Indian Economy

India changes bankruptcy law to close 'wilful default' loophole

President approves legislation to stop debtors bidding for their own collapsed assets

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YESTERDAY Amy Kazmin in New Delhi

India has tweaked its new bankruptcy code to prevent wilful debt-defaulters from bidding for their own collapsed companies at auction, closing a loophole that critics said would have allowed wily businessmen to regain control of their insolvent assets at deep discounts.

The amendments to India's year-old bankruptcy law — approved by the president on Thursday — were made through an emergency ordinance and take effect immediately. But the changes to the law will eventually have to be approved by Parliament, or else they will lapse.

The changes come as test cases of India's bankruptcy law are winding their way through the system, including 12 large companies that together account for 25 per cent of the bad debts weighing on the books of India's banks.

Among them are include units of Essar, Bhushan Steel, Monnet Ispat, and Lanco Infratech, all of which are said to have attractive assets but are weighed down in high debt levels.

The new clauses apply to businessmen who are formally designated as "wilful debt defaulters" because they are considered to have the ability but not the willingness to repay bank debts. They will be prohibited from bidding for any assets during the liquidation phase of insolvency proceedings.

The law also seeks to prevent those connected to such business people from bidding for stressed assets being auctioned as part of insolvency proceedings.

"The ordinance aims at putting in place safeguards to prevent unscrupulous, undesirable persons from misusing or vitiating the provisions of the code," the finance ministry said in a statement after the new rules were approved on Thursday.

"The amendments aim to keep out such persons who have wilfully defaulted, are associated with non-performing assets, or are habitually non-compliant and therefore are likely to be a risk to successful resolution of insolvency of a company," the statement said.

Companies referred to the bankruptcy process have up to 270 days to agree a debt restructuring plan with their lenders; at that point the companies go into liquidation and viable assets are put up for sale. The first such auctions are expected in the next few months.

But analysts had warned that debt defaulters that had been unable to reach agreement with their lenders could conceivably regain control of their companies by bidding for them at auction — a possibility that the new law sought to prevent.

“To ensure the law doesn’t get misused these tweaks have been made,” said Sonal Verma, an economist at Nomura.

Amit Tandon, the founder and managing director of Institutional Investor Advisory Services, said the new rule also appears to “make a distinction between business failure and a recalcitrant borrower who has the ability but not the willingness to repay.”

Manish Aggarwal, head of resolutions at KPMG in India, warned that the process ought not block every entrepreneur whose company has failed from bidding for assets under liquidation. In reality, many Indian companies have run into financial trouble due to circumstances far beyond the owners’ control.

“They have recognised there is a problem here and you can’t allow the guys that have done fraud or siphoned money to participate in this process,” he said. “But you can’t say that every promoter is responsible for leaving companies in this state. It’s a fine balance.”