Addressing the Insolvency and Bankruptcy Code's oversights and flaws

By Zubin Mehta and Amrita Sinha

It has been asserted that the Insolvency and Bankruptcy Code (IBC) intends to effectively resolve distressed companies and safeguard the interest of all stakeholders by providing a collective mechanism for resolving insolvency within a framework of equity and fairness. However, it remains to be seen if the process under the IBC indeed upholds the objectives of fairness, collective resolution and equality.

The financial creditors have been provided the "privilege" of selecting a resolution plan for a distressed company owing to their ability to take business decisions. This gives rise to a conflict of interest between the voting financial creditors and other creditors since, at the resolution stage, the immediate focus tends to be on debt pay-outs to lenders rather than on charting a course to get the company back on its feet. Since the resolution applicants are guided by an evaluation matrix prepared by financial creditors (which focuses on the amount of upfront and deferred payment that will be paid to them), the resolution plan could well become a recovery plan. Furthermore, there are no safeguards against the non-voting stakeholders getting squeezed out, since no one participant in the process has been tasked with the objective of keeping a watch on this risk.

Even among the voting creditors, it is unclear if the process promotes collective decision-making. The recent IBC amendment ordinance proposes that only 66% (as opposed to 75%) of the financial creditors are required to approve a resolution plan, with no substantial explanation for such change. This raises two problems. First, lower aggregate percentages for approving a resolution plan mean greater control in the hands of a few creditors who can swing the voting on the resolution plan, thereby moving away from the objective of collective decision making. Second, if the amount promised to each lender under the resolution plan is not significantly higher than the liquidation value payable to each lender (which is usually the case), minority creditors may be encouraged to vote against a plan in the hope that the plan will be passed by the majority creditors – since as dissenting creditors, the minority creditors will recover their dues in priority to the assenting creditors. This could result in each creditor second-guessing the other lenders' decisions, and, based on that, deciding to vote collectively or to compete for an early payout.

These concerns and other issues under the IBC will need to be ironed out with time and evolution of jurisprudence. Piecemeal, knee-jerk changes to the IBC may hamper such an evolution and the continuous shifting of principles may dilute the IBC's desired effect.

Please read the full article here:
https://www.livemint.com/Opinion/EhwzbhjanrTThHRr6dxBzO/Addressing-the-Insolvency-and-Bankruptcy-Codes-oversights-a.html

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