THE NUTS AND BOLTS OF THE IBC AMENDMENT BILL 2019

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The Insolvency and Bankruptcy Code (IBC) effective from 1st December 2016 is probably one of the most talked about legislation in the country. The merits in the law and the relevance of the law was explained by the Supreme Court in the case of ***Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors. (2019) SCC OnLine SC 73***.

The Government apparently is tracking this law including judicial and business developments and the Insolvency and Bankruptcy Code (Amendment) Bill, 2019, which was tabled in the Rajya Sabha, is a clear evidence that the law would continuously change and the evolve by way of adapting to the business environment. The amendments have been made in order to ensure time bound resolution of a corporate debtor facing insolvency, to bring about clarity about the dynamic nature of a resolution plan and to bring clarity on the treatment of various classes of creditors.

Mergers and Amalgamations

The resolution of a stressed entity can be through many ways. Merger, amalgamation and demerger need not be confined to only healthy entities. Recognizing this important business solution, an explanation has been inserted in Section 5(26) with the prefix 'for removal of doubts' to clarify that a resolution plan may include provisions for restructuring of the Corporate Debtor and such restructuring may be carried out by way of merger, amalgamation and demerger.

Given the fact that the amendment is clarificatory in nature and has a beneficial impact, it is likely to be interpreted as an amendment which has retrospective effect.

Delay in admission of petitions

In India, anything that is successful attracts traffic. Given the huge potential for recovery of debts when all other previous legislative attempts did not bear fruit, everyone rushed to NCLT. The natural corollary was pendency and delay due to no fault of NCLT.

A proviso has been inserted in Section 7(4) mandating the NCLT to record its reasons in writing if it does not pass orders within 14 days of receipt of application. The intention of the amendment is to usher expeditious disposal. However, it is to be noted that such a requirement is mandated only in case of petitions filed by financial creditors. The thought process seems to be that in case of an application filed by an operational creditor, establishment of debt and ensuring that there exists no prior dispute is likely to consume more time and hence the absence of a need to pressurize the NCLT's to expedite the process. Further, pre-admission settlements are more unlikely in financial creditor applicants.

While the intent of the amendment is good, practically one of the main reasons for delay is the non-availability of sufficient number of benches and members. There is tremendous pressure on existing benches and members and to stipulate a time limit and mandate recording of reasons will only affect the administration of justice and to some extent it can also amount to interference in the functioning of the judiciary for no fault of theirs.

Extension of time for resolution

Originally, the time fixed for resolution of a stressed entity was 180 days with an extended period of 90 days. A proviso has been inserted to Section 12(3) to cap the maximum time allowed to complete the Corporate Insolvency Resolution Process at 330 days including the time taken in legal proceedings in relation to such resolution process and any extension of time allowed by NCLT.

In case of an ongoing Corporate Insolvency Resolution Process which has exceeded 330 days, such resolution processes shall be completed within a period of 90 days from the date of commencement of the Amendment Act.

If resolution is not completed within such period the NCLT shall pass an order to liquidate the corporate debtor.

This amendment has been necessitated on account of the fact that resolution could not be completed within the time frame due to extensive litigation and the NCLT has to pass orders extending the time. While a fixation of an outer time limit makes sense in the context of the objective of the legislation, it would be counter-productive in a scenario where resolution of a stressed entity would need time given the nature of the business or the type of debts. Straight jacket formulas do not work. Interestingly, the Corporate Insolvency Resolution Process Regulations which contain a model timeline is yet to be amended even though there was a round of amendments to these Regulations on 25th July 2019.

Individual home buyers

Where the stressed entity is in the real estate space, the number of persons affected would be significant and individual home buyers were represented by an authorised person who was also a resolution professional though different from the resolution professional for the entity. Issues emerged in the recent ***Jaypee Infratech*** where the views of the individual home owners were different and consensus did not emerge.

Section 25A(3A) has been inserted in terms of which the authorised representative shall cast his vote in the Committee of Creditors (CoC) on behalf of all the financial creditors that he represents in accordance with the decision of majority (identified as exceeding 50% present and voting). The amendment applies only to authorized representatives appointed under Section 21(6A) [*creditors belonging to a class*].

This amendment brings about a change from the earlier requirement wherein the authorized representative should cast his vote in the CoC based on the individual instructions received from such creditors he represents. The earlier requirement also required the authorized representative to abstain from voting in case he does not receive any instruction from a creditor.

While the amendment is to address the issue experience in one real estate company's case, it is not clear whether this would be a solution or a problem. All stressed companies are not the same. For example, there could be a scenario where the project development could have been stages and the impact on each individual buyer could be different. Further, while some buyers may want an exit with return of their money, some could be interested in the completion of the project. The majority rule to some extent affects the rights of the creditors.

However, the exception is that this amendment has no application where the voting is in respect of an application under Section 12A by the original petitioner for withdrawal of its insolvency petition. In such cases, the authorised representative should vote as per Section 25A(3) that is based on individual instructions received from creditors.

Share of the pie

The NCLAT in its recent judgement in the case of ***Essar Steel*** had held that Section 53 has no applicability in distribution of proceeds in the resolution process. Section 53 establishes the priority of distribution and in this decision the NCLAT ensured that operational creditors were treated at par with financial creditors. A financial creditor is necessarily a secured creditor and treating secured and unsecured creditor equally created a massive debate across the Country.

In order to nullify this decision and to restore the rights of the financial creditors to a large extent, Section 30(2)(b) has been amended to provide that a resolution plan shall provide for the operational creditors to receive at least the liquidation value of their debt or the amount that would have been received if the amount distributed under the resolution plan had been distributed in accordance with the waterfall mechanism provided for in section 53 of the Code.

The NCLAT in the case of ***Sirpur Paper Mills*** held that the regulations have gone beyond its mandate to prescribe amounts to be paid to dissenting financial creditors in a resolution plan, and the regulation was amended based on the NCLAT judgement. Section 30(2)(b) has been amended to provide that a resolution plan shall provide for the dissenting financial creditors to receive at least the liquidation value due to them. However, there is no corresponding amendment to the Regulations which were last amended on 25.07.2019.

The amendments to Section 30(2) are with retrospective effect.

Fair and Equitable Distribution

When the IBC resolution process seeks to treat operational creditors and financial creditors differently and the treatment is also different within each class of creditors in the context of voting etc. to visualize 'fair and equitable distribution' as a statutory mandate runs contrary to the other parts of the IBC.

The amendment was probably on account of certain judicial developments. The Supreme Court in the case of ***Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors.— (2019) SCC OnLine SC 73*** has held that the distribution among the creditors shall be fair and equitable based on which principle the NCLAT in ***Standard Chartered Bank Vs. Satish Kumar Gupta, R.P. of Essar Steel Ltd. & Ors. Company Appeal (AT) (Ins.) No. 242 of 2019*** had treated secured and unsecured creditors at par.

An explanation has been added to Section 30(2)(b) in order to clarify that the distribution of proceeds under Section 30(2)(b) shall be fair and equitable to <u>such</u> creditors.

It is not clear as to whether the explanation will achieve the objective. The term 'such creditors' would be the subject matter of interpretation as to whether it covers all creditors within the distribution flow or whether it deals with class of creditors such as operational and dissenting financial creditors.

<u>Distribution Plan to be considered by CoC</u>

The NCLAT in the case of ***Essar*** had observed that distribution is not within the purview of CoC and hence the Tribunal can decide on the distribution ratio. Section 30(4) has been amended whereby the manner of distribution as proposed in the resolution plan is also specifically brought within the purview of CoC to facilitate its decision-making process.

The amendment has now given CoC the responsibility to ensure that the manner of distribution of proceeds is in accordance with the order of priority as laid down in Section 53 of the Code.

In essence the amendment made to Section 30 has ensured that the secured creditors have climbed back in the priority ladder.

<u>Resolution Plan Binding on Governments</u>

When there is a stressed entity, while there is a debate on distribution between operational and financial creditors; secured and unsecured creditors, one of the effected parties was the Government itself. The tax dues to the Centre or the State may also have been outstanding and in the distribution hierarchy, the Government was positioned after financial creditors. On one side, the

Government of India wants to ensure the health of the banks and financial institutions and on the other side, the Government of India as well as the States had to forgo their tax dues. Since Government operates in silos, the tax departments continue to make their claims and there were instances of claims even during the moratorium period.

Section 31(1) has been amended to clarify that the resolution plan approved by the NCLT is binding on the Central Government, State Government or any local authority to whom statutory dues are owed by the corporate debtor.

In so far as statutory dues are concerned, the recovery can be only in accordance with the resolution plan.

Liquidation even before preparation of Information Memorandum

The NCLT were hesitant to order liquidation of a corporate debtor at a stage when even the information memorandum was not prepared. An Explanation has been inserted in Section 33(2) to the effect that the CoC can choose to liquidate the corporate debtor and make an application in that regard to the NCLT at any time before the confirmation of the resolution plan. Such a decision can also be taken even before the preparation of the information memorandum.

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