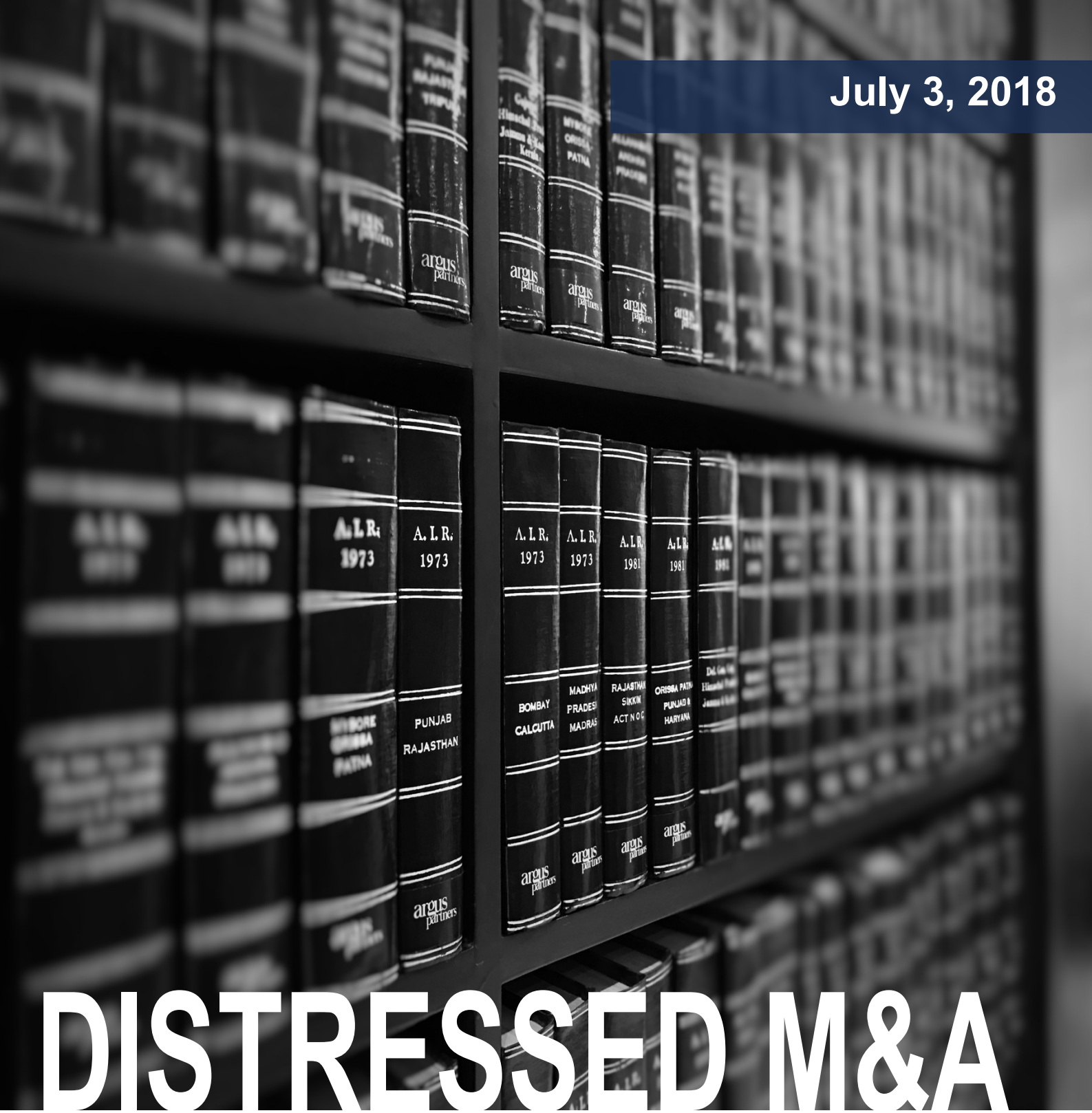

July 3, 2018

DISTRESSED M&A

UNDER THE INSOLVENCY AND BANKRUPTCY CODE

argus partners
SOLICITORS AND ADVOCATES

1. Introduction

Given the surge in stressed assets in the Indian economy, it is no wonder that the regulatory landscape governing stressed assets is in the midst of a massive overhaul. The complexity of the problem has necessitated multiple changes to various laws and introduction of several new ones. With the introduction of new rules and regulations, new tools have been made available with the aim of having a comprehensive approach for effective and timely resolution of stressed assets.

One of the most significant tools introduced to address the problem of stressed assets is the Insolvency and Bankruptcy Code, 2016 ("**IBC**"). It has been a little over a year that the IBC was enacted. Till date more than 650 cases have been admitted by the National Company Law Tribunal ("**NCLT**") under IBC. Out of these, so far, resolution plans for around 26 companies have been approved and orders for liquidation for more than 100 companies have been passed. While the ratio of successful resolution versus liquidation may not be encouraging, there has been a flurry of activities in the distressed M&A space with many sensing an opportunity to acquire some good assets.

This paper provides an overview of the legal framework under the IBC for undertaking distressed M&A and the potential risks and challenges in the process.

2. The IBC

The IBC was enacted as a comprehensive code to consolidate laws relating to reorganisation and insolvency resolutions of corporates, partnerships as well as individuals. The entire process beginning from institution of proceedings until approval of a resolution plan or liquidation, is intended to be time bound. The Insolvency and Bankruptcy Board ("**IBBI**") has also framed the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("**CIRP Regulations**") to address several aspects pertaining to the insolvency resolution process of a corporate debtor.

Initiation of a corporate insolvency resolution process

Once a corporate debtor defaults for an amount of Rs. 1 lac, a financial creditor, an operational creditor or the corporate debtor itself may initiate corporate insolvency resolution process ("**CIRP**") in respect of such corporate debtor by filing an application before the NCLT. The CIRP commences from the date such application is admitted by NCLT. The IBC mandates that the entire CIRP should be completed within 180 days from the date of admission. This time period can be extended only once by NCLT for upto an additional 90 days. Thus, the entire process has to be completed within 270 days.

NCLT can allow withdrawal of an application admitted for initiation of CIRP, on an application filed by the applicant with the approval of 90% voting share of the COC. The manner in which withdrawal shall be permitted by NCLT is to be prescribed.

What happens after admission?

Moratorium

Once an application for commencing CIRP against a corporate debtor is admitted, a moratorium order is passed prohibiting the institution of suits or continuation of pending suits or proceedings against the corporate debtor or any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property. Transfer of assets by the corporate debtor is also prohibited. This order of moratorium remains in effect till the completion of the CIRP or earlier if NCLT approves a resolution plan or passes an order for liquidation of the corporate debtor.

A moratorium, however, will not affect any suit or case pending before the Supreme Court under Article 32 of the Constitution of India or where an order is passed under Article 136 of Constitution of India[1]. A moratorium will also not affect the power of the High Court under Article 226 of Constitution of India. However, a money suit or a suit for recovery, against the corporate debtor, filed before any High Court under original jurisdiction, cannot proceed after declaration of moratorium.

The effect of moratorium on actions by governmental authorities have arisen in various cases before the NCLT. In one case NCLT has held that issuance of demand notice against the corporate debtor by the mining authority and demanding stoppage of mining operations during the period of moratorium is illegal and inoperative and it directed the mining authority to lift the order demanding stoppage of mining operations. In another case, NCLT has held that withdrawal of permission to procure, store and transport coking coal and iron ore for want of consent to operate while moratorium is not valid. However, in another case, NCLT upheld the action of the Government, during the moratorium period, terminating a coal mines development and production agreement and vesting order in favour of the corporate debtor.

Appointment of Resolution Professional

An interim resolution professional ("**IRP**") is appointed by the NCLT whose term continues till the date of appointment of the resolution professional ("**RP**"). The committee of creditors (*discussed below*) once formed, either appoints the IRP as the RP or replaces the IRP by another resolution professional, by a majority vote of not less than 66% of the voting share of the financial creditors, at its first meeting.

Management of the corporate debtor

From the date of appointment of the IRP, the management of the affairs of the corporate debtor vests in the IRP. The powers of the Board of Directors stand suspended and are exercised by the IRP. The officers and managers of the corporate debtor are required to report to the IRP. If any personnel of the corporate debtor, its promoter or any other person required to assist or cooperate with the IRP does not assist or cooperate, then the IRP can make an application to NCLT for necessary directions. This right has already been exercised in various ongoing insolvency resolution processes, and NCLT has given directions to the personnel of corporate debtors to extend all co-operation.

The IRP/RP has to make every endeavour to protect and preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern. Further, the IRP/RP is responsible for complying with the requirements under any law for the time being in force, on behalf of the corporate debtor.

The IRP and thereafter the RP, therefore, plays a central role in the entire insolvency resolution process as, unlike a *debtor-in-possession* bankruptcy regime in many other countries, the IBC provides for the suspension of the Board of Directors and vesting of the management in the IRP/RP.

Formation of Committee of Creditors

The IRP is required to constitute a committee of creditors ("**COC**") comprising all financial creditors (other than related parties) of the corporate debtor. However, a financial creditor who is regulated by a financial sector regulator and is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity, prior to the insolvency commencement date, shall have a right of representation, participation and voting in a meeting of the COC.

If there are no financial creditors or if all financial creditors are related parties of the corporate debtor, then the COC will comprise of the 18 largest operational creditors by value, 1

[1] *Canara Bank* v. *Deccan Chronicle Holdings Limited*, Company Appeal (AT) (Insolvency) No. 147 of 2017, NCLAT.

representative elected by all workmen and 1 representative elected by all employees of the corporate debtor.

While the RP is responsible to preserve and protect the assets of the corporate debtor, including the continued business operations of the corporate debtor, the COC also plays an important role. Prior approval of the COC (by obtaining consent of 66% of the voting shares) is required before the RP can take certain actions. These include: raising any interim finance, creating any security interest over the assets of the corporate debtor, changing the capital structure of the corporate debtor, undertaking any related party transaction, amending any constitutional documents, delegating any authority, change in the management, and transferring rights or financial debts or operational debts under material contracts otherwise than in the ordinary course of business. For routine matters, decisions of the COC can be taken by a vote of not less than 51% of the voting share of financial creditors.

3. Invitation to submit Resolution Plans

Information Memorandum

As a first step towards kickstarting the process of inviting resolution plans, the RP is required to prepare an information memorandum ("**IM**"). The IM has to contain the following details of a corporate debtor:

- assets and liabilities, as on the insolvency commencement date;
- latest annual financial statements;
- audited financial statements of the corporate debtor for the last 2 financial years and provisional financial statements for the current financial year made up to a date not earlier than 14 days from the date of the application;
- a list of creditors containing the names of creditors, the amounts claimed by them, the amount of their claims admitted and the security interest, if any, in respect of such claims;
- particulars of a debt due from or to the corporate debtor with respect to related parties;
- details of guarantees that have been given in relation to the debts of the corporate debtor by other persons, specifying which of the guarantors is a related party;
- the names and addresses of the members or partners holding at least 1% stake in the corporate debtor along with the size of stake;
- details of all material litigation and an ongoing investigation or proceeding initiated by Government and statutory authorities; and
- number of workers and employees and liabilities towards them.

The RP also has to provide all resolution applicants access to all relevant information in physical and electronic form.

Evaluation Matrix

The CIRP Regulations provides that at the time of inviting resolution plans, the RP should include an evaluation matrix containing such parameters to be applied and the manner of applying such parameters, as approved by the COC for consideration of resolution plans for its approval, at least 30 days before the last date of submission of resolution plans.

Who can submit Resolution Plans?

The IBC, as originally enacted, allowed any person to be a resolution applicant i.e. any person could submit a resolution plan for a corporate debtor. However, pursuant to an amendment, the RP can invite only those applicants ("**Resolution Applicant**") to submit a resolution plan who fulfil the criteria as laid down by him with the approval of the COC, having regard to the

complexity and scale of operations of the business of the corporate debtor and such other conditions which may be specified by IBBI.

Further, a new section 29A has been introduced in the IBC which sets out certain disqualification parameters. Notably, a person is disqualified from submitting a resolution plan if the person or any other person acting jointly or in concert with such person, at the time of submission of the resolution plan, has an account which is classified as a non-performing asset ("**NPA**") or if such person is a promoter or in management or control of a corporate debtor whose account has been classified as an NPA and 1 year has lapsed from the date of classification till the date of commencement of the CIRP of the corporate debtor. Thus, existing promoters would find it difficult to bid for their own companies which have been declared an NPA. However, such persons can submit a resolution plan if they make payment of all overdue payments with interest thereon and charges relating to non-performing assets before submission of the resolution plan.

Notably, the aforesaid restriction will not apply to a resolution applicant who is a financial entity and is not a related party of the corporate debtor. Therefore, if a financial entity acquires a significant stake in a company pursuant to conversion of its loan, and such company is classified as an NPA, then the financial entity[2] will not be disqualified to submit a resolution plan.

Also, where the resolution applicant has acquired the NPA pursuant to a prior resolution plan approved under the IBC, then the aforesaid restriction shall not apply for a period of 3 years from the date of approval of such resolution plan under the provisions of the IBC.

A person shall also not be eligible as a resolution applicant, if such person, or any other person acting jointly or in concert:

- is an undischarged insolvent;
- is a wilful defaulter in accordance with the guidelines of Reserve Bank of India under the Banking Regulation Act, 1949;
- is disqualified to act as a director under the Companies Act, 2013;
- is prohibited by Securities and Exchange Board of India ("**SEBI**") from trading in securities or accessing the securities markets;
- has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by NCLT under the IBC. However, if a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place prior to the acquisition of a corporate debtor by the applicant pursuant to a resolution plan approved under the provisions of the IBC or pursuant to a scheme or plan approved by a financial sector regulator or a court, and the applicant has not otherwise contributed to such transactions, then the said disqualification pertaining to such transactions would not apply;

[2] An entity to be considered as a 'financial entity' has to meet the following criteria:
- a scheduled bank;
- any entity regulated by a foreign central bank or a securities market regulator or other financial sector regulator of a jurisdiction outside India which jurisdiction is compliant with the Financial Action Task Force Standards and is a signatory to the International Organisation of Securities Commissions Multilateral Memorandum of Understanding;
- any investment vehicle, registered foreign institutional investor, registered foreign portfolio investor or a foreign venture capital investor, where the terms shall have the meaning assigned to them in regulation 2 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017;
- an asset reconstruction company register with the Reserve Bank of India under section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- an Alternate Investment Fund registered with Securities and Exchange Board of India; and
- such categories of persons as may be notified by the Central Government.

- has executed a guarantee in favour of a creditor in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted and such guarantee has been invoked by the creditor and remains unpaid in full or in part;
- has been convicted for any offence punishable with imprisonment for 2 years or more under any act specified under the twelfth schedule to the IBC or for 7 years or more under any law for the time being in force. It may be noted that after the expiry of a period of 2 years from the date of his release from imprisonment, the said disqualification would not apply;
- has been subject to any disability, corresponding to the above, under any law in a jurisdiction outside India.

The disqualification criteria in sub-sections (c) and (h) of section 29A of the IBC would not apply in respect of CIRP of any micro, small and medium enterprises ("**MSMEs**") as defined under the Micro Small and Medium Enterprises Development Act, 2006 ("**MSME Act**"). However, it is pertinent to note that the way MSMEs are currently defined under the MSME Act, only a limited number of companies would be covered under the above exemption.

Conducting a due diligence

Due diligence becomes a critical exercise in the entire process because unlike in a normal M&A transaction, a Resolution Applicant will not have the benefit of representations and warranties from the promoters. Often the Resolution Applicant is required to submit a bid on an *as is where is* basis, and to that extent the risks are passed on to the Resolution Applicant with very little fall-back option.

A Resolution Applicant may work under various constraints while undertaking a due-diligence of a corporate debtor. A potential constraint in conducting a due diligence is the quality of information provided. The Resolution Applicant is dependent on the RP to provide all relevant information who in turn may have to depend on the existing management to a large extent for providing relevant information.

As the CIRP is a time bound process, a Resolution Applicant has a limited time frame to complete the due-diligence process, which may further impact an effective due-diligence.

Maintaining confidentiality

In order to maintain the integrity of the entire process, it is imperative that confidential information pertaining to the corporate debtor which can be accessed by any potential Resolution Applicant including competitors, is kept strictly confidential. The IBC recognises the importance of maintaining confidentiality and accordingly requires all Resolution Applicants accessing information about the corporate debtor to comply with provisions of law for the time being in force relating to confidentiality and insider trading, protect any intellectual property of the corporate debtor it may have access to and not to share relevant information with third parties unless the above is complied with.

Liquidation value and fair value

Liquidation value is the estimated realizable value of the assets of the corporate debtor if the corporate debtor were to be liquidated on the insolvency commencement date. The CIRP Regulations, as originally enacted, provided that the IRP should appoint 2 registered valuers to determine the liquidation value of the corporate debtor. The liquidation value was required to be disclosed in the IM. However, pursuant to an amendment, the IM is not required to state the liquidation value. After the receipt of resolution plans, the RP is required to provide the liquidation value to every member of the COC after obtaining an undertaking from the member to the effect that such member shall maintain confidentiality of the liquidation value and shall not use such value to cause an undue gain or undue loss to itself or any other person. The RP is also required to maintain confidentiality of the liquidation value.

Apart from the liquidation value, the fair value should also be determined and provided to the COC after receipt of resolution plans. 'Fair value' has been defined as the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion.

4. Resolution Plans

Mandatory contents

The IBC and CIRP Regulations stipulate certain matters which are mandatorily required to form part of a resolution plan. These are discussed below.

Payment of IRP Costs

The insolvency resolution process costs ("**IRP Costs**") have to be paid in priority to the repayment of other debts of the corporate debtor. IRP Costs include the following:

- amount of any interim finance and the costs incurred in raising such finance;
- fees payable to the RP;
- costs incurred by the RP in running the business of the corporate debtor as a going concern;
- costs incurred at the expense of the Government to facilitate the insolvency resolution process;
- amounts due to suppliers of essential goods and services;
- amounts due to a person whose rights are prejudicially affected on account of the moratorium; and
- other costs directly relating to the CIRP and approved by the COC.

Debts of operational creditors

Specific sources of funds have to be identified for payment of the liquidation value due to operational creditors. This has to be paid in priority to any financial creditor which shall in any event have to be made before the expiry of 30 days after the approval of a resolution plan by the NCLT.

Dissenting financial creditors

Specific sources of funds have to be identified for payment of the liquidation value due to dissenting financial creditors. Such payment has to be made before any recoveries are made by the financial creditors who voted in favour of the resolution plan. Dissenting creditors include a financial creditor who voted against the resolution plan as well as a financial creditor who abstains from voting for the resolution plan, approved by the COC.

Treatment of all stakeholders

A resolution plan has to include a statement as to how it has dealt with the interests of all stakeholders, including financial creditors and operational creditors of the corporate debtor.

Term and implementation schedule and adequate means for supervising implementation

The term and manner of implementation of the resolution plan including timelines are required to be provided in the resolution plan. To provide for a check and balance, the resolution plan is also required to provide the manner in which the implementation of the plan will be supervised.

Typically, an independent agency or a representative of the financial creditors is proposed for the supervision.

Pursuant to a recent amendment, before passing an order for approval of the resolution plan, the NCLT is required to satisfy itself that the resolution plan has provisions for its effective implementation.

Management and control of the business

The resolution plan has to provide for the management and control of the business of the corporate debtor during its term. This issue is discussed in detail hereinbelow.

Details of the Resolution Applicant and its connected persons

Pursuant to a recent amendment, a resolution plan is required to provide several details about the Resolution Applicant and its connected persons. The expression 'connected person' has been given a wide meaning. Following would qualify as connected persons:

- any person who is the promoter or in the management or control of the resolution applicant; or
- any person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; or
- the holding company, subsidiary company, associate company or related party of a person referred to in the clauses above[3].

What can a Resolution Plan provide?

IBC is a complete code

The Supreme Court of India, in the case of *M/s Innoventive Industries Limited Appellant v. ICICI Bank*[4], observed that a consolidating and amending act like the IBC enacted by the Parliament of India forms a code complete in itself and is exhaustive of the matters dealt with therein. If an earlier law enacted by a State Government is repugnant to the IBC such that it hinders and obstructs in such a manner that it will not be possible to go ahead with the insolvency resolution process outlined in the IBC, then the IBC will prevail.

Further, section 238 of the IBC states that the IBC shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

Thus, the IBC is a complete code in itself and would have an overriding effect over other legislations. However, such overriding effect would not extend to permitting something which is illegal. For example, if foreign direct investment is not permitted in a sector, a resolution plan cannot provide otherwise. Infact, the resolution professional is required to certify that a resolution plan is in compliance with applicable laws.

Against the above backdrop, the issue that arises is the scope of powers of NCLT while approving a resolution plan, and the matters which may be included in a resolution plan.

The CIRP Regulations provide that a resolution plan may provide for the measures required for implementing it. These could include (but are not limited to) the following:

- transfer of all or part of the assets of the corporate debtor to 1 or more persons;

[3] A financial entity who is not a related party of the corporate debtor is exempt from this requirement. Also, a financial entity who is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares, prior to the insolvency commencement date, is exempt from this requirement.

[4] *M/s Innoventive Industries Limited Appellant* v. *ICICI Bank & Another,* Civil Appeal Nos. 8337-8338 of 2017.

- sale of all or part of the assets whether subject to any security interest or not;
- substantial acquisition of shares of the corporate debtor, or the merger or consolidation of the corporate debtor with 1 or more persons;
- satisfaction or modification of any security interest;
- curing or waiving of any breach of the terms of any debt due from the corporate debtor;
- reduction in the amount payable to the creditors;
- extension of a maturity date or a change in interest rate or other terms of a debt due from the corporate debtor;
- amendment of the constitutional documents of the corporate debtor;
- issuance of securities of the corporate debtor, for cash, property, securities, or in exchange for claims or interests, or other appropriate purpose; and
- obtaining necessary approvals from the Central and State Governments and other authorities.

Given the fact that IBC is still at a nascent stage, the jurisprudence on the scope of the powers of NCLT is still evolving. Summarised below are some of the decisions of NCLT which may throw some light on this matter:

Interim order passed on February 7, 2018 by NCLT, Ahmedabad Bench in IDBI Bank Limited v. Essar Steel Limited

Section 60(5) of the IBC states that notwithstanding anything to the contrary contained in any other law for the time being in force, the NCLT shall have jurisdiction to entertain or dispose of:

(a) any application or proceeding by or against the corporate debtor or corporate person;
(b) any claim made by or against the corporate debtor or corporate person, including claims by or against any of its subsidiaries situated in India; and
(c) any question of priorities or any question of law or facts, arising out of or in relation to the insolvency resolution or liquidation proceedings of the corporate debtor or corporate person under the IBC.

In the said case, Essar Steel Limited (corporate debtor) through its RP filed an application before NCLT seeking a direction that a particular pipeline is the pipeline of the corporate debtor. NCLT observed that it has jurisdiction under section 60(5) of IBC to decide the claims of the corporate debtor, questions of fact or law, provided if such claims, questions of fact or law *arise out of or in relation to the corporate insolvency resolution process*. However, such jurisdiction does not extend to granting declaratory reliefs to the corporate debtor.

Order passed on December 15, 2017 by NCLT, Allahabad Bench in the matter of JEKPL Private Limited

The NCLT approved a resolution plan which, *inter alia*, provided the following[5]:

- Rescinding or cancellation of the existing equity and preference shares of the company;
- All security provided by the corporate debtor for the term loans granted by State Bank of India and Central Bank of India shall be rescinded;
- All security provided by the shareholders, promoters and guarantors of the corporate debtors to State Bank of India and Central Bank of India shall be assigned to the resolution applicant or an SPV (special purpose vehicle);
- All contingent liabilities of JEKPL Private Limited, whether claimed or unclaimed, excluding 1 bank guarantee, shall be extinguished or annulled. This would include liabilities to the Government of India under production sharing contracts;
- There will be no liability under the Income Tax Act, 1961 including any liability under minimum alternate tax on account of the transactions in the resolution plan;
- All liabilities of the corporate debtor shall be written off including contingent liabilities; and
- All approvals from the Government of India in a production sharing contract will be granted by the Government of India.

[5] This matter was appealed before the National Company Law Appellate Tribunal.

NCLT also observed that NCLT is not expected to substitute its view with the commercial wisdom of the RP or COC nor should it deal with technical complexity and merits of a resolution plan unless it is found contrary to the express provisions of law and goes against public interest.

Order passed on December 13, 2017 by NCLT, New Delhi, Principal Bench in the matter of Alchemist Asset Reconstruction Co. Ltd. v. Hotel Gaudavan Pvt. Ltd.

NCLT approved a resolution plan which, *inter alia*, provided that the existing share capital of the corporate debtor will be transferred to the resolution applicant at Re. 1 per share, and thereafter the resolution applicant shall take steps as per law for reduction of share capital.

Order passed on March 9, 2018 by the National Company Law Appellate Tribunal ("NCLAT") in the matter of Tarini Steel Company Pvt Limited v. Trinity Auto Components Limited

An appeal was filed against the impugned order of the NCLT approving a resolution plan with certain modifications. The appellant contended that the NCLT has no jurisdiction to make any modification to the resolution plan after it was approved by the COC. Without expressing any opinion, NCLAT gave liberty to the appellant to withdraw the resolution plan if it was not satisfied with the amendment made therein. It was submitted before the NCLAT that the NCLT has no jurisdiction to modify the 'resolution plan' once approved by the Committee of Creditors. NCLAT observed the following: *"…if such submission is accepted in that case then only recourse will be available to the Adjudicating Authority is to reject the resolution plan, being not satisfied with the resolution plan.*"

Order passed on May 2, 2018 by NCLAT in the matter of Darshak Enterprises Pvt. Ltd. v. Chhaparia Industries Pvt. Ltd.

NCLAT in the said case held the following: "*In a particular case, what should be the percentage of claim amount payable to one or other Financial Creditor' or 'Operational Creditor' or 'Secured Creditor' or 'Unsecured Creditor' can be decided by the Committee of Creditors based on facts and circumstances of each case. In absence of any discrimination or perverse decision, it is not open to the Adjudicating Authority or this Appellate Tribunal to modify the Plan."*

Order passed on December 12, 2017 by NCLT, Mumbai Bench in the matter of Shirdi Industries Limited

While approving the resolution plan submitted, NCLT held that the corporate debtor will be liable to pay all applicable taxes without any exemption as sought in the resolution plan.

Binding nature of resolution plans

A resolution plan, once approved by NCLT, is binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.

The CIRP Regulation provides that a provision in a resolution plan which would otherwise require the consent of the members or partners of the corporate debtor, as the case may be, under the terms of the constitutional documents of the corporate debtor, shareholders' agreement, joint venture agreement or other document of a similar nature, shall take effect notwithstanding that such consent has not been obtained.

The Ministry of Corporate Affairs has issued a circular (General Circular No. IBC/01/2017) dated October 25, 2017 clarifying that the approval of shareholders/ members of the corporate debtor for a particular action required in a resolution plan for its implementation which would have been required under the Companies Act or any other law if the resolution plan was not

being considered under the IBC will be deemed to have been given on its approval by NCLT. A recent amendment to the IBC provides further clarity on this aspect and states that if any approval of shareholders is required under the Companies Act, 2013 or any other law, for the implementation of actions under the resolution plan, then such approval shall be deemed to have been given.

5. Some Considerations

Approval of third parties

While the IBC is a complete code in itself, it may not obviate the requirement of obtaining the consent of other regulators and governmental authorities such as the Competition Commission of India ("**CCI**"), Reserve Bank of India, SEBI, Stock Exchanges, Insurance Regulatory and Development Authority etc, if the plan provides for a matter which would ordinarily require approval from other authorities, unless a specific exemption has been provided. It is pertinent to note that a recent amendment to the IBC provides that after approval of the resolution plan by the NCLT, the resolution applicant shall obtain the necessary approvals required under any law within 1 year from the date of approval or within such period as provided for, in such law, whichever is later.

Further, as mentioned above, a resolution plan, once approved by NCLT, is binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan. The issue that arises is whether the resolution plan is also binding on contractual counterparties. For instance, if a resolution plan provides for the assignment of a contract entered into by the corporate debtor and the contract requires consent of the counterparty for any assignment, then the issue that arises is whether such an assignment can take place without obtaining such consent. Such a proposition is yet to be tested in a court. It is pertinent to mention that there are multiple case laws under sections 391 to 394 of the Companies Act, 1956 (schemes of arrangements) which establish that the sanction of a scheme of arrangement by courts would not affect the obligations of the parties to apply for and receive the necessary consents under contracts and regulations, including contracts relating to rights in immoveable property and under the specialized laws, as applicable. However, as mentioned, the said case laws pertain to sanctioning of schemes of arrangement under the Companies Act, 1956 (now replaced by the Companies Act, 2013).

Approval of CCI

CCI's approval would be required if the resolution plan contemplates a combination as defined in section 5 of the Competition Act, 2002 ("**Competition Act**"). The said section defines 'combinations' in terms of 'assets' and 'turnover' thresholds and is broadly categorized in the following manner:

- Acquisition of control, shares, voting rights or assets of an enterprise.
- Acquisition of control by a person over an enterprise when such person has already direct or indirect control over another enterprise ("**Existing Enterprise**") engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service.
- Merger or amalgamation.

If the aforesaid categories of '**combinations**' satisfy the following thresholds, then a prior notice is required to be given to CCI for its approval.

Thresholds to be satisfied*

	In India		In India or outside India	
	Assets**	**Turnover#**	**Assets****	**Turnover#**
(i) Acquirer + Target (ii) Existing Enterprise + Target (iii) Merged Entity	more than Rs. 2,000 crores	more than Rs. 6,000 crores	more than USD 1,000 mn (including atleast Rs. 1,000 crores in India)	more than USD 3,000 mn (including atleast Rs. 3,000 crores in India)
Group## to which the Target/ merged entity would belong to after the acquisition	more than Rs. 8,000 crores	more than Rs. 24,000 crores	more than USD 4 bn (including atleast Rs. 1,000 crores in India)	more than USD 12 bn (including atleast Rs. 3,000 crores in India)

** 'Assets' or the 'Turnover' thresholds have to be met*
*** The value of assets shall be determined by taking the book value of the assets as shown, in the audited books of account of the enterprise, in the financial year immediately preceding the financial year in which the date of proposed merger falls, as reduced by any depreciation, and the value of assets shall include the brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, homonymous geographical indication, geographical indications, design or layout design or similar other commercial rights.*
#'Turnover' includes value of sale of goods or services.
##Group has been defined in the Competition Act as meaning two or more enterprises which, directly or indirectly, are in a position to:
(i) exercise 26% or more of the voting rights in the other enterprise; or
(ii) appoint more than 50% of the members of the board of directors in the other enterprise; or
(iii) control the management or affairs of the other enterprise.

SEBI regulations

Exemption from preferential allotment rules

Preferential issue of specified securities (equity shares and convertible securities) by a listed company is required to be in accordance with Chapter VII of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 ("**ICDR Regulations**"). However, the provisions of the said Chapter VII of the ICDR Regulations (except lock-in provisions) are not applicable where the preferential issue of specified securities is made in terms of a resolution plan approved by NCLT under the IBC.

Exemption under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Regulations")

Regulation 10(1)(da) of the Takeover Regulations exempts acquisitions made pursuant to a resolution plan approved under section 31 of the IBC, from the obligation to make an open offer under regulations 3 and 4 of the Takeover Regulations.

Further, the Takeover Regulations have been amended to state that an acquisition of shares by an acquirer, pursuant to a resolution plan approved under section 31 of the IBC would be exempted from the obligation under the proviso to regulation 3(2) of the Takeover Regulations. The said provision prohibits an acquirer from acquiring or entering into any agreement to acquire shares or voting rights exceeding such number of shares as would take the aggregate shareholding above the maximum permissible non-public shareholding i.e. 75%.

Exemptions under Delisting Regulations

The SEBI (Delisting of Equity Shares) Regulations ("**Delisting Regulations**") have been amended to state that Delisting Regulations shall not apply to any delisting of equity shares of a listed entity that is made pursuant to a resolution plan approved under section 31 of the IBC. However, for the aforesaid exemption to apply, the resolution plan should provide for the following:

- Specific procedure to complete the delisting of such shares; or
- An exit option to the existing public shareholders at a price specified in the resolution plan.

Further, it has been stipulated that the exit to the shareholders should be at a price that is not less than the liquidation value determined in accordance with the provisions of the IBC. The details of delisting of shares along with justification for exit price in respect of the proposed delisting, have to be disclosed to the recognised stock exchanges within 1 day of the resolution plan being approved under section 31 of the IBC.

Under the extant provisions of the Delisting Regulations, an application for listing of equity shares that have been delisted under voluntary delisting (Chapter III of the Delisting Regulations) or under delisting by operation of law (Chapter VII of the Delisting Regulations) cannot be made unless a period of 5 years has passed since delisting and an application for listing of shares that have been delisted under compulsory delisting (Chapter V of the Delisting Regulations) cannot be made unless a period of 10 years has passed since delisting. However, sub-regulation 2A has been introduced in regulation 30 of the Delisting Regulations, stating that an application for listing of delisted equity shares may be made in respect of a company which has undergone CIRP under the IBC.

LODR Regulations

Exemption from obtaining shareholders' approval for certain matters

Pursuant to a recent notification dated May 31, 2018 issued by SEBI ("**LODR Amendment**") several amendments have been introduced to the SEBI (Listing Obligations and Disclosure Requirements), 2015 ("**LODR Regulations**"). Various matters which earlier required approval of the shareholders would no longer require such approval from the shareholders, if the same is in respect of a resolution plan approved by the NCLT under the provisions of the IBC.

- **Material related party transactions**

  Pursuant to the LODR Amendment, the requirement of obtaining the approval of shareholders for material related party transactions is not applicable if such material related party transaction is in respect of a resolution plan approved by NCLT, provided that such event is disclosed to the recognized stock exchanges within 1 day of the resolution plan being approved.

- **Disposal of shares in a material subsidiary**

  Pursuant to the LODR Amendment, the requirement of obtaining approval of the shareholders by a special resolution for the following matters is not applicable if the same is under a resolution plan that has been approved by the NCLT and such an event is disclosed to the recognized stock exchanges within 1 day of the resolution plan being approved:

  a. disposal of shares in a material subsidiary resulting in reduction of shareholding to less than 50%;
  b. ceasing to exercise control over the subsidiary; and
  c. sale, disposal or leasing of assets amounting to more than 20% of the assets of the material subsidiary on an aggregate basis during a financial year.

- **Reclassification of promoters**

  When a new promoter replaces a previous promoter, reclassification requires approval of shareholders. The LODR Amendment provides that the said requirement would not apply if reclassification of the existing promoter is as per a resolution plan approved by the NCLT. Certain other relaxations have been provided in relation to reclassification of existing promoters which are discussed below.

- **Relaxation from the norms for reclassification of existing promoters**

  Regulation 31A was introduced in the LODR Regulations to set out the procedure for reclassification of a status of a shareholder. Prior thereto, there were instances where promoters of a listed company sought to reclassify themselves from the category of 'promoter' to 'public'; however, there were no objective criteria for the same. In order to bring about objectivity to the process, SEBI prescribed specific criteria for allowing reclassification of the status of a shareholder.

  As per the criteria laid down by SEBI, when a new promoter replaces an existing promoter, apart from approval of shareholders, it has to be ensured that such promoter along with persons acting in concert do not hold more than 10% of the paid-up equity capital of the entity and do not continue to have any special rights. Further, such promoters and their relatives cannot act as a key managerial person for a period of more than 3 years. Also, reclassification cannot be used as a tool for achieving compliance with minimum public shareholding requirements.

  In regulation 31A, SEBI has also laid down criteria where reclassification of the status of existing promoters into public is proposed as a result of an entity becoming professionally managed. As per the existing criteria, an entity would be considered as professionally managed if no person or group along with persons acting in concert taken together hold more than 1% paid-up equity capital of the entity. The promoter seeking reclassification along with his promoter group entities and the persons acting in concert cannot have any special right through formal or informal arrangements. Further, the promoters seeking reclassification and their relatives can act as key managerial personnel in the entity only subject to shareholders' approval and for a period not exceeding 3 years from the date of shareholders' approval.

  Pursuant to the LODR Amendment, the aforesaid criteria which are contained in sub-regulations (5), (6) and clause (b) of sub-regulation (7) of regulation 31A of the LODR Regulations would not apply if re-classification of an existing promoter or promoter group of the listed entity is as per a resolution plan approved by NCLT. To avail of the exemption the existing promoter should not remain in control of the listed company and the underlying rationale for reclassification has to be disclosed to the stock exchanges within 1 day of the resolution plan being approved.

  The above relaxation granted pursuant to the LODR Amendment is a significant and welcome change. Many resolution plans for listed companies undergoing a CIRP contained a provision which sought to reclassify an existing promoter into public, however, all the criteria prescribed by SEBI were not being met. Hence, special relaxation was sought from SEBI in these cases even though the resolution plan may have taken away all special rights of the existing promoters and significantly reduced their shareholding.

- **Relaxation from the norms for restructurings**

  Regulations 37 and 94 of the LODR Regulations provide that a listed entity desirous of undertaking a scheme of arrangement or involved in a scheme of arrangement, is required to file the draft scheme, with the stock exchange(s) for its approval, before filing such scheme with any Court or NCLT. Further, on March 10, 2017, SEBI issued a circular no.

CFD/DIL3/CIR/2017/21 with respect to conditions to be complied with by a listed entity undertaking a scheme of arrangement. Some of the conditions included obtaining a valuation report and a fairness opinion. Also, in certain cases approval of a majority of the public shareholders was required. Further, additional conditions were stipulated for a merger involving an unlisted company.

The IBC was enacted with the stated objective of being an Act to consolidate and amend the laws relating to reorganisation and insolvency resolution. The Supreme Court in the case of *M/s Innoventive Industries Limited Appellant v. ICICI Bank* has held that the IBC is an exhaustive code on the subject matter of insolvency in relation to corporate entities and is complete in itself.

On the implementation of the IBC, questions arose with respect to whether the processes under the SEBI regulations and Companies Act, 2013 would have to be separately followed in case of a restructuring being implemented under a resolution plan approved by NCLT including a merger, demerger and capital reduction. It has been argued that considering that IBC is a complete code in itself, the procedural requirements prescribed under the SEBI regulations and Companies Act, 2013 would not be required to be followed separately in case of a restructuring under a resolution plan which has been approved by the NCLT.

The LODR Amendment has now provided clarity on the issue. Schemes of arrangement that are pursuant to a resolution plan that has been approved by the NCLT and that have been disclosed to the recognized stock exchanges within 1 day of the resolution plan being approved, have been exempt from the application of the procedures and requirements laid down for the same in regulations 37 and 94 of the LODR Regulations. The amendment would help in avoiding unnecessary duplication of procedure.

Tax issues

Carry forward of losses

Section 79 of the Income-tax Act, 1961 ("**IT Act**") provides that if a change in shareholding has taken place in a previous year then no loss incurred in any year prior to the previous year can be carried forward and set off against the income of the previous year unless there is continuity of ownership i.e. 51% of the voting power should be beneficially held by same persons the previous year and the year or years in which the loss was incurred. Pursuant to the Finance Act, 2018 the said section shall not apply to a company where a change in the shareholding takes place in a previous year pursuant to approved resolution plan under the IBC *after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner*. This implies that the income tax department would be heard before NCLT approves a resolution plan.

Minimum alternative tax

Under section 115JB of IT Act, in case of a company, if the income tax payable is less than a specified percentage of the book profit of the company, then such book profit is deemed to be the total income of the company. The amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of accounts is reduced from the calculation of such book profits. Companies against whom CIRP had been initiated were facing hardships due to restriction in allowance of both brought forward loss and unabsorbed depreciation for computation of book profit under section 115JB of IT Act.

Pursuant to the Finance Act, 2018 in case of a company, against whom an application for CIRP has been admitted under IBC, the aggregate amount of unabsorbed depreciation and loss brought forward shall be allowed to be reduced from the book profit and the loss shall not

include depreciation. However, waiver of loan or interest is not specifically excluded from book profits; only a set-off for brought forward losses and depreciation is excluded.

Section 56(2)(x) of the IT Act

Section 56(2)(x)(c) of the IT Act states the following:

> *"In particular, and without prejudice to the generality of the provisions of sub-section (1), the following income, shall be chargeable to income-tax under the head "Income from other sources", namely -*
> *…*
> *(x) where any person receives, in any previous year, from any person or persons on or after the 1st day of April, 2017,—*
> *…*
> *(c) any property, other than immovable property,—*
> *…*
> *(B) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration."*

Hence, if a resolution plan provides for issuance of shares for a consideration below the fair market value, then the recipient of shares may be taxed with the amount by which the aggregate fair market value of the shares exceeds the consideration being chargeable to income-tax under the head 'income from other sources'. Fair market value has to be determined in accordance with Rules 11U and 11UA of the Income-tax Rules, 1962.

Section 50CA of the IT Act

Section 48 of the IT Act provides the manner in which capital gains tax chargeable under section 45 of the IT Act is computed. Section 45 of the IT Act specifically provides for imposition of capital gains tax in case of transfer of capital assets. The Finance Act of 2017 had inserted a new section 50CA in the IT Act which states that if the consideration received for the transfer of unquoted shares, is less than the fair market value of such shares (determined as per the Income-tax Rules, 1962) then, the value so determined shall, for the purposes of calculation of tax on capital gains under section 48 of the IT Act, be deemed to be the full value of consideration received or accruing as a result of such transfer.

Thus, if a transfer of shares of a corporate debtor undergoing CIRP takes place at a price less than the fair market value of such shares, then there may be a capital gains tax incidence.

Section 281 of the IT Act

Where a resolution plan contemplates an asset transfer or a business transfer, section 281 of the IT Act may become relevant. Section 281 of the IT Act provides that where during the pendency of any proceeding under the IT Act or after the completion thereof, but before the service of notice of demand under rule 2 of the second schedule, an assessee creates a charge on, or parts with the possession (by way of sale, mortgage, gift, exchange or any other mode of transfer whatsoever) of, any of his assets in favour of any other person, such charge or transfer shall be void as against any claim in respect of any tax or any other sum payable by the assessee as a result of the completion of the said proceeding or otherwise, unless any of the following conditions are satisfied:

a. such transfer is for adequate consideration and without notice of the pendency of such proceeding or, as the case may be, without notice of such tax or other sum payable by the assessee; or
b. with the previous permission of the Assessing Officer.

Therefore, a no-objection certificate maybe required from the income tax authorities. However, in this connection it may be mentioned that a transfer does not become void *ab initio*. Section

281 only declares that any transfer is void against the claims of the Revenue in respect of the tax finally determined in a proceeding which has been pending at the time of the transfer. Having stated the above, it is pertinent to mention that an argument has been made that if the transfer of assets is pursuant to an order of the NCLT approving a resolution plan, then section 281 of the IT Act should not apply as it may not be an *inter vivos* transfer. However, this argument is yet to be tested in court.

Stamp duty

There may be a significant stamp duty incidence depending on the transactions contemplated in a resolution plan which may include transfer of immovable property, amalgamation, issuance of shares etc.

Management of the corporate debtor

The IBC provides that a resolution plan should provide for the management of the affairs of the corporate debtor after approval of the resolution plan.

In certain cases, for a resolution plan to become effective, approvals of certain third parties may be required such as CCI and SEBI. In such a case, it may be that though NCLT approves the resolution plan, the plan becomes effective thereafter. The resolution plan has to provide for the management of the corporate debtor in the interim as technically the resolution professional may not continue after approval of the resolution plan by NCLT. However, where approval from CCI is pending, a resolution applicant cannot take over the management of the corporate debtor as it may constitute *gun-jumping* in violation of the Competition Act. Section 6(2A) of the Competition Act provides that a combination cannot be implemented until approval of CCI is obtained. Any attempt to control a target company or exercise a significant influence in its operations (whether directly or indirectly) pending approval of the CCI, such as by means of standstill obligations and management control, is typically viewed as *gun-jumping* by CCI which in turn may lead to imposition of penalty. Accordingly, while providing for the management of the corporate debtor in the interim, the *gun-jumping* provisions of the Competition Act have to be kept in mind.

With regard to the management of the corporate debtor, another issue that arises is when a resolution plan provides for a slump sale of an undertaking of the corporate debtor and does not provide for the management of the corporate debtor. This proposition has to be tested against the requirement in the IBC that, a resolution plan should provide for the management of the affairs of the corporate debtor after approval of the resolution plan. Further, 'resolution plan' itself is defined as a plan proposed by a resolution applicant for insolvency resolution of the *corporate debtor as a going concern*. In this regard a reference may be made to the observation of NCLT (Mumbai Bench) in *Roofit Industries Limited,* where a proposal from a resolution applicant was for only one factory and excluded other units of the company. NCLT held that this cannot be considered a resolution at all under the IBC and ordered the liquidation of the company; thus, discouraging cherry picking of assets.

6. Summing up

Some have described distressed M&A as an art. It requires a special skill set and a certain level of risk appetite. As the IBC is still at a relatively nascent stage with several ambiguities and uncertainties, one has to be careful in assessing the potential risks and liabilities which may arise in future, and also while drafting a resolution plan. However, distressed M&As have their own benefits. Potentially an acquirer may get an asset at a lower valuation than in ordinary circumstances.

We are at the beginning of distressed M&A deals under IBC and such deals are expected to only increase as the IBC regime matures.

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