LEGAL UPDATE

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IBC Minimum Threshold Increase: Anomalies And The Way Forward

In view of the Covid-19 outbreak, the Ministry of Corporate Affairs on 24 March 2020 notified that the minimum amount of default under Section 4 of the Insolvency and Bankruptcy Code, 2016 ("**the Code**") shall be one crore rupees, thereby increasing the existing minimum threshold of one lakh rupees to its maximum permissible limit. This has been done in exercise of the powers of the Central Government under the proviso to Section 4, which pertains to the insolvency and liquidation of corporate debtors under Part II of the Code.

Further, if the current situation of lockdown on account of Covid-19 continues beyond 30 April 2020, the Ministry of Finance may consider suspending Section 7, 9 and 10 of the Code for a period of 6 months.[1]

Minimum amount of default under Section 4 of the Code shall be one crore rupees, thereby increasing the existing minimum threshold of one lakh rupees to its maximum permissible limit.

Although the Notification is applicable to all creditors under the Code, the justification provided by the Finance Minister for this significant increase in the minimum threshold is that it is for the benefit of Micro, Small and Medium Enterprises (MSMEs) during this crisis. It will prevent the trigger

of insolvency process against MSMEs for default owing to the outbreak of COVID-19 and its consequential impact.

Does this really benefit MSMEs?

MSMEs are small sized businesses classified by the quantum of their investment. MSMEs typically supply goods and/or render services to large businesses, and are "operational creditors" under the Code.[2] Operational debts (such as trade debts, salary or wage claims) tend to be of lower amounts in comparison to financial debts.

Therefore, while the move might come as a relief for certain MSMEs who owe financial or operational debts, the notification does not account for the large proportion of MSMEs occupying the position of "operational creditors" under the Code. Operational debts, often involve sums lower than one crore which are now entirely excluded from the scheme of the Code, in what could be a potential setback to MSMEs, amongst other operational creditors, looking to recover such debts.

Interestingly, the Supreme Court in *Pioneer Urban Land and Infrastructure Ltd. & Anr. v. Union of India & Ors.*[3] also made it clear that the threshold of trigger of insolvency was intentionally kept low so that small individuals may also trigger the Code along with banks and financial institutions to whom crores of money may be due. It is therefore doubtful whether the increase in threshold ultimately serves the purpose of benefit to MSMEs that the Ministry is seeking to achieve.

What's the alternative?

The increase in the minimum threshold enacted by the Ministry is likely to have a greater impact on operational debts, which typically involve smaller sums, as against financial debts. This could render a considerable number of operational creditors to large businesses effectively remediless under the Code.

> **In light of the Notification, those creditors to whom debts between one lakh and one crore is owed, who no longer fall within the ambit of the Code,**

The differential treatment of Financial Debt and Operational Debt under the Code has been upheld by the Supreme Court, as one based on *intelligible differentia*.[4] In light of the distinct nature of the two debts and in order to protect MSMEs

> must now examine the alternative legal remedies available to them for recovery of the said debts.

from the business impact of COVID-19, the possibility of specifying separate amounts as the "minimum amount of default" for financial and operational debts respectively should be considered. A similar approach was also suggested by the Insolvency Law Committee Report, February 2020 wherein an increase in the minimum threshold amount up to 50 lakhs was recommended for recovery of financial debts, whereas an increase up to 5 lakhs was recommended for operational debts.

Alternatively, and in exercise of its powers under Section 240A(2) of the Code, the Ministry may by Notification direct that the provisions of the Code would apply to MSMEs subject to certain amendments, as may be specified.

The Creditors' Conundrum

Under the scheme of the Code, a financial or operational creditor has a period of three years from the date of default to institute appropriate proceedings before the National Company Law Tribunal (NCLT).[5] In light of the Notification, any debt under the Code which is (i) more than one lakh rupees and less than one crore rupees, and (ii) default of which occurred on or after 24 March 2017, which was otherwise recoverable prior to the Notification, is no longer recoverable under the Code. This leads to an anomalous situation. For a default of the same amount (i.e., any amount more than one lakh rupees and less than one crore rupees), which may have occurred on the same day (on or after 24 March 2017), two creditors – one who initiated insolvency proceedings before 24 March 2020 and one who did not do so – have different rights and remedies. The latter's right to recover the debt, though not time-barred, now stands extinguished under the Code. Thus, the decision disentitles an entire class of creditors from approaching the NCLT who were otherwise entitled to initiate insolvency proceedings, had they done so before 24 March 2020.

Measure not in line with stated purpose

While the stated purpose of the measure is to protect MSMEs from defaults owing to the Covid-19 outbreak, the measure effectively prejudices any creditor looking to recover debt in the range of one lakh

rupees and one crore of rupees, the default of which may have occurred much prior to the Covid-19 outbreak. Such a default may be wholly un-attributable to the outbreak. The Notification also does not account for those operational creditors who have already issued Demand Notices under Section 8 of the Code prior to the date of the Notification but have not yet initiated recovery proceedings.

What's the alternative?

The Notification ought to be made applicable only to those debts wherein the date of occurrence of default is subsequent to the date of issuance of the Notification. This would ensure that creditors, default of whose debts is completely unconnected to Covid-19 and occurred prior in time, are able to recover their debts.

Conclusion

While the stated purpose of the action of the Central Government is laudable, the decision itself leads to avoidable anomalies and practical inconsistencies, as explained hereinabove. This must be clarified and explained by the Central Government. It must think of the possibility of specifying separate amounts as the "minimum amount of default" for financial and operational debts respectively. There is also a lack of clarity as to whether the current minimum threshold will be restored to one lakh rupees after the COVID-19 crisis is over.

In light of the Notification, those creditors to whom debts between one lakh and one crore is owed, who no longer fall within the ambit of the Code, must now examine the alternative legal remedies available to them for recovery of the said debts.

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[1] Ss. 7, 9 and 10 of the Code deal with the initiation of Corporate Insolvency Resolution Process by a financial creditor, operational creditor and corporate applicant, respectively.

[2]Report of the Insolvency Law Committee, March 2018, available at http://www.mca.gov.in/Ministry/pdf/ReportInsolvencyLawCommittee_12042019.pdf

[3] Pioneer Urban Land and Infrastructure Ltd. & Anr. v. Union of India & Ors. [(2019) SCC OnLine SC 1005]

[4] ibid

[5] BK Educational Services Private Limited v. Parag Gupta and Associates [(2019) 11 SCC 633]

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