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IBC AMENDMENT – LEGISLATING FOR MORAL HAZARD WITH A BROAD BRUSH – TAKE 2

The President of India promulgated an ordinance on November 23, 2017 amending the Insolvency and Bankruptcy Code, 2016 ('IBC') ('Ordinance'). Please refer to our previous edition of Inter Alia update attached herewith (readers may benefit from a second read of our previous edition before considering this update). A key change brought in by the Ordinance was the introduction of eligibility criteria for resolution applicants with an express prohibition on certain persons from submitting a resolution plan for a corporate debtor in a corporate insolvency resolution process ('CIRP') and also preventing such persons from purchasing the corporate debtor's assets in liquidation.

Some market participants argued that these new eligibility criteria were too restrictive and may disqualify applicants whose participation in the IBC resolution process could be economically and strategically important for all stakeholders.

In this backdrop, a Bill was introduced in the Parliament ("**Bill**") on December 29, 2017 by Mr. Arun Jaitley, the Finance Minister, to replace the Ordinance. The Bill has now been passed by the Lok Sabha and the Rajya Sabha (Lower and Upper House of the Parliament respectively). When the Bill is approved and signed by the President of India and then notified, it will amend some of the provisions of the IBC recently introduced by the Ordinance. The key changes proposed are set out below:

1. **Who must be eligible?**

   The eligibility criteria for submitting a resolution plan under the Ordinance applied to the applicant or any person acting jointly with such person. The Bill requires that any person acting in concert with the applicant must also meet the eligibility criteria.

   While 'acting jointly' may have been interpreted to be restricted to a joint applicant or equivalent, 'persons acting in concert' will be interpreted to have a wider import. The interpretation of this phrase as used in other Indian laws will be referred to. Resolution applicants, insolvency professionals and members of committees of creditors will carefully consider this much expanded scope and eagerly await jurisprudence to clarify the reach of this term.

2. **Some disqualifications now time bound**

   The Bill clarifies that ineligibility on account of: (a) being a willful defaulter, (b) being disqualified to act as a director, and (c) prohibition by the Securities and Exchange Board of India from trading in securities or accessing the securities market, will only subsist as long as the person suffers from such 'deficiency' and not thereafter.

3. **Disqualification for being classified as a non-performing asset ('NPA')**

The Bill clarifies that in order to ascertain if one year has elapsed from classification of an account as an NPA (resulting in disqualification), the relevant look-back period will be from the date of the commencement of the CIRP of the corporate debtor. The interpretation of the language of the Ordinance was that the look-back period started from the date of submission of a resolution plan. This may help would-be-applicants that are involved with companies that have only recently become stressed.

The Bill clarifies that this 'disqualification' also applies to the promoter of the corporate debtor (whose account is so classified) and to anyone in management or control of the corporate debtor. Many stakeholders were already interpreting the language in the Ordinance to mean this. The clarification is, nonetheless, helpful.

The Ordinance indicated that any person affected by such 'NPA disqualification' may cure such ineligibility by making payments of all overdue amounts with interest thereon. The Bill clarifies this. There has been some suggestion in the Parliamentary debate on the Bill and speeches of Government officials that payment of overdue interest may be enough to avail of this cure. However, the text of the Bill which refers to "overdue amounts with interest" suggests otherwise and this now remains a matter left for interpretation by the relevant lenders.

The Bill also permits a resolution applicant who is otherwise ineligible due to this disqualification to remain an eligible resolution applicant if such person makes payment of the overdue amounts with interest within 30 days (or such shorter period permitted by the committee of creditors).

4. Preferential, undervalued or fraudulent transactions; and now extortionate credit transactions

The Bill clarifies that this 'disqualification' also applies to the promoter of the corporate debtor (in which such transactions took place) and to anyone who has been in management or control of such corporate debtor. Some stakeholders were already interpreting the language in the Ordinance to mean this. The clarification is, nonetheless, helpful. The Bill also adds extortionate credit transactions to the list of disqualifications.

5. Connected persons – now a global check with some exceptions

The Ordinance listed a number of disabilities in the context of Indian law. The Ordinance also listed any 'corresponding disabilities' under any foreign law as a relevant disability. This 'foreign disability' test did not seem to apply to connected persons under the Ordinance. The Bill will extend this 'foreign disability' test to connected persons also.

Under the Ordinance, connected persons included the holding company, subsidiary company, associate company or a related party of the relevant person. As all connected persons also need to pass the eligibility test, this became a challenge for some '*bona fide*' applicants. The Bill provides that the extension of connected persons to include holding companies, subsidiary companies, associate companies or related parties will not apply to a scheduled bank, a registered asset reconstruction company or a registered alternate investment fund.

6. Disqualifications in respect of Guarantors

The Ordinance disqualified any person who had executed an enforceable guarantee in favour of a creditor in respect of a corporate debtor under CIRP. This provision was recently interpreted by a Court to refer to guarantees which had been invoked but remained unpaid. The Bill seems to narrow

the scope of this disqualification – which may assist persons involved with corporate debtors that have become stressed more recently.

To conclude, the Bill seeks to reduce some of the rigour of the disqualifications contained in the Ordinance while raising the bar and widening the impact in other respects. The eligibility criteria remain restrictive and may end up disqualifying some key players.

Separately, on December 31, 2017 the Insolvency and Bankruptcy Board of India amended the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 and the Insolvency and Bankruptcy Board of India (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017 ("**Amendments**"). The Amendments clarify that the term "dissenting financial creditor" will also include financial creditors who abstained from voting for the resolution plan approved by the CoC. Many stakeholders were already interpreting the language in the IBC and the regulations to mean this (including in relation to payment of liquidation value to such creditors). The clarification is, nonetheless, helpful. Additionally, the Amendments (i) omit the requirement to state the liquidation value of the corporate debtor in the information memorandum; (ii) mandates all stakeholders to keep the liquidation value of the corporate debtor confidential; and (iii) provides for submission of resolution plan within the time given in the invitation for the resolution plans. Many members of the CoC were concerned that general publication of liquidation value could depress bids. This amendment attempts to alleviate this concern.