A Non-performing Code for Bad Debt*

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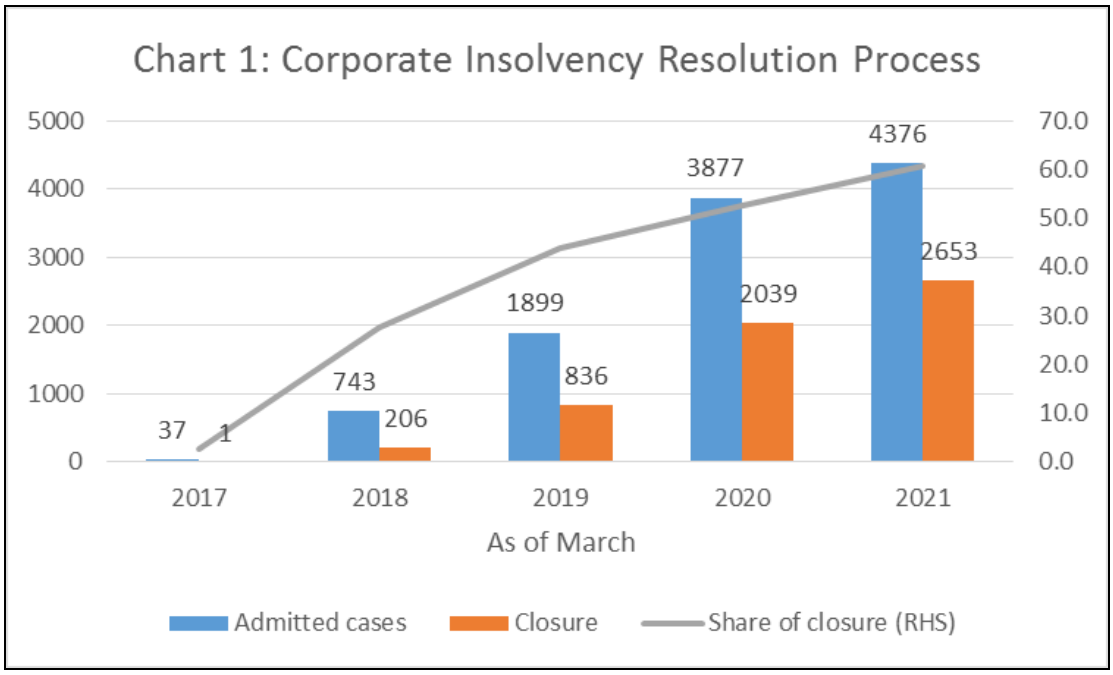
In mid-June, the National Company Law Tribunal (NCLT) approved a resolution plan for the Rs. 35,000 crore non-performing debt of Videocon Industries. The plan was a successful offer made by Twin Star Technologies, a Vedanta group company, and accepted by a committee representing the creditors exposed to Videocon. While granting approval, the NCLT noted that the scheme involved Vedanta paying almost nothing, with its successful offer amounting to 4.15 per cent of the outstanding claim and the creditors settling for a "hair cut" of 95.85 per cent. 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. Twin Star's successful bid offered creditors Rs. 2962.03 crore, whereas the valuers had estimated the liquidation value at Rs. 2568.13 crore. By flagging the small difference between the two, the NCLT was implicitly casting doubt on the integrity of the resolution process.

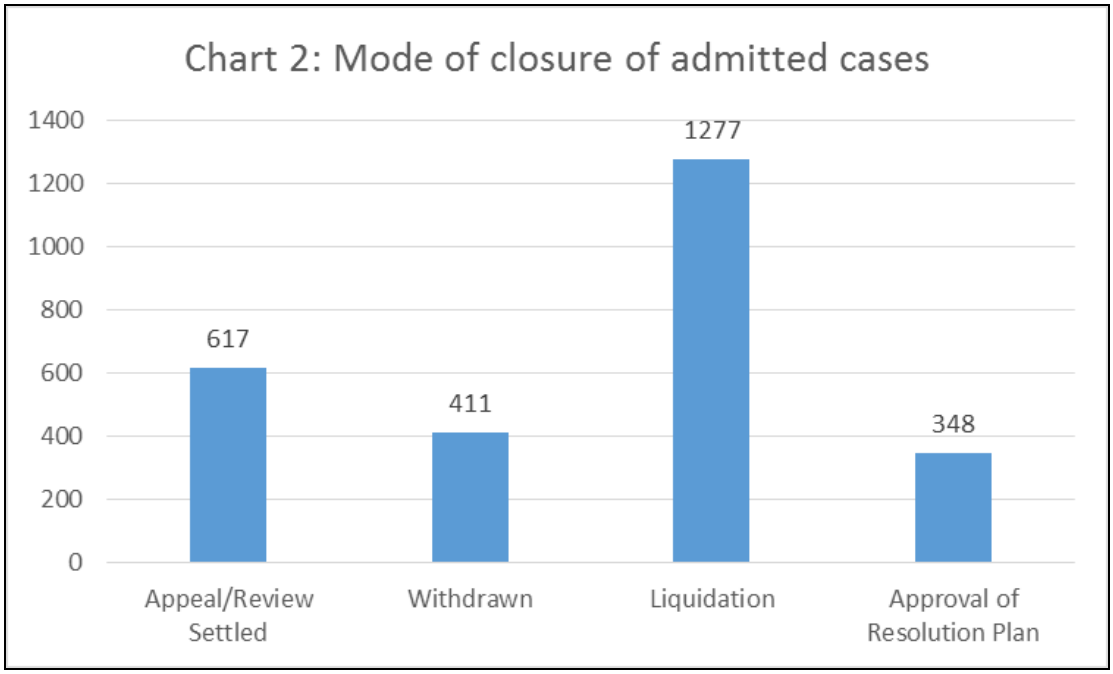
This is of significance since the Insolvency and Bankruptcy Code (IBC), which the NCLT oversees, has been touted as a game changer in the effort at debt resolution. It has been known for close to a decade now that the credit boom of the 2000s had led to the unsustainable accumulation of bad debt in the books of Indian banks. It was also clear that with the defaulters now consisting mainly of big corporates with huge loan exposures and deep side pockets, 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 Insolvency and Bankruptcy Code (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. 49,0000 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, out of the 4376 cases for which the Corporate Insolvency Resolution Process (CIRP) had commenced, only 2653 have been closed, with just 348 (or 13.1 per cent) of those closed being disposed after approval of a debt resolution plan (Charts 1 and 2). As many as 1277 cases closed (48.1 per cent) were sent for liquidation. (The remaining were either closed after appeal/review or withdrawn.) The high share of liquidation indicates that resolution was ensured only in a minority of cases.

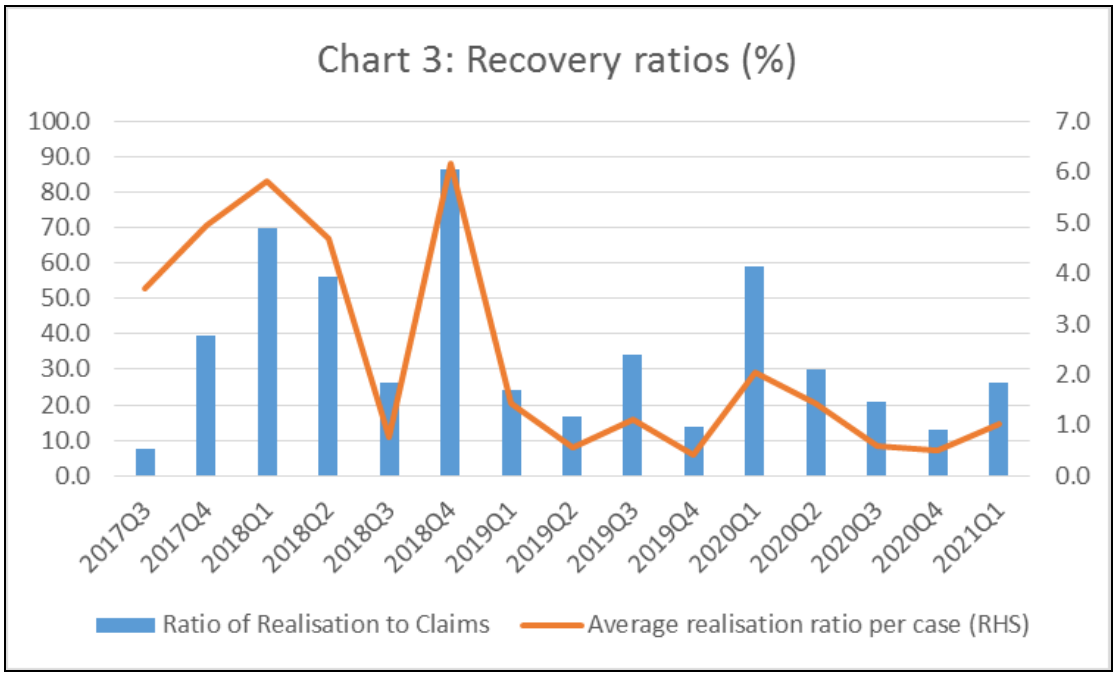




Second, if we consider the proportion of outstanding credit recovered from defaulters through the resolution process, the figure stands at 39.26 per cent even for the

minority of cases resolved through the 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.

Third, 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 (Chart 3), or the haircut accepted by creditors has been less than 70 per cent on average. Moreover, if we consider the average realisation ratio per case, even accounting for the successes, that figure has been less than 6 per cent in all quarters, indicating that the realisation ratio in the poor performers must have been extremely low.

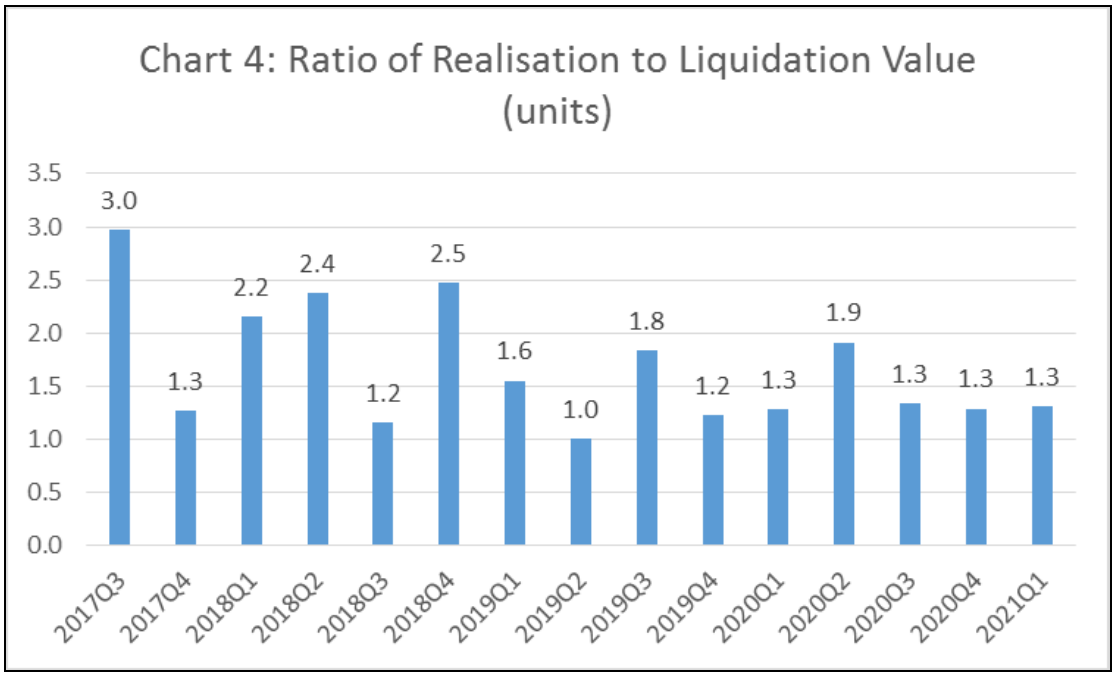


Finally, if we examine the ratio of realisation value to liquidation value, it was below 2 in 11 out of 15 quarters, and has been at or below 1.3 in 8 out of 15 quarters (Chart 4). Despite the successes, the average amounts realised in most periods have not been significantly above the liquidation value. 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.

All these of course refer to the 348 cases that were closed through approval of the 2653 cases admitted to the corporate insolvency resolution process. There are 1723 cases still awaiting closure. Many of these have been under consideration for long, and the delay in closure suggests that they are cases where it is either difficult to find

a bidder for the asset or where the committee of creditors is unsatisfied with the bids received. We can expect that, when some of these are resolved, the haircut would on average be high and the recovery would not be very much higher than the liquidation value.

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.



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