Our bankruptcy code deserves credit for what it has achieved

An examination of the IBC's record on resolving cases of business insolvency reveals greater success than critics acknowledge.

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...withstanding the different legal frameworks for bankruptcy and insolvency in place in various countries, all of them have two leading objectives: to facilitate liquidation of financially viable companies, and to protect the rights of and provide equal treatment to similarly situated creditors and other stakeholders. The Indian insolvency framework in the form of the Insolvency and Bankruptcy Code (IBC), 2016, is unique as it has a business-rescue mechanism, thereby providing resolution options for financially viable companies as yet another objective. Indeed, resolution is the first-order objective of the Code, as held by the National Company Law Appellate Tribunal in the matter of Binsani Industries Ltd. vs. Bank of Baroda & Ors.

However, a high liquidation rate and large haircuts have fueled a lot of negative talk about the IBC’s success, with many viewing these outcomes as a mark of the code’s failure. Both these arguments need to be examined in the correct perspective.

It is important to appreciate some nuances. A good insolvency system cannot be judged by the number of companies being liquidated for the reason that the purpose of an insolvency law is to swiftly liquidate firms that have had value erosion and stand a low chance of survival. For instance, Germany is known for its efficient insolvency system despite a very high liquidation ratio. Even in the UK and the US, where the insolvency regime is well developed, the number of companies being liquidated is higher than in India.

In the UK, one in 396 active companies (at a rate of 25.3 per 10,000 active companies) went into liquidation between 1 April 2020 and 31 March 2021. This is a decrease from the 40.5 per 10,000 active companies that went into liquidation in the 12 months ended 31 March 2020. According to data from the ministry of corporate affairs, there are nearly 3.5 million active companies in India with 6,893 under liquidation as on 31 March 2021. After the coming into force of the IBC, liquidations can take place under the Companies Act, 2013, or theIBC. Under both the IBC and the Companies Act, 2013, the companies that were already defunct got liquidated. Excluding legacy cases from the Board for Industrial and Financial Reconstruction (BIFR), only 26% of the IBC-referred firms have gone into liquidation.

Further breakdown of data offers useful insights. Of the 1,270 liquidations ordered under the IBC for which information is available with the Insolvency and Bankruptcy Board of India, 944 were already defunct or BIFR cases (i.e., 74%) till 31 March 2021. The reasons for liquidation may vary. Of the non-defunct 326 companies, 170 did not receive any resolution plan. This could be for reasons such as unsuitable business models, no market for their products or just lack of a well-developed market for such assets to be bought and turned around. There was also another set of companies that received up to six resolution plans but none was found suitable in the commercial wisdom of the committee of creditors (CoC), or they had to be rejected on technical grounds. In fact, there are companies such as Kamani Ispat Pvt Ltd and Infinity Fab Engineering, which were defunct but their resolution plans received value greater than the admitted claims. It was confidence in the IBC process that led defunct companies such as LML Ltd and Lanco Infratech Ltd to receive more than four resolution applications. Each case was unique and had a different reason leading up to an order of liquidation being passed by a resolution professional.

The Supreme Court has in various matters noted that courts should not interfere with the CoC’s commercial wisdom in approving or rejecting a resolution plan or deciding to liquidate such a company. K. Sashikumar vs. Indian Overseas Bank and Others and Maharashtra Seamless Limited vs Padmanabhan Venkatachalam.

Examining details of the 353 companies yielding resolution under the IBC since 1 March 2021, it is observed that 123 of them were defunct or in the process of being wound up. In 130 voluntary liquidations, the total realizable amount by financial creditors was 34% of their admitted claims even in these companies. Their financial creditors actually realized 160% of the liquidation value.

It is important to appreciate these nuances, which seem to get lost in the overall outcomes. Any new economic law takes time to settle and for all stakeholders to accept it and outcomes to be reflected properly. Things do not change overnight. It has been only five years since the IBC came into force, and the law was suspended for a year as well. It has been afflicted by many challenges, one of them being the lack of a developed market for distressed assets that can help discover competitive prices for companies. Even now, especially in the wake of the covid pandemic, there is a dearth of resolution applicants ready to take on the challenge of turning around a distressed company, and some more liquidations could well be in the offing. However, these should not be construed as negative for the IBC. The IBC is a market mechanism and market-driven outcomes should be acceptable to all.

What needs to be appreciated is that in a short span of time, the IBC has created a discipline in the market, formalized an insolvency framework, offered a one-stop solution for companies to undergo insolvency resolution, and created a new cadre of insolvency and valuation professionals. One must marvel at these achievements, which will only strengthen in the long run.

These are the authors’ personal views.