INSOLVENCY CODE :
AN EFFECTIVE TOOL OF FINANCIAL RESTRUCTURING IN COMING DECADE

IBC: the motive of promulgation

Prior to the commencement of the Insolvency and Bankruptcy Code, 2016 (IBC, 2016 or code), the legislative framework in India dealing with the insolvency and restructuring procedures of corporate entities, partnership firms and individuals was very complex and fragmented across multiple legislations viz. the Companies Act, 1956, the Sick Industrial Companies (Special Provisions) Act, 1985, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), the Recovery of Debts due to Banks and Financial Institutions Act (RDDBFI Act), 1993, etc. The presence of multiple laws, forums and complexities resulted in delays in the timely resolution of the distressed entities, partnership firms or individuals, which further lead to the devaluation of the assets of the borrower, making insolvency negotiations redundant.

To deal with the inconsistencies prevalent in this space, the Insolvency and Bankruptcy Code, 2016 ("**Code**") was enacted by the legislature as a regulatory reform for addressing the companies/ partnership firms/ individuals ("**Corporate**") in financial distress or sometimes in operational distress through reorganisation and process of insolvency resolution.

The new Code replaced all the foregoing debt recovery laws and created an unified procedure to resolve the corporate distress pertaining to insolvency and bankruptcy. The Code empowered the creditors to examine and inspect the viability of the debtors before making business decisions. Further the delays in disputes were addressed by formulating a time-bound mechanism for resolutions which further helped in promoting entrepreneurship and availability of credit in the market. The quintessence of the new Code is to balance out the interests of all stakeholders and revive the Corporate as a going concern by way of timely resolutions.

The Code introduced a completely new mechanism of Corporate Insolvency Resolution Process ("**CIRP**") that granted corporate debtors a moratorium period during which financial creditor, operational creditor or debtor himself, resolves the insolvency of a debtor through financial restructuring and creditor management approach. Further to facilitate a formal and time bound CIRP, the Code created a robust institutional framework, comprising of Insolvency Professionals, Insolvency Professional Agencies, Information utilities, Adjudicating Authorities and Insolvency and Bankruptcy Board.

Present status of execution of the Code

On completion of over five years of new Code, the regime has drifted away from the debtor in control to the creditor in control. The latter model curbs out the unfair benefit that the Debtors had over the creditors during the recovery process by giving the managerial control of corporate debtor to the creditors. The creditor appoints its managers to run the company till the time company is fully revived and able to function again effectively. This concept was essential to ensure the continuance of business and to get the maximum value of the company by way of resolution. The adjudicating authority and the apex court has time and again cleared the objective of the new Code which is to ensure revival and continuation of business of the corporate debtor as a going concern. In a country where we still find the existence of pre-colonial laws, the new code even in its nascent stage has been a subject of various judicial pronouncements.

The Indian insolvency laws have seen a drastic change post-enactment of the new Code. At the present time there have been disciplined borrowings amongst corporates and there are more potential investor pitching in because of the assurance of repayment against the debts. Moreover, the promotors are taking extra precautions while doing business due to the fear of losing control of their enterprise to the creditors in the event of default. There has been an increase in the number of insolvency resolutions that have taken place within the time limit of 330 days due to the effective adjudication of the matter. The key issues that the Code has faced during the last five years are pertaining to low recovery rates, huge haircuts, prolonged delays, digitalisation of insolvency ecosystem and shortage of resources.

Way Forward for making the Code effective & successful

The laws relating to insolvency and bankruptcy have come a long way since the inception of the Code. However, it is pertinent to note that there are certain benchmarks that still need to be addressed and probably be covered by the year 2025. Some of them are as follows:

1. ***Increasing the Resolution, Diminishing the Liquidation***:

The object of the legislation was to ensure the effective resolution of the corporate debtor, however, it is seen that more than half of the companies go into liquidation after the initiation of the CIRP. The main reason behind the rising number of liquidation cases may be that the corporate debtors under CIRP neither have any assets nor any lucrative business out of which debts can be recovered by the resolution applicant. It is pertinent to note that the resolution applicant only submits its resolution plan when there is unsold inventory, land bank or receivables from clients. Another reason may be that the resolution plan presented by Committee of Creditor is not found to be commercially feasible and the haircut or mode of commissioning is unacceptable by the resolution applicant. Thus, it is expected that in the next three years the number of liquidation cases for corporates undergoing CIRP will be reduced.

2. ***Resolving bottlenecks of delay***:

The essence of the Code is the time-bound mechanism of insolvency resolution, however, there have been prolonged delays seen in numerous cases thereby breaching the statutory deadline of 330 days. It is noted that the value of the assets of the debtors diminishes over time due to long delays in insolvency process. The government is expected to improve facilities to upskill the insolvency resolution professionals, infrastructure, and digitalisation of insolvency eco-system. Further it is expected that the prolonged delay at the stage of admission by the Adjudicating authorities are addressed in a proper manner.

3. ***Value difference between resolution and liquidation***:

It is eminent to note that the value of company vide resolution should always be higher than the value vide liquidation, however, it has been seen that over the period this gap between the value of resolution and liquidation has been narrowing. The goal is to make genuine efforts to save the lucrative businesses by way of resolution and restructuring and only when no option is left, liquidation should be resorted to. The nature of the Code is to augment the chances of preserving the business of the corporate debtor because liquidation would mean the death of the business. Generally, liquidation is resorted in cases where resolution plan is not workable, or the Committee of Creditors determines liquidation or adjudicating authority rejects the resolution plan. A robust mechanism is expected in the following years to increase the gap between resolution and liquidation.

4. ***Keeping the interest of creditors supreme***:

A haircut is when a creditor gives up a part of his share of the debt. Apparently, in the last five years, the haircuts have gone up to 95% in certain cases thereby affecting the business and profitability of the creditors. Large haircuts affect the potential investor from lending money because the value of money lend becomes very less against the money recovered at a later stage. A benchmark for the quantum of haircut is expected in the upcoming years and large and unjustified haircuts should be addressed in a structured manner. It should emphasize on securing the rights of the creditor which would lower the borrowing costs as the risk will be minimized. The vision should be to recover the maximum value from the corporate debtor and impose justified haircuts.

5. ***Pre-packaging Insolvency Model***:

A quick resolution process where the resolution takes place not by way of public bidding but through an agreement between secured creditors and investors. The key feature of pre-pack insolvency is the quick and timely resolution process of maximum of 120 days for distressed companies. The corporates prefer pre-pack insolvency over CIRP as the managerial control stays with the corporate debtor and approval of the court is not compulsory. However, outcome is binding on all stakeholders. It is eminent to note that the pre-pack insolvency is currently only limited to Micro, Small and Medium Enterprises. Therefore, it is expected that in the forthcoming years pre-pack insolvency resolution will also be applicable to other corporate structures.

6. ***Global integration and standardization of IBC practices***:

In the past few years there has been a tremendous shift in the insolvency regime yet the provisions relating to Cross border insolvency have been stagnant. Currently, there are no standards to restructure the firms participating in cross border jurisdictions. It is noteworthy that foreign creditors are eligible to make claims against an Indian company, however, the Code does not have standard tools for automatic recognition of insolvency proceedings in foreign jurisdiction. It is expected in the coming years, relevant amendments will be made in the code pertaining to the Cross-border insolvency to enhance the effectiveness of the insolvency resolution process and cater to cross border insolvency resolution.

Conclusion

Inspite of all the resistance to change, frequent modifications and ambiguity all around, the Code has affected companies and assets across industries and has been established as a safer tool of investment vis-à-vis acquisition for potential investors. To make it more effective, practical and robust, it is important that the legal framework is clear and practically enforceable to facilitate investment and ensure definitive mechanism of recovery of distressed assets. Inspite of frequent amendment, modifications and clarifications at regulatory level, ambiguity exists regarding so many relevant issues that may have practical implications for prospective investors and resolution applicants. Therefore, the vision in the coming years should be to come up with full proof mechanism which caters to the present challenges being faced by insolvency laws in India. The Code is still evolving and emerging and it has introduced substantial changes in the insolvency lanscape.

NPAs has substantially reduced over the period of five years by emergence of the Code. It has not only helped in the survival of the businesses but also secured the creditors from risk. Undoubtedly, there is still a lot to be achieved to stand up to the enchmark set by the developed jurisdictions, however, the Code is yet to see some remarkable improvement in the forthcoming years.