From the Desk of the Chairperson

Resolution: The Soul of IBC

Where a firm is in a state of insolvency, that is, it has defaulted in repayment obligations, the creditor has broadly two options, namely, recovery or resolution. Further, he has many options for recovering default; so also for resolving insolvency. He may use the Insolvency and Bankruptcy Code, 2016 (Code) for resolution, though he can resolve insolvency outside the Code. He must not use the Code for recovery, though he may recover from future earnings of the firm, post-resolution.

The soul of the Code is resolution of insolvency of a firm by (a) a collective effort (b) to keep it going (c) to maximise the value of its assets, and (d) to balance the interests of all stakeholders. As a collective body of financial creditors (FCs), the Committee of Creditors (CoC) acts in unison to resolve insolvency through a process that does not have petitioner/respondent or plaintiff/defendant. In contrast, recovery is an individual effort by a creditor to recover its dues through a process that has the debtor and the creditor on opposite sides. When creditors recover their dues - one after another or simultaneously - from the available assets of the firm, nothing may be left in due course. Thus, resolution endeavours to keep the firm alive, while recovery bleeds it to death. It would be an economic catastrophe if many creditors seek recovery from insolvent firms.

The CoC engenders competitive resolution plans and approves the best one that maximises the value of assets of the firm. In contrast, recovery maximises the value of the creditor alone to the detriment of the firm and other creditors. Resolution makes the stakeholders share the fate of the firm and thereby balances the interests of all stakeholders. However, recovery serves the interests of creditors on first come first served basis - the creditor, who initiates recovery first, realises the highest, and who initiates the last, realises the least - and yields inequitable distribution of available assets. Thus, recovery, which is not a collective effort, does not keep the firm alive, maximize the value of its assets and balance the interests of all stakeholders, and hence it is an antithesis of resolution.

The Code strives for resolution and discourages recovery in several ways. It enables any FC to trigger the resolution process even when the firm has defaulted to another FC. This prevents a firm from granting a preferential treatment to a noisy creditor while ignoring others. The Code prohibits any action to foreclose, recover or enforce any security interest during resolution process and thereby prevents a creditor(s) from recovering its dues. It does not envisage termination of the process even if dues of the creditor, who had initiated the process, are satisfied. The adjudicating rules permit withdrawal of application for initiation of resolution till its admission. Regulations allow payment of only liquidation value, not the default amount or proportionate share in enterprise value, to FCs who vote against the approved resolution plan.

Several pronouncements of the adjudicating authority reiterate prohibition on recovery. In the matter of M/s Nowfloats Technologies Pvt. Ltd., the National Company Law Tribunal (NCLT) reiterated that resolution process is initiated for the benefit of the general body of creditors. It is a representative action and is not for the recovery of money of an individual creditor. In the matter of Parker Hannifin India Pvt. Ltd., the NCLT observed that after the resolution process commences, the nature of proceeding changes to representative suit and the lis does not remain only between a creditor and the debtor. Therefore, they alone do not have the right to close the process because the creditor has been paid its dues. In the matter of Prowess International Pvt. Ltd., the Hon'ble National Company Law Appellate Tribunal (NCLAT) held: *"It is made clear that Insolvency Resolution Process is not a recovery proceeding to recover the dues of the creditors. I & B Code, 2016 is an Act relating to reorganisation and insolvency resolution of corporate persons, …"*. In the matter of Lokhandwala Kataria Construction Pvt. Ltd., the Hon'ble NCLAT held: *"..matter cannot be closed till claim of all the creditors are satisfied by the corporate debtor."* When this matter came up on appeal before the Hon'ble Supreme Court, it allowed closure with the observation: *"However, since all the parties are before us today, we utilize our powers under Article 142 of the Constitution of India to put a quietus to the matter before us."*

Liquidation brings the life of a firm to an end. It destroys organisational capital and renders resources idle till their reallocation to alternate uses. Further, it is inequitable as it considers the claims of a set of stakeholders only if there is any surplus left after satisfying the claims of a prior set of stakeholders fully. Thus, liquidation is also antithesis of resolution. The Code, therefore, does not allow liquidation of a firm directly. It allows liquidation only after the process fails to yield resolution. It rather facilitates and encourages resolution in several ways. It obliges an insolvency professional (IP) to manage the affairs of the firm as a going concern and to protect and preserve the value of its assets. It empowers the IP to raise interim finances for continued business operations of the firm and mandates continuation of essential services. It ensures a calm period when nobody disturbs the firm undergoing resolution.

The Code envisages initiation of the resolution process at the earliest, well before the insolvency balloons to an un-resolvable proportion. A stakeholder is entitled, though not obliged, to initiate process as soon as there is a default of the threshold amount. In early days of default, enterprise value of a firm is usually higher than its liquidation value and hence the CoC is motivated to resolve insolvency to preserve its value rather than to liquidate it. However, the enterprise value of the firm reduces exponentially with time, as prolonged uncertainty about its ownership and control and general apprehension surrounding insolvency leads to a flight of customers, vendors, workers, etc. The Code, therefore, mandates closure of the process ordinarily at the latest by 180th day. The essence of the Code is timeline and in the matter of JK Jute Mills Company Ltd., the Hon'ble NCLAT has held this timeline to be mandatory.

State is leaving no stone unturned to facilitate resolution. A resolution plan may create book profits arising from write-off of debt in the books of the firm. Such book profits attract minimum alternate tax and consequently could discourage the prospect of resolution. The Central Government has recently allowed set off of such book profits against the losses brought forward. A resolution plan may entail allotment of shares at a discount. The Companies (Amendment) Act, 2017 has allowed companies to issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan. The Central Government has clarified that approval of shareholders of the company for a particular action required for implementation of a resolution plan, which would have been required under the Companies Act, 2013 or any other law, is deemed to have been given on approval of resolution plan by the adjudicating authority.

With a view to maximise the value, the Code envisages boundless possibilities of resolution with or without the existing promoter, management, products, technology or business model. The resolution plan, however, must be feasible and viable so that it is sustainable. It needs to come from a person who has a credible record and is likely to deliver and, therefore, debars a person who does not have a credible record and is unlikely to deliver. It is the bounden duty of the CoC to make best endeavor towards resolution at least in all cases where enterprise value exceeds liquidation value.

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