

## **SUBSTANTIVE CONSOLIDATION IS HERE IN INDIA! WHAT DOES THIS MEAN FOR LENDING AND RESTRUCTURING TRANSACTIONS PAST, PRESENT AND FUTURE?**

13 August 2019

After being the first ever instance of procedural consolidation under the Insolvency and Bankruptcy Code, 2016 (**IBC**) (previously discussed by us [here](#)), the corporate insolvency resolution process (**CIRP**) for the Videocon group has yet again witnessed a landmark order on 8 August 2019, when the Mumbai Bench of the National Company Law Tribunal allowed substantive consolidation of CIRP proceedings against 13 of 15 insolvent group companies. We discuss in brief the order and its significance for lending and restructuring transactions past, present and future.

### **Background:**

The Principal Bench of the National Company Law Tribunal, Delhi had passed an order on 24 October 2018 directing that CIRP proceedings against the 15 insolvent Videocon group companies be heard before the same NLCT Mumbai bench (headed by Hon'ble Mr MK Sherawat (Judicial)) (**NCLT Mumbai Bench**). The question of substantive consolidation was specifically left open, to be decided by the NCLT Mumbai Bench.

The NCLT Mumbai Bench heard all applications favouring as well as opposing substantive consolidation of CIRP proceedings and through a common order dated 8 August 2019 ordered substantive consolidation of proceedings of 13 group companies including consolidation of assets and liabilities. A common interim resolution professional was appointed for these 13 companies and the CIRP period was ordered to be calculated from the date of such substantive consolidation order.

### **Order of the NCLT Mumbai Bench:**

*International precedents:* The NCLT Mumbai Bench discussed judicial precedents from the UK and USA, to analyse the basic criteria for allowing substantive consolidation. The tribunal observed that courts in UK and USA utilised consolidation to maximise the value of financially stressed group companies, taking into consideration the benefit of all stakeholders and the facts and circumstances of each case.

*Considerations:* The NCLT Mumbai Bench examined each of the following conditions as requirements to ordering any substantive consolidation - common



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control, common directors, common assets, common liabilities, inter-dependence, inter-lacing of finances, pooling of resources, co-existence for survival, intricate link of subsidiaries, intertwined accounts, inter-looping of debts, singleness of economic units, common financial creditors and common group for the corporate debtors. The Mumbai Bench also appears to have been significantly influenced by the fact that (i) the 13 entities had executed facility agreements agreeing to be “co-obligors” to each other’s facilities; (ii) no bids may be received for the separate insolvencies for each of these companies; and (iii) a majority of the creditors of the 13 companies supported substantive consolidation.

*One-size- fits -all?:* The tribunal emphasised that no blanket view can be taken on substantive consolidation of insolvent group companies and that the facts of each case would need to be examined.

*Excluded entities:* 2 entities from the Videocon group were excluded from substantive consolidation given that they were self-sufficient and could function independently from other group companies. The tribunal took into account factors such as whether a company would be in a better position to pay its dues if kept out of consolidation, and whether a company with good asset value would be treated at par with other group entities, which may be detrimental to its resolution plan as and when received.

### Implications:

Interestingly, the IBC does not provide for procedural or substantive consolidation. In fact, the Insolvency Law Committee in its report noted that it is too early for India to adopt group insolvency. Indeed, the Insolvency and Bankruptcy Board of India (the insolvency regulator in India) has recently constituted a committee to examine how and when to bring group insolvency principles into India. The NCLT Mumbai Bench quotes US and UK cases to establish that substantive consolidation is an equitable remedy. Therefore, since in its opinion, the NCLT Mumbai Bench has the power to do justice, it found for itself the power to order substantive consolidation. It is debatable whether the National Company Law Tribunal has the power to give to itself these powers especially since legislative history appears to be quite clear that the IBC itself does not quite deliberately contain a regime for substantive consolidation. Being an order passed by the NCLT Mumbai Bench, substantive consolidation ordered here will not necessarily serve as a judicial precedent for other National Company Law Tribunals but will have strong persuasive value.

The powers of the National Company Law Tribunal aside, substantive consolidation can have significant implications for restructuring and lending transactions. Where the conditions for substantive consolidation are met, it would be an effective tool to defeat any embedded “poison pills” adopted by erstwhile controlling shareholders. This would permit easier resolution of complex group structures. Substantive consolidation could also resolve looming issues of information



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asymmetry between group companies during insolvency, release of third party security interests, “double dipping” by financial creditors by sitting in two committee of creditors for the same underlying debt, investigation of avoidance transactions, etc and could also be cost and time effective and ensure better value realisation in some cases.

But group consolidations could also become victims of a “too big to fail” conundrum, since the IBC still does not contain an express and helpful mechanism for asset sales, without which it could mean that the entire group would necessarily need to be sold to a successful resolution applicant, and takers for that could be few.

But, the real challenge with this decision of the NCLT Mumbai Bench is its potential retrospective application to lending transactions in India where till now there has been limited jurisprudence on substantive consolidation. Its implementation without warning, may mean that lenders with bespoke pieces of the debt stack in complex groups with significant inter-linkages may now unwittingly be exposed to substantive consolidation and thereby lose their loan value and voting rights in the committee of creditors, which they would otherwise expect to retain if their borrower alone had been put into insolvency.

Complex group structures with close inter-linkages which may meet the threshold requirements set out by this order are quite likely to be found in the real estate, infrastructure, renewables and power sectors, to name a few. Going forward, lenders to these sectors will need to build careful protections in their lending documents to ensure against substantive consolidation or to ensure that in such an event at least their rights and interests are properly protected.

**AUTHORS: Ashwin Bishnoi, Partner and Charu Chitwan, Senior Associate**

R&I India Flash Report is published by the firm’s Restructuring & Insolvency practice group. For further information regarding this publication please do not hesitate to contact [restructuring.insolvency@khaitanco.com](mailto:restructuring.insolvency@khaitanco.com) or any of the following partners who are members of the R&I practice group: <https://www.khaitanco.com/rigroup.aspx>

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### Bengaluru

Simal, 2nd Floor  
7/1 Ulsoor Road  
Bengaluru 560 042, India

T: +91 80 4339 7000  
F: +91 80 2559 7452  
E: [bengaluru@khaitanco.com](mailto:bengaluru@khaitanco.com)

### Kolkata

Emerald House  
1B Old Post Office Street  
Kolkata 700 001, India

T: +91 33 2248 7000  
F: +91 33 2248 7656  
E: [kolkata@khaitanco.com](mailto:kolkata@khaitanco.com)

### Mumbai

One Indiabulls Centre  
13th Floor, Tower 1  
841 Senapati Bapat Marg  
Mumbai 400 013, India

T: +91 22 6636 5000  
F: +91 22 6636 5050  
E: [mumbai@khaitanco.com](mailto:mumbai@khaitanco.com)

### New Delhi

Ashoka Estate, 12th Floor  
24 Barakhamba Road  
New Delhi 110 001, India

T: +91 11 4151 5454  
F: +91 11 4151 5318  
E: [delhi@khaitanco.com](mailto:delhi@khaitanco.com)