

## **Coronavirus outbreak: Relaxed IBC timelines may be a face-saver for Indian corporates**

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Suspension of the IBC for a period of 6 months shall further disable the creditors from initiating insolvency resolution proceedings against the corporate debtors, thereby further blocking the mechanism to resolve the debt and recover the credit

In order to prevent community transmission of COVID-19, the government has extended the pan India lockdown. India's Lockdown 2.0 commenced on April 15, 2020 and shall continue until May 3, 2020. The total count takes it to 40 days since the first phase of the lockdown.

The lockdown has brought India Inc to a standstill, although considering the need to bring the economy back into motion, certain activities in the essential goods and services sector have been allowed, subject to conditions, with effect from April 20, 2020.

The Insolvency Bankruptcy IBC, 2016 (IBC) was enacted in order to provide a solution to creditors, resolve the insolvency of corporate debtors and very importantly, provide a time-bound mechanism to the creditors for debt resolution. Amid COVID-19 outbreak, the government has taken several necessary yet difficult measures such as lockdown, which may render resolution of debts by corporate debtors, strenuous.

### **Will the IBC be suspended?**

As a protectionist move for corporate debtors under the IBC, on March 24, 2020, the Union Finance Minister Nirmala Sitharaman, for the first time, had announced the intention of suspending Sections 7, 9 and 10 of the IBC, in case the difficulties faced by the corporates continue beyond April 30, 2020, amidst the lockdown.

Now that the lockdown has been extended, the government is mulling on promulgation of an ordinance for suspension of the said sections of the IBC. The suspension shall not allow financial and operational creditors as well as corporate debtors themselves from initiating insolvency proceedings. This is primarily aimed at protecting the medium and small enterprises, which are hit the hardest due to the COVID-19 pandemic, because of disruption of supply chains and disabilities caused by lockdown in carrying out the businesses and generating revenue.

However, a blanket ban on initiation of insolvency proceedings may have been uncalled for as it is likely to have adverse repercussions for certain sections e.g. the creditors. But, the situation may well be unavoidable since the initiation of insolvency proceedings during these times are likely to severely clog the courts and therefore, the government may well press the suspension button, albeit for a temporary period.

We have already seen various measures under the IBC being taken since the last few months including the threshold of minimum default under the IBC being increased ten times from Rs. 1 lakh to Rs. 1 crore thereby swiping off a large number of operational creditors from filing applications for recovery and leaving them toothless under the IBC.

### **The Force Majeure difficulty**

Force majeure is basically a clause which provides an ability to contracting parties to not perform their obligations without being held responsible for it, due to the happening of extraordinary events

that were not in their control. Importantly, force majeure is generally not seen in loan agreements. However, business contracts that contain such clauses are likely to see parties invoking it, thereby rendering the performance of contract for the time period, impossible, which means that a corporate debtor, owing to zero or substantially lowered revenues during the lockdown is likely to default on its pay-outs to financial creditors as well as operational creditors. Worse, force majeure clauses in certain contracts may well be drafted in a manner which may not allow an interpretation to be taken such that a pandemic of this nature does not get covered.

If the IBC is suspended, without a doubt, creditors, especially the operational creditors shall be hit hard. Operational creditors, unlike financial creditors are engaged in the supply chain of the corporate debtor and if they are not paid due to invocation of force majeure, this shall further impact their ability to repay their creditors, thereby showcasing a devastating ripple effect on the economy.

### **RBI's COVID-19 Regulatory Package**

The Reserve Bank of India has allowed financial creditors, i.e., all banks and financial institutions (including NBFCs) to grant a moratorium of 3 months on payment of all term loan installments (including agricultural, retail and crop loans) and interest on working capital loans (such as overdraft facilities), which are due between March 1, 2020, and May 31, 2020.

This not being mandatory in nature, posed a difficult question for borrowers and lenders alike, until India's largest public sector bank, State Bank of India, opened this line of moratorium and others followed suit. Such moratorium has already made it easy for the debtors to repay their loans and interest after the end of the moratorium.

However, this moratorium shall restrict the liquidity of the creditors and pose difficulty in extending credit to potential borrowers. Even if the credit is extended to potential borrowers considering the hiatus in business activities created by the novel coronavirus pandemic, such borrowers shall be in limited or no capacity to repay at this juncture, which shall only further dry up the liquidity of the creditors. If creditors run out of liquidity, since the Indian banking sector is already exposed to several NPAs, businesses shall be hampered, as a substantial majority run on credit.

### **How will a suspension be brought about?**

The central government may exercise its powers under Section 242 and other provisions of the IBC to issue a notification suspending Sections 7, 9 and 10 of the IBC, in order to prevent the companies at large from being forced into insolvency proceedings. Section 242 empowers the central government to make such provisions not inconsistent with the provisions of the IBC in order to remove any difficulty.

### **Will a temporary suspension be useful?**

Suspension of the IBC for a period of 6 months shall further disable the creditors from initiating insolvency resolution proceedings against the corporate debtors, thereby further blocking the mechanism to resolve the debt and recover the credit.

In light of the aforementioned measures already taken by the government to ensure the corporate debtors to sail through this period of financial stress, suspension of IBC maybe a little too much of an overprotection of the corporate debtors.

Certainly, this suspension will put the creditors in dire financial crisis, as despite the end of the second phase of the lockdown, they will have to remain remediless for at least a period of 6 months,

only after which they may seek redressal under the IBC, which shall further take a period of 330 days to recover the loan from the corporate debtors.

This is a long period to throw a lot of creditors, especially the operational creditors out of business. Also, during this extended time, the quality of the asset is most likely going to further decrease. It is imperative to question whether the period of 6 months would be enough for the corporate debtors in regaining the same financial position, as was before the first phase of the lockdown so that repayment towards the loans can be made?

Especially since no economy in the world knows the end date for the current pandemic. Despite that, optimistic economists predict the economic recovery to take at least a span of 9-12 months.

During the IBC's temporary suspension, corporate debtors may not be reinstated into the pink of their financial conditions, so as to repay their loans. The feeble repayment capacity of the borrowers is evident from various circulars released by RBI upon requests of various stakeholders amid COVID-19.

For instance, the RBI released a circular upon requests of exporters, seeking relaxation in the timeline for realisation and repatriation of funds to India from 9 months to 15 months.

Hence, unless the proceeds are realised, payment of borrowings made by the exporters is only a dream for creditors not coming true anytime soon, even after the period of 6 months for suspension of the IBC is over. This implies that the period of six months may not be enough for the borrowers to regain their repayment capacity, hence the suspension of the IBC may not render envisaged outcomes.

#### **How necessary is suspension of IBC?**

However, the suspension of IBC appears to be the last resort before the government to prevent the initiation of mass insolvency proceedings against the companies that may have defaulted during the COVID-19 pandemic impacted period.

Mass insolvency proceedings may cause retardation of economic growth, as vital activities to keep the businesses going are carried out during the insolvency proceedings. Additionally, the already overburdened National Company Law Tribunals (NCLT) shall become further burdened.

Strangely, this time, the debate on whether or not a suspension will be imposed may lie on different pedestals which may not have been why the IBC was brought about in the first place. Unfortunately for the government, India Inc's engines are corporates themselves and the burden of keeping this engine running may push the government to once again require the banks and financial institutions to shoulder this responsibility. In turn, the government may infuse funding into these banks for sustenance.