

## **Govt moves to ease exits from bankrupt firms**

### ***Finance ministry sets up committee to create separate set of laws to streamline, update regulations that deal with bankruptcy***

In a move aimed at facilitating the faster wind-up of insolvent companies and providing an easier exit route to investors, the government is considering introducing a bankruptcy code for corporate entities that are headed for failure.

The legislation could be introduced by the time of the presentation of the next Union Budget in February, government officials said.

The finance ministry formed a committee last month headed by former law secretary T.K. Viswanathan and comprising members from the departments of economic affairs and financial services, the ministries of law, corporate affairs, and micro, small and medium enterprises, the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (Sebi).

The idea is to create a separate set of laws to streamline and update the existing regulations that deal with bankruptcy, although a final decision will be taken only after the terms of reference are finalized by the department of economic affairs towards the end of this month.

“The country does not have an insolvency law. This will be for the domestic corporate sector,” a government official said on condition of anonymity.

Investors and the regulators have highlighted the need for an efficient bankruptcy system to deal with distressed companies so that investors are able to recover their money at the earliest, especially in the light of many companies facing financial difficulties as economic growth slowed to below 5% in each of the past two years.

In his budget speech, finance minister Arun Jaitley had said the government will bring out an entrepreneur-friendly legal bankruptcy framework for small and medium enterprises to enable easy exit, but there are plans to now extend it and create an over-arching framework.

Viswanathan confirmed the setting up of the committee, but said the terms of reference are yet to be finalized.

“We are in the process of holding consultations and inviting comments. Once the terms of reference are finalized, we will start work on this. The idea is to give our recommendations within the next six months so that the legislation could be brought about in the next budget,” he said.

The archaic nature of India's bankruptcy laws was also flagged by RBI governor Raghuram Rajan last month.

"We need a bankruptcy code. We need equity to be seen as equity and debt to be seen as debt. Today there's a lot of confusion... We need that confusion to be changed," news agency Reuters quoted Rajan as saying.

Although the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act ensured that banks get a preference over other stakeholders in settling of dues, there has been no effective mechanism for a company to wind up its business and compensate other stakeholders.

The Board for Industrial and Financial Reconstruction (BIFR) was envisaged as a tribunal for creating a revival mechanism for companies using specialized tribunals, but has not yielded the desired results.

The new Companies Act also has provisions related to bankruptcy, but they have not been implemented.

The National Company Law Tribunal (NCLT) that was supposed to replace the Company Law Board, BIFR and the Appellate Authority for Industrial and Financial Reconstruction has also not taken off as the Madras Bar Association has filed a writ petition against its provisions in the Supreme Court.

Countries such as the US have a formal process wherein companies file for bankruptcy and are taken through a court-monitored process of liquidation or restructuring.

Another senior government official said the idea behind this legislation is to give foreign investors an exit route.

"Investors invest in companies, and when they go bust, they have no way to recover the money. SARFAESI helps banks to recover loans. But it doesn't help bondholders to recover their money. The idea of a bankruptcy law is to ensure that there is some way that these investors can recover the money," the official said.

A bankruptcy law would be "fantastic" for foreign investors, but the key will be execution, said Brijesh Mehra, managing director and India head at Royal Bank of Scotland NV.

"Even now, foreign investors can pursue Indian companies under the Companies Act, but the process takes a long time. A new law will work only if it speeds up the process and does not end up like the existing laws," said Mehra.

Narayan Ramachandran, chairman of InKlude Labs, a company that works in the social sector, and a Mint columnist, said it was important to put in place a bankruptcy framework that balances the interests of the company and financial institutions.

“Unfortunately, the laws are written mainly from the point of view of financial institutions rather than looking at ways for a business to restructure itself,” he said.

Ramachandran added that in the Indian scenario, given that the workforce is largely self-employed, individuals and very small businesses should be put into one category while handling bankruptcy rather than small businesses being clubbed with big companies.

“A model similar to Chapter 11 of the US Bankruptcy Code should ideally be applicable to only big companies,” he added.

Chapter 11 involves a court-supervised reorganization of the company so that all stakeholders get an opportunity for an optimal exit.

Sridhar Gorthi, partner (mergers and acquisitions, and private equity) at law firm Trilegal, said that currently the bankruptcy law in India is in the form of personal insolvency legislation for individuals and winding up provisions under the Companies Act for companies. According to him, both these provisions are “fairly inflexible and time consuming”.

“While the current provisions can be used as a threat against a defaulting company, the actual liquidation or winding up is not easy. International bankruptcy laws are much more flexible, and if a similar law is introduced in the country with appropriate safeguards, it will not only help the foreign investors/lenders, but also help in debt restructuring,” said Gorthi.

Currently, there are at least three cases of foreign currency convertible bond (FCCB) default by Indian firms Zenith Infotech Ltd, Geodesic Ltd and GOL Offshore Ltd pending in the Bombay high court.

The Bank of New York Mellon, London branch, a trustee of bondholders, has in two separate cases filed winding up pleas against Zenith Infotech and GOL Offshore for defaulting on FCCB payments.

While Zenith Infotech defaulted on two FCCBs aggregating to \$83 million that were due in 2011 and 2012, GOL Offshore defaulted on a \$40 million FCCB in 2012.

Citibank NA’s London branch has also filed a case against Geodesic that defaulted on its FCCB obligations of \$157 million in early 2013.

The high court has already appointed liquidators to wind up Geodesic and Zenith Infotech. However, the cases are pending as the companies have challenged some of the decisions of the court.

Amarjit Chopra, former president of the Institute of Chartered Accountants of India, said what the government should do is to essentially streamline the existing regulations by introduce a new law.

“The question is when should insolvency be declared? Should it be on the basis of net worth loss or the failure to pay or when the bank wants to proceed against the defaulter? I think it should be based on a demand by the creditors, but under the orders of a court.”

Several provisions on bankruptcy in the new Companies Act cannot be enforced because the formation of NCLT is sub judice, said Pavan Kumar Vijay, managing director at New Delhi-based Corporate Professionals Capital Pvt. Ltd, a financial and legal consultancy.

“Existing laws have to be modified and changed. In fact, all that is related to company law has to be brought under ,” he said.

*(Live Mint)*