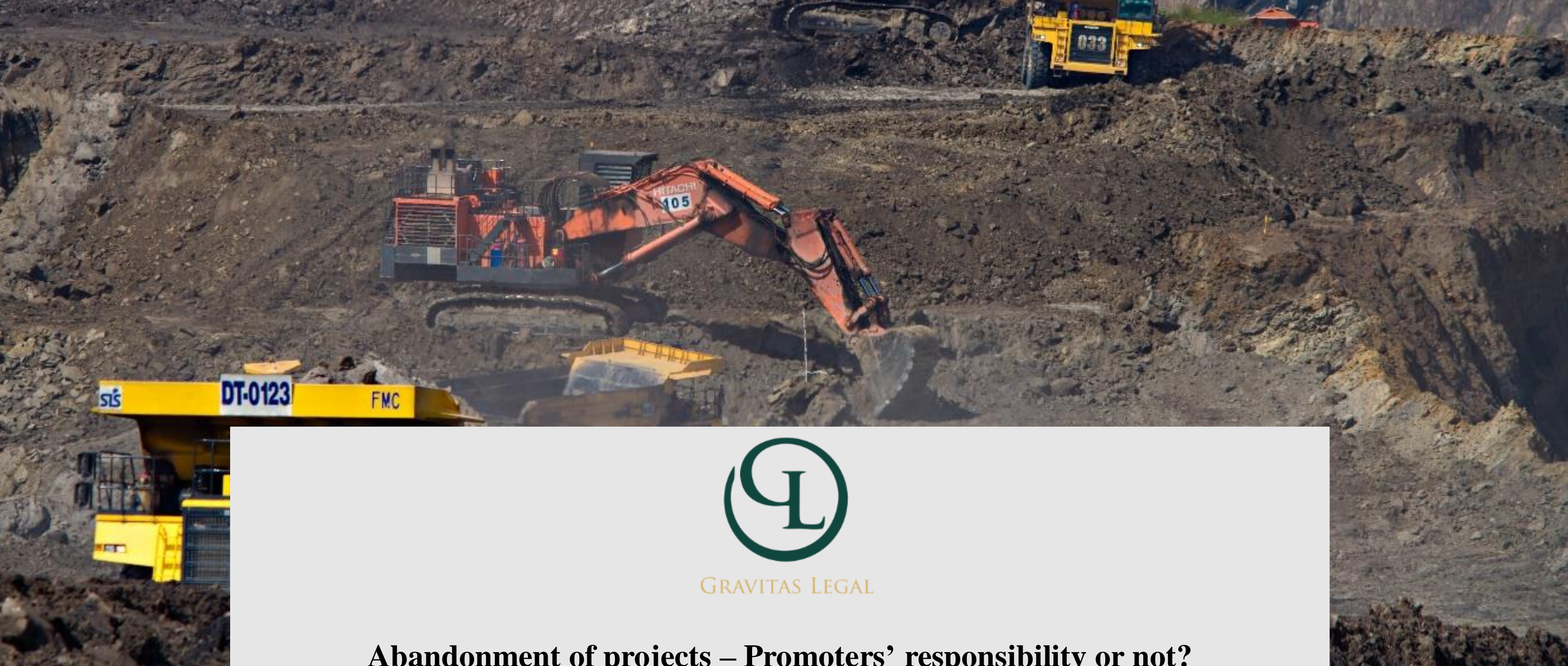

Abandonment of projects – Promoters' responsibility or not?

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Typically, one of the key elements of a project financing structure is a special purpose project company ("**Project Company**" or "**SPV**") with no business antecedents, which is set up with the sole aim of developing and implementing the project being housed in it. This structure for project finance is not new, and is designed to ensure bankruptcy remoteness as also no (or limited) recourse to the promoters.

Historically, the promoter's liability with respect to the project being set up by the Project Company was limited in view of the limited role promoters played in the day to day functioning of the Project. Gradually, from a regulatory perspective and to address, *inter alia*, changing dynamics of the economy, mismanagement of the accounts of the Project Company by the promoters and other discrepancies, the participation of/recourse to the promoters has increased.

This article focusses on one of the most common, yet most contentious and rebuttable, stipulations *qua* promoters (typically) contained in project finance documentation – the obligation to ensure no abandonment takes place.

Evolution of Regulatory Landscape (Financing) as regards Promoters
Before we delve into analysis of the above, we have outlined the positions taken by Reserve Bank of India ("**RBI**") from time to time with respect to the interplay between financing by lenders regulated by RBI and promoters of Project Companies:

(a) **2002**: As per the RBI's 2002 Circular on Financing of Infrastructure Projects[1], promoters' obligations were limited to provide standby support for cost-overruns in the projects, provided the quantum of such support crystallised prior to financial closure. Additionally, insofar as security is concerned, the RBI contemplated pledge of promoters' holdings in the Project Company. RBI *vide* Guidelines on Infrastructure Financing[2] has clarified that infrastructure projects are often financed through a special purpose vehicle model who are '*financially viable and not acting as mere financial intermediaries*' in order to ensure that the financial difficulties of the parent/sponsor should not affect the financial health of the special purpose vehicle. Additionally, RBI

[1] Financing of Infrastructure Projects bearing reference number IECD.No.16 /08.12.01/2001-02 dated February 20, 2002
[2] Guidelines on infrastructure financing bearing reference number no. DBOD. No. BP. BC. 67 / 21.04.048/ 2002- 2003 dated February 04, 2003.

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has recognized[3] that "*infrastructure projects are often financed through Special Purpose Vehicles. Financing of these projects would, therefore, call for special appraisal skills on the part of lending agencies. Identification of various project risks, evaluation of risk mitigation through appraisal of project contracts and evaluation of creditworthiness of the contracting entities and their abilities to fulfill contractual obligations will be an integral part of the appraisal exercise.*" It has therefore, always been quite clear that the lenders are required to separately appraise/evaluate the project contractors and promoters' creditworthiness, thereby clearly establishing a distinction (insofar as project implementation is concerned) inasmuch as the promoters (when viewed from a regulatory perspective) were of importance for financial support, but the 'project execution risk' always lay on the credibility and capability of the contractors and the Special Purpose Vehicle itself.

(b) **2008[4]**: RBI *vide* its 2008 Circular on Prudential Guidelines on Restructuring of Advances by Banks[5] introduced some additional conditions, *inter alia*, promoter's sacrifice and additional funds brought by the promoters in case of restructuring should be a minimum of 15% of banks' sacrifice and that the restructured loan should additionally be secured by way of a personal guarantee except when the borrower was affected by external factors pertaining to the economy and industry.

(c) **2010:** RBI[6] in addition to the existing norms mandated that the promoter's contribution be brought up front and not be phased over a period of time.

(d) **2011:** RBI, based on the representations received from Banks and Indian Banks' Association, that corporates under stress find it difficult to bring in the promoters share of sacrifice and additional funds upfront on some occasions, decided[7] that the promoter's sacrifice and additional funds required to be brought in by the promoters should generally be brought in upfront. However, if banks are convinced that the promoters face genuine difficulty in bringing their share of the sacrifice immediately and need some extension of time to fulfill their commitments, the promoters could be allowed to bring in 50% of their sacrifice, i.e. 50% of 15%, upfront and the balance within a period of one year.

(e) **2013**: The principal changes brought about by RBI *vide* the 2013 Circular on Review of Prudential Guidelines of Restructuring of Advances by Banks and Financial Institutions[8] were:

1. Increase in promoters' sacrifice (in the case of restructuring) to the higher of: (x) 20% of the banks' sacrifice; and (y) 2% of the restructured debt; and
2. Mandatory obtainment of personal guarantees, except where promoters were corporate entities.

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[3] This assertion has oft been repeated by RBI and also finds its way into Circulars on Loans and Advances.

[4] The position that the promoter's sacrifice to be a minimum of 15% of bank's sacrifice continued till 2013 whereby the promoter's sacrifice was increased upto 20% of the bank's sacrifice or 2% of the restructured debt.

[5] Prudential Guidelines on Restructuring of Advances by Banks bearing reference no. DBOD.No.BP.BC.No.37 /21.04.132/2008-09 dated August 27, 2008.

[6] Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances bearing reference no. DBOD.No.BP.BC.21 /21.04.048/2010-11 July 1, 2010 dated July 01, 2010.

[7] Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances bearing reference no. DBOD.No.BP.BC.12/21.04.048/2011-12 dated July 01, 2011.

[8] Review of Prudential Guidelines of Restructuring of Advances by Banks and Financial Institutions bearing reference no. DBOP.BP.BC.No.99/21.04.132/2012-13 dated May 30, 2013

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Essentially, the idea was that if the lenders are to implement restructuring (and take a risk on an asset that had already deteriorated) with a view to turnaround/revival of the business, there should be sufficient 'skin in the game' of the promoters as well.

(f) **2014**: The regulatory intent became clearer inasmuch as more and more stringent norms were put in to place to ensure participation by promoters prior to lenders taking exposure. Vide the 2014 JLF Circular[9], RBI required that banks, in situations of cost overrun, limit their funding to: (1) additional interest during construction; and (2) funding to a maximum of 10 per cent of the original project cost for other line items of the construction costs, subject to the conditions: (1) debt equity ratio (as agreed at the time of initial financial closure) remaining unchanged subsequent to funding of the cost overruns; or (2) the debt to equity ratio improving for the benefit of the lenders; (3) the revised debt service coverage ratio being acceptable to the lenders; and (4) promoters bringing in their share of contribution prior to the lenders taking exposure.

(g) **2015**: *Vide* the 2015 Circular[10], RBI reiterated (in the context of restructuring) that the extent of funding by promoters be the higher of: (1) 20% (twenty per cent) of the lenders' sacrifice; or (2) 2% (two per cent) of the restructured debt, and mandated that the promoters' sacrifice should invariably be brought upfront[11] while extending the restructuring benefits to the borrowers.

(h) **2019**: RBI *vide* the Prudential Framework for Resolution of Stressed Assets bearing reference DBR.No.BP.BC.45/21.04.048/2018-19 dated June 7, 2019 has enumerated various conditions that need to be complied in case change in ownership is implemented pursuant to the said Framework, such as: (a) the acquirer is not a person disqualified in terms of Section 29A of the Insolvency and Bankruptcy Code, 2016 ("**IBC**"), (b) new promoter should not be a person/entity/subsidiary/associate etc. (domestic as well as overseas), from the existing promoter/promoter group, and (c) the conditions for implementation of RP as per Section I-C of the covering circular are complied with. It is evident from a bare reading of the said Circular that the capabilities of execution of a particular kind of project or the technical knowledge of the project is not one of the requirements of the circular nor the criterion or pre-requisite that needs to be met before change in ownership of a Project Company is considered and approved by lenders.

The Concept, Anomaly of Abandonment and Promoters' Stance on Abandonment

Concept of Abandonment

Unlike certain other legal concepts that one would come across in every sphere of life, 'abandonment' is not found under any of the laws that can be said to apply directly to project finance as such. That said, the Industrial Disputes Act, 1947 defines 'lockout' as temporary closing of a place of employment, or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him[12]. The Black's Law Dictionary[13],

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[9] Framework for Revitalising Distressed Assets in the Economy – Refinancing of Project Loans, Sale of NPA and other regulatory measures bearing reference no. DBOD.BP.BC.No.98 / 21.04.132 / 2013-14 dated February 26, 2014

[10] Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances bearing reference no. DBR.No.BP.BC.2/21.04.048/2015-16 dated July 01, 2015.

[11] As recognized in the paragraph 20.2.2 (iv) of Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances bearing reference no. DBR.No.BP.BC.2/21.04.048/2015-16 dated July 01, 2015 *"Prior to May 30, 2013, if banks were convinced that the promoters face genuine difficulty in bringing their share of the sacrifice immediately and need some extension of time to fulfill their commitments, the promoters could be allowed to bring in 50% of their sacrifice, i.e. 50% of 15%, upfront and the balance within a period of one year."*

[12] Section 2 (l) of the Industrial Disputes Act, 1947

[13] Page 2 of the Black's Law Dictionary, Deluxe Tenth Edition

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defines 'abandonment' as (1) the relinquishment of a right or interest with the intention of never reclaiming; (2) the act of withdrawing or discontinuing one's help or support, especially when a duty or responsibility exists.

Extending such definition and, for the sake of discussion, applying it contextually to project finance, abandonment would simply translate to discontinuance of project execution. Now, practically speaking, the foremost questions that can be put to lenders while discussing stipulations in sanction letters/terms sheet around the subject of abandonment are:

(a) how often do SPVs implement project themselves, as opposed to farming out turnkey EPC contracts[14]?

(b) if EPC contractors implement projects, and especially those that do not belong to the 'promoter group' so to say, how can borrowers or promoters be held accountable or liable for abandonment (discontinuance of project execution) that would fall under the ambit of an EPC contractor's scope of work, when the lenders themselves would have, in consonance with RBI norms, appraised the project execution capabilities of the EPC contractor? and

(c) if the RBI itself has recognized that time period for project execution can be extended for reasons beyond the control of promoters without additional provisioning or implications on borrowers, can the promoters be held liable during the period when RBI itself has permitted time extension on this account?

The Anomaly around Abandonment

From the chronology of evolution of RBI norms elucidated above, it becomes apparent that RBI has tightened the noose around the promoters' necks and required increased deployment of capital by the promoters to ensure 'skin in the game' for revival of fledgling loan accounts. Yet, RBI has (even with the knowledge that most projects are implemented by Project Companies that belong to closely held groups) consciously refrained from transgressing the boundaries of contracting capacities and has not stipulated any specific project execution covenants for lenders to place on promoters.

That said, increasingly, one finds reference to covenants to the effect that promoters will not (or allow the borrower to) abandon the project in financing documentation. While this cannot be said to be set firmly in stone, one only has to pick up sponsor support documentation (sponsor support deeds/agreements or promoters/sponsors undertakings) to find this stipulation as commonplace. In cases of documents that haven't been as carefully negotiated, one could even find circuitous and convoluted obligations placed on borrowers to ensure compliance by promoters/sponsors with the obligation to ensure there is no abandonment.

Promoters' Stance on Abandonment – What it ought to be

Obligations around project execution, and especially those requiring promoters to ensure that there is no 'Abandonment', should be heavily contested by promoters. Some of the bases on which this contestation may be predicated are:

a. **Distinct Legal Entity**: The Project Company is a separate legal entity, and one of the reasons for incorporation of a separate company by any parent company for the purpose of developing a project is to ensure bankruptcy remoteness as also the fact that the promoter will not be involved in the day to day affairs of any one Project Company. It

[14] For present purposes, we have not delved into whether or not EPC Contracts ought to be split package or component or scope wise in view, *inter alia*, of applicable tax laws.

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is a well-established principle, one that cannot be disputed in law, that a company is a legal entity distinct from its members (that is the promoters for present purposes). It was so laid down by the House of Lords in 1897 in the leading case of Salomon v. Salomon & Co. (1897) A.C. Ever since this decision has been followed by the Courts in England as well as in this country[15]. The Hon'ble Supreme Court of India in Tata Engineering and Locomotive Company Ltd. v. State of Bihar & Ors.[16], has observed that a company is entirely separate from its shareholders; it bears its own name and has a seal of its own; its assets are separate and distinct from those of its members; it can sue and be sued exclusively for its own purpose; its creditors cannot obtain satisfaction from the assets of its members; the liability of the members or shareholders is limited to the capital invested by them; similarly, the creditors of the members have no right to the assets of the corporation.

That said, it should also be borne in mind that the 'corporate veil' is not impregnable and may be lifted in certain circumstances. The Hon'ble Supreme Court of India has clarified that generally, and broadly speaking, the corporate veil may be lifted where a statute itself contemplates lifting the veil, or fraud or improper conduct is intended to be prevented, or a taxing statute or a beneficent statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern. It is neither necessary nor desirable to enumerate the classes of cases where lifting the veil is permissible, since that must necessarily depend on the relevant statutory or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of the public interest, the effect on parties who may be affected etc[17].

b. **Functioning of the Project Company**: From the bare reading of the Companies Act, 2013 (the "**Act**") it is quite clear and evident that the functioning of any company is the responsibility of the board of directors of the company and not the shareholders of the company. Essentially the directors of a company are the hands of the company and the business decisions including the day to day operations of a company are meant to be taken by (or as delegated by) the directors. By virtue of Section 180 of the Act, subject to the consent of the shareholders, the directors have the power to deal with any undertakings[18] of the company including the assets. There is no room for doubt that a company acts through its officers who are its real organs and the directors are the brain of the company. Other than the specific instances under the Act where the board of directors are meant to seek approval of shareholders, there is no recognition of the role to be discharged by shareholders in the day to day running of the company. Infact, it is a settled position in law that the interests of a company and those of its members need not always be aligned.

c. **Estoppel**: In any given financing transaction (involving provision of security/guarantee by promoters), lenders normally seek confirmation for compliance of Section 185 of the Act which prescribes compliances as to processes and limits for liability/obligation undertaken by a promoter towards its subsidiaries. It is only once such confirmation is obtained (and it is noteworthy that in some cases there are specific due diligence mandates awarded to this effect) that lenders believe that borrowers have, along with

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[15] New Horizons Limited and Ors. vs. Union of India (UOI) and Ors. (1995)1 SCC 478
[16] [1964] 6 SCR 885
[17] Life Insurance Corporation of India vs. Escorts Limited and others AIR 1986 SC 1370
[18] As per Explanation to Section 180(1)(a) of the Act, *"undertaking shall mean an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent. of the total income of the company during the previous financial year".*

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other relevant items of compliance, requisite authorizations in place to be considered eligible for disbursement. Now, having crossed this specific compliance threshold and having made an independent determination regarding this aspect, it belies logic and is fundamentally not reconcilable that the lenders themselves negate the independence (as between promoters and the SPV) established through the above compliance test by then requiring that the promoters be responsible for ensuring that no abandonment takes place.

The above practical argument could be coloured with a legal brush by relying on the doctrine of estoppel. In order for rule of estoppel to apply, the following conditions[19] have to be satisfied:

1. A person must, by his declaration, act or omission intentionally cause or permit another person to believe a thing to be true;
2. Such other person has to act on such belief.

In view of the fact that the lenders would disburse only after ascertaining compliance with Section 185 and seeking (where relevant) confirmations regarding independence of the promoters and the SPV, the SPV/promoters can argue that the lenders are precluded from subsequently taking the plea that the degree of overlap between, and the nature of interdependence of, the promoters and the SPV is of such an extent as would justify the promoters being liable for decisions taken (or abstention) regarding termination/waiver of project construction/operation contracts.

d. **Casus Omissus**: Courts in India have ruled that words and phrases in statutes are references to be used for ascertaining the intention of the legislature enacting it and thus attention must be paid to what has and (equally) has not been said. It is contrary to all rules of construction to read words into an Act unless it is absolutely necessary to do so. The rules of interpretation only allow reading words into a provision or stipulation when the provision as it stands is meaningless or of doubtful meaning. This is because while interpreting a provision the court only interprets the law and cannot legislate it. It is usually supplied if literal construction of a particular clause leads to manifestly absurd or anomalous results which could not have been intended by the legislature[20]. The first and primary rule of construction is that the intention of the legislation must be found in the words used by the legislature itself. The question is not what may be supposed and has been intended but what has been said.[21] This legal maxim and doctrine could be applied contextually to the evolution of RBI norms (as elucidated above) to say that, despite several revisions and clear intention to tighten the noose around promoters, RBI has consciously refrained from blurring the boundaries and attaching obligations extracted from the territory of technical competence and compliance to promoters. Therefore, it can safely be stated that even the regulator does not expect the lenders to ensure project completion obligations rest with promoters and consequences arising from failure in project completion fasten upon promoters.

Another indirect example (and cornerstone of argument) of this doctrine coming into play *qua* project execution by promoters would be the (when viewed from the promoters' perspective) draconian IBC. Even under IBC, where the legislature intended

[19] Section 115 of Indian Evidence Act, 1872.
[20] Sangeeta Singh v. Union of India, (2005) 7 SCC 484.
[21] Padma Sundara Rao v. State of Tamil Nadu., (2002) 3 SCC 533.

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that promoters be disbarred from taking over companies, Section 29A was specifically enacted. Other than Section 29A of IBC, the only other provisions that would fasten liability upon promoters would be Section 19 (non-cooperation) and Section 66 (fraudulent activities). Even under a law with far reaching consequences, save for certain identified circumstances, the legislature has refrained from viewing promoters and the SPV from the same prism. This would lend further credence to the argument that promoters cannot be obligated to ensure no abandonment takes place.

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