

CRITICS FOCUSING ON LIQUIDATION STATS MUST SEE THAT IBC IS MEANT TO ENABLE THE MARKET TO DETERMINE THE VIABILITY OF A COMPANY—AND ON THAT BASIS, RESCUE IT OR CLOSE IT DOWN

The soul of the IBC

A NARRATIVE IS gaining ground that the Insolvency and Bankruptcy Code 2016 (IBC/Code) is failing in its objective(s). It is not resolving the insolvency/stress of companies, and is rather liquidating many of them. Claim recovery is far from satisfactory. This is not surprising as the IBC has overwritten many pre-insolvency rights and entitlements of parties and thereby created several adversaries. They are out to malign the IBC for its failure to achieve something which is neither the intention nor design of the law.

Let us be clear on the objective of the Code. It provides for reorganisation and insolvency resolution and the resolution of the stress of corporate persons, among others. If stress is resolved in the manner the IBC provides—a time-bound process, calm environment, priority rule for claims (waterfall), and clean slate takeover, it yields several benefits. It maximises the value of the assets of the stressed entity, promotes entrepreneurship, and improves credit availability in the economy, and balances the interests of stakeholders. Thus, the objective is only one, while the benefits are many.

It is useful to recall the Tinbergen Rule, named after the first Nobel laureate in economics. This Rule suggests that the policymakers should have at least one policy for each objective. There can be more than one policy to achieve one objective but having one policy to achieve more than one objective is troublesome. It is not easy to kill more than one bird with one stone if they are flying in opposite directions. There can be many policies for stress resolution. In fact, there are. One may resolve stress under RBI's prudential framework, the Companies Act 2013, or the IBC, or even outside any formal framework.

It is important to note that resolutions under different frameworks yield different benefits: the benefits arising

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from resolutions under the IBC are different from those accruing from resolutions under the Companies Act. For example, the IBC accords a priority to unsecured financial debts above government dues. Such priority intends to promote alternative sources of finance and a market for corporate bonds and other unsecured debt. Therefore, the manner of resolution defines the likely benefits, which must not be confused with the objective.

The Code provides for stress resolution of a company in two ways, the first being by the rescue of the company through a resolution plan, which, if fails, is followed by the second—the closure of the company through liquidation. A company is under stress if it is not performing well; the resources at its disposal are under-utilised. If the company has a viable business, it should be possible to revive it. The IBC provides for the corporate insolvency resolution process (CIRP), that enables the market to find a feasible and viable resolution plan to revive the company as a going concern. If such a plan is approved, the company gets a new lease of life, and resources are put to optimal use. If the company has an unviable business, the market is unlikely to find a resolution plan. In such a case, the

company undergoes liquidation, which releases resources, including entrepreneurs, as per the priority rule, for optimal use elsewhere.

Thus, the Code enables the market to determine the viability of a company and, on that basis, to rescue or close it down. In either case, the stress is resolved: the company either continues

without any stress and uses the resources optimally, or disappears along with stress, releasing the resources for fresh allocation. Both resolution plan and liquidation serve the same economic purpose: resolve stress by putting resources to optimal use. It does not matter whether stress is resolved by way of a resolution plan or liquidation. Liquidation is not a bad outcome as such. It is a legitimate

means of resolution of stress for rejuvenating a market economy through 'creative destruction'.

Since liquidation typically takes longer than a resolution plan to put the resource back to optimal use, the IBC requires the market to first explore the possibility of a resolution plan. Further, since liquidation of a viable company is irreversible, the law provides for certain facilitation like interim finance and write-off of claims to revive it, if it has a viable business. Beyond this, the Code is

Since liquidation is irreversible, the law provides for certain facilitation like interim finance and write-off of claims to revive the asset, if it has a viable business. Beyond this, the Code is agnostic about the outcome

agnostic about the outcome—resolution plan or liquidation.

IBC does not promise to revive every stressed company or recover full money for creditors. One must not fret if it is yielding liquidations or recovering only a part of claims. Even these must be seen in the context. Though, in terms of numbers, three-fourths of companies were resolved by liquidations and three-fourths of stressed assets were resolved by resolution plans in value terms. Moreover, a third of the companies resolved by resolution plans were either sick or defunct. The companies ending up with liquidation had assets, on average, valued at about 6% of the outstanding debt, when they entered the CIRP. If a company has been sick for years and its assets have depleted significantly, the market is likely to liquidate it.

The companies which are getting rescued by resolution plans had assets, on average, valued at about 17% of the outstanding debt, when they entered the CIRP. This means that the creditors were staring at a haircut of 83% to start with. The IBC not only rescued these companies but also reduced the haircut to 68% for creditors. More importantly, it recovered 168% of the liquidation value of these companies. These are no small achievements. As we move forward and the legacy cases get over, every company could be rescued and creditors could realise their complete claims if CIRP is pressed at early stages of distress, when they have assets valued, most probably above 50% of the outstanding claims.

A law is as good as how it is understood and used by the stakeholders. Negative narratives by vested interests and gaming the law is the worst that can happen to a law enacted with great expectations. The narrative should capture whether the IBC is resolving stress, and if so, with what efficiency in terms of value rescued, cost, and time.