Asia Pacific Guide to Lending and Taking Security - India

If things go wrong

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# 1. Please provide a brief description of the insolvency regime. In particular what rights and duties do unsecured and secured lenders have on the insolvency of a debtor? Are there any other matters of concern?

The insolvency regime for a company is governed by the Insolvency and Bankruptcy Code, 2016 ("**Code**"). The insolvency resolution process of corporate persons (CIRP) is governed by Part II (Corporate Insolvency Resolution Process) of the Code and the regulations made under it. The adjudicating authority in relation to any matters relating to the CIRP of a corporate person is the National Company Law Tribunal (NCLT). No civil court or any other authority has jurisdiction in relation to insolvency matters of companies. Under the Code, prepackage insolvency resolution is currently only permitted with respect to companies classified as micro, small and medium enterprises.

**Insolvency resolution process**

**Commencement of process**

The CIRP of a corporate person under Part II of the Code can be commenced when a corporate debtor has committed a default in relation to the payment of a debt of at least Indian rupees 10 million owed to a financial creditor or an operational creditor. Part II is applicable to companies (except for financial service providers) and limited liability partnerships.

To commence a CIRP, an application must be filed before the NCLT in the form prescribed, informing the NCLT of the details of the default and suggesting an insolvency resolution professional.

The Code prescribes a 14-day timeline for the NCLT to admit or reject the application (although this has been interpreted to be recommended and not mandatory). The CIRP commences from the date of admission of the application by the NCLT ("**Insolvency Commencement Date**").

Under the Code, a public announcement must be made by the insolvency resolution professional at the time of the commencement of the CIRP in relation to the company. The public announcement, among other things, is required to notify the last date for the submission of claims by all the creditors of the company.

The CIRP is to be completed within 180 days from the Insolvency Commencement Date. The above time period may be extended by the NCLT for a period of 90 days if an application to do so is made by an insolvency professional (acting pursuant to a resolution of a committee of creditors passed by a vote of 66% of the voting shares). Further, the Code prescribes that in any event, the CIRP must be completed within a period of 330 days from the Insolvency Commencement Date, including any extension of the period of the corporate insolvency resolution process granted and the time taken in legal proceedings in relation to such resolution process. However, this time period has been extended by the courts and tribunals on a case-by-case basis.

**Moratorium**

The Code prescribes that from the Insolvency Commencement Date until the completion of the CIRP or the passing of a liquidation order (whichever is earlier), a moratorium will be imposed in relation to the company as follows:

No suits or proceedings are permitted to be instituted against the company.

No security is permitted to be enforced.

The company is not permitted to transfer or encumber any of its assets.

**Interim resolution professional**

An interim resolution professional must be appointed by the NCLT on the Insolvency Commencement Date. That resolution professional must be registered with an insolvency professional agency under the Insolvency and Bankruptcy Board of India (Insolvency Professionals) Regulations, 2016 and be an independent party in relation to the company. From the date of appointment of the interim resolution professional, the management of the company's affairs will vest with the interim resolution professional.

The insolvency resolution professional is vested with the power to collate claims against the corporate debtor and, on the basis of claims received, constitute a committee of creditors. The form and manner, including the relevant documents that are required to be submitted by a financial creditor, operational creditor or a worker/employee in relation to their respective claims, must be in accordance with the applicable regulations. Please note that, in relation to any debt in foreign currency, such debt will be valued in Indian rupees at the reference rate published on the RBI's website on the Insolvency Commencement Date.

**Creditors' committee**

The insolvency resolution professional identifies the financial creditors and constitutes a creditors' committee. Operational creditors above a certain threshold are permitted to attend committee meetings but have no voting power. Depending on the item to be decided on, the creditors' committee can approve matters by a 51%, 66% or a 90% majority vote (depending on the type of matter). Decisions of the creditors' committee are binding on the corporate debtor and all its creditors.

The creditors' committee considers proposals for the revival of the debtor and must decide whether to proceed with a revival plan or liquidation within 180 days (subject to extensions as mentioned above). Any interested party may submit a revival proposal but it must provide for the payment of operational debts to the extent of the higher of the amounts that the operational creditors would have received had the company been liquidated and the amounts that the operational creditors would have received had the proceeds of the resolution plan been distributed as per the prescribed liquidation waterfall. Further, a plan must also provide for financial creditors who did not vote in favor of the plan to be paid a minimum of the amounts that they would have received had the company been liquidated.

If the resolution plan meets the requirements of the Code, the resolution professional will submit it to the creditors' committee for its consideration. Once a resolution plan is approved by the creditors' committee (by a 66% majority), the resolution plan will be submitted to the NCLT for its approval. A resolution plan approved by the NCLT is binding on all stakeholders, including employees, creditors, joint venture partners, members, partners of the corporate debtor and governmental authorities.

**Liquidation**

Under the Code, liquidation may be initiated against the corporate debtor in the following scenarios:

A 66% majority of the creditors' committee resolves to liquidate the corporate debtor at any time during the CIRP.

The creditors' committee does not approve a resolution plan within 180 days (or within the extended time periods as mentioned above).

The NCLT rejects the resolution plan submitted to it on technical grounds.

The corporate debtor contravenes the NCLT-approved resolution plan and an affected person makes an application to the NCLT to liquidate the corporate debtor.

In the case of liquidation, the priority waterfall for distribution of liquidation proceeds, prescribed under the Code, is as follows:

The costs of the insolvency resolution (including any interim finance) and liquidation.

Secured creditors (that are not enforcing their security outside the liquidation) together with worker dues for the preceding 24 months, on an equal basis.

Wages and any unpaid dues owed to employees other than workers for the 12-month period preceding the liquidation commencement date.

Financial debts owed to unsecured creditors.

Amounts payable to the central and state governments for the preceding 24 months, and unrealized dues of secured creditors outside the liquidation on an equal basis.

Any remaining debts and dues.

Preference shareholders, if any.

Equity shareholders or partners, as the case may be.

On liquidation, a secured creditor may choose to realize its security and receive proceeds from the sale of the secured assets as first priority. If the secured creditor enforces its claims outside the liquidation, it must contribute any excess proceeds to the liquidation trust. Further, in the case of any shortfall in recovery, the secured creditors will be junior to the unsecured creditors to the extent of the shortfall.

# 2. Is it possible to obtain a moratorium before insolvency?

**Code**

See the "Moratorium" paragraph in the answer to question 1 of this section in relation to the moratorium under the Code.

**Prudential Framework for Resolution of Stressed Assets**

The RBI issued the Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions, 2019 ("**RBI Prudential Framework**") dated 7 June 2019. The RBI Prudential Framework applies to banks and financial institutions, as well as large nonbanking financing companies, and also requires asset reconstruction companies to adhere to the relevant resolution framework. The RBI Prudential Framework does not apply to foreign ECB lenders as they would not fall under the above category. However, such ECB lenders may voluntarily agree to participate in the resolution process and be bound by it (if the lenders that are bound by such a framework are agreeable).

Under the RBI Prudential Framework, upon the occurrence of a default (i.e., a day-one nonpayment) the lenders have to decide a resolution strategy within a review period of 30 days. A timeline of 180 days after the end of the review period is provided under the RBI Prudential Framework for preparing and implementing the resolution plan. Additional provisioning norms apply after 180 days.

To implement the resolution strategy, during the review period the lenders are required to sign an intercreditor agreement (ICA) to provide for basic rules for the finalization and implementation of the resolution plan. A resolution plan has to be agreed to by 75% of the creditors by value and 60% by number for it to be binding on all the creditors, and an ICA has to be entered into by the creditors for them to be bound. The resolution plan may, among other things, provide for a one-time settlement of the debt, a restructuring of the debt, a moratorium on principal and interest payments and/or conversion of some of the debt into equity/other instruments. It may also provide for a change of ownership. Further, resolution plans should provide for payment no less than the liquidation value (i.e., the estimated realizable value of the relevant borrower's assets, if such borrower were to be liquidated on the date of commencement of the review period) due to the dissenting lenders.

A resolution plan under the RBI Prudential Framework is not binding on creditors that do not sign the ICA. It is not mandatory for foreign ECB lenders to sign the ICA. However, if foreign ECB lenders sign the ICA, their dues will be paid or restructured per the resolution plan.

Please note that the ICA provides for a standstill period of 180 days within which no security can be enforced against the company, nor can an insolvency resolution process be commenced by the lenders that are signatories to the ICA.

**State-specific legislation**

Special state-specific legislation such as the Maharashtra Relief Undertakings (Special Provisions) Act, 1958 (applicable to Maharashtra), the Rajasthan Relief Undertakings (Special Provisions) Act, 1961 and the Karnataka Relief Undertakings (Special Provisions) Act, 1977 can also provide a veil of protection to debtor companies from claims by creditors on express notification by the debtor company as a relief undertaking by the respective state government.

# 3. When a company is the subject of a formal insolvency procedure, can the company’s pre-insolvency transactions be set aside?

**Preferences**

If the liquidator or the insolvency resolution professional is of the view that the corporate debtor has given a preference to any person, they may apply to the NCLT to seek a declaration that any preferences that occurred at the relevant time are void and that their effect be reversed.

Under the Code, a corporate debtor is deemed to have given a preference if the following conditions are met:

There is a transfer of property or an interest in the property of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor.

That transfer has the effect of putting the creditor or a surety or a guarantor in a better position than it would have been in had the distribution of assets been made in accordance with the Code.

However, a preference does not include the following transfers:

A transfer made in the ordinary course of the business or financial affairs of the corporate debtor or the transferee.

Any transfer creating a security interest in property acquired by the corporate debtor to the extent that the following conditions are met:

The security interest secures new value and was given at the time of, or after, the signing of a security agreement that contains a description of that property as a security interest and was used by the corporate debtor to acquire that property.

The transfer was registered with an information utility (i.e., a depository of financial information registered with the Insolvency and Bankruptcy Board of India pursuant to the Code) on or before 30 days after the corporate debtor receives possession of that property.

"Relevant time" means:

The period of two years preceding the Insolvency Commencement Date in relation to a related party (other than by reason only of being an employee).

The period of one year preceding the Insolvency Commencement Date in relation to any other person.

**Undervalued transactions**

Additionally, the Code provides that the liquidator or the appointed insolvency resolution professional may make an application to the NCLT to seek a declaration that any undervalued transactions are void and that their effect be reversed. An undervalued transaction is a transaction that is not in the debtor's ordinary course of business and one where the corporate debtor does either of the following:

Makes a gift to a person; or

Enters into a transaction with a person that involves the transfer of assets by the debtor for consideration that is significantly less than the consideration provided by the corporate debtor at the time of acquisition of those assets.

An undervalued transaction may be declared to be void and be reversed if made with a related party within a period of two years preceding the Insolvency Commencement Date or with any other person within a period of 1 year preceding the Insolvency Commencement Date.

Separately, the Code provides that the NCLT must make an order restoring the position as it existed before the transaction and protecting the interests of persons who are victims of the transactions if the corporate debtor has deliberately entered into an undervalued transaction to do either of the following:

Keep the debtor's assets beyond the reach of any person who is entitled to make a claim against the debtor.; or

Adversely affect the interests of such a person in relation to the claim.

However, any order of this type will:

Not affect any interest in property that was acquired from a person other than the corporate debtor and was acquired in good faith, for value and without notice of the relevant circumstances, or affect any interest deriving from such an interest; and

Not require a person who received a benefit from the transaction in good faith, for value and without notice of the relevant circumstances, to pay any sum unless they were a party to the transaction.

**Extortionate credit transactions**

Further, the Code also provides the liquidator or the insolvency resolution professional with the power to make an application for the avoidance of any extortionate credit transaction entered into by a corporate debtor within a period of two years preceding the Insolvency Commencement Date. Under the regulations under the Code, a transaction is considered an extortionate credit transaction where one of the following conditions is met:

The terms require the corporate debtor to make exorbitant payments in respect of the credit provided; or

The terms are unconscionable under the principles of law relating to contracts.

# 4. When can a lender enforce its security? Can security be enforced out of court following an event of default (or other contractual trigger event), or is a court order required? Are there any restrictions that apply before a lender may enforce its security?

The terms and conditions of the security documents govern enforcement of security. Generally, a lender may enforce its security on the occurrence of an event of default. The process to be followed for enforcing the security is briefly set out below. (See the answer to question 11 of the "If taking security" section for the different types of security interest referred to below).

Except in the case of an equitable mortgage, a court order is generally not required for the enforcement of security. However, if the security provider objects to, or disputes, the enforcement and makes an application to the court, the dispute must be resolved through a court process.

**Immovable property**

If the mortgage is an English mortgage, the mortgagee has the power to sell the mortgaged property without the court's intervention, subject to certain notification requirements. Where the mortgage is an equitable mortgage, the mortgagor must apply to the court for a decree to sell the mortgaged property to recover the debt.

**Movable property**

The rights and remedies of a hypothecatee (that is a foreign lender or a security trustee for a foreign lender) are entirely regulated by the terms of the deed of hypothecation between the hypothecator and hypothecatee. A deed of hypothecation can be enforced by either compelling the delivery of the movable property or by selling or obtaining a decree for sale of the movable property if that is stipulated in the deed of hypothecation. If the deed does not specify the manner in which the hypothecated property may be dealt with, the remedy open to the creditor would be to obtain a money decree declaring its lien on the property and the right to sell that property.

**Pledge over shares**

A pledgee may enforce a pledge and sell the pledged shares by giving reasonable notice of enforcement to the pledgor. The pledgee does not need to obtain a court order to sell the pledged shares. If the pledged shares are held in physical form, the pledgee must submit to the company whose shares are being pledged the executed share transfer forms held by the pledgee. The company will then need to approve the transfer of shares in the name of the lender or third-party transferee at its board meeting. If the company refuses to approve the transfer of shares, the lender or third-party transferee will need to approach the competent courts and tribunals to challenge the refusal.

# 5. Do any limitation periods apply in relation to bringing an action to enforce security?

Any proceeding in court for the enforcement of security must be brought within the relevant limitation period. For example, a suit ordering the sale of the mortgaged property must be brought within 12 years from the date on which the money sued for becomes due, and a suit ordering a sale of charged or pledged property must be brought within three years from the date that the cause of action arises.

# 6. Is there any particular way in which secured assets must be liquidated on enforcement (e.g., by auction or court sale)?

No. The process is governed entirely by the terms of the security documents. However, please note the following stipulations under the ECB Guidelines (see under "Background") in relation to enforcement of security over relevant assets:

In the case of the invocation of a pledge, any transfer of financial securities must be in accordance with the extant foreign direct investment policy, including provisions relating to sectoral cap and pricing, as applicable in accordance with the Foreign Exchange Management Act, 1999 and rules and regulations framed under it.

In the event of the enforcement of a mortgage, immovable assets must only be sold to a person resident in India and the sale proceeds must be repatriated to liquidate the outstanding ECB.

Charged movable assets may be taken out of India by a lender to the extent of the lender's claim, subject to obtaining permission from domestic lender(s), if any.

# 7. Are there any particular legal or practical difficulties or delays in enforcing security?

If the security provider contests enforcement action in relation to the security (which generally is the case), the enforcement process is time-consuming. It could take several years to obtain a judgment in India. The timeline depends on the facts and the relief sought, as well as the backlog of cases at the time of enforcement. However, it may be possible to obtain interim relief in a shorter time frame.

# 8. In relation to enforcement, are there any specific requirements to be borne in mind if the lender is a foreign entity?

Yes. The RBI's prior approval may be required to repatriate to an offshore lender from India any amounts recovered on enforcement of a judgment of a court that is not an Indian court.

# 9. Is there any reason why you think that arbitration rather than litigation might be advantageous in resolving disputes under the finance documents, and if so, why? Please outline the relative merits of arbitration and litigation, including the ease of enforcement of foreign judgments and foreign awards from different jurisdictions. Is it possible to rely on a hybrid enforcement provision that allows the lenders to opt for either arbitration or litigation as they see fit?

It is not very common for a loan agreement between an Indian borrower and a foreign lender to select arbitration as the dispute resolution mechanism as it may be quicker to obtain a judgment in a foreign court rather than to appoint (after the dispute) an arbitral tribunal and have the dispute heard by arbitration.

Any judgment that is a money decree obtained from a superior court of any reciprocating territory notified under the Code of Civil Procedure, 1908 of India will be recognized and enforced by the courts in India, subject to certain statutory provisions, without re-examining the issues. The UK and Singapore have been declared reciprocating territories, and certain courts in those jurisdictions have been declared superior courts for the purposes of the Code of Civil Procedure.

India is a signatory to the New York Convention for the Enforcement of Foreign Arbitral Awards, 1958. Awards handed down by an arbitral tribunal whose seat is in a country that is a signatory to the New York Convention will be enforced in India as a "foreign award" under Part II of the Arbitration and Conciliation Act, 1996, without the need for any retrial and the award will be deemed to be a decree of an Indian court. However, there are certain grounds for objection to the enforcement of a foreign award governed by the New York Convention. These include the following:

The parties to the arbitration agreement were, under the law applicable to them, under some incapacity, or the agreement is not valid under the law to which the parties have subjected it or under the law of the country where the award was made.

The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitral proceedings or was otherwise unable to present its case.

The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration.

The composition of the arbitral authority or the arbitral procedure was not in accordance with the parties' agreement, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place.

The award has not yet become binding on the parties or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

The subject matter of the dispute is not arbitrable under the law of India.

The enforcement of the award would be contrary to Indian public policy.

However, even if the arbitration takes place at a venue outside India, the parties are entitled to obtain interim relief in Indian courts against the Indian entity while the arbitration proceedings are still pending.

Under Indian law, there must be a clear intention and obligation under the contract to arbitrate. If an option is given to one party to arbitrate or litigate, Indian courts have, to date, largely held that there is no clear obligation to arbitrate on both the parties. While there are arguments to suggest that a hybrid enforcement provision does not mean that there is a lack of intention and obligation, the possibility of an Indian court ruling that such an arbitration or litigation provision is invalid and, therefore, the award or judgment is not enforceable cannot be ruled out.

# 10. Are asymmetrical jurisdiction clauses enforceable? (By this we mean clauses that allow the lenders, but not the borrowers, to make certain choices in relation to choice of jurisdiction and how to litigate. These types of clauses allow the lenders, but not the borrowers, to commence proceedings in any court they choose, but restrict the borrowers to commencing proceedings in one jurisdiction only. This may also allow the lenders, but not the borrowers, to choose whether to litigate the finance documents before a court or to submit to arbitration in relation to them, but restrict the borrowers to either litigation or arbitration, as specified in the agreement).

Yes, asymmetrical jurisdiction clauses are generally recognized by Indian courts.

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