

Reimagining the Code

The low recovery rate for creditors suggests IBC needs to be far more effective; the IL&FS solution is worth a look

KOTAK MAHINDRA BANK vice chairman and managing director Uday Kotak's observation that a public interest board mechanism be considered for certain cases under the Insolvency and Bankruptcy Code (IBC) need to be heeded. In a media interview, Kotak has pointed out that group resolutions via the corporate insolvency resolution (CIRP) have resulted in a low recovery rate for creditors, bringing them disproportionate pain. Moreover, resolutions for bankrupt non-banking finance companies, too, have attracted bids that are far smaller than the liquidation value. There is no doubt that in a small market, in which asset restructuring companies have limited resources, prices of assets have been beaten down due to a dearth of buyers. As Kotak said, the IBC is a fine piece of legislation but needs to be far more effective—a recovery rate of below 30% suggests it is not. So while staying within the basic tenets of the law, a public interest board for cases where the debt is more than ₹25,000 crore could be looked at. There is certainly merit in re-imagining the code, and in doing so, it would be instructive to take a look at the IL&FS solution.

The key difference at IL&FS was that the government had seized control of the company and superseded the board. A new team was put in place, and this ensured that there was no room for promoters to stall the recovery process. As the new IL&FS team, comprising private sector professionals and bureaucrats, enjoyed the government's blessings, its decisions were considered to be above board and there was no interference from the courts or tribunals. While the recovery team opted for a group resolution—with all subsidiaries and step-down subsidiaries being part of the process—the company was not to be sold as a whole. Instead, it opted to sell the assets separately; in hindsight, a good decision. In designing the bidding process, value was chosen as the key factor; establishing the fair values and liquidation values was done quickly. Experts point out this was possible because the team didn't draw on any external expertise unlike in the CIRP where external valuers are enlisted. The team also insisted on bank guarantees for the bidders so that there would be limited incentive to withdraw if selected as a winner. Unlike in the CIRP where the resolution process is often hampered by many rules, the IL&FS team had a free hand because it was not bound by any code.

Also, it got lucky with some of the assets; for instance the renewable energy piece was bought out by a joint-venture partner which had a right of first refusal. The team was also able to use the Invit option for roads—a route not available under the CIRP. Most of the road projects were not in good shape but the Invit structure, while not offering the creditors immediate money, gave them a decent return. Critically, the assets were preserved and restored. Such options could be built into the IBC. Negotiating with entities like the National Highways Authority of India (NHAI) was easier for the IL&FS team as the process was backed by the government. This kind of support would certainly help the insolvency process. As Kotak says, it is a shame that the values being recovered are lower than the liquidation value. We simply cannot afford such destruction of wealth.