

Insolvency and Bankruptcy Law in India

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Lecture 43

Hello, welcome to the 43rd session on IBC, specifically focused on liquidation.

Let's recap what we have done in Session 42.

In session 42, we discussed the circumstances that led to the initiation of liquidation. After that, in section 34, we saw how to appoint and replace the liquidator. In section 35, we saw the powers and duties of the liquidator. Along with certain case laws, I hope you are very clear, and I am sure you are revising from time to time. So let us go forward. Today's session is slightly longer. We will have more syllabus to cover. Therefore, we will provide quick coverage today. Once you understand this, you will know how liquidation typically occurs and what type of liquidation estate will constitute the sale proceeds. The liquidator creates a liquidation estate for the CD's assets; that's the first thing. The liquidator now holds the estate, having created it within the asset base of the liquidator. However, the liquidator does not have any title to the assets; they will not enjoy the benefits of that estate. Instead, the liquidator will act as a trustee for the benefit of creditors. In other words, we refer to it as a fiduciary capacity, in which he holds these assets, and hence he is accountable to creditors for the sale proceeds. In the last line, there are certain inclusions and exclusions for the liquidation estate; we will shortly see what these inclusions and exclusions are.

Without wasting time, let's go to the next slide, and what are these? These are simply inclusions in the liquidation estate. This means that the following types of assets can be included in the liquidation estate, as mentioned in Section 36. What kind of assets can be part of the liquidation estate, on which creditors will ultimately have a beneficial interest? Number one assets on which the debtor has ownership rights include certain plant and machinery whose owner is a corporate debtor, which are certainly part of the liquidation estate. I won't go into depth with that; it is pretty easy to understand, you know, ownership rights. Two intangible assets, such as copyrights, patents, trademarks, designs, etc., which are not tangible assets, can also be part of the liquidation estate. For example, if you know Chhota Bheem, it's a brand, right? However, Chhota Bheem, apart from producing animations, does not create a large number of articles and goods; however, you can see Chhota Bheem's characteristics being applied to hundreds of items and products.

The trademarking of the Chhota Bheem character will result in millions of rupees in revenue for the company that owns the rights. So, you know, IPRs are not something that are, you know, very cheap. Depending on what kind of intellectual property or intangible assets you have created, they can yield phenomenal sale proceeds at times, and they are an important part of your liquidation estate. Any relinquished security interest that you think I don't want for now includes assets in position, including encumbered assets. Any assets in the possession of the company under liquidation can also be considered part of the liquidation estate, including encumbered assets and assets under dispute. However, the sale proceeds will become part of the liquidation estate only if the dispute is resolved.

Then, any property vested in CD at the beginning of the CIRP will also be part of the liquidation estate, including tangible assets such as movable and immovable properties, as well as assets or value recovered through avoidance proceedings. This is an important part of the entire liquidation process; please note that we refer to it as avoidance proceedings. Mark that, write it somewhere, and eventually, when we are talking about the entire liquidation process, I'll make it very clear to you what kind of asset that is. Currently, we are trying to understand whether, if you have taken proceedings against any party under avoidance transactions and recovered any money from such proceedings, that amount will become part of the liquidation estate. Lastly, the proceeds of liquidation will become part of the liquidation estate, and all this should be paid to the creditors. This is important.

Then, the next obvious question is: what are the exclusions that cannot form part of the liquidation estate? These are the exclusions. First, obviously and logically, assets owned by a third party, although they are in possession of the CD, cannot actually be part of the liquidation estate; those should be returned to the third parties. Workmen's dues, such as the provident fund, which is accumulated but not paid to the employees if it is lying in your bank accounts, cannot be treated as an asset of the company; it has to ultimately go to the workmen and employees; hence, that will not form part of the liquidation estate. Please mark these words.

Then, assets in security collateral cannot be part of the liquidation estate. Let's say you borrowed a certain loan from a certain bank, and you have given a certain property as collateral to that bank. If there's a default in repayment, the bank will have the first right to such security and collateral, and therefore it cannot be part of the liquidation estate. Then, if you look at the second row first, it talks about assets held in trust for a third party. The third party has given you certain assets and instructed you to Please hold these assets for me. Those assets cannot be part of the liquidation estate. Non-transferable contractual assets that you're holding cannot be like hired machinery that is with you. They have to be returned one day. These are not transferable to you and, therefore, are not part of the liquidation estate. Personal assets of shareholders, which have been given to the company for temporary use, or those of partners, which have been given for

temporary use, cannot be considered part of the liquidation estate. Bailment contracts, where the goods are held for a temporary period and then returned, can involve any property.

Then, the next one, if you look at the third row, second column, we are referring to other assets, as notified by the central government, that may not be part of the liquidation assets. Then, assets belonging to the subsidiaries of the holding company will be held as shares in the subsidiary company, but the assets of the subsidiary company will belong to the holding company. The holding company will not have any rights to any particular asset of a subsidiary company; hence, it is not part of the liquidation estate. I'm sure, now, with the help of these two slides, we are clear about what inclusions can be included in the liquidation estate and what exclusions cannot be included in the liquidation estate. This is all about Section 36.

Now, let's examine a case law that provides greater clarity on how to interpret Section 36. This is a dispute between BR Traders and Venkat Ramana Rao, Nagarajan, and others. This pertains to Section 36 of the Act and the adjudicatory authorities, specifically the NCLAT, not the NCLT. Therefore, remember, it's an appeal to the appellate tribunal. Facts of the case. The appellant claimed, whoever was making that case, that the machinery belonged to it rather than the corporate debtor. White Clause 15 of the Internal Agreement entered into between them. Therefore, someone has provided machinery to the CD under an agreement in which Clause 15 states that the machinery belongs to a third party, not to the company. So, the appellant is claiming rights to that machinery under the agreement. Fact number two. The Resolution Professional, with reference to Section 36 of the IBC, denied the fact that there was any such agreement or any such right. He states that there are several claims and counterclaims between the parties; hence, it is unclear who owns what, and he wishes to bring it to the liquidation estate under Section 36 of the Act. Now I'm sure you understand what the issue is. The issue is to determine who will be the rightful owner of the property and whether it should be included in the liquidation estate or not.

Now let's see what has come. This is the issue, as I said. Firstly, the terms and conditions of the agreement will prevail over the IBC, which has an overriding effect on both the IBC and the agreement. Two, the appellant argued that the asset to be handed over to them should not form part of the liquidation estate; therefore, the NCLAT shall now determine conclusively who should be the rightful owner of these assets. Analysis, we are saying again and again, that we have to look at various Supreme Court and NCLAT-decided cases to understand that the IBC will have an overriding effect on all agreements between the parties. Whenever there is a conflict between the IBC, its provisions, and private contracts between the parties, the IBC generally prevails, with its provisions having an overriding effect. That's analysis number one. Analysis number two: The Apex tribunal held that the appellant shall only be able to recover its claim as part of the

resolution plan, or, if the same is not approved, as a claimant in the liquidation estate. If you think that you have rights to property, you can claim your money under the resolution plan, or you can claim under the liquidation plan, but you cannot insist that the assets be returned to you.

Let's look at the conclusion here. In conclusion, the NCLAT held that machinery forms part of the estate of the corporate debtor, and the appeal was dismissed; hence, the liquidator will prevail, and this asset will be included in his estate. NCLAT held that the act of the resolution professional was absolutely correct and directed accordingly to continue the liquidation proceedings. Now we are clear about what Section 36 is saying. There is also one more case that makes it very clear what cannot be part of the liquidation estate. This is section 36 of the Act, Precision Fasteners Limited versus Employees Provident Fund Organization. The NCLT Mumbai bench is dealing with this matter, and the issues involved are, first, whether the provident fund and pension fund, which are due and payable to the workers but have not been paid yet, will be part of the liquidation estate of the CD or not. Without showing you the result, I want you to quickly stimulate your brain. You know, think about what we have read under section 36 in the inclusions and what we have read under section 36 under the head exclusions. Do you think the provident fund and pension fund will be included or excluded? Quickly. I'm sure you've got the answer, but anyway, let me proceed and tell you what the conclusion is. The conclusion is that the NCLT held that, in light of section 36 of the CODE, the dues in respect to the provident fund, pension fund, and gratuity fund are not part of the liquidation estate. It is a resounding verdict that there will be no dispute in future cases regarding PF, gratuity, and other employee benefits. We now proceed to Section 37, which discusses the liquidator's powers to access information. There is not much to this that is particularly complex or analyzable.

Let's quickly review the provisions of the section and what it says about how you obtain your information. The only thing you must note about this section, as a Liquidator, is that unless you have information on what assets you have and who owes you money, you cannot actually make a great liquidation plan. Hence, section 37 gives a specific power to the liquidator to obtain information, and he will have access to information from the following sources, right? Let's examine sources for access. Number one, whenever in doubt about information, he can have full access to the information utility to understand the company's debts and borrowings, as well as the available assets.

Then the credit information system maintained by various agencies across the CIBIL rating is what we call that will affect your credibility, right? So, the credit information system is what we broadly refer to it as, and the liquidator shall have access to the credit information system to understand what information is available. He will also have access to the government agencies' financial and non-financial liability systems, securities, assets, and information database maintained by IBBI and various other sources. So,

whenever I am in the capacity of a liquidator, if I request information from any of these listed sources, they shall provide me with timely information. Additionally, Section 37 states that the right to information extends not only to the liquidator but also to creditors. Therefore, they can also seek information or ask for information from the liquidator, in which case, there are primarily two responsibilities or obligations on the liquidator. Number one, he shall provide the requested information within seven days from the date of the request. And if he cannot provide the requested information, he must provide a reason for his inability to provide the information to the creditor. So, 37 is simple; the liquidator has a right to information. He can access various government agencies and utility centers to obtain information. Number two, creditors have a right to access; therefore, they can request information from the liquidator, and the liquidator is obligated to provide it to them.

Let's move forward. Now we go to section 38. This discusses the consolidation of claims. What do you mean by that? There are two types of claims. Firstly, I can claim in my capacity as a financial creditor. Number two, I can claim in the capacity of an operational creditor. How should I claim if I'm a financial creditor? How should I claim if I'm an operational creditor? And if I'm both, it is sometimes possible for a certain agency to be both a financial creditor and an operational creditor. Then how should I claim? All of those are written clearly on this slide. Let's move forward to understand. First line. The liquidator must receive or collect creditors' claims within 30 days from the commencement of liquidation. Therefore, he creates an advertisement and invites everyone to submit a claim to the liquidation estate, with a deadline of 30 days. Now, if you are a financial creditor, how do you submit your claim? Very simply. You must give a record of the claim, which will act as evidence.

If an information utility maintains a record and puts your name as a creditor with a certain sum of money, this is enough evidence to say that you are a creditor and you can make your claim. How do you make your claim? I already said with the help of the record. But if the claim is not recorded in any information utility's books, then you must submit a specified form as well as supporting documents, which can be substantial evidence for your claim to the corporate debtor. This is part one, which is a financial creditor. On the other hand, if I'm an operational creditor, please note that in such cases, there will be no recorded evidence in the information utility. Therefore, the operational creditor shall always submit a specific form, along with supporting documents, to establish their credit with the corporate debtor. However, if a creditor has both, they must make two separate claims in two distinct ways that we have discussed so far. Lastly, the most important point is that a claim can be withdrawn if you believe it is not viable, or you can modify the claim if you feel that you have under- or over-claimed your money from the corporate debtor.

Let's move on to Section 39. Section 39 talks about the verification of claims. What do you mean by verification? If you are asking everybody to claim what they want from the liquidator, everyone in the world can make a claim and say that, you know, the CD owes them money. As a liquidator, it is my primary responsibility to determine whether the claimant is stating the truth and whether their claim is accurate. This entire process is referred to as the verification of claims. The Liquidator must verify the claims submitted under Section 38 within the time period specified by the board. We will eventually see the time period, but let's try to understand the section first. How does he verify? He will look at the supporting documents. He will look at the record produced by the financial creditor and determine whether this claim is genuine or not. And if it is an original, genuine claim, then he's going to admit that. The liquidator may request any creditor or the corporate debtor to provide additional documents or information if they are not convinced that the claim is complete. Therefore, he can ask for more and more information until he is convinced. And once he is convinced, he will make a decision. This is Section 39 of the Act. We've seen that, basically, there are claims and verification of the claims. And after the claims are verified, of course, you now have to decide whether you are going to accept that claim or reject it under section 40.

After verifying claims, the liquidator may admit or reject a claim either in whole or in part. Always remember that if an excess claim is made by the creditor, the liquidator may accept a reasonable claim and reject only those that exceed the acceptable limit. In that case, it will be a partial acceptance. In some cases, he may totally reject the entire claimed amount. This section provides phenomenal flexibility, as the liquidator may partly accept your claim and partly reject it, or he may wholly accept or wholly reject your claim. But if the claim is rejected, the liquidator shall provide his reasons in writing. The liquidator must communicate the decision of admission or rejection to every claimant within seven days of making the decision. In the case of Prasad Gempex v. Star Agro Marine Exports Pvt. Ltd., Section 40 of the Act was dealt with by the NCLAT in New Delhi. Watch it. It is not the NCLT; it is the NCLAT. Therefore, it will be an appeal to the appellate tribunal. The issue involved whether a creditor can file a claim after failing to resolve the plan. The point is simple: I would have made a claim and a resolution plan if it had failed; otherwise, I wouldn't have made a claim. It doesn't matter.

Now, when it comes to liquidation, can I make a fresh claim again? That is the question. So, what is the answer? The NCLAT decided that, in the event the resolution plan is not approved and the order of liquidation is passed, the parties will always be open to filing a fresh claim before the liquidator under Section 40 of the Act. Therefore, the failure of a resolution plan or a CIRP does not affect the rights of claimants in any way. Consequently, they can make a fresh claim in the context of liquidation as it stands. So, we have come to the end of session 43, in which we have understood five different sections, starting with the liquidation estate, what inclusions are, what exclusions are, the

powers of the liquidator to access information, and how claims are made by the financial creditor, operational creditor, and a person who is both. And finally, how does a liquidator verify the claim and, if he has made a decision to accept or reject a claim, within what time should he communicate? Remember, 30 days is the time frame for making the claim, and once the decision is made by the liquidator, he shall inform all concerned parties within seven days of his decision.

So, this brings us to the end of session 43, my friends. We will meet in session 44.