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# IL&FS' Resolution: How To Keep Calm And Carry On?

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With a debt of over Rs 94,000 crore and banks, NBFCs, mutual funds, insurance companies, pension funds as its creditors, the six-member board of IL&FS will need a magic wand to make its creditors happy.

Anticipating that the outcome of the IL&FS insolvency issue may not have a fairy-tale ending, the board has pointed out the final resolution plan will entail sacrifices from various stakeholders. The board presented a status report and roadmap to the National Company Law Tribunal last week, in which it said that:

- The creditor profile of the IL&FS Group is spread across different categories and verticals.

- Individual creditors may have access to cash trapped in escrow accounts that may lead to preferential payments, including through unauthorised set offs.
- Over 130 creditors have issued notices to IL&FS Group entities.
- Individual creditor action is unlikely to realise value for creditors, making an orderly resolution impossible.

It has requested the NCLT to extend the moratorium so that legal action can't be taken by creditors against IL&FS or its 347 group entities. The National Company Law Appellate Tribunal had granted a moratorium to the entities last month.

The progress report submitted by IL&FS' new board raises several important questions:

- Is it fair for the board to ask for suspension of third-party and creditors' rights until the final resolution, and more importantly does the law allow it?
- Do the foreign creditors of IL&FS' offshore entities have remedy, or will they run into the moratorium granted by NCLAT?
- How can the board minimise the risk of litigation for IL&FS and its entities once the moratorium subsides?

Watch Fereshte Sethna, senior partner at DMD Advocates; and Pratibha Jain, head of regulatory practice at Nishith Desai Associates; discuss these issues on BloombergQuint's weekly law and policy show—*The Fineprint*.

**Here Are Edited Excerpts Of The Interaction**

**The NCLAT had earlier allowed the moratorium under section 242 of the Companies Act, 2013 until the next hearing on November 13. Can it be extended until the final resolution is achieved?**

**Sethna**: It is a very interesting situation. We need to evaluate what's going on in the context of law as it stands and on the other hand the pragmatic reality. We must understand that the steps which have been taken in this matter are unprecedented.

We do not have a legislative framework that addresses what is going on here and what is done by triggering the NCLAT process. It has no valid sanction legislatively. Given that there is seemingly a lacuna, let's talk about the pragmatic reality. We have a systemically important NBFC, a core investment company, effectively regulated by the RBI, which is on the verge of bankruptcy. Given the exposure, what are the possible solutions? Do we just allow it to go under? Or do we adopt the pragmatic measures that are in fact underway in NCLT, NLCAT - the manner in which they have superseded the board and gone about all that they are doing. This is in tandem with what the situation requires, notwithstanding a lack of legislative sanction. That throws up a series of conundrums which we may be able to address by bringing in a legislative amendment.

**Jain:** I will disagree that there is no legislative mechanism. Section 242 of Companies Act does allow- if there is a case of mismanagement and in public interest - for the courts to intervene and give interim measures. There might not be precedence of it. However, plain reading of the law does allow for it. This is systemically important and too big to fail. However, you have to think of the rights of the creditors and how they plays under the Insolvency and Bankruptcy Code (IBC). The insolvency law has a non-obstante clause which says that notwithstanding anything inconsistent under any other law, IBC will supersede them. Tomorrow, the creditors can question any proceedings [in the IL&FS case]

under the IBC using this specific provision and it will again go to the NCLT and NCLAT.

**Do the creditors of IL&FS' offshore entities have any recourse if they have any outstanding dues or will they too run into the moratorium?**

**Jain**: The offshore instruments will have a dispute resolution mechanism and the assets will be offshore as well. The offshore subsidiaries would've borrowed in foreign denomination for projects outside India. So, foreign creditors will have access to assets offshore. The only issue that comes into question is enforcing guarantees given by the likes of ITNL [IL&FS Transportation Networks] and other group companies.

To enforce these guarantees, they'll have to come to India. At that point, they will have to join whatever process is available in India - whether it is section 242 moratorium or any insolvency process that may be going on. In either case, they'll become an unsecured creditor and they will have to join the process.

**Sethna**: There is significant scope for challenge here. The moratorium which is contemplated can apply to the Indian entity. We have a concept called corporate separateness or independent juridical person. There could be judgment holders and award holders. On the one hand, there is remedy but you have no right. The right is eviscerated by bringing about this moratorium in a mechanism which does not exist. It can be argued by an offshore party that you have a mechanism which is IBC and that an insolvency process must necessarily be effectively brought against the entity in question.

You do not have a concept in law, anywhere in world, where you can bring the umbrella which will cover the entire group in a manner which we are doing here. In the absence of a legislative mandate, how do you achieve it? How do you explain to offshore creditors of what it is that you are offering them? There is significant scope for challenge. If a challenge were to be brought, it will hold unless there were quick measures brought legislatively in order to address the current situation.

The first issue which needs to be resolved legislatively is whether or not India has a mechanism which can permit for re-organization of bankruptcy at a parent level which will confer that protection upon all subsidiaries within that group. I do not think that mechanism is there under section 241-242 which has been invoked. There is a pragmatic requirement but a legislative lacunae exists as well.

**Several insolvency applications have been filed against IL&FS' group entities. If these have to be included in the final resolution plan, will these applications need to be withdrawn? Additionally, the payment of dues and haircut by the creditors' committee under IBC has a legislative backing. Would any such decision by IL&FS' board outside of the IBC be susceptible to litigation once the moratorium subsides?**

**Sethna**: The IBC process is on hold because of the moratorium which has come in under section 232. We do not have any sense of how long that moratorium can get rolled over for. If there is no certainty, then you are going to have a lot of creditors who will start losing patience. You have a situation where the existing insolvency remedy is being taken away from those creditors who have properly exercised their rights in law.

If we were to legislate, we will be able to put in place a framework which will permit for this process to go on un-interfered by courts and will address litigation brought about by creditors on grounds of lack of a legislative mandate.

**Jain**: The creditor's rights are well enshrined in IBC. The non-obstante clause in IBC gives it overriding effect over any other law, including Companies Act. But there is precedence otherwise. In Jyoti Structures, the [high] court said that where an action is in favor of the company as a whole, then the moratorium granted by the IBC can be ignored. The courts have seen this situation before and allowed the IBC process to be superseded by enforcement action under the Arbitration Act. Given the circumstances today, the creditors also recognize that if they go through an IBC process, the unsecured creditors are not getting anything there. The whole idea is to see what assets can be sold or find re-organization plans which provide a much better value than IBC.