

# IBC - The Subtle Art of Resolving Insolvency



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*“When learning is purposeful, creativity blossoms. When creativity blossoms, thinking emanates. When thinking emanates, knowledge is fully lit. When knowledge is lit, economy flourishes.”*

*~Dr. A.P.J. Abdul Kalam, Indomitable Spirit*

Four years ago, in the backdrop of the festering ‘Twin

Balance Sheet’ problem with banks and corporates reeling under financial stress and snowballing proportions of debt, the Insolvency and Bankruptcy Code, 2016 (IBC/Code) was baptised. The enactment of this piece of legislation was a venture into uncharted waters, as India attempted to overhaul its insolvency and bankruptcy regime from scratch. The objective of the Code is time-bound reorganisation and insolvency resolution of firms for maximisation of value of assets of the firm concerned, to promote entrepreneurship and availability of credit and balance the interests of all its stakeholders. The first order objective is resolution. The second order objective is maximisation of value of assets of the firm and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests. This order of objectives is sacrosanct<sup>1</sup>.

The Code consolidated several extant arrangements for insolvency and bankruptcy resolution into one comprehensive framework and marked a decisive shift from a ‘debtor-in-possession’ to a ‘creditor-in-control’ regime in the country. The law was put into operation in full swing, remarkably quickly, with the creation of an entirely new institutional infrastructure. The ecosystem that was created brick-by-brick back then, today stands stronger, comprising of the National Company Law Tribunal with benches in more than a dozen cities; the regulator i.e. the Insolvency and Bankruptcy Board of India, 3800 insolvency professionals (IPs), 3 insolvency professional agencies, about 70 insolvency professional entities ; 1 information utility (IU), 3000 registered valuers and 12 registered valuer organisations. The Code has also created a thriving market for education and capacity building of these professionals. Nearly 3700 corporate debtors (CDs) have entered the process by March, 2020. Of them, 1135 have completed the

process either yielding resolution plans or ending up with orders for liquidation. 312 processes have been closed on appeal or review or settled and 157 have been withdrawn. Another 467 firms have commenced voluntary liquidation.

## **An arduous albeit fruitful journey**

The journey of the Code since its enactment has been a bittersweet symphony, traversing through numerous challenges. Other than challenges of building institutional capacity and developing the markets and practices to implement the law, it passed the constitutional muster when almost every provision in the Code in respect of corporate insolvency resolution process (CIRP) had been challenged on grounds of constitutional validity.

The Code is a dynamic piece of legislation that has moulded its contours as per arising needs of the stakeholders and market realities. Since its enactment in 2016, it has been amended four times to streamline the processes and address any lacuna to ensure proper operationalising of the provisions of the Code. While quite a number of provisions were amended and a few new were added, some of the notable ones were: introduction of section 29A barring promoters from bidding for their own companies to break the corrosive culture that allowed fencing of the distressed company by the promoters; according home buyers the status of financial creditors (FCs) to give them a voice in the insolvency proceedings against defaulting real estate developers; specifying time limit of 330 days to complete the CIRP under the Code to instil discipline amongst the stakeholders to avoid inordinate delays in CIRP; making Adjudicating Authority (AA) approved resolution plans binding on Central Government, any State Government and any local authority to whom the CD owes debt under any law; and barring termination or suspension of 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, during moratorium period.

The Code has always been receptive to the changing environment, often emerging as a knight in shining armour to either protect distressed companies or other stakeholders of the ecosystem. A case in point is the economic and financial stress emanating from the Covid-19 pandemic and the consequential tweaks in the Code to protect the health of companies. To this effect, the latest tweak in the Code was made on 5th June, 2020 through an Ordinance promulgated by the President of India, suspending the recourse to the IBC under sections 7, 9 and 10 for any default arising on or after 25th March, 2020 for a period of six months or such further period, not exceeding one year from such date. The intention is to

prevent companies, particularly MSMEs, to be pushed into insolvency proceeding for their failure to service debt obligations on account of the pandemic induced stress.

Another antidote to fight Covid-19 induced financial distress was the raising of the threshold of default for filing of an insolvency petition under the Code from Rs 1 lakh to Rs 1 crore by the Government on 24th March, 2020.

The judiciary has played a leading role in upholding the cause of the Code. A body of rich jurisprudence has developed over the course of four years. They have passed numerous landmark judgements settling contentious issues and imparting clarity pertaining to running of the processes and role of various stakeholders like the IPs, committee of creditors, etc.

### **IBC report card**

The outcomes of the Code have been in consonance with its laid down objectives. In terms of efficiency of the Code, the parameters of recovery, time and cost have made significant strides. The Code lays emphasis on resolution over liquidation of a CD in distress. The word 'resolution' is certainly not a euphemism for 'recovery'. Till March, 2020, 221 companies have been rescued through resolution under the Code. The realisation by FCs under resolution plans in comparison to liquidation value is about 183%, while the realisation by them in comparison to their claims is nearly 46%. It is pertinent to take note of that fact that of the 221 CDs rescued under the Code, 70 were in the erstwhile Board for Industrial and Financial Reconstruction or defunct. The Code has laid down a timeline of 330 days to take a CIRP under the Code to its logical end. As of March, 2020, the average time taken for completion of 221 CIRPs yielding resolution was 375 days, excluding the time excluded by the AA. This is a far cry from the previous regime wherein the processes took nearly 4.3 years for completion. Through its linear processes, professionalised insolvency services, quick authentication of records by IU and a 'one-stop shop' approach, the Code has effectively driven down the costs involved in conducting an insolvency resolution process from a high of 9% of estate value under the previous regimes.

The Code has been enabling the banking sector in resolving their NPA woes. The figures speak for themselves. The Code has helped resolve some of the big wagon NPA cases like that of Bhushan Steel Limited, Essar Steel India Limited, Alok Industries Limited and the Bhushan Power & Steel Limited. Out of the twelve large cases or the 'dirty dozen' that had been referred by RBI to undergo CIRP under the Code, resolution plans for eight of them are already underway with realisation for FCs to the tune of 1.36 lakh crore. The realisation by FCs in the 221 resolved cases has been over 1.77 lakh crore. RBI data indicates that as compared to other options, banks are recovering much better through IBC, almost as much as 42.50 per cent<sup>2</sup>.

Through provisions for resolution and liquidation, the

Code enables creditors to recover their dues from either future earnings, post-resolution or sale of liquidation assets. It incentivises creditors to extend credit at lower costs, particularly when they have rights under the Code to initiate CIRP in case the CD defaults. These aspects will increase the overall availability of credit in the market.

One of the key qualitative outcomes of the Code has been the significant behavioural change it has effectuated in the parties to a debt contract. Existing promoters and managers are now incentivised to keep the firms up and going at an optimum level due to the looming threat of being taken into CIRP under the Code, which will take away their control over the firm. The Code is not only encouraging them to avoid default but also settle default at the very first instance, outside the Code. There have been several instances where debtors have settled their debts voluntarily or settled immediately on the filing of an application for CIRP with the AA, before the application is admitted.

The Code is a beacon of hope for entrepreneurs to start anew in case of honest business failure. It has given a push to the entrepreneurial spirit of young India by providing a simplified exit strategy in case of genuine failure. This has also given a boost to Start-up ventures in the country.

The World Bank's Doing Business Report (DBR) has acknowledged the positive impact of the Code on the ease of resolving insolvency. India's ranking in the 'Resolving Insolvency' parameter leap frogged from 103 in DBR of 2018 to 52 in DBR released in 2019. India is now, by far, the best performer in South Asia in this parameter and does better than the average for OECD high-income economies. The DBR released in 2019 noted that the overall recovery rate for creditors jumped from 26.5 to 71.6 cents on the dollar and the time taken for resolving insolvency also came down significantly from 4.3 years to 1.6 years in India. The DBR has credited the Code for instituting a process that enables sale of firm "as going concern" rather than "sold in piecemeal" showing that the Code is a resolution mechanism and not just a recovery tool.

### **Moving above and beyond**

After four incredible years, the Code is all set to embark upon a new voyage with many reforms on the anvil. While provision with respect to individual insolvency resolution in respect personal guarantors to CDs were notified on 1st December, 2019, work has already begun for operationalising other elements of individual insolvency. Further, implementation of a globally accepted and well recognised cross border insolvency framework is currently in the works, with rules and regulations being cemented. In the case of developing a framework for group insolvency, a protocol has been designed for resolution of firms in a group under the guidance of the AA. Moreover, the Working Group on Group Insolvency, constituted by the Government, has recommended a

framework that will be implemented in phases. The first phase will facilitate the introduction of procedural coordination of only domestic companies in groups and cross-border group insolvency and substantive consolidation could be considered at a later stage, depending on the experience of implementing the earlier phases and the circumstances at that point of time.

In view of the recent financial and economic stress caused by the Covid-19 pandemic, the Government is working on a special resolution framework for MSMEs. Moreover, given the uncertainty surrounding the duration of the pandemic and invention of a possible cure, a large number of countries are exploring special out-of-court restructuring mechanisms to tide over this phase. Pre-packaged administration of bankruptcy is a popular out-of-court mechanism that is typically less time-consuming and cheaper than formal proceedings, as the resolution

is negotiated and agreed before initiating the statutory resolution framework<sup>3</sup>. The flexibility, timeliness and informal setting of out-of-court workouts can be beneficial for CDs especially MSMEs, not only during this period of COVID-19 crisis but even post COVID-19 recovery phase.<sup>4</sup> India may also consider exploring such options in the near future.

The Code is a living document, as dynamic, zealous and resilient as a living being, rising up to emerging challenges and striving hard to deliver its mandate effectively and efficiently. The Government is committed to protect and preserve the vitality of this legislation today, tomorrow and for the times to come. Together with the ecosystem, its passionate constituents and the fervent will to ease the 'ease of exit', the Code will continue to move above and beyond in the realm of insolvency and bankruptcy resolution.

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<sup>1</sup> Binani Industries Limited Vs. Bank of Baroda & Anr., CA (AT) No. 82,123,188,216 & 234 -2018.

<sup>2</sup> Reserve Bank of India's (RBI) Report on Trend and Progress of Banking in India 2018-19

<sup>3</sup> Vanessa Finch (2009), "Corporate Insolvency Law Perspectives and Principles", Cambridge University Press, 456.

<sup>4</sup> World Bank (2020), Fernando Dancausa and Sergio Muro, "COVID-19 Outbreak: Corporate Insolvency -How Can Out-of-Court Workouts Help?", Equitable Growth, Finance and Institutions - COVID-19 Notes, Finance Series.