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What Videocon, RCom And IL&FS Need Most - Group Insolvencies

- Shivani Saxena@shivanisaxena91

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Videocon Industries Ltd., Reliance Communications Ltd., and IL&FS—three large groups, two common problems: too much debt and no group insolvency framework to resolve it.

For instance, Infrastructure Leasing & Financial Services Ltd., a systemically important core investment NBFC parents over 169 group companies, of which 24 are direct subsidiaries and the rest indirect subsidiaries or joint ventures. Six of these contribute over 60 percent of the consolidated assets of the company, according to an NCLT order.

Without recourse to these assets, the lenders of the parent don't stand to recover much. The NCLT order in the IL&FS case noted that unfortunately the Insolvency and Bankruptcy Code doesn't provide for a joint resolution of group of companies. This is necessary, the tribunal said, because the resolution of the parent and group companies as a whole is inextricably linked to the resolution of each of these companies.

The Undeniable Need

The Indian law does not explicitly permit group insolvencies. A group insolvency framework is specially desirable in instances where a holding company houses project-specific special purpose vehicles or SPVs, which may have majority of the assets, L Vishwanathan, partner at Cyril Amarchand Mangaldas, told BloombergQuint.

The holding company may have raised finance to fund the SPVs. A resolution process for the holding company alone—without the SPVs which own the assets—may not attract any resolution plan, Vishwanathan said. That's because a resolution applicant may want the certainty of acquiring the assets of the SPVs and not merely the shareholding, especially since the individual SPVs may be taken under IBC by their specific creditors, he explained.

Vyapak Desai, partner at law firm Nishith Desai Associates, said pointed to Videocon as an example where an ad hoc attempt to carry out a group resolution process was made by the principal bench of the NCLT. Venugopal Dhoot, the promoter of the 13 Videocon group companies under insolvency, insisted that the insolvency petitions of all these companies be heard by the same bench to avoid conflicting orders. The bench concurred.

With various groups like Reliance Communications and Videocon in the insolvency net, it is important for the creditor's committee of each group entity to have access to information like resolution plans of the other entities in the group, Desai said.

The presence of intra-company loans makes it imperative to have access to this information, including flow of sale proceeds. This will make the entire process streamlined, expedient and fair towards all stakeholders. This might also be the solution for double dipping issues at a group level.
Vyapak Desai, Partner, Nishith Desai Associates

Lesson From BCCI

The early 90s gave the world one of the first examples of a cross-border and synchronised group insolvency—the bankruptcy of The Bank of Credit and Commerce International.

BCCI's bankruptcy was spread over at least 70 countries, 380 offices and multiple group, often shell, companies. Back in 1991, The Times article put it as: the bank was chartered in Luxembourg, run by Pakistanis, owned by Arabs, headquartered in Britain.

It is in this bankruptcy case that the English courts established the 'pooling principle' or the consolidation of assets and liabilities. The court deemed it fit to consolidate the properties and assets of BCCI group companies, spread across different jurisdictions, with a view to distribute maximum possible proceeds to their creditors. In the U.S., however, the pooling strategy did not quite take off. Each branch of the bank was treated as a separate legal entity under the U.S. insolvency laws.

But Viswanathan says that the U.S. bankruptcy law has evolved to include a mechanism for substantive consolidation, which is a lot like merger. The process involves merging the estates of the relevant companies so that it becomes a single insolvency estate with a common pool of assets and creditors.

In other jurisdictions, like the European Union and Germany, procedural coordination system is prevalent, he explained.

Procedural coordination is the process of consolidation of insolvency process of two or more members of an enterprise group. It typically permits a common court file, a single set of notices to creditors, a common administrator, and joint proceedings in the court.

India can definitely adopt the regime for procedural coordination with a framework to take multiple companies into insolvency together. But in special circumstances, courts must be allowed to use their inherent powers for substantive consolidation.
L Viswanathan, Partner, Cyril Amarchand Mangaldas

Indian Framework: Ingredients

The first principle that India's group insolvency framework would need to explicitly recognise is that of lifting of corporate veil.

Overcoming The Corporate Veil Doctrine

Introducing a framework for insolvency of group companies which allows, even to a limited extent, consolidating assets and liabilities of separate companies, contrasts with the doctrine of corporate veil, which states that creditors shall only have claim against assets of the company to which they have extended funds. But businesses are often conducted through a web of interlinked companies, ring-fencing assets and retaining control.

In India, the battle is already half won. Viswanathan explained that the Supreme Court has already recognised the principle of piercing the corporate veil in Essar Steel Ltd.'s insolvency case.

The Supreme Court held that "*where a statute itself lifts the corporate veil, or where protection of public interest is of paramount importance, or where a company has been formed to evade obligations imposed by the law, the court will disregard the corporate veil. Further, this principle is applied even to group companies, so that one is able to look at the economic entity of the group as a whole.*"

Desai offered another example of Jaypee Infratech Ltd. where the apex court saw through corporate entities to reach the intended entity which is in control.

In the case of Jaypee Infratech, the Supreme Court had ordered the parent Jaypee Associates to provide a guarantee and deposit amounts for repayment of creditors of its subsidiary, which would not have been possible if the corporate veil had not been lifted.
Vyapak Desai, Partner, Nishith Desai Associates

The Guarantee Mess

Lifting of corporate veil is a less contentious issue compared to treatment of corporate guarantees, which experts say, the group insolvency framework needs to tackle.

So far, courts have held that moratorium extended to the corporate debtor will not extend to the corporate guarantee given by the parent, which has led to numerous simultaneous recovery claims against multiple companies.

Desai said there is a lot of confusion over treatment of corporate guarantees, since different adjudicating authorities have provided different guiding principles.

Viswanathan added that the group insolvency framework will need to have provisions that allow for resolution of the guarantor and borrower together. Otherwise, each of them will undergo a separate resolution process which may lead to issues on value of claim against the guarantor and borrower, especially since recovery and timing of the insolvency process for the guarantor and borrower is neither clear nor certain, he said.

Procedural Consolidation

Experts point out that for group insolvencies, procedural coordination is a must since it saves time and costs, and most importantly, ensures that diverse proceedings against different group entities do not result into divergent directions.

It would be helpful to have a statutory framework in place, Viswanathan said, possibly with an agreement for co-ordination and sharing of information—subject to confidentiality—among group companies in the course of their insolvencies.

The ability to invite common resolution plans for multiple related companies under the same group must be allowed. If multiple entities of the same group are undergoing insolvency, they must necessarily be before the same NCLT, have common resolution professionals who can co-ordinate among the various committees of creditors and voting for resolution plans for different parts of the group.
L Vishwanathan, Partner, Cyril Amarchand Mangaldas

Desai added that at the very least, there could be an overarching ‘supervising committee’ which may comprise the resolution professional and a representative from the CoC of each group entity having the highest outstanding debt by value. “This committee can oversee the entire process. This will ensure a holistic, commercially viable and practical resolution of stress within a group,” he added.

Experts unanimously agreed that having a law that recognises that enterprises exist with multi-level and complex structure would ensure that insolvency of a company or group of companies within such a structure can be handled pragmatically. Most importantly, doing so will lead to better valuation and attract more meaningful investor interest.

But where some of the group companies are located offshore, the framework for cross-border insolvency must be applied, Viswanathan said. While the Insolvency Law Committee had recommended that India adopt the UNCITRAL Model Law of Cross Border Insolvency, as of now, there is no framework for cross-border insolvency.

If group insolvencies are attempted in the absence of cross-insolvency framework, it could lead to jurisdictional conflicts, wasteful litigation and competition for assets and control by national courts and insolvency administrators, Viswanathan said.