International Journal of Law
ISSN: 2455-2194; Impact Factor: RJIF 5.12
Received: 23-03-2020; Accepted: 21-04-2020; Published: 28-04-2020
www.lawjournals.org
Volume 6; Issue 2; 2020; Page No. 178-180

Increasing the IBC minimum threshold: A notification passed in larger interest and larger complexities

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Abstract
The authors have tried to discuss the idea behind the notification which appears to be minimizing of large-scale insolvencies as anticipated by the disruptions caused by the disparaging COVID-19 and the unending destruction created by it and which is clearly an act of a 'welfare state'. It is also expected that the minimum threshold may be a temporary measure to fight against the unforeseen event of COVID-19 and is introduced by the government to cope with the present situation though leaving a doubt as it does not provide any expiry date. However, apart from appreciating the move of the government of India, the authors have also highlighted the issues that go against the primary spirit of the code which aims at safeguarding the interest of everyone while reviving and restricting the commercial entities.

Keywords: insolvency, Covid-19, amendment, threshold, notification, IBC

Introduction

With the outbreak of COVID-19 establishing its foothold in the country anticipating a natural slowdown and financial stress in the economy owing to the above, the Union Finance and Corporate Affairs Minister, Ms. Nirmala Sitharaman on 24th March, 2020 announced certain reliefs in the regulatory and compliance mechanism under Income Tax, GST, Custom and Central Excise, Insolvency and Bankruptcy Code among several others. That the aforesaid relaxations brought in are being regarded as a corollary to the pandemic and the need of the hour.

One such change brought in by the Government of India includes escalating the minimum threshold to initiate the Corporate Insolvency Resolution Process (*hereinafter referred to as* "CIRP") by the Creditors against a defaulter under Insolvency & Bankruptcy Code, 2016 (*hereinafter to be referred as the* "Code"). From its inception, the knee-high threshold of Rs. 1,00,000/- of a default for filing an application for the initiation of CIRP has always been seen with skepticism because of its potential exploitation at the behest of the Creditors while putting an unbridled burden on the commercial entities for a dwarfish default of Rs. 1,00,000/-. The minimum amount of default now stands increased from Rs. 1,00,000/- to Rs. 1,00,00,000/- vide Notification dated 24-03-2020 (hereinafter to be referred as the "Notification") passed by the Ministry of Corporate Affairs [1].

Analyzing Insolvency Vis-A-Vis the Notification

Section 4 of the Code while stating the minimum threshold to file an application for the initiation of CIRP provides that the Central Government by notification may specify an amount higher to the minimum amount of default which shall not be more than Rs. 1 Crore. In light of the above amendment brought in Section 4 of the Code, the Operational and Financial Creditors can now knock the doors of NCLT only when the default by the Corporate Debtor amount to more than Rs. 1 Crore. One of the intentions behind such a move is the protection of the Micro, Small and Medium Enterprises (MSMEs) from being pushed into the flood of insolvency during the economic slowdown as anticipated by the government during the current times. However, the minimum threshold of Rs. 1 Lac has always been a point of major concern for the commercial entities defaulting the least amount while giving an upper hand to the creditors. The same situation was discussed in the report [2] submitted by the Insolvency Law Committee wherein the committee categorically mentions that,

"*It was stated to the Committee that pursuant to the introduction of the Code in 2016, it has seen around 2,400 applications so far, out of these, a large number have been filed by operational creditors — such as vendors, suppliers, and employees — who can potentially lead the company into liquidation for a default of as low as INR one lakh. Data from the IBBI pertaining to the period January - December, 2017 also supports this trend. The data suggests that out of 540 cases admitted for corporate insolvency resolution process under the Code, as many as 234 cases were filed by operational creditors* [3]".

Taking into account the lower amount of time taken by the Authority to adjudicate the matter and from absolving from payment of the court fee to be submitted while filing a civil suit for recovery, the Creditors prefer CIRP to be initiated against the defaulter entity to recover their monies and only in order to curb this practice, the committee suggested that the minimum threshold be revisited to keep the frivolous petitions at bay and as such to prevent the misuse of the legislative intent behind the introduction of the Code.

Taking into account the distressed time created by COVID-

[1] MCA Notification SO 1205(E)

[2] Report of the Insolvency Law Committee dated 26-03-2018 by Ministry of Corporate Affairs, Government of India.
[3] *ibid.*

19, the government is also considering the suspension of section 7, 9 and 10 of the Code for the time being to save the MSMEs from further exploitation by the creditors. However, in the absence of any such notification as of now, if for a moment it is assumed that the concerned sections are not suspended, the notification leaves a room for many questions and complexities which are still required to be answered. This article in the considered opinion of the authors attempt to point out those complexities and the questions and urges the Ministry of Corporate Affairs for a clarification on the practical guide to the problems posed by the notification.

MCA Notification No 1205 (E) and the Imbibed Legal Complexities

There are several question and complexities which are posed by the notification and are required to be answered by the Government as it creates a room for assumptions for everyone leading to bewilderment, which includes:

- **No right of filing a joint application to the Operation Creditors under the Code in contrast to the Financial Creditors:** The explanation provided under section 7 of the Code reads as, *"For the purposes of this sub-section, a default includes a default in respect of a financial debt owed not only to the applicant financial creditor but to any other financial creditor of the corporate debtor* [4], thereby leaving the field open for the Financial Creditors to file joint applications to meet the minimum threshold of Rs. 1 Crore as set out by the Notification either individually or jointly for the defaulted amount. However, section 9 which talks about the initiation of CIRP by the Operational Creditors gives no such power to them and therefore, makes it mandatory for the Operational Creditors to meet the minimum threshold, individually. Having said that this Notification majorly undermines the interest the Operational Creditor which is in clear contravention to the basic spirit of the Code which lies in safeguarding the interests of every class of creditor.
- **Employees as Operational Creditor, almost burying their rights to initiate CIRP:** The Code empowers the Employees of the commercial entities to come under the ambit of Operational Creditor, however, this empowerment makes it almost impossible for them to initiate CIRP for the salaries due to be paid to them by their employers. There is no provision for filing the aggregated or combined claim by the Operational Creditor defined in the Code and practically, meeting the current minimum threshold of Rs. 1 Crore as "unpaid debt" in individuality as salary seems to be an outlandish task for an employee.
- **Homebuyers as Financial Creditor, Notification posing a new hurdle:** The IBC Amendment, 2019 has already created ample of trouble for the homebuyers by stipulating that insolvency proceedings against the developer can be initiated only in the case where 10% or 100 of the homebuyer (whichever is lower) agrees to the move. However, this notification poses an additional burden on the innocent homebuyers where even if they meet the requirement of the IBC Amendment, 2019 having 10% of the homebuyers agreed to initiate the CIRP but if they do not meet the minimum threshold of Rs. 1 Crore which seems to be rare though not impossible, they cannot pursue it and vice versa.
- **The question of retrospective or prospective application of the Notification:** The Notification is a silent piece of delegated legislation in terms of its applicability and therefore, it would be safe to assume that it would apply prospectively to the disputes and not otherwise [5]. It is a cardinal principle of construction that every statute is *prima facie* prospective unless it is expressly or by necessary implication made to have retrospective operation [6]. The Notification would come under the definition of 'delegated legislation' and 'law' within the meaning of Article 13(3)(a) of the Constitution of India, 1950. However, the Government of India should come up with the clarification in terms of applicability to answer the complexities it has raised by being silent on this position.
- **The question of the overall applicability of the Notification on the pending applications**: The Notification does not specify the date of its applicability and so for the sake of safety, it is assumed that it would apply from the date it was released i.e. 24th March, 2020. Having said that, it is crucial to decide the fate of applications which are pending for admission before the various NCLTs. To all the intents and purposes, the NCLTs can't decide the question of admission within the timeline given in the Code and therefore a situation may arise where these applications might have to meet the new threshold requirement of Rs. 1 Crore and in the case otherwise, they would have to be withdrawn. This is a question of a very serious nature that is required to be analyzed, anticipated and answered by the Government of India. In the humble opinion of the authors, the same shall not affect the *lis pendente* as the notification has been issued owing to the pandemic which otherwise would not have been thought of and seems to be transitory in nature.
- **Disputes where demand notice u/s 8 of the Code is sent by the Operational Creditor:** There will be cases where an Operational Creditor has sent the demand notice u/s 8 of the Code and is anticipating a reply from the Corporate Debtor and thus, has not filed the Application under section 9 to initiate CIRP against the Corporate Debtor. Going by the current situation, it would be just to assume that such Operational Creditors will not be able to file Application under section 9 as they will not meet the new threshold requirement of Rs. 1 Crore thereby leaving their demand notice redundant in the eyes of law. In the humble opinion of the authors, the same shall not affect the filing of the *lis* as the notice was issued prior to coming into force of the notification and more so it is concerning the default committed bereft of the effect of the pandemic.

Concluding Remarks

The legislative intent behind the notification appears to be the minimizing of large-scale insolvencies as anticipated by the disruptions caused by the disparaging COVID-19 and the unending destruction created by it and which is clearly

[4] Section 9 of the Insolvency and Bankruptcy Code, 2016

[5] Hitendra Vishnu Thakur vs. State of Maharashtra; AIR 1994 SC 2623

[6] Singh, Justice G.P, *Principles of Statutory Interpretation*, 13th Edition, Page 532 (II)

not a bad move by the Government of India, towards becoming of a 'welfare state'. It is also expected that the minimum threshold may be a temporary measure to fight against the unforeseen event of COVID-19 and is introduced by the government to cope with the present situation though leaving a doubt as it does not provide any expiry date. However, there are several legal complexities that are highlighted in this article by the authors that go against the primary spirit of the code which aims at safeguarding the interest of everyone while reviving and restricting the commercial entities. In the current situation, the need of the hour is that clarification should be notified by the Ministry of Corporate Affairs, GOI to ensure smooth functioning and delivery of the Notification and to cater to its interest for minimizing the havoc created by the economic slowdown.

References

1. MCA Notification SO 1205(E)
2. Report of the Insolvency Law Committee dated 26-03-2018 by Ministry of Corporate Affairs, Government of India.
3. *ibid*.
4. Section 9 of the Insolvency and Bankruptcy Code, 2016.
5. Hitendra Vishnu Thakur vs. State of Maharashtra; AIR 1994 SC 2623
6. Singh, Justice G.P, Principles of Statutory Interpretation, 13th Edition, Page 532 (II)