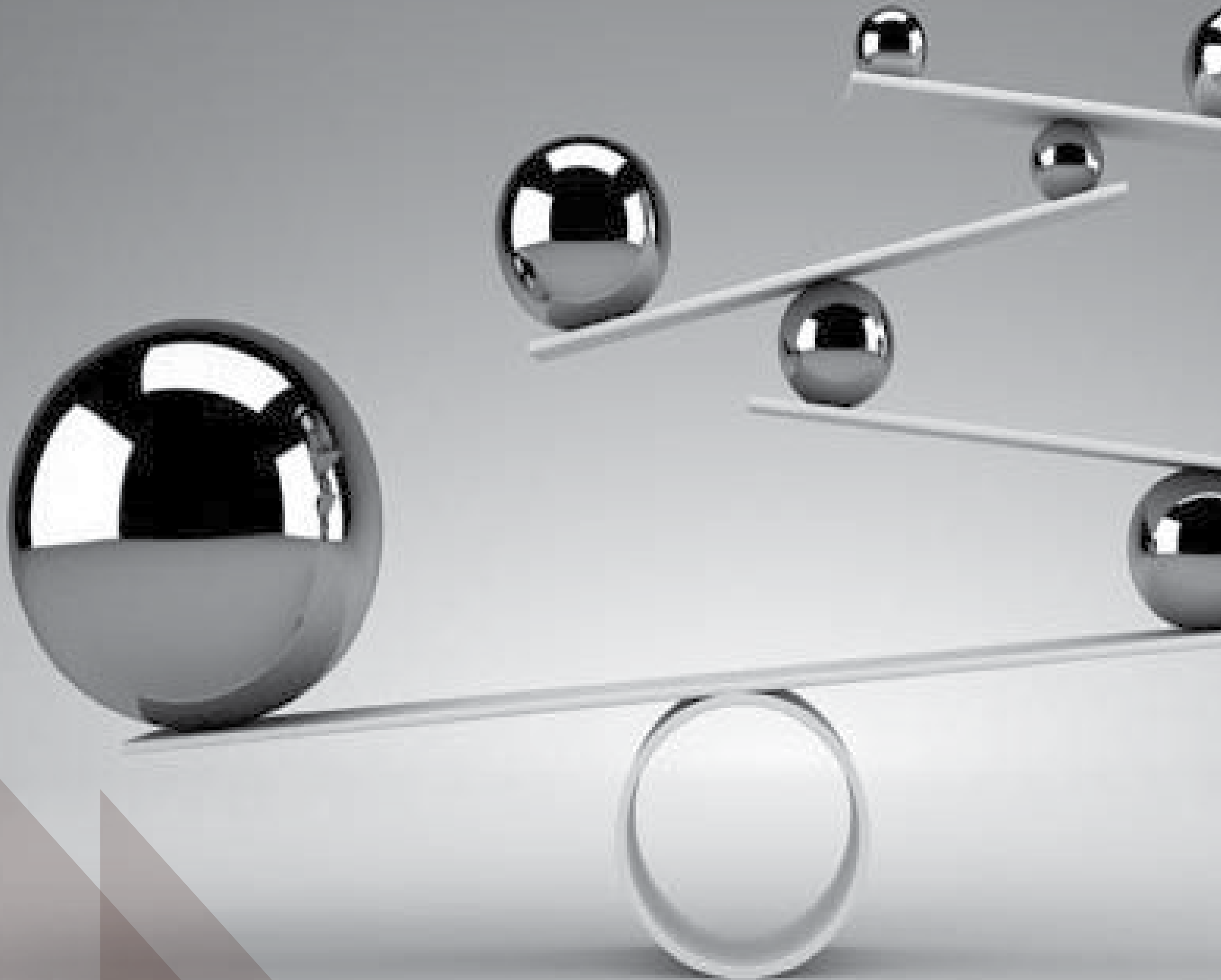
A NEW YEAR'S WISHLIST FOR THE IBC



The Insolvency and Bankruptcy Code, 2016 ("IBC") completed its fourth anniversary in December 2020. As it enters its fifth year, one cannot help but look back at what a monumental impact this legislation has had on the Indian insolvency and liquidation landscape, and consequentially, the Indian economy.

AASHIT SHAH
Partner

Over the past four-year period, more than 4000 corporate insolvency resolution processes (**"CIRP"**) have commenced under the IBC as per statistics provided by the Insolvency and Bankruptcy Board of India (**"IBBI"**). Of these, over 275 CIRPs have resulted in an approved resolution plan, more than 1000 companies have gone into liquidation (although about 74% of them were already defunct or undergoing restructuring before the Board of Industrial and Financial Reconstruction), and almost 300 cases have been withdrawn from the CIRP. The average timeline for approved resolution plans is about 384 days i.e., less than 11 months, and the average recovery rate during the CIRP by financial creditors has been almost 44% of their claims. This is a marked improvement over the erstwhile regime of winding up under our company law where it took several years for winding up a company and financial creditors on an average received about a quarter of their claims.

The IBC has improved fiscal prudence amongst borrowers, increased scrutiny of errant accounts by lenders, inculcated disciplined lending practices, enhanced information symmetry amongst stakeholders, emphasized maximization of value for all stakeholders, and created an institutional framework to swiftly deal with corporate insolvencies. The Government and the IBBI have been receptive of the challenges faced by stakeholders, which has resulted in numerous amendments to the IBC and the rules and regulations framed under it. Whether it was the constitutionality of the IBC, the distribution amongst financial creditors and operational creditors, the primacy of the commercial wisdom of the committee of creditors or issues pertaining to ineligibility under Section 29A, to name a few, the tribunals and courts have swiftly resolved unprecedented issues that came up before them.

While it is evident that a lot has already been done, there are still some concerns that need to be resolved for the IBC to be more efficacious. I have set out below five key concerns on my wish list.

MAKING PRE-PACKS A REALITY

A pre-pack is an agreement between the debtor and the financial creditors for resolution of the debts of a distressed company. Pre-packs have been widely used in the US and UK to resolve stressed debts. For promoter-led Indian companies, pre-packs could result in limited disruption to the business, ensure stability for employees and minimal asset deterioration (provided Section 29A is not applicable to pre-packs). However, given the baggage of the SICA and long-winded winding-up schemes and to protect the interests of other stakeholders (mainly operational creditors), pre-packs should be completed within a compressed timeframe, Further, to provide legal sanctity, they ought to be ideally blessed by the National Company Law Tribunals (**"NCLTs"**).

However, it is also imperative that the Ministry of Company Affairs and IBBI work collaboratively with the RBI to ensure that there are sufficient benefits vis-à-vis provisioning norms for lenders whilst a pre-pack scheme is being prepared and implemented so that lenders are encouraged to use this route. In order to make pre-packs effective, they must benefit from the statutory moratorium available under the IBC (which is unfortunately not available under the RBI restructuring schemes). Attendant changes may also be needed to exchange control and securities regulations to permit flexible restructuring deals. Further, to mitigate the risk of litigation, the legislative framework around pre-packs could provide guidance on how financial creditors should deal with the interests of other stakeholders.

A committee constituted by the Government has issued a report on pre-packs which was released for public comments in early January.

CO-OPERATION FROM GOVERNMENT AUTHORITIES

The success of a CIRP depends on the support received from different government authorities, whether they are tax authorities or sector-specific regulators. For instance, government authorities must willingly agree to the write-offs provided for government dues in a resolution plan which is binding on all stakeholders, including the authorities themselves. Nuisance litigation and interference (or the potential thereof) from authorities during and after the conclusion of a CIRP can delay a timely insolvency resolution, and sometimes repel potential resolution applicants. Further, where governmental consents are required to implement a plan (for instance, in case of a transfer of license or change of ownership of a licensee), there must be bright-line conditions based on which such consent may be refused.

Non-payment or reduction of past dues under a NCLT-approved resolution plan should not be one of them. This issue is currently being tested in a couple of telecom insolvencies. If the Government wants the IBC to be successful, it must ensure that it puts in appropriate mechanisms in place for its instrumentalities to uniformly uphold and adhere to it.

CLARITY ON THE LIABILITY OF GUARANTORS

The law on the liability of guarantors when a company undergoes CIRP is still not fully settled. Section 14 of the IBC is clear that the moratorium does not apply to invocation of a guarantee or filing any proceedings against a guarantor of a corporate debtor. However, there are some fundamental issues that need urgent clarity.

An issue that remains uncertain is whether applications for CIRP can be filed by the creditors simultaneously against the guarantor and the corporate debtor for the same claim. In State Bank of India vs. Ramakrishnan, the Supreme Court has ruled that the moratorium does not apply to personal guarantors. Implicitly, lenders ought to be able to initiate the CIRP against the guarantor as well as the corporate debtor. The recent judgment of the National Company Law Appellate Tribunal ("NCLAT") in the case of Athena Energy Ventures is helpful as it clarifies that claims can be made by creditors in the CIRPs of the corporate debtor and the guarantor. However, the Athena judgment does not explicitly overrule a previous NCLAT judgment in the case of ACCIL Hospitality Limited, where it was held that once the resolution professional has collated the claims in the CIRP of a corporate debtor, triggering a fresh CIRP against the corporate guarantor may amount to duplicity of claims. Further, in the Piramal Enterprises case, the NCLAT held that simultaneous proceedings cannot be filed against two corporate guarantors.

Secondly, whether the liability of the guarantor continues even after the CIRP of a corporate debtor concludes is not free from debate. In the Essar Steel case, the Supreme Court upheld that the resolution plan is binding on personal guarantors who are stakeholders in the CIRP of the corporate debtor. The Court also upheld a provision in the resolution plan that extinguished the right of subrogation of the personal guarantors in respect of any amounts paid under the guarantee for the corporate debtor's debt. Guarantors have argued that once the principal debt is resolved under a NCLT-approved resolution plan, their liability ought to be extinguished as their liability is only co-extensive with that of the principal debt. However, creditors are naturally opposed to this argument and would want to seek any unpaid debts from the guarantors. While creditors may buttress their arguments with the usual "waiver of defenses" provision in most guarantees, a clear decision from

the apex court or a legislative amendment on this issue would be welcome.

DISTRIBUTION TO SECURED CREDITORS

An issue which still creates some ambiguity amongst secured creditors is the amount that should be paid to them during the CIRP. Unlike an explicit waterfall prescribed under Section 53 for distribution of assets in case of liquidation, the distribution provisions for a CIRP are not engraved. The IBC and its regulations provide priority of payment to operational creditors over financial creditors, and priority of payment of the liquidation value due to dissenting financial creditors (those who don't approve a resolution plan) over payments to the assenting financial creditors. The IBC was amended in August 2019 to state that the committee of creditors may take into account the priority amongst creditors as laid down in Section 53, including the priority and value of security interest of a secured creditor when determining the distribution in a CIRP. However, in the CIRP of Ruchi Soya Industries, the NCLAT held that a financial creditor could not dissent on a plan merely because it would receive a higher amount of recovery as a dissenting financial creditor. This has muddied the waters once again on this issue. If the Supreme Court does not overturn the NCLAT judgment, it would substantially dilute the sanctity of obtaining exclusive or better ranking security in lending transactions.

IMPROVING THE JUDICIAL INFRASTRUCTURE

Even though CIRPs of more than 2,000 companies have either been resolved, settled, withdrawn or proceeded to liquidation, there are still a similar number of ongoing CIRPs. In addition, over 9,000 applications for CIRP are still pending for admission before various NCLTs and 60% of these have been pending for over 6 months. While part of the slowdown is pandemic-related, the NCLTs were already bogged down by a humungous caseload even pre-COVID. One of the cornerstones of the IBC is a time-bound completion of the CIRP. What the Government needs to do is significantly increase the bench strength of the NCLTs and NCLAT. There also needs to be a serious deterrent for frivolous litigation and unwarranted interference in the process. Unless this is done soon, delays in the insolvency process will be more protracted.

What the Government needs to do is significantly increase the bench strength of the NCLTs and NCLAT

As per a RBI Financial Stability Report, the NPA ratio in Indian banks is likely to balloon from about 8.5% at the end of March 2020 to over 12% at the end of March 2021. While this is likely to provide opportunities for distressed debt acquisition, the concerns set out above need to be addressed urgently to ensure a meaningful outcome for distressed companies and maximization of value for stakeholders in a time-bound manner.

ABOUT THE AUTHOR

Author: **Aashit Shah**
Designation: *Partner*

Aashit Shah is an equity partner at J. Sagar Associates and chairs the Finance practice at the firm. He regularly advises Indian and multinational banks, NBFCs, financial institutions, investors and Indian borrowers in relation to credit facilities to Indian borrowers, including in relation to capital expenditure, project financing, real estate financing, acquisition financing and trade finance. He has been actively involved in various debt restructuring and security enforcement assignments, and the corporate insolvency resolution processes under the IBC. He was awarded the Banking and Finance Lawyer of the Year Award 2020 by IFLR 1000.

Disclaimer – The views expressed in this article are the personal views of the author and is purely informative in nature.