Grey Issues Under IBC: Dissection of Quintuple Oddities

In the past six years, IBC, 2016 has witnessed six amendments by the Parliament of India. Besides, IBBI has made over 84 amendments to its 18 Regulations made under the IBC. However, there still exists some grey areas in the IBC, which poses problems in its implementation on the ground. This article aims to examine in detail five distinct issues faced in the CIRP/Liquidation Process i.e., Charges to Secured Creditors, priority to Provident Fund, Going Concern Sale, Voting Share Calculation, and Section 29 A. For better understanding of these relevant provisions of IBC analyzed in the light of related jurisprudence. The author has also recommended 'feasible solutions' to address these issues through legislative amendments. ***Read on to know more…***

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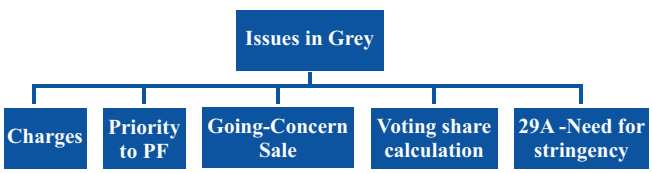
Introduction

It has been a 5-year journey since the launch of the Insolvency and Bankruptcy Cody, 2016 (IBC) - "A unified code" for revival of different forms of entities, which has been and is being witnessing a lot of amendments and fine-tuning to its best version. A recapitulation of the path travelled by IBC would reveal that almost all issues of simple/intricate nature have been addressed appropriately by the amendments/notifications/clarifications issued by Insolvency and Bankruptcy Board of India (IBBI) from time to time.



On the other hand, there are a few issues faced during Corporate Insolvency Resolution Process (CIRP)/ Liquidation of corporate debtors which remains grey and perplexing. It is difficult to attain a conclusion with respect to such issues and whenever it is felt that the issue has been settled, there crops another perspective to the issue and thus the conclusion keeps changing its substance. Let us probe into 5 such issues to understand the intricate nature of the issues which makes it puzzled.

Issue No. 1 - "Charges" and "Secured Creditors"

Section 3(30) of IBC defines a Secured Creditor as a creditor in favour of whom a Security Interest is created, and Section 3(31) defines Security Interest as that which includes mortgage, charge, hypothecation, assignment, encumbrance, agreement/ arrangement. For discussion purposes, let us narrow the definition and restrict the focus on "Charges". The term "Charge" is defined under Section 3(4) of IBC 2016 and Section 2(16) of Companies Act 2013, and both these definitions are precisely the same under both the Acts. Prior to initiation of CIRP, the CD being a "Company" would have been governed by the provisions of Companies Act 2013, thereby adhering to the compliances mandated therein.

In connection to the above, as per Section 77(1) of Companies Act 2013, every company shall mandatorily register the charge created on its property with the Registrar of Companies within thirty days of its creation and as per Section 77(3), no unregistered charges shall be taken into consideration even by the Liquidator appointed under the IBC 2016. Thus, charge registration with Registrar is mandatory for a valid charge creation. Analysis of few related judgements are as follows:

a) However, based on the recent Judgement of the Apex Court in *State Tax Officer Vs. Rainbow Papers Limited* (Civil Appeal No. 1661 of 2020 dt. 06.09.2022), the State was considered as a Secured Creditor, since as per Section 48 of the Gujarat VAT Act, 2002, "Tax shall have a first charge on Property" of a Person who is liable to pay the dues and thus the order provided that "Security Interest" can be created by "Operation of Law" and hence the State is a Secured Creditor under the Gujarat VAT Act.

b) However, another interesting judgement passed by the High Court of Bombay in the matter of *Jalgaon Janta Sahakari Bank Ltd. & Anr Vs. Joint Commissioner of Sales Tax Nodal 9* dt. 30.08.2022, held that a "Crown debt enjoys no priority over secured debts and that the dues of a Secured Creditor (subject of course to CERSAI registration) and subject to proceedings under the IBC would rank superior to the dues of the relevant department of the state government".

Table 1: Summarized Viewpoints

Companies Act 2013	Judgements	
	Supreme Court	High Court of Bombay
Charge registration is mandatory for valid charge creation.	Security interest can also be created by operation of law and thus the State is a Secured Creditor.	Dues of Secured Creditor who has registered the security interest would rank superior to the dues of the relevant department of the state government.

Though IBC 2016 and SARFAESI Act 2002 are two Independent Acts, they share a common theme of "auctioning the properties and recovering amounts" *(Liquidation phase of IBC)*. Under these circumstances, there exists a dilemma as to how the same set of creditors (Banks and/or Financial Institutions and State Department Dues) are being given two different treatments under the same theme of "recovery process". Further, when statutory departments are to be treated under the secured Operational Creditor (OC), then the following queries may arise.

a) Since security interest is created by operation of law, no charges would have got registered with Registrar of Companies (ROC). In that case, how would the statutory departments identify the assets on which a security interest has been created?

b) Section 52(3) of IBC 2016 permits the Secured Creditor to realize "Only such security interest", the existence of which may be proved either by records available with Information Utility (IU) or such other means as may be specified by IBBI". So how will the statutory creditors prove their security interests?

c) Should the statutory departments always consent to "Relinquishment of Security Interest", since in case of opting for "Non- Relinquishment of Security Interest" they will not be in a position to identify the asset which they are going to realize on their own outside the Liquidation Estate.

d) In case the secured financial creditors (Secured FCs) having exclusive security interest opt to not relinquish their security interests, then how will the statutory creditors be entitled to the distribution of proceeds? Is it still possible for the FC to retain its security interest and recover the

dues outside liquidation estate or should both creditors be treated at par thereby resulting in mandatory relinquishment of security interest by the FC?

e) Incase if statutory dues are to be considered as secured creditors, then would the entire statutory claim or only the dues of the period of two years preceding the liquidation commencement date (as per Section 53(1)(e)(i)) be ranked under Section 53(1)(b)(i).

Issue No. 2: An all-time conundrum - "Priority Payment to PF"

Section 36 of IBC 2016 excludes a few assets from the Liquidation Estate and such assets shall not be used for recovery in Liquidation.

One such asset which is excluded from Liquidation Estate is "all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund".

This exclusion clearly applies only when a separate PF Fund/Gratuity Fund is maintained by the company. In the absence of such a fund, there is no question of exclusion of the same from the Liquidation Estate since the entire logic behind the exclusion is that the hard-earned money of the workmen/employees in the form of PF should not be appropriated for settlement of other creditors.

This fact is clearly established by the NCLAT Judgment in the matter of *Mr. Savan Godiwala, The Liquidator of Lanco Infratech Limited Vs. Mr. Apalla Siva Kumar*, wherein it was held that the Liquidator need not make provision for payment of Gratuity without there being a separate fund in this regard. The same concept applicable to Gratuity Fund also applies in case of PF dues. Few judgements related to PF dues are as follows:

Against PF	Judgements
NCLAT, Chennai in the matter of *B. Parameshwara Udpa Vs. Assistant PF Commissioner, EPFO* dt. September 23, 2022, mentioned that only when the CD maintains an established fund in terms of Section 16-A of the EPF Act 1952, the exclusion from Liquidation Estate Assets as well as from recovery in Liquidation, as stipulated in Section 36(4)(a)(iii) of IBC 2016 shall apply.	NCLAT, New Delhi in the matter of *Sikander Singh Jamuwal Vs. Vinay Talwar Resolution Professional* dt. March 11, 2022, directed the Successful Resolution Applicant (SRA) to release full provident fund dues in accordance with EPF Act 1952.

However, there are a plethora of cases where there are orders favouring and against PF dues, creating a dilemma in reaching a conclusion on full and priority payment to EPF even in the absence of separate funds. In case of full and priority payment to PF dues, the following query arises.

> **In case the Secured FCs having exclusive security interest opt to not relinquish their security interests, then how will the statutory creditors be entitled to the distribution of proceeds?**

a) As per Section 53 of the IBC 2016, the wages and unpaid dues of employees shall be paid only after payment to secured creditors and workmen dues. However, in the event of full and final priority payment of PF dues (in the absence of separate PF funds) belonging to employees, does it not tantamount to violation of the priority stipulated in Section 53 since employees are paid prior to secured creditors resulting in a change in order of priority?

Issue No. 3: Concerns over "Going-concern Sale"

A Corporate Debtor (CD) is pushed to Liquidation in the absence of a Successful Resolution Plan. Though it is generally felt that Liquidation results in death of the CD, IBC still implants hope for revival of the CD in the form of "Going-Concern Sale (GCS)" during Liquidation.

In general terms, GCS means selling the entire company along with its status as legal entity, so that the company can function under the same name, with a change only in its management post acquisition. However, neither any definition for GCS is explicitly provided in the IBC nor in IBBI Regulations. Following two judgements with respect to GCS are note-worthy:

Liabilities transferred in GCS	Liabilities not transferred in GCS
NCLAT, New Delhi in the matter of *M/S. Visisth Services Limited Vs. S.V. Ramani & Another*, dt. January 11, 2022, decided that Sale as a 'Going Concern' means sale of assets as well as liabilities and not assets sans liabilities and all assets and liabilities, which constitute an integral business of the CD would be transferred together and the consideration paid must be for the business of the CD.	NCLAT, New Delhi in the matter of *Shiv Shakthi Inter Globe Exports Pvt Ltd Vs. KTC Foods Private Limited* dt. February 25, 2022, held that in sale under Regulation 32(e), the CD need not be burdened by any past or remaining unpaid outstanding liabilities prior to the sale of the Company as a 'Going Concern' and after payment of the sale proceeds distributed in accordance with Section 53 of the Code.

Generally, GCS is conducted via e-Auction. As per Liquidation Regulations, the reserve price of the asset is based on the valuation done by registered valuers. Therefore, the price at which the buyer acquires the CD as a Going Concern is nothing, but the Liquidation Value of the assets acquired by the buyer. Thus, it may not be fair to impose the burden of past liabilities in the nature of arrears like electricity dues, maintenance charges and other liabilities on the new buyer.

Even if it is considered that valuation in case of GCS should reflect the consideration to be paid for acquiring the entire business of CD, then for major quantum of companies in liquidation, the valuation would be zero or remote, since as per Net-Asset Method, the value of liabilities would absorb the value of all assets and only a negative figure would remain as the value of company and "Fair Value" of the company based on share prices will also remain meagre in case of liquidation.

Further, GCS during Liquidation is similar to a Resolution Plan during CIRP, then how can there exist a differential treatment between the Resolution Applicant who gets a clean-slate company whereas the auction buyer is loaded with past liabilities. Assuming, if a GCS should be coupled with transfer of assets and liabilities, the following questions would arise:

a) Predominantly in GCS, the statutory liabilities in the form of arrears of electricity, water and maintenance charges pose a major threat to auction buyers. The FCs move out of the picture after receipt of distribution in accordance with Section 53. Whereas only on clearance of the full and final dues of statutory charges, the new buyer is granted re-connection facilities. In this scenario, does this settlement not tantamount to violation of the priority stipulated in Section 53 since the operational creditors are paid more than the secured creditors resulting in a change in order of priority.

b) Section 240A of the IBC 2016, exempts MSMEs from application of clauses (c) and (h) of Section 29A and therefore allowed the promoters of MSME's to bid for their own company. Thus, they are also eligible to participate in an auction sale during Liquidation.

c) Assume that an MSME company is acquired by the promoters (same management) as a Going Concern during liquidation. Under these circumstances what would be the logic behind transferring the same old liabilities of the CD back to the CD, when in fact the CD was actually Ordered for CIRP only on account of default of these liabilities.

Issue No. 4: Computation of Voting Share

Though an un-frequent issue, it still remains grey as to "Whether a creditor who abstains from voting on a Resolution Plan be counted for the purpose of voting?" Analysis of certain case laws and relevant provisions and Regulations of IBC will shed some light on the nature of this issue.

In the matter of *K. Sashidhar Vs. Indian Overseas Bank & Ors. (Civil Appeal No. 10673 of 2019),* the Supreme Court observed that, "For that, the 'percent of voting share of the financial creditors' approving vis à vis dissenting is required to be reckoned. It is not on the basis of members present and voting as such. At any rate, the approving votes must fulfill the threshold percent of voting share of the financial creditors". In view of the SC judgment, inference may be drawn that the SC judgment overrules the "Liberty House Order" and suggests that the percent of voting sharing is "not on the basis of members present and voting".

A reference may also be made to Regulation 25(4) of the CIRP Regulations, which states that *"*at the conclusion of a vote at the meeting, the resolution professional shall announce the decision taken on items along with the names of the members of the committee who voted for or against the decision or abstained from voting*"*. Further, as per Regulation 26(4) *of the CIRP Regulations, "*at the conclusion of a vote held under this Regulation, the resolution professional shall announce and make a written record of the summary of the decision taken on a relevant agenda item along with the names of the members of the committee who voted for or against the decision or abstained from voting". Thus, as per the Regulations, a member may vote for or against a resolution or a member may abstain from voting. However, this opens several questions,

a) *Firstly,* regarding the inclusion or exclusion of

the votes of those who abstained from the numerator and the denominator for the purpose of calculation of votes when the members who abstained were present at the CoC.

b) *Secondly,* regarding the inclusion or exclusion of the abstained votes from the numerator and the denominator for the purpose of calculation of votes when the members who abstained were absent from the CoC.

As regarding the voting by authorized representatives, Section 25A (3) of the IBC, stipulates that, "the authorised representative shall not act against the interest of the Financial Creditor (FC) he represents and shall always act in accordance with their prior instructions [...] Provided further that if any FC does not give prior instructions through physical or electronic means, the authorized representative shall abstain from voting on behalf of such creditor."

In view of this the IBC seems to have envisaged this as the only situation in which there could be abstention from voting, namely, in cases wherein the authorized representative has not received instructions from the FC, elsewhere in the IBC and the Regulations, although the term abstained has been used, however, no circumstances for abstention from voting have been provided for. Therefore, *thirdly*, whether the "abstained from voting" is to be limited to cases in terms of Section 25A (3) of the IBC. The significance of this issue can be demonstrated with the following illustration:

At a meeting comprising total creditors of 1000/-, the following votes were obtained: -

a) Creditors for 600/ - Voted in favour

b) Creditors for 300/ - Voted against

c) Creditors for 100/ - Abstained/Did not vote.

Abstaining-Creditors are included in Denominator	Abstaining-Creditors are excluded in Denominator
Computation of Votes in favour of Resolution Plan	
Voted in Favour / Total share of FCs = 600 / 600+300+100 = 60%	Voted in Favour / Total voted = 600 / 600+300 = 66.67%
Result: Since Resolution Plan did not secure 66% voting, the Plan stands rejected.	**Result:** Since Resolution Plan secured the requisite 66% voting, the Plan stands approved by CoC.

Based on the above computation, it appears that even a creditor with smallest voting share of 10% can change the entire fate of revival of the CD. Thus, it may be unfair to include such abstaining creditors for counting the decision of the majority who have explicitly expressed their views.

Thus, a person who has decided not to vote on a Resolution Plan or is unable to decide on the voting cannot be considered as assenting/dissenting. Hence abstaining financial creditors are neutral in nature and therefore, by implication, it is understood that they have decided to follow the decision of the majority. Such abstaining members need not be counted for voting at all – neither in the numerator nor in the denominator. Court orders with different perspective on the above issue is as follows:

Abstaining Creditors are Counted in Denominator	Abstaining Creditors are Excluded in Denominator
NCLT, Chennai in the matter of *Rahul Jain Vs. J. Karthiga, RP of M/s. Capricorn Foods Product India Limited* dt. July 22, 2022, held that by removing 'Abstained' vote from the total number of votes from the denominator, the voting share of the other financial creditors have been increased indirectly. By removing the 'Abstained' vote from the total number of voting share, the vote of abstained creditor has been indirectly construed as they have voted in favour of the 'Resolution Plan'. Accordingly, the NCLAT directed to convene a fresh voting on approval of the Resolution Plan.	NCLAT, New Delhi in the matter of *IDBI Bank Vs Mr. Anuj Jain, IRP, Jaypee Infratech* dt. June 10, 2019, held that if any of the FC remains absent from voting, their voting percentage should not be counted for the purpose of counting the voting shares.

Issue No. 5: 29A – Is there a need for further stringency?

The core-theme of IBC is to revive the falling CD. During the infancy of the Code, there were no restrictions on the

eligibility of a person to submit a Resolution Plan. This was considered as an advantage by the defaulting promoters, who either directly or indirectly through their connected parties tried to regain control over their company by submitting a Resolution Plan at a substantially lower value.

To be precise, the acquisition of the company by its own promoters through a Resolution Plan was similar to waiver/reduction of the existing debts and obtaining a clean-slate company. Therefore, Section 29A – "one of the remarkable amendments to IBC" was inserted at the appropriate time through an amendment to defy the intentions of defaulters. Section 29A emphasizes on the eligibility of Resolution Applicants along with their connected parties in the following phases:

a) **Initial Restriction:** As per Section 29A there is an entry blockage for ineligible applicants to submit a Resolution Plan.

b) **Restriction during the Resolution Plan Implementation Phase:** If the Resolution Applicant has an ineligible, connected person proposed to be the promoter or in management or control of the business of the CD, during the implementation of the Resolution Plan, in such case the entry or further access to proceed with the Resolution Plan will be restricted to the Resolution Applicant.

However, the Code is silent about the re-entry of the defaulting promoter/s into the management of the CD post the conclusion of the Resolution Plan implementation Process, since there is neither any lock-in period restrictions nor any other restriction barring the re-entry of the promoters into the management of the revamped CD.

Illustration: The Resolution Plan of "XYZ Limited" provides for settlement to stakeholders and restart of business operation within six months from NCLT approval date. Under such circumstances, the Resolution Plan implementation will be completed within six months from NCLT date and after the completion of the implementation phase, the erstwhile promoter of the CD joins the company.

In this case, the re-entry of the erstwhile promoter into the management of the CD will indirectly outwit the intention of Section 29A. Thus, the defaulters will get back their company ultimately and it was only a matter of waiting time for the defaulters to get it back.

Conclusion

The above-mentioned are the handful of issues which remain grey and open-ended in the conduct of CIRP/Liquidation. The article is not intended to provide any solutions to the above issues, but only intends to address the perplexing nature of the issues which may serve as a decisional impediment in the CIRP/Liquidation Process.

One of the distinguishing salient features of IBC is the timely resolution process. With respect to CIRP/Liquidation Process, the timeline of one year for completion of the entire process signifies the efficient resolutions in a time bound manner. However, the above discussed oddities with contradictory perspectives may pose hurdles and hinder the smooth conduct of CIRP/Liquidation. The lack of clarity on the above issues may derail the CIRP/Liquidation Process and consume substantial time and efforts in litigations.

The major pillar of success of IBC 2016 lies in the role played by judicial authorities. Due to the increase in number of IBC cases, there was news that there appears a shortage in the number of judicial members. However, the number of CDs resolved, and the landmark judgement in IBC is a clear witness to the tremendous contributions of the NCLT, NCLAT and other judicial forums towards the remarkable growth of Indian insolvency law. Thus, it may not be viable to utilize the valuable-irreplaceable time of the tribunal in issues of repetitive nature, when there are other important matters which can be resolved only with the wisdom of the judiciaries, towards which the time of the tribunals may be utilized.

The feasible solution to address the above matters may be by way of incorporating the final conclusions on the above issues in the form of legislative amendments to the Act, so that the amended law will serve as a "Guide & Precedence" to the issues of similar nature arising in future and will also be binding on all stakeholders. If conclusions are embedded in Acts, then it will lead to uniform decisions and will eliminate unnecessary arbitrary views on the issues and will curtail the time and money spent on litigations of repetitive nature.