

[2019] 2 IJ (Art.) 47

## Going Concern Liquidation – Make the ‘Deal’ Happen



*The primary objective of the going concern sale is to facilitate the turnaround of the corporate debtor as a going concern and not merely as a sale of assets and distribution of funds amongst the stakeholders. In this article, the author has discussed key proposals for going concern sale stated in the Discussion paper besides need therefor and challenges therein. He believes that going concern sale of corporate debtor is undoubtedly a better approach than the piecemeal sale of assets.*

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### Introduction

The Insolvency and Bankruptcy Code, 2016 (**‘Code’**) has resulted in several merger and acquisition (**‘M&A’**) deals in the past two and a half years. Some of the prominent M&A deals include acquisition of Bhushan Steel Ltd. by Tata Steel Ltd., Electrosteel Steels Ltd. by Vedanta Ltd. and Monnet Ispat & Energy Ltd. by JSW Steel Ltd. While these acquisitions have helped the lenders recover a substantial amount of their outstanding debt, the acquirers have also used this as an opportunity to acquire some lucrative facilities.

As per an estimate, the resolution plans under the Code have yielded about 200 per cent of liquidation value for the creditors and they are on an average realising 43 per cent of their claims through resolution plans. However, there are various instances where the corporate insolvency resolution process (**‘CIRP’**) has concluded with the order for liquidation of the corporate debtor. As per the data available on the website of the Insolvency and Bankruptcy Board of India (**‘IBBI’**), as on 31<sup>st</sup> March 2019, 378 corporates

are facing liquidation under the Code due to failure of the CIRP.

In terms of section 33 of the Code, the Adjudicating Authority has the authority to pass an order for liquidation of the corporate debtor if (a) the Adjudicating Authority rejects the resolution plan under section 31 for the non-compliance of the requirements specified therein, or (b) no resolution plan is received by the adjudicating authority before the expiry of maximum period permitted for completion of CIRP, or (c) the committee of creditors (**‘CoC’**) with the approval of not less than 66 per cent of the voting share decides to liquidate the corporate debtor at any time during the CIRP.

### Need for Going Concern Liquidation

The primary objective of the Code is resolution of the corporate debtor. The preamble to the Code does not mention anything about liquidation of the corporate debtor. In the matter of *Binani Cement Ltd.* [2018] 1 IJ (JP) 665, the National Company Law Appellate Tribunal (**‘NCLAT’**) said that liquidation would bring the life of a corporate

debtor to an end and that the Code does not allow liquidation of a corporate debtor directly but only on failure of the CIRP. The Supreme Court, in its order in *Swiss Ribbons*<sup>1</sup>, held that the Code is first and foremost a Code for reorganization and insolvency resolution of corporate debtors and that the liquidation should be availed of as a last resort only if there is no resolution plan or the resolution plans submitted are not up to the mark. Further, in *Arcelor Mittal India Pvt. Ltd. v. Satish Kumar Gupta*<sup>2</sup>, the Supreme Court opined that the corporate debtor consists of several employees and workmen whose daily bread is dependent on the outcome of the CIRP. If there is a resolution applicant who can continue to run the corporate debtor as a going concern, every effort must be made to try and see that this is made possible. The Hon'ble Supreme Court also observed that even in liquidation, the liquidator can sell the business of the corporate debtor as a going concern. In view of these judgments, the NCLAT and the adjudicating authority have, in several cases including *Bharati Defence & Infrastructure Ltd.* and *Reid & Taylor (India) Ltd.* directed the liquidators to make efforts to sell the corporate debtor as a going concern before selling the assets of the corporate debtor on a piecemeal basis.

Regulation 32 of the IBBI (Liquidation Process) Regulations, 2016 (**'Liquidation Regulations'**) which specifies the options for sale of assets of the corporate debtor was amended on 27<sup>th</sup> March, 2018, to provide for sale of the corporate debtor as a going concern as one of the modes for sale of assets of the corporate debtor undergoing liquidation.

The sale of a corporate debtor in liquidation as a going concern (**'Going Concern Sale'**) is expected to help in realisation of a higher value, value preservation and rescuing a viable business. The going concern sale may also offer some lucrative opportunities for the M&A deals. However, at present, there is a lack of clarity under the Code and the Liquidation

Regulations on the implementation aspects of the proposal for sale of a corporate debtor as a going concern. To address this concern and to provide guidelines for implementation of the going concern sale proposals, the IBBI has issued a discussion paper along with draft regulations on 27<sup>th</sup> April 2019 (**'Discussion Paper'**).

### Key Proposals in the Discussion Paper Concerning Going Concern Sale

The Discussion Paper proposes that in case no resolution plan is received by the CoC or if the CoC does not approve any resolution plan, the CoC may, at the time of passing a resolution for liquidation of the corporate debtor, recommend the going concern sale of the corporate debtor. In case of failure to achieve the going concern sale within a period of ninety days, the liquidator may proceed with other modes of liquidation. If there is no recommendation from the CoC, the liquidator shall explore all options of sale simultaneously keeping in view with the market practice in the line of business of the corporate debtor.

In terms of section 35(1)(e) of the Code, the liquidator can carry on the business of the corporate debtor for its beneficial liquidation. It has been proposed that in the going concern sale option, the corporate debtor along with the business, assets and liabilities will be transferred to the acquirer. Also, the employees of the corporate debtor will be transferred to the acquirer, hence, the employees will not be discharged on passing of the liquidation order by the adjudicating authority. Once the corporate debtor is sold as a going concern, the liquidator shall make an application to the adjudicating authority for the closure of the liquidation process of the corporate debtor and not for the dissolution of the corporate debtor.

Section 35(2) of the Code enables the liquidator to consult any of the stakeholders entitled to the distribution of proceeds under section 53 of the Code subject to the condition that such consultation shall not be binding on the liquidator. In line with the

1. *Swiss Ribbons Pvt. Ltd. v. Union of India* [2019] 2 IBC (JP) 73 (SC)

2. [2018] 1 IBC (JP) 563 (SC)

said provision of section 35(2), the Discussion Paper has proposed constitution of an advisory committee called stakeholders consultation committee (**'Consultation Committee'**) to advise the liquidator on matters related to liquidation of the corporate debtor. The Consultation Committee shall comprise of representatives of financial creditors, employees, workmen, operational creditors, representatives of the Government and shareholders, wherever relevant. The advice of the Consultation Committee shall not be binding on the liquidator. However, the liquidator shall record the reasons in writing where the liquidator takes a decision against the advice of not less than 66 per cent of the members of the Consultation Committee.

As regards the consideration to be paid by the acquirer for the going concern sale, the Discussion Paper provides that the total consideration to be paid by the acquirer shall be bifurcated into share capital and liabilities at the option of the acquirer. The fresh shares shall be issued to the acquirer against the share capital part of the total consideration. The existing shares of the corporate debtor would be cancelled and extinguished and the existing shareholders would become claimants from the liquidation proceeds under Section 53 of the Code which provides for a waterfall mechanism.

### Challenges in the Going Concern Sale

The acquisition of corporate debtor under the going concern sale would be like any other M&A deal and may face certain regulatory challenges which are faced in such M&A deals. It is pertinent to note that the regulatory authorities have amended several regulations and relaxed various regulatory requirements to facilitate the acquisition of the corporate debtors pursuant to the resolution plan under the Code. However, similar relaxations are not available to the proposal of acquisition of the corporate debtor pursuant to the going concern sale as of now.

For instance, the Reserve Bank of India (**'RBI'**) has

amended the regulations governing external commercial borrowings (**'ECB'**) and has allowed the resolution applicants to raise loans under the approval route from foreign entities for repayment of the rupee term loans of the corporate debtor being acquired pursuant to the resolution plan under the Code. An acquirer proposing to acquire the corporate debtor under the going concern sale would also need funds to discharge the debt owed by the corporate debtor to the lenders. However, the ECB regulations, at present, do not permit the acquirer to raise foreign loans for repayment of the rupee term loans of the corporate debtor being acquired through the going concern sale.

In case of a resolution plan for the listed corporate debtors, the Securities and Exchange Board of India (**'SEBI'**) has made various amendments in the regulations with the objective of easier implementation of the resolution plans. A proposal for the acquisition of equity shares beyond the stipulated threshold and/or control of a listed corporate debtor pursuant to the resolution plan enjoys absolute exemption from the applicability of open offer requirement under the takeover regulations. The allotment of equity shares of corporate debtor pursuant to the resolution plan does not attract the preferential issue guidelines prescribed by the SEBI. The SEBI had also amended the delisting regulations consequent to which delisting of corporate debtors pursuant to the resolution plan does not require compliance with the delisting regulations if the resolution plan sets out any specific procedure to complete the delisting or provides an exit option to the existing public shareholders at a price specified in the resolution plan. In addition to the above, the re-classification of promoters of listed corporate debtors pursuant to the resolution plan does not require any approval of the stock exchange(s) under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The provisions relating to minimum public shareholding were also amended for the listed corporate debtors which are not delisted but continue to be listed on stock exchange(s) after the approval of the resolution plan.

It has been noticed that, in the event an order for liquidation of a corporate debtor has been passed under the Code, though the stock exchange(s) suspends the trading in shares of the corporate debtor, the corporate debtor continues to be listed on the stock exchange(s). Therefore, it can be argued that any proposal to acquire a listed corporate debtor through the going concern sale mechanism may attract the regulations framed by the SEBI including preferential issue guidelines, takeover regulations etc., in the absence of specific provisions/exemptions in this regard.

As proposed in the Discussion Paper, the existing equity shares of the corporate debtor will not be transferred but will be extinguished in the going concern sale. It is, however, unclear if such extinguishment of existing share capital of corporate debtor needs to comply with section 66 of the Companies Act, 2013, considering that no requirement of approval by the adjudicating authority is contemplated for the actions as may be involved in implementation of the going concern sale.

The acquisition of the corporate debtor pursuant to the going concern sale may also attract the requirement of obtaining certain regulatory approvals including the approval of Competition Commission of India ('CCI') under the provisions of the Competition Act, 2002, depending on case to case basis. While the Code has specific provision for obtaining approval of the CCI and other regulatory authorities in case of the resolution plan, there needs to be some clarity on whether the acquirer would be required to obtain such approvals to implement the going concern sale proposal and if yes, at which stage.

This is on account of the fact that in view of the Discussion Paper, the liquidator would make an application to the adjudicating authority for closure of liquidation proceedings upon completion of the going concern sale and is not supposed to seek approval of the adjudicating authority in relation to the actions required to implement the proposal. Though, in terms of section 35(1)(n) of the Code, the

liquidator can apply to the adjudicating authority for necessary orders or directions in relation to the liquidation process, this is not clear if the adjudicating authority can grant relief from the above mentioned regulatory requirements to implement the going concern sale.

Another important aspect in the going concern sale is related to the selection of the preferred bidder/acquirer by the liquidator. In the CIRP, the resolution applicants are shortlisted basis the evaluation matrix to be decided by the CoC. However, neither the Code nor the Liquidation Regulations presently stipulate the selection criteria for the potential bidders in the going concern sale. This remains unclear whether the preferred bidder/acquirer will be selected at the discretion of the liquidator or the scope of 'advice' to be given by the Consultation Committee would also include evaluating the feasibility and viability of the proposal submitted by the potential bidders. This becomes important in view of the fact that the primary objective of the going concern sale is to facilitate the turnaround of the corporate debtor as a going concern and not merely as a sale of assets and distribution of funds amongst the stakeholders.

## Conclusion

The going concern sale of the corporate debtors is undoubtedly a better approach than the piecemeal sale of assets of the corporate debtor. This is a win-win option for the creditors and the employees of the corporate debtors. While the creditors may realise a higher value, the going concern sale would save the employment of many workers and employees whose daily bread is dependent on the corporate debtor. However, to make a 'deal' happen under the going concern sale mechanism, the regulatory authorities should bring a clear and unambiguous regulatory framework.

