

RESHAPING INSOLVENCY SOLUTIONS: ANALYZING THE NEED FOR INFORMAL CORPORATE RESCUE STRATEGIES IN INDIA

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Abstract

Globally, modern banking and business practices have used a number of tactics throughout the years to deal with financially challenged businesses and the loans and obligations they hold. Many factors, such as the size of the business, the level of difficulty, the vulnerability of certain creditors, and its prospective viability, among others, affect the final decision and its actions. The particular insolvency regime concerned is a significant factor that influences how simple it is to execute one alternative over another. Thus, a creditor-oriented system makes it easier for the lenders to take charge of the legal process and take measures to recover their debts, which might ultimately lead to the winding up of the bankrupt company. Conversely, a government that helps debtors usually succeeds in regaining the company.

Keywords: Corporate rescue, informal insolvency, India, business restructuring, out-of-court settlements, insolvency and bankruptcy code (IBC), creditor-debtor negotiations.

INTRODUCTION

The term "corporate rescue" refers to a significant intervention that is required to prevent a company from failing in the end, to revive businesses that are about to collapse

economically, and to save economically viable units to increase production capacity, create jobs, and to continue rewarding capital and investment. Rescue operations include going above and beyond the typical management reactions to business difficulties, and they may be carried out via both official and informal legal channels¹. The assumption that severe corrective action is performed during a company crisis is fundamental to the rescue concept. All these perspectives essentially agree with the idea that informal rescue techniques should be used in rescue operations instead of being limited to official processes². Globally, modern banking and business practices have used a number of tactics throughout the years to deal with financially challenged businesses and the loans and obligations they hold. Many factors, such as the size of the business, the level of difficulty, the vulnerability of certain creditors, and its prospective viability, among others, affect the final decision and its actions. The particular insolvency regime concerned is a significant factor that influences how simple it is to execute one alternative over another³. Thus, a creditor-oriented system makes it easier for the lenders to take charge of the legal process and take measures to recover their debts, which might ultimately lead to the winding up of the bankrupt company. Conversely, a government that helps debtors usually succeeds in regaining the company⁴.

¹ Kastrinou, A. (2016) Comparative Analysis of the Informal Pre-Insolvency Procedures of the UK and France. *Int. Insolv. Rev.*, 25: 99–118. doi: 10.1002/iir.1247.

² James H.M. Sprayregen & Tarun Warriar, *The IBC and Interim Finance: Potential Developments Based on DIP Lending Experience*, *Legal Era* (Dec. 12, 2017), [https://www.legaleraonline.com/articles/the-ibc-and-](https://www.legaleraonline.com/articles/the-ibc-and-interim-finance-potential-developments-based-on-dip-lending-experience)

[interim-finance-potential-developments-based-on-dip-lending-experience](https://www.legaleraonline.com/articles/the-ibc-and-interim-finance-potential-developments-based-on-dip-lending-experience).

³ Julian Chung & Gary Kaplan, *An Overview of Debtor in Possession Financing*, in *Lending & Secured Finance Laws and Regulations 2021* 120 (Thomas Mellor ed., 2021).

⁴ Chen, T. W., Azmi, R., & Rahman, R. A. (2021). *Theories of corporate insolvency: A philosophical*

The current economic downturn has led to many loan defaults and business difficulties. Considering that the current situation is the consequence of a systematic breakdown rather than isolated incidents, closing businesses does not seem to be the appropriate course of action. What is often sought is saving businesses and giving them new life—as long as they remain viable⁵. There are two types of rescue mechanisms: official and informal. A court-led or supervised procedure would be part of the official rescue process, which eventually results in the firm being saved by actions like debt restructuring and management changes⁶.

India is one of the youngest countries to enter the informal debt restructuring market. Before 2001, there was no organized structure in place to accelerate non-formal debt restructurings and other business rescue procedures. The Board of Industrial and Financial Reconstruction (BIFR) was given permission to oversee the reorganization process by the Sick Industrial Companies Act, 1985, which established the legal framework for the recovery of financially troubled Indian enterprises⁷. Nonetheless, the BIFR's contribution to the procedure was and is still very inadequate. As a result, the Reserve Bank of India (RBI)'s Corporate Debt Restructuring (CDR) mechanism was used to institutionalize informal rescue via debt restructuring in 2001⁸. This platform, which was mostly based on the London principles, has seen a lot of usage recently. The Reserve

Bank of India has released a number of circulars about the CDR process. Regarding corporate rescue processes, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act of 2002 was another positive move. The Act facilitated the establishment of Asset Reconstruction Companies (ARC) in India, primarily focused on managing non-performing debts that were obtained from secured creditors⁹.

INFORMAL CORPORATE RESCUE MECHANISMS

Informal corporate rescue process focuses on business reorganization outside official statutory bankruptcy proceedings. Such methods provide indebted firms with a flexible chance to fix their problems outside the inflexible, complex, and sometimes time-consuming statutory bankruptcy processes. Informal corporate rescue processes are via informal 'workouts', 'pre-packs' and 'debt for equity swaps', cherry-picking and purchase and assumption¹⁰.

An informal workout refers to a voluntary out-of-court restructuring process in which a financially troubled firm and its creditors arrange to modify their debts. Essentially, the creditors reach a consensus on a "coordinated approach" by attempting to collaborate in order to come up with a group solution that serves their shared interests. There are noticeable differences in how exercises are implemented in various

analysis of the corporate rescue mechanisms under the Companies Act 2016. UUM Journal of Legal Studies, 12(2), 167-202. <https://doi.org/10.32890/uumjls2021.12.2.8>.

⁵ Vijaykumar V. Iyer et al., Performance Analysis of M/s Binani Cement Limited, Indian Inst. of Insolvency & Prof. of ICAI (Jan. 2020), <https://www.iiipicai.in/images/PDF/CASE-STUDY-BINANI-CEMENT.pdf>.

⁶ LawTeacher. November 2013. Informal Corporate Rescue Mechanism. [online]. Available from: <https://www.lawteacher.net/free-law-essays/finance-law/informal-corporate-rescue-mechanism.php?vref=1> [Accessed on 15 August 2024].

⁷ Sachin Gupta & Varsha Banerjee, India: Restructuring & Insolvency Laws & Regulations, Int'l Comp. Legal Guides (May 05, 2020), <https://iclg.com/practice-areas/restructuring-and-insolvency-laws-and-regulations/india>.

⁸ Pandya, Param, Corporate Insolvency and Corporate Recue in India - An Economic Analysis (May 1, 2015). Available at SSRN: <https://ssrn.com/abstract=2970582> or <http://dx.doi.org/10.2139/ssrn.2970582>.

⁹ Shikha N. Takeover through Scheme of Arrangement: A Changing Trend in the UK. Vikalpa. 2013;38(1):87-103. doi:10.1177/0256090920130107.

¹⁰ Finch, V. (2009). Corporate Insolvency Law: Perspective and Principles (2nd ed.). UK: Sweet and Maxwell.

jurisdictions, but they nonetheless share several key traits¹¹.

PRE-PACKS

This essentially entails a pre-insolvency phase of discussion with a potential buyer of an insolvent company's operations. The assets that the buyer needs will be decided upon, and the selling price of the company will always be determined with reference to an impartial appraisal. When a subsequent administration is made, the buyer receives ownership of the company together with all agreed-upon assets, goodwill, contracts, staff, and similar items. Pre-packs may include the selling of the company to a third party or a "phoenix" sale in which the former directors take control the newly formed company¹².

DEBT FOR EQUITY SWAP

A debt for equity exchange might be implemented as an informal company rescue strategy. This is the situation in which a creditor consents to swap a loan for an equity stake in the business in the anticipation of a higher return down the road. It is a technique that may allow an acceptable agreement to be struck with creditors. This strategy, however, may be limited since it may be costly and time-consuming to negotiate because the approval of most ¹³creditors and the company's shareholders is often needed¹⁴.

PURCHASE AND ASSUMPTION

This is the process by which an investor or other corporation buys the assets of a failing business and takes on its obligations, often for an auction price. The assumed company is dissolved by a judicial sale of its assets and liabilities to the buying company or investor through a judicial accent rather than through regular winding up procedures. The transaction is completed by means of a properly signed Deed of Purchase and Assumption by the parties, resolutions endorsing the deal, or, in the event of a government company or a company bought or taken over by a regulatory body, a government white paper. There are many options for the ease of purchase and assumption in connection with bank reorganization: buy and assumption for the whole bank, purchase and assumption for a portion of the bank, purchase and assumption for loss sharing, and bridge bank¹⁵.

CHERRY PICKING

Similar to Purchase and Assumption, but with one key difference: the investing company or buying company is not assuming full liability for the failing business; instead, it is permitted to examine the failing business's assets, operations, and books in order to identify any aspects that it could integrate into its own operations and save costs¹⁶.

NEED FOR INFORMAL CORPORATE RESCUE MECHANISMS IN INDIA

¹¹ Sui-Jim Ho & Surya Kiran Banerjee, Indian Bankruptcy Code—How Does it Compare?, 8 Emerging Markets Restructuring J. 51, (2018)

¹² Maksym Iavorskyi et al., Resolving Insolvency - New Funding and Business Survival, Doing Bus. (2016), <https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB16-Chapters/DB16-CS-RI.pdf>.

¹³ Manaswita Nakwaal, Maximisation of Value of Assets under the Insolvency & Bankruptcy Code, 2016, Indian Rev. Advance Legal Res. (Oct. 01, 2020), <https://www.iralr.in/post/maximisation-of-value-of-assets-under-the-insolvency-bankruptcycode-2016>.

¹⁴ Vishwanath Nair, As Banks Deny Working Capital to Insolvency Cases, Resolution Professionals Turn to Funds, Bloomberg Quint (Aug. 28, 2017), <https://www.bloomberquint.com/business/2017/08/28/as-banks-deny-working-capital-to-insolvencycases-resolution-professionals-turn-to-funds>.

¹⁵ Nwafor, Anthony. (2017). The goal(s) of corporate rescue in company law: A comparative analysis. Corporate Board: role, duties and composition. 13. 20-31. 10.22495/cbv13i2art2.

¹⁶ Megha Mittal, Interim Financing Becomes Effective and Attractive, in IBC: Ushering in a New Era 150 (Megha Mittal ed., 2019).

To modernize India's debt settlement system, the Insolvency and Bankruptcy Code (IBC), 2016, a historic piece of legislation, was put into effect. The old insolvency rules were superseded, and a unified framework for handling stressed assets was established. Resolution of distressed assets has undergone major changes because of the IBC, which has had a major influence on the business sector¹⁷.

The financial system's overall health is directly impacted by the prompt settlement of stressed assets. Without a deadline, the process of resolving stressed assets would often take years, piling up non-performing assets (NPAs) on the balance sheets of banks and other financial organizations. Consequently, this would impact the credit flow and cause the rate of economic growth to decelerate. The financial system has been less affected by stressed assets because of the IBC's time-bound approach, which has drastically shortened the time required for their resolution¹⁸.

Additionally, the Insolvency and Bankruptcy Code (IBC) stipulates a moratorium period that stops creditors from pursuing recovery actions against an insolvent corporation throughout the insolvency process. By conducting the resolution process more systematically and effectively, this helps to preserve the value of the company's assets. This is beneficial to the financial system because it fosters investor and creditor

confidence, both of which are necessary for the financial markets to run smoothly¹⁹. Bringing India into line with its international equivalents, such as the United Kingdom, the United States, Canada, and Singapore, is a major step forward with the introduction of a pre-packaged insolvency system²⁰. Particularly, the implementation of a PPIRP presents good possibilities for the MSME sector, emphasizing their rehabilitation during economic problems such as those presented by the COVID-19 epidemic. But there are still issues that need to be resolved, such as voluntary haircuts and judicial intervention that impedes the 120-day deadline²¹. Pre-packs that are implemented should gradually, focus on properly managing enterprises first and then expanding to smaller organizations with simpler debt arrangements to maximize their effectiveness²². Transparency issues, particularly with operational creditors' participation, might be minimized by requiring their presence in negotiating procedures and establishing a window for complaints. Additionally, imposing a minimum compensation for operational creditors equivalent to liquidation rights under Section 53 of the Code might assure justice²³. Given the current backlog of CIRP applications, the effectiveness of PPIRPs depends on supplementary actions to improve the ability of adjudicating authorities to manage applications²⁴. Although pre-packs provide

¹⁷ Avinash Kumar Khard, *Rescue Financing: Helping Hand for Entities in Distress*, Indian Bus. L. J. (Feb. 03, 2019), <https://law.asia/rescue-financing-helping-hand-entitiesdistress/>.

¹⁸ van Zwieten, Kristin, *Corporate Rescue in India: The Influence of the Courts* (July 1, 2014). *Journal of Corporate Law Studies*, Vol. 1, 2015, Forthcoming, Oxford Legal Studies Research Paper 37/2014, Available at SSRN: <https://ssrn.com/abstract=2466329>.

¹⁹ Ajanta (P.) Ltd., In re [2017] 77 taxmann.com 232 (Gujarat); also, Aditya Birla Money Mart Ltd., In re [2016] 76 taxmann.com 270 (Gujarat)]. Also see Cello Pens (P.) Ltd., In re [2017] 83 taxmann.com 399 (NCLT - Ahd.)

²⁰ Buljevich, E.C. (2005). *Cross Border Debt Restructuring: Innovative Approaches for Creditors, Corporates and Sovereigns*. (Euromoney Institutional Investor PLC, 2005) Chapter 1 at 1.

²¹ Don Weinland, *Global Investors Sidestep Indian Bankruptcy with Rescue Finance*, Fin. Times (Jan. 02, 2019), <https://www.ft.com/content/6059445a-0d82-11e9-acdc-4d9976f1533b>.

²² Dr. Neeti Shikha & Urvashi Shahi, *Restructuring in COVID-19: Reinventing the old wheel*, The Daily Guardian (11th July, 2020) <https://thedailyguardian.com/restructuring-in-covid-reinventing-the-old-wheel/>

²³ Ashwin Bishnoi, *The Indian Insolvency & Bankruptcy Code 2016: No More a "Wait and Watch" Space for Private Equity*, 22 EMPEA Legal & Reg. Bull. 7 (2017).

²⁴ Dinesh Unnikrishnan, *Explained: Why Pre-Packaged Insolvency Resolution is Great for MSME Borrowers*, Money Control (Apr. 05, 2021), <https://www.moneycontrol.com/news/business/explaine>

a productive alternative for resolving financially troubled enterprises, changes to the Code and strong regulatory structures are essential. It is, therefore, vital to modify the pre-pack processes to fit the Indian environment, recognizing its supplemental function alongside the current bankruptcy resolution structure rather than a total replacement²⁵.

CONCLUSION

If a company's financial crisis is identified early on, it may be remedied swiftly via an informal rescue that benefits both creditors and debtors, rehabilitating it without the need for the official bankruptcy procedure. What matters is that the firm should have a workable business plan and a turnaround specialist, sometimes known as the "company doctor," who can provide guidance on the best course of action to pursue in order to save the company sooner and boost its chances of success. Informal rescue methods often entail voluntary agreements between the debtor and some or all of its creditors. These discussions are often facilitated by the banking and business sectors and usually urge for the troubled enterprises to undergo some kind of reorganization. Informal rescue provides a variety of potential rewards since it is quicker and cheaper than official rescue and gives a lot of anonymity, therefore maintaining the goodwill and status of the organization. Informal rescue negotiations provide more flexibility since the terms and circumstances of the rescue may be altered throughout the negotiation process. This is not the case with the official rescue procedure. Informal rescue has shortcomings in addition to its many positive aspects. The first flaw is the need for unanimity, which is necessary if the rescue is to be successful (such as in the

event of a workout or settlement with the lenders). The consent of all parties whose privileges are at risk is usually necessary. The absence of a formal moratorium is the second flaw. Consequently, creditors who object to the method are free to stop the unofficial rescues by starting official bankruptcy processes, such as liquidation. But implementation in the Indian environment might be highly problematic for both regulatory (IBBI) and adjudicating authorities (NCLT) as the market and the business trends are quite volatile in nature. An unofficial rescue is consequently a delicate mechanism that depends on everyone's participation because of this danger. It is evident, however, that a prompt completion of an informal rescue always has tangible benefits for both creditors and debtors.

Authority determines that the corporate debtor is liable for liquidation it may order for liquidation of the corporate debtor.

d-why-pre-packaged-insolvency-resolution-is-great-for-msmeborrowers-6729901.html.

²⁵ Neeti Shikha, The Changing Trend of Schemes of Arrangement and Approaches towards Its Efficacy, Indian J. Int'l Econ. L., 2011.