

Insolvency and Bankruptcy Law in India

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Week 06

Lecture 29

Welcome to all.

As part of the course on Insolvency and Bankruptcy Law in India, we will discuss the concept of valuing a corporate debtor and other aspects related to valuation today.

In the previous class, we discussed what an information memorandum is, its meaning, and its contents. Then we subsequently discussed the request for the resolution plan. When requesting a resolution plan, the major points to be considered and stated in the information memorandum have been discussed. Then, the common steps involved in requesting a resolution plan were discussed in the previous class, along with the evaluation matrix. All of these topics were discussed in the previous class.

Now, let us discuss valuation. Regulation 27 of the CRP regulations provides for the regulations related to valuation, which states that the resolution professional shall, within seven days of his appointment but not later than 47 days from the insolvency commencement date, appoint two registered valuers to determine the fair value and the liquidation value of the corporate debtor in accordance with Regulation 35. Regulation 27 of the CRP Regulation stipulates that, within seven days from the date of appointment, the resolution professional, once appointed, is expected to immediately appoint two registered valuers. These registered values will determine two key values that we will discuss in detail: two categories of values, namely fair value and liquidation value. To determine the fair value and liquidation value of the corporate debtor, they will appoint two registered valuers. So, the NCLAT, in the case of Jayanta Banerjee versus Shashi Agarwal, held that the resolution professional shall appoint valuers as required under Regulation 27 within the specified time limit. In this case, the law was actually reiterated. There is no further explanation. It was reiterated that it is the responsibility of the resolution professional to appoint the two registered valuers compulsorily so that they can provide two valuations. If there is any discrepancy or a significant difference, they can also appoint a third valuer in such cases. However, they will generally assess based on the two valuations.

Let us then examine Regulation 35. According to Regulation 37, it is clearly stated that the fair value and liquidation value will be determined in accordance with Regulation 35.

Now, let's examine what is in Regulation 35. The fair value and liquidation value shall be determined as follows. Please consider how you will determine this. The two registered valuers appointed under Regulation 27 shall submit to the Resolution Professional an estimate of fair value and the liquidation value computed in accordance with internationally accepted valuation standards. From this regulation, we must highlight the key points regarding fair value, liquidation value, and internationally accepted valuation standards. So, after physical verification, which is also very important, after the physical verification of inventory and fixed assets of the corporate debtor. Therefore, the estimation of the fair value is required, as is the liquidation value, which must be in accordance with internationally accepted valuation standards. Please note that the valuers are responsible for conducting the physical verification. Without physical verification, the valuation is not valid. Provided that the resolution professional shall facilitate a meeting wherein the registered valuers shall explain the methodology being adopted to arrive at the valuation to the members of the committee before the computation of the estimation. So why? Because the committee of creditors is obviously comprised of creditors, but they may not possess expert knowledge on valuation, so once registered valuers are appointed.

Once they have done it, they are supposed to explain what a methodology is, because various methodologies are available whenever you are doing the valuation. Therefore, the methodology used to perform the valuation must be explained to the creditors' committee so that they can make an informed decision, as they are the ones who will ultimately make the decision. They should understand whether the valuation is proper or not; obviously, it is expected to be proper, but the committee of creditors needs to know how they arrived at that conclusion. Therefore, if the two estimates of the value in an asset class differ significantly or upon receipt of a proposal to appoint a third registered valuer from the committee of creditors, the resolution professional may appoint a third registered valuer. As we have already discussed, generally, you will go with the two valuations. If the difference between these two valuations is significant, then you are going to appoint another third registered valuer, or if the committee of creditors is asking you or proposing that you appoint another valuer, then in such cases. So, when there is a difference in the valuation, or when the committee of creditors is demanding to appoint another valuer, in these two circumstances, you are going to appoint another person as a third registered valuer.

Let us then try to understand what fair value is. In Regulation 2(1) of HB, it was actually defined. So, fair value means the estimated realizable value of the assets of the corporate debtor if they were to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an arm's length transaction after proper marketing, and where the parties had acted knowledgeably, prudently, and without compulsion. So, what is the meaning of fair value? Fair value means, as of the commencement date, the insolvency CRP commencement date, that is, the insolvency commencement date, if I am

selling the same product outside or in the open market. I'm handling the marketing, etc., so after completing the marketing, an opposing person has made a prudent decision. If I sell the product in the open market, how much will I get? In simple language, how much am I going to get for the assets of the corporate debtor if I sell on the date of the insolvency commencement date? So that is called fair value. Fair value is the value that I am expected to receive if I sell the assets on the date of insolvency commencement. In the case of Dr. Vijay Radhakrishnan versus Bijoy P. Pulipra, RP of PVS Memorial Hospitals Private Limited, the NCLAT held that the estimated realizable value of the corporate debtor's assets is an estimate, as it is based on an estimation. If I am selling in the open market, what would be the value? So that's why, in this case, the law held that fair value is an estimated realizable value. In another case law, Dr. Periyasamy Palani Gounder v. Radhakrishnan Dharmarajan, R.P. of Appu Hotels Ltd. NCLAT held that CIRP regulations do not permit an asset-level valuation but require the corporate debtor to be valued as a whole. When performing the fair valuation, as we have already discussed, the registered valuer will conduct the valuation. So, when he performs the valuation, is he expected to do it for each asset separately? No, he is not expected to do the valuation for each and every asset separately. Overall, if I were to sell these assets, what value would I receive? So, we don't assess based on the asset classification, which is the class of assets. At the asset class level, we will not do that; instead, we will perform the valuation as a whole.

Then what is the liquidation value? As I mentioned at the beginning, this regulation should help you understand the concepts of fair value and liquidation value. So, what is the meaning of liquidation value? Regulation 2(1)(k) defines the term liquidation value. So, the liquidation value refers to the estimated realizable value of the corporate debtor's assets if the corporate debtor were to be liquidated on the insolvency commencement date. So, I'm not selling the assets. Imagine I'm liquidating, I'm liquidating the company. So, if I am liquidating on the insolvency commencement date at the rate of the insolvency commencement date, what value will I receive? That is estimated. So there is a meaning of estimated realizable value. So, how much will I receive if I liquidate the company today, which is the date of insolvency commencement? So that is referred to as the liquidation value. Please remember that the valuation can be, but it's not actually; it shall be. You have to interpret it as it shall be. So it can be undertaken based on any internationally accepted valuation standard. You can accept any of the international valuation standards, but it shall be one of the standards you are supposed to follow. You are expected to follow one of the internationally recognized standards for valuation. So, in the case of Mandeep Singh, suspended director of Satnam Agri Products Limited versus Mahesh Bansal, liquidator of Satnam Agri Products Limited, the NCLT held that the valuation should be done by two independent registered valuers. So, who is expected to do the valuation? The valuation must be done by two independent registered valuers.

So, if COC disagrees, there is a possibility that they can direct them for a fresh valuation as well. Again, a fresh valuation can also be requested.

In most cases, they will opt for a third valuation if any discrepancies are found. As we have already discussed, whenever you perform a valuation, you are expected to do so according to international valuation standards. Generally, there are certain valuations; this is an inclusive list, not an exhaustive one. However, in India, we typically follow these practices. The International Valuation Standards Council is a single council that sets international valuation standards, which are a unified set of valuation rules that we may follow. The Institute of Chartered Accountants of India has also prescribed valuation standards. You may follow those standards. Or else, the Companies Register Valuer and Valuation Rules 2017 are notified by the central government. So, you may follow either international valuation standards, or you may follow the standards prescribed by the ICAI (Institute of Chartered Accountants of India), or you may follow the valuation notified under the Companies (Registered Valuer and Valuation) Rules, 2017. So, that is up to you. You must follow one of the applicable valuation standards. Which one you choose is up to you.

Then, physical verification. So is it mandatory? Yes, it is mandatory. In the case of Appu Hotels Limited, the NCLAT held that the valuer is expected to conduct the valuation and perform the physical verification. So, who is responsible for the physical verification? Physical verification must be done by the valuer himself. Okay, so suppose the valuation is not done by the valuer, but his representatives, trainees, and assistants are present. So, his assistants are doing the physical verification. Will it be a valid verification? No. Therefore, the NCLAT held that the valuation process was vitiated because the registered valuer never physically verified the corporate debtor's assets, although a representative had physically verified them. So, though representatives are verifying such assets, they're not valid. The valuer is expected to verify the assets physically.

Then each asset class should be valued, so the asset classes are actually different. Whenever you are doing the valuation, we don't calculate or perform the valuation for each and every asset. I'm using the word very carefully: we don't perform the valuation for each and every asset, but we do, or we will, for asset classes. Suppose we categorize land and buildings as one class and machinery as another. These are one class under machinery; again, you can have many types of machinery. So, plant one, plant two, plant three, there are so many types of machinery. A lot of machinery can be there. So, whenever you are doing the valuation for each class, you will do okay; you will not do the valuation for each and every asset. What is the meaning of an asset class? An asset class is defined under the company's register values and valuation rules 2017. There is a definition. An asset class means a distinct group of assets, such as land and buildings. So, you may have many lands and many buildings, but collectively, they are referred to as land and buildings. Machinery and equipment display similar characteristics that can be

classified and require a separate set of valuers for each valuation. So, this is very important.

Each class is separate. When appointing valuers, not everyone may be eligible to perform valuations for each class. So, suppose you take the immovable property, the valuers will be different. If you take the securities, the valuers will be different. If you take the intellectual property, the valuers will be different. Depending on the nature of the assets, if you have IPR in your company, in the case of a corporate debtor, if the corporate debtor has any IPR, such as patents, copyrights, etc., then you are supposed to appoint a valuer who can do the valuation for intellectual property because each category is separate. Under the IBBI regulations, there are three categories of valuation examinations for qualified individuals who are eligible to take the valuation examination. Therefore, a separate qualification is required for each and every aspect. That is why a separate set of valuables is required for valuation. Then, the valuation report and the value it contains create no vested rights in favor of any creditor. If you examine this case law, specifically Dr. Vijay Radhakrishnan's case law, the NCLAT held that if a valuation report is based on the valuation report, it is stated that a certain person has certain rights; accordingly, this is the value assigned in the valuation.

That's it. Will it create any vested rights in favor of such a person, or will it create any vested rights in favor of the creditor? No, okay, so in this case law, it was clearly held that the valuation report is only an estimation and an aid to exercise commercial wisdom by COC. No vested interest can be claimed based on the valuation report. Therefore, based on the valuation report, you cannot claim any vested interest. It is only an estimate and is used solely for the purpose of informing the decision to be made by the COC. Then, there is confidentiality of the valuation and the valuation report. Section 29 speaks about the confidentiality of the valuation and the valuation report.

Let us look at Section 29. The Resolution Professional shall provide the Resolution Applicant access to all relevant information in physical and electronic form, provided such Resolution Applicant undertakes to comply with the provisions of the law for the time being in force relating to confidentiality and insider trading, and to protect any intellectual property of the corporate debtor that it may have access to, and not to share relevant information with third parties. The more important thing is that we have already discussed Section 29. So, whenever the resolution professional requests that resolution applicants submit a resolution plan, he is expected to provide the necessary information to the resolution applicant. Such information may be provided in either physical or electronic form. We have already discussed this point. However, the important thing is that he is the person receiving the information as a prospective resolution applicant. He is not supposed to share such information with related parties. So, unless you are complying with the law regarding intellectual property, you are not supposed to share the

information related to intellectual property, and you are not supposed to engage in insider trading, so these are the things you are supposed to follow. In the case of Appu Hotels, the NCLAT held that it is unclear whether these obligations extend to MSMEs or not. In this case law, the NCLAT observed that Section 29 exists and imposes a responsibility on the resolution applicant not to share information; however, it is unclear whether this provision will be applicable to MSMEs.

Suppose the corporate debtor is an MSME. Whether it is applicable to MSMEs or not, given that we have certain exemptions for MSMEs, is not yet clear. So we need to clarify this. The appointment of other professionals, apart from the two valuers, should also be noted; the resolution professional may also need to appoint additional professionals. If you refer to regulation 27 of the CRP regulation, it clearly provides that the resolution professional may appoint two valuers or any other professionals as may be required, as and when there is a need, because everything cannot be done by two professionals. Therefore, they also need to have other professionals, such as charity accountants, cost accountants, company secretaries, and legal officers; various offices are required during the resolution process. That is why the resolution professional, under Regulation 27, has the option and the power to appoint other professionals as well. Please remember that whoever has knowledge of financial discipline and a lack of conflict of interest is important. Therefore, when appointing other professionals, it is essential to verify whether they possess knowledge of financial discipline. Please verify. Generally, it's not only professionals with knowledge of financial discipline who can be appointed, but preferably, professionals with such knowledge are preferred. Additionally, legal professionals are also required. Why? Because if you want to deal with legal issues, you need to consult with legal professionals. That is why he is supposed to verify whether such a person has knowledge of financial discipline or not, and he should not be a related party; he should not have any conflict of interest. These things are supposed to be verified.

Let us discuss and recap what we have covered so far. In this lesson, we discussed that the resolution professional shall appoint a registered valuer, and when doing so, a minimum of two valuers shall be appointed. Valuers refer to those who are qualified and have passed the examination conducted by the IBBI, and are therefore registered valuers. Then two valuers must be appointed whenever there is a difference in the valuation given by these two valuers; if there is a major difference, then in such cases, you may appoint a third valuer, but under normal circumstances, two valuers will be sufficient. Then, when the valuer is subsequently appointed, he is supposed to determine the fair value and liquidation value. We have already discussed the meaning of fair value and liquidation value. In this lesson, we have discussed fair value and liquidation value. We then discussed the meanings of fair value and liquidation value, and also emphasized the importance of physical verification. Therefore, whenever the registered valuer performs

the valuation, they are required to verify the inventory physically. In one of the case laws we have discussed, if physical inventory and verification are not conducted by a professional but rather by representatives, then the valuation is not valid. So that's where physical verification is mandatory.

And subsequently, we have discussed that each and every class should be valued separately. As we have discussed, suppose land and buildings are present; there is one class, and they must be valued separately. But it's not that each and every land is to be valued separately. Okay. As a whole, one block of assets must be valued separately. Confidentiality should be maintained; therefore, whenever the valuation is done, as per the information memorandum, you are required to disclose this information to the prospective resolution applicants. If prospective resolution applicants request the information and have access to it, they are expected to maintain confidentiality. For this, we have already discussed the need for a non-disclosure agreement (NDA), and these are the various points we have covered in this class.

Thank you.