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RGICS LEGISLATIVE BRIEF

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The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017

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KEY MESSAGES

- The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, amended the Insolvency and Bankruptcy Code, 2016, prohibiting promoters and associated entities under several categories from submitting a resolution plan for their defaulting companies under the resolution process.
- While the intention to keep out wilful defaulters cannot be faulted, as the amendment does not distinguish between wilful and ordinary defaulters who may have defaulted due to reasons beyond the reasonable control of the promoter/defaulting company – such as the market situation, government policies – the highly stringent eligibility criteria for resolution applicants may have a negative impact on price discovery of stressed assets as a result of the reduced pool of bidders.
- The Ordinance would especially impact Small and Medium enterprises, as they will largely see promoters submitting resolution plans for them.

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PART I. INTRODUCTION

- The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, was enacted on November 23, 2017. The Ordinance amends the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as the Code), which consolidates the existing procedures of insolvency resolution into a single legislation. The Ordinance lays down the eligibility criteria for persons who intend to submit a resolution plan to the Resolution Professional – who takes over the control of a defaulting company and invites resolution plans – under the Code.
- The aim of the Ordinance, as proposed by the Central Government, is to prohibit persons who have wilfully defaulted, are associated with non-performing assets, are habitually non-compliant, from taking part in the resolution process – lest they, by virtue of their antecedents, prove to be “a risk to successful resolution of insolvency of a company.”ⁱ
- In effect, promoters of defaulting companies who have unclear dues will be ineligible to submit resolution plans to regain control of their defaulting company under the resolution process. This has been done with the aim to stop wilful defaultersⁱⁱ and habitually non-complaint persons to re-purchase their stressed assets at discounted prices.
- The Ordinance has been sent to a committee, which is chaired by the secretary, ministry of corporate affairs, and includes members involved in the drafting of the Code.ⁱⁱⁱ

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PART II. MAJOR PROVISIONS OF THE BILL

I. Eligibility of ‘Resolution Applicant’

As opposed to the Code wherein the Resolution Professional freely invites applicants to submit resolution plans, the Ordinance allows the Resolution Professional to invite only those applicants who fulfil the eligibility criteria laid down under Section 5.

Under Section 5, the Ordinance introduces ‘Section 29A’ into the Code, specifying that a person, including a promoter, shall not be eligible to submit a resolution plan to the Resolution Professional if s/he falls under any of the ten following categories:

Criteria for Ineligibility

1	an undischarged insolvent
2	a wilful defaulter identified by the RBI under the Banking Regulation Act, 1949
3	Whose account has been identified as an NPA for more than a year in accordance with the RBI guidelines under the Banking Regulation Act, 1949
4	convicted of any offence punishable with imprisonment for two or more years
5	disqualified as a director under the Companies Act, 2013
6	prohibited by SEBI from trading in securities
7	Who has indulged in preferential, undervalued or fraudulent transactions
8	Who has executed an enforceable guarantee in favour of a creditor who is a defaulter undergoing a resolution process under the Code
9	connected to any person who meets any one of the above mentioned criterion - including promoters of the defaulting firm during the implementation of the resolution plan
10	Who has indulged in any of these activities outside India.

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II. Liquidation

Whereas the Code grants the Resolution Professional the power to sell the immovable and movable property of the corporate debtor in liquidation, the Ordinance, through amending section 35 of the Code, prohibits the Resolution Professional from selling the property to a person who is ineligible to become a resolution applicant under ‘Section 29A.’

III. Retroactivity

Under Section 30 of the Ordinance, the committee of creditors has been barred from approving a resolution plan submitted before the commencement of the Ordinance, where the resolution applicant is ineligible under ‘Section 29A’ to submit a plan. The Ordinance requires that the Resolution Professional invites fresh resolution plans.

IV. Penalties

The Ordinance inserts ‘Section 235A’ specifying that any person who contravenes the provisions of the Code, for which no penalty or punishment is provided, shall be punishable with fine ranging between one lakh rupees to two crore rupees.

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PART III: KEY ISSUES

I. No distinction between wilful defaulters and genuine defaulters

Experts opine that the Ordinance clubs all promoters into the same bracket of wilful defaulters, whereas most promoters get trapped into unfavourable business cycles and don't default as a result of mala fide intentions.^{iv}

It is pertinent to note that the Ordinance, while painting all promoters with the same brush, goes against one of the objectives of the Code as stated in the Report of the Bankruptcy Law Reforms Committee Report, 2015. Highlighting what a sound bankruptcy law can achieve, the report points to the distinction that needs to be drawn between “malfeasance” and “business failure.” The report observes: “under a weak insolvency regime, the stereotype of ‘rich promoters of defaulting entities’ generates two strands of thinking: (a) the idea that all default involves malfeasance; and (b) the idea that promoters should be held personally financially responsible for defaults of the firms that they control.”^v

II. Restricts the Number of Prospective Bidders

With the Ordinance barring not only wilful defaulters but several other categories of persons, the number of bidders submitting a resolution plan is expected to go down. This is expected to have several effects. Legal experts point out that “barring companies from bidding would further depress the price of such assets resulting in more losses to the banking sector.”^{vi} If this is to happen, then one of the ostensible purposes of the Ordinance – to prevent promoters and other entities from buying back their stressed assets at lower prices – stands defeated.

Moreover, Section 29A-(h) practically implies that almost 98 percent of the promoters would not be able to submit resolution plans even if they don't fall under other restrictions under newly inserted section 29A, because almost all promoters would have given personal guarantee for securing the corporate lending.

III. Effect on Small and Medium Enterprises

As the number of prospective bidders goes down, commentators point to the effect it would have on small and medium enterprises (SMEs) under insolvency proceedings – since for most of them, the promoters are the only bidders. Media reports highlight that around 70 per cent of SMEs undergoing insolvency proceedings face liquidation as their promoters – who now stand debarred from bidding for their stressed assets – are the only ones presenting a resolution plan.^{vii}

IV. Disruption in Ongoing Proceedings

Owing to the amendments made in Section 30 of the Code, the Ordinance is retrospective in nature, which means it will be applicable to the resolution plans already submitted and under consideration.

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Experts suggest that retroactivity will disrupt nearly all pending insolvency proceedings. Moreover, if promoters/other bidders, who defaulted owing to extraneous factors, choose to challenge their classification as wilful defaulters in court,^{viii} it could further complicate the insolvency resolution process.^{ix}

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PART IV. CONCLUSION

The Ordinance would result in reducing the number of bidders which in turn may have negative effect on the price discovery of stressed assets. While the idea is that wilful defaulters must be stopped from regaining control of their assets at a discounted price, by introducing highly stringent eligibility criteria for resolution applicants, the Ordinance will actually limit the amount that the banks will be able to recover from the insolvency process, and force them to take deeper ‘haircuts.’ Due to retroactivity, it would also lead to litigation by affected parties and hence act as an impediment to the aim of the Code to ensure resolution happens in time bound manner.

Additionally, the Ordinance may have a significant repercussion: pushing a large number of SMEs, which are yet to fully recover from the effects of demonetisation and the hasty implementation of the Goods and Services Tax, into liquidation, as these enterprises rely largely on promoters for resolution.

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PART V. REFERENCES

ⁱ Ministry of Corporate Affairs. (2017, November 23). ‘President grants assent to Ordinance to amend Insolvency and Bankruptcy Code, 2016,’ *Press Information Bureau*. Retrieved from <http://pib.nic.in/newsite/PrintRelease.aspx?relid=173771> on December 19, 2017.

ⁱⁱ For the RBI’s definition of ‘wilful defaulter,’ read ‘Important Guidelines on Wilful Defaulters,’ RBI Master Circular. Retrieved from <http://www.iibf.org.in/documents/wilful-defaulters.pdf> on December 19, 2017.

ⁱⁱⁱ Upadhyay, J. & Archana, A. (2017, December 12). Govt asks panel to review amendment to Insolvency and Bankruptcy Code. *Livemint*. Retrieved from <http://www.livemint.com/Industry/i417lx3rY025x0eT0NAa2H/IBC-ordinance-Govt-asks-panel-to-review-amendment-to-Insolv.html> on December 19, 2017.

^{iv} Read TNN. (2017, November 23). Insolvency Bankruptcy Code modification to strike loan defaulters another body blow. *The Times of India*. Retrieved from <https://timesofindia.indiatimes.com/business/india-business/new-ordinance-to-strike-loan-defaulters-another-body-blow/articleshow/61760744.cms> on December 19, 2017; and Menon, S. & Mazumdar, R. (2017, November 30). IBC Ordinance: End of the road for dishonest promoters, but has anyone thought of the collateral damage? *The Economic Times*. Retrieved from <https://economictimes.indiatimes.com/news/economy/policy/ibc-ordinance-end-of-the-road-for-dishonest-promoters-but-has-anyone-thought-of-the-collateral-damage/articleshow/61856357.cms> on December 19, 2017.

^v The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design, November 2015. Retrieved from http://ibbi.gov.in/BLRCReportVol1_04112015.pdf on December 19, 2017.

^{vi} PTI. (2017, November 23). IBC ordinance: Several companies say not 'wilful defaulters'. *The Economic Times*. Retrieved from <https://economictimes.indiatimes.com/news/company/corporate-trends/ibc-ordinance-several-companies-say-not-wilful-defaulters/articleshow/61770608.cms> on December 19, 2017.

^{vii} Mani, V. (2017, November 30). Nearly 70% of Stressed SMEs Face Liquidation. *Business Standard*. Retrieved from <https://www.pressreader.com/india/business-standard/20171130/282093457057667> on December 19, 2017.

^{viii} The Ordinance has already been challenged in the Punjab and Haryana High Court on two key grounds – retroactivity of the ordinance and no distinction between a genuine promoter and a wilful defaulter. Read: BQ

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Desk. (2017, December 8). Insolvency Ordinance Faces First Challenge In Court. *Bloomberg Quint*. Retrieved from <https://www.bloombergquint.com/insolvency/2017/12/08/insolvency-ordinance-faces-first-challenge-in-court> on December 19, 2017.

^{ix} Leading insolvency lawyer Sumant Batra points to the possibility that a promoter challenges the classification of a ‘wilful defaulter’ in court, and the court does not stay the insolvency process. This, at first, will result in the promoter losing her company. “But later, if the bank’s decision is found to be illegal by the court, the promoter would become entitled to claim damages from the bank.” Read: Special Correspondent. (2017, November 23). ‘IBC ordinance will affect pending suits’. *The Hindu*. Retrieved from <http://www.thehindu.com/business/Economy/ibc-ordinance-will-affect-pending-suits/article20724711.ece> on December 19, 2017.