View: India swaps bankruptcy teeth for dentures

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By Andy Mukherjee

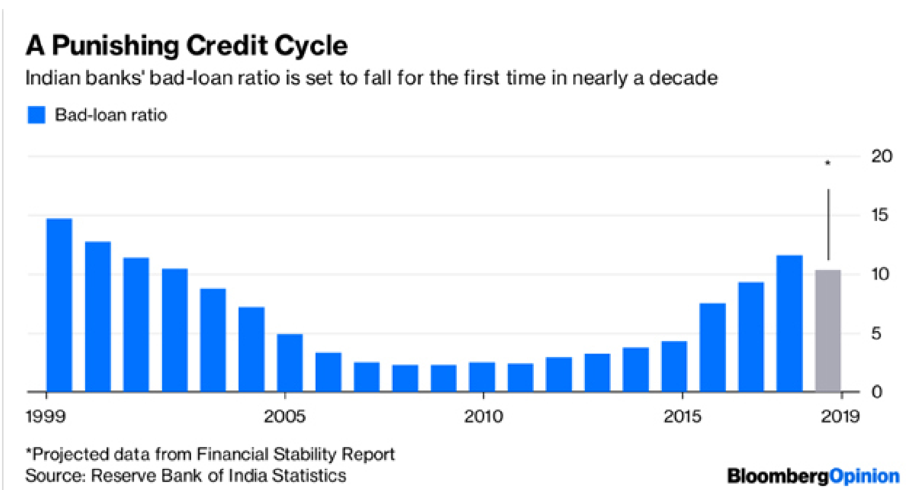
Errant debtors are forever looking for ways to undermine creditor protection; but when lenders themselves start making a mockery of a fledgling insolvency law, nobody can save it.

That's where India's two-year-old bankruptcy regime is today, brought to the brink of irrelevance by the strain of resolving its most high-profile case: Essar Steel India Ltd.

The billionaire Ruia brothers have used every trick in the book to ensure their prized asset stays in the family, despite owing financial creditors Rs 50,800 crore ($6.3 billion) in unpaid dues. Just as the process was crawling to a conclusion, with the lenders accepting ArcelorMittal's Rs 42,000 crore bid for the 10 million tons-a-year steel plant, an unexpected wrinkle has emerged. State Bank of India, the largest creditor, has put its entire Rs 15,400 crore exposure on the block.

The bank is saying it would accept more than Rs 9,600 crore today from loan buyers who can then collect Rs 11,300 crore from ArcelorMittal in the future. Assuming that takes another year, an implied annual return of 18 per cent maximum is hardly mouthwatering for a global vulture fund that needs to hedge the currency risk: It would be raising money in dollars and getting paid in rupees.

State Bank should know that any investor group buying out the bank's loans will do so because it will automatically replace the Indian lender to become the strongest voice on Essar's all-important creditors' committee. If this debt holder then backs the Ruias' last-ditch offer to outwit ArcelorMittal and pay lenders about Rs 54,000 crore — with no clear explanation for where the cash-strapped group is raising the funds — then it's game over.



Other creditors could go along, especially Standard Chartered Plc, which would get next to nothing out of ArcelorMittal's proposal anyway. Who knows, by the time the messy situation gets to the Supreme Court for one final, decisive battle for control, the Ruias' lawyers might just argue that there's no insolvency to resolve here. After all, the two creditors who moved to have the steelmaker declared bankrupt — State Bank and StanChart — are either no longer in the picture or lukewarm to a new owner.

Poor, rich Lakshmi Mittal. He would be left red-faced for thinking that buying assets out of bankruptcy would be his ticket to building a steel empire in his home country. The domestic industry has until now kept the acquisitive global steel baron out of India, where rising incomes and accelerating urbanization are expected to pick up some of the slack from abroad, with an already overbuilt China witnessing the worst fatigue in car buying in at least two decades.

Four Deaths for Every Rescue

India's new corporate insolvency process is being used more, but large debtors are stalling while many smaller businesses are getting liquidated

Quarter Ended	Already In pipeline	Admitted during qtr	Closure by appeal/review	Closure by resolution plan	Closure by liquidation	Left in pipeline
Mar 2017	–	37	1	-	-	36
Jun 2017	36	129	8	-	-	157
Sep 2017	157	231	15	2	8	363
Dec 2017	363	147	33	8	24	445
Mar 2018	445	194	14	13	57	555
Jun 2018	555	244	18	11	47	723
Sep 2018	723	216	29	18	76	816

Source: Reserve Bank of India

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Mittal has already set aside Rs 7,000 crore to settle creditor claims in two unrelated Indian bankruptcies — only to become eligible to bid for Essar Steel. If he still fails, investors would worry less about him and more about the signal India would be sending about the integrity of its bankruptcy process. Cases were supposed to be resolved in no more than nine months and it's already taken a year and a half for Essar.

Large Indian family businesses, it would thus be proven beyond a doubt, are impossible to dislodge. Any constraint that the state seeks to place on their behavior can always be defeated with the help of supportive partners like Russia's state-controlled VTB Group, which is the only continuing lender to the Ruias' holding company.

A bankruptcy law that appears creditor-friendly on paper but can only be used against small entrepreneurs would take the country back to where it was in 2001. Debtors want precisely that, and it's rational. Yet if taxpayer-funded Indian state-run banks don't wield their voting power on creditor committees to push for better outcomes, then the moral core of the bankruptcy code will collapse. The ability of the law to force superior and timely out-of-court settlements would also diminish. Indian creditors' abysmal recovery rates will remain forever depressed.

A country that needs to sweat every investor rupee and dollar to put its swelling, restive labor force to work will continue to abuse that very thing it doesn't have enough of: capital. The bankruptcy law will exist – with dentures in place of teeth.

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