HERBERT SMITH FREEHILLS

# RESTRUCTURING, TURNAROUND AND INSOLVENCY E-BULLETIN

CONTACTS SHARE

## Issues arising under the Indian Bankruptcy Code – an international perspective

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It is timely, with further reform of the new Indian Bankruptcy Code (**IBC**) in prospect, to outline our thoughts on some of the current issues on which various market participants have requested an understanding of the approach and learnings of overseas practitioners.

In this note we identify six issues which have come up in our recent discussions and on which we offer our thoughts and experiences. In respect of each issue we will provide a short summary of the approach taken in the United Kingdom (**UK**), and then we will offer a comment which is based on our (admittedly subjective) experience and knowledge of the current position under Indian law but which is intended as a constructive contribution to the ongoing debate as to whether, and if so how, to refine the Indian legal and regulatory provisions further.

These are the issues we will address in turn:

- Should the resolution professional be an individual or an incorporated entity (e.g. company, limited partnership or other partnership entity)?
- Should the law permit the disposal of viable businesses and assets as part of a resolution plan rather than emphasizing the survival of the corporate debtor in question?
- How best to “whitewash” liabilities predating the commencement of the corporate insolvency resolution process (**CIRP**) in a resolution plan (those liabilities being actual, future, contingent, known or unknown at that date and thereafter)?
- What approach to take in relation to legal, governmental or regulatory approvals necessary during the CIRP for the continuation of the business and then necessary for the implementation of the resolution plan?
- Should the role and accountability of the resolution professional be adjusted in any way to ensure consistency of his or her role and responsibilities with the interests of the whole creditor community?

- What is the most effective way of investigating antecedent transactions for the benefit of the whole creditor community?



## The resolution professional – individual or firm?

### UK position

An administrator or liquidator must be an individual who is qualified and licensed to act as an insolvency practitioner.

Generally at least three administrators or liquidators from the same firm will be appointed on each large matter and work together to ensure there is adequate bandwidth.

The individual appointees generally are partners or directors in the large accounting and advisory firms. The firm will then make available to the individual appointees the large numbers of staff and resources required to deliver a complex restructuring with the cost of those staff (and the cost of other advisers such as lawyers and valuers retained by the administrator or liquidator) being a priority claim in the administration or liquidation.

To give the individual appointees comfort that they will not bear the sole risk in relation to the appointment (i.e. that firms will take the risk as well as the reward), firms will also generally indemnify each insolvency practitioner in respect of liabilities arising from appointments taken whilst working at the firm. Insolvency practitioners and the firm will also have appropriate insurance arrangements in place.

### Comment

It is likely that a firm will be equally effective as a resolution professional as an individual. Such a change would require being satisfied that appropriate arrangements were in place to regulate firms in addition to individuals. We would also expect that to the extent the intention is to invite the larger accounting and advisory firms to take appointments, it will be necessary to clarify the resolution professional's liability so that this risk can be understood, quantified and firms can make an informed commercial decision as to whether to seek appointments (including developing an insurance market so firms and individuals can seek appropriate cover).

In conjunction with any such changes, we also note that it is more important that the resolution professional, whether an individual, partnership or firm, has sufficient resources that they can call on so ensure appropriate expertise and staff are available

to run an effective process. There is a link here to our comments in paragraph 5 (Should the role of the resolution professional be expanded?) below, and the creditors' committees must accept the cost implications of deploying appropriate resources in this way.

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## Should the focus of CIRP be survival of viable businesses rather than survival of the corporate debtor?

### Position in UK

The primary purpose of administration is to rescue the company as a going concern. Administrators will exercise their judgment to determine whether this is possible. If not, an administrator is able to act quickly and decisively and will usually prioritise deal certainty – even where that means the company is not rescued as a going concern. Courts are generally supportive of administrators' exercising their own commercial judgment. The key is delivering the best outcome for creditors. Where all or part of a business is sold by way of an administration asset sale, there is some protection for employees by way of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246) (known as TUPE) which provide that, subject to certain exceptions, the employees associated with that part of the business which is being sold, and their rights under employment law, automatically transfer to the buyer.

### Comment

Whilst it is a matter of policy for each country, the UK insolvency regime focuses on maximizing value for creditors. Generally, this means identifying the viable elements of a debtor's business and finding a way to allow that business to flourish (whether by way of sale to a new vehicle leaving non-viable parts of the business with the debtor or implementing a restructuring of financial creditors only). The outcome for creditors is more important than the mechanism used and therefore, in our view, the CIRP should contain sufficient flexibility to focus on either rescue of the debtor as a going concern or enabling the viable parts of the business to survive, which may result in a hive down structure as we discuss below. However, as we note further on, this is more complex in India at present due to the lack of a regime under the IBC to deal with approvals. If as a matter of policy it is important that employees have a level of protection, whether from the corporate debtor or as part of the transfer of all or part of the business to the buyer, then this can be provided for in the CIRP.

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## Leaving behind unwanted liabilities

### Position in UK

English law has detailed rules that provide for all "provable debts" in an administration or liquidation to rank pari passu. There is a lot of detail on the precise meaning of provable debts but, in high level terms, it relates to a liability whether actual, contingent or prospective as at the date the administration or liquidation started.

Where the company is rescued as a going concern, all of these provable debts are paid in full (plus interest).

Where they cannot be paid in full, the options for an administrator or liquidator are either:

a. seek to compromise and release those liabilities using a scheme of arrangement or company voluntary arrangement (known as a **CVA**) so that the debtor can be sold as a going concern – usually the CVA or scheme offers creditors a higher return than they would receive absent the release and this payment is funded by the incremental additional value to the buyer in acquiring shares rather than assets;
b. sell the assets of the company and distribute the recoveries to creditors in accordance with the priority of payments. As this is an asset sale, the purchaser has no liability for the provable debts or any other liabilities of the vendor (i.e. the corporate debtor) unless it agrees otherwise; or
c. we have the flexibility to transfer assets to a new SPV and then sell to that SPV, which achieves the same effect as in paragraph (b) above.

**Comment**

The broad scope of a resolution plan means that it can be used in a similar way to an English CVA or scheme of arrangement so that it compromises and releases existing debts – in return for a payment where appropriate. This can "clean up" historic liabilities to allow the corporate debtor to be sold as a going concern. This would be particularly attractive to buyers (therefore maximizing price) where the third party consents required to deliver an asset sale are difficult to deliver.

As far as we are aware, a number of resolution plans have sought to compromise existing liabilities in order to facilitate a sale of the debtor as a going concern. It is to be hoped that some form of emerging practice develops in how the various resolution plans define these compromised liabilities, possibly drawing on settled English law concepts of provable debts and the approach in English law CVAs and schemes of arrangement.

Critical to the success of such compromises will however be the approach of:

a. domestic Indian Courts in enforcing compromises contained in resolution plans. Currently we would expect buyers (and any providers of new debt or equity finance) to price in an element of uncertainty into the effectiveness of the resolution plan compromises. If Indian Courts uphold these compromises then it would remove some of the uncertainty associated with this new technology and therefore maximize value; and
b. international Courts in the context of a resolution plan that purports to compromise non-Indian law governed debts. Where overseas Courts refuse to give effect to compromises of non-Indian law governed debts and the debtor (or guarantors or other relevant parties) have material assets in that overseas jurisdiction then this may undermine in practice the effectiveness of resolution plans. An example of such an approach would be overseas Courts applying the rule in *Antony Gibbs and Sons v La Société Industrielle et Commerciale des Métaux* (1890) LR 25 QBD 399. The likelihood of overseas Courts taking this approach would need to be assessed on a jurisdiction by jurisdiction basis. This links to the broader issues associated with the cross-border recognition and enforcement of the CIRP.

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## Approvals required during CIRP and to achieve resolution plan once approved

### Position in UK

The key approvals required to deliver an offer will be assessed by the administrator as part of deciding which bid to accept. Generally, an administrator will prioritise deal certainty so a buyer will need to show that it can deliver any key approvals. In certain circumstances, the underlying approvals may be capable of being expedited where the parties can show that there is genuine commercial urgency – for example, regulatory bodies such as The Pensions Regulator have stated that they will seek to respond to clearance applications more quickly in such circumstances.

### Comment

The practical issue for the CIRP is that the rigid timeframe for a restructuring gives little time to obtain necessary approvals. It is therefore likely that resolution plans will be required to be submitted with little (if any) engagement from any of the bidders, the corporate debtor and resolution professional with the third parties whose approvals may be required to implement fully the restructuring. This makes it harder for bidders to raise the necessary committed financing (whether debt or equity) in order to submit the best bid possible. This is likely to result in fewer and/ or lower offers and therefore a less efficient process.

There are broadly two approaches to addressing approvals in the CIRP:

a. some form of expedited approach for obtaining approvals built into the CIRP – for example, a statutory provision disapplying any change of control events on a sale of either a corporate debtor or its assets under the CIRP; or
b. identifying (to the extent you are able) the key approvals proving challenging (such as competition law or tax) and amending the underlying process for obtaining that approval to enable a fast track process where an approval is sought in connection with a resolution plan.

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## Should the role of the resolution professional be expanded?

### Position in UK

The administrator or liquidator owes duties to creditors as a whole. The administrator or liquidator has full control of the process and will drive the restructuring with a view to maximizing value for creditors. The administrator or liquidator is subject to the ultimate oversight by the Court – although generally only on the application of the administrator/liquidator, creditor or an interested party rather than the Court taking an active day to day role.

The effect of this clear position is that a competitive market has developed where insolvency practitioners compete to deliver the best outcome for creditors.

### Comment

This to our mind would be a most worthwhile improvement to the position in India. It is not clear whether the resolution professional owes duties to the committee of creditors (**CoC**), all creditors, the promoters (whether or not there is equity value), or the

corporate debtor itself. The result of this lack of clarity is that there is no single focus for the resolution professional that empowers them to drive the process towards their commercial assessment of the best objective.

It seems to us from cases we have observed that an effect of this is that the resolution professional acts very cautiously and relatively (compared to a foreign insolvency officer) passively. He deposits significant volumes of (unfiltered) information in a dataroom, invites proposals without offering a view as to the structure of a proposal that the resolution professional thinks is most likely to maximise value (in part because the resolution professional has neither the time nor the resources to understand the business they are trying to sell), he puts the plans before the CoC for them to decide without, so far as we are aware, any recommendation or comparison of the various resolution plans. The process effectively runs as a significant and complex piece of M&A (running within the CIRP process) with a very passive seller. Bidders do not at the moment receive enough guidance as to evaluation criteria and methodology to prepare (or perhaps to be willing to prepare) a compelling bid.

A significant constraint on expanding the role of the resolution professional is probably fees – since an active resolution professional driving the process will be significantly more expensive than the CoC appear willing to approve. This would require a change in approach from CoCs in recognising that paying money up front to a skilled and properly resourced resolution professional who is clearly acting only in the interests of all creditors is likely to deliver a better outcome.

Clarifying duties will also help to maximise learning from other markets where, for example, advisers are well-versed in delivering the best outcome for creditors. Overseas advisers brought on to assist with a resolution process will be able to advise holistically and transfer their skills from other markets.

An expanded and empowered resolution professional should result in higher bids as will the bidding community as they will have more deal certainty through greater clarity and understanding of how their bids are to be received and evaluated. Bidders should therefore be able and more willing to commit time and resource to an outcome without fearing it a waste of time or money.

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## Investigation of antecedent transactions

### Position in UK

Administrators and liquidators are obliged to assess whether there are transactions that can be challenged and/or claims brought against directors or former directors. Similarly, they are required to provide a report on the directors' conduct to the Secretary of State for Business, Energy and Industrial Strategy – who may then decide to launch a separate investigation and bring disqualification proceedings. Such an investigation can run in parallel to the challenge by an administrator or liquidator of antecedent transactions.

Administrators and liquidators will generally first look to sell the viable business to maximise value and then investigate claims (although where there are serious concerns these will likely be done in parallel). Together with the ability of officeholders to incentivise management and a generally weaker grip of promoters over

management in the UK, this means that administrators and liquidators face fewer challenges investigating businesses, and the fact that they have that responsibility does not hinder them in running the business or achieving a sale.

**Comment**

Challenging antecedent transactions is frequently a piece of complex litigation. This takes information and documents (often from a number of jurisdictions), resources to analyse documents and information, and time to formulate and bring legal proceedings. Concerns we have heard expressed in relation to the current situation in India are that the investigation by resolution professional is a tall order in the time available at the same time as the resolution professional is expected to run an unfamiliar business and invite offers. In particular, there is a tension in running the business with management – who will retain close links to the promoters – whilst at the same time investigating the debtor's dealings with the promoters.

An alternative is to have a properly funded government agency (potentially the Ministry of Corporate Affairs (**MCA**)) to have some responsibility for investigating directors and promoters. The resolution professional can distribute proceeds of action or assist in recovery process but regulatory body/ministry to be responsible for investigation itself. The CIRP could replicate some aspects of the English law and require the resolution professional to report to the MCA on their initial investigations so that there is coordination, but the resolution professional would be freer to get on with his or her job.

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