Mediation In Corporate Insolvency: A Game Changer

The question before us is: how to achieve the aforesaid objective and ease the pressure of the NCLT? Our suggested solution is introduction of mediation in the resolution process.

June, 2019
by Justice A.K. Sikri , Anuroop Omkar

Insolvency and Bankruptcy Code, 2016 (IBC) has proved to be a successful path for lenders to recover their loans from defaulting companies. According to a Reserve Bank of India (RBI) report, the recovery rate of the IBC is 42 per cent against 10-18 per cent in earlier regimes.

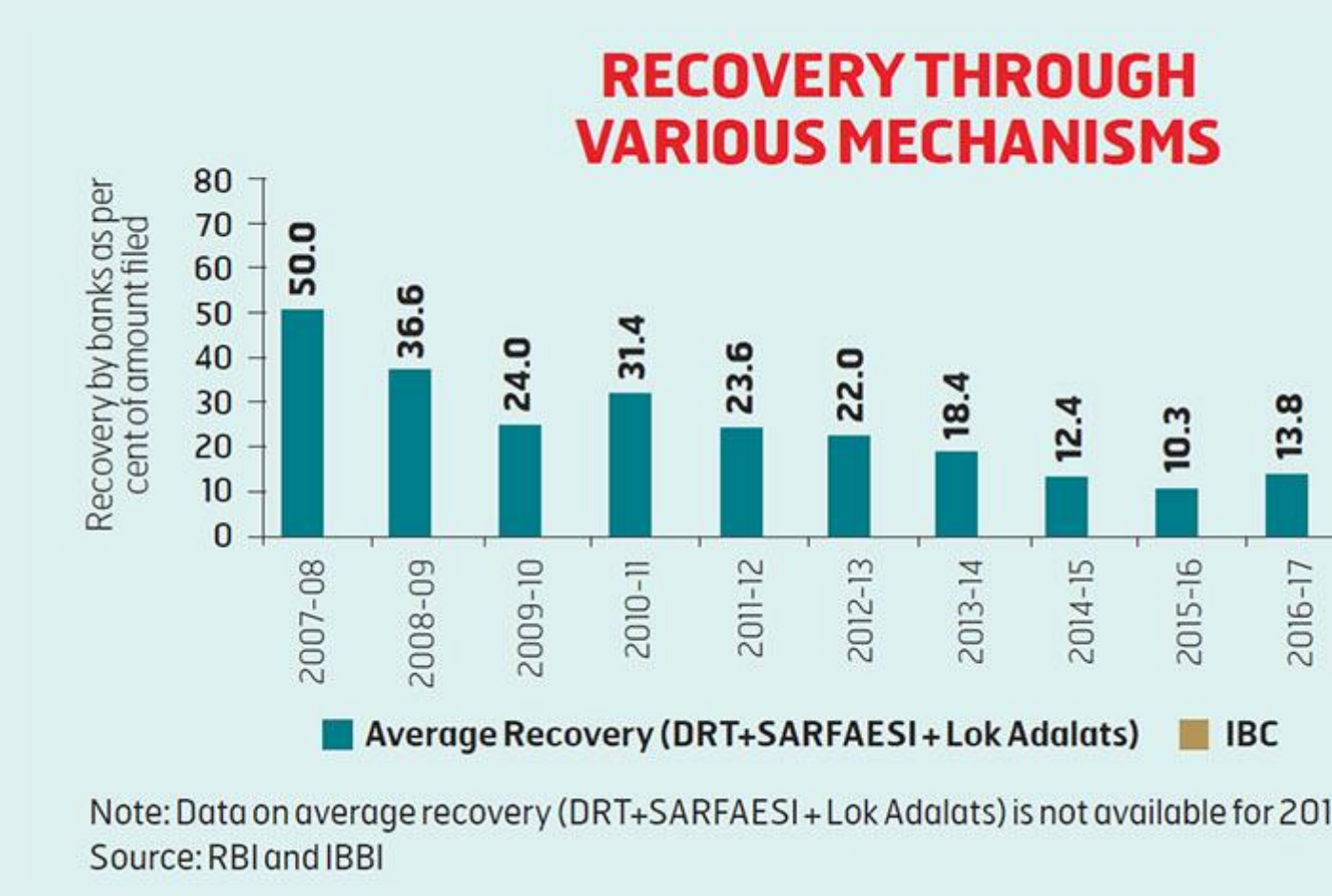
Till December 2018, the IBC has resolved cases involving debt of Rs 3 lakh crore - Rs 1.2 lakh crore at the pre-admission stage, another Rs 1.2 lakh crore through 60 resolved cases and about Rs 60,000 crore NPAs that turned standard accounts. However, coming into effect of the IBC for the banking industry brings with it constant fear of a witch hunt among corporates in India, especially small and medium enterprises (SMEs). Moreover, debt recovery was never the intended aim of the IBC.

Ideally, the total time a corporate insolvency should take from start to finish including extensions, is 270 days. However, pendency exceeds more than a year in most cases. Although the NPAs of banks are declining, the total NPA from public sector banks alone stands at approximately Rs 9.39 lakh crore as of January 2019. Added to this, the National Company Law Tribunals (NCLT) are overburdened. The time taken to decide whether to liquidate a company or adopt a resolution plan shall only increase if we do not approach the backlog and flouting of timelines through a problem-solution approach.

Although there is no data on how this “to-be-insolvent-or-not-to-be” is affecting businesses, it is obvious that goodwill and sales are hampered owing to the cultural taboo of insolvency and fear of dealing with companies who may enter moratorium

any time. Owing to the backlog of the IBC, oppression and mismanagement cases under the Companies Act, 2013 are also not getting heard on time, leading to many shareholder deadlocks in companies.

This scenario amply demonstrates the role of the NCLT in debt recovery and resolution of NPA accounts on the one hand and its difficulties in proper implementation of the true aim of the IBC, such as balancing creditors' rights and the rehabilitation and introduction of insolvency professionals to ensure professionalism and efficiency, on the other.



Rehabilitation should be the first attempt, especially if insolvency is due to market conditions. Even if insolvency is a result of mismanagement, endeavour should be made to rehabilitate the company through a change in management. If rehabilitation is impossible, the IBC aims at quicker liquidation while taking maximum care of creditor rights. If the IBC is utilised only for debt recovery, the aforesaid objectives are lost. This may result in a situation of tyranny of the IBC, an otherwise well-considered legislation. The Supreme Court in its recent judgments has highlighted these problems and has reminded stakeholders of the true objective of the IBC.

The question before us is: how to achieve the aforesaid objective and ease the pressure of the NCLT? Our suggested solution is introduction of mediation in the resolution process.

India is not the first jurisdiction in the world to face this problem. In 2017, Singapore also recommended use of mediation in insolvency resolution to transform into an international insolvency resolution hub. The committee constituted for this purpose has recommended that:

* Judges encourage parties to consider mediation in insolvency disputes;
* Use of existing institutional mediation centres such as the Singapore Mediation Centre (SMC) and Singapore International Mediation Centre (SIMC); and
* Strengthening the panels of SMC and SIMC to include mediators with experience in cross-border restructuring.

The committee also highlighted types of insolvency mediation – individual creditor disputes; same nature disputes from multiple creditors, to achieve consensus in a restructuring plan etc.

Mediation is already used successfully in various kinds of disputes in India. A recent Supreme Court order, referring the Ayodhya Dispute to mediation is a classic example. In Mediation, a neutral person called a mediator facilitates dialogue between disputants to find win-win solutions to problems/issues.

In the recent Jaypee Infratech case, a number of issues between the financial creditors and the home-owners could have been settled through mediation. Just like the recent Jaypee Infratech case, which led to the collapse of the real estate market in India, the Lehman Brothers insolvency too had led to the collapse of financial markets in the United States of America and internationally in the subprime mortgage crisis of 2008-09.

In September 2008, Lehman Brothers filed for Chapter 11 bankruptcy. A Lehman Brothers' arm dealing in derivatives, was counterparty to at least 1.2 million derivative transactions with over 6,500 different parties. In September 2009, the court ordered compulsory mediation for the derivative contract disputes. As of 2016, 110 mediations have brought in $333 million for Lehman Brothers' estate, from outstanding claims of about $9 billion.

Subsequently, eight Lehman Brothers companies were put in liquidation in Hong Kong consisting of an estimated 48,000 investors holding more than HKD 20 billion in Lehman Brothers' 'minibonds'. The principal monetary regulators of Hong Kong –

Hong Kong Monetary Authority (HKMA) and Securities and Future Commission (SFC)– had power to initiate and investigate the activities of intermediaries but lacked the power to award compensation if intermediaries were found guilty of misconduct.

In 2008, the HKMA appointed Hong Kong International Arbitration Centre (HKIAC) to administer a mediation scheme of the claims subject to references made by the HKMA and SFC and both parties' consent for mediation. The scheme provided for arbitration if mediation failed generally, known as the 'med-arb' model. By 2009, 85 cases proceeded to mediation, of which full settlement was reached in over 85 per cent of cases.

It is time India take a leaf out of the Singapore and Lehman Brothers books. Mediation saves time, money and ensures confidentiality of negotiations which is lacking in insolvency proceedings. Since mediation allows parties to come up with out-of-the-box solutions, there is also a possibility that the resolution plan arrived at during mediation shall be more financially beneficial for financial as well as operational creditors than a vanilla resolution plan involving sale of assets and reconsolidation of business interests.