'See innovative options outside IBC'

By Tushar Chakrabarty and Sagar Sen

NEW DELHI – The government's decision to suspend fresh proceedings under the Insolvency and Bankruptcy Code may lead to several innovative options, including pre-packaged resolution plans, Insolvency and Bankruptcy Board of India Chairperson M.S. Sahoo said.

"... necessity is the mother of invention. It is expected that both stakeholders and authorities would explore innovative options of resolution, including pre-pack," Sahoo told Cogencis in an interview over email.

Under a pre-packaged insolvency resolution plan, the debtor and creditor agree on a restructuring or resolution plan in advance, before the case is admitted for insolvency proceedings.

During the suspension of the code, both parties could use several other options to work out a resolution outside the code, Sahoo said. "They may use statutory, court-supervised compromise or arrangement under the Companies Act, 2013. They may use the Reserve Bank of India directive for resolution of stressed assets. They may sit across a table and work out a solution," he said.

Sahoo said he did not expect a surge in insolvency cases once the suspension is lifted, as the threshold for initiating insolvency proceedings has been increased from 100,000 rupees to 10 mln rupees.

Following are edited excerpts from the interview with Sahoo:

Q. The government has provided a number of relief measures under the IBC to mitigate the impact of COVID-19. However, some experts say these measures may prove to be a setback to the insolvency and recovery process. What is your take on it?

A. Such a black swan event requires a matching response to save lives and livelihood. We must rescue the economy first, even if it means a setback for insolvency reforms, though I do not see a setback at all. Please look at the 30-year history of reforms. While we have, at times, changed gears, moved one step back and two steps ahead, moved sideways, and even stood still, we have ultimately reached the destination. We need to stir bankruptcy reforms with extreme care in these trying times.

It is dangerous for an economy if the market fails to rescue a viable firm, as this cannot be rectified. It is bad for an economy if it fails to liquidate an unviable one, but this can be rectified. Typically, rescue of a viable firm requires a saviour. When every other firm is under stress, the market may not have many saviours to rescue others. If all such firms are pushed into insolvency, many of them may end up with premature liquidation. Upon such liquidation, the assets would have distress sale, realising abysmally little for creditors. Consequently, the firms would have a premature death while creditors would realise next to nothing.

The endeavour is to allow the firms breathing space to recalibrate their operations and business to an all-new normal, while enabling debtors and creditors to work out resolutions outside the code. Rescuing firms being the prime objective of the code, it must not be used to take away their lives prematurely.

Q. What is the rationale behind the special resolution framework for the micro, small and medium enterprises sector? How will it operate and help the sector?

A. MSMEs are different from other firms in many ways. Among others, the market for resolution plans for MSMEs is local, while for bigger firms, the entire globe is the market. Almost every MSME is an operational creditor, which comes at the lower end of the liquidation waterfall. Most MSMEs are a cradle for entrepreneurs. Entrepreneurs being catalysts for growth, 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 to banks are not available to lenders to MSMEs. Most countries have a special dispensation for resolution of insolvencies for this category of firms. The Insolvency and Bankruptcy Code, 2016, enables the central government, in public interest, to provide a different framework for resolution of insolvency of MSMEs. The framework should provide some flexibility while simplifying the process and reducing the associated cost and time, thereby rescuing viable MSMEs.

Q. The government has said it will increase the minimum threshold for initiating insolvency proceedings from 100,000 rupees to 10 mln rupees. Do you think this will put smaller creditors at a disadvantage?

A. The government increased the threshold amount of default required to initiate insolvency proceedings from 100,000 rupees to 10 mln rupees. The intent was to prevent debtors from being pushed into insolvency for their inability to meet repayment obligations due to business disruptions for exogenous factors, even before imposition of the lockdown. It is working on a special dispensation, whereby both creditors to MSMEs and MSME debtors can work out a resolution. A creditor has 'n' other options, both formal and informal, to work out a resolution with non-MSME debtors.

Q. The government has said COVID-related debt will be excluded from the definition of default under the IBC for the purpose of triggering insolvency proceedings. How will the definition of COVID-19 related debt be worked out? And, if this is actually the case, what is the need to suspend all fresh proceedings under IBC?

A. It appears the intention is to exclude defaults arising out of COVID-19 from the purview of the code. A company that had not defaulted earlier but did so after the advent of COVID-19 could be considered COVID-19 related default. Such default would not be the basis for initiation of insolvency proceeding. However, one could initiate insolvency proceeding in respect of a default which has occurred prior to COVID-19. Suspension would prevent initiation of fresh proceedings in respect of such default.

Q. Will a blanket suspension under the code give more leeway for the provision being misused?

A. I do not see any misuse of any provision on account of suspension. If you are hinting at wilful default, there is a remedy for this. Besides, the debtor would attract disability under section 29A. In any case, suspension is for a short period, probably six months or a year. Further, the applications already filed and ongoing insolvency proceedings will continue to be dealt with under the code.

Q. Given that the number of insolvency cases may spike and exert more stress on the National Company Law Tribunal in the post COVID-19 period, should we look at implementing pre-packaged insolvency resolution plans?

A. I do not see a spike of matters before the NCLT after the suspension is lifted. First, the increase in threshold amount of default for initiating insolvency would reduce the number. Second, stakeholders would use several other options in the intervening period 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. They may sit across a table and work out a solution. More importantly, necessity is the mother of invention. It is expected that both stakeholders and authorities would explore innovative options of resolution, including pre-pack.

Q. The Economic Survey pointed out that while there has been progress under IBC, its pace has been slow. What can be done to ensure that the timelines for resolution are adhered to?

A. A law of this nature, which affects the rights and interests of stakeholders so deeply, takes time to settle down. In the meantime, there has been considerable learning by all elements of the ecosystem over the last three years. The beneficiaries of old order have exhausted all excuses. Most contentious issues have been resolved by the Supreme Court. The bench capacity of the NCLT and NCLAT have been substantially enhanced recently. We should see time-bound resolution on the other side of COVID-19. End

Edited by Avishek Dutta