INTERVIEW WITH RUCHIR SHARMA

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IN DEPTH
THE BANKRUPTCY MESS

AUTO SPECIAL | MAHINDRA GROUP

THE GREAT REBOOT

THE ₹1.75 LAKH CRORE CONGLOMERATE IS WITNESSING A REJUVENATION OF ITS AUTO BUSINESS POWERED BY A SLEW OF NEW LAUNCHES AND A SHARP FOCUS ON AUTHENTIC SUVs

RAJESH JEJURIKAR, ED & CEO-AUTO & FARM SECTOR, MAHINDRA & MAHINDRA LTD (LEFT); AND ANISH SHAH, MD & CEO, MAHINDRA GROUP

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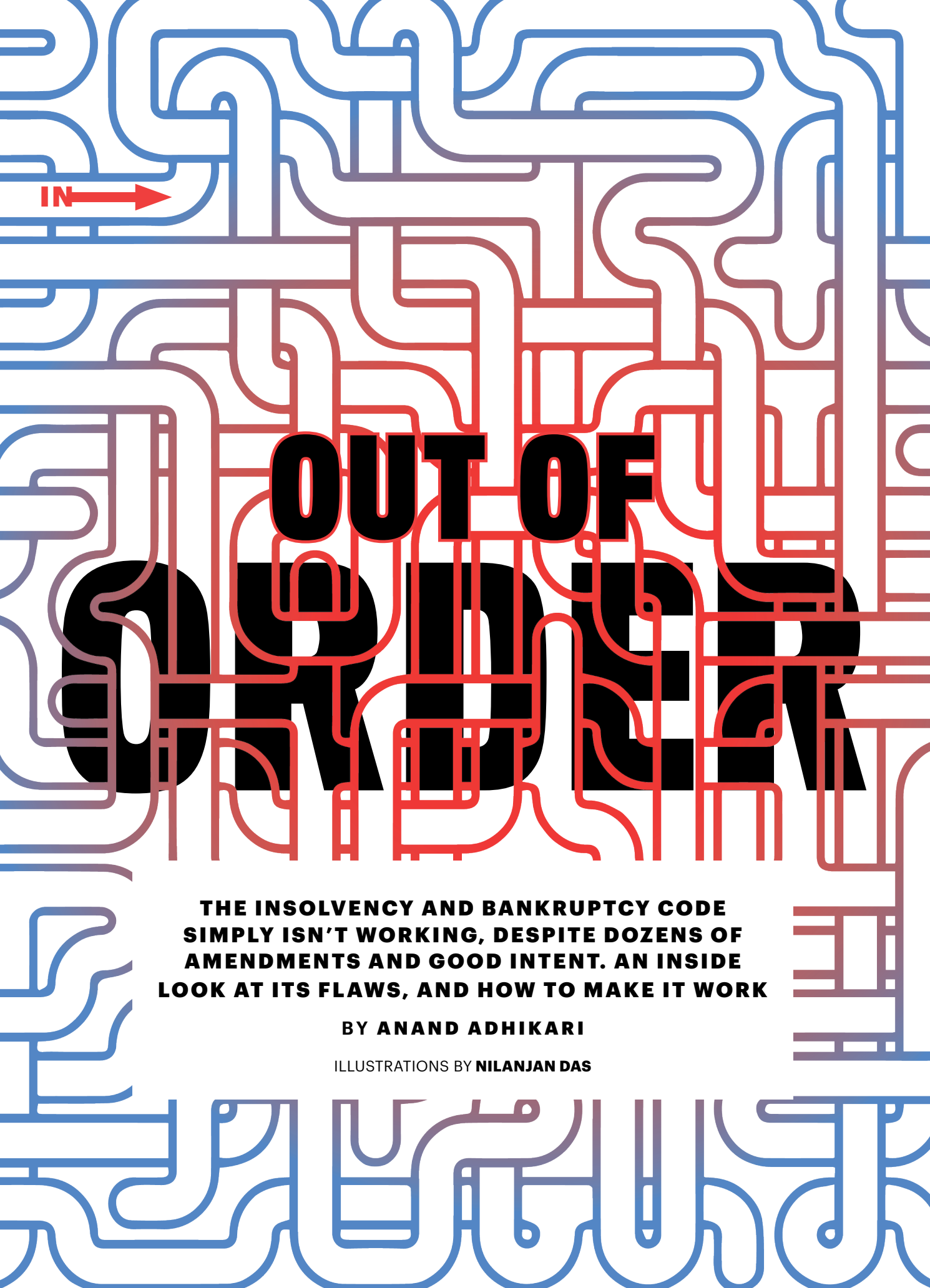


OUT OF ORDER

THE INSOLVENCY AND BANKRUPTCY CODE SIMPLY ISN'T WORKING, DESPITE DOZENS OF AMENDMENTS AND GOOD INTENT. AN INSIDE LOOK AT ITS FLAWS, AND HOW TO MAKE IT WORK

BY **ANAND ADHIKARI**

ILLUSTRATIONS BY **NILANJAN DAS**

SOME SIX MONTHS ago, Hyderabad-based Ind-Barath Energy walked out of the Insolvency and Bankruptcy Code (IBC) proceedings with a new buyer, JSW Energy, after nearly four years. Under the IBC's timelines, the process should have taken six months, or a maximum of a year if one factors in litigation. The outcome was equally disappointing, with banks recovering just ₹1,047 crore of the ₹5,500 crore of dues the thermal power producer had. Ind-Barath isn't an exception. More than half the default cases at the IBC have been languishing for more than nine months without any resolution. Besides, the financial creditors—mostly banks—are usually able to recover only a small percentage of the admitted claims. For instance, in the case of Videocon Industries, the recovery was just around 5 per cent. The average recovery value stands at 34 per cent of the claims since this game-changing law came into force in 2016.

What ails the IBC? In its seventh year, the law is caught in a maze of litigation, new interpretations, amendments (as many as 84 to date), challenges from stakeholders, and new precedents set by the Supreme Court. (*See graphic Hits & Misses*). That's a far cry from the IBC's intent, which is to restructure and revive a defaulting company. According to Daizy Chawla, Managing Partner at S&A Law Offices, the IBC is being used as a recovery tool, not just by operational creditors or suppliers, but also financial creditors.

The IBC did have some success in its initial days with the resolution of Essar Steel and Binani Cement, where bankers had recoveries of 90-100 per cent. Times have changed since then. But the time taken for resolution has always been a challenge. Technically, the IBC operates on strict deadlines; for instance, 14 days for admission or rejection of an insolvency application and 90 days for submission of claims. "How the courts can incorporate the IBC process within these timelines is a challenge," says Rajesh Narain Gupta, Managing Partner at law firm SNG & Partners.

Some quick fixes seem to be on the anvil. The Parliament's monsoon session is expected to see more amendments to the law. "We are so focussed on changing the law. The law is very mature. The participants are not mature enough to implement the law. We need some initiatives on skill development before improving the law," advises Abizer Diwanji, Financial Services Leader at EY India. More than the amendments, experts feel the IBC also needs intent, judges with subject expertise, trust in the banking system and an ecosystem of investors who invest in distressed assets (*See box An Agenda for Change*). How does one do that? Let us have a look at the long-term fixes.

HITS & MISSES
The seven-year report card

6,567
TOTAL NUMBER
of default cases admitted to IBC

678
NUMBER OF CASES
Resolved by IBC successfully (10.32 per cent)

₹8.9
LAKH CRORE
Total outstanding dues of the creditors in all the admitted cases

₹2.86
LAKH CRORE
The amount realised by the creditors in the resolved cases (32.13 per cent)

₹1.69
LAKH CRORE
Liquidation value of the resolved cases (18.99 per cent)

68
PER CENT
Haircut taken by creditors since inception

614
DAYS
Average time taken for closure of cases

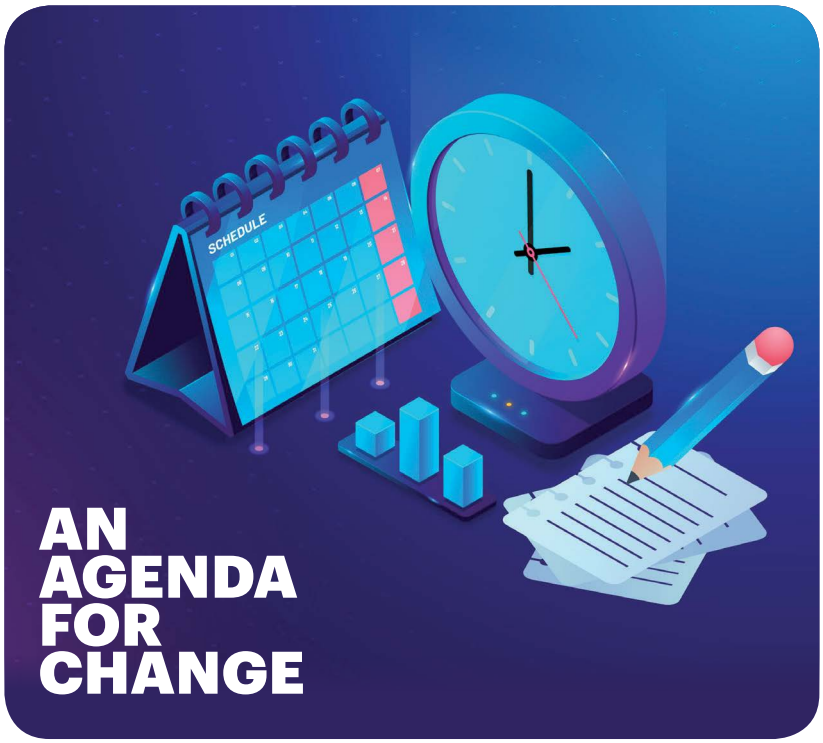
7
PER CENT
Liquidation value as a percentage of claims

DATA AS OF MARCH 31, 2023
SOURCE INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (IBBI)

The Pre-pack Model

Two years ago, when Covid-19 impacted MSMEs the most, the government introduced a simpler, pre-pack insolvency model. Unlike the court-driven IBC process, here the lenders are allowed to restructure the stressed loans. But the model didn't find many takers, with only

- **Extend the pre-packaged insolvency facility from MSMEs to bigger companies as well**
- **Evaluate the viability of a fast-track insolvency process outside the judicial process**
- **Reserve a fixed share of resolution proceeds for operational creditors to minimise litigation and facilitate early resolution**
- **Allow resolution through group-level insolvency proceedings, which includes invoking IBC for subsidiary companies as well**
- **Strengthen the insolvency process for realty firms by allowing project-wise insolvency instead of for the whole company**
- **Allow the sale of assets of defaulting corporates in parts if there is no resolution plan for the company**



GRAPHICS BY **RAHUL SHARMA**

- **Create a code of conduct for members of the Committee of Creditors**
- **Enforce appropriate deterrents like imposing penalties against stakeholders who initiate frivolous litigation to delay the process**
- **Mandate operational creditors to file dues data with the information utility**
- **Take away the right of a corporate debtor that is under default to propose the interim resolution professional**

four companies opting for it. "The design of the pre-packs is quite complicated, involving various procedural steps as well as the involvement of the NCLT [National Company Law Tribunal]," says Misha, Partner at Shardul Amarchand Mangaldas & Co (SAM). First, it requires the consent of 66 per cent of lenders. Second, if there is a haircut, then it has to be recorded. This makes bankers jittery. "There is also unease, particularly with public sector banks, because in the past (pre-IBC era), commercial decisions have been scrutinised," says Mani Gupta, Partner at Sarthak Advocates & Solicitors. Pre-pack regulations put the debtor in control, as opposed to IBC, where the creditors are in control. Despite that, promoters fear that a pre-pack may turn into a full-fledged insolvency process. For instance, if the lenders detect a fraud, the company defaults, or the enterprise value is lower than the liquidation value, the financial creditors can call for a bid.

The promoters also fear the Swiss challenge clause, which gets triggered if any resolution plan offers a haircut to operational creditors (suppliers owed money by the bankrupt party). "The pre-pack model is convoluted, as it requires the operational creditors to receive the full value to proceed without

going through a bidding process," says Aashit Shah, Partner at law firm JSA.

Under the Swiss challenge mechanism, there is an open bidding process. "Fear of losing control may delay early recognition of stress and the initiation of pre-pack by promoters," says Bhrugesh Amin, Partner at BDO Restructuring Advisory LLP.

Experts suggest the solution lies in strengthening the decision-making abilities of bankers. SAM's Misha says it would help if there is the "concept of rating agencies or an independent committee of external experts to endorse the commercial viability of pre-pack resolution plans".

Gupta of Sarthak suggests that the government—perhaps the banking regulator Reserve Bank of India—could reassure bankers that if a restructuring is within the commercial framework and commercially justifiable, nobody will question their commercial wisdom. That's a tall order.

Tackling Delays

Next comes delays. According to the IBC, the NCLT should be satisfied with the existence of a default within 14 days of receiving an insolvency application. But this has often been extended to months. "There are times when creditors file objections, and courts also entertain such petitions," says a lawyer. A lot of time is often spent to decide on whether a default has taken place. EY India's Diwanji suggests taking the help of the RBI's Central Repository of Information on Large Credits (CRILC). "The CRILC is the best information utility we have. We should tap into its infrastructure," he says. Currently, the CRILC collects the credit exposure of all corporates in India.

Second, there are situations where a single judicial member or a technical member of the NCLT could be sitting on up to three benches on a particular day, which compounds the problem. "There is a need for three to four times the number of the existing benches (there are 16 currently) as these adjudicating authorities are also dealing with matters relating to M&As, winding up, competition commissions, etc.," says Gupta of Sarthak. Plus, there are delays in appointing NCLT judges.

Further, the Supreme Court's judgement in the Vidarbha Industries Power versus Axis Bank case—where the lender had initiated insolvency proceedings against the defaulting power firm—has also hit the process. The apex court, in 2022, ruled that the NCLT and the National Company Law Appellate Tribunal (NCLAT) had erred by assuming that an application to initiate the resolution

KANIKA KITCHLU-CONNOLLY
PARTNER, TLT'S INDIA GROUP

"Insolvency cases need timely attention because things are urgent... We are able to appoint administrators outside the courts in the UK, which means fewer delays, but we also approach them on an urgent basis"

CONDUCTING THE CODE

- **Focus should be on operational efficiency, enterprise value and investor value creation**
- **CoC should respond promptly to the IBC-appointed Resolution Professional's requirements/requests**
- **Sector experts from the creditor groups should be nominated to the CoC for better decision-making**
- **Members attending CoC meetings must have sufficient prior authorisation to take decisions and vote**

DAIZY CHAWLA
MANAGING PARTNER, S&A LAW OFFICES

"The top priority should be to fill the gaps due to different interpretations of the same issue (provisions). We should fix the legislation first... It won't serve the real purpose even if we have more judges"

ABIZER DIWANJI
FINANCIAL SERVICES LEADER, EY INDIA

"The RBI's Central Repository of Information on Large Credits (CRILC) is the best information utility we have in the financial services industry. We should tap into the infrastructure of CRILC for default data"

OUT

DAIZY CHAWLA PHOTO BY **VISHAL GHAVRI; ABIZER DIWANJI** PHOTO BY **BANDEEP SINGH**

process under Section 7 of the IBC must be made if the corporate debtor is in default. The apex court said that the use of the word "may" instead of "shall" in Section 7(5)(a) suggests it is not a mandatory provision. In light of this, the adjudicating bodies will now have to consider the grounds presented by the corporate debtor against admission to the NCLT. "Now, it's not only about proving a default but also the circumstances that led to the default," says Saloni Kothari, Associate Partner at BDO.

However, earlier this year, the apex court, in the case of M. Suresh Kumar Reddy versus Canara Bank, ruled that the NCLT had limited discretion to reject an application once a default has been established. The Supreme Court also often sets new precedents. For instance, in the State Tax Officer versus Rainbow Papers case, its order states that the IBC should not be the first resort and that the lender should try everything else to resolve the issue first. This has resulted in NCLT judges asking the parties to first try to resolve the matter, and if they can't within three to six months, to come back to the tribunal. "There needs to be an automatic process in place. Once

A set of guidelines for the highest decision-making body, the Committee of Creditors (CoC), would help the process

- **The CoC should be supportive of the proposal for interim finance and take a prompt decision for its approval, when justified**
- **Members of the CoC must diligently examine and analyse the valuation reports and seek an audience with the valuation experts to provide input and clarify any doubts**
- **The CoC Must monitor the actions of the resolution professional and the justification of decisions/ measures taken by them**

a lender or creditor demonstrates a default, there should be an admission without ambiguity," says Soumitra Majumdar, Partner at JSA Solicitors.

IBC's original intent was to give NCLT the authority to approve the resolution chosen by the lenders or creditors. "NCLT had no discretion. It has taken that jurisdiction and started propounding where, strictly speaking, it should not," says a lawyer on condition of anonymity. There are also instances of judges reserving the final order for months. "We are destroying the value [of a company with delays]," says another lawyer. What, then, is the solution? Some suggest that admission to the process could be faster if a few NCLT benches dealt exclusively with IBC cases. It has also been proposed that the NCLT be empowered to impose penalties for frivolous challenges.

Is there an existing template to avoid delays? One could look at the UK, which has an urgent list. "Insolvency cases need timely attention... We are able to appoint administrators outside of courts, which means fewer delays, but we are also able to approach the insolvency courts on an urgent basis and within a very short timeframe," says Kanika Kitchlu-Connolly, Partner at TLT's India Group, a law firm based in the UK. That, then, is the way to go.

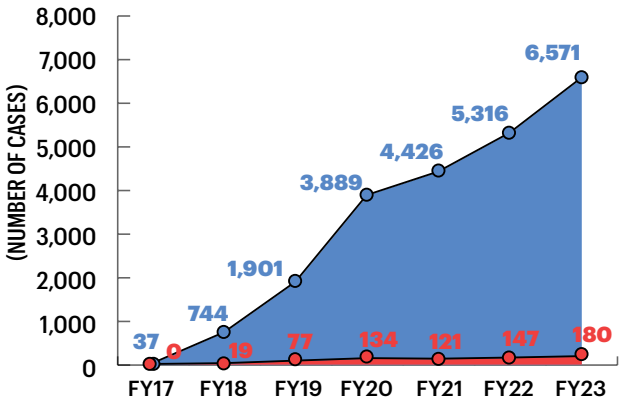
The Operational Creditors

There is a view that under IBC, operational creditors get a raw deal. "Operational creditors, who have been supporting the defaulting company in the run-up to insolvency, should at least get something," says Gupta of Sarthak. The IBC does provide for a seat for operational creditors in the Committee of Creditors (CoC) if their total dues are more than 10 per cent of the outstanding debt. But they don't have voting rights. If financial creditors take a haircut, it means operational creditors get nothing. "The government is considering the implementation of a fixed percentage to minimise litigation and facilitate the resolution plan's execution," says Shah of JSA.

Second, the absence of a specific deadline for submission of claims leads to some operational creditors, especially government entities (tax authorities and utility companies), not filing claims on time. In July 2018, an amendment to the IBC introduced a deadline of 90 days from the insolvency commencement date for the submission of claims with proof. However, some benches have taken the view that this is not mandatory, leading to a long process. Then there is the question of secured creditors (lenders with a collateral). In the Rainbow Papers case, the apex court also ruled that governmental authority be considered a secured creditor.

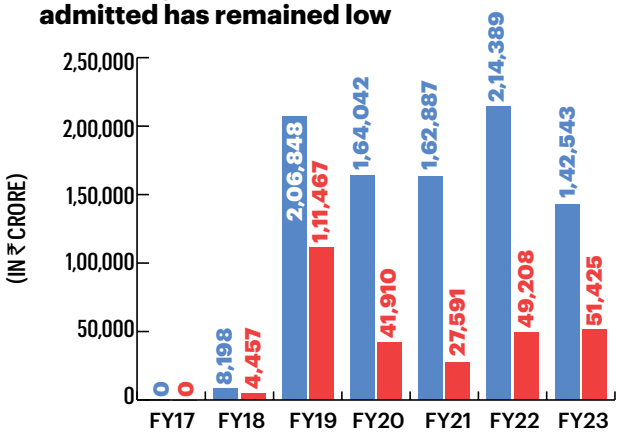
UNDER PRESSURE

Even as the number of cases admitted under IBC is rising at a rapid pace, the number of resolutions provided has not kept pace...



● **ADMITTED CASES** ● **RESOLUTIONS; SOURCE** IBBI

...And the share of realisation as a percentage of the total amount of claims admitted has remained low



● **TOTAL CLAIMS ADMITTED** ● **TOTAL REALISATION**

NOTE TOTAL REALISATION INCLUDES LIQUIDATION CASES; NO CLAIMS OR REALISATIONS WERE RECORDED IN FY17 AS THE IBC HAD JUST COME INTO FORCE; **SOURCE** IBBI

This decision can significantly dent the IBC framework. "The secured creditor's security will be diluted to the extent that unsecured creditors (those lending without any security) are treated as secured," says C.D. Mehta, Managing Partner at law firm Dhruve Liladhar & Co. The bureaucracy is also a major hurdle as claims are not filed on time, say experts. "Increasing awareness and advocacy programmes by the Ministry of Corporate Affairs (MCA) and Insolvency and Bankruptcy Board of India (IBBI) can be the only way to address this," says Misha of SAM. The government is trying to link the re-

AASHIESH AGARWAAL
SVP, ANAROCK CAPITAL

"Resolution of insolvency in real estate remains tough on account of the multiplicity of stakeholders. This includes local authorities, which are the key approving authorities but cannot be directed by the courts to share relevant project information in a time-bound manner, which is critical"

R.K. BANSAL
MD & CEO, EDELWEISS ARC

"There is still some ambiguity regarding the priority of secured lenders. The waterfall mechanism isn't clearly spelt out. These need to be sorted out; otherwise, secured and unsecured lenders would become equal, which would impact lending"

alisation of operational creditors to liquidation value. "The financial creditors will get up to liquidation value, and anything over and above will be shared equally between secured, unsecured, and operational creditors," says R.K. Bansal, MD & CEO of Edelweiss ARC.

Misha says one needs to conduct a thorough economic study to determine how many operational creditors have gone bankrupt in companies under the IBC. "Making changes to the law based solely on apprehensions would not be prudent," she says. Good point.

Real Estate Recoveries

The IBC framework covers not just corporate insolvency. In November 2019, non-banking finance companies (NBFCs) were brought under the IBC. The RBI was given the power to file insolvency applications. So far, there has been only one resolution—when the Piramals bought DHFL. In 2018, a separate IBC process was introduced for the real estate sector. Under this, homebuyers are treated as financial creditors, provided at least a 100 buyers, or 10 per cent of the allottees, come together. Today, real estate accounts for the second highest number of admitted cases at 29 per cent of the total admitted cases, after the manufacturing sector, which is at 39 per cent.

In real estate, a default on one project triggers an IBC process against the whole business, affecting all other ongoing projects. But experts say there is likely to be an amendment introducing project-wise resolutions. The concept of project-wise insolvency for corporate debtors has emerged as a result of judicial interpretation by the NCLAT. In February 2020, the Delhi-based Umang Realtech was the first real estate company for which the NCLAT allowed project-wise insolvency. In May, the Supreme Court upheld the project-level resolution for Supertech. The current IBC provisions do not provide for such a procedure.

In addition, real estate insolvency is a tough proposition on account of the multiplicity of stakeholders. This includes local authorities, which are the key approving authorities but cannot be directed by the courts with respect to sharing relevant project information in a time-bound manner. "We have to ensure that the local authorities provide all project-level information (including approvals and plans) to the resolution professional (RP) well before the bids are received. This will help the RP assess the time and cost required to complete the project," says Aashiesh Agarwaal, Senior VP at ANAROCK Capital Advisors.

Some suggest an NBFC-type insolvency mechanism for real estate. The Real Estate Regulatory Authority (RERA) should take the lead in appointing an administrator to take a company to the IBC. But that's not without problems. "RBI has a long history of six to seven decades, whereas RERA is state-specific. It's not a centralised organisation like RBI, so giving RERA a lead might not be easy," says Chawla of S&A Law Offices.

MANI GUPTA
PARTNER, SARTHAK ADVOCATES & SOLICITORS

"The comfort has to be given by the government—perhaps the RBI—that if you do restructure, which is within the commercial framework, and commercially justifiable, nobody is going to question the commercial wisdom of officers who have signed on to it. If that is done, then perhaps there is some kind of hope for pre-packs"

MISHA
PARTNER, SHARDUL AMARCHAND MANGALDAS & CO

"While we advocate for the rights of operational creditors, it is important to conduct a study to determine how many trade creditors have actually gone bankrupt due to the successful insolvency resolution of corporations. Making changes to the law based on apprehensions would not be prudent"

Strong Decision-makers

Under IBC, the CoC is the highest decision-making body. A recent apex court judgement says the NCLT cannot apply the commercial mind of the CoC. "It [the CoC] should set the highest levels of standards in conduct and performance," says EY India's Diwanji. But financial creditors heading the CoC often take a long time to take a call on a resolution plan. For instance, Reliance Capital's bidding war. In December 2022, Torrent Group emerged as the highest bidder by offering ₹8,640 crore. But the CoC later decided to conduct another bidding round, in which a Hinduja Group entity emerged as the highest bidder. The matter is before the apex court as Torrent has challenged the second bidding process. "The bank's [financial creditor] approach is not rule-based, but on a case-by-case basis," says an RP.

Plus, there are challenges associated with bidding from promoters as well as competing bidders. "Valuations of such assets need to be adequately insulated from their erstwhile promoters and owners, who at times use proxies to either derail the bidding process or jack up the valuations," says Mehta of Dhruve Liladhar.

The Insolvency Law Academy, an independent institution dedicated to insolvency, has proposed a comprehensive code of conduct for the CoC that includes the role and duties of financial creditors. (*See box Conducting the Code*) At times, a minority creditor among secured lenders gets a raw deal. "There is still some ambiguity regarding the priority of secured lenders. The waterfall mechanism isn't clearly spelt out. This lack of clarity extends even to the liquidation stage. These need to be sorted out; otherwise, secured and unsecured lenders would become equal, which would impact lending by banks, etc.," says Bansal of Edelweiss ARC. The waterfall mechanism defines the priority of payment in case of liquidation, where secured lenders are paid first, then wages are paid, followed by unsecured lenders, and finally, government dues are paid.

Time, Time, Time

The IBC, as it stands, is gradually maturing. Let us look at how things panned out in the UK. "We are now over 35 years since our Insolvency Act came out, and we still have cases going through the courts about the interpretation of certain key provisions here in the UK," says Kitchlu-Connolly of TLT's India Group. "The Supreme Court has passed several orders and set new precedents. Now the legislature has to decide what amendment or modification they want to do," says Mehta of Dhruve Liladhar. "We must now focus on enhancing governance and transparency within banks and reducing delays in court proceedings," says Gupta of SNG. Some experts, like Misha, also point to the tribunalisation of the judiciary. The appeals first move to the NCLAT and then go to the Supreme Court. But where do Supreme Court judges come from? They come from the high courts, where they have not dealt with IBC cases, say experts.

The IBC is one of the biggest reforms in the financial sector. "It was aimed at promoting bond markets and attracting foreign investments, including foreign funds lending to Indian companies," says Misha. But its current form is likely to scare away potential investors and lenders. Just like in Bollywood, where it's all about entertainment, entertainment, and entertainment, a seasoned lawyer draws an analogy to say that under the IBC, it's all about time, time, and time. And it's time to act now. **BT**

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PATH TO
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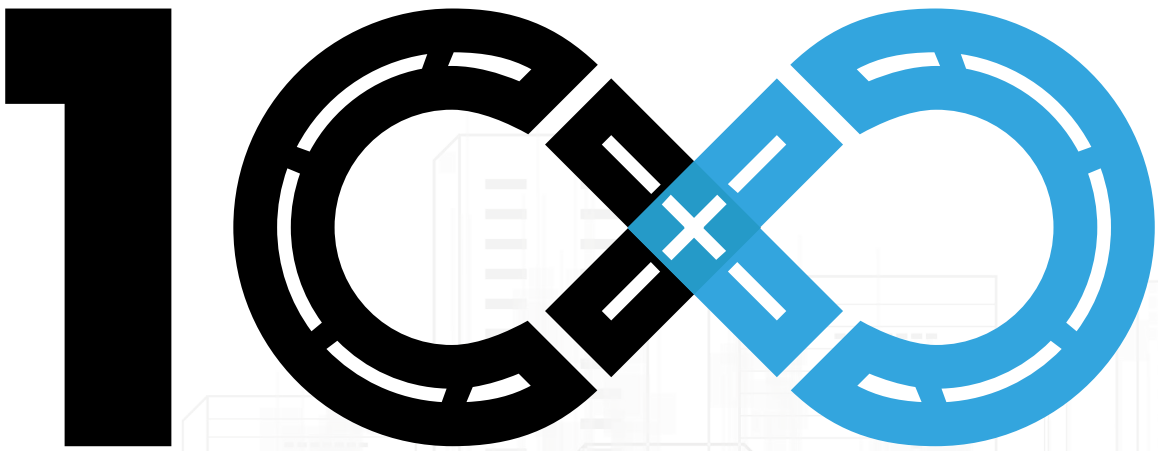

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