Insolvency and Bankruptcy Hotline

February 28, 2017

BANKS TO MANDATORILY FOLLOW JOINT LENDER FORUM GUIDELINES – IMPACT ON BANKRUPTCY CODE

BOMBAY HIGH COURT:

- Reiterates the binding and statutory force of RBI circulars and guidelines;
- Makes it mandatory for Banks to follow RBI guidelines on Joint Lender Forum before initiating recovery proceedings against a corporate debtor, including but not limited to a winding up proceeding;
- States that the interest of all stakeholders must be considered before winding up an entity, as against an individual creditor

INTRODUCTION:

The Bombay High Court ("**Court**") in the case of *IDFC Bank Limited* ("**IDFC**") *versus M/s. Ruchi Soya Industries Limited*[1] ("**RSIL**" and "**Company**") dismissed a winding-up petition filed by IDFC seeking winding up of RSIL on *inter alia* the following grounds (a) RBI Circulars have statutory force and need to be mandatorily followed by Banking Companies; (b) the RBI guidelines on Joint Lenders Forum ("**JLF Guidelines**")[2] have to be complied with by Banking Companies, before initiating recovery proceedings including winding up proceedings and (b) a court would have to take a holistic and inclusive approach while determining the prospects of a company and not just the dues and defaults to one financial creditor.

FACTS

RSIL is a listed company being in the food industry with vast access to land, plantations and 21 manufacturing units across the country. Over the last two years, it had accumulated significant debt and its loans had to be classified as a Special Mention Account – 2 ("**SMA-2**") under the JLF Guidelines.[3] Amongst other creditors, RSIL had also failed to repay its loans to IDFC, consequently IDFC initiated the present winding-up proceedings to recover its dues from RSIL.

IDFC had provided its loans to RSIL as a part of a consortium of banks, the debt owed to IDFC was 2% of the total debt owed to the entire consortium by RSIL. The creditors, including IDFC, had formed a Joint Lenders' Forum ("**JLF**") as required under the JLF Guidelines. The JLF was in the process of formulating a Corporate Debt Restructuring ("**CDR**") Scheme. The rest of the creditors, including the consortium of banks which sought to be impleaded as an intervener in the preset petition, were opposed to winding up RSIL and sought to proceed with the restructuring scheme as being formulated under the JLF Guidelines.

ISSUE:

A. Whether the JLF Guidelines had statutory force, and hence were mandatorily to be followed by Banks

B. Whether the Court, in hearing a winding up petition, must admit the petition solely on the event of default, or whether the views and interests of the creditors in general must be taken into consideration

C. Whether the Consortium of Bankers should be heard at the admission stage

JUDGMENT

On the first issue, the Court held that RBI Circulars have statutory force, and are legally binding on banking companies. Given that the RBI performs a regulatory function for the banking industry, and has prepared guidelines towards the regulation of debt restructuring and/or recovery through the Circulars, they have the same force as a statute passed by the legislature. It referred to the Supreme Court case of *Central Bank of India v. Ravindra*[4] read with Sections 21 and 35-A of the Banking Regulation Act, 1949 to hold that banking companies must necessarily comply with the directions provided by RBI, and hence are bound by the provisions and requirements provided in the JLF Guidelines. The Court also held that not being a party to the Inter Creditor Agreement and Debtor Creditor Agreement, would not absolve IDFC of its obligations under the JLF Guidelines, as such requirements must be seen in the broader context of the Circular, which clearly mandates the participation of all creditors in the JLF.

Further, the Court stated that the JLF Guidelines provides for dissenting lenders, who do not want to participate in the rectification or restructuring of an account the option to exit their exposure completely by selling their exposure to a new or existing lenders within the prescribed timeline for implementation of the agreed Corrective Action Plan ("**CAP**").

The JLF Guidelines indicate that all banks have to monitor the asset quality closely and take corrective action for effective resolution. The three corrective action plans are specifically provided i.e. Rectification, Restructuring and Recovery. The action of Recovery can be initiated, only if the first two options i.e. Rectification and Restructuring of the borrower are not feasible.

Therefore, IDFC could have independently adopted appropriate legal steps to recover its dues only after Rectification

Research Papers

From Capital to Impact: Role of Blended Finance
June 15, 2024

Opportunities in GIFT City
June 14, 2024

Start-up Governance Essentials
May 30, 2024

Research Articles

Private Client Insights - Sustainable Success: How Family Constitutions can Shape Corporate Governance, Business Succession and Familial Legacy
January 25, 2024

Private Equity and M&A in India: What to Expect in 2024?
January 23, 2024

Emerging Legal Issues with use of Generative AI
October 27, 2023

Audio

Why is the ad industry unhappy with MIB's self-declaration mandate?
June 18, 2024

Incorporation of arbitral clause by reference: Position in India and other Asian Jurisdictions
June 12, 2024

Third-Party Funding: India & the World
April 27, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Future of India-Mauritius tax treaty – Impact of new Protocol on M&A deals and Private Equity structures
April 23, 2024

and Restructuring were not found feasible. The Court stated that the process of rectification and restructuring on one hand and the process of recovery by one of the members of the JLF on the other hand could not be permitted simultaneously and at the same time.

On the second issue, the Court relied on the Bombay High Court cases of *Bharat Petroleum Corporation Limited v. National Organic Chemical Industries Ltd*[5] and *Tata Capital Financial Services Ltd. v. Infraprojects Ltd.*[6] to hold that in deciding the admissibility of a winding up petition, the Court must not simply assess whether there has been default on the part of the Company but must take into account the general economic situation of the company, and must specifically account for the general interest of all stakeholders and not the specific interest of any one creditor. In this case, 98% of the creditors were opposed to winding up RSIL and the debts owed to IDFC constituted a mere 2% of the total debt owed by the Company.

ANALYSIS

Although the present judgment dealt with a winding up petition under the Companies Act, 1956, the proposition of law being propounded could have ramifications on the newly introduced Insolvency and Bankruptcy Code, 2016 ("**the Bankruptcy Code**"). The Bankruptcy Code provides for a mechanism under which a Financial Creditor ("**FC**") (includes Banks amongst others) can initiate an Insolvency Resolution Process ("**IRP**") to restructure the dues payable by a Corporate Debtor ("**CD**"), failing which, the FC can move to liquidate the CD. Under the Bankruptcy Code, only specific legislations are repealed and the ambit of certain others have been curtailed. The circulars/directives issued by RBI are not overridden by the provisions of the Bankruptcy Code. Therefore the JLF Guidelines and the Bankruptcy Code are presently both in force and running simultaneously. As per the present Judgment, the JLF Guidelines need to be mandatorily followed irrespective of any other right that a Bank might have under law, i.e. the right to institute winding up proceedings under the Companies Act. Similarly, the Bankruptcy Code provides Banks with certain statutory rights to recover its dues, which could also be usurped by the JLF Guidelines in the following ways.

In a situation where either an IRP is to be initiated when JLF is already in existence and a CAP is being formulated or when JLF has been mandatorily triggered during the pendency of an IRP, the question would be as to which process would supersede or take precedence over the other?

In cases where the JLF has already been formed and then the IRP is triggered, whether the restructuring process which is mandatory under the Bankruptcy Code will have to be duplicated after the same has been done under the JLF Guidelines, leading to a delay in the IRP process and thus defeating the objective of the Bankruptcy Code.

The existence of simultaneous processes requires harmonization, wherein it should be considered that certain essential fail-safe mechanisms under the JLF process must be retained. For instance, under the JLF process, if the SMA-2 debtor company having an aggregate exposure above a certain threshold, has to undergo restructuring, the JLF should carry out a detailed Techno-Economic Viability (TEV) study which has to be evaluated by an Independent Evaluation Committee. These mechanisms are essential in order to ensure that consortiums take necessary precautions while carrying out restructuring of debts.

Therefore, the onus is on the RBI and/or the legislature to look at the entire situation in a holistic and pragmatic manner while using prudence and foresight to bring about some much needed clarity on the process of debt restructuring and recovery to be followed by banking companies. We might see a situation where the RBI releases fresh guidelines to categorically deal with the multiplicity of prescribed mechanisms, which will synergize the conflicting guidelines and retain their essence.

- Arjun Gupta & Vyapak Desai

You can direct your queries or comments to the authors

(*We would like to thank Osho Chhel for his assistance and contribution)

---

[1] Company Petition No. 570 of 2016

[2] Frame Work for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plans (CAP)

[3] Before a loan amount turns into a Non-Performing Asset (NPA), banks are required to identify incipient stress in the account by creating three categories under the Special Mention Account (SMA), where SMA-2 is a situation where the principal or Interest payment overdue between 61-90 days.

[4] (2002) 1 SCC 367

[5] 2004 (2) Mh.L.J. 114

[6] (2015) SCC Online Bom. 3597

Q&A 2024 Protocol to the Mauritius India Tax Treaty
April 22, 2024

Boost to India's Space Potential: India Liberalizes Foreign Direct Investment
April 03, 2024