# Our Views

## Pre-insolvency resolution for a listed stressed company – bridging an important gap

The first comprehensive Indian bankruptcy law introduced in 2016, provided for several measures to facilitate quick resolution of stressed companies. It also provided concessions for listed companies from applicability of SEBI requirements for pricing of preferential allotment and the provisions of open offer. However, often bankruptcy stage is too late for a company to revive as its operations and finances are already significantly impacted by this time. An effective pre-insolvency mechanism can prevent value erosion caused by disruption of business, de-clog the NCLTs, provide access and certainty to potential buyers, and, protect interests of all stakeholders by enabling quick resolution of companies before it is too late.

Businesses facing financial stress often require immediate infusion of capital to save themselves from being referred to bankruptcy. So far, one of the main challenges in capital infusion by a strategic investor into a stressed listed company had been the SEBI guidelines imposing pricing restrictions on preferential allotment and the requirement of open offer. Typically, a stressed listed company experiences progressive fall in their share price. Attracting capital at higher than the prevailing market price for such a company becomes an issue. Also, the requirement of making an open offer by a strategic buyer diverts funds to existing shareholders than to the company which requires immediate financial support.

In the past couple of years, we have had situations where inspite of adequate capital being available for investment, a stressed company had to file for bankruptcy as the investors were unable to meet these requirements. In addition, the revised RBI framework for the resolution of Stressed Assets announced in February 2018 further complicated the matters for stressed businesses. As per this framework, post a default, a period of only 180 days was allowed to restructure the stressed assets. Failing this, the company was mandatorily required to be referred to IBC within 15 days. A time-bound activation of bankruptcy proceedings left very little time for the borrowers to bring in a strategic/ financial investor.

The 2018 circular of RBI was struck down by the Hon. Supreme Court of India in 2019 thereafter RBI came out with a new Framework for Resolution of Stressed Assets in June, 2019 which provided for a comprehensive guidelines for resolution of stressed assets outside the IBC. Now there was a real opportunity for businesses to restructure outside the bankruptcy process.

In this backdrop, SEBI this week, has come out with certain relaxations in preferential allotment norms and open offer obligations for stressed companies to help them raise capital from financial/strategic investors and possibly clear the path for resolution before it goes under IBC.

SEBI has granted two key relaxations to companies with stressed assets- (a) easing of pricing guidelines for preferential issue and (b) exemption from open offer obligations. The shares issued to the investors in such an issue need to be locked in for a period of three years. There are other checks and balances prescribed such as disclosure of end use, barring the promoter and promoter group from participating in such an issue and the requirement of majority of minority shareholders' approval. To avail such relaxations, the stressed companies would need to comply with two of the three conditions laid out by SEBI – (i) disclosure of defaults in payment of interest or principal and continuing default for a period of at least 90 calendar days after the occurrence of such default, (ii) downgrading of the credit rating of the financial instruments of the company to "D" and (iii) existence of an inter-creditor agreement in terms of RBI (Prudential Framework for Resolution of Stressed Assets) Directions 2019.

***RBI's June 2019 guidelines and SEBI's June 2020 announcement together bridge an important gap in the possibility of a resolution plan outside IBC for a listed company.***

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