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AN OVERVIEW OF IMPACT OF CHANGES – 2018 INSOLVENCY AND BANKRUPTCY ORDINANCE

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Abstract
While doing such changes recent cases highlighted several practical issues and interpretational anomalies under the code.

A senior government official suggested that changes made to the Insolvency and Bankruptcy Code (IBC)by a review panel are likely to be prospective and will not apply to cases already undergoing resolution which means that the cases which are already undergoing, the resolutionplans has come up with the changes under consideration related to the eligibility criteria of bidders to participatemay not be of much benefit. The issues were undertaken by an insolvency law committee constituted by the Ministry of Corporate Affairs (Committee) in consultation with key stakeholders. The Insolvency and Bankruptcy Code (Amendment) Ordinance 2018 (Ordinance) was recommended by the Committee and notified on 6 June 2018. This ordinance come with some specific changes which affect real estate and financial sectors. The changes held in some part of the previous Act like homebuyers , real state and other provisions. The law should not be retrospective as it will then be very difficult to implement and we will see a rise in litigation," said Manoj Kumar, partner, Corporate Professionals. "It has to be made applicable from a specific date.

Introduction

To improve the insolvency resolution framework in India, The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 brings about significant changes. While doing such changes recent cases highlighted several practical issues and interpretational anomalies under the code.

A senior government official suggested that changes made to the Insolvency and Bankruptcy Code (IBC)by a review panel are likely to be prospective and will not apply to cases already undergoing resolution which means that the cases which are already undergoing, the resolutionplans has come up with the changes under consideration related to the eligibility criteria of bidders to participatemay not be of much benefit.

Based on the recommendations of the committee, the government is likely to move an amendment to IBC in the ongoing session of Parliament. The government tasked the panel with suggesting changes to the IBC to remove ambiguities.ET reported last week that the 14-member committee reviewing the law favors easing the IBC's related party norms to ensure it's not overly restrictive and doesn't reduce the number of those eligible to bid for assets. Section 29A of the IBC bars certain persons and entities from bidding for stressed assets. These include undischarged insolvents, willful defaulters and anyone with a non-performing loan among others. Any other person acting jointly or in concert with such persons is also barred from the resolution process. This provision makes a wide range of persons or entities ineligible because of ties to entities barred under Section 29A.

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The issue of "connected persons" came up in the case of Essar Steel NSE 0.00 % among others, raising fears of the process getting caught up in a legal logjam. That rendered bids by Numetal and Arcelor Mittal ineligible but any relaxation in the rules on this front will not be applicable to companies or individuals that have already submitted bids for companies undergoing resolution.

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Key Highlights and Takeways

the Government once again amended certain provisions of the Insolvency and Bankruptcy Code, 2016 On June 6, 2018, by introduced an ordinance[1] (**the 2018 Ordinance**) which provided sweeping changes to the both substantive as well as procedural aspects relating to the insolvency process. Some of the key changes are analysed below.

Homebuyers – 'Financial Creditors'

When the Code and regulations framed in 2016 there under were brought into force, the insolvency resolution framework provided 'operational creditor' (i.e. any person to whom an operational debt such as a trade debt is owed) that any 'financial creditor' (i.e. any person to whom a financial debt being a debt for borrowed money is owed), or a corporate debtor itself could initiate an insolvency resolution process.

The issue arose that the Code did not provide a suitable framework for the protection of homebuyers who had advanced significantly larger amounts to the company as compared to the banks who had constituted the committee of creditors and were steering resolution processes.The question was whether advances paid by homebuyers to the real estate developers should be categorised as a financial or operational debt (or instead, a separate category of debt), assumed significance in a spate of insolvency petitions against failing real estate projects.

In August 2017, the regulations under the Code were amended to classify homebuyers as 'other creditors' who would have the right to file claims before the liquidator, but the amendment did not elaborate on other rights available to them (i.e., whether 'other creditors' could initiate insolvency proceedings or participate in the committee of creditors, whether their claims would be protected under the resolution plan approved by the committee of creditors etc.). The Ordinance has now definitively resolved this ambiguity by classifying any 'amounts raised from an allottee under a real estate project' as **financial debt**.

The 2018 Ordinance has amended the definition of '**financial debt**' to include amounts raised from 'allottees' in respect of a real estate project (as defined under the Real Estate (Regulations and Development) Act, 2016 (**RERA**)). Accordingly, homebuyers will now be entitled to a seat on the 'committee of creditors' of the corporate debtor. However, given the large number of homebuyers for a project, they will be treated as a class of creditors and be represented in the 'committee of creditors' by an authorised representative' to be appointed by the National Company Law Tribunal (**NCLT**). It is worth noting that Section 18 of RERA affords allottees the right to:

1. Demand a refund of the entire amount advanced by the allottee (along with interest at the prescribed rate); or
2. Be paid interest (by the promoter/ developer) for every month of delay till possession is handed over.

In proceedings of insolvency, it is likely that the allottees (even where they have not withdrawn from the project) may file their claims for the **entire advance amount** and accrued interest. In such cases, it will have to be considered if, on account of filing of such claims (i.e. for the advance paid), the allottees would be deemed to have withdrawn from the project and if their claim against the corporate debtor can be limited to monetary claims only (i.e. the advance amount and interest).

[1]The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018

Key Takeaway
With the Ordinance coming into effect, retail consumers in the real estate industry such as homebuyers will now have the right to initiate insolvency against real estate developers and the right to be represented in the committee of creditor bringing them at par with banks and other financial creditors in real estate projects.

It is seen whether similar protection will be sought by other consumer facing industries, where retail consumers typically pay large "advances" to purchase goods and services.

Section 29A –scope of Applicability Widened and Eligibility Criteria Refined
Section 29A of the IBC had considerable impact on the working of resolution of corporate debtors. The 2018 Ordinance has widened its applicability scope and provided limited exemptions to resolution applicants by providing the eligibility criteria.

Parties Related (Individual)– The definition of 'related party' in the context of an individual person has been introduced (which was earlier missing), providing clarity to the scope of connected persons (of a resolution applicant) who have to be tested for disqualifications set out in paragraphs (a) through (i) of Section 29A (the **Disqualification Criteria**). The definition[2] of an individual's related party is extensive and will cast a wide net. In addition, where the individual (whose connected persons need to be determined) is married, the relative of the individual's spouse will also be included within the scope of 'connected persons'[3]. This, on the face of it is excessive and could have been handled better by limiting the definition of relatives as used in the Companies Act, 2013. The wider definition under the 2018 Ordinance will increase the burden on the resolution professional and the CoC (from the perspective of eligibility determination).

Under the recently introduced section 29A of the Code, related parties of the corporate debtor and other entities or their promoters whose loans have been non-performing assets (NPAs) for a period of 1 year, were disqualified from being resolution applicants. The underlying intent of the amendment was to prevent persons who had contributed to the failure of the debtor from getting back their assets at significant discounts.

There was however broad consensus among stakeholders in the industry that the extension of the disqualification to persons acting jointly or in concert had led to unintended consequences of multiple layers of persons being disqualified (even if remotely connected to the disqualified person).

The Ordinance now clarifies that the following persons will not be disqualified from participating in the resolution process:

1. financial entities (defined to include asset reconstruction companies, alternate investment funds, scheduled banks, overseas financial institutions, investment vehicles, registered foreign portfolio investors and foreign venture capital investors), who are not affiliated to the corporate debtor; and
2. entities who hold an NPA account pursuant to the acquisition of a corporate debtor under an earlier insolvency resolution process – this exemption is available for a period of three years from the date of approval of the prior resolution plan.
3. regulated financial creditors who are affiliated to the debtor solely because of their equity holdings pursuant to a debt restructuring scheme implemented prior to the initiation of insolvency proceedings.
4. guarantors of a corporate debtor, unless the guarantee has been enforced and remains unpaid in full or part by the guarantor.

In the context of disqualification of persons who control companies in which a preferential, undervalued, fraudulent or extortionate credit transaction has taken place, the Ordinance has brought some clarity by providing

[2]As introduced in Section 5(24A) of the IBC
[3]See Section 5(24A)(a) of the IBC

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that this disqualification will not apply to bona-fide acquirers of such companies under an insolvency resolution or other similar restructuring process.

Key Takeaway

The amendments have refined the disqualification criteria under Section 29A to focus on wilful defaulters, persons responsible for the financial failure of the corporate debtor under resolution, or those persons who themselves are in financial distress in other entities and are hence unsuitable to drive a turnaround in the corporate debtor under resolution.

The Ordinance removes uncertainty with respect to the ability of genuine strategic and financial investors, creditors and specialised players in the distressed debt space to participate in insolvency resolution.

Exemption For A Category of 'Connected Persons' – Connected persons referred to in Explanation I(iii) (to Section 29A(j)) have now been exempt from the Disqualification Criteria set out in paragraphs (d)[4] and (e)[5] of Section 29A.

Exemption for 'MSMEs' –The Committee noted that micro, small and medium enterprises (MSMEs) who are mostly operational creditors to businesses are especially susceptible to working capital mismatch (i.e., any temporary credit disruption created by the insolvency of the debtors of such MSMEs could have implications on the ability of MSMEs to service their debts). MSMEs being pushed into liquidation affects the livelihood of employees and workers. Further, the sale of an MSME in a timebound bid process under insolvency resolution is unlikely to attract interest from large number of bidders.

The 2018 Ordinance provides further relief to 'micro', 'small' and 'medium' enterprises[6] (**MSMEs**) by exempting them from the Disqualification Criteria under paragraphs (c) and (h) of Section 29A and also allows the Government to exempt the other Disqualification Criteria for MSMEs as well (or direct their applicability with modifications).

Amendments to Section 29A however will not apply to any resolution applicant that has submitted a resolution plan prior to June 6, 2018[7].

Moratorium Not to Apply to Guarantors

The admission of an insolvency application under the Code by the NCLT, a moratorium of 180 days applies which prohibits the creditors from taking any action to recover or enforce any security interest created by the debtor. There have been divergent judgements on whether the scope of the moratorium includes enforcement action against assets of third parties such as the promoter or guarantor provided as security to the creditor. NCLAT held in a recent case that a security or guarantee provided by a third party and a guarantor's personal property can be proceeded against by a financial creditor to recover its outstanding dues even during the moratorium period, as properties not owned by the debtor would not fall within the ambit of the moratorium declared under the regulations.

The 2018 Ordinance has clarified that the moratorium imposed by the National Company Law Tribunal under Section 14(1) will not apply to guarantee contracts in relation to the corporate debtor's debt.the scope of the moratorium is restricted to the assets of the corporate debtor only. Therefore, there is no bar against enforcement actions taken against the assets of a guarantor to a corporate debtor during the moratorium period.

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[4]Ineligibility on account of conviction of an offence punishable with imprisonment of more than 2 years
[5]Ineligibility on account of being disqualified to act as a director under the Companies Act, 2013

[6]As defined under the Micro, Small and Medium Enterprises Development Act, 2006
[7]Third proviso to Section 30(4) of the IBC

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Additionally, Section 61(3) of the Insolvency Bankruptcy Code has been amended to ensure that the National Company Law Tribunal (which has jurisdiction over the insolvency resolution of the corporate debtor) will also have jurisdiction over the insolvency resolution of the corporate guarantor (irrespective of the jurisdiction (within India) where the corporate guarantor may have been incorporated in). This provision previously only covered personal guarantors.

Lowering of Committee of Creditors Voting Thresholds

To encourage a speedy resolutionthe Ordinance has relaxed voting threshold for certain decisions taken by the Committee of Creditors . Threshold for approval of a resolution plan, extension of CIRP beyond 180 days, appointment of the resolution professional, and certain other critical decisions Previously, all decisions of the Committee of Creditors needed to be approved by 75% of the voting share of the Committee of Creditors members. This threshold has now been reduced to 51%.,90% approval for withdrawal of an insolvency application post admission by the National Company Law Tribunal (dealt with in more detail below).

Post Admission Withdrawal

Following the Supreme Court's decisions to permit withdrawal of insolvency proceedings post admission (by using its inherent powers under Section 142 of the Constitution of India) on a case specific basis, the 2018 Ordinance has introduced Section 12A permitting the National Company Law Tribunal to now allow insolvency proceedings to be withdrawn provided it has the consent of 90% of the voting share of the Committees of Creditor members. Certain additional conditions (for withdrawal) have been prescribed under the regulations[8]:

1. The application to withdraw must be submitted: (i) by the same person who had filed the insolvency application to the resolution professional in the specified format prior to issuance of the invitation for expressions of interest(pursuant to Regulation 36A); and (ii) be accompanied by a bank guarantee for the specified amounts[9].
2. The application (as submitted to the resolution professional) must be approved by the Committee of Creditors by the relevant majority (i.e. 90%) within seven days (of the constitution of the Committee of Creditors or the application, whichever is earlier) and the resolution professional is required to submit the application to the National Company Law Tribunal within three days of such approval.

The condition (imposed under the regulations) that withdrawal is permitted only prior to issuance of the advertisement inviting expressions of interest considerably limits the applicability of this provision, which was not included in the 2018 Ordinance and is questionable.

Operational Creditors

One of the practical concerns under the Code, in the context of operational creditors, was that a corporate debtor was required to establish both the existence of a dispute and the pendency of a suit or arbitration proceeding, to dispute an insolvency application brought by an operational creditor.

In this context, the Supreme Court recently held that a dispute prior to the receipt of a demand notice from an operational creditor, may exist in forms other than a pending suit or arbitration proceedings. In line with the Supreme Court ruling, the Ordinance now clarifies that there is no dual requirement to establish the existence of a dispute and outstanding proceedings, to dispute insolvency proceedings initiated by an operational creditor.

[8]Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 as amended on July 3, 2018

[9]Being resolution process costs incurred under Regulation 34 of the CIRP Regulations and such other costs as directly relating to the insolvency resolution process and as approved by the CoC.

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The requirement for submission of a certificate from a financial institution confirming that the operational debt is due has been made optional. Alternate means of proving non-payment of operational debt, such as records from information utilities or other record as may be notified by the Central Government, has also been permitted.

Key Takeaway

The Ordinance can be expected to stem the flow of premature insolvency actions brought by trade creditors against debtors who have bona-fide disputes regarding the existence of such debts.

From the perspective of trade creditors, this Ordinance has eased the process of initiation of insolvency for foreign suppliers and vendors, as the process of obtaining a certification from an Indian financial institution was cumbersome.

Authorised Representative For Creditors

The Ordinance provides a new mechanism for debenture holders, deposit holders, retail creditors (such as large numbers of homebuyers in real estate projects) and other specified classes of financial creditors in the Committee of Creditors to be represented in Committee of Creditors meetings through a separate trustee, agent, authorised representative or insolvency professional, who would act on their behalf in Committee of Creditors meetings.

Initiating IBC proceedings where winding-up proceedings are pending

The leave of the High Court or National Company Law tribunal (NCLT) must be obtained for initiating insolvency proceedings under the Code, if any petition for winding up is pending in any High Court or National Company Law Tribunal against the corporate debtor under the Companies Act.

Application of Limitation Act, 1963

Prior to the Ordinance, there was ambiguity regarding the applicability of the Limitation Act, 1963 to the Code. Specifically, the issue regarding the revival of the right of creditors holding time-barred debts to file for insolvency resolution and right of claimants to file time-barred claims with the insolvency resolution professional were considered by the National Company Law Tribunal in various matters. The NCLAT(National Company Law Tribunal) ruled that the limitation period (3 years) for initiating insolvency proceedings for all claims existing prior to the Code would begin from the date of its coming into effect, i.e., 1 December 2016. This gave an opportunity to the creditors to initiate fresh insolvency proceedings for debts which otherwise were not recoverable due to the expiry of the limitation period.

The Committee was however of the opinion that insolvency laws should not have the effect of affording a fresh opportunity for creditors and claimants who did not exercise their remedy in a timely manner. The Ordinance now expressly clarifies this position, by providing that the Limitation Act would apply to proceedings under the Code.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Conclusion

The changes introduced by the 2018 Ordinance bring much needed clarity to the Insolvency Bankruptcy Code and should hopefully be enacted into legislation soon, in the monsoon session of Parliament commencing July 18, 2018.