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Why resolution process is virtually impossible under the Insolvency and Bankruptcy Code

BY [SUMAN LAYAK](#), ET BUREAU | UPDATED: JUL 07, 2019, 01.35 PM IST

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On Dr Dadabhai Naoroji Road in Mumbai's Fort business district, barely 300 metres from the [National Company Law Tribunal \(NCLT\)](#) courts in Mumbai, sits Kini House, the offices of the law firm MV Kini & Company. Its entrance is easy to miss, with an array of shops on the ground floor selling cheap electronic gadgets and knick-knacks.

The facade is partially hidden by construction paraphernalia of the Mumbai Metro line that's coming up. An old hand at working the wheels of the debt recovery tribunals across India, this firm is the legal counsel for most Indian public sector banks.

Two years ago, its area of business underwent a dramatic shift. The [Insolvency and Bankruptcy Code \(IBC\)](#) came into effect in 2016, becoming the preferred debt default resolution route, and the legal needs of lenders and insolvent companies changed.

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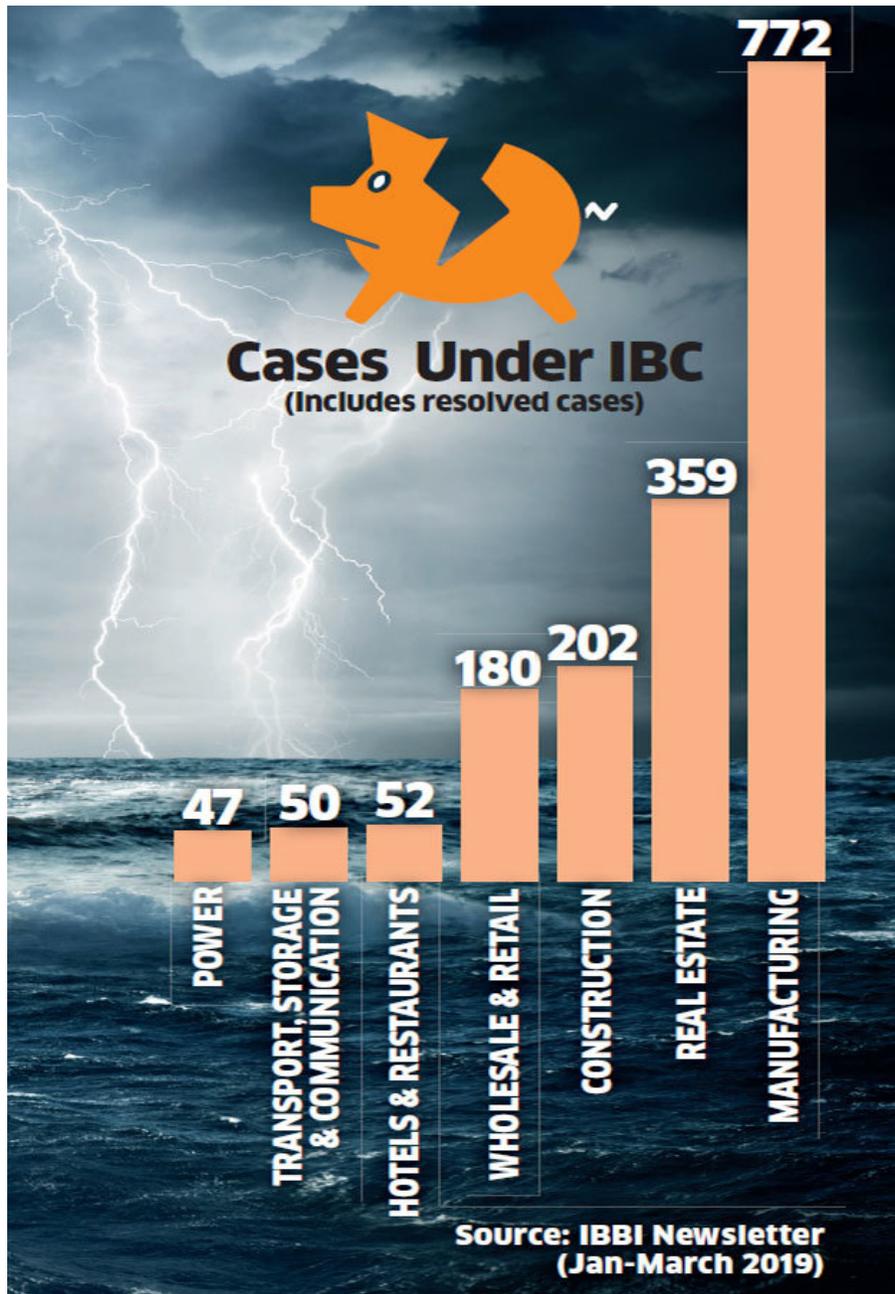
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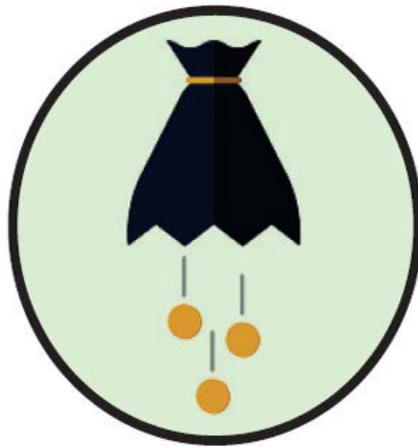


The firm quickly retrained, hired and deployed people to run the show, and also upgraded the staid interiors to a more modern look. Today, it handles 30-odd IBC briefs, representing lenders, debtors and, in some cases, operates as the “resolution professional” who takes charge of an insolvent company. Many law firms across the country, the large audit and accounting firms, as well as investment bankers and consultants made similar moves to work on the new insolvency regime.

In the last nine quarters — between January 2017 and March 2019 — 1,858 companies have been admitted to the corporate insolvency resolution process. Of this, 715 have exited the process — 378 of them have been liquidated and 337 have either withdrawn or accepted the resolution plans. Many from the latter group have also moved the appellate authority, the National Company Law Appellate Tribunal, or the Supreme Court.

The number of cases exiting the system per quarter has dropped over the last two quarters. Consider the 12,000-odd insolvency petitions, a majority of which are yet to be admitted by the NCLT courts, and one can gain an estimate of the humongous amount of litigation that the IBC has unleashed.

Deals Off the Table



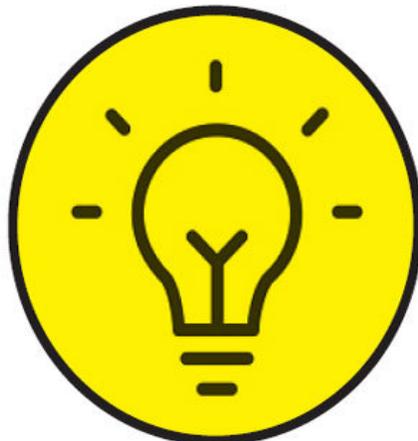
74%

drop in deal
value in
Jan-May 2019
over same
period in 2018



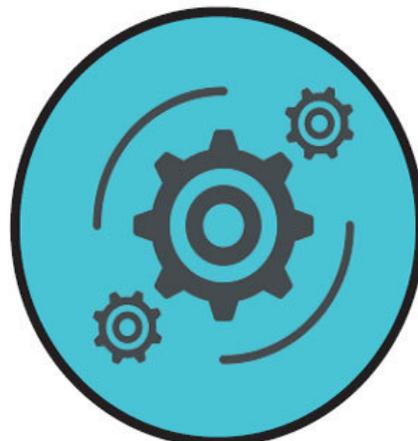
11%

drop in volume
of deals
in Jan-May
2019 over the
same period in
2018



61%

of the deal
volume (34)
in Jan-May
2019 came
from IT sector



81%

of deals by
value were from
manufacturing,
pharma,

and tech
startups

IT, energy &
banking

Source: Grant Thornton India

The central promise of IBC was a time-bound resolution of debt that has gone bad, which, when unresolved for long periods, has a corrosive effect on lenders, investors, liquidity and sentiment. Resolution of insolvent companies allows lenders to recover their dues partly and, also where possible, salvage parts of the company's business after debt obligations have been met. The process also allows a company to make a fresh start, with a new set of promoters and a healthier balance sheet.

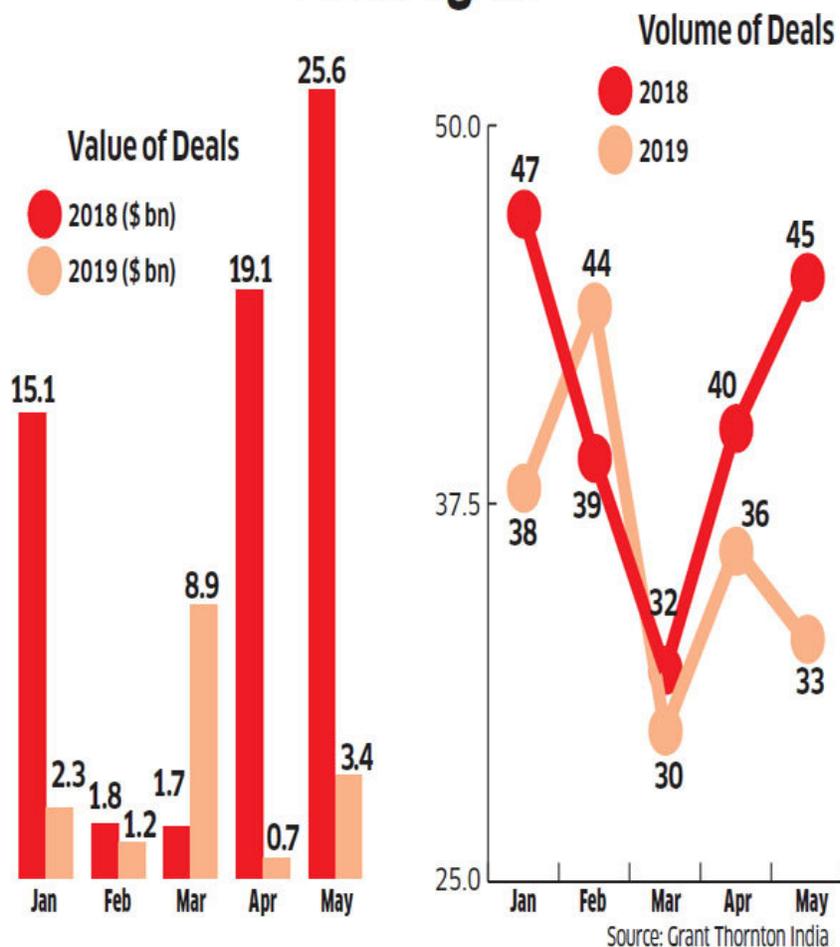
But this promise now appears to be under threat, with the NCLT infrastructure proving woefully inadequate for the quantum of cases flooding the system. The lack of established legal precedents, which will only build up over time, also makes litigation under the IBC framework elaborate and time-consuming.

The net result is that resolution, especially in marquee cases involving large amounts of bad debt, is often taking far longer than the envisaged timeline of 180-270 days.

"The NCLT courts are starting to resemble metropolitan magistrate's courts with little infrastructure and makes us wonder if the government is serious about recovery of debt," says Supreme Court senior advocate MV Kini.

The Reserve Bank of India had flagged IBC as its preferred solution for bank bad debts, by pushing 12 flagship cases such as Essar Steel, [Bhushan Steel](#) and Bhushan Power and Steel into the IBC process in June 2017. It followed up with a second list of 26 defaulters in October 2017. Upping the ante, on February 12, 2018, the apex bank recommended a mandatory push to IBC for any corporate defaulter, after banks had spent 6 months trying to find a resolution.

Deal Digest

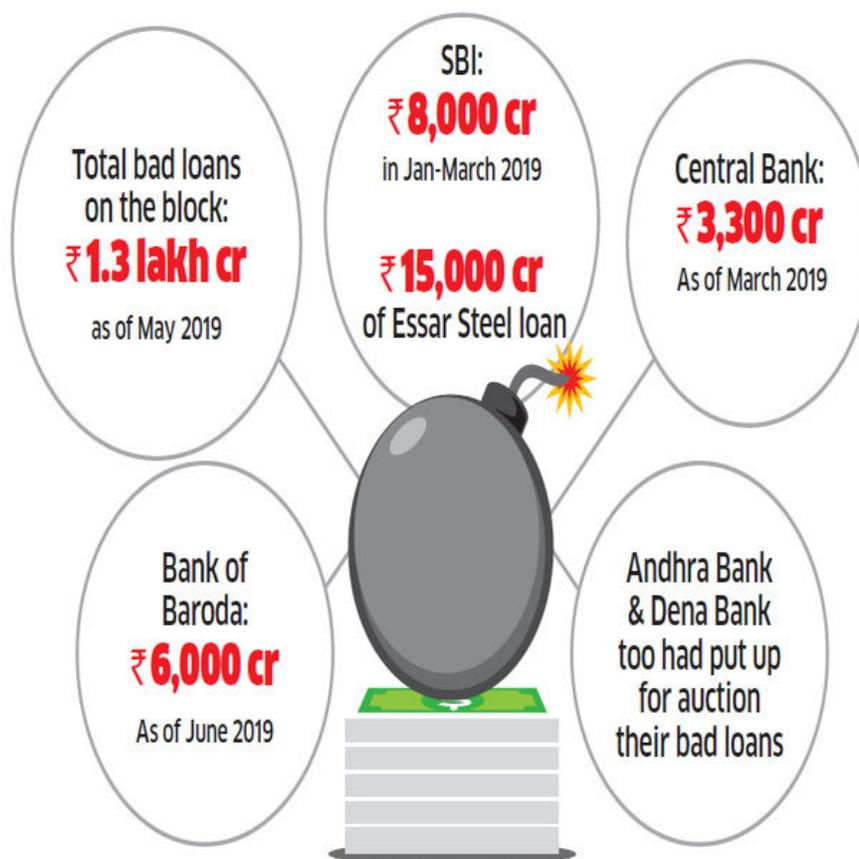


This last bit, known as RBI's February 12 circular, was set aside by the Supreme Court in April 2019. However, in the intervening months, many Indian bankers had generally adopted RBI's stance of pushing every bad debt/debt default case into the IBC process. The IBC process was meant to serve as a deterrent, incentivising promoters to pay up or reach a deal with lenders, rather than end up in the NCLT, with the risk of losing their companies.

Matters indeed started off well. By late 2018, the prospect of quick resolution via the IBC had spurred a healthy market for bad loans, and by May 2019 Indian banks had put Rs 1.3 lakh crore worth of bad loans on the market, for funds specialising in distressed companies to take over. That is around 10% of all bad loans (gross non-performing assets) with the banks.

However, only Rs 30,000 crore to Rs 35,000 crore worth of bad loans have changed hands. The sluggishness at NCLT has dampened pre-NCLT deals as well. There has also been a general slowdown in all kinds of deals in 2019 over 2018. According to Grant Thornton, between January and May 2019, deal values were down by 74% year-on-year, whereas by volume they were down 11% over the same period of 2018.

Lenders' Bad Loans for Sale



At a recent meeting in Singapore in the first week of June, where mandarins of Insolvency & Bankruptcy Board of India were present along with Indian lawyers and insolvency professionals, foreign distressed funds expressed their concern with the slow processes. "There is serious deal fatigue setting in within the investor group as despite their efforts, time and costs being incurred towards diligence, deals are still not getting closed.

There is an urgent need to correct measures that are creating impediments for deal closures pre-NCLT and in NCLT as well," says Manish Aggarwal, partner and head of Infra M&A and Special Situations Group at [KPMG](#).

Running Circles Around Process Let us take the case of Vijay Kalantri-promoted Dighi Port, where MV Kini & Company represents the Committee of Creditors, a committee of all the financial lenders of the company set up under the IBC. The company owes its lenders Rs 2,628 crore. The case illustrates how different arms of the government worked at cross purposes.

Abhay Itagi, who heads MV Kini & Co's IBC practice, throws up his hands as he explains how the case has meandered through legal and bureaucratic logjams. While state-owned Jawaharlal Nehru Port Trust (JNPT) emerged as the preferred bidder to take over the port around 150 kilometres to the south of Mumbai, JNPT was unable to get the central government to okay bank guarantees worth Rs 100 crore it needed to provide. Last week, on July 2, the NCLT allowed the creditors to file an application to seek out other bidders who had earlier been rejected in favour of JNPT.

Among the rejected bidders was Adani Enterprises, which had offered a higher bid, but without guarantees. Earlier in March, at the end of another legal battle, the NCLT had allowed IMICL Dighi Maritime Limited (IMDL), a subsidiary company of IL&FS, the status of a financial creditor.

IMDL had advanced money to Dighi Port in lieu of getting control and revenues of some berths at the port. Now, consider the fact that most creditors to Dighi Port are public sector banks, some of whom also own large stakes in IL&FS that controls IMDL - effectively under government control.

Asset Rescuers

Global funds that are buying distressed assets in India

AION Capital Partners

Apollo Global-ICICI Ventures joint venture

KEY DEALS

Sep 2018

Acquired Creixent Special Steels and Milloret Steel from JSW under IBC

Mar 2018

Winning bid to buy Monnet Ispat under IBC

India RF

Piramal Enterprises-Bain Capital Focus JV

KEY DEALS

May 2019

Bought Indian Steel's bad debt from SBI

Jun 2018

Invested in Archeon Chemicals

Oaktree

Alternative investment fund

KEY DEALS

Jan 2019

Bought ₹1,375 crore debt from DHFL

Sep 2018

Partnered with Edelweiss ARC to acquire GTL Infra's ₹4,000 cr debt

SSG
Alternative asset management firm

KEY DEALS

Apr 2018

Took 47% stake in Shapoorji Finance

Feb 2018

Bought \$385 million of debt from Bhushan Steel via its ARC

May 2016

Acquired 14.7% in Asset Care and Reconstruction Enterprise

Blackstone
Private equity fund

KEY DEALS

Oct- 2018

Winning bid to acquire Trident Hyderabad

Nov 2017

Bought IARC to enter India's asset reconstruction segment

Other Players: KKR, Multiples, Varde, Lonestar, Avenue Capital Group, PAG, Centerbridge, Fight Capital, ADV Partners.

Cereberus, Broad Peak, Carval, Bay Capital, Bank of America

Source: News agencies and investment bankers



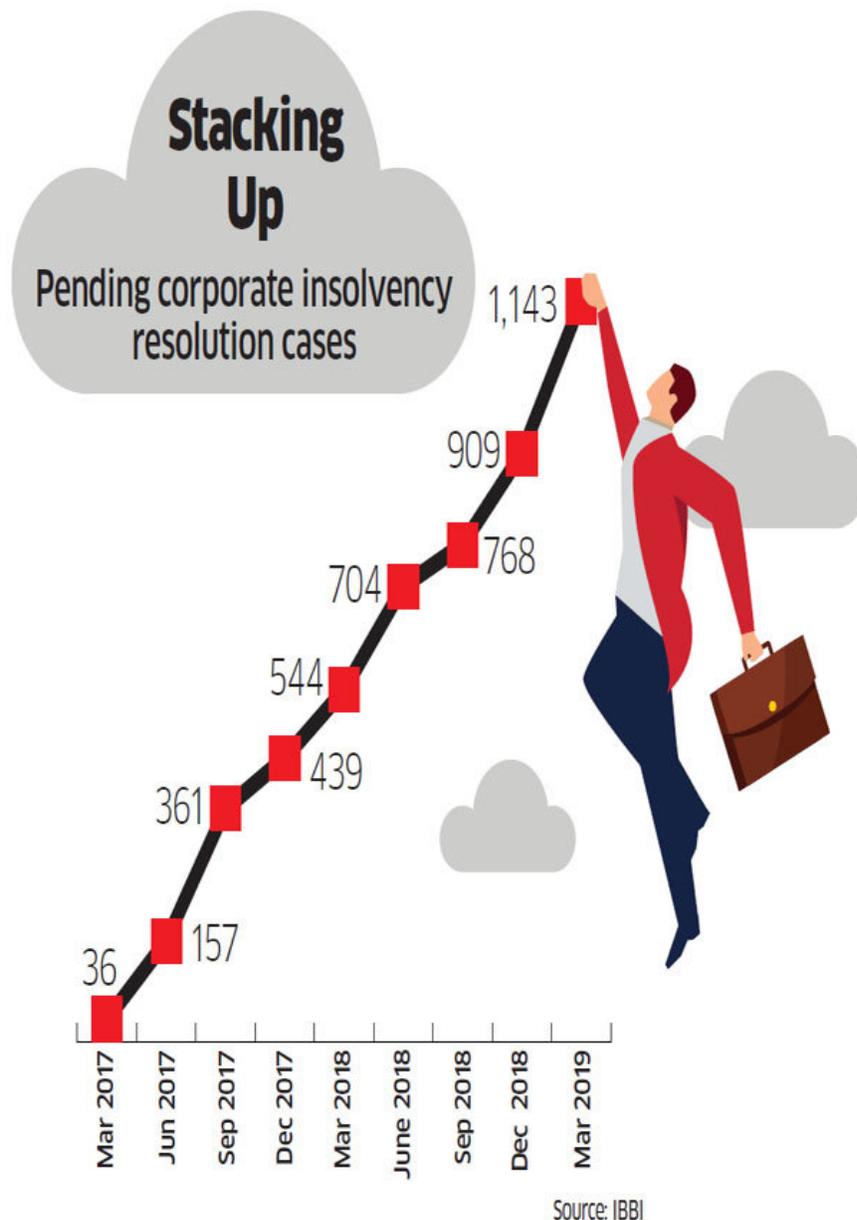
Or, take the case of Jyoti Structures, a power infrastructure company that owes lenders Rs 7,091 crore. It was among the first 12 companies sent to NCLT by the RBI in June 2017. The resolution professionals for the company had filed a resolution plan in March 2018, and the NCLT approval came in July. However, the issue went to the appellate tribunal and the final approval from the NCLAT came only in March 2019. Sources indicate that because of the year-long delay, the sole bidder for Jyoti Structures, a consortium of companies led by Sharad Sanghi, might now need some help in arranging necessary funds.

Sandeep Upadhyay, MD of [investment banking](#) firm Centrum Infrastructure Advisory, says a company being in NCLT is akin to a patient being in an ICU. "The longer it takes to consummate a transaction, the asset quality is exposed to potential deterioration, leading to deal fatigue in many cases."

Top cases like Essar Steel have seen their share of litigation too, with many going to the Supreme Court. Only on July 4, 2019, did NCLAT finally reject promoter Prashant Ruia's case challenging the eligibility of [ArcelorMittal](#) to bid for the company. For Essar and Jyoti, the process has been on for two years from the time when they were referred to the NCLT, a far cry from the 180-270-day resolution envisaged in the IBC.

Essar Steel's debt was among the earliest to be sold off -ICICI Bank sold Rs 1,600 crore worth of debt in 2016 to Edelweiss ARC, while [State Bank of India](#) had put debt worth more than Rs 15,000 crore on the block in January 2019.

The market for bad loans is often affected by the speed of the resolution process. These loans are bought at a discount with the hope for a higher recovery when the resolution takes place. For Essar Steel, given the interest from top global steel companies, there was a good chance of recovering its entire debt, offering a high return to anyone buying the loans.



However, once the process is delayed by more than a year, the returns fall. One of the earliest players in the game of buying out loans, Anil Bhatia, MD of JM Financial ARC, said global interest in Indian distressed assets after IBC started had created a rush.

"Every other investor wanted a piece of the action, expecting multifold returns. Some overseas brokers and investment bankers started distributing deals without understanding the underlying assets. These brokers and investment bankers thought this is easy money and probably promised the same to their investors -'buy at 50 cents to a dollar and make closer to 100 cents'," he said. He added that now with the delays, these investors are confused as their internal rate of returns calculations are going awry, developing in turn a fatigue with the Indian situation.

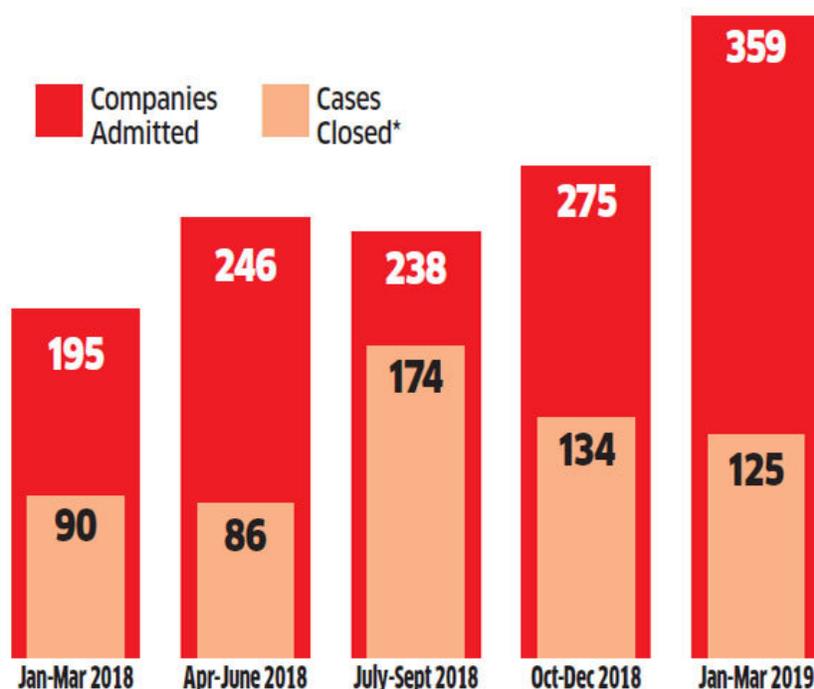
Bargain Hunters

However, a different kind of buyer is finding the circumstances attractive. These are the experts in distressed assets, who know how to play the waiting game. Today, however, there are too many deals chasing too few buyers. While some players such as Apollo Global, SSG, Bain and Oaktree have set up Indian shops, or JVs, others are still playing the waiting game, preferring to invest in select deals. Alvarez & Marsal, a global distressed assets expert, has opened a large presence in India and is involved in a range of services, from managing assets to finding investors. Some players, such as Bank of America, Cantor Fitzgerald and SC Lowy, are also placing Indian distressed debt papers with their global clients.

Bhavik Hathi, MD for the financial sector at Alvarez & Marsal, says that early investors in distressed assets in India were foreign PE funds that operate with small teams, and may not find it worth their while chasing the deals any more if the process lingers. "Funds specialising in distressed assets, however, have a different DNA, and are used to longer processes that also need more manpower. Many of them are interested in India."

Such a Long Queue

While numbers of new cases admitted to insolvency resolution has risen, the number of cases exiting the system per quarter has dropped after an initial spurt



Source: IBBI Newsletter (Jan-March 2019)

*Cases closed include withdrawals, settlements or those being appealed against, approval of resolution plans and liquidations

Aggarwal of KPMG adds: "The test for IBC is when due to the fear of losing control and with the NCLT process not always providing optimum value, both lenders and sponsors work out a solution much earlier and that's why pre-NCLT deals will be the norm in a majority of the cases."

Prateek Jhawar, director of investment banking at Avendus Capital, predicts a turnaround in the situation in the next 12-18 months with speedier deals in distressed assets. He says, "Global interest in Indian distressed assets remain, but they will now seek the right price. Gross NPAs with banks have peaked. When the demand cycle turns and demand for loans pick up, banks will be more willing to let go of old assets at lower prices and deploy the capital in a more profitable manner."

Much more can happen in the next 18 months; at the least one can be hopeful. For one, the Mumbai Metro construction is likely to be over and reaching the NCLT courts from Kini House would be a hop, skip and jump.

The IBC, three years old today, would be closing in on five years. Market players feel time-bound resolution of insolvency through NCLT courts should also take five years to settle down, like it did in the United Kingdom. For starters, it will need a library of Supreme Court judgments on IBC cases to ensure faster resolution in the future. On July 4, 27 new judges took oath to sit on NCLT benches, and the next 18 months will likely see the resolution process gaining some much needed speed.

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