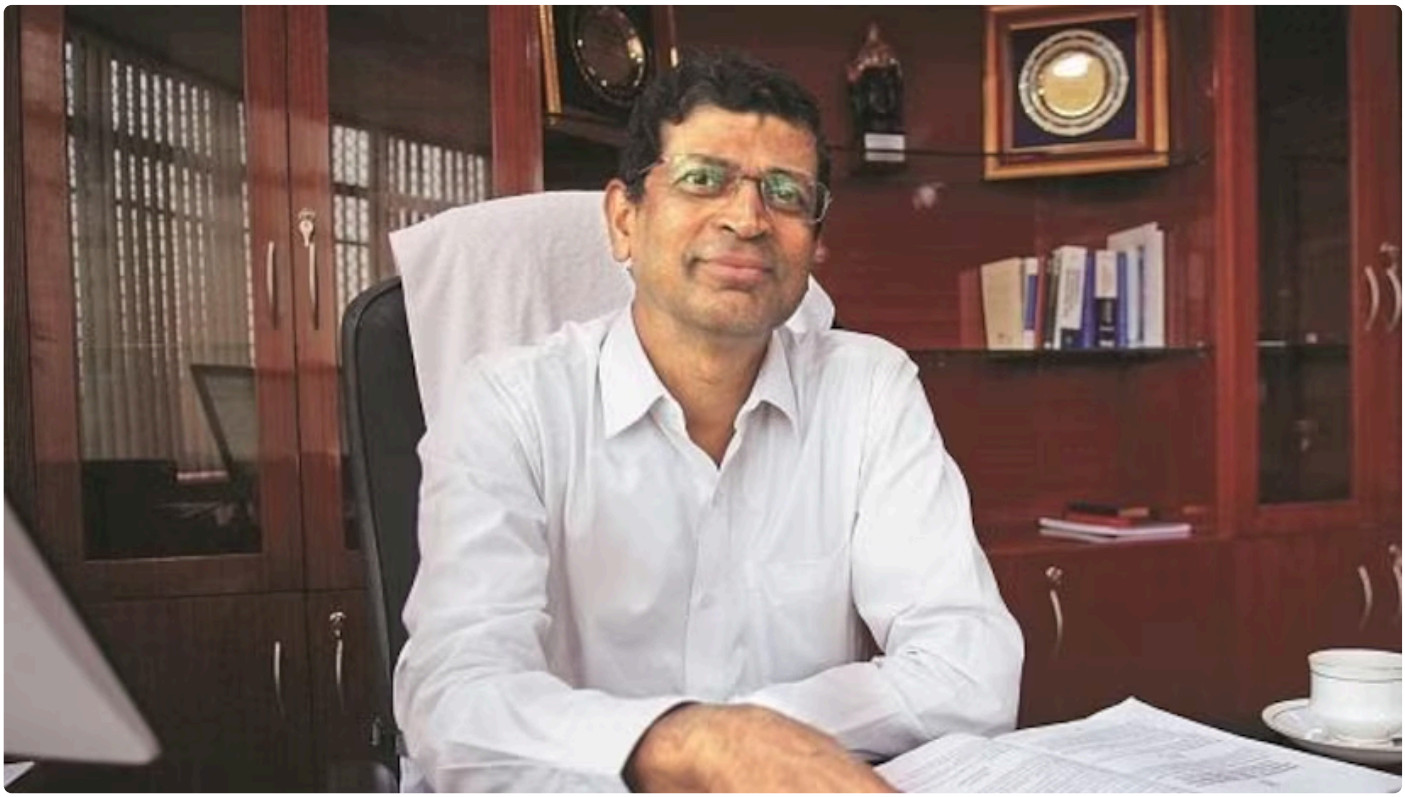
IBC suspension will fuel innovative options outside the Code: IBBI's Sahoo

In a Q&A, the chairman of the Insolvency and Bankruptcy Board of India says IBC should not be used to snuff out firms prematurely



"The Suspension Of A Few Sections Of The Code For Covid-Related Defaults Would Give Further Momentum To The Informal Or Formal Workouts Between Lenders And Creditors Outside The Code", Says M S Sahoo, Chairman Of The IBBI

Ruchika Chitravanshi | New Delhi

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Even with corporate insolvency having been suspended for six months, the Insolvency and Bankruptcy Board of India has its hands full with existing cases, designing a special framework for MSMEs and implementing individual insolvency process. **M S Sahoo**, chairman of IBBI, in an email interview with

Ruchika Chitravanshisaid that best use of the Insolvency and Bankruptcy Code (IBC) is not using it at all and that the suspension will give momentum to

innovative options for lenders outside the Code. He said IBC should not be used to take away the lives of firms prematurely. **Excerpts**:

How will IBBI's role evolve with the latest changes made to the code and what will the top priorities be?

Our hands are quite full. In addition to routine engagements, the priority would include a swift response as the Covid-19 story unfolds further and recalibration of the ecosystem is in sync with the 'new normal'. It will assist the Government in exploring innovative options for resolutions, such as, special insolvency resolution framework for MSMEs under Section 240A. It will also help implement Part III of the Code relating to individual insolvency, such as, fresh start process.

How do you think the suspension of IBC impacts creditors especially in the case of wilful defaulters who might misuse the provision?

The suspension impacts the rights of lenders in relation to defaults arising during a short window of time. And it is in their interest. Further, the Finance Minister has indicated the intention to make available a special resolution framework for MSMEs, which, with revised definition of MSMEs, probably covers a significant percentage of the total universe of corporates.

In any case, the menu available for Banks in case of default is quite long. If they are interested in recovery, IBC is not an option for them. Debtors and creditors would explore innovative options in these challenging times. One should focus on what one has rather than on what one doesn't. The IBC deals with default, agnostic of its nature, whether wilful or otherwise. The Ordinance has not changed this position. It has not also changed section 29A which makes a wilful defaulter ineligible to be a resolution applicant. There are enough laws to deal with wilful default.

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If other options work, how will it affect IBC?

The IBC is certainly not the first resort for a lender, though it has been effective even from a recovery perspective compared to the pre-IBC recovery rate and timelines. I have always held that the best use of IBC is not using it at all. Therefore, the suspension of a few sections of the Code for COVID related defaults, would give a further momentum to the informal or formal work outs between lenders and creditors outside the Code.

Will the exemption extend to companies who had given corporate guarantees before March 25 and could not perform their obligations?

The Code provides for initiation of insolvency proceedings under sections 7, 9 or 10 against a corporate debtor, whether it is the principal borrower or a corporate guarantor, upon default. If it has committed default prior to 25 th March, 2020, an insolvency proceeding could be initiated. But one would weigh the underlying situation, the underlying value, and the likely consequence, before initiating an insolvency proceeding.

Does the insertion of sub-section (3) to Section 66 provide undue protection to the Directors of a Corporate Debtor for any fraudulent transaction undertaken during the said period?

Sub-section (3) provides protection to directors of corporate debtor in respect of liability under sub-section (2), which does not deal with fraud. It deals with exercise of due diligence to minimise the potential loss to creditors, while sub-section (1), which deals with fraud, has not been touched. Further, section 166 of the Companies Act, 2013, which requires a director to discharge his duties with due

and reasonable care, skill, and diligence, remains unchanged. I do not see any undue protection.

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How does the suspension of section 10, which enables a corporate debtor to initiate insolvency help?

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 proceeding, while a creditor does not have, and vice versa. Further, irrespective of whether the debtor initiates or a creditor initiates the proceeding, the outcome is the same, which is not acceptable. Rescuing lives of firms being the prime objective of the Code, it must not be used to take away their lives prematurely.

What is the impact on the insolvency professionals, valuers of the suspension?

It does not affect at all in terms of the availability of work. There are 10000+ applications for initiation of corporate insolvency pending with the Adjudicating Authority at the admission stage. There are 2,000-plus ongoing corporate insolvency proceedings, 1,000-plus ongoing corporate liquidations, and 500-plus ongoing voluntary liquidations. Fresh applications in respect of defaults that have occurred on or before 25 th March, 2020 can be filed. Special resolution framework for MSMEs is coming up. Work has begun for operationalisation of provisions relating to individual insolvency. Besides, these professionals have huge demand for restructuring and valuation services outside the Code. Thus, what they have on table is much more than what they can take, given that there are only 3000 insolvency professionals and 3000 registered valuers.

What is your view on prepackaged schemes for resolution of MSME insolvencies and is it a viable model for other insolvencies too?

While one can consider prepacks for both MSMEs and non-MSMEs in due course, the immediate mandate is to have a special resolution framework for MSMEs. MSMEs are different from other firms in many ways. Among others, the market for resolution plans for MSMEs is local, while the entire globe is the market for bigger firms. Almost every MSME is an operational creditor, who comes at the lower end of liquidation waterfall. Most of the MSMEs are a cradle for entrepreneurs.

Entrepreneurs being catalysts for growth, the insolvency resolution aims to rescue both the firm and the entrepreneur. Since the value of an MSME often lies in informal arrangements, a very formal, rigid framework for resolution is not always conducive. Since most of them have loans from informal sources, the frameworks for resolution as available for banks are not available to lenders of MSMEs. In recognition of their uniqueness, most countries have a special dispensation for resolution of insolvencies of this category of firms.

Is prepack one of the options being considered for MSMEs?

It is difficult to spell out at this stage what the special framework will look like. Section 240A provides enormous flexibility. The framework should offer flexibility in process, and improve cost and time efficiency, within the basic structure of the Code, given that they are small and have simpler structures.

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