

INORDINATE DELAYS MAKE THE MARKET FOR
DISTRESSED ASSETS MIMIC THE LEMONS PROBLEM

A problem of timely resolution

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Compare this with CIRPs that took on average 236 days for conclusion in 2017-18, realising 193% of LV for FCs. Several factors, including the pandemic, explain the decline in realisation from 193% to 98%; increase in CIRP period from 236 days to 734 days is probably the most significant of them, which is a cause for major concern.

Unlike pre-pack, where the Adjudicating Authority (AA) and the market have separate time limits for completion of their tasks, the CIRP provides a combined time limit of 180 days for both. Broadly, a CIRP has two phases: the first is from commencement of CIRP till approval of resolution plan by the CoC, and the second is from approval of resolution plan by the CoC till the approval of the same by the AA. The second phase of the 29 CIRPs took, on average, 325 days. For at least four of them, it took more than two years.

On the one hand, LV recedes with time. On the other, inordinate and indefinite delay in closure of the CIRP depresses value realisation. A resolution plan approved by CoC may become unviable by the time it is approved by the AA. It is a huge risk for a resolution applicant to implement an unviable resolution plan. A prospective applicant may refrain from sub-

mitting a resolution plan to avoid such delay-induced risk, as it has no option to get out once its plan is approved by the CoC. Where it is willing to take the risk, it would offer a value that it expects to acquire on approval of the resolution plan.

Based on its worst estimate of the time for approval, say X years, it would

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offer the value available with the company after X years, discounted to the present date. If resolution plans are approved within a firm timeline of, say, 30 days, there would be relatively more and competing resolution plans, increasing realisation for FCs.

A CIRP technically closes on approval of the resolution plan by the AA. But that is not the end of the journey. The litigation continues through the appellate tribunal and the Supreme Court—at times, leading to the restarting of the CIRP. The CIRP in the matter of Jaypee Infratech Ltd. has been on for the last five years.

The successful resolution applicant undergoes harassment as stakeholders submit fresh claims and fight it out till the level of the apex court. Most of the applications relating to avoidance transactions are yet to be disposed. All these uncertainties and confusion dampen the market for distressed

assets.

Several factors and players contribute to delay in initiation and closure of the CIRPs. For example, we had highlighted delays attributed to the CoC in an earlier article in this paper (bit.ly/3NC8U2Q). This piece highlights delays attributed to the AA. This is not to say that the AA is not performing at its best, but it simply does not have the capacity matching the workload, which needs to be addressed on a priority basis.

An admission to a CIRP should take only 14 days as per the IBC. Against this, as reported by the IBBI in a recent discussion paper, the admission of applications filed by OCs took, on average, 650 days in 2021-22. As many as 82 of them were admitted after a lapse of two years.

Value recedes very fast between the filing of an application and its admission for obvious reasons. If admission of an application takes two years, and the first and second phases of a CIRP take two years each, particularly when a company reaches the AA after 3-5 years of stress, it is difficult to realise reasonable value for creditors or rescue the distressed company.

When many applications take as long for admission and many resolution plans take as long for approval, the market believes that any admission or approval will take that long in all cases. It factors in such delays in relation to its decisions and accordingly offers a value, which may fall short of even the LV. Unless this belief is reversed by demonstrable expediency in admissions and approvals, value realisation may decline further in the days to come, making the IBC irrelevant.

The market for distressed assets has an underlying 'lemons problem'. Inordinate and indefinite delay in the CIRP, apart from rapidly depleting the LV of the stressed assets, is converting the underequipped institutional structure also akin to 'lemons', which must be avoided.

SINCE THE RELEASE of the January-March 2022 issue of the Insolvency and Bankruptcy Board of India (IBBI) Newsletter, the media has been awash with some gloomy observations—“Delay, thy name is IBC”, “IBC recovery falls to new low of 10%”, “The realisation dropped below the assets’ liquidation value for the first time”, etc. Though most such observations appear off the mark, they convey an important message that deviation from the basic ‘start early, close early’ philosophy of the Insolvency and Bankruptcy Code (IBC) has serious consequences. Value recedes with time, and it cannot be rescued or realised if timely and swift action is not taken.

The newsletter reports that 29 corporate insolvency resolution processes (CIRPs) concluded with resolution plans during January-March 2022. They realised only 98% of the liquidation value (LV) for financial creditors (FCs). Total realisation, however, includes realisation towards CIRP costs, realisation for operational creditors (OCs), including workmen who are paid at par with secured FCs, and realisation in the form of equity for FCs. If these are factored in, for which data are not presently available, we would have a better picture on the realisation in relation to LV. Nevertheless, realisation for FCs, as a percentage of LV, tells its own story.

LV is estimated value of assets of a company at the commencement of the CIRP. The longer the company remains under CIRP, the higher is the loss of value arising from uncertainty surrounding the fate of the company and, in some cases, continuing losses from operations—and, consequently, the lower is the realisation. To limit the loss, the IBC caps the CIRP period to 180 days in normal circumstances. As against 180 days, the 29 CIRPs took, on average, 734 days, that is, more than two years, realising 98% of LV for FCs.