THE LEGAL TALK SHOW

FEB 2023

ISSUE BRIEF

IBC - CHANGING GEARS IN 2023

Jointly Organised by

HAMMURABI & SOLOMON PARTNERS

INDIA STRATEGY GROUP

SUMMARY

On 21st Feb 2023, Hammurabi & Solomon Partners & the India Strategy Group jointly convened a virtual discussion on IBC, and how it's changing gears in 2023. This report tries to capture the discussions with the distinguished speakers and highlight the dos and don'ts in this regard.

The Legal Talk Show ("LTS") was convened with the aim to discuss, deliberate, and analyze implications of recent legal developments – legislative, regulatory/policy as well as judicial pronouncements.

DISTINGUISHED SPEAKERS

Hon'ble Mr. Justice S.J. Mukhopadhaya,
Former Chairperson, NCLAT & Former Judge, Hon'ble Supreme Court of India

Dr. M.S. Sahoo,
Professor, NLU Delhi & Former Chairperson, Insolvency and Bankruptcy Board of India

Ms. Shweta Bharti,
Senior Partner, Hammurabi & Solomon Partners (HOST)

KEY POINTS

Despite the proactive steps by the government of India, the data released by IBBI in December 2022 released that 6199 CIRPs have commenced, 4199 have been closed, of the CIRP that were closed in 2298 cases, of which 894 cases were closed on appeal or been settled, 793 cases have been withdrawn, 611 cases have ended in approval of resolution plan, 1901 cases have been ended in liquidation.

Even after 8 years of IBC, there is more liquidation than successful resolution and revival, so what are the underlying reasons or determinable factors? How has IBC helped in ease of Doing business? Why are there more liquidations as compared to successful resolution and revival? Underline reasons?

Insolvency and Bankruptcy Code is a law for reorganization or insolvency resolution of companies, limited liability partnership etc. The sole objective of IBC is to reorganize and promote entrepreneurship, availability of credit, and maximization of the value of the asset of the corporate debtor.

The code provides for re-organization in 2 ways- Rescue by Resolution plan, failing which the company goes into liquidation, thereby enabling the market to make its choice and the market usually chooses to revive a company if the business is viable or close it if the business is found to be unviable.

The law doesn't consider that liquidation is bad. It is also one of the ways of resolution of stress. Unfortunately, many people perceive that resolution of a company through a resolution plan is the only option, but that's not the case. The Resolution can be achieved by:

- Resolution by the resolution plan
- Resolution by liquidation

While both methods are effective for resolving stressed assets, it is immaterial how the company resolves the stress and utilizes the assets and resources for alternate uses.
Second, the data mentioned above is deceptive and doesn't give the right picture; possibly 2000 companies may would have moved to liquidation, however, the company that has not moved to liquidation are 10x or 100x times the company that has moved into resolution.

Further, as per the data in the IBBI newsletter, 25k applications were filed but withdrawn before admission involving an amount of Rs. 7 lakh crore. So, these were the applications that were filed but not admitted. Also, there are many cases which were withdrawn after admission. However, we don't have the data on how many were resolved after getting the notice under Section 8 of IBC or even before the notice of the Operational Creditor, so those data are not available on record.

While the number of Companies which have achieved Resolution may not be as high, however the amount of Assets that these Companies owned were significant and thus if the total assets of all these Companies who have achieved resolution through a Resolution Plan vis a vis Liquidation, the Companies which have been resolved through Resolution Plan have own 3/4th of the total assets as compared to the Companies which have been Liquidated and owned about 1/4th of the total assets.

Most Companies that are getting liquidated are the sick and defunct Companies. Thus the Companies which have been liquidated were left with no assets and the Financial Creditors received almost nil of their debt amount.

Development in India's ranking in ease of doing business

If we look at the past 3 years of operation of IBC, as per the World Bank data (before covid), India's ranking improved from 136th to 52nd position. The overall recovery rate for creditors jumped from 26% to 72%. Further, the time taken for resolving insolvency has significantly come down from 4.3 years to 1.66 years, the cost of transactions has come down from 9.65% to 1.5%, and India is by far the best performer in South Asia on the resolving insolvent component and is doing much better than the high-income countries in terms of the recovery rate, CIRP and the Cost of recovery etc. India has won the Global Restructuring Review Award for the most improved jurisdiction in 2018.

The enactment of IBC has provided the freedom to exit, reducing the company from financial stress and helping creditors, and, most importantly, bringing about behavioural changes in creditors and debtors. The list of achievements is a long one.

Revival of companies at what cost?

Large conglomerates with valuable assets are accepting bids that are far less than the liquidation value. Shockingly, in a growing number of cases, creditors are happy to accept haircuts of 80-90% leaving nothing for other stakeholders. In these circumstances, are massive haircuts impacting the purpose and objective for which IBC was introduced?

It is necessary to understand that there are no Companies, which have value, but no takers. It is axiomatic that if a company is coming to IBC, they don't have enough assets to repay all its creditors. As per the data, Companies that are coming to IBC and ones that have been rescued had about 17% of the amount due to creditors meaning thereby, the liquidation value of the assets available with them was only 17% of the claims due, meaning the creditors were starting at a haircut of 83% (⅓ of them being defunct). IBC rescued these Companies and reduced the haircuts to 65% and the Creditors are getting more than 35% and thus the reduction of haircuts from 83% to 65% in itself is a huge progress.In its usual context Liquidation is not considered as Resolution, which is not a correct understanding. Further so far as the Haircuts are concerned, it is necessary to understand what construes haircuts.

Haircut, means total amount realised divided by total claim. While calculating the amount of realization, it does not include the amount realized from equity holding post-resolution, it does not include the amount realised through the reversal of avoidance transactions and also does not include the amount realised through the revocation of personal guarantees. All of these factors also add upto the value of the Company which are not taken into consideration while calculating haircuts. IBC can maximize the value of only those assets which existed at the commencement of the resolution process and not the assets which did not even exist when the process started. Thus, IBC has been able to undertake some successful hair transplantations instead of haircuts, which no one talks about in the general parlance.

The other relevant factors to be considered are that, post its revival, the company is also generating employment, it is eligible to take a loan, the operational creditors are ready to supply goods on credit, and the government also generates money by the GST, Income tax etc. Therefore, post-survival benefits should be notionally calculated, and revenue generated by the companies after the revival process should be calculated.

Commercial wisdom of COC

In the case of Shiva Industries and Holdings, wherein the matter went from NCLT to the Supreme Court, where the NCLT and NCLAT rejected OTS and withdrawal under Section 12A and observed that it was not in conformity with the principles of IBC and merely because 9 lenders accepted the settlement and agreed to take 328 crores instead of an admitted claim of 4063 crores, the OTS cannot be accepted.

This decision of NCLT and NCLAT was overruled by Hon'ble Supreme Court which re-emphasized on the principle that the commercial wisdom of the COC is the cornerstone of the IBC, and the need for judicial intervention from NCLT and NCLAT should be kept at its bare minimum and should not disturb the foundational principles of the IBC.

In such circumstances it is imperative to examine if we are giving too much power to COC and if it would be correct to say that one of the major contributors to escalating haircuts is the one-time settlement through withdrawal of insolvency done by Section 12A of IBC?

In response to the above, it necessary to understand that NCLT or NCLAT must not intervene into the commercial wisdom of COC. It is a commercial call of the Lenders to decide what protects their interest the best and if the Lenders are agreeable to revive the Company after accepting haircuts, the Courts and Tribunals must not intervene in such commercial decision.

Prior to the Innoventive judgement of the Hon'ble Supreme Court, there were uncertainty surrounding the factors that the NCLT should consider when assessing an application under Section 7 of the IBC. The common defences used by Corporate Debtors included the claim that the default was unintended, brought on by events outside their control, or they were otherwise financially solvent. The Supreme Court's dual objective tests of 'debt' and 'default', which were established in the Innoventive judgement, helped resolve and streamline the Section 7 application adjudication process, bringing an end to this ambiguity.

"The moment the adjudicating authority is satisfied that a default has occurred, the application must be admitted unless it is incomplete...".

This statement made by the Hon'ble Supreme Court in Innoventive has been the benchmark for NCLTs and NCLATs to decide cases pertaining to Section 7 of the IBC. However, that changes on 12.07.2022 when the Supreme Court gave the judgement for Vidarbha Industries Power Limited v. Axis Bank Limited. The court decided that despite the court being convinced of the existence of a debt and the Corporate Debtor being in default, Section 7(5)(a) of IBC gave the NCLT discretion to refuse to admit an application for CIRP submitted by a Financial Creditor. Contrastingly, it is also noted that, if an application for CIRP submitted by an Operational Creditor satisfies the same conditions of 'debt' and 'default', the NCLT has to mandatorily admit the application. The court pointed out that typically, the word 'may' is directory and the phrase 'may admit' gives admission a discretion. However, the term 'shall' implies a rule that must be followed. The court assumed the legislation's intentions by stating that the use of the word 'may' in Section 7(5)(a) in contrast to the use of the word 'shall' which is provided in Section 9(5)(i) by the legislature meant to imply the discretionary powers that were intended to be given to the court in matters of Section 7(5)(a). The court suggested that this difference in the use of words for two provisions that are almost similar in nature was a conscious effort made by the legislators to imply that the Operational Creditor will be impacted more severely than the Financial Creditor in case of a non- payment of admitted dues.

Now this ruling of the Supreme Court raises the question, should law have room for subjectivity? The Court's statement in this judgement reversed the clock by taking us back to the chaotic era where the factors of 'default' and 'debt' were not established by the Innoventive judgement. It could be argued that the ruling in Vidarbha has failed to move alongside not only the landmark judgement in Innoventive, but also the Insolvency Laws in other prestigious Countries and led the Indian Insolvency Law to considerable amount of subjectivity, which is harmful for the country's Insolvency Law in the long run because it makes it incomprehensible and unfair to a certain extent. The insolvency regime in India has already been facing an issue of delays in admission of CIRP applications which is further ignited by the passing of this judgement.

In such circumstances, it is necessary to examine if there is a need for an amendment to clarify the position with respect to the power of the Adjudicatory Authority in terms of Section 7 to examine the solvency and financial health of the corporate debtor contrary to the decision of the Hon'ble Supreme Court, in Vidarbha Industries Power Limited v. Axis Bank Limited, (Civil Appeal No. 4633 of 2021), which has interpreted the use of 'may' in section 7(5) to indicate that the AA has the discretion to admit or reject despite existence of a default. In such circumstances, it is worth considering whether the proposed Amendment, a way to dilute the impact of the Vidarbha judgment / nullify the effect of Vidarbha.

Section 7 (5) is mandatory as explained in the Innoventive judgement where it categorically states that if there is a default, and there is a payable debt, the Application has to be admitted.

In the Vidarbha judgement, it has been held that ordinarily, the Adjudicating Authority would have to exercise its discretion to admit an Application under Section 7 of the IBC and initiate CIRP on the satisfaction of the existence of a financial debt and default on the part of the Corporate Debtor in payment of the debt unless there are good reasons to NOT to admit the petition. The Adjudicating Authority has to mandatorily admit the Petition in case of the existence of debt or default, unless the Corporate Debtor is able to provide sufficient cause (dispute) for not making the payment.

Cross Border Insolvency

The Code offers two provisions that assist in cross-border insolvency disputes i.e. Section 234 and Section 235. In fact till date we have only one precedence in this regard when in 2019, Jet Airways became the first Indian company to be involved in a cross-border insolvency concerns and a direction to conduct a "Joint Corporate Insolvency Resolution Process", was passed by the NCLT which set a leading precedent for the coming cross-border insolvency disputes.

If we look at the UNCITRAL Model Law for cross border Insolvency of 1997, it provides for wide ranging solutions in order to resolve the cross border insolvency issues. The model law itself provides for the 4 cornerstones in this regard being Access, Recognition, Coordination and Cooperation.

Still, the development of a cross-border insolvency regime is mostly still up in the air and not many positive steps have been taken in that regard.

MCA had proposed for an analytical study on the need for a Cross Border Insolvency Framework for India for years now. There are various concerns in relation to the delay in implementation of the cross border insolvency provisions and there exists many challenges in this regard. One of the key objective of the cross-border insolvency frame work is to extend the reach of the IP in India to the overseas assets of Indian entities. In such circumstances it is necessary to make the Cross-border Insolvency more effective in India. Additionally, various measures are required to be taken in case the assets of the Corporate Debtor are lying overseas.

The Government is definitely keen on taking necessary steps in this regard. It is difficult for Parliament to have the law if such research isn't there as there's not much story on how this cross border will affect the country, not written or available. Some paper or study focusing on economic analysis is required to mention the amount of gain, loss or the net situation. There needs to be a clear map and economic analysis of what we gain or lose once we get this law.

As per Section 234, the Government needs to negotiate with the other countries and make an agreement, provide for terms and conditions for both governments. Thus, it is not in the hands only of one Government (say Indian Government) to take such decisions, unless the Government of the corresponding Countries also join hands together to make cross border insolvency regime between the two countries effective.

Further, there needs to be high demand for cross-border insolvency law, with sufficient data and details supported by the figures in this regard. Merely desiring Cross Border Insolvency without there being a demand for it shall not serve the purpose either for the Industry or for the Government in this regard. Jet airways case paved the way and navigated us through the process, but there needs to be sensitization.

In the case of M/s. Sheltrex Developers Pvt. Ltd. Vs. M/s. Tata Capital Housing Finance Ltd. (2022), an application was filed under Section 60(5) of IBC, 2016 by the Resolution Professional for M/s Sheltrex Developers Pvt. Ltd (Corporate Debtor) seeking the following reliefs:
a) Permit the Applicant herein to constitute Project-based Committee of Creditors, for the purpose of conducting reverse corporate insolvency resolution process, as mandated by the Hon'ble NCLAT in Flat Buyers Association Winter Hills – 77 Gurgaon Vs. Umang Realtech Pvt. Ltd through IRP & Ors. [2020];
b) Permit the Applicant hereinto issue separate Expression of Interest for each project under control of the Corporate Debtor and to consequently invite and place before the respective Committee of Creditors, Resolution Plans for each project under control of the Corporate Debtor.

The NCLT Chennai Bench, in the said matter, held that on a thorough reading of the IBC, 2016 read along with the regulations made there under, envisages the insolvency of the Corporate Debtor and it can be seen that there is no concept of limited CIRP or CIRP for specific projects anywhere. The NCLT Chennai Bench has been of the view that the mechanism adopted by the Hon'ble NCLAT is too peculiar to the facts and circumstances of the Winter Hills judgment and cannot be used as a precedent in the present scenario.

Further despite the seminal development in the IBC vide the judgement of Flat Buyers Association v. Umang Realtech Pvt. Ltd & Ors. the NCLT's yet do not favour the concept of 'Reverse Insolvency'. It is necessary to understand the gap or the loop hole which is yet to be covered and whether there is a need for an amendment to provide clarity with respect to the concept of 'Reverse Insolvency'. It is also necessary to understand if there is a need for a body to be constituted by the IBBI/NCLT to assist the Homebuyers to raise a plan for reviving their respective project.

Also the proposed amendment contemplates that when an application is filed to initiate the CIRP in respect of a CD who is the promoter of a real estate project, and the default pertains to one or more of its real estate projects; the Adjudicating Authority, at its discretion, shall admit the case but apply the CIRP provisions only with respect to such real estate projects, which have defaulted. In such circumstances the practical challenges that are likely to emerge are:

- Would the Real Estate Companies provide for Project wise Books of Accounts?
- In case of several Projects of the Corporate Debtor going on simultaneously, how would the Operational Creditors ascertain as to which Project are they supplying the goods and services for?
- What would the Resolution Applicants bid for in such Project based CIRP's? More so in case there are little or no inventory left by the Promoters in the specific Project under CIRP?
- How would the proportionate shares of the Corporate Debtor limited to the Project be transferred to the Successful Resolution Applicant?

With respect to the above, the judgement of the Supreme Court, Pioneer Judgement, is relevant to be referred. In this judgement it was held that IBC shall have to move along with RERA. RERA refers to the definition of the term Allottee with respect to a real estate project. Since RERA is different for different States, the RERA has to be read alongwith IBC. One RP cannot look into all the Projects of the Developer, having different Projects since RP also has the obligation to meet the requirements of RERA. In the Flat Buyers Association judgement, the rationale in this regard has been provided, on why is it termed reverse insolvency. The Supreme court has made a comparison in this regard in the Swiss Ribbons judgement, wherein the distinction has been made with respect to the nature of the Operational Creditors, Financial Creditors and the Allottees, and on the role and responsibility of the Allottees. Further discussion has been made with respect to the varied interests of the Allottees in different Projects. The RP has no power to seek the prayers as were sought in the Sheltrex Case. The RP had no power to assume the role of RP for all the Projects of the Real Estate company, moreso of such Projects where there are no defaults. Pioneer judgement emphasises that RERA has to be followed in case of Real Estate Companies and thus since RERA is different in different states, there cannot be a clubbing of all the Projects for a Real estate Company and one RP cannot act as a RP for all the Projects of the Real Estate Company.

Homebuyers are Client's. When a business runs on client's money (who have not confirmed risks) and not on equity and debt money, in those cases, IBC is not suitable. IBC does not apply to financial service providers. An interim arrangement has been made to address the financial services as a stop-gap arrangement. Homebuyers are clients, so the IBC structure does not fully support that kind of structure so; therefore, we need some innovation.

Section 462 of the Companies Act, proposed changes to take into consideration that certain classes or classes of corporate debtors should be kept out of the provisions of IBC. In a similar sense, if Real Estate companies are taken out of the purview of IBC, then it would probably be a better solution OR if a business model in our company changes so that IBC becomes suitable for them.

The NCLT, Principal Bench, New Delhi vide an order on November 29, 2021, admitted the PPIRP application filed by Loon Land Development Limited. The company joined hands with M3M Construction Private Limited to provide a viable Base Resolution Plan (BRP) which was duly approved by the financial creditors in Form P4. This was probably the first case of a real estate entity availing the benefits of a PPIRP Process.

However till date there has been only 2 PPIRPs in India. Thus, the effectiveness of Pre-Packs in the case of MSME's are yet to be tested. Further while it is understood that Pre-Packs shall pave the way for maximizing the value of assets, which is the essence of IBC, in case of Corporate Debtors (which are not MSME's). It is also necessary to understand whether the case of Loon Land Development Limited a success (Ref: IB PP 03 PB 2021 dated 29.11.2021.

- Further the option of availing PPRIP is not available to those corporate debtors who have undergone PPRIP or CIRP in the three years preceding the date of the application or are ineligible under Section 29A of IBC. The New Amendment only mentions that certain categories of CD in addition to MSMEs. It is thus to be tested whether the same is ambiguous since the cornerstone of PPRIP is a debtor in possession model, and Section 29A bars the concept and envisages a creditor in possession.
- Further, the amendment proposes to delete Section 53C(3)(c) that mandates the declaration of avoidance transactions. If the option of PPRIP is envisaged for CDs beyond MSMEs, the declaration of avoidance transactions is a must. This gap needs to be understood in the right context.

Pre-pack is an arrangement that allows parties to agree to something mutually and will be blessed by the IBC system. In both processes, there are arrangements to have value maximization. It is difficult to say that pre-pack will have better values and CIRP will give less value. Both are modelled in such a pattern that both allow the swiss challenge method also. It is a question of convenience who wants to keep the market? Law has given a choice depending on suitability.

Only 4 cases have been admitted in the past, which means either there is no demand or the design of a pre-package is unsuitable. The market requires persuasion or pressurization. If there is a demand, at least they would use some other kind of pre-pack mechanism, not necessarily under IBC, and they are also not using under IBC.
This only available to MSME companies which are only 1 lakh in the country, however, there are 6 crores MSMEs in the country and they are the real beneficiaries, while it is only available to corporate MSMEs.

Pre-pack is a market innovation. Practice no 16 of Insurance Professional UK covers it, and it is not under the ambit of the law. In India, people wanted it under the statute. This way, we have introduced more rigidity, so it's hard to make changes without going to parliament. Ideally, it should be an informal practice in regulations, not in the statute.

As per Section 12, there is a 330-day deadline for closing a resolution. If a statute of time bound in nature, then the extension provided defeats the purpose of having a mandate.

Government, NCLT, COC and RP need longer time, well-equipped NCLT, and more responsive RP. This problem needs to be seen holistically. People are discouraged from submitting resolution plans because of approval delays and the fear of bankruptcy.

As per Section 12, sub-section 3, except for the subject matter concerned, NCLT has no jurisdiction to extend even for 70 days. NCLAT and SC must explain the law. The subject matter of the case is different depending on the circumstances. IBBI has been given regulatory power to take disciplinary action, but monitoring power has not been delegated to IBBI.

IBBI should be given more power to ask for an explanation or reason for not completing it within 100 days and not following the guideline. NCLT requires colloquium with respect to their power under sub-section 3 of Section 12 and the meaning of "subject matter".

TAKEAWAYS

Way Forward

IBC is the only law with a better economic justice delivery system than any other law.
The scope for the code seems bright and clear, as the government has seriously considered this law, amendments, and developments, but the path will be one of progress as the law holds such power and impacts the rights of so many!

However, There's a need to club various laws for a better interpretation of the statute, and more points need to be developed by the lawyers. Further, the law will be clarified in the years to come.

Click below to watch the LTS session

https://www.youtube.com/watch?v=K_Qnph6jA3o&t=353s

Click below to listen to LTS session Podcast

https://anchor.fm/hammurabi-solomon

ABOUT US

Hammurabi & Solomon Partners was founded in the early 2001 and is ranked amongst the top #15 law firms in India. Our journey has been marked by stellar growth and recognition over the past 2 decades with over 16 partners handpicked from the top of their fields. Paving our way into the Indian legal landscape we believe in providing complete client satisfaction with a result driven approach.

We have always aimed at being the change-maker for a newer India and the world around us. With our portfolio of services - law, public policy, regulation and justice converge to enable solutions to our client needs within the legal framework to operate in India with ease and predictability.

Our main aim is to provide world-class legal services with a unique client-centric approach. We aim at providing the utmost quality and result-oriented solutions with our out of the box thinking and teamwork. We focus on being very approachable and highly reliable legal advice with a practical and relevant approach, we tailor solutions with each client's needs.

Our firm implements a holistic approach towards client satisfaction by offering higher level of services, in-time solutions and exercising greater insights to understand the clients' sectors.

Visit us at www.hammurabisolomon.in/

DELHI-NCR | MUMBAI | BENGALURU | CHENNAI | HYDERABAD | AHMEDABAD | RANCHI | PATNA

INDIA STRATEGY GROUP

Strategic Business Planning,
Regulatory & Public Policy Consulting

India Strategy Group (ISG) is a multi-disciplinary Policy, Regulation & Strategy consulting firm with a result-oriented execution philosophy.

For over two decades. ISG has worked with multiple Fortune 50/500 MNC's and brands across sectors. ISG has worked with a spectrum of Government departments and enterprises at both national as well as state levels and has successfully assisted the Government of India, State Governments, and Public Sector Institutes & organizations on a multitude of policy & regulation issues to enable deeper public-private participation and better governance and welfare of all stakeholders.

ISG offers an array of strategic services along with a network of globally spread clients, strategic alliances, governmental contacts, leading Think-Tanks, Influencers, the Media, Academicians, Research Centers, Industry bodies, Business Sectoral Associations, Sectoral Regulatory Bodies, Bi-lateral and Multi-lateral working groups, to name a few.

Know more at
https://www.indiastrategygroup.com/