

FAIRLY CONFIDENTIAL OR CONFIDENTIALLY FAIR

IBBI prescribes new rules for valuation of distressed entities

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Editor's Note: Maximisation of stakeholder value is one of the core objectives of IBC. The resolution plans submitted by resolution applicants should affirm to this very objective. Also, given that this is a negotiation stage, there can be several parameters which can be used to evaluate a particular resolution plan. IBBI thus came up with the concept of 'evaluation matrix', proposed to be a set of parameters to be used for consideration of resolution plans. The evaluation matrix is to be approved by the CoC and the resolution plans are to be strictly evaluated with reference to this matrix. Evaluation matrix serves as a uniform guiding tool for the resolution applicants – they know the criteria on which their plan will be evaluated.

Besides, IBBI also required fair valuation of the assets of the corporate debtor. This ensured due comparison and assessment of downside by the creditors. To ensure a healthy competition and to ensure that the liquidation value does not become a benchmark, the regulations were amended to require that the values (fair value and liquidation value) be kept confidential, and be shared only with CoC only after receipt of resolution plans. As such, the resolution applicants will have to rely on their own independent valuations while deciding on pay-outs under their respective resolution plans.

The Insolvency and Bankruptcy Board of India has issued the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations, 2018³³, effective from 6th February, 2018 ('Amendment Regulations, 2018'), to make amendments in the CIRP Regulations. The prominent changes made by the Amendment Regulations relate to introduction of "evaluation matrix" and "fair value", information memorandum and invitation of resolution plans. We have covered each of these amendments in detail below:

Evaluation Matrix

The Amendment Regulations define "evaluation matrix" as follows:

2. (1) In these Regulations, unless the context otherwise requires – XX

(ha) "**evaluation matrix**" means such parameters to be applied and the manner of applying such parameters, as approved by the committee, for consideration of resolution plans for its approval;

The concept of 'Evaluation Matrix' has been introduced vide the Amendment Regulations, 2018. As defined, it lays down such parameters for the purpose of analyzing and verifying a resolution plan, as to whether it is good to be considered for approval by the Committee of Creditors ('CoC'). Such matrix should also contain the manner of application of defined parameters.

Note that the parameters are to be approved by the Committee of Creditors.

³³http://ibbi.gov.in/webadmin/pdf/whatsnew/2018/Feb/CIRP%20Amendment%2006022018_2018-02-06%2021:47:42.pdf

Fair Value

The Code read with the CIRP Regulations, 2016 made stipulations only with regard to "liquidation value". Now, the Amendment Regulations also provide for determination of "fair value".

"Fair value" has been defined as follows --

(hb) "fair value" means the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion;"

XX"

Why fair value?

By the experience of all the interest for resolution plans being received by resolution professionals, it is evident that liquidation values, being more on the conservative side, have been largely driving down the valuation of the assets of the corporate debtors. This combined with the discussions from the [Economic Survey, 2017-18](#), critically highlights the disadvantages held by such liquidation values to the acquisition of assets of distressed entities and its negative impact on one of the objectives of maximization of value of such assets.

Key Highlights of the (Insolvency Resolution Process for Corporate Persons) [Amendment]	
Evaluation Matrix	means such parameters to be applied and the manner of applying such parameters, as approved by the committee, for consideration of resolution plans for its approval
Fair Value	"fair value" means the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date
Liquidation Value	means the estimated realizable value of the assets of the corporate debtor, if the corporate debtor were to be liquidated on the insolvency commencement date.
Information Memorandum	Submission of IM to each member of CoC : Within 2 weeks of appointment as RP Submission to prospective applicants : Latest by the date of invitation of resolution plan
Invitation of Resolution Plans	At least 30 days before the last date of submission of resolution plans; or at least 15 days before the last date for submission of resolution plans (for sending evaluation matrix with approval of Committee of Creditors)

Availability of a duly computed and approved fair value will enhance the valuation of the assets of the Company. It may also be useful to compare the two values in order to arrive at the value which is more beneficial than the other.

Such arrived fair value and liquidation value will be made available to the CoC members only on getting a declaration to the effect that they shall

Figure 14: Key highlights of the CIRP Amendment Regulation

maintain utmost confidentiality of such values. Additionally, it is also the responsibility of the RP and the registered valuers.

Fair Value vs. Liquidation Value

Fair value and Liquidation value, both are estimated realizable value of the assets of the company determined with reference to the insolvency commencement date. However, the underlying assumptions in determining these two values are exactly opposite.

As regards liquidation value, the definition of 'liquidation value' has been substituted with the following, which is the replica of regulation 35 (1) of the CIRP Regulations, 2016 itself:

"(k) "liquidation value" means the estimated realizable value of the assets of the corporate debtor, if the corporate debtor were to be liquidated on the insolvency commencement date."

It may be noted that the definition of liquidation value is derived from the text of regulation 35(1). Earlier, the definition was clause-specific, however, post amendment, it shall become universal for all the provisions, wherever the reference of 'liquidation value' is made, throughout the CIRP Regulations, 2016, and even in the Code.

Therefore, liquidation value is the realizable value of assets, if the company was to be 'liquidated' as on the liquidation commencement date. On the other hand, fair value is the realizable value of assets if assets were to be 'exchanged' between 'willing buyer and willing seller' on arms' length basis 'without any compulsion or pressure'. While the former takes a conservative approach, the latter is optimistic in nature.

For example, in the matter insolvency of Gujarat NRE Coke Ltd., CoC emphasized on selling off one of the assets i.e. windmill because the value of the assets was depleting day by day. Value of windmill doesn't deplete on a daily basis usually, however, the value was depleting in this case because of following reasons:

- a. Asset belonged to a company which was under CDR Mechanism first and then undergoing CIRP;
- b. There was no maintenance of the assets because the company was unable to pay for the maintenance.

Liquidation value in the case was arrived to be at Rs. 180 Crore owing to above factors. Had the above two factors were not in play, fair value of the said asset would have been more than Rs 180 Crore.

Particulars	Fair Value	Liquidation Value
Definition	Basic assumption is that the company will continue as a going concern. It is the estimated realizable value if the assets were to be exchanged between a willing buyer and seller on an arm's length basis, as on the insolvency	Basic assumption is that the company is to be liquidated as on the insolvency commencement date. The values of assets are therefore estimated on this assumption.

	commencement Date	
Approach	Optimistic	Conservative
Arm's length basis/"without compulsion"	<p>Value will be termed as fair only if the exchange of the asset(s) is on an arm's length basis, where:</p> <ol style="list-style-type: none"> 1. <i>Proper marketing</i> has been conducted to ensure wide public disclosure; 2. The parties to the transaction acted: <ol style="list-style-type: none"> a. <i>knowledgeably,</i> b. <i>prudently,</i> and c. <i>without compulsion</i> 	<p>Since the company is assumed to be under liquidation, the value would be arrived, in most of the cases, assuming that the bargaining power of the company would be lower than the counter-party.</p>

Determination of fair value alongwith liquidation value

Regulation 35 has been amended so as to provide for determination of "fair value" as well, in a manner similar to the determination of "liquidation value". Regulation 35 has been substituted with the following regulation:

"35. Fair value and Liquidation value.

- (1) *Fair value and liquidation value shall be determined in the following manner:-*
 - (a) *the two registered valuers appointed under regulation 27 shall submit to the resolution professional an estimate of the fair value and of the liquidation value computed in accordance with internationally accepted valuation standards, after physical verification of the inventory and fixed assets of the corporate debtor;*
 - (b) *if in the opinion of the resolution professional, the two estimates of a value are significantly different, he may appoint another registered valuer who shall submit an estimate of the value computed in the same manner; and*
 - (c) *the average of the two closest estimates of a value shall be considered the fair value or the liquidation value, as the case may be.*
- (2) *After the receipt of resolution plans in accordance with the Code and these regulations, the resolution professional shall provide the fair value and the liquidation value to every member of the committee in electronic form, on receiving an undertaking from the member to the effect that such member shall maintain confidentiality of the fair value and the liquidation value and shall not use such values to cause an undue gain or undue loss to itself or any other person and comply with the requirements under sub-section (2) of section 29:*
- (3) *The resolution professional and registered valuers shall maintain confidentiality of the fair value and the liquidation value."*

Fairly Confidential or Confidentially Fair

A third registered valuer shall be appointed, if the difference between two estimates of any or both the values is significant, For eg. Valuer A, submitted fair value of Rs. 5 lakhs, Valuer B submitted fair value of Rs. 5.5 lakhs, and Valuer A submitted liquidation value of Rs. 2.5 lakhs and Valuer B submitted liquidation value of Rs. 5 lakhs. There is a significant difference in the two estimates of liquidation values submitted by Valuer A and B respectively. Even if there is no significant difference between fair values provided by A and B, a third Valuer C, shall be appointed for determination of liquidation value.

The Amendment Regulations also require that the fair value too, besides liquidation value, shall be given to each member of the committee of creditors post receipt of resolution plans. Such requirement seems counter-intuitive in nature. The Code requires that the resolution plan shall provide for liquidation value due to dissenting financial creditors and operational creditors. As such, any prospective resolution applicant shall have to proceed independently to determine liquidation value/fair value on the basis of information memorandum supplied by the resolution professional.

Information Memorandum

Timelines have been provided in the Amendment Regulations pertaining to submission of information memorandum (IM). The same are detailed below:

Description	Timeline
Submission of IM to each member of CoC	Within 2 weeks of appointment as RP
Submission to prospective applicants	Latest by the date of invitation of resolution plan under section 25(2)(h)

Description of assets and liabilities

The information memorandum shall now provide “details” of assets of the corporate debtor, which in turn will assist the resolution applicants to determine “liquidation value” and/or “fair values” on their own:

Before amendment	Post amendment
Mandatory to contain details of assets and liabilities	Mandatory to contain the following, but not limited to, description of assets and liabilities: <ol style="list-style-type: none">1. Date of acquisition;2. Cost of acquisition;3. Remaining useful life;4. Identification no.;5. Depreciation charged;6. Book value;7. Any other relevant details.

Invitation of Resolution Plans

Amendment Regulations, 2018 has inserted a new regulation 36A. The regulation mandates RP to issue an invitation including evaluation matrix, to the prospective resolution applicants in accordance with section 25(2)(h) of the Code for submission of resolution plans.

Timeline has been specified in the Amendment Regulations, 2018 for sending invitation or evaluation matrix to prospective applicants:

- a. **At least 30 days** before the last date of submission of resolution plans; or
- b. **at least 15 days** before the last date for submission of resolution plans (for sending evaluation matrix with approval of Committee of Creditors)

RPs are given liberty to modify the invitation or the evaluation matrix.

Amendment Regulations, 2018 bring in **Form G** to facilitate publication of brief particulars of the invitation. The Form shall be uploaded on the website of the Company and on any other website as directed by IBBI. However, nothing is mentioned w.r.t. publication of invitation for resolution plans in Form G by way of newspaper publication.

The RP may choose not to use the format while giving public announcement in newspaper and instead give a link to this Form, as uploaded on the website of the Company, in the announcement.

It is to be noted here that this provision shall not be applicable upon following on going CIRPs:

- a. where a period of less than 37 days is left for submission of resolution plans (for issuing invitation); and
- b. where a period of less than 18 days is left for submission of resolution plans (for sending evaluation matrix).

Authority of RP instead of IRP

Amendment Regulations, 2018 authorize RP in place of IRP for following:

- a. Appointment of Registered Valuers;
- b. Invitation of Resolution Plans;
- c. Preparation and submission of Information Memorandum

Additional measures which may be adopted in Resolution Plan

Regulation 37 has been substituted by a new regulation vide Amendment Regulation, 2018. Amendment Regulations, 2018 provide for two additional measures for resolution of insolvency:

- a. **change in portfolio of goods or services** produced or rendered by the corporate debtor; (Regulation 37(j))
- b. **change in technology used** by the corporate debtor (Regulation 37(k)).

Submission of Resolution Plan

Regulation 39(4) has been substituted with new sub-regulation dealing with submission of the resolution plan as is approved by CoC. The analysis of this amendment is discussed below:

Text before amendment	Text post amendment	Impact
<p>The resolution professional shall submit the resolution plan approved by the committee to the Adjudicating Authority with the certification that:</p> <p>(a) the contents of the resolution plan meet all the requirements of the Code and the Regulations; and</p> <p>(b) the resolution plan has been approved by the committee.</p>	<p>(a) The resolution professional shall submit the resolution plan approved by the committee to the adjudicating Authority, at least fifteen days before the expiry of the maximum period permitted under section 12 for the completion of the corporate insolvency resolution process, with the certification that the contents of the resolution plan meet all the requirements of the Code and the Regulations; and</p> <p>(b) the resolution plan has been approved by the committee: Provided that the timeline specified in this sub-regulation shall not apply to an ongoing corporate insolvency resolution process which has completed 130th day from its commencement date.</p>	<p>1. Earlier, there was no timeline for submission of resolution, except that it was to be submitted within the period of moratorium. Post amendment, the resolution must be submitted to the AA, before the expiry of 15 days of the moratorium period.</p> <p>Proviso has been inserted to the effect that this timeline shall not be applicable to an ongoing corporate insolvency resolution process which has completed its 130th day from its commencement.</p>

Amendment in the Fast Track CIRP Regulations, 2017

Amendments made in the CIRP Regulations, 2016 have also been replicated in the Insolvency and Bankruptcy Board of India (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017, with minor differences as to timelines vide Insolvency and Bankruptcy Board of India (Fast Track Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations, 2018⁴.

Conclusion

The overall impact of the Amendment Regulations, 2018, seems fairly positive – changes such as introduction of concepts like evaluation matrix, provision of determination of “fair value”, comprehensive description of assets and liabilities in IM, etc. are all welcoming.

We expect to see more such changes in future, as per the requirements of the time and circumstances to be.

Know More....

In the matter of *State Bank of India vs. Su Kam Power Systems Ltd.*, the Hon'ble NCLT, Principal Bench, *vide* its order dated 05.09.2018, held regulation 36A of the IBBI (Insolvency Resolution Process for Corporate Persons), 2016 as ultra-vires of section 240 (1) of IBC, 2016 which states that the Board i.e. IBBI may, by notification, make regulations **consistent with this Code**and the rules made thereunder, to carry out the provisions of this Code. It was observed by the Principal Bench that it was beyond the powers of the Board to lay down the procedure of inviting expression of interest, linking the same with "form G", by way of an insertion in the CIRP Regulations. The Bench held that such provision negates the salient features of the Code and as such, directed the Board to frame the Regulation according to its competence bestowed upon it by the Code.

Subsequently, pursuant to an appeal filed by IBBI against the said order in the High Court of Delhi, the Hon'ble High Court has, as an interim measure, stayed the order to the extent it declares Regulations 36A as ultravires.