

Discussion Paper on Corporate Liquidation Process

This discussion paper discusses two issues relating to liquidation process under the Insolvency and Bankruptcy Code, 2016 (Code).

Issue-1: Relinquishment of Security Interest in Corporate Liquidation Process

Statement of Problem

2. The Code enables a secured creditor in the liquidation proceedings to: (a) relinquish its security interest to the liquidation estate and receive proceeds from the sale of assets by the liquidator in the manner specified in section 53; or (b) realise its security interest in the manner specified in section 52 of the Code. Regulation 32 of the IBBI (Liquidation Process) Regulations, 2016 (Regulations) prohibits the Liquidator to sell an asset which is subject to security interest, unless the security interest therein has been relinquished to the liquidation estate. Regulation 21A of the Regulations provide that where a secured creditor does not intimate its decision within thirty days from the liquidation commencement date, the assets covered under the security interest shall be presumed to be part of the liquidation estate. In terms of section 36 (3)(g) of the Code, the liquidation estate of a corporate debtor (CD) comprises all liquidation estate assets which include any asset of the CD in respect of which a secured creditor has relinquished security interest.

3. The Bankruptcy Law Reform Committee (BLRC), which conceptualised the Code, recognised the rights of the secured creditors and provided the drafting instructions enforcing the rights of secured creditors in liquidation as-

“Box 5.20 – Realization of the security of secured creditors

Secured creditors can withdraw the asset against which they have security interest from the liquidation trust subject to the following conditions:

- (a) Existence of records establishing their claim on the asset present in a registered IU or proved in a manner as may be specified; and*
- (b) Payment instruction for their share of the IRP costs.”*

4. In pursuance to the above, section 52 (4) of the Code provides: *“A secured creditor may enforce, realise, settle, compromise or deal with the secured assets in accordance with such law as applicable to the security interest being realised and to the secured creditor and apply the proceeds to recover the debts due to it.”*

5. The decision of a secured creditor to relinquish its security interest is connected to its claims from the liquidation estate. Section 52(9) of the Code provides: *“where the proceeds of the realisation of the secured assets are not adequate to repay debts owed to the secured creditor, the unpaid debts of such secured creditor shall be paid by the liquidator in the manner specified in clause (e) of sub-section (1) of section 53”*. Section 53(1)(e)(ii) provides for distribution of proceeds from liquidation estate towards debts owed to a secured creditor for any amount unpaid following the enforcement of security interest. On the other hand, section 52 (7) of the Code provides: *“Where the enforcement of the security interest under sub-section (4) yields an amount by way of proceeds which is in excess of the debts due to the secured creditor, the secured creditor shall-*

- (a) account to the liquidator for such surplus; and*

(b) tender to the liquidator any surplus funds received from the enforcement of such secured assets.”

6. Similarly, the notes on clauses on the Insolvency and Bankruptcy Code Bill, 2015 provides: - “in a liquidation proceeding, the secured creditor may choose to relinquish its security interest and participate in the distribution of assets or realise its security interest outside the liquidation proceedings. If a secured creditor decides to realise its security, the amount of insolvency resolution process costs payable by the secured creditor shall be deducted from the realised proceeds. Where there is a surplus realised from the enforcement of a security interest, the secured creditor has to account for the same to the liquidator. Similarly, if the proceeds of the realisation of the secured assets are not sufficient to repay the debts owed to the secured creditor, he may claim in accordance with the priority of payments under Clause 53 for such unpaid portion.”

7. An example would make it clear. Suppose, a CD owes Rs.100 to X, a secured financial creditor as on the liquidation commencement date. This amount is secured by an asset. There are four situations:

Sl. No.	Situation	Treatment (Assuming no transaction costs)
1	X relinquishes the secured assets to liquidation estate, and the liquidator realises Rs.80 from disposal of the said asset.	X will get Rs.80. He will stand to get up to Rs.20 as an unsecured financial creditor from the liquidation estate.
2	X relinquishes the secured assets to liquidation estate, and the liquidator realises Rs.120 from disposal of the said asset.	X will get Rs.100. The balance Rs.20 will form part of the liquidation estate.
3	X enforces security interest and realises Rs.80 from disposal of the said asset.	X will retain Rs.80. He will stand to get up to Rs.20 as an unsecured financial creditor from the liquidation estate.
4	X enforces the secured interest and realises Rs.120 from disposal of the said asset.	X will retain Rs.100. The balance Rs.20 will form part of the liquidation estate.

Thus, irrespective of whether a secured creditor enforces its security interest or relinquishes the secured asset to the liquidation estate, the deficit or surplus of realisation vis-à-vis the amount due to it gets reflected in the liquidation estate.

8. In sync with the above, the regulation 21A(2) of Regulations provide that if a secured creditor, instead of relinquishing its security and proving for its debt, proceeds to realise its security, it shall be liable to pay its share of the expenses towards the insolvency resolution process costs and the liquidation costs, which stand higher to it in the waterfall, and towards the workmen’s dues for the period of twenty-four months preceding the liquidation commencement date, which stands at par with it in the waterfall.

9. The Code and the Regulations, however, do not provide a time limit for secured creditor to realise its security interest. Due to this, a secured creditor, after deciding not to relinquish its security interest, may not realise the security interest in a definite time frame. Until all secured creditors realise their securities fully, payment may neither be made under regulation 21A(2) of the Regulations nor under section 52 (7) of the Code. Thus, while the rights of secured creditors are well defined, their liability to contribute towards insolvency resolution process costs, liquidation costs and the workmen’s dues is not bound in a timeframe. Till such time the

secured creditors do not realise their security interest, the process of liquidation may not complete.

International Practice

10. Sub-clause (1) of Rule 14.16 of the UK Insolvency Rules, 2016 provides:

“(1) If a secured creditor fails to disclose a security in a proof, the secured creditor must surrender that security for the general benefit of creditors, unless the court, on application by the secured creditor, relieves the secured creditor from the effect of this rule on the grounds that the omission was inadvertent or the result of honest mistake.”

11. Further rule 14.17 states:

“(1) The office-holder may at any time deliver a notice to a creditor whose debt is secured that the office-holder proposes, at the expiration of 28 days from the date of the notice, to redeem the security at the value put upon it in the creditor’s proof.

(2) The creditor then has 21 days (or such longer period as the office-holder may allow) in which to alter the value of the security in accordance with rule 14.15.

(3) If the creditor alters the value of the security with the permission of the office-holder or the court then the office-holder may only redeem at the new value.

(4) If the office-holder redeems the security the cost of transferring it is payable as an expense out of the insolvent estate.

(5) A creditor whose debt is secured may at any time deliver a notice to the office-holder requiring the office-holder to elect whether or not to redeem the security at the value then placed on it.

(6) The office-holder then has three months in which to redeem the security or elect not to redeem the security.”

12. Rule 14.18 states:

“(1) If the office-holder is dissatisfied with the value which a secured creditor puts on a security in the creditor’s proof the office-holder may require any property comprised in the security to be offered for sale.

(2) The terms of sale will be as agreed between the office-holder and the secured creditor, or as the court may direct.

(3) If the sale is by auction, the office-holder on behalf of the company or the insolvent estate and the creditor may bid.

(4) This rule does not apply if the value of the security has been altered with the court’s permission.”

Thus, in the UK legislation, the Secured creditor cannot keep the liquidation process at hold for its inaction.

Proposed amendment

13. It is proposed to provide in the Regulations that when a secured creditor proceeds to realise its security interest, it shall:

- (i) contribute its dues under sub-regulation (2) of regulation 21A within 90 days of the liquidation commencement date.
- (ii) pay the excess of realisable value, as estimated by a registered valuer, of the security interest over the admitted claim within 180 days of the liquidation commencement date, even if the security interest has not been realised.
- (iii) if the secured creditor fails to contribute to liquidation estate within 90 days or 180 days as the case may be, the asset will be transferred to the Liquidation Estate.

Economic Analysis

14. A total of 587 CIRPs have yielded liquidation as on 30th September, 2019, of which data is available for 354 CDs. About 70% of the total debt of Rs. 345,674 crore is owed to the secured financial creditors in these 354 CDs.

Sl. No.	Claimant	Amount (In Rs. crore)	Claim as % of total claim
1	Secured Financial Creditors	2,43,692	70
2	Unsecured Financial Creditors	71,704	21
3	Operational Creditors	30,278	9
	Total	345,674	100

The liquidation value of these 354 CDs is Rs. 30,762 crore. Since claims of secured creditors account for 70% of the total claims, even with most conservative approach, the total value of the security held by secured creditors would be more than 70% of the liquidation value, i.e. Rs. 21,533 crore.

15. As per data available with the Board, total value of security interest realised till 30th September, 2019 is Rs. 609 crore. Thus, assets with secured creditors are worth more than Rs. 20,924 crore. There is an opportunity cost attached with the assets that are not being put to use. Faster realisation of the assets would result in optimal utilisation of resources.

16. The proposed amendment nudges the secured creditors to realise their security interest at the earliest, which in most cases will improve their realisation with the underlying hypothesis that delay depletes the value of the security interest. While, in some cases it might require the secured creditor to dispose of the asset at a time when market is subdued, it is expected that most of the secured creditors will be able to realise fair value for the asset within a period of six months, given the size of Indian market and interest of foreign investors in India. If the regulations nudge secured creditors to dispose of the asset or relinquish the security interest even by one month, the gain is considerable.

17. The proposed amendments would help to achieve the objectives of the Code by expediting the liquidation process and balancing the interest of stakeholders. The Code provides a mechanism whereby the inefficient or defunct firms vacate the space and release the idle resources for efficient uses in an orderly manner. The objectives of the Code can be achieved only if the processes under the Code are accomplished in a time bound manner. The proposed regulation takes care of interest of the workmen and ensures that payment toward the insolvency resolution process and liquidation process cost are met. It helps in early conclusion of the liquidation processes, which helps in release of assets of CDs for alternate uses at the earliest.

Amendment Regulations

18. A draft of the amendment regulations is given in Annexure.

Issue-2: Applicability of section 29A of the Code to Compromise and Arrangement

Statement of Problem

19. The Code provides for a market mechanism for rescuing failing but viable CDs and liquidating failing and unviable ones. The liquidation process starts in case the insolvency resolution process fails or the CoC decides to liquidate the company at any time during CIRP. During the liquidation process, the Companies Act, 2013 (Act) envisages compromise or

arrangement. Section 230 thereof, as amended by the Code, enables compromise or arrangement on the application by a liquidator appointed under the Code, as under:

“230. Power to compromise or make arrangements with creditors and members. —

(1) Where a compromise or arrangement is proposed—

(a) between a company and its creditors or any class of them; or

(b) between a company and its members or any class of them,

the Tribunal may, on the application of the company or of any creditor or member of the company, or in the case of a company which is being wound up, of the liquidator, appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs”

20. There have been many instances where the Hon’ble NCLAT has allowed application of the section 230 of the Code. Excerpts from some such orders is given below:

a. The Hon’ble NCLAT, in the matter of S. C. Sekaran Vs. Amit Gupta &Ors., directed as under:

*“ .. we direct the ‘Liquidator’ to proceed in accordance with law. He will verify claims of all the creditors; take into custody and control of all the assets, property, effects and actionable claims of the ‘corporate debtor’, **carry on the business of the ‘corporate debtor’ for its beneficial liquidation** etc. as prescribed under Section 35 of the I&B Code.... Before taking steps to sell the assets of the ‘corporate debtor(s)’ (companies herein), the Liquidator will take steps in terms of Section 230 of the Companies Act, 2013. The Adjudicating Authority, if so required, will pass appropriate order. Only on failure of revival, the Adjudicating Authority and the Liquidator will first proceed with the sale of company’s assets wholly and thereafter, if not possible to sell the company in part and in accordance with law.*

.. The ‘Liquidator’ if initiates, will complete the process under Section 230 of the Companies Act within 90 days...”.

b. The Hon’ble NCLAT, in the matter of Y. Shivram Prasad Vs. S. Dhanapal &Ors, observed as under:

“.. we hold that the liquidator is required to act in terms of the aforesaid directions of the Appellate Tribunal and take steps under Section 230 of the Companies Act. If the members or the ‘Corporate Debtor’ or the ‘creditors’ or a class of creditors like ‘Financial Creditor’ or ‘Operational Creditor’ approach the company through the liquidator for compromise or arrangement by making proposal of payment to all the creditor(s), the Liquidator on behalf of the company will move an application under Section 230 of the Companies Act, 2013 before the Adjudicating Authority i.e. National Company Law Tribunal, Chennai Bench, in terms of the observations as made in above. On failure, as observed above, steps should be taken for outright sale of the ‘Corporate Debtor’ so as to enable the employees to continue.”.

c. In the matter of M/s C. Mahendra International Ltd. Vs. Naren Sheth &Anr., the resolution plan of shareholder of Corporate Debtor was not accepted due to him not being eligible under section 29A of the Code. The Hon’ble NCLAT observed as under—
“However, we are not inclined to grant relief the application being ineligible in terms of Section 29A. It is also accepted that more than 270 days have passed and, therefore, order of liquidation cannot be interfered with.

However, we are of the view that in view of the order of liquidation, the 'Liquidator' is now required to act in terms of the decision of this Appellate Tribunal in Company Appeal (AT) Insolvency) No.224 of 2018 (Y. Shivram Prasad vs. S. Dhanapal & Ors.)”

- d. In the matter of M. Palanisamy Vs. M/s. Senthil Papers and Boards Pvt. Ltd, the resolution plan submitted by Director / Shareholder of M/s. Senthil Papers and Boards Pvt. Ltd. was rejected on the ground that the Appellant is ineligible in terms of Section 29A (c) & (h) of the Code. The Hon’ble NCLAT observed: *“In the fact and circumstances, we are not inclined to grant any relief in this appeal nor intend to express any opinion with regard to delay in preferring the appeal. However, we are of the view that liquidator is required to act in accordance with decision of this Appellate Tribunal passed in Company Appeal (AT) (Insolvency) No. 224 of 2018 in the matter of Y. Shivram Prasad Vs. S. Dhanapal & Ors. dated 27.2.2019”*
- e. The Hon’ble NCLAT, in the matter of R. Vijay Kumar & Anr. Vs. Kasi Viswanathan & Anr, observed: *“Learned counsel for the appellants who are the Directors of ‘M/s. Gemini Communication Limited’- (‘Corporate Debtor’) submitted that the liquidation value of the property of the ‘corporate debtor’ is Rs.3 Crores whereas the ‘Promoters’ are willing to pay a sum of Rs.30 Crores. However, such submission cannot be accepted in view of their non-entitlement under Section 29A of the I&B Code. For the reasons aforesaid, we are not inclined to interfere with the impugned order dated 28th February, 2019. However, as order of ‘Liquidation’ has been passed by the Adjudicating Authority, we direct the ‘Liquidator’ to act in terms with the decision of ‘Y. Shivram Prasad vs. S. Dhanapal & Ors.’ in ‘Company Appeal (AT) 2 Company Appeal (AT) (Insolvency) No. 340 of 2019 (Insolvency) No. 224 of 2018 etc. ”*

21. Section 29A of the Code prohibits certain persons from becoming a resolution applicant / submitting a resolution plan in a CIRP. Proviso to section 35(1)(f) of the Code mandates that a Liquidator shall not sell the immovable and movable property or actionable claims of the CD in liquidation to any person who is not eligible to be a resolution applicant. These provisions were inserted in the Code with effect from 23rd November, 2017, while section 230 of the Act was amended along with the enactment of the Code. There is no explicit prohibition on persons ineligible to submit resolution plans under section 29A from proposing compromise or arrangement under section 230 of the Act, which may result in person ineligible under section 29A acquiring control of the CD. Thus, while section 29A of the Code is applicable to a CD when it is under CIRP and when it is under Liquidation Process, it is not applicable to the same CD when it is undergoing compromise or arrangement, in between CIR process and liquidation process. This has created an anomaly that section 29 A is applicable during the stage before and the stage after compromise and arrangement and not during compromise and arrangement.

22. Section 29A of the Code keeps out a person, who is a wilful defaulter, who has an account with non-performing assets for a long period, etc. and therefore, is likely to be a risk to successful resolution of insolvency of a company. This rationale equally applies to the stage of compromise and arrangement. Non-applicability of section 29A at the stage of compromise or arrangement may undermine the processes and may reward unscrupulous persons at the expense of creditors. Thus, it may be necessary to harmonise the provisions in the Code and the Act to provide level playing field.

23. The Hon'ble NCLAT, in the matter of Jindal Steel and Power Limited Vs. Arun Kumar Jagatramka & Anr, has held that:

“10. As noticed above, the Hon'ble Supreme Court in Swiss Ribbons Pvt. Ltd. & Anr. Vs. Union of India & Ors. – Writ Petition (Civil) No.99 of 2019 held that the ‘primary focus of the legislation is to ensure revival and continuation of the corporate debtor by protecting the corporate debtor from its own management and from a corporate death by liquidation’.

11. The aforesaid judgment makes it clear that even during the period of Liquidation, for the purpose of Section 230 to 232 of the Companies Act, the ‘Corporate Debtor’ is to be saved from its own management, meaning thereby the Promoters, who are ineligible under Section 29A, are not entitled to file application for Compromise and Arrangement in their favour under Section 230 to 232 of the Companies Act.

...”

24. Further it referred to Section 35(f) of the Code and held that:

“12. From the aforesaid provision, it is clear that the Promoter, if ineligible under Section 29A cannot make an application for Compromise and Arrangement for taking back the immovable and movable property or actionable claims of the ‘Corporate Debtor’.”

25. The Code is a comprehensive legislation and also that the recent Insolvency and Bankruptcy Code (Amendment) Act, 2019 has made it explicit that the resolution plan may include provisions for the restructuring of the CD, including by way of merger, amalgamation and demerger. The objectives that a scheme of compromise or arrangement under the Act seek to achieve are available under the Code through resolution process. Having two provisions in two different legislations for a single cause is confusing for the stakeholders besides being superfluous. It may even be considered to take up to review the applicability of the Section 230 of the Act in the processes under the Code.

26. It is considered to have the discussion on the following points from the two issues:

- a. Should there be a time frame for a secured creditor to pay as under regulation sub-regulation (2) of regulation 21A?
- b. Should there be a time frame for realisation of security interest in case a secured creditor does not relinquish its security interest?
- c. If yes, what should be these time frames?
- d. Further, if the secured creditors fail to realise by such time frame, should they be mandated to contribute the difference between realisable value of the security interest and the admitted claim?
- e. Further, if the secured creditor fails to contribute to liquidation estate within 90 days or 180 days as the case may be, whether the asset be transferred back to the Liquidation Estate?
- f. Should the persons ineligible under section 29A of the Code to be a resolution applicant be barred from becoming a party in compromise or arrangements under section 230 of the companies act, 2013?
- g. Or, should applicability of section 230 of the companies act, 2013 during liquidation process under the Code be reviewed?

Public Comments

27. The proposals in the preceding paragraphs aim at achieving the objectives of the Code by expediting the liquidation process and balancing the interest of all stakeholders. This is issued

in pursuance to regulation 4 of the Insolvency and Bankruptcy Board of India (Mechanism for Issuing Regulations) Regulations, 2018. The Board accordingly solicits comments on:

- a. any specific para in this discussion paper; and
- b. any specific regulations in the draft Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2019, placed at **Annexure**.

28. Comments may be submitted electronically by 24th November, 2019. For providing comments, please follow the process as under:

- (i) Visit IBBI website, www.ibbi.gov.in;
- (ii) Select 'Public Comments'; and then select 'Discussion paper - Liquidation';
- (iii) Provide your Name, and Email ID;
- (iv) Select the stakeholder category, namely, -
 - a) Corporate Debtor;
 - b) Personal Guarantor to a Corporate Debtor;
 - c) Proprietorship firms;
 - d) Partnership firms;
 - e) Creditor to a Corporate Debtor;
 - f) Insolvency Professional;
 - g) Insolvency Professional Agency;
 - h) Insolvency Professional Entity;
 - i) Academics;
 - j) Investor; or
 - k) Others.
- (v) Select the kind of comments you wish to make, namely,
 - a) General Comments; or
 - b) Specific Comments.
- (vi) If you have selected 'General Comments', please select one of the following options:
 - a) Inconsistency, if any, between the provisions within the regulations (intra regulations);
 - b) Inconsistency, if any, between the provisions in different regulations (inter regulations);
 - c) Inconsistency, if any, between the provisions in the regulations with those in the rules;
 - d) Inconsistency, if any, between the provisions in the regulations with those in the Code;
 - e) Inconsistency, if any, between the provisions in the regulations with those in any other law;
 - f) Any difficulty in implementation of any of the provisions in the regulations; and
 - g) Any provision that should have been provided in the regulations, but has not been provided; or
 - h) Any provision that has been provided in the regulations but should not have been provided.

And then write comments under the selected option.

- (vii) If you have selected 'Specific Comments', please select para/regulation number and then sub-para/sub-regulation number and write comments under the selected para/sub-para or regulation/sub-regulation number.

- (viii) You can make comments on more than one para/sub-para or regulation / sub-regulation number, by clicking on more comments and repeating the process outlined above from point 28 (v) onwards.
- (ix) Click 'Submit', if you have no more comments to make.

**GAZETTE OF INDIA
EXTRAORDINARY
PART III, SECTION 4
PUBLISHED BY AUTHORITY
INSOLVENCY AND BANKRUPTCY BOARD OF INDIA
NOTIFICATION
New Delhi,, 2019
INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (LIQUIDATION
PROCESS) (SECOND AMENDMENT) REGULATIONS, 2019**

IBBI/2019-20/GN/REG.....-In exercise of the powers conferred by clause (t) of sub-section (1) of section 196 read with section 240 of the Insolvency and Bankruptcy Code, 2016(31 of 2016), the Insolvency and Bankruptcy Board of India hereby makes the following Regulations further to amend the Insolvency and Bankruptcy Board of India (Liquidation process) Regulations, 2016, namely: -

1. (1) These Regulations may be called the Insolvency and Bankruptcy Board of India (Liquidation Process) (Second Amendment) Regulations, 2019.
(2) They shall come into force on the date of their publication in the Official Gazette.

2. In principal regulation, in regulation 21A, for sub-regulation (2), the following sub-regulations shall be substituted, namely: -
“(2) Where a secured creditor proceeds to realise its security interest, it shall pay as much towards the amount payable under clause (a) and sub-clause (i) of clause (b) of sub-section (1) of section 53, as it would have shared in case it had relinquished the security interest within ninety days from the liquidation commencement date.”

3. In principle regulation, in regulation 21A, after sub-regulation (2), the following sub-regulations shall be inserted, namely: -

“(3) Where a secured creditor proceeds to realise its security interest as under sub-regulation (1), it shall pay the excess of realizable value of the security over the admitted claim amount of such secured creditor, if any, not later than one hundred and eighty days from the liquidation commencement date”.

4. In principle regulation, in regulation 21A, after sub-regulation (3), the following proviso shall be inserted, namely:

“Provided that, where a secured creditor fails to comply with sub-regulation (2) or (3) of Regulation 21A, the assets covered under the security interest shall become part of the liquidation estate.”

(Dr. M. S. Sahoo)
Chairperson
Insolvency and Bankruptcy Board of India
[ADVT]

Note: The Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 were published vide notification No. IBBI/2016-17/GN/REG005 on 15th December, 2016 in the Gazette of India, Extraordinary, Part III, Section 4, No. 460 dated 15th December, 2016 and was subsequently amended by –

(1) The Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2018 vide notification No. IBBI/2017-18/GN/REG028, dated the 27th March, 2018.

(2) The Insolvency and Bankruptcy Board of India (Liquidation Process) (Second Amendment) Regulations, 2018 vide notification No. IBBI/2018-19/GN/REG037, dated the 22nd October, 2018.

(3) The Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2019 vide notification No. IBBI/2019-20/GN/REG047, dated the 25th July, 2019.