VALUE MAXIMISATION UNDER THE IBC: MYTH, REALITY, AND THE PROBLEM OF HAIRCUTS

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ABSTRACT

The Insolvency and Bankruptcy Code, 2016 was introduced as a comprehensive legal framework aimed at ensuring timely resolution of insolvency and maximisation of the value of assets. A key objective of the Code is to enhance recovery for creditors through a structured and efficient insolvency resolution process. However, in practice, the resolution of distressed assets has frequently resulted in substantial "haircuts," wherein creditors accept significantly reduced amounts against their admitted claims. This phenomenon raises critical questions regarding the effectiveness of the IBC in achieving its objective of value maximisation. While such haircuts are often justified within the framework of creditor autonomy and the doctrine of commercial wisdom, their magnitude in several cases suggests potential inefficiencies in the insolvency process. This paper critically analyses the concept of haircuts under the IBC by examining its legal framework, judicial interpretation, and economic implications. It evaluates whether haircuts represent a pragmatic compromise inherent in insolvency resolution or indicate a structural failure in achieving optimal recovery outcomes. The study further identifies key factors contributing to high haircuts, including delays, lack of competitive bidding, and institutional constraints. The paper concludes by proposing reforms aimed at strengthening valuation mechanisms, enhancing transparency, and improving institutional efficiency to ensure that the objective of value maximisation is more effectively realised.

Keywords: Insolvency and Bankruptcy Code, Haircuts, Creditors' Rights, Value Maximisation, Committee of Creditors, CIRP.

1. INTRODUCTION

The introduction of the Insolvency and Bankruptcy Code, 2016 marked a fundamental transformation in India's insolvency regime by replacing a fragmented and inefficient system with a unified and time-bound framework for resolving financial distress.[1] Prior to its enactment, insolvency and debt recovery were governed by multiple legislations such as the Sick Industrial Companies (Special Provisions) Act, 1985, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, and the SARFAESI Act, 2002, which operated in isolation and resulted in delays and inefficiencies.[2]

The IBC was designed to address these systemic shortcomings by introducing a creditor-driven mechanism that prioritises timely resolution and maximisation of asset value.[3] A key feature of the Code is the Corporate Insolvency Resolution Process, through which creditors collectively evaluate and approve resolution plans via the Committee of Creditors.[4]

Despite its progressive structure, the practical implementation of the Code has revealed certain limitations. One of the most significant concerns is the prevalence of substantial haircuts, where creditors accept recoveries far below their admitted claims. This raises important questions regarding the effectiveness of the IBC in achieving its core objective of value maximisation.

2. CONCEPT OF HAIRCUTS UNDER THE IBC

A "haircut" refers to the reduction in the amount that creditors agree to accept under a resolution plan in comparison to their total admitted claims. It represents the financial loss borne by creditors when the corporate debtor is unable to fulfil its obligations in full.

Haircuts are an inherent feature of insolvency resolution, as the value of distressed assets is often insufficient to meet all liabilities. In such situations, creditors must choose between accepting reduced recoveries through resolution or facing potentially lower returns in liquidation.[5]

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[1] Insolvency and Bankruptcy Code 2016.
[2] Sick Industrial Companies (Special Provisions) Act 1985; Recovery of Debts Due to Banks and Financial Institutions Act 1993; Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002.
[3] Bankruptcy Law Reforms Committee, *Report of the Bankruptcy Law Reforms Committee* (2015).
[4] Insolvency and Bankruptcy Code 2016, s 21.
[5] M S Sahoo, *Indian Insolvency Law* (Sage Publications 2020).

The extent of haircuts varies depending on factors such as the nature of the business, the degree of financial distress, market conditions, and the level of interest from resolution applicants.[6] In several high-profile cases, creditors have accepted reductions exceeding 70–80 percent of their claims, reflecting the severity of value erosion.[7]

Notably, the IBC does not prescribe any statutory limits on haircuts.[6] Instead, their determination is left to the commercial wisdom of the Committee of Creditors, which assesses the feasibility and viability of resolution plans. This approach allows flexibility but also raises concerns regarding consistency and fairness in outcomes.[8]

3. JUDICIAL APPROACH TOWARDS HAIRCUTS

Judicial interpretation has significantly influenced the treatment of haircuts under the IBC. The Supreme Court has consistently upheld the primacy of the Committee of Creditors in commercial decision-making.

In Committee of Creditors of Essar Steel India Ltd v Satish Kumar Gupta, the Court held that the commercial wisdom of the CoC cannot be interfered with by adjudicating authorities except on limited grounds.[7] This principle effectively places decisions regarding haircuts within the exclusive domain of creditors.

Similarly, in K Sashidhar v Indian Overseas Bank, the Supreme Court reaffirmed that the approval or rejection of a resolution plan is a commercial decision not subject to judicial review on merits.[9]

While these decisions promote efficiency and creditor autonomy, they also limit judicial scrutiny of disproportionately high haircuts, raising concerns about accountability and equitable outcomes.

4. CRITICAL ANALYSIS: COMPROMISE OR FAILURE?

The issue of haircuts raises a fundamental question: whether they represent a pragmatic compromise or a failure of the insolvency framework. From a practical perspective, haircuts

[6] IBBI Quarterly Newsletter.
[7] IBBI Quarterly Newsletter.
[8] Umakanth Varottil (2018).
[9] *K. Sashidhar v. Indian Overseas Bank*, (2019) 12 SCC 150.

are often justified as an inevitable consequence of financial distress. Creditors may accept reduced recoveries to avoid the uncertainties associated with liquidation, where asset values may deteriorate further.[10] This approach aligns with the objective of ensuring timely resolution and preventing prolonged value erosion.

Additionally, the emphasis on speed under the IBC may encourage creditors to prioritise resolution over maximisation of individual claims. This reflects a shift from recovery-oriented mechanisms to a resolution-focused framework.[11]

However, excessive haircuts raise serious concerns regarding inefficiencies in the insolvency process. High haircuts may result from delays in initiating proceedings, inadequate competition among bidders, or undervaluation of assets.[12] In some cases, limited participation by resolution applicants forces creditors to accept suboptimal offers.[13] Thus, while haircuts may be unavoidable in certain situations, their extent serves as a critical indicator of the effectiveness of the insolvency framework.

5. ISSUES AND CHALLENGES

The prevalence of high haircuts under the IBC can be attributed to several structural and procedural challenges. One of the primary issues is the delay in initiating insolvency proceedings, which leads to a decline in asset value even before the commencement of the resolution process.[14] Procedural delays during CIRP further exacerbate this problem, resulting in continued erosion of value.[15]

Another significant challenge is the lack of adequate competition among resolution applicants. In many cases, limited participation reduces competitive pressure, leading to lower bids and higher haircuts.[16]

Institutional constraints also play a crucial role. Backlogs in the National Company Law Tribunal affect the timely disposal of cases and undermine the efficiency of the resolution

[10] Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (1986).
[11] Insolvency Law Committee Report (2020).
[12] IBBI, *Insolvency Data Reports*.
[13] IBBI Insolvency Data.
[14] Reserve Bank of India, *Financial Stability Report*.
[15] BLRC (2015).
[16] Sreyan Chatterjee et al., NLS Review (2018).

process.[17]

Moreover, information asymmetry and lack of transparency hinder informed decision-making by potential bidders, ultimately affecting recovery outcomes.[18]

6. ECONOMIC IMPACT OF HAIRCUTS

Haircuts have significant implications for the broader economy. High levels of haircuts can reduce creditor confidence and encourage cautious lending behaviour, thereby restricting the flow of credit.[19] This may lead to increased borrowing costs and reduced investment activity.[20]

Furthermore, large write-offs impact the financial health of banks and may necessitate government intervention through recapitalisation.[21] This creates additional fiscal burdens and affects overall economic stability.

However, it is important to recognise that haircuts may also reflect the true market value of distressed assets.[22] In such cases, they represent economic realities rather than failures of the legal framework.

7. COMPARATIVE PERSPECTIVE

A comparative analysis of insolvency regimes reveals that jurisdictions such as the United Kingdom and the United States emphasise early intervention and restructuring.[23]

Mechanisms like Chapter 11 bankruptcy in the United States enable reorganisation of distressed companies, thereby preserving enterprise value and reducing losses for creditors.[24]

In contrast, the Indian framework faces challenges such as delays, limited competition, and institutional constraints, resulting in higher haircuts.[25] This highlights the need to adopt global best practices to improve recovery outcomes.

[17] Government of India, Economic Survey (2023).
[18] World Bank, *Doing Business Report*.
[19] Prasanna Tantri (2020).
[20] RBI Monetary Policy Reports.
[21] RBI Reports on NPAs.
[22] IMF Working Paper.
[23] UK Insolvency Act, 1986.
[24] US Bankruptcy Code, Chapter 11.
[25] OECD Insolvency Report.

8. SUGGESTIONS

To address the issue of excessive haircuts, it is necessary to strengthen valuation mechanisms and improve transparency in the resolution process.[26] Encouraging greater participation by resolution applicants can enhance competition and improve recovery rates.

Reducing procedural delays and strengthening institutional capacity are equally important for preventing value erosion. Additionally, improving information availability can facilitate better decision-making and enhance overall efficiency.

9. CONCLUSION

Haircuts under the Insolvency and Bankruptcy Code, 2016 reflect the complex interaction between legal objectives and economic realities. While they may be justified as a practical outcome of distressed asset resolution, their excessive prevalence raises concerns regarding the effectiveness of the insolvency framework.

Addressing the challenges associated with haircuts is essential for ensuring that the objective of value maximisation is achieved in practice. A balanced approach that combines efficiency, transparency, and fairness will be crucial in strengthening creditor confidence and improving the overall performance of the insolvency regime in India.

[26] IBBI Quarterly Newsletter.

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