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# INSOLVENCY & RESTRUCTURING

## Monthly update | February 2020

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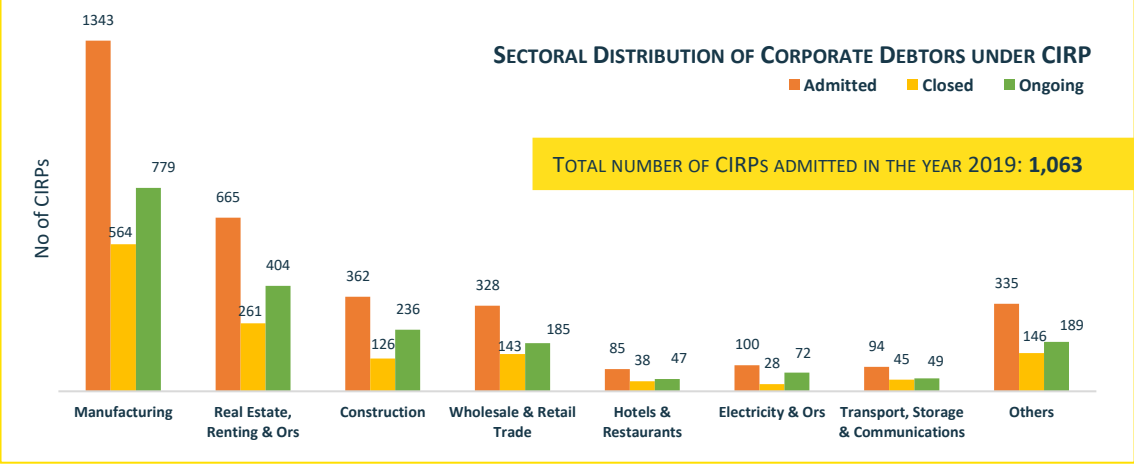
## CONTENT

# IMPACT OF IBC – DATA ANALYSIS

Considered as the biggest insolvency reform in India, IBC has had a multi-faceted impact on India Inc and significantly reduced the time taken to resolve debt-related situations as compared to earlier regime, besides instilling a heightened focus on governance, transparency, promoter rights, debt repayment and other attendant issues.

- The latest data put out by the IBBI, for the Oct-Dec 2019 quarter, underlines the growing concerns over the slow progress under the Code.

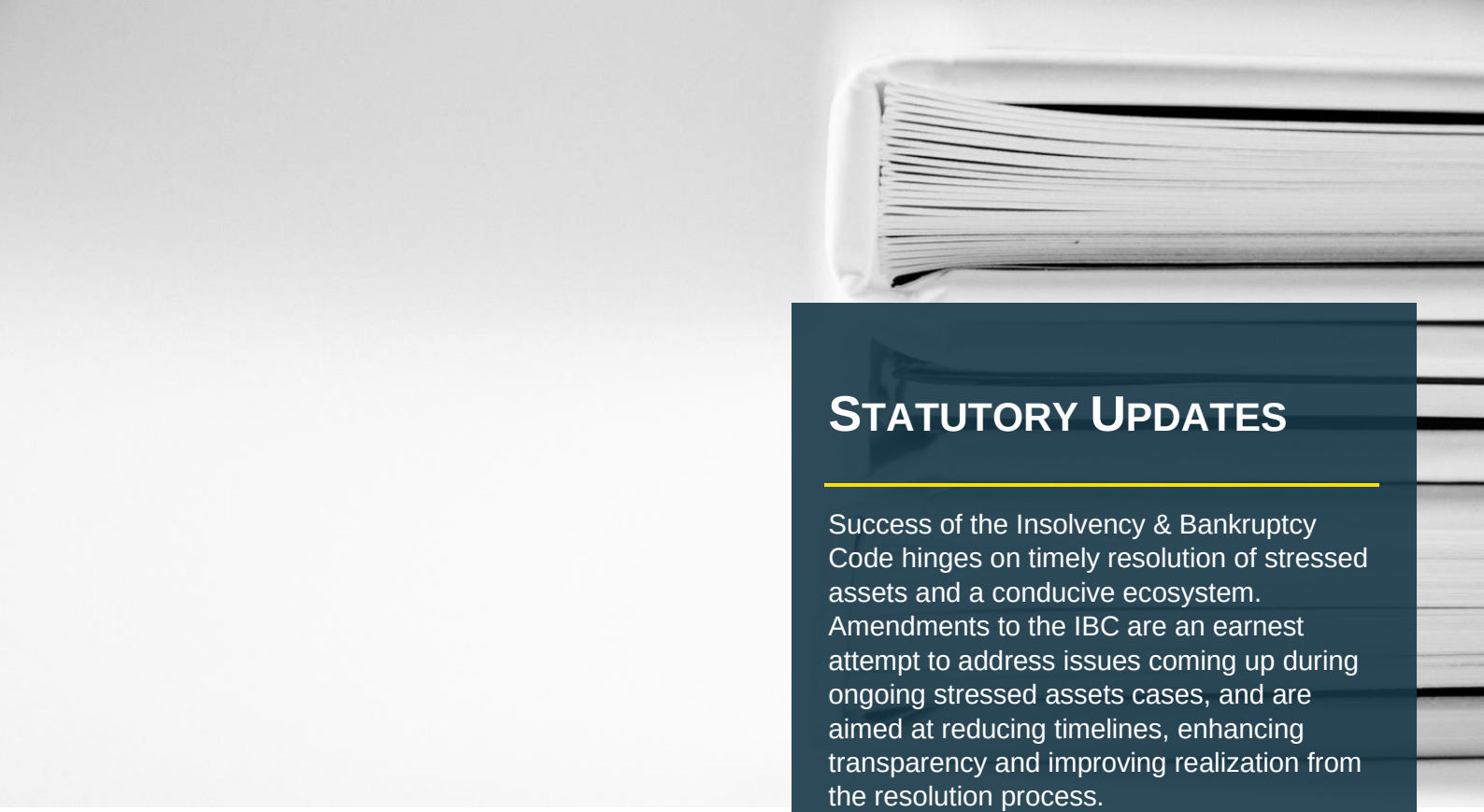



**Source:** IBBI Quarterly Newsletter (October, 2019 – December, 2019) and HSA Analysis

- **Cases admitted for corporate insolvency: 3312** (as on December 31, 2019)

| | |
|---|---|
| Ongoing cases | 1961 (59.20%) |
| Closed cases | 1351 (40.79%) |
| Cases headed for liquidation | 780 (from the closed cases) |
| Successfully resolved under the IBC | 190 (which is clearly a small portion of the total admitted cases) |

- Time taken for resolution of cases is an ongoing concern, with long delays leading to erosion in value of assets and majority of financial creditors realizing just 43.14% of the value in comparison to their claims
  - Of the 1,961 current cases, 635 (32.38%) have surpassed the mandated 270 days period
  - Average time taken for closure of CIRPs is around 394 days against the revised timeline of 330 days
  - Status of liquidation process too is sluggish: out of 780 cases, only 41 have been closed (725 are still on-going)
- The biggest challenge for IBC at present pertains to prolonged litigation. The recent amendment to complete resolutions within 330 days, including legal objections, has been stayed by the Supreme Court. While the Government's plans to introduce e-bidding to reduce the timeline, improve transparency and reduce potential litigation might provide some succor, the road ahead requires behavioral change amongst all stakeholders—creditors, debtors, bidders and the judiciary – for this statute to achieve its envisaged potential.



# STATUTORY UPDATES

Success of the Insolvency & Bankruptcy Code hinges on timely resolution of stressed assets and a conducive ecosystem. Amendments to the IBC are an earnest attempt to address issues coming up during ongoing stressed assets cases, and are aimed at reducing timelines, enhancing transparency and improving realization from the resolution process.

## INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (LIQUIDATION PROCESS) (AMENDMENT) REGULATIONS, 2020

- On January 06, 2020, the Insolvency and Bankruptcy Board of India (**IBBI**) notified the IBBI (Liquidation Process) Amendment Regulations, 2020 (Amended Regulations) and consequently, amended the IBBI (Liquidation Process) Regulations, 2016.
- The salient features of this amendment are as under:
  - Under the Amended Regulations, a person ineligible to submit a resolution plan in terms of the IBC would not be permitted to become a party to any agreement or compromise pertaining to the corporate debtor, proposed under Section 230 of the Companies Act, 2013.
  - Under Section 52 of the IBC, upon liquidation of a corporate debtor, a secured creditor has the option of standing out of the liquidation proceedings by choosing not to relinquish its security interest and by realizing its security interest under any other law. In terms of the amended Regulations, a secured creditor who proceeds to realize its security interest instead of relinquishing its security, would have to provide its share of the insolvency resolution process cost, liquidation process cost and workmen's dues of the corporate debtor within 90 days of the liquidation commencement date. Further, such secured creditor would have to provide the surplus (if any) of the realized value of the asset (over the amount of its admitted claims) within 180
  - Days of the liquidation commencement date. In case, the said secured creditor fails to deposit the aforementioned amounts within the specified timeframe, the asset(s) will become part of Liquidation Estate.
  - A secured creditor is under an obligation to not sell or transfer an asset of the corporate debtor, which is subject to a security interest, to any person ineligible to submit a resolution plan in terms of the IBC. A corresponding bar on the liquidator from selling assets to ineligible persons was already part of the IBC (Proviso to Section 35(1)(f) of the IBC).
  - As per the amended Regulations, prior to submitting an application for dissolution of the corporate debtor, the liquidator is required to deposit the unclaimed dividends, undistributed proceeds, if any, along with any income earned in the liquidation process, in a Corporate Liquidation Account which would be operated and maintained by the Board in the Public Accounts of India. The amendment also provides a procedure for a stakeholder to seek withdrawal from the said Account upon submitting the required evidence and satisfying the Board of his claim.

**Our viewpoint**: This amendment is quite significant in that it ensures that the control of the corporate debtor is not handed back to the persons who were responsible for the default in the first place.

The amendment *inter alia* bars certain persons, including the promoters of the corporate debtor, who are ineligible to submit a resolution plan under Section 29A of the IBC, from taking over the corporate debtor by way of Section 230 of the Companies Act, 2013.

However, it raises certain doubts regarding the secured asset returning to the liquidation estate as it is likely that third party rights are created on the asset in the interregnum, which will require clarification.

## INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (VOLUNTARY LIQUIDATION PROCESS) (AMENDMENT) REGULATIONS, 2020

- On January 15, 2020, the IBBI notified the IBBI (Voluntary Liquidation Process) (Amendment) Regulations, 2020 and amended the IBBI (Voluntary Liquidation Process) Regulations, 2016. The amended Regulations came into effect from January 16, 2020.
- Akin to the amendments made in Liquidation Process Regulations, the amended Voluntary Process Regulations provide that prior to filing an application for dissolution of the corporate debtor, the liquidator would be required to deposit the unclaimed dividends, undistributed proceeds, if any, along with any other income earned in the liquidation process in a Corporate Voluntary Liquidation Account which would be operated and maintained by the Board in the Public Accounts of India. A stakeholder is permitted to seek withdrawal from the said Account upon submitting the required evidence and satisfying the Board of his claim.

**Our viewpoint**: This amendment is a welcome step since it removes ambiguities in the liquidation process and provides for submission of the undistributed proceeds, unclaimed dividends and income of the corporate debtor in a separate account made for the said purpose.

## FINANCE BILL, 2020

- The Finance Bill was introduced before Lok Sabha on February 1, 2020. This included certain amendment to the Income Tax Act, that impact the taxation structure applicable to companies undergoing resolution under IBC.
- Amendment to Section 140 of the Income Tax Act, 1961
  - In terms of Section 140 of the Income Tax Act, 1961 (**Income Tax Act**), the income tax return in case of a company is required to be verified by the managing director of the company. If the managing director is not able to verify the return for any unavoidable reason or where there is no such managing director, then any director of the company can verify the return.
  - The proviso to Section 140(c) further provides that in case of a company, in respect of which an application for insolvency resolution process has been admitted by the Adjudicating Authority under the IBC, the income tax return would be verified by the insolvency professional appointed by such Adjudicating Authority.
  - Clause 67 of the Finance Bill, 2020 inter alia proposes an amendment to Section 140(c) of the Income Tax Act so as to enable any other person, as may be prescribed by the Central Board of Direct Taxes to verify the return of income in the cases of a company.
- Amendment to Section 288 of Income Tax Act, 1961
  - Section 288 of the Income Tax Act provides for persons entitled to appear on behalf of an assessee before any Income-tax Authority or the Appellate Tribunal, in the capacity of the assessee's authorized representative.
  - In this regard, it is relevant to mention that Section 25 of the IBC casts a duty on the Resolution Professional to represent and act on behalf of the Corporate Debtor with third parties, exercise rights for the benefit of the Corporate Debtor in judicial, quasi-judicial or arbitration proceedings. However, Section 288 of the Income Tax Act, though covering numerous situations, did not expressly provide for an insolvency professional to act as an authorized representative of the Corporate Debtor in proceedings before any Income-tax Authority or the Appellate Tribunal.
  - Consequently, by way of Clause 102 of the Finance Bill, 2020, it has been proposed that Section 288(2) of the Income Tax Act be amended so as to enable any other person, as may be prescribed by the Central Board of Direct Taxes, to appear as an authorized representative.
- This Finance Bill, and specifically the above introductions, which are set to become law on April 1, 2020, in our opinion would pave way for Resolution Professionals to act and appear on behalf of the Corporate Debtors before the Income-tax Authority or the Appellate Tribunal, without any procedural impediments.

# RECENT JUDGEMENTS

By interpreting, clarifying and sometimes even modifying the Insolvency & Bankruptcy Code, judgements and orders by courts and other fora have played an important role in the evolution of the Insolvency & Bankruptcy framework in India.

## NAVIN RAHEJA V. SHILPA JAIN AND ORS.

COMPANY APPEAL (AT) (INSOLVENCY) NO. 864 OF 2019

### Whether insolvency can be commenced against a real estate developer if default is on account of Force Majeure conditions?

- In this particular case, the Respondents had booked an apartment in a residential project being developed by Raheja Developers Limited. As per the terms of the Buyer's Agreement, the possession of the apartment was to be provided within 36 months from the date of the execution of the said Agreement subject to the 'Force Majeure' conditions.
- Due to delay in handing over the possession, the Respondents filed an Application under Section 7 of the IBC and the National Company Law Tribunal (**NCLT**), Special Bench, New Delhi, vide order dated August 20, 2019 initiated Corporate Insolvency Resolution Process (**CIRP**) against the Corporate Debtor, which was subsequently challenged by the Corporate Debtor by way of the present appeal.
- The primary issue before the National Company Law Appellate Tribunal (**NCLAT**) was that whether a Corporate Debtor can be held to have committed a default if the offer of possession of an otherwise ready premises was delayed due to reasons beyond the control of the Corporate Debtor?
- In the instant case, the Appellant (Chairman cum Managing Director of Raheja Developers Limited) contended that the delay was on account of non-availability of necessary infrastructure facilities being provided by the Government for carrying development activities, such as outside water discharge system by HUDA or State Government, for which the Corporate Debtor cannot be made responsible. Further, the occupation certificate by the Government/ Central Government/ Competent Authority was not given within time. Therefore, the delay was attributed to Force Majeure conditions.
- The NCLAT observed that a Corporate Debtor cannot be held responsible for delay on account of non-availability of necessary infrastructure facilities being provided by the Government for carrying development activities. Also, the Corporate Debtor offered the possession of the apartment on November 15, 2016 and obtained completion certificate immediately thereafter. Therefore, delay in granting approval by the Competent Authority cannot be taken into consideration to hold that the Corporate Debtor defaulted in delivering the possession. In light of this, the NCLAT set aside the order dated August 20, 2019 for initiating CIRP against Raheja Developers Limited.

**Our viewpoint**: This judgment comes at a time when there are a plethora of cases pending against real estate developers citing default in handing over possession of flats, apartments, etc. The instant judgment would help to weed out the cases where the default is not attributable to the real estate developer but certain other extraneous factors which are beyond the control of the developer, and consequently, would provide a fresh lease of life to such developers and would give them an opportunity to finish the project(s) on time. This, in our opinion, would be in the best interest of the homebuyers and the economy in general.

However, at the same time, the NCLT would be burdened with the task of ascertaining whether the cause of default was attributable to the real estate developer or not. Hence, to what extent the NCLT would delve in the facts, would ultimately determine whether the real estate developer goes into insolvency or not.

## MAHARASHTRA SEAMLESS LIMITED V. PADMANABHAN VENKATESH

CIVIL APPEAL NO. 4242 OF 2019

### Whether a Resolution Plan can be below liquidation value?

- In the present case, the NCLT, Hyderabad Bench, by an order passed on January 21, 2019 approved the resolution plan submitted by the resolution applicant, Maharashtra Seamless Limited (**MSL**) in CIRP of United Seamless Tubulaar Pvt. Ltd. The amount offered under this resolution plan was lesser than the liquidation value of the Corporate Debtor. Consequently, appeals were filed against the said order before the NCLAT, which were allowed vide judgment dated April 08, 2019 wherein it was held that the resolution plan was against the statement and object of the IBC and MSL was directed to modify its resolution plan. Aggrieved by this, MSL approached the Supreme Court by way of the present appeal.
- The main issue which the Supreme Court addressed was whether the scheme of the IBC permits a resolution plan below the liquidation value of the corporate debtor?
- The Supreme Court observed that there exists no provision in the IBC or Regulations under which the bid of any Resolution Applicant has to match liquidation value of the Corporate Debtor. Further, once a resolution plan is approved by the Committee of Creditors (**CoC**), the statutory mandate on the NCLT is to ascertain that the resolution plan meets the requirement of sub-sections (2) and (4) of Section 30 of the IBC thereof.
- The Court held that there was no breach in approving a resolution plan which offers less than the liquidation value of the corporate debtor.

**Our viewpoint:** The instant case would play a crucial role in increasing the autonomy of the committee of creditors to accept resolution plans which are even below the liquidation value of the corporate debtor (provided they are commercially viable). This is important at a time when there are not a lot of resolution applicants in the market due to which more and more corporate debtors are going into liquidation.

However, this would also mean that there is no compulsion on the resolution applicants to submit resolution plans which offer an amount which exceeds the liquidation value of the corporate debtor. Hence, this is a double-edged sword and its true effect would only be seen with time.

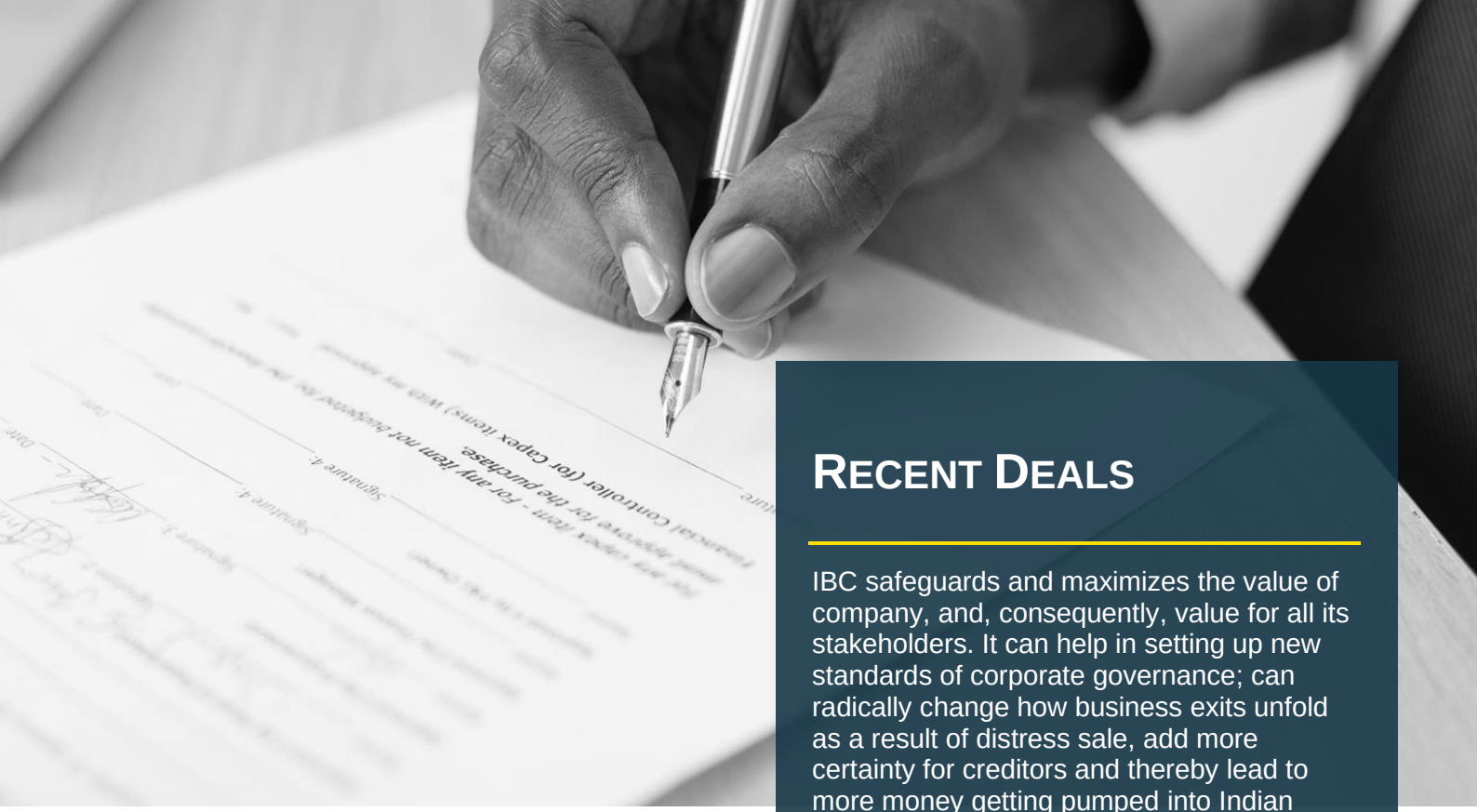
## M RAVINDRANATH REDDY V. G KISHAN AND ORS.

COMPANY APPEAL (AT) (INSOLVENCY) NO. 331 OF 2019

### Whether unpaid lease rentals are an Operational Debt?

- In the present case, the NCLT, Hyderabad Bench, admitted a petition filed under Section 9 of the Insolvency and Bankruptcy Code, 2016 against the Corporate Debtor, M/s Walnut Packaging Private Limited, in respect of purported non-payment of enhanced rent. Thereafter, the admission order was challenged before the National Company Law Appellate Tribunal.
- The primary issue raised before the NCLAT was whether a landlord by providing property on lease would be treated as providing services to the corporate debtor, and hence, an operational creditor within the meaning of Section 5(20) read with Section 5(21) of the IBC?
- The NCLAT observed that lease of immovable property cannot be considered as a supply of goods or rendering of any services and, thus, cannot be termed as 'Operational Debt'. It further observed that the lessor, who filed an application for recovery of alleged enhanced lease rent, cannot be treated as an 'Operational Creditor' within the meaning of Section 5(20) read with Section 5(21) of the IBC.
- In view of the above, the NCLAT set aside the order passed by the NCLT for commencement of CIRP of M/s Walnut Packaging Pvt. Ltd.

**Our viewpoint:** This judgment has come in the wake of contradictory judgments of different benches of NCLT wherein lease rentals were held to be operational debts in certain cases while they were held not to be operational debts in certain other instances. This judgment helps remove the ambiguity and clarifies that lease rental does not qualify as an operational debt.



# RECENT DEALS

IBC safeguards and maximizes the value of company, and, consequently, value for all its stakeholders. It can help in setting up new standards of corporate governance; can radically change how business exits unfold as a result of distress sale, add more certainty for creditors and thereby lead to more money getting pumped into Indian businesses.

## VEDANTA GROUP TAKEOVER OF FERRO ALLOYS CORPORATION

- Vide Order dated January 30, 2020, the NCLT, Cuttack approved the resolution plan submitted by Vedanta Group's Sterlite Power Transmission Limited in the Corporate Insolvency Resolution Process of Ferro Alloys Corporation Limited (**FACOR**), the Corporate Debtor. FACOR produces Ferro Alloys and owns a ferrochrome plant, two operational chrome mines and 100 MW of captive power plant through its subsidiary, Facor Power Limited.
- This resolution plan – approved by approximately 95% voting share of the CoC – provides for a consideration of INR 10 Crore as well as equivalent of cash balance in FACOR as upfront payment and zero coupon, secured and unlisted Non-Convertible Debentures of aggregate face value of INR 270 Crore payable equally over four years commencing March 2021 to the Financial Creditors.
- The takeover is a step taken in furtherance of Vendanta Limited's aim to become the world's largest long-life integrated zinc-lead-silver producer in two years while maintaining their cost leadership.
- It is relevant to note that in the instant case, the promoters of FACOR submitted a proposal for settlement under Section 12A of the IBC. However, the same was rejected by the committee of creditors on grounds of commercial viability. An appeal preferred by the promoters is pending before the NCLAT, which has reserved judgment on February 03,2020. However, there is no stay on the implementation of the Resolution Plan.
- Vide order dated July 06, 2017, the NCLT Kolkata ordered for commencement of CIRP against FACOR. This was a hotly contested case by all stakeholders, where the issue of filing of an insolvency petition against a Corporate Guarantor (without proceeding against the principal borrower) was held to be permissible by the NCLAT.

## ACQUISITION OF DHFL GENERAL INSURANCE BY FLIPKART CO-FOUNDER

- Mr. Sachin Bansal, one of the co-founders of Flipkart which was recently taken over by Walmart, has acquired DHFL General Insurance from Wadhawan Global Capital (**WGC**), the parent company that ran Dewan Housing Finance Limited (**DHFL**).
- Mr. Bansal's company BAC Acquisitions, now renamed Navi Technologies, has reportedly paid INR 100 Crore for 100% of the stake owned by WGC in DHFL General Insurance. It has further been reported that DHFL General Insurance has approximately INR 400 Crore in assets under management.
- Meanwhile DHFL (the parent company of DHFL General Insurance) is facing insolvency proceedings before the National Company Law Tribunal, for a debt of approximately INR 40,000 Crore. It is to be noted that DHFL is the first financial service provider against which insolvency proceedings have been initiated.

# SECTOR FOCUS: REAL ESTATE

## Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019

Real estate sector has been significantly impacted by the promulgation of IBC, more so the residential real estate segment. The recent amendment to IBC – the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 – has created certain thresholds for filing an application for initiation of insolvency proceedings in relation to a real estate project.

- Since its advent, there has been an ever-increasing number of homebuyers taking recourse to IBC to seek resolution and compel the project developers to uphold prior commitments, which contributed significantly to the open IBC cases pending before the NCLT.
- In order to address this situation, the Union Cabinet on December 24, 2019 approved the promulgation of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 and on December 28, 2019, the same received the approval of the President.
- As a result of this Amendment, an application for initiation of insolvency proceedings in relation to a real estate project can now only be filed by a minimum of 100 allottees or not less than 10% of the total number of allottees of the same real estate project, whichever is lesser.
- Constitutional validity of certain provisions of the above Ordinance was challenged before the Supreme Court of India. Vide Order dated January 13, 2020 in *Manish Kumar v. Union of India and Anr.*[1] the Hon'ble Supreme Court directed for maintaining status quo on the pending petitions filed by the homebuyers. This order does not clarify whether the Applications which would be filed henceforth would have to comply with the thresholds provided under the impugned Ordinance or not. Further, the said order does not mention whether the status quo order would extend to applications filed under Section 9 of the IBC or in cases where the applicants were promised 'assured returns' by the real estate developer. It is worth recollecting that allottees who were promised such assured returns were declared to be financial creditors by NCLAT in the *Nikhil Mehta/AMR* judgment, even before the amendment dated June 06, 2018 which classified all real estate allottees as financial creditors. In furtherance of this order, the NCLTs, in most cases, are simpliciter adjourning matters filed against real estate developers – including applications under Section 7 as well as Section 9 of the IBC – while they await the decision of the Hon'ble Supreme Court.
- In our opinion, the order dated January 13, 2020 would only apply to applications under Section 7 of the IBC, initiated by homebuyers against the real estate developers. Further, regarding the impugned Ordinance, we are of the opinion that the requirement of application for initiation of insolvency proceedings in relation to a real estate project being filed by a minimum of 100 allottees or not less than 10% of the total number of allottees of the same real estate project, whichever is less, is well intended since it would prevent multiplicity of proceedings against the same real estate developer and would prevent individual allottees to use the IBC as a tool for recovery of their dues, if any. Moreover, at a time when India's economy is in a precarious situation, this would provide much needed support to the real estate developers to meet their commitments towards the homebuyers.
- Interestingly, recently, the NCLAT has also held that insolvency cannot be commenced against any real estate developer, in cases where the cause of default is beyond the control of the developer. This judgment titled *Navin Raheja v. Shilpa Jain and Ors.* has been explained in greater detail in the "recent judgments" section.

[1] Writ Petition (Civil) No. 26/2020

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