# The Restructuring Review

Seventh Edition

Editor
Christopher Mallon

Law Business Research

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# The Restructuring Review

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# THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW

THE RESTRUCTURING REVIEW

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

THE DISPUTE RESOLUTION REVIEW

THE EMPLOYMENT LAW REVIEW

THE PUBLIC COMPETITION ENFORCEMENT REVIEW

THE BANKING REGULATION REVIEW

THE INTERNATIONAL ARBITRATION REVIEW

THE MERGER CONTROL REVIEW

THE TECHNOLOGY, MEDIA AND
TELECOMMUNICATIONS REVIEW

THE INWARD INVESTMENT AND
INTERNATIONAL TAXATION REVIEW

THE CORPORATE GOVERNANCE REVIEW

THE CORPORATE IMMIGRATION REVIEW

THE INTERNATIONAL INVESTIGATIONS REVIEW

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THE INTERNATIONAL CAPITAL MARKETS REVIEW

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# EDITOR'S PREFACE

I am very pleased to present this seventh edition of *The Restructuring Review*. As with the previous editions, our intention is to help general counsel, government agencies and private practice lawyers understand the conditions prevailing in the global restructuring market in 2014 and 2015 and to highlight some of the more significant legal and commercial developments and trends that have been evident in recent years, and that are expected to be significant in the future.

In many jurisdictions the general economic trends are now more positive than they have been for many years. Against this background, the trend of diminished large-scale restructuring activity has continued in many markets. This picture may suggest a global economy in robust health after the long and difficult years of recession but it would be naïve to think that stability has returned for the long term as several warning signs remain.

First, the dramatic growth of high-yield issuances of past years may lead to unknown consequences further down the road. In the United States, 2012 and 2013 were each record years for high-yield issuance, and across the Atlantic this market is finally achieving a similar stage of development. At the time of writing, total European high-yield issuances for 2014 had already surpassed the annual totals for every year before 2013, and Credit Suisse was forecasting a record level of issuances for the year. As has happened in the past, it is inevitable that such large increases in economic activity will include inappropriate or unfortunate deals, the effects of which will need to be unpicked in future years with the help of restructuring professionals. The same will no doubt apply to the surge in M&A activity that has recently been observed in many developed economies.

A further factor to note is the continued employment of unorthodox monetary policy by many central banks. There remains considerable uncertainty as to the broader economic effects when quantitative easing is unwound and when interest rates return nearer to the long-term average; many commentators expect that when the monetary tide retreats many businesses that until now have managed to conceal their weaknesses may be left dangerously exposed.

With the above in mind, and taking into account also the stresses that continue to lie beneath the surface in the eurozone and some worrying signs of instability in the emerging economies, only the very brave would forecast a prolonged period of calm for the global economy. As such, this work continues to be relevant and important, in particular as a result of the international nature of many corporate restructurings.

I would like to extend my gratitude to the contributors from some of the world's leading law firms who have given such valuable support and cooperation in the preparation of this work, and to our publishers, without whom this Review would not have been possible.

**Christopher Mallon**
Skadden, Arps, Slate, Meagher & Flom (UK) LLP
London
August 2014

## Chapter 10

# INDIA

*Nilesh Sharma and Sandeep Kumar Gupta*[1]

## I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

The outlook for the Indian economy has improved over the past two months with cautiously positive business sentiments, improved consumer confidence, expectations of a modest recovery in growth and decline in inflation expectations.

The liquidity situation in the industry continued to remain tight as the Indian corporate sector witnessed relatively a subdued performance during 2013/14 as evidenced by the continuing contraction in net profits and decline in net profit margin.

Since March 2011, non-performing assets (NPAs) of the banks have been increasing; at the end of December 2013, the gross NPAs of the domestic banking system were 4.4 per cent of gross advances. The total stressed assets in the banking system (which includes NPAs and restructured standard assets) at December 2013 made up 10.13 per cent of the gross advances of the banks. Gross NPAs at 30 September 2013 stood at 2,290.1 billion rupees, which was 27 per cent higher than the 1,799 billion rupees at 31 March 2013 (for the 40 listed banks) NPAs for the Indian banking system are likely to deteriorate further in 2014 as a large number of restructured advances are likely to slip into the NPA net.

Due to the continued domestic slowdown and the liquidity crisis, there has been a surge in matters being referred to the Corporate Debt Restructuring (CDR) Mechanism or Board for Industrial and Financial Reconstruction (BIFR) for restructuring. The increase in cases of distressed advances is also attributable to the global recession, reckless lending by some banks in the past, improper monitoring of borrowers' accounts, high interest rates, power shortages, etc. The increased numbers have stressed the Indian

1 Nilesh Sharma is a partner and Sandeep Kumar Gupta is an associate partner at Dhir & Dhir Associates, Advocates & Solicitors.

banking system and in the event the economic situation does not improve, the health of the Indian banking sector may be very adversely affected.

In January 2014, the RBI permitted the securitisation companies (SCs) and asset reconstruction companies (RCs) to convert their debt into shares of borrower companies, subject to a 26 per cent equity cap. Pursuant to the incentives granted to the SCs and RCs by the RBI and the increased pressure on the banks from the regulators and government to reduce NPA levels, asset reconstruction players aggressively acquired non-performing loans from banks.

Due to increased deterioration in asset quality, the restructuring of corporate loans is on the rise in India, and the rising level of debt restructuring is a cause for concern for the banking sector and the economy as a whole.

As per the latest performance report of the CDR Cell,[2] as at 31 March 2014 the number and value of restructuring cases referred to the CDR Cell speaks volumes about the surge in the number of cases of deteriorated debts. The rising number of CDR cases does not augur well for the banking sector as also for corporate.

| | *No. of cases* | *Aggregate debt (million rupees)* |
|---|---|---|
| Total cases approved (including cases withdrawn/exited) | 476 | 3,304.4 |
| Cases rejected/closed | 111 | 575.4 |
| Cases under finalisation of restructuring packages | 35 | 420.1 |
| **Total references received** | **622** | **4,299.9** |

Source: CDR Cell – Progress Report as on 31 March 2014.

## II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

### i Insolvency law and security enforcement law

There is no single comprehensive and integrated corporate insolvency law in India that would address the needs of an entity in distress. The insolvency and restructuring framework in India is guided by the following four major legislative Acts:

*a* Companies Act 1956;[3]
*b* Sick Industrial Companies (Special Provisions) Act 1985 (SICA);[4]

2 www.cdrindia.org/cdrcell.htm.

3 The Act is soon to be scrapped because the Companies Act 2013 has been enacted and 283 Sections of the same have already been notified in the Official Gazette of the Government of India, and are applicable from 1 April 2014. The remaining sections of this Act (including the provisions related to arrangement and compromise and winding up) are yet to be notified. The same shall become effective from the date the same are notified in the Official Gazette of the Government of India.

4 The SICA (Repeal Act) 2002 has already been passed, but it has still not been notified. The Repeal Act will come into effect from the date it is notified in the Official Gazette. of the Government of India and thereafter the Revival and Rehabilitation of Sick Companies will be

*c* The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI); and

*d* The Recovery of Debts due to Banks and Financial Institutions Act 1993.

***Companies Act 1956***

Chapter V of the Companies Act 1956 lays down the law relating to 'arbitration, compromises, arrangements and reconstructions' of companies in India. Said chapter contains the provisions for the compromises, arrangements and reconstructions between the company and its creditors and shareholders. Salient provisions of the said Chapter relating to compromises and arrangements are summarised below.

Where a compromise or arrangement is proposed between a company and its creditors, or between a company and its members, the company court having jurisdiction[5] may, on application of the company or of any creditor or member of the company (or in the case of a company that is being wound up, of the liquidator) order a meeting of the creditors, or of the members (as the case may be) to be called, held and conducted in such manner as the court directs. If a majority in number representing three-quarters in value of the creditors or members agree to any compromise or arrangement, it will be binding if sanctioned by the court.

The court will not sanction any compromise or arrangement unless it is satisfied that the company, or any other person by whom an application for winding up has been made, has disclosed all material facts relating to the company to the court, such as the latest financial position of the company and the latest auditor's report on its accounts.

From the application until the completion of proceedings, the court is empowered to stay the commencement or continuation of any suit or proceeding against the company on such terms as it thinks fit. The court also has the power to supervise and monitor the implementation of any sanctioned compromise or arrangement, and may also modify it if necessary. If the court is of the opinion that a compromise or an arrangement sanctioned earlier cannot be worked satisfactorily with or without modifications, it may pass an order for winding up a company.

Under this Chapter, the court also has the power to issue directions for the transfer of the whole or any part of the undertaking, property or liabilities of any company to a transferee company, where the compromise or arrangement is for the amalgamation of any two or more companies.

*Winding up*

As per the Companies Act 1956, the company court can order winding up of a registered company if:

*a* the company has, by a special resolution, resolved that the company be wound up by the court;

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governed in terms of the provisions of Chapter XIX of the Companies Act 2013. However, the relevant provisions of Chapter XIX of Companies Act 2013 are yet to be notified by the central government.

5 The High Court of the state in which the registered office of the company is situated.

*b* the company commits a default in delivering the statutory report to the Registrar or in holding the statutory meeting;

*c* the company fails to commence its business within one year of its incorporation, or suspends its business for a whole year and the court is satisfied that there is no intention to carry on the business;

*d* the number of members falls below the statutory minimum (seven in the case of a public company and two in the case of a private company);

*e* the company is unable to pay its debts; or

*f* the court is of the opinion that it is just and equitable that the company be wound up.

The petition for winding up by the court may be made by the company itself, a creditor of the company, a contributory or contributories, the Registrar of Companies, or the central or any state government. A creditor of a company can file an application for the winding up of the debtor company for latter's inability to pay its debts.

In the event that a company is wound up by members or creditors without the intervention of the court, it is called a voluntary winding up. It may take place on the passing of an ordinary resolution in the general meeting of its shareholders under certain circumstances and on the passing of a special resolution of the shareholders to wind up voluntarily for any reason whatsoever. Voluntary winding up is possible for solvent companies that are capable of paying their liabilities in full.

A creditor's voluntary winding up is possible for insolvent companies. It requires the holding of meetings of creditors besides that of the members, from the very beginning of the process of the voluntary winding up. It is the creditors who get the right to appoint the liquidator and, hence, the winding-up proceedings are dominated by them.

*Chapter XV of the Companies Act 2013*[6]

Although much of the procedure is broadly similar to that already existing, some new provisions have been incorporated under the Companies Act 2013, which lay down the procedure for the merger of two or more small companies, between a holding company and its wholly-owned subsidiary, or a prescribed class of companies by giving notice of the proposed arrangement to the Registrar of Companies, the official liquidator or the persons affected by the scheme, and inviting objections thereupon. There is no requirement to convene any creditors' meetings. The scheme must be approved by members of both the transferor and transferee companies (holding 90 per cent of the total number of shares) at a general meeting, and also by 90 per cent in value of the creditors of the respective companies. A copy of the approved scheme has to be filed with the central government. On registration, the transferor company is deemed dissolved.

The Act also contains provisions relating to mergers of domestic companies registered under this Act with foreign companies and *vice versa*. It further states that, subject to the approval of the RBI, the terms and conditions of the merger scheme may

6 Corresponding to Chapter V of the Companies Act 1956.

provide for payment of consideration to the shareholders of the merging company in cash, partly in cash or partly in Indian depository receipts.

### *The Sick Industrial Companies (Special Provisions) Act 1985*

The Sick Industrial Companies (Special Provisions) Act 1985 (SICA) was enacted in the public interest with a view to securing the timely detection of 'sick' and potentially sick companies owning industrial undertakings. The focus of insolvency legislation in India is currently on reorganisation of the financial and business structure of potentially viable entities facing financial distress so as to allow them to revive and continue their businesses, and on the liquidation of unviable insolvent entities.

Under the provisions of SICA, only medium-sized and large industrial companies in distress can approach the bankruptcy tribunal (BIFR) for formulation of a rescue or revival plan for them. A company entitled to refer its matter for revival to BIFR is termed a 'sick industrial company' (SIC), and the test of its being under distress is balance-sheet based and not default-based.[7] Small and ancillary industrial undertakings have been specifically excluded from the jurisdiction of SICA and only medium and large scale industrial undertakings fall within its ambit so that focus remains on rescuing the industries in which large resources in terms of capital, human resources, etc. have been deployed.

#### *Proceedings under SICA*

A company that becomes an SIC at the end of a financial year is required to file a mandatory referral to the BIFR within 60 days of the finalisation of its accounts for that said financial year at the AGM of its shareholders.

The Act provides that no referral should be made to the BIFR in the event that the financial assets belonging to a company have been acquired by an SC or RC. The Hon'ble Appellate Authority for Industrial and Financial Reconstruction (AAIFR) and the Hon'ble Delhi High Court have, in the matter of *M/s Shamken Spinners Ltd*, held that 75 per cent or more of the financial assets of a company qualifying as an SIC need to be acquired by an SC or RC before it need not refer itself to the BIFR.

It further provides that where a referral is pending before the BIFR, it will abate if the secured creditors, representing at least than 75 per cent in value of the amount outstanding against financial assistance disbursed to the borrower of such secured creditors, have taken any measures to enforce their security under Section 13(4) of the SARFAESI Act 2002.

After receipt of a referral of a company, the BIFR is empowered to make an inquiry into its working to determine whether it has become an SIC, and will declare it such once satisfied. During the period of the inquiry, the BIFR may appoint one or more persons as special directors on the board of the company in order to safeguard the financial and other interests of the company, or the public interest.

7 An industrial company, which, in addition to fulfilling other prescribed requisites, has at the end of any financial year accumulated losses equal to or exceeding its entire net worth, becomes an SIC.

Once a company is declared an SIC, the BIFR decides whether it is practicable for it to make its net worth exceed its accumulated losses on its own, within a reasonable period of time, and, if it deems it possible, the BIFR may allow this.

If the BIFR decides that it is not practicable for this to happen, and that it is necessary or expedient in the public interest to revive the company by adoption of various measures for its revival, the BIFR will appoint any secured lender or independent bank as the operating agency to formulate a scheme for the revival of the company.

Said scheme may provide for the financial reconstruction of the SIC, proper management of the SIC by means of a change in or takeover of its management, its amalgamation with any other company, the sale or lease of a part or whole of any of its industrial undertakings, the rationalisation of managerial personnel and employees in accordance with the law, and such other preventive, ameliorative and remedial measures as may be appropriate. These measures may also include a reduction in the interest or rights of the shareholders of the company and the lease of industrial undertakings of the SIC to any person, including cooperative societies formed by the employees.

The scheme prepared by the operating agency is examined by the BIFR and, thereafter, a draft rehabilitation scheme (DRS) is formulated and published by the BIFR seeking suggestions and objections from all concerned. The DRS must also be circulated to the central government, state government, any scheduled or other bank, any public financial institution, state-level institution or any other institution or authority from which any financial assistance has been sought under the DRS, for their consent. For the purpose of the consent of the said parties, 60 days is allowed, which may be extended by the BIFR by a further 60 days. The BIFR may, after considering the objections and suggestions of the various parties, sanction the scheme for the revival of the company. The implementation of the sanctioned scheme is monitored by the BIFR and a monitoring agency is appointed by the BIFR for said purpose. In the event that the need so arises, the sanctioned scheme may be modified by the BIFR.

Should the BIFR be of the opinion that the SIC is unlikely to make its net worth exceed its accumulated losses within a reasonable period of time, that it is not likely to become viable in future, or that it is just and equitable that the company be wound up, the BIFR records and forwards its opinion to the competent high court for winding up. Based on this opinion, the court may pass the order and proceed to winding up in accordance with the provisions of the Companies Act 1956.

Throughout proceedings under this Act, no recovery proceedings (including winding-up proceedings) against the company or its guarantors may be initiated or continued, and the BIFR can also issue directions to the SIC that it may not dispose of any of its assets without the permission of the BIFR.

Under Section 22(3) of SICA, the BIFR can also order that any contracts, agreements or other instruments to which the SIC is a party remain suspended, or be carried out as specified by the BIFR. Such an order can initialy last up to two years, but may be extended one year at a time up to a maximum of seven years.

The BIFR can also initiate misfeasance proceedings against any managerial persons of the SIC if it appears that they have retained or misappropriated any company assets. It may direct them to repay or restore the money or assets with or without interest to the SIC and report the matter to the central government for action against them as it deems fit. The BIFR may also direct public financial institutions, scheduled banks and state-level institutions not to provide financial assistance to such persons or any companies or other corporate bodies to which they are associated for up to 10 years.

The provisions of SICA override the provisions of all other laws except the provisions of Foreign Exchange Regulation Act 1973 and the Urban (Land) Selling and Regulation Act 1976.

*Proceedings in terms of Chapter XIX of the Companies Act 2013*

As and when the provisions of Chapter XIX of the Companies Act 2013 come into force, all referrals of SICs must be filed before national company law tribunals (NCLTs), to be set up in terms of the provisions of Chapter XXVII of the Act of 2013. Under the new Act, the criterion for the determination of sickness will no longer be 'net worth-based' but becomes 'liquidity-based'.[8] The company will also be able to file an application for sickness before the NCLT.

Without prejudice to the foregoing, if the RBI, a state government, public financial institution, state-level institution or scheduled bank has sufficient reason to believe a company has become sick, it may make a referral to the tribunal for determination of measures for its revival that may be adopted. The provisions of the Act of 2013 permit any company to approach the NCLT for determination of sickness and revival measures (if it fulfils the criteria), in contrast with the existing provisions of SICA, which are applicable only to 'industrial' companies.

After a determination of sickness, the NCLT will fix a hearing and appoints an interim administrator, who will appoint a creditors' committee (representative of all classes of creditors) and holds a meeting to decide whether it is possible to revive the company or whether it should be wound up, and the interim administrator will submit its report to the tribunal accordingly.

If the company does not file a revival scheme, the NCLT may direct the interim administrator to take over its management. In such circumstances, the directors and management of the company are required to extend their full cooperation to the interim administrator to manage its affairs.

If the interim administrator reports that it is possible to revive the company, the tribunal appoints an administrator to prepare a plan for its rehabilitation. The tribunal may also direct the administrator to take over control of the assets or the management of the company. The administrator is also required to convene separate meetings of the secured and unsecured creditors of the sick company for their consent (of at least 25 per cent of unsecured creditors in value terms and by at least three-quarters of secured creditors in value terms) and thereafter present the scheme before the NCLT for its approval. After such approval the NCLT may authorise the administrator to implement the scheme until completion and to also furnish periodic reports on the its progress. If, however, the scheme is not approved by the creditors in the required

8 If, on demand by secured creditors representing 50 per cent or more of the total secured debt, the company fails to pay or secure the same, then the secured creditors may refer the company to the tribunal.

ratio, the administrator submits a report to this effect to the tribunal, which will order its winding up.

Another important provision is the creation of a rehabilitation and insolvency fund solely for sick companies to use to pay their employees, protect their assets, etc., to the extent of their contributions made to the fund.

*Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002*

The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act 2002) deals with foreclosure and aims to enable secured lenders to realise long-term assets, manage problems of liquidity, asset liability mismatches and improve recoveries by exercising powers to take possession of securities, sell them without the intervention of the court, and reduce NPAs by adopting measures for their recovery or reconstruction.

Under the SARFAESI Act, security interests created in favour of any secured creditors may be enforced without the intervention of a court or tribunal. Where any borrower under a liability to a secured creditor under a security agreement defaults in repayment of a secured debt, and its account is classified by the secured creditor as an NPA, the secured creditor may require the borrower by notice in writing to discharge its liabilities in full within 60 days, failing which the creditor is entitled to exercise all or any rights under Section 13(4).[9] Upon receiving a notice, no borrower can sell, transfer, or lease the secured assets mentioned in the notice without the consent of the lenders. The secured creditors are empowered to act even in cases pending before the BIFR or with the official liquidator provided 60 per cent or more of the secured lenders are in agreement.

*Recovery of Debts Due to Banks and Financial Institutions Act 1993*

In line with the international trends on helping financial institutions recover their debt quickly and efficiently, the Government of India has constituted the debt recovery tribunals (DRTs) in place of civil courts under the aegis of Recovery of Debts Due to Banks and Financial Institutions Act 1993 (RDDB&FI Act).

Under Section 19 of the RDDB&FI Act, banks and financial institutions can file suits for recovery of their dues, known as original applications, and after recording of evidence, final arguments are heard and if in order, a decree is passed in favour of the banks or financial institutions.

Due to the long drawn-out legal procedures and ineffectiveness of the RDDB&FI Act, the SARFAESI Act 2002 was enacted. Despite the introduction of the SARFAESI Act, the RDDB&FI Act continues to be constitutionally valid, however, as the SARFAESI Act addresses only secured lenders, and the determination of dues of all lenders is carried out by DRTs as per the provisions of RDDB&FI Act. The co-existence of both acts has been extensively dealt with in the judgment of the

9 The lender may take possession of the secured assets or the management of the borrower's business and also have the right to transfer same by way of lease, assignment or sale.

Hon'ble Supreme Court of India in *Transcore v. Union of India*.[10] The DRTs are also the appellate authority for appeals filed against proceedings initiated by secured creditors under the SARFAESI Act.

### ii Informal procedures

In addition to the formal insolvency and restructuring procedures available in India, there are also informal procedures for restructuring of corporate facing distress. The Corporate Debt Restructuring (CDR) Mechanism was introduced in 2001. It is a voluntary, non-statutory system that allows a financially distressed company with two or more lenders and debts of more than 100 million rupees to restructure its debts with the super-majority consent of its lenders.[11] Such restructuring is binding on the remaining lenders provided they are member of the CDR System. The CDR Mechanism is based on debtor-creditor agreements (DCAs) and intercreditor agreements (ICAs), which provide the legal basis for the whole mechanism. Debtors are required to execute a DCA and abide by the terms therein. Similarly, all the lenders participating in the CDR Mechanism are required to execute a legally binding agreement among them to agree to abide by the policies and systems of the CDR mechanism. One of the most important clauses in the DCA is the standstill clause, as a result of which all parties agree not to initiate any legal action against each other, normally for between 90 and 180 days. Further, the borrower also undertakes that during the standstill period the loan documents executed in favour of its lenders will be automatically extended without limitation and the borrower will not approach any other forum for similar relief. That will also not be any change in the directorship of the company in as much as this relates to resignation from the board of directors.

The objective of the CDR Mechanism is to ensure a timely and transparent mechanism for restructuring the corporate debts of viable entities facing problems, outside the purview of the BIFR, DRTs and other legal proceeding. It further aims at preserving viable companies that are affected by certain internal and external factors and at minimising losses to creditors and other stake holders through an orderly and coordinated restructuring programme.[12]

### iii Duties of directors of companies in financial difficulties

SICA requires that in the event a company is potentially an SIC, its board of directors should bring the fact, along with reasons why, to the notice of the shareholders by convening a meeting, and to the notice of the BIFR by filing a report.

SICA further requires that in the event that a company becomes an SIC, it should make a mandatory referral to the BIFR within 60 days of the date of finalisation of the accounts for the relevant period, seeking adoption of remedial measures necessary for its

10 2008 1 SCC 125.

11 With the consent of lenders representing 75 per cent or more of its debt in value terms and by 60 per cent of the lenders by numbers.

12 www.cdrindia.org.

revival. In a case of non-compliance, the directors of the company are liable for strict penalties.

The directors are further required to give a notice of the appointment of a liquidator of the company at its general meeting to the Registrar of Companies. The directors of the company cease to exercise all powers of the board and, similarly, the managing directors and the other full-time directors also cease to exercise their powers on the appointment of a liquidator for winding up of the company. In the case of a creditors' voluntary winding up, the directors must convene the meeting of the creditors of the company, and at such meeting the directors must present a statement of the position of the company's affairs together with a list of creditors of the company and the estimated amount of the creditors' claims. The directors must file the notice of any resolution passed at the creditors' meeting with the Registrar of Companies.

In the case of winding up by court the directors have the duty to defend the company in the winding-up petition filed by the creditor. Each director must file a statement of the state of affairs of the company upon appointment of an official liquidator by courts. The directors also have the duty to assist the official liquidator from time to time by providing relevant information, records and assistance during the process of winding up by the court.

In addition to the above, directors must act honestly, without negligence and in good faith in the *bona fide* best interests of the company. Directors are further expected to make proper use of their powers, not to fetter their discretion for any reason whatsoever, must not place themselves in a position in which their personal interest or duties to other persons may conflict with their duties to the companies, except with the informed consent of the company.

Directors are the trustees for the assets of the company handled by them as well as the exercise of the powers vested in them. If they dishonestly or in a *mala fide* manner exercise their powers and perform their duties, they will be liable for a breach of trust and shall also be required to compensate the company for any loss or damage suffered by it by reason of their such acts.

As per Section 542 of the Companies Act if, in the course of the winding up of a company, it appears that the business of the company has been carried on with intent to defraud creditors or any other persons, or for any other fraudulent purpose, the court may direct that the person responsible shall be personally liable without any limitation for all or any of the debts or other liabilities of the company as the court may direct.

### iv Clawback actions

As per Section 531 of the Companies Act 1956, the court has the power to declare any act made, taken or done by or against a company in the six months before its winding up a fraudulent preference of its creditors and thus invalid. Further, as per Section 531A, any transfer of property or delivery of goods made by a company for an excessive consideration, if made within the year before a petition is made for winding up or passing of a resolution for voluntary winding up of the company, will be also void. The law further provides that in the event of a fraudulent preference, the preferred person will be subject to the same liability and will have the same rights had it undertaken to be personal liable as surety for the debt to the extent of the mortgage or charge on the property or the value of its interest whichever is less.

In the case of a company being wound up, any floating charge on the property of the company created within the 12 months immediately preceding the commencement of the winding up, unless it can be is proved that the company was solvent immediately after the creation of the charge, will be invalid.[13]

The law further provides that in the case of a voluntary winding up, any transfer of shares in the company not being a transfer made to or with the sanction of a liquidator, and any alteration of status of a member of the company made after the commencement of the winding up, shall be void. Similarly, in the case of a winding up by the court, any disposition of property or actionable claims of the company and any transfer of shares in the company or alternation in the status of its members made after the commencement of its winding up shall, unless the court orders otherwise, be void.

## III RECENT LEGAL DEVELOPMENTS

In January 2014, the RBI permitted SCs and RCs to convert a portion of their debt into shares of a borrower company subject to a maximum of 26 per cent. For the purposes of the enforcement of security interest, the SC or RC are required to have consent of 60 per cent of secured creditors instead of 75 per cent presently. SCs or RCs are also permitted to acquire debt from other SCs or RCs, subject to certain conditions. Following are some of the recent judgments emanating out of the insolvency and restructuring law and practice.

The High Court of Andhra Pradesh in the matter of *M/s Deccan Chronicles Holdings Ltd v. Union of India*[14] held that as the original lender M/s India Bulls Financial Services Ltd[15] was not a 'financial institution' under Section 2(m) of the SARFAESI Act when the transaction took place, the lending agency (i.e., IBHFL) could not invoke the provisions of the SARFAESI Act as the basis of any subsequent arrangement.

The Delhi High Court in the matter of *M/s Global Infrastructure Technologies Ltd v. Kotak Mahindra Bank Ltd & Ors*[16] held that a secured creditor must satisfy the condition that it represents at least three-quarters in value of the total amount borrowed by the petitioner from all secured creditors before it can it fall within the third proviso to Section 15(1) of SICA and apply to the BIFR for abatement of the petitioner's referral. It further observed that while Section 13(9) of the SARFAESI Act speaks of financing of a 'financial asset', the third proviso to Section 15(1) of SICA speaks of 'financial assistance disbursed to the borrower of such secured creditors'. The referral can only be

13 Except to the amount of any cash paid to the company at the time of or subsequent to the creation of, and in consideration for, the charge, together with interest on that amount at the applicable rate.

14 WP No. 37381/2013.

15 Which was later merged with its sister concern M/s India Bulls Housing Finance Limited (IBHFL), which was registered under the SARFAESI Act.

16 WP(C) 4862/2013 12.

up to the total amount borrowed by the petitioner from all the secured creditors that is outstanding.

## IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

Many companies have made referrals to the CDR Mechanism seeking restructuring of their debts. Of the cases approved by CDR to 31 March 2014, the infrastructure sector tops the list with an aggregate debt of 572 billion rupees in 25 cases (accounting for around 20.72 per cent of the total debts restructured under the CDR), followed by the iron and steel sector, with an aggregate debt of 435 billion rupees across 53 cases, and the power sector with an aggregate debt of 191 billion rupees across 15 cases. The recession in the economy, coupled with delays in regulatory approvals, resulted in delayed execution of infrastructure projects. Further, an acute shortage of coal and natural gas in conjunction with the increased cost of equipment pursuant to the depreciation in value of the rupee has dealt a huge blow to many power projects. The iron and steel sector has also been hit as a result of the overcapacities created during the boom period and the shortage of iron ore (being the main raw material) pursuant to restrictions on mining imposed by the government of India.

In a large number of cases, companies whose dues had previously been restructured have approached the CDR for a reworking of their restructuring package, as they have not been able to honour their commitments under the initial restructuring due to the continuation of the recessionary phase. Such a rework was possible, prior to February 2013, as a 'rework' rather than being considered a repeated restructuring. The RBI, however, issued a circular dated 18 February 2013, which specified that any subsequent change in the terms of restructuring debts would be tantamount to a repeated restructuring and, accordingly, the account would be classified as an NPA by the banks. As a result, and the continued distressed position of several companies, many companies have made filings with the BIFR for seeking protection against recoveries and for a determination of measures for their revival and restructuring under the aegis of SICA. Companies referred to CDR, or where restructurings have been approved under CDR, include Gammon Infrastructure Limited (debt of 140 billion rupees), Lanco Infrastructure Limited (debt of 73 billion rupees), Electrolux Steel Castings Limited (debt of 64 billion rupees), ABG Ship Yard Limited (debt of 110 billion rupees), and Soma Enterprises Ltd (debt of 50 billion rupees).

Companies formally referred to the BIFR include Shri Laksmi Cotsyn Limited (debt of 33 billion rupees), Jyoti Limited (debt of 5.4 billion rupees), Ankur Drugs and Pharma Ltd (debt of 10 billion rupees), Deccan Chronicles Limited (debt of 44 billion rupees), Helios Photo Voltaic Limited (debt of 10 billion rupees).

## V INTERNATIONAL

India has not adopted the UNCITRAL Model Law neither do EC Regulations apply to it. As per the provisions of the Companies Act 1956, Indian courts exercise jurisdiction over the winding-up proceedings of all Indian-registered companies, even over their activities outside Indian boundaries. Foreign entities having dues recoverable from said companies may, however, approach the Indian court conducting the winding up to lodge claims over the estate of the company being wound up.

The law for the recognition of foreign judgments and proceedings is contained in Sections 13 and 44A of the Code of Civil Procedure, which consider foreign judgments in reciprocating countries as conclusive, barring certain exceptions, such as fraud or the judgment not being based on the merits of the case. Despite the existing provisions in the Companies Act and the Code of Civil Procedure, Indian laws on cross-border insolvency are inadequate and need to be reviewed in order to provide a regime conducive to transnational activity in terms of investment and security.

Both committees appointed by the government of India and the RBI for revamping the bankruptcy law[17] have recommended for enactment an insolvency law based on the UNCITRAL Model Law, but no concrete steps have yet been taken by the government of India.

## VI FUTURE DEVELOPMENTS

The Companies Act 2013 has been partially implemented and the remaining provisions are likely to be implemented shortly, which will bring about a radical change in the restructuring and rescue process of sick companies in India. One of the most important measures contained in the new legislation with respect to the rehabilitation of sick companies is to encompass all companies within its scope, and not limit its applicability to 'industrial' companies. Further, the new legislation does away with the concept of the automatic stay on legal proceedings against a sick company, which is presently available in terms of Section 22(1) of SICA. Under the provisions of the 2013 Act, an application will have to be made for such a stay against legal proceedings, which will be granted at the discretion of the tribunal. Further, such a stay, if granted, would be operative only for 120 days and a fresh application will need to be made thereafter.

The Act of 2013 lays down specific time limits in the revival and rehabilitation process, which is a welcome endeavour and may go some way to curtailing endless litigation. The new provisions give a greater say to the creditors in the whole revival process. Under the provisions of the Act of 2013, it is felt that a speedy revival of sick companies can be achieved, which will help in the overall improvement of the country's economy.

17 The Justice Eradi Committee and the NL Mitra Advisory Group on Bankruptcy Laws.

# Appendix 1

# ABOUT THE AUTHORS

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Nilesh Sharma is a partner in Dhir & Dhir Associates, Advocates & Solicitors. He is a law graduate and a chartered accountant and looks after the restructuring and insolvency practice of the firm. His association with the firm and his experience in this practice area is more than two decades. His experience includes providing advisory on restructuring and insolvency issues, negotiated settlements, cross-border insolvency issues, representation before the bankruptcy courts, etc. He is a member of INSOL India and AAIFR BIFR Association of India.

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Sandeep Kumar Gupta is an associate partner in Dhir & Dhir Associates, Advocates & Solicitors. He is a qualified chartered accountant with an extensive experience of around 21 years in banking, project finance and debt restructuring of entities in distress, both through the CDR Mechanism and on bilateral basis. He is a part of the corporate consultancy team of the firm, advising client on matters related to settlements with lenders and other insolvency-related issues.

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