

## ● MORATORIUM EXEMPTION

THE LIST OF EXEMPTIONS WOULD KEEP GETTING LONGER, WEAKENING THE MORATORIUM RATIONALE

# Don't let sectoral laws dilute IBC

**T**HROUGH A NOTIFICATION on October 3, 2023, the Union government exempted aircraft leases from the IBC moratorium that prohibits the repossession of any leased assets of a company undergoing insolvency process. This was a discharge of an obligation under the Cape Town Convention (CTC), which India acceded to in March 2008. Reportedly, this move would reduce leasing costs for Indian carriers by about \$1.3 billion.

IBC has only one objective, namely, stress resolution of a company. It provides for stress resolution in two ways: a resolution plan to rescue the company, failing which, liquidation to close it. It provides several enablers to rescue the company. A key enabler is the moratorium that keeps the company intact to explore its rescue as a going concern. Therefore, IBC prohibits the repossession of leased assets of the company during the moratorium. Given the importance of the objective, the provisions of the IBC prevail over every other law.

Leasing of aircraft is becoming popular with the percentage of fleet on lease increasing from 0% to 50% over the last 50 years. Considering the unique nature of this business, the CTC has standardised the treatment of leased aircraft during insolvency. It provides two alternatives. The alternative chosen by India allows a lessor to repossess the aircraft after a moratorium of two months. During this period, the company can elect to retain the aircraft after paying/agreeing to pay the lease rental for the moratorium period.

The IBC moratorium is typically for six months, but is routinely extended. The CTC moratorium is typically for two months unless the country has agreed to a different duration. The lessor gets back the aircraft if the company does not elect to retain it within two months, which conflicts with the six-month moratorium under the IBC. There are several options to address this conflict. An obvious but difficult option is to shorten the IBC process to two months

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for the airline industry. It is not rare for insolvency proceedings to conclude in two months and proceedings like prepack take less than two months in some jurisdictions.

Other options include increasing the period of the CTC moratorium to match the IBC moratorium; applying the moratorium that is shorter of the two; applying the moratorium that is longer of the two; and not having any moratorium. The exemption opts for the last one in respect of leased aircraft. Consequently, a leased aircraft must return to the lessor on day one, before the expiry of the CTC moratorium, and even when the aircraft is in use and the company is willing to pay the lease rental for the moratorium period. This does not serve the interests of either the airline or the lessor of the aircraft. The notification must be modified to exempt aircraft leases from the IBC moratorium subject to the CTC moratorium.

A bigger concern is the existing provision enabling exemption. It initially allowed the exemption of transactions from moratorium in consultation with any financial sector regulator. It was based on the premise that some transactions in the financial markets are mind-boggling in terms of their volume, value, complexity, and interconnectedness.

They pose systemic risks to the market and economy if they are not closed in time. Therefore, the provision enabled the exemption of such transactions from the moratorium, implicitly assigning a higher priority to systemic stability over rescuing a distressed company.

While no financial market transaction has been exempted so far, the provision was amended in 2018 to exempt any transaction from the moratorium in con-

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sultation with any authority. In June 2023, the government exempted licences and leases relating to oil-fields from the purview of the moratorium. Now, the exemption of leased aircraft. The door for exemption is open: the list of exemptions would keep on increasing and, over time, could be larger than the remaining, diluting the central idea behind the moratorium.

Simultaneously, sectoral laws tend to encroach on the areas common to every sector and occupied by market-wide laws. IBC is a market-wide law and a comprehensive Code for insolvency. Yet a few legislative proposals in the offing (examples: the Indian Telecommunication Bill, 2022 and the Protection and Enforcement of Interests in Aircraft Objects Bill, 2022) provide for certain aspects of insolvency. They further provide that such provisions would prevail

over the provisions in the Code.

The provision for exemption, coupled with encroachment by sectoral laws, is extremely problematic. This practically amounts to having a different insolvency dispensation for each sector, converting an otherwise market-wide law to a sectoral law. A key objective of insolvency law is the efficient allocation of resources. Sectoral dispensation rather aids inefficient resource allocation. Besides, this is inequitable since it alters the rights of stakeholders in an insolvent company, with some creditors getting precedence over others.

This is not to argue against any exemption. However, such an exemption must be based on sound principles. The primary objective of an insolvency moratorium is to rescue the life of a distressed company. It is necessary to juxtapose the objective of exemption of a transaction from moratorium with that of the moratorium itself, from the perspective of the economy. Exemption must be allowed where the former is weightier.

For example, the exemption of leased aircraft from moratorium strengthens the rights of lessors and reduces the cost of leasing. It increases the possibility of liquidation of a distressed airline. It promotes the interests of one set of creditors at the cost of others. A systematic impact analysis to quantify the gains and losses from the perspective of an economy should guide an exemption.

Consultation with an authority is desirable, but not sufficient to grant a differential dispensation (exemption/special treatment). The law must lay down guiding principles and require the Government to apply those principles to carry out an impact analysis of any proposed differential dispensation, in consultation with the public. Further, any differential dispensation, if warranted based on impact analysis, must be made in the IBC itself. This will limit differential dispensation to deserving cases and avoid disharmony, minimising resource misallocation and dilution of IBC.