

The Art of Value Maximisation in CIRP

A unidirectional approach is antithetical to value maximisation, while higher level of information adds value to value maximisation.

Through this Column I have been attempting to explain the several features of the Code that drive value maximisation. Value, however, is a misnomer and has several context specific shades and colours in the commercial world. One needs to tread carefully while aiming to maximise the value in a corporate insolvency resolution process (CIRP), as unidirectional approach may yield sub-optimal outcomes. The following may help in appreciating some of the dynamic aspects in practice.

Value ≠ Price: The Code envisages maximisation of 'value', and not maximisation of 'price'. The value improves if business is continued and its assets are used more efficiently. Efficiency may improve from a change of management, technology, or product portfolio; acquisition or disposal of assets, businesses or undertakings; restructuring of the organisation, business model, ownership, or balance sheet; strategy of turn-around, buy-out, acquisition, or takeover; and so on. The Code, therefore, envisages a resolution plan to provide for anything and everything, subject to applicable laws, that maximises the value of assets. It provides for CIRP whereby a collective body of creditors, namely, committee of creditors (CoC) and resolution applicants interact with one another to arrive at a resolution plan that maximises the value of the assets of the CD. For this purpose, the CoC applies its mind on the feasibility and viability of resolution plans and capability as well as credibility of resolution applicants. The Code does not envisage a sale whereby a buyer pays a sum of money, called 'price', to the seller in exchange of the CD or its assets. If it were so, the CD could be simply placed on an auction platform and sold to the highest bidder to maximise the price.

CD ≠ Claimants: Though the Code envisages maximisation of value of assets, the CoC, at times, has a dilemma, whether the resolution plan should maximise value of the assets of the CD or realisations for claimants or both. Differently put, whether to maximise the interests of the CD or of claimants? Infusion of funds to the CD may improve the value of assets but may not improve realisation for a claimant. Similarly, a lower hair cut improves realisations for a claimant but may not improve value of assets. Thus, maximisation of value for claimants may not always maximise the value of the assets of the CD and vice versa. Further, claimants are not a homogeneous lot. A resolution plan may yield different realisations for different claimants. Thus, a creditor has further dilemma whether to maximise realisations for the class of claimants he belongs to or for all claimants.

Yet another dilemma is whether to maximise value for shareholders who do not submit a claim during the CIRP. A resolution plan typically provides for the amounts payable to claimants. This is based on the premise that by the time a CD gets into CIRP, its equity is zero or negative. This premise may not always hold good. A default, which is the trigger for CIRP, does not necessarily mean that the value of equity is completely eroded. Recognising this, the Code entitles the shareholders to receive the balance sale proceeds of liquidation estate after all claims are fully satisfied, and does not mandate a resolution plan to cancel the existing shares. Withdrawal of large number of applications for CIRP, before or after admission, and satisfaction of all claims in full in some CIRPs evidence this.

Resolution value (RV) ≠ Enterprise value (EV): Sans technical niceties and nuances, EV means the present value of future anticipated earnings of the CD, which one is willing to pay to acquire it as a going-concern, along with its work force, operational plants, licenses and

systems, customer base, and brand value. There is no definition of RV in the Indian context. The US Courts have defined reorganization value, equivalent of RV in the US context, as the present value of future anticipated earnings of the CD. RV intuitively means the amount paid under a resolution plan that results in the resolution applicant acquiring complete ownership and control of the assets of a CD as a going concern. In this sense, RV equals EV.

However, in common parlance, RV refers to the amount of money a resolution applicant puts on the table for resolution of a CD as a going concern. It is less than EV to the extent the resolution plan allows pre-resolution shareholders to continue with the CD, post-resolution. It is more than EV to the extent the resolution plan provides for purposes, such as, infusion of funds to rehabilitate / scale up the business post-resolution, over and above settlement of all claims. It varies from EV depending on the strategy of resolution. For example, if a resolution plan converts all claims to equity, RV could be zero. Many other factors, including market imperfections, contribute to RV diverging from EV.

LV ≠ Realisable value: LV is estimated realisable value of the assets of the CD if it were liquidated on the insolvency commencement date (ICD). While taking a decision whether to accept a resolution plan, one often considers LV as the default outcome. This is based on the premise that at least LV would be realised on liquidation. Very simplistically, consider three dates: CIRP commences on March 31, 2019, liquidation process commences on March 31, 2020 after failure of CIRP, and sale proceeds of liquidation estate is realised on March 31, 2021. The LV is 200 on the ICD. As value usually declines with time, it may reduce to 195 by March 31, 2020 and further to 190 by March 31, 2021. If cost of realisation is 3 and cost of redeployment is 2, net realisation is 185. The NPV of realisation of 185 on March 31, 2021 is 180 on March 31, 2020, when resolution plan is considered and rejected. Hence the realisable value is 180, while LV is 200.

The above nuances demonstrate that decisions involving values cannot be straight jacketed as either black or white. One does not decide in favour of X because A exceeds B. Such decisions require tremendous commercial wisdom and cannot be scrutinised ex-ante to determine if it is appropriate. That is why the Code empowers the CoC to take commercial decisions, after application of mind, and keeps such decisions beyond judicial scrutiny. It does not prohibit approval of a resolution plan where RV is less than EV or even LV, or rejection of a resolution plan where RV exceeds LV or even EV.

The CIRP of *United Seamless Tubulaar Pvt. Ltd.* is instructive in this regard. The CoC and subsequently the Adjudicating Authority (AA) approved a resolution plan that provided for an upfront payment of ₹477 crore. On an appeal, the NCLAT directed the resolution applicant to modify the plan to increase upfront payment to ₹598 crore, which is the average liquidation value. On further appeal, the Supreme Court, in *Maharashtra Seamless Limited Vs. Padmanabhan Venkatesh & Ors.*, observed that there is no provision in the Code or regulations which prescribes that the RV has to match the LV and that the object behind prescribing the valuation process is to assist the CoC to take an appropriate decision on a resolution plan. It reiterated that once a resolution plan is approved by the CoC, the AA ought to cede ground to the commercial wisdom of the creditors rather than assess the resolution plan itself.

Table: Decision on Resolution Plans

Description	CD 1	CD 2	CD 3
Information Level I			
Liquidation Value	200	200	200
Resolution Value	190	190	190
Decisions	Reject	Reject	Reject
Information Level II			
Liquidation Value	200	200	200
Debt Claims	150	200	250
Resolution Value	190	190	190
Decision	Accept	Reject	Reject
Information Level III			
Liquidation Value	200	200	200
Debt Claims	150	200	250
Realisable Value on Liquidation	180	180	180
Resolution Value	190	190	190
Decision	Accept	Accept	Accept
Information Level IV			
Liquidation Value	200	200	200
Debt Claims	150	200	250
Realisable Value on Liquidation	180	180	180
Resolution Value	190	190	190
Break-up of	Debt Claims	130	180
Resolution	Equity	10	00
Value	Induction	50	00
Decision	Reject	Accept	Accept

Let us delve into this a little deeper with an example (Table above). Assuming that the CoC is maximising interests of its creditors, it would accept a resolution plan, where the sum available for creditors is not less than their claims or the realisable value, whichever is lower. There are three CDs with a LV of 200 each, as presented in the table. The best resolution plan in each case offers a RV of 190 each. With this level of

information, the CoC is likely to reject resolution plans in respect of all three CDs. While the LV is same for all three CDs, the debt claims varies across them, as captured in the next level of information. The CoC is likely to accept resolution plan for CD I, RV being more than debt claims. The next level of information captures the realisable value, where the CoC accepts resolution plans in case of all three CDs, the RV being more than realisable value. Let us introduce further information, which breaks up RV, purpose-wise. Since the RV towards debt claims is less than the realisable value on liquidation, resolution plan in respect of CD I is likely to be rejected. Thus, with the first level of information, resolution plan in respect of all three CDs are rejected, while all three are accepted with the third level of information. The resolution plan in respect of each CD is accepted at two levels of information and rejected at other two levels of information. The above working assumes that the CD has only one kind of debt and it is secured, the CoC is maximising the interests of creditors, and the RV, LV, realisable value, etc. are exogenous variables to keep the decision making simple. It avoids host of complications associated with determination of RV or LV, different objective functions of members of the CoC, etc. Yet the decision changes with every additional piece of information.

With this understanding, the Code avoids prescribing any rule or formula for decision making. It leaves it to the wisdom and ingenuity of the financial creditors to decipher the colours and, if higher degree of information is available, the shades as well. Though value maximisation is constrained optimisation, those constraints get relaxed with higher degree of information, making it a colourful art, rather than a bland, black and white arithmetical calculation.

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