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RSP INDIA LEGAL UPDATE

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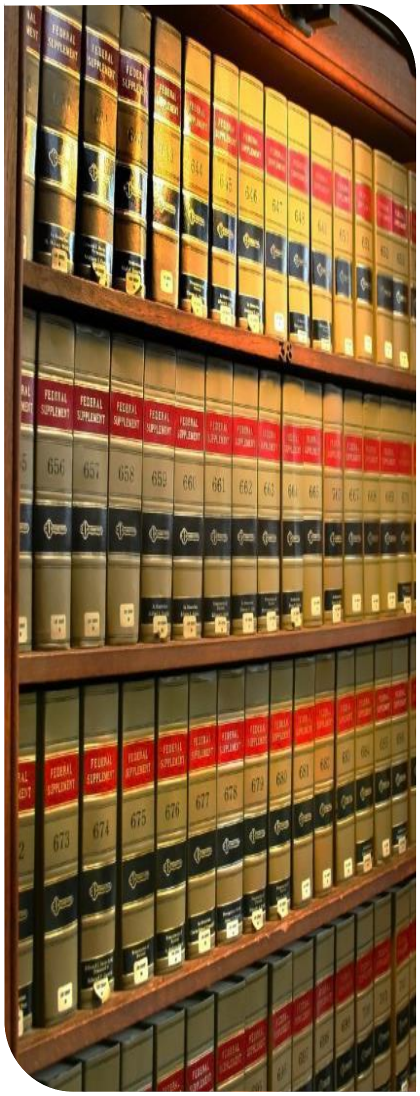
INDIA LEGAL UPDATE is a journal of Rajani, Singhania & Partners which offers a legal perspective on the new business climate and opportunities in India in keeping with the existing laws, current happenings and events in Corporate India.



Dear Readers,

Welcome to the July 2015 edition of India legal Update.

In this issue, we have presented an overview on 'Strategic Debt Restructuring' ("SDR"). The SDR scheme acts as a last resort to revive sinking companies that have already undergone a long drawn financial restructuring process. We have made an attempt to analyse the SDR scheme as a concept.

We hope you find this issue interesting and informative.

We look forward to your suggestions and feedback at info@rsplaw.in

Best Regards,

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STRATEGIC DEBT RESTRUCTURING- AN INTRODUCTION

- The concept of Strategic Debt Restructuring ("**SDR**") has been introduced by the Reserve Bank of India (the "**RBI**") in the SDR Scheme (the "**Scheme**") to help banks recover their loans by taking control of the distressed listed companies.
- The Scheme has been enacted with a view to revive stressed companies and provide lending institutions with a way to initiate change of management in companies which fail to achieve the milestones under Corporate Debt Restructuring ("**CDR**").
- The Scheme is subsequent to CDR or any other restructuring exercise undertaken by the companies.

ELIGIBILITY

- Conversion of outstanding debts can be done by a consortium of lending institutions. Such a consortium is known as the Joint Lenders Forum ("**JLF**").
- The JLF may include banks and other financial institutions such as NBFCs.
- The Scheme will not be applicable to a single lender.

CONDITIONS

- At the time of initial restructuring, the JLF must incorporate an option in the loan agreement to convert the entire or part of the loan including the unpaid interest into equity shares if the company fails to achieve the milestones and critical conditions stipulated in the restructuring package.
- This option must be corroborated with a special resolution since the debt-equity swap will result in dilution of existing shareholders.
- Such a mandate will result in the lenders acquiring a majority (51%) ownership.
- If the company fails to achieve the milestones stipulated in the restructuring package, the decision of invoking the SDR must be taken by the JLF within thirty (**30**) days of the review of the account during the restructuring.
- The JLF must approve the debt to equity conversion under the Scheme within ninety (**90)** days of deciding to invoke the SDR.
- The JLF will get a further ninety (**90**) days to actually convert the loan into shares.

WHAT HAPPENS AFTER THE DEBT-EQUITY SWAP?

- On completion of conversion of debt to equity as approved under the Scheme, the JLF shall hold the existing asset status of the loan for another eighteen (**18**) months.
- The JLF must divest their holdings in the equity of the Company. If the JLF decide to divest their stake to another Promoter, the loan will be upgraded to 'Standard'. The 'new promoter' should not be a person/entity from the existing promoter/promoter group. However, the quantum of provisions held by the bank as on the date of the divestment will not be reversed.

PRICING

The conversion price of the equity shall be determined as follows:

- Conversion of outstanding debt into equity will be treated at a *'Fair Value'* which will not exceed the lowest of :
    - *Market value, average of the closing prices during the 10 day average price in the market.*
    - *Book value per share to be calculated from the company's latest audited balance sheet without considering revaluation resources.*
- In any case, the price cannot be lower than the face value of the share.

OPEN OFFER? OR NOT?

- The pricing formula stated above has been exempted from the Securities and Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements) Regulations, 2009.

- Further, the acquiring lender on account of conversion of debt into equity will be exempted from making an open offer under *Regulation 3* and *Regulation 4* of the provisions of the *Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011*.

ANALYSIS

- In the current global scenario and economic downturn, where loan defaults are looming over corporates, the concept of debt-equity swap is being considered by various jurisdictions globally in an effort to revive a significantly important or a supposedly viable company. This model of revitalizing bankrupt corporations has come into vogue since the global financial crisis in 2009.
- RBI has recently proposed this concept in India. Although banks would get ownership and control over these corporates, at this stage, the value of the underlying assets would have deteriorated substantially. Banks are, in effect, left with a bagful of non-performing assets. It will be challenging for the lenders to continue to run the business of these companies till the time a suitable buyer is found and may have to deploy professional management to efficiently run and manage these companies leading to "putting good (public) money behind bad money". Until these corporates turn-around and become viable, finding a suitable buyer for the lenders will be difficult and may take many years. SDR can be considered as a last resort to revive such companies which have already undergone a long drawn financial restructuring process.
- One of the critical problems of the Scheme could be the price at which the debt to equity conversion must take place. The conversion price could be higher than the market price as the market value of these scrips would have substantially reduced, whereas the lenders as per the Scheme will be required to convert the debt into equity at a price which shall not exceed the fair value (i.e. market value or break-up value, whichever is lower subject to the floor of face value). This may result in further losses to the lenders.
- As per certain news reports, the lenders of **GTL Infrastructure**, a mobile tower company, such as **State Bank of India, IDBI Bank, United Bank of India** and **Dena Bank** are planning to invoke the SDR to convert GTL's debt of more than Rs.5000 crore into equity and taking over its ownership and management. Other lenders of companies such as **Electrosteel Steels Limited** and **Ratnagiri Gas and Power Limited** are also considering the SDR route.

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