AMENDMENT TO THE IBC – LEGISLATING FOR MORAL HAZARD WITH A BROAD BRUSH

Earlier today, the President of India promulgated an ordinance making certain amendments to the Insolvency and Bankruptcy Code, 2016 (‘IBC’). This ordinance had been approved by the Union Cabinet of Ministers yesterday.

The key change is the introduction of eligibility criteria for being a ‘resolution applicant’ which leads to the explicit prohibition of certain persons from submitting a resolution plan (and from such persons purchasing assets of a company in liquidation). It is believed that no other restructuring law in the world has provided such restrictive thresholds. The ordinance brings about these changes with immediate effect and these changes also apply for ongoing corporate insolvency resolution processes where the committee of creditors is yet to approve a resolution plan.

An applicant and any person acting jointly with the applicant who meets the following criteria are disqualified from submitting a resolution plan: (i) an undischarged insolvent; (ii) a willful defaulter as per norms laid down by the Reserve Bank of India, (iii) classified as a non performing assets for over one year unless it makes all overdue payments prior to submitting a resolution plan, (iv) convicted of any offence punishable with imprisonment for two years or more, (v) disqualified to act as a director under the Companies Act, 2013, (vi) prohibited by the Securities and Exchange Board of India (SEBI) from trading or accessing the securities market, (vii) indulged in preferential, undervalued or fraudulent transactions (and an order of the NCLT has been passed in this regard), (viii) has executed an enforceable guarantee in favour of a creditor for a company under IBC proceedings or liquidation, (ix) a person connected to the applicant who meets the criteria set out in (i) to (viii) above and (x) has been the subject of disability as per (i) to (ix) under any law outside India.

And ‘connected persons’ means: (i) any person who is a promoter or in the management or control of the resolution applicant, (ii) any person who is to be a promoter or in the management or control of business of the corporate debtor during the implementation of the resolution plan and (iii) holding company, subsidiary company, associate company or related party of a person referred to in (i) and (ii) above.

Over the last few months, there has been considerable discussion amongst various stakeholders as to whether certain persons (especially promoters or owner managers) are less desirable or potentially inappropriate resolution applicants. The IBC did not previously bar anyone from submitting a resolution plan. The Insolvency and Bankruptcy Board of India (‘IBBI’) amended certain regulations just over a couple of weeks ago requiring resolution plans to contain more information about resolution applicants’ negative markers. Those changes meant that the committee of creditors would need to consider that information closely and be careful before approving a resolution plan despite such negative markers.

The disqualification thresholds brought in by the ordinance however, rely on a longer and wider number of negative markers than the IBBI amendments. This ordinance seeks to end the debate, for now, on whether all promoters of stressed companies should be disqualified from bidding for their companies or
those promoters whose companies have suffered due to extraneous reasons should not be punished (indeed, all such promoters are now disqualified not only from bidding for their own companies but also any other companies in an insolvency resolution process and from acquiring assets in any liquidation process). Stakeholders are now querying whether in an attempt to prevent moral hazard, this amendment has now created a potential economic hazard: will the lack of strong promoter bids dilute the competitive process between the remaining resolution applicants and so, lower the recovery for lenders?

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