COMMERCIAL WISDOM OF CREDITORS FOR VALUE MAXIMIZATION

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COMMERCIAL WISDOM OF CREDITORS FOR VALUE MAXIMIZATION

Abstract. This Article discusses the Indian Insolvency law making a shift from a debtor-in-possession to a creditor-in-control model. It discusses how this model relies on the commercial wisdom of those that would be most affected by it. It discusses the interplay of the creditors and the Adjudicating Authority in the decision making process. The basic assertion the Liquidation value and the Resolution value should either be equal and if not, opt for the value which is higher is not be determined by the adjudicating authorities or any other parties other than the financial creditors of the Corporate Debtor (CD). The analysis of the decision-making process of the Creditors of the CD helps us understand how information and long-term thinking and vision are significant for Creditors when considering the feasibility of a Resolution Plan. The role of Insolvency and Bankruptcy Code (IBC) 2016 in the commercial machinery is to set a fair and effective system to resolve the problem.

Keywords: Commercial wisdom, Committee of Creditors, Maharashtra Seamless Limited, decision making, value maximisation

Introduction

Businesses are the backbone of the economy, and when a business is successful it is due to the knowledge of the its leaders, and when a business fails it leads to insolvency which is then in the hands of the individuals who understand the commercial sector. The role of Insolvency and Bankruptcy Code (IBC) 2016 in the commercial machinery lies in the latter. Wisdom is referred to the quality of sound experience, knowledge, and good judgement to arrive at a decision; Commercial wisdom is the same presented specifically in the field of economics.

When IBC made the shift from debtor-in-possession to creditor-in-control regime, it gave the creditors of a business their due right of deciding what happens to their investments in the business. The revolutionary legislation, albeit, set a fair system to the effect. Once an application for default is filed against the Corporate Debtor, the Corporate Insolvency Resolution Process (CIRP) guides the formation of a Committee of Creditors (CoC) where the goal is to reach an amicable resolution or opt for liquidation. During the CIRP, the claims by the creditors, the Resolution value, and the Liquidation value are analysed. The resolution is reached by assessing the circumstances and information available which will result in the creditors receiving monetary compensation as close as possible to their admitted claims.

Basic instinct justifies that if the Liquidation value is higher than the Resolution value, the creditors must opt for the former, but an important factor to be put into consideration is the realisable value i.e. the monetary amount the creditors will receive at the end of the resolution or liquidation which is dependent on the time, as the value of the assets tend to fluctuate within the time period it takes to assess them and when they are actually sold. This is where the commercial wisdom of the creditors comes into play, as we will discuss in this article with the case of
Maharashtra Seamless Limited. The basic assertion the Liquidation value and the Resolution value should either be equal and if not, opt for the value which is higher is not be determined by the adjudicating authorities or any other parties other than the financial creditors of the Corporate Debtor.

Review of Literature

Fuentes and Maquieira (1999), the paper undertook an in-depth analysis of loan losses in the Chilean credit market due to the reasons such as, composition of lending by type of contract, cost of credit, volume of lending and default rates. The researchers empirically analyzed and examined different variables which may affect loan repayment: (a) limitations on the access to credit; (b) collection technology; (c) macroeconomic stability; (d) bankruptcy code; (e) pre-screening techniques; (f) the judicial system; (g) information sharing; and (h) major changes in financial market regulation. They concluded that a satisfactory performance in terms of loan repayments of the Chilean credit market, hinges on good information sharing system, macroeconomic performance, an advanced collection technology and major changes in the financial market regulation [1].

Reddy, P.K. (2002), studies the handling of NPAs through the experiences of other Asian nations. This paper further looks into the impact of the reforms on the level of NPAs and suggests mechanisms for handling the problem of NPAs by drawing on experiences from other countries. It says that the changes are necessarily required for tackling the NPA problem by spanning the entire gamut of judiciary, polity and the bureaucracy to be truly effective [2].

Ranjan, R., Chandra Dhal, S. (2003), this paper makes an empirical investigation into the non performing loans of the Indian commercial banks. It evaluates as to how the non performing loans are influenced by the economic and financial factors. The results show that the credit variables have significant effect on the non performing loans of the banks. It also suggests that better credit culture and favourable macroeconomic and business conditions lead to reduction of the NPAs [3].

Das & Ghosh (2004) empirically analyzes the issue of corporate governance in the banking system of India and the non-performing loans of the Indian Public Sector Banks on the basis of various indicators such as size of the assets, operating efficiency, and Indian macroeconomics conditions and credit growth. The authors have used the data of the banking systems of the period 1996-2003. The findings of the researchers reveal that the CEOs of the banks having poor performance are likely to have higher turnover than the CEOs of the well performing banks [4].

Meenakshi, R., Mahesh, H. P., (2010), the present study is an exploratory paper which examines the trends of NPAs at global level, one interesting observation is that most of the countries which fall under the category of higher “NPA/Total Loan” ratio are in the Asian region. It also examines the trend of NPAs in India from various magnitudes and also identifies the problem of NPA and recovery mechanisms to a great extent. This study also shows that NPA in the priority sector is higher than non – priority sector. The role of joint liability groups (JLGs) or self help groups (SHGs) in enhancing the loan recovery rate is also discussed in this
paper. This exploratory research paper explains that merely recognizing the NPA problem and self-monitoring can reduce the level of NPA to a great extent [5].

**Cirmizi, E., Klapper, L. F., Uttamchandini, M. (2010)**, this research paper accounts that the financial crisis of the year 2008 was followed by an economic downturn globally, reduction in cross-border lending, credit crunch, decrease in foreign remittances, trade finance and Foreign direct investment (FDI) and the crisis adversely affected the businesses all around the world. The paper points out that the 2008 crisis consequently led to the increase in the corporate insolvencies in the corporate and financial sectors and hence, the paper highlights the importance of effective and efficient insolvency and bankruptcy laws in the economy. The paper discusses the challenges of introducing and implementing bankruptcy reforms, summarizes the empirical and theoretical literature on the bankruptcy design, and presents examples of how policymakers have been trying to use the current economic downturn of the 2008 financial crisis as an opportunity to engage in meaningful reform of the bankruptcy procedures [6].

**Joesph, A.L., Prakash, M. (2014)**, this paper mentions that a healthy and sound banking system is very essential for an economy in order to grow and exist in this competitive environment. It then mentions that the RBI and other regulatory bodies have taken several policies to develop the functioning of the banking sector. It says that the best indicator for the health of the banking industry in an economy is its level of NPAs and NPAs in the Indian banking sector have become a major concern for the Indian economy. NPAs have a direct impact on the profitability, liquidity and solvency position of the bank. Higher NPA indicates inefficiency of the bank and lower NPA indicate better performance and management of funds. This paper basically deals with the trends of rising level of NPAs in the banking industry, the factors that mainly contribute to NPA in the banking industry and also provides some suggestions to overcome the problem of NPA in banking industry [7].

**Arora, N., and Ostwal, N. (2014)** conducted study on which deals with the concept of Non-performing assets and analyze the classification of loan assets of public and private sector banks. It also analyzes the comparison of loan assets of Public sector and private sector banks. The study concluded that private sector banks are improving due to decline in NPAs ratio compare to Public sector banks due to recovery management done in NPAs and suggest that there is need to check the NPAs of public sector banks so that Indian banking system becomes efficient and that the NPAs are a threat for the banks [8].

**RBI Report (2016)**, this report of the Reserve Bank of India assessed that the burden of non-performing assets has put the Indian banking industry under stress which has increased sharply during the year 2015-2016. The Asset Quality Review (AQR) of the banks was conducted during 2015-16 for supplementing the supervisory processes, apart from the prudential regulatory measures. This was done to address the concern over the increasing level of NPAs. The report analyzed that the banks were making efforts to reduce their NPAs through various legal channels like Lok Adalats, DRTs and invocation of SARFAESI and evaluated that the public sector banks are burdened with a high concentration of NPAs as they could recover
Rs 197.57 billion as against Rs 278.49 billion during the previous year. The banks had tried to reduce their stressed assets by them to the Asset Reconstruction Companies (ARCs) [9],

_Laveena, Guleria K. S. (2016)_], the paper deals in NPA problem and understands the causes of NPAs. It discusses the magnitude of the issue of NPA over the last three years and also discusses the effect of NPA on the Indian economy. It says that the large number of NPAs erode the value of assets in banks and suggest that as the credit defaults have increased then ultimately the net worth of the banks have decreased. This growth of NPA level also decreases the shareholders’ value and profits too [10].

_Moli, P.A. (2017)_], this study analyzes the problems and solutions taken for controlling and managing the problem of NPAs in both the private and public sector banks which will help in improving the financial position of the banks in India. It is based on the secondary data retrieved from the RBI and various journals and reports. It also identifies the causes and impacts of NPAs in the Indian banking system [11].

_Report of Insolvency Law Committee on Cross Border Insolvency (2018)_], the committee noted that with respect to cross border insolvency the existing provisions (Sections 234 and 235) of the IBC did not provide a comprehensive framework. The committee in its report attempted to deliver a comprehensive framework for the cross border insolvency which is based on the UNCITRAL Model Law on Cross-border insolvency 1997. The committee made research and the report provides recommendations and modifications necessary in the context of India for this purpose. The committee recommended increasing foreign investments for positive signalling to global investors, creditors, International Organizations, Governments and multinational corporations with regard to the financial sector reforms of India, along with protecting domestic market and giving flexibility and providing mechanism for cooperation between courts and insolvency professionals [12].

_Srivats, K.R. (2018)_], the present write up says that according to the experts the investors globally are likely to take a positive view of the centre’s plan of ushering in the cross-border insolvency framework. Its approval will result in more cross border deals and will help India in making an attractive FDI target as the IBC will reduce the risk associated with the insolvency. It reported that there is increase in the FDI inflows in 2017-18 to $61.96 billion as compared to $60.08 billion in 2016-17. The Indian Government is taking initiative to provide for the provisions for cross-border insolvency in the Code for making IBC a more comprehensive framework. It mentions that the cross-border insolvency framework will help India in further enhancing ease of doing business, providing a mechanism of cooperation between India and other countries in insolvency resolution, protect global investors, increase Mergers and Amalgamations deals involving India and make India an attractive FDI destination by giving certainty and increased predictability to the foreign investors. The purpose of this write up is to recognize the importance of the cross-border insolvency laws on the enhancement of the FDI inflows in India [13].
Jason, J. (2018), this research paper recognizes the impact of the cross-border insolvency laws on the foreign direct investment of a nation. It has made an analysis of two figures which are the scores given by the World Bank: (i) for the legal rights of creditors in a given state and (ii) data of FDI inflows of the countries. The result of the analysis shows that the countries with more developed legal rights for the creditors are inclined to have higher levels of FDI. According to this study there are many economies which have increased FDI inflows from one year to another immediately after the revisions and updates made in their insolvency laws. The individuals and corporations engaged in FDI consider insolvency law as a significant factor in making FDI decisions. The purpose of this study is to explore the impact of cross-border insolvency laws on the FDI and understand the impact of the insolvency laws on the FDI decisions of the corporations and individuals [14].

Research Methodology
The research on the present study is a Doctrinal Research involving review of the earlier insolvency and bankruptcy laws that existed before the advent of IBC and the present insolvency and bankruptcy legislation in India and its impact on the economic development of India. The present study is Empirical and an Economic Policy Research. The research design is exploratory design is chosen for this study. Since, the study has to explore the impact of IBC on Indian Economy, therefore, it is exploratory in nature.

Analysis and Results
Background of the Case
The Corporate Debtor (CD) is United Seamless Tubulaar Private Limited with a total debt of INR 1897 crores. The application for default was filed by one of the Financial Creditors, Indian Bank. The assets of the CD were assessed by three different registered valuers due to substantial difference in valuation. The final valuation was considered the average of the closest two estimations at INR 432 crores. Out of the four Resolution Plans submitted to the Resolution Professional (RP), the plan by Maharashtra Seamless Limited was approved by the CoC with approximately 87% votes. The point of contention was raised by the suspended Board of Directors of the CD, who alleged that the Resolution Plan was approved in contravention to the IBC, and the maximisation of the value of assets of the CD was lost. The NCLT passed an order to re-assess the Liquidation value of the CD [15].

An appeal was raised and the NCLAT directed the NCLT to pass the order under Section 31 of the IBC, which is to allow the Resolution Plan to pass if the approval of the CoC has been obtained at their discretion. Also, the re-assessment of the Liquidation value was conducted which placed the value of the CD at INR 597.54 crores- a jump of almost INR 170 crores from the agreed Resolution value. The appellate authority also held that the CoC should suggest the Resolution Applicant (RA), Maharashtra Seamless Limited to make changes to the Resolution Plan if necessary, instead of the adjudicating authority [16].

Consequently, the agreed Resolution Plan value was set at INR 477 crores, and the NCLAT directed the RA to pay INR 120 crores more to compensate the
difference between the Resolution Plan value and the Liquidation value. Owing to which, the RA would be allowed to take possession of the CD, otherwise not.

**Supreme Court Judgement**

The RA appealed to the Supreme Court based on the order passed by the NCLAT. It was contended that the adjudicating authority, NCLAT in this instance, cannot sit in appeal over the commercial wisdom of the CoC in approving a Resolution Plan. Furthermore, the RA applied for withdrawal of the Resolution Plan following depositing INR 477 crores in accordance with the Plan and was subsequently denied access to the assets of the CD [17].

The Supreme Court addressed the two issues on January 22, 2020. First issue concerned whether the IBC stipulated that the Resolution Plan value should be equal to the Liquidation value. The Apex Court held that the Adjudicating Authority cannot interfere in the decision based on the commercial wisdom of the CoC, as long as the CoC made sure that the business of the CD was kept going as a going concern, the value of the assets have been maximised, and the interest of all stakeholders have been taken care of. The Resolution Plan value does not have to match the Liquidation value under the IBC or any of the IBBI Regulations, even if it seems that the difference between the values is inequitable. Only when the circumstances point to the otherwise of the stated, the Adjudicating Authority should ask the CoC to make amendments to the Resolution Plan which the NCLAT and the Supreme Court did not find. It was stipulated that the role of the Adjudicating Authorities is limited to judicial review, reiterating the late 2019 judgement in the case of Essar Steel India Limited [18].

On the issue of RA seeking withdrawal from the Resolution Plan via Section 12-A of the IBC 2016, the Supreme Court held that the provision is not applicable to the RA but to applicants who invoke Section 7, 9 and 10 of the Code [19]. The NCLAT order was set aside and the Supreme Court allowed the RA to take possession of the assets of the CD within four weeks of the judgement with the assistance of administrative and law enforcement authorities [20].

**Decision-Making Process for Value Maximisation**

The Judgement in the case of Maharashtra Seamless Limited has a twofold significance. First, in re-establishing the precedent [21]. on the role of the Adjudicating Authority. And secondly, on the reliance on the decision-making process of the Creditors of the CD. The Code is designed to promote resolution-seeking among the stakeholders. Of course, the stakeholders would seek a resolution which would allow them a fair return of their admitted claims, but value maximization is not simply about numbers projected by the Registered Valuers during the CIRP. Let us consider the case at hand, the value of the assets of the CD fluctuated immensely during the CIRP as shown in Table 1 below.

**Table 1. The value of the assets of the Corporate Debtor (CD)**

<table>
<thead>
<tr>
<th>Value assessing Entity</th>
<th>Value of the assets (approx.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered Valuer 1 (K. Vijay Bhasker Reddy)</td>
<td>INR 681 crores</td>
</tr>
</tbody>
</table>
Registered Valuer 2 (P.Madhu) &nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp; INR 513 crores
Valuer 3 (Duff and Phelps) &nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp; INR 352 crores
Final Valuation (via Resolution Professional) &nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp;&nbsp; INR 597 crores


The mistake a layman would make is to equate the value of the assets of the CD to its Liquidation value. Sure, the Liquidation value of the CD is INR 597 crores at that particular period of time. But if the value assessment during CIRP via three different valuers result in such drastic monetary differences, then when the CD actually goes into liquidation, say after a year or two of the assessment, the certainty of the final valuation is compromised. The market value of the assets may have dropped or increased significantly than the value at which the CoC decided the CD to undergo liquidation. The realisable value might only be INR 352 crores, as suggested by the Third Valuer, instead of INR 597 crores.

Another aspect in consideration of the Creditors is that Resolution value is generally considered the amount of money an RA offers for a resolution of the CD [22]. Thus, the Resolution value of INR 477 crores offered by the RA- Maharashtra Seamless Limited is the amount the Claimants will definitely receive at the end of the CIRP, unlike the Liquidation value of the time.

Well-informed decisions are important in economic matters and it is put forward that the more information the Creditors receive, the better decisions they take during an insolvency process. A fantastic explanation of this is laid down by Dr. M.S. Sahoo in his article “The Art of Value Maximisation,” which will be used to analyse the decisions of the Creditors within the CoCof the case at hand- Maharashtra Seamless Limited.¹ In Table 2, the Creditors are only aware of the Liquidation and Resolution value, and thus would tend to reject a Resolution Plan put forward by the RA.

<table>
<thead>
<tr>
<th>Description</th>
<th>Creditor 1</th>
<th>Creditor 2</th>
<th>Creditor 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidation value</td>
<td>597</td>
<td>597</td>
<td>597</td>
</tr>
<tr>
<td>Resolution value</td>
<td>477</td>
<td>477</td>
<td>477</td>
</tr>
<tr>
<td>Decision on Resolution Plan</td>
<td>Reject</td>
<td>Reject</td>
<td>Reject</td>
</tr>
</tbody>
</table>

Source: M.S. Sahoo “The Art of Value Maximisation,”

In Table 3, the Creditors now compare their claims with the Liquidation and Resolution value and thus make their decisions as follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Creditor 1</th>
<th>Creditor 2</th>
<th>Creditor 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt Claims</td>
<td>250</td>
<td>550</td>
<td>650</td>
</tr>
</tbody>
</table>

¹ The analysis is different from the what the presented in the Article. The instances of Corporate Debtors is replaced with Creditors to study the decision-making process of Creditors in the CoC in the present case.
It is when the Creditors compare their claims, Liquidation and Resolution value with the realisable value (in Table 4) that the Creditors tend to accept a Resolution value of INR 477 crores to the Liquidation value of INR 597 crores.

Table 4. Liquidation and Resolution value of Assets of the Corporate Debtor.

<table>
<thead>
<tr>
<th>Description</th>
<th>Creditor 1</th>
<th>Creditor 2</th>
<th>Creditor 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt Claims</td>
<td>250</td>
<td>550</td>
<td>650</td>
</tr>
<tr>
<td>Liquidation value</td>
<td>597</td>
<td>597</td>
<td>597</td>
</tr>
<tr>
<td>Resolution value</td>
<td>477</td>
<td>477</td>
<td>477</td>
</tr>
<tr>
<td>Realisable Value on Liquidation</td>
<td>450</td>
<td>450</td>
<td>450</td>
</tr>
<tr>
<td>Decision</td>
<td>Accept</td>
<td>Accept</td>
<td>Accept</td>
</tr>
</tbody>
</table>


Thus, it is important to give due credit to the Creditors and their ingenuity and commercial wisdom when they make decisions during a CIRP [23]. A deal which satisfies all the stakeholders requires more information than just the comparison of the Liquidation and Resolution value of the assets of the CD.

We also notice that the cases where the CIRPs resulted in resolutions, the realisable value received by the Creditors was 183% of the value they would have received at liquidation [24]. This is highly valuable information because it suggests that the commercial wisdom of Creditors allowed them to sift through information as analysed in Table 4 above. This is testament of the fact that no third party can assess the situation at hand better than the Financial Creditors of the CD during an insolvency process, as long as they are compliant with the rules of IBC (Table 5).

Table 5. Claims and Liquidation value

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Total Admitted Claims by FC (INR crores)</th>
<th>Liquidation value (INR crores)</th>
<th>Realisable by FCs (INR crores)</th>
<th>% of their Admitted Claims</th>
<th>% of Liquidation value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-Mar ’18</td>
<td>4405</td>
<td>1427</td>
<td>3070</td>
<td>69.70</td>
<td>215.11</td>
</tr>
<tr>
<td>Apr-Jun ’18</td>
<td>76239.12</td>
<td>18084.36</td>
<td>42885.44</td>
<td>56.25</td>
<td>237.14</td>
</tr>
<tr>
<td>Jul-Sept ’18</td>
<td>42269.56</td>
<td>9541.80</td>
<td>11079.32</td>
<td>26.21</td>
<td>116.11</td>
</tr>
</tbody>
</table>
Oct-Dec ‘18  |  8447.71  |  2953.97  |  6958.46  |  82.37  |  235.56  
Jan-Mar ‘19 |  39675.20 |  6155.97 |  9568.5  |  24.11  |  155.43  
Apr-Jun ‘19 |  32385.84 |  6836.19 |  7151.33 |  22.08  |  104.60  
Jul-Sept ‘19 |  79442.25 |  14870.43|  27159.17|  34.18  |  182.63  
Oct-Dec ‘19 |  25762.51 |  2853.32 |  3513.61 |  13.63  |  123.14  
Jan-Mar ‘20 |  39101.77 |  19567.67|  25063.79|  64.10  |  128.09  
Total       |  384436.67|  96349.52|  176673.70|  45.96  |  183.37  


Conclusions and Recommendation
The Judgement of the Supreme Court in the case of Maharashtra Seamless Limited is similar to the judgements that have been reached by other Adjudicating Authorities in different cases [25], including the apex court itself [26], i.e. the feasibility of the Resolution Plan is best left to the ingenuity of the Creditors. The analysis of the decision-making process of the Creditors of the CD helps us understand how information and long-term thinking and vision are significant for Creditors when considering the feasibility of a Resolution Plan.

There is a counter argument to this commercial wisdom of the CoC which might allow malpractice to seep into the resolution-making process. Although this is a valid argument, the point is to understand that the decision-making process of the CoC is multi-faceted and what might seem like malpractice might actually just be the utilisation of commercial wisdom of the Creditors. And the Adjudicating Authority in its judicial capacity still carries a lot of punch in assessing if the CoC complied with the provisions of the IBC and relevant IBBI Regulations.

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