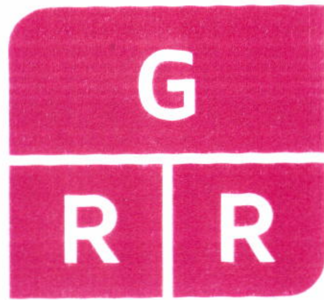

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Indian Insolvencies: From Blank Slate to Boomtown

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By Global Restructuring Review

In the course of less than a year, India's National Company Law Tribunals – the first port of call for hearing insolvency cases – have gone from a standing start to becoming fully fledged adjudicatory bodies capable of handing down tens of thousands of final decisions. With the first real test of the new system looming in the form of the Indian banking system's huge volume of non-performing assets, *GRR*'s Richard Woolley spoke to practitioners in and outside the country about the opportunities presented for lawyers, advisers and distressed investors.

December 2017 marks the first anniversary of reforms to India's Companies Act to include new provisions on compromises, schemes of arrangement and winding-up proceedings. Among the key changes was the extension of powers to the National Company Law Tribunal (NCLT) – a quasi-judicial body with 11 branches launched across India in June 2016 – to call meetings of creditors in compromise arrangements or schemes for reconstruction, and to enforce agreed compromises or schemes.

The Companies Act reforms capped off a year of major overhauls to India's restructuring regulations, which included the approval of the country's new Insolvency and Bankruptcy Code (IBC) in May 2016 and the slow introduction of its measures over the following months, as well as the introduction of amendments to the Indian legislation on securitisation and debt recovery in August.

The various interlocking suites of regulations – which take their cues from international best-practice norms established by English law and the US Bankruptcy Code – are one of the more prominent legal examples of the political will Narendra Modi has brought to his role as prime minister since being elected in 2014. That same year, India was languishing at 142 in the World Bank's global "Ease of Doing Business" ranking and the incumbent has made the country's improved performance in the survey one of his policy goals. In the latest edition of the research, India is up to number 100 in the overall list and placed 103rd for "Resolving Insolvency" – up from 136 when that metric was introduced in the 2016 edition of the research.

Whether reforms to the country's insolvency and restructuring laws – which, as we will see, are ongoing – will have a material impact on India's attractiveness as a business destination is, commentators agree, too early to predict. However, international investors (and their lawyers) are increasingly interested in the market, particularly special situations funds that see opportunities in the combination of a more dependable restructuring regime and the working out of historical bad debts.

A blank slate

"The historical background on India and insolvency is that it was more or less a blank slate," says Richard Heis, the recently retired global head of restructuring at KPMG. "Foreign companies that had any assets or interests in India had no real remedy at all in an insolvency situation. You would end up giving up on whatever assets you had or, if you were lucky, you'd get a bit of money selling as a 49% shareholder to the 51% shareholder with little competition and a tax problem with whatever money you did manage to get.

the state of Maharashtra had imposed a moratorium over the company's assets, putting them beyond the reach of the bank.

The NCLT initially found that the IBC had precedence over the Maharashtra Act "notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law". The ruling was upheld by the NCLAT – which nevertheless found that the IBC and the Maharashtra Act operated in "different fields" and were "not repugnant to each other" – leading Innoventive to bring the issue before the Supreme Court.

Harish Salve, one of the most senior advocates in the country, took the case for ICICI, arguing that, under the 2016 Code, a full, automatic moratorium comes into play the moment an application is admitted by the NCLT, and management of the company is taken over by an interim resolution professional. Such measures cannot, as Innoventive had said, be allowed to coexist with the limited moratorium imposed under the Maharashtra Act, which allows state government to take over the management of the company.

Supreme Court justices Rohinton Nariman and Sanjay Kaulagreed agreed that the IBC took precedence over the state statute and that, once an insolvency professional is appointed to manage a debtor, the company's directors "obviously cannot maintain an appeal on behalf of the company". They added that they hoped the judgment would encourage "all Courts and Tribunals [to] take notice of a paradigm shift in the law."

Sumant Batra, managing partner of Kesar Dass B & Associates in New Delhi and a former president of INSOL International, hailed Innoventive as one of the most "significant" judgments of the past year, that recognises "the overriding effect of the insolvency law over other laws"

James Sprayregen, a partner at Kirkland & Ellis in Chicago and New York, agrees. "The court gave resounding support to the IBC (and reassurance to creditors)," he said. As well as establishing that the code is "exhaustive and will be applicable notwithstanding any other prior law in operation," he noted that the judgment also held that company directors are no longer in management and can't maintain an appeal on behalf of the company after the appointment of an interim resolution professional. Moreover, "when an insolvency application is made by a financial creditor, the only reason to oppose [it] is that the debt is not due for any reason."

While this precedent is important, another Supreme Court judgment that Batra flagged – in the case of *Uttara Foods* – illustrates the potential problems that can still be thrown up by the NCLT system.

Pharmaceuticals company Mona Pharmachem filed a bankruptcy petition against poultry feed producer Uttara in the summer of 2017, claiming debts of 2.2 million rupees (US$34,000) in overdue payments from 2014. However, during the course of the NCLT proceedings, both parties agreed to settle the dispute and moved to have the case dismissed. Both the NCLT and the NCLAT went on to find that they lacked the authority to approve a settlement, as rule 8 of the IBC holds that an adjudicating authority can only approve a creditor's withdrawal application before a case had been admitted.

The Supreme Court eventually found the power to approve the settlement under article 142 of the Indian Constitution and disposed of the case, but "directed the Government to consider amending the law to give inherent powers to the Bankruptcy Tribunal to permit withdrawal of cases where parties settle the matter after the insolvency petition is admitted," Batra says. Such an amendment would eliminate unnecessary appeals.

Another Supreme Court ruling from September arose out of an appeal by Mobilox Innovations – a company that manages telephone voting for an Indian TV dance competition – against an NCLAT ruling that the company hadn't shown sufficient evidence of a dispute with toll-free number provider Kirusa Software over alleged overdue debts.

This "very unattractive" scenario has changed dramatically since Modi took power in May 2014, Heis notes. Within three months of the election, the Indian finance ministry's Department of Economic Affairs had set up the Bankruptcy Law Reform Committee with a mandate "to study the corporate bankruptcy legal framework in India and submit a report to the Government for reforming the system".

The committee released a 210-page draft bill in November 2015, calling for one bankruptcy law to unify existing legislation, the creation of dedicated insolvency regulators, and a streamlined insolvency timeline of just 180 days. Companies have the potential to extend this period by a further 90 days, but if that still doesn't lead to a resolution or if 75% of the financial creditors cannot agree on a revival plan within that time, the company must go into a liquidation process, to be completed within two years.

"Therefore, inaction or fence-sitting by lenders will now have dire financial consequences for all the stakeholders," Pulkit Gupta, director at Ernst & Young in Delhi, wrote in these pages in February 2016.

"One of the big problems with the existing system was the incredibly time-consuming court system," says Heis. "A lot of people think introducing a 180-day deadline is a dramatic change, but it will force people to get on with the process, and that will be good for creditors' rights."

Jonathan Leitch, a partner in the restructuring and special situations team at DLA Piper in Hong Kong, agrees. "In a market where liquidations used to take anywhere from four to 20 years, the NCLT has been dealing with cases at a pace that has surprised everybody."

According to a report published by Alvarez & Marsal in January 2017, the NCLT inherited a backlog of 25,000 pending cases from the various courts and tribunals that were dealing with insolvencies before the changes to the Companies Act. Comparing the productivity of judges in one of these bodies – the Debt Recovery Tribunal, which was set up to adjudicate debt recovery proceedings involving banks and financial institutions – to the turnover in the US bankruptcy courts, the report found the US judges were able to dispose of eight cases in the time it took their Indian counterparts to resolve one. The lack of administrative staff and the absence of an analogous role to that of US trustees could also present stumbling blocks for the new system, the report warned.

Again, it is perhaps too early in the lifespan of the NCLT to gauge how effectively it is tackling its insolvency caseload. There are no stand-alone figures for concluded insolvency cases in the NCLT's online database (the tribunal hears a host of other matters arising under the Companies Act) and among those final orders that do relate to insolvencies and windings up, several are simple records of parties withdrawing their claims. Nevertheless, the Mumbai branch of the NCLT alone handed down more than 16,000 final orders between January and December 2017.

The courts and the Code

While this figure is impressive by any standard, parties to the proceedings themselves have not always been ready to accept the new code or the NCLT's decision making.

The insolvency proceedings of Pune-based steelmaker Innoventive Industries are notable for a host of reasons. The case was the first to be opened under the IBC in December 2016 and, the following August, was the first under the Code to elicit a ruling to the Indian Supreme Court. The ruling itself has been hailed as important in deciding the interplay between the IBC and India's numerous pre-existing statutes. Moreover, the background to the case, which originated in a bankruptcy petition filed by Mumbai's ICICI Bank, is illustrative of a changing climate in the attitudes of lenders in India, who lacked incentives to tackle their debts before the introduction of the IBC.

ICICI claimed that Innoventive was eligible to be wound up under section 7 of the Bankruptcy Code, which empowers creditors to file against defaulting debtors. Innoventive, which had entered restructuring proceedings in 2013 and had clinched 13 billion rupees (US$190 million) in new financing following a series of negotiations with creditors the following year, responded that the government of

The Supreme Court accepted Mobilox's broad interpretation of the concept of a "dispute", which Kirusa had argued was limited to a lawsuit or arbitration case, accepting email correspondence between the two parties in which the debt was disputed as sufficient to allow Mobilox to make an application under the IBC. Again, the ruling was hailed as a "landmark" by lawyers: Vanita Bhargava and Shweta Kabra of Indian firm Khaitan & Co added that it marked "a welcome step towards defining the newly formulated Code".

"There will be a huge focus on these decisions," according to Michael Fiddy of DLA Piper in London. "Where there is pre-existing case law and well-established practice, it fills a lot of holes in how matters are handled, but that isn't the case here. It will be an interesting and challenging time."

Further reforms

While the courts have been busy clarifying the new regulations, the IBC itself hasn't been standing still. At the beginning of April 2017, the cross-border provisions of the IBC formally came into effect, giving India's central government the power to organise "reciprocal arrangements" with other countries, so that the IBC can be applied to the assets or property of an overseas debtor.

Where a reciprocal arrangement exists, a resolution professional, liquidator or trustee can make an application to the "adjudicating authority" – be that a court or the NCLT – to take action relating to the debtor's foreign assets. That authority, if it is satisfied the action is necessary, can hand down a request to an overseas court to deal with it.

Abhishek Saxena, a partner at Phoenix Legal in Delhi, tells GRR that it is likely that "international lawyers will have more opportunities under the new law" once reciprocal arrangements start to be notified and the IBC is enforced overseas.

However, for the reciprocal arrangements to take effect, the cross-border provisions, under the IBC, which take up just four paragraphs of the 109-page code, need to be more fully developed. Siddharth Srivastava, a partner at Link Legal in New Delhi, reminded GRR at the time that "entering into bilateral agreement requires a lot of time and negotiation. There is a possibility of prolonged and difficult negotiations since different countries have wide variations in their substantive insolvency law regimes. Not only this, various bilateral agreements with substantial variations from country to country could lead to uncertainties in implementation."

Sprayregen also said he would like to see greater clarity on cross-border recognition. "This is a key component of an effective insolvency regime, and will result in issues with reciprocity where, for example, a resolution professional seeks recognition of an IBC moratorium in a foreign jurisdiction to prevent a company's assets being attached by offshore creditors," he noted: "but there is no process for recognising insolvency proceedings in that jurisdiction in India."

Srivastava also noted that the new provisions in the Code are silent on the mechanics for an Indian court to seek or give assistance to a foreign court. As such, Batra told GRR that the creation of a comprehensive cross-border insolvency framework would be at the top of his wishlist of future reforms to the IBC.

Saxena added that he would like to see greater clarity on the role of insolvency practitioners in the Indian system, which he said was "unclear and inconsistent". An article in Indian newspaper *The Economic Times* from July noted that the country's Institute of Chartered Accountants had registered more than 700 new IPs, having received thousands of applications since the IBC came into effect. Batra himself will have a key role in the process, having been appointed to head India's newly formed Insolvency Practitioners Bar Association (IPBA) in August.

"It is crucial to develop high standards and quality of insolvency practitioners," he told GRR at the time: "It is to achieve this larger goal that the IPBA has been established."

A more recent tweak to the IBC could, observers think, help clear the way for foreign involvement in distressed Indian assets.

As Salve told the Supreme Court in Innoventive: "[T]he old notion of a sick management which cannot pay its financial debts continuing nevertheless in the management seat has been debunked by the Code." That debunking formally took place in November, when the IBC was amended to prevent "wilful defaulters" from bidding for their own troubled companies at auction, closing a loophole that would have allowed business owners to regain control of their insolvent assets for a fraction of their former value.

This presents a possible opportunity for foreign investors, according to Leitch in Hong Kong. "Taking the main players out of the ecosystem opens the door to foreign investors; there are fewer barriers in the bidding process."

Open for business?

An easier bidding process alone, however, isn't enough to spur foreign investment into bad assets – especially when the laws protecting creditors when businesses fail are still in a state of flux – but several large funds, including Blackstone, KKR, Bain Capital and alternative investor Varde Partners, are reportedly willing to take the risk. And the reason for that is the value of the assets up for grabs.

In June, the Reserve Bank of India (RBI) ordered 12 of India's largest companies to enter bankruptcy proceedings, after the government empowered the central bank to direct lenders to take steps to resolve stressed assets. The list of companies – quickly named the "dirty dozen" by the Indian business press – was not published by the bank, but has been said to include major players in the country's manufacturing and technology sectors, such as Bushal Steel, Essar Steel, Amtek Auto and Jaypee Infratech. Taken together, the 12 companies hold around 25% of all the non-performing assets in the Indian banking system, according to the RBI.

In an interview with Bloomberg in October, India's richest banker, Uday Kotak, said the US$207 billion pile of bad loans represented a "once-in-a-lifetime" opportunity for investors into India. The "dirty dozen", he suggested, were only the outliers of a broader trend that might see as many as 50 of India's biggest defaulters having their debt sold off by court-appointed restructuring professionals, with lenders – once so happy to sit on the fence when loans soured – expected to take substantial haircuts. Kotak also told Bloomberg investors could use the system to "get assets that would give disproportionate returns for long periods of time".

Sprayregen, however, points out the potential issues that may face acquirers of Indian companies. These include the still-unclear treatment of contingent liabilities, and whether a buyer out of the IBC process will still be liable for them; the fact that acquirers still require regulatory, including antitrust, clearances; and tax issues thrown up by debt haircuts.

With a surge of interest coming from international investors, non-Indian law firms – which are still excluded from practising in India under the 1961 Advocates' Act – expect their role to increase in clinching deals.

"There are plenty of ways we can be involved," Fiddy tells GRR. "Being able to offer solutions across other jurisdictions will be crucial, so we are working with Indian firms and trying to integrate our service with theirs to offer a complete package."

"We have advised foreign clients having claims against companies undergoing the corporate insolvency resolution process," says Saxena. "The basis of these claims has been debt (in the form of bonds) constituted under financial agreements which are governed under foreign law and accordingly interpretation of such contracts requires assistance from international lawyers."

"Foreign lawyers' and IPs' capacity to interpret the outcomes of the cases is really important," Fiddy agrees. "We speak international investors' language and, what's more, the capital markets elements of a lot of the structures are more likely to come out of Hong Kong and Singapore – where we play – than from India itself."

Leitch added that the more investors are able to observe the IBC in action and the more certainty creditors have about the handling of bankruptcy proceedings, the more likely special situations funds will be to buy debt in India. "Foreign investors are a key part of the solution to the debt problem in India," he tells GRR, adding that he hoped the regulators would recognise this by altering exchange controls to make it easier for offshore investors to get money out of the country.

At a conference in September organised in Mumbai by industry organisation INSOL India – a similar outgrowth of INSOL International to the more famous INSOL Europe, set up by India's current finance minister Arun Jaitley in 1997 – Batra, Heis and other notable domestic and foreign names met to discuss the next steps for the IBC.

"It was a really great, quite lively event with a lot of talking, a lot of questions," Heis told GRR. He was there to discuss the use of pre-packs in the UK and their potential to take off in India. "Pre-packs aren't part of the regime in India, but they've never been formally part of the UK system either, they just developed," he noted, suggesting this and other issues, such as raising interim finance in restructurings, will develop over time.

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That India is now a forum where such practices can develop is perhaps the most important legacy of the IBC's turbulent first year. "It's about the growth of an ecosystem that brings together expertise and creates networks of people, and that improves the efficiency of the process," Fiddy said, adding that each new decision issued by the courts "creates a ripple effect of awareness, knowledge-sharing, and common values, and over time that becomes the legal infrastructure."

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