Profiting from Debt*

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In a stealthy game played over two decades, corporate India is walking away with huge wealth transfers, largely from the public banking system. After much delay, the halting process of settling the bad debt of defaulting corporates using the Insolvency and Bankruptcy Code (IBC) is being completed in a rising number of cases. When examining the outcome of cases of completed resolution what emerges is that (i) public banks are taking huge "haircuts" and suffering losses, the burden of which falls on the tax payer who funds recapitalisation; (ii) those who acquire the assets of the corporate defaulters that underlie this debt, obtain it at bargain prices; and (iii) promoters and principal share owners who are the managers of the defaulting corporate are beneficiaries of massive debt write offs in companies from which they skimmed profits in the past. Incurring debt, defaulting on its repayment and arriving at a settlement that may or may not bring in a third party seems to be a means to transfer wealth from the State to big business in post-liberalisation India.

The evidence has become so compelling that even the National Company Law Tribunal (NCLT), the judicial agency through which the resolution plan proposed by the "resolution professional" and accepted by a "committee of creditors" (CoC) must pass, has expressed doubt about the integrity of the process. Consider for example the case of Videocon Industries, that had been lined up for resolution of its non-performing debt of Rs 35,000 crore and brought before the National Company Law Tribunal. The resolution involved the takeover of Videocon by Twin Star Technologies, a Vedanta group company, owned by mining magnate Anil Agarwal. According to the resolution plan, which the creditors of Videocon had approved, Twin Star is to pay Rs 2,962 crore in return for the "bankrupt" defaulter. That is, the creditors were settling for a scheme that involved Vedanta acquiring Videocon by clearing the equivalent of just 4.15 per cent of the outstanding debt and the creditors settling for a "hair cut" of 95.85 per cent.

Mind-Boggling Logic

The logic used to justify this transaction is mind-boggling. The Committee of Creditors found the offer acceptable solely because the sum offered by Vedanta was higher than the estimated "liquidation value" of Rs 2568.13 crore arrived at by the "valuers" accredited by the Insolvency and Bankruptcy Board. The liquidation value is the (hypothetical) sum the valuers believe the creditors would recover if they stripped Videocon of its assets and flogged them in the market. The problem here is that the method of arriving at a firm's liquidation value may not reflect its true value for the acquirer. In the case of Videocon, among its assets is a 25 per cent stake in the Ravva oilfield, which is jointly owned by ONGC (40 per cent), Videocon (25 per cent), Cairn energy (which Vedanta had earlier acquired) and sundry others. The average output from the Ravva oilfield reportedly rose from 14,232 barrels of oil equivalent per day in 2019-20 to 22,037 barrels per day during April-June 2020. By acquiring Videocon at what is a huge discount relative to its debt to creditors, Vedanta is raising its combined stake in Ravva from 47.5 per cent, well ahead of ONGC's 40 per cent. This alone, besides whatever other assets in the form of production capacities and real estate Vedanta gets from Videocon, would warrant the company

paying a sum much higher than the liquidation value. But the way the IBC resolution scheme is being framed and implemented, the CoC can accept what appears to be a ridiculously low offer and the NCLT does not have much option other than approve the transfer to Vedanta, since the IBC process has been followed.

However, even the NCLT could not remain silent in the face of what seems to be a gratuitous transfer of wealth from the banks to a big corporate. While granting approval, the NCLT noted that the scheme involved Vedanta paying almost nothing to the creditors. Moreover, the NCLT felt it necessary to request the Insolvency and Bankruptcy Board of India (IBBI) to examine whether confidentiality requirements had been met in the resolution process, especially since the successful bid was so close to the liquidation value at which assets could, probably, have been sold as scrap. By flagging the small difference between the successful Vedanta bid and the liquidation value, the NCLT was implicitly casting doubt on the integrity of the resolution process, and perhaps signalling the possibility of fraud. Meanwhile, the original promoters of Videocon, who may or may not have managed to divert a part of the wealth and profits created with the Rs 35,000 crore of debt they did not repay, can rest satisfied that they have cleared their commitments by handing over to the creditors the assets they built with the help of those loans.

Sometimes the outcome of the debt settlement process can be even more bizarre. Defaulting promoters have the possibility of getting a huge discount on the debt they are called on to repay even while retaining control over the defaulting corporate. A case that is in the final stages of adjudication by the Chennai bench of the NCLT is revealing. Siva Industries Holdings Ltd promoted by C Sivasankaran was brought by creditors to the Corporate Insolvency Resolution Process in July 2019 for defaulting on payments of debt of Rs 4,863 crore. In a curious turn, close to two years later, the CoC led by IDBI bank decided to exercise a provision (Section 12A of the IBC) allowing for a one time (negotiated) settlement with the debtor, and sought withdrawal of its application for redress through the normal resolution process. As per the proposed settlement creditors would receive only Rs 323 crore from Siva Industries and an expected Rs 555 crore from third party guarantors, while Mr Sivasankaran will regain control over his company. Not surprisingly, the NCLT has asked the creditors represented by IDBI to explain the rationale underlying their decision to settle. If the settlement plan is approved, this can be a new precedent for defaulters to buy back at a huge discount companies put up for sale because of promoter default on debts they incurred.

These recent instances only underline the fact that the Insolvency and Bankruptcy Code (IBC), hailed as a game-changing bankruptcy law is serving as a means of transferring wealth to capitalists. The code merely gives the process a veneer of legality. It has been known for close to a decade now that the credit boom of the 2000s that saw huge increases in lending to big business had led to the unsustainable accumulation of bad debt in the books of Indian banks. It was also clear that with the defaulters now consisting mainly of big corporates with huge loan exposures, recovering a reasonable share of that debt was proving to be extremely difficult. Disputes were dragged to the courts and languished there for years, even while assets with the corporate debtors that could be expropriated as compensation were stripped or just suffered erosion of value.

It was in this context that the government decided to frame and enact the IBC of 2016. Earlier frameworks for resolution, such as the Debt Recovery Tribunals, the Lok Adalats and even the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act (SARFAESI Act) of 2002, which sought to provide more power to the creditor's elbow, had proved unequal to the task. Unable to recover these big loans, banks faced the prospect of insolvency, unless the government underwrote a large share of their losses. The IBC, it was argued, through an efficient and time-bound process, would achieve what the legacy channels could not.

This view has been bolstered by referring to instances such as Essar Steel, where the creditors managed to recover 92 per cent of Rs 49,000 crore of debt outstanding, Bhushan Power and Steel in which 41 per cent of Rs 47,157 crore debt outstanding was recovered, Bhushan Steel in which 64 per cent of Rs 56,022 crore outstanding was retrieved, and Binani Cements in whose case all of the Rs 6,469 crore outstanding was recovered. Not only were these recovery rates significantly higher than recorded under legacy channels including the SARFAESI Act, but they reflected substantially lower haircuts than the paltry sums which could be garnered through the liquidation route.

The problem with this argument is that it fails to note that these instances of high recovery are more the exception than the rule. If we take the experience with resolution under the IBC till March-end 2021, several features stand out. First, if we consider the proportion of outstanding credit recovered from defaulters through the resolution process, the figure stands at 39.26 per cent even for the minority of cases (348 out of 4376) resolved through the Corporate Insolvency Resolution Process (CIRP), which is not very much higher than the 26 per cent registered for cases dealt with under the SARFAESI Act. The argument that the IBC would be a game changer is yet to be validated.

Second, even this 39.26 per cent recovery figure is explained by the overwhelming influence of the "exceptional" cases which were few in number but large in terms of the claims admitted and resolved. Thus, in the second quarter of 2018, Bhushan Steel accounted for Rs 35,571 crore of the total of Rs 42,885 crore realised from a total of 12 resolution approvals; in the third quarter of 2019 Bhushan Power and Steel accounted for Rs 14,789.63 crore out of the Rs 27,159.17 crore realised from 31 cases, and in the first quarter of 2020 Jaypee Infratech accounted for Rs 23,223 crore of the Rs 25,355.37 crore realised from 29 cases. As a consequence, there have been only 7 out of 15 quarters in which the ratio of realisation value to the claims admitted has been at or above 30 per cent, or the haircut accepted by creditors has been less than 70 per cent on average.

Finally, if we examine the ratio of realisation value to liquidation value, it was below two in 11 out of 15 quarters, and has been at or below 1.3 in 8 out of 15 quarters. Despite the successes, the average amounts realised in most periods have not been significantly above the liquidation value. That is, the resolution process has not helped recover very much more than what could have been obtained through liquidation in most cases. That validates the NCLT's query on the integrity of the resolution process.

For all the hype, the IBC has not been able to help banks recover the loans they have given major corporate players, who with impunity have just refused to service those liabilities. Rather it has served as an instrument to engineer a transfer of wealth from the banks to big business. And most of those banks are publicly owned, in essence by the ordinary citizens of India.

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