

Reflection of Delays in Redressing Corporate Insolvency: An Economic Analysis

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Abstract:

The market's cost of borrowing, innovation, investment, and economic growth are all impacted by a stable and effective bankruptcy law. The way resources are distributed within the economy is directly impacted by the bankruptcy rule. Therefore, a strong insolvency environment is vital for overall economic growth and development. To evaluate and contrast the bankruptcy regimes of various countries, the World Bank and OECD have created a set of metrics. The amount of time needed to resolve insolvency is one of the important factors. Before enactment of IBC the Indian insolvency regime took 4.3 years to resolve. Speed is the essence of the IBC. The insolvency resolution process has greater negative repercussions the longer it takes. The backlog of cases admitted under the Code and the protracted timescales are currently causing concern.

Keywords: IBC, Time/Delay, Corporate Insolvency Resolution Process, World Bank.

“Timely resolution is very important. I'd request you to ensure that the resolutions are done in time, not just for the regulatory requirement but also because it will result in better valuation going forward.”

N. S. Vishwanathan¹

Introduction

The corporate entity has indefinite life. The success of a company is reflected in its sustained financial growth, market leadership, customer satisfaction, and strategic adaptability. However, various factors can influence the longevity and success of a company for example

competition, technological changes, economic challenges, changing consumers' habits, mismanagement, fraud etc. are some of the factors which impacts the life of company. The failure of company adversely impacts the whole ecosystem of the economy.¹ For avoiding the effects of corporate failure the policy makers shall design an effective corporate rescue

procedure. When India introduced economic reforms in 1991, more than 1.5 million cases filed by public sector banks and 304 cases by financial institutions were pending in various courts. The recovery of debts involved more than Rs. 5622 Cr. owed to public sector banks and Rs. 391 Cr. to other financial institutions.² Therefore, Government of India established a Debt Recovery Tribunal for effective and speedy recovery of bad loans. However, DRT also could not speed up the recovery of bad loans as expected. The total number of cases filed in DRTs by Scheduled Commercial Banks as a whole amounted to 1, 50,503 with amount involved being Rs. 2601 billion. Only Rs. 427 billions (constituting 16.43%) were recovered till March, 2014.³ All these years, India continued to fare badly in the World Banks Ease of Doing Business ranking, despite of number of reforms and measures in other areas impacting ease of doing business ranking.

World Bank on Indian Insolvency Regime

The Ease of Doing Business Report rankings plays a significant factor in shaping opinions about how strong a nation's bankruptcy and insolvency resolution systems are. The World Banks 'Ease of Doing Business'⁷ website anticipates an inter-jurisdictional analysis on the research conducted on the corporate insolvency regime of the various jurisdictions, this anticipated India's ranking in the year 2015 was 136 out of 190 countries on the ease of resolving the insolvency based on the following parameters:

- Time
- Cost;
- Recovery rate for the creditors;
- To manage the debtor's asset during the insolvency proceedings;
- Creditor's role in insolvency proceedings.

World Bank identified and recommended the need of robust insolvency framework in the country. According to the report (2015), time taken to resolve the corporate insolvency was average 4.3 years if compared with the United Kingdom insolvency system which took 12 months and USA took 18 months' time period for corporate resolution process. The recovery rate was (before enactment of Code) 26.5 (cent per dollar), which shows a dismal performance. Indian legal system that deals with the issue of company distress was multilayered, and combination of winding up provisions⁴, rehabilitation of sick companies⁵ debt enforcement laws⁶. Before the enactment of the IBC there were no single law deal with bankruptcy and insolvency. The existence of several fora occasionally, if not frequently, led to contradictory rulings, which weakened investors' trust in Indian businesses. Confronted with this crisis, bad loans/NPA (Non-Performing Assets)⁸ coupled with the desire to improve ease of doing business in India Government of India decided to accelerate the enactment of new insolvency law on the recommendations of the Bankruptcy Law Reform Committee⁹.

Insolvency and Bankruptcy Code, 2016: A Game Changer Law

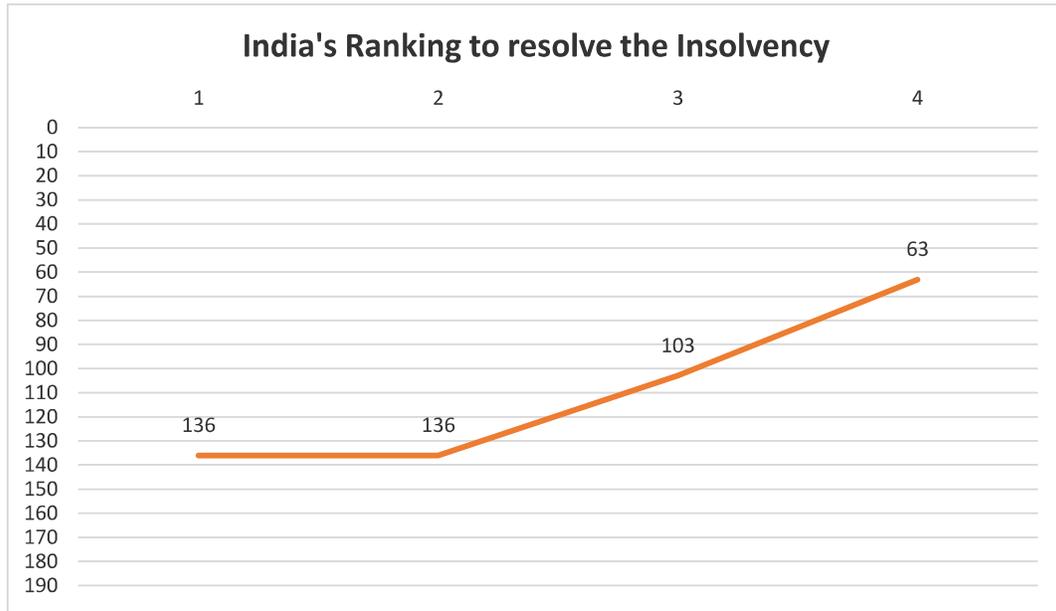
The Insolvency and Bankruptcy Code in India established for the revival of the sick

company, the paradigm shift from debtor in possession model (SICA) to creditor in possession model (IBC). The basic idea of the Insolvency Code is that when an enterprise defaults in payment of its dues, the control shifts to Committee of Creditors (CoC) of financial creditors. There are specified time limits to evaluate proposals for resuscitating the corporate entity or on the occasion of failure taking it to liquidation. Insolvency Professional has the control over the debtor under the supervision and monitoring of the CoC. Decisions are required to be taken in a time bound manner so that there are greater chances that the enterprise is saved as a going concern and productive resources of the economy can be put to best use.¹⁰ IBC provides a resolution-oriented strategy, allowing businesses to continue as a going concern even after default, in contrast to traditional recovery-oriented methods.

IBC and Upgrading the Ease of Doing Business Ranking

After enactment of the Code, India’s ranking on the insolvency has been exceptionally improvised from 136 in the year 2015, 2016 & 2017 to 103 in 2018 and 63 in the year 2020¹¹, and overall recovery rate also jumped from 27 cents to 72 cent dollars. The World Banks Ease of Doing Business Report (DBR), identified the significance of the enactment of the Code by mentioning, “India made resolving insolvency easier by adopting a new insolvency and bankruptcy Code that introduced a reorganization procedure for corporate debtors and facilitated continuation of the debtor’s business during insolvency proceedings.”¹² Following pictorial graph shows India’s improved ranking on insolvency resolution after enactment of IBC:

Figure: 1



Source: World Bank Doing Business Report, (DBR) 2020.

An improved ranking in the World Banks Ease of Doing Business index for India can have several positive impacts on the business culture in the country. The examples are: a higher ranking attracts the foreign investors (as it is signal of stable and efficient market); encourage entrepreneurship by reducing bureaucratic hurdles; it also indicates the improvement in efficiency and transparency in government procedures which highly positively impact on business culture; improved access credit to businesses, facilitating capital flow and expanded the opportunities. A more business friendly environment enhances the competitiveness in Indian companies and also promote the innovation and productivity. Hence, the improved insolvency resolution ranking is the indicator of the economic progress and reforms in the Indian economy specifically after enactment of the IBC.

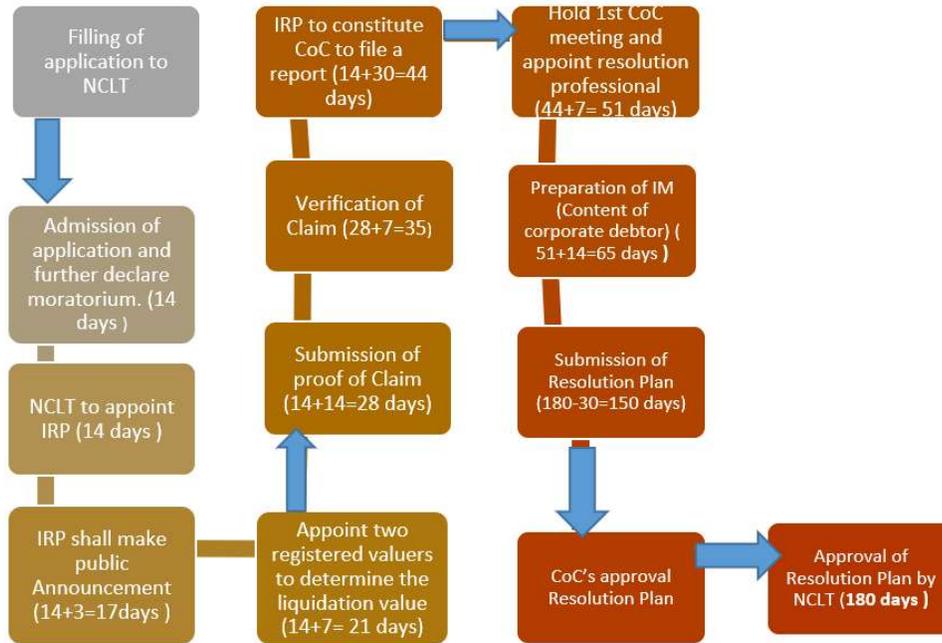
Corporate Insolvency Resolution Process

According to Peter Bernstein “The market is not a very accommodating machine; it won’t provide high returns just because you need them”. India adopted a rescue-oriented approach to corporate insolvency when the Sick Industrial Companies Act¹³, 1985 (SICA) was enacted, inspired by US’s debtor in possession model. However, in India the Insolvency and Bankruptcy Code, 2016 provides a corporate rescue but based on the UKs practices and procedures. The new statute is designed by the policymakers to explore corporate rescue, or corporate resolution. Chapter II of Part II of IBC provide the process for corporate

insolvency resolution of a corporate entity. The resolution process is intended as a mechanism of facilitating the rescue of corporate debtor (insolvent company) as a going concern. It allows the company to continue to trade initially through IRP and later through RP, with protection from its creditors through a statutory moratorium¹⁴ and other related measures. One of the key objective of the IBC is to resolve the corporate insolvency within stipulated time period to protect the time value of money and maximize the value of the assets. Initially the time period for corporate resolution process was 180 days which can be extended up to a maximum period of 90 days.¹⁵ If within such timeline a resolution plan is not approved by CoC and an application for approval of such CoC approved resolution plan is not filed with Adjudicating Authority, the CD has to be mandatorily liquidated. Prior to Insolvency and Bankruptcy Code (Amendment) Act, 2019¹⁶ the 180/270 days’ period were considered sacrosanct, and the IBC not contain any specific provision for ‘**exclusion of timelines**’. Hence, there was a gradual development of case law whereby Appellate Authority allowed certain time periods to be excluded for the purpose of counting the total period of 180/270 days in certain circumstances. By way of amendment, 270 days’ period was extended to 330 days including time taken in legal proceedings.

There are around eighteen stages in the whole CIRP under the IBC. Following chart describes the model timeline of CIRP¹⁷:

Figure: 2



Considering several deadlines associated with the Code's phases, NCLAT in the case of M/S J.K. Jute Mills¹⁸ held that, “time is the essence of the Code and all the stakeholders, including the Adjudicating Authority, are required to perform its job within the time prescribed under the Code except in exceptional circumstance, only if the adjudicating authority for one or other good reason fails to do so”.

Time is the essence of Corporate Insolvency Resolution Process

The core objective of the IBC is to complete the resolution process in time bound manner. The Code describes the time schedule for every stages of the resolution process. But the concern is whether the code is successful to achieve this objective or not? To get answer of this question data analysis from the quarterly report prepared by IBBI is required to be done. Before enactment of the Code the

previous Indian insolvency regime took 4.3 years to resolve the corporate insolvency of the country.

Delay becomes the critical issue due to prolonged time taken by the CIRP process. Bankruptcy law Reform Committee also has recognized by noting that time is the gist of the Code. The Committee observed the rationale behind it as:

“Speed is the essence for the working of the bankruptcy Code for two reasons. First, while the ‘calm period’ can help to keep an organisation afloat, without the full clarity of ownership and control, significant decisions cannot be made. Without effective leadership, the firm will tend to atrophy and fail. The longer the delay, the more likely it is that liquidation will be the only answer. Second, the liquidation value tends to go down with time as many assets suffer from a high economic rate of depreciation. From the view point of creditors, a good

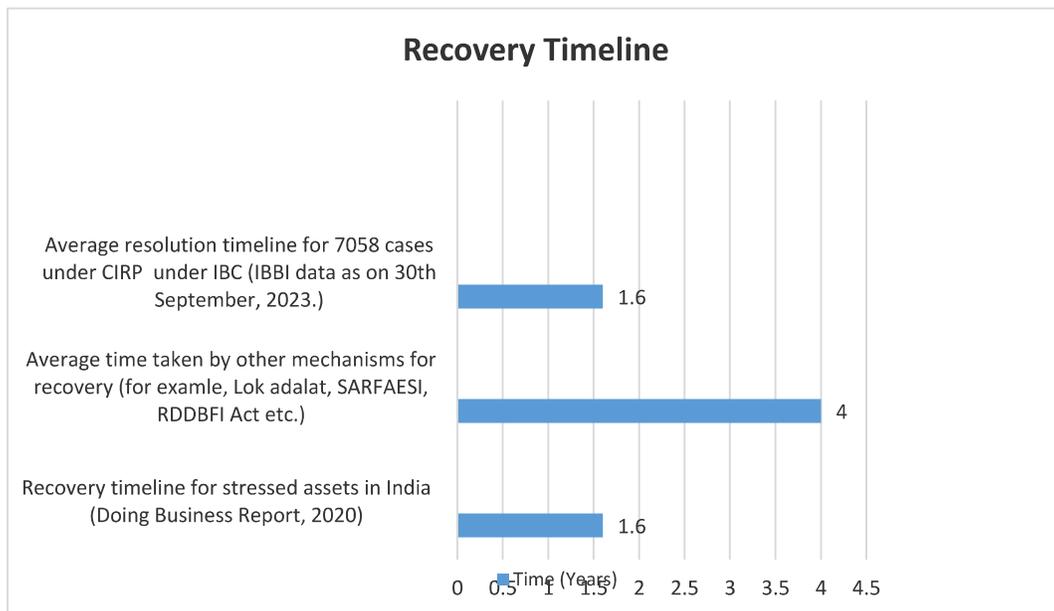
realization can generally be obtained if the firm is sold as a going concern. Hence, when the delays induced the liquidation, the realization is lower, when there are delays. Hence, delays cause value destruction. Thus, achieving a high recovery rate is primarily about identifying and combating the sources of delay.”

It appears that, the biggest obstacle for the successive/effective implementation of the Code is the ‘delayed timelines’. According to survey based analysis done by Shon Gadgil, Dr. Bindu Ronald & Ms. Lasya Vyakarana, the possibility of CIRP completion within 180 days is <_ 5%, the possibility of CIRP completion within 270 days is <_ 22% and the possibility of CIRP completion within 180 days is 45%.²¹ Although the results rely on the opinions of several stakeholders that were gathered

through a survey, they are not entirely trustworthy.

Different organizations observed the different reasons behind the delayed timeline in insolvency resolution procedure, according to the OECD²⁰, there are a number of reasons why resolution processes could take longer than expected. One of the main obstacles to resolving the insolvency case is prolonged legal proceedings to increase in nonperforming loans. The World Bank observes that judges and courts frequently obstruct the effective settlement of insolvency.²¹ In a bankruptcy procedure, the interests of stakeholders concerned are balanced in part by the operation of the legal system in that nation. Regarding this the significant role of NCLT in well-functioning of IBC cannot be denied.

Figure: 3



The source of above pictorial graph is IBBI and World Bank’s Ease of Doing Business Report, 2020. The graph clearly portrays

that the average time taken by other mechanisms to recovery methods by earlier recovery mechanisms were up to 4 years.

The average timeline in CIRP (total 808 CIRP which have resulted into resolution plans) is 1.6 years, (took an average 541 days for conclusion of process) i.e. reduction in 50-60%.

This is the undisputable fact that the availability of financial information plays a significant role to timely resolve insolvency process. Fast access to accurate and uncontested information is essential to the timely completion of the insolvency or bankruptcy procedure. Inaccurate and confusing financial reporting is a common indicator of bankruptcy. In the modern corporate world, disclosure of corporate information, it's recording, organizing and summarizing in useful way, and provide that information to those who will utilize this. However, the asymmetry of financial information may be the reason to complete the timely resolution of the distress company. A less-than-ideal resolution may arise from this information discrepancy. The private incentives of management to conceal the actual financial status of the company and take a chance on its revival are increased by insolvency procedures that do not offer enough protection for the current management. This presents a significant difficulty in the Indian setting when an outsider (Resolution Professional) takes over Corporate Debtor administration, increasing the incentive for incomplete disclosure of information. The timely start of insolvency might be significantly harmed by the dismissal of management during restructuring of the distressed firm. Hence, it is essential that

the CIRP be finished on time and that the weak points in achieving a timely resolution are sufficiently addressed given the legal framework in India. The backlog of cases admitted under IBC is a growing source of worry, which makes deadline compliance essential.

‘Delay’: A major cause of Concern in CIRP

Despite the ever evolving processes in IBC and major thrust being laid down in curtailing the time frame involved in CIRP till date it remains major cause of concern for the entire ecosystem being the lawmakers, Adjudicating Authorities, and the creditors:- financial and operational. It seems that still they are unable to redress this tricky issue as the entire CIRP foundation remains resolution in a time bound manner. Insolvency and Bankruptcy Code is becoming more and more popular as an effective recovery tool, the excessively long resolution procedure is still a cause for concern.

The tabular data, depicts that, as on 31st December, 2019 out of 635 cases 32% cases took more than 270 days. It shows at initial stage of IBC only 32% cases were struggling to follow the model timeline mentioned in IBC.

Till 31st December, 2020 total 1717 CIRPs were ongoing and 1481 means 86% cases took more than stipulated timeline.²⁵ After removing the period excluded by the AA, the 317 CIRPs that produced resolution plans by the end of December 2020 took an average of 386 days to complete.

Table: 1

Total Time Taken to Resolve the CIRP under IBC (2016-2023)²⁴

Sr. No.	Year	Status of CIRP
1.	December, 2019	32% (total 635 cases took > 270 days out of 1961)
2.	December, 2020	86% (Ongoing CIRP cases were 1717, and 1481 cases took > 270 days)
3.	December, 2021	73% (Total 1240 cases out of 1699, took >270days.)
4.	December, 2022	64% (1280 cases out of 2000 ongoing CIRP)
5.	September, 2023	67% (1341 cases out of 2001 ongoing CIRP)

Total 1699 CIRPs were ongoing and 1240 cases took more than 270 days’ timeline to resolve the insolvency as on 31st December, 2021. After deducting the period excluded by the adjudicating authority, the 457 CIRPs that produced a resolution plan by the end of December 2021 required an average of 441 days to complete the corporate insolvency resolution procedure.

December, 2022 data reveals that total 1280 cases out of 2000 ongoing CIRP took more than 270 days’ time line. The Code seeks to close down the different processes as soon as possible. For some of them, timetables are prescribed. After deducting the period excluded by the Adjudicating Authority, the 611 CIRPs that produced resolution plans by the end of December 2022 took an average of 482 days to complete.

Till September 2023 total 2001 CIRPs were ongoing and 1341 cases took more than 270 days’ time to resolve the insolvency. After deducting the time excluded by the AA, the 808 CIRPs that produced

resolution plans by the end of September 2023 took an average of 541 days to complete. From the above tabular data, it is crystal clear that ‘delay’ is the significant concern in the implementation of the Insolvency and Bankruptcy Code, in India. And as delay by every passing day is hampering the smooth outcome of the resolution plan may it be the maximization of value, recovery rate for creditors, & the economic viability of the CD. Thus to sum up in spite of all round efforts & emphasis been laid on timely completion of resolution plan, it seems that the entire ecosystem is still struggling to find a viable way out on addressing the timeframe involved in resolution mechanism. An overview analysis on timelines in CIRP remains a major stumbling block in the CIRP process & all stakeholders involved in the ecosystem needs to contribute overwhelmingly in a positive way to adhere to the timelines stipulated in the Code.

Debt Recovery

As per data revealed by IBBI s newsletter till September, 2023 total 808 CIRPS has ended with Resolution Plans. In these cases, the creditors realized 3.16 lakh Cr. under the resolution plans against the total claims of the creditors worth Rs. 9.92 lakh Cr. The realization to the creditors was 31.85%.²⁴ It implies that the creditors have undertaken haircut of 68.15%. It implies that despite of initial hiccups the dismal performance of CIRP as far as recovery is a concern which remains to be address. However, there is still a great deal of space for improvement in the recovery value.

Economic Impact of Delay on Value Maximization

The fundamental rationale of the insolvency law is to maximize the value of assets. The statement of objects in IBC states that one of the key objective for the enactment of the Code is to “maximization of value of the assets”. Timely resolution is necessary for value maximization, but it also requires a smooth Corporate Insolvency Resolution Process (CIRP). In order to make an expeditious decision regarding the revival or liquidation of the corporate debtor in order to put its assets to the best possible economic use, the Preamble of the Code refers to the maximization of the value of the debtor's assets in a time-bound manner while balancing the interests of all stakeholders. According to experts, delays have caused a degradation of asset value. The Insolvency Law Committee expressed worry over these delays. Committee recognized the importance of time in any bankruptcy procedure, and observed that delays might result in a major decline in the value of the corporate debtor's assets.²⁵ A long process

of CIRP and to sell the assets poses the risk of frustrating the objective of value maximization. Asset can lose their value rapidly.

For enterprises with little or no activities, and delay in the CIRP period results in higher CIRP expenditures, which must eventually be covered by the creditors in the form of a reduced recovery. Recovery percentages decrease drastically to 15–25 percent as resolution time’s rise.

During the CIRP timeline, a number of components, both controllable and uncontrollable, impact the firm’s performance. These elements include the company's foundation, management competence, vendor and client assistance, RP and RP's team competent, sectoral policies, macroeconomic considerations, etc. Additionally, many of the enterprises lack sufficient cash and operating capital as a result of the lenders' lack of interim finance backing. The enterprises that recorded greater revenue over the aforementioned period also benefited from the cyclical upswing in the steel industry, with regards to both volume and pricing. In certain instances, lenders that are proactive and helpful, together with a similarly effective RP and team, have outperformed their counterparts and added value for investors.

Conclusion

IBC is seven years old law and settled now. Although the bankruptcy and Bankruptcy Code (IBC) has significantly transformed India's bankruptcy scene, the ongoing delays provide a significant challenge. It has enhanced the financial behavior of all the players of insolvency field, it also

improves recoveries enormity by two to three times, it has reduced resolution timeline significantly. Time is of the essence, and it must be recognized from the manner of resolution, chosen in the resolution plan by the corporate debtors and committee of creditors, as well as from the stakeholder causing the delay. The Insolvency and Bankruptcy Code of 2016 is subject to many internal and external events

that may cause delays. The government and other relevant parties have demonstrated agility in addressing the concerns that have arisen from the current legal disputes. The Code has been effective in stabilizing important legislative issues during the past seven years. For stakeholders, however, the prospect of a deadline-bound conclusion remains a far-off fantasy.

Reference & Note:

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6. Companies Act, 1956/2013
7. SICA 1985
8. Recovery of Debts Due to Banks and Financial Institution Act, 1993 (RDBFI), Securitisation and Reconstruction of Financial Assets and Security Interest, 2002 (SARFAESI).

9. Which affected badly on the ranking in the World Banks Ease of Doing Business. In 2010 India ranked 133 in the list of 189 countries. <https://archive.doingbusiness.org/en/data/explortopics/resolving-insolvency>
10. The Government of India setting up the Bankruptcy Law Reform Committee under the chairmanship of Dr. TK Vishwanathan in August, 2014. In its report the committee recommended the urgent need of enactment of Insolvency Regime in the country. For details visit:
https://ibbi.gov.in/BLRCReportVol1_04112015.pdf accessed on 25th October, 2023.
11. Part II of the Code deals with the Corporate Insolvency Resolution Process and liquidation procedure. Corporate insolvency Resolution Process can be initiated on when a corporate debtor commits a default [section 4 (1) of the IBC]
12. World Bank Group, Doing Business Report, 2020.
13. World Bank Group, Doing Business 2018, 15th edition, p. 132.
14. SICA was repealed in December 2016 after the coming into effect of Insolvency and Bankruptcy Code, 2016.
15. With reference to Sec. 14 of IBC, Once the resolution proceedings are initiated the statutory moratorium is imposed which prevented creditors to initiate/continue a legal

proceeding against the Corporate Debtor. The reason behind this provision is to preserve the assets of corporate debtor, and to provide a breathing space to debtor work on the resolution plan without any disruption.

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