

# 'Bankruptcy code has balanced rights of creditors and debtors'

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Since the Insolvency and Bankruptcy Code (IBC) came into force in 2016, India's corporate turnaround ecosystem underwent a massive change, making rescue of sinking companies quicker and less painful with lower chances of distressed assets losing value. Quicker resolution meant major shareholders could no longer seek refuge under procedural delays and chances of them losing control over their business became real. But is the IBC, designed for normal times, fit for an economy ravaged by a pandemic? In an interview, M.S. Sahoo, chairperson, Insolvency and Bankruptcy Board of India (IBBI), who had served in senior positions at the finance ministry, Securities and Exchange Board of India (Sebi) and the Competition Commission of India (CCI), said several new flexible business turnaround options are being added to the code in view of the extraordinary circumstances. Besides, under a proposed scheme, owners of small businesses could retain control even during bankruptcy proceedings and not be forced to leave the company's affairs to an administrator. Edited excerpts:

**The manufacturing sector has recovered since the September quarter, but the services sector is still in contraction. Will the suspension of new bankruptcy proceedings against defaulting firms be extended beyond 24 December, at least for MSMEs and the services sector, considering that the law allows another three months of suspension?**

Market problems are generally poly-centric and are often not amenable to a black and white resolution. Even after having complete data and information, the policy choice ex-ante (before the event) is not clear and, therefore, the choices made may prove wrong afterwards. That is why market-related laws evolve

under different scenarios.

One scenario, for example, is of the stress of viable businesses getting to be resolved, and unviable businesses getting liquidated when resolution applicants are available and the suspension of bankruptcy proceedings is withdrawn. If investors are not available and the suspension is withdrawn, viable businesses "could be" liquidated, while unviable ones "would be" liquidated. Other scenarios point to other outcomes.

One needs to carefully assess the availability of resolution applicants vis-a-vis the level of delinquencies, consider the availability of other options for resolution and the need to allow some amount of "creative destruction", weigh the consequences of suspension in terms of carrying unviable businesses vis-à-vis liquidating viable ones, and prognosis of covid-19 in the days ahead.

All-time high stock market, green shoots of recovery around the world, huge inflow of foreign capital to the economy and return of some sectors of the economy to pre-pandemic levels suggest improvement in availability of resolution applicants.

However, with the world economy in negative zone, drying up of liquidity support and stimulation packages, uncertainty surrounding covid-19 and the depleting stamina of business to withstand stress may suggest higher incidence of delinquencies.

Sector-specific dispensation is, however, unlikely as it is neither feasible nor desirable. **Given the massive impact of covid-19 on businesses, it is inevitable that there may be a wave of bankruptcy petitions when the suspension is lifted. Are you prepared to face that?**

As hibernation ends, the tribunals are likely to see increased filings. However, this increase may not be significant. It is because cases are getting resolved under IBC in respect of non-covid-19 stress, under the scheme of compromise or arrangement (between company and lenders or company and shareholders for corporate reorganisation) under the Companies Act and under the Reserve Bank of India's prudential framework.

They may be exploring innovative options for resolution outside any formal framework. Besides, viable companies would have normal business operations after the pandemic subsidies.

Also, the higher threshold of default (of ₹1 crore) for initiation of insolvency proceedings will keep MSMEs out of insolvency proceedings. Also, covid-19 defaults will remain outside insolvency proceedings forever. Nevertheless, the government is aware of the need to strengthen bench capacity of the NCLT matching the need. The number and capacity of professionals is increasing day by day.

**Small firms do not have the resources like big corporations for legal and other professional help to deal with financial stress. How will the proposed special insolvency resolution regime for MSMEs address this?**

MSMEs are unique in many ways. In recognition of their uniqueness, most countries have a special dispensation for their resolution. IBC enables the central government to provide a modified frame-

work for MSMEs. A special insolvency resolution framework, which is likely to be a blend of corporate insolvency and individual insolvency, is proposed to be notified.

For example, it may borrow the "debtor-in-possession" feature from individual



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insolvency and retain the authority of the committee of creditors to determine the fate of the firm from corporate insolvency. It may provide for the debtor to have some preference in submission of resolution plan. The procedures should be rapid, simple, cost-effective and have minimal role of court.

**Businesses are grappling with a recession and are facing questions about their viability. Considering the nature of the situation, is there a case for rebalancing the rights of both the creditors and debtors under IBC?**

A firm has two main sets of immediate stakeholders—shareholders and creditors. If debt is serviced, shareholders have complete control of the company. When the company fails to service the debt, the Code shifts control of the company to the creditors for resolving insolvency. The Code has, therefore, balanced the rights of creditors and debtors. This balance has been upheld by courts and has delivered results in sync with the objectives of IBC. However, given the unfortunate current situation, without rebalancing the rights of stakeholders, options such as pre-pack (out-of-court turnaround plans to be placed before tribunals for approval) could be explored to facilitate resolution. It is under works.

**Is there a need for**

**reviewing the restriction on promoters of defaulting companies from bidding to win the company back (Section 29A), considering that the overall demand for stressed assets in the current economic environment may be sluggish?**

Section 29A prohibits undeserving persons from submitting resolution plans to avoid moral hazard (rewarding unscrupulous persons at the expense of creditors). This has changed the debtor-creditor relationship. In the words of the Supreme Court, defaulters' paradise is lost.

A debtor resolves stress when stress is imminent and settles default to avoid landing up at the door of the NCLT.

Even after an application is filed for initiation of insolvency resolution, the debtor tries hard to settle the default before its admission. The debtor also tries to close the proceeding midway through settlement, review, mediation or withdrawal. The entire world is the market for resolution plans.

The overall demand does not reduce just because a few undeserving persons are kept out of the process. In any case, such persons are free to work out resolution under alternative resolution frameworks or outside any formal framework. I do not see a case for dilution of Section 29A.

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**CONVERSATION**

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**Section 29A stops undeserving persons from submitting resolution plans, offsetting the debtor-creditor relationship.**

continuously through experimentation and market participants continuously learn and realign their strategies.

The world is still in the grip of the pandemic, with no end in sight. Businesses are grappling with liquidity and survival challenges, while recalibrating their affairs to an all-new normal. Estimates vary about the intensity of the pandemic on businesses.

Initiation of insolvency proceeding was suspended in the case of businesses, which did not default prior to the first lockdown, but defaulted thereafter. The objective was to protect these otherwise viable businesses which could be liquidated for want of resolution applicants in the wake of the pandemic. Its continuation would depend on how policy makers view the outcomes



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