I do not think firms will misuse ban on insolvency under IBC: Sahoo

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The ban is Covid-specific, and there are checks and balances, says the IBBI Chairperson

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Insolvency and Bankruptcy Board of India (IBBI) Chairman MS Sahoo

In a bid to offer respite to stressed corporates, the recent

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amendment to the Insolvency and Bankruptcy Code (IBC), promulgated through an ordinance, suspended fresh insolvency proceedings with respect to Covid-19- 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, Insolvency and Bankruptcy Board of India (IBBI), shared his views and elaborated on the amendments in an email interview with *BusinessLine*.

Excerpts:

The recent amendment to the IBC has suspended fresh insolvency

proceedings for a 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 IBC 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 that 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 with liquidation. 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 restores. 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 capacity to pay their debts) and escape insolvency forever?

First, let us understand the nature of the ban. It is limited to (Covid-19) default arising during a short window of time. It neither absolves the debtor of the debt nor suspends the liabilities in respect of Covid-19 default under various other laws. It insulates a firm from insolvency for Covid-19 default, not for all defaults. It suspends Covid-19 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. Second, it is not fair to assume that firms have a high propensity to default or firms which 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 society and economy, with checks and balances to prevent the possibility of misuse.

It is also unclear how a default

during the six-month period that remains a default (unless the debtor repays during this period) after the exempted period, can escape insolvency. Could you elaborate? Default arising during the Covid-19 period shall not be the 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 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, not because of market pressures, but because of the *force majure* in the form 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 the 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 the case of a default is quite long. So also the menu available to debtors and creditors for resolution.

Instead of a blanket ban on all defaults, should accounts that were already under stress or delinquent even before the Covid-19 crisis have been dealt with separately?

It is not a blanket ban on all defaults. It bans defaults arising during the Covid-19 crisis only. An insolvency proceeding can be initiated for defaults existing before the onset of Covid-19 and for defaults arising after it recedes. It does not affect the applications

already filed before the Adjudicating Authority for initiation of CIRP, and ongoing corporate insolvency resolution, corporate liquidation, and voluntary liquidation proceedings.

You said that over the next year, given the Covid-19 crisis, it would be difficult to find bidders, and hence companies will be unnecessarily pushed into liquidation. But isn't that the same for all cases under IBC already? What about them?

The ordinance distinguishes failures on account of Covid-19 and market pressures (competition and

innovation). It is only fair that they are treated differently. The ordinance prohibits resort to IBC where a firm, which withstands market pressures, defaults on account of Covid-19. It enables resort to IBC where a firm defaults on account of market pressures. In such cases, the stress is unlikely to disappear on the other side of Covid-19.

The ordinance also does not address the issue of other financial creditors or operational creditors where moratorium does not apply. Many operational creditors are MSMEs that will now not be able to find recourse under IBC...

The IBC is not a mechanism for recovery. It does not distinguish lenders based on the 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 suspension of insolvency proceedings in respect of defaults arising during the Covid-19 period insulate an MSME as corporate debtor from insolvency proceedings. As operational creditors, they have a rich menu of options — formal and informal — for

recovery as well resolution. They can even initiate insolvency proceedings for defaults that occur before or after the Covid-19 period.

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 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 the debtor has the right to initiate insolvency proceedings, while a creditor does not, and vice versa. Irrespective of whether the debtor or a creditor initiates the proceedings, the outcome is the same, which is perhaps not acceptable in present times.

After a year, will there be a surge in cases under IBC? With erosion in the value of underlying assets, banks can face the risk of steep fall in recovery rates...

I do not see a surge of matters before the NCLT after a year. The 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 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, debtors and creditors would explore innovative options in this challenging time. As regards recovery by banks, 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.

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