Expediting IBC process–lessons learnt and way forward

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Background

As we are celebrating completion of two years of a path breaking reform in the field of indirect taxation, the introduction of Goods and Services Tax (GST), and are taking stock of where are we today and what needs to be done now, let us also take stock of our experience thus far and what next for another major reform introduced a little before introduction of GST, The Insolvency and Bankruptcy Code, 2016 (The Code).

Enacted to achieve time bound resolution of insolvency, maximising value of assets, enhanced availability of credit and to balance interests of all stakeholders, it too is a path breaking reform with bold measures, on international lines, coupled with our own experiences in dealing with reorganisation, reconstruction and resolution of stressed assets/sick and potentially, sick companies.

During past two and half years of implementation of the Code, we have seen resolutions in few really large cases though different stakeholders have different perspectives on the results. Some wonder whether the process is used more as a mode of recovery for large financial creditors and/or for justification of huge write offs or as a revival plan, in true sense.

Even if it is all of these, I believe, it certainly leads to revival of the concerned undertaking and saving several jobs with reduced burden of loans, infusion of fresh capital and new management who has bid after appropriate due diligence. The debate, discussion or investigation as to the cause of sickness, build-up of non-performing financial and other assets, who is responsible and so on should not hold up or delay the process which would otherwise lead to further deterioration or even destruction of the value as we have witnessed in few cases.

And, that is one of the most critical aspects of success and effectiveness of the Code – t**he time taken for commencement of the process as also for the process to identify the resolution applicant** while deriving best possible value and also balancing interests of all stakeholders.

Expediting the process, to my mind, could be achieved by addressing following three aspects, early on, and my views on possible mode of doing so are in this Article:

- Point of time for reference
- Time taken in the process for identification of the resolution applicant
- Time taken on account of constraints of infrastructure and capacity/capabilities of participants in the process

Point of time for reference – it is little too late in the day ?

Prior to the enactment of the Code, we had Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) to detect sick or potentially sick companies which owned industrial undertakings. The objective of SICA too was revival of sick companies. The Act envisaged early detection of potential sickness and had objective criteria to do so viz., erosion of fifty per cent of peak net worth of preceding four financial years.

While the Act had detailed mechanism for revival of sick or potentially sick industrial companies keeping in mind interests of all stake holders, the experience was that the process was becoming fairly lengthy with several objections from different stakeholders and litigation leading to delay in revival process, as envisaged. The promoters and directors continued to be in charge of operations with additional oversight by nominated director(s), if any, by Board for Industrial and Financial Reconstruction (BIFR).

Reserve Bank of India too announced several schemes with modifications/new schemes from time to time to achieve resolution of impending insolvency and expediting revival of impacted business undertakings, especially, from the perspective of recovery and restructuring of amounts due to banks. Here again, the promoters and directors continued to be in control and management of companies.

Taking lessons from those experiences, new Code seeks to achieve the objective of revival of undertakings by placing financial creditors in the driver's seat and taking away powers of the promoters and directors.

Reference to BIFR is replaced by reference to National Company Law Tribunal (NCLT) and some functions of BIFR are transferred to the Committee of Creditors (CoC) comprising financial creditors and others to resolution professionals. These persons bring in specialised talent and facilitate expeditious decision making.

Has this achieved the objective of quicker resolution? Experience so far is not so encouraging and except for few cases, hair cut even for financial creditors is fairly substantial and others do not get anything at all. Could the commencement of process earlier than it is currently commencing, have resulted in lowering losses/haircuts?

The Code envisages fairly early stage identification of potential sickness or indication of cash crunch of a corporate debtor by enabling any creditor, financial or

operational, to whom company owes Rs 1 Lakh or more and where there is default in payment, to make reference to the NCLT for commencement of proceedings for resolution.

Has this measure, in practice, led to early commencement of resolution/revival process? Experience is otherwise. This measure is being used either to put pressure for recovery of dues by operational creditors or by others to get more ongoing business. They believe that even if there is delay in payments, cost of which is built into the price, they are getting business on an on-going basis and that keeps their machines also running.

Financial creditors are more often than not, banks and/or a consortium of banks/financial institutions. They need to follow due process which is time consuming and decision making requires concurrence of several people. RBI did take a firm stand and provided guidelines/directions as to the stage of referral, rather, mandatory referral to NCLT. Some cases did get referred to under this guidance/direction but, the guidance was challenged and same was held by Supreme Court to be beyond RBI's mandate. RBI has now issued new directions.

What could be the solution?

One measure could be that, wherever, there is default in making payment of undisputed dues to any operational creditor, the concerned creditor ought to give notice to the defaulting company and also provide self-declaration that the dues are not disputed. The company ought to be obliged, within 30 days from that date of such posting, to seek e-voting on the proposal for reference to NCLT. If more than 50% of all operational creditors, in numbers as also value, resolve to refer the matter to NCLT, the company should be obliged to refer the matter to NCLT. Safeguards would be required to ensure that the dues of operational creditor giving notice are correct and there is no dispute. If later, it is found that the declaration was incorrect, there ought to be tough action against the concerned creditor.

Besides timely resolution, this measure may reduce the use of the Code merely as a means of recovery. This will also facilitate early identification of potential larger default and timely reference to NCLT to commence process of resolution. Ordinarily, first default would be in making payments to operational creditors before default in payments to financial creditors.

Another measure could be to set out objective criteria like erosion of 50% of peak net worth of past 3 financial years, cash losses for past 2 financial years and place obligation on the Board of Directors to make reference to NCLT. This would also lead to early identification of stress.

Though the Code has set out time limit for various processes, in practise, it is found that these are breached. There are legal challenges too at the stage of reference itself. This aspect could be addressed by the NCLT/appellate bodies by taking stricter view of the matter and imposing penalties if the challenge is found to be on frivolous grounds, with a view to only buy time. Availability of judges for taking up these matters and infrastructure constraints also contribute to delays and they too need to be addressed urgently.

Time taken in the process for identification of resolution applicant – can litigation be avoided ?

The process currently followed is to call for bids, resolution professional evaluating them and presenting to the Committee of Creditors who determine the successful applicant. In practise, the financial creditors look at it as a means of recovery and all the amount that the resolution applicant offers is mainly for financial creditors. The logic is that the interests of employees and those of operational creditors will be taken care of when the company is turned around with infusion of fresh funds by the resolution applicant. The resolution professional verifies claims of such operational and other creditors but, in practise not many resolution plans provide for such payments if there is not much on offer for financial creditors themselves. On a different note, operational creditors are often small and medium sized businesses and not honouring their dues is leading to down streaming of the stress.

The promoter is removed and, in most cases, is not permitted to submit resolution plan. The objective is that the promoter who caused stress and has not been able to turn around the operations or bring in additional funds required for revival when it was under his control and management, would not be able to do so even after resolution plan acceptance.

Further, if there is a haircut, why should financial and other creditors take hair cut for the promoter under whose leadership the stress is caused and when he remains in the driver's seat and his own investment is protected ?

There are arguments otherwise too especially, that the losses and defaults are not always due to action or inaction of the promoters and distinction ought to be made between business cycles, external factors and so on. There is merit in both arguments but, stress and default is a fact and needs to addressed. Some stakeholders including promoters will have to take hit even though it is harsh.

Currently, the resolution plan is debated at the CoC, the meeting of financial creditors and the promoters, current management or other creditors do not have a say in this. This leads to significant heart burn and challenges to the process. Also, it is seen in practise that after the proposals are discussed by the Committee of Creditors and selection of successful applicant is made, unsuccessful applicants challenge the selection on the ground of comparativeness, information/data provided and so on or offer better terms including, in some cases, by those who did not even participate in the process earlier.

So, what is the solution?

A solution, to my mind, is, fully transparent e-auction - bidding process. We have seen such processes being

successful in deriving maximum value in other auctions and these should work in the case of resolution process as well.

The process could be as under:

- Call for bids on the basis of detailed parameters and information posted on the specified site. So, all are on the same page. Any data or information available to one is also available to all.
- Evaluation is also on the same basis for all. All adjustments made to bid price to bring them on same level like timing of payment, additional funds to be brought in, expected write offs, time for revival and so on is made and displayed on the website.
- Highest bidder, after giving due consideration/effect/ adjustment to all aspects of bid, is then identified.
- Thereafter, a period of 7 days could be provided, if any bidder or promoter wishes to raise any objection to the selection. The objecting party should be required to give detailed reasons for objection with evidence, if relevant to the objection.
- Such objection(s) should be placed on the website and dealt with within 7 days from the date of filing of objection. Response should also be on the website.
- If based on such objection(s) and response(s), re-bidding is required, the same should be done and time period of 7 days be provided for filing revised bids
- Same transperancy ought to be maintained and same process for evaluation of bids ought to be followed. Such evaluated should be completed within 7 days of last date for receipt of revised bids.
- A bidder should be allowed to better its offer till the close of the bid.
- The offer of the highest bidder is then accepted and the bidder is declared successful who immediately takes over charge of the company.
- No challenge to the process of selection of highest bidder including evaluation and so on be entertained unless it is really on fundamental aspect and, in that case, the challenger should be asked to deposit bid amount in escrow with identified bank to be returned on final decision by the Court, after deducting costs due to delay, if the challenger is not successful.

A special format like the redfern[1] schedule/document used during arbitration process, could be developed for the process so, reference to each objection and response is easily available and decisions of resolution professional as also CoC are also easily accessible.

Also, leaving out promoters fully may not be a good idea since, in some cases, the company undergoing resolution process may be a subsidiary of a listed company and, keeping them completely out would mean injustice to the stakeholders of the listed holding company. There are strong views on this aspect too but, my view is that the resolution applicaqnt ought to allocate and distribute cash available, if any, fairly and equitably among claimants; loss ought to be suffered by all stakeholders proportionately. The truth that any injustice is bound to lead to litigation or use of all available means to ensure some return, ought to be recognised.

Delays due to infrastructure and capacity constraints

The NCLT is heavily burdened today and physical infrastructure is also not adequate to deal such large number of cases leading to delays.

The solution?

First and foremost need is to have specialised benches only hearing IBC matters and making available proper physical infrastructure. The bench also ought to be provided with assistants who could help them in analysis.

Capacity building at all levels is very critical including at the level of judiciary. Possibility of engaging international judges with specialized experience of handling such resolutions in other countries working hand in hand with current judges of NCLT could be examined and tried for at least two years.

Gains from global knowledge and experience combined with local knowledge and experience will go a long way in strengthening the institution of NCLT and enhance global confidence in India's systems and processes in handling such matters. Similarly, cadre of highly experienced turn around strategists can also be roped in to work in advisory capacity with resolution professionals.

Conclusion

To conclude, a much needed reform taken up to reduce level of non-performing assets and to revive viable units or realise value of non-viable units, has been successful in meeting its objective albeit with delays and significant costs. A comprehensive review based on experiences thus far would go a long way in enhancing the pace of resolution especially, the aspect of timely action and minimising time taken at all stages. We do hope that this too will be addressed in all earnest and, at the earliest.

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[1] **Redfern Schedule**: is a collaborative document which both parties and the tribunal use for the production of documents. It is usually used for international arbitrations to create records for the requests for production of documents and responses between both parties- http://www.mondaq.com/india/x/651400/Arbitration+Dispute+Resolution/Discovery+In+Arbitration