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About 19,000 insolvency cases closed, liquidation remains minimal: IBBI chief Sahoo

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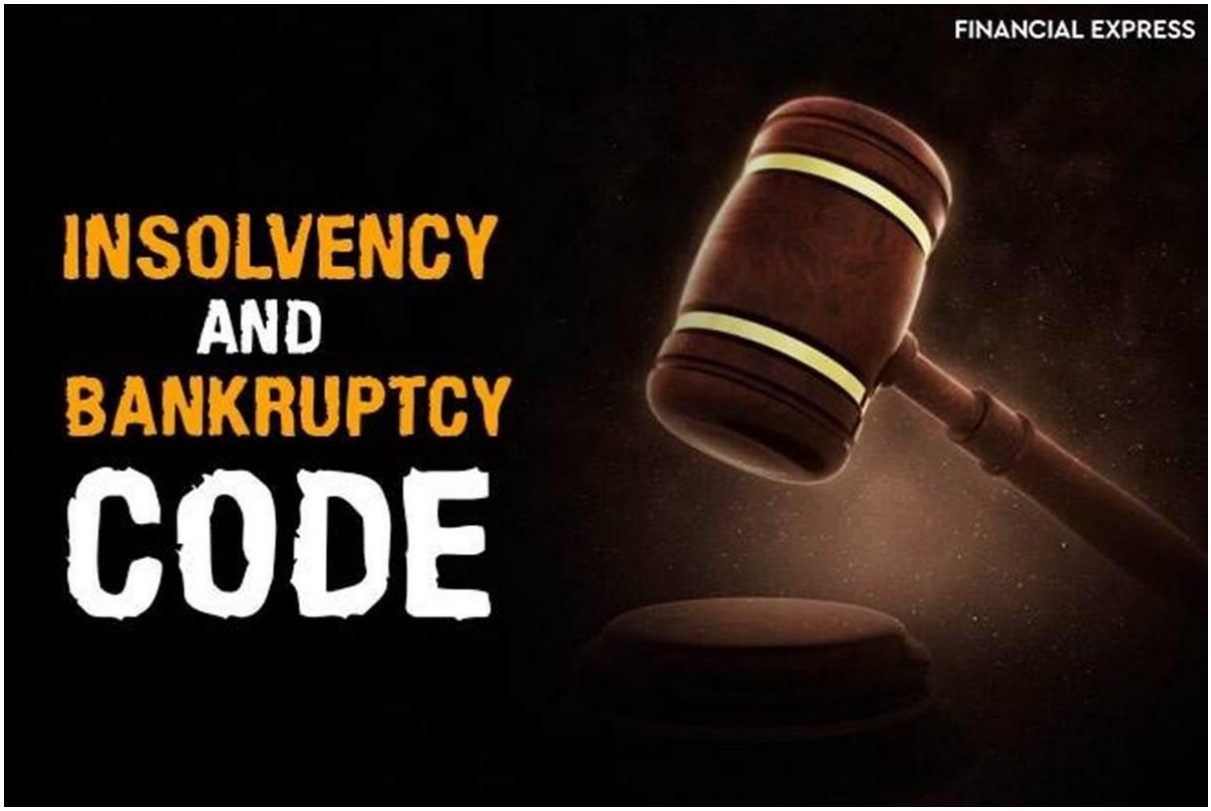

The basic idea is to provide a platform which enables the debtor and creditors to work out a resolution consensually, within the basic structure of the Code.

Amid growing criticism that the Insolvency and Bankruptcy Code (IBC) has yielded more liquidation than resolution, MS Sahoo, the chairman of the insolvency regulator IBBI, stresses that as many as 19,000 cases have been closed either before or after admission; so, if the entire universe of companies touching the IBC is considered, the percentage of those proceeding for liquidation is negligible. In an interview to ***FE's Banikinkar Pattanayak*** *on Sunday, he also refutes the claim of massive haircuts for lenders due to the IBC. On an average, the asset value of the companies that witnessed resolution until March 2021 was only 22% of their dues to creditors when they entered the IBC, he says. This means that while creditors were staring at a haircut of 78% to start with, the IBC not just rescued these companies but also reduced the haircut to 61% for financial creditors, he explains.*

Five years after the IBC came into being, as many as 1,277 cases ended up in liquidation while only 348 cases witnessed resolution (until March 2021). Has the IBC turned out to be an instrument of liquidation rather than resolution?

watching only the end game, where you see about 1,600 cases reaching the finishing line. However, 19,000 cases were closed, either before or after admission, but before reaching the finishing line. If the entire universe of companies touching the IBC is considered, the percentage of companies proceeding for liquidation is negligible.

Even at the end game, what matters is the value of stressed assets rescued. In value terms, companies accounting for 70% of the stressed assets were rescued, while those accounting for 30% of the stressed assets proceeded for liquidation.

Further, of the companies proceeding for liquidation, three-fourths were defunct, and of the companies rescued, one-third were defunct. This means that of the companies touching the finishing line, two-thirds were defunct to start with. The companies ending up with liquidation had assets valued, on an average, at about 6% of the claims against them, when they entered the IBC. If a company has been sick for years and the assets have depleted significantly, the market is likely to liquidate it.

The Code provides for reorganisation in two ways, first by a resolution plan, failing which, by liquidation. It is the market that makes the choice, and the law is only an enabler. The market releases resources through liquidation for alternate uses. Liquidation is not the end, rather a means for efficient cycling of resources.

How do you respond to the criticism that the IBC has turned out to be a tool for haircut?

It is axiomatic that a company coming to the IBC does not have adequate assets to repay all its creditors. The companies, which have been rescued through the IBC until March 2021, had assets valued, on an average, at 22% of the amount due to creditors when they entered the IBC. This means that the creditors were staring at a haircut of 78% to start with. The IBC not only rescued these companies, but also reduced the haircut to 61% for financial creditors.

Why does IBC yield zero haircut in one case and 100% in another? It depends on several factors, including the nature of business, business cycles, market sentiments, and marketing effort. It, however, critically depends on at what stage of stress, the company enters the IBC, as much as at what stage a patient arrives in the hospital.

Haircut is typically the amount of realisation in relation to the amount of claim. The amount of realisation often does not include the amount that would be realised from equity holding post-resolution, and through reversal of avoidance transactions and insolvency resolution of guarantors. The amount of claim often includes NPA (non-performing asset), which may be completely written off, and interest on such NPA. It may include loans as well as the guarantee against such loans. These project a higher haircut than it actually is.

It may be appropriate to see haircut in relation to the assets available on the ground and not the claims of the creditors. Because the market offers a value in relation to what a company brings on the table, and not what it owes to creditors. The IBC maximises the value of the assets at the commencement of the process, not of the assets which probably existed earlier. Since it redeems a part of the going concern surplus, rescue is realising, on an average, 190% of the liquidation value of the existing assets, generating 90% bonus, instead of haircut. In addition to rescuing the company, the IBC realises, of the available options for creditors, the highest in percentage terms.

Has there been a surge in insolvency cases after the moratorium was lifted on March 25? How many cases have been filed since then?

Since the expiry of suspension on filing, applications have been filed for the initiation of insolvency proceedings of about 250 companies. This is on expected lines and has been the experience internationally. The higher threshold of default of ₹1 crore, coupled with support and forbearances, has limited the flow of applications. More importantly, the stakeholders like to use the Code when the likelihood of resolution is high. They may be waiting for the appropriate time to invoke the Code.

How do you see the response to the pre-pack scheme for MSMEs so far?

It takes three-six months for the market to understand a new framework, compare it with other available options and prepare itself to use it. Prepack requires prior understanding between the debtor and creditors before initiating the formal process. It envisages 90 days of informal preparatory work before the formal part begins. It is, therefore, too early to see the response.

Will there be a pre-pack scheme for large companies as well, going forward?

An economic law is essentially empiric, and it evolves continuously through experimentation. The IBC is no exception; it has been a road under construction for good reasons. It envisaged standard, plain vanilla processes to start with, but anticipated prompt course corrections to continue to remain in the service of the business and economy. Therefore, I do not rule out any possibility, but it is too early to think about it before experiencing how it pans out for MSMEs.

Few cases in recent months have tested the spirit of the IBC. For instance, in the case of Siva Industries Holding, the lenders accepted a one-time settlement by its former promoter, who had offered just 6.5% of the total debt, and filed a withdrawal application before the NCLT. This has raised suspicion that the provision of allowing withdrawal of insolvency proceedings can be abused and can potentially facilitate backdoor entry for ineligible promoters? Is there a case for a review of this provision?

There is no prohibition on promoters to retain their company through a competitive resolution plan. The prohibition is on a person, whether a promoter or not, who does not have credible antecedents. Any person is connected or related to a prohibited person is also prohibited. He is also prohibited from buying assets in liquidation or participating in compromise or arrangement of the company. Therefore, what is of concern is an ineligible person wresting control of a company through a resolution plan.

The Apex Court, in the Arun Kumar Jagatramka case, recently observed that withdrawal under section 12A leads to a status quo ante in respect of the liabilities of the company. It is in the nature of settlement, which is distinct from a resolution plan, which is binding on everyone.

The matter regarding Siva Industries is sub-judice. I do not have full facts about it. It may not be appropriate to comment on this.

To file for pre-pack insolvency, an MSME debtor will require the approval of unrelated financial creditors with at least 66% of voting power. But if the idea is to empower the debtors so that they can trigger their own insolvency, why insist on the approval of two-thirds of financial creditors? Will it yield faster resolution?

The basic idea is to provide a platform which enables the debtor and creditors to work out a resolution consensually, within the basic structure of the Code. It is empowerment in terms of continued possession of the company during resolution, and the opportunity to set the tone for resolution through a base resolution plan, and to compete with alternate resolution plans. Further, it is only fair that creditors are taken on board, as they would be foregoing their rights to initiate a normal insolvency proceeding. If 66% of unrelated creditors are not on board, the process could be an empty formality or would take much longer to build consensus.

Last week, the IBBI stipulated that resolution professionals must probe transactions carried out by the promoters to detect potential malfeasance. While the idea seems well-intentioned, is it possible to enforce the regulation effectively? Some analysts have said it will make the lives of resolution professionals, who are as such burdened with the affairs of the stressed companies and many of whom are not always trained to evaluate such transactions, much harder. Your view.

I strongly believe that insolvency professionals (IPs) are not ordinary professionals. There was scepticism in early days whether IPs can conduct resolution process as they did not have any experience. They surprised the sceptics that they not only conducted the processes well, but also made good profits in some cases during resolution period. They have in many cases unearthed avoidance transactions and filed applications for appropriate directions. Further, the law empowers them suitably for the tasks. They can hire any professional to assist them in discharge of their duties. The IBBI and IPAs are having workshops to build their capacity in various areas, including on avoidance transactions. The best practices in this area are evolving. The Supreme court has delineated the role of an IP in respect of such transactions.

Let me make it clear that it is not a new obligation. The Code provides for this for good reasons; the IBBI is merely facilitating. The clawback of value lost in avoidance transactions increases the likelihood of resolution of stress by a resolution plan and discourages the potential miscreants from indulging in such transactions, preventing stress.