UP's new sugarcane order faces flak from banks

RUCHIKA CHITRAVANSHI & SANJEEB MUKHERJEE
New Delhi 20 February

In yet another example of insolvency and bankruptcy law getting sidelined by competing laws, Uttar Pradesh government's Sugarcane Amendment Act has come under criticism from banks and Insolvency and Bankruptcy Code (IBC) watchers. This is because it allows the state to attach assets or use receivables of a company or subsidiaries based there to recover sugarcane dues of farmers.

The amendment called the UP Sugarcane (Regulation of Supply and Purchase) – Second Amendment Act, 2021, empowers the state government to forfeit the dues, loans or investment that any subsidiary or associate of a sugar manufacturing company had towards the state government — or any of its corporations — to clear the outstanding sugarcane dues of farmers.

Bankers are expected to approach the Reserve Bank of India a over concerns that UP's new law undermines their position

The immediate fallout of the order, according to experts, is the case of the Bajaj Group. The state government has used ₹1,000 crore that it had to pay to Bajaj Group's Lalitpur Power Generation Company to clear a portion of the around ₹2,300-crore sugarcane dues accruing to farmers from Bajaj Hindustan Sugar, another group company.

Bajaj Hindustan Sugar, is one of the biggest sugar manufacturing companies in UP, having a total of over 14 units spread across the state. Lalitpur Power is also the group's own firm, producing around 2,000 Mw of power annually, solely for UP Power Corporation. The power unit is located in Lalitpur area of Jhansi district.

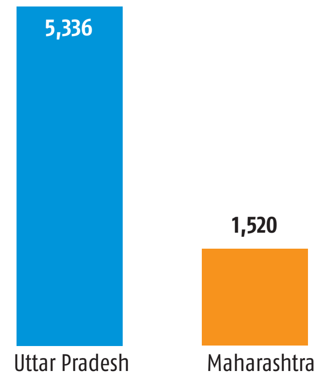
Data sourced from various agencies show that as on February 16, 2022, in UP around ₹5,356 crore of sugarcane dues are still to be paid to the farmers for cane purchased from them. Of this, a substantial quantity could be linked to Bajaj Hindustan Sugar.

Sources said Lalitpur Power of Bajaj Power had a long-term power purchase agreement (PPA) with the state corporation to purchase electricity at a predetermined rate. The state had decided to forfeit a portion of the dues to clear pending sugarcane amounts using the provisions of the amendment Act.

Several experts said the move, ahead of the crucial state Assembly elections, was made to ensure that big sugarcane companies clear their cane dues fast. But this has set the cat among the pigeons as far as IBC watchers are concerned over banks' authority to recover dues ahead of anyone else.

THE DUES

Sugarcane dues as on February 15 in two main producing states (₹ crore)



Source: Trade and industry sources

In this case, bankers are expected to approach the Reserve Bank of India (RBI) over concerns that UP's new law undermines their position. Also, other states may see it as a precedent and create similar provisions.

IBC experts believe that as bank non-performing assets (NPAs) rise, this amendment will impede their ability to recover dues.

In 2019, an amendment to the Code clarified that a resolution plan once approved is binding on the Centre, state governments and the local authority.

Corporate affairs ministry's IBC also clashed with the Prevention of Money Laundering Act (PMLA), where courts have ruled in favour of the former.

For instance, on December 15, the Delhi High Court said that power under PMLA to attach properties ceases to exist when an order of liquidation has been delivered under the IBC, 2016.

"The sugar business is in financial distress, and this change will impede bank recovery attempts. This amendment hurts banks since the state can seize property or file a claim to recover debts. But the RBI must intervene to protect bankers' interests," said Sonam Chandwani, managing partner at KS Legal & Associates.

The secured creditors such as banks get priority under the waterfall mechanism of the IBC. Their claims are prioritised over unsecured creditors.

Under the present situation, the state will be able to seize the assets of a corporation or its subsidiaries if it defaults on agricultural dues, leaving the banks in the lurch. IBC experts also say that bank payment default may potentially impact an entity's business prospects.

This could result in banks becoming wary of taking on additional state government liabilities. "It will be fascinating to see how RBI safeguards the interests of all parties concerned and what solution it comes up with," Chandwani added.