A STUDY ON THE EVOLUTION AND EFFECTIVENESS OF CORPORATE DEBT RESTRUCTURING IN INDIA

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ABSTRACT

Since its inception in 2001, the corporate debt restructuring (CDR) mechanism has exerted a profound influence on the reshaping of syndicated/consortium based loans. It sprouted as a platform for creditor banks and institutions to furnish sustenance to viable companies grappling with financial adversities. The restructuring package could involve various changes, such as business transformations, asset sales, interest rate reductions, deferred repayment schedules, working capital limit swaps, debt-to-equity swaps, waivers and sacrifices, and even new loans for admitted corporations. The number of CDR cases in India increased dramatically in 2013-14 compared to 2009-10, and the annual CDR exposure during this period rose by more than nine times. This abundance of CDR instances raises important questions about its impact. Does it truly expedite the optimal allocation of capital, or is it merely a tool wielded by vested parties, such as promoters and bankers, to manipulate and protract the inescapable bankruptcy of a company? The likelihood of manipulation is further intensified by the fact that until March 2015, the Reserve Bank of India practiced regulatory forbearance for cases where restructured assets were still deemed standard. This article aims to analyse the origin, growth, and effectiveness of the CDR mechanism in India.

INTRODUCTION

Corporate debt restructuring is a crucial aspect of any thriving economy, as it allows struggling companies to regain financial stability and avoid insolvency. In India, the issue of corporate debt restructuring has gained significant attention due to the increasing number of companies facing financial distress. The corporate debt restructuring (CDR) mechanism has become an important tool for restructuring syndicated/consortium based loans in India. Since its establishment in 2001, the CDR mechanism has provided a platform for creditor banks and institutions to offer support in restructuring to viable companies experiencing financial difficulties. The restructuring package provided through the CDR mechanism includes various transformations such as business reorganizations, asset sales, interest rate reductions, deferrals in repayment schedules, debt to equity swaps, and even new loans. The effectiveness of the CDR regime can be gauged by the increasing number of new CDR cases in India, which have seen a remarkable surge in recent years. This article aims to explore the evolution and effectiveness of the corporate debt restructuring regime in India, examining its history, the transformations included in the restructuring package, and the changing trends in the influx of new CDR cases over time. By analysing these aspects, we hope to gain insights into the impact and efficacy of the CDR mechanism in addressing financial predicaments faced by companies in India.

AN OVERVIEW OF CORPORATE DEBT RESTRUCTURING IN INDIA

The Corporate Debt Restructuring (CDR) mechanism is a discretionary system offered to eligible corporations that meet the criteria established by the Reserve Bank of India (RBI) and reach an agreement with their creditors. The CDR system operates on the basis of two important agreements: the Debtor-Creditor Agreement (DCA) and the Inter-Creditor Agreement (ICA). These agreements are crucial components of the mechanism and provide a legal framework for its functioning. To avail the benefits of the CDR mechanism, corporations must adhere to the guidelines outlined in the DCA. This adherence can be established either during the initial loan documentation process, for future cases, or when referring to the Corporate Debt Restructuring Cell. In a similar vein, all participating creditors must enter into a legally binding agreement, the ICA, which encompasses enforcement and penal clauses. This ensures that all parties comply with the established policies and guidelines of the CDR system.

The CDR mechanism serves as a valuable tool for eligible corporations facing financial distress. It allows them to restructure their debts and negotiate with their creditors, ultimately aiming to improve their financial health and avoid potential bankruptcy. By providing a legal framework and enforcing compliance through the DCA and ICA, the CDR mechanism promotes fairness and transparency in the debt restructuring process.[1]

The purpose of corporate debt restructuring is to negotiate with creditors, such as banks and financial institutions, to reduce the company's total debt, lower interest rates, and extend the repayment period. This process aims to infuse liquidity into business operations, keeping the company afloat and avoiding bankruptcy[2]. By reducing the amount of debt owed, lowering interest rates, and extending the repayment tenure, corporate debt restructuring helps to alleviate the financial burden on the company and increase its chances of avoiding insolvency. It also provides support to businesses facing financial difficulties and seeks to protect the interests of stakeholders, investors, and other lenders. Corporate debt restructuring may involve various approaches, such as debt-for-equity swaps, where creditors receive a share of the company in exchange for forgiving some or all of its debt. In some cases, the ultimate outcome may be creditors taking control of the company. This restructuring, is a voluntary framework that aims to restructure the debt of distressed companies, rehabilitate their operations, and ensure their long-term viability in the market.

CDR is a mechanism that has been in place since the early 2000s and has been used to restructure corporate debt for various purposes[3]. The mechanism has been subject to various changes throughout its history, in order to better address the needs of creditors and debtors alike. The CDR system was initially introduced as a tool to restructure corporate debt on a case-by-case basis. It has since evolved to become a more comprehensive and efficient debt restructuring mechanism, capable of handling large-scale debt restructurings. Over the years, the CDR system has seen significant changes in terms of its scope and coverage, as well as its eligibility criteria for

[1] SUMANTH BATRA, *Out of court CDR framework in India* 461-478 (2016), https://www.elibrary.imf.org/downloadpdf/book/9781616350819/ch019.pdf, Last visited on July 25,2023.

[2] Reserve Bank of India, Notification, *Corporate Debt Restructuring*, BP. BC. 15/21.04.114/2000-01 (Issued on August 23, 2001)

[3] VAROTTIL UMAKANTH, *The scheme of arrangement as a debt restructuring tool in India: Problems and prospects*, European Company and Financial Law Review, Vol.15, Issue No.3 (2018).

debt restructuring. These changes have allowed the CDR system to become more reliable, efficient and effective in helping debtors and creditors to reach a mutually beneficial debt restructuring agreement. In addition, the CDR system has also seen the introduction of various incentive schemes, such as tax breaks and interest rate discounts, to encourage debtors to take advantage of the debt restructuring process. These incentives have proven to be effective in encouraging debtors to take advantage of the CDR system and restructure their debt in a timely manner. As such, the CDR system has become an important tool for debtors and creditors alike in managing and restructuring corporate debt in India.

INDIA'S LEGAL AND REGULATORY LANDSCAPE FOR CORPORATE DEBT RESTRUCTURING

The legal and regulatory framework for corporate debt restructuring provides various mechanisms to facilitate the process. One important aspect of this framework is the role played by the National Company Law Tribunal (NCLT) in overseeing bankruptcy proceedings and approving the withdrawal of applications in debt restructuring cases. In fact, lenders often approach the NCLT to request the withdrawal of their bankruptcy proceedings application, signaling their willingness to restructure the debt and explore alternative solutions. Furthermore, the framework allows for the conversion of debt into equity and convertible instruments as a means of restructuring corporate debt. This can clearly be observed in the case of Jaiprakash Power Ventures, where financial institutions, such as ICICI Bank, opted to restructure their outstanding debt through the conversion of a substantial portion into equity and convertible instruments[4]. These provisions are outlined in Sections 230 and 231 of the Companies Act 2013[5], which grant the NCLT the authority to make orders on the application of the corporation or creditor/member. Additionally, the corporate debt restructuring process encompasses various actions such as rehabilitation, acquisitions, mergers, demergers, transfers of undertakings, and debt restructuring itself. It is crucial to understand the meaning of Compromise or Arrangement of Capital, which is often used in Corporate Debt Restructuring (CDR) schemes, highlighting its significance within this legal and regulatory framework. Overall, the legal and regulatory framework in India provides

[4] ARUN KUMAR, *Jaiprakash Power Ventures to exit insolvency process*, The Economic Times (January 14, 2020).
[5] Section 230 and 231, The Companies Act, 2013.

a structured approach to corporate debt restructuring, ensuring the involvement of key stakeholders and promoting effective resolution of distressed companies.

FACILITATING THE RESTRUCTURING PROCESS: THE CRUCIAL ROLES OF LENDERS, BORROWERS, AND REGULATORY AUTHORITIES

Indian corporate debt restructuring mechanism, as discussed in the article, is based on the INSOL principles. The Corporate Debt Restructuring system is intended to ensure economic efficiency and optimal utilization of assets[6]. It is also considered beneficial for the stakeholders as it allows them to negotiate and come to an understanding[7]. In India, the Standing Forum has taken the responsibility of laying down the policies and guidelines for the debt restructuring package. The package includes many components such as committees, corporate debt restructuring mechanism etc. to ensure a quicker recovery or restructuring process[8]. The corporate debt restructuring norms have been customized to be effective in India, taking into account the country's developing status.

In the process of corporate debt restructuring (CDR), multiple stakeholders play key roles to ensure a fair and effective resolution. The lenders, represented by the CDR Empowered Group, hold the responsibility of selecting a panel of members to ensure fair representation. This group, consisting of representatives from participating institutions such as the Industrial Development Bank of India Ltd. ICICI Bank Ltd. and State Bank of India, is tasked with making decisions regarding individual cases of debt restructuring. To determine the viability and feasibility of the debts, the CDR Empowered Group considers the preliminary report submitted by the CDR Cell. If the preliminary report is approved, the group may order the restructuring of the company's debts, with their decision being final and binding. The role of borrowers is also crucial in the restructuring process. Companies facing debt-related challenges seek support from all stakeholders to succeed, as they are not considered bankrupt but in need of assistance. These debt-ridden firms often face difficulties in recovering and fixing their finances. To initiate the restructuring process, companies

[6] NIMRIT KANG AND N.K NAYAR, *The Evolution of corporate bankruptcy law in India*, *(2003)*, Last Visited July 21, 2023.
[7] STEPHEN QUINN, S. *Securitization of Sovereign Debt: Corporations as a Sovereign Debt Restructuring Mechanism in Britain, 1694-1750*, (March 2008), Last Visited July 21, 2023.
[8] RAKESH MOHAN, *Financial sector reforms in India: policies and performance analysis*, Reserve Bank of India Bulletin (October 2004), Last Visited July 21, 2023.

make their first application to the CDR Cell, which will then be scrutinized by both borrowers' and lenders' restructuring plans by the CDR cell. Regulatory authorities also play a significant role in the restructuring process. The CDR system was established as an alternative to debt recovery tribunals and the Board for Industrial and Financial Reconstruction (BIFR) to restructure corporate debt outside of these institutions. The CDR Standing Committee is responsible for setting rules and regulations related to debt restructuring. The resolution plan for debt restructuring must be accepted by at least 75% of creditors based on the outstanding financial debt, ensuring a collective decision-making process among lenders. Ultimately, the final decision to approve the restructuring package lies with the CDR Empowered Group, which carefully evaluates all the factors and recommendations provided by the CDR Cell before making a determination. The involvement of lenders, borrowers, and regulatory authorities ensures a comprehensive and fair approach to corporate debt restructuring, aiming to alleviate financial difficulties and promote sustainable recovery.

The involvement of lenders, borrowers, and regulatory authorities ensures a comprehensive and fair approach to corporate debt restructuring, promoting sustainable recovery. The research paper also emphasizes the role of the CDR Empowered Group in approving the restructuring package, considering all factors and recommendations presented by the CDR Cell. This collective decision-making process among lenders ensures a balanced approach. Moreover, the legal and regulatory framework in India provides mechanisms to facilitate the corporate debt restructuring process, offering support to businesses facing financial difficulties and protecting the interests of stakeholders, investors, and other lenders.

NAVIGATING THE CHANGING LANDSCAPE: EXPLORING CORPORATE DEBT RESTRUCTURING REFORMS AND CONFRONTING CHALLENGES

The current CDR mechanism in addressing corporate debt distress faces various challenges and issues that need to be addressed. One of the challenges is the presence of non-bank financial institutions, such as hedge funds, which may have differing incentives and interests compared to traditional banks[9]. Additionally, there are action problems when it comes to sovereign debt

[9] DAVID A. GRIGORIAN AND FAEZEH RAEI, *Government Involvement in Corporate Debt Restructuring: Case Studies from the Great Recession*. November 1, 2001,

restructuring, which can affect the effectiveness of the CDR mechanism[10]. Moreover, different countries have unique reorganization and debt restructuring problems and issues that need to be taken into account[11]. In the UK, for example, there are discussions about the government's role in organizing the restructuring process[12]. Furthermore, the inclusion or exclusion of government-owned bonds from the voting process can also impact the effectiveness of the CDR mechanism[13]. Moreover, there are many unanswered questions regarding debt restructuring, particularly in India, where interpretation of the existing legal regime plays a significant role[14]. Lastly, uncertain economic conditions and difficulties in cash flow further decrease market demand and add to the challenges faced by the CDR mechanism[15]. These challenges highlight the need for continuous evaluation and improvement of the current CDR mechanism to effectively address corporate debt distress.

Despite significant evolution since its inception, the Corporate Debt Restructuring mechanism necessitates further growth and reform. One key aspect is the importance of governments having the necessary political capital to initiate and sustain legal and institutional reforms relevant to corporate debt restructuring, as these reforms may face opposition from various stakeholders. Many countries have already implemented reforms to their legal frameworks for corporate debt restructuring in recent years, recognizing the need to adapt to changing economic conditions resulting from crises. However, attempting to change the rules or practices for credit enforcement during or after a crisis may encounter heightened opposition. To address concerns about delaying debt restructuring, it is suggested that law reform be pursued during the crisis containment phase.

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https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Government-Involvement-in-Corporate-Debt-Restructuring-Case-Studies-from-the-Great-Recession-24365, Last Visited July 23, 2023.

[10] ANNE O. KRUEGER, *A new approach to sovereign debt restructuring*, Last Viewed on July 23, 2023.

[11] CHARLES BOOTH, *Corporate/Debt Restructuring: Japan, the Hong Kong SAR & the People's Republic of China-A Roundtable Discussion*, ABI Law Review, Vol.10, Issue No. 1, (2002).

[12] PAYNE J, "*Debt Restructuring in Transition*." Law Quarterly Review, Vol. 139, no. January, (2023), 101–25.

[13] WRIGHT MARK LJ, "*Sovereign debt restructuring: Problems and prospects*", *Harvard Business Law Review, Vol.* 2, (2012), 153.

[14] LARYEA THOMAS, "*Approaches to Corporate Debt Restructuring in the Wake of Financial Crises*", *Vol. 10, Issue 02*. 2010.

[15] FRIEDRICH HEINEMANN, "*The Political economy of euro area sovereign debt restructuring*", Constitutional Political Economy, 502-522, (2021)

To enhance the coordination of policy aspects within the CDR framework, a debt restructuring committee cab be established comprising of representatives from various agencies. This committee should include members from the ministries of finance, economy, and justice, as well as central banks and financial sector regulators. Furthermore, implementing an effective public communication strategy is crucial for instilling confidence and managing expectations within the CDR framework.

In addition, it may be necessary to implement legal and institutional changes to provide support for the strategy of restructuring debt. This could involve addressing the enforcement of claims by creditors through laws governing corporate insolvency. A reliable method of enforcing credit is essential for encouraging debtors to engage in negotiations and facilitating widespread debt restructuring. The suggested alterations might also include placing limits on shareholder liability and revising rules regarding corporate governance in relation to the obligations of managers, as well as the rights and responsibilities of shareholders.

To further streamline the CDR process, a clear and concise timetable for the various stages of the debt workout process should be enforced with as little scope for delay as possible. This helps to establish a sense of structure and accountability, ensuring that all parties involved are aware of the expected timelines and can plan accordingly[16]. Additionally, imposing supervisory penalties for non-compliance can incentivize maximum participation from both sides and minimize disruptions during the CDR process. By holding all parties accountable for their actions and imposing consequences for non-compliance, greater efficiency can be achieved.

Another effective strategy is the utilization of Sovereign Debt Restructuring Mechanisms (SDRMs) and Collective Action Clauses (CACs). SDRMs provide temporary liquidity to creditors during the restructuring process and ensure equal treatment of diverse creditors, similar to private insolvency procedures. On the other hand, CACs define creditor voting rules and qualified majorities, binding all bondholders within the same issuance to the restructuring terms. This helps to streamline the process by avoiding lengthy negotiations with each individual bondholder. However, it is important to note that CACs alone are not a complete substitute for a fully developed

[16] Laryea, supra note 15.

SDRM, which provides a comprehensive framework for preparing, negotiating, and executing sovereign debt restructurings. SDRMs cover a wider range of sovereign debt instruments beyond bonds, ensuring a more efficient and inclusive process. In certain cases, an intermediate approach can be considered to improve the efficiency of the CDR process. This approach leverages private resources and helps contain deadweight losses compared to across-the-board solutions. By adopting multiple approaches simultaneously, such as using an across-the-board approach for small and medium-sized enterprises (SMEs) and an intermediate approach for larger corporates, a more tailored and efficient debt restructuring process can be achieved.

Additionally, it is essential to differentiate between the phase of crisis containment and the subsequent phase of debt restructuring. In the crisis containment phase, there may be a need for measures like extending repayment terms and forgiving payment defaults. However, these measures are not the complete solution and cannot effectively address the underlying issues of debt structure and excessive debt burden. The subsequent phase of debt restructuring calls for a more comprehensive strategy that considers the viability of individual firms and optimizes the restructuring process accordingly. It is imperative to streamline and enhance the efficiency of the corporate debt restructuring (CDR) process in order to design and implement a successful debt restructuring strategy. By implementing clear timetables, imposing penalties for non-compliance, utilizing SDRMs and CACs, considering an intermediate approach in certain cases, and distinguishing between crisis containment and debt restructuring phases, the CDR process can be made more efficient and beneficial for all stakeholders involved.

CONCLUSION

The resources within the banking sector are valuable and limited, and it is crucial that they are not used imprudently. Corporate Debt Restructuring (CDR) is a necessary tool, particularly given the cyclical nature of the economy and its impact on individual companies. In India, CDR has been in place for over a decade and has largely achieved its objectives. It serves as a mechanism for protecting the economic value of banks' assets and should not be misused for other purposes. Regulatory forbearances, on the other hand, should only be employed during the most challenging times. The success or failure of these measures will ultimately depend on the ethics and integrity of the individuals involved in the restructuring process.

The restructuring process itself is designed to assist struggling sectors of the economy in overcoming temporary difficulties that are beyond their control. In order for us to justify its use as a means of benefiting the economy and society as a whole, it is crucial that it is accessible to all classes of borrowers and provided in a timely and fair manner. This can only be achieved by developing the necessary structures, systems, and processes to uphold these objectives.