

**RAISE IN THE TRIGGERING THRESHOLD FOR DEFAULTS UNDER IBC:
PRAGMATISM, OBJECTIVITY AND POSSIBLE KNOCK-ON EFFECTS**

-Adab Singh Kapoor¹

BRIEF BACKGROUND

The Finance Minister of India, Nirmala Sitharaman, on 24.03.2020, announced a slew of measures to shield the companies from the possible challenges and resultant difficulties that may ensue, on account of the COVID-19 pandemic, and obviate such difficulties.² Amongst other relief measures, it was announced that on account of the large-scale economic distress caused by COVID 19, it has been decided to raise the threshold of default under section 4 of the Insolvency and Bankruptcy Code, 2016 (“**IBC**”) to Rupees 1,00,00,000/- (Rupees One Crore Only) from the earlier threshold of Rs. 1,00,000/- (Rupees One Lacs Only).

The Finance Minister stated that the relief measure is being undertaken “*so that we can prevent triggering of insolvency proceedings against Micro, Small & Medium Enterprises (“MSMEs”)*” and the relief measure shall be applicable forthwith. It was further stated that in the event the situation continues beyond 30th of April 2020, the Ministry may also consider suspending Sections 7, 9 and 10 of the IBC, to stop companies, at large from being forced into insolvency proceedings in such *force majeure* causes of default.³

Interestingly, even in the past, there have been many concerns and talks about the raising of the threshold limit, *inter alia* with respect to the large number of litigations which had been instituted by the creditors for recovering claims from the Corporate Debtors.

On 24.03.2020, the Ministry of Corporate Affairs (**MCA**) issued a notification bearing S.O. 1205 (E) in exercise of its powers under Section 4 of the IBC to raise the minimum threshold for default to One Crore Rupees. Appositely, the National Company Law Appellate Tribunal

ADAB SINGH KAPOOR
&
ASSOCIATES
Advocates

(NCLAT) in light of the Supreme Court order extending the period of limitation in all such proceedings across all the courts/tribunals,⁴ has also excluded for the purpose of counting of the period for Resolution Process under Section 12 of IBC and further ordered that any interim order/stay passed by the NCALT to continue till the next date of hearing.⁵

On 29.03.2020, the Insolvency and Bankruptcy Board of India (IBBI) issued a notification inserting Section 40C which states that the period of the lockdown imposed by the Central Government in the wake of COVID-19 outbreak shall not be counted for the purpose of the timeline for any activity that could not be completed due to such lockdown, in relation to the Corporate Insolvency Resolution Process (CIRP).⁶

**DISSIMILARITY IN APPLICATION OF THE AMENDMENT TO THE FINANCIAL CREDITORS (FC)
AND OPERATIONAL CREDITORS (OC)**

Interestingly, Section 7 of IBC which deals with the initiation of the CIRP by Financial Creditor, states under the Explanation to Section 7(1), that a ‘*default*’ includes a default in respect of the financial debt owed not only to the applicant financial creditor but to any other financial creditor of the Corporate Debtor.

However, no corresponding provisions have been incorporated under Section 8 and 9 of the IBC which deal with the initiation of the CIRP by the Operational Creditors.

This, in essence means that a Financial Creditor, against whom the Corporate Debtor may not have individually committed a default amounting to Rupees One Crore, may also initiate insolvency resolution process against the Corporate Debtor, provided that there are other Financial Creditors against whom the Corporate Debtor has committed a default, and the amount of all such defaults, collectively, of all the Financial Creditors, amounts to Rupees One Crore. While Section 7(1) allows the Financial Creditor to file an application on the basis of

ADAB SINGH KAPOOR
&
ASSOCIATES
Advocates

aggregated claim, such claim should not include the amount qua the default committed by the Corporate Debtor against the Operational Creditors.

However, the same is not applicable to the Operational Creditors, whereby for each Operational Creditor who initiate insolvency proceedings, the threshold of Rupees One Crore in respect of the default being made by the Corporate Debtor would have to be satisfied.

While the Hon'ble Supreme Court in *Swiss Ribbons*⁷ has upheld the classification of the creditors into Financial and Operational Creditors on grounds of *inter alia*, the differences in the nature of agreements, finance, nature of debt, and dispute resolution, the amendment raising the threshold, may adversely prejudice the rights of the Operational Creditors who may seek to initiate the insolvency proceedings against the Corporate Debtor but fall short of the threshold of Rupees One Crore. This may further reduce the number of cases of such default which may be adjudicated upon by the NCLT, more so given the fact that out of the total of CIRP's triggered as of December 2019, the Operational Creditors have triggered 49.21% of the CIRPs, followed by about 43.44% by the Financial Creditors and remaining by the Corporate Debtors.⁸

Further, the amendment may be misused by prospective Corporate Debtors who may intentionally not make payments to the Operational Creditors, in response to the demand notice, being aware that the insolvency proceedings may not be initiated against them.

PRE AND POST COVID-19 'DEFAULTS'

While the notification increases the applicable threshold for the amount of “*default*”, it fails to stipulate the time period from which such default may be calculated. Pragmatically, any transactions basis which the default may occur during the period of cessation of activities due to COVID-19 ought to be included within the ambit of such defaults. However, it may be

ADAB SINGH KAPOOR
&
ASSOCIATES
Advocates

required to be established that such defaults have occurred, due to the force majeure conditions subsisting due to the COVID-19.

Moreover, whether the amount of ‘*default*’ would also include the transactions basis which the default occurred prior to COVID-19 is also required to be clarified.

Moreover, after the cessation of the lockdown, post which the earlier threshold of Rupees One Lacs may be reimplemented, the clarification, as to whether the petitions filed would also include the amount of defaults which had occurred during the period of lockdown due to COVID-19 would be included or not; ought to be provided.

PETITIONS PENDING ADMISSION

There have been several petitions filed under Section 7, 9 and 10 of the IBC that are pending at the stage of Admissions across various benches of NCLT. Whether the amendment would be retrospectively applicable to all such petitions is a question which may need clarification.

SUMMARISING OBSERVATIONS

While the increase in the triggering threshold may decrease the filing of frivolous petitions before the adjudicating authority, it may also at the same time, adversely affect the creditors, more so the Operational Creditors.

There are several ambiguities surrounding the amendment which may require clarifications , in respect of, *inter alia*, the time period which may be accounted for, for assessing such ‘defaults’ by the Corporate Debtor and whether the transactions basis which the defaults may occur during the COVID-19 lockdown, albeit at a subsequent stage, may be included in such ‘defaults’.

ADAB SINGH KAPOOR
&
ASSOCIATES
Advocates

Further, clarification may also be required, as to whether the petitions pending admission would also have to satisfy the threshold.

Although Financial Creditors may file the application for the initiation of Corporate Insolvency Resolution Process against the Corporate Debtors on the basis of aggregate claim, the Operational Creditors may not be able to fulfil the threshold, given that they cannot initiate insolvency proceedings on the basis of an aggregated claim and thus, would individually have to now satisfy the newly introduced threshold requirement under Section 4 of IBC.

¹ Managing Partner, *Adab Singh Kapoor and Associates* (“Firm”), assisted by Raghav Mittal, Associate at the Firm

² Ministry of Finance, *FINANCE MINISTER ANNOUNCES SEVERAL RELIEF MEASURES RELATING TO STATUTORY AND REGULATORY COMPLIANCE MATTERS ACROSS SECTORS IN VIEW OF COVID-19 OUTBREAK*, PIB Delhi, 24th March 2020 at 5:10 PM, available at <https://pib.gov.in/PressReleaseDetail.aspx?PRID=1607942>

³ Official Channel of Press Information Bureau, the Nodal agency for communicating to media on behalf of Government of India, *PIB India, Union Finance Minister Nirmala Sitharaman will address media via video conference*, streamed live on 24.03.2020, available at <https://www.youtube.com/watch?v=XS8npogyg34&t=1924s>

⁴ Order dated 23.02.2020, *Suo Motu Writ Petition (Civil) No. 3/2020, In Re: cognizance for extension of Limitation*, Supreme Court of India

⁵ Order dated 30.03.2020, *Suo Moto – Company Appeal (AT) (Insolvency) No. 1 of 2020*, National Company Law Appellate Tribunal

⁶ Notification dated 29.03.2020, Published in the Extraordinary Gazette of India, Part III, Section 4, *Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Third Amendment) Regulations, 2020*.

⁷ *Swiss Ribbons Pvt. Ltd. & Anr. v. Union of India & Ors.*, (2019) 4 SCC 17

⁸ Insolvency and Bankruptcy Board of India, *The quarterly newsletter of the Insolvency and Bankruptcy Board of India, October-December 2019, Volume 13, Page 15, Table 3*