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The year 2016 saw a great many law and policy changes that would significantly affect the financial and economic landscape of the country. Among those changes was the passing of the Insolvency and Bankruptcy Code of India in May, 2016. The Code sought to reform the scattered legislation relating to insolvency and bankruptcy in India and overhaul the diverse and often conflicting provisions that dealt with the same. The Code and its associated Rules lay down a regime that creates a step-by-step process to resolve insolvency and bankruptcy. However, the changes to the legislative framework were not to affect certain erstwhile methods of insolvency resolution, one of those being corporate debt restructuring. In this paper, I will examine different approaches to insolvency resolution and assess the efficacy of the Reserve Bank of India mandated debt restructuring guidelines in the face of the new insolvency resolution. While the RBI guidelines point towards a more "privatized" form of resolution, the regulatory approach of the Code and its Rules adopt a more systematic method of examining the same. Through this paper, I will evaluate both approaches and conclude on which may be better for financial entities in India.

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INTRODUCTION

In early 2016, Bhushan Steel Ltd. (the largest manufacturer of auto-grade steel in India) was classified as a non-performing asset ('NPA') by the Reserve Bank of India ('RBI').[109] The debt mounting upon Bhushan Steel Ltd. was to the tune of Rs. 40,000 crore and the account had been struggling since 2014. In that year, the creditors of Bhushan Steel formed a Joint Lenders' Forum ('JLF') in order to oversee the affairs of the company following the arrest of its Vice-Chairman in a bribery scandal. The banks collectively reviewed and implemented several options, including a refinancing scheme wherein the tenor of the loan was extended.[110] In 2016, after almost two years of a highly stressed account, the loan was declared to be an NPA.

In October, 2016, the creditors of Bhushan Steel agreed to restructure the debt (which has since increased to almost Rs. 45000 crore) under the debt restructuring regulations issued by the RBI over the last decade and a half.[111] The consortium of banks is led by the State Bank of India and the Punjab National Bank. In the event that the restructuring is successful, this will be the largest debt that has been restructured under the regula-

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1 *See*, Vishwanath Nair, *Banks classify Bhushan Steel loans as non-performing assets*, LIVEMINT, April 22, 2016, *available at* http://www.livemint.com/Companies/dJysX-hum8SFZFQO9uzFUTK/Banks-classify-Bhushan-Steel-loans-as-nonperforming-assets.html (Last visited on November 2, 2016).

110 *Id.*

111 *See*, Vishwanath Nair, *Bhushan Steel lenders to restructure loans*, LIVEMINT (October 7, 2016), *available at* http://www.livemint.com/Companies/RVPIcHk97jPtTBzRJ65A8O/Bhushan-Steel-lenders-to-restructure-loans.html (Last visited on November 2, 2016).

tions issued by the RBI (the S4A or the Scheme for Sustainable Structuring of Stressed Assets).

Debt restructuring as a concept is not a new phenomenon. It has been a tool used by multiple lenders to ensure that loans are repaid and has aided many borrowers in settling debt accounts without resorting to judicial methods. It occurs at various levels, from individual lenders reworking the terms of debt agreements with their debtor to sovereign debt restructuring, wherein governments that are in debt work out plans to settle accounts. The options to restructure debt in India are manifold and with the coming of the Insolvency and Bankruptcy Code, 2016, the process has been streamlined even more. Although the RBI has claimed that the Code will not replace RBI guidelines and that corporate debtors will be free to utilise these avenues for debt restructuring, it remains to be seen whether it is an option that will continue to be used.[112]

The example of Bhushan Steel is one among many that shed light on the state of debt recovery in the country. In this paper, I seek to analyse key points relevant to working of the the debt restructuring regime in India, and how recent changes in law have affected the same. In Part I, I will provide a general overview of what debt restructuring is and introduce its crucial components. In Part II, I will examine how corporate debt restructuring has been subject to a governing framework internationally and assess the underlying rationale for the same. In Part III, I will elaborate on the informal mechanism available in India under multiple RBI Circulars. In Part IV, I will examine the ambit of debt restructuring under the Insolvency and Bankruptcy Code. Finally, I will offer concluding remarks.

I. Overview of the Concept of Debt Restructuring

In a debt restructuring similar to that proposed by Bhushan Steel, the cornerstone is an agreement between the debtor and her creditors. This agreement is privately entered into between the two parties in order to rework crucial terms of the debt agreement and to reach a solution that is most viable and practical for the debtor and her creditors. When a company is facing financial trouble, there are multiple routes that it can take to resolve the crises. One is, of course, the private re-negotiations of key terms, which will be explained subsequently in this paper. Alternatively, the crisis may

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[112] *See*, Gopika Gopakumar, *Insolvency and bankruptcy code won't replace SDR and S4A: Sudarshan Sen*, Livemint, November 2, 2016, *available at* http://www.livemint.com/Industry/KCAE2uvgB54HpDCLtzbykL/Insolvency-and-bankruptcy-code-wont-replace-SDR-and-S4A-Su.html (Last visited on November 3, 2016).

be resolved through judicial or regulatory reorganization wherein a specific body seeks to formulate an action plan to resolve the debt – this is what the Insolvency and Bankruptcy Code of 2016 seeks to crystallise. Finally, the company may opt for winding-up and liquidation to pay off its creditors.[113]

Renegotiating or restructuring debt agreements outside of a court or a formal mechanism is often done so as to increase the overall efficiency of the transaction and to ensure that time is not wasted in complying with the procedural steps under relevant statutory laws. Much the same as full-blown formal regulatory measures, private restructuring takes place by changing the nature of the assets and liabilities of the debtor so as to ensure time and cost-efficient payback. Restructuring can take place in mainly two ways – *operational restructuring* and *financial restructuring*.[114] Operational restructuring refers to measures wherein the debtor's business is restructured. This can include a plan to merge with another company, shut down a branch of the company, sell a part of the company etc.[115] In essence, these are large-scale business measures which seek to make the corporate debtor a more economically viable and valuable asset in the eyes of the creditor. On the other hand, financial restructuring is when the debtor's finances are restructured. This could be by altering the rate of interest, the tenor, or the number of repayment instalments, availing refinancing options etc. in a debt agreement. In either case, these measures are taken through an agreement between both parties, free of any regulatory hindrance or procedure.

A. Prerequisites to a Debt Restructuring Agreement

In order for a debt restructuring agreement to be valid, there are certain general prerequisites that must be complied with. The *first* is that the debtor must be in a situation of "financial difficulty" – that is to say, they should be in a state of insolvency or potential insolvency or any other state of being financially unstable such that it could lead to the possibility of a prior debt agreement being defaulted upon. The *second* is that there should be a "plurality of creditors".[116] In the case of a sole creditor, the procedure to reclaim debt is through one-on-one negotiation or formal judicial or regulatory mechanisms.

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113 PHILIP R. WOOD, PRINCIPLES OF INTERNATIONAL INSOLVENCY 619 (2007).

114 *See*, Jose M. Garrido, *Out-of-court Debt Restructuring*, *available at* http://siteresources.worldbank.org/INTLAWJUSTICE/Resources/OutOfCourtDebtRestructuringBeforeTypesetting.pdf 7 (Last visited on November 2, 2016).

115 *See*, Ian H. Giddy, *Corporate Financial Restructuring*, *available at* http://people.stern.nyu.edu/igiddy/restructuring.htm (Last visited on November 2, 2016).

116 Garrido, *supra*, note 6, at 12.

Further, it is usually advisable for such agreements to be entered into solely with financial creditors such as banks and financial institutions. This means that other creditors of a company like employees, tax authorities, etc. would not be party to any such agreement. This particular stipulation exists in order to ensure that similar debts are discharged through a common contract. If all the creditors of a debtor are lumped into the same contractual agreement, there arises a significant problem of adequately and appropriately coordinating the debt repayment.[117] Restructuring agreements are also most effective when the group or consortium of banks and financial institutions are owed the majority of the company's debt.[118] It is mostly in this situation that the debtor is likely to take the agreement and obligations thereunder into serious consideration.

Along with these technical factors, there is also the requirement that the debtor in question must be facing some form of financial inability which causes him/her to be unable to repay the debt according the original terms agreed upon. Whether this difficulty is in the form of complete insolvency or foreseen inability to repay is immaterial for the purposes of a restructuring agreement.[119] What must be focused on is the nature of the indebtedness and the extent to which it affects the capability of the debtor to service the financial debt that she is in. In that light, the ability of the debtor to service other debts such as wages or tax payments is immaterial.[120]

B. Parties in a Restructuring Agreement

There are two primary parties who will be involved in or affected by the contents of such an agreement: the corporate debtor and the corporate creditor or creditors. The extent of each party's role in decision-making and impact is elucidated below.

1. The Corporate Debtor

The corporate debtor is the most important party in this agreement as it is the entity that is to implement a large majority of the actions set out in the agreement. The most ubiquitous form of a corporate debtor is a public or a private company registered under the Companies Act, 2013, or the Companies Act, 1956. As companies grow larger, there is a move towards increasing the capital invested in the company so as to increase production

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[117] Garrido, *supra*, note 6, at 13.
[118] Garrido, *supra*, note 6, at 13.
[119] Garrido, *supra*, note 6, at 13.
[120] Garrido, *supra*, note 6, at 13.

or maximise the output of services. This is done through larger debt contracts and increased public shareholding.[121] This often means that their obligations tend to be proportionate in magnitude, whether to lenders or to shareholders. In these types of companies, the duties that directors have to the shareholders often takes precedence[122] which can pose problems for large and small scale lenders. For example, from a different jurisdiction, French online communications company Solocal SA was in talks to restructure its debt of 1.2 billion euros. However, these arrangements had to be approved by two-thirds of the company's shareholders which could not be secured at the company's general meeting.[123] This highlights one of the crucial factors that go into a debt restructuring agreement being successful in public and private companies.

Along with the general health of the company, a priority for the corporate debtor is to ensure that its affairs are still run by a competent management. As a result, companies will examine restructuring agreements so as to evaluate whether a change in management is required or sought by the same.[124]

2. Banks or Corporate Creditors

Creditors in restructuring agreements are usually the bank or the consortium of banks that lends the corporate debtor money. Banks often dictate the course of company actions through their ability to finance key company operations through multiple loan arrangements such as term loans, working capital loans, syndicated loans and so on. While they have considerable influence in directing the course and plan of a debt restructuring agreement, there are certain crucial factors that affect banks in their operations as well. At the *first* instance, the banks must ensure that depositors' interests are not affected by any restructuring agreement that they enter into with the corporate debtor. Banks themselves are involved in the business of borrowing from the public and defaulting on that obligation can lead to serious consequences for the bank itself. *Second*, the bank must ensure that the agreement entered into is likely to benefit the bank. For example, debt-equity swaps are now gaining traction as a means of debt recovery.[125]

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[121] Garrido, *supra*, note 6, at 625.

[122] Garrido, *supra*, note 6, at 625.

[123] *See*, Luca Casiraghi, *Solocal Bonds Fall as Shareholders Reject Debt Restructuring*, (October 20, 2016), *available at* http://www.bloombergquint.com/onweb/2016/10/20/solocal-s-bonds-fall-as-shareholders-reject-debt-restructuring (Last visited on November 3, 2016).

[124] PHILIP R WOOD, *supra*, note 5, at 625.

[125] *See, for e.g.*, Rimin Dutt, *Why RBI's Debt-Equity Swap Scheme Is Good News For Indian Banks Saddled With Bad Loans*, HUFFINGTON POST INDIA, June 14, 2016, *available at*

However, it must be ascertained whether such a move (which includes change of control of the corporate debtor) will indeed yield greater profits in order to service the original debt of the company with the consortium of banks. In the case of the ABG Shipyard debt-equity swap, the original promoters were in a minority and the change in management is doing very little to revive the company's production output.[126] *Finally*, banks must ensure that their reputation as bankers, lenders, and creditors is not damaged by their actions attempting to leniently restructure debt instead of invoking liquidation and sale of the corporate debtor's assets. As an example, the recent case of Vijay Mallya's wilful default upon company loans may be cited. While Mallya's actions were heavily criticised, a major portion of the backlash was on the consortium of banks which continued to refinance and restructure loans instead of invoking guarantees or securitising assets.[127]

C. Features of a Debt Restructuring Agreement

Before proceeding to look at how such agreements are governed by different regulatory bodies, I will briefly look at options that are available to the corporate debtor and creditors under these agreements. In most cases, these measures involve a change in the debtor's original commitments, resulting in a novation of the original debt agreement.

The first option is to change the interest rate at which the loan has been serviced. Being unable to service debt due to high interest rates is a recurring phenomenon in the world of financial debt. This can be due to variable interest rates (as opposed to fixed rates) which are difficult to keep up with in the face of falling company finances. It may also be that a fixed rate of interest is incommensurate to the company's overall earnings and cannot be repaid in time. In 2012, when Bharati Shipyard was undergoing initial Corporate Debt Restructuring formulations, lenders agreed to reduce interest to 11% for easier servicing of the debt.[128]

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http://www.huffingtonpost.in/2016/06/14/indian-banks-and-bad-debt_n_10452542.html (Last visited on June 20, 2017).

[126] *See*, Shishir Asthana, *Why debt conversion to equity is a bad deal for ABG Shipyard shareholders*, Business Standard, October 7, 2016, *available at* http://www.business-standard.com/article/markets/why-debt-conversion-to-equity-is-a-bad-deal-for-abg-shipyard-shareholders-116100700279_1.html (Last visited on November 3, 2016).

[127] *See*, M.G. Arun, *Banking on a goodwill that wasn't*, India Today, March 16, 2016, *available at* http://indiatoday.intoday.in/story/vijay-mallya-kingfisher-airlines-kfa-money-laundering-loan-default-case/1/622051.html (Last visited on November 3, 2016).

[128] *See*, Shayan Ghosh, *'Bharati Defence approached BIFR with malafide intention*, Financial Express October 25, 2016, *available at* http://www.financialexpress.com/markets/bharti-defence-approached-bifr-with-malafide-intention/428832/ (Last visited on November 3, 2016).

Another option is to alter the due dates of the loan. Under this method, the interest rate may remain the same but the date on which the debt is due is extended. This option has been adopted by creditors of Malaysian oil company TH Heavy Engineering Bhd wherein the maturity date of its debt is extended by one year (from September 2016 to September 2017).[129] This can take place with altered interest rates as well.

In some cases, the currency of the debt can be changed. This usually happens due to fluctuating interest rates and presence of a cross-border loan transaction. Some parties also opt to modify key covenants in their debt agreements so as to service the debt more effectively.

Another option is refinancing. In this method, new loan facilities can be extended to the creditors which will aid its operations.[130] In this arrangement, there are multiple measures taken to ensure that the additional risk is taken into account – either through an agreement between creditors or increased security.

In some cases, creditors will choose to waive the interest requirement in order for the debtor to pay back the principal amount at a faster rate. While this is an extreme move, it can have several variations, such as waiving past interest or interest up until a point so that future interest is paid.

A more extreme path is for the debt to written off by the creditor. Partial or total writing off of debt involves waiving the debt amount along with interest which effectively means that the debtor pays nothing and the creditors suffer a potential loss. This is an extremely contentious plan to implement and must be done with extreme caution. History is replete with examples of writing off at political levels such as Germany during World War II and Europe during the 1930s Depression.[131] In early 2016, the RBI released a statement on how Rs. 1.14 lakh crore worth of debt was written off by various banks between 2013 and 2015 in India.[132]

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[129] *See*, *TH Heavy seeks to extend maturity date of debt papers*, The Star, October 12, 2016, *available at* http://www.thestar.com.my/business/business-news/2016/10/12/th-heavy-seeks-to-extend-maturity-date-of-debt-papers/ (Last visited on November 3, 2016).

[130] *See, for e.g.,* The RBI's 5:25 scheme: Reserve Bank of India, *Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries*, (July 15, 2014), *available at* https://rbi.org.in/scripts/NotificationUser.aspx?Id=9101&Mode=0 (Last visited on November 3, 2016).

[131] *See*, Mehreen Khan, *The biggest debt write-offs in the history of the world*, The Telegraph, February 2, 2015, *available at* http://www.telegraph.co.uk/finance/economics/11383374/The-biggest-debt-write-offs-in-the-history-of-the-world.html (Last visited on November 3, 2016).

[132] *See*, Utkarsh Anand, *Rs 1.14 lakh crore of bad debts: The great government bank write-off*, Indian Express, February 9, 2016, *available at* http://indianexpress.com/article/india/india-news-india/bad-loan-financial-year-rti-rbi-bank-loan-raghuram-rajan-

Finally, the debtor and creditor may restructure the debt security. Through this plan of action, earlier securitised assets may be brought back against the loan or security interests in general can be altered and reworked.

II. A Governing Mechanism For Debt Restructuring Agreements

While the entire process and plan of restructuring is according to a contract between the aforementioned parties, there is still significant risk in such an endeavour. This is due to difficulty in executing contracts which have a large number of participants whose risks and expectations may vary according to individual interests. Through these coordination and aggregation problems, a standalone contractual modification of original terms hardly seems like a viable option for restructuring debt agreements.

It is in that light that the creation of informal norms to govern restructuring agreements and their contents is a popular concept in financial governance. By looking at the problem through the lens of behavioural science, the presence of informal norms to guide the placement and practice of restructuring agreements facilitates an easier mechanism to go about restructuring and eventually recovering debt. This ease of doing business motivates banks, financial institutions and corporate debtors to work within the set framework of regulations. These norms can be adopted by a central agency – in India's case the concept of debt restructuring has been espoused in multiple RBI circulars and notifications, spanning over fifteen years, from 2001 till 2016. These circulars will be analysed in the next part of this paper. This centralised guideline incentivises corporate debtors and creditors and straying from it may cause social difficulties for such parties.[133]

Below, I have outlined key international approaches to regulating restructuring debt. There are multiple jurisdictions which have dealt with the matter. I have limited my analysis to the approaches followed in London, Bangkok, and Istanbul.

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bad-loan-financial-year-rti-rbi-bank-loan-raghuram-rajan-1140000000000-bad-debts-the-great-govt-bank-write-off/ (Last visited on November 3, 2016). *But see*, clarification by the RBI: Reserve Bank of India, *Bank Write-Offs: Clarification* (February 9, 2016), *available at* https://www.rbi.org.in/scripts/rbi_clarification.aspx (Last accessed on November 3, 2016).

[133] Gopakumar, *supra*, note 4, at 49.

A. London Approach

A 1990 document by the Bank of England titled 'The Provision of Financial Support for Companies with Liquidity Problems' contained elaborate guidelines on how to regulate and manage debt restructuring agreements.[134] The guidelines themselves are called the London Approach and are non-statutory. The main pillar of the Approach is that banks should be supportive towards companies facing financial troubles and work with them to find an effective solution. In principle, the London Approach espouses several key ideas:

a) Standstill: This means that lenders agree not to initiate formal insolvency proceedings against the borrower for a particular period of time or until a conclusion is reached between the debtor and the creditor.[135]

b) Information: This entails sharing all vital information relating to the debt and the borrower's status with each bank that is a lender. Further, it brings forth the point of retaining the confidentiality of all information that is passed during these channels.[136]

c) Viability of restructuring: The banks together must come to a conclusion on whether restructuring the debt is a viable option for all financial creditors.[137]

d) Lead bank and steering committee: There should be a lead bank whose role is to coordinate the agreement and obligations between all other banks in a procedural and set manner. Further, there should be a steering committee which will contain representations from all banks.[138]

e) Unanimity: The only way in which the agreement and restructuring plan will work out to the benefit of all parties is if all banks are unanimous in their decisions and operations.[139]

The London Approach also states the importance of the Bank of England itself in mediating disputes and negotiating restructuring agreements. Although the Bank of England no longer adopts a major role in such

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[134] *See*, *The London Approach*, Bank of England (1990), *available at* http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/1993/qb93q1110115.pdf (Last visited on November 3, 2016).
[135] *Id.*
[136] *Supra*¸ note 26.
[137] *Supra*¸ note 26.
[138] *Supra*¸ note 26.
[139] *Supra*¸ note 26.

mediations or negotiations,[140] the Approach envisages a financial supervisor doing the same.

The major critique of the London Approach lay in its non-addressal of debt trading as a means of recovery.[141] When debt is traded, it leads to new parties being involved in the restructuring agreement, thereby further complicating matters for the consortium and the corporate debtor. This issue was partially addressed and resolved by the 1998 Bangkok Approach.

B. Bangkok Approach

Following the Thai economic crises of 1997, the government went through intensive stages of developing an appropriate policy for debt restructuring and recovery in the country. In what is called the "Bangkok Approach", the principles and procedures for the same were laid out for non-performing loans involving multiple creditors in Thailand.[142] The goal of this framework was to minimise losses to the corporate debtor and creditors as well as to avoid company liquidation. While it mirrored many of the Bank of England's key principles such as the requirement of complete and accurate information, the presence of a lead bank and a steering committee, and a standstill period, it also contained guidelines on the creation of a separate committee to review all restructuring plans and debt trading. It also contained elaborate timelines within which certain procedural requirements, like meetings between creditors and the debtor, the formulation of the restructuring plan and so on were laid out.[143]

The formation of the Corporate Debt Restructuring Advisory Committee ('CDRAC') is a measure that was taken to ensure that all restructuring agreements were in tandem with the principles of the Framework. The CDRAC's role as a mediator between differing parties has been crucial in restructuring debt in Thailand. It oversaw restructuring agreements and worked out appropriate plans for the same.[144]

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140 WOOD, *supra*, note 5, at 627.

141 Garrido, *supra*, note 6, at 53.

142 *See*, Tumnong Dasri, *Out-of-court Corporate Debt Restructuring in Thailand*, *available at* http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan005376.pdf for a useful summary and analysis (Last visited on November 3, 2016).

143 *Id.*

144 *See*, Tilleke & Gibbins, *Bankruptcy and Restructuring*, November, 2011, *available at* http://www.tilleke.com/sites/default/files/2011_TLB_bankruptcy.pdf (Last visited on November 3, 2016).

C. Istanbul Approach

In the wake of the 2001 Turkish financial crises, the government moved towards intervening in nineteen private banks, which were acquired by a state public asset management agency. Following this, the Banking Regulation and Supervision Agency worked out a plan to ensure that non-performing loans in the non-intervened banks were repaid.[145] This plan was developed by Turkish Bankers Association and was based on the London Approach. At its core, the Istanbul Approach is characterised by the Inter-Creditor Agreement, which was approved and signed by the major banks in the country.[146]

The program, like its international counterparts, had several key elements. In the *first* place, creditors had to agree to move forward with a non-judicial method of resolving this debt conflict instead of resorting to formal methods.[147] *Second*, there should be a lead bank and a creditors committee which work out the modalities of each individual plan and direct the course of action that is to be taken.[148] *Third*, it looked at specific timelines for resolution of debt-related conflicts.[149] *Fourth,* all decisions had to be approved by a 75% majority of the creditors. In addition, there were previously mentioned clauses on standstill periods and confidentiality.[150]

III. REGULATION OF CORPORATE DEBT RESTRUCTURING IN INDIA

In India, the framework for corporate debt restructuring has surfaced through multiple RBI circulars over the last fifteen years. These guidelines and regulations have been heavily based on the London Approach, along with significant inputs from the Bangkok Approach as well. In this Part of the paper, I will chronicle the key features of main circulars in this time period.

A. Initiation of the Corporate Debt Restructuring Process in India: 2001

In 2001, an RBI circular was issued which provided a set of guidelines for the process and mechanism of Corporate Debt Restructuring ('CDR') in

[145] MICHAEL POMERLEANO, CORPORATE RESTRUCTURING: LESSONS FROM EXPERIENCE 76 (2005).
[146] *Id.*, at 81.
[147] POMERLEANO, *supra*, note 37, at 82.
[148] *Id.*
[149] *Id.*
[150] *Id.*

India.[151] This mechanism was formulated following extensive analysis of laws and policies in other jurisdictions like the United Kingdom, Korea, and Thailand. The primary objective of this mechanism was to alleviate debt obligations and restructure them in an efficient manner without involving legal or regulatory bodies like the Board of Industrial and Financial Reconstruction and the Debt Recovery Tribunal. By creating this overarching system, governance systems began to move closer towards settling potential and ongoing disputes in a more efficient – and even privatised – fashion, with minimal interference from government-mandated regulatory bodies. These guidelines have allowed for a decentralised method of resolving corporate insolvency or potential insolvency by allowing the process to be formulated and governed by a non-governmental and non-regulatory body.

In terms of structure, there is a three-tier structure of the CDR mechanism. At the *first* level, there is the CDR Standing Forum which is a body which represents all financial institutions and banks that wish to be a part of the CDR system. The role of the Standing Forum is to formulate policies and guidelines which will cover the way in which CDR is to work in India. At the *second* level, there is the CDR Empowered Group which consists of high-level representatives of financial institutions and banks. The Empowered Group will play the role of deciding specific and individual cases of CDR. The Empowered Group is to look at each application for debt restructuring and conclude upon whether it is viable and possible for the Company in question to restructure its debt in a specific manner. It will then approve the restructuring package within a time frame. If the Empowered Group does not find the possibility of restructuring viable for the Company, the creditors are then free to take any step for recovery of debt, which may include winding up of the Company and liquidation of assets. At the *third* level, there is the CDR Cell. This Cell will receive all references and applications for CDR by borrowers/lenders and conducts the initial examination of proposals from borrowers or lenders. The Cell will examine them in light of the general policies laid down by the CDR Standing Forum and submit the restructuring plan before the Empowered Group.

The RBI Circular also provides for the creation of a "stand still" clause in the Debtor-Creditor Agreement. According to this, both parties will agree to not take any recourse in legal or formal dispute resolution bodies for a period of 90 or 180 days, during which the CDR scheme is being devised by the CDR Cell, Empowered Group, or Standing Forum.[152]

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[151] *See*, Reserve Bank of India, *Corporate Debt Restructuring*, (August 23, 2001), *available at* https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=440&Mode=0 (Last visited on November 3, 2016).

[152] *Id.*

CDR can take place before the commencement of commercial production, after the commencement of commercial production but before the asset is classified as sub-standard, or after the commencement of commercial production and after the asset is classified at 'sub-standard' or 'doubtful'.[153]

The CDR mechanism is to be legally provided for in the Debtor-Creditor Agreement and the Inter-Creditor Agreement. The Debtor-Creditor Agreement can be entered into at the time of signing the original debt agreement or later while enforcing the CDR mechanism.[154] This mechanism is not available to one debtor or one creditor but is applicable only when there are multiple banking accounts or a syndication/consortium of banks. All banks and financial institutions must necessarily enter into Inter-Creditor Agreements which contain enforcement and penal provisions. The CDR mechanism is completely non-statutory and is to proceed on a voluntary basis with full consent between the debtor and creditor. The most crucial part of the CDR mechanism, however, remains the stipulation that if 75% of creditors (by value) agree to a debt restructuring plan, it will be compulsorily enforced on the remaining creditors also. There is no need for a unanimous agreement upon a particular plan to be taken.[155] A CDR can occur without a company being sick, a non-performing asset ('NPA') or in default. However, cases which appear to be NPAs will get priority by the CDR Cell. The process can be initiated by any creditors who jointly have at least 20% share in the company's working capital or term finance or by the company itself, if the idea is supported by the bank or financial institution having a minimum of 20% share.[156]

B. Revised Guidelines of 2003

In 2003, the RBI issued amendments and revisions to the guidelines of 2001. One major change was the division of accounts into two categories: accounts which are 'standard' or 'sub-standard' would be restructured under 'Category 1' whereas accounts which are 'doubtful' would be restructured under a new Category 2. Under Category 2, the existing loans will be restructured and there is not *per se* requirement to create an additional financing arrangement. Other than that, the procedure and manner of CDR are the same as for standard or sub-standard accounts.[157]

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[153] Added by the 2003 Circular. Reserve Bank of India, *Corporate Debt Restructuring* (February 5, 2003), *available at* http://www.cdrindia.org/downloads/CDR-RBI-Circular%20-5%20February%202003.pdf (Last visited on November 3, 2016).

[154] *Id.*

[155] *Supra*, note 45.

[156] *Supra*, note 45.

[157] *See*, Reserve Bank of India, *Corporate Debt Restructuring* (February 5, 2003), *available at* http://www.cdrindia.org/downloads/CDR-RBI-Circular%20-5%20February%202003.

Additionally, the concept of stand still clauses was expanded upon. It stated that these clauses only apply to civil action and that criminal actions could be initiated during the concerned period. Further, the borrower must confirm that the documents would be extended for the purposes of limitation. Additionally, the borrowing company must state that its directors will not resign from the Board during the pendency of the stand still period.[158]

This revision also creates an option to convert debt or a part of the debt into equity. This option has been elaborated upon in future circulars dealing with the matter.

C. 2014 Guidelines

After several circulars and notifications in 2005 and 2008, the next prominent guidance on CDR came in the 2014 *Framework for Revitalising Distressed Assets in the Economy*.[159] A new mechanism was established in 2002 wherein banks would identify certain accounts as Special Mention Accounts ('SMA') in order to pre-empt the possibility of default. These SMA accounts are to be reported to the RBI and in case the potential of default reached a particular threshold, the lenders were to form a Joint Lenders' Forum ('JLF') and work out a Corrective Action Plan ('CAP') for the account in question. This CAP by the JLF could provide multiple options to the debtor such as rectification, restructuring and recovery. The Framework covers the process in which restructuring is to be done. However, it also briefly covers rectification and recovery as viable options for the lenders. Rectification involves creating a plan of action wherein the borrower makes a commitment that the account will not become a non-performing asset and agrees to regularise the debt repayment through proper cash flows. In the event that the company's promoters cannot do so, they can explore the option of getting external investment, in consultation with the JLF.[160] Additional financing can also be provided if the JLF is certain that this will regularise the account. Restructuring involves rethinking the terms of the debt agreement. This will be elaborated upon in the following paragraphs. A final option is recovery, which may be resorted to in case rectification or restructuring is not possible. This may be done through legal options like application to Debt Recovery Tribunals or the new Insolvency and Bankruptcy Board of India.

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pdf (Last visited on November 3, 2016).

[158] *Id.*

[159] *See*, Reserve Bank of India, *Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalising Distressed Assets in the Economy* (January 30, 2014), *available at* https://rbidocs.rbi.org.in/rdocs/content/pdfs/NPA300114RFF.pdf (Last visited on November 3, 2016).

[160] *Id.*

The process to restructure an account can be formulated by the JLF or by the CDR Cell.[161] While there are specific technical differences in how this can be done, the overarching principle is that the loss should be borne by the shareholders of the company and not the creditors. Apart from a general renegotiation of the terms of the loan agreement, this Framework creates the possibility of converting the debt of the company into equity. This is done through transfer of the promoters' equity to the lenders so that there is some form of compensation for the potential loss of cash flow. Alternatively, promoters can issue further shares to increase the capital of the company and also increase cash flow. Finally, the promoters' holdings can be transferred to a security trustee or an escrow account until the company resolves its financial difficulties. If the lenders so wish, this can also provide for a change in management or control of the company.[162]

These Guidelines also lay down which cases would not be considered for CDR. In the first place, cases which were referred to the Board for Industrial and Financial Reconstruction are not eligible. Similarly, debtors who are wilful defaulters are not allowed. However, in both of these cases, if the CDR Core Group grants approval, they may have their debts restructured under CDR mechanisms. However, cases in which corporate creditors or debtors have engaged in fraud or malfeasance are completely barred from accessing relief through CDR.[163]

D. Reasons for Adopting CDR

Despite flaws in its working, CDR in India has been a huge source of attention for the past several years. It is important to understand why it is such a popular option for both debtors and creditors before analysing the problems associated with it.

In the first place, it appears to be a more convenient option that the other formal means of recovering debt such as the revival of sick companies or winding up under the Companies Act, 2013. Both these processes can be long-winded and tedious as they involve considerable interaction with tribunals or courts, particularly for recognition of sick or unprofitable status, formulating of plans, and enforcement. Alternatively, the company can explore options under the Sick Industrial Companies Act, 1985. However, this only applies to industrial companies, in the first place, and in the second place,

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161 *See infra,* Part V-C for a step-by-step explanation of the process.

162 *Id.*

163 *See*, Reserve Bank of India, *Review of Prudential Guidelines - Revitalising Stressed Assets in the Economy* (February 25, 2016), *available at* https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=10293&Mode=0 (Last visited on November 3, 2016).

companies whose losses exceed their net worth – and are usually beyond any meaningful restructuring of debt. In that light, opting for CDR, with its set timelines and relatively lenient and flexible procedures is a highly efficient plan of action for debtors.

On the other hand, from a lender's perspective, CDR is a non-statutory form of debt recovery which allows creditors to avoid losses coming out of debt transactions. Unlike formal procedures like liquidation, which are likely to yield lower returns, the various schemes and possibilities under a Debtor-Creditor Agreement in accordance with CDR mechanisms can be more efficient for the creditors. Further, with the existence of useful feasibility studies, it does look like an attraction option for creditors as well. All in all, it would appear that a non-regulated private workout between the borrower and lenders would enable parties to arrive at a mutually desirable solution.

Therefore, despite flaws in terms of implementation, CDR seems to be a meaningful departure from strictly rule-based methods of debt recovery. Although there are these positive aspects of CDR, the difficulties associated with it must not be neglected and will be discussed later in this paper.

E. Key Components of CDR

The mainstay of any CDR process lies in the two agreements upon which the entire plan rests: the Debtor-Creditor Agreement and the Inter-Creditor Agreement. In this Part, I will examine both the form and content of both these agreements.

1. Debtor-Creditor Agreement ("DCR")

In this kind of agreement, the two parties are the consortium of banks and the debtor. This agreement often works in such a manner that it consolidates all the debt that the debtor owes to various creditors in one document and sets out new terms for repayment of the debt. The advantage of this is that the new terms apply across the board to all creditors, making the debtor's burden slightly less for the purposes of this consolidated debt. Further, the restructuring of loans into one arrangement ensures that all debt is covered in a way that lists all obligations of the debtor in a systematic manner. The terms of restructuring may be any of the options listed above in Part II-C.

An absolutely crucial part of the DCA is the standstill clause – which is a necessity in light of how the process of debt restructuring is sought to work. This clause is vital as it seeks to provide a window of time within which information will be collected and plans to restructure the debt will be made. At the first instance, all lenders will agree to refrain from seeking formal adjudication or debt resolution means like courts or tribunals.[164] Secondly, the creditors will maintain their facilities at erstwhile agreed conditions until the plan has been formed. More specifically, however, there are some terms of the standstill clause that deserve to be mentioned:

a) All creditors to be treated equally: This means that no creditor will be given an undue advantage once the CDR mechanism is brought into operation. Clauses which seek to protect this include those which prohibit prepayment of specific loans, new security to specific creditors, no increases in interest rates, disclosing relevant information for the better working of the Agreement as a whole.[165]

b) Creditors maintain status quo: This means that no bank will undertake measures which will adversely affect the working of the CDR plan. Appropriate covenants in this regard are bans on termination of accounts, enforcement of security, set-offs, petitions for insolvency, assignment of debt, or loan acceleration agreements.[166]

There will also be clauses on fees to be paid to various committees or to the CDR Cell for the formulation of the plan. Additionally, maintaining confidentiality will be a major term in this agreement.

Indispensable to such an agreement are clauses which pertain to a monitoring and review of the debtor throughout the course of the plan. At a preliminary stage, this will involve complete access to all of the company's documents pertaining to its debt obligations, such as analysis on profit and loss, sales projections, transactions within the industry, the value of its assets, documents on its banking and credit history, prominent sales/service contracts, licences, clearances, approvals, and so on.[167] In essence, the consortium of banks and the CDR Cell will perform the equivalent of a due diligence on the bank in order to ascertain the possibility and extent of debt restructuring. In addition, the DCA can contain milestones that must be achieved by the corporate debtor, which will be periodically reviewed by a committee constituted under the Agreement itself.

A DCA will also contain a clause on consequences in case of default, which can include liquidation of assets or change of management and control of the company itself.

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164 WOOD, *supra,* note 5, at 629.
165 *Id*, at 630.
166 *Id*, at 631.
167 *Id*, at 631.

2. Inter-Creditor Agreement ("ICA")

Inter-creditor agreements are common in cases where a common borrower has two or more creditors. In order to avoid and resolve any potential conflict with respect to the repayment of debt to these creditors, they may enter into an ICA. The primary purpose of such an agreement is to ensure that there is parity among all the creditors in the CDR process and that no creditor is disadvantaged during the implementation of the plan.[168]

In essence, the ICA involves multiple creditors agreeing to abide by the CDR plan that will be formulated by the CDR Cell. It also contains procedural guidelines on how the CDR Cell and EG will carry out their responsibilities and how the banks or creditors in question will respond to the plan so made. This agreement also includes a standstill provision, which under the 2001 RBI Guidelines, is required to be a period of 90 days, and may be extended to 180 days.[169] The ICA will look at how major decisions such as loan acceleration, waiver, change of interest rate or tenor may be made by the consortium of banks.[170] Additionally, these agreements may have loss-sharing clauses, which will deal with how loss will be distributed among different banks in the case of a default or a lack of output on the part of the corporate debtor.[171] This kind of agreement also attempts to place an order of priority among the banks themselves, by working out which debt is to be paid first.

F. Working of CDR

The website of the CDR Cell frequently updates the status of applications and plans made before it. As of June 2016, the Cell has received a total of 655 debts to restructure, which aggregates to a total of Rs. 4,74,002 crore.[172] Of these, 125 cases (Rs. 70,998 crore worth of debt) have been rejected by the Cell, leaving 530 cases accepted (with Rs. 4,03,004 crore of debt). Out of this 5,30, 228 cases have failed to achieve set goals and were withdrawn (the debt amounted to Rs. 97,242 crore). However, 94 cases were successful and Rs. 68,894 crore worth of debt was restructured. There are currently 208 "live cases", of which 207 have been approved and implemented (with Rs.

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[168] *See*, Debra J. Schnebel, *Intercreditor and Subordination Agreements - A Practical Guide*, 118 Banking LJ 48 (2001).

[169] *Supra*, note 44.

[170] Wood, *supra*, note 5, at 641.

[171] *Id*,

[172] *See*, Corporate Debt Restructuring Cell, Progress Report (June 30, 2016), *available at* http://www.cdrindia.org/pdf/CDR%20Performance%20upto%20June%202016.pdf (Last visited on November 3, 2016).

2,34,959 crore) and one case (debt of Rs. 1,909 crore) is under implementation. Here is a percentage-wise analysis of these figures:

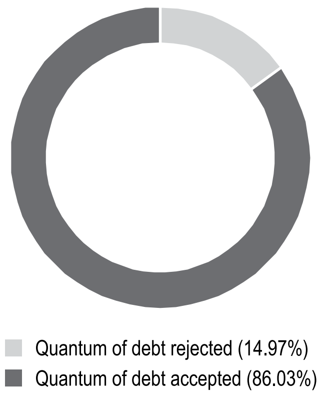

Fig. 1

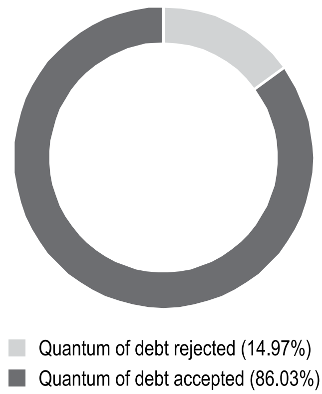

Fig. 2

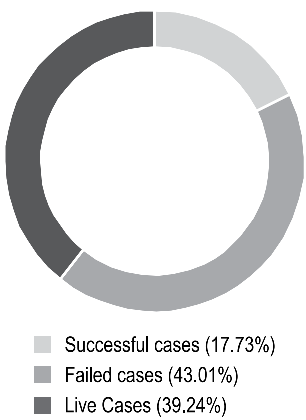

Fig. 3

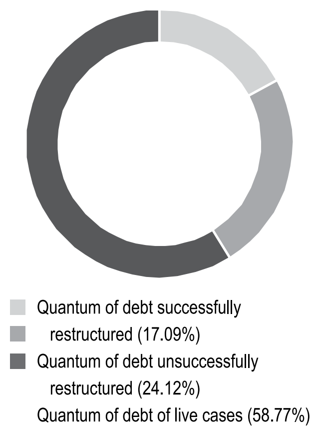

Fig. 4

In addition, it is seen that the iron and steel industry has formed the largest proportion of live cases to be restructured under CDR, with 48 cases and Rs. 52,190 crore in debt (forming 23.07% of the total number of cases and 22.03% of the debt). This is followed by infrastructure, which constitutes 17 cases and Rs. 40.941 crore (8.17% of cases and 17.28% of the debt).[173]

Despite the seeming popularity of CDR mechanisms with respect to application numbers, it is clear that the process has largely failed to produce any meaningful outcome in the scheme of debt restructuring in India.

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[173] *Id.*

With such a large percentage of failed cases, it is doubtful as to whether this policy measure is likely to result in any positive outcome for debt recovery in India. Once the restructuring package has failed to produce any tangible output, the creditors have three main options: i) to recognise the account as an NPA; ii) to invoke measures like Strategic Debt Restructuring ('SDR') or 5:25 refinancing; or iii) sell the account to asset reconstruction companies.[174]

The failure of the CDR mechanism, albeit carefully thought out over a period of fifteen years, can be attributed to several key reasons. At the first instance, the entire scheme is non-statutory and hence, defaulting or dissenting from a proposed plan causes minimal consequence within the ambit of the scheme. Furthermore, the non-statutory backing of the schemes also allows creditors to default on the Inter-Creditor Agreement, even when a majority has agreed to its implementation.

Another reason for failure may lie within the process of implementing the CDR mechanism. Prior to allowing for CDR in a particular case, it is necessary for the CDR Cell to conduct a techno-economic viability study which will look at the feasibility of restructuring the loans. After this, plans are made regarding the concessions to be made. This analysis is made on the basis of the projected profit and loss margins as against the expected sales of the concerned company. However, it is often seen that this projection is flawed. In a case study of 73 companies, it was seen that 42 of them did not match up to the required projections necessary for compliant restructuring of the existing loan amounts.[175]

In other cases, the lack of coordination among lenders is a source of considerable confusion for plans. This is often due to information asymmetry and different timelines for approvals from boards and members.[176] In yet other cases, the promoters of the company cannot bring sufficient capital to the company so as to achieve production goals.[177] Finally, in cases of debt-equity swap, the new management is less invested in the health of the company and projected output cannot be attained due to this reason.[178]

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[174] *See*, Religare, SDR: A Band-aid For A Bullet Wound (January 4, 2016), *available at* http://research.religarecm.com/INDIA/India%20Banks%20-%20Sector%20Report%204Jan16.pdf 12 (Last visited on November 3, 2016).

[175] *See*, Indian Institute of Banking and Finance, CDR Report, *available at* http://www.iibf.org.in/documents/reseach-report/CDRultimateFinal_Report_2909.pdf 55 (Last visited on November 3, 2016).

[176] *Id.*, at 61.

[177] *Id.*

[178] *See, for e.g.*, Shishir Asthana, *Why debt conversion to equity is a bad deal for ABG Shipyard shareholders*, Business Standard (October 7, 2016) *available at* http://www.business-standard.com/article/markets/why-debt-conversion-to-equity-is-a-bad-deal-for-abg-shipyard-shareholders-116100700279_1.html (Last visited on November 3, 2016).

G. 2015 Guidelines

In June 2015, the RBI released another guideline on Strategic Debt Restructuring ('SDR'), wherein debt can be converted to equity shares after the failure of CDR mechanisms to resolve the debt conflict.[179] Such a debt restructuring agreement must possess certain vital features, which the RBI has listed out. First among these is that the JLF must place the proposal to convert a part of or the entire loan amount with interest into shares in case the debtor is not able to reach certain milestones in the restructuring agreement. However, this move must be supplemented by the required approvals and authorisations (including those by shareholders) that are mandated by law. The process works as follows: the JLF must monitor whether the account is able to reach certain milestones and in the event that it does not or reaches certain "critical conditions", the JLF should review the account and decide whether a change in ownership will be beneficial to the account and its associated creditors. This decision to convert debt to equity shares should be taken within at least thirty days of the JLF's review and must be approved by a majority of the JLF (which means 75% of the creditors by value and 60% by number). The creditors should become majority shareholders. The entire package must be approved by the JLF within 90 days of deciding to adopt this method and the conversion should be complete within 90 days of this approval.[180]

This plan would require shareholder approval as it would result in a 51% shareholding of the consortium of banks and would dilute the shareholding of erstwhile shareholders. The JLF will hold the asset status of the loan for eighteen months, at the end of which it must divest its holding in the distressed company.

H. 2016 Guidelines

In mid-2016, the RBI issued yet another Circular, this time containing the S4A or the Scheme for Sustainable Structuring of Stressed Assets.[181] This is a closer regulation of the SDR mechanism. In order for accounts to qualify for this scheme, there are three criteria: the project must have begun operations; the total debt including interest is more than Rs. 500 crore; and the

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[179] *See*, Reserve Bank of India, *Strategic Debt Restructuring* (June 8, 2015), *available at* https://rbi.org.in/Scripts/NotificationUser.aspx?Id=9767 (Last visited on November 3, 2016).

[180] *Id.*

[181] *See*, Reserve Bank of India, *Scheme for Sustainable Structuring of Stressed Assets* (June 13, 2016), *available at* https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10446&-Mode=0 (Last visited on November 3, 2016).

debt must be sustainable as concluded by the JLF or the consortium or they must conclude that the principal amount can be repaid at the same tenor and sustainable debt must also not be less than 50% of the current funded liabilities. The JLF or consortium will divide the debt into two parts: Part A and Part B. Part A will be the sustainable debt and the remaining part of the debt which is unsustainable will be Part B. There will be a resolution plan drawn up which will not include a fresh moratorium, extension of the repayment schedule, or reduction in interest rate of Part A of the debt. Part B will be converted to equity or redeemable cumulative optionally convertible preference shares.[182]

The conclusion of the resolution may result in one of the following three outcomes:

a) The existing promoter continues to possess majority shareholding and control over the debtor company.

b) The existing promoter is replaced by a new promoter – through conversion of the debt into equity under the Strategic Debt Restructuring scheme and following sale to a new promoter or according to the norms under Prudential Norms on Change in Ownership of Borrowing Entities.

c) The creditors have majority holding in the shares and either allow the existing management to continue or change the management to another body under an "operate and manage" contract.[183]

The resolution plan should be submitted to an Overseeing Committee which will review the plan before its implementation.

I. Analysis of Debt-Equity Conversion as an Option For Creditors

The 2015 and 2016 Guidelines (as elaborated upon above) pertain to the possibility of converting debt to equity in order for the creditors to be repaid through returns on their equity. Through this method, the creditors become the shareholders. It is usually effected by setting off the debt amount against the subscription price of the shares or by releasing debt to to the extent of the subscription price. This option is only taken as a last resort measure and requires existing shareholder approval in order to be effective.[184]

182 *Id.*
183 *Id.*
184 *See*, Steptoe & Johnson LLP, *Debt to Equity Swaps* (May, 2009), *available at* http://www.steptoe.com/publications-6418.html (Last accessed on November 3, 2016).

The primary reason for engaging in such a swap is that it reduces the burden on a loss-making company at the first instance. Since returns on shares and investments are made only out of profits and not the company's capital, it is beneficial for the company to convert debt to equity for short-term relief. Additionally, the banks are likely to receive returns on profits if the debtor picks up and resumes production, which is an incentive to invest in the company. In what is relevant to the health of the company and the creditors' interests, the lender will have a degree of control in the affairs of the company and will be able to vote in major decisions as a shareholder. In this manner, they will be motivated to ensure that the company is revived and that its dues are settled as a result thereof.[185]

However, there are flipsides to such conversions. The first is that the creditor loses priority upon becoming a shareholder and will rank only after creditors of the company.[186] Additionally, it is time-consuming and involves heavy procedure to redeem shares, as opposed to debt which is simpler in its repayment procedure.[187] Swapping debt for equity will also result in the loss of securities and guarantees which are given against loans, which means that obtaining the borrowed money against some kind of surety or collateral becomes impossible.[188] Existing shareholders will find that their shareholding has been diluted due to this plan and may be in favour of the move if it appears likely that it will result in a profit for the company. Under the Indian guidelines, SDR schemes prove difficult due to the possibility of not finding new promoters (elaborated upon later), resistance from shareholders and workers, and the need for constant monitoring of the corporate debtor post the swap.[189]

J. Working of SDR and S4A

Much like CDR, the debt-equity conversion guidelines by the RBI have been heavily criticised on the ground that it will only result in further debt and bring about no tangible change to the indebtedness in the industry.

A preliminary practical problem that arises in this operation is that the banks often have difficulty in finding new promoters for the company, which

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[185] WOOD, *supra*, note 5, at 645.
[186] *Id*, at 646.
[187] Companies Act, 2013, §5 which imposes conditions on the redemption of preference shares.
[188] WOOD, *supra* note 5, at 648.
[189] *See*, RBSA, STRATEGIC DEBT RESTRUCTURING (September, 2015), *available at* http://rbsa.in/archives_of_research_reports/Strategic_Debt_Restructuring.pdf (Last visited on November 3, 2016).

must be done within 18 months as per the guidelines.[190] In a telling report by Religare, the analysis concluded that SDR mechanisms were unfit to deal with the mounting debt in India. At the first instance, the report concluded that by the time SDR measures are invoked, the debt levels will have risen by 70% upon finishing the SDR process from the date of restructuring.[191] If the SDR mechanism fails, the company will be written of as an NPA which will be detrimental to the creditors.[192]

The functioning of these schemes also pose several legal and practical challenges. Take the case of Kingfisher Airlines, which in 2010 underwent a debt-equity conversion of Rs. 1355 crore, resulting in the banks owning 23.21%.[193] Despite this and promoter conversion of debt into equity, the company could not be revived. Equity is also more expensive than debt due to tax liabilities that arise in the case of shareholding. Another problem that has been highlighted is that unsecured creditors can approach formal adjudication forums and demand repayment of their debt. Since SDR and S4A schemes are non-statutory, courts and tribunals are likely to pay heed to unsecured creditors and outstanding debt will have to be paid.[194]

IV. The Insolvency and Bankruptcy Code: A Game Changer?

In May, 2016, the Parliament passed the Insolvency and Bankruptcy Code ('the Code'). This Code was brought in to simplify insolvency proceedings as a whole and to replace the multiple Acts and regulations which governed debt recovery in India. In this Part of the paper, I will look at the efficacy of "hybrid" procedures dealing with insolvency over completely informal and non-statutory procedures like CDR, SDR and S4A – and assess whether the Code falls within this category. I will then look at how the Code may serve as a viable alternative for CDR and SDR agreements by closely examining the provisions of the Code and of the Draft Rules associated with the Code.[195]

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[190] *See*, Namrata Acharya & Ishita Ayan Dutt, *Little success for SDR as banks scout for promoters*, Business Standard (November 30, 2015), *available at* http://www.business-standard.com/article/companies/little-success-for-sdr-as-banks-scout-for-promoters-115112700444_1.html (Last visited on November 3, 2016).

[191] *Supra*, note 66.

[192] *Supra*, note 66.

[193] *See*, Tamal Bandyopadhyay, *S4A won't solve the bad loans problem*, Livemint, June 27, 2016, *available at* http://www.livemint.com/Opinion/0tjjJ3EIJsuAK52VFJy0ZO/S4A-wont-solve-the-bad-loans-problem.html (Last visited on November 3, 2016).

[194] *Supra*, note 66.

[195] The Rules have been placed on the Ministry of Corporate Affairs website for public comments and are expected to be finalised by November.

A. Hybrid Procedures

Hybrid procedures are those that fall between formal insolvency proceedings such as winding up before the Company Law Board and informal agreements such as those under CDR and SDR in India. Hybrid procedures combine elements of both formal and informal options.[196] This means that there is usually a contractual agreement between the creditors and the debtor but there is oversight by a judicial or quasi-judicial body at the same time.[197] There are several ways in which a hybrid procedure can play out. It can be such that a court order is sought for a stay on all creditors to call for liquidation while the majority of creditors are formulating a workout plan. Alternatively, it can be that the court appoints a mediator to resolve the debt dispute and reach an appropriate plan.

Hybrid measures often have an advantage over wholly formal and wholly informal means of debt restructuring as they provide parties with the flexibility to decide the terms of the workout and restructuring but still subject the entire procedure to adjudicatory control.

Under the Code, the procedure is one that adopts a hybrid approach to insolvency and debt restructuring. According to the provisions of the Code, upon default of loan payment, any creditor can apply to the Insolvency and Bankruptcy Board for insolvency of the corporate debtor. Upon this application, the Board will appoint an Insolvency Professional[198] who will be approved by the Committee of Creditors.[199] This Insolvency Professional will also take over the management of the company as the Board of Directors will be suspended and all powers will be in the hand of the Insolvency Professional.[200] The Insolvency Professional will then create the information memorandum,[201] following which the resolution plan will be proposed by the creditors along with the Insolvency Professional.[202] This plan must be approved by 75% of the creditors[203] and then by the Adjudicating Authority.[204] Failing this approval, the company will go into liquidation.[205]

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[196] *See*, Francisco J. Garcimartin, *The Review of the Insolvency Regulation: Hybrid procedures and other issues*, *available at* http://www.eir-reform.eu/uploads/papers/PAPER%20 6-1.pdf (Last visited on November 3, 2016).
[197] Garrido, *supra*, note 6, at 57.
[198] Insolvency and Bankruptcy Code, 2016, §16.
[199] Insolvency and Bankruptcy Code, 2016, §22.
[200] Insolvency and Bankruptcy Code, 2016, §17.
[201] Insolvency and Bankruptcy Code, 2016, §29.
[202] Insolvency and Bankruptcy Code, 2016, §30.
[203] Insolvency and Bankruptcy Code, 2016, §30(4).
[204] Insolvency and Bankruptcy Code, 2016, §31.
[205] Insolvency and Bankruptcy Code, 2016, §33(1).

Under the Code, therefore, it is clear that the process to resolve insolvency and to develop a plan for recovering and restructuring the debt is not one that is fully subject to court or tribunal intervention but follows a hybrid approach of allowing parties to come to a conclusion among themselves and work out a solution.

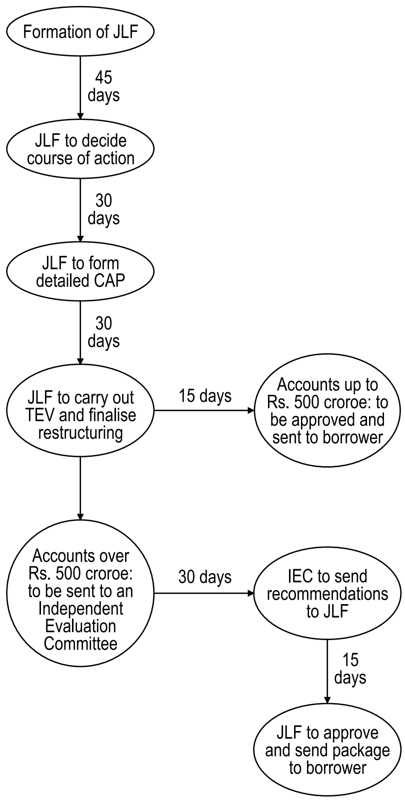
B. Comparison between CDR (JLF Route) and The Code[206][207][208]

	Corporate Debt Restructuring (JLF route)	**Insolvency and Bankruptcy Code, 2016**
Is there a minimum debt amount?	Yes. Rs. 10 crore.	Yes. Minimum default amount is Rs. 100,000. The Central Government can increase this minimum amount to a higher value, which cannot exceed Rs. 10,000,000.[98]
What is the trigger event that causes initiation of the mechanism?	The reporting of an account to the RBI as SMA-2 by one of more lending banks/ non-banking financial companies. OR A request from the borrower to form a JLF (if it foresees financial distress). [***SMA-2****: Payment of principal or interest is overdue for 61-90 days*]	An application by a financial creditor or operational creditor or the corporate debtor to initiate the corporate insolvency resolution process before the Adjudicating Authority (currently the NCLT).[99]
Can either the debtor or the creditor cause the trigger?	Yes.	Yes.
What happens post-trigger?	The JLF should be formed and it must formulate a Corrective Action Plan.	The Adjudicating Authority appoints and Insolvency Resolution Professional.[100]

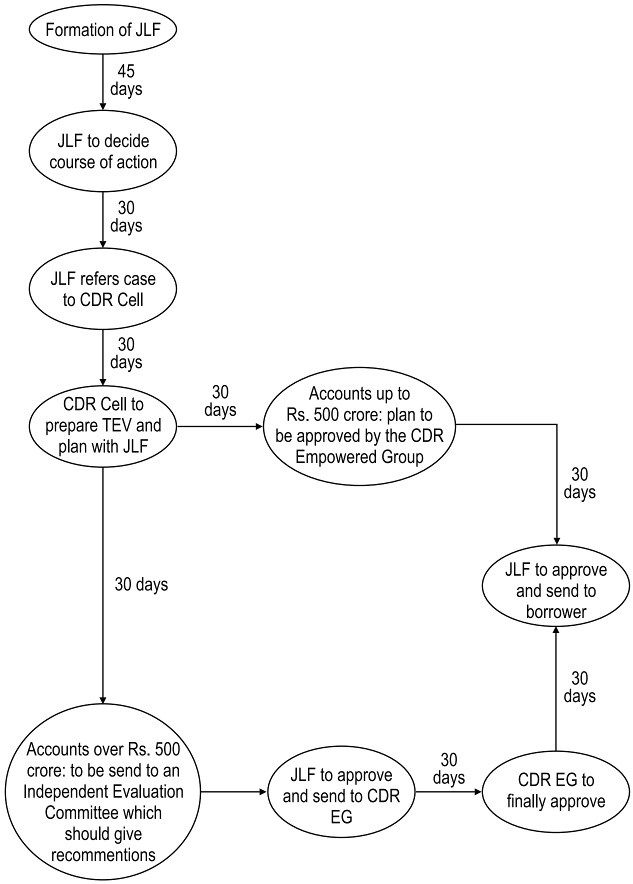
[206] Insolvency and Bankruptcy Code, §4.
[207] Insolvency and Bankruptcy Code, 2016, §§7-10.
[208] Insolvency and Bankruptcy Code, 2016, §13.

What is the procedure to formulate the plan?

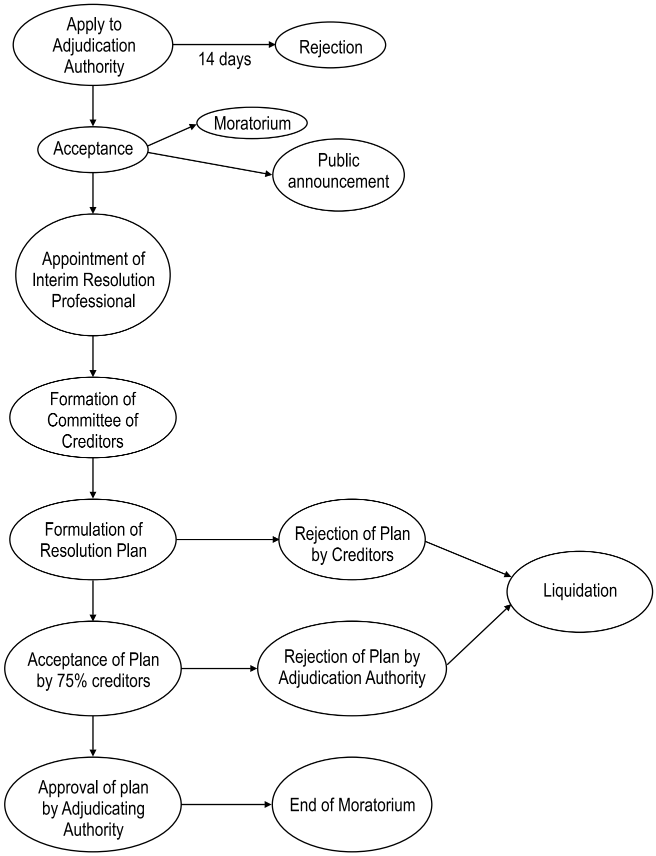
JLF:



CDR:


Formation of JLF
45 days
JLF to decide course of action
30 days
JLF refers case to CDR Cell
30 days
CDR Cell to prepare TEV and plan with JLF
30 days
Accounts up to Rs. 500 crore: plan to be approved by the CDR Empowered Group
30 days
JLF to approve and send to borrower
30 days
Accounts over Rs. 500 crore: to be send to an Independent Evaluation Committee which should give recommentions
JLF to approve and send to CDR EG
30 days
CDR EG to finally approve
30 days

IBC:



What is the total number of regulatory steps to be complied with?	JLF Route Accounts up to Rs. 500 crore: 5 Accounts up to Rs. 500 crore: 7 CDR Cell Route Accounts up to Rs. 500 crore: 6 Accounts up to Rs. 500 crore: 8	7

What are the broad timelines to be followed?	JLF Route Accounts up to Rs. 500 crore: 120 days Accounts over Rs. 500 crore: 150 days CDR Route Accounts up to Rs. 500 crore: 165 days Accounts over Rs. 500 crore: 195 days	The plan must be approved by the creditors within 180 days of the date of application; this can be extended by 90 days.[101]
What is the legal basis for the plan?	The Inter-Creditor Agreement and the Debtor-Creditor Agreement.	Part II, Chapter II, Section 6-32.
Is any class of debtors/creditors barred from availing this option?	Yes. Wilful defaulters; may be allowed if the JLF is satisfied that the defaulter can rectify. Borrowers who have engaged in fraud or malfeasance.	Yes. The following debtors/creditors cannot initiate an IRP: A corporate debtor undergoing the IRP; A corporate debtor that has completed an IRP in the twelve months preceding the application date; A corporate debtor/financial creditor which has violated the terms of an IRP in the twelve months preceding the application date; A corporate debtor who has been ordered into liquidation.[102]
Are unsecured creditors covered under the plan?	They may be, if covered in the ICA.	Yes.
What percentage of creditors must agree to the plan?	75% (by number) and 60% (by value).	75% of financial creditors (by value).[103]
Are there any compulsory terms in the plan?	Standstill clause.	Yes. Terms concerning the cost of insolvency resolution, i.e., estimates, timelines, burden etc.; Payment of operational creditors' liquidation value; Payment of dissenting financial creditors' liquidation value; Duration of the plan; Transfer of management of the corporate debtor.[104]

[101] Insolvency and Bankruptcy Code, 2016, §22.
[102] Insolvency and Bankruptcy Code, 2016, §11.
[103] Insolvency and Bankruptcy Code, 2016, §12.
[104] Draft Insolvency and Bankruptcy (Insolvency Resolution Process) Regulations, 2016, Regulation 42.

What is the standstill/ moratorium period?	Depends on the DCA/ICA; usually 90 days, which can be extended to 180 days.	180 days; can be extended to 270 days.
Is it applicable to foreign creditors?	Yes. It applies to all commercial banks.	Yes. Sections 5(7) and 5(20) define financial and operational creditors respectively as *persons* to whom a financial or operational debt is owed. Section 2(23) further defines a person to include a person resident outside India.
Is there an exit option for dissenting creditors?	Yes, with a condition precedent. Dissenting lenders can exit the ICA and CAP by selling their debt to new or existing lenders. If a buyer cannot be arranged for, the lender must agree to the ICA and CAP.[105]	Yes. The dissenting financial creditors can be paid their liquidation value before recoveries are made by operational or majority financial creditors.[106]
Is a change of management at any stage envisaged?	Not in the ordinary course – it may happen if SDR or S4A is invoked.	Yes. The Interim Resolution Professional will be responsible for the management of the corporate debtor and run the business as a going concern with direction from the committee of creditors[107] - but this is subject to change according to the resolution plan.
Who oversees the implementation of the process?	Unclear. The lenders are supposed to monitor the process but there is no clear stipulation of a body for the same.	The Resolution Professional or else an Insolvency Professional appointed by the Committee of Creditors.[108]

[105] *See*, Reserve Bank of India, *Review of Prudential Guidelines – Revitalising Stressed Assets* (February 25, 2016), *available at* https://rbidocs.rbi.org.in/rdocs/notification/PDFs/330NT250216EFF71EF8EC454943A584E9DD0A3E77FB.PDF (Last visited on November 3, 2016).

[106] Draft Insolvency and Bankruptcy (Insolvency Resolution Process) Regulations, 2016, Regulation 42.

[107] Insolvency and Bankruptcy Code, 2016, §§17-23.

[108] Draft Insolvency and Bankruptcy (Insolvency Resolution Process) Regulations, 2016, Regulation 43.

What happens in case the plan is not successful?	The JLF can enter into an SDR or S4A arrangement, 5:25 scheme (for infrastructure and core industries). If this is also unsuccessful, the creditors can initiate recovery proceedings.[109]	The corporate debtor goes into liquidation.[110]

C. The Resolution Plan

The Draft Insolvency and Bankruptcy (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, which have been uploaded on the Ministry of Corporate Affairs website, contain comprehensive guidelines on the content of insolvency resolution plans. Unlike the RBI circulars which contain vague directions on options available to defaulting debtors and desperate creditors, the Regulations mentioned herein are a far more reliable guideline for what the contents of the DCA ought to be.

At the first instance, Regulation 42 provides for mandatory components of the plan. These are an estimate of costs, of the time that will be taken, identification of assets and funds in relation to the corporate debtor, payment of resolution costs. Since the Code draws a difference between operational and financial creditors, the Regulations also provide for separate relief. Operational creditors are to be paid earlier than financial creditors. Operational debt, as defined in Section 5(21) of the Code includes debt accruing from goods, services, employment agreements, and government dues. Financial debt, under Section 5(8) consists of debts disbursed against the time value of money. The earlier payment of operational creditors means that contracts or dues external to corporate financing are to be paid first. Another notable part of the Regulations is that it provides for any dissenting financial creditors to be paid their debts in liquidation value before the consenting financial creditors are paid. The plan must also specify what happens to the management and control of the company for the duration of implementation of the plan.

[109] However, analysts predict that the outcome of unsuccessful SDRs will be massive write-offs. *See supra¸* note 66.

[110] Insolvency and Bankruptcy Code, 2016, §33.

Regulation 42 provides for the different measures that can be included in the plan, which vary from extension of maturity date to change in interest rate to debt-equity conversions.

D. Analysing Qualitative Differences between the Code and Existing CDR/SDR measures

With the coming of Code, it is clear that the process of recovering debt in India promises to simplify itself. By replacing the earlier swarm of often conflicting laws, the Code attempts to bring some clarity to the domain of insolvency and bankruptcy. While the Code effectively overrides erstwhile legislative measures to recover debt, the question of it fully replacing informal methods such as CDR and SDR still remains. Upon a close analysis (as elucidated above) of the provisions of the Code and its associated Regulations, it appears that these newly passed laws and guidelines do act as an effective substitute to CDR and SDR schemes that the RBI had promulgated, proving to be simpler, more straightforward, and with lesser steps of compliance to be adhered to, but without compromising on the enforcement aspect of debt recovery options. This can be attributed to the hybrid approach that has been adopted in debt recovery, wherein parties can reach their own resolution and also be subject to a quasi-judicial authority. This is definitely a positive step in debt recovery as the failures of CDR lay in the inability of banks and lenders to effectively enforce the terms of the Debtor-Creditor Agreement, despite allowing parties to work out a common solution.

The need for a proper code can be put into perspective by looking at World Bank Rankings for Resolving Insolvency (2017), which is based on data collected till June, 2016, one month after the coming of the Code. India currently ranks 136th, with a recovery rate placed at 26 cents on the dollar, and an average time of 4.3 years. This is in comparison to Finland, which is ranked 1st, with a recovery rate of 90.3 cents and, an average time of 0.9 years. Even in South Asia, India fares poorly, with Pakistan ranking 85th, having a recovery rate of 43 cents, and average time of 2.6 years; and Sri Lanka, ranking 75th, with a recovery rate of 46.2 cents, and average time of 1.7 years. India's neighbours at ranks 135 and 137 are the Maldives (recovery rate: 50 cents; average time: 1.5 years) and Papua New Guinea (recovery rate: 24.9; average time: 3 years).[111] It cannot be doubted that a revamped insolvency regime was the need of the hour and its coming into force promises to bring forth revolutionary change.

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[111] *See*, World Bank, *Doing Business, Resolving Insolvency* (2017), *available at* http://www.doingbusiness.org/data/exploretopics/resolving-insolvency (Last visited on June 20, 2017)

The following characteristics of the Code are a definite game-changer in the process of debt recovery and deserve to be highlighted. *First*, the presence of a formal body which oversees the working of the resolution plan is a welcome step as it ensures that there is constant accountability on the part of the debtor and creditors to a higher regulatory authority. *Second*, the Code also creates Information Utilities, which will make the process of obtaining relevant credit information much easier. The creation of a separate class of professionals who will work on the resolution plan is also a welcome change as it enables resolution plans to be neutral of creditor or debtor biases and will move towards the most efficient solution for all parties. *Third*, the institutionalisation of such professionals in an organised and regulated manner will make it easier for corporate debtors and their creditors to access quality advice on how to go about restructuring debt. This is a worthy replacement for the position of lead bank and a steering committee, both of which may be unsuitable in monitoring the entire process of debt restructuring in the long run.

Fourth, with respect to the manner in which the debt can be dealt with, the Code provides a far more flexible paradigm by ensuring that the option to undertake debt-equity swaps may be done at an earlier stage and not when other methods have failed. This may go a long way in recovering debt. *Finally*, a uniform process that applies to all corporate debtors, irrespective of the quantum of debt provides a far more efficient and homogenous system. On the whole, the Code lays down a hard regime for debt defaulters and its strict timelines may aid creditors in their efforts to recover debt.

Despite the obvious advantages that the Code has over existing RBI guidelines, it cannot be said that they have no value. The greatest advantage of the CDR mechanism lies in its early identification of stressed assets, which could potentially save considerable time and energy over addressing non-performing loans after more significant defaults. Furthermore, the CDR mechanism does not provide for a change in management at the first instance – this option is triggered only under SDR/S4A invocation. This may be positive for the corporate debtor whose management will compulsorily change (even if just for a time) under the Code. At present, the conflict that exists is between informal methods under CDR and SDR mechanisms and the formal, legislative route under the Code. If this is not resolved, it could lead to a situation where debtors and creditors are stuck in between two legitimate methods of debt recovery, which is what the Code itself tries to eliminate. One method of resolving this conflict is by the RBI remodelling its guidelines and limiting them to identification of stressed assets and formulation of plans to neutralise potential NPAs, i.e., to minimising the possibility of debt defaults *prior* to actual default. Upon actual default, the provisions of the Code would come into effect and the timelines and options therein would be applicable.

The Code, much like CDR, also incorporates principles from the international approaches outlined earlier in the paper. The major parts of the London Approach are seen in the standstill clause and the creation of information utilities. The Bangkok Approach is also incorporated in the form of an overseeing entity, whose duty it is to ensure implementation. However, the concept of Inter-Creditor Agreements, as outlined in the Istanbul Approach is conspicuously missing in the Code. In fact, Section 53(2) clearly states that agreements between equal-ranking creditors will be disregarded by liquidators. This is in contrast with American law, wherein Section 510(a) of the United States Bankruptcy Code, allows for the enforcement of debt subordination agreements by bankruptcy court – therefore, agreements between creditors can impact distribution of assets.[112] This is another area where the Code could look to reform itself and allow for more flexibility in debt recovery, particularly where there is a consortium of lenders, as envisaged by the RBI guidelines as well.

Overall, the Code certainly offers a more holistic and comprehensive plan of action for debt restructuring in India. It incorporates many of the attractive parts of CDR mechanisms, most importantly the idea of a moratorium period, and the possibility of exit of dissenting creditors. Additionally, since the Code offers a hybrid approach to restructuring and allows the creditors (along with the Insolvency Professional) to decide the exact terms of the resolution plan, it appears to be far more flexible than CDR, which allows certain options only after the occurrence of certain events – case in point is how SDR cannot be invoked until CDR measures have failed. In light of the positive outlook that can be gleaned from an analysis of the Code, it can safely be said that it can act as an effective replacement for informal mechanisms like CDR as well.

Conclusion

Through the course of this paper, I have examined informal arrangements on debt restructuring and assessed how these measures have panned out in the Indian financial scenario. While the RBI Guidelines have been issued with the London Approach in mind, recent evidence makes the casual observer wonder whether they prove to be effective at all, considering the massive failures of CDR mechanism to recover corporate debt. The new Insolvency and

112 11 U.S.C. §510(a).

Bankruptcy Code, on the other hand, showcases considerable potential to overtake the RBI Guidelines, and indeed, several other outdated legislations in regulating corporate finance in India. Through a comparative analysis of the two, I have attempted to look at which option may be more viable for a corporate debtor. In conclusion, I am of the opinion that considering the drawbacks of CDR and SDR in India and indeed, the ineffectiveness of non-enforceable and informal means of debt recovery, the Code would be a viable alternative.