

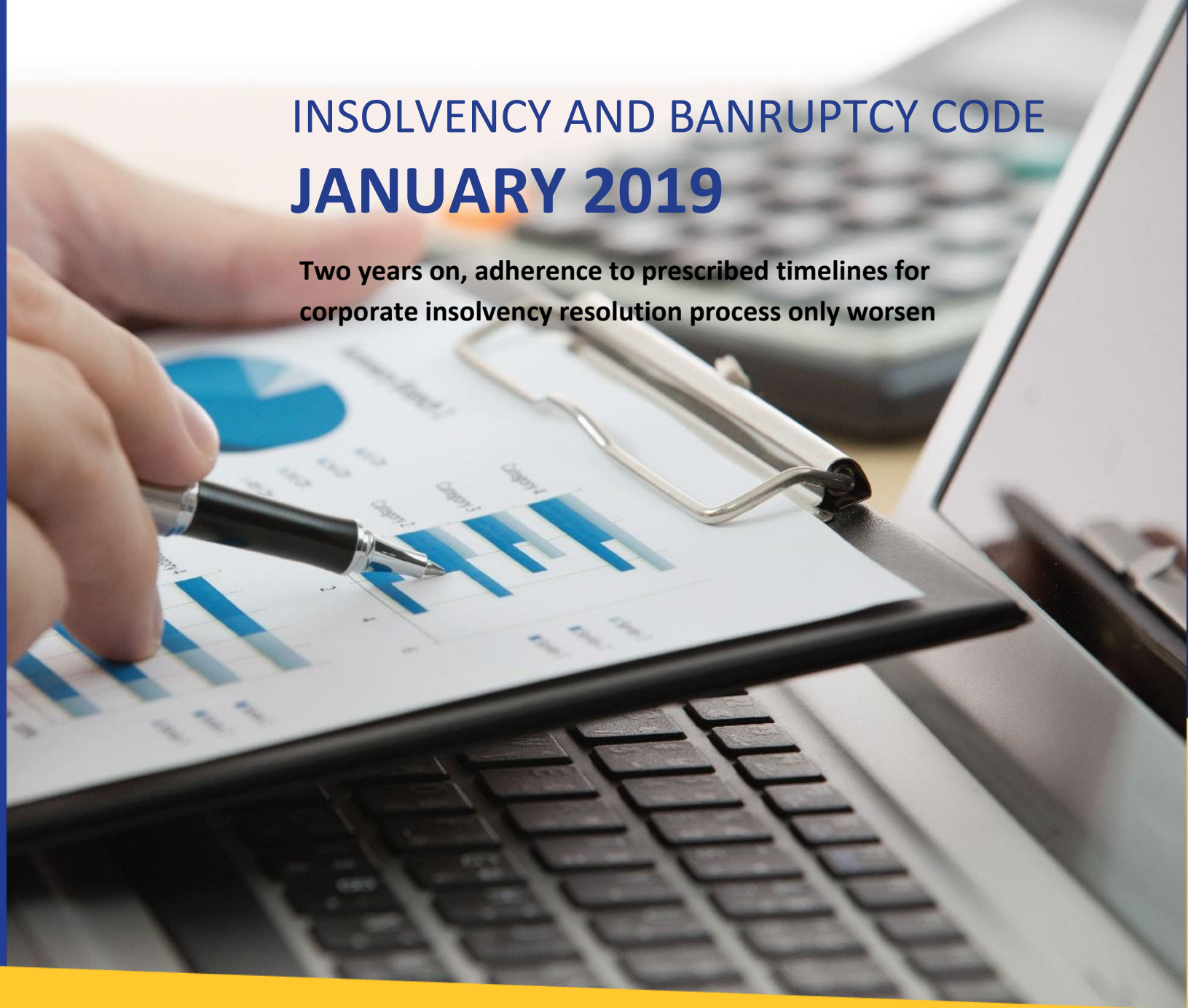


ICRA

A MOODY'S INVESTORS  
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# INSOLVENCY AND BANKRUPTCY CODE JANUARY 2019

**Two years on, adherence to prescribed timelines for corporate insolvency resolution process only worsen**



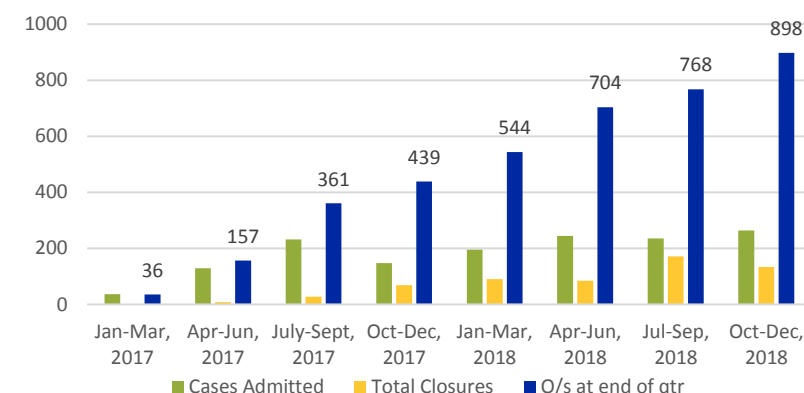
Abhishek Dafria  
+91 22 6169 3344  
[abhishek.dafria@icraindia.com](mailto:abhishek.dafria@icraindia.com)

The Insolvency and Bankruptcy Code (IBC) has completed two years of its existence since its introduction in December 2016. The journey so far has been a mixed bag, with its Constitutional validity itself recently being challenged. In an important judgement, the Honourable Supreme Court has upheld the validity of the IBC in its entirety thus cementing the need and importance of the Code in the country. The IBC undoubtedly was a much-needed piece of legislation to resolve the growing NPA (non-performing assets) crisis in the country. In its strictest form, the IBC allowed an operational or a financial creditor to seek an insolvency resolution process for a defaulting corporate debtor at an early stage itself, which would protect the assets of the corporate debtor from deteriorating further. However, the fructification of the vision of the Code has faced challenges owing to lack of adequate infrastructure to handle the ballooning applications filed to the National Company Law Tribunal (NCLT) and the inability to honour the timelines mentioned in the Code, primarily due to litigations resulting in a lengthy judicial process.

The number of corporate debtors admitted by the NCLT that are yet to be resolved through the corporate insolvency resolution process (CIRP) have been steadily increasing as seen in Exhibit 1. Of the 1,484 cases admitted by the NCLT in the last two years (upto December 31, 2018), 898 cases are yet to be resolved. With the number of cases being admitted for CIRP expected to continue to increase (264 cases admitted in the quarter ending December 2018 compared to 235 cases admitted in the previous quarter) and the timely closure of CIRPs getting delayed due to various reasons, ICRA expects the number of cases outstanding to continue to further increase at least for the next few quarters until adequate steps are taken to ensure that the CIRP does not significantly exceed the 180/270-day timeline prescribed under the IBC.

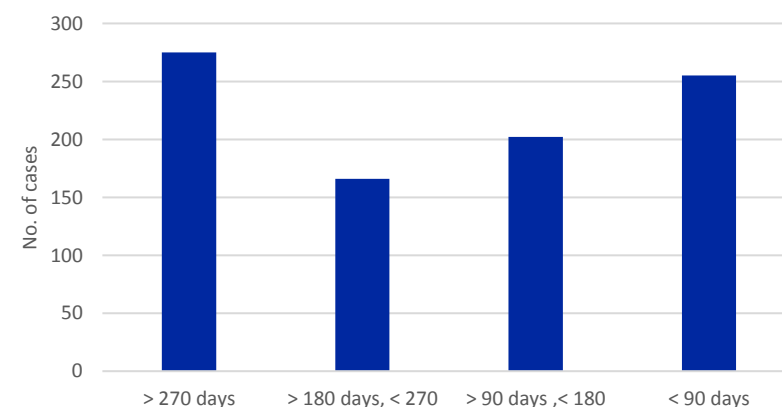
Of the 898 on-going CIRPs as on December 31, 2018, 31% of them have already exceeded the 270-day timeline which was supposed to be the maximum timeframe allowed for the resolution process to be completed as per the IBC. The number of such CIRPs exceeding the prescribed timeline only worsened to 275 as on December 31, 2018 from 238 as on September 30, 2018. Another 18% of the cases have crossed the 180-day timeline, as seen from Exhibit 2. Enhancing the NCLT benches remains of paramount importance so as to expedite the closure of the CIRP. Moreover, the numerous litigation issues, especially for large-size corporate debtors, need to be disposed off in a speedier manner in order to give confidence to the creditors as well as the new set of investors that are bidding for the stressed assets. ICRA, however, notes that the introduction of Section 12A to the IBC in August 2018 that allows for withdrawal of the corporate debtor from the CIRP with at least 90% vote of the Committee of Creditors (CoC) is a positive step to achieve a speedier closure when a corporate debtor is in a position to repay its outstanding dues. Upto December 31, 2018, already 63 CIRPs achieved closure under Section 12A. The recent Supreme Court ruling that upholds the ban on promoters' bids for the defaulting

**EXHIBIT 1: Number of cases undergoing CIRP**



Source: IBBI, ICRA Research

**EXHIBIT 2: Timelines for on-going CIRPs as on December 31, 2018**



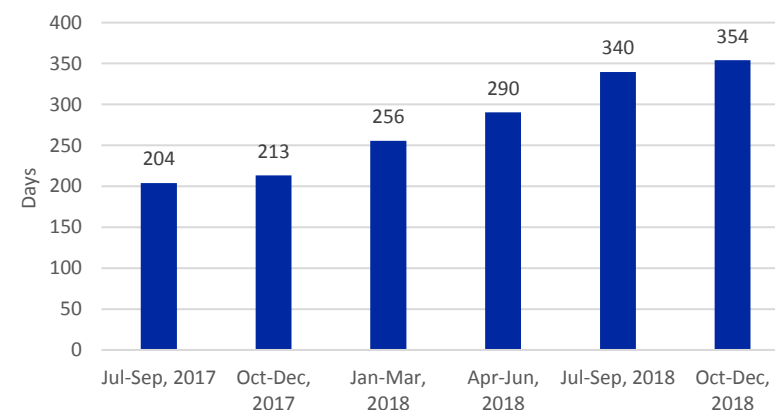
Source: IBBI, ICRA Research

company undergoing the CIRP would also help in providing more clarity regarding Section 29A of the IBC.

We have observed that the number of corporate debtors undergoing CIRP which eventually enter into liquidation continue to remain significantly higher than those that have an accepted resolution plan which keeps the entity as a going concern. As of December 31, 2018, 302 corporate debtors had entered into liquidation while only 79 corporate debtors had a resolution accepted. One key reason for such a high proportion of corporate debtors entering into liquidation is that 75% of these entities were already either in BIFR<sup>1</sup> or were non-functional at the commencement of CIRP which makes it difficult to maintain a 'going-concern' status for them. In order to avoid the number of cases entering into liquidation to remain so high, it is imperative that steps are taken on both fronts, a) the creditors need to approach the NCLT at an earlier date when the assets of the corporate debtor are still in a relatively healthy position since the IBC allows the creditors to file an application immediately after a default of payment, and b) NCLT needs to commence the CIRP within the prescribed 14-day timeline from the date of application which at present is getting significantly delayed.

ICRA observes that the duration taken by the CIRPs that have yielded resolution plans has steadily increased as seen from Exhibit 3. CIRPs which concluded in the quarter ending December 2018 took an average duration of 354 days compared to 340 days taken for CIRPs concluded in the quarter ending September 2018. Not only is the time being taken much greater than that allowed under IBC but is also significantly higher than the time that was being taken a year back. Of the 79 CIRPs that yielded a resolution plan (upto December 31, 2018), almost 68% of them exceeded the 270-day timeline allowed under the IBC. The delay in the CIRPs for the large-scale entities is even more astonishing. Of the 12 large defaulting accounts identified by the Reserve Bank of India (RBI) in June 2017 (refer Annexure), only four have had resolution plans approved and one entity has entered into liquidation. The fate of the remaining seven entities remains unknown as their CIRPs have been delayed due to multiple factors such as late bids by resolution applicants, varied interpretation of Section 26A on eligibility of applicants, challenges made by original promoters, challenges by the operational creditors etc. The average duration of these pending seven CIRPs has now exceeded 500 days which does not help the investor sentiment. Even amongst the completed CIRPs, one corporate debtor (namely, Amtek Auto Limited) faces an uncertain future as the successful resolution applicant (Liberty House Group) failed to make the necessary payments as per the resolution plan, and the matter is thus being taken up with the NCLT once again. The delay in the CIRPs is also pushing lenders to look at outright sale of their loan exposure, with State Bank of India recently willing to auction its loan exposure to Essar Steel Limited, and thus even take a higher haircut rather than wait for the CIRP to get completed.

**EXHIBIT 3: Average duration of CIRP for cases that yielded resolution plans**



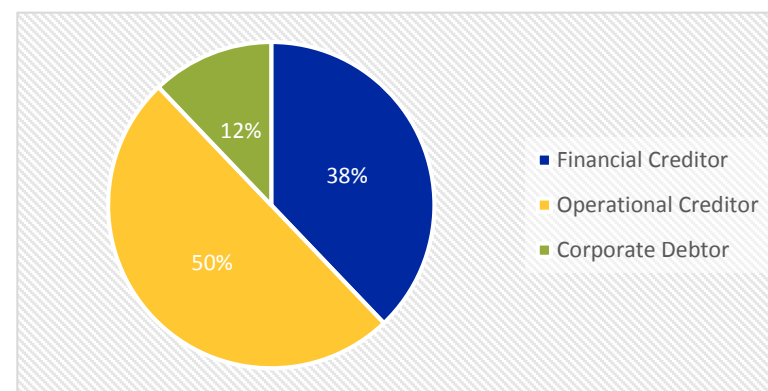
Source: IBBI, ICRA Research

<sup>1</sup> Board of Industrial and Financial Reconstruction

The haircuts taken by the financial creditors for the 79 CIRPs that have yielded resolution plans have seen a mixed trend depending on the present state of the respective industry, the relative health of the corporate debtor's assets, the willingness of the resolution applicant to enter a particular geography etc. The haircuts have been as high as 94% for certain corporate debtors, while in some other instances, there have been no haircuts realised by the financial creditors. On an average, the financial creditors have taken a haircut of 52% and would be realising an aggregate amount close to Rs. 650 billion (to be received either upfront or in a staggered manner) from these 79 CIRPs<sup>2</sup>. The financial creditors have particularly benefitted from the successful closure of CIRPs for Bhushan Steel Limited, Binani Cements Limited and Electrosteel Steels Limited which together accounted for realisation of Rs. 473 billion. Nevertheless, in ICRA's estimates, the timely conclusion of CIRPs of the pending entities in RBI's list of June 2017 could have brought in additional Rs 650~670 billion to the financial creditors, which is equivalent to about 6.5% of the gross NPAs in the banking sector.

It is nonetheless encouraging to note that despite the elongating period of concluding the CIRP and arriving at a resolution, the operational creditor continues to take the lead in triggering the CIRP. For the quarter ending December 2018, 58% of the cases that were admitted to the CIRP had been referred to the NCLT by an operational creditor, whereas only 36% of the cases had been referred by the financial creditor. Of the total cases admitted upto December 31, 2018, the operational creditors had referred 50% of them, while the financial creditors had referred 38% of the cases with the remaining referred by the corporate debtor itself, as shown in Exhibit 4. The Honourable Supreme Court recently observed that operational creditors of companies should have a say in the Committee of Creditors (CoC), which if implemented, could further increase the number of CIRPs being initiated by the operational creditor, though their inclusion in CoC would also bring in additional operational challenges.

**EXHIBIT 4: CIRP initiating parties**



Source: IBBI, ICRA Research

While the IBC would continue to remain a strong tool to address the issue of defaulting payments from corporate debtors, it still has a long road ahead of it before its potential can be fully realised. The support from all the stakeholders would remain of paramount importance for the IBC to achieve its objective. Improvement in the infrastructure with addition of NCLT benches, speedier judicial proceedings and introduction of requisite amendments by the GoI would play a big part in smoothening out the IBC, going forward.

<sup>2</sup> includes expected realisation of Rs 43 billion from the resolution process of Amtek Auto Limited which is currently uncertain

## ANNEXURE

### EXHIBIT 5. Duration for CIRP for RBI's first 12 companies

Corporate Debtor	Date of admission by NCLT	Duration for CIRP (as on Jan 24, 2019) (in days)
Bhushan Steel Limited	26-Jul-17	293 ( <i>resolved</i> )
Essar Steel India Limited	2-Aug-17	540 ( <i>on-going</i> )
Bhushan Power and Steel Limited	26-Jul-17	547 ( <i>on-going</i> )
Alok Industries Limited	18-Jul-17	555 ( <i>on-going</i> )
ABG Shipyard Limited	1-Aug-17	541 ( <i>on-going</i> )
Electrosteel Steels Limited	21-Jul-17	270 ( <i>resolved</i> )
Amtek Auto Limited*	24-Jul-17	366 ( <i>resolved</i> )
Monnet Ispat & Energy Limited	18-Jul-17	371 ( <i>resolved</i> )
Jyoti Structures Limited	4-Jul-17	569 ( <i>on-going</i> )
Lanco Infratech Limited	7-Aug-17	385 ( <i>liquidation</i> )
Jaypee Infratech Limited	9-Aug-17	533 ( <i>on-going</i> )
Era Infra Engineering Limited	8-May-18	261 ( <i>on-going</i> )

Source: ICRA research; \* case has been referred to the NCLT again as the resolution applicant has not complied with the initial payments as per the resolution plan



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- Provide intermediaries with a tool to improve efficiency in the funds raising process.

## Business Contacts

Mr. L. Shivakumar  
E-mail: shivakumar@icraindia.com  
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee  
E-mail: jayantac@icraindia.com  
Tel: +91 80 4332 6401/ +91 98450 22459

## Media and Public Relations

Ms. Naznin Prodhani  
E-mail: communications@icraindia.com  
Tel: +91 124 4545 860

## Registered Office:

1105, Kailash Building, 11th Floor,  
26, Kasturba Gandhi Marg,  
New Delhi - 110 001  
Tel: + 91 11 2335 7940-45

## Corporate Office:

Building No.8, 2nd Floor,  
Tower A, DLF Cyber City Phase II,  
Gurgaon- 122 002  
Tel: +91 124 4545300

## Ahmedabad

907 & 908, Sakar – II,  
Ellisbridge, Opp. Town Hall,  
Ahmedabad - 380 006  
Tel: +91 79 4027 1500/01

## Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,  
10th Floor, 1 & 2 Murphy Road,  
Bengaluru - 560 008  
Tel: +91 80 4332 6400

## Bengaluru 2

2nd Floor, Vayudooth Chamber,  
15-16, Trinity Circle, M.G. Road,  
Bengaluru - 560 001  
Tel: +91 80 4922 5500

## Chennai

5th Floor, Karumuttu Centre,  
634, Anna Salai, Nandanam  
Chennai - 600 035  
Tel: +91 44 4596 4300

## Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',  
Above SBI-HPS Branch, Ameerpet,  
Hyderabad - 500 016  
Tel: +91 40 4920 0200

## Hyderabad 2

4A, 4th Floor, SHOBHAN,  
6-3-927, A&B Somajiguda,  
Raj Bhavan Road,  
Hyderabad – 500082  
Tel: +91 40 40676500

## Kolkata

A-10 & 11, 3rd Floor,  
FMC Fortuna 234/3A,  
A.J.C. Bose Road,  
Kolkata -700 020  
Tel: +91 33 7150 1100/01

## Mumbai

3rd Floor, Electric Mansion  
Appasaheb Marathe Marg,  
Prabhadevi,  
Mumbai - 400 025  
Tel: +91 22 6169 3300

## Pune

5A, 5th Floor, Symphony,  
S. No. 210 CTS 3202 Range Hills Road,  
Shivajinagar, Pune - 411 020  
Tel: +91 20 2556 0194, 020 6606 9999

**Email:** info@icraindia.com

**Helpdesk:** 124 3341580

**Website:** www.icra.in/ www.icraresearch.in