

Insolvency and Bankruptcy Law in India

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Week 09

Lecture 44

Hello, welcome to Session 44 on Liquidation under the IBC.

Let's quickly recap what we did in the previous session. In the previous session, we covered five sections, spanning sections 36 to 40, where the liquidation estate, including its inclusions and exclusions, was discussed under section 36. Powers of the liquidator to access the information were discussed under Section 37. Consolidation and making of claims were discussed under Section 38. Verification under Section 39 and admission or rejection of claims under Section 40.

This is what we discussed yesterday. Going forward, we will discuss several other aspects of the liquidation process. Section 41 now deals with the determination of the valuation of claims, which is a very important part, as we have understood in Section 40 that a liquidator may partly accept and partly reject a claim, wholly reject a claim, or wholly accept a claim; however, it is crucial to first understand the valuation of the claims, as only then can he decide whether to accept or reject the claim. Therefore, the liquidator shall determine the value of claims admitted under Section 40 in a manner specified by the board. Only the board will instruct you on how to accept or reject claims and how to value them. Section 42 says that if a certain claimant is unhappy or aggrieved by the decision of the liquidator to accept, not accept, partly accept, or partly reject a certain claim, then what can the claimant do? Obviously, the claimant should now go and appeal. Appeal where? The appeal should obviously be made to the adjudicatory authority. We will quickly see how it works. If you examine the picture, it indicates that once you make a claim under Section 38 and the verification is completed under Section 39, the liquidator will inform you, under Section 40, whether your claim is admitted or rejected. In that case, there are two things that are probably going to happen: either he will accept your claim, or he will reject your claim.

Let's look at the rejection. The moment he rejects the claim, you have the right to appeal to the NCLT. However, on the other hand, if he accepts your claim, you still have the right to appeal. The logical question is, if the claim is accepted, then why should I appeal? Obviously, we are saying that if the claim is partly accepted and partly rejected, or if the valuation of the claim is substantially less than what you have claimed, that's

when there is probably a chance for you to appeal to the NCLT. And what is the time limit within which I can make an appeal? A very important question: You should make the appeal within 14 days from the date of receipt of the information from the liquidator. Remember, it is not the date of claim, nor is it the date of decision; it is the date of receipt of the communication from the liquidator regarding their acceptance or rejection of the decision. From there, you will have 14 days to go to NCLT and seek admission of the claim. Straight away, there's a case law: IFCI Limited versus BS Limited, with legal provisions affecting Section 42 of the Code. Then we have the adjudicating authority sitting at NCLT Hyderabad. The issues involved are straightforward: can the NCLT exercise its inherent powers and condone the delay in filing an appeal? Let me explain the issue to you once again: if your claim is accepted or rejected, you can make an appeal to the NCLT within 14 days from the date of receipt of the claim or the date of receipt of the communication. However, if you have delayed this appeal by 10 days and then go to the NCLT to make an appeal, your appeal will obviously be delayed. Now, can you see the condonation of delay? Is there any specific provision in the section for the condonation of delay? If there is no such provision, can we assume that the NCLT has an inherent power to condone the delay? The conclusion is very clear, loud, and simple. There is no provision under Section 42 for condonation of delay. The Honorable NCLT held that when there is a clear statutory bar to entertaining an appeal under section 42 of the IBC that is filed beyond the prescribed period, the NCLT cannot exercise its inherent powers to condone the delay; therefore, the appeal cannot be made anymore.

In Section 42, I have jumped a few sections and come to Section 52; let me go back to the previous section that we have covered. We have covered Section 42 and a case. After that, we move straight to Section 52. I have skipped a few sections in between for a reason. The reason is simple. These are known as extortionate fraudulent avoidance transactions, which can be avoided by the company. All the proceeds can be recovered by the company during the liquidation process if it becomes aware of illegal transactions. However, those are complex in nature. I have saved them for the next session, so for the current session, we will focus on Section 52 and explore the position of a secured creditor.

Let me explain to you, before I read out the provisions of section 52, what the confusion is here. If I lend a loan to a company and have an asset as security, will that asset now be part of the liquidation estate? As a creditor, can I retain this asset without being involved in the liquidation proceedings? This is a very important question because the majority of creditors who hold a secured asset would not wish to be part of the liquidation proceedings and would prefer to walk away with the liquidation asset. This can be a major concern for the liquidator. Hence, Section 52 makes it very clear, although eventually, numerous case laws have been decided in favor of or against the liquidator. However, let us first attempt to understand the provisions of Section 52. So, let me repeat

the confusion: should a secured creditor take possession of its asset and walk away, or should it participate in the liquidation proceedings and make the asset part of the liquidation estate?

So, the options at the hands of the secured creditor. A secured creditor in the liquidation proceedings may, but is not obliged to, relinquish its security interest in the liquidation estate and receive proceeds from the sale of assets. Right, so you have an asset you don't want to take away; you want to make it part of the liquidation estate, let it go through the sale, and then you will wait for the same proceeds to come your way. This is option one, or option two is to realize your own security interest in the manner specified in this section and walk away with this asset, and therefore not wait for the liquidation proceedings. You can realize your own assets. These are the two options available under Section 52. While you have these two options, the liquidator will always remain uncertain about your decision. Hence, it is your moral and legal responsibility to inform the liquidator of what your stand is. Your stand is to make it part of the liquidation proceedings or to, you know, realize the asset by yourself. You have to inform the liquidator of your decision as soon as possible. And number two, identify the asset that you are making part of the liquidation estate or retaining for your own realization.

When making a claim on an asset and wanting to retain it for yourself, it is crucial to verify the security interest. Before realizing the security interest, the liquidator must verify it. The creditor can only realize a security interest that is provable through; remember, you should be able to prove your security interest in the following formats. Only then can you truly realize your security asset. Otherwise, you're part of the regular liquidation proceedings. Part A states that you must be able to prove your claim or asset through records maintained by an information utility. If your debt is recorded, your asset security is recorded, and the asset is identified, then you can walk away with your asset.

Alternatively, if you can prove your claim or security interest in any other manner specified by the board, then your interest is verified, and you can proceed with the assets. Lastly, the enforcement and application of proceeds. What do you mean by that? After you have walked away with the asset, what will you do with those proceeds? First, the secured creditor may enforce, realize, settle, compromise, or deal with the secured asset in accordance with applicable laws and use the proceeds to recover its own debt. Now, watch an interesting scenario. I have lent five crores to a borrower. Right, he has given me an asset as collateral for the mortgage. Now I have walked away with this asset. When I sell this asset, I get only 2 crores against my 5 crore debt. This is one possible scenario. The other possible scenario is that I sold this asset for 10 crores, whereas my debt is only 5 crores. One is a case of under-recovery, and the other is a case of excess recovery. What should be the consequence in both cases? We will deal with that.

Resistance in realization. Let's say that if the secured creditor wants to walk away with an asset and realize it by himself, and somebody is causing trouble or is actually putting up resistance to the process of realization, then such a creditor can apply to the adjudicating authority to facilitate the realization of his own asset, in which case the AA will interfere and ensure that the sale and realization process is smooth. What can the order from the adjudicating authority be? The adjudicating authority may pass an order to help the secured creditor realize the security interest in accordance with the law, and this makes your life smoother in realizing the asset. As I said, when you realize the asset, there are two consequences. One is that you recover more than what you deserve, or you recover less than what you deserve. What we are trying to cover here is surplus proceeds, where you've recovered more than what is owed to you.

In that case, the creditor must account for the surplus to the creditor or the liquidator and transfer the surplus funds to the liquidator himself so that the excess money recovered by the secured creditor will go to the liquidation estate and will be distributed as part of the liquidation proceedings or proceeds to all other claimants. What happens to the costs of the insolvency resolution process? The cost of the insolvency resolution process due from secured creditors who realize their security interest will be deducted from the proceeds of realization and transferred to the liquidator for inclusion in the liquidation estate. That is an important provision.

On the other hand, if what you received is inadequate to meet your own debts, then what happens? If the proceeds from realized secured assets are insufficient to repay the secured creditors' debts, the unpaid debts will be paid by the liquidator in accordance with the priorities outlined in Section 53. Now remember, if, as a secured creditor, I am bound to recover 5 crores from the CD or its assets, and I have recovered only 4 crores, I am left with one crore that I have to receive from the CD; then my one crore claim will become part of section 53, and depending on the priority at a certain stage, I will have the right to receive my one crore that I could not realize from the secured asset.

Very, very important provision again. This is Section 52, which discusses the position of a secured creditor and gives them the choice to either participate in the liquidation proceedings or retain their asset. To understand this clearly, consider the case of Srikanth Dwarkanath versus BHEL. In this case, what happened? It's a case that went to the NCLAT, and section 52 of the IBC was under discussion. Facts of the case. An application was filed under Section 9 of the IBC for the initiation of a CIRP for a company named SPL. Section 9 deals with, I'm sure, an operational creditor who is making a claim and who initiates CIRP proceedings with the NCLT. After a CIRP order was passed, no resolution plan was received or approved. The liquidation of the corporate debtor was initiated under Section 33 of the Act, as is well known. Then BHEL, a secured creditor with a 24% secured interest in the overall asset value of the CD, stated that it didn't want to be part of the liquidation proceedings. Hence, because I have an

asset with me, I want to walk away with a secured asset and realize it by myself. Then what happened? NCLT or NCLAT, there are two sentences here. Watch it carefully. Under the heading 'Conclusion', in the first line, the liquidator made an application to the NCLT and sought to prevent BHEL from taking possession of the asset.

However, the NCLT rejected the liquidator's application and stated that he cannot take over the asset; instead, it will be transferred to BHEL. The liquidator then went to the NCLAT and filed an appeal. Interestingly, the NCLAT ruled in favor of the liquidator, stating that BHEL cannot walk away with the asset. How and why? To, you know, know the logical reason, you should understand the provisions of Section 13, Subsection 9 of the SARFAESI Act, which says that a secured creditor who wants to walk away with the asset by himself shall have at least 60 percent of the value of the asset in the form of a security interest; only then can he walk away. Now that, as previously understood, he only has 26, 24 percent, not 60 percent, as enshrined in Section 39 of the SARFAESI. The NCLAT stated that BHEL cannot walk away with the asset; hence, it forms part of the liquidation estate. Now we come to the most important section, which is section 53, also called the waterfall section, which provides the waterfall mechanism, which we have already covered at the time of CIRP, but just for the sake of it, we are going to cover that once more under liquidation, so that we know how the liquidation procedure will be distributed. Insolvency resolution costs and liquidation costs will be met from the liquidation proceeds as a top priority. The first line in the entire table indicates that priority is given to the insolvency resolution and liquidation costs. That means one positive aspect for liquidators and resolution professionals is that their fees are protected to a large extent under Section 53, and they will always recover their investment.

However, if any proceeds are received from the liquidation, the money will be recovered. Second, a secured creditor, if they have relinquished their security interest, will stand second in priority, but they will stand on equal footing with the workmen whose dues were pending for the last 24 months before the commencement of liquidation, right? The top layer is for insolvency costs and liquidation costs. The second layer is collectively for the secured creditors and the workmen who have not received their payments in the last 24 months. Then comes the third layer, which includes employee wages and any unpaid dues for the 12 months preceding the commencement date of the liquidation. Remember, for workers, we have 24 months, but for employees, we only have 12 months. Lastly, we have a few more priorities: financial debts owed to unsecured creditors will now come in fourth position. You look at the ranking: number one is insolvency costs, number two is secured creditors and workers, number three is employees, number four is financial debts to unsecured creditors, and number five is any amount due to the central or state government. Again, they will rank on par with secured creditors for any unpaid amount following the enforcement of the security interest.

As stated in Section 52, if the secured creditor walks away with their asset but cannot realize the full amount, the balance of money that they could not realize will now stand on the same rank as the government's claims under Section 53, which are all given priority. Once you have completed payments to all parties under Section 53, any remaining debts and dues can be paid. Now, ironically, all the investors who had put large amounts of money into the company's operations will have the last priority, and among those, preference shareholders will rank above equity shareholders, with equity shareholders being the last to claim. This is the clear waterfall mechanism under Section 53 of the Act, and each party's position is clearly outlined, along with the conditions under which they are eligible to receive their claim.

Let's now move forward to Section 54 of the Act, which deals with the dissolution of the corporate debtor. Let's quickly recall what dissolution is. If you remember from my first session, which is session number 41, I made it clear that liquidation is a process that comprises multiple events. However, dissolution is the final step that completely shuts down the company, and its name is struck off from the register of existence. So now Section 54 of the Act deals with dissolution. How was the dissolution done? When the assets of the corporate debtor have been completely liquidated, the liquidator shall make an application to the adjudicatory authority and seek dissolution. Remember, this is very interesting. Though a liquidator has a lot of powers, the liquidator by himself cannot dissolve a company or order dissolution. He can only request the adjudicatory authority to pass an order for dissolution, and the AA will pass the order for dissolution.

Now, is it an option for AA, or is it an obligation for AA? Remember that the wording under Section 54 is that AA shall, upon an application filed by the liquidator, order that the CD be dissolved from the date of that order. But who will implement the dissolution of the name struck by the ROC? When the liquidator makes an application, the adjudicatory authority issues an order, which is then delivered to the liquidator. The liquidator will then submit this order to the ROC and inform them that they must strike the company's name off the register. The ROC will then act on this order and strike the name from the register. This is what brings a company to an end.

To understand this, we have to go to the Gujarat Urja Vikas Nigam Limited versus TCS case, where the adjudicatory authority was the Honorable Supreme Court, which means that there was an appeal filed to the Supreme Court regarding the issues involved in the case, specifically whether NCLT has inherent power to deal with any issues arising out of the liquidation process that are not mentioned either in the Act or in the regulations, and whether NCLT can now deal with them and exercise its discretionary power. The conclusion was very simple. The Honorable Supreme Court held that the adjudicatory authority has jurisdiction to deal with any issue arising out of the liquidation process.

This brings us to the conclusion of Session 44. We will quickly summarize what we have learned. We've learned five sections today spanning sections 41, 42, 52, 53, and 54. 41 tells us how to determine the value of a claim. 42 tells us how to make an appeal to the adjudicatory authority if you are not happy with the decision of the liquidator in the case of a claim. Section 52 talks about the position of the secured creditor in liquidation proceedings; he can be part of the liquidation, or he can walk away with his asset, and Section 53 tells you how to distribute the assets or sale proceeds of the liquidation estate. Lastly, Section 54 deals with the dissolution of the corporate debtor. The liquidator makes an application, the AA passes an order, and the ROC implements the order, which brings an end to the company. Also, to session 44 of ours.

We will meet in Session 45.

Thank you.