

# The Journey of Insolvency Laws in India and the path ahead – A Game Changer

# Insolvency and Bankruptcy Code, 2016

- ❑ Enforced on 28.05.2016
- ❑ Repealed SICA
- ❑ Creditor friendly code
- ❑ Committee of creditors drives the process
- ❑ Resolution Professional takes over the management
- ❑ Debtor revival approach
- ❑ Dissolution of company last resort
- ❑ Selling business as a going concern

# Milestone In Journey

- ❑ Existing promoters disqualified from bidding for assets in most situations [S.29A]
- ❑ Home buyers classified as a financial creditor
- ❑ Reduction of the voting majority from 75% to 66%
- ❑ Insolvency proceedings to be set-aside if at least 90% of financial creditors agree [S.12A]
- ❑ Dissenting financial creditors concept removed
- ❑ Interim Finance declared as CIRP cost and to be paid in priority



## **Other statutory / regulatory concessions extended:**

- Gains on debt settlement not to be taxed to the extent of accumulated losses
- Benefit of carry forward of losses to continue
- Exemption from making public offer on change of management
- Shareholder's approval not required for action under NCLT approved plan
- Delisting norms made easier

# Positive Judicial Pronouncements for Creditors

- **Constitutional Validity of IBC Upheld - Swiss Ribbons**
- **Guarantors cannot piggy-back a Corporate Debtor's Insolvency:** - Moratorium does not apply to guarantors. **Ramakrishnan matter- SC**
- **Timelines are Sacrosanct** - SC ruled that CIRP process CANNOT extend beyond the stated timeline of 180/270 days. [However certain exclusions allowed for certain delays caused by pending litigations – NCLAT in **Quinn Logistics**]
- **IBC to override other laws including tax: Monnet Ispat**
- **Moratorium would apply to all tax proceedings** also and income tax dues do not take precedence over secured creditors.
- **Similarly Customs** cannot auction the goods in its custody, belonging to the Corporate Debtor when the Moratorium under section 14 is in place - **Ramsarup Industries Limited**

# Positive Impacts - 1

- **Saving and creating jobs**

- ❖ IBC regime has saved nearly four lakh jobs in India (direct and indirect employment)
- ❖ Sale of business as a going concern prevents retrenchment of employees

- **Transformed Credit Culture**

IBC unlike other mechanisms provides a safeguard against writing debt off and giving control back to promoters through S-29A that prevents defaulting promoters and connected persons from wrongful gaining

- **Reducing Haircut and Large Recoveries by lenders**

- ❖ Recovery of Rs. 80,000 crores in 66 cases so far
- ❖ Rs.70,000 crores likely to be received during this financial year
- ❖ Under SARFESI/DRT, recover of **less than 20 %** of the bank loans with significant delays.

## Positive Impacts - 2

World Rankings - Improvement in India's global ranking in World Bank's Ease of Doing Business by **23 ranks**.

For the year 2018, India stood at **77 position**, earning the credentials of being a top global improver for a second consecutive year. On the parameter of resolving insolvency, the India has improved by 33 ranks from 136th rank to **103rd rank**.

# Downsides and Unresolved issues-1

- **Timelines Scorecard-**

- 4/12 cases referred by RBI in June 2017 resolved
- Others pending for more than 470 days
- 30% of ongoing 800 CIRPs have surpassed 270 days, out of which 20% have exceeded 6 months .
- Losses to Banks- Rs.4000 crores due to pendency in 12 large accounts.
- In Essar alone, each day delay - interest losses of Rs.17 crores.

- **Simultaneous claims –**

- Claim accepted against one corporate debtor, then for same set of claim and default, another application against the other corporate debtor (principal borrower or corporate guarantor) not to be accepted.
- Joint claims against two or more corporate debtors allowed if they are **Joint Venture Companies**.



- **Statutory Dues under the code**

- Considered operational debt and rank below unsecured creditors in distribution waterfall
- Matters to consider- statutory dues and regulatory dues both amount to operational debt , the treatment given to such dues in Plan whether binding on govt. Authority

- **Distributions under a Resolution Plan [Binani / Jyoti / Essar Cases]**

- In Binani Cements , the NCLAT held that entitlement as per ranking of charges OR does not exist during CIRP.
- In Jyoti Structures, NCLAT held that ”the similarly situated lenders” should be treated equitably
- This has been challenged in Essar case- decision awaited

- **Defaulting Resolution Applicants**

- Successful RA to furnish Performance Guarantee after approval from CoC which security will stand forfeited if the Plan is not implemented. (36B-4A CIRP)
- Amendment doesn't discuss the RA's liability between the duration plan approved by CoC but not by NCLT.
- Suggestion- stringent penalties in line with S-29A for wilful defaulters.

# Strategic way forward

- **Adherence to timelines** is the most important to prevent IBC from going in the same line as , CDR, BIFR, SDR, JLF etc
- **Infrastructure enhancement** - by adding more new NCLT Benches across the country at a much faster pace to match the increasing pending cases
- **Training** – Training program for the IP and the NCLT Judges .International best practices to be taken into consideration .
- **Innovative Tools for faster resolution –Parallel arbitration proceedings to resolve inter-party commercial / technical disputes or areas of disagreements** as done in in a few international jurisdictions which saves huge amount of judicial times Non-critical yet significant such issues can be amicably resolved.
- **Pre-packs** – Pre-packs is yet another instance of a very successful capacity augmenting tool used in other jurisdictions, including US, UK, Singapore etc which can be highly effective in our systems.

## Emerging trends - Treatment of promoters – Section 230 vs. 29A

- Recourse to S-230 of Comp. Act, 2013 possible even if it has gone into liquidation
- **Going into scheme of arrangement even after liquidation is a well established principle in UK**
- If revival under S-230 fails, company can be liquidated under IBC
  - Preamble of IBC refers to liquidation as last resort if no revival possible (Swiss Ribbons case)
  - Even under liquidation, business can be sold as a going concern (ArcelorMittal case)
  - S-391 and 230 of Companies Act, 1956 and 2013 allows compromise or arrangement even on the application of liquidator
- Problems that may arise
  - Approval of 75% of each class of creditors and shareholders required as opposed to 66% under Resolution plan. Debtor might use it to prolong the process of liquidation
  - Promoters or other ineligible persons not barred under S-230. The purpose of S-29A becomes redundant.

# Latest Judicial Developments

- In *Brilliant Alloys* SC allowed **withdrawal of CIRP** even after issue of **EOI** depending on the facts of each case.
- In *Anuj Bajpai*, the NCLT extended the scope of S-29A, which would apply to liquidation under IBC Code as held in *Swiss Ribbon case*, to SARFESI or the RDDB Act if creditor decided to **realize his security outside liquidation**.
- In *Indiabulls Housing Finance Ltd. Vs Rudra Buildwell Project Private Ltd.*, the NCLAT held that under a tripartite agreement, the applicant is the financial creditor of the borrower only and not of the third party who had undertaken to pay interest on behalf of the borrower.
- However, in *Indiabulls Housing Finance Ltd. Vs Alpine Realtech Private Ltd.*, the NCLT allowed the applicant's claim against the **third party** as loan had directly been disbursed in the account of third party.

# Creditor rights in different countries

## Dissenting financial creditors

- U.S. allows “cramp down” subject to “best interest of creditors” and “fair & equitable treatment”
- Best interest of creditors- no creditor would receive under a plan less than what they would receive under liquidation – This where IBC has to draw heavily for secured creditors
- ❖ U.K. Court applies two test to see whether creditor’s right has been “unfairly prejudiced” in a CVA [CVA is like Res Plan under IBC]
- ❖ Vertical approach -whether the plan provides the creditor less than it would expect to receive in a **hypothetical liquidation**
- ❖ Horizontal approach -whether the creditor is being treated differently than other creditors in its class in a hypothetical scheme of arrangement
- In India, horizontal approach of UK followed but vertical approach cannot be ignored which seems to be an internationally accepted principle in U.S., U.K., UNICTRAL guidelines and others. Citing **horizontal approach in India, certain class of secured Creditors having preferential rights over assets of CDs are denied their entitlements in a Plan**

# Treatment of Promoters in Foreign jurisdictions

## S-29A

- **UK, US , Germany** – no bar on promoter to submit resolution plan
- Not right to compare the Indian system with that of the UK or the US
- In these countries, **the companies are generally widely held** and there is **no equivalent to the typically family-controlled business in India**, where there is excessive concentration of power.
- Accordingly, the emphasis there is on **disqualifying errant directors** responsible for making the company insolvent whereas the emphasis here is on **disqualifying errant promoter**

# Status of insolvency cases under the new IBC regime

CIRP for Jan to March, 2019 :-

CIRPs at the beginning of the year, 2019	CIRP initiated by Operational Creditor	CIRP initiated by Financial Creditor	CIRP initiated by Corporate Debtor	CIRPs admitted	Appeal/ Review/ Settled	Resolution Plan approved	Commencement of Liquidation
909	168	172	19	359	11	14	73

The data clearly shows that the CIRPs admitted are very less as compared to CIRPs filed. NCLT are piled up with applications and it takes sometimes one or two years for cases to get admitted. The NCLT to case ratio is very bad and there is a need for opening many more benches.

As of 31<sup>st</sup> March, 2019, the status of CIRPs-:

STATUS OF CIRP	NO. OF CIRP
Admitted	1858
Closed on Appeal/Review/Settled	152
Closed by Resolution	94
Closed by Liquidation	378
Ongoing CIRP	1143
>270 days	362
>180 days ≤ 270 days	186
>90 days ≤ 180 days	247
≤ 90 days	348

CIRPs ending with orders for Liquidation as of March 31<sup>st</sup>, 2019-:

State of Corporate Debtor during CIRP	No. Of cases
Resolution Value ≤ Liquidation Value	314
Resolution Value > Liquidation Value	64



## **Pre-pack in U.K.**

- In UK, The Enterprise Act, 2002 brought relief from the time consuming and expensive procedure.
- No dedicated legislation regarding pre-pack
- Developed as a market tool or practice to promote corporate rescue.
- The procedure of Pre pack insolvency is used despite the objections of the majority creditors

## **Advantages of pre-pack in Indian context**

- To adhere the timelines mentioned under the code.
- There are more chances to save the business.
- To get the fair asset value.
- Supports the going concern principle.
- To reduce professional cost.

## **Disadvantages of pre-pack in Indian context**

- Lack of transparency.
- Management and Promoter may misuse the procedure.

# The Road Ahead - 1

**Group Insolvency** - Presently, the IBC does not provide for simultaneous insolvency of group companies. An entity-wise approach is value destructive on account of information asymmetry and potential lack of coordination among different creditors and NCLT benches and also prone to delays.

**Pre-packaged insolvency** Presently bidding process is followed during CIRP. There is a need to propose a CIRP where groundwork for resolution can be undertaken by the insolvency professional confidentially, prior to the commencement of the CIRP but which becomes binding on all stakeholders through a quick court approval akin to a 'pre-pack' process common in many other countries.

## The Road Ahead - 2

- **Cross Border Insolvency** Present provisions not adequate to deal with cross border insolvency issues. MCA had set up an Insolvency Law Committee on November 16, 2017 to make recommendations to the Government of India in relation to adoption of the UNCITRAL Model Law on Cross Border Insolvency, 1997. The committee submitted its Report in October 2018. The Government of India proposes to bring about the changes by amending the IBC and adding a chapter on cross-border insolvency, a report said. The amended law is aimed at giving comfort to foreign investors in India and efficient handling of assets situated in India and outside India.

## The Road Ahead - 2

- (iv) **Individual Insolvency** - Three categories of individuals envisaged under IBC, namely, personal guarantors to CDs, partnership firms and proprietorship firms, and other individuals. Each category is unique and needs a separate dispensation for resolution of its insolvency. Given the complexities involved, an appropriate phasing and sequencing of implementation of individual insolvency is essential, in sync with the legislative intention. The IBBI plans to implement the regime governing individual insolvency in a phased manner. In the first phase, the provisions of the IBC dealing with insolvency and bankruptcy of personal guarantors to CDs may be implemented. This would complement the corporate insolvency regime and put personal guarantors and corporate guarantors on a level playing field.

# Concluding Remarks

- The evolutionary process of the Law is still road under construction.
- The RBI Circular of June 7, 2019. While it has reduced the rigours of its previous version, still lot of clarity is needed on various issues covered by the Circular, including the format for ICA and how to make it binding for all to sign.
- Still several issues remain to be decided as IBC evolves through judicial precedents
- Future looks promising with potential advent of Pre-packs, Insolvency of individuals, Cross-border insolvency and Group Insolvency besides carving out possibilities of use of Arbitration as parallel proceedings with in IBC
- However, the above mechanism together with much improved IBC is expected to write greater success stories despite the road blocks the stakeholders have witnessed in the eventful last 2 years.