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‘Early initiation prevents ballooning of insolvency’ PREMIUM

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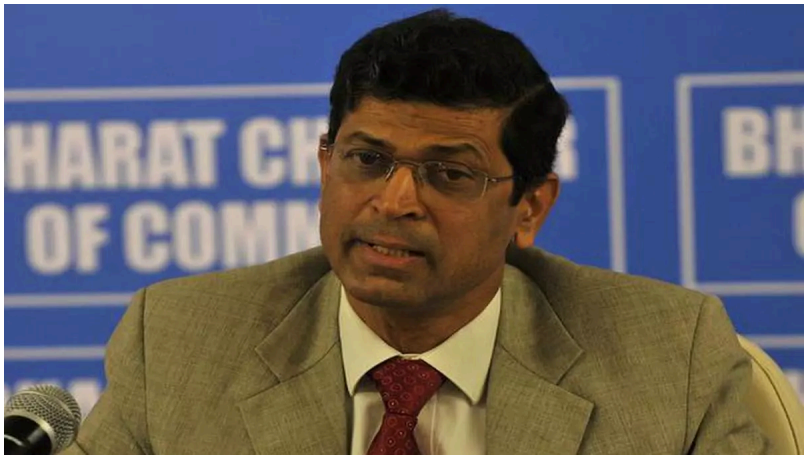
IBC ensures minimum liquidation value for operational creditors: Insolvency and Bankruptcy Board head

BY RADHIKA MERWIN



Kolkata, Date: 13/01/2017.
M. S. Sahoo, Chairman, Insolvency and Bankruptcy Board of India, Ministry of Corporate Affairs, Government of India.
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MS SAHOO Chairperson, Insolvency and Bankruptcy Board of India | Photo Credit: Ashoke Chakrabarty

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In a bid to prevent chronic defaulters and fraudulent promoters from regaining control of their company, at a fraction of what they owe lenders, the Insolvency and Bankruptcy Code (IBC) was amended last year by introducing Section 29 A. However, there have been concerns on certain other clauses under Section 29A that narrows down the pool of bidders substantially.

The Insolvency Law Committee (ILC) recently proposed some modifications to address the unintended exclusions, says MS Sahoo, Chairperson of the Insolvency and Bankruptcy Board of India,

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adding that the objective is sustainable resolution.

He was speaking at the launch of a knowledge base and research portal on the laws on insolvency and bankruptcy, www.IBCcases.com. AK Mylsamy (AKM) and Associates, a corporate law firm, is behind the portal.

Excerpts from an interview with Sahoo:
While the core essence of the IBC is resolution, we are hearing bankers and industry players mostly talk of recovery and possible liquidation in some cases. Your thoughts...

The soul of the Code is resolution of a firm for

maximisation of its assets' value.

Liquidation brings a firm's life to an end. It destroys organisational capital and renders resources idle till reallocation to alternative uses. Thus, liquidation is the antithesis of resolution. The Code, therefore, does not allow liquidation of a firm directly. It allows liquidation only after the process fails to yield resolution.

IBC encourages resolution in several ways. It obliges an insolvency professional to manage the affairs of the firm as a going concern and preserve the value of its assets. It allows the firm to raise

interim finances, and mandates continuation of essential services for continued business operations of the firm. It ensures a calm period when nobody disturbs the firm. It envisages initiation of the resolution process at the earliest, when the stakeholders have motivation to rescue the organisational capital. It mandates closure, to prevent organisational capital from declining with time.

The State is committed to facilitating resolution. The Finance Act, 2018, allows reduction of unabsorbed depreciation and loss brought forward from the

book profits arising from the write-off of debt under a resolution plan. The Companies (Amendment) Act, 2017, allows companies to issue shares at a discount to creditors when their debt is converted into shares, in pursuance of a resolution plan. The IBC (Amendment) Act, 2018, allows only credible resolution applicants to takeover a failing business.

There have been concerns on Section 29A being restrictive, narrowing the pool of bidders...

Section 29A prohibits certain persons — who on account of their antecedents may adversely impact the credibility of

the process under the Code — from submitting resolution plans. The ILC has proposed some modifications to address unintended exclusions.

For example, Section 29A disqualifies a person who has an account classified as NPA. Let us say, a clean resolution applicant takes over a firm which has a chronic NPA account, for resolution under IBC. After taking it over, it would be having an account classified as NPA and, therefore, disqualified from submitting resolution plans in future. The ILC has recommended that the disqualification should not apply to an otherwise

clean resolution applicant for a period of three years from the approval of the resolution plan.

Section 29A also disqualifies a person who has been convicted for any offence punishable with imprisonment for two years or more. This disqualification may not have any nexus with the ability of a person to run a firm.

The ILC has limited the disqualification to offences under economic and commercial laws. It has made a person eligible after six years from the date of release from imprisonment.

Some point out that the issue with a low threshold (₹1 lakh default) is that when an

operational creditor triggers the Code, he could possibly be looking at it only as a 'recovery' tool to achieve a quick settlement, rather than the revival or turnaround of the corporate debtor...
The resolution process aims to pass on a business having an economic value to a credible and competent resolution applicant. The Code assigns the process to a committee of creditors (CoC) comprising financial creditors only, while a financial or an operational creditor can initiate the process.

As reasoned by the Bankruptcy Law Reforms Committee, the financial

creditors have the capability to assess the business viability of competing resolution plans as well as the ability to modify the terms of existing liabilities.

It matters little as to who initiates the process and for whatever motive or consideration, as the decision rests with the financial creditors.

Further, whosoever initiates the process bears the initial expense unless the financial creditors own it up. This reduces frivolous initiation of the process.

An early initiation always helps the cause as it prevents the ballooning of

insolvency to an unresolvable proportion.

How do we address the concerns of operational creditors? In many cases, operational creditors, either employees or suppliers, are raising objections against non-settlement of their full dues.

The Code ensures minimum liquidation value for operational creditors. There are two possibilities: the firm does not have much resources, or has reasonable resources

In the initial days of IBC, we would have relatively more firms of the former category, where there is not enough in

the pot to fully satisfy all claims. You can give relatively more to one claimant only at the cost of another. One should see the ground reality.

Let us take an example. A firm has an aggregate claim of ₹1,000; the best resolution value is ₹100 and the liquidation value is ₹10. If the insolvency of the firm is resolved, the claimants get ₹100, that is 10 per cent of their entitlement or 10 times the liquidation value.

However, 2-3 years down the line, we would have relatively more firms of the latter category. The firms will come up for resolution at the earliest default of ₹1 lakh, when there is enough

organisational capital to fully meet all claims.

In either situation, the resolution plan includes a statement as to how it has dealt with the interests of all stakeholders, including operational creditors.

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