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### UNDERSTANDING SECTION 10 OF THE INSOLVENCY AND BANKRUPTCY CODE

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#### Abstract

*In present time, India along with the other countries, is facing the biggest crisis ever existed in the human history caused by the pandemic Covid-19. The repercussion of this corona virus has put the economy on hold. Due to lockdown, many businesses activities were closed, unemployment is at its peak resulting in fall of production of goods and services. But in this bad time, there is good news from Insolvency and Bankruptcy Code, 2016 (IBC) which has brought some relaxation in corporate and tax law. The decision is taken to push the economy floating. Due to the lockdown many small as well as large corporate houses filed multiple applications for initiation of Corporate Insolvency Resolution Procedure (CIRP). The government has made amendment in the IBC by introducing Section 10A to protect the businesses from the hardship of IBC rules. Suspending IBC for 6 months would help in removing the risk of company and these companies would be able to secure their assets, loans and other reliefs from banks.*

*In this paper, it is argued that merely suspending certain provisions of the IBC will not solve the problem. Government is required to provide some alternative to safeguard the interests of the creditors.*

**Keywords:** Bankruptcy and Insolvency Code, Insolvency, IBC, CIRP, Covid-19.

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#### Introduction

The Insolvency and Bankruptcy Code, 2016 (IBC) <sup>1</sup> is a bankruptcy framework which was enacted in 2016 to resolve the delay in insolvency resolutions. It brings clarity by providing a robust process and time frame for resolution of insolvency. The framework of insolvency and bankruptcy is at its nascent stage, and as such there is a long way to cure the lacunae present therein. Whenever a default occurs, the resolution process begins under IBC, and this may be initiated by the creditor or the debtor.

Covid-19 outbreak, as we all know, has created various key challenges to the insolvency framework throughout the world. As a result of this crisis, the government has made various changes to the insolvency framework in India in order to recuperate with the challenges posed by the Novel Corona virus. The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 was promulgated on 5<sup>th</sup> June, 2020 to rescue several businesses from the devastating effects of Covid-19. Section 10A of the Code, which is the subject matter of the present paper, makes provision for suspension of the application of Section: 7, 9, 10 of the Code, and thereby restrict the applications for initiation of corporation insolvency resolution process (CIRP) with retrospective effect from 25 March, 2020,<sup>2</sup> for a

certain exemption period but not beyond 1 year from date of effect. This provision aims at protecting the creditors or corporate debtors from filing CIRP. Apart from this, the Government of India through Ministry of Corporate Affairs had raised the threshold/ minimum default amount from Rs. 1 lakh to Rs. 1 crore *vide* notification S.O. 1205(E) dated 24-03-2020.<sup>3</sup> The said revision was done in order to prevent a large number of CIRP being filed in the wake of ongoing crisis and the pandemic outbreak.<sup>4</sup> This move largely serves to safeguard the struggling small and medium industries which may default on account of crisis following the pandemic.<sup>5</sup>

These notifications have turned out to be a double-edged sword. On one hand it offers protection, while on the other, it takes away the right of creditors to recover loans which have been defaulted.<sup>6</sup> The insertion of Section 10A has caused serious outcomes to the operational creditors on an immediate effect. As a result of this insertion, the initiation of insolvency proceedings has been suspended on 05-06-2020, with effect from 25-03-2020, in pursuance to Section 7, 8, and 10 of the IBC by corporate debtors against itself or creditors.<sup>7</sup> Initially, the period of application of the said section was from 25 March, 2020 till September, 2020, i.e. 6 months but not later than 1 year.

However, the given section is not without any ambiguity. By these provision and Notifications, the National Company Law Tribunal (NCLT) has been conferred huge discretion to define and interpret the scope of Section 10A.<sup>8</sup> The application and the effect of this provision has been particularly dealt with by the Supreme Court in *Ramesh Khymal v. M/s Siemens Gamesa*.<sup>9</sup> While announcing the judgement on 9 February, 2021, Justices D.Y. Chandrachud, and Justice M.R. Shah observed that the embargo contained therein must receive purposive construction. The court also consider the steps taken by the legislature on account of widespread distress caused by Covid-19. The court also examined its own judgement of *Swiss Ribbons (P) Ltd. v. Union of India*<sup>10</sup> with respect to the objective of IBC.

### **Suspension of Section 10 of the IBC**

First, the major drawback of the amendment is that it Suspends Section 10 of the Act. Section 10 was giving the power to the companies to undergo the voluntary insolvency and also allow them to take the benefit of the forbearance period so that it can reduce the liabilities and also ensure for the maximum profit to all the stockholders in the company. Due to the striking Covid-19 all the businesses of the Companies have been stuck into the demand and supply chain. Furthermore, this Covid- 19 is going to extend for a long period of time which is highly unpredictable and according to such situations it is very hard for many businesses to get back on the track and cover up the damages caused due to Covid-19 break, so it would be fine to give the remedy of insolvency and the benefit of forbearance to the businesses of the Companies.

This will be advantageous to all the shareholders of the Companies as it will assist the companies in increasing the valuation of the Company. By avoiding the insolvency proceedings on such debt, other ways such as summary winding up will be a route available, but the remedy of Section 361 of Companies Act, 2013 is not available to every company, when Section-361 of the Companies Act, 2013 read with Companies (Winding up) Rules, 2020 will show the Summary Liquidation, the company shall have assets value less than Rupees 1 Crore and as per the revised audit balance sheet the Companies should have a turnover upto Rupees 50 Crores or either, paid up share capital should not be less than Rupees 1 Crores, or loan which should not exceed Rupees 50 Lakhs and if there is a case of deposits outstanding then it should not exceed Rupees 25 Lakhs.

So, the above given procedure is not available to every type of companies which is usually used by start-ups and MSMEs because they fulfill this criterion. Furthermore, when the IBC was introduced, then the provision Chapter XX (Voluntary Winding up) of the Companies Act, were shifted to the IBC. So now, the

option of winding up is not available to the debtor. Now with the introduction of new section i.e., Section 10A, the government has taken away the power that would have ordinarily been available for the establishment, and now they are forced to face further losses and also leave the assets of business open to litigation. However, the amendment in the act has stressed over the entities which have no other options to save themselves. Adding to this the amendment fails to fulfill the foremost objective of reducing the burden from the debtor because it is only applicable to insolvency proceedings.<sup>11</sup>

This results that if business does not undergo insolvency, but any claims or any other proceedings different from insolvency can be filed against the business in a civil court. Although the business will be allowed to operate at low level, even if that sum is related to Covid-19 related debt. So, this type of amendments will not be going to reduce any type of burden from the businesses which are facing difficulty in such unprecedented times.

### **Whether Section 10A has a Retrospective applicability and Retroactive Effect?**

The legislature has power to enact statute with retrospective application with respect to substantive or vested rights, now the question of the hour is that whether section 10A can be applied retrospectively and whether there is any express provision in the legislation to this effect or above section is not found in the legislation.

Simple reading of the main provision of Section 10A of the code it states that with respect to the defaults arising on or after 25<sup>th</sup> March 2020, no application for the initiation of CIRP shall be entertained for a period of 56 months or such can-not be further exceed the period of 1 year.

The suspension time in relation to filing of application is for six months which can be further extended to a period of 1 year. In relation to the section 7, 9 and 10 it is the default on the debtor's end to pay the due debt in the specified time which will affect the filing of a petition. As there is nowhere 'debt' is defined in Section 3(11) of the code which is due and payable and no default is defined under section 3(12) of the code. Also, there is no question of any cause related to creditor's invoking the provisions of Insolvency and Bankruptcy Code seeking for the initiation of CIRP.

The Hon'ble Supreme court supported it by giving its judgement in the case of *Innoventive Industries v. ICICI Bank*<sup>12</sup> in relation to define financial debt and its default and in *Mobilox Innovations v. Kirusa Software Private Limited*<sup>13</sup> to define an 'Operational Debt' and its 'default' it is defined in paragraph 30 of the *Innoventive Case* which summaries the purpose of admitting or rejecting an application filed

by a creditor in respect to financial debt and its default under section 7 of the code.

To answer the question that the application of Section 10A can be applied retrospectively by filing it back to 25.03.2020 being the relevant date to be considered in respect to suspension of filing of application for the initiation of CIRP is in positive, the only thing that tribunal should ascertain is to whether the date of default falls within or outside the 'Lakshman Rekha' or also the date 25.03.2020 drawn by the legislature through the means of ordinance (No. 9 of 2020) published on 05.06.2020 in the present case.

#### Conclusion:

The court recorded that while constructing the Section 10A care should be taken to maintain the very purpose, object and intent for which it was inserted. the interpretation of Section 10A is not to be based purely on a literal sense based on the language used, but a harmonious construction has to be done which also considers the object and intent behind the insertion of Section 10A because this amendment is not complete in itself and needs further amendments to have any substantial effect and as this provision is incomplete so at many places in the provision itself it misses the major content of such Section which is amended by the 2020

Ordinance. This is an *ad hoc* provision whose effect has strictly been reduced to not more than a year, i.e., the application of the said provision is not to take effect for more than a year from 25-03-2020.

Furthermore, the purpose of Section 10A was reiterated many times which is to avoid corporate debtors getting into insolvency proceedings due to economic crisis caused by the pandemic.

The 2020 Ordinance fails to provide blanket safety during these difficult times of Covid-19, the Ordinance that is avoiding the initiation process under CIRP under Section 7, and 9 and it is a good step to safeguard businesses from being going under the process of insolvency, although the prohibiting the Section 10 of the IBC is harmful or damaging to the businesses and it works against the intention of asset maximisation which given under the preamble of the Code.<sup>14</sup>

Furthermore, the Ordinance ignores the personal guarantors as they are open to abuse of the Code and are not protected. Moreover, as explained above Section 10 is not only section which is a question for amendment but there are other issues also which are to be amended or should be tackled by the legislature through the means of Amendment or clarification.

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#### End Note

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<sup>1</sup> See Insolvency & Bankruptcy Code, 2016, available at <<https://www.prindia.org/administrator/uploads/media/Bankruptcy/Bankruptcy%20Code%20as%20passed%20by%20LS.pdf>> Accessed 21 February, 2021

<sup>2</sup> Kumar, Harsh. "Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020: Is it a step in the right direction amidst Covid-19?" published by Singh & Associates on Mondaq on 4 August, 2020, available at <<https://www.mondaq.com/india/insolvencybankruptcy/966672/insolvency-and-bankruptcy-code-amendment-ordinance-2020-is-it-a-step-in-the-right-direction-amidst-covid-19>> Accessed 22 February, 2021

<sup>3</sup> Gazette of India, MCA, No. 1076, 24 March, 2021, available at <<https://www.ibbi.gov.in/uploads/legalframework/48bf32150f5d6b30477b74f652964edc.pdf>> Accessed 22 February, 2021

<sup>4</sup> Nichani, Anchal. Eshawars "Impact of revision on threshold of default under IBC on operational creditors" Lexology, 5 April, 2020, available at <<https://www.lexology.com/library/detail.aspx?g=51269ab8-fa6a-4d08-91cb-e1db12abb848>> Accessed 22 February, 2021

<sup>5</sup> PTI, "Govt raises default threshold to Rs 1 cr for invoking insolvency proceedings against firms" The Economic Times, 24 March, 2020, available at <<https://economictimes.indiatimes.com/news/economy/policy/govt-raises-default-threshold-to-rs-1-cr-for-invoking-insolvency-proceedings-against-firms/articleshow/74796076.cms?from=mdr>> Accessed 23 February, 2021

<sup>6</sup> Rana, Vikrant. Jhavar, Anuj "IBC threshold – Whether prospective in nature?" published by S.S. Rana & Co., on Mondaq, 20 September, 2020, available at <<https://www.mondaq.com/india/insolvencybankruptcy/988562/ibc-threshold-whether-prospective-in-nature>> Accessed 23 February, 2021

<sup>7</sup> Choudhri, Gurmukh. "Section 10A of the Insolvency and Bankruptcy Code, 2016 – Dispensable or Indispensable" 19 February, 2021, Mondaq, available at <<https://www.mondaq.com/india/insolvencybankruptcy/1038454/section-10-a-of-the-insolvency-bankruptcy-code-2016-dispensable-or-indispensable>> Accessed 23 February, 2021

<sup>8</sup> Id.

<sup>9</sup> Civil Appeal No. 4050 of 2020, Supreme Court of India

<sup>10</sup> (2019) 4 SCC 17

<sup>11</sup> Amay Bahri, Diganth Raj Sehgal, *Issues surrounding the IBC Ordinance 2020 and Section 10A*, May 12, 2021, Available at <<https://blog.ipleaders.in/issues-surrounding-ibc-ordinance-2020-section-10a/>> Accessed at December 2, 2021

<sup>12</sup> (2018) 1 SCC 407

<sup>13</sup> (2018) 1 SCC 353

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<sup>14</sup> Amay Bahri, Diganth Raj Sehgal, *Issues surrounding the IBC Ordinance 2020 and Section 10A*, May 12, 2021, Available at <<https://blog.iplayers.in/issues-surrounding-ibc-ordinance-2020-section-10a/>> Accessed at December 2, 2021