

THE INSOLVENCY AND BANKRUPTCY CODE (AMENDMENT) ORDINANCE 2018: ANALYSING SIGNIFICANT AMENDMENTS

INTRODUCTION: The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 (“**Ordinance**”) endeavours to ensure that the Insolvency and Bankruptcy Code, 2016 (“**Code**”) continues to evolve and retain its relevance. The Ordinance provides necessary clarifications and modifications with regard to the insolvency resolution structure thereby ameliorating the provisions of the Code.

KEY HIGHLIGHTS AND OUR ANALYSIS

1. Substitution of the terms “repaid/ repayment” with the terms “paid/payment” in several provisions of the Code:

The Ordinance has substituted the terms ‘repaid/ repayment’ with the terms ‘paid/ payment’ for several provisions in the Code. The term ‘repayment’ implies the action of paying back or reimbursement of the debt. However, the term ‘payment’ provides a wider meaning to include other outstanding amounts in relation to the debt which may include taxes and cess.

2. Amendment to the definition of ‘Financial Debt’ to include the amount raised from allottees in a real estate project:

The amendment of Section 5(8)(f) with respect to the definition of ‘Financial Debt’ ensures inclusion of home buyers as financial creditors under the Code. This is because any amount raised from an allottee under a real estate project shall be taken to be an amount having the commercial effect of borrowing.

Prior to the amendments, the home buyers were not categorised as financial creditors or as operational creditors. Several judgments laid down that buyers of under construction flats could not be classified as creditors under the Code. The non-inclusion of home buyers as financial creditors put such buyers in a disadvantageous position. The home buyers could

neither initiate the Corporate Insolvency Resolution Process (“**CIRP**”) nor be a part of the Committee of Creditors nor be guaranteed the receipt of liquidation value under the Resolution Plan. The only option available to the aggrieved home buyers was to approach the courts for requisite reliefs.

The apex court in its judgment dated 9th August 2018 **Chitra Sharma and Ors. v. Union of India and Ors.** noted the grievance of home buyers who were not recognised as financial creditors prior to the Ordinance coming into effect. By the said judgement, the Supreme Court recognised that a substantial amount of Rs. 1300 Crores was required to be refunded by way of principal alone to the homebuyers who were seeking refunds and could not initiate insolvency process for not being recognised as financial creditors. In contrast, IDBI Bank as a financial creditor, sought initiation of CIRP against Jaypee Infratech Limited which had defaulted in repayment of its dues amounting to Rs. 526.11 Crores. The apex court took note of the fact that the CIRP initiated by IDBI Bank had ended on 12th May 2018 but no Resolution Plan had been approved. Accordingly, keeping in view the amendments made to the Code, the CIRP was directed to be revived with the reconstitution of the Committee of Creditors to include home buyers.

Home buyers have been rewarded with much sought after relief by their inclusion as financial creditors. Home buyers as financial creditors now possess the right to initiate the CIRP under Section 7 of the Code. The Committee of Creditors which is constituted by the Interim Resolution Professional under Section 21 of the Code is comprised of all financial creditors of the corporate debtor. With the amendments to the Code coming into effect, home buyers shall be permitted to be included in the Committee of

Creditors. Such inclusion is beneficial to the homebuyers in several ways. Firstly, the aggrieved homebuyers can commence and participate in the CIRP. Secondly, in accordance with the recognition accorded to the homebuyers under the Code, the homebuyers can participate in the decision-making aspects, ascertain the CIRP, approve or reject the Resolution Plan. Thirdly, home buyers shall be guaranteed an opportunity to receive the liquidation value under the Resolution Plan.

3. Insertion of the Definition of 'Related Party':

The term 'related party' in relation to an individual has been specifically defined by the insertion of Clause (24A) in Section 5 of the Code. Several Sections of the Code and regulations use the term 'related party' with respect to an individual but the same had not been defined earlier and lacked clarity.

4. Insolvency resolution by Operational Creditors:

The Ordinance clarifies Section 8(2)(a) of the Code pertaining to the insolvency resolution by operational creditors. The provision shall henceforth also include disputes that are not pending in a suit or arbitration proceedings.

Prior to the amendment, the corporate debtor was required to bring to the operational creditor's attention, existence of a dispute and its record of pendency in a suit or arbitration proceedings before such operational creditor could file an application to initiate the CIRP. However, the Ordinance has amended the provision to render incapable the operational creditor from initiating the CIRP even if the existing dispute has not been taken to court or the arbitration forum. Moreover, the Supreme Court in its decision in **Mobilox Innovations Private Limited v. Kirusa Software Private Limited, AIR 2017 SC 4532** held that a dispute must be in existence prior to the receipt of notice to the corporate debtor and such dispute need not be only in the form of a pending suit or arbitration proceedings.

Further, whilst filing an application for the initiation of CIRP by an operational creditor under Section 9 of the Code, the amendments introduced by the Ordinance make the requirement of submitting a certificate from the financial institutions where an operational creditor has account/s, validating non-payment of unpaid operational debt by the corporate debtor under Section 9(3)(c) of the Code, optional.

Prior to the amendments, fulfilment of such requirement by the operational creditor for initiating the CIRP was taken to be mandatory due to the wording of the said clause under Section 9. Such requirement was impeding the operational creditors from filing applications for several reasons. Firstly, foreign banks and non-scheduled banks are not included in the definition of 'financial institutions' provided in the Code. Therefore, an operational creditor holding account/s in such banks could not initiate CIRP. Secondly, if an operational creditor possesses several bank accounts in different banks then it is an arduous task for the said creditor to obtain the certificates for all the accounts in question. Further, obtaining certificates for some accounts and not all of them would not be sufficient evidence of non-payment. Thirdly, a universal format for such certificates did not exist with the banks. Finally, the said certificate is not conclusive proof of the concerned operational debt having been fulfilled. To cater to such problems faced by the operational creditors, the requisite amendment in Section 9(3)(c) was made.

Moreover, a new requirement as per the amended Section 9(3)(d) is to submit any record, if available, with the information utility validating non-payment of unpaid operational debt by the corporate debtor. In addition, Section 9(3)(e) permits the operational creditor to submit any other evidence that confirms non-payment of unpaid operational debt by the corporate debtor.

5. Shareholders' approval for initiating Corporate Insolvency Resolution Process by the corporate applicant:

As per the Ordinance, the corporate debtor is now required to obtain either a special resolution passed by its shareholders or a resolution passed by a minimum of three-fourth of the total number of its partners in case of a limited liability partnership, approving the filing of the application initiating the CIRP under Section 10 of the Code.

This new requirement recognizes that initiating the CIRP is a significant step and may have consequences on the functioning of the corporate debtor, therefore corraling the approval of its shareholders/ partners should be undertaken by such corporate debtor. The amendment ensures that the corporate applicant is prevented from misusing the provision under the Code permitting it to initiate the CIRP.

It must be noted that now the Adjudicating Authority shall admit the application submitted by the corporate debtor only if it is complete and that there is no pendency of disciplinary proceedings against the proposed Resolution Professional. In the alternative, the Adjudicating Authority shall reject such application if it is incomplete or there is pendency of disciplinary proceedings against the proposed Resolution Professional.

6. Alterations to the voting thresholds for decision making by Committee of Creditors:

The Ordinance has altered the voting threshold with respect to the decisions being taken by the Committee of Creditors. Post amendments to the Code, all decisions taken by the Committee of Creditors shall require at least 51% of vote share of the financial creditors.

Further amendments have been made to the Code wherein the voting threshold for getting approval of the Committee of Creditors in respect of all major decisions to be taken by the Committee of Creditors has been reduced from 75% to 66%. For instance, the

voting threshold has been lowered for seeking approval of the Committee of Creditors in raising interim finance, creating any security interest over the corporate debtor's assets, changing the capital structure of the corporate debtor, extending the time period for completing the CIRP, continuance or replacement of the Interim Resolution Professional, approval or rejection of Resolution Plan, etc.

The requirement of 75% of the voting shares by the Committee of Creditors was proving to be a deterrent to obtaining the extension of the time period for the CIRP and was impeding a substantial number of corporate debtors from going into liquidation due to being rejected by the Committee of Creditors.

Similarly, during the CIRP, the Committee of Creditors is permitted to approve the filing of an application with the Adjudicating Authority for passing an order of liquidation by a vote of 66% of the voting share instead of the earlier requirement of 75%.

The Ordinance reduced the voting threshold from 75% to 66% to prevent frustrating the CIRP and subsequently to advance the objective of the Code.

It is pertinent to note that the Ordinance has inserted a new provision being Section 12A to the Code to the effect that once the application for initiation of CIRP filed by financial creditor, operational creditor or corporate applicant has been admitted by the Adjudicating Authority, the same can be withdrawn by the applicant only with the approval of 90% of the Committee of Creditors.

Prior to the amendment, the Adjudicating Authority would allow the withdrawal of the CIRP application before admitting such application upon the request of the applicant. However, there were cases wherein the withdrawal of the CIRP application was allowed by the Court pursuant to a settlement between the corporate debtor and the applicant creditor. It is pertinent to note that once the CIRP commences, such proceeding involves all the creditors and the corporate debtor and is not restricted to the

corporate debtor and the applicant creditor only. Thus, the Ordinance provides for the option to withdraw the CIRP application post admission in exceptional circumstances subject to the approval of the Committee of Creditors by 90% of voting share.

7. Non-extension of Moratorium to a Surety in a Contract of Guarantee to a Corporate Debtor:

The provision for moratorium states that instituting suits or continuation of suits or proceedings against the corporate debtor and its assets shall not be permitted for the duration of the moratorium. The Ordinance has amended Section 14(3)(b) of the Code to clarify that the applicability of moratorium shall not be extended to a surety in a contract of guarantee to a corporate debtor. The assets of guarantors of corporate debtors shall be excluded from the scope of moratorium and the moratorium provisions shall be solely applicable to the assets of a corporate debtor.

The inclusion of moratorium within the Code is to ensure that the assets of the corporate debtor are held together whilst the CIRP is ongoing so that the creditors can focus on insolvency resolution and not undertake any action which may obstruct the CIRP.

This clarification provided by the Ordinance seeks to resolve the conflicting decisions laid down by the National Company Law Tribunal (NCLT), National Company Law Appellate Tribunal (NCLAT) and the High Courts. In ***Alpha and Omega Diagnostics (India) Ltd v. Asset Reconstruction Company of India***, NCLAT, New Delhi, by Order dated 10th July 2017, it was laid down that moratorium had no application on properties not under the ownership of the debtor. Thus, there was no bar to proceed against third party assets. Whereas, in ***Sanjeev Shriya v. State Bank of India, 2017 (9) ADJ 723***, the Allahabad High Court held that the scope of moratorium extended to the enforcement of guarantee against personal guarantor to the debt. The Court reasoned that since the debt owed by the corporate debtor is not clarified until the Resolution

Plan is authorised, the liability of the guarantor is ambiguous. Hence, such amendment seeks to elucidate that the assets of guarantor are not protected by the moratorium provision.

The insertion of Section 5A to the Code provides for the definition of a Corporate Guarantor to mean a corporate person who is the surety in a contract of guarantee to a corporate debtor.

8. Extension of the Tenure of Interim Resolution Professional:

Earlier, the tenure of the Interim Resolution Professional could not be more than 30 days. However, post amendment of Section 16(5), the term of the Interim Resolution Professional extends until such date when the Resolution Professional is appointed.

This amendment seeks to rectify the inadvertent error in the proviso of the Code when read together with the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016. It was observed that the term of the Interim Resolution Professional may have expired and yet the meeting of the Committee of Creditors would not have been convened, thus there existed a period wherein a Resolution Professional was not present during the CIRP.

9. Compliance of statutory requirements by the Interim Resolution Professional:

The Interim Resolution Professional must also comply with legal requisites under applicable law whilst managing the affairs of the corporate debtor to ensure that the corporate debtor continues to function as it used to before the commencement of the CIRP subject to the restrictions imposed upon it under the relevant provisions of the Code. The Ordinance sheds clarity on the responsibility of the Interim Resolution Professional/ Resolution Professional to correct the ambiguity in the provision prior to such amendment by the insertion of Section 17(2)(e).

10. Tenure of Resolution Professional to extend beyond the expiry of the Corporate Insolvency Resolution Process:

The amendment to Section 23(1) permits the Resolution Professional to continue to manage the operations of the corporate debtor even after the expiry of the CIRP till such time the Adjudicating Authority passes an order.

Prior to such amendment, the Resolution Professional was permitted to manage the affairs of the corporate debtor for the duration of the CIRP i.e., 180/ 270 days. However, it was observed that the management of the corporate debtor was required to be undertaken even after the CIRP had ended but the Adjudicating Authority had yet to pass an order pertaining to the approval or rejection of the Resolution Plan. Hence, the Ordinance sought to rectify the inadvertent error to provide for the management of the corporate debtor's affairs to remain the responsibility of the Resolution Professional for the abovementioned duration.

11. Appeal against the decision of the Liquidator:

With respect to Section 42, the Ordinance clarifies that the creditor is entitled to appeal to the Adjudicating Authority against the decision of the liquidator even upon the acceptance of the claims by such liquidator. Thus, the option to appeal does not arise solely upon the rejection of the claims by the liquidator. Therefore, it appears that if a creditor is not satisfied with the manner in which his claim is accepted, he has a right to appeal.

12. Applicability of the Limitation Act:

The insertion of Section 238A seeks to clarify that the provisions of the Limitation Act, 1963 shall be applicable to the proceedings before the NCLT, NCLAT, DRT and DRAT depending on the case. This means that a creditor must ensure that such creditor seeks remedy under the law within the prescribed time period as provided in the Limitation Act.

It is essential to specify the application of the Limitation Act to the Code in order to prohibit creditors and claimants from filing claims in relation to time-barred debts. Creditors and claimants should not be permitted new opportunities to obtain remedy once such debts have become time-barred. The Ordinance seeks to clarify that right to remedy is lost in case of time-barred debts.

13. Applicability of the Code to Micro, Small and Medium Enterprises:

The insertion of Section 240A clarifies that the Central Government is empowered to direct the non-applicability of the provisions of the Code to the micro, small and medium enterprises (MSMEs) or permit the applicability subject to modifications.

MSMEs are a vital facet of the Indian economy and contribute greatly towards the GDP of the country. In fact, the World Bank Report on the Treatment of MSME Insolvency recommends that in order to alleviate the burden on such enterprises it would be prudent to exempt or relax some provisions during their application to such MSMEs from the prescribed insolvency process. MSMEs should not be intentionally driven towards insolvency which may eventually trigger liquidation. Hence, the Central Government shall be entitled to utilise its power to enable certain classes of companies, more particularly the MSMEs to benefit from less severe procedure under the Code for the sake of public interest whilst ensuring that the Code's objective is upheld.

CONCLUSION:

Upon an analysis of the key amendments to the Code, it can be seen that the Insolvency Law Committee constituted by the Ministry of Corporate Affairs had taken under consideration the lacunae existing in the provisions of the Code and sought to clarify and/ or elaborate the same. It is essential that the Code is reviewed periodically to ensure that it retains its relevance and continues to be utilised extensively.

The key amendments in relation to the reduction of voting thresholds of the Committee of Creditors ensures that the obstacles faced by the creditors prior to such amendments may be reduced significantly. The Ordinance aims to convey that the resolution of insolvency is of greater significance than liquidation. Further, the recognition given to the homebuyers shall prove to be a strong deterrent for promoters and real estate developers from raising huge amounts from unsuspecting homebuyers for real estate

projects and defaulting on their commitment. Moreover, the adjustment to the voting threshold of the Committee of Creditors shall ease the decision-making process and ensure that the object of the Code is preserved. The amendments have brought about ample clarity qua the leniency extended to MSMEs by the Code.

The content of this article is intended to provide a general guide to the subject matter and should not be construed as legal advice.