Insolvency and Bankruptcy Law in India

Dr. A. Sridhar

NALSAR University of Law, Hyderabad

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Lecture 42

Hi, welcome to the 42nd session, where we are discussing the Insolvency and Bankruptcy Code, with a specific focus on the liquidation of companies.

Lets quickly recap what we discussed in the previous session. We have so far understood what the term insolvency means, what we mean by bankruptcy, and the meaning of the word liquidation. We have understood different types of liquidation, including voluntary liquidation, as well as other kinds of liquidation, and the winding-up provisions under the Companies Act 2013, which are similar to liquidation. Lastly, we have understood what you mean by the term dissolution, and from today, we will understand the legal provisions pertaining to liquidation as enshrined in the Insolvency and Bankruptcy Code.

So, lets quickly move on. Firstly, Section 33, as I have mentioned before, encompasses the entire concept of liquidation within the IBC, which begins with Section 33 of the Insolvency and Bankruptcy Code. We are dwelling on the first section, which deals with liquidation, specifically discussing the circumstances that lead to its initiation, the conditions under which it can be initiated, and the conditions under which it cannot. Therefore, when we discuss the circumstances under which liquidation can be initiated, we understand that this is a standard methodology or set of circumstances under which liquidation can begin.

Lets examine the first case: whenever a rejection of a resolution plan occurs. Do you know why a resolution plan is generally rejected? The first and primary reason for the rejection of a resolution plan is when it is not in compliance with the provisions of the IBC, especially sections 30 and 31, which tell you what the contents of this resolution plan should be and what it cannot miss. Therefore, if the provisions of this section are not met, the resolution plan is rejected. Upon rejection of the resolution plan, the next step is the initiation of liquidation. Therefore, this is the first circumstance where liquidation can be initiated. The second one would be where the COC is unhappy about any resolution plan and feels that the proceeds it is going to receive under any resolution plan are far below acceptable standards; therefore, it feels that, rather than going for a resolution plan, it is better to actually do a liquidation, and hence, the COC decides to start a liquidation. In that case, it is also absolutely permissible under section 33 to initiate liquidation. So

far, the key points are the rejection of the resolution plan and the COCs decision to proceed with liquidation. Number three, the time given under the IBC for presenting a resolution plan has passed, and therefore, there is no further waiting for the resolution plan. In those circumstances, the adjudicating authority may also order the liquidation of the company on an application made by the resolution professional. The last one is that this is slightly different from all other circumstances; please note that in other circumstances, a resolution was never made or approved, and hence, it was a very straightforward scenario for liquidation. That is, if the resolution plan is rejected, the COC determines that the resolution plan is not viable, and hence liquidation is deemed necessary. The time allotted for submitting a resolution plan has elapsed, and therefore, there is no further waiting period. However, the fourth one you are looking at is now very different. What is it? In this case, a resolution plan was already approved by the adjudicating authority. The resolution plan is being implemented, and at this point in time, the resolution applicant, the successful applicant who took over the management of the company, is actually contravening the resolution plan that he submitted himself; hence, because the resolution plan is not being complied with and is contravened, it can be a very fitting scenario for the initiation of a liquidation.

As for Section 33, it outlines four circumstances under which liquidation can be initiated, and we are now very clear about all four of these circumstances. The next question would be, okay, the order of liquidation has been passed, and liquidation is being initiated. What are the effects of such initiation of liquidation? Which means, will there be a moratorium? Will there be any other benefits? Will there be any other special effects on the entire company? This is what we are trying to understand. This is reiterated in Section 33, which outlines the effects of initiating liquidation. First, no one shall initiate any legal proceedings against the company that is under liquidation; that is the first restriction or effect of the liquidation plan. Two, you, uh, I mean, even the corporate debtor, which is a CD, cannot initiate any proceedings against anybody, so it cannot fight a legal case on behalf of itself, nor can it actually defend itself in any legal case because the institution itself is not allowed.

However, the liquidator may initiate legal proceedings against any other debtor of the CD with the special permission of the adjudicatory authority; in our case, it will be the NCLT. The order shall be deemed a notice of discharge, which means that the moment the NCLT confirms this is a fit case for liquidation and liquidates the CD, the order shall take effect. This order, given by the NCLT, is a discharge notice to the employees, officers, and workmen of the company, which is very important. That means they need not be given a separate letter of termination by the company again, but the order given by the NCLT itself will serve as a discharge notice, and their employment comes to an end with immediate effect upon the passing of such a liquidation order. However, there is one exception to the entire scenario: the employees and workers may not be discharged if the

corporate debtors business continues during the liquidation process. Only then is it an exception. Otherwise, in all other cases, it is deemed that this is a notice of discharge for all the employees, workmen, and officers of the company.

To understand the circumstances that led to the initiation of liquidation and its effects, lets examine a key case involving Jigar Tarun Kumar Bhatt, Resolution Professional of Eternal Motors Pvt. Ltd. In this case, the Ahmedabad Division Bench in Court Number One has dealt with certain matters under Section 33. Well see what they are. First, lets try to understand the facts of the case. Eternal Motors Pvt. Ltd. filed for CIRP under Section 10 of the Act; we are aware that Section 10 is a provision that enables the CD itself to file insolvency proceedings. So, when the CD files are under section 10, what happens is that the Honorable NCLT passes orders for CIRP, the RP makes several public announcements, and issues RFRP. RFRP is a request for a resolution plan, which means that as a resolution professional of a CD, I am inviting various parties to submit their resolution plans. Despite several attempts, the resolution professional was unable to receive any plan that actually met the criteria mentioned under Section 30, subsection; hence, the COC advised the RP, that is, the resolution professional, to apply for liquidation.

However, remember one thing: to decide whether to liquidate or not, it is only the adjudicatory authority that is empowered; hence, the adjudicatory authority will, by an order, ask for liquidation, but no other party can decide; they can only recommend, advise, and make an application, but the final order comes from NCLT; until then, the liquidation cannot begin. So, the COC advised the resolution professional to make an application to the NCLT seeking liquidation orders. These are the five important facts. Then, what are the legal issues involved in the proceedings? Number one: Can the application for liquidation be made where a resolution plan has already been submitted, though it is not in compliance with the provisions of section 30? While the plan has been submitted, is it a fit case for liquidation? This is the primary issue that the NCLT should observe now. Second, can the honorable NCLT allow liquidation in such scenarios? Third, what would be the consequences of such orders of liquidation? These are the three primary issues that the Supreme Court, specifically the NCLT Ahmedabad division bench, had to consider to decide what happened there. NCLT Ahmedabad has decided in the following manner and passed an order.

The first point under the order stated that it allowed the liquidation because the resolution plan did not meet the specified criteria. So, remember, under Section 33, the first circumstance I mentioned is when a resolution plan is rejected. Owing to not meeting the criteria given in section 30, subsection 2, it is a very, very fit case for the initiation of liquidation. Exactly that is what happened in Jigar Tarun Kumar Bhats case, where he was an RP of Eternal Motor Private Limited. The company had a resolution plan, but it was rejected on the grounds that it did not meet the basic criteria outlined in Section 30,

Subsection 2. Hence, the NCLT Ahmedabad stated that it was a fit case for liquidation. Number 2: The cost of the liquidation shall be borne by the claimants in proportion to their claim ratio. We will deal with the matter in a while, but while we were covering the distribution of proceeds under the IBC, we observed a waterfall mechanism that prioritizes payment.

Similarly, even in the case of liquidation, we have a priority regarding who gets the payment. However, the point here is that if the sale proceeds from the assets are insufficient to cover the cost of liquidation, then the claimants must provide for the cost of liquidation in the same ratio as they claim the proceeds. This is a crucial part of the order, and it is a direct result of the liquidation order. Third, the third effect of the order is that no cases can now be instituted against the CD, as the NCLT has passed an order for liquidation. And the fourth and very important consequence of the liquidation order that they clearly stated is that this liquidation order shall be an order or notice of discharge for all the employees, workmen, and officers of the company. This is exactly what we understood from section 33. I hope you are now clear about Section 33.

To recap and summarize, Section 33 provides for two things. First, the circumstances for initiating liquidation: there are four circumstances that we have discussed. Number two, it discusses the effects of passing a liquidation order, which prevents suits from being initiated against the CD and serves as a discharge order for all employees, workmen, and officers of the company.

Lets turn to Section 34 of the Act, which is the second section under the heading of liquidation. The appointment of the liquidator and the fee, as we understand, will be carried out by a qualified insolvency professional, who will be referred to as the liquidator for the purposes of liquidation proceedings, in accordance with the entire process of liquidation outlined in the IBC and IBBI regulations. He will be termed a resolution professional. In the case of a CIRP, he will be termed a liquidator in the case of a liquidation. So, how and by whom will this liquidator be appointed? Can he be changed subsequently? And what is the component of the fee to be paid to the liquidator is what is enshrined in section 34 of the IBC. So, the first point. Section 34 empowers the National Company Law Tribunal, as in our case, to appoint a liquidator after the commencement of the liquidation process.

The moment the NCLT pronounces that there should be a liquidation, at that very moment, the NCLT will have to appoint a liquidator because he is the one who is giving effect to the order, without which it cannot proceed forward. And remember one thing: as far as the liquidators appointment is concerned, there are two questions. Number one: Can the existing RP continue to be a liquidator? Yes, an existing RP can continue to be a liquidator unless and until they have done certain things that will disqualify them from being a liquidator, which we will address shortly. Number two, can this liquidator be

eventually replaced, and who has the authority to make the decision regarding the appointment or replacement of a liquidator? Therefore, remember, my friends, as far as the appointment is concerned, it is an order of the NCLT that will decide who can be the liquidator. In the majority of cases, it will be the RP who handled the insolvency that will continue to serve as the liquidator.

Thats exactly what is written in the second point. The RP will continue to be the liquidator unless the order specifies otherwise. What they will specify is what we will deal with shortly. Then we come to Section 34, Subsection 4 of the IBC, which discusses the replacement of an RP. Why, how, and when should the RP be replaced? Lets think logically. Why should the RP be replaced? RP will be replaced because there is a specific issue with the RP that could be a disciplinary matter, a matter of non-performance, or a matter of disqualification, correct? In those cases, if you decide to replace the RP, the procedure we are discussing is the one we are referring to. The adjudicating authority, mark the word here, shall by order replace the RP; is it a discretionary power of the adjudicating authority, or is it bound by the words of section 34? Mark my words, my friends: wherever the section uses the word “shall,” it casts a certain responsibility or obligation on the adjudicating authority to actually do a certain thing. What it will do is replace the RP if the resolution plan submitted by the RP is rejected for failure to meet the requirements of Section 30, subsection 2. All right. So what we are saying is that the resolution plan given by a resolution applicant was accepted by the RP; he had presented the same to the COC without considering the fact that this resolution plan is completely missing the provisions of Section 30, subsection 2, in which case it actually disqualifies the RP from being appointed as a liquidator—a very, very important aspect.

Lets move on to the second point. The second point states that the board recommends replacing an RP with the adjudicating authority, for reasons to be recorded in writing. Whos this board? This board here is the Insolvency and Bankruptcy Board of India. The IBBI may have some disciplinary issues against the RP and, therefore, recommends to the AA that it replace this RP for certain reasons. In the third case, the RP fails to submit his written consent under section 34, subsection 1. So, remember, if I am an RP and I want to continue as a liquidator in the liquidation process, then I must submit my consent to act as such within the stipulated time. Why is that required? Most of the time, RPs may not wish to continue to be a liquidator. Therefore, it is essential for the adjudicatory authority to verify whether the RP wishes to continue as a liquidator or not. If the RP does not give consent within the stipulated time, they will not be appointed as a liquidator; instead, another person will be appointed to act as a liquidator. So, these are the primary reasons for which the RP can be replaced.

We recall that we have covered sections 33 and 34 so far. Section 33 discusses circumstances, and Section 34 addresses the appointment and replacement of a liquidator. We are now moving forward to Section 35 of the Act, which outlines the powers and

duties of the liquidator. This is a very important section; most of the time, we, as liquidators and resolution professionals, get confused about whether we can do a certain thing or not. Provisions like this will bring clarity to the limitations of his powers and the scope of a liquidators actions. The first power of the liquidator is to manage and sell the companys assets. As we recall, the term liquidation itself refers to the process of selling the assets of the corporate debtor, receiving the sale proceeds, distributing those proceeds to the companys creditors, and ultimately dissolving the company. The duties of the liquidator include, firstly, managing the assets and subsequently selling them. What do you mean by managing the assets? Until we sell the assets, lets say I have a hotel property that is operational, and as a liquidator, I must sell this hotel property. We must maintain the property in a certain state and manner until it is sold; only then can it be sold. Therefore, managing and selling the asset will both be part of the liquidators powers.

Second, he can formulate and execute a liquidation plan outlining how he will sell these assets and distribute the proceeds to creditors. In this, its very important to understand whether he is going to sell the assets one by one or whether he is going to sell the assets in a slump sale; that is a call to be made by liquidators. Thats why its called a liquidation plan. Then, after you make a plan, you really dispose of the companys assets. How do you dispose of them? It is already stipulated in the IBBI regulations that disposal is your power, followed by paying creditors in the order of priority. When discussing payment to creditors, it is essential to remember Section 53 of the Act, which outlines the waterfall mechanism, detailing how proceeds should be distributed, who has priority, and who comes next. Then, filing claims for debts owed to the company is very important. I am a corporate debtor myself; I owe money to someone, but I am also a creditor to someone else. So, someone else owes me money as a corporate debtor. As a liquidator of this corporate debtor, it is crucial that he recovers the money owed to the corporate debtor, consolidates the entire proceeds, and distributes them to the creditors of the corporate debtor; this is a very important function. Then, in the event that anyone initiates a legal proceeding against the company or the company initiates legal proceedings, the liquidator will represent the company in all proceedings. We recall that Section 33 parses unless a leave is granted by the adjudicatory authority. Lastly, we should report to the tribunal on the plan of action, how it was implemented, and why its a fit case for dissolution.

There are a couple of case laws that give us clarity on how Section 35 operates. If you examine Mr. Kiran Shah, the liquidator of Org Informatics, it becomes clear. This was at the NCLAT in Delhi; NCLAT is an appellate tribunal, whereas NCLT is an adjudicatory authority. Remember that. It is Punjab National Bank versus Kiran Shah. The facts of the case are that COC made an application for the removal of the RP after the liquidation order was passed. Remember, the first question was who appoints the RP and who replaces the RP, right? Here, the COC has decided to replace the RP. Therefore, it seeks a

new liquidator and has filed an application with the NCLT for the appointment of a liquidator who is not the same as the RP. Second, it has not shown any valid reason for such removal or replacement of the RP. If this is the application made by the COC, part of the COC, or one creditor, then what will be the issue? The issue is simple. Whether COC has such power to make an application where there is no specific legal provision.

Now, there are two things. If there is no specific legal provision, we can refer to it as an implied power, or we can say that such a power does not exist at all. For the common person, those learning the law, or even experts, it can be very confusing at times. Therefore, it should be a matter to be decided by the adjudicatory authority once and for all. So, what happened? What did the NCLAT say? NCLAT concluded that when there is no specific power given in the provisions of the Act, you cannot deem that power or presume that power, and hence, the COC or any part of the COC creditors cannot make any application for the replacement of the RP.

Then the next case is SIDBI versus Tirupati Jute Industries Limited. This again revolves around Section 34 of the Act, which deals with the appointment and qualification of a liquidator. The adjudicating authority was the NCLT Kolkata Bench, and what are the facts? The fact is that the resolution plan submitted by the applicant was subject to many conditions; it was not in conformity with the legal provisions outlined in Section 30; therefore, the COC should not have approved such a plan. However, the COC approved the plan; the RP should have advised the COC not to do so, but it was overlooked by both the RP and the COC, and ultimately, it was admitted. Issues include whether the application for liquidation should be allowed where the RP is appointed, and whether the RP is appointed as liquidator. Now, here, remember that although the plan was approved by the COC, it was eventually rejected by the NCLT because it did not meet the criteria mentioned in Section 30 of the Act.

In such a case, is it a fit case to pass a liquidation order? Yes, Section 33 of the Act says, yes, its a fit case to pass the liquidation order, but what is the context? The context is Section 34 of the Act. Now it is asking whether the RP can be appointed as the liquidator. Now you can see the last line, which has a punch of the decision that says that because the RP did not advise the COC about the resolution plan and the laxity of compliance with section 30, the RP now cannot be appointed as a liquidator because he failed to watch that very, very important condition. This acts as a disqualification for the RP, and hence, he cannot be appointed as a liquidator. Now we know what Section 33 is, and we know what Section 34 is.

There is another case, IFCI Limited versus BS Limited, again involving Section 34 of the Act, before the NCLT in Hyderabad. Issues involved are: can the COC make an application for the replacement and removal of a liquidator? Remember, the appointment was made by NCLT. However, if COC is not satisfied, can they submit an application to

the NCLT and request the removal of the liquidator? A fantastic context and a wonderful decision given by the NCLT Hyderabad. It says that section 34 does not deal with the replacement and removal of the liquidator at the instance of creditors and claimants, so as creditors and claimants, your role of dominance is substantial throughout the CIRP, but the moment the CIRP is done, and we are talking about liquidation, the role of the COC is minimal. You can receive the sale proceeds distributed to you by the liquidator, but you cannot make an application to remove or replace the liquidator, as this order was passed by the NCLT.

Fantastic context. One more point on a similar line: Section 35 of the Code; the NCLT Hyderabad issues involved are whether the consultations of creditors have a binding effect on the liquidator or not. Now, what we are saying is if the liquidator consults the creditors and takes their opinion, and the creditors give an opinion, is such an opinion binding on the liquidator? Shall he follow that? Now, the NCLT gave a clear decision from Hyderabad, which says in the second line of the conclusion that, if you see, the proviso makes it amply clear that the consultation is not binding on the liquidator; hence, he may or may not follow the opinion rendered by the COC when he consults the COC.

Lets quickly wrap up our session. What is it that we have discussed so far? We have discussed sections 33, 34, and 35, 33 states how to initiate liquidation. There are four circumstances, and the effects of liquidation are what we have completed. 34 discusses the appointment and replacement of the liquidator. We have very clearly understood that the liquidator can be the RP. If RP was throughout CIRP, he can also continue to be the liquidator. However, if you have not observed minor things like section 30 and have approved the resolution plan presented to COC, then he will be disqualified from acting as the liquidator. Then, lastly, we have seen the powers and duties of the liquidator. We said that the liquidator may consult the COC, but he need not be bound by the consultations with the COC.

This brings us to the end of Session 42.