Insolvency and Bankruptcy Board of India

Sub: Corporate Insolvency Resolution Process

Background

The Governing Board, in its meeting on 21st September, 2017, had considered the Board Note No.051/2017 titled 'Balancing the interests of Stakeholders and other matters related to CIRP' and approved certain amendments to regulations. It had advised that other issues in the Board Note may be brought up in its next meeting, keeping in view discussion in the meeting.

2. Insolvency and Bankruptcy Code, 2016 (Code) was enacted on 28th May, 2016. Following notifications of rules and regulations by MCA and IBBI, the provisions relating to corporate insolvency came into force on 1st December, 2016. Presently, about 400 corporate debtors (CDs) are undergoing corporate insolvency resolution process (CIRP). Stakeholders have since gained considerable experience into the working of the Code and have made several suggestions, formally and informally. IBBI has been receiving suggestions from stakeholders through roundtables and advisory committees. The adjudicating authority and Hon'ble Courts have dealt several matters and ruled on various issues. Media, press and professional journals have been carrying different perspectives. This note consolidates all suggestions for the consideration of the Governing Board.

Corporate Insolvency Resolution Period

3. The timeline is the USP of the Code. The insolvency needs to be resolved in a time bound manner as undue delay is likely to reduce the organizational capital of the firm. When the CD is not in the pink of health, prolonged uncertainty about its ownership and control may lead to flight of customers, vendors, workers etc. and reduce the enterprise value exponentially, making the possibility of resolution remote, impinging on economic growth. Therefore, the Code provides a maximum time of 180 days for completion of CIRP. However, regulation 39(1) of CIRP Regulations provides that "A resolution applicant shall endeavour to submit a resolution plan prepared in accordance with the Code and these Regulations to the RP, thirty

days before expiry of the maximum period permitted under section 12 for the completion of the CIRP.", that is, up to 150 days from the CIRP commencement. This gives an impression that the resolution plan cannot be finalised until 150 days.

4. In the matter of *Prowess International Pvt. Ltd. Vs. Parker Hannifin India Pvt Ltd.,* the Hon'ble Appellate Authority observed: "…*in case(s) where all the creditors have been satisfied and there is no default with any other creditor, the formality of submission of resolution plan under section 30 or its approval under section 31 is required to be expedited on the basis of the plan if prepared. In such a case, the Adjudication Authority without waiting for 180 days of resolution process, may approve the resolution plan under section 31, after recording its satisfaction that all creditors have been paid/satisfied and any other creditor do not claim any amount in absence of default and required to close the Insolvency Resolution Process."*

5. The Regulations may be suitably amended to facilitate resolution at the earliest. The timeline for submission of resolution plans may differ for different CDs depending on the unique business of the debtor. It may be efficient to allow the resolution professional (RP) to provide timelines for receipt and approval of resolution plans, subject to the provisions in the Code and approval of the Committee of Creditors (CoC).

Invitation of Resolution Plan

6. Regulation 36 (1) of the CIRP Regulations requires the Interim Resolution Professional (IRP) / RP to submit an information memorandum in electronic form to each member of the CoC and any potential resolution applicant. Based on the information memorandum, prospective resolution applicants are expected to submit resolution plans. Section 25(2)(h) of the Code provides that a RP shall invite prospective lenders, investors and any other persons to put forward resolution plans. In many cases, a resolution plan may be available for consideration of CoC at a much earlier stage. In many overseas jurisdiction, a creditor triggers CIRP only after it has organised a resolution plan, which is called pre-pack, so that resolution closes immediately or in a few days of commencement of process. It is in the interest of everybody to close a CIRP at the earliest. The Code and regulations may allow closure of CIRP without making an invitation for a resolution plan.

7. The BLRC observed that "the limited liability company is a contract between equity and debt. As long as debt obligations are met, equity owners have complete control, and creditors have no say in how the business is run. When default takes place, control is supposed to transfer to the creditors; equity owners have no say". Further, it believes that that there is only one correct forum for evaluating such possibilities, and making a decision: a creditors committee, where all financial creditors have votes in proportion to the magnitude of debt that they hold….. The appropriate disposition of a defaulting firm is a business decision, and only the creditors should make it." Thus the decision of whether to invite a resolution applicant or not, in the context of the issue, should primarily be that of the CoC. They are accountable for their decisions. If they have a readymade plan, they should be able to implement it.

8. In Chhaparia Industries Private Ltd. (since resolved), it is understood, the CoC had only one FC who permitted the CD to propose its resolution plan and the same was accepted. No potential resolution applicant was invited to submit a resolution plan. In Prowess International Private Ltd, it is understood, there were no claims other than that from the OC who had triggered the process. The CoC accepted the resolution plan of the CD without inviting resolution plan from potential resolution applicants as the OC was paid in full. The CD continued to operate as a going concern and there was no haircut for the FCs.

9. The Code envisages market forces to resolve the insolvency in the best possible manner. This can happen if every potential resolution plan gets an opportunity to offer his best. If resolution plan is not invited, the CD will lose the globally optimum plan and end up with a local optimum plan, which is not in sync with maximization of assets of the CD, a key objective of the Code.

Interim Finance

10. Section 20 of the Code mandates an IRP to make every endeavour to protect and preserve the value of the property of the CD and manage the operations of the CD as a going concern. For these purposes, the IRP has the authority to raise interim finance (IF) provided that no security interest is created over any encumbered property of the CD without the prior consent of the creditors whose debt is secured over such encumbered property. However, no prior consent of the creditor is required where the value of such property is not less than the amount equivalent to twice the amount of the debt. Section 25 of the Code mandates RP to preserve and protect the assets of the CD, including the continued business operations of the CD. For

these purposes, the RP has authority to raise IF subject to the approval of the CoC. Section 5(15) of the Code defines 'Interim Finance' to mean 'any financial debt raised by the RP (including the IRP) during the insolvency resolution process period'. Under section 5 (13) of the Code, "insolvency resolution process costs" include the amount of any IF and the costs incurred in raising such finance. Resolution plan identifies specific sources of funds that is used to pay the insolvency resolution process cost.

11. During the CIRP, the IRP / RP needs to run the CD as a going concern. He often needs IF to run it. However, it may be difficult for him if the CD is not in pink of its health or does not have adequate liquid assets to continue its operation, at least at the same level of capacity and efficiency as in the pre-CIRP period. The failure to operate it as a going concern may reduce the enterprise value of the CD and may fail to attract good valuation or viable resolution plans. This may eventually push the CDs in some cases towards liquidation, which may not be consistent with the objective of the Code. Therefore, it may be useful to facilitate development of a market mechanism that makes available flow of IF to CDs under CIRP.

12. It may be difficult for an IP to obtain IF for the CD despite the protection available under the Code. He faces several challenges:

a. Banks may not be willing provide IF as they sometimes apprehend that it would be used to pay dues of vendors who are typically related parties of promoters of the CD.
b. The existing creditors may not have capacity to extend IF.
c. A lender may be willing to extend IF, which is a short term and risky finance, if it is offered above normal interest rates, as well as legal protections.
d. Banks may be reluctant to provide IF in the absence of clarity on norms for provisioning and asset classification in respect of new finance to an NPA account, particularly where insolvency proceedings have commenced. It prima facie appears that regulations governing banks, NBFCs and asset reconstruction companies require them to make 100% provisioning on such loans irrespective of the borrower.
e. A CD may have a large number of lenders and the security cover may have completely depleted. The existing security holders may be reluctant to share the security with the IF providers. Thus, the CD may not have unencumbered assets to be offered as security to cover IF.

f. Foreign funds may be willing to provide IF. The restriction on debt investment may on their way. They may have hesitation to provide IF as the lock in for foreign corporate debt is three years.

13. The US Bankruptcy Code offers legal protections to interim financiers in the form of an escalating series of inducements. These range from granting post-petition finance the status of unsecured first-priority administrative expense, all the way to a lien that is senior or equal in priority to pre-existing liens. The UK Insolvency law also allows new loans that have higher priority over existing charges. Globally, there is a well-developed market for special situation funding. There are lenders that specialise in and focus on investing in this area.

14. In the event of approval of a resolution plan by the adjudicating authority, the IF is repaid in full along with interest and other costs due on it till such day of repayment. However, regulation 27 of Liquidation Regulations provide: "In case of rent, interest and such other payments of a periodical nature, a person may claim only for any amounts due and unpaid up to the liquidation commencement date." This gives an impression that interest on IF availed for the benefit of a CD can only be claimed up to the liquidation commencement date. Since liquidation is usually long process, the lender would not receive repayment of IF for a long period and during this period IF may not earn any interest. Inability to earn interest until repaid in full discourages the financiers to extend IF. Since IF and the costs incurred in raising the same are considered as part of 'insolvency resolution process costs', interest payable on IF should also constitute cost of raising IF and, therefore, may not be subject to the restriction in regulation 27.

15. Under the circumstances, the questions are:

a. Are the extant provisions in law adequate to make adequate IF available required for CDs under CIRP;
b. How a deep, liquid market for IF be developed and deepened?
c. What should be provisioning norms for IF?
d. How should foreign funds be facilitated to extend IF?
e. How should AIFs registered with SEBI be facilitated to provide IF? Can any special situation fund be encouraged?
f. What safeguards are required to ensure that IF is not used for ever-greening or otherwise misused?

g. What safeguards are required to protect the interests of providers of IF?
h. Should IF be restricted to a minimum amount required for carrying on operations and not to expand capacity utilization, considering the remit of the Code?
i. How to create liquid and dep market for IF?
j. Should IUs, NSE and BSE be encouraged to provide a platform for raising IF?
k. Should regulation 27 be modified to allow interest on IF till full repayment?

Resolution Plans

16. The Code aims at maximisation of value through resolution of viable businesses. It envisages resolution within the firm as a going concern, as closure of the firm destroys organisational capital and renders resources idle till reallocation to alternate uses. It empowers and facilitates the stakeholders to complete the resolution process in time. It expects the best possible resolution. It, therefore, envisages anybody, including the promoters and the CD, to propose resolution plans and empowers the CoC to choose the best of them. It envisages limitless possibilities of resolution – with or without the existing promoter, existing products, technology or business model and it can be a turn-around, buy-out, merger, acquisition, takeover, and what not. It is useful to facilitate development of a market mechanism that encourages submission of many competitive resolution plans.

17. A resolution plan, irrespective of its form and content, represents a value for all stakeholders of the CD. The objective of every resolution plan is to maximise the aggregate value, which is usually expressed in monetary terms, as price. Higher the enterprise value, higher is the likelihood of resolution. Some of the issues relevant for facilitating the maximisation of the value under a resolution plan are:

a. Legal certainty: A resolution applicant would offer the best price only when it gets clean rights over control and assets of the CD, so that it would be in a position to implement the resolution plan expeditiously.
b. Facilitations from other Agencies: IBBI has taken up with MCA and SEBI to facilitate running of the CD as a going concern. SEBI has already exempted public offer under Takeover Code and allotment from preferential pricing norms. It is considering facilitation under LODR Regulations, Delisting Regulations, etc**.**
c. Further approvals: Implementation of resolution plan may require further approvals under other laws from authorities. For example, a resolution plan may require approval

of CCI if it entails a combination. MCA has been requested to dispense with the approval under competition law as about 99% of combinations notified to CCI over last 6-7 years were found to have no appreciable adverse effect on competition. In fact, the alternative to resolution of the firm is its liquidation. If the corporate is liquidated, competition suffers the most. In the interest of competition, the firm needs to survive.

d. Other approvals: The Code deals with the process of restructuring and liquidation, but does not deal with issues post transfer of ownership. The concerned authorities are not bound by an order of the NCLT approving a resolution plan, and further, no exemptions or relaxations having been provided so far for obtaining approval of such authorities for change in ownership/ transfer of operating approvals required for implementation of resolution plan, may lead to uncertainty regarding the success of a resolution plan and extend timelines for deal consummation. If resolution plan changes ownership, the CD may require fresh approvals like the Environment Clearance granted under the Environment Protection Act, 1986, Forest Clearances granted under the Forest Conservation Act, 1980, Consents to Establish and Operate granted under the Air (Prevention and Control of Pollution) Act, 1981 and the Water (Prevention and Control of Pollution) Act, etc. A seamless process for approvals to an acquirer based on the approved resolution plan may be considered. Approvals could be granted on a fast track basis subject to acquirer satisfying eligibility criteria under relevant legislations, facilitating smooth transition of ownership, quicker redeployment of productive resources and ease of doing business.

e. Past Non-compliances and Liabilities: The acquirer of the CD may be subject to subsisting liabilities and non-compliances which may impact valuation and timelines for implementation of the resolution plan. The non-compliances may impact revenues and business continuity. The acquirer may have to be provided sufficient transition time to regularise past non-compliances and continue with operations during such transition period. Or, the past management may be required to deal with compliance shortfalls and legal legacy of the CD.

f. Settlement of Ongoing litigation and Regulatory Proceedings: The Code does not clarify the discharge or settlement of existing litigation proceedings with tax and other regulatory authorities, and whether the order of the NCLT would be binding on such authorities / tribunal / courts. It needs clarification if the payments made to tax and other regulatory authorities in their capacity as operational creditors as provided under an

approved resolution plan should discharge the CD from all further obligations with respect to such matters.

g. EPCG Liabilities: Some CDs have taken the benefit of Export Promotion Capital Goods (EPCG) schemes, and are in default of their export obligations. They may not be in a position to fulfil these obligations, and their liabilities in this regard may have to be resolved as part of the resolution plan. Suggestions to make the resolution plans viable include: (i) reduction in the export obligation and extension of time period to fulfil export obligations, (ii) complete waiver of EPCG liability; (iii) settlement of EPCG liabilities – the interest and penalty payable may be waived, and a haircut on the liability may be allowed, in line with haircut agreed with secured financial creditors of the CD.

h. Pre-packs: In many jurisdictions, pre-packaged arrangements are used in the insolvency process. This puts the CD on track expeditiously, much before the timeline available for CIRP. It would be useful to develop capacity – technical, financial and execution - in the economy that can offer viable pre-packs for each kind of CD to facilitate quick closure of CIRP.

i. Difficulty in continuation business: Royal Twinkle Star was apparently carrying on illegal CIS activity. The CoC, therefore, decided to liquidate business as resolution cannot allow continuation of this illegal activity. In Anrak Aluminium Limited, business requires supply of bauxite. As Bauxite was not available, the business has to be liquidated. Instead of admitting the application for CIRP, the adjudicating authority advised the parties to try to obtain supply of bauxite. Where a CD commenced construction of real estate in pre-RERA period, and it is continuing construction without registration with RERA in post RERA period, probably construction has to be discontinued. There are many such situations where continuation of business may not be an easy option. However, resolution plan has infinity possibilities. It can change the business or product line.

j. Information asymmetry: The existing promoters are in an advantageous position as they know the true position of the CD and can come up with a realistic resolution plan in their wisdom and capability. The purpose of the information memorandum prepared by the RP is to level the playing field by making high-quality information available to all resolution applicants. It may still be difficult to provide as much details as available to the existing promoters. However, the prospective resolution applicant may need to have independent due diligence. It is necessary to ensure that the information memorandum provides comprehensive and accurate information and that the IRP makes further

details available, as may be required, to resolution applicants, without compromising confidentiality and providing scope for insider trading.

k. Cost: If the process under IBC is not cost effective, the stakeholders may not like to use it, particularly when they have other options to arrive at the same resolution plan. It is necessary to streamline process and adopt cost effective procedures.

l. Sustainable Debt: The Code does not provide a criterion for determining the sustainable level of debt which can be serviced by the business, which could be a factor in the effectiveness of a resolution plan and have a bearing on the credibility of the business plan proposed by a resolution applicant.

m. Custody and safety of business after NCLT Approval: After the Order of the NCLT approving a resolution plan, the role of the RP gets over. Clarity over the transfer of custody of the business and assets of the CD, implementation of the resolution plan, is necessary.

n. Associate companies of the CD: The Code does not clarify the manner in which the operations, activities or assets of the CD's associate companies (which are not subsidiaries) are to be dealt with. The resolution plan / corporate insolvency resolution process may include within its scope the manner in which the holding in associate companies is dealt with and also the operations of such associate companies.

o. Quantitative metrics for selection of resolution plan: To assess the resolution plans, considerations may include: (a) competence and track record of the resolution applicant in running its own business and in turning around similar businesses acquired in the past -A high score may be assigned to proposals submitted by applicants with strong track record in the same business, a strong management team and a robust balance sheet; (b) the resolution applicant and its promoters may have a demonstrable experience in raising finance for acquisitions and capital expenditure projects of a minimum stipulated amount which can be linked to the size of the amount required for restructuring the NPA in question; (c) the resolution applicant and its promoters may have demonstrable synergies with the target business; (d) quality of the turnaround proposal: Based on details of the strategy, action plan and management team proposed by the applicant to revive the asset; (e) infusion of fresh capital is critical in distressed situations as the assets are struggling to revive operations due to shortage of cash for working capital needs, maintenance capital expenditure, stalled expansions, etc.; (f) upfront payment to the banks results in a permanent reduction in debt and creates liquidity for the banks in an otherwise stressed assets where the recovery is uncertain;

(g) the debt regarded as sustainable in the resolution plan in not simply postponing the problem of unsustainable debt, which cannot be serviced, in the future. A minimum qualifying score may be specified against the qualitative criteria; an application that fail to meet the minimum qualifying score may be rejected. The financial criteria should entail a comparison of the various proposals after adjustments for the risk associated with these proposals. This may be done by assigning a probability factor to the projected cash flows to the banks, possibly based on credit rating of the proposal from credit rating agency appointed by the RP/CoC. Detailed and objective criteria may protect FCs and their officials from legal challenges based on any alleged arbitrary exercise of jurisdiction.

p. The best practices that are being followed currently are private, not public. While the large cases now under consideration may be following these best practices, they should percolate to all the hundreds of cases that are undergoing resolution for an efficient and effective insolvency resolution mechanism to be established.

q. As the CIRP begins, a number of contingent liabilities start getting crystallized, adding to the claims against the CD. Some contingent liabilities such as court cases, tax issues, etc. may continue for long. While tax liabilities have been addressed to a large extent in the waterfall mechanism, the legal issues are still alive. The RP would have to be alive to such liabilities before proposing the EoI to a prospective bidder. There are adequate numbers of domestic and international risk takers for the primary business of the borrower company. However, the ability or intent to take on legal, compliance, and management risks may be limited. Since the reservation of the FC and the promoter to agree on a resolution plan stem from a common handicap: an inability to have a clear view of the way forward, in terms of available alternatives, the focus be to provide maximum clarity (information) to both the parties at the earliest, to help them put their best foot forward at the first instance itself.

r. To ensure high realisation of value, it is may be necessary that several interested and suitable parties should bid competitively. Many RPs may not have the capacity to ensure this. CoC may be willing to bear the cost of specialised M&A experts who can increase the reach, get many suitable bidders, and help in negotiations. They could be paid on a success fee basis.

s. Success depends on capability and motivation of CoC. They should be business savvy and need to consider interests of all stakeholders.

18. It may be useful to encourage IUs, NSE and BSE to offer a structured platform for submission of competitive resolution plans and modifications therein.

Valuation

19. Regulation 27 of the CIRP Regulations mandate the IRP to appoint two registered valuers to determine the liquidation value (LV) of the CD in accordance with regulation 35 within seven days of his appointment. Regulation 35(3) mandates the RP to provide the LV to the CoC in electronic form. Regulation 36(1) (b) further mandates the RP to provide the liquidation value as part of the IM to the CoC and the resolution applicant within 14 days of the first meeting of the CoC. This time period may not be sufficient for valuation of multi-location large plants.

20. Regulation 36 (2) of the CIRP Regulations specify the contents of an information memorandum. It shall include, among others, (i) the liquidation value (LV); and (ii) the LV due to OCs. A CD expected to operate as a going concern has enterprise value. The disclosure of liquidation value is likely to impact the enterprise valuation and hence impacts true price discovery, as revealing LV leads to bids received around LV, setting a ceiling for the bids. While the LV should be disclosed to enable dissenting creditors take an informed decision, its disclosure to others including prospective investors/resolution applicants could be delayed till after receipt of resolution plans. The contrary view is that unless LV is disclosed, the prospective resolution applicant cannot know its obligation to OCs and dissenting FCS, and hence cannot arrive at an enterprise value. It is known from the large cases currently undergoing resolution that the CoC has in many instances given the proposal of exploring the EV. Some RPs have gone a step ahead to find out distress value.

21. The regulations, however, do not mandate calculation of the enterprise value. There is a view that the calculation of enterprise value is necessary as it provides the best price discovery. The enterprise value will also help the FCs to facilitate the decision regarding selection of the resolution applicant. It may be useful to provide for EV to enable a corridor of the value of enterprise to emerge. This could provide the best possible value to the CoC. This is also likely to prevent misuse of the LV as a floor price for bidding. However, in light of the CD being present in the CoC and thus privy to this information, there must be clarity on providing

information regarding LV to the CoC. The options are: computer both LV and EV and disclose both or do not disclose either.

Voting in CoC

22. The Code stipulates that all members of CoC have to necessarily vote on every resolution**.** The voting is reckoned on the basis of total value attributed to the creditors**.** Various acts currently provide for approvals to be binding on stakeholders based on the concept of **'**present and voting**'.** The stakeholders suggest that the same principle of 'present and voting may apply to meetings of the CoC.

Participation in CoC

23. Section 21 (2) of the Code provides that the CoC shall comprise all FCs of the CD. There are a few CDs who have a large number of FCs. Generally, the number of fixed deposit holders or debenture holders is quite large. The stakeholders have expressed difficulty with conducting meeting with such large number of FCs. One way could be to allow participation of these FCs through their representatives, as the workmen and employees have been allowed. It is doubtful if this can be done through regulations. In the case of Jaypee Infratech Limited (JIL) there are more than 7000 FD holders and thousands of small investors who are located all over the country, many at remote places. In order to protect the larger interest of the small investors, FD holders, the NCLT directed "…*the Insolvency & Bankruptcy Board of India to nominate its officer or an Insolvency Professional as the case may be, to attend such meeting and to take case of the adequate interest of the depositors/FD holders in the meeting of the CoC."* Further, in the same matter, the Hon'ble Supreme Court directed: "…*Mr. Shekhar Naphade, learned senior counsel along with Ms. Shubhangi Tuli, Advocate-on-Record, shall participate in the meetings of the CoC under Section 21 of the Insolvency and Bankruptcy Code, 2016 to espouse the cause of the home buyers and protect their interests."* At times, the financial creditors may run into thousands or even lakhs in case the corporate debtor has issued of debentures or fixed deposits. It becomes operationally difficult to have a meeting of the CoC given such huge numbers and many of them may not be able to effectively participate in the meetings of the CoC as they are dispersed all over the world. It may be necessary to enable participation of such large number of creditors through an authorised persons.

Essential Services

24. Dues to Essential Services Suppliers: Certain pre-petition claims to supplier of essential services are vital to keeping the debtor as going concern and may need to be paid. However, if past dues are paid, the waterfall is disturbed. If it is not paid, it may be difficult to comply with the requirement of keeping debtor as a going concern during CIRP. Further, if certain essential supplies are disrupted during CIRP and business is impacted, the intrinsic value of business as going concern may go down, which may be against the spirit of maximizing value for stakeholders. There is a request from some sections that a clarification may be provided that either (i) specific services from continuing vendors are critical for operations as a going concern and hence dues from pre-petition period should be paid, or (ii) such pre-petition payments are against the waterfall and non-negotiable.

25. Essential supplies: Essential suppliers like electricity companies are reluctant to resume supply unless previous dues are paid. The IRPs/RPs have informed us that though jurisprudence has emerged in this area, the electricity boards across the country have taken a stance and are not agreeable unless a specific NCLT order in respect of the CD is provided. In this connection the relevant ministry may issue some directive/ clarification that can put some obligations on the suppliers to continue providing essential goods and services. NCLT has adjudicated that if services were continuing in the pre-petition period, the supplier should continue to provide the services post-petition. Some clarification may be provided regarding definition of essential supplies and priority of payment.

Liquidation

26. Where resolution is not possible, an insolvent CD needs to exit with the least disruption and cost, and release the idle resources in an orderly manner for fresh allocation to efficient uses. The Code envisages a process of liquidation and provides for a liquidator to conduct the process. The Code empowers the liquidator to sell the immovable and movable property and actionable claims of the CD in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels. The regulation enables the liquidator to (a) sell an asset on a standalone basis; or (b) sell the assets in a slump sale, a set of assets collectively, or the assets in parcels. The liquidator shall

ordinarily sell the assets of the CD through an auction and may sell the assets of the CD by means of private sale in certain circumstances.

27. Previous liquidation regimes were reportedly undermined by cartelisation. Care needs to be taken to ensure that transparent processes, including e-auctions, help reduce this problem. Besides, promoters, who are wilful defaulters, should be barred from repurchasing the firm's assets. However, the legislative intent is clearly that there should be as many bidders as possible, and that the promoter is free to bid. If the promoter or a related party bids, the law requires the liquidation professional to report this to the NCLT.

28. There is no formal market place where the assets of the CDs, particularly specialised equipment or high value assets, can be bought and sold conveniently. Notwithstanding the economic principles 'supply creates its own demand' and 'everything sells if price is right', development of market for any asset needs facilitation at least in the initial days. It is necessary to facilitate development of a market mechanism which enables competing bids to buy assets and the sale of the asset to the highest bidder, the objective being the highest realisation for the stakeholders. There is need to create market for stressed assets**.** It may be useful to encourage IUs, NSE and BSE to offer a structured platform for submission of competitive resolution plans and modifications therein.

Balancing Interest of Stakeholders

29. In the early days of the implementation of the Code, the CDs having default since long are coming up for resolution. The liquidation value available in many of such cases for OCs is insignificant. This may mean that OCs would stand to lose from CIRP and accordingly the business of OCs may be adversely impacted. Should the Board consider providing better protection under section 30(2)(b) for OCs?

30. While considering protection for OCs and other creditors, the impact on choice of the decision makers, namely, FCs has to be considered. The FCs constitute the CoC. The CoC has two choices, namely, resolution and liquidation, subject to compliance with the Code and approval of adjudicating authority, wherever required. One would expect that it would be guided by the interests of FCs in making the choice. Quite often, the likely gain or loss of FCs would depend on what the OCs and other creditors are entitled to get from these processes

under the law. If the FCs stand to gain more from liquidation as compared to what they would get from resolution, the CoC may decide on day one to liquidate the CD, may not come up with a resolution within the prescribed time, or comes up with a plan which does not meet the requirements of the Code.

31. Thus there is a fallout of providing excessive protection to OCs and other creditors in CIRP. However, if the law does not require any protection for OCs and other creditors, it is possible that the FCs may not provide any protection. Should the law be calibrated to increase or decrease the rights or entitlement of OCs and other creditors vis-a-vis FCs depending on the public policy objective? Further, the CoC may like to give more than their entitlement to OCs and other creditors in CIRP, if it finds that the process would also benefit the FCs more or it apprehends that the adjudicating authority may not approve otherwise and consequently, the CD will be pushed to liquidation which may not be in the interests of the FCs.

32**.** The three amendments made to the CIRP Regulations have aimed towards serving these interests. The first amendment made on 16th August, 2017 provides other creditors to submit their claims and facilitate interim RP to receive and collate claims for determining the financial position of the CD**.** The second amendment made on 5th October, 2017 mandates a resolution plan to include a statement as to how it deals with the interests of all stakeholders. The third amendment made on 7th November, 2017 provided for adequate information to enable the CoC and carry out due diligence of every resolution plan to satisfy itself that the plan is viable and thus select the most suitable plan under the circumstances.

Perception Management

33. In the early days of the implementation of the Code, the CDs having default since long generally come up for resolution. In these cases, particularly the cases transferred from BIFR, the outcome may not be very attractive as compared to book values, though attractive as compared to liquidation value. In these cases, particularly those which have been to BIFR as well, the firm may not have been operational for many years, and the physical and organisational capital may also have deteriorated long ago. Thus, the early cases that come to CIRP may not always be successfully resolved – many of them are likely to go into liquidation. Even if these firms are restructured, the outcome in these cases may not be attractive as there will be large haircuts. As newer cases with ongoing operations come into the resolution process, the rate of

successful resolution and the realisation of value will improve. In the interregnum, it is important to calibrate and manage expectations of all stakeholders, so that they are not prematurely disappointed with the initial outcomes**.** This will also help in building a constructive perception about effectiveness of the mechanism under the Code may inhibit discovery of fair price**.**

CD as a Resolution Applicant

34. BLRC, while drawing the line between malfeasance and business failure, observed that under a weak insolvency regime, the stereotype of "rich promoters of defaulting entities" generates two strands of thinking: (a) the idea that all default involves malfeasance and (b) The idea that promoters should be held personally financially responsible for defaults of the firms that they control. However, it also held the perspective that some business plans will always go wrong. In a growing economy, firms make risky plans of which some plans will fail, and will induce default. If default is equated to malfeasance, then this can hamper risk taking by firms. This is an undesirable outcome, as risk taking by firms is the wellspring of economic growth. Bankruptcy law must enshrine business failure as a normal and legitimate part of the working of the market economy. In the case of Anrak Aluminium Vs. SBI the NCLT did not admit the application triggered by the CD as it found that for no fault of theirs, and directly on account of Stage Government *force majeure,* a potential national asset was lying waste for more than four years. Instead, it directed all parties to explore the avenues for operating the company.

35. Existing promoters start from a position of advantage since they have better knowledge of the company's real situation than others and be in a better position to repurchase the company, forcing the lenders to take haircuts. Some proposals for a level playing field could include: (i) CoC imposing eligibility criteria on resolution applicants, including net-worth requirements. These criteria might specify that the existing promoter should not be allowed to include the value of his holdings in the CD in his net-worth, (ii) If resolution plans are submitted by several parties, the members of the CoC could attach different discount rates to the different offers, based on their judgement of the risks involved. They could calculate the NPV of each resolution plan based on appropriately risk-adjusted discount rates. The NPV should also include the risk-discounted value of the Personal Guarantees or Corporate Guarantees offered by different resolution applicants.

Tax Liability

36. Tax impact on waiver/haircut : Agreement for acquisition of the CD may be accompanied with an agreement for settlement of the borrowings with the respective lenders and agreement for settlement of the liabilities with the respective creditors. This could involve a waiver of a part of the liabilities or a haircut in the form of time value of money. Such waiver or haircut is reflected as a gain in the income statement of the CD. Recognition of such gain may result in a Minimum Alternate Tax ("**MAT**") liability in the hands of the CD. Further, based on the proposed amendment to Section 115 JB(2A) of the Income Tax Act, 1961, certain arrangements/transactions that may be entered into in the resolution process (include transactions such as (i) capital reduction of the CD,(ii) merger of the CD or acquisition of the purchase, (iii) issue of convertible instruments, however, accounting treatment of any convertible instrument issued by the CD, i.e., amount credited to equity on issuance of convertible may be subject to MAT either for the CD itself or for the acquirer company.[1]

37. Income tax liability on purchase of shares at less than Fair Market Value: Under the Income Tax Act, 1961, any purchase of shares for a consideration lower than fair market value may result in additional tax liability under section 56(2) of the Income Tax Act. Given that resolution plan for CDs may normally involve a bargain purchase, this tax liability may significantly affect the return on investment of the applicant. Such tax liability arising from purchase of shares at discounted value pursuant to an approved resolution plan may have to be rescinded.

38. GST law puts criminal liabilities on management of the company if GST collected is not deposited promptly. On the other hand, since Government is considered as an operational creditor, its dues are treated at par with dues to other operational creditors and hence need not

[1] The MAT-Ind AS Committee had requested for comments to be provided on the proposed amendments by 11th August 2017. In case the Committee decides to issue the amendment without any changes from the proposed amendment, specific exemption may be provided for CD under the resolution process. Further, such waiver of interest /loan could also have potential tax implications under section 41(1)/section 28(iv) of the Income tax Act. Specific amendments to the Income Tax Act to exempt such tax incidence /MAT liability for CD arising from haircuts as part of the resolution process may have to be considered.

be deposited during CIRP. The CD is holding the GST as trustee and has a fiduciary duty to deposit it with Government. The money collected on account GST does not belong to the CD.

39. Tax authorities may need to be advised: (a) to file claims against a CD when it is under CIRP or Liquidation (tax authorities should not go after the new owners), (b) not to initiate / continue proceedings for recovery of their dues from the CD when it is under CIRP or Liquidation, (c) not to unwind transactions undertaken to implement resolution plans (risks to new owner should be minimised), and (d) not to freeze or attach bank accounts of the CD under CIRP/ Liquidation. In a few cases, the authorities have not pursued proceedings at the request of the IRP. Some RPs and resolution applicants have taken up the issues with the respective authorities**.** It may be useful to take this up with the Ministry of Finance so that all taxation issues be considered holistically**.**

Public Announcement

40. Regulation 6 of the CIRP Regulations mandates that an IP shall make a public announcement immediately on his appointment as an interim RP in a Form to be published in (i) one English and one regional language newspaper with wide circulation at the location of the registered office and principal office, if any, of the CD and any other location where in the opinion of the interim RP, the CD conducts material business operations; (ii) on the website, if any, of the CD; and (iii) on the website, if any, designated by the Board for the purpose. For this purpose, the Board has designated its website www.ibbi.gov.in and has been publishing the public announcements with respect to all those which have been admitted by the Adjudicating Authority as of now. The said website and the information available therein is accessible to the general public at large.

41. Stakeholders of a CD may not necessarily be geographically located in its vicinity. Unless a CIRP receives media attention, it may not be possible for all stakeholders to know the admission of the CD under CIRP. It may be considered whether it will be appropriate to have one central place for publishing of such information which, could provide automatic alerts to those who wish to receive them, thereby providing succour to many. This will also obviate the need for financial creditors to look for advertisements across newspapers all over the country.

Consolidated Resolution

42. Group companies are located in different NCLT jurisdictions. There is a suggestion that group companies may be resolved before one NCLT, have one CIRP, one IRP and one resolution plan. Section 60 of the Code allows the FC (himself or jointly with other financial creditors), an OC or the CD to initiate corporate insolvency resolution process in case a default is committed by a CD by filing an application before the NCLT, being the Adjudicating Authority having territorial jurisdiction over the place where the registered office of the corporate person is located as provided. A corporate group or group of companies is a collection of parent and subsidiary/associate companies that function as a single economic entity through a common source of control and such companies may be located at different places in the same country. They generally give corporate guarantees to their group companies. Moreover, there may be some cases wherein two or more companies may undergo insolvency belonging to the same group but located at different places and before different benches of NCLT. Being part of common structure of one CD will have elements in common with the other group CD also in insolvency. It is therefore suggested that a consolidated CIRP be conducted in cases where corporate guarantee of group company is given. It will be efficient if the same IRP undertakes CIRP of both companies. However, this may entail conflict of interest as the IP has the duty to work towards maximization of value of both the CDs and maximisation of one may compromise the interests of the their other.

Robustness of the framework

43. Quality and Independence of IPs: There is no prescribed time limit for liquidation. It could be a longer process as compared to the CIRP. Given that the RP is likely to continue as the Liquidator, a conflict of interest might arise: will the RP push cases towards liquidation since (s)he stands to make more money in liquidation? It is, therefore, necessary to align the incentive of the IPs with the success of the CIRP in an objectively defined manner. In cases where rights granted by regulators are involved, these rights should go with the assets. Without these rights, the assets themselves might not be useful. In general, liquidation markets will not clear in the presence of complications such as regulatory or legal restrictions.

44. Setting of Professional Standards: Institutes like ICAI, ICAI (Cost), and ICSI have laid down professional standards for the services in their domain. Ideally, IPs should sit in groups / study circles to discuss the issues they encounter and explore various options to resolve an issue and choose the most desirable course of action which could be used initially issued as

FAQs by IPAs. With passing of time, the FAQs would emerge as practice, then best practice, then customs, then ultimately standards, if required.

45. As the regulator under the Code, IBBI has a mandate not only to regulate but also to develop the profession. In this direction, it rolled out the Limited Insolvency Examination, which puts a threshold in terms of qualification and experience to filter eligible professionals. The certification is the minimum reference point which must be followed with practice and continuing professional education, else the capabilities run the risk of becoming redundant. For continuing professional education, a blend of designated conferences, seminars, and workshops that bring clarity to contemporary/burning issues relevant to the insolvency with focused intervention across a range of topics depending on the learning curve and personalized learning needs of IPs is suggested.

46. Immunity from litigation for IPs: Protection of IPs for actions taken by the CD prior to CIRP commencement date or during CIRP. Regulation 39(7) of CIRP Regulations provides relief in respect of actions prior to CIRP. Section 233 of the Code provides relief in respect of actions taken in good faith. The onus that an action is not in good faith should be on the complainant and not IP. There is a growing demand for Insurance / indemnity for IPs -Whether IPs need insurance indemnity against personal liability. The Board may not intervene and let the market for this evolve and provide products.

Awareness about Regime

47. The successful implementation of the Code requires building capacity among the ecosystem comprising professionals, participants and institutions and creating awareness among the stakeholders. Corporate insolvency requires a very high degree of competence at all levels while individual insolvency needs a great deal of human touch. Both require all-round awareness to prepare stakeholders to prevent, address and manage insolvency. Several initiatives have been suggested earlier for awareness: inclusion of insolvency in syllabus of professional courses, inclusion of insolvency awareness in school curriculum, advocacy programmes through filed offices of MCA and industry chambers, etc.

48. The National Centre for Financial Education (NCFE), comprising representatives from relevant regulators, under the auspices of National Institute of Securities Markets (NISM),

implements the National Strategy for Financial Education (NSFE), under the guidance of a Technical Group on Financial Inclusion and Financial Literacy of the Financial Stability and Development Council (FSDC), which caters to all sections of the population in the country. The financial literacy initiatives of NCFE do not adequately cover how to deal with an eventual default of a loan. Even contemporary literature in India does not include much of such discussion. For the next FSDC Meeting scheduled on November 23, 2017, IBBI has proposed that the financial literacy initiatives of NCFE may incorporate a module on individual insolvency.

49. IBBI needs an institutional arrangement that can create and sustain awareness of a scale commensurate with the number of stakeholders spread across the country. SEBI has about 1,000 resource persons and is believed to have made an impact across the country. NISM runs this scheme for SEBI. Indian Institute of Corporate Affairs (IICA) probably can operate a resource person scheme whereby it empanels the statutorily regulated professionals within the purview of MCA, namely, company secretaries, chartered accountants, cost accountants, insolvency professionals, and registered values as resource persons and trains them for about a week. These resource persons may organise awareness programmes of three hours' duration for stakeholders across the country with the help of standard printed material, PPTs and video presentations.

50. Two specific representations representing two sets of important stakeholders, namely, creditors (IBA) and debtors (Assocham), which detail some of the issues narrated above are attached **at Annexure A and B respectively.**

51. The regime requires huge developmental efforts in initial days. A view needs to be taken as to what extent IBBI can play the developmental role consistent with its responsibilities under the Code.

Indian Banks' Association

Corporate & International Banking

C&I-II/IBBI/2017-18/**3994**

November 20, 2017

Dr. M.S Sahoo
Chairperson, IBBI
Mayur Bhawan, Shankar Market,
Connaught Circus,
New Delhi -110001

Dear Sir,

Issues & Concerns of Banking Industry on Insolvency & Bankruptcy Code, 2016

With reference to the meeting with Senior Bankers held on November 13, 2017 and based on the discussions with member banks, we submit the issues and concerns of Banking Industry on Insolvency & Bankruptcy Code, 2016 for your kind consideration:

I Legal Issues:

a) Liquidation value arrived as a part of CIRP process, is normally much lower than the Enterprise value of a going concern. However, as per experience so far, the liquidation value as disclosed in the Information Memorandum becomes a kind of bench mark against which most of the interested buyers bid for the Corporate Debtor (CD) in their Expression of Interest. This leads to a poor price discovery and bidding at levels much lower than the real market/enterprise value (disclosure in Information memorandum) of the CD. Hence, the concept of liquidation value may be revisited to facilitate realistic price discovery.

b) As per section 238 of the Code, the provisions of the Code override other Laws. The provision of the Code shall have effect notwithstanding anything inconsistent there with contained in any other Law. However, the Resolution Plan formulated under the Code has to abide by all Laws of the Land. In this regard, the cases involving assets such as spectrum licenses, mining licenses or other similar assets, may require the approvals of concerned Govt./State Govt. Dep't. for transfer or assignment of such assets under Resolution plan. However, such Government approval may take more time than available under the CIRP process (180 days extendable up to 270 days). Hence, unless a mechanism to expedite such sanctions in CIRP cases is available, most of such Corporate Debtors may go into liquidation despite having interested buyers/viable Resolution Plans in place.

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c) Under Section 21 (8) of the Code, all decisions of the Committee of Creditors shall be taken by a vote of not less than 75 % of voting share of the financial creditors. The said Section 21 (8) needs to be amended as "All decisions of the Committee of Creditors shall be taken by a vote of not less than 75 % of voting share of the Secured Financial Creditors, present and voting." including through electronic voting.

d) The moratorium provided under Section 14 of IBC does not extend to the contracts executed by the Government in relation to the projects under execution by the corporate debtor. In many cases (especially in the infrastructure sector), the main commercial agreement of the corporate debtor is a license / concession from the Government or Government instrumentalities. Onset of insolvency of the concessionaire / licensee is usually a termination event in such contracts. If the Government authorities exercise their right of termination upon initiation of the CIRP, the prospects of revival of the corporate debtor will be adversely impacted. It is recommended that termination of such license / concession agreements should not be permitted on onset of insolvency proceedings under CIRP and till expiry of moratorium period. Further, when a resolution plan is approved by NCLT, such concessions should continue even in the event of change of management without any further approvals from any authorities, to ensure continuity of business.

e) Most resolution plans may involve waiver of certain amount of debt, leading to income on the books of the corporate debtor. Such income recognition would result in MAT obligations arising out of the notional profits booked due to reduction on debt. It is recommended that IBBI may take up this matter with Income tax Authorities and Ministry of Finance, for issuing suitable amendments such that gains to the corporate debtor balance sheet on account of waiver of debt as a part of resolution plan should not be taxable under normal provisions of the Income Tax Act. This tax liability may dissuade the potential investors from bidding (**Section 115 JB of Income Tax Act).** In as much on banks are taking a haircut, IT department should be asked to similarly waive this tax.

f) In case of financing done to a Corporate Debtor under Obligor and Co-Obligor structure, it is not clear whether the CIRP is to be filed individually against all Co-Obligors or filing against the Corporate Debtor will include the Co-Obligor. The problem will arise if Registered Offices of Co-Obligor and Obligor are situated at different places. This needs clarification.

g) Treatment of guarantors or enforcement of assets of guarantors during moratorium. The provision of applicability of moratorium to guarantor's assets is not clear in view of the various orders/ judgments of the different courts/tribunals and the same needs to be clarified.

h) Sec.60 (6) restricts the exclusion of computation of limitation during moratorium only to corporate debtor without making any reference to guarantors. In the absence of notifying the provisions of IBC relating to individuals, the creditors, to avoid losing the legal remedies, is left with no option than to file the applications against the individual guarantors before DRTs. In case of approval of Resolution Plan submitted by the Corporate Debtor, such approval of modified terms of repayment without the concurrence of Guarantors may lead to challenging any future action against the guarantor on the basis of novation of contract by the creditors with corporate debtor.

i) The proviso to Section 3 (31) {Definition of "security interest"} which does not include performance guarantee within the ambit of security interest needs to be deleted.

j) **Section 281 of Income Tax Act-** Tax risks to resolution applicant acquiring assets of corporate debtor. The resolution plan may need to provide for transfer of assets of corporate debtor by way of slump sale or under any other structure to a different entity. Section 281 provides powers to assessing authorities to recover dues from acquirer/ transferee in case dues from Corporate Debtor do not get recovered. This will deter new investors

k) With regards to Shareholders' approval for extinguishment of share capital of listed companies. Recently, MCA issued a clarification that shareholders' approval shall be deemed to have been obtained under Companies Act or any other law, if a resolution plan is approved by NCLT under Section 31 of IBC. It is expected that greater investor interest would be generated if write down of equity is permitted to the fullest extent, free from any ambiguity. Section 66 of the Companies Act, 2013 read with the recent clarification obviates the need for a special resolution as well as a separate approval from NCLT, once it forms part of a Resolution Plan. However, it needs to be clarified that this is feasible even in cases of listed entities. As per **Chapter X - Reg 39 (6) of IBC and the Companies Act, 2013 -** Shareholder approvals for implementing a resolution plan. Shareholder's approval under Companies Act and SEBI Regulations would be required for capital reduction, sale of substantial part of undertaking, preferential issue etc. envisaged under Resolution Plan. Currently as per regulations, approvals only under Shareholder Agreements and Incorporation Documents are exempt. Hence, the shareholders may block any resolution plan that provides for such matters. The secured lenders have been demanding that equity share capital under a resolution plan should be written down to zero since secured lenders themselves have not got a full recovery. Possibility of fully writing off equity share capital in such cases has to be evaluated.

l) **Chapter X - Reg 38 (C)-** Liquidation value due to dissenting financial creditors and provide that such payment is made before any recoveries are made by the financial creditors who voted in favour of the resolution plan. In case, payments are made to dissenting financial creditors before any recoveries to financial creditors who voted for the Plan, will not get any incentive for their participation. The Financial Creditors may prefer to get an upfront payment of liquidation value instead of continuing with the Company and get higher recovery over the years in future. This anomaly needs to be addressed.

m) **Section 52 and 53 of the IBC-** Treatment of different priority of charges for determining recoveries under section 53. Ambiguity on whether 1st and 2nd charge would be treated equally or differentially needs to be clarified. In a consortium account, lender who is having both paripassu charge as well as Exclusive Security charge need to pool their exclusive security to common security pool.

n) **Resolution Plan under Provisions of IBC 2016-** Management of Corporate Debtor after CIRP period. Under provisions of IBC, a resolution plan duly approved by CoC is required to be submitted to NCLT within 180/ 270 days. Upon completion of 180/ 270 days, the office of RP comes to an end, the erstwhile board is still suspended and any new or old management may not have authority to take charge or control of the Corporate Debtor. Pending NCLT and other regulatory approvals (from SEBI, Shareholder etc) who would run the management of the company. Moratorium is not available post 180/ 270 days.

o) **Harmonization of Code with other laws-** There are several provisions of other statutes that practically cannot be complied with. There are various provisions under various laws that cannot be complied with during CIRP period. Some of these are- Requirement Signing of audited accounts by two directors, Requirements relating to audit committee and remuneration committee and Signing of audited accounts for period where RP was not in control of business. We request for keeping abeyance these provisions.

p) **Harmonization of Code with other laws -SEBI Delisting requirements-** De-listing requirements are not exempt for IBC cases. De-listing requirements were exempt under BIFR. Resolution plans may provide for companies to be de-listed

II Operational Issues:

a) Treatment of companies which belongs to a group of companies, which is also defaulting or under stress, common resolution plan may be practical/feasible. This apart from saving time on several procedural issues that will subsequently arise during the CIRP (Corporate Insolvency Resolution Process) process of each of these companies will also help in saving huge cost involved in the process.

b) In case Operational Creditors /Corporate Applicant files application under the Code before NCLT, then specific provision should be made making them liable for all the expenses during the Resolution Process, instead of Financial Creditors, especially if the latter are reluctant joinee.

c) E-mail subscription services may be started by IBBI to enable instantaneous push e-mail notification of fresh filings.

d) As per Section 27 of the Regulations on Liquidation process, interest on all debt of the company can only be claimed till the liquidation commencement date. Hence, insolvency professionals are facing issues in raising interim finance since interest on the same would not be payable for the liquidation period, which may be a time consuming process. It is proposed that any interim finance provided during the insolvency period should carry interest till the date of repayment, irrespective of the liquidation commencement date.

e) As per Section 14 of the Code, on admission of a case under IBC, there is a moratorium imposed on any proceedings against the corporate debtor until completion of CIRP, in order to ensure continuity of operations while seeking prospective resolution plans. Hence, it is recommended that during CIRP, business operations are also not impacted due to cancellation of on-going business contracts and invocation of bank guarantees given for these contracts. In view of the above, it is suggested that stand still should also be imposed on invocation of bank guarantees during the moratorium period.

f) **Lack of precedence and guidance notes-** IBBI may consider drafting and issuing guidance notes for the RPs covering- Process of inviting and evaluating resolution plans, Conduct of CoC meetings, Running corporate debtor as going concerns, Incurring CIRP costs and Other matters.

g) **Database on IBC cases on similar lines of CRILC of RBI-** For better understanding and monitoring of the IBC initiated cases on pan India basis, an effective network giving critical information/milestones is required.

III. Administrative Issues:

a) Clarification is required as to the commencement of appointment of IRP; whether from the date of the order or after receipt of the certified copy of the order.

b) Uniform and standardized method should be notified for determining liquidation value.

IV. Other Issues:

a) Section 5(8)(h) provides for amount of any liability in respect of any of the guarantee or indemnity, bond, Letter of Credit, Bank Guarantor or any other instruments. However, the IRP will accept claims only against invoked Guarantees or LCs, or claims which are crystallized till finalization of Resolution Plan or liquidation date. However, in most of the cases with Banks as financial creditors, BGs/LCs/other Non-Fund based exposures of large amounts are outstanding but not crystallised on the date of finalization of Resolution Plan or liquidation. Code and regulations are silent on admission and valuation of such claims.

b) In some NCLTs the time taken for issuance of Order for appointment of IRP takes more than a month time against fourteen days provided by the Section 7 (4) of the Code.

c) As per the Information Utility (IU) design if the borrower/guarantor either jointly or singly does not confirm/respond to the IU the data cannot be used under the Code and the bank will have to prove the debt before the NCLT in the normal course as is being done before any legal forum, since there is no mandatory requirement under the Code for the borrowers to acknowledge the debt/data to the IU, hence code to be suitably amended. There should be a provision in the Code stipulating that in case the borrower/connected parties do not authenticate or rebut the data provided to them by the IU within a specified time it will be deemed to be authenticated. This will make it obligatory on the borrower/concerned to respond to the data received from the IU. If the data stored in the IU is so authenticated such data can not only be used by the NCLT under the Code but it can also be used by the DRT and other judicial forums/civil courts which adjudicate in recovery suits thereby saving a lot of time spent in proving the debt due.

d) Un Crystalized FB facilities outstanding, in case of NPA accounts should be included in debt while filing the claim.

e) The secured creditor should have recourse against the IRP in the event of non/lower acceptance of claim by filing an application.

f) Provisions pertaining to IBC relating to Personal Guarantee given to Corporate Debtor needs to be notified forthwith.

g) **Resolution Plan under Provisions of IBC 2016-** Haircut to statutory dues and operational creditors. In cases where liquidation value due to statutory dues and operational creditors is nil, can a resolution plan provide for waiver of all pre CIRP dues to such class of creditors. Would a NCLT plan providing for the same be binding on such parties.

h) **Admission of claims, Section 5(20)-** Treatment of customer advances. Clarification needed - Whether operational creditors include customer advances (this is more pertinent in case of real estate sector).

h) **Admission of claims, Committee of Creditors-**

(i) Treatment of live LCs and BGs in financial creditor claims.

(ii) Invocation of Corporate Guarantee of Holding company (under IBC) in Subsidiary Company for the purpose of filing claims with RP. Whether claims in respect of Live LCs and BGs would be considered as part of CoC. In case, there are guarantees such as LC/BG which are live on CIRP commencement date and gets devolved/uncashed during the CIRP period, would that change the voting percentage for the CoC ?

i) **Liabilities of Resolution Professional-** While section 14 provides moratorium cover to corporate debtor there is no immunity available to Resolution Professional. There have been cases where, PF (other labour authorities for that matter) have initiated actions against the RP for the pre-CIRP dues, Actions have been initiated against RP under Negotiable Instruments Act for Cheques issued before CIRP period, RP has been considered as occupier or officer in charge of a factory under labour laws. Such liabilities unduly cause implications on RP who is a custodian of business on behalf of the CoC and would have inherited several non-compliance from pre-CIRP period.

We seek your guidance and clarification on the above mentioned points, in order to alleviate the concerns of the Banking Industry.

Yours faithfully,

V.G. Kannan

ASSOCHAM
INDIA

THE ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

D S RAWAT
Secretary General

ASSOCHAM/ Dept. of Banking & Finance
30th August 2017

Subject: Representation on framing guidelines for evaluation of resolution plans submitted for Corporate Insolvency Resolution Process (CIRP) under Insolvency and Bankruptcy Code, 2016 (IBC).

We recognize that IBC is landmark legislation focussed on bringing in realistic turn-around resolution plans for non-performing assets (NPA) in India and thereby potentially transform the manner in which distressed assets are dealt with. We appreciate the urgency shown by the Government of India to amend the Banking Regulation Act to empower RBI to deal with NPAs. It is also commendable that twelve cases amounting to 25% of the gross NPAs of the banking system have already been referred to Hon'ble NCLT which has already admitted eleven of them.

It is imperative to ensure that the resolution plan adopted by the Committee of Creditors (CoC) is in the best long term interest of all stakeholders, including the employees, financial and operational creditors. We believe the most crucial aspect in the CIRP process would be the criteria of evaluation of the resolution plans submitted by the resolution applicants. For instance, if the resolution plan is not a robust and a real turnaround resolution, there is a very high risk that such plan will fail in a very short time post approval and the asset would go back into the non performing category, thereby defeating the main objective of IBC.
In addition, there could be potential non-serious resolution applicants who may choose to submit their resolution plan with structures which may look superior on paper but are mired with execution and implementation risks. For example:-

- A resolution plan could well primarily comprise limited or no fresh capital infusion, with no change in management and debt being restructured into sustainable and unsustainable portion with sustainable portion paid over asset life (15-20years) and unsustainable portion payment being a bullet repayment the end of the tenor, with accumulated coupon. If such a proposal was evaluated with 100% weightage being given to the Net Present Value (NPV*) of revised debt terms and no weightage given to the other terms of the offer or credentials of the bidder, it may be seen as ranking superior to any other proposal as debt remains on paper as being fully serviced. However, in reality the unsustainable debt continues to be on the books and grow year on year with accrued interest accumulation, and as such, if rated, any rating agency would downgrade the asset basis such a resolution plan due to the high levels of debt and gross insufficiency of cash flow generation in the future for servicing 100% of the debt. Such a plan, while will look superior in terms of NPV, we believe, is basically only window dressing and postponing the critical issue of addressing the high level of unsustainable debt once again to the future, which will further worsen if there is an industry downturn. Any rating agency would rate such a plan poorly despite better NPV recovery and hence such a plan will not be an effective distress resolution and would fail in short period of time. We have provided an illustration of the same in Annexure I.

  * *Net Present Value (NPV) is the discounted value of debt repayment at bank-specified discount rate*

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- Some of the resolution applicants would, on opportunistic basis submit their plans with an inflated, unsustainable quantum of continuing debt, purely with a view to controlling the asset knowing fully well that the asset is unlikely to service the debt over time. However, they would nonetheless achieve their short term objective of controlling the asset if such a plan is approved. There is a high probability that existing management / promoters with some opportunist investors may adopt this strategy. Such proposals will be fraught with inherent risks like limited financial backing of shareholders, limited fresh capital infusion to correct the high lever on the balance sheet, inability of existing management to deliver having already failed once etc. As a consequence, the financial and operational creditors will once again be left to deal with the default which will occur in a short span of time.

Hence, in order to address such challenges, whilst it is important to run a fair and open transparent process so as to maximise recoveries for all stakeholders, it is equally important to adopt an evaluation criteria which will give weightage to the operating and financial credentials of the resolution applicant, demonstrable track record, and executable business plan backed by fresh equity capital infusion which would go towards funding the turnaround plan and repaying / settling financial and operational creditor's dues, so that the resolution plan submitted and approved does not fail in a very short time and the asset would go back into the non performing category thereby defeating the main objective of IBC.

It is therefore imperative that all stakeholders including concerned regulators andthe Committee of Creditors ("CoC") adopt a mechanism that ensures that the approved resolution plan is best positioned to revive the asset. Accordingly, we have the following suggestions:-

- The selection of the resolution plan should be based on a combination of financial and qualitative metrics to ensure revival of the asset and, thereby, best returns to all concerned stakeholders. This is in line with the Quality and Cost Based System often used by public sector enterprises to award contracts.
- The qualitative metrics should include certain basic qualification criteria that all bidders should fulfil for their financial bids to be considered. Examples of such qualification criteria, which should apply to any applicant, its affiliates or any consortium to which they belong, include:-
    - Not being classified as a wilful defaulter or non-cooperative borrower at the time of the bid or the previous 5 years;
    - Not being barred from accessing the capital markets at the time of the bid or the previous 5 years;
    - Not being classified as a red flag account;
    - No adverse finding in any forensic audit conducted by the banks and should not be under any investigation of a lender or any governmental authority for diversion of funds in the previous 5 years;
    - No past history of financial weakness: Should have either (i) not restructured any debt in the last five years; or (ii) where any such restructuring has taken place in the last five years, the concerned person should have complied with conditions of restructuring.
- Some of the qualitative criteria that should be used to assess the resolution plan include:-
    - Bidder credentials: Competence and track record of the resolution applicant in running its own business and in turning around similar businesses acquired in the past. A high score should be assigned to the proposals submitted by applicants with a strong track record in the same business, a strong management team and a robust balance sheet.
    - Demonstrated ability to raise capital: The bidder and its or its promoters should have a demonstrable experience in raising finance for acquisitions and capital expenditure projects of a minimum stipulated amount which can be linked to the size of the amount required for restructuring the NPA in question.

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INDIA

- Synergies. The bidder or (in case of SPVs) its promoters should have demonstrable synergies with the target.
- Quality of the turnaround proposal: Based on details of the strategy, action plan and management team proposed by the applicant to revive the asset.
- Infusion of fresh capital: This is critical in distressed situations as the assets are struggling to revive operations due to shortage of cash for working capital needs, maintenance capital expenditure, stalled expansions etc.
- Upfront payment to the banks: This results in a permanent reduction in debt and creates liquidity for the banks in an otherwise stressed asset where recovery is uncertain.
- The debt regarded as sustainable in the resolution plan should be rated by an RBI-approved rating agency to ensure that the resolution plan in not simply postponing the problem of unsustainable debt, which cannot be serviced, into the future.

- A minimum qualifying score should be specified against the qualitative criteria; applications that fail to meet the minimum qualifying score should be rejected.
- The financial criteria should entail a comparison of the various proposals after adjustment for the risk associated with these proposals. This can be done by assigning a probability factor to the projected cash flows to the banks, possibly based on a credit rating of the proposals from a credit rating agency appointed by the Resolution Professionals/CoC.
- Detailed and objective criteria will also protect public sector banks and their officials from legal challenges based on any alleged arbitrary exercise of discretion.

Structured and objective evaluation criteria will ensure participation of serious resolution applicants which will be in the best interests of all stakeholders. The resolution plans approved using this criteria will result in quick revival of assets, freeing up liquidity for banks for further lending, increased economic activity, job creation, increased contribution to exchequer and will have multiplier effect on the associated economy. The re-rating of assets and upfront cash realization will also improve balance sheets of the banks, thereby lowering capital infusion requirement from the Government. Further, a quick and timely resolution to the stressed assets with positive outcome implemented in a transparent manner will improve India's "Doing Business" ranking thereby ensuring participation from global players and resultant capital inflows.

Given that several cases have already been admitted under IBC by the Hon'ble NCLT, it is imperative that these guidelines be framed at the earliest and be incorporated into the information memorandum being circulated to the potential resolution applicants.

We remain committed to the Government's cause of nation-building, and thank you for your kind consideration of our representations.

Thank You.

Warm Regards,

(D.S. Rawat)

Shri M.S. Sahoo
Chairman
Insolvency and Bankruptcy Board of India (IBBI)
7th Floor, Mayur Bhawan, Shankar Market,
Connaught Circus, New Delhi, Delhi 110001.

All nos. in INR Cr	Yr.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
Total Debt	2,000																					
EBITDA		175	184	193	203	213	223	235	246	259	271	285	299	314	330	346	364	382	401	421	442	464
Growth	5%																					
Realistic Resolution Proposal																						
Upfront cash settlement	***250***																					
Sustainable debt	***1,000***																					
Opening debt balance		1,000	900	800	700	600	500	400	300	200	100	-	-	-	-	-	-	-	-	-	-	-
Repayment	10 yrs	100	100	100	100	100	100	100	100	100	100	-	-	-	-	-	-	-	-	-	-	-
Closing debt balance	1,000	900	800	700	600	500	400	300	200	100	0	-	-	-	-	-	-	-	-	-	-	-
Interest	10%	95	85	75	65	55	45	35	25	15	5	-	-	-	-	-	-	-	-	-	-	-
NPV (as % of Total Debt)	**43%**																					
Debt/EBITDA	1	5.4x	4.6x	3.9x	3.2x	2.6x	2.0x	1.5x	1.0x	0.6x	0.2x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x	0.0x
Surplus/Shortfall in cash flows for debt service		(99)	(84)	(69)	(54)	(38)	(22)	(6)	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Opportunistic Resolution Proposal																						
Upfront cash settlement	***0***																					
Sustainable debt	***1,000***																					
Opening debt balance		1,000	900	800	700	600	500	400	300	200	100	-	-	-	-	-	-	-	-	-	-	-
Repayment	10 yrs	100	100	100	100	100	100	100	100	100	100	-	-	-	-	-	-	-	-	-	-	-
Closing debt balance	1,000	900	800	700	600	500	400	300	200	100	0	-	-	-	-	-	-	-	-	-	-	-
Interest	10%	95	85	75	65	55	45	35	25	15	5	-	-	-	-	-	-	-	-	-	-	-
Unsustainable debt	1,000																					
Opening debt balance		1,000	1,100	1,210	1,331	1,464	1,611	1,772	1,949	2,144	2,358	2,594	2,853	3,138	3,452	3,797	4,177	4,595	5,054	5,560	6,116	6,727
Repayment	Bullet in 21st yr	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	6,727
Closing debt balance	1,000	1,000	1,100	1,210	1,331	1,464	1,611	1,772	1,949	2,144	2,358	2,594	2,853	3,138	3,452	3,797	4,177	4,595	5,054	5,560	6,116	0
Accumulated interest	10%	100	110	121	133	146	161	177	195	214	236	259	285	314	345	380	418	459	505	556	612	336
NPV (as % of Total Debt)	**76%**																					
Debt/EBITDA	2A	11.4x	10.9x	10.5x	10.1x	9.8x	9.6x	9.4x	9.3x	9.3x	9.3x	9.6x	10.0x	10.5x	11.0x	11.5x	12.1x	12.6x	13.2x	13.9x	14.5x	7.6x
Surplus/Shortfall in cash flows for debt service		(99)	(84)	(69)	(54)	(38)	(22)	(6)	0	0	0	0	0	0	0	0	0	0	0	0	0	(6,472) 2B

1 Sustainable debt metrics

2A Unsustainable debt metrics

2B Grossly insufficient cash flow for debt service; unlikely to pass muster with credit rating agencies

Note: Net Present Value (NPV) is the discounted value of debt repayment at bank-specified discount rate