

September 13, 2019



LIQUIDATION PROCESS ON A GOING CONCERN BASIS

- SOME OBSERVATIONS

argus
partners
SOLICITORS AND ADVOCATES

MUMBAI | DELHI | BENGALURU | KOLKATA

Background

On April 27, 2019, the Insolvency and Bankruptcy Board of India (“IBBI”) had issued a *Discussion Paper on Corporate Liquidation Process along with Draft Regulations* (“**Discussion Paper**”), *inter alia*, deliberating on the requirement to provide a complete framework for undertaking sale of a corporate debtor and a business as a going concern under Regulation 32 of IBBI Liquidation Process) Regulations, 2016 (“**Liquidation Process Regulations**”).

Subsequent to the issuance of the Discussion Paper, both the Liquidation Process Regulations and IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (“**CIRP Regulations**”) were amended on July 25, 2019 to *inter alia* specify the process governing sale of a company under liquidation on a *going concern basis*.

The purpose of this paper is to analyse the scope of the recent amendments in the backdrop of the historical jurisprudence developed in the context of a *going concern sale* (“**GCS**”) post liquidation/ winding up order and critically examine the issue of transfer of *liabilities* as part of such GCS.

Evolution of Framework of GCS under Insolvency Code - A Timeline Journey

The sale of a corporate debtor under liquidation by way of GCS was not contemplated under the Insolvency and Bankruptcy Code, 2016 (“**IBC**”), nor did it find any place in the Regulation 32 of Liquidation Process Regulations (*Manner of Sale*), as it was originally framed¹.

The absence of a specific enabling mechanism to allow sale of a corporate debtor under liquidation on a GCS basis, however, did not deter Kolkata Bench of National Company Law Tribunal to direct the liquidator of Gujarat NRE Coke Limited to dispose off the corporate debtor as a going concern². Such power was derived by the bench by relying on Regulation 32(b)(i) of the Liquidation Process Regulations, which allowed the liquidator to sell the assets on a *slump sale* basis.

Taking a cue from the aforesaid decision, the Liquidation Process Regulations was amended on March 27, 2018 by IBBI (*Liquidation Process*) (*Amendment*) Regulations, 2018 to introduce a new sub-clause (c) in Regulation 32, allowing the liquidator to *sell the corporate debtor as a going concern*.

Regulation 32 was substituted again on October 22, 2018 by IBBI (*Liquidation Process*) (*Second Amendment*) Regulations, 2018, whereby the following modes were specified:

32. Sale of Assets, etc.

The liquidator may sell-

- (a) *an asset on a standalone basis;*
- (b) *the assets in a slump sale;*
- (c) *a set of assets collectively;*
- (d) *the assets in parcels;*
- (e) *the corporate debtor as a going concern; or*
- (f) *the business(s) of the corporate debtor as a going concern;*

¹ At the time of inception of the Liquidation Process Regulations, Regulation 32 (*Manner of Sale*) read as follows:
The liquidator may

- (a) sell an asset on a standalone basis; or
- (b) sell
 - (i) the assets in a slump sale,
 - (ii) a set of assets collectively, or
 - (iii) the assets in parcels

² See, *Gujarat NRE Coke Limited In Re CP (IB) No. 182/KB/2017*, order dated January 11, 2018 (NCLT Kolkata)

Provided that where an asset is subject to security interest, it shall not be sold under any of the clauses (a) to (f) unless the security interest therein has been relinquished to the liquidation estate. (emphasis supplied)

What followed next was the Discussion Paper, where the ambit of Regulation 32(e) was explained as follows:

Sale under regulation 32(e): *In this form of GCS, the CD will not be dissolved. It will form part of liquidation estate. It will be transferred along with the business, assets and liabilities, including all contracts, licenses, concessions, agreements, benefits, privileges, rights or interests to the acquirer. The consideration received from sale will be split into share capital and liabilities, based on a capital structure that the acquirer decides. There will be an issuance of shares by the CD being sold to the extent of the share capital. The existing shares of the CD will not be transferred and shall be extinguished. The existing shareholders will become claimants from liquidation proceeds under section 53 of the Code. (emphasis supplied)*

The Discussion Paper then goes on to examine if there should be a specific definition of 'Going Concern Sale' and decided against the same by noting the following:

The term is well-understood in legal parlance. The jurisprudence in this regard is fairly well-developed out of the erstwhile liquidation regime under the Companies Act, 1956. The Code recognises 'going concern' and envisages resolution as a 'going concern' but does not define it. It has been in vogue for more than two years and has not caused any difficulty. The Insolvency Law Committee in its report dated 26th March, 2016 (sic 2018) noted that the phrase "as a going concern" implies that the CD would be functional as it would have been prior to initiation of CIRP, other than the restrictions put by the Code. It may not, therefore, be defined. However, it may be explained that going concern means all such assets and the liabilities, which constitute an integral business or the CD, that must be transferred together, and the consideration must be for the business or the CD. The buyer of the assets and liabilities should be able to run business without any disruption. The business or the CD must be a running one, and it must be transferred along with its employees. In case of sale of the CD as going concern, the equity shareholding of the CD must be transferred, and the buyer must take over the CD, its business, affairs and operations, including its licenses, assets, entitlements, beneficial interests, trademarks, brand, government approvals, etc. (emphasis supplied)

Regarding how the assets and liabilities may be transferred, the Discussion Paper offered the following suggestion:

In case, the GCS is undertaken at the choice of the CoC, the CoC, including secured financial creditors, shall indicate composition of assets and / liabilities to be sold as going concern. In any other case, the Liquidator may have flexibility to package the assets and liabilities as per market practice and offer every option under regulation 32 of the Regulations simultaneously. He will compute value of each option and each combination of options and sell the asset, business or the CD in the manner which gives the highest value. For example, a CD has three assets A, B, and C, and three liabilities X, Y and Z. He may offer for sale, (a) A only, (b) B only, (c) C only, (d) A and B, (e) B and C, (f) A and C, (g) A, B and C, (h) A and X, (i) A and Y, (j) A and Z, (k) A, B and X, and so on. After receipt of bids for each package, he may find that sale of one business comprising A, B and Y, and sale of one asset (C) give the highest value. He may sell these and discharge the liabilities X and Z from the sale proceeds as per section 53 of the Code. (emphasis supplied)

The aforesaid suggestions were formalized by the recent amendments to the CIRP Regulation and Liquidation Process Regulation, where Regulation 39C and Regulation 32A were introduced, respectively, with effect from July 25, 2019.

As per Regulation 39C of the CIRP Regulation, the committee of creditor (“CoC”), if it recommends sale of the corporate debtor as a going concern, has been entrusted to identify and group the assets and liabilities. In the even no such recommendation is forthcoming from the CoC, in terms of sub-clause (3) of Regulation 32A of Liquidation Process Regulations, the liquidator is mandated to identify and group the assets and liabilities to be sold as a going concern, in consultation with the consultation committee.

Transfer of Company as GCS during Liquidation - Review of Pre-IBC Jurisprudence

Transfer of the company under liquidation on GCS basis is not a new concept developed under the IBC, with reference of such an approach being seen as early as in the late 19th century³. The reason for opting for a GCS as opposed to sale of assets on parcel basis is not difficult to comprehend. Such rationale was noted by Chief Justice Marten of Bombay High Court way back in 1930⁴, when he noted as follows:

“...Thus as stated in *Palmer*, Edn. 13, Part. 2, p. 376:

“But it often happens that the business of the company is its most valuable asset, and in such a case it may be very proper to carry on the business, and sell it as a going concern : to stop it would impair, if not destroy, its value so also it may be proper to carry it on when there are pending contracts which can be carried out without much difficulty, and if not parried out would involve forfeiture or heavy claims against the company for damages. And so also where the company has partly manufactured materials, it may be proper to carry ” on the business so far as may be necessary to complete the manufacture, if by so doing a loss will be avoided or a sale effected.” (emphasis supplied)

Whilst the aforesaid case primarily dealt with the legality of certain ‘dispositions’ made post the winding up order to ensure that the company was run on a ‘going concern’ basis to preserve its value, in the case of *M.C.T.M. Chidambaram Chettiar vs The Official Receiver, High Court*,⁵ we note of an instance where the assets of the Madras Chemical Industries Limited, which was in the process of being wound up, was ordered to be sold as a going concern.

There have been other numerous incidents, where the Courts (including Supreme Courts) have given direction regarding sale of assets of a company under liquidation on *going concern* basis. For instance, in the case of *Allahabad Bank v. ARC Holding Limited*⁶, the Supreme Court was faced with the issue of whether after an order passed in execution proceedings for the sale of plant, machinery and moveable lying at the factory, can the same court later pass an order for sale of the factory of the company as a ‘going concern’. The Supreme Court allowed such GCS, *inter alia* with the following condition:

“The Official Liquidator for this purpose shall advertise the sale of the company in liquidation-judgment debtor as a ‘going concern’ as ordered by the High Court. Such publication shall indicate that the reserve price, shall be the amount equal to the total decree including interest which has accrued upto 31st December, 1999 in favour of the appellant-bank, and shall also has to pay the balance interest which accrues, till full payment is made. The publication shall also indicate that purchaser has also to pay the liabilities of other claimants in the proceeding for the liquidation of the company.” (emphasis supplied)

³ See, *In re Bridgewater Engineering Company* (1879) 12 Ch. D. 181; and *In re International Marine Hydropathic Company* (1884) 28 Ch D 470

⁴ See, *Tulsidas Jasraj Parekh v. Industrial Bank of Western India* [AIR 1931 BOM 2]

⁵ *M.C.T.M. Chidambaram Chettiar vs The Official Receiver, High Court* (1943) 1 MLJ 123 (Madras)

⁶ *Allahabad Bank v. ARC Holding Limited* [AIR 2000 SC 3098]

From our review of the other similar orders passed by other courts directing GCS of companies under liquidation, the direction regarding purchaser being required to discharge the liabilities of the company under liquidation probably stands out. The only other instance, that we could come across where a GCS was ordered along with liabilities, was a direction issued by single bench of the Calcutta High Court in the case of *AOP (India) Pvt. Ltd. [In Liqn.] v. OL*⁷, noting that *the purchaser would have to take over all liabilities of the company in liquidation*.

In all other instances that we have come across, the direction has been to ensure that the company be transferred as a running unit, with specific undertaking to employ the existing workforce⁸. Whilst admittedly none of the aforesaid decisions specifically dealt with the obligation of the purchaser towards the existing liabilities of the company, at least in one instance, the Allahabad High Court had noted that where the purchaser is taking over the employees of the company under liquidation, the obligations towards the workers would be limited to the amount payable under the Companies Act 1956 and the Companies (Court) Rules, 1959. Any further offer/obligation would be subject to the arrangement between the successful bidders and ex-workers/employees of the company (In Liquidation)⁹.

Transfer of Company as GCS during Liquidation - Experience under IBC

We have already referred to the case of *Gujarat NRE Coke Limited*¹⁰, where the Kolkata Bench had directed sale of corporate debtor on a *going concern* basis. The Discussion Paper also lists down three indicative illustrations¹¹, where NCLT had directed the liquidators to explore sale of corporate debtor or its units on GCS basis.

Whilst there have been a significant number of other orders where the NCLT had directed sale of corporate debtor in liquidation on GCS basis, there have been scant jurisprudence on what would constitute a GCS.

One of the first cases, where the concept of GCS was discussed was the order of the Mumbai bench of NCLT in the case of *Alchemist Asset Reconstruction Company Ltd. v. Abhijeet MADC Nagpur Energy Pvt. Ltd.*¹², where the bench clarified what would amount to a GCS as follows:

“It is to be clarified that when sale is to be made on a going concern basis, then certainly after the transfer of undertaking, acquirer gets all right, title and interest in the whole and every part of the undertaking, without any security interest, encumbrance, claim, counter claim, or any demur, into the acquirer. But the only condition is that sale is made on going

⁷ *AOP (India) Pvt. Ltd. [In Liqn.] v. OL* [CA NO.162 of 2012, order dated March 2, 2012 (Calcutta)]

⁸ See, *Union Bank of India v. Official Liquidator H.C. of Calcutta* [C.A. No. 3109 of 1998, decided on April 26, 2000 (SC)], where the Supreme Court noted the decision of Division Bench of Calcutta High Court to postpone the asset sale and subsequent decision to direct sale of the company on GCS basis, basis the interest shown by the West Bengal Government to re-employ the workers of the company after acquiring the same as a going concern. Also see the decision of a Division Bench of Calcutta High Court in the case of *West Bengal Small Industries Development Corporation Ltd. v. The Official Liquidator* [A.P.O. No. 385 of 2001, decided on December 4, 2012], where it noted the decision of the company court to accept the offer of the purchaser who had offered to acquire the assets of the company (in liquidation) as a going concern with an undertaking to engage all the employees who were eligible and were on record.

⁹ See, *Grasim Industries Ltd. v. Uttar Pradesh Cement Corporation Ltd.* [Special Appeal No. 1466 of 2005, order dated January 16, 2006 (Allahabad)]

¹⁰ See, *Gujarat NRE Coke Limited In Re* CP (IB) No. 182/KB/2017, order dated January 11, 2018 (NCLT Kolkata)

¹¹ *Edelweiss Asset Reconstruction Company Ltd v. Bharati Defence and Infrastructure Ltd.* [MA 170/2018, CP292/I&B/NCLT/MAH/2017, order dated January 14, 2019 (NCLT Mumbai)], *Edelweiss Asset Reconstruction Company Ltd v. Reid and Taylor (India) Ltd.* [M.A. 116/MB/2019 in C.P. (IB)-382/MB/2018, order dated February 5, 2019 (NCLT Mumbai)] and *Rukmani Infra Projects Private Limited* [CP (IB) No. 336/KB/2018, order dated March 1, 2019 (NCLT Kolkata)].

¹² *Alchemist Asset Reconstruction Company Ltd. v. Abhijeet MADC Nagpur Energy Pvt. Ltd.* [MA 1343/2018 IN CP (IB)-1315/MB/2017, order dated November 29, 2018 (NCLT Mumbai)].

concern basis and the sale proceeds shall be distributed in accordance with the provisions as given in Section 53 of the IBC, 2016.

.....

Since as per the amended Regulation, sale of the Corporate Debtor can be made on a going concern basis, no further clarification is required. (emphasis supplied)

In the context of our discussion, an important decision would be another order of the Mumbai bench of NCLT in the case of *Gupta Global Resources Pvt Ltd*¹³, where the bench, dealing with an application made by the liquidator of Gupta Global Resources Private Limited, had made the following observation:

Ld. Counsel appearing on behalf of the Liquidator submitted that the meaning of “going concern” is not at all clear in the Liquidation Regulations. Different meanings have emerged in the context of accounting standards, GST law and from several rulings. “Going Concern” means all the assets, tangibles or intangibles and resources needed to continue to operate independently a business activity which may be whole or a part of the business of the Corporate Debtor without values being assigned to the individual asset or resource.

.....

It is pertinent to mention that when the business of the Corporate Debtor is being sold on going concern basis, then it has a presumption that sale will be with assets and liabilities.

No further clarification is required. However, Liquidator is directed to follow the procedures as laid down in Regulations prescribed under the Code. (emphasis supplied)

Interestingly, this order dated March 12, 2019 preceded the Discussion Paper issued on April 27, 2019, which had explained the concept of *going concern* to include all such assets and the liabilities, which constitute an integral business.

It may not be out of place to mention that a review application against the aforesaid part of the order was made by way of a miscellaneous application, where the applicant contended that the particular part of the order, relating to GCS including even liabilities was *either an obiter dicta, or refers to sales on going concern basis outside of liquidation, and does not refer to going concern sale in terms of Regulations 32 of the IBBI (Liquidation process) Regulations, 2016, or is otherwise not binding in respect of the going concern sale under Liquidation Regulations.* The appellant further contended the following in support of the application:

It is further stated by the applicant that every sale of assets must result in consideration and that will be distributed by the Liquidator in terms of Section 53 of the Code. If the liabilities are to go to the buyer of the going concern, then the various claimants who have a claim on the liquidation estate would have dual claims – a claim on the liquidation estate, as also a claim on the buyer of the going concern. In essence, this will lead to an impossibility. (emphasis supplied)

The Mumbai bench, however, refused to interfere with the order noting that it did not have power to review its own order, especially when the order was passed on merit¹⁴.

Transfer of Pecuniary Liabilities as Part of GCS - A Critique

Whilst the application made by the Liquidator in the *Gupta Global* seeking clarification that transfer of liability as part of GCS under liquidation was not allowed, the application probably accurately

¹³ See, *Gupta Global Resources Pvt Ltd*, CP(IB) 1239(MB)/2017, MA 654/2018, order dated March 12, 2019 (NCLT Mumbai)

¹⁴ See, *Gupta Global Resources Pvt Ltd*, CP(IB) 1239(MB)/2017, MA 1502/2019, MA 1462/2019, order dated April 23, 2019 (NCLT Mumbai)

identified the problem of linking transfer of pecuniary liabilities in a GCS, especially during liquidation.

It may be noted that, neither the Bankruptcy Law Reforms Committee (2015) nor the Insolvency Law Committee (2018) had equated GCS with transfer of liability. For instance, the Insolvency Law Committee, in paragraph 8.1 of its report dated March 26, 2018 had noted that the phrase “as a going concern” would imply that the corporate debtor *would be functional as it would have been prior to initiation of CIRP, other than the restrictions put by the IBC*. It was only in the Discussion Paper and subsequent amendments to the CIRP Regulation and Liquidation Process Regulations, that we come across the framework of identifying assets *and liabilities* which are to be transferred as part of the GCS.

What would be relevant for a unit to remain functional as a *going concern* is the availability of relevant licenses, approvals and manpower, and is not dependent upon whether a specific pecuniary liability has been transferred or not. Such transfer of liabilities as part of GCS during liquidation, in our view, creates issues in so far as it suggests a parallel mechanism to the waterfall mechanism specified under Section 53 of the IBC. As has been rightly argued in the *Gupta Global case*, *If the liabilities are to go to the buyer of the going concern, then the various claimants who have a claim on the liquidation estate would have dual claims – a claim on the liquidation estate, as also a claim on the buyer of the going concern,* which is not contemplated under IBC.

Our argument, however, should not be misunderstood to imply that no *obligations* may be transferred as part of GCS. For instance, where such obligations are directly related to the future of the business being acquired by the purchaser, the liquidator may insist that an appropriate assumption of those liabilities by the purchaser is included in the contract. Such items might include, for example, long-term supply contracts where the goods are to be called off over a period as required¹⁵, indemnification obligations, performance warranty. It is only *pecuniary liability* that the liquidator should not insist to be transferred as part of GCS, with all pecuniary liabilities to be covered under Section 53 distribution mechanism only.

Parting Thoughts

The recent amendments to the CIRP Regulation and Liquidation Process Regulations, whilst clarifying the scope of GCS during liquidation, by suggesting grouping of assets and *liabilities* as part of the undertaking proposed to be transferred, may have advocated a principle which would require further clarification. It probably would require another round of amendment (including to the provisions of Section 53 of the IBC) or at the least judicial interpretation to limit the ambit of such *liabilities* to *non-pecuniary* liabilities.

This paper has been written by Arka Majumdar (Partner).

¹⁵ See, *Sales of businesses by insolvent companies*, Jonathan M Lewis, published in (1990) International Company and Commercial Law Review 44.

DISCLAIMER

This document is merely intended as an update and is merely for informational purposes. This document should not be construed as a legal opinion. No person should rely on the contents of this document without first obtaining advice from a qualified professional person. This document is contributed on the understanding that the Firm, its employees and consultants are not responsible for the results of any actions taken on the basis of information in this document, or for any error in or omission from this document. Further, the Firm, its employees and consultants, expressly disclaim all and any liability and responsibility to any person who reads this document in respect of anything, and of the consequences of anything, done or omitted to be done by such person in reliance, whether wholly or partially, upon the whole or any part of the content of this document. Without limiting the generality of the above, no author, consultant or the Firm shall have any responsibility for any act or omission of any other author, consultant or the Firm. This document does not and is not intended to constitute solicitation, invitation, advertisement or inducement of any sort whatsoever from us or any of our members to solicit any work, in any manner, whether directly or indirectly.

You can send us your comments at:
argusknowledgecentre@argus-p.com

Mumbai | Delhi | Bengaluru | Kolkata

www.argus-p.com