# IBC Unravelled*

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The Indian government's effort to resolve by force its banking crisis with the help of the Insolvency and Bankruptcy Code (IBC) has hit yet another roadblock. Even when major secured creditors agree to a resolution plan, because they have to take a smaller haircut or loss, the IBC process may not work. This is because the tribunal at the apex of the specially constructed resolution architecture has chosen to reinterpret the Code in a manner that could make it difficult to implement that solution.

The unravelling of the IBC has occurred in the long-standing Essar Steel debt default case, where the debtor had accumulated debt in the neighbourhood of Rs. 50,000 crore. The lead creditor, State Bank of India, decided to use the IBC route to recover its share of the dues and filed an insolvency petition with the National Company Law Tribunal in August 2017. Having gone through a long tortuous journey that effort at resolution of a large non-performing asset (NPA) seemed to have reached its goal in March this year when the Ahmedabad bench of the National Company Law Tribunal (NCLT) approved a plan for takeover of Essar by Arcelor Mittal for a sum that would have covered as much as 70 per cent of the credit due to the secured creditors from Essar. Arcelor's offer to pay Rs 42,202 crore upfront is reportedly adequate to cover the principal (without interest) due and outstanding to all secured financial creditors, ostensibly winning their approval.

But the resolution, which had already been delayed by the attempt of the promoters, the Ruia's, to win back control, has stalled again for two different reasons. First, on grounds that did not stand up to scrutiny Standard Chartered Bank was initially excluded from the Committee of Creditors (CoC) that negotiates the resolution plan. Standard Chartered had advanced a loan to an Essar subsidiary to secure coal supplies, against a corporate guarantee. The loan was subsequently restructured with an extended repayment period and backed by a pledge of shares of Essar Steel. The bank is due to be paid Rs. 2,646 crore as principal, and is owed interest of more than Rs. 1,000 crore. When excluded from the CoC, Standard Chartered approached the resolution professional who verified the banks claim of being owed a sum Rs. 3,478 crore and found that debt to be secured credit. So Standard Chartered had to be included in the CoC. Yet the "core committee" which negotiated with Arcelor, reportedly provided for only Rs. 60.71 crore to be repaid to Standard Chartered under the resolution plan. So Standard Chartered has approached the courts on grounds of losses arising from discrimination.

A second problem is that operational creditors, such as GAIL (India) and Gujarat Energy Transmission Corporation, were also left out of the resolution plan on the grounds that they were not eligible to be included, since they were not secured creditors. However, these grounds of priority for secured creditors relative to other lenders apply to a situation of "liquidation", when what secured creditors have to be paid off before the others from whatever sum if recovered through disposal of assets. Essar Steel was, not being liquidated. Rather it was being subjected to a "resolution" process worked out by a Committee of Creditors consisting of secured creditors, assisted by the tribunals and the resolution professionals who are part of the IBC-mandated process. Since resolution involves working with competing bidders to get

the best recovery and terms, it is different from liquidation per se, which all admit would yield less, and provides the price floor for any successful resolution process.

The NCLT did recognise that there was a problem equating liquidation and resolution when, in its judgement approving the Arcelor Mittal takeover of Essar, it recommended that 15 per cent of the Rs 42,202 crore be earmarked to compensate operational and other creditors, and the rest be shared equally among financial creditors, which included Standard Chartered. Despite these recommendations the core committee of the CoC chose to put together a resolution plan that reportedly covers 85 per cent of the admitted claims of secured creditors, whereas operational creditors get about 4 per cent.

This decision, endorsed by the NCLT with just a recommendation for revision, forced operational creditors and Standard Chartered to go to the tribunal and the courts. In its most recent judgement the National Company Law Apellate Tribunal (NCLAT) has ruled against the core committee. Stating that the Committee of Creditors (CoC) had unwarrantedly differentiated creditors of different kinds, the NCLAT went on to rule "that the 'Committee of Creditors' has no role to play in the matter of distribution of amount amongst the Creditors including the 'Financial Creditors' or the 'Operational Creditors." It also decided to rework the resolution plan in a manner such that the sum offered by Arcelor Mittal will be used to pay all individual financial and operational creditors 60.7 per cent of their total outstanding claims. This would mean financial creditors as a group would get less out of the settlement than even the share recommended by the NCLT. This has triggered another round of litigation with some the members of the CoC approaching the Supreme Court against the NCLAT's order. This delays the resolution of the Essar NPA problem even further. A process that according to the IBC should have been completed by February last year in 180 days, or at most by May with an extension of 90 days, is still incomplete, despite the fact that there is a bidder willing to pay a sum to acquire the company that would make creditor default the lowest among the 12 firms that were identified as accounting for the largest NPAs.

This points to a problem at the core of the IBC process, which was seen as one that would force banks to not just recognise NPAs but take them to resolution within a short period. That problem arises from the motivation of the IBC, which in the first instance was to clean up the books of the banks without burdening the government and its budget too much. The resulting forced-march to resolution meant that different players involved must share the loss involved. However, the manner of distribution of the loss burden among the players was poorly specified. This encourages all players to try and game the system, with Essar being an extreme and therefore revealing case. With hindsight it appears that the promoters of Essar Steel, from the Ruia family, had planned to force banks into accepting a huge haircut, by claiming that the firm was non-viable and could not pay back its debt. Having defaulted they held back on payments, possibly looking for a settlement.

The banks led by the State Bank of India chose to put an end to this game by approaching the NCLT and initiating an IBC-based resolution process. But the Ruia's returned. After initial expressions of interest, the two companies in the fray to acquire Essar Steel were Arcelor Mittal and Numetal. It soon became clear that Rewant Ruia the son of Ravi Ruia was the original owner of Numetal, which had then drawn in Crinium Bay, Indo International Ltd. and Tyazhpromexport (TPE) as shareholders.

Numetal was identified as a front for the return of the Ruia's. So the Ruia's had to exit Numetal. Arcelor too ran into difficulties, because of NPAs accumulated by related firms, which had to be first settled to make it an eligible bidder. This delayed the process and took it into further rounds of bidding, between restructured Numetal and Arcelor alliances.

The Ruia's were, however, unwilling to give up. It was at this point that they shocked everyone by announcing in October last year that they were willing to pay Rs 54,389 crore, which would allow creditors to recover debt in full. This effort at regaining control made it clear that the original default was driven by considerations other than the viability of the firm. The intention of the new offer from the Ruia's was to get 90 per cent of the creditors to vote to withdraw the action against Essar Steel under IBC and allow it to take back the company. The NCLT decided to reject the offer from the Ruia's leading to the decision to accept Arcelor Mittal's substantially hiked bid when compared with its orginal offer of Rs 32,000 crore. Arcelor too had been attempting to use the forced march to resolution to get itself a sweet deal.

But it is now clear that promoters and bidders in the IBC process are not the only one's attempting to game the system. So are the lead creditors, including the State Bank of India, who are attempting to get themselves a disproportionate share of the sums on offer from the bidders by keeping not just unsecured creditors but even secured ones like Standard Chartered out of the final resolution. Besides conflating liquidation and resolution, this ploy can have serious repercussions as became clear in the case of the resolution plan that was being considered by the secured creditors in the case of Jaypee Infratech. Home buyers, who had paid up vast amounts in instalment payments but had not been given possession of the homes they had bought, were in principle creditors too, but secured only by the promise of an asset to be delivered. To the extent that the IBC is interpreted to favour banks and secured creditors, these 'third parties' were told that the settlement would leave them out in the cold bearing losses. In this instance they went to the Supreme Court and won a stay. But that too made it clear that the claims of all creditors need to be considered when working out an acceptable resolution.

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