



WILL THE NEW INSOLVENCY ORDINANCE INCREASE SPECIAL SITUATIONS M&A IN INDIA?

At the end of December, the Indian government promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 (the “**Ordinance**”) to iron out certain issues faced by buyers of assets in a corporate insolvency resolution process (the “**CIRP**”).

While the Insolvency and Bankruptcy Code, 2016 (the “**Code**”) has largely achieved its objectives, certain aspects of the Code have caused bottlenecks in the CIRP, which has, *inter alia*, deterred last-mile funding to distressed corporate debtors.

Changes to the Code

Immunity from past liabilities

One of the key tenets of resolution of distressed assets under the Code is to provide a smooth post-resolution experience to acquirers so as to incentivize the purchase of distressed assets in India. However, a number of acquirers faced substantial litigation after the completion of the CIRP on account of liabilities which arose prior to the asset acquisition. Given this, the Ordinance has introduced Section 32A of the Code which extinguishes the liability of the corporate debtor in respect of any offence committed prior to the commencement of the CIRP and prohibits any action against any property of the corporate debtor covered under the resolution plan. While this immunity is subject to the corporate debtor extending the necessary assistance and co-operation to any investigating authority and is not available for the promoters or other related parties of the corporate debtors, it will ensure that buyers of distressed assets are protected from pre-existing liabilities of the corporate debtor.

Recoveries by a debtor during its insolvency

Section 11 of the Code did not specifically clarify whether a corporate debtor could file an insolvency application against a third party during the pendency of the CIRP, which resulted in corporate debtors not being able to recover their dues from other corporate debtors. This, in turn, limited the asset pool available for repayment of debts to creditors. Recognizing that the primary purpose of the Code is to maximize the value of assets of the corporate debtor, the Ordinance has introduced an explanation to Section 11, which clarifies that Section 11 does not restrict a corporate debtor from initiating a CIRP against other corporate debtors.



Interim supply of essential goods and services to corporate debtors

Section 14 of the Code imposes a moratorium on all proceedings initiated against a corporate debtor during the CIRP, thereby preventing: (i) the alienation of assets by the corporate debtor in any manner; and (ii) the initiation of any other recovery action against the corporate debtor during the CIRP. A new explanation to this provision states that no license, permit, registration, quota, concession, clearance or similar right can be terminated or suspended during the moratorium period, provided that the corporate debtor has not defaulted on any payments in respect of the foregoing benefits. The Ordinance has also introduced Section 14(2A) which prevents the termination of supply of those goods and services which are essential to keep the corporate debtor running as a going-concern, as per the resolution professional's discretion.

Threshold imposed on home-buyers

In the amendments to the Code introduced in 2018, home-buyers were included in the definition of “financial creditors,” and they were empowered to initiate CIRPs against real estate developers delaying projects. However, this power was being misused by some home-buyers who, on a solo basis, were initiating CIRPs against developers and delaying the completion of ongoing projects. Given the hue and cry raised by developers, Section 7 of the Code has been amended to provide that a minimum of one hundred (100) flat/real estate allottees or allottees constituting 10% of the total number of allottees of one real estate project are needed to file a CIRP against a developer. This threshold has also been imposed on creditors who have extended financial debts to a corporate debtor in the form of securities or deposits.

Scope of “interim finance” widened

Under Section 5(15) of the Code, “interim finance” is defined as any financial debt raised by the resolution professional during the CIRP period (to run the corporate debtor as a going concern), and is accorded priority in repayment when distributing assets during liquidation under the Code. Previously, interim finance covered only financial debts, and not operational or any other debts. This restriction limited the interim funding that could be raised during the CIRP as interim creditors (other than creditors extending interim financial debts) did not enjoy priority in repayment. Given this gap, the Ordinance has introduced a mechanism to enable the government to widen the scope of interim finance to cover other debts by notification and to give such creditors priority in repayment.



Conclusion

The Ordinance addresses several issues and eliminates existing lacunae. In addition, it incentivizes last-mile funding and ring-fences successful buyers from liability. The Ordinance has also introduced a corrective amendment in Section 7, under which frivolous litigation that was being initiated by certain financial creditors and home-buyers will be eliminated.

In our view, each of the amendments introduced by the Ordinance will promote the primary objectives of the Code and will strengthen special situations M&A activity in India. Although many state that the Code has not achieved its objective of providing a quick resolution of companies threatened by insolvency, significant progress has been achieved in the three (3) years since the Code was enacted. The promptitude with which the Indian government has brought in amendments to the Code will surely boost investor confidence in India's financial regulatory environment.