

## Issues in CIRP of CD with Assets primarily on Lease/License from Third Parties



*Assets of the Corporate Debtor which are on lease/license from third parties play a crucial role in the resolution of companies during CIRP. They may also be crucial for running the CD as Going Concern, preparing Information Memorandum (IM) for the Prospective Resolution Applicants (PRAs). Nonavailability of Third-Party Assets (TPAs) such as impounding of airplanes in another jurisdiction, land, classes of contractual agreements, and national security etc. may lead to complete cessation of the business. Besides, the actual information related to the TPAs are important for PRAs in preparing Resolution Plan which also facilitative during implementation of the Plan. Read on to know more...*



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### 1. Introduction

“The first order objective is resolution. The second order objective is 'maximization of value of assets of the Corporate Debtor (CD) and the third order objective is promoting entrepreneurship, availability of credit and balancing the interests. This order of objective is sacrosanct,” said the NCLAT in the matter of *Binani Industries Ltd. Vs. Bank of Baroda*<sup>1</sup> on November 14, 2018. Thus, value maximization is second in the order of the three primary objectives of the IBC. In pursuance to this objective, the IRPs/ RPs are required to make list of assets of the respective CDs and plan a strategy for value maximization. The present article is focused on the issues related to the assets of the CD which are on lease/ license from third parties at the time of CIRP. This would enable the IRPs/RPs to imbibe the finer details which are critical for value maximization of the CD.

### 2. Third Party Assets (TPAs): Meaning, Type, Holding, Use in Business

#### 2.1. Definition

Asset's tangible or intangible, taken on license or lease by Corporate Debtor (CD) from a Third Party (TP) who is the owner of such assets. These include:

<sup>1</sup> Company Appeal (AT) (Insolvency) No. 82 of 2018, NCLAT (<https://nclat.nic.in/Useradmin/upload/744324065bebc1bd0ef4a.pdf>)

- i. Assets where CD holds custody, but which are owned by a TP.
- ii. Assets owned or under the control of contractor or a visitor to the property including vans, trucks, vehicles, storage equipment etc.

## 2.2. Type of Contractual Relationship

The TPAs may be governed under varied contractual relationship between CD and TP which includes:

- i. Assets Owned by TP and used by CD
- ii. Asset held in trust for any TP
- iii. Assets held under bailment contract with TP
- iv. Assets held under hire purchase/ lease
- v. Assets owned by Related Party
- vi. Contractual Arrangements which may not stipulate transfer of title but only use of assets

## 2.3. Use in Business

Depending on utility and requirements of the CD, the TPAs can be used for varied purposes. However, their use can be classified on the basis of their bearing on the business of the CD as under:

- i. Critical Assets (for CD's operations):  
Airplanes on lease and intangible assets on licence to CD such as Patents, copyrights, trademarks, designs etc.
- ii. Non-critical (General-purpose asset):  
Vehicle on hire for general use.

## 2.4. TPA: Type of Ownership

The TPAs can be owned by different parties, but are broadly classified into two categories:

- i. Owned by Government/Governmental bodies, such as sovereign assets and others. Sovereign assets are restricted to those assets which are to be used only for public good.
- ii. Owned by Private Party

Though sovereign assets are not defined in the IBC, in general parlance, it means:

- i. Scarce natural resources like land, water, spectrum, agriculture and animal husbandry, forest, wildlife, and minerals.

- ii. Strategic assets such as airways, waterways, nuclear assets, space technology, defense assets, scientific assets such as patents & licenses for use of these assets, strategic PSU assets, exclusive economic zone of 200 nautical miles and assets to be used for the benefit of the public of the country.
- iii. Other assets of the Government / PSUs which are not strategic in nature.

**Though sovereign assets are not defined in the IBC, in general parlance, it means scarce natural resources, strategic assets and other assets of the government which are of non-strategic nature.**

## 3. Provisions of IBC Related to TPAs

**3.1. Protection to CD during Moratorium:** Section 14(1)(d) of the IBC prohibits any recovery during the moratorium period of the property by owner/ lessor where such property is occupied by or in the possession of the CD.

- i **Protection to CD for Critical Assets - Section 14(2A):** If the supply of goods or services is critical to protect and preserve the value of the CD and manage the operations of such CD as a going concern, then the supply of such goods or services shall not be terminated, suspended or interrupted during the period of moratorium, except where such CD has not paid dues arising from such supply during the moratorium period or in such circumstances as may be specified.
- ii **Protection to CD for certain assets held under trust, bailment, or any other contractual arrangement :** Section 18(f) - explanation - provides that TPA held under trust, or under contractual arrangements including bailment, cannot be taken under control or custody by IRP/RP. In case of license, permits registration etc., issued by Central Government, State Government, or any authority constituted under law, the same shall not be suspended or terminated on the grounds of insolvency, however subject to payment of current dues.

This TPA's of private parties are not covered under the above protection except to the extent of supplies and services are determined as critical u/s 14(2A). The IP can negotiate with them, if the assets are critical to the operations of the CD or seek direction from NCLT.

### 3.2. Asset exclusions

Section 18 – duties of IRP

- Explanation. – For the purposes of this [section], the term “assets” shall not include the following, namely:

- (a) Assets owned by a third party in possession of the CD held under trust or under contractual arrangements including bailment.

### 3.3. Insolvency resolution process costs

Regulation 31(b)

Insolvency resolution process costs under Section 5(13)(e) shall mean-

- (b) Amounts due to a person whose rights are prejudicially affected on account of the moratorium imposed under section 14(1)(d).

## 4. Impact of Critical and Non-Critical TPAs on Business of CD during CIRP

### 4.1. Critical Assets

Non-availability of critical assets, may lead to complete cessation of business like:

- a) Impounding of airplanes in another jurisdiction
- b) Land Development Authority may revoke lease and ask for vacation of property
- c) Agreement terms may provide for automatic cancellation on initiation of CIRP [e.g., Termination clause in Container Freight Station agreements, etc.]
- d) Similar cancellation clauses exist in contractual arrangements for use of intangible assets such as patents, copyright, trademarks etc. in case of non-payment of license fee or royalty
- e) Strategic assets may have termination clause in view of national security

### 4.2. Non-Critical Assets

The TPAs owner may take recourse to the followings in case of non-critical assets

- a) Seek re-possession of assets
- b) Seek cancellation of contracts
- c) Demand past dues settlement before permitting further use

- d) Insist on revision of contract with additional conditions which may not be favorable to CD
- e) Can claim back Hire Purchase (HP) assets (shown as assets in the books, whereas the title transfers only on payment of the last installments) which are strictly third-party assets.

## 5. Issues faced by IP during the Resolution Process: Value / Renewal / Eligibility Criteria for RA to Qualify for Replacement of CD / Current Structuring of Agreements

**5.1 Issues faced by IP:** Some of the issues encountered by IP's during the resolution process are:

- a) Directors may not disclose the criticality of these TPAs for the business.
- b) Many contracts might have expired which require renewal/renegotiation. The renewal terms [when the CD is a going concern] can be negotiated easily by the IP. Whereas, in case of closed units, the value can be ascertained only upon commencement of operations, and in such scenario the RA will be in dark to that extent.
- c) Valuation of right to use of critical assets, licenses, patents etc. depend on future operations and the terms of the arrangement which may not be easy for IRP/RP to estimate /project.
- d) The requirement of the Resolution Applicant (RA) to ensure that they fulfil the eligibility criteria and qualify to take over the CD prior to submission of Resolution Plan, may be difficult as the RA can't put this as a 'condition precedent' in his/ her plan (this will be tantamount to a conditional plan).

**5.2 Current Structuring of Agreements:** Current structuring of agreements particularly some Public Private Partnerships (PPPs) are generally not addressing the concern of treatment of TPAs during CIRP.

- a) The PPP concession agreements may be only between the Grantor and the CD (Concessionaire), and the lender may not be a party to the same.
- b) Agreements may not be having the cure rights, step in rights, substitution, and novation clause etc.

- c) Change in ownership or control to a nominee of lender is generally not perceived
- d) Share pledge of existing concessionaire in favour of lenders are not envisaged
- e) Clause of indemnification by the concessionaire to substituting entity does not include
- f) Substitution clause of concessionaire agreement may not be included in other supporting agreements
- g) Substituting entity faces delay in obtaining permits etc. in its name as all the authorities are not taken on Board at the time of initial signing

- c) Discuss with the CoC members, the eligibility criteria to be included in the EOI in light of such TPA's. Also, to decide on appropriate clauses to be included in the Request for Resolution Plan (RFRP).
- d) The role of the CoC is more of a facilitation than approvals, as there is no mandatory requirement to involve CoC [not covered u/s 28 of the Code]. However, as the final resolution plan approval is in the domain of CoC engaging them is essential.

## 6. Suggested Approach for IP (Key Considerations in Information Memorandum / CoC Meetings / Resolution Plan Request etc.)

### 6.1 While preparing Information Module (IM)

- a) Include the details of the critical third-party assets (both tangible and intangible) and the salient features of the terms of use and the critical clauses governing termination of such agreements.
- b) In case of intangible assets - include the unexpired period of the license along with the terms and conditions of such license.
- c) The responsibility of the RA to satisfy the owner that they fulfill the criteria set by the owner of the assets for being eligible to use the assets.

### 6.2 While conducting CoC Meetings

- a) The CoC members should be appraised regarding the terms of use and the eligibility requirement for obtaining right to use of critical TPA by the Prospective Resolution Applicant (PRA).
- b) In cases of critical TPA where resolution is not possible due to the contractual arrangement requiring reworking with the TPA owner; the concerned government/statutory/ local authorities/TPA owner may be invited to the CoC meeting to hear their stand for the continuation of such contracts by the CD, post approval of the plan [including the due diligence requirement to determine the eligibility of the RA].

### 6.3 Involving TPAs owners in CIRP

- a) The PRA may need an option to work out arrangement with the TPA owner before submitting a resolution plan, in the case of Critical TPAs. This will facilitate implementation of the Resolution Plan [RP] in the event of the RA becoming the successful resolution applicant [SRA].
- b) There can be a suggested structuring of Agreements to deal with issues of substitution, novation, cure rights etc. One may refer certain NHAI agreements in this regard which contains remedial measures like 110412 concession agreement – NHAI – Kerala. Certain extracts are reproduced hereunder:

**The PRA may need an option to work out arrangement with the TPA owner before submitting a resolution plan, in the case of Critical TPAs.**

#### Page 28 of said Agreement:

- The Concessionaire shall procure that each Subcontract shall contain provisions that entitle the Authority to step into such agreements, in substitution of the Concessionaire, if this Agreement is liable to be terminated due to a Concessionaire Event of Default or a Force Majeure Event. However, the step-in rights of the Authority shall be subject to the rights of the Lenders under the direct agreements (if any) between the Lenders and the Subcontractors.

#### Page 30 of said Agreement:

Subject to Clauses 6.1(c) and 6.1(f), no Change in Ownership may occur during the Lock-in Period.

- c) Clause 6.1(b) shall not apply: (i) where the Change in Ownership arises as a consequence of the grant or enforcement of security in favour of the Lenders over or in relation to any of the shares of the Concessionaire, provided that any document conferring security over any of such Capital of the Concessionaire has been approved by the Authority. If the Authority has not granted or withheld its approval for any document conferring security over any Capital of the Concessionaire within forty-five (45) days of an application being made by the Concessionaire, such approval shall be deemed to have been granted;

- Page 44 of said Agreement:
- Clause 12.3 – direct agreement
- Page 114 of said Agreement:

#### Lenders' Rights

Subject to the provisions of the Concession Agreement, the Lessor hereby expressly agrees that in the event of exercise of rights of the Lenders under the Direct Agreement or any similar right, the Parties hereto shall assign or novate this Lease Agreement in favour of the Lenders', or any other person duly authorized by the Lenders', within [10 (ten)] days of such an occurrence.

#### 6.4 While issuing RFRP

- a) The IP should set out the eligibility criteria for the use of the assets by the owner and the eligibility criteria for replacing the CD.
- b) The claims (prior to commencement of CIRP) of private TPAs needs to be tactfully handled as the TPA owner reserves the right to cancel the arrangement.
- c) If IRP/ RP has declared the use of these assets are critical for the CD to be operated as a going concern, this shall also be indicated in RFRP to facilitate PRA's discussion with the TPA owner.
- d) There may be multiple owners owning one or more assets like leased land held by more than one party and the total land being used to put machine for manufacturing. In such cases, make appropriate disclosure in RFRP so that PRA can separately negotiate with

each lease owner and file a draft memoranda agreement with Resolution Plan. If pre-negotiated by PRA, the Plan may accompany signed or agreed upon extended lease agreements which guarantees TPA continuity in plan implementation.

#### 7. Some Important Judgement on Issue of TPAs

Law in India on IBC is nascent and evolving. However, certain principles are already settled by supreme court as enumerated hereunder:

- a. Approval from Statutory authorities is a must where required to be taken prior to disposal of property upheld the Supreme Court in the matter of *Ram Singh Vijay Pal Singh<sup>2</sup> & Ors. Vs. State of U.P. & Ors.* (2007).
- b. Treatment of natural resources and national assets should be done in fair and transparent method consistent with the fundamentals of the equality clause enshrined in the constitution, upheld the Supreme Court in the matter of *Dr. Subramanian Swamy Vs. Union of India* W.P. (Civil) 10 of 2011.
- c. In the matter of *Embassy Property Development Pvt. Ltd. Vs. State of Karnataka* [C.A.No.9170 of 2019], the Supreme Court ruled that IBC Code does not apply to right conferred by mining lease<sup>3</sup>.
- d. Any authority cannot terminate the agreement since Section 14(1)(d) grants protection to CD for right to use, said the Supreme Court in the matter of *Rajendra K. Bhutta Vs. Maharashtra Housing and Area Development Authority & Anr.* [Civil Appeal No. 12248/2018] – Guru Ashish CHSL (SC).
- e. A Resolution Plan cannot restructure liability of CD by creating fresh debt and mortgage of land which directly affected Third party rights - *Municipal Corporation of Greater Mumbai (MCGM) Vs. Abhilash Lal & Ors.* [Civil Appeal No. 6350 of 2019 SC]
- f. NCLAT in April 2021 ruled that spectrum can be transferred as part of the Resolution Plan but only after clearing all government dues, thus

<sup>2</sup> *Ram Singh Vijay Pal Singh & Ors vs State of U.P. & Ors* on May 01, 2007 (<https://indiankanoon.org/doc/586046/>)

<sup>3</sup> *Embassy Property Development Pvt. Ltd. Vs. State of Karnataka* ([https://main.sci.gov.in/supremecourt/2019/33953/33953\\_2019\\_4\\_1501\\_1875\\_7\\_Judgement\\_03-Dec-2019.pdf](https://main.sci.gov.in/supremecourt/2019/33953/33953_2019_4_1501_1875_7_Judgement_03-Dec-2019.pdf))

upholding that the rights of the asset owner under a contract with the CD, overrides the provisions of IBC - Aircel Judgement [Civil Appeal No. 6328-6399 of 2015 SC]. The judgment has been challenged in SC by the CoC, UAVRCL on the grounds that IBC overrides the universal access service license conditions, tripartite agreement and spectrum trading guidelines. Further, such a decision gives preferential treatment to Government Departments, an Operation Creditor, and amounts to discrimination against other creditors.

### 8. Recommendations for Amendments in IBC

The author recommends following modifications in the Code, for better on ground implementation:

- a) Define 'Sovereign Assets' in the Code and enumerate the list of such assets [may be an inclusive definition].
- b) Appropriate amendment of provision for right to use third-party assets [like sovereign asset usage in Explanation to sec 14(1)], which are critical to the operations of the CD in section 14(2A).
  - c) Stipulate prior approval of concerned authority (for transfer of such critical sovereign rights to RA), prior to approval of the Resolution Plan by CoC, similar to the approval by Competition Commission of India (CCI) in proviso to section 31(4) of the Code when it involves enterprises contemplated in Section 5 of the Competition Act.
  - d) The implementation and monitoring committee post approval, be cast with an obligation to monitor such 'right to use' up to the completion of the implementation period.
  - e) Incorporate appropriate provisions for dealing with cross border assets of third parties, irrespective of its criticality for the operations of the CD.

**Appropriate amendment is required in the provision for right to use third-party assets [like sovereign asset usage in Explanation to sec 14(1)], which are critical to the operations of the CD in section 14(2A).**

