CORPORATE DEBT RESTRUCTURING IN INDIA: AN OVERVIEW OF THE SCHEME

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I. INTRODUCTION

The global financial crisis that paved its way into India in 2008 and 2009 shattered the financial health of the companies affected by a tightening of credit and weaker consumer demand. The non-performing assets ('NPAs') for banks were on the rise. The cases filed in the corporate debt restructuring cell ('CDR Cell') increased at a rapid pace. By the end of March 2009, thirty-four cases were filed with the CDR Cell as against the 10 filed at the end of the previous year. These cases were mainly from the textile and steel sectors that suffered highly because of a lag in exports. It went to show that companies were unable to deal with the high level of debt they had accumulated over time and such cases were an inevitable result of the same. Fortunately the Reserve Bank already had a mechanism in place and that too easily accessible,[1] whatever the effectiveness of it, for handling such a crisis. It was way early in 2001 that the Reserve Bank had developed or rather adopted guidelines for debt restructuring by corporate entities and the same were revised twice subsequently to overcome the insufficiency of the insolvency laws to address debt distress. Therefore, when it occurred to the companies that their debt structure was in a predicament, the Reserve Bank early move had put in place a mechanism that these distressed companies could look forward to in order to avoid a liquidation since their current situation was but a reaction to the global financial crisis.[2] The various facets of this mechanism need to be understood to appreciate the debt restructuring of corporate in India.[3]

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[1] Corporate Debt Restructuring Cell had launched its website in 2005, www.cdrindia.org providing information about itself for facilitation of restructure.

[2] CORPORATE DEBT RESTRUCTURING – AN UNDERSTANDING OF A NON-STATUTORY MECHANISM [2010] 96 CLA (Mag.) 1

[3] *Ibid.*

II. CORPORATE DEBT RESTRUCTURING: A GLANCE

It was in light of this that the Reserve Bank of India came up with the Corporate Debt Restructuring model in August 2001[4] providing detailed guidelines for establishing the corporate debt restructuring system. The present framework is provided by a November 2005 circular of the RBI.[5]

The model for corporate debt restructuring essentially has two elements- factual and legal. RBI is the regulatory body for most of the financial institutions and all banks. Also, the central government is either the sole or majority shareholder in most of them.[6] As the regulatory agency (with the backing of the majority/sole owner), the RBI can prod such financial institutions to become involved in the corporate debt restructuring exercise. Those financial institutions which are not regulated by the RBI, e.g. Life Insurance Corporation of India, General Insurance Corporation of India and its subsidiaries, Unit Trust of India but are important players, are allowed to join either on individual case to case basis or become general members.[7] Thereafter the members are bound together by the Inter-Corporate Contractual Agreement entered into by the members.[8] So the legal foundation of the agreement rests on the basis of Inter-Corporate Contractual Agreement, which has come about because RBI regulates the entities which are signatories to it.[9] In fact up to 2005, RBI was a member of the Corporate Debt Restructuring Standing Forum and oversaw some of the most important corporate debt restructuring cases and enabled and establishment of precedents for guidance in future cases.[10]

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[4] RBI Circular: Corporate Debt Restructuring (CDR) BP.BC. 15 /21.04.114/2000-01,Dated 23 August 2001.

[5] RBI Circular: Revised Guidelines on Corporate Debt Restructuring (CDR) Mechanism RBI /2005-06/ 206 DBOD.No.BP.BC. 45 / 21.04.132/ 2005-06, Dated 10 November 2005.

[6] RAJIV LUTHRA, THE CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA 323 (2007 Ed.)

[7] As these institutions are owned by the central government, they generally comply with the directions issued.

[8] P. T. Jyothi Datta, *Wockhardt on road to recovery*, (June 2012) Available at http://www.thehindubusinessline.com/companies/wockhardt-on-road-to-recovery/article3566202.ece (Last Visited at 25/11/2013)

[9] *Mechanism And Laws To Deal With Sickness In India*, Financial Restructuring and Its Impact On Corporate Performance In India Available at http://shodhganga.inflibnet.ac.in/bitstream/10603/4347/11/11_chapter%204.pdf (Last Visited on 24/11/13)

[10] *Supra* note 6.

A. Structure Of The Corporate Debt Restructuring Mechanism

The corporate debt restructuring mechanism system has a three-tier structure. At the top is the Corporate Debt Restructuring Standing Forum and its Core Group. At the second layer is the corporate debt restructuring Empowered Group and thereafter we have the Corporate Debt Restructuring Cell.

The *Corporate Debt Restructuring Forum* has as its permanent members Chairmen and Managing Directors of all banks, financial institutions such as the Industrial Development Bank of India, Industrial Finance Corporation of India and Chairman of Indian Bank Association.[11] The Life Insurance Corporation of India & Unit Trust of India can also participate in it. As the very structure and representative character of the Standing Forum suggests, this body is there essentially to lay down the policies and guidelines as to how the system of corporate debt restructuring should operate and thereafter review and monitor the programme.[12] As a policy making body it lays down the important parameters to be taken into account in restructuring e.g. minimum level of promoter sacrifice, maximum period to be taken into account for a unit to become viable, which complicated cases should get special treatment, etc.[13] The guidelines are also supposed to address the modalities for enforcement of the corporate debt restructuring mechanism, the time frame within which it should be done and as to how to deal with the operational difficulties which might be experienced inthe functioning of the Empowered Group. One important area of concern of the guidelines is ensuring that over optimistic projections (e.g. of capacity utilisation of the plant, future demand of products, price expected from the sale of products , margin of profit in operations, raw material availability, comparative national and international competitiveness) are not assumed while preparing or approving the restructuring proposals.[14] While the Corporate Debt Restructuring Standing Forum has to ensure the smooth functioning of the Empowered Group and Corporate Debt Restructuring Cell, there is a Core Group to guide and assist it in taking decisions relating to policy. The Core Group consists of Chief Executives of the financial institutions that have the greatest bearing on decision making because they are the biggest lenders and are associated with most of the big loans (Industrial

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[11] *Supra* Note 6

[12] A Ramaiya, Guide To Companies Act 4031 (17TH Ed., 2010)

[13] Rajiv Luthra, The Corporate Debt Restructuring Mechanism in India 323 (2007 Ed.)

[14] CDR Mechanism Available at http://www.cdrindia.org/aboutus.htm (Last Visited on 24/11/13)

Development Bank of India, State Bank of India, ICICI Bank Ltd., Bank of Baroda, Bank of India, Punjab National Bank and Chairman and Vice Chairman of Indian Banks Association). It is hoped that their wide-spread exposure would help in formulation of standards which will have a common thread through them.[15]

The next layer is the Corporate Debt Restructuring Empowered Group which finally decided on the specific cases of corporate debt restructuring as per the guidelines of the Corporate Debt Restructuring Standing Forum. Since its work consists of looking into specific individual cases, the composition of the Corporate Debt Restructuring Empowered Group will first of all have to necessarily reflect the lenders of the troubled debtor. It consists of executive director level representatives of financial institutions and banks which have an exposure to the debtor. The high level of representation is there so that they can take decisions on behalf of their financial institution/banks.[16] The RBI Circular issued in November 2005 also requires that the concerned creditor should authorize its chief executive officer and /or executive director to decide on the restructuring packages. In addition, so as to maintain a continuity in the discussion/decision making process and also speed it up, the same person is required to represent the creditor in the Corporate Debt Restructuring Empowered Group meetings. For guidance of the creditors the Corporate Debt Restructuring Empowered Group also consists of representatives (executive level) of Industrial Development Bank of India, ICICI Bank and State Bank of India as they bring their experience in corporate debt restructuring proposals and because most of the proposals generally involve them.[17]

The *Corporate Debt Restructuring Empowered Group* first of all looks into the preliminary reports of arequest for restructuring submitted to it by the Corporate Debt Restructuring Cell. Only after it ascertains that the restructuring its prima facie feasible and the enterprise has the potential to become viable as per policies and guidelines of the Corporate Debt Restructuring Standing Forum, will a detailed restructuring package be worked out by the Corporate Debt Restructuring Cell with the help of the lead institution (usually the major creditor to the

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[15] *Genesis of CDR Mechanism* Available at http://www.caclubindia.com/forum/genesis-of-cdr-mechanism-in-india-212887.asp#.UpQ7-tJHIhs(Last Visited on 24/11/13)

[16] RAJIV LUTHRA, THE CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA 323 (2007 Ed.)

[17] R GOODE, COMMERCIAL LAW 510 (ED. E. MCKENDRICK, 2010)

enterprise). When the restructuring package is submitted to the Corporate Debt Restructuring Empowered Group, it will after examining the viability and chances of rehabilitation of the enterprise decide on the package within a time span of ninety days of reference to Corporate Debt Restructuring Cell. IN some cases, for sufficient reasons, the time span may be extended to 180 days. To decide on whether the time span should be increased or not, the Corporate Debt Restructuring Empowered Group will have to take into account certain parameters, applied individually taking into account each enterprises' circumstances and peculiarities. The Corporate Debt Restructuring Empowered Group while deciding on the viability of restructuring has to take into account parameters like the return on capital employed, debt service coverage ratio, gap between internal rate of return and cost of fund and the extent of sacrifice entailed and proposed. The decision of the Corporate Debt Restructuring Empowered Group will be final and shall be taken on the basis of exposure. So those who are secured or unsecured creditors, or who have provided term loan or working capital finance are on the same footing. Seventy five percent of creditors by value and 60 percent of them by number have to vote in favour of the restructuring for it to pass.[18]

The *Corporate Debt Restructuring Cell* is the first step in the restructuring exercise. It has staff on deputation from participating banks and financial institutions, but there is no prohibition on taking outside professional help. The costs are met by contributions by members of the Corporate Debt Restructuring Empowered Group, which within one month to be feasible, then the Corporate Debt Restructuring Cell, and the lead institution or major creditor to the enterprise will work out a plan within 30 days with the help of other creditors and experts. It is based on this proposal that the final decision is taken by Empowered Group.[19]

B. OPERATION OF THE CORPORATE DEBT RESTRUCTURING MECHANISM

The benefit of this mechanism is not available to those cases where there is only one creditor bank or financial institution. This is because the concerned creditor can in any case enter into a compromise with the defaulter and there is no need to bind the other creditors to the arrangement. Thereafter, it is at present applicable only to those cases where the exposure of

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[18] CDR Cell Available at http://www.cdrindia.org/cdrcell.htm (Last Visited on 24/11/13)

[19] RAJIV LUTHRA, THE CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA 323 (2007 Ed.)

banks and financial institutions is more than INR 100,000,000.[20] The reason being that it is these cases which present a threat to the financial system and also the costs involved in working out the package and it implementation be justified. Cases which are with the Board for Industrial and Financial Reconstruction are not eligible to be considered under the system, so as to prevent conflict with the Board for Industrial and Financial Reconstruction, which also deals with the case on the basis by and large. But the Core Group can recommend exceptional large value corporate debt restructuring cases for consideration on a case to case basis though the package can be implemented only after getting approval of the Board for Industrial and Financial Reconstruction. Those corporate, which had in the past been found to be indulging in fraud or malfeasance, even if only with one bank or financial institutions, are not eligible to be considered. The operation of the system involves the creditor waiving off his rights so as to enable repayment for an entity which is finding it difficult to repay due to genuine reasons. The system should not operate in a manner so that it creates a moral hazard of deliberate default so as to get concessions from creditors.[21] The Core Group, however, can relax in those cases where it is satisfied that the concerned debtor was classified as a willful defaulter, in a non-transparent manner and he can repay the loan if he is given an opportunity under the corporate debt restructuring system. But it is worth noting that there is no necessity that the company be sick or be in default or an account be a non-permanent asset for reference to the corporate debt restructuring system.[22]

For reference to corporate debt restructuring system of a concerned company/enterprise all that is required is that either creditor or creditors, having a minimum 20 percent by value exposure to the debtor enterprise's working capital loans or term loans, refer it to the system or they support the application by the debtor for consideration. At the time of reference the debtor enterprise has to enter into a debtor-creditor agreement.[23] In addition to contractually binding them to the future restructuring proposal upon their approaching the system, with necessary enforcement and penal clauses, the debtor-creditor agreement also has a stand still clause which

[20] CDR empowered Group Available at http://www.cdrindia.org/empgroup.htm (Last Visited on 24/11/13)

[21] RAJIV LUTHRA, THE CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA 323 (2007 Ed.)

[22] . CDR Core Group Available at http://www.cdrindia.org/coregroup.htm (Last Visited on 24/11/13)

[23] *Suzlon completes corporate debt restructuring*,(April 2012) Available At http://www.thehindubusinessline.com/companies/suzlon-completes-corporate-debt-restructuring/article4653113.ece (Last Visited on 25/11/2013)

is binding for 90 days or 180 days as the case may be, on both the parties.[24] The stand still clause prevents the parties from taking recourse to any legal action (other than criminal action) during the said period so that restructuring exercise takes place without any outside intervention. The directors of the referred company are not supposed to resign from the board of directors during this period and the debtor also agrees that the period of limitation on all relevant matters and documents is extended by the duration of the period.

III. VARIOUS RESTRUCTURING OPTIONS/METHODS EMPLOYED IN CORPORATE DEBT RESTRUCTURING SYSTEM

The corporate debt restructuring system has three different aspects broadly i.e. promoter sacrifice, creditor sacrifice and creditor's assistance. The system requires the creditors to forsake some of their rights and money. But before this is done or is agreeable to them, the concerned promoter of the company (who are the final beneficiaries) and shareholders are required to sacrifice as well. The various

Sacrifices are in the form of reduction in share capital, changing the composition of the share capital from pure equity to equity and preference with the latter being redeemable at a long date (under 20 years) with only a notional divided (.01 per cent) being paid on them, conversion of debt due from company to the promoter as equity or preference share, bringing in of additional capital by the promoter or merging the company with an another healthy profit making company controlled by the promoter.[25] The methods of extricating sacrifice from the promoter enumerated here are not exhaustive. But from the sacrifice entailed from the promoters, what is analysed is whether the promoters are keen and interested in revival of the unit as the creditors or whether the promoters are more free riders.[26] The sacrifice also ensures that the moral hazard of

[24] CDR Standing Forum Available at http://www.cdrindia.org/standingforum.htm (Last Visited on 24/11/13)
[25] Abhijit Lele, *Corporate debt restructuring cases to come under scanner,* (September 2013) Available at http://www.business-standard.com/article/companies/corporate-debt-restructuring-cases-to-come-under-scanner-113090600859_1.html (Last Visited at 25/11/2013)
[26] *Corporate Restructuring and Insolvency* Available at http://www.caclubindia.com/articles/corporate-restructuring-and-insolvency-16079.asp#.UpQ4wNJHIht (Last Visited on 24/11/13)

indifferent/bad managements being rewarded with better and more lenient deals due to the operation of the corporate debt restructuring system is taken care of.[27]

The second aspect f the corporate debt restructuring system is the sacrifice by the creditors. It ca entail extension of the repayment period of the existing debt and rescheduling it, reduction of the high interest charged on loan (either the interest rate might be lowered uniformly for the full amount or the loan might be divided in two parts), deferring the interest charged o loan or taking up zero coupon bonds in lieu of part of it, converting part of debt or accrued interest into capital of the company either as equity shares or cumulative redeemable preference shares(sometimes the promoter or promoter group company is required to guarantee its representation of future returns, i.e. internal rate of return on capital employed, by providing that it will buy the converted equity shares at a particular rate in future whenever offered to it) and waiver of penalty. The package usually will be an amalgamation of the above with the weightage given to different components/methods taking into account the peculiarities of the case.[28]

The third aspect of corporate debt restructuring system is provision of additional finance that may be required by the concerned corporate that is to be revived. Here, the corporate debt restructuring system discriminates between the types of debtors referred to it. Category 1 corporate debt restructuring scheme is applicable where the concerned account is a standard[29] or sub-standard account[30] (it is of this category if it is so in the books of minimum 90 per cent of creditors by value). Since, the account is standard or sub-standard and 75 per cent of creditors by value have agreed, it is perceived that further lending to the concerned company is not that risky. So all creditors, whether working capital or term finance lenders, if there is in package any provision for additional finance , have to provide loan at a prorate basis. Of course, they can arrange for a new or existing lender to take up their commitments.[31] In case the concerned creditor is not the one which has voted for the proposal, then it also has the option of not

[27] RAJIV LUTHRA, THE CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA 323 (2007 Ed.)

[28] Supra note 27.

[29] As per RBI's Master Circular dated 1 July 2005 on Prudential norms on Income Recognition Asset Classification and Provisioning pertaining to Advances ('Prudential Norms'), if arrears of interest and principal are paid by the borrower in the case of loan accounts classified as non-performing, the account should no longer be treated as non-performing and may be classified as 'standard' accounts.

[30] As per Prudential Norms, a sub-standard asset would be one, which has remained non-performing for a period less than or equal to 12 months.

[31] RAJIV LUTHRA, THE CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA 323 (2007 Ed.)

providing the additional finance.[32] But to ensure that the concerned creditor does not have the free rider advantage, in lieu of it, it will have to forego the first year's interest payable as per the restructured package and it will be paid, without compounding along with the last instalment of the principal.[33] It not only entails a small financial price but also means the uncooperative bank or institution will be prevented from cleaning up its book for a year more. Category 2 corporate debt restructuring system is for those accounts which are classified as doubtful. In such cases, there is no requirement that under the package, the existing creditors shall provide any additional financial. It will be for the creditor to arrange it.[34]

Lastly all corporate debt restructuring which are approved will give a right to the debtor to prepay the credit and to the creditors to accelerate the payment.

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[32] Jain. *Existing CDR cases to face review test: Takru*, (June 2013) Available at http://www.business-standard.com/article/companies/existing-cdr-cases-to-face-review-test-takru-113090600120_1.html (Last Visited at 25/11/2013)

[33] *Supra* note 30

[34] *Report of the Working Group to Review the existing prudential guidelines on restructuring of advances by banks/financial institutions*Available at http://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=676 (Last Visited on 23/11/13)

IV. LIMITATIONS OF THE INDIAN LEGAL SYSTEM FOR RECOVERING THE DEBT DUE FROM DEBTORS

The Indian legal system is based on the premise that between the creditor and the debtor it is the former who is in the driver's seat and can, and usually does drive a hard bargain. So the focus of the legal system has been to provide checks in the ability of the creditor to enforce an unreasonable contractual term which may be the result of unequal bargaining power. In addition to this handicap, enforcement of creditor's rights were subject to normal delays present in the Indian legal system.

Insolvency and liquidation proceedings were quite drawn out, and in an industrial undertaking, by the time an asset was disposed neither the economy nor the creditor gained anything. Usually due to deterioration or pilferage of the assets of the company during the time of the proceedings, a productive asset was forever lost. Due to this the Sick Industrial Companies Act, 1985 ('Sick Industrial Companies Act') was enacted.

A. SICK INDUSTRIAL COMPANIES ACT

Under the terms of Sick Industrial Companies Act, the Board for Industrial and Financial Reconstruction was constituted.[35] The Board for Industrial and Financial Reconstruction is a quasi-judicial body. If and when an industrial company becomes sick, its board of directors is required to make a reference to the Board for Industrial and Financial Reconstruction within 60 days for it to determine and decide the measures that may be taken to revive the company. A sick company has been defined in the Act as one which has accumulated losses equal to or more than its net worth.[36] Thus in effect, the Board for Industrial and Financial Reconstruction was given jurisdiction over manufacturing companies that were insolvent. If a reference has been made by the directors of a company to the Board for Industrial and Financial Reconstruction, its creditors were disallowed from pursuing any recovery or any other Reconstruction is sized of the matter.[37]

[35] A RAMAIYA, GUIDE TO COMPANIES ACT 4031 (17TH ED., 2010)

[36] See Section 2(o) of the Sick Industrial Companies Act(1965).

[37] RBI's Revised Guidelines on Corporate Debt Restructuring (CDR) Mechanism Available at http://www.rbi.org.in/upload/notification/pdfs/67158.pdf (Last Visited at 3/11/2013)

Though, the Board for Industrial and Financial Reconstruction is supposed to recommend measures for the revival and rehabilitation of the company only with the consent of the parties, the requirement of Board for Industrial and Financial Reconstruction proceedings and the oversight became a means by which the debtors many a times sought to delay the creditors. It became another clog in the liquidation process and unfortunately, the misuse of it by the debtors meant that success in revival and rehabilitation were few and far between.[38]

Due to definition of the term 'sick',[39] the very jurisdiction of the Board for Industrial and Financial Reconstruction related to companies that were insolvent and not just financially challenged due to temporary losses or cash flow problems.[40] This definition of 'sick' in the Sick Industrial Companies Act prevents any intervention by the Board for Industrial and Financial Reconstruction until the accumulated losses have made any meaningful rehabilitation as impossibility.[41] Moreover, for a company which is technically insolvent, for a viable revival solution to emerge, the creditors have to be in a position to dictate, otherwise it merely hands over to the debtor an additional bargaining chip. It is not just the creditor, but also the debtor who has to take cuts.[42] One of the favourite means which were usually sought to be adopted by the Board for Industrial and Financial Recons truction was seeking a White Knight i.e. an outside investor who would buy out the company or its majority owners.[43] But this usually was resisted by the group in control as loss of control usually entitled a loss of privileges associated with the control.[44] This continued control, over an entity which in any case was technically insolvent,

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[38] RAJIV LUTHRA, THE CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA 323 (2007 Ed.)

[39] Section 2(o) of the Sick Industrial Companies Act states that a 'sick industrial company' means an industrial company (being a company registered for not less than 5 years) which has at the end of any financial year accumulated losses equal to exceeding its entire worth.

[40] Nagesh Kini, *Economic malaise in India and corporate debt restructuring* (September2012) Available at http://www.moneylife.in/article/economic-malaise-in-india-and-corporate-debt-restructuring/27642.html (Last Visited at 26/11/2013)

[41] Nimrit Kang and Nitin Nayar, The Evolution of Corporate bankruptcy Law in India (October 2003- March 2004) ICRA Bulletin- *Mercy & Finance* 44. The few cases of success usually relate to disposal of real estate at historical book value in Company's books, in spite of the appreciation in the value during the intervening decades to raise the cash revival.

[42] R GOODE, COMMERCIAL LAW 510 (ED. E. MCKENDRICK, 2010)

[43] Tanvi Varma, *A Perfect Reboot* (August 2013) Available at http://businesstoday.intoday.in/story/stocks-of-companies-in-recasting-debt-cdr-give-good-returns/1/197166.html (Last Visited on 24/11/13)

[44] Karthikeyan Sundaram, *Kingfisher Woes Show Need for Bankruptcy Law: Corporate India* (November 2012) Available athttp://www.bloomberg.com/news/2012-10-31/kingfisher-woes-show-need-for-bankruptcy-law-corporate-india.html (Last Visited at 25/11/2013)

meant that the role of the controlling group could in the intervening period be more of a scavenger and thus worsen an already bad situation.[45]

B. INDIAN COMPANIES ACT, 1956 ('COMPANIES ACT')

The second method to deal with the problem of distressed companies was provided in the Companies Act modelled on the English Companies Act. The Companies Act governs the setting up and governance of the companies that are formed and registered under it.[46] Chapter V of the Companies Act provides the framework under which compromise and arrangements can be proposed between a company and its creditors. Such compromise and arrangements between the company and the creditor are however required to be sanctioned by the High Court with the jurisdiction.[47] The Companies Act also provides for the procedure for winding up of companies, in case the company is unable to pay its debts, and this can be voluntarily or pursuant to a court order.[48]

V. LEGAL ASPECTS OF THE CORPORATE DEBT RESTRUCTURING MECHANISM

The legal basis of the corporate debt restructuring mechanism is not based on any statutory provision.[49] The RBI has come out with guidelines on it and has provided suitable carrots for the acceding banks. First of all, all the major financial institution and all banks are part of the Inter Creditors Agreement, which has necessary enforcement and penal clauses. This agreement oversees that banks adhere to what was agreed.[50]

Thereafter, the debtors are governed by the Debtors Creditors Agreements entered into. Now the RBI envisages that the debtors be required to, at the time of original loan documentation

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[45] Report of the Working Group to Review the existing prudential guidelines on restructuring of advances by banks/financial institutions, Available at http://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=676 (Last Visited 25/11/2013)

[46] RAJIV LUTHRA, THE CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA 323 (2007 Ed.)

[47] Patrick Bolton, Toward a Statutory Approach to Sovereign Debt Restructuring: Lessons from Corporate Bankruptcy Practice around the World *IMF Staff Papers* (2003) **50,** 44 Available at http://www.palgrave-journals.com/imfsp/journal/v50/n1s/abs/imfsp200325a.html (Last Visited at 25/11/2013)

[48] ROY M. GOODE, PRINCIPLES OF CORPORATE INSOLVENCY LAW 283 (2011)

[49] RAJIV LUTHRA, THE CORPORATE DEBT RESTRUCTURING MECHANISM IN INDIA 323 (2007 Ed.)

[50] ROBERT PARRINO, PETER MOLES & DAVID S. KIDWELL, FUNDAMENTALS OF CORPORATE FINANCE 575 (1ST ED., 2011).

itself to accede to the debtors creditor agreements. Though the inter creditor agreements are valid for three years, however of the RBI wants, it can have the agreement renewed. The provisions for corporate debt restructuring in future debtor creditor agreements means that even if Inter Creditor agreement is not renewed, the system may continue on the basis of an enforceable debtor creditor agreement.[51]

In addition the Reserve Bank of India has sought to provide some carrots in form of treatment of assets on the balance sheet.[52] For this purpose the RBI has also sought to ensure that it does not become a source of window dressing by banks or financial institutions. So corporate debt restructuring benefit with regard to assets classification and write offs and provisioning will be available only if certain conditions are fulfilled. So first of all restructuring benefit with regard to asset classification and write offs and provisioning will be available only if certain conditions are fulfilled.[53] So first of all restructuring of the company should have been done for the first time only. The second condition is that unit should become viable in seven years and repayment period for restructured debts should not exceed ten years. The third requirement is that promoter's sacrifices in the form of writing off of loans from group companies, reduction of capital etc, additional funds brought by them should atleast 15 percent of the sacrifice made by the creditors. Lastly the CDR requires that promoters should give personal guarantee except where the unit is affected by external factors like economic down turn or something which affects the concerned industry. It is t note that CDR is not barred in cases which do not come within the above. Only the palliatives to banks will be unavailable.

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[51] S. WESTON, J. MITCHELL, R. MULHERIN, TAKEOVER, RESTRUCTURING AND CORPORATE GOVERNANCE, 26 (4TH ED. 2012)

[52] Supra note 49

[53] Thomas Laryea, Approaches to Corporate Debt Restructuring in the Wake of Financial Crises an IMF Staff Position Note delivered on January 26, 2010 Available at http://www.imf.org/external/pubs/ft/spn/2010/spn1002.pdf (Last Visited on 23/11/2013)

VI. DEBT RESTRUCTURING MECHANISM IN UK AND MALAYSIA

UK – Debt restructuring was introduced in the UK and all other countries only modified the same to apply it to themselves, like in India. The Legislature and courts have shifted to procedures other than insolvency proceedings.[54] In the UK company voluntary agreements ('CVA') and the London Approach are used as tools for the same. With the introduction of the Insolvency Act, 1986, traditional liquidation was given various alternatives which favored reorganization of the juristic persons which was considered to be a better financial outcome than liquidation.[55] It was the Cork Committee who first noted that rescue remedies were better than liquidation.[56] CVA procedure was created by the Insolvency Act. Thus, it has a statutory bearing unlike in India. It provided a mechanism for companies to go for a rescue attempt before insolvency. It was meant to do away with formalities of the scheme of arrangements entered into between corporations and their creditors.[57]

PURPOSE OF CVAS*:* CVAs are used to formulate a scheme to pay off the creditors at a later point of time or dispose of assets to pay off creditors. The purpose of a CVA has been highlighted as a regime to be flexible and additional to liquidation in case of a corporate insolvency.[58] CVAs are restricted to viable businesses which are adequately financed and preconditions such as cash flow, profit and good credit control systems are required. These CVAs as the name suggests are binding due to the contractual arrangements. CVAs in certain cases have the concept of a moratorium, that is, a "legally authorised ban or delay" or "a temporary prohibition of an activity, a legal authorisation to debtors to postpone payment". This is like a one-sided stand-still clause which the Reserve Bank scheme envisages. The company, in a CVA, has a blank canvas whereby it can make any offer to the creditors. The creditors should be satisfied of the offer made by the debtors as to the dividends such that the offer is better than alternative remedies. Generally, the company reserves money aside for the creditors lent by a

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[54] Andrew Keay, "What Future for Liquidation in Light of the Enterprise Act Reforms" [2005] JBL 143.

[55] M Hunter, "The Nature and Functions of a Rescue Culture", [1999] JBL 49.

[56] "Insolvency Law and Practice", Report of the Review Committee. HMSO, 1982. Cmnd 8558 (Cork Report).

[57] Doyle & Keay, Insolvency Legislation : Annotations and Commentary, Bristol : Jordans Publishing Ltd, 2006, p.21

[58] Inland Revenue v. Wimbledon [2004] EWCA Civ 655.

third party or by sale of assets, from which dividend will be paid to the creditors in full satisfaction of the debts owed.[59]

LONDON APPROACH*:* The 'London Approach', on the other hand, is closer to the Indian CDR and is probably the mechanism that Reserve Bank has tried to adopt in India with modifications. It is a framework by the Bank of England in 1990 which is non-statutory and informal. It deals with restructuring of companies by a temporary support operation from lenders.[60] It came into existence because the Bank of England found the Insolvency Act to be insufficient for saving the viable companies. Like CDR in India, it is mainly concerned with actions between the announcement of the problem and the restructuring over a long-term. With the increase in overseas subsidiaries, the approach encourages adoption of similar procedures outside formal insolvency procedures. Like in the CDR in India, it is only a broad framework and not a set of rules.[61] The standstill rules also exist. Thus, the London Approach is very similar to the Reserve Bank's CDR.[62]

MALAYSIA: In Malaysia, CDR is prevalent. There also it is believed that preservation of the company's business as far as possible is more desirable than insolvency procedures.[63] Similar to the Indian scenario, a corporate debt restructuring Committee ('CDRC') was set up. But the operations of the CDRC were shut down in 2002 after a financial crisis was over. There may be plans to get CDRC back as the recession has hit Malaysia too. Like the RBI, the Central Bank of Malaysia initiated this mechanism. The CDRC's objective is to facilitate the restructuring of large corporate debts.[64] Thus, it is clearly similar to the London Approach and the Indian CDR mechanism. It supervises negotiations between the creditors, banks and debtors and mediated the same as well. In Malaysia also the arrangement is informal, has no binding legal

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[59] Dr. K. C. Chakrabarty, *Corporate Debt Restructuring- Issues and Way Forward*, Corporate Debt Restructuring Conference 2012 (August 11, 2012) Available at http://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=716 (Last Visited on 23/11/13)

[60] *Supra* note 2

[61] Corporate Debt Restructuring Mechanism, Available at http://www.assocham.org/events/recent/event_791/S2_YC_Jain.pdf (Last Visited at 26/11/2013)

[62] Mr. Ashok S. Luhar, Mr. Hiresh S. Luhar Mr. Hitesh G. Suthar *Corporate Debt Restructuring Mechanism in India* IV(2)Variorum Multi-Disciplinary (November 2013)

[63] Aishah Bidin, "Insolvency and Corporate Rescues in Malaysia", International Company and Commercial Law Review, ICCLR 2004, 15(11), 344-355.

[64] *Supra* note 2

status. The eligibility requirement of more than one financial institution and a minimum debt exposure amount also exist here. Thus, the Indian and Malaysian CDRs are almost identical. The difference between India and Malaysia is the three-tier system that exists in India which is the RBI's original innovation. The drawback in the Malaysian mechanism is the absence of a standstill clause like in India or the London Approach.[65]

VII. CONCLUDING REMARKS

It is pertinent to note that in 2005, Y V Reddy (the Governor of Reserve Bank then) had in his speech said that this mechanism of CDR serves as a platform for banker-corporate interface. Also, the fact that over a hundred cases have been approved for restructuring under the system goes to show the efficacy of it.12 This scheme proved to be quite a boon for the Indian market with the advent of the recession and the scheme saw an enormous response which continues till date. The Reserve Bank has constantly made changes to this scheme and the self-restricted approach of being only the regulator and not interfering with the restructuring cases is a commendable feat of the Reserve Bank. Although this scheme is currently vital in light of the recessionary conditions that hit India, every scheme has its own drawbacks. A debt restructuring is a huge event which has many chances of failures like in the recent case of Subhiksha Trading Services Ltd, a retailer, hit a dead-end in its attempt at CDR when the consortium of banks could not submit the proposal on time even after an extension. One possible reason of this failure was the retailer's non-cooperation with the auditor appointed by the consortium, which gave rise to questions of good faith. In an out-of-court, non-statutory and flexible mechanism such as CDR, if any possibility of bad faith creeps in, it can blemish the whole process which is otherwise for the good of the corporation and looks to save an otherwise collapsing entity. Also, the fact that CDR is informal, it may be prone to weaknesses such as large secured creditors may dominate the negotiations with the company while unsecured creditors may not be consulted. Another drawback is that when the debt restructuring is underway the first reaction of the creditors is to make certain that the company pays the current debts and, therefore, the creditors hold on to all applications for new credit. Lastly, the sensitivity of the public to any information clearly reflects from the fluctuations of the stock market and, therefore, when such a case of a company applying

[65] CORPORATE DEBT RESTRUCTURING – AN UNDERSTANDING OF A NON-STATUTORY MECHANISM [2010] 96 CLA (Mag.) 1

for CDR comes to public knowledge they would shift from this company thinking that it is close to bankruptcy. Discounting these minor drawbacks these informal mechanisms that give a chance to the companies to mend their ways and save them from bankruptcy are here to stay.

It should be kept in mind that corporate debt restructuring was introduced by the RBI in 2001. In the approximately five years of its functioning 175 accounts involving INR 817,160,000,000 have been referred to corporate debt restructuring system. Many of these units have turned around, so in a way it can be said that corporate debt restructuring system has been helpful in arresting and to some extent reversing the ballooning of non-performing assets in the balance sheets of the banks. But it should be remembered that one of the reasons for the smooth running and relative success of the mechanism has been that almost all the big lenders except ICICI bank were owned or controlled by the government. In future, as the corporate bond market grows and different funds or financial intermediaries neither owned or controlled by the government nor regulated by RBI, play an increasingly important role, the corporate debt restructuring mechanism might face problems. These new players, together with individual investors might not be willing to agree to the reduction in their dues not to lend further cash. There might even be cases where there is another regulator which prohibits further lending. So while the success of corporate debt restructuring has prompted the RBI to envisage its continuance in future, the evolution of Indian capital and financial markets might not make its operation as smooth in future and one may have to revert to the Companies Act to resolve the problems.

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