The CoC *dharma* should be maximisation with fairness

The Committee of Creditors has a statutory role. It can even write off dues of stakeholders. So, it must apply highest standards of duty of care. It must not only follow the due process, but also be fair towards all stakeholders and transparent in discharge of its responsibilities

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FAILURE BY A FIRM to service debt, which is otherwise known as insolvency, is an outcome of the market. The Insolvency and Bankruptcy Code, 2016, therefore, envisages market-led solutions to address insolvency. It offers resolution, wherever possible, and liquidation, wherever required, of the firm.

Committee of creditors

The Code believes that a limited liability firm is a contract between equity and debt. As long as debt is serviced, equity—represented by a Board of Directors—has complete control of the firm. When the firm fails to service the debt, the control of the firm shifts to creditors, represented by a committee of creditors (CoC), for resolving insolvency.

Resolution invariably entails restructuring of business as well as liabilities of the firm. The financial creditors (FCs) typically have the ability to restructure liabilities and to take business decisions. The CoC, therefore, comprises FCs in the interest of resolution.

The Bankruptcy Law Reforms Committee, which conceptualised the Code, used *inter alia* two design principles, namely (1) the liabilities of all creditors, who are not part of the process, must also be met; and (2) the rights of all creditors shall be respected equally. The Code, accordingly, envisages resolution for maximising the value of the assets of the firm to promote entrepreneurship, and availability of credit, and balance the interests of all the stakeholders.

Maximisation of value

If a firm has failed to service debt, most probably it is not performing well. If it has the potential to perform well, the Code envisages and facilitates resolution to put the firm on a viable track, one that improves its performance and maximises the value of its assets. The turnaround of the firm, thus, is the heart of resolution—that preserves the going concern surplus.

The Code doesn't contemplate recovery as it destroys the value of the firm. When creditors recover their dues—one after another or simultaneously—from the available assets of the firm, nothing may be left in due course, bleeding the firm to death. Recovery serves the interests of the creditors on a first-come, first-served basis—the creditor, who initiates recovery first, realises the highest, and who initiates the last, realises the least.

The Code does not contemplate liquidation either, as it destroys the going concern surplus, and renders its resources idle till reallocation, reducing the value of the assets of the firm. Further, it considers the claims of a set of stakeholders only if there is any surplus after satisfying the claims of a prior set of stakeholders fully. The Code, therefore, does not allow liquidation until the option of resolution is exhausted.

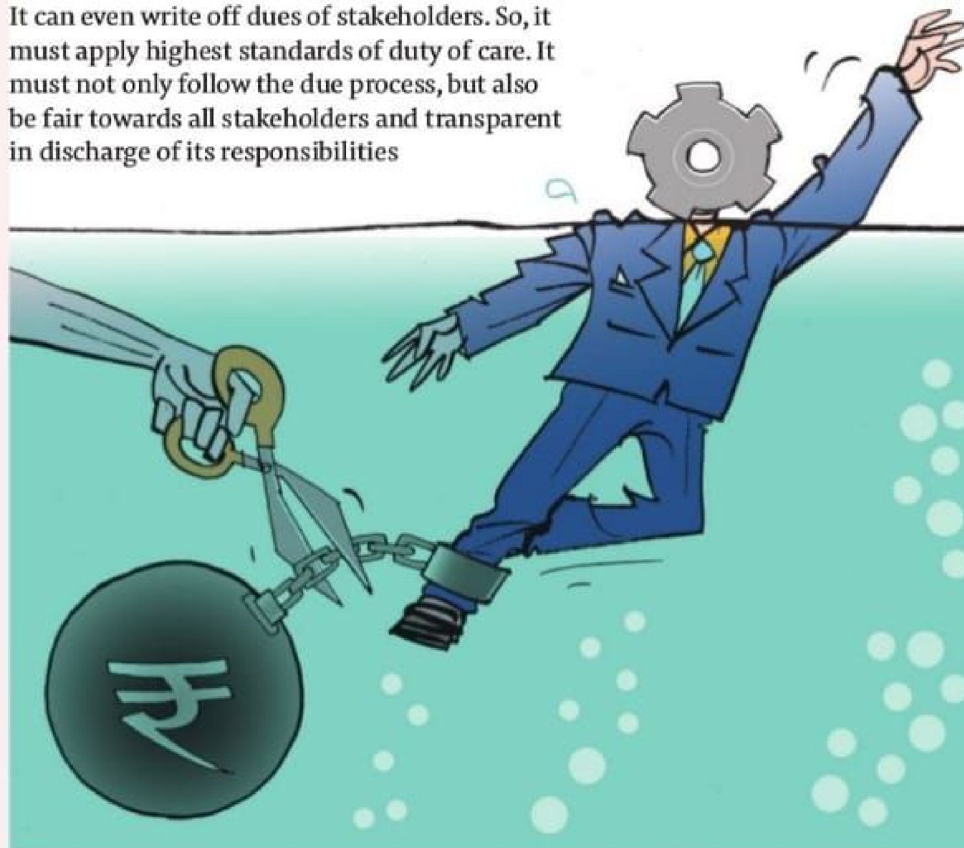

ILLUSTRATION: ROHNIT PHORE

Resolution preserves the going concern surplus. Therefore, the CoC must prefer resolution wherever fair value exceeds liquidation value. It must not confuse fair value with resolution value, which a resolution applicant offers for resolution of the firm. It must engender competitive resolution plans through appropriate enhancement to push up the resolution value. Then it must extrapolate the resolution value to arrive at the fair value. If such fair value exceeds the net liquidation value, it must prefer resolution.

The Code does not contemplate a haircut simpliciter that diminishes value for a creditor. It also does not contemplate sale of the firm where the stakeholders merely trade places. One does not need the Code and a detailed regulatory framework for selling a firm. The Code envisages resolution plans that uniquely package limitless combinations of business, financial and operational restructuring entailing change of technology, product mix or management; acquisition or disposal of assets or businesses; infusion or withdrawal of resources in cash or kind; modification of capital structure or leverage; capability and credibility of resolution applicant; etc, immediately or over a period of time, as may be required to resolve insolvency of the firm as a going concern. Consequently, each resolution plan has a unique likelihood of resolving insolvency. The choice of best plan requires application of mind by market savvy FCs, through deliberation and voting.

Fairness

The CoC or its members do not own the assets of a firm. They hold the assets as trustees for the benefit of all the stakeholders. The gain or pain emanating from the resolution, thus, need to be shared by the stakeholders within a framework of fairness and equity. The CoC must not allocate a higher share of gain or a lesser share of pain to FCs. It must not allow FCs to be paid before the operational creditors (OCs) are paid. That is why the Code mandates that the OCs be paid first and be paid at least the liquidation value.

A firm gets credit from FCs and OCs. Either credit is not enough for a firm. Nor does the State have any reason to promote either. If OCs, for example, are not provided a level-playing field, they would not provide goods and services on credit. If their interests are not protected, they will perish. This defeats the objective of promoting the availability of credit.

The Code allows initiation of resolution process on default of a threshold amount. If it is initiated early, the firm can probably meet the dues of all the creditors, and yet remain viable. In such cases, the CoC must not approve a resolution plan that curtails the rights of shareholders. Wherever such curtailment is absolutely required, it must be reasonable and not more than required, subject to the shareholders getting at least the liquidation value.

Statutory role

The CoC has a statutory role. It discharges a public function. It can even write off dues of the stakeholders. It must, therefore, apply the highest standards of duty of care. It must not only follow the due process, but also be fair towards all the stakeholders and transparent in discharge of its responsibilities.

The CoC influences the resolution plan through an evaluation matrix. If the evaluation matrix assigns zero weight to claims of OCs, the resolution applicant may not offer any value for them. Similarly, if it assigns zero weight to improved operations, the resolution applicant may not offer better technology. The CoC must design the evaluation matrix to engender resolution plans that consider the interests of all the stakeholders of the firm with fairness and equity, while maximising the value of assets of the firm.

The Code has demarcated responsibilities of the CoC and the insolvency professional (IP), while assigning certain responsibilities to them jointly. For example, the CoC needs to approve a resolution plan after considering its feasibility and viability, while the IP needs to file an application before the Adjudicating Authority in respect of fraudulent transactions seeking appropriate relief. The CoC must not usurp the role of the IP and must not allow the IP to its role.

The CoC must have competent and empowered representatives of FCs. They must attend the meetings, deliberate the matters and take decisions in accordance with the provisions of the Code. The CoC should also benefit from the presence of members of the suspended Board of Directors of the Corporate Debtor and OCs in its meetings.

The CoC holds the key

A firm embodies interests of many stakeholders. The CoC holds the key to the fate of the firm and its stakeholders. It must seek resolution and avoid recovery, liquidation, or sale of the firm. While pursuing resolution, it must maximise the value of the firm for the benefit of all the stakeholders. It must rise to the occasion to preserve its stature and authority.