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India's jump from Rank 130 to Rank 100 in ease of doing business¹ can be largely attributed to various legal reforms in the country, including the Insolvency and Bankruptcy Code, 2016 (**IBC**), which has been notified with a vision to resolve the rampant insolvency situation. IBC preliminarily provides for revival of insolvent corporate entities through a corporate insolvency resolution process (**CIRP**) in a time bound manner, failing which such entities undergo liquidation. As per the news sources, private equity players have raised stressed assets funds totalling over USD 4 billion in the past 3 years, sensing an opportunity in the increasing number of bad assets in the banking system.

Over the past two years, IBC has proved instrumental in addressing the corporate insolvency situation in the country, however, several crucial issues have emerged under IBC framework, including challenge to its constitutionality, questions on time bound process, ability and eligibility of bidders to bid for a corporate debtor, role of insolvency professionals, Reserve Bank of India's mandate to mandatorily require banks to initiate CIRP against large debtors.

These are interesting times for the stressed assets space in the country, as the Government is moving various amendments in IBC, planning to launch an asset management company (**AMC**) to take over non-core assets and sell them through a bidding process, aims to give relief to stressed power sector companies. Similarly, the large banks and financial institutions are taking steps for faster resolution of stressed assets, by entering into inter-creditor pacts, launching schemes.

We have provided below certain interesting and contentious points in the stressed asset space:

Reserve Bank of India's mandate to refer large accounts to IBC and ways proposed to deal with such mandate by the banks and power sector stakeholders – Samadhan Scheme, Inter-creditor agreement

1. Mandate by the RBI. The Reserve Bank of India (**RBI**), the Indian banking sector regulator, issued a directive to the banks and financial institutions, on the subject 'Resolution of Stressed Assets – Revised Framework' (**RBI Circular**), on February 12, 2018. As per the RBI Circular, in respect of the accounts with aggregate exposure of the lenders at INR 20 billion and above, on or after March 1, 2018 (**Reference Date**), including accounts where resolution may have been initiated under any of the existing schemes as well as accounts classified as restructured standard assets which are currently in respective specified periods, as per the previous RBI guidelines, a resolution plan shall be implemented as per the following timelines:
 - (i) if in default as on the Reference Date, then 180 days from the Reference Date;
 - (ii) if in default after the Reference Date, then 180 days from the date of first such default.

If a resolution plan in respect of such large accounts is not implemented as per the aforesaid timelines, the lenders are mandated by RBI to file insolvency application, singly or jointly, under IBC within 15 days from the expiry of the aforesaid timelines.

2. Samadhan scheme for power sector. The banks had earlier approached the RBI to provide special dispensation for the power sector, however, the RBI had declined to provide the same. In the interim, as per the order dated May 31, 2018 passed by the Hon'ble Allahabad High Court in the matter of *Independent Power Producers Association of India vs. Union of India and Others*, the High Court held that an action may be avoided on the basis of the RBI Circular issued by the RBI to all scheduled commercial banks and all India financial institutions, against members of the Association, subject to the condition that such member(s) is/are not wilful defaulter(s), till the meeting is conducted by the Secretary, Ministry of Finance, Union of India.

¹ As per the World Bank Group Flagship Report on Doing Business, 2018

Based on the aforesaid directions of the High Court, a meeting was conducted on June 21, 2018 by Ministry of Finance, which was attended by various stakeholders. In this meeting, the RBI indicated that the RBI Circular provides enough space for resolution of bad loans in the power sector. The RBI maintained that the RBI Circular does not stop the restructuring. Even if there is a default, the restructuring is possible within the time frame available.

In furtherance of the above, as per the news reports, a Scheme of Asset Management and Debt Change Structure (**Samadhan Scheme**) was floated by the State Bank of India (**SBI**) and other banks. Under the Samadhan Scheme, SBI along with certain other banks identified around 11 power plants with an overall capacity of over 12 GW situated across India which are almost completed, or nearing completion but lying under stressed conditions. Amongst various features of the Samadhan Scheme, following are important to note:

- the lenders seek to complete the process in 120 days;
- the lenders are addressing those assets which are either complete or near completion with the idea to carry out an assessment what would be sustainable debt of these assets, and the remaining debt which is unsustainable would be converted into equity;
- not more than 24.50% will be allowed to remain with promoters;
- the lenders will put up bid for equity to players who want to run these plants so that these plants will be run and not liquidated;
- the banks would put 51% of the equity of these power projects up for auction to evaluate the industry's interest for such project and the remaining shareholding would be held by banks and the existing promoters so that they get a chance to redeem their stakes when the demand for the power revives;
- from the unsustainable debt, the lenders will select a new developer (mostly government owned, like NTPC Limited), who will get 51% equity while the remaining 49% of the equity will be distributed between the present developer and the lenders;
- the lenders will get maximum portion of the unsustainable portion and the sustainable portion will be selected based on their availability of the power purchase agreements and other features of the project which will provide a good value.

Bearing in mind the aforementioned factors, as per the recent news reports, the Government is likely to recommend that bankruptcy proceedings for stressed power plants should kick in after 360 days of default, giving relief to banks and companies that are struggling to meet the 180-day deadline set by the RBI Circular. The recommendation is expected to be presented to the Allahabad High Court which is hearing petitions against the RBI Circular and had asked the Government to present its views after consulting all stakeholders. In the light of the above, it will be interesting to see how the Government protects the power sector without diluting the effectiveness of IBC.

3. Inter-creditor agreement. Along side the aforementioned steps to protect the power sector, as per the news reports, various large banks in the country including SBI, entered into an inter-creditor agreement (**ICA**) on July 23, 2018, to deal with faster resolution of stressed assets in the range of INR 500 million to INR 5 billion under consortium lending, after getting a conditional approval from the RBI over the terms of the ICA. The ICA is to be signed by 22 public sector banks (including India Post Payments Bank), 19 private sector banks and 32 foreign banks. Besides, 12 major financial intermediaries, like Life Insurance Corporation, Power Finance Corporation and Rural Electrification Corporation, are also signatories, according to the ICA.

Following are the key features of the ICA as per the news reports:

(i)	The ICA would bind minority lenders in accepting a resolution plan of the majority of lenders in terms of value of the loan. As per the RBI Circular, all lenders in a consortium should approve and implement a resolution plan within 180 days of default, and even if one creditor disagrees, the loan should be referred to the bankruptcy court, that is, National Company Law Tribunal (NCLT). The ICA, on the other hand, talks about binding minority lenders in implementing a proposal if 66% lenders agree to it;
(ii)	The lead lender, with the highest exposure, shall be authorised to formulate the resolution plan, which shall be presented to the lenders for approval;
(iii)	A dissenting creditor could sell its loan at a discount of 15% of the liquidation value to other lenders or buy the entire loan at 125% of the resolution plan agreed to by other lenders;
(iv)	Another option with a dissenting creditor is to sell their loans to any person at a price mutually arrived between dissenting lender and the buyer. However, a dissenting creditor cannot sell it to an asset reconstruction company;
(v)	The ICA also has a standstill clause wherein all lenders are barred from transferring or assigning their loan to any other person except a bank or finance company;
(vi)	Each resolution plan will have to be in compliance with the RBI's norms, applicable laws, and guidelines.

However, the ICA will only be treated binding on the parties to the ICA, and other creditors will still have the option to initiate CIRP under IBC, including foreign banks, if they do not sign the ICA.

Government's move to launch AMC to help banks offload non-core assets

As per the news reports, the Government is looking at setting up an AMC to help banks sell non-core assets including real estate. The Government wants state-run banks to sell these non-core assets to beef up capital. The AMC would take over the asset, determine a valuation and sell it through a bidding process.

Introduction of the Insolvency and Bankruptcy (Amendment) Ordinance, 2018 and Insolvency and Bankruptcy Code (Second Amendment) Act, 2018

With a view to address some of those issues, including to balance the interests of various stakeholders in IBC, especially interests of home buyers and micro, small and medium enterprises, promoting resolution over liquidation of corporate debtor by lowering the voting thresholds of committee of creditors and streamlining provisions relating to eligibility of resolution applicants, the President of India promulgated the Insolvency and Bankruptcy (Amendment) Ordinance, 2018² (**2018 Ordinance**) on 6 June 2018. An Ordinance promulgated unless withdrawn, is required to be laid before both houses of Parliament and shall cease to operate at the expiration of six weeks from the reassembly of Parliament, or, of before the expiration of that period resolutions disapproving it are passed by both Houses, upon the passing of the second of those resolutions. Accordingly, to replace the 2018 Ordinance, the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 (**IBC 2nd Amendment**) has been tabled before the Lok Sabha and is currently pending its approval.

² The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 (No. 6 of 2018), dated 6 June 2018

Following are certain key changes aimed to be introduced by the IBC 2nd Amendment:

(i)	Any amount raised from an allottee under a real estate project shall be deemed to be an amount having a commercial effect of borrowing;
(ii)	Requiring the corporate debtor to furnish along with application for initiation of CIRP, a special resolution passed by the shareholder of the corporate debtor;
(iii)	Permitting withdrawal of application admitted for initiation of CIRP by the NCLT, on an application made by the applicant with the approval of 90% of voting share of committee of creditors;
(iv)	Moratorium shall not apply to a personal guarantor or a corporate guarantor to a corporate debtor;
(v)	Appointment of authorised representative by financial creditors and to provide for rights and duties of such authorised representative;
(vi)	Exemptions from ineligibility to act as a resolution applicant;
(vii)	Resolution applicant shall obtain necessary approval required under any law for the time being in force within the period specified therein;
(viii)	Reduction of voting threshold for various decisions of the committee of creditors to 66% for important decisions and 51% for routine decisions;
(ix)	The Limitation Act, 1963 shall apply to the proceedings or appeals under IBC;
(x)	Certain eligibility criteria exempted for the resolution applicants in respect of CIRP of micro, small and medium enterprises

Despite this move, certain issues still remain unresolved and require proper analysis. A few critical points are discussed below.

- **Obligations on the insolvency professional.** IBC has provided various obligations upon an insolvency professional including keeping the corporate debtor as a going concern. In addition, the 2018 Ordinance has casted another responsibility for complying with the requirements under any law for the time being in force on behalf of the corporate debtor. The regulator, being the Insolvency and Bankruptcy Board of India, in many instances has imposed penalties on insolvency professionals who have failed to comply with their obligations casted upon them under IBC. The obligations casted upon the insolvency professionals (being individuals) may find it difficult to ensure strict compliance with IBC, rules and regulations therein, as sole responsible persons appointed for the purpose. We may expect a change in the existing rules and regulations permitting a body corporate or a firm to be appointed as an insolvency professional to run the CIRP. Such an amendment would enable safeguarding and ring fencing the value of a corporate debtor under CIRP.
- **Mandatory sale of shares of existing shareholders in a resolution plan?** As per the provisions of IBC, a resolution plan may provide for the measures required for implementing it, including but not limited to the substantial acquisition of shares of the corporate debtor. It will be an interesting situation to see whether a contemplation in the resolution plan to require the sale of shares of an existing shareholder/promoter can be made binding against such shareholder/promoter, especially as IBC makes the resolution plan binding against the shareholders. In fact, IBC also provides that a provision in a resolution plan which would otherwise require the consent of the members or partners of the corporate debtor, under

the terms of the constitutional documents of the corporate debtor, shareholders' agreement, joint venture agreement or other document of a similar nature, shall take effect notwithstanding that such consent has not been obtained. These provisions seem to largely undermine the rights of the shareholders of the corporate debtor, especially when IBC has been introduced as a *non-obstante* law.

- **Claims after or prior to approval of the resolution plan.** As per the provisions of IBC, once the resolution plan has been approved by the NCLT, it shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan. The resolution applicants would want to get into the corporate debtor with a clean slate or at least with a clear vision around the liabilities against the corporate debtor. Even though IBC is a non-obstante law, it is not clear if such non-obstante effect can rule out creditor claims against the corporate debtor even after the resolution plan is approved.
- **Difficulties around withdrawal of an application under IBC.** Until the 2018 Ordinance, the language under IBC did not specifically provide for withdrawal once a petition for initiation of CIRP against a corporate debtor was admitted. Many parties had explored the settlement options after their cases were admitted. The NCLAT and Supreme Court of India had also allowed withdrawal on a case-by-case basis, which led to plethora of litigations. The Supreme Court had been exercising its powers under Article 142 of the Constitution of India (which gives it the power to pass orders for doing complete justice) to allow withdrawal. The 2018 Ordinance now provides for withdrawal after admission of an application under IBC, subject to the approval of the Committee of Creditors (**COC**) with 90% of the voting share. Since the procedure for such withdrawal has not been laid down yet, it will be interesting to see whether this mechanism proves viable, in practice. Also, keeping such high threshold for withdrawal may pose practical difficulties, especially for operational creditors who do not form part of the committee of creditors.
- **Applicability of the Limitation Act, 1963, to proceedings under IBC.** The law relating to limitation of suits and other legal proceedings is covered under the Limitation Act, 1963 (**Limitation Act**). IBC earlier did not clearly set out whether the Limitation Act was applicable to the proceedings under it. Though NCLAT had in the matter of *Speculum Plast Private Limited. v/s PTC Techno Private Limited (Speculum Case)* held that the Limitation Act was not applicable to the proceedings under IBC, an appeal was referred to the Supreme Court. Pending the appeal, the 2018 Ordinance has shed some light on this issue by making

the provisions of the Limitation Act applicable to the proceedings under IBC. The status of various applications pending before the NCLTs and pending appeal before the NCLAT or the Supreme Court may need to be seen in view of this newly inserted provision, especially since the new provision does not clarify whether the pending applications are protected under this provision. Also, the status of various applications which could not be filed in light of the *Speculum Case*, needs to be clarified.

Interestingly, the NCLAT in the *Speculum Case* had observed that even if the Limitation Act were to be made applicable to IBC, the period of limitation of 3 years as per the Limitation Act would begin to run from the date when the right to apply under IBC accrue, i.e. 1 December 2016 (when IBC was notified). If the NCLTs take a cue from these observations of the NCLAT, could it mean that virtually no application can be rejected on the grounds of expiry of limitation period until 1 December 2019 or 3 years from the date of enforcement (6 June 2018) of the 2018 Ordinance?

- **Applicability of moratorium to guarantors.** IBC provides for applicability of 'moratorium' upon the admission of an application by the NCLT against a corporate debtor. The moratorium is essentially a period wherein no suits or proceedings for recovery, enforcement of security interest, sale or transfer of assets, or termination of essential contracts can be instituted or continued against a corporate debtor. However, whether personal guarantee of the corporate debtor can be invoked pending the proceedings under IBC and

in the light of the moratorium, was a question that created a lot of stir.

While the Allahabad High Court in *Sanjeev Shriya v/s State Bank of India & Ors*, and *Deepak Singhania & Anr v/s State Bank of India*, (**Sanjeev Shriya Case**) vide order dated 6 September 2017 had answered the question in negative, with the ratio that while the liability of guarantors is co-extensive, but the entire proceeding which is going on before IRP under IBC is still in fluid stage and for the same cause of action, two split proceedings cannot go simultaneously before the debt recovery tribunal as well as NCLT.

The 2018 Ordinance has intended to resolve the confusion, by stating that moratorium shall not apply to the surety in a contract of guarantee to a corporate debtor. This move could, however, give rise to multiple parallel proceedings as certain creditors would choose to rather invoke the guarantee than wait for CIRP to conclude. This might also lead to reconstitution of many COCs which have already been formed. It will also be interesting to see how the guarantors parallelly run two proceedings in light of the ratio of Sanjeev Shriya Case.

- **Whether operational creditors have any say in CIRP?** As per IBC, the resolution plan requires approval from the COC which is constituted of financial creditors only even if there are operational creditors; however, in case there are no financial creditors, the COC comprises of operational creditors. There can be circumstances where a corporate debtor may have higher exposure of operational debt than financial debt – in such scenario, it is not right to allow only the financial creditors to have the ability to adopt or reject a resolution plan.

The 2018 Ordinance has in fact brought the allottees of any real estate project within the ambit of the “financial creditors”. Such allottees would also enjoy the rights available to a financial creditor such as forming a part of the COC and voting during the CIRP, but the operational creditors have been kept out of it.

- **Criteria for eligibility of ‘resolution applicant’: too stringent?** With an aim to put in place certain safeguards to prevent unscrupulous, undesirable persons from misusing or vitiating the provisions of IBC, amendments have been made vide the Insolvency and Bankruptcy Code (Amendment) Act, 2018 and further by the 2018 Ordinance, to IBC to keep-out such persons who have wilfully defaulted, or are associated with non-performing assets, or are habitually non-compliant and, therefore, are likely to be a risk to successful resolution of insolvency of a company. However, the grounds for eligibility of such a resolution applicant have been made quite stringent – given that the amendment is new, and its effects are still being tested, there is an apprehension that it might become impractical for bona-fide resolution applicants to submit a resolution plan, thereby defeating the spirit of IBC for revival of insolvent corporate entities. The 2018 Ordinance however states that the eligibility criteria as amended thereunder shall apply to the resolution applicant who has not submitted a resolution plan as on 6 June 2018. It would mean that the eligibility criteria applicable to the resolution applicants who have already submitted a resolution plan would be different from the eligibility criteria applicable to the resolution applicants who are yet to submit a resolution plan vis-à-vis the same corporate debtor. This might lead to an unfair advantage to certain resolution applicants over the others, so far as their eligibility criteria is concerned.
- **Special resolution (75%) under Section 10 (suo-moto initiation of CIRP by corporate debtor).** Section 10 of IBC contains a provision whereby the corporate debtor itself can file an application for initiation of CIRP. This provision was earlier misused by certain promoters to avoid the attachment of their personal property which was secured against the loan facilities availed by the corporate debtor by obtaining a order of admission and hence moratorium. In order to rectify this shortcoming, the 2018 Ordinance has inserted a requirement of special resolution of the shareholders of the corporate debtors to trigger insolvency resolution under Section 10 of IBC. Given that this change is in its nascent and has not been tested, in case of a typical joint venture structure (51%-49%), just one joint venture partner of a loss making joint venture may find it difficult to invoke the provisions of Section 10 of IBC for initiating CIRP.

IBC has brought about various welcome changes in the insolvency regime in India, such as incorporation of insolvency professional entities, through which both Indian and foreign insolvency professionals can provide services, thereby increasing the pool of talented and experienced insolvency professional in the country. In fact, IBC also contemplates and contains provisions whereby the Indian Government can enter into bilateral treaties with other countries for application of IBC to assets or property situated outside India.

Further, with a view to boost the micro, small and medium sector enterprises (**MSME**), the 2018 Ordinance has empowered the Government of India to provide a special dispensation under IBC. The immediate benefit it would provide is that, it would not disqualify the promoter to bid for his enterprise undergoing CIRP, provided he is not a wilful defaulter and does not attract other disqualifications not related to default. It has also empowered the Central Government to allow further exemptions or modifications with respect to the MSME Sector, if required, in public interest.

Though it is true that there are various gaps which need to be filled and various practical difficulties which need to be addressed under IBC, it has so far proved to be effective in meeting its purpose. As this law evolves, it is likely to further boost India Inc's corporate governance practices and help the country optimally address the widespread problem of mounting corporate debt.