Why bankruptcy ordinance may need more fine-tuning

Last week, the government promulgated an ordinance to amend the Insolvency and Bankruptcy Code, 2016, which effectively tightens the screws around unscrupulous promoters to regain control of their companies, once they are forced to file for bankruptcy.

Simply put, the new rules bar willful defaulters, whose accounts have been classified as 'non-performing assets' for more than one year, from trying to regain control of their bankrupt companies.

Experts say that this should put the brakes on promoters trying to wrest back control of their debt-laden companies from bankruptcy courts, not only at rock bottom valuations, but with a drastically reduced loan burden, after creditors take a significant haircut. Moreover, a stricter regime should also dissuade promoters from over-leveraging their balance sheets.

While statistically there is no available data on the number of such cases, Ayush Rajani, partner at MDP & Partners, said that in three out of 10, or 30%, cases, promoters would win back control of their firms. "After the new amendment, this could come down to, say, one in 10 cases."

To be sure, however, the ordinance does not impose a blanket ban on promoters bidding to get back control of their companies. Promoters who have not been declared willful defaulters and do not have an NPA account, will not be barred.

Having said that, experts say that several key legal aspects have either not been addressed in the ordinance or have been completely overlooked. MS Ananth, senior member, international litigation and dispute resolution, at law firm Nishith Desai Associates, said the new law overlooks certain compliance issues vis-a-vis the Competition Commission of India (CCI) and the Securities and Exchange Board of India (Sebi).

For instance, Section 6 of the competition act mandates a firm working on a takeover to notify the CCI if the merged entity's turnover crosses a certain threshold, Ananth said, adding that there could be some conflict if the target company happens to be a distressed asset and the IBC is invoked.

Ananth also felt that the ordinance did not address critical issues related to exemptions by Sebi, capital gains or carry forward of losses.

Nidhi Singh, director, legal and regulatory affairs at the New Delhi-based International Business Advisor, agrees. Yet another aspect that has been overlooked is the one related to the Foreign Exchange Management Act, which regulates external trade and payments, she said.

Rajani, however, had a different take. “IBC is a complete code by itself, and it supersedes everything that is parallelly affecting any such prosecutions or proceedings, except for the criminal party,” he said. “Any resolution plan is completely within the powers and provisions given under the IBC. End power, in any case, lies with the financial creditor, because they are the ones who have to take the haircut.”

Rajani said that capital gains, if any, will also be applicable, although for the most part, assets would be sold at a loss. “So, the question of capital gains may not necessarily arise.”

Legal experts, however, said that edging promoters out from the bidding process could impact valuations. “That is the biggest worry for the creditors,” added Rajani.

“There are two sides to the valuation question. One, is a requirement under the IBC. So, the moment a process is initiated two valuers will have to be brought on board. Two, the valuation would depend on whether one is valuing an asset from the perspective of liquidation, or as a growing concern.”

According to him, liquidation would translate into rock bottom valuation, but if one values it as a growing concern, other aspects, such as goodwill, could also come into play to arrive at the right valuation.

Singh of International Business Advisor, however, said that India’s insolvency laws will need a fair bit of fine tuning, going forward, and the new norms is only first step towards ushering in a viable bankruptcy law.

“When there is a new regulation, things are ambiguous, and things have to be streamlined. The regulation has to be very specific to the territory we are in. We are currently in the first phase and are just starting to get into the second,” she said, adding that the second phase will have to follow a process to make a resolution plan. “So, issues such as the conflicting guidelines between CCI and Sebi would come up, and will be addressed.”