



# M&A IN DISTRESSED ASSETS: AN IBC PERSPECTIVE

L & L Partners

Total M&A Deals by value (till October 2018)	USD \$ 72.2 bn
Percentage of distressed assets M&A	12% (at US \$ 14.3 bn)
Total M&A deals by volume	623
Distressed M&A deals by volume	21

- Data collated from Duff & Phelps's October 2018 Report on '*Distressed M&A in India: A risk worth taking?*'

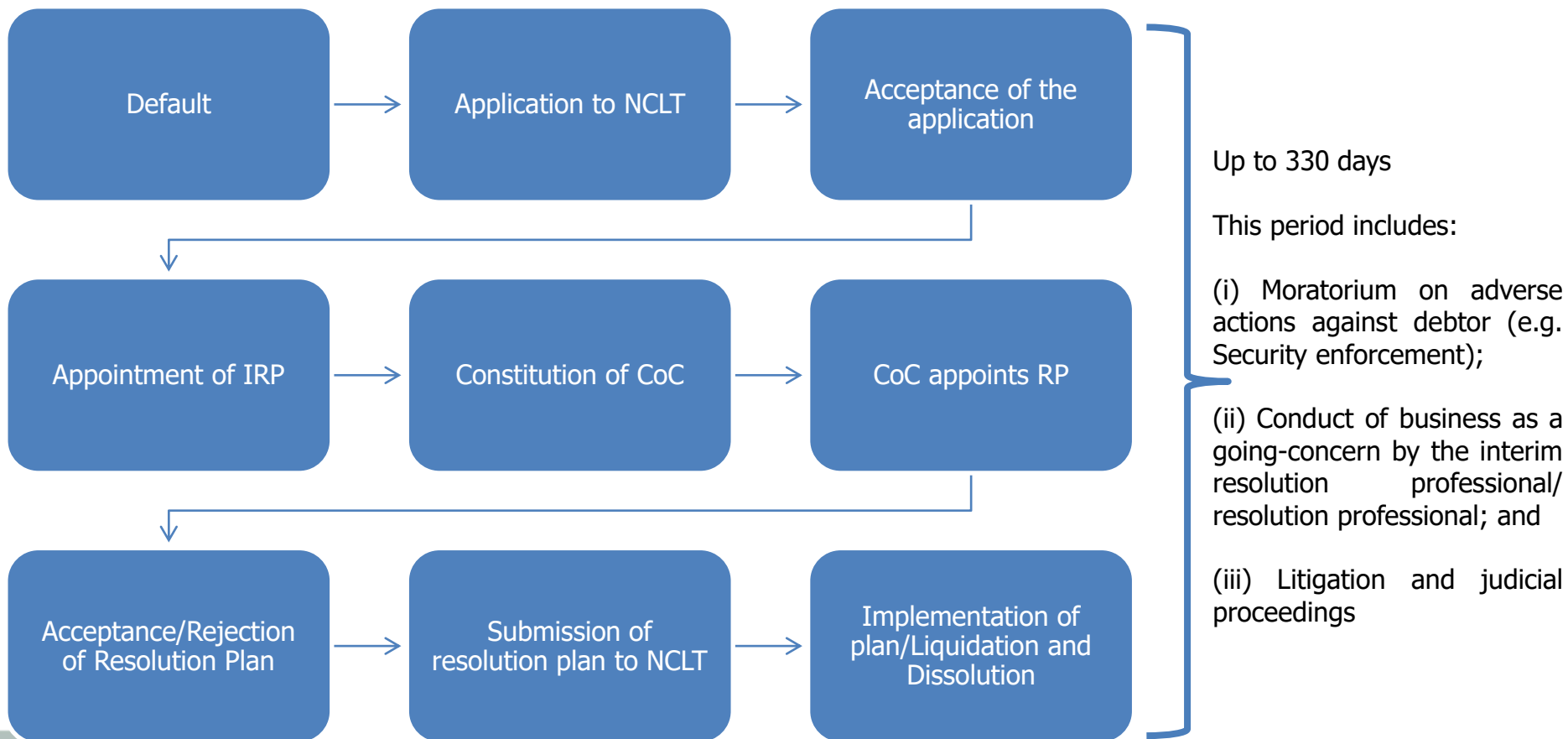
- Unified Code, one stop shop
- Creditor in control v. debtor in possession
- Emphasizes commercial determination over judicial determination
- Time bound process for value maximization
- Emphasis on keeping the entity as 'going concern'
- Establishes priority of creditors and liquidation waterfall

- ELIGIBLE DEBTS
- WHO CAN INITIATE CIRP?
- RESOLUTION PROCESS
- MILESTONES AND TIMELINES

- **Financial Debt:**
  - a) Debt (including interest) disbursed against time value of money
  - b) Purchaser of real estate would also be considered as a financial creditor – if element of time value of money present
  - c) E.g. Money borrowed against interest payment, guarantee
  
- **Operational Debt:**
  - a) Claim in respect of provision of goods or services
  - b) Claim in respect of provision of services provided during employment
  - c) Dues arising under any law and payable to the Government/local authority (including statutory debts like taxes, etc.)
  
- **CIRP can be initiated against:**
  - a) Company
  - b) Limited Liability Partnership
  
- **CIRP cannot be initiated against:**
  - a) Financial service providers
  - b) Individuals
  - c) Partnership firms

- **Financial Creditors**
  - a) Banks
  - b) Financial institutions
  - c) NBFCs
  
- **Operational Creditors**
  - a) Vendors
  - b) Customers (except in case of home buyers)
  - c) Employees
  - d) Government Agencies
  
- **Corporate debtor**

# CORPORATE INSOLVENCY RESOLUTION PROCESS (CIRP)



## NCLT

- Declaration of Moratorium
- Appointment of IRP, Public Announcement (deadline for claim submission, closing date of CIRP)
- Public Announcement (IRP constitutes CoC, deadline for claim submission, closing date of CIRP)

## IRP

- Powers of board suspended and the management of the corporate debtor vests in IRP
- Prepares the Information Memorandum
- Receives claims and manages the affairs of the corporate debtor
- Constitutes CoC

## CoC

- Confirms IRP as RP or replaces
- Arrange interim finance
- Opt for liquidation
- Approves/Rejects Resolution Plan

If Resolution Plan approved, CIRP is successfully completed

If Resolution Plan is rejected or no RP submitted, liquidation triggered

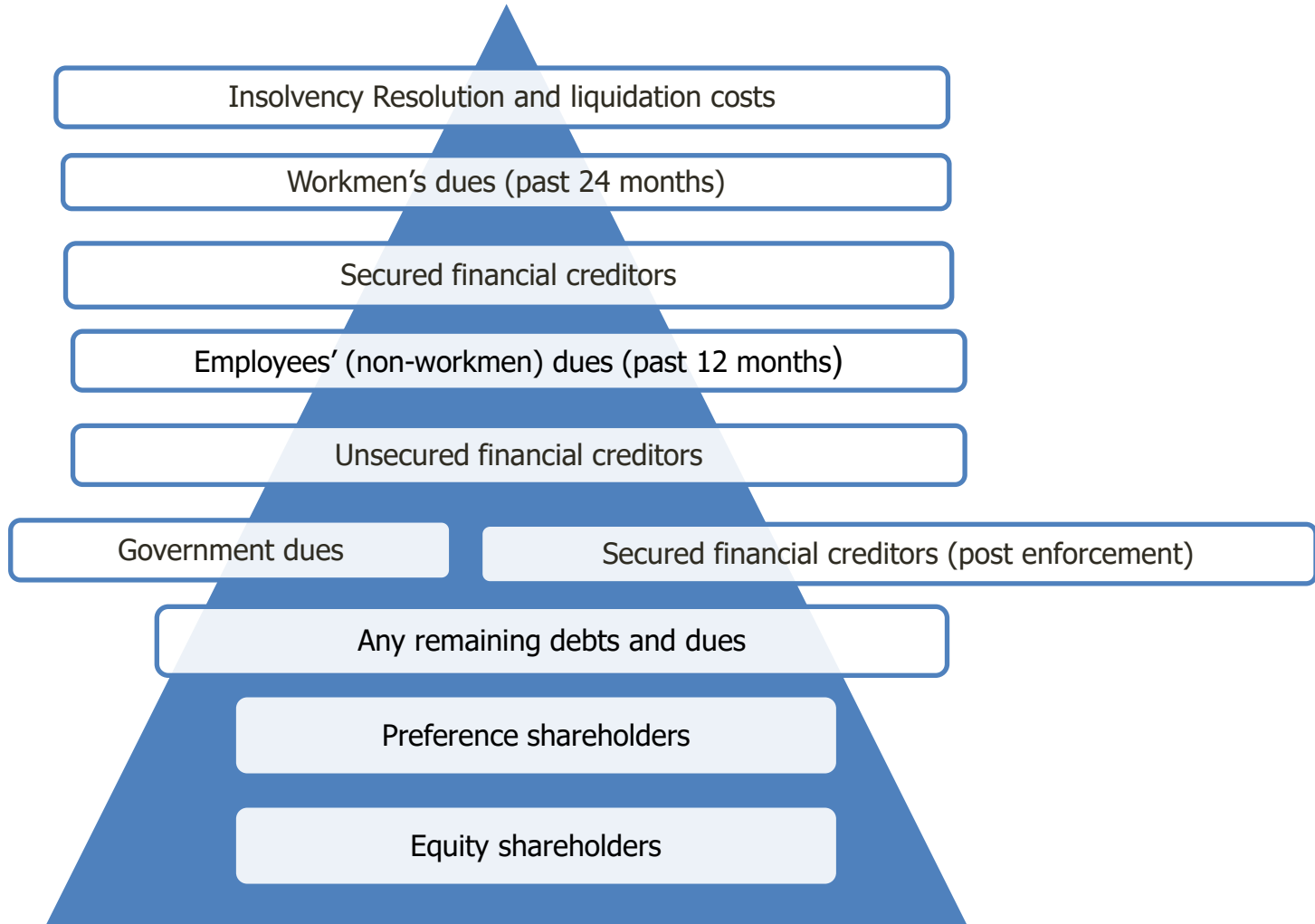


- Moratorium on enforcement by creditors
- Raise interim finance to maintain corporate debtor as a going concern
- Maximize the value of the corporate debtor's assets
- Right to avoid extortionate credit transactions/ preferential transactions/ undervalued transactions
- The Resolution Professional is required to examine each Resolution Plan received by him and ensure that each Resolution Plan provides for:
  - payment of CIRP costs in priority to payment of all other debts,
  - payment to the Operational Creditor is higher of:
    - A. The amount they would receive case of liquidation process as per the waterfall in Section 53; or
    - B. The amount they would receive under the resolution plan in accordance with the waterfall in Section 53(i).

## WHEN IS LIQUIDATION TRIGGERED?



- CoC decides to liquidate the corporate debtor without inviting resolution plans
- No bidders or resolution applicants.
- No consensus within the CoC and it decides to liquidate the corporate debtor
- Overall timeline of 330 days is breached
- Corporate debtor fails to adhere to the resolution plan



- Resolution Applicant as defined before the introduction of Section 29A defined resolution applicant to be any person who submits a resolution plan to the resolution professional.
- Thus, the resolution applicant could be any person i.e. creditor, promoter, prospective investor and there was no specific criteria or qualification assigned to who could submit a resolution plan. This lacuna gave back-door entry to the existing promoters to bid for their own companies and acquire them at a discounted price under the IBC.
- However, by way of an amendment, Section 29A was incorporated under the IBC. As a consequence of inclusion of Section 29A, persons who have contributed to the defaults of the corporate debtor or are undesirable due to incapacities as specified in the section or are a related party to another defaulting party, are prevented from gaining control of the corporate debtor by being ineligible by virtue of Section 29A.
- Section 29A, amongst others, provides that a person shall not be eligible to submit a resolution plan, if such person acting jointly or in concert with such person is an undischarged solvent, willful defaulter as per RBI, a person having an account of the corporate debtor under its management or control or of whom such person is a promoter, classified as a NPA.

- **Avoidance of Preferential Transactions**

- a) If any person is given a preference in any transaction by the borrower which has the effect of putting such person in a beneficial position, then it will be considered as a preferential transaction. The time period for related parties is 2 years and for unrelated is 1 year. NCLT can pass an order to release or discharge the security interest or transfer the property back to the debtor.
- b) Exceptions: (i) Transfer made in the ordinary course or financial affairs of the corporate debtor or transferee; and (ii) transfer creating security interest in property acquired by the corporate debtor which secures new value and was registered with an information utility.

- **Avoidance of Undervalue Transactions**

- a) An undervalue transaction is when the borrower enters into a transaction with any person which is undervalued and not in the ordinary course of business. The timelines are the same as for preferential transactions. NCLT can restore the position as it existed before.
- b) Exception: Transactions which have taken place in the ordinary course of business of the corporate debtor.

- **Avoidance of transactions defrauding creditors**
  - a) If the borrower deliberately defrauds creditors, then the NCLT can restore the position as it existed before the defrauding transaction and protect the interests of the victims of the transaction.
  - b) Exception: (i) not to affect any interest in property which was acquired from a person other than the corporate debtor in good faith for value and without notice of the relevant circumstances, or affect any interest deriving from such an interest; and (ii) shall not require a person who received a benefit from the transaction in good faith for value and without notice of the relevant circumstances to pay any sum unless he was a party to such transaction.
  
- **Extortionate Credit Transactions**
  - a) If the borrower is a party to an extortionate credit transaction which is unconscionable under the law of contracts or require the debtor to make exorbitant payments, then it will fall within the ambit of this section. The transaction must have taken place in the last 2 years. NCLT can set aside, restore the position or modify the terms of the transaction.
  - b) Exceptions: debt extended by any person providing financial services which is in compliance with law in relation to such debt.

- How is Distressed M&A different?
- Distressed M&A under IBC
- Interplay with other laws

## HOW IS DISTRESSED M&A DIFFERENT?

General	Distressed
Parties have relatively similar leverage.	Seller is forced to sell due to financial distress.
Allows for detailed due diligence.	Focused and time bound due diligence.
Parties determine the commercials of the transaction.	IRP is required to maintain the entity as a ' <i>going concern</i> ' for maximization of the value of the corporate debtor.
Drafting and negotiation of transaction documents.	Submission of resolution plan with mandatory contents as prescribed under IBC.
Representation, warranties and indemnity clauses apply.	Contents of resolution plan backed by judicial approval.
Standstill clauses apply until closing.	Moratorium applies from initiation till implementation of CIRP.
Compliance requirements under different laws apply.	Several waivers in place to facilitate resolution.
Material adverse change may give rise to walk-away rights	Limited ability to walk-away from an approved resolution plan



- **When looking at distressed M &A in the context of IBC, one can say that the opportunity arises in the following distinct scenario:**
  - a) Pre-CIRP M&A Activity:**
    - M&A in the context of distressed potential Corporate Debtor who is likely to go into CIRP within a period of 24 months from the date of such transaction.
    - Issues will be whether that M&A activity can be hit by Sec. 45 and Sec. 46 as an undervalued transaction.
  
  - a) M&A opportunity may also arise following the commencement of CIRP**
    - Regulation 29 of CIRP Regulations allow the RP to sell assets of the corporate debtor, provided
      - i. the book value of the assets does not exceed 10% of total claims admitted by the IRP; and
      - ii. The sale is consented to by 66% of voting share of the COC.
    - Once the above conditions are met, the Regulations clearly state that a bona fide purchaser in such a case will have free and marketable title to the assets it so acquires notwithstanding the constitutional documents of the CD, SHA, JV or any other documents of a similar nature.
    - This deemed sanctity before law creates M&A opportunities for an acquirer to acquire assets during the insolvency and yet ring fence the acquisition from subsequent legal challenges.

- c) **M&A opportunity may also arise as a part of the CIRP when a Resolution Plan is invited by the RP:**
- The entire process must comply with all the steps prescribed under the Code.
  - A resolution applicant must be eligible under Section 29A.
  - Resolution Plan should meet the requirements prescribed under the Code.
  - The plan can be a creative document it can provide for:
    - i. transfer of all or part of the assets of the corporate debtor to one or more persons;
    - ii. sale of all or part of the assets whether subject to any security interest or not; and
    - iii. substantial acquisition of shares, or the merger or consolidation of corporate debtor with one or more persons.
- d) **M&A opportunity could also arise following the CIRP when as part of the Resolution Plan the Resolution Applicant has taken approval to divest all or parts of the corporate debtor's assets through M&A activity over a pre-agreed period of time following the conclusion of the CIRP.**

- IBC is a special statute which facilitates distress M&A and how.....
- Amendments have been introduced under other legislations to facilitate the object of IBC.
- Under the Companies Act an exemption has been provided for seeking of shareholders' approval required in connection with the implementation of the Resolution Plan.
- Similarly, SEBI has also amended its regulations such as under the resolution plan the shareholding of the resolution applicant can exceed 75%. Further, mandatory open offer requirement does not trigger in case of acquisition of shares pursuant to a Resolution Plan.
- Though, RBI has not notified any exemptions, however, a resolution applicant can through the resolution plan seek for dispensation of RBI's approval.

- Unsuccessful distress transaction under IBC (Amtek Auto)
- Successful distress transaction under IBC (Bhushan Steel)

- Liberty House Group had emerged as the highest bidder for Amtek Auto but soon backed out citing inadequate information being provided, which was allowed by the NCLT after imposing a cost.
- But the creditors moved the NCLT, alleging that Liberty House Group wilfully withdrew. The NCLT in agreement with creditors said IBBI may move against Liberty House Group as per the regulations laid down under the IBC.
- Section 74(3) of the IBC says that any party that violates conditions laid under the resolution plan is liable for prosecution and may face a prison term of up to five years with a penalty of up to Rs 1 crore.

- Bhushan Steel Limited (now Tata Steel Bhushan Limited) was successfully acquired by Tata Steel Limited under the IBC process.
- It acquired 72.65 percent of shares through Bamnival Steel Limited, a wholly owned subsidiary of Tata Steel Limited.
- The aggregate fund received from this investment is to the tune of INR 35,152.58 crore.
- 37% haircut was taken by the bank on their outstanding loan of INR 56,080 crore.

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