

Increase in IBC Default Threshold - Issues at Play

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Background

One of the first measures announced after the imposition of the nationwide lockdown was the [increase in default threshold](#) for the purposes of triggering the Insolvency Bankruptcy Code, 2016 ('Code').

Part I of the Code deals with the Insolvency Resolution and Liquidation of Corporate Persons. Section 4 of the Code provides that Part I of the Code applies to matters where the minimum amount of default is Rs.1 Lakh. Proviso to Section 4 empowers the Central Government to notify

an amount of default of higher value with an outer limit of Rs.1 Crore. Utilizing the powers conferred by the proviso to Section 4 on 24.03.2020, a notification was issued to specify the minimum amount of default as Rs. 1 Crore.

Effect of Change

A creditor will be able to initiate insolvency proceeding under the Code only on the occurrence of a default of Rs.1 Crore or more. The increased threshold was introduced in the background of overall gloom and the anticipated impact on the economy on account of Covid and with the view to protect financially healthy companies. Thus it seeks to insulate businesses from possible IBC action in an environment where business had come to a standstill and cash flow management was a nightmare.

Prospective or Retrospective?

The key question that arises is whether a creditor who is owed a debt by the Corporate Debtor and a default of such debt had occurred before 24.03.2020, loses his right to initiate insolvency against the Corporate Debtor as a result of increase in threshold or not?

The general rule of interpretation is the rule against retrospectivity. Retrospectivity is not to be inferred unless expressly or necessarily implied in the legislation, specially those dealing with substantive rights and obligations.^[1]

It is well settled that a law relating to right of action and right of appeal even though remedial, is substantive in nature. The Supreme Court in [B.K. Educational Services Private Limited Vs. Parag Gupta and Associates](#) in the context of the Code has held that the right to sue accrues to creditor when the default occurs.

If the notification increasing the default threshold to Rs.1 Crore is taken to have retrospective effect, the accrued right of a creditor, in whose case a default has already occurred prior to 24.03.2020, to sue will be jeopardized. Since, there is no doubt that the notification is substantive in nature and it affects the accrued right to initiate insolvency of a creditor retrospective effect can be given only if it is expressly stated or if necessarily implied.

Moreover, the notification is a delegated/subordinate legislation. Ordinarily, a subordinate legislation should not be construed to be retrospective in operation^[2]. It is also pertinent to note that that the Supreme Court has affirmed the view that unless a statute confers on the government an express power to make an order with retrospective effect, it cannot exercise such power^[3].

Therefore, in the instant case, for the notification to operate retrospectively, two conditions are imperative. The first is that the Code ought to have conferred upon the Central Government power to make rules or issue notifications with retrospective effect; the second is that the notification issued in exercise of such power also identifies the effective date to be an anterior date. Both these conditions are not met.

NCLT and NCLAT decisions

The NCLT Chennai Bench in [Arrowline Organic Products Pvt. Ltd. Vs. Rockwell Industries Limited](#) has held that the Code under Section 4 does not expressly grant any power to the delegate (Central Government) to issue a notification with retrospective effect.

Further, the NCLT Kolkata Bench in [Foseco India Limited Vs. Om Boseco Rail Products Limited](#) has held that the notification increasing the default threshold is prospective since the notification nowhere mentions that it shall be applicable with retrospective effect. Both the NCLT Benches have concluded that the increase in threshold is only prospective.

The NCLAT in [Madhusudan Tantia Vs. Amit Choraria](#) has affirmed the decision of NCLT Kolkata in [Foseco India](#).

Delhi High Court - New Perspective

In both the NCLT decisions, to some extent the issue pertained to applications filed before 24.03.2020 and matters were heard. In a matter before the Delhi High in the case of [Pankaj Aggarwal](#)^[4], the Ld. ASG has submitted that the 24.03.2020 notification will not have a retrospective effect. However an interesting issue has been raised before the Delhi High Court as to what would be the date from when the amount, as amended by the notification under Section 4, would be applicable? i.e whether it would be from the date of filing of the petition before the NCLT or the date of admission of the petition. The matter is pending and the Court has not decided on the issue.

Consider a situation where the default involves an amount less than Rs.1 crore which had occurred before 24.03.2020. Assuming the petition had been filed before 24.03.2020 and it is up for admission after that date, if the Delhi High Court concludes that the increased threshold will have to be reckoned at the time of admission then the amendment becomes retrospective. If the Delhi High Court were to conclude that the admission would be relatable to the date of application and the law prevailing on the date of the application will only have to be seen then the notification is clearly prospective.

In another interesting situation, the amount could be less than Rs.1 crore and the application are filed after 24.03.2020. If the Court concludes that the threshold will have to be examined at the point of filing of application, the petition will not be maintainable, even though the default occurred prior to 24.03.2020 and the Covid circumstances could have prevent the applicant from moving the NCLT earlier.

The decision of the Supreme Court in **B.K. Educational Services** comes to play wherein the Supreme Court had held that the right to sue accrues to a creditor when the default occurs. Therefore, applying this rationale any interpretation on the Notification to ensure that the right of a creditor is not affected in a scenario where the defaults had occurred before 24.03.2020 and the action could not be immediately taken for various reasons.

Is the Notification illusory after suspension of the Code?

The Notification which increases the default threshold addresses the issue to a large extent. However, anticipating a serious economic crises and to protect businesses, the Government went one step further and suspended the operation of the Code for defaults that occur on or after 25.03.2020. If the operation of the Code itself stands suspended, there is no necessity for default threshold notification except in a scenario where the Notification is interpreted to have retrospective effect or in a scenario where the suspension period is not extended further but threshold based protection is intended to continue.

Concluding Thoughts

One cannot but wonder as to whether surgery has been carried out where a pain balm would have served the purpose. The Notification was in the right direction and would have achieved its objective. However, probably given the unpredictable scenario; impact of Covid; continued lockdown; problems in other countries, the Government took the surgical route of cutting off the Code itself through Section 10A. Further, the language adopted in Section 10A would ensure that no action can ever be taken for defaults that occur during the suspension period. This could be unfair to many businesses, banks, financial institutions, and most importantly MSME as inability to initiate action under the Code for enforcing their rights could result in their business getting affected apart from the impact on public funds. Ideally, Section 10A should have confined itself to suspension for a particular period without granting perpetual protection. It may be better for the Government to clarify or even bring in an Explanation to address the prospective aspects of the Notification to avoid unnecessary litigation.

^[1] Dena Bank Vs. Bhikhabhai Prabhudas Parekh & Co. (2000) 5 SCC 694

^[2] State of Jharkhand Vs. Shiv Karampal Sahu (2009) 11 SCC 453

^[3] Dr. Indramani Pyarelal Gupta And Others Vs. East India Cotton Association Ltd AIR 1963 SC 274

^[4] Pankaj Agarwal Vs. UOI W.P.(C) 3685/2020 & CM APPLs. 13194/2020, 13195/2020, 13196/2020