India

Chapter 6: Restructuring and insolvency

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6.1 Insolvency and Bankruptcy Code

In late 2016, the Indian corporate insolvency regime was repealed and replaced by the IBC, which provided for certain novel features such as a creditor-in-possession model, time-bound insolvency and mandatory reference to liquidation upon failure of insolvency resolution. The enactment of the new insolvency law was primarily driven by rising 'non-performing assets' in the Indian banking system, which had turned into a crisis.

A stressed company (the 'corporate debtor') may be placed under the corporate insolvency process prescribed under the IBC through an application filed by any creditor or by the corporate debtor itself in case of a default of INR 100,000 (approximately $1,300) or more. Once the insolvency application is admitted, an 'interim resolution professional' (akin to an administrator) is appointed and takes over the management of the corporate debtor; its board of directors is immediately suspended. The interim resolution professional issues a public notice and invites claims from the creditors of the corporate debtor. Once the claims are received, the interim resolution professional verifies and admits the claims, and constitutes the 'committee of creditors' of the corporate debtor. The committee of creditors, usually comprising the financial creditors (discussed below), oversees the key decisions of the interim resolution professional/resolution professional, including the process to invite bidders (known as resolution applicants) to place their bids (resolution plans) for the corporate debtor.

The IBC has divided creditors into two broad categories: (1) financial creditors, which include traditional lenders lending for time value of money; and (2) operational creditors, which include trade creditors, workers and government. While drafting the IBC, law-makers were of the view that the committee of creditors must consist of members with the capability to assess the viability and modify existing liabilities in negotiations. Typically, operational creditors are not in a position to do this. Hence, the law-makers felt that the committee of creditors should be restricted to financial creditors.[3] In view of this rationale, the Supreme Court has upheld the differential treatment accorded to financial creditors and operational creditors under the IBC.[4]

The differential treatment led to the National Company Law Appellate Tribunal, the appellate authority under IBC, to hold that operational creditors should be provided equitable treatment; that is, they should be required to take the same percentage haircut as the financial creditors under a resolution plan providing for the settlement of all creditor claims.[5] However, this principle was overturned by the Supreme Court, which allowed for differential treatment for different creditor classes and held that, ultimately, the wisdom of the committee of creditors must prevail.[6]

As aforementioned, the purpose of the corporate insolvency process is insolvency resolution of the corporate debtor through a resolution plan provided by a resolution applicant. The resolution plan must provide for the corporate debtor as a going concern. This 'going concern' condition has restricted transaction structures that may be employed by bidders and compels them to take on the corporate debtor's liabilities. This has naturally raised the question of the treatment of contingent liability under the resolution plan. The IBC requires creditors to file their claims with the interim resolution professional, but does not stipulate what happens to claims that are not filed with the interim resolution professional. The IBC further requires that claims be filed as of the 'insolvency commencement date'. Accordingly, it is (or was) not clear what should be done in respect of claims that may not be crystallised as of the insolvency commencement date. The resolution applicant requires a 'fresh slate' or a complete settlement of all such claims so as to be sure that the asset bought by it will be able to be revived and will not be subject to antecedent claims, even after coming out of insolvency. This issue was analysed by the Supreme Court in the case of the *Committee of Creditors*

3 The *Report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design*, p 84.

4 *Swiss Ribbons Private Limited v Union of India* (MANU/SC/0079/2019).

5 *Standard Chartered Bank v Satish Kumar Gupta, RP of Essar Steel Ltd & Ors* (Company Appeal (AT) (Ins) No 242 of 2019; Order dated 4 July 2019).

6 *Committee of Creditors of Essar Steel India Limited v Satish Kumar Gupta* (Civil Appeal No 8766-77 of 2019; Order dated 15 November 2019).

of Essar Steel India Limited v Satish Kumar Gupta,[7] where the Supreme Court agreed that the resolution applicant requires a fresh slate and therefore must know what payment is required. Accordingly, the resolution applicant must ascribe a value to contingent claims as well and admit the same so that they may be dealt with under the resolution plan.

Another unique requirement is section 29A, which prescribes certain eligibility criteria for prospective resolution applicants. These eligibility criteria are required to be met by the resolution applicant, persons acting jointly or in concert with the resolution applicant, 'connected persons' of the resolution applicant (which includes its promoters, management and their holding company, subsidiaries and related parties). Certain limited carve-outs are available for financial entities, the acquirer of a company under insolvency and so on. The eligibility criteria include not being an undischarged insolvency, not having or controlling a company that has an account declared a non-performing asset for more than one year, not being convicted of certain specified offences, not being prohibited from accessing the securities market and not being disqualified to act as a director. Section 29A has been a leading cause for litigation in IBC cases, and in many instances has led to protracted litigation leading to delay in insolvency resolution. The Supreme Court has attempted to rationalise the use of section 29A by: (1) streamlining its usage by bidders to maintain the time-bound nature of IBC transactions;[8] and (2) restricting the scope of 'related party' and 'relative' to parties connected with the business activity of the resolution applicant.[9] However, there is still ambiguity regarding the scope of section 29A due to its broad language.

The IBC was amended in August 2018 to provide for the withdrawal of corporate insolvency proceedings with the consent of 90 per cent of the financial creditors. The regulator stipulated that such a withdrawal may only occur prior to the issuance of an invitation to prospective bidders. However, subsequently, this timeline has also been held to be directory, and the withdrawal of IBC proceedings was recently allowed when a resolution plan approved by the committee of creditors was pending the approval of the adjudicating authority.[10]

There are numerous other aspects of the IBC from the perspective of various stakeholders (eg, the financial creditors, operational creditors, resolution applicants and erstwhile directors), which present their own intricacies.

6.2 Prudential Framework for Resolution of Stressed Assets

The regime for pre-IBC debt restructuring and resolution has also undergone a material change in recent times. Under the power granted to the RBI at the same time as the enactment of the IBC, the RBI issued a circular dated 12 February 2018 (the '12 Feb Circular') laying down a radically new framework for stressed assets resolution, and repealing all previously issued debt restructuring mechanisms, such as corporate debt restructuring, strategic debt restructuring and scheme for the sustainable structuring of stressed assets. However, the 12 Feb Circular was challenged by several industries, and, due to its features, such as

7 Order dated 15 November 2019 in Civil Appeal No 8766-77 of 2019.

8 *Arcelor Mittal India Private Limited v Satish Kumar Gupta and Ors*; Supreme Court Order dated 4 October 2018.

9 *Swiss Ribbons Private Limited v Union of India* (MANU/SC/0079/2019).

10 *Satyanarayan Malu v SBM Paper Mills Ltd* (MA 1396/2018,827/2018, 1142/2018 and 828/2018 in CP (IB)-1362(MB)/2017; Order dated 20 December 2018).

mandatory reference to the IBC in the case of failure to resolve stress, ultimately to be *ultra vires* the powers granted to RBI by the legislature.[11]

The RBI has now replaced the 12 Feb Circular with a new Prudential Framework for the Resolution of Stressed Assets issued pursuant to its circular dated 7 June 2019 (the '7 June Framework'). The 7 June Framework applies to banks and certain categories of financial institutions and non-banking financial institutions. Certain provisions also apply to asset reconstruction companies.

The 7 June Framework has attempted to rectify a number of pitfalls of the 12 Feb Circular, such as a lower consent threshold for approving a resolution plan and no mandatory reference to the IBC. The framework also provides for the mandatory execution of an inter-creditor agreement between all creditors of a debtor upon default in order to review the situation and arrive at a future course of action (whether it be resolution or recovery).

The framework provides for various means of implementing a resolution plan involving a change in ownership, restructuring, one-time settlement and so on. In this regard, it is pertinent to note that provisional norms may make it unattractive for lenders to approve a resolution plan that involves the continuation of the same promoter. However, in case of a resolution plan to qualify for 'change in ownership', the new acquirer must not be disqualified under section 29A of IBC nor be a person from the existing promoter group.

The framework also provides for measures such as increased provisioning in the case of failure to resolve stress within the stipulated timeline, the prudential norms or the pricing norms for the issuance of securities as part of the resolution plan.

All in all, the 7 June Framework provides a holistic paradigm for resolving stressed debt without resorting to IBC proceedings and a last resort to promoters to turn their companies around. Although resolutions under the 7 June Framework do not benefit from the numerous exemptions available to IBC resolutions, significant interest has been seen in pre-IBC resolutions under the 7 June Framework due to the flexibility it affords.