

Non-Cooperative Bargaining in Bankruptcy Resolutions: A Game Theory Approach

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ABSTRACT

Traditionally, the goal of bankruptcy proceedings has been viewed as a cooperative problem, aiming to find a solution that maximizes the overall value of the debtor's estate for the benefit of all creditors. However, this paper investigates the non-cooperative bargaining dynamics between secured and unsecured creditors in the context of India's Insolvency and Bankruptcy Code (IBC) resolution process. By applying game theory, I analyze the potential conflicts that arise when creditors prioritize maximizing their recoveries. Secured creditors have a claim on specific assets of the debtor (collateral) which serves as security for their debt. In liquidation, the secured creditors have the highest priority and can choose to sell the collateral to recover their debt. The value of this collateral provides an anchor value for their payout. Unsecured creditors have no collateral and rely on the debtor's general assets for repayment. In a restructuring plan, secured creditors receive the full liquidation value of their collateral first. Any amount remaining after payment of liquidation value is considered the surplus. This surplus is then distributed among all creditors (secured and unsecured) according to the terms of the restructuring plan. Non-cooperative bargaining theory predicts that secured creditors will indeed vote for the plan that prioritizes the distribution of maximum (or complete) surplus to them, even if it means a smaller recovery for unsecured creditors. However, it also shows that unsecured creditors might also engage in strategic voting or holdout tactics to influence the outcome. After incorporating iterative bargaining rounds, the model predicts that the outcome depends on their bargaining power and willingness to accept a compromise solution. Additionally, the threat of a lengthy court battle might incentivize both sides to reach a negotiated settlement. The model provides valuable insights for policymakers aiming to promote efficient and fair resolutions. By understanding the potential for conflict and cooperation, strategies can be developed to encourage productive negotiations and achieve outcomes that benefit all stakeholders involved.