

Sale as a Going Concern: Key Issues and Concerns

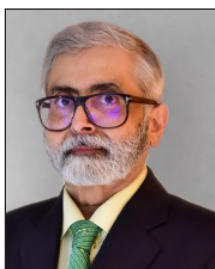


*Though Section 35 empowers the liquidator, to carry on the business of the corporate debtor for its beneficial liquidation, IBC, 2016 does not empower the CoC to continue the business of the corporate debtor in liquidation. After analysing various provisions of the Code related to the liquidation process, the authors argue that if the continuity of business is not for the beneficial liquidation of the corporate debtor, the CoC cannot identify the group of assets and liabilities, which can be sold as a going concern. The authors have recommended a comprehensive legal framework for providing due recognition to the sale of corporate debtor as a going concern and adequately protect of the interests of the stakeholders. **Read on to Know More...***

Introduction

The provisions concerning liquidation process are set out in Chapter III of the Insolvency and Bankruptcy Code, 2016 (Code). Section 33 of the Code stipulates the circumstances under which the Adjudicating Authority can pass an order requiring the corporate debtor to be liquidated in the manner as laid down in this Chapter.¹

The conditions triggering liquidation of a corporate debtor provide that if before the expiry of the insolvency resolution process period or the maximum period permitted for completion of the Corporate Insolvency Resolution Process (CIRP) under Section 12 or the Fast Track CIRP under Section 56, as the case may be, the Adjudicating Authority does not receive a resolution plan under Section 30(6) or rejects the resolution plan under Section 31 for the non-compliance of the requirements specified therein, then the Adjudicating Authority shall pass an order for liquidating the corporate debtor. Further, the Adjudicating Authority shall issue a public announcement and require such order to be sent to the Authority with which the corporate debtor is registered.



Shardul S. Shroff and Kritika Poddar

The author is Executive Chairman and Co-author is Research Fellow at Shardul Amarchand Mangaldas & Company. He can be reached at iiipi.journal@icai.in

¹ Section 33(1)(b)(i), Insolvency and Bankruptcy Code, 2016

A resolution professional can at any time during the CIRP but before confirmation of the resolution plan intimate the Adjudicating Authority of the decision of the committee of creditors (CoC) approved by not less than 66% of the voting share to liquidate the corporate debtor, where the Adjudicating Authority shall pass the liquidation order in accordance with Clause (b)(i), (ii) and (iii) of Section 33(1).²

Provisions related to Liquidation

Section 33(5) also provides that once the liquidation order is passed, no suit or other legal proceeding shall be instituted by or against the corporate debtor, provided that a suit or legal proceeding may be instituted by the liquidator on behalf of the corporate debtor, with the approval of the Adjudicating Authority. Section 33(6) further states that Section 33(5) shall not apply to legal proceedings in relation to such transactions as may be notified by the Central Government in consultation with any financial sector regulator.

The consequence of an order of liquidation is set out in Section 33(7), which states that the order will be deemed to be a notice of discharge to the officers, employees and workmen of the corporate debtor, except where the business of the corporate debtor is continued during the liquidation process by the liquidator.

Section 35 of the Code specifies the powers and duties of the liquidator. Such powers are set out in Section 35(1)(a) to (o) and are subject to the directions of the Adjudicating Authority. Section 35(1)(e) categorically states that the liquidator can carry on the business of a corporate debtor for its beneficial liquidation as he considers necessary. Section 35(1)(f) stipulates that subject to Section 52 of the Code, the liquidator has powers and duties to sell the immovable and movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate or to sell the same in parcels in such manner as may be specified. Proviso to section 35(1)(f) provides that the liquidator shall not sell the immovable and movable property or actionable claims of

the corporate debtor in liquidation, to any person who is not eligible to be a resolution applicant. None of the powers or duties enumerated under section 35 of the Code empower the liquidator to sell the corporate debtor on a going concern basis.

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After the initiation of liquidation under Section 33 of the Code, Section 36 provides for the formation of the liquidation estate. For the purposes of liquidation, the liquidator shall form an estate of assets mentioned in subsection (3) of Section 36, which will be called the liquidation estate in relation to the corporate debtor. Section 36(2) provides that the liquidator holds the liquidation estate as a fiduciary for the benefit of all creditors.

Section 36(3) further specifies the elements of the liquidation estate. Again, it nowhere provides that the liquidation estate includes incorporeal assets like licenses, entitlements, mining leases and other statutory permissions to carry on business as part of the liquidation estate, except broadly in Section 36(3)(h), which provides that the liquidation estate shall include any other property belonging to or vested in the corporate debtor at the insolvency commencement date.

Subsequent thereto, Section 36(4) specifies what is not included in the liquidation estate assets. Assets which are not included in the liquidation estate inter alia include assets owned by a third party, which are in possession of the corporate debtor or such other assets as may be notified by the Central Government in consultation with the financial sector regulator, assets in security collateral held by financial services providers, subject to netting and set off in multilateral trading or clearing transactions. Furthermore, any other assets as may be specified by the Insolvency and Bankruptcy Board of India (IBBI) including assets which could be subject to set off on account of mutual dealings between the corporate debtor and any creditor are not to be included in the liquidation estate asset.

² Section 33(2), Insolvency and Bankruptcy Code, 2016

Chapter VI of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 (Liquidation Process Regulations) provides for realisation of assets. Regulation 32 provides that the Liquidator may sell (a) assets on a standalone basis; (b) assets in a slump sale; (c) a set of assets collectively; (d) assets in parcel; (e) the corporate debtor as a going concern; or (f) the business of the corporate debtor as a going concern, provided that where an asset is subject to security interest, it shall not be sold under any of the provisions of (a) to (f), unless the security interest therein has been relinquished to the liquidation estate. The phrase “going concern” is undefined under the Code but it implies that the corporate debtor would continue to function as it did prior to the initiation of the CIRP, other than as restricted under the Code.³ Contrast this with the relevant provisions in the Code

Section 35(1)(e) contemplates that the business of the corporate debtor can be carried on only for its beneficial liquidation as the liquidator may consider necessary. The liquidator has no authority to carry on the business if it is not for the beneficial liquidation of the corporate debtor.

Liquidator’s powers are circumscribed to selling immovable and movable property and actionable claims of the CD by public auction or private contract and does not include of sale of the CD or its business as a going concern.

Section 35(1)(f) is telling. The liquidator’s powers and duties include to sell the immovable property, movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract with power to transfer such property to any person or body corporate or to sell the same in parcels in such manner, as may be specified. Thus, the liquidator’s powers are circumscribed to selling the immovable and movable property and actionable claims of the corporate debtor by public auction or private contract and does not include of sale of the corporate debtor or its business as a going concern.

Even Section 36(3)(a) provides that cash in bank or cash on hand where the corporate debtor has ownership rights including all rights and interests therein as evidenced in the balance sheet of the corporate debtor etc. are part of the liquidation estate. A running business cannot form a liquidation estate as liquidation means corporate death. This is clear from Section 33(7) of the Code.

Hence, unless and until the liquidator can support the proposition that continuing the business is in the interest of beneficial liquidation i.e., realising higher value, the business of the company has to cease for the creditors to realise maximum value, rather than frittering away the liquid assets of the corporate debtor in a mis-directed continuation of business.

The only exclusion, as we considered above, is set out in Section 35(1)(e) and it must be proved that the business is being engaged for the beneficial liquidation of the corporate debtor for continuing such business or part of such business.

Again, examining the provisions of Regulation 32A read with Regulations 32(e) and (f) of the Liquidation Process Regulations, conceptually an ultra vires principle has crept in. It is only the liquidator empowered under Section 35, who can carry on the business of the corporate debtor for its beneficial liquidation. The Code does not empower the CoC to continue the business of the corporate debtor in liquidation. The entirety of Regulation 32A is at cross purposes with the Code as, if the continuity of business is not for the beneficial liquidation of the corporate debtor, the CoC cannot identify the group of assets and liabilities, which can be sold as a going concern. Regulation 32A(3) proceeds on the basis that upon the failure of the CoC, the liquidator is entitled to identify and group the assets and liabilities to be sold as a going concern in consultation with the Consultation Committee.

The provisions of Regulation 32A(4) create a condition precedent to attempting to sell the corporate debtor as a going concern and provide that if the liquidator is unable to

³ Report of the Insolvency Law Committee, March 2018 available at https://ibbi.gov.in/ILRRport2603_03042018.pdf pg. 36.

sell the corporate debtor or its business as a going concern within ninety days from the liquidation commencement date, then he shall proceed to sell the assets of the corporate debtor by other manners of sale as specified under Regulation 32. The provisions of Regulation 32A (4) must be construed as mandatory as otherwise they conflict with the period available for the sale of assets. Regulation 33 also clearly indicates that the normal method of liquidation is by selling the assets and not the business or the corporate entity, as a going concern.

The consequence of a company being ordered for liquidation is for the Registrar of Companies to include the words “in liquidation” along with the corporate name of the corporate debtor to give public notice that the company is in insolvent circumstances.

Having demonstrated that the order of liquidation as made under Section 33 of the Code is civil death or corporate death of the company, the law does not provide for a Christ like action of reviving a dead person. It is only when the business of the corporate debtor is continued for the beneficial liquidation thereof that the order of liquidation does not constitute a notice of discharge. In every other case the order of liquidation under Section 33 strips the company of life as the living corporate being.

Just as a dead person cannot engage in business activity or enter into contracts, continue collections, etc., a company or a corporate debtor in liquidation is also barred from doing so. When an order under Section 33 is passed, it amounts to notification of the death of a corporate juristic person. The provisions of Section 35 and 36 demonstrate that after an order of liquidation, liquidator makes an estate known as the liquidation estate from the company, which would not have been possible if it were alive. A company in liquidation results in the liquidation estate being held by the liquidator as a fiduciary for the benefit of its creditors. Therefore, the entire edifice of sale as a going concern after initiation of liquidation of the corporate debtor is on extremely shaky grounds.

Concerns Regarding Sale as a Going Concern

As stated in Section 33 of the Code, the power of the Adjudicating Authority to pass an order of liquidation is

provided in Chapter III and its liquidation order and process must be in the manner as laid down in Chapter III.

However, Chapter III has not provided the manner or process of a sale nor the concept of sale as a going concern. Hence, inclusion of the process of sale of a going concern in the Liquidation Process Regulations is well beyond the provisions of the Code. It is excessive delegation of legislative power as the substantive law has not made provisions for it. The authority to sell a company in liquidation as a going concern is a contradiction in terms as liquidation means cessation of the juristic person. A liquidation order can be equated to a certificate of death. The subsequent process in corporate liquidation is like a mix of succession and distribution of assets of the deceased. If lenders exist and are secured, then an unpaid secured creditor can realise in priority.

Therefore, the process of sale as a going concern is unknown to law of liquidation and is an impossibility after pronouncement of a liquidation order. Such a liquidation order means discontinuity. It is the date when the board of directors of the corporate debtor stands dissolved as only the liquidator can represent the company.⁴ Post the liquidation order what remains is the liquidation estate as there is no live corporate juristic being and the liquidator represents the corporate debtor in liquidation. A company which has had its board of directors negated and ceases to exist is not a continuing legal personality as a corporate debtor entitled to be sold as a going concern.

Despite such fundamental legal issues, sale as a going concern has been gaining recognition and acceptance from various benches of the Adjudicating Authorities. The lack of a comprehensive legal framework governing such a sale gives rise to certain concerns:

(i) Sale as a going concern under Liquidation Process Regulation is ultra vires the Code

As discussed above, the Code stipulates a two-step process where the resolution of the corporate debtor is attempted through CIRP driven by the creditors failing which the corporate debtor is liquidated.⁵ The provisions of the Code

⁴ It is only when the business of the corporate debtor is continued for the beneficial liquidation thereof that the order of liquidation does not constitute a notice of discharge.

contemplate dissolution of the corporate debtor upon liquidation.⁶ No provision of the Code allows resolution of a corporate debtor in liquidation or empowers a liquidator to sell the corporate debtor as a going concern once liquidation has commenced. In this regard, the observations of the NCLT in the case of *Invest Asset Securitisation & Reconstruction Private Limited V. M/s Mohan Gems & Jewels Private Limited*⁷ succinctly discusses this primary concern.

“34. Insolvency and Bankruptcy Code is an embodiment of substantial rights laced with procedural mandates. When procedure itself is part of the enactment, the Regulating Authority cannot rewrite the procedure obliterating the provisions IBC. Yes, the Regulating Authority may bring in subordinate procedure for full implementation of the sections of the Code. What could be liquidated is the assets of the debtor company, this concept of liquidation of assets shall not be construed as inclusion of sale of the company.”

(ii) Lack of creditor consent and approval of the Adjudicating Authority

The scheme of the Code ensures that a resolution plan approved for the revival of the corporate debtor undergoes extensive examination and scrutiny. Firstly, the Code requires a resolution plan to be approved by the CoC by a majority vote of sixty-six percent.⁸ This collective business decision, reached upon after due deliberations and exercise of commercial acumen by the CoC ensures that the resolution plan proposed is one that is feasible and viable, and the corporate debtor is being transferred to an efficient management. The resolution plan is then approved by the Adjudicating Authority after ensuring necessary compliance with the provisions of the Code and the regulations thereunder.⁹ In contrast, a sale as a going concern neither requires the majority approval of the CoC nor the consent of the Adjudicating Authority. Limited oversight by the CoC and Adjudicating Authority leaves scope for misuse of the process.



(iii) No requirement of mandatory contents or minimum safeguards for stakeholders

A resolution plan approved by the CoC is required to contain several mandatory provisions such as inter alia priority payments to operational creditors, demonstration of feasibility and viability, term of the plan and its implementation schedule, management, and control of the business of the corporate debtor during its term and adequate means for supervising its implementation.¹⁰ However, adherence to no such minimum standards are required in a case of sale as a going concern.

(iv) Disincentivises submission of resolution plans

The scheme of the Code allows for submission of resolution plans at competitive prices to ensure value maximisation for all stakeholders of the corporate debtor. Permitting sale of the corporate debtor as a going concern after expiry of the CIRP leaves scope for foul play as interested resolution applicants may misuse lack of commercial interest generated in the market to quote lesser value for a corporate debtor after a failed resolution.

(v) Exclusion of non-relinquished assets

In liquidation proceedings, secured creditors have the right to realise their security under section 52 of the Code or alternatively relinquish their security and partake in the distribution of liquidation proceeds under section 53 of the Code. Proviso to regulation 32 of the Liquidation Process Regulations makes it amply clear that assets subject to

⁵ Section 54, Insolvency and Bankruptcy Code, 2016

⁶ Section 54, Insolvency and Bankruptcy Code, 2016

⁷ I.A. No. 1490/2020 in CP. No. (IB) 590 (PB)/2018, order dated 16 September 2020.

⁸ Section 30(4), Insolvency and Bankruptcy Code, 2016

⁹ Section 31, Insolvency and Bankruptcy Code, 2016

¹⁰ Regulations 38, CIRP Regulations, 2016

security interest can only be sold if the security interest therein has been relinquished. However, in cases where creditors have *pari-passu* charge over one asset, there is lack of clarity on how such an asset will form part of the liquidation estate in case all creditors do not relinquish their security interest held therein.

A comprehensive legal framework is required to give due recognition to this concept (sale as going concern during liquidation process) and adequately protect of the interests of the stakeholders.

(vi) Uncertainty with regard to timelines

The liquidator applies for the closure of the liquidation process once the sale certificate is issued to the successful bidder.¹¹ However, in cases of a deferred payment structure in a case of sale as a going concern, the liquidator or the corporate debtor may be faced with multiple obstacles such as challenges in distribution of subsequent payments in accordance with section 53 of the Code or lack of clarity as to when to apply for closure of the liquidation process.

¹¹ Regulation 45(3)(a), Liquidation Process Regulations, 2016

In case of an auction, if the payment is not received within 90 days, the sale is cancelled.¹² However, given the lack of statutory backing of sale as a going concern, successful bidders may be hesitant to make payments till the approval of the Adjudicating Authority and grant of appropriate reliefs and concessions. Moreover, mere grant of sale certificate may not be sufficient for the successful bidder to take control of the corporate debtor as an explicit approval from the Adjudicating Authority will be required for capital restructuring of the corporate debtor.¹³

Way Ahead

The constitutional validity of sale as a going concern is a pertinent question that remains unanswered. While courts have been allowing sale as a going concern and have adopted a lenient approach when granting reliefs to effectuate such a sale, a comprehensive legal framework is required to give due recognition to this concept and adequately protect of the interests of the stakeholders.

¹² Schedule 1, Regulation 33, Liquidation Process Regulations, 2016
¹³ Section 66, Companies Act, 2013.

