‘Covid impact will not derail IBC’

IBBI chief MS Sahoo is optimistic that firms will not misuse the suspension of insolvency proceedings due to Covid defaults

RADHIKA MERWIN

In a bid to offer respite to stressed corporates caught in the Covid-led crisis, the recent amendment to the Insolvency and Bankruptcy Code (IBC), promulgated through an ordinance, has suspended fresh insolvency proceedings with respect to Covid-related defaults. Was a permanent ban on such defaults necessary? Can this leeway be misused and lead to bigger problems for banks already plagued by poor recovery rates? MS Sahoo, Chairperson, IBBI, shares his views and elaborates on the amendments in an email interview with *BusinessLine*. Edited excerpts:

The recent amendment to the IBC has suspended fresh insolvency proceedings for any default occurring on or after March 25, for a period of six months (can be extended up to one year). What is the rationale behind this move?

The rationale is quite simple. We have the Insolvency and Bankruptcy Code, 2016 (Code) to rescue, and not take away, the lives of viable firms. It typically requires a rescuer to rescue a firm in distress. When every firm, which was viable till recently, is reeling under stress on account of Covid-19, are there rescuers? For example, when every airline is under stress, which airline will rescue another?

If all such firms are pushed into insolvency, many of them will end up being liquidated. Upon liquidation, there would be distress sale of assets, realising abysmally little. Consequently, the firms would face a premature death while creditors would realise next to nothing. On the other hand, if such firms have breathing space, many of them would bounce back on their own as soon as normalcy gets restored. Or, they would recalibrate their operations and businesses to an ‘all-new normal’. They may even explore innovative options for resolutions outside the Code. The suspension, therefore, furthers the objectives of the Code.

But was a permanent ban necessary on such defaults? Will companies not use this leeway and default (even if they have the propensity to pay their debts), and escape insolvency forever?

First, let us understand the nature of the ban. It is limited to default (Covid default) arising during a short window of time. It neither absolves the debtor of the debt nor suspends the liabilities in respect of Covid default under various other laws. It insulates a firm from insolvency for Covid default, not for all defaults. It suspends Covid default for initiation of CIRP (corporate insolvency resolution process), and not for any other purpose under the Code. Therefore, I do not think, firms would misuse the leeway.

THE BL INTERVIEW

Second, it is not fair to assume that the firms have a high propensity to default or the firms, who did not default till March, 25, 2020, would default now taking advantage of the suspension, even when they can repay. Further, should we not have a policy, which benefits everyone, just because it could be misused by a few? Policies are made in the interest of the society and economy, with checks and balances to prevent the possibility of misuse.

It is also unclear as to how a default during the six-month period, that remains so after the exempted period (unless the debtor repays during this period), can escape insolvency? Could you elaborate?

Default arising during the Covid-19 period shall not be basis of insolvency proceeding at any time.

Let us get into the basics of the IBC. A firm in a market economy gets into stress on account of market pressures — financial stress when it fails to compete at the marketplace, and economic stress when every firm in the industry fails on account of innovation. The IBC rescues firms in financial stress and closes firms in economic stress. Every firm, every industry, and every economy is under deep stress today because of Covid-19. The firms which were viable before the onset of Covid-19 may earn normal profits from current operations and become viable again after the impact of pandemic subsides, but they would take years to wipe off the deep stress.

If such firms, which were viable before and are viable after Covid-19, are pushed into insolvency, they may end up in liquidation for want of a resolution applicant. In any case, the menu available for creditors in case of default is quite long.

You said that given the Covid crisis, it would be difficult to find bidders and, hence, companies will unnecessarily be pushed into liquidation. But isn’t that the same for all cases under the IBC already?

The ordinance distinguishes failures on account of the Covid-19 and market pressures (competition and innovation). It is only fair that they are treated differently. The ordinance prohibits resort to the IBC where a firm, which withstands market pressures, but defaults on account of Covid-19.

The ordinance distinguishes failures on account of the Covid-19 and market pressures (competition and innovation). It is only fair that they are treated differently

MS SAHOO
Chairperson, IBBI

The ordinance also does not address the issue of other financial creditors or operational creditors, where moratorium does not apply...

The IBC is not a mechanism for recovery. It does not distinguish lenders based on any moratorium they are subject to or not. As regards MSMEs, they have a dual role — corporate debtor and operational creditor — in corporate insolvency. The increase in threshold of default required to initiate insolvency proceedings from ₹1 lakh to ₹1 crore and the suspension of insolvency proceedings in respect of defaults arising during the Covid-19 period insulate an MSME as a corporate debtor from insolvency proceedings. As operational creditors, they have a rich menu of options — formal and informal — for recovery as well as resolution.

Suspending Section 10 of the Code, that allows corporate debtors to file for insolvency themselves, will hurt businesses wanting to exit. Should this option have been kept open?

The corporate debtors have not been major users of the IBC. Only 2 per cent of the insolvency proceedings that commenced during 2019-20 were initiated by them. Further, a key design feature of the Code is that it balances the rights and interests of all stakeholders. It creates imbalance if only debtor has right to initiate insolvency proceeding, while a creditor does not, and vice versa. Irrespective of whether the debtor initiates or a creditor initiates the proceeding, the outcome is the same, which is perhaps not acceptable in present times.

After a year, will there be a surge in cases under the IBC?

I do not see a surge of matters before the NCLT after a year. Stakeholders would not sit idle for a year. They would use several other options to work out a resolution outside the Code. They may use a statutory, court-supervised compromise or an arrangement under the Companies Act, 2013. They may use the RBI directive for resolution of stressed assets. It is said, necessity is the mother of invention. I believe, the debtors and creditors would explore innovative options in these challenging times.

As regards recovery by banks, the IBC is not an option. They may have to initiate recovery under the Recovery of Debts and Bankruptcy Act, 1993; the SARFAESI Act, 2002; civil courts, etc.