

Discussion Paper on “Strengthening Regulatory Framework of Liquidation Process”

The first order objective of the Insolvency and Bankruptcy Code, 2016 (‘Code’) is insolvency resolution, as evident from the long title to the Code, which reads as: *“An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of Government dues and to establish an Insolvency and Bankruptcy Board of India, ...”*. Thus, the Code enables a stakeholder to file an application for initiating Corporate Insolvency Resolution Process (‘CIRP’) first and only upon failure of the CIRP to yield a resolution plan, the liquidation process commences.

2. During liquidation process, the liquidator makes a public announcement inviting filing of claims and verifies them. He takes into his custody or control of all the assets of the corporate debtor (CD) and forms a liquidation estate. He endeavors to sell the assets of the liquidation estate through public auction, in consultation with the Stakeholders’ Consultation Committee (SCC) and wherever required, avails assistance of professionals in the discharge of his duties, obligations and functions. He distributes the realized proceeds among the stakeholders as per the waterfall mechanism provided under section 53 of the Code. On completion of liquidation process, the liquidator submits an application, along with the final report, to the Adjudicating Authority (AA) for either closure of the liquidation process or dissolution of the CD.

3. The regulatory framework of liquidation process has been improvised on several occasions during the last five years to address the difficulties faced by stakeholders, meet the evolving requirements and in aid of achievement of objectives of the Code. With the emergence of new issues, as detailed in this paper and the gaining of sufficient experience, a need is felt to further strengthen the regulatory framework of liquidation process in terms of accountability of liquidator towards stakeholders and certain matters related to sale. The present paper has grouped the issues in the following manner for their easier examination:

Part-A: Accountability of liquidator

Issue-1: Expanding and Deepening the Scope of SCC

Issue-2: Refining Procedural Framework of Constitution of SCC

Part-B: Matters related to sale of assets

Issue-3: Engagement of Marketing Professionals for Sale of Asset(s)

Issue-4: Pre-bid Qualifications for Auctions

Issue-5: Power of liquidator in Auction

Issue-6: Swiss Challenge as a Mode of Auction under Liquidation Process

Part-C: Security interest related

Issue-7: Relinquishment of Security Interest

Part-A: Accountability of liquidator

4. The Code and IBBI (Liquidation Process) Regulations, 2016 ('Liquidation Regulations') provide that the liquidator shall carry on the business of the CD for its beneficial liquidation, exercise all powers of its board of directors, key managerial personnel and the partners, complies with applicable laws on behalf of the firm, etc. The liquidator exercises the powers in fiduciary capacity to protect the interest of stakeholders and as an officer of the Court. The liquidator is expected to imbibe the highest standards of ethics and professionalism while conducting a fair and rule-based liquidation process.

5. It is pertinent to note that though the liquidator has been empowered with greater autonomy during liquidation process as compared to interim resolution professional (IRP) / resolution professional (RP) during CIRP, the accountability mechanisms are not as robust. It leads to ineffective participation and dissatisfaction amongst stakeholders, information asymmetry and sometimes even abuse of the process. The effective participation and information symmetry are fundamental to robust supervision and monitoring of the process. A need is, therefore, felt to further enhance the accountability of liquidator by enlarging the scope of consultation with stakeholders.

Issue-1: Expanding and Deepening the scope of SCC

Statement of Problem

6. The Code provides mandatory constitution of committee of creditors (CoC) during CIRP and prohibits the IRP or RP from taking certain actions without seeking its prior approval. The CoC may even replace the IRP or RP, if it is not satisfactory with his performance. In contrast, though constitution of SCC is mandatory during liquidation process, the consultation with the same is neither mandatory nor its recommendations binding on the liquidator, as elucidated ahead.

7. Section 35(2) of the Code empowers the liquidator to consult any of the stakeholders entitled to distribution of proceeds under section 53 of the Code subject to the condition that such consultation shall not be binding on him. Considering the need for oversight and monitoring of the liquidation process, necessity of stipulating formal structure for consultation under section 35(2) and ensuring representation from all relevant stakeholders, regulation 31A regarding constitution of SCC was inserted vide Notification dated 25.07.2019 in the Liquidation Regulations. It mandates the liquidator to constitute SCC, with representative(s) of each class of stakeholders, within sixty days from the liquidation commencement date, to advise him on matters related to sale.

8. The consultation with stakeholders during liquidation process is crucial and can also be appreciated from the order dated 09.02.2021 of the Hon'ble NCLT, in the matter of Mr. P.C. Gagar, Liquidator vs. M/s. Multichemical Industries Pvt. Ltd, wherein the liquidator had filed an application for dissolution of the corporate debtor. The Hon'ble NCLT, while taking note of the fact that the liquidator had failed to form SCC despite the existence of five operational creditors and promoter / shareholders of the corporate debtor (and the pending realization, inter alia, of a disputed fixed deposit), had directed the liquidator to form SCC within 10 days of the order as per regulation 31A of Liquidation Regulations (and make all attempts to ensure maximization of assets of corporate debtor).

9. The liquidator has three broad responsibilities, namely, adjudication of claims, sale of assets or business, including assignment of not readily realizable assets and distribution of realized proceeds. In this context, the existing consultative framework has been examined as under:

- a. Section 35(2) of the Code provides *discretionary* power to the liquidator to consult any stakeholder for discharging his duties. Further, the specified role of SCC to advise *only* on matters related to sale including assignment of not readily realizable assets under regulation 31A read with regulation 37A of Liquidation Regulations has led to inadequate and ineffective participation of stakeholders in the liquidation process. It also causes dissatisfaction and grievances amongst stakeholders, and may result in unavailability of an active sounding board for the liquidator.
- b. The limited role of SCC regarding sale related matters gets further narrowed, in practice, on account of regulation 31A(6) of Liquidation Regulations, which states that: “*The liquidator shall convene a meeting of the consultation committee when he considers it necessary and shall convene a meeting of the consultation committee when a request is received from at least fifty-one percent of representatives in the consultation committee.*” (Emphasis supplied).
- c. The discretion provided in regulation 31A(6) for consultation with the committee, does not provide mandatory force for its implementation. Sometimes the liquidator takes crucial sale related decisions regarding fixation of reserve price, manner of sale, terms and conditions of sale, etc. without consulting the SCC.

10. To efficiently conduct the liquidation process, maintain the CD as a going concern (which sometimes require highly complex decisions) and discharge the mandated duties / obligations, the liquidator may seek professional assistance in accordance with section 35(1)(i) of the Code read with regulation 7 of the Liquidation Regulations. The professionals render assistance to liquidator in various spheres such as accountants or auditors in book-keeping or audit, advocates or legal luminaries in defending or instituting suits, valuers in valuation of assets, etc. However, there is clear demarcation between the role of the liquidator and professionals. In this context, the following aspects are relevant for consideration:

- a. The engagement of professionals should not lead to delegation of duties cast upon the liquidator under the Code. Further, the appointment of disproportionately large number of professionals may not be justifiable and attract criticism of avoiding responsibilities by the liquidator.
- b. The payment made to professionals should be commensurate with the underlying responsibilities and should not create undue burden on liquidation estate. It is pertinent to note that higher liquidation cost reduces realization by stakeholders.

11. Considering the above, the expanded and enriched role of SCC in terms of mandatory consultation regarding appointment of professionals, sale of assets including fixation of reserve price, etc., is felt necessitated for enhancing accountability of liquidator, stakeholders’ confidence and participation in the process, effective supervision and monitoring, and improved

outcomes of the process. Further, the appropriate checks and balances in appointment of professionals, without curtailing the flexibility of liquidators in such appointments, is apposite to ensure more process transparency and safeguard the interest of the stakeholders.

Position in India

Companies Act, 1956

12. The old Companies Act, 1956 ('CA 1956') recognizes the extensive role of the committee of inspection formed during the winding up of a company. Section 460(1) of the CA 1956 mandates the liquidator, appointed in case of winding up by Tribunal, to have regard to *any* directions given by the committee of inspection in the administration of the assets of the company and the distribution thereof. Further, section 512(1)(a) read with section 457, of the CA 1956 mandates the liquidator, appointed in case of creditor's voluntary winding up, to perform the below mentioned duties with the sanction of the committee of inspection (or if there is no such committee, of a meeting of the creditors, or the Tribunal):

“(a) to institute or defend any suit, prosecution, or other legal proceeding, civil or criminal, in the name and on behalf of the company;

(b) to carry on the business of the company so far as may be necessary for the beneficial winding up of the company;

(c) to sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer the whole thereof to any person or body corporate, or to sell the same in parcels;

(ca) to sell whole of the undertaking of the company as a going concern;

(d) to raise on the security of the assets of the company any money requisite.”

13. Further, the liquidator may avail legal assistance with the sanction of the Tribunal (under section 459 of the CA 1956): *“The liquidator may, with the sanction of the Tribunal appoint one or more chartered accountants or company secretaries or cost accountants or legal practitioners entitled to appear before the Tribunal under section 10GD to assist him in the performance of his duties.”*

Companies Act, 2013

14. Under section 287 of the Companies Act, 2013 ('CA 2013'), the advisory committee is appointed by the Tribunal to advise the Company Liquidator. The requirement for the liquidator to have regard to *any* directions of committee of inspection under section 460(1) of the CA 1956 has been similarly provided for the Company Liquidator vis-à-vis advisory committee under section 292(1) of the CA 2013. Further, section 277 of the CA 2013 provides for the constitution of winding up committee to assist and monitor the progress of liquidation proceedings by the Company Liquidator in the areas of taking over and sale of assets, recovery of property, review of audit reports, finalization of list of creditors, etc. The Tribunal has also been empowered to appoint a sale committee to assist the Company Liquidator in sale of assets of the company, under section 282(2) of the CA 2013.

15. The Company Liquidator is also vested with the power to seek professional assistance from chartered accountants, company secretaries, legal practitioners, etc. subject to sanction of the Tribunal (section 291 of the CA 2013).

International Practice

16. The UNCITRAL Legislative Guide on Insolvency Law provides guidance about:

a. The extent and requirement of involvement of creditors in liquidation process, as under:
“In liquidation, although generally it may not be important for creditors to intervene in the proceedings or participate in decision-making, they can provide a valuable source of expert advice and information on the debtor’s business, in particular where it is to be sold as a going concern. It may also be desirable for creditors to receive reports on the conduct of the liquidation to ensure their confidence in the proceedings, as well as its transparency...”

b. The requirement of notifying or approval of the creditor committee for sale of assets in liquidation process, as under:

“Where a creditor committee is formed and the insolvency law provides for creditors to be consulted on the sale of assets outside the ordinary course of business, a requirement to notify creditors of any proposed sale might be satisfied by notifying the creditor committee in order to minimize costs and avoid any delay associated with notifying all creditors. Different procedures are adopted with respect to the sale of assets. Many insolvency laws require assets to be sold by auction, with some providing that the creditor committee, or some other creditor representative or the insolvency representative, can approve some other means of sale, such as by private contract, if it will be more profitable...”

82. While it may be expected that assets sold in the context of insolvency proceedings will achieve a lower sale price than similar assets sold under normal market conditions, an insolvency law can adopt a number of procedural protections to ensure that the proceedings are fair, that the maximum price is achieved and that, overall, the procedure for disposal of assets is transparent and well-publicized. Such protections include providing notice to creditors and to prospective purchasers in a manner that will ensure the information is likely to come to the attention of interested parties; allowing creditors to raise their objections or concerns (either with the insolvency representative or the court, as appropriate); ...”

c. The authorization required for appointment of professionals by the insolvency professional and their remuneration in liquidation process, as under:

“Some insolvency laws require court authorization for the insolvency representative to retain accountants, attorneys, appraisers and other professionals that may be necessary to assist the insolvency representative in carrying out its duties...Different approaches may be adopted towards payment of the professionals employed by the insolvency representative. Some laws require an application to and approval by the court of the amount of the remuneration, while another approach may be to require approval by creditors.”

17. The consultation with creditors or stakeholders during liquidation process has been recognized in various mature jurisdictions, detailed as under:

- a. In United Kingdom, section 101 of the Insolvency Act 1986 states that *“The creditors may in accordance with the rules appoint a committee (“the liquidation committee”) of not more than 5 persons to exercise the functions conferred on it by or under this Act.”* The main functions of the liquidation committee are sanctioning the exercise of powers by the liquidator regarding accepting the shares as consideration for sale of company property, making calls from contributories, fixing the liquidator’s remuneration, etc. Further, Rule 17.2 of the Insolvency (England and Wales) Rules, 2016 stipulates the additional functions of the liquidation committee to assist liquidator in discharging his duties and reads as:

“In addition to any functions conferred on a committee by any provision of the Act, the committee is to—

- (a) assist the office-holder in discharging the office-holder’s functions; and*
- (b) act in relation to the office-holder in such manner as may from time to time be agreed.”*

- b. In Australia, the Insolvency Law Reforms Act, 2016 (‘ILRA’) has provided the functions of advising, directing and monitoring the external administrator / administration to the committee of inspection constituted during liquidation process under the Corporation Act, 2001:

“80-35 Functions of committee of inspection

(1) A committee of inspection has the following functions:

- (a) to advise and assist the external administrator of the company ;*
- (b) to give directions to the external administrator of the company;*
- (c) to monitor the conduct of the external administration of the company;*
- (d) such other functions as are conferred on the committee by this Act;*
- (e) to do anything incidental or conducive to the performance of any of the above functions.*

(2) An external administrator of a company must have regard to any directions given to the external administrator by the committee of inspection, but the external administrator is not required to comply with such directions.

(3) If an external administrator of a company does not comply with a direction, the external administrator must make a written record of that fact, along with the external administrator’s reasons for not complying with the direction.”

The committee of inspection may also request information, documents and reports from the external administrator under Division 80 of ILRA. The committee of inspection is also empowered to determine remuneration of the external administrator and apply before the court to enquire into the external administration. It ensures active role for the committee of inspection and enable it to act as the gatekeeper for the liquidator. Further, Australian Securities and Investments Commission which administers insolvency laws, is also entitled to attend any meeting of Committee of Inspection (section 80-65 of ILRA).

- c. In Singapore, Insolvency, Restructuring and Dissolution Act 2018 (‘IRDA’) stipulates that the committee of inspection or the Court shall authorize the liquidator to perform

certain acts / transactions, including managing the affairs of the company in liquidation and appointing a solicitor. Further, the liquidator must have regard to any directions given by the committee of inspection. Section 144 of IRDA provides as under:

“Powers of Liquidator

144. The liquidator may, after authorisation by either the Court or the committee of inspection -

(a) carry on the business of the company so far as is necessary for the beneficial winding up of the company...

(b) subject to section 203, pay any class of creditors in full;

(c) make any compromise or arrangement with creditors or persons claiming to be creditors, or having or alleging themselves to have any claim...

(d) compromise any calls and liabilities to calls, debts and liabilities capable of resulting in debts, ...

(e) bring or defend any action or other legal proceeding in the name and on behalf of the company;

(f) appoint a solicitor —

(i) to assist the liquidator in the liquidator’s duties; or

(ii) to bring or defend any action or legal proceeding in the name and on behalf of the company; and

(g) assign, in accordance with the regulations, the proceeds of an action arising under section 224, 225, 228, 238, 239 or 240.”

- d. In South Africa, section 386 of the Companies Act, 1973 envisaged extensive role of the meeting of creditors and empowers the liquidator to perform the undermentioned duties subject to the authority granted, *inter-alia*, by a meeting of creditors:

“(a) to bring or defend in the name and on behalf of the company any action or other legal proceedings of a civil nature, ...

(b) to agree to any reasonable offer of composition made to the company by any debtor and to accept payment of any part of a debt due to the company in settlement thereof or to grant an extension of time for the payment of any such debt;

...

(h) to sell any movable and immovable property of the company by public auction, public tender or private contract and to give delivery thereof;

(i) to perform any act or exercise any power for which he is not expressly required by this Act to obtain the leave of the Court.”

- e. In Canada, section 35(1) of Winding-up and Restructuring Act, 1985 (‘WURA’) enumerates the powers of the liquidator, wherein the liquidator has been mandated, with the approval of the court, and on such previous notice to the creditors, contributories, shareholders or members of the company as the court orders, to sell the assets of the corporate debtor, by public auction or private contract, or sell them in parcels for such consideration as may be approved by the court. Further, section 36 of the WURA permits the liquidator to appoint a solicitor or law agent to assist him in the performance of his duties, with the approval of the court.

Analysis and Views

18. From the foregoing, it is observed that:

- a. The committee(s) formed during liquidation under the Indian Companies Act regime and across the above-referred commonwealth jurisdictions, is discharging both advisory and monitoring functions. Further, the committee's assistance to the liquidator has not been confined to a particular arena, rather a wide canvas for its intervention has been provided.
- b. Even prior to the insertion of reg. 31A regarding constitution of SCC in the Liquidation Regulations, the necessity of constituting consultation committee was being felt and the *scope of such consultation was kept wide open* in a particular matter. The Hon'ble NCLT, while ordering liquidation of Rasoya Proteins Limited in its order dated 30.10.2018, had directed the liquidator to form a Monitoring Committee and mandated him to perform day-to-day functions during liquidation, as and when required, in consultation with the Monitoring Committee.
- c. There is also a need to provide counterbalance regarding appointment of professionals, without compromising the flexibility of liquidators in such appointments.

19. It is suggested that role of the SCC may be expanded to *all* significant matters relating to the liquidation process, including appointment of professionals (and their remuneration) and sale of assets (including major aspects such as fixation of reserve price, manner of sale, etc.). It shall ensure higher and active participation of stakeholders in the process, and availability of relevant information with the stakeholders, thereby, reducing information asymmetry, while the liquidator shall continue to have the ultimate authority to take decisions.

Proposed Amendment

20. It is proposed to provide in the Liquidation Regulations that the liquidator shall consult SCC for all significant matters related to liquidation process, including appointment of professionals (and their remuneration), and sale of assets (including major aspects such as fixation of reserve price, manner of sale, etc.).

Issue-2: Refining Procedural Framework of Constitution of SCC

Statement of Problem

21. Regulation 31A(2) of the Liquidation Regulations mandates the constitution of SCC by the liquidator, with representative(s) from each class of stakeholders - secured financial creditors, unsecured financial creditors, workmen and employees, government, other operational creditors, and shareholders. The liquidator may facilitate the stakeholders of each class to nominate their representative(s) for inclusion in the consultation committee (regulation 31A(3)). However, the regulatory framework does not provide specific criteria and procedure for nominating the representative(s) by stakeholders. Where the stakeholders fail to nominate their representative(s), regulation 31A(4) of the Liquidation Regulations enables the liquidator to choose the required number of stakeholders with highest claim amount in that class as member of SCC.

22. Though the saving clause in terms of regulation 31A(4) exists, it is imperative that the stakeholders exercise their rights in choosing their representative(s) for enhanced confidence and participation in the process, and greater monitoring. While exercising this choice, the stakeholders sometimes face stalemate situations on account of - a) disagreement between criteria of *number* of claimants or *value* of claims to be followed, for nomination; and b) non-participation of few stakeholders in the nomination process leading to ambiguity on the size of denominator, i.e., *all claimants or present and voting*, to be followed, for considering votes, etc.

23. In the matter of SBS Transpole Logistics Private Limited ('SBS'), its ex-director / shareholder, who was nominated by three shareholders (including himself), having total shareholding of 24.99%, out of the total five shareholders, under regulation 31A(3), opposed the liquidator's choice of representative of shareholders, who was having 70.37% shareholding, under regulation 31A(4). He filed an application before Hon'ble NCLT for directing the liquidator to reconstitute the SCC since his nomination as the representative of shareholders by majority in number (60%) was ignored by the liquidator (given the fact the liquidator's choice of representative of shareholders did not even participate in the nomination process). He further contended that the nomination by majority either in number or value should be considered as valid nomination under regulation 31A(3). The Hon'ble NCLT, while observing that regulation 31A(3) is silent on both "*the criteria as well as process of nomination*" of a representative, held that the nomination by majority in number cannot be rejected by the liquidator on the ground of the said nomination being not made unanimously by all shareholders (and in the absence of such criteria being informed upfront by the liquidator to shareholders). It also advised the Board to notify clear guidelines regarding "*criteria and process of nomination of Representative of Stakeholders*" under regulation 31A(3) to avoid ambiguity.

Position in India

Companies Act, 2013

24. Section 287(3) of the CA 2013 states that "*The Company Liquidator shall convene a meeting of creditors and contributories, as ascertained from the books and documents, of the company within thirty days from the date of order of winding up for enabling the Tribunal to determine the persons who may be members of the advisory committee.*". Further, rule 51 and 52 of the Companies (Winding Up) Rules, 2020 ('Winding up Rules') prescribe that resolution at creditors' or contributories' meeting shall be deemed to be passed, when a majority in value of the creditors / contributories present personally or by proxy and voting on the resolution have voted in favour of the resolution. The detailed procedure has been laid out regarding the notice, time and conduct of the meeting, etc. in the Winding up Rules.

International Practice

25. The process of appointment of representative(s) to committee (of inspection) in some international jurisdictions is elaborated as under:

- a. In IRDA of Singapore, section 151 provides that the committee of inspection shall consist of creditors and contributories of the company, who shall be appointed by the meetings of creditors and contributories in such proportions as are agreed or, in case of difference, as are determined by the Court. Insolvency Restructuring and Dissolution (Corporate Insolvency and Restructuring) Rules 2020 specifies that an ordinary resolution is deemed to have been passed if a majority in number and value of the

creditors or contributories present and voting on the resolution, votes in favour of the resolution, in the meeting of creditors or contributories, as the case may be. Further, section 446 of IRDA facilitates the officeholder (which *inter alia* includes liquidator) to obtain passing of resolutions by creditors or contributories by correspondence without holding a meeting by giving notice of the resolution to every creditor or contributory. However, if no valid vote is received by the specified closing date, a meeting of creditors or contributories must be called for passing the resolution.

- b. In Australia, Division 80 of ILRA provides that the members of committee of inspection in relation to external administration of the company may be appointed by resolution in meeting of creditors, by an employee or a group of employees that are owed at least 50% of the entitlements owed to all employees, and by a large creditor or group of creditors that are owed at least 10% of the value of the creditors' claims. Regulation 5.6.19 of the Corporation Regulations 2001 ('CR 2001') prescribes the voting on resolution to be decided on the voices unless a poll is demanded. Regulation 5.6.20 of the CR 2001 further stipulates that the manner and time of poll shall be determined by the chairperson. After a poll has been demanded, the resolution at meeting of creditors is carried if (a) a majority of the creditors voting vote in favour of the resolution; and (b) the value of the debts owed by the corporation to those voting in favour of the resolution is more than half the total debts owed to all the creditors voting (regulation 5.6.21 of CR 2001).

26. Considering the afore-mentioned provisions of the Companies Act, 2013 and international jurisdictions regarding the criteria to be followed for appointing the members of committee, the nomination of representative(s) of each class of stakeholders by the criterion of majority in value of claims by those present and voting may be adopted. No specific process of nomination may be stipulated to retain the existing flexibility in the process.

Proposed Amendment

27. It is proposed to provide in the Liquidation Regulations that the liquidator may facilitate the stakeholders of each class to nominate their representative(s), while adhering to the voting principle of majority of value of claims of those present and voting, for inclusion in the consultation committee.

Economic Analysis

28. The proposed amendments in Part-A shall ensure availability of domain expertise of various classes of stakeholders, which is highly appreciated in the complex and challenging liquidation cases. Further, it shall promote transparency, reduce the scope of arbitrariness to minimum and prevent abuse of the process, thereby ensures overall value maximization of the CD. Though the mandatory consultation with SCC has minor time and cost implications for the liquidator, the benefits of such consultation for the stakeholders and the society at large far outweigh the negligible costs involved. The proposed changes regarding constitution of SCC are only clarificatory in nature to ensure fair representation of the stakeholders in the process. It also saves time from legal challenges on the grounds of biasedness and arbitrariness.

Part-B: Matters related to sale of assets

29. This section proposes to streamline certain matters related to sale during liquidation process and address the difficulties being faced by stakeholders.

Issue-3: Engagement of Marketing Professionals for Sale of Asset(s)

Statement of problem

30. As stated in the preceding paras, the liquidator may seek professional assistance for a reasonable remuneration, in accordance with section 35(1)(i) of the Code read with regulation 7 of the Liquidation Regulations. To assist the liquidator in auctioning assets of the CD, sub-clause (2) of clause 1 of Schedule I provides that the “...liquidator shall prepare a marketing strategy, with the help of marketing professionals, *if required, for sale of the asset. The strategy may include-*

- (a) releasing advertisements;*
- (b) preparing information sheets for the asset;*
- (c) preparing a notice of sale; and*
- (d) liaising with agents.”*

31. It is pertinent to note that the marketing professionals may be appointed by the liquidator to undertake primarily the tasks encompassing marketing strategy. However, it has been noticed that the liquidators at times appoint marketing agents on commission / success fee basis for sale of asset(s) during liquidation process and such agents are paid as a percentage of realisation from asset(s). One of the duties of the liquidator, as provided under section 35 of the Code, is “... *to sell the immovable and movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract...*”. The appointment of commission agent to perform this duty of the liquidator is against the legislative intent.

32. Further, the liquidator gets remunerated in terms of fees fixed by the committee of creditors or as per regulation 4 of the Liquidation Regulations for performance of his duties stipulated under the Code / Liquidation Regulations. The payment of commission / success fee as a percent of realisation of assets leads to payment of dual fees for the sale of same asset(s), especially in situations where the liquidator is drawing his remuneration as a percentage of realisation of proceeds and distribution thereof. Such commission agents are not ‘professionals’, and they are not regulated. The appointment of commission agents for sale of asset(s) of the CD is, thus, an additional burden on the liquidation estate, in addition to amounting to overlapping of work with the liquidator and must be avoided.

33. With the evolution of market, there are many alternate methods to tap a larger pool of potential bidders rather than relying on such agents. One option could be to use the services offered under Platform for Distressed Assets (PDA), besides many online platforms to list assets for sale for free or at negligible amount. Such means may be explored to extend the reach to stakeholders, maximize the value of distressed assets and ensure transparency. Also, the Board is contemplating to provide the facility to liquidators to upload auction notices on its website, which would allow greater visibility for the assets being sold and curtail the information asymmetry in the process.

34. It is considered to explicitly prohibit the appointment of agents/professionals for sale of assets during the liquidation process, on commission or success fee basis. Further, the liquidator shall prepare a marketing strategy in consultation with SCC, which shall ensure proper checks and balances in the process.

Proposed Amendment

35. It is proposed to modify Schedule I of the Liquidation Regulations to provide that:

(i) The liquidator shall not engage a professional/agent for sale of asset(s) on commission / success fee basis;

(ii) The liquidator shall prepare a marketing strategy for sale of assets of the CD in consultation with SCC.

Issue-4: Pre-bid Qualifications for Auctions

Statement of Problem

36. Regulation 33 of the Liquidation Regulations provides for *Mode of Sale* under the liquidation process. Its sub-regulation (1) provides that: “*The liquidator shall ordinarily sell the assets of the corporate debtor through an auction in the manner specified in Schedule I.*” Schedule I provides detailed mechanism for auction and private sale of assets of the CD. Sub-clause (3) of clause 1 of Schedule I provides that: “*The liquidator shall prepare terms and conditions of sale, including reserve price, earnest money deposit as well as pre-bid qualifications, if any.*”

37. Maximization of value of assets of the CD is a key objective of the Code, and it directly impacts the realization by the stakeholders. Apart from the nature of the asset(s) being auctioned, the success of the auction and the resultant price fetched depends upon several factors such as the number of participants in the auction, nature of pre-bid qualifications prescribed, intensity of marketing efforts undertaken to promote the asset(s), etc. Greater the level of competition in an auction, higher the expected realization value.

38. In a few liquidations, it has been noticed that the liquidators have imposed unreasonable pre-bid qualification conditions such as stipulation of exorbitant Earnest Money Deposit (EMD) and in some cases even stipulated the non-refundable participation fee, for participation in the auction. Such conditions adversely impact the extent of participation in the auction(s), which reflects in the realization of the assets. To ensure higher realization in the auction, it is critical that the liquidator does not impose conditions which inhibit participation in the auction.

39. In this regard, as a comparison, it is pertinent to mention that while inviting expression of interest for resolution plans in a CIRP, the regulation 36A(4)(d) of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (‘CIRP Regulations’) provides that the invitation for expression of interest by resolution professional shall “... *not require payment of any fee or any non-refundable deposit for submission of expression of interest.*”. Further, Rule 170(i) of General Financial Rules, 2017 (which is compilation of rules and orders of Government of India to be followed by all Government Departments and Organizations under the Government while dealing with the public finance matters) prescribe that the EMD should ordinarily range between *two to five percent* of the estimated value of the goods to be procured. Though goods and services procured by the Government are not strictly comparable with the assets auctioned

under liquidation, it indicates that the amount of bid security could play a vital role in determining market participation in the process.

40. To promote competition in auction(s) conducted during liquidation process, it is proposed to stipulate that the liquidator may not impose conditions which shall in any way hinder market participation in auction(s). Accordingly, it may be specified that the liquidator shall not require payment of non-refundable participation fee or deposit and the EMD shall not exceed 10% of reserve price of the asset(s), for participation in the auction.

Proposed Amendment

41. It is proposed to provide in Schedule I of the Liquidation Regulations that for participation in the auction, the liquidator shall not:

- (i) require payment of any fee or non-refundable deposit from potential bidders; and
- (ii) prescribe EMD in excess of 10% of reserve price of the asset(s).

Issue-5: Power of Liquidator in Auction

Statement of Problem

42. Sub-clause (11) of clause 1 of Schedule I of Liquidation Regulations provide: *“If required, the liquidator may conduct multiple rounds of auctions to maximize the realization from the sale of the assets, and to promote the best interests of the creditors”*. While exercising the aforesaid power, the liquidators in some cases have mentioned in auction notices that the liquidator is not bound to accept the highest offer and has the absolute right to accept or reject any or all offer(s) from the e-auction proceedings at any stage of the bid **without assigning any reason**.

43. The intention of sub-clause (11) is not to provide unbridled power to the liquidator in terms of rejection of a fair bid without assigning any reason(s). The Code aims to maximize value of assets of the CD, however, the liquidator shall endeavour to achieve the same while ensuring utmost transparency and objectivity in the conduct of liquidation process. The liquidator, while exercising the rights, should also meet his obligations.

44. The attention is drawn to the judgement dated 09.09.2019 of Adjudicating Authority in the matter of M/s Nawa Engineers and Consultants Private Limited where the liquidator had declined to accept the bid by H1 bidder as the winning bid in the auction. The Adjudicating Authority held: *“... this Adjudicating Authority finds that the **condition inserted in the e-auction sale catalogue which authorizes the Liquidator to reject the highest bid without assigning any reason is void ab initio**. The Liquidator appointed by this Adjudicating Authority being an officer of this court has to act in a highly responsible and transparent manner as he is dealing with the valuable Assets of the Corporate Debtor under Liquidation.”*

(Emphasis supplied)

45. In order to address the issue of arbitrary rejection of highest bid, it is proposed that the liquidator shall provide the reason(s) for rejection of the highest bid to the highest bidder and record the same in the quarterly progress report. While affording more transparency, it shall maintain the flexibility accorded to the liquidator to decide in respect to conducting multiple rounds of auctions in the facts and circumstances of the matter.

Proposed Amendment

46. It is proposed to insert the clarification in sub-clause (11) of clause 1 of Schedule I of the Liquidation Regulations to explicitly provide that the liquidator shall provide the reason(s) for rejection of highest bid in the auction process, if applicable, to the highest bidder and shall record the same in the quarterly progress report submitted to AA.

Issue-6: Swiss Challenge as a Mode of Auction under Liquidation Process

47. A Swiss Challenge Method (SCM) is a bidding process wherein a bidder ('original bidder') makes an unsolicited bid to the auctioneer. Once approved, the auctioneer then seeks counter proposals against the original proposal and chooses the best amongst all options (including the original bid). The original bidder in most cases is granted the 'right to first refusal'. If the original bidder agrees to match its offer to the challenging proposal, the project is awarded to him, else it is awarded to the challenging bidder.

48. In the absence of express provision for adoption of SCM for sale of assets during liquidation process, the Hon'ble High Court of Delhi, while disposing off a writ petition in the matter of M/s Amira Pure Foods Private Limited, vide order dated 15.12.2020, has directed the Board to consider the petition as a representation on the issue of adoption of SCM as a form of auction under its Regulations.

Legal Position under the Code

49. The report of Bankruptcy Law Reforms Committee which had conceptualized the Code does not provide for any specific type of auction to be adopted during liquidation process and guides that "*The Liquidator can call for bids, run auctions, hire the services of third party valuation experts in order to assess the value of the assets in the Liquidation trust ...*".

50. The regulatory framework for sale of assets during liquidation process is as under:

(a) Sub-regulation (1) of regulation 33 of the Liquidation Regulations provides that, "*The liquidator shall ordinarily sell the assets of the corporate debtor through an auction in the manner specified in Schedule I*".

(b) Schedule I under regulation 33 of the Liquidation Regulations provides for Mode of Sale. The Schedule provides that the sale may happen either through auction or private sale. Sub-clause (9) of clause 1 of the Schedule I provides that, "*An auction shall be transparent, and the highest bid at any given point shall be visible to the other bidders*". The said clause 1 of the Schedule is silent on the exact type of auction to be used by the liquidator. Therefore, there is no express prohibition on the adoption of SCM for sale of assets under liquidation process.

51. There are several types of auctions such as English auction, Sealed-bid auction, Dutch auction, Swiss Challenge Method, etc. The choice of type of auction to be used in the liquidation process for sale of assets lies within the domain of the liquidator, in consultation with SCC so long as the provisions of the Code and the Liquidation Regulations are complied with. The Code and Regulations made thereunder only mandate that the auction should be undertaken in a transparent manner and should lead to maximization of realization from sale as well as promote the interests of the creditors.

The Companies Act

52. The specific methods of auction have also not been specified under Companies Act. Rule 273 of the Companies (Court) Rules, 1959 prescribe that all sales shall be made by public auction or by inviting sealed tenders or in such manner as the Judge may direct. This Rule also prescribes every sale shall be held by the Official Liquidator or if the Judge so directs by an agent or auctioneer approved by the Court. Similar provision has been provided under section 290 of the CA 2013 read with Rule 166 of Winding up Rules 2020 specifying the power of company liquidator in respect to sale.

SCM under Banking

53. RBI has on 01.09.2016 issued Guidelines on Sale of Stressed Assets by Banks¹. The essence of the Guidelines is urging banks to create mechanism for timely identification of stressed accounts and take appropriate actions to ensure there is low vintage and better price realization for banks. Under the guidelines, SCM is envisaged to be introduced for sale of stressed assets. The banks have also resorted to SCM to offload their stressed assets under the SARFAESI Act, 2002.

Issues under SCM

54. The SCM begins with a base bid. A liquidator may not have any preferred party or bid at its first place. It may be noted that recently under the Pre-packaged Insolvency Resolution Process (PPIRP) framework, a process like swiss challenge has been adopted, but the base resolution plan submitted by promoters there forms the base bid for swiss challenge. There may be concerns regarding transparency in choosing the preferred bidder, or it has to be a two-stage bidding, first stage to become preferred bidder and second stage for the swiss challenge, which has cost and time implications.

55. Considering the afore-mentioned position, there is a need to deliberate whether a guided path is to be explicitly stipulated for the adoption of SCM for the auction under liquidation, especially in the context of absence of prohibition on adoption of any method of auction in the Liquidation Regulations currently.

Economic Analysis

56. The Code, *inter-alia*, aims to maximize value of assets of the CD, balance the interest of stakeholders and ensure timely completion of liquidation process. The proposed amendments in Part-B would aid in achievement of these objectives by:

- i) Eliminating unwarranted expenses burden on liquidation estate and thereby ensuring higher realization for stakeholders, through placing prohibition on engagement of agents / professionals, on commission / success fee basis, for sale of assets;
- ii) Enhancing competition and thereby, leading to higher realization from sale by prohibiting imposition of pre-bid qualifications which hinder market participation;
- iii) Ensuring greater transparency in auction(s) by mandating disclosure of the reason(s) for rejection of highest bid by the liquidator.

¹ <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10588&Mode=0>

Part-C: Security interest related

57. This part proposes to resolve the impasse regarding relinquishment or realization arising in cases where multiple secured creditors have *pari passu* charge over assets of the CD.

Issue-7: Relinquishment of Security Interest

Statement of Problem

58. The Code enables a secured creditor in the liquidation proceedings to either: (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 Liquidation 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. Further, Regulation 21A of the Liquidation Regulations enables quick decision on relinquishment or realization of security interest by secured creditors by stipulating that the security interest shall be presumed to be part of the liquidation estate if the secured creditor does not intimate its decision regarding the same, to the liquidator within thirty days from the liquidation commencement date.

59. In some liquidation processes, wherein there were more than one secured creditor having *pari passu* charge over asset(s) of the CD, some secured creditor(s) having relatively smaller share in the value of the secured debt decided not to relinquish the security interest, while the remaining secured creditor(s) having majority of the share in secured debt decided to relinquish the same. The liquidators in such stalemate situations were unable to proceed with the sale of such encumbered assets for a considerable period, leading to depletion in value of assets and delay in completion of liquidation process.

UNCITRAL Legislative Guide on Insolvency Law

60. UNCITRAL Legislative Guide on Insolvency Law informs about the international practices if secured creditor does not relinquish the security interest:

“Some laws also provide that, where the holder of the security interest does not consent to the sale, the insolvency representative may request the court to authorize the sale. This may be granted provided the court is satisfied, for example, that the insolvency representative has made reasonable efforts to obtain the consent; that the sale is in the interests of the debtor and its creditors; and that the sale will not substantially prejudice the holder of the interest.”

UNCITRAL Legislative Guide on Secured Transactions

61. UNCITRAL Legislative Guide on Secured Transactions states that effective priority rules are central to promoting the availability of secured credit and contemplates that one of the criteria to fix priority rule by the State can be the percentage of the obligation outstanding. It reads as: *“when States decide to fix priority by reference to various features of a claim, an even greater range of possibilities arises. The question is whether priority should be based on: (a) a legislative ranking that focuses on the character of the claim (for example, a term loan, a line of credit or a claim arising from a wrongful act); (b) the character of the claimant (for example, a seller, a repairer or a municipality); (c) the amount of the obligation due (small claims, medium claims, large claims); (d) **the percentage of the obligation outstanding (for example, less than 25 per cent, 25-50 per cent or more than 50 per cent)**; or (e) the manner in which third-party*

effectiveness is achieved (for example, registration in a general security rights registry, possession, registration in a specialized registry or control)”.

(Emphasis supplied)

SARFAESI Act, 2002

62. It is pertinent to note sub-section (9) of section 13 of the SARFAESI Act, 2002, which provides:

*“Subject to the provisions of the Insolvency and Bankruptcy Code, 2016, in the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of **such right is agreed upon by the secured creditors representing not less than sixty per cent in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors.**”*

(Emphasis supplied)

Jurisprudence

63. The Hon’ble NCLT, vide order dated 22.10.2019, in the matter of Edelweiss Asset Reconstruction Co Ltd vs Abhijeet MADC Nagpur Energy Pvt Ltd, observed that if a secured creditor wants to realize its security in accordance with section 13(9) of SARFAESI Act, 2002 then he must have 60% in the value of the secured debt and then his action shall be binding on all such secured creditors.

64. The similar principle was laid down in the matter of Mr. Srikanth Dwarkanath, Liquidator of Surana Power Limited Vs. Bharat Heavy Electricals Limited, wherein the Hon’ble NCLAT, vide order dated 18.06.2020, while relying on section 13(9) of the SARFAESI Act, 2002, had held that a secured creditor may proceed to realize its security interest for an asset over which it does not have an exclusive charge only with the consent of secured creditors holding at least 60% in value of the secured debt.

65. While applying the principle enunciated in the foregoing judgements, it is proposed to provide that the secured creditor(s) may realize or relinquish the security interest if it holds minimum 60% of the value of secured debt. It would promote collective liquidation process, facilitate its timely completion and balance the interest of stakeholders.

66. It is important to note that if the deadlock is not resolved by an intervention, the assets will become part of liquidation estate through deemed relinquishment as mandated under regulation 21A of Liquidation Regulations, denying the secured creditors their right to make a choice of relinquishment or otherwise.

Proposed Amendment

67. It is proposed to provide in the Liquidation Regulations that if the secured creditors having 60% of the value in the secured debt decide to relinquish or realize the security interest, such decision shall be binding on the other *pari-passu* charge holders.

Economic Analysis

68. Under the Code, each ‘early’ action in the process may translate into ‘higher’ realization for stakeholders. The proposed amendment enables the secured creditors to exercise their right

of relinquishment or otherwise in deadlock situations, thereby, ensures timely completion of the liquidation process and promotes overall value maximization. It further supports collective liquidation action envisaged in the Code.

69. It is considered to have discussion on the following points from the aforesaid seven issues:
- a. Should the consultation with SCC be mandated for *all* significant matters related to liquidation process, including appointment of professionals (and their remuneration), and sale of assets (including major aspects such as fixation of reserve price, manner of sale, etc.)?
 - b. Is there any need to specify criterion for nomination of representatives of the stakeholders under regulation 31A(3)? If yes, should the stakeholder be nominated by majority of value of claims, present and voting?
 - c. Should the engagement of a professional/agent for sale of asset(s) on commission / success fee basis be prohibited? Should SCC be consulted for preparing a marketing strategy for sale of assets of the CD?
 - d. Should the prohibition on payment of fee or non-refundable deposit for participation in the auction during liquidation process be explicitly provided under Liquidation Regulations? Should the maximum threshold of EMD for participation in the auction be fixed?
 - e. Should the liquidator provide the reason(s) for rejection of highest bid in the auction process to the highest bidder and in the progress report?
 - f. Is there any need to specify specific methods of auction to be employed for sale of assets?
 - g. Should the decision of secured creditors holding 60% of the value of secured debt, to relinquish or realize the security interest be binding on other *pari passu* charge holders during liquidation process?

Public Comments

70. 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 points mentioned in Para 69.

71. Comments may be submitted electronically by 17th September, 2021. 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 Process August, 2021';
- (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 number and then sub-para number and write comments under the selected para/sub-para number.
- (viii) You can make comments on more than one para/sub-para number, by clicking on **More Comments** and repeating the process outlined above from point 71(v) onwards.
- (ix) Click ‘Submit’, if you have no more comments to make.
