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Theoretical Framework of Insolvency Law

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It is important to recognise that the world in which we live and the creation of wealth depends upon a system founded on credit and that such a system required as a correlative, an insolvency procedure to cope with its casualties.

- The Cork Committee[1]

INTRODUCTION

Non-viable businesses need to be allowed to fail so that the larger economic ecosystem can reallocate resources from non-viable projects to viable initiatives. This is, in a sense, a *sine qua* none of an efficient, effective, efficacious economic system. The important role of exit mechanisms for businesses has also been recognised by Joseph Schumpeter, the 20th century economist, who argued that innovation by entrepreneurs leads to what he described as 'creative destruction'. He suggested that: *'Capitalist reality is first and last a process of change.'* For this change to be facilitated, entrepreneurs need to be provided easy entry and exit opportunities from the markets.[2] The purpose of insolvency and bankruptcy law is to provide an orderly process for such an exit.

This article explores the theoretical underpinnings of various aspects of the insolvency and bankruptcy laws which work towards meeting its objectives, looking away from bankruptcy being envisaged mainly as a practical and legal matter. The first step is to understand the differing views that Traditionalist and Proceduralist theories have on the role of insolvency law and manner of its conduct. What aspects of these theories are embodied in the Indian insolvency law, the Insolvency and Bankruptcy Code, 2016 (IBC/Code) is discussed further. While doing so, the authors blend the theories into questions of why formal insolvency procedures are required in the first place and how the IBC holds as against these theories. Some theories guiding the procedure of distribution or entitlement in bankruptcy among a group of agents and the manner in which IBC stands against them are also explored.

TRADITIONALIST AND PROCEDURALIST PERSPECTIVES ON CORPORATE INSOLVENCY

There are two dominant theoretical schools in the field of insolvency and bankruptcy law, viz. 'Traditionalist' and 'Proceduralist'. These two camps of theories were first discussed in detail in the celebrated article of Douglas G. Baird (1998)[3]. These two theoretical schools have differing perspectives on the role of insolvency law in the reorganisation and rescue of insolvent but viable businesses; the substantive law

that is or ought to be applied in a bankruptcy process; the inter-se rights of different types of creditors and the role of judges in interpreting insolvency disputes during insolvency proceedings.

While the Traditionalists, such as Korobkin (1993)[4] propose a more inclusive approach to resolving corporate insolvency that takes into consideration the interests of all stakeholders, Proceduralists contend that insolvency law should address issues that arise only within bankruptcy and non-insolvency creditors should not be protected by law unless doing so maximises value for creditors, such as Alan Schwartz (1998)[5].

Traditionalists believe that the objective of insolvency law should be to reorganise a financially distressed company and avoid liquidation so as to maintain the going concern value of the business and preservation of the company itself. On the contrary, Proceduralists advocate that the question of life or death of a company should be a market-determined process. The insolvency law should not attempt to prolong the life of a sick company and should only strive to prevent premature liquidation of the company due to uncoordinated creditor actions. Proceduralists also contend that secured creditors should have the same absolute priority in an insolvency setting as in a non-insolvency setting. They believe that calls for fairness or equality of distribution, such as to employees and other stakeholders, twist these rights of secured creditors and that such principles should have no place in insolvency laws unless they are given effect outside bankruptcy. *Au contraire*, Traditionalists propagate principles of fairness and equity for all stakeholders as it increases the probability of reorganisation of the distressed company and minimises chances of liquidation.

The role of the judiciary in the insolvency law is also viewed through opposite lens by Proceduralists and Traditionalists. The role of the judge is envisaged to be to minimise stakeholders' conflicts, ensure transparency and integrity of the entire process by the Proceduralists. Their role is not to question the commercial wisdom of the creditors. Traditionalists however rely on the judges for upholding the equity goals of an insolvency law on a case by case basis and suggest that judges should exhibit broader discretionary powers.

Ted Janger (2001)[6] summarised Baird's identification of the important aspects of the Traditionalist-Proceduralist divide, as follows:

> According to Douglas Baird, three litmus test questions, or axioms, determine a scholar's affiliation. These questions are (1) whether the Bankruptcy Code should seek to rehabilitate firms; (2) whether bankruptcy judges should alter non-bankruptcy entitlements in order to rehabilitate firms; and (3) whether bankruptcy judges are capable of distinguishing likely candidates for reorganization from firms that are destined to fail. The paradigmatic proceduralist answers "no" to each question, while the paradigmatic traditionalist answers "yes" to all three.

Having recognised these two schools of thought on the role of insolvency law and its contours, the next section explores what aspects of these theories have found favour in the design of the IBC in the Indian context.

FORMAL INSOLVENCY PROCEDURES

When a firm becomes insolvent, there are two options before its stakeholders to resolve the insolvent firm. They can either choose informal out-of-court workouts such as pre-packaged restructuring, alternative dispute resolution mechanisms or choose formal insolvency proceedings that are overlooked

by a Court or Tribunal. The pros and cons of each procedure have been well documented by scholars. However, due to the inherent conflict of interest between the various stakeholders of the corporate debtor (CD), especially the promoters/managers and the creditors, peculiar problems emerge which can be effectively resolved through formal insolvency procedures. In fact, some of the negative fallouts of informal insolvency procedures can be mitigated when such procedures are fused with formal insolvency procedures backed by legislation. In this section, how information gaps, conflict of interest and perverse incentive structures between the managers and the creditors of the CD can be resolved through formal insolvency and bankruptcy procedures such as the IBC is discussed. Further, this section also delves into the debate of high bankruptcy costs in formal procedures and how the IBC is striving to minimise them.

Information Asymmetry

The renowned 'market for lemons' hypothesis by George Akerlof[7] explains how information asymmetry can affect choices made by the parties to a transaction. In the context of insolvency and bankruptcy, information asymmetry seeps in when the insiders, that is, the promoters and equity holders of the CD have more information about the affairs of the CD than the outsiders who are the creditors and the debtholders. In a precarious situation such as this, the outsiders may not be able to differentiate between a 'good firm' and a 'bad firm' in terms of value, viability, and future prospects of the firm, while the promoters/management (who may hold a major equity shareholding, a scenario which is typical of Indian corporates) are privy to such valuable information. This creates an asymmetry of information between the equity and debtholders of the CD.

Firms can signal their type, whether 'good firm' or 'bad firm', by offering the creditors a carefully calibrated debt-equity package. One theory suggests that the presence of information asymmetry between public debt holders and firm insiders ensures that firms with adverse private information will offer highly contingent claims such as equity to bondholders, while firms with favourable private information will offer the least contingent claim possible, such as senior or secured debt.[8]

Information asymmetry frustrates the chances of negotiating a private workout between the promoters/ managers and creditors of the CD. In the presence of asymmetric information distressed firms may in fact forgo private or informal workouts and enter the formal resolution process to resolve financial distress. The Bankruptcy Law Reforms Committee (BLRC) in its report recognised that asymmetry of information was a critical barrier to fair negotiations or ensuring swiftness of the process.[9] A formal insolvency proceeding is an 'information revelation process.' In a formal insolvency proceeding, the court can force mandatory information disclosure on all relevant aspects of the firm to the extent desirable to the creditor and the court.[10] The substantial amount of judicial discretion in the formal proceedings may help mitigate the asymmetric information problem between bondholders and stockholders about the firm value.[11]

The IBC facilitates the 'information finding' and 'information revelation' process when a CD formally enters the corporate insolvency resolution process (CIRP). The BLRC noted one of the principles of design of the Code as an enabler of symmetry of information between creditors and debtors including third parties who can participate in the resolution process, through the regulated professional.

As the control of the CD shifts away from the CD's promoters/management to the Insolvency Professional (IP), the process of attenuating asymmetric information problems begins immediately. The BLRC envisaged the role of the IP to be the manager of all information about the CD so that debtors and creditors are equally informed about the business and viability of the entity during the negotiations.

To this effect, the IP furnishes an Information Memorandum to the committee of creditors (CoC) which details all material information about the assets, finances, operations and more importantly the value of the CD. This enables the CoC to gauge the economic and financial viability of the CD. The IP conducts a thorough inspection into the financial transactions of the CD to unearth any preferential, undervalued, fraudulent and extortionate transactions. Further, the IP regularly files progress reports to the Adjudicating Authority (AA), making extensive disclosures about the CIRP of the CD. The IP shares vital information about the CD with the resolution applicants (RAs) to facilitate drawing up of viable resolution plans based on credible information. All the resolution plans received for resolution of the CD are laid before the CoC for its consideration, enabling it to weigh the options of resolution or liquidation objectively. The IBC thus tips the balance scale for both outsiders and the insiders in the information disclosure process. It grants credibility to the information revelation process.

Another facet of information asymmetry addressed by the BLRC is the inability of the creditors to assess revenue flows and assets over which the debtor has a beneficial control or exercises a power over its disposition. The Committee thus suggested creating provisions in the law that would capture all possible violations that the debtor may engineer to maintain opacity over his assets and deny the creditors access to those assets that legally fall within the ownership of the insolvent. To this effect, the Code provides for the IP to report to the AA any preferential, undervalued, extortionate, or fraudulent transactions noticed by him.

Hold-out Problem

Hold-out problems arise when there are multiple groups of creditors, creating incentives to holdout, or to free ride, especially when a reorganisation plan allows creditors to decide whether to participate or not. In a hold-out situation, a group of creditors decline to participate in the restructuring work of a firm and use this as a leverage to pocket value for themselves by demanding full payment of their dues either from the firm or from the other creditors and become 'free riders'. Free riders are those creditors that do not contribute to the restructuring of the firm, at the expense of cuts by other creditors, but garner gains of a financially stable firm once restructuring is complete. Simply put, hold-out creditors that are unsuccessful in preventing restructuring become free riders when restructuring is successful. Studies have shown that private workouts and the conflicting interests of creditors give rise to coordination failure and result in a free-rider or hold-out problem among creditors. A legal bankruptcy procedure resolves these problems because the bankruptcy court plays the coordination role.[12]

The IBC is designed to effectively resolve the free rider problem. While the Code was being designed by the BLRC, it provided that the Code will ensure a collective process that allows all stakeholders to collectively assess viability of a firm. It envisaged that all creditors who have the capability and the willingness to restructure their liabilities must be part of the negotiation process while also providing that the liabilities of creditors who are not part of the negotiation process must also be met in any negotiated solution. By clearly laying out the priority of distributions in bankruptcy to all stakeholders, the BLRC envisioned to incentivise all stakeholders to participate in the cycle of building enterprises with confidence.

In line with the vision of the BLRC, the Code incentivises creditor participation. The CoC under the IBC comprises of financial creditors (FCs) who have the right to vote on decisions and operational creditors (OCs) who can participate in the CoC but cannot vote. The CoC facilitates coordination between various creditors and strives to balance the interest of all stakeholders. Major decisions of the CoC, such as appointment of the Interim Resolution Professional (IRP) as Resolution Professional (RP), approval of resolution plan or decision to liquidate the CD, are taken with a majority vote of 66 per cent or more.

This majority vote is binding on all members of the CoC. The binding nature of decisions of the CoC dilute the possibility of hold-outs by a creditor or creditors. In fact, this voting threshold was brought down from 75 per cent to 66 per cent with the very objective of mitigating hold-out problems. The IBC allows creditors to decide the fate of the firm as well as the fate of their dues. The creditors get to retain synergies generated if the firm is resolved or receive their dues in accordance with the waterfall mechanism prescribed in section 53 of the IBC in case the firm is liquidated. The BLRC noted that a sound legal framework provides procedural certainty about the process of negotiation, in such a way that it reduces problems of common property.

Conflict of Interest in Value Estimation

The resolution of a firm effectuates a change in the value of the assets of the distressed firm. In case of a private workout, different stakeholders perceive a different value of the firm, based not only on differing information but also conflicting interests between them. Each class of claimants has an incentive to present a biased estimate of firm value depending on the priority of its claims and the management also has its own biased estimate.[13] For example, those situated at the lower end of hierarchy of claims will favour an upward biased estimate of firm value as this would increase the share of firm value they receive. Similarly, senior claimants would favour a downward-biased estimate as this would increase their share in firm value if eventually the firm ends up performing well. The managers have an incentive to value the firm above its liquidation value to save their jobs, but below the true value (if it is higher than the liquidation value) so that they can deliver 'abnormally' good equity performance post the distress resolution.[14]

The aforesaid biases can lead to conflicts of interest between various stakeholders, making the probability of resolution bleak outside a formal resolution framework. The IBC seeks to ameliorate such conflicts by enabling coordination and cooperation amongst the members of the CoC. It has laid down an objective mechanism for estimation of value of the CD. When CIRP is initiated, the IBC mandates estimation of fair value and liquidation value of the assets of the CD. The estimation of these values lies in the capable hands of registered valuers (RVs) who are qualified and carefully screened by the Insolvency and Bankruptcy Board of India, the regulator, under IBC before they can be employed in CIRPs. The RV's estimates are realistic and scientific. These values serve as reference for evaluation of choices, including liquidation, and selection of the choice that decides the fate of the CD and consequently of all the stakeholders. Formal insolvency procedures aid in dissipating the smoke screen of incredulous firm value that the managers may portray to the outsiders.

Investment Incentives and Debt Overhang

The investment incentive problem arises when inefficient investment decisions are taken by the managers of a CD due to the inherent conflict of interest between the shareholders and the bondholders. The managers feel that benefits of a good investment will end up flowing to creditors instead of them. In the absence of a formal insolvency framework, the managers (acting on behalf of shareholders) of the CD may hold the upside potential of an investment project fixed, and prefer projects with lower payoffs in states of bankruptcy, because that would induce individual bondholders to accept poorer terms in a debt exchange offer, thus generating a greater residual for shareholders in states of solvency.[15] As explained by Myers (1977)[16], due to the absolute priority rule that is accorded to debtholders, the managers have an incentive to pass up projects with positive net present values when such returns are certain. This is the classic under-investment problem.

The conflict that arises in the approach of the creditors and debtor to preserving the time value of their own investment was also flagged by the BLRC in its report. The report rightly identified that creditors have the incentive to close out their investments quickly to avail of alternative investment opportunities. On the flip side, the debtor has the incentive to hold on to the assets, either to benefit from potentially higher returns by deploying the assets in more risky ventures or to benefit by stripping asset value.

Another form of under-investment problem is that of debt-overhang. Sometimes firms can accumulate such large proportions of debt that almost all earnings of the company are spent on servicing the debt, leaving small amount for investment. The under-investment problem will arise in such a situation when the managers exercise their discretion on whether a new investment should be taken or not. The managers will have a bias as they know that any increase in the firm's value, on account of the investment, will be split with the firm's creditors. At the same time, they will have an incentive to invest in riskier projects, as the upside of such investments will accrue to them, while the downside risk will be borne by the creditors.

The debt-overhang problem is maximised when the firm is insolvent because it may be unable to finance projects at all if later lenders are subordinate to earlier ones (or even take pro rata). In the US, the Bankruptcy Code authorises the bankruptcy court to give later lenders a super priority in any (or all) of the firm's assets, which mitigates the debt-overhang effect for insolvent firms.[17] Literature indicates that the debt-overhang and the consequent underinvestment problem can be reduced by various measures such as: (a) creditors can forgive a part of their debt, renegotiate it or give up their seniority to reduce the debt burden (although these offer only a partial solution); (b) shortening debt maturity; (c) matching the maturities of the firm's assets and liabilities; and (d) covenant restrictions in the debt contract that preserve the value of senior debt such as restricting the financing policy, maintaining the seniority, limiting leverage ratios, etc. [18]

A formal insolvency and bankruptcy process, such as the IBC, can effectively mitigate the problems identified in the aforesaid discussion. By taking away control from managers and prescribing their ineligibility in submission of resolution plans vide section 29A, any vested interests which may translate into underinvestment problems are effectively stalled by the IBC. This allows creditors to take charge of the firm through the RP. The creditors can choose which resolution plan received from RAs has the potential to restore the health of the firm thereby improving its investment prospects in the future. The creditors can choose to take a few haircuts on their own or restructure their loan contracts by tweaking maturities or inserting contract covenants to resolve the debt overhang problem of the CD. The creditor-in-control feature of the Code allows the creditors to objectively assess the viability of the CD and incentivises them to consider resolution of the CD for their own good.

Bankruptcy Costs

There are *ex post* or deadweight costs associated with insolvency and bankruptcy procedures. The direct costs of bankruptcy are in the form of payment of legal and professional fees. As the time taken in resolving or liquidating the CD increases, the cost of engaging professionals also rises. There are indirect costs of bankruptcy as well. Altman (1984)[19] has identified these indirect costs to be disguised in the form of inefficient investments induced by the reorganisation process, disruptions in the relationship of the firm with stakeholders such as capital providers, customers, suppliers etc., causing increase in input costs, reduction in product demand as customers fear that the firm may go bankrupt again and flight of key personnel to other competitor firms. There is also the probability of certain social costs that may arise if a viable firm, whose going concern value is higher than liquidation value, is liquidated.

While there is a large amount of literature that points to the fact that the direct costs of bankruptcy are not that significant, the studies pertaining to indirect costs have shown mixed results[20]. Some studies indicate indirect costs to be quite significant like that of Altman (1984) while others suggest the costs are insignificant, like Andrade and Kaplan (1998).[21]

Castanias (1983)[22] finds that firms with high probabilities of bankruptcy employ smaller amounts of debt. He concludes that this is consistent with significant *ex-ante* costs associated with bankruptcy. These *ex-ante* costs are perceived to be the perverse incentives for incumbents when they expect that financial distress in imminent. These costs, also known as 'financial agency costs,' are more pronounced where the interests of shareholders and managers' are closely aligned as in the case of a closely-held debtor.

Even though there are mixed empirical results on the indirect costs of bankruptcy, whether significant or not, the BLRC was of the view that under a common law in the form of IBC, the resolution can be synchronous, less costly and help more efficient recovery.

The IBC provides for a creditor to trigger insolvency against a CD using evidence of a default through an Information Utility (IU) which is a central repository of financial information of CDs, thereby reducing the cost of determination of default. The IBC has helped in reducing the time taken to resolve or liquidate an insolvent firm, within a range of 300 to 375 days on an average, thereby reducing the cost of engaging various professionals. This is a far cry from the earlier regime that entailed a cost of almost 9 per cent of estate value and took 4.3 years, according to the World Bank's Doing Business Reports. The indirect cost of disrupted relations with suppliers and customers is mitigated by the IBC as it strives to keep the CD as a going concern throughout a CIRP. This also allows retaining key personnel and workmen of the CD. Further, the current operations of the CD are kept in motion as the IBC provides for raising of interim finance. Another indirect cost such as risk of inefficient investments induced by resolution is minimised as the CoC approves a resolution plan only when it is convinced that the plan is financially and commercially sound. The CoC which comprises of competent institutional FCs weighs whether the RA has the capacity and the 'know how' to effectively turnaround the CD. The aforesaid features of the IBC aid in minimising the direct and indirect costs of formal insolvency procedures.

From the discussions above, it appears that the Traditionalists' concepts of equity and fairness for all stakeholders in an insolvency process and preserving the value of the firm in distress are enshrined in the basic architecture of the IBC. At the same time, the Proceduralist principles of allowing the commercial wisdom of creditors to prevail is also imbibed in the Code.

THE DISTRIBUTION PROBLEM

The bankruptcy problem is, in effect, an entitlement distribution system involving the distribution of a given asset, which is inadequate to meet and satisfy all the creditors' demands. The insolvency of a corporate impinges upon a diversity of interests, including that of creditors, employees, customers and the community at large. Whose interests are more important to safeguard or should they all be treated at par? It is also a fact that claims recovery may not be achieved by all creditors when a company becomes bankrupt because the assets are insufficient to satisfy all the demands. The theories underpinning bankruptcy is discussed in the next section. It also looks into how close is the IBC to these theories when it comes to distribution to the proceeds of liquidation.

Creditors' Bargain Theory

The Creditors' Bargain theory of bankruptcy, developed by Jackson (1982)[23] postulates that the main objective of insolvency law is to maximise the collective return to creditors through a compulsory collective system. This theory generally embraced the principles attributed to Proceduralists by Baird (1998), including respect for non-bankruptcy entitlements in bankruptcy except as necessary to solve the collective action problems facing creditors. According to the theory, the bankruptcy process aims to regulate the inherent conflicts among difference groups having separate claims against a debtor's assets and incomes. Secured and unsecured creditors act differently preferring liquidation or reorganisation to suit their interests and maximum recovery. Given this position, the theory suggests that bankruptcy law should provide incentives for creditors such that each of them finds it optimal either to wait or to collect immediately their share with the central objective of maximising the total welfare of the group as a whole. In effect, the creditors' bargain conception focuses on maximising group welfare through collectivisation. The theory is based on the idea that bankruptcy law generally reflects the hypothetical creditors' bargain that creditors would reach if they were to bargain before their extensions of credit.

Risk-sharing Theory

The Creditors' Bargain theory was modified by Jackson and Scott (1989)[24] considering the gap that presumes that creditors would agree to alter pre-existing contractual priorities, which seemed unrealistic. Risk-sharing theory argues that all types of investors in a business entity, viz. bondholders, equity investors and creditors, need to be compelled to share the risk of loss from the debtor's insolvency, with the aim to maximise general value of available assets and resources of the debtors. These risks are of two types as identified by Miles (2011)[25], viz (a) common, economic-wide, industry specific or government policy risks which are exogenously determined and are outside the control of the management and (b) company –specific risks relating to endogenous sources. The creditors can bargain and choose to bear one or other type of risks. The bankruptcy law can provide a manner in which this sharing of risk of bankruptcy is handled so that all participants are able to obtain optimum value.

Value-based Theory

This theory, presented by Korobkin (1991)[26] suggests that a mere economic account of bankruptcy may be flawed and needs to be understood in terms of all its facets. The bankruptcy legal framework provides a forum in which competing interests and values associated with financial distress are expressed and recognised. The theory proposes that insolvency law should consider the distributional impact of winding up of a corporate entity on those who are not technically creditors and who may not have formal legal rights to the assets of the business. In other words, aim of the bankruptcy law is to take into consideration and resolve the multidimensional, social and political issues arising from the financial stress of a corporate. Since each claimant would necessarily possess conflict of interest, the law should provide for each of them to derive optimum value.

IBC and Value Maximisation

The theories discussed above emphasise on the value maximisation aspect of a bankruptcy law and more importantly how it should strive to distribute the value so maximised in the most efficient manner amongst the stakeholders. At the same time, the theories highlight that a bankruptcy law that incentivises either voluntary or compulsory collectivisation and risk-sharing amongst the stakeholders, especially creditors, welfare gains are maximised for all, allowing positive spillovers to be funneled to those stakeholders who may have weaker rights to the assets of the CD vis-à-vis formal creditors. The IBC's design and implementation channel these principles to the core.

The BLRC used, *inter alia*, two design principles for a CIRP under the IBC, namely, (a) the liabilities of all creditors, who are not part of the process, must also be met; and (b) the rights of all creditors shall be respected equally. Thus, it appears that the framework of the Code is closer to the value-based theory. In keeping with these principles, the IBC provides opportunity to all key stakeholders to participate in the insolvency proceedings and collectively assess the viability of the defaulting firm. This is different from the individual recovery rights accorded to secured financial creditors by laws such as the SARFAESI, to the detriment of other creditors.[27] It casts a duty on the CoC to maximise the value of the assets of the firm while also balancing the interests of all stakeholders, irrespective of composition of the CoC.

The National Company Law Appellate Tribunal (NCLAT), in the matter of *Binani Industries Limited Vs. Bank of Baroda & Anr.*[28], held that given that resolution plans are complex financial structures that require analysis by commercial minds in order to maximise the value of the assets, they cannot be treated at par with a sale or auction where the only measure for value is the monetary value. It further held that: *'I&B Code' is for reorganisation and insolvency resolution of corporate persons, ….for maximisation of value of assets of such persons to…. balance interests of all stakeholders. It is possible to balance interests of all stakeholders if the resolution maximises the value of assets of the 'Corporate Debtor'. One cannot balance interest of all stakeholders, if resolution maximises the value for a or a set of stakeholders such as 'Financial Creditors'. One or a set of stakeholders cannot benefit unduly stakeholder at the cost of another.'*

The Code enables maximisation of value of the assets of the CD by requiring the creditors to make a collective endeavor to revive the failing CD and improve utilisation of the resources at its disposal. If revival is not possible, the Code releases resources for other efficient uses. In either case, the value of the assets of the CD improves. It prevents depletion of value by enabling early initiation of process for revival and expeditious conclusion of process. In fact, the CD would be tempted to initiate process early with a view to minimise potential loss to creditors. It makes provision for information symmetry which would enable discovery of best value.

The Code mandates the RP and the Liquidator to determine if the CD has been subject to irregular transactions, such as preferential transactions, fraudulent transactions, undervalued transactions, and extortionate transactions in the past, and if so, he is obliged to file an application with the AA for appropriate directions. This exercise will not only recover lost value for the stakeholders, but also deter the management from indulging in such transactions. This will cleanse the corporate governance and improve confidence of stakeholders.

The Code envisages the CoC to consider only those resolution plans which (i) have been received from credible and capable RAs, (ii) comply with the applicable laws, (iii) are feasible and viable, (iv) have potential to address the default, and (v) have provision for effective implementation of the plan. These considerations ensure that the resolution plan achieves reorganisation of the firm as a going concern, on a sustained basis. Of the plans which meet these requirements, the CoC must approve that resolution plan which maximises the value of the assets of the firm, irrespective of realisation for creditors under the plan.

By imbibing principles of preserving going concern value and striving to maximise value for all stakeholders, the Code leans towards the Traditionalist theory of insolvency law. This is opposed to the Proceduralist theory that envisions maximising value for creditors only, to the detriment of other stakeholders like employees and suppliers.

CONCLUSION

Economic theories try to unearth the invisible workings of an economy by working them into their models to verify their presence. While theorists supply advice, forecasts and proposals, policymakers, try to imbibe them into their policies. Thus, policy making and economic theories tie into a neat bow, enabling the market forces to operate in a free yet calibrated policy tweaked environment. The insolvency and bankruptcy regime has evolved over time, across jurisdictions, moulding its contours as per emerging theories that have helped identify market failures and fallouts of a particular policy. Theories have strived to settle the evergreen debate on formal versus informal bankruptcy processes by identifying the pros and cons of each. Overtime, policymakers have facilitated the creation of an environment that provides both the options to the market, formal as well as informal procedures, allowing stakeholders to pick and choose on a case-by-case basis. This is the equilibrium where theoretical underpinnings of a particular policy and the policy itself meet. As the insolvency regime in the country matures, the IBC will continue to evolve, backed by a vast body of supporting literature, to meet the emerging challenges and deliver its mandate effectively.

NOTES

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[14] *Ibid.*

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[20] Supra note 9.

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[28] Company Appeal (AT) (Insolvency) No. 82 of 2018.