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Driving Successful Resolutions through IBC

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Bankruptcy law prevents a destructive race to the firm's assets by offering a collective proceeding that freezes the rights of all investors in a firm, values them and then distributes these assets according to the priority scheme that the parties agreed would be used in the event that such a day of reckoning should come about.

- Douglas G. Braid[1]

India experienced a major structural change with the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC) which was enacted to consolidate and amend the law on insolvency, revival and liquidation of companies, limited liability partnerships, partnerships, and individuals. Its introduction repealed the Presidency Towns Insolvency Act, 1909 and Provincial Insolvency Act, 1920[2] while amending eleven other statutes including Sick Industrial Companies Act, 1985, Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), Recovery of Debt and Bankruptcy Act, 1993 and the Companies Act, 2013. IBC provides a mechanism of reorganisation and insolvency resolution of debtors, in a time bound manner. In the pre-IBC era, the growth of the insolvency ecosystem in India was marred by the presence of multifarious statutes which simultaneously governed this sphere.

One of the fundamental changes brought about by this legislation is moving away from the 'debtor-in-possession' regime to a 'creditors-in-control' (CIC) regime where creditors decide matters with the assistance of Insolvency Professionals (IPs). This regime promotes efficiency in credit markets besides improving availability of credit as lenders by virtue of having control over the process of resolution would be willing to lend and a healthy competition amongst lenders would ultimately bring down credit cost. CIC regime also promotes entrepreneurship while maximising value of assets. IBC has helped create discipline in how borrowers raise financing from banks and how banks take measures to recover the debts before the value of the underlying asset has deteriorated. Promoters are now afraid of losing control of their businesses on default and the moment a resolution professional (RP) is appointed. India has seen repayment rates materially improving owing to a fear among controlling shareholders of borrowers that they may lose control of their businesses if placed in insolvency. Investors and bidders have seen this as a great opportunity to buy stressed companies at attractive prices and foreign investors are seeing this as an opportunity to enter the Indian market.

Despite being hit by several roadblocks and challenges since its inception, continuous monitoring of developments by the regulator, proactive legislative interventions by the legislature as well as the prompt and active judiciary has helped shape IBC into an efficacious legislation. IBC has been successful in serving its two-fold purpose of allowing credit to flow more freely in India, and instilling faith in investors for quicker resolution of cases filed. Publicly available data supports the positive impact this legislation has had on Indian economy - as per the report on Doing Business 2020 released by the World Bank on October 24, 2019, India has jumped to 63rd position amongst 190 countries in 2020 in overall rating as against 131 in 2015 and 77 in 2019, making it one of the world's top ten improvers in ease of doing business. Further, the report suggests that the overall recovery rate for creditors in India has leaped from 27 cents to 72 cents on the dollar and the time taken for resolving insolvency has remarkably come down from 4.3 years to 1.6 years. Reserve Bank of India's Report on Trend and Progress of Banking in India 2018-19, indicates that recovery of banks under IBC stood at 42.5 per cent as against 14.5 per cent, 3.5 per cent and 5.3 per cent under SARFAESI Act, Debt Recovery Tribunals and Lok-Adalat modes, respectively. India was also awarded the Global Restructuring Review Award for the Most Improved Jurisdiction in restructuring and insolvency regime.

IBC: AN EFFECTIVE LEGISLATION

One of the highlights of the process under IBC has been that ever since the law has been enacted, there has been a continuous feedback mechanism put in place for collating valuable information from the various stakeholders. This has enabled the Government and the Insolvency and Bankruptcy Board of India (IBBI/Board), the regulator of processes and professionals under the IBC, to review the efficiency of systems, processes and dispensations under the law and ensure that there is a constant upgrade to achieve its objectives. As we have seen earlier, one of the key objectives of IBC is to ensure protection of value and capital through enabling successful resolutions. The intent is not only to complete a resolution but to satisfy oneself that a proposed resolution will stand the test of delivery to stakeholders over time through a mechanism of evaluating the strength of the bid over key parameters. Towards achieving such objectives, the IBC has also been subject to several legislative and judicial actions, including amendments in the provisions of the Act and the Rules and Regulations framed under it, enabling faster, better, and efficient resolutions.

Legislative actions

The journey of the evolution of IBC has seen many challenges including a challenge to its constitutionality. However, these have been effectively addressed by identifying the required changes and bring in suitable amendments, to keep pace with the changing demands. IBC has, in this short span, already undergone four sets of amendments. A snapshot of the key amendments and other notable developments are as follows:

- Introduction of section 29A dealing with ineligible resolution applicants (RAs), which achieved the objective of preventing backdoor entry of errant promoters in getting back their assets during the corporate insolvency resolution process (CIRP) at significant discounts.[3]
- Introduction of section 12A, permitting creditors to withdraw insolvency petition even after admission. Non-availability of the said provision was resulting in creditors being forced to take huge haircuts in CIRP despite better settlement offers being available from the promoters.
- Uninterested, frivolous and vested interest bids are kept out by enabling the RP, together with the committee of creditors (CoC), to specify the eligibility criteria while inviting resolution plans, considering the size and structure of the corporate debtor (CD).
- Clarification on homebuyers being treated as financial creditors (FCs), which resolved the ambiguity surrounding the rights available to them under IBC.

- Clarification that moratorium does not apply to guarantors, thereby putting an end to various litigations surrounding this issue.
- Reduction in voting threshold, for approval of resolution plans, from 75 per cent to 66 per cent, which enabled speedy resolution and increased the rate of achieving a resolution.[4]
- Providing that under a resolution process, the operational creaditors (OCs) and dissenting FCs shall not be paid less than the amount payable to them in the event of liquidation of the CD, thereby balancing interests of all stakeholders and cutting down the number of litigations filed during CIRP.
- Empowering the CoC to commercially consider the manner of distribution in a resolution plan, which may take into account priority and value of security, feasibility and viability of the plan, thus advancing the vision of IBC to uphold the primacy of creditors and their commercial wisdom.[5]
- Increasing minimum threshold for initiating CIRP proceedings by a class of creditors, thereby preventing frivolous filings.
- Ring-fencing the assets of the CD and providing immunity to the RAs from liabilities in relation to an offence committed prior to the commencement of CIRP, which has assisted in eliciting an increased interest amongst the RAs and attracting better bids.[6]
- Exemption of the applicability of section 29A (c) and (h) for the RAs in respect of CIRP of Micro, Small and Medium Enterprises (MSMEs) was allowed (a critical segment of the Indian economy and saves precious capital and employment). It was provided that the Central Government may also in public interest direct that MSMEs be exempted from application of any of the provisions of IBC.
- Securities and Exchange Board of India (SEBI) amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, SEBI (Delisting of Equity Shares) Regulations, 2009 and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 in light of the IBC, to facilitate the process of resolution.
- In order to boost interim financing, repayment was given super priority under IBC. To further encourage interim finance, in 2018, interest on interim finance, was made part of 'liquidation cost' which is also given super priority status in the distribution waterfall. In 2020, scope of interim finance was expanded and included financing provided to keep the debtor as a going concern, thereby preserving value of assets.
- The resolution plan was made binding on all the stakeholders including the Central Government, any State Government or local authority to whom a debt in respect of the payment of the dues was owed - a key development that helped faster resolution and improved bids.
- The licenses and permits regarding the supply of goods or services critical to protect and preserve the value of the CD and manage the operations of such CD as a going concern, were not allowed to be terminated or suspended during moratorium period, provided there was no default in payment of dues arising from such supply during this period, by the CD - a vital factor for protection of value of the CD.

Evolution of Jurisprudence

Courts have played a pivotal role in modelling the insolvency law in India and one has witnessed some landmark judgments which upheld the spirit of IBC and paved way for evolving jurisprudence. Some of the important legal positions established through note-worthy judgments include:

(a) IBC passing the test of constitutional muster[7];

(b) sending the message loud and clear that IBC is not intended to be substituted for a recovery forum[8];

(c) safeguarding the supremacy of the overriding provisions of IBC which shall have to be interpreted in the widest terms possible, so that any right of the CD under any other law does not come in the way of its implementation and upholding principle of natural justice- *audi alteram partem*, despite no express provisions being present[9];

(d) upholding the supremacy of commercial wisdom of CoC[10];

(e) explaining the requirement of providing equitable treatment to various kind of creditors and balancing their interests, redefining the roles of RP and CoC during CIRP and highlighting the limited judicial review available to the Adjudicating Authority in a CoC approved resolution plan under IBC[11]; and

(f) clarifying the position that there is no provision under IBC which requires that the bid of the RA has to be at least the liquidation value[12].

DRIVERS FOR EFFECTIVE RESOLUTION

While there have been various proactive steps taken, both legislatively and judicially, to enhance the insolvency regime, some of the key drivers which can be considered to further assist in effective resolution are:

Avoiding delay between CoC approval and National Company Law Tribunal (NCLT) approval: There have been times where the application for approval of resolution plans have been pending before the NCLT for over 12-15 months. Considering such delay will severely affect the feasibility and viability of resolution plan and given that the scope of judicial intervention is minimal in a resolution plan approved by the CoC, in its commercial wisdom and the RP is duty bound to check the compliance of resolution plan with applicable laws, endeavor should be made by NCLTs to approve/ reject the resolution plan in a time bound manner.

Pro-activeness of RP: While CIRP regulations provide timelines for RP to accept/ reject claims, it is often observed that there is considerable delay in RP's response thereby leading to initiation of multiple suits. Therefore, RPs need to ensure timely (i) evaluation of claims to avoid last minute challenges and (ii) communication to all the stakeholders regarding the acceptance / rejection of claims. Further, though not statutorily mandated, RPs may be encouraged to send specific communications to the statutory authorities for filing of their claims to avoid last minute claim filing and delay in the process.

Balancing interests of OCs: While minimum statutory protection of liquidation value has been accorded to OCs, there are still challenges on account of litigations initiated by them citing that their interests have not been adequately taken care of. In order to effectively counter such allegations, following measures may be encouraged: (i) introduction of specific scoring criteria in the objective evaluation matrix for payments to OCs and (ii) due recording in the CoC minutes of the discussions amongst the CoC members regarding OCs' claims, along with specific negotiation points being raised by CoC with the RA regarding their payments.

Introduction of CoC approved Sub-Committees for administrative convenience: In line with the Essar Judgment, formation of sub-committees may be encouraged to monitor administrative matters, such as supervision of CIRP costs and business of CD as a going concern. This will assist in avoiding prolonged delays in operational and administrative matters.

Continued support from judiciary in settling the law: Given that the insolvency jurisprudence in India is constantly evolving, it is imperative that Courts continue to be pro-active in settling debated legal positions and its associated interpretational issues. For instance, the issue on initiation of simultaneous IBC proceedings against the borrower and guarantor still remains unresolved. The judiciary should provide its views on such contested matters to ensure speedy and effective resolution in a time bound manner.

Decongesting NCLTs: As per the quarterly reports published by the IBBI, as on March 31, 2020, a total of 3774 CIRP cases have been initiated, out of which OCs accounted for 49.65 per cent of the total CIRPs triggered, followed by FCs with 43.61 per cent. Such high number of cases has exponentially increased the burden on the NCLTs. The Report of the Insolvency Law Committee, submitted in February, 2020 suggests that one of the major reasons contributing to such high number of IBC cases is the low default threshold of Rs. 1 lakh. However, the move by the Central Government to increase the minimum default threshold for initiating CIRP to Rs. 1 crore vide its notification dated March 24, 2020, is expected to ease the pressure on NCLTs in dealing with IBC cases. Various other measures may be taken to ease the burden and decongest NCLTs, such as establishing additional benches and introducing specialised benches exclusively for IBC matters.

THE WAY FORWARD

It is imperative that a systematic approach be followed and IBC's hold over the economy is not lost. Creditors need to show more maturity in changing their mindset and viewing IBC as an avenue for resolution rather than merely for recovery. Data shows that majority of the cases which have slipped into liquidation are either erstwhile Board of Industrial and Financial Reconstruction cases or companies with eroded assets. Therefore, efforts should be made to resolve companies without much tangible assets (especially in sectors such as Engineering, Procurement, Construction, Electricity etc.) outside IBC as such companies generally attract fewer RAs. This would also free up the bandwidth of NCLTs to deal with cases where IBC is indeed a suitable solution.

While this legislation has proved its efficacy, coronavirus pandemic has given the country another opportunity to consider stepping back and looking at various legislations to provide further fillip to economic growth of the country. This is a good time to consider capacity building. A few such aspects to consider further could be:

- Launch a Public Outreach Program to create awareness amongst various stakeholders like State Agencies, Developmental Corporations, Port Authorities etc. This would enable smooth implementation of resolution plans.
- Take measures to build capacity of IPs with domain knowledge (currently there are limited number of organisations which are competent to provide insolvency services).
- Facilitate formation of Zonal Appellate Benches at metro locations for quicker resolution of appeals.
- Using technology for case management by NCLTs, including Artificial Intelligence, to ensure cases of similar nature filed before various benches are dealt in a consistent manner so that judicial risk of uncertainty is reduced, would be a welcome move for business and facilitate development of the distressed asset market in India.

It is also time to introduce Online Dispute Resolution (ODR) especially for retail / individual insolvency matters. ODR, being the modern counterpart of rendering online Alternate Dispute Resolution (ADR) methods such as arbitration, mediation and conciliation, which are cost effective, less time consuming and have a global access and impact, should be encouraged to supplement the personal insolvency framework. This move would also assist in reducing the workload on the concerned tribunals.

Another interesting aspect which may be considered is to explore providing a framework for pre-packed deals in India whereby the CD or shareholders approach the NCLTs with a pre-negotiated corporate reorganisation plan prior to the initiation of insolvency process. This would, *inter-alia*, ensure

(a) continuity of the business of the CD;

(b) preservation of value and maximisation of recovery; and

(c) resolution of the company in a shorter time frame while saving court's time.

It is further note-worthy to mention that the framework in relation to group insolvency and cross border insolvency is already under consideration which will further provide the required stimulus to the growth of insolvency regime in India.

CONCLUSION

Having stated the above, the IBC has certainly matched up to the challenge of reinvigorating the insolvency regime in India. Not only has it been able to tackle the menace of non-performing assets, but it also has been effective in contributing to the economy in various indirect ways such as improving credit discipline in the market owing to the fear instilled in the minds of promoters of losing their control in the companies, creating foreign investment opportunities in light of increased confidence on account of the structured and time bound approach and saving jobs by preventing companies from going into liquidation.

The thought provided by Orison Swett Marden, an American inspirational author, is quite relevant in this regard-

> Success is not measured by what you accomplish but by the opposition you have encountered, and the courage with which you have maintained the struggle against overwhelming odds.

NOTES

[1] Baird G. Douglas (1996), “The Uneasy Case for Corporate Reorganisations” in J Bhandari and L Weiss (eds.), *Corporate Bankruptcy* (New York, Cambridge University Press, 1996), 339.

[2] However, the provision relating to repeal of these two Acts is yet to be notified.

[3] The Insolvency and Bankruptcy Code (Amendment) Act, 2018.

[4] The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018.

[5] The Insolvency and Bankruptcy Code (Amendment) Act, 2019.

[6] The Insolvency and Bankruptcy Code (Amendment) Act, 2020.

[7] *Swiss Ribbons Pvt Limited v. Union of India & Ors.*, (2019)4 SCC 17.

[8] *Mobilox Innovations Private Limited v. Kirusa Software Private Limited*, AIR 2017 SC 4532.

[9] *Innoventive Industries Ltd v. ICICI Bank & Ors.*, AIR 2017 SC 4084.

[10] *K. Sashidhar v. Indian Overseas Bank & Ors.*, AIR 2019 SC 1329.

[11] *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta & Ors.*, 2019 SCC OnLine SC 1478.

[12] *Maharashtra Seamless Limited v. Padmanabhan Venkatesh & Ors.*, Civil Appeal No. 4242 of 2019.