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Debtwire India Insolvency Summit 2018

Abridged Transcript

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Anubhav Srivastava joined ICICI Bank in 2003 and has almost 15 years of experience in corporate strategy and corporate banking with relationship management for large corporates across various sectors including steel, infra, hospitality, EPC, real estate, infotech, etc. Anubhav currently handles a portfolio of clients which includes some large cases in IBC and some other large business groups. Anubhav is an engineer with a post graduation in management from IIM Lucknow.

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Mihir Chandra joined SC Lowy in 2011 and has more than 10 years of experience in capital markets, including restructuring, M&A, leveraged finance and debt capital markets. Mihir leads the desk analyst team and is also responsible for risk management. Previously, Mihir was with Deutsche Bank and One East Partners in New York. Mihir graduated Magna Cum Laude from University of Michigan with a BS in Economics and Financial Mathematics.

Chaim Estulin
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Chaim helps look after the *Debtwire* team covering debt restructuring — particularly of Indian and Chinese corporates — and high-yield financing across Asia Pacific. A journalist with 20 years of experience covering Asian politics, finance and culture, he joined *Debtwire* in October 2007 at the precipice of the global economic crisis and has since written on a slew of private financing and restructurings, from the surprisingly smooth (Anil Ambani's default on a shareholder loan) to relatively successful (Suzlon Energy) to the eminently ugly (Asia Aluminum). He also hosts a podcast series for *Debtwire* on Asian restructurings and debt financings. Before joining Debtwire, Chaim was a business editor at the *South China Morning Post* and was a Hong Kong-based generalist reporter for the *Time* magazine.

Luc Mongeon, Debtwire Asia Managing Editor: This is Debtwire's inaugural insolvency event in India. As you all know, this has been exciting times for debt restructurings and insolvency here.

When Debtwire started covering India over 10 years ago, there were very few active restructuring opportunities to write about. We had only one reporter in Mumbai then, whose stories didn't get a lot of hits, although they included very interesting coverage on some busted CBs.

Now, when we write a story about India, it's likely the most-read story. We have two reporters covering the market — Pranav and Pallavi, whose bylines you probably recognize — and we have a team of analysts. The situation has changed very much; the whole world's interest is on this market.

That is why we have this event — to discuss the questions people have about this market — where this market is going and how things will end up. With the sponsorship of Deloitte and Clifford Chance, we have been able to organize this event.

So without any further ado, I would like to introduce Chaim Estulin, the senior editor for Debtwire out of Hong Kong who supervises our coverage in India.

Chaim Estulin, Debtwire Asia Senior Editor: Welcome to the Inaugural India summit from Debtwire. So great to see so many people out here from India, Hong Kong, Singapore, other parts of the world.

If we held this conference a year ago, the core discussion would have been very simple: Is the IBC [The Insolvency and Bankruptcy Code, 2016] just another acronym in the series of acronyms for failed attempts by Indian governments and regulators to create a viable restructuring mechanism?

We are now seeing the first signals that that might not be the case — that the Insolvency and Bankruptcy Code implemented in late 2016 could be very different form CDR [Corporate Debt Restructuring] or SDR [Strategic Debt Restructuring] or S4A [Scheme for Sustainable Structuring of Stressed Assets]; that the corporate insolvency and resolution process, or to use its acronym, CIRP, has real teeth that can really be used to take a bite out of India's vast non-performing-asset problem.

Just last week, Bhushan Steel became the first of the so-called Dirty Dozen large corporate defaulters to complete its resolution process with the bluest of blue-chips, Tata Steel, coming in to acquire a more-than-70% stake; and the lenders getting a cash settlement of almost two-thirds of the principal as well as equity.

Hundreds of other companies are going through the cleansing process; Indian banks are starting to get serious about offloading some of their bad loans; and all that is creating a plethora of opportunities for investors and advisors like yourself.

The scale of activity is evident in the two reports that Debtwire posts every quarter. One credits the advisory mandates for that quarter in Asia and the other tallies up the distressed-loan

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trades.

What you see in those reports is that, of all the Asian restructuring-advisory mandates in 2017, Indian situations made up more than 40% of the debt. Much of that was Dirty Dozen, but it wasn't all of them. In the first quarter, the percentage rose to 50%. The 180-day rule that the RBI [the Reserve Bank of India] implemented and announced in February is sure to keep the flow of mandates and opportunities going for quite some time.

With all these resolution processes and with the banks finally offloading the bad assets, investors — particularly international distressed-debt players — are jumping at the opportunity. Loans to Indian corporates comprised 44% by value of the nearly USD 700m principal of loan trades that we covered in the fourth quarter of last year. And the first quarter was even stronger. Of the USD 1.32bn face that we wrote about in the first quarter, USD 1bn was Indian loans. That is quite a bit, considering that there were almost no Indian loan trades a year-and-a-half ago.

These large numbers are definitely something to crow about, but they are also posing major challenges. To some people, they are teething pains; to many others, they are concerning reminders of the failed previous experiments in restructuring in India. After all, the success of Bhushan Steel conversely highlights the delays in many of the other Dirty Dozen cases.

For all its power, the IBC process is still largely reliant on many of the same players making the kind of decisions they weren't ready to make three years ago. And while new infrastructure was created to try to speed the process along, it is clearly bursting at the seams, ripping apart the supposedly sacrosanct timeframe that was at a core mission of the IBC.

These are some of the many issues that we will discuss tonight with our eminent panel.

Chaim: Sumit, Let's jump straight into the point at hand. From what you have experienced so far in trying to complete these resolution processes — and in fact completing one recently -- what are the signs that the IBC is actually different from the previous regimes?

Sumit: Thanks Chaim. I think that is a very interesting question. Because the IBC, as we see it, — I know it is a cliche — but it has generally been a paradigm shift. What has changed is that for the first time, you have the creditor in possession.

Firstly, it is a mechanism, or a process, which is run to seek a resolution. And secondly, this resolution has an objective: maximization of value in a time-bound manner. Now it sounds simple, but it really is. While the code has been written quite simply, I think, we are now in the process of the law getting settled. But that is the essential difference. Now the creditor comes in and takes possession of the company.

Earlier, the various regimes would be a restructuring for the management. [They] used to get highly influenced by the existing management and the restructuring therein would end up being not as it should have been -- a fair, unbiased and transparently run process.

There were other regimes and all of them also faced significant challenges because trying to take over an asset owned by somebody else is a tooth extraction. So, you never actually got into the assets.

Now, along with a simple law, there is also a very strong political will and intent. When you talk about the "dirty dozen" and the second lot of 28 coming in, it is the demonstration of that strong political will—and the will of the central regulator to say that look, if banks are going to take time triggering insolvency on larger cases, then the central regulator would step in.

And third, the death knell that came was on 12 February, when [the RBI] said that after September 30, if you have a restructuring, do it. But now you do the restructuring with a 100% acceptance by all banks, which never [used to] happen, in our experience.

So, I think the IBC is different simply because the creditors take possession and they are duty-bound to look at value maximization in a time-bound manner. And that's been the success story we have seen in Bhushan.

I don't think anyone was expecting the kind of result we finally came out with. Prior to the case getting into insolvency, there were talks about the debt getting restructured. There were third parties who had come in and offered somewhere between INR 10,000 and INR 15,000 crores (INR 100bn-INR 150bn) for settlement of the debt. And finally, the banks got INR 35,200 crores plus a 12% equity in the company as an upside. So, I think it is a step in the right direction and hopefully this is going to help clean out the banks for whatever excesses happened in the past.

Chaim: How did the process help create bids that were so much higher than before the IBC was introduced?

Sumit: This is what transparency and the fear of somebody else getting over the asset does to processes and we have seen this happen repeatedly — the moment you eliminate information asymmetry, much like you people strive to do through *Debtwire*.

In another case, Binani, now it's there in court litigating, but every time the value is going up - so nobody should complain. Essentially, what's happening is that we are going to see the situation where probably there will be more money than is owed to people.

Mihir: A couple more points. One, you get it in a timely fashion. Previously it would take seven, eight, nine, ten years. Fine, you're not going to stick to the 270 days [mandatory timeframe] but maybe it's a year-and-half or two years, which is a lot better for creditors and foreign investors. The second point is, when you look at the previous regime, it was more kicking the can down the road, with effectively the banks funding the equity check, or giving a free option to the equity owners. With the change of control, which creditors get today, what that's effectively done is improve recoveries, not just through competition, but also through [preventing] leakage.

Previously, let's say over a three or four years' time frame, the incumbent promoter, especially as the debt levels kept going higher and higher, would sort of bleed the company dry of assets or cash — not in every case, but often. And that's been struck down because of the professional managing of the asset today.

Anubhav: Just adding to that, one significant change that has happened also is that finally we have a judicial body that is kind of blessing the whole process. It's not like these assets we didn't try bidding out earlier. There were processes running in some of these assets earlier as well. But now finally we have a judicial body -- maybe not as clean as a Chapter 11 in the US where the debtors completely wash clean. But at least there is a judicial body blessing everything that is happening. You can clean up things to the extent possible, and that may be giving more confidence to bidders.

Mihir: I think the biggest issue was the control element because it is very hard to get control over an asset when another incumbent promoter was running in. Today that's changed - hopefully that has changed.

Sumit: Absolutely right. I remember in 2012, we were working with the State Bank [of India] and looking at invoking Sarfaesi [Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest act] and taking possession of an asset and actually running the sale of that asset.

We had an offer at the time we started the process for INR 700 crores (INR 7bn). Taking symbolic possession of the asset and actually running the sale process took us over 18 months. And after 18 months, the best offer we had on the table was INR 158 crores (INR 1.58bn). And then, SBI decided not to sell it.

So, trying to put in place a process, taking possession, to take cognizance of an offer they had, took them so long that the offer was destroyed, and they had nothing left. And you're absolutely right - getting possession is everything.

Chaim: Ashwin, from your side, what are the parts of the law that are frustrating from a legal standpoint?

Ashwin: I've been quite fortunate to be advising quite a few of these bidders and some of them are even cross-border bidders. And I find that at least in some instances, you end up wasting a lot of time negotiating things which are really not that relevant.

Case in point being this whole battle of [Section 29a] disqualification [of bidders]. Effectively, it's a game of one-upmanship, where the losing bidder finds some chink in the armor of the winning bidder and you're litigating.

This game of one-upmanship being played through the court system needs to stop. The bankruptcy court should be a court for restructuring and not one where you play a game of thrones. So, hopefully going forward, it becomes more streamlined, where either the CoC [committee of creditors] or the RP [resolution professional] has found for one bidder to be objectively eligible and put the highest marks on the evaluation matrix. Then if there is a challenging process, it should be a streamlined process. It shouldn't be one where today you are in various forums litigating whether somebody is eligible.

The other where I find it challenging is that this law only allows for share deals. So, you must buy the entire company with all its legacy issues. And that obviously lends itself to many questions.

When the joint parliamentary committee was set up to review the bankruptcy code, one of the things that they left open was that at some point, we will have an asset-sale mechanism - maybe not a prepack, but something like a US [Bankruptcy Code Section] 363 sale mechanism. So, I am hoping that we learn from these experiences and allow for some sort of an asset-sale mechanism, which, I think, will result in better maximization of value in a time-bound manner.

Mihir: I think your first point is something pretty interesting. You've seen a lot of the incumbents here litigating. Example being Essar Steel. And I think the key strategy is to push this through the 270-day timeframe to get to liquidation when they can sort of re-enter the process driven by the assets on the cheap, which just frustrates the whole process. I mean, it just kills sort of what the government is trying to do.

Chaim: Is it that 270 days is too short?

Mihir: If you look at every other jurisdiction probably….

Scott: I think for the insolvency system to work — and I think what's been done in India is a terrific start — you don't want to be too prescriptive. The unique thing with the restructuring compared to most transactions is that there are so many more people sitting around the table with different agendas and quite often it's like herding cats.

If you're very prescriptive around time, around whether sponsors can buy in, you are not necessarily going to get the best outcome. I still look at things from a very holistic point of view, and at the end of the day, the thing that should drive a transaction is value. And it shouldn't really matter who is providing that value - whether it is the promoter or a third party. As long as the process is transparent and everyone knows what the ground rules are and there is no way of gamming the system, then I think you end up with the right result for that particular company, its stakeholders and ultimately India.

And what India is done, compared to a lot of the other jurisdictions in the region, is really to be commended. In today's world, there is no shortage of supply of capital. India is in competition with other countries for that.

If you just use an example of Indonesia, which is a country that needs access to foreign capital, and look at what they have done over the last 20 years — which is not a lot — and you look at what India has done recently. India and Indonesia are not comparable, but both had systems that have been slightly jammed for different reasons. What India has done is unplug the prices, which has given lot of people the confidence to participate in Indian deals.

Anubhav: You know Mihir, just starting off from what you said... You were in CoCs as well. If it weren't for the 270 days, there is nothing to push bankers to really take decisions and move things ahead. So yes, maybe it won't get over in 270 days. But even when Chapter 11 was implemented in the US, it took a couple of years for the case laws to get developed and to come through and that will take time over here as well.

Chaim: Could this process function without a rigid time frame?

Sumit: If you ask me, 180 days and then 270 days has worked fantastically well. Clearly, as Anubhav said, it puts some kind of limitation on the decision makers amongst the creditors. Otherwise, work can always expand to fill the time you have.

Ashwin: Restructuring is an art and a science. So you need a little flexibility. But I think it's an India thing. Speaking for myself, work always seems to expand to fill the time. And so, I think having some sort of a guideline really helps.

And I'll give you an example. You know general litigation, maybe a couple of years ago, we tried to implement some timelines that you must file an affidavit within 30 days, you must make an appeal within so many days. And what was generally found was that while those timelines were not strictly adhered to, they tend to become a very strong guiding principle. And if you want to deviate from that, you must have a good reason.

And I think that's what we're seeing now with the 270 days as well. It's not sacrosanct. I don't think you will find a judge who says that there are two resolution plans on the table and we are in the final stages of negotiating but we are on the 271st day, so the company must go into liquidation. I think you will see a judge who will overlook that and find a way to restructure the company. But it serves as a strong guiding principle to get things done in an orderly manner.

Scott: I think that's right - because I am currently working on a deal — it's an out-of-court restructuring and term sheets have been agreed with principal creditors. But there is no judicial oversight and management tinkering around the edges of the deal as I look to improve the post-restructuring situation and looking for additional pockets of liquidity in those things. And it's complicating an already really complicated situation and there's no time limit lever on them.

Ashwin: If I could ask a question to Sumit and Mihir. What do you make of the story that the 270 days may actually result in less value?

Mihir: I think 270 days is enough in terms of just running a clean process. Where I disagree is, for example Essar Steel - you're running Section 29A checks [on whether any bidder has a default history], right? And that took about two, two and half months because of the large [bidders] with 2,000 entities.

So that's why there needs to be some flexibility.

Chaim: The Section 29A promoter law — can the system survive without it?

Mihir: I think it's necessary for the first round of cases because you had a lot of promoters that ran companies into the ground. There was fraud in a few of those cases. But going forward, the hope would be that companies try to avoid liquidation and insolvency, and therefore, at least my view would be, as long as [the company] tried to avoid it, then why shouldn't the [promoters] be given a fair chance.

Anubhav: Very frankly, as a banker, it's the color of money that matters. If the promoter later gives us the best value, it really shouldn't make a difference on paper. But I think the whole philosophy behind IBC is resolution and not settlement. It was resolution for the financial creditors, it was resolution for the operational creditors, it was resolution for all the stakeholders. And that is where for a promoter, who's not been able to resolve an NPA [non-performing asset] for more than 12 months, to continue with the company even after settling the banks - would it be actually be right? May be not.

Sumit: If you look at it, it has probably been contrarian to people's expectations that if you take the promoter out you will not get bids for the assets. And that was a genuine fear when 29A came and everybody was running it down as a very stupid law. As a matter of fact, what's happened is that without the fear of the promoter re-entering, all the other people have bid fearlessly and now know that they can get the asset without the promoter looking to do something akin to a poison pill. And that has led to enhancement of value.

Scott: I've got a question on the promoter issue. Do you think that's going to be a catalyst for promoters to try and engineer out-of-court restructurings?

Sumit: I think that's clearly happening. The mind shift has happened. People were disbelieving and suddenly as they say, they smell the coffee. So, they are very active. What you now need to do is, you moved it back one stage further to early signals, and that's the stage at which the promoters are starting to get serious. After the 30th of September, they would not have a choice to restructure once it becomes an NPA with the bank.

Earlier, what used to happen is, even when you knew that there's going to be a problem, you would resist the change. And now they know if they resist the change, then they will get nothing out of it. And it's not only get nothing. It's also ignominy. It’s also, you lose face, because you were an owner and now you've lost an asset.

Chaim: Anubhav, in what ways has the code improved your ability to deal with these companies?

Anubhav: We've attended joint lenders meetings in the past where it's been much more difficult to come to a consensus. First of all, because of the timeline issue. It's always difficult to take decisions and there's no timeline hanging over you.

Secondly, I think the law may be a simple code but essentially, it's quite prescriptive. So, all that the lenders have to do is to follow the code and the RP pretty much guides them through it and makes sure that all the tick boxes are ticked. So, to that extent, yes, it has made decision-making easier.

In fact, if I make that statement in all the cases that are currently stuck in litigation, you really can't fault the CoCs. It's not the lenders’ decisions which have delayed the processes. These are case laws being written which will take time. But as a banker, I think overall, from a value-maximization perspective, from a time perspective, from an ease-of-closing-things perspective, yes, definitely made it easier.

Mihir: I definitely think it's a step towards positive. I think the only issue is when you sit in a CoC, there is a lot of people in there that are afraid of getting put behind bars, for their jobs. So, decision making is slow and a part of that is because you know there's the delineation between the RP’s role and the CoC's role — sometimes sort of a gray line. And that's something I think the court will need to address. We've seen instances where the RP says this is not my responsibility, and then the CoC says it's not me, and then we just waste a week.

Chaim: Ashwin, so far, the white knights have largely been either Indian companies or entities that have strong relationships with India. Why is that? And is that going to change over time?

Ashwin: I should hope so. And I think there's some reason for why you've seen a lot of interest from foreign bidders, but not feet on the ground just yet. That said, ArcelorMittal is bidding, Liberty House is bidding. Some other private-equity funds have bid. But if one were to be honest, ArcelorMittal knows how to do business in India. So, does Liberty House. So do some of these funds.

So, what that tells me is that A, I think there is clearly some inhibition about this law. And with what you began, is it yet another acronym that's going to lie dormant and not achieve something? And so there has been a little bit of wait and watch.

Secondly, I feel that there has always been this perception in India that it's difficult to do hostile M&A. And I think we're seeing some of the pangs of that today with the incumbent controlling shareholders litigating. So, if the messaging from that comes out that - no, this is not a hostile M&A, this is a process that's been driven under a statutory body - I think it will again give confidence.

Thirdly, I think if you look at the sectors that are in the Dirty Dozen, these aren't really easy sectors to be coming in, from a pure financial-sponsor perspective. How do you bid for power-purchase agreements? How do you get to know the next power-purchase agreement? How do you get to know the pricing for steel, cement? These aren't easy sectors to be making your first foray into India on.

And if you look at the other sectors - you look at auto parts -- you are seeing foreign-investment interest. If you look at hospitality, you are seeing foreign-bidder interests. So, if you solve for each one of these in sample cases going forward, I think you will see more foreign interest. I still feel that in the first cycle of foreign interest, it will still be folks who know how to get deals done in India.

Sumit: See, I don't believe that just because you have assets selling for cheap, you will have everybody and his uncle from everywhere in the world descending into India — or any country for that matter.

There must be a rationale behind every acquisition, especially if it's a larger one and a more strategic one, unless you're part of a vulture fund or distress fund with a mandate and capital which can flow into the country.

Now, if you look at the steel assets, you look at Essar Steel. So, it's documented that the world number one, the world number three, the world number six [are interested]. Two of these are incidentally of Indian origin. Let's forget that. But they are in the process. You look at Bhushan. It had world number one and world number six there, and the second largest producer or third largest producer in India are also there in the fray. Vedanta arguably is not a steel producer, but it's large commodities and metals company globally. It is in the fray. It has picked up one of the largest steel assets in the top 12.

We are running a cement plant [sale]. Three of the top ten cement producers [are interested], of which only one is of Indian origin. The other two happen to have a business in India, which is the reason why they're interested in this. If they didn't have a business in India, why ever they look at spending time, resources and significant capital - it's a billion-dollar deal.

Another company, in the infra sector, is now going into liquidation. Now that asset was too complex, but we had interest from as far out as China, the US, Europe — Chinese-China players, US-US players, not Indian-origin players. But because of the complexity of the asset, they were not able to resolve because they were interested in the underlying assets whereas we were resolving for the whole company.

But the interest we have seen is across assets and across asset classes. For example, we are running a telecom company today. Had the same law come in five years ago and the company had to go bankrupt back then, I'm sure everybody and his grandmother in the telecom sector globally would have been vying for it today. Nobody's putting money in that sector - therefore you're not getting interest. That's how I would like to look at it.

Ashwin: It sorts of ties in with the 270 days. Some of the foreign investors struggle because of their internal processes -- they are used to doing fewer auction deals and more strategic, friendly deals, where you have a longer time horizon for due diligence.

Scott: I think, when I will be doing due diligence is not the issue. The issue is, I don't know how the system works and there's very few things in life where being the first mover is the best play.

But this is such a big opportunity. If people believe that the system is working and it's transparent and it's open to everyone, [then] a lot of capital [could] come into India. There's not huge amounts of opportunities in other countries, but that can change pretty quickly and if people don't believe in the system here, then if there's another opportunity, they'll move onto [those] pretty quickly.

Sumit: The quantum and the time for diligence required in these processes is significantly lower than in a regular M&A. More so if you are a strategic player, because what you need to do is look at the assets. You don't really need to get into financial diligence. You don't need to look for hidden liabilities, because all of them can be addressed in the plan. You don't have reps and warranties, indemnifications. You save zillions of hours.

Mihir: Wouldn’t it be easier as the asset sale opposed to share sale then because that adds complexity?

Sumit: I see no reason why you need further complicate it by taking, extracting the assets and putting into a company which may have defects to begin with, you know, when you incorporate it.

Chaim: Ashwin you have mentioned earlier that asset sale might be something to look at. Why?

Ashwin: Let's just take a couple of examples. So let us say there is a tax liability, where you feel that there was some action that the company has taken which may result in a tax liability two years down the line. And under the Indian law, the tax authorities have eight years to open proceedings. Now yes, I think every one of us is writing in our resolution plans that any tax liability that arises as a result of any action taken today should be cleansed under that resolution plan. So, the new incoming bidder was really not responsible for that action, really didn't even have the time to conduct diligence and find out for himself whether he was stepping into that liability. And so should that tax liability crystallize, it should not be payable by the bidder in the avatar of being the promoter of the company that he's acquired.

But whether the tax authorities are going to agree with that position of law, we don't know.

If on the other hand [this] was a pure asset deal, you only assume those liabilities that you want to assume.

That said, I think our government believes that this is a law for restructuring, so the company itself must revive. I think personally — and world over you have evidence to show — that if you allow asset deals, then the deals will be faster, better value, easier to diligence and greater comfort.

Chaim: One area we have seen lots of interest from offshore investors — some here tonight — is Indian distressed loans that have been put up for auction by Indian banks. What have been challenges in this suddenly new grand market?

Mihir: Assume you're talking about rupee loans. There's a few in there. The first one being the way the sales are conducted. Any transaction in India has to be done, for a foreign investor, through an ARC [asset-reconstruction company]. The issue is there are very few sizable ARCs in India.

So, let's say you're buying Essar Steel for example. You have to find an ARC that's willing to put 15% of its capital or 15% of the transaction value in cash. For a transaction of that size, you may have three or four ARCs, possibly. There are very limited options. That actually kills options for the seller because you've got four or five buyers potentially trying to use the same ARCs.

The second point is the new FPI [foreign portfolio investors] regulation, where you've got to hold 20%. Again, that narrows the list of buyers because you have to do diligence on those assets and have an onshore presence.

And the last point is taxation. So, on the FPI structure, there has been new tax regulations. We've asked seven different law firms and we've got seven different answers as to which way we're going to be taxed. And so that's a big issue because it's unclear whether it falls on capital gains or business income and the level you're going to be taxed if any.

That should be cleaned up to have a tax pass-through or a low-level of taxation to encourage people to invest in India. Because, as Scott said, you're competing with other jurisdictions and, today, there's a lot of money chasing India. But if there's a recession in a year or two, that's going to change.

Chaim: Anubhav, Can you give us insight — I'm not saying ICICI does this — about why banks are putting loans for sale and then pulling them because they failed to get board approval beforehand?

Anubhav: All of us have seen a few of those instances happening. Luckily, ICICI Bank wasn't involved in them. I think we need to step back a little. All of us know that Indian banks have never had flow desks for loans. We have never had a buy-sell philosophy on loans. Loans have typically been a [hold-to-maturity] instrument. There is no mindset or other mechanism in place for really pricing these loans.

You sell a loan today and 270 later or 300 days later, the loan realizes better value. Will there be questions asked, especially in these 12 large cases, which are under scrutiny. Every step that we take is a headline news. Every bank that sells a loan becomes headline news. Every recovery action becomes headline news. Every bit that comes in becomes headline news.

I think it'll take time to evolve. I hope it doesn't become a case of the boy crying wolf.

Mihir: Let's start with State Bank of India. If SBI sells stuff, the floodgates open.

Scott: On the point about value down the line and the embarrassment that comes with selling at 60 or there being a 90 or par recovery down the track. A lot of the value is created by the ability to implement a solution and quite often that involves a massive balance sheet restructuring, which involves deferred equity swaps, which a lot of banks just simply can't do. So I think you shouldn't be embarrassed if someone gets a better return, if the return is a function of them being who they are compared to a bank. That's just life.

Chaim: Interim financing is an important feature of the new code -- only it hasn't been used much, as highlighted by the Insolvency Law Committee in their April 3rd report highlighted. What has to be done to start generating real opportunities for investors and getting banks to sign off on it?

Sumit: Again, the law has evolved. Prior to the evolution, I think there were all of two interim financings. One of which was handled by us, in the case of Binani Cement, where we took over a plant which was shut down. We started operations. We took interim financing and we turned around a plan to make it EBITDA positive in something like 2-3 months of starting operations. But, the big worry at that time was that while the interim financing happened, preference to all the other debt, there was a big question mark on how interest would be paid out the moment the company was referred to liquidation.

There have now been guidelines which provide for liquidation and there is something known as liquidation financing, which again sits on top of all other owings of the company.

Now, there is a way of providing interim financing — provided it is justifiable and people can find due interest in doing it — and it takes time. When you're looking at financing, unless someone knows the asset very well, it takes time and invariably that is where you will feel 180- or 270-day test because if you're trying to finance and improve operations, then, clearly, we need more time.

Mihir: The other thing is getting enough financial participants interested. Banks aren't going to do it [every time]. So, you're going to need an alternative method of financing. That becomes a little difficult unless you've cleaned up a few parts of the code.

Chaim: Are banks going to be comfortable being primed?

Ashwin: I think priming is almost a foul word in the US. Because it means that banks are effectively getting shunted over. I think it was a deliberate move on the part of the Committee to protect the banks in India to only allow interim finance with the consent of the banks. So, I don't see that changing in the near term.

There are opportunities out there where you want funding. You need to deepen the market. I think there's a regulatory logjam which does not allow you to deepen the market. Banks cannot fund. ARCs can only fund where they have exposures. Players such as Mihir's firm cannot fund because they cannot withdraw the money in first one year because regulations don't allow for that. So, these logjams need to be cleared.

As things stand today, there are really only a couple of players who can play the interim-finance game. If that's cleared, I think you will find that there will be people wanting to provide interim finance especially now that the interest point has been clarified in the committee report and that should find its way into law shortly.

Funnily enough, there is a provision in the law that says that the interim resolution professional can take interim finance so long that there is 2x cover still available for the banks. It's a funny provision because it's highly unlikely. But, it goes to show that the drafters of the law thought about situations where you can effectively force interim finance down the throat of banks. If, as empirical evidence evolves, and the government sees that banks are not taking action required for the revival of the company, it's worth petitioning to say, "Look you should reconsider whether that 2x needs to be 1.25x or whatever." Just throwing out an idea. I'd be interested to hear a bank's perspective.

Anubhav: Interestingly, we really haven't seen too many cases of interim financing being raised by RPs. My view is that, actually, the IBC makes it easier for interim finance to be raised because, finally, it comes down to the resolution professional to really evaluate whether it is needed to keep the company a going concern, which is the RP's job really. And, if it is needed for the company to be kept a going concern, then, I would think that banks would be OK with that.

Chaim: One final forward-looking question. The Dirty Dozen will get done soon. The 28 are sort of working through the process. Longer term, it's about all these other companies - smaller companies and more diverse. How do you think that will change the dynamic?

Sumit: Interestingly, we are running two smaller processes where we are inviting bids. Loan sizes are around INR 1,600 crores (INR1.6bn). In the smaller of the two, we've seen over 20 expressions of interest. And we are hopeful of getting well over five bids.

So the issue will be, whether the asset is good and if the asset is good, how bad is the balance sheet. Because if the balance sheet is too bad, then bankers will dither whenever they need to take too deep a haircut to resolve.

Do we have a deep enough distressed market of financial players and a mature-enough market? Clearly No. That needs to evolve and sadly that's not even started evolving as yet.

Since there's been so many false starts on so many regulations in India, that's not still taken roots. But, the moment that happens, you'll have a robust market.

Ashwin: You started the session by saying how is this law different from all the other laws and I think, from my point of view, this is a much more transparent process and a much more transparent law. It will surprise some of you in this room to know that under erstwhile law, which was the Sick Industrial Companies Act, many of the orders passed by the regulator were not available to the public. So, it was very difficult to know what's par for the course, what to expect, what to anticipate.

[Now], there is a vast body of law that is evolving at a pace which has never been seen before. And, if it's unfortunate and fortunate that that vast body of case law has been built on the bedrock of the top 12 most nasty defaults, in the sense of the size of the defaults. But, looking forward, I think that's an advantage. If you look at the next round of cases, I think, there is much greater transparency and much better understanding of what may or may not happen. I think the judges across the courts have also grappled with some of these issues at a very high stress level. I think they will be able to apply their mind to these smaller cases and not for a second assume that because it's a smaller case, it's less complicated. It might be more complicated. But, signs are good.

Scott: China tried to do a similar thing 17-18 years ago. There was a massive amount of excitement around the China NPL markets as the Chinese government wanted to clean up the state-owned banks before they were privatized. They set up four asset-management companies and the thing with asset-management companies is that they should go out of business as the assets are resolved. [Instead], those four asset-management companies now exist. They are listed on the Hong Kong stock exchange. And the market, in terms of cleaning up, it never really opened up to foreigners. Just never really took off.

I suspect India is not going to go down that path. It's really important that once you say you are going to do something, just follow through. Early signs are that follow-through is there and when people look back in 4-5 years' time, India as an economy and a place to do business will be pretty well positioned.

Anubhav: I think three things will probably happen. One is -- thanks to the 12 most complicated cases being the basis for the case laws that would be written — things should get more boring and predictable.

The second thing that will happen is unless we modify section 29A, we also expect a lot of the mid-sized companies to go into liquidation, if the promoters are not bidding. I'm not saying that promotor should be allowed to bid. But, unless there are assets backing these companies, it looks like there isn't enough investor interest in them, there isn't enough private-equity interest in them.

Third, of course, we expect the market to develop.

Mihir: Legislation needs to improve, especially the case law. That should help. The mid-sized companies should provide with enough for the investor community to look at. Again, it comes with its own set of challenges and opportunities. Challenges being diligence, opportunity being the ability to actually control the situation and the other thing would be legislation for ARCs and FPIs – taxation -- because that's very important to open up the market, to have money flow into the country.

Rama (Audience): Hi, I'm Rama from Kotak Realty Fund. Fortunate enough to be one of the shortlisted bidders for the dirty dozen and got a front row seat for one of the cases.

My question is -- taking a cue from Sumit's view that the distressed-finance market is not really deep in India -- Mihir, what would be the strongest point to pitch for a foreign investor who's sitting on the fence, to make him jump onto the other side, into the Indian side and put his money in?

Mihir: I think, the opportunity makes sense and is sizeable enough [and] that in itself should be enough and typically is. But again, you need an ARC. So, as long as the opportunity makes sense and you have an ARC, there shouldn't be other impediments.

There's a lot of people looking. I'd say there's maybe 10 players that have invested in it so far, maybe 12. I think the issue is, as Scott mentioned, till 18 months ago, India, Indonesia and China were in one bucket. A lot of guys didn't look at them, no matter what. So that has changed in the minds of the people that are actually involved in the market. I think [other] people are waiting to see the test cases go through.

Rama: I have another question to Ashwin. I'm sure you're reading a lot of case laws and current NCLT judgments. Is the taxman having any holding, any stand with any of the cases which the NCLT is hearing?

Ashwin: In one of the cases, the tax department has come forward and said, I wish to be heard because this plan directly impacts me. But, frankly, if you ask me, I find that to be a better situation than the alternative. Because, the alternative is where the tax authorities sit quietly, the plan is approved by the court, you implement the plan, as a bidder you take control of the company. And, then, the tax authority comes out and says, I never got a copy of the plan. I was never heard in court. I'm an operational creditor. How can I be, how can my rights be determined by a committee of creditors where I am not represented… so on and so forth.

So, I would much rather have tax authorities filing proof of claim and I think Sumit is better placed on [whether] tax authorities are filing proofs of claims. In the cases that I have looked at, not really. So, we are not seeing tax authorities filing proofs of claim. Getting involved in the process is a better outcome in my mind than them creating hurdles later on.

Scott: Quite often there is not a tax liability; it is actually a tax loss. Which is more consistent with a company that's in financial difficulty, particularly high tax places like Australia. Yet, that loss is actually an asset. That's got value. Authorities say they understand the concerns around the tax liability but what's the [Indian] taxman's attitude towards carry-forward tax losses and restructures?

Ashwin: The real elephant in the room is something called MAT liability in India, which is Minimum Alternate Tax. Effectively when the target company or a corporate debtor takes a debt write-down, it seemed to be income in the hands of the company and it's liable to tax, which is the minimum alternate tax or other income tax and in some instances even perhaps capital gains tax.

So the real question is, I mean, clearly this company has been suffering. Why should the taxman tax a debt write-off? It's taxing thin air. The taxman did try and address it by saying that erstwhile carry forward losses and depreciation — and here's where I think Sumeet can really enlighten us — all can be set off against MAT liability. But, perhaps it's a case in point: Bhushan and other large assets, sometimes the debt write-off is so huge that there isn't enough carry-forward losses to set off against and that, even today in India, remains to my mind an open question. And so, people find a way to structure around and find elegant ways to protect what the real intent of the bankruptcy law is. How the taxman views that is something that we'll find out in due course.

Sumit: So, very quickly, there are three categories. Forget the corporate taxes, indirect taxes, GST now, erstwhile VAT, sales tax, whatever. There will always be taxes on companies making sales or selling services, if not goods. What we do in such cases is to aggressively write to the tax authorities and ask them to file claims. And, in most of our cases, we've heard claims coming through. In one of the cases we've had the tax authority coming through to the court when the plan was being heard, trying to make a case for, what their claim should be, should be accepted, so on and so forth.

Now, that is very good, like Ashwin said, because once they come and stand in front of court it makes that much less a reason for them to litigate against it later because they've already been heard. But irrespective, law is not settled. I don't know how it will get settled. But the way it treats is plain simple vanilla. As a taxman, you stand number 5 or number 6 in the list of people who need to be paid under the waterfall. In all likelihood, nothing will trickle to you except for the largesse of the new owner of the business or if he's god fearing or wants to support taxation in the country or doesn't otherwise have a good relationship with the tax authorities. But other than that, you know unless the asset has a lot in it, for example now, in the case of Binani Cement — which is there in public — if the asset has enough to be able to provide to the operating creditors and statutory creditors, it will flow through.

Now, the second question was, What do you do with carry-forward losses. Again, this is a company-versus-asset argument. As long as you are trading the company, the carry-forward losses get preserved in the company.

The third question is — which is probably unique in the Indian case — what do you do when you take a debt write-down. I think there also the law is getting settled in terms of what to do with the principle but probably [we] still don't know what to do with the interest.

But people are finding ways to write what in a typical merger scheme of arrangement could have been. So, they are finding ways to write this resolution plan or scheme of arrangement or debt re-arrangements, whatever you call this, in a way in which you can be suitably safeguarded against a tax scenario when you are actually writing down principal and interest.

Now, whether these safeguards will work. Of course, tax authorities will challenge it. But it will be a failure of the law if eventually they are able to come back and harass you for this and the resolution plan will fail. But that's the only grey piece according to me. When you look at what are due to authorities at the beginning of the process, prior to commencement date, and what happens to losses which are there in the company, I think that's pretty vanilla.

Chaim: Like so much else. We'll wait, and we'll see, we'll work it out. Thank you guys so much. Thank you Sumit, Ashwin, Scott, Anubhav, Mihir. And thank you all for staying here this late night to hear this great conversation. Have a good night.

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