution of India to provide relief to JaypeeInfratechcustomers.

   While the amendment may prove to be quite draconian for the real estate developers in the sense that the management & control (and eventually even shareholding) will be lost on a mere delay in delivery/ refund to a single flat buyer, it protects the interest of the home buyers (in an election year) by giving them a seat at the table.

   Further, even concerns about multiplicity of home buyers and their sheer number derailing the time bound process have been sufficiently addressed in the ordinance by inserting a new subsection 6A in section 21 which stipulates that all the home buyers will be represented by the qualified insolvency professional appointed by the NCLT bench concerned.

2. ***Guarantor***

Just like the introduction of 29A by way of ordinance last year, in the current ordinance the Government has closed the loophole which was being exploited by unscrupulous guarantors. This has been done by amending the subsection 3 of Section 14 which specifically states that moratorium under 14(1) would not apply to guarantors of the Corporate Debtor.

In absence of a specific provision to the contrary the guarantors of the corporate debtor sought to seek the benefit of the moratorium applied under section 14 of the Code when the insolvency petition was admitted against the troubled enterprise. They were also supported in this quest by conflicting order of the Hon'ble High Court. The Hon'ble Allahabad High Court, in the case of *Sanjeev Shriya vs State Bank of India*, elucidated on the question of whether the Moratorium under section 14 of the Code was applicable on the Guarantor of the Corporate Debtor. The Hon'ble High Court observed that Moratorium will be applicable against the personal guarantors, hence expending the scope of the Section 14 of the Code. However, in the case of *ScheweitzerSystemtek*, Hon'ble NCLT Mumbai gave a divergent view observing that the Moratorium has no application on the properties beyond the ownership of the corporate debtor. Even the Hon'ble High Court of Bombay, in *Sicom Investments*, held that Moratorium under section 14 will not extend to personal guarantors.

In a bid to settle the confusion around the issue the NCLAT, in*State Bank of India vs V. Ramakrishnan,* held that the moratorium will extend to the personal guarantor and later in *State Bank of India V/s. D.S. Rajendra Kumar* clarified it to extend to all proceedings other than under the Code.

Bearing in mind the conflicting views on the true position of Personal Guarantor, the Legislature through this Ordinance, 2018 has settled the debate. Though the decision of NCLAT in V Ramakrishna is under challenge before the Hon'ble Supreme Court, it is expected to become infructuous in view of the express stipulation provided in the code.

3. Limitation

Another amendment having far reaching consequence is making the Limitation Act applicable to the proceedings under the Code by way of inserting 238A in the Code. Initially various benches of NCLT differed while deciding upon applicability of Limitation act to proceedings under the Code and it was the Appellate tribunal which through cryptic mention in *Neelkanth Township* and elaborate order in *Speculum Plast* held that provisions of Limitation Act are not applicable to proceedings under the Code. While such a position earned a lot of praises from one section of people as it gave them a remedy to enforce their the debts which had become time barred, it also caused a lot of heartburn as it upset the equilibrium that the Companies were in with respect to the treatment of time barred debts.

The legal proposition created by the decision of the Appellate Tribunal was under challenge before the Hon'ble Supreme Court at the time of promulgation of the ordinance and is now likely to be held infructuous.

4. Withdrawal of petition after admission

Earlier the Code did not provide for withdrawal of the Insolvency application once the application is admitted by the Adjudicatory Authority. The same question was considered by the NCLAT in the case of *Lokhandwala*, where the Hon'ble NCLAT was of the opinion that in view of the Rule 8 of the I&B (Application to Adjudicatory Authority) Rules, 2016, the NCLAT could not utilize inherent power to allow to withdraw the insolvency application. Further, the Supreme Court in the same case has held that the view of the NCLAT is prima facie to be correct position of law and its only Supreme Court can allow for such withdrawal of the application under its inherent power envisaged under article 142 of the Constitution.

However, faced with repeated instances of such petitions under article 142, the Hon'ble Supreme Court, in *Uttara Foods*,sought action from the Competent Authority to amend the concerned rules and include such

inherent power in the rules, thereby reducing such matters from coming directly before the Hon'ble Supreme Court.

Following the remarks of the Hon'ble Supreme Court, the Government through the Ordinance 2018 inserted section 12A, whereby the Adjudicating Authority has the power to allow the withdrawal of the application made by the applicant with the approval of ninety percent voting shares of the committee of creditors.

5. Voting percentage

The intent of the Code was to ensure maximisation of the value of Assets by aiming for revival of the troubled enterprise and liquidation being the last resort. The Code, as enacted in 2016, stipulated approval by Financial Creditor having more than 75% of voting share in the committee of creditors (COC) for even the minutest of the decisions. While the provision was well intentioned to ensure acceptability of action and reduce resultant litigation in a time bound process, in effect, it led to a lot of logjam not only over approval of resolution plans but also in routine decisions.

The approval of 75% of the COCcan be effective and achievable where the Financial Creditors were a part of loan consortium and also to an extent where the COC comprised only of banks. However where the COC comprised ARCs, NBFCs, Individual money lenders, achieving the approval of 75% of the member proved to be an enigma which almost led to derailing the entire process. The Hyderabad bench, in a very detailed and well written order in *Kamineni Steels* matter, tried to reduce the threshold following the spirit of the Code and the Mumbai bench, in *InnoventiveIndustries* though sharing the concerns of the resolution process being stalled due to slightly less than 75% of COC support, chose to follow the letter of the codified law.

Having witnessed the development from the side-lines, the Government has stepped in to make sure divergent view of a minority does not result in failure of the insolvency resolution process. By way of the recent ordinance the threshold of 75% has been brought down to 66% for important decision like appointment of RP, raising of finances, selling of assets, and approval of resolution plan, for routine decisions the threshold has been set at 51%. Below table represents how the voting percentage stands in view of the new ordinance:

	Existing threshold under the Code	Threshold as revised by Ordinance
Withdrawal of Petition after admission	N/A	90%
All Major Decisions Extending the CIRP period Appointment of RP Raising Finance, Sale of Assets and other action u/s 28 Approval of Resolution Plan	75%	66%
All other decisions	75%	51%

It is expected that this amendment will result in better and smoother management of the corporate debtor, as a going concern, during the insolvency resolution process and most importantly result in more resolution plans being accepted.

6. Relief to Micro, Small and Medium Enterprises and changes to 29A

The ordinance also brings relief to the MSME section by relaxing the provisions of section 29A in their case. Initially by way of ordinance and then subsequently by way of enactment in January 2018, section 29A was inserted in the Code in a bid to restrain promoters and director (and their relatives) to come back into the control of the Corporate Debtor, directly or through back door, at reduced debt levels. While the amendment was well intentioned and sought to enforce fiscal discipline among corporate citizenry rather than make it a tool to incentivize defaults (by first defaulting and then using the Code to come back and reduced debt levels), it has led to a vacuum of resolution applicant especially in the MSME section. The MSME sector is a major employment generator of the economy as is hence very politically sensitive.

Realising the earlier amendment might have been too harsh for the sector, where unrelated resolution applicants are hard to come, the Government has now exempted the section from the provisions of the stringent section 29A. This is done by inserting section 240A which specifically dispenses with applicability of 29A clause c –h in case the Corporate Debtor is Micro, Small or Medium Enterprise. It is expected that with the section not being applicable, the relatively smaller companies may find takers and they won't have to face liquidation.

Additionally, the disqualifications for resolution applicants have been tempered down especially with respect to convictions faced by way of amending the clause d& e of Section 29A. Firstly, the disqualification

for conviction is limited only for the offences mentioned in the newly inserted twelfth schedule of the Code, that too if the punishment exceeds more than 2 years (7 years in case of any other law). Secondly, the convictions for which release from imprisonment happened prior to two years are not be considered against the resolution applicant and thirdly, convictions will not disqualify an applicant if the conviction are in respect of a connected. These amendments, reducing the ambit of disqualifications, will make sure that conviction unrelated to an applicant's ability to the turnaround the corporate debtor, or past crimes, do not disentitle a genuine applicant as what is being sought against Tata Steel in the Bhushan Power matter.

2. ***Others minor changes***

Some minor changes have also been brought vide this amendment to formalise the legal position which has been more or less settled by way of legal pronouncement of the tribunals and courts. These relate to the following:

Operational Debt: With respect to the existence of dispute, Section 8(2)(a) of the Code has been amended to make optional the record of any suit or legal proceeding thereby following the ratio laid down by the Hon'ble Apex Court in *Shilpi Cables* matter..

Further, the amendment in Section 9(3) stipulates that the information specified in the Code i.e. copy of certificate from financial institution and proof of default with information utility are made optional which is yet again in line with the decision in Shilpi Cable (supra) matter.

Section 10: A new clause has been added in Section 10 which stipulates that the Corporate Debtor making an application for admission of insolvency against itself have to produce a special resolution supported by at least ¾ of shareholders. This is done ostensibly to ensure that rival factions may not jeopardise the interests of other in while taking the Company to insolvency Court.

Continuation of IRP/ RP: As regards the continuation of IRP/ RP, the amendment stipulates that the IRP appointed will continue till being confirmed as/ or replaced by another RP meaning thereby that if there is a delay in appointment of RP, beyond the stipulated 30 days, the corporate debtor is not left orphaned and multiplicity of litigation, seeking clarification, is avoided. This is done by way of amendment in Section 16(5) where limit of 30 days is done away with. It also stipulates that the RP will continue till the NCLT passes an order approving or rejecting the Resolution plan necessarily implying that the RP can continue to function as RP and run the corporate debtor as a going concern beyond the period of 180(270) days without having to further approach the NCLT and seeking direction in this regard, in case the decision on the approval or rejection of the plan is not decided upon with the stipulated period. This is done by way of inserting a proviso in Section 23(1) which stipulates that the RP will continue to function till an order under section 31 of the Code is passed by NCLT.

Responsibility on IRP/RP: By way of inserting a new clause i.e. 17 (2)(e) it has been expressly stipulated that the IRP concerned will be responsible for complying all requirement under law on behalf of Corporate Debtor under CIRP. This is just formalising the obvious in a bid to reduce miscellaneous application coming before NCLT seeking directions.

Related Party and Relative: The Code defined the related party with respect to the Corporate Debtor however, its significance was with respect to understanding the related party transactions and to block such parties from taking a seat in the COC.

The newly inserted Section 29A, by way of amending act in January 2018, used the same definition to keep the related parties of the Corporate Debtor from coming in as resolution applicant. Though the Code contained the related parties with respect to a corporate person, it was silent on the related party with respect to Individual Persons who could also be resolution applicants. In a bid to address the void a new subsection 5(24A) has been inserted to detail the related parties with respect to an individual.

Also, while the 'related party' definition used in the Code included the term 'relative' and restrained, from bidding, not just the expressly disqualified people but also their relatives. However, the definition of relative was not provided in the Code and reliance was being placed on the definition provided in the Company's Act. This gap has now been addressed vide the ordinance and the term 'relative' is defined in explanation to the newly inserted 5(24A)

Also, Section 30(1) has been amended to mandate the submission of affidavit regarding eligibility under Section 29A at the time of submission of resolution plan. While an affidavit towards this was already being sought by the RPs when inviting resolution plans, it has now been given legal backing.

Approval of Resolution plans: Several small yet important changes have been brought in to the process regarding the approval of resolution plans.

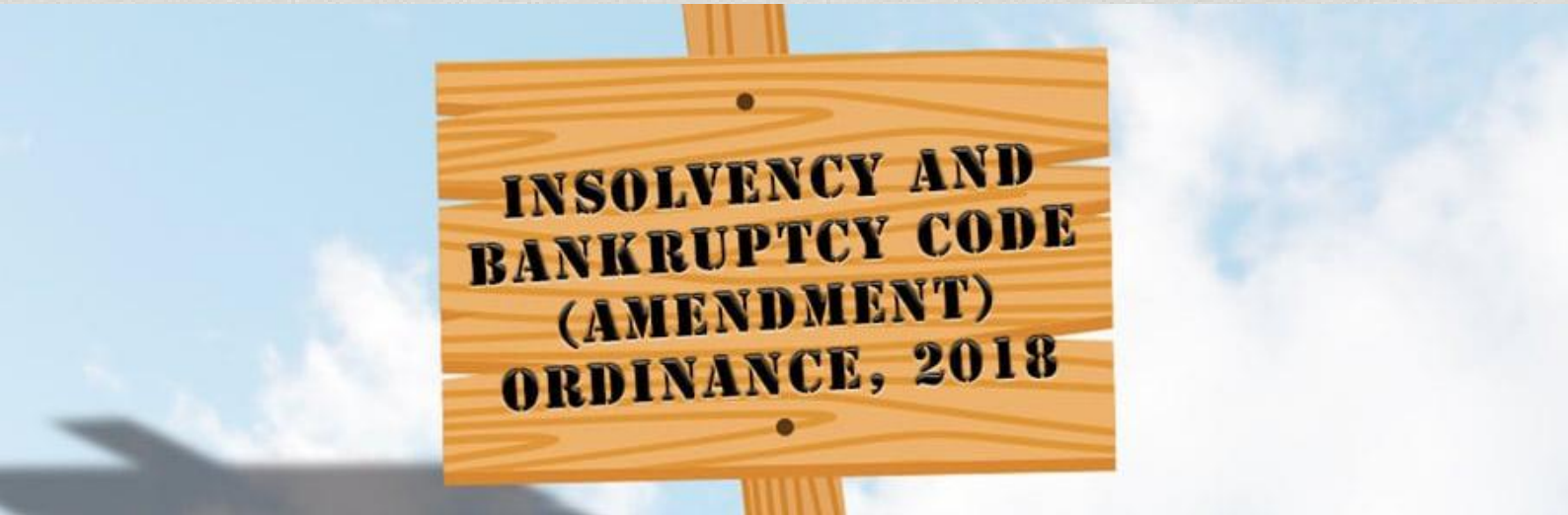
Deemed Approval or Shareholders: What had been clarified by the Ministry of Corporate Affairs vide its circular dated 25.10.2017 has now been formalised vide the inserting an explanation in Section 30(2)(f) thereby stipulating that with respect to approval of a resolution plan, if any approval is of shareholders is required under law, then it is deemed to be given.

Satisfaction of NCLT: A proviso has been added in 31(1) stipulating that, before approving a resolution plan, the NCLT will satisfy itself that the resolution plans can be effectively implemented. This is meant to formalise the discretion exercised by the Adjudicating Authority in reviewing the merits of the resolution plan and not act as pure rubber stamping authority.

Other Approvals: A new subsection i.e. 31(4) has been inserted by way of the amendment stipulating that the approvals required under any other law, in pursuance of the resolution plan, shall be obtained within a maximum period of 1 year from the approval of the plan or the date or as specified in the law concerned. This amendment is significant not only as it provides clarity in an area marked with ambiguity but it also takes away the discretion of the COC or NCLT in giving time for seeking such approvals which also might have been in conflict with concerning laws and still prevailed in view of the widest possible non obstante clause provide in section 238.

Conclusion

The ordinance is definitely a step in the right direction and bound to have significant impact in the way the insolvency resolution process is managed. While sceptics may raise a cry about frequent changes, in reality the changes are not structural but only to address the loopholes and making the Code fit to purpose. Given the significance of the Code for the overall economy, it is expected that the Government will continue to keep a close watch and this might just be one of the several amendment as new situation arise.



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