

Insolvency and Bankruptcy Law in India

Dr. A. Sridhar

NALSAR University of Law, Hyderabad

Week 12

Lecture 59

Hi, welcome to the 59th session on the IBC liquidation process. In this session, I'm going to bring to you a very, very special case, which is a success story of a liquidator who successfully completed a liquidation process after facing an enormous number of challenges. It's a wide variety of challenges thrown in front of him; how he used his wits, how he actually focused on the work he did, and how he brought this entire case to a successful resolution is what we need to see in this case. I will take you through that.

This case also tells you how a battery of lawyers from both parties litigates the cases and how the other party actually tries to mitigate these cases. This case will tell you all about liquidation, its challenges, and how to face these challenges, how to resolve them, and bring a logical solution to each kind of problem. So, without wasting time, we will proceed to the first slide and introduce this very specific case. Firstly, we need to understand the name of the corporate debtor. The name of the corporate debtor is S.R. Foils & Tissues Ltd. (SRFTL); in short, we call it a corporate debtor. The CIRP of this company began on August 7, 2017; mark this date, alright. It began in August 2017, for which Mr. Anil Kohli was appointed as the IRP. IRP, we understand, is an interim resolution professional who was subsequently confirmed as a resolution professional to oversee the entire job. As far as the interim resolution professional is concerned, his job is only to constitute the CoC; after that, he will follow what the CoC tells him. The CoC may change or confirm him as an RP. After the resolution plan of SRFTL was not approved or rejected by the COC, the Honourable National Company Law Tribunal, New Delhi, the adjudicating authority in this case, vide an order in March 2020, approved the liquidation of the company and appointed Mr. Anil Kohli himself as the liquidator.

So, you can see that Mr. Anil Kohli was initially appointed as an interim resolution professional; after that, he was confirmed as a resolution professional, and after a resolution plan failed, he was confirmed as a liquidator himself. So, one man played three roles here; we will see what kind of expertise he used in bringing the logical conclusion to the matter. But before that, we need to understand the issues; we need to understand the background of the corporate debtor, and we need to understand the reasons for insolvency. After that, how did the CIRP begin, what happened during the CIRP, and

how did it go into liquidation? So, we said the liquidator in this case handled crucial and sensitive issues spanning the cancellation of the lease of the main asset of the CD, on which the CD was relying, and this was cancelled by RIICO, which we will explain shortly; that is one issue.

There were issues with respect to avoidance transactions regarding how the resolution professional and liquidator dealt with the prolonged litigations on different matters, including IPR, more specifically, trademarks; additionally, there were customs duties issues involved here. There was a fixed deposit with SBI that SBI was not releasing, which should have formed part of the liquidation estate, and how the liquidator fought against all these agencies, faced these challenges, overcame them, and how he resolved the whole matter is what we're going to see.

Firstly, the business profile of the corporate debtor. This case is going to give you a fair understanding of the entire matter. So, S.R. Coils, I will call it SR Coils for all our future references. Without going into details, it was incorporated on July 21, 1997, so you can see that a company that was incorporated in 1997 hit an insolvency scenario in 2017; that's when CIRP began. So, for 20 years, it has been conducting business in many ways. What happened during this business? Why did it borrow loans, and why did it reach an insolvency scenario? Its earlier name was actually Messrs R. S. Hygiene Private Limited, which is registered with the ROC (Registrar of Companies) in the state of Haryana. It was later converted into a company, and a fresh certificate of incorporation was issued in the year 2007; the name of CD was changed from Messers RS Hygiene to SR Foils and Tissue, and a fresh certificate was issued to it in October 2007. We are stating that for 10 years, it continued the business under a different name, and after that, it changed its name and obtained a new certificate of incorporation.

Henceforth, after 2007, it will be called SR Foils. This is a brief background. It began operations with the production of aluminum foil. So, while understanding the profile of the corporate debtor, it's important to note when they started the business. Though the company was incorporated in 1997, it immediately started business with aluminum foil production in the financial year 1997 and entered into tissue paper production only in the year 1999. So initially, it was foil, and after that, it was tissue; therefore, you see the whole name is called foils and tissue. Initially, they started with foil and then added tissue to their business line. Initially, the company was in the business of buying aluminum sheet rolls and paper rolls from the market, cutting them into the desired size, and making foils and tissues, packaging and selling them under its own brand name.

So, what it does is buy the bulk paper and foil, then cut them into different sizes and pieces, and market them under its own brand. This is basic business; it's more like trading. Aluminium foils are sold under the brand name Home Foil. These brand names are important; please see them very carefully because the moment I mention a brand

name, it should already strike in your mind that this is an intellectual property right and it can be a trademark, which can be of immense value if done properly. So, the brand name was Home Foil, while tissues were sold under the brand name Mystic. Later, the company ventured into the manufacturing of plastic food wrap under the brand name Clean Wrap. So, we have already seen three trademarks or three brand names. Thereafter, it expanded its product portfolio by installing downstream product manufacturing lines, which means there are many products that are similar but may not be exactly the same, so they've added those products as well into the entire product portfolio. Now the business is expanding in the financial year 2007, so we are trying to understand the reasons why there is a financial crisis.

In the financial year 2007, the company set up a paper mill as backward integration for tissue paper. I don't know how many of you really understand what backward integration is. So, there are two types of mergers possible in the industry: one is called a horizontal merger. A horizontal merger is when two competitors merge to carry on the same business line. The best example of that is Idea and Vodafone merging to run the cellular network business, which is actually called a horizontal merger. Similarly, there is a vertical merger that involves merging with our supplier or our dealer instead of a competitor. When we merge with the supplier of raw material, we call it backward integration because, in my trading business, I need raw material, which in this case is actually aluminum foil. I am merging with a company that will provide me with raw materials. This is known as backward integration, a type of vertical integration. So, with the help of this, they also started manufacturing aluminum foil instead of buying and selling it.

The company achieved a turnover. Now look at this: unbelievable numbers, right? The company achieved a turnover that peaked at Rs. 603 crores in the financial year 2012-13. During the same period, FY 12-13, the working capital limits of the company were enhanced to 381 crores. To achieve that kind of turnover, you need large amounts of working capital, and the bankers have enhanced the limit. Currently, in 2012-13, they were operating with a working capital limit of 381 crores, keeping in view the challenges being faced by the company.

Now we are trying to understand when everything was going well from 2007 to 2012-13; what was the major setback? The major setback occurred then. The major setback for the company came in the form of unhealthy competition from domestic players. Domestic players and foreign players, we need to understand this: every product in a country will face competition from the domestic parties who are similar manufacturers in our own country, and we also face competition from our neighboring countries or from foreign countries that export goods into our country. We import them, and then these goods become competition for our own products here, so that's how competition works.

Now, as far as the setback we are talking about is concerned, it is caused by the domestic competitors who have actually adopted some strategies and tactics that are absolutely unhealthy. Let's see what they have done. They have started offering higher discounts to attract better customers. They have started giving higher margins to the dealers. They have started offering attractive incentive schemes.

Now, when one of your competitors indulges in this kind of practice, you are forced to also indulge in similar practices; otherwise, you will be thrown out of the competition. Now, the point is, do you have enough financial background? Do you have sufficient margins to offer this kind of discount? The moment you struggle to get better margins, the moment you struggle to get finances into your company; these schemes, these discounts, are going to be killer for you, and they will entirely change your business structure. This is exactly what happened to this company, which is SR Foils and Tissues. The industry was already facing competition; now you can understand if somebody is facing competition from Chinese imports, and then a major setback for the company came in the form of unhealthy competition from domestic players. So, after understanding what happened with the cutthroat strategies of the domestic players, we also need to understand what was happening from an international competition perspective.

The industry was already facing competition from Chinese imports, and then a major setback for the company came in the form of unhealthy competition from domestic players, who, in a bid to gain better market shares, started offering higher discounts, and so many things happened at the same point in time. There were also fluctuations in raw material prices, so nobody can adopt a clear-cut strategy; nobody can have a clear-cut financial plan as to what kind of working capital is needed when the raw material prices are fluctuating enormously. At the same time, you also do not have control over the selling price because your competitors are offering products at a substantial discount, so this is going to play havoc in any domestic manufacturer's life; that is exactly what has happened to S. R. Foils & Tissues. The company also tried to counter that by following the same strategy. Its sales also increased and peaked at 603 crore, which we have just discussed, but came at a huge cost of discounts offered to the dealers. Now, strange to understand that the person or the company manufacturing and creating the product at a certain cost is offering these products to the dealers at substantial discounts. Alright, the dealer is going to sell the product at the MRP, whereas the dealer is making enormous profits, and the manufacturer himself is unable to make any profit. This is how the dealers are benefiting from the entire scenario, but the manufacturer is not.

Now see how one strategy of actually becoming a manufacturer from a trader backfired on SR Right Foils and Tissues. Had you not been a manufacturer and had you been a trader, you would have enjoyed the situation by actually exploiting the manufacturers. Unfortunately, you have now become the manufacturer, and you are being exploited by

all the dealers who are making enormous profits while you suffer. So, understanding what strategies have what kind of impact on the company's business, we are very uncertain at times. We believe that these things will change our lives dramatically; we will make huge profits, but instead, they will have a completely adverse effect on the business scenario, and we will start losing money.

That's exactly what happened to SR Foils and Tissues here. Subsequently, the company got entangled in a working capital debt trap; that is exactly what I said: on one side, you need more funds to keep running your manufacturing business; on the other side, your funds do not come back to the company in the form of revenue, so you are borrowing more, and your revenue is slowly coming down, leading to a substantial increase in debt. Revenue is not able to service the debt, and therefore, you will be caught in a trap; one day, you will end up being insolvent. That is exactly what happened here. The company got entangled in the working capital debt trap, as per the financial information filed with the Ministry of Corporate Affairs; the revenues of the company fell sharply from 2013-14, as it had clocked the highest turnover of 603 crores in 12-13.

Immediately, the next financial year, it saw a fall in its own turnover, and the company clocked a heavy loss the same year. These financial setbacks sharply eroded its net worth, and the company's account became NPA with the lenders during this period. Now, the lenders, after having tried several measures to recover the amount, finally had no other choice but to actually initiate a case of insolvency against the company under the IBC. I hope you have a lot more clarity now on what actually causes insolvency and what will push the lenders to resort to an application under IBC; otherwise, the lenders would not have thought of this, but because they waited for a long period of time, they saw no other choice but to go to IBC. They did that as a final resort. Now, once it went into IBC, what happened from there and what kind of challenges it faced is what we are trying to understand. The CIRP of this company was initiated on August 7, 2017, as I told you before, and the RP was appointed. At that time, what was the total amount of claims?

Let's see what happened to the claims. The financial creditors made a total claim of, I mean. Let's examine the scenario of the claims after the admission of the CIRP case. If you see that the financial creditors claimed 704 crores, right? 46,79,253. This is a massive number for financial creditors. Additionally, we have statutory dues of 230 crores and 83 lakhs, and operational creditors are requesting around 28 crores and 43 lakhs. Lastly, we have employees who have 32 lakhs pending for them, and therefore, the total debt appears to be somewhere near 1000 crores; I would say approximately 940 crores. So, as the claims continue to increase, it may amount to approximately 1000 crores.

Now the question is, do you think a 1000 crore debt liability on the head is a light scenario or is it a very, very bad scenario? This is going to be a very, very bad scenario,

and there is going to be enormous pressure on the resolution professional to resolve the matter and maximize the returns to the lenders as well as various stakeholders concerned. So, let's see what happens from here on. As we saw in 2013-14, the profits declined, and the company incurred substantial losses during that year. After that, in 2015-16, it somehow scraped through, but in the financial years 2016 and 2017, the company completely closed down its operations.

The advertisements inviting expressions of interest for the CD were published four times, but you need to understand this: we are making public announcements and providing a list of assets that are being sold. Nobody is willing to buy. Why? There are two ways to look at it: number one, the list of assets that are, you know, to be sold may not be worthwhile for anybody; or two, they are overpriced and therefore we are not willing to buy them. And the third and most important strategy of the buyers would be that they want to wait because right now, when you are making a first offer of sale, you will always have the highest expectations and you will think, "I am going to get the best price," but once it fails the second time, and then three or four times, you become desperate. Then what you do is start reducing the price of the assets, and that's exactly what the buyers want. The moment you give deep discounts and slash these prices, the buyers will come forward to buy the asset.

Until then, they play the game of waiting. That's exactly what happened. The resolution professional further approached and scouted for prospective investors to submit their expressions of interest. However, despite the best efforts, only one compliant resolution plan was received. What do I mean by compliant? A resolution plan that was in accordance with the provisions of sections 31 and 32 of the IBC and that contained all the necessary ingredients was submitted and subsequently placed before the COC for its approval. Then what happened? The plan envisaged payment of only 32 crores for the financial creditors. You saw what the amount of claims made was; they claim something like about 700 crores approximately. In response to such a claim, we have only a payment plan of 32 crores from the resolution applicant. Now, do you think, as a lender, you would be happy to approve this plan pursuant to which the CoC resolved not to take that plan and completely liquidate the company?

Now, see, I will show you towards the end what happened, but right now I want you to understand that 703 crores was the claim by the financial creditors against which the offer was only 32 crores, and hence they thought it was better to liquidate the company. Now the question is, while you liquidate the company, will you get better money than the 32 crores, or will it be worse than this? Will you succeed at all in getting some money? These are the questions that you must keep in mind while we talk about liquidation. So, they've decided to go into liquidation. Subsequently, an application under Section 33 was filed by the RP before the AA post-approval of the COC. That means the COC has made it clear that I don't want to take up this resolution plan. Please go ahead and file for the

liquidation of the company, and then we will see what will come out of the liquidation. Accordingly, the resolution professional will follow the instructions of the COC and file an application for liquidation. Then what happened from here? The liquidation of this company was initiated by an order dated March 4, 2020.

Now, initially, I told you to please note the timelines. The CIRP began in 2017. Now we are talking about 2020. How many years have passed from the CIRP to the liquidation stage? At least 3 good years have passed from the CIRP to the liquidation stage, whereas we all understand that the statutory timelines give only 270 days for the resolution professional to close the entire CIRP. Now the question is, if I am not meeting my timelines as a Resolution Professional, what is the accountability? Am I liable for any actions by the adjudicator or by the regulator? No.

As long as you have a valid reason for the delay in your process, you are not liable for any penalty and are not accountable. You can continue to seek an extension from the adjudicatory authority, explaining the reasons for the delay. So, however, the resolution process could not be completed because there was no successful resolution plan, and eventually, there was a liquidation order passed in the month of March 2020. Now, when do you think the liquidation will be completed? Again, mark my words and note the timeline: when we say we commenced the liquidation process, LCD is actually March 4, 2020. Then the liquidation completion date should be what? It should actually be March 3, 2021, before which the liquidation process should be completed.

Note this and again watch how much time the liquidation has taken, and I will explain the reasons for the delay, if any. So, despite the best efforts, only one resolution plan was received, which envisaged paying 32 crores; hence, liquidation was applied for and granted on March 4, 2020.

Let's move forward. What is happening at the liquidation stage? At the liquidation stage, there were the following claims: financial creditors claimed about 107 crores. So, let's understand, at the time of liquidation, what the claims were. We have earlier seen that the financial creditors' claim was around 703 crores; now, when you look at the time of liquidation, the claim swelled to about 1,072 crores, 61 lakhs, 30 thousand, 328. So, 300 crores of further claim is added from the CIRP to the liquidation stage, which had seen a period of three years. Now, why did the claim amount increase? Obviously, any wise person can answer this question: because the financial creditors added interest to their claims, it became 1,072 crores in the next three years. Also, statutory dues will keep swelling because there will be more interest and penalty added by all the parties. Operational creditors have increased, so overall now you can see the claim is about 1,160 crores as against 940 crores earlier.

While the claims kept on increasing, the RP was struggling to, you know, bring the claims together, finalize the amounts, and then find a resolution for the scenario. Suddenly, there was one specific challenge thrown against him by the Rajasthan State Industrial Development and Investment Corporation Limited. This board, or this state corporation, had actually done something very specific that is hurting the entire resolution process. Let's see what happened: RIICO, which I'll refer to as RICO for our future discussions. Okay, so as I said, there was one specific challenge thrown against the liquidator at this point in time.

What had happened was that Rajasthan State Industrial Development and Investment Corporation Limited had cancelled a particular lease and put the liquidator resolution professional in serious trouble, hampering the entire resolution process. What happened there? I will call this RICO. This is the Rajasthan State Industrial Development and Investment Corporation Limited. For our limited discussion, we will call it RICO. RICO had allotted a plot of about 17,132 meters and a plot number that measures about 20,485 meters.

So, I will say that roughly both of these together were about 38 thousand square meters in an industrial area called Chotanala near Tehsil Baror, district Alwar, Rajasthan. To the CD, for the execution of two lease deeds which were dated July 20, 2005, and August 22, 2005. Both were allotted in 2005 on different dates, and these two lease deeds gave a large amount of land bank to this company. What happened after that? However, these land banks were leased.

Remember, they were not owned by the company. They were leased to it by RICO. For how long? We will always remember that whenever we are talking about leases as lawyers, we know that the maximum amount of time for which the lease is given is absolutely 99 years, and it is extendable after that. Also, permission was granted to mortgage these lands to financial creditors way back in 2011, so based on this large chunk of land and its mortgage, the company could successfully raise an enormous amount of loans. Now, when RICO cancels this lease, what happens is there is a sudden loss of huge assets, and then there is nothing to actually resolve in this whole scenario. When you lose the assets that you are going to sell, from which you get money to pay the creditors, what do you now have to do with the resolution plan? There is nothing more and it is totally a blank scenario for financial creditors, for all other creditors, and more importantly for the liquidator or RP.

So now you see that when such situations hit you, what you should do is keep calm and try to resolve the problem. So, what RP or the liquidator did to get out of this scenario is an important question. We'll continue to understand this case. RICO also sent a demand notice in March 2020, which was physically received by the liquidator in 2020, and the sum demanded by RICO was 53,29,000 against the sale proceeds or against the lease

extended to them, being the dues payable to them from the sale proceeds of the auction. So, what they said is, if at all you sell these assets, which are leased to you, you will have to pay us 53,29,000 from the sale proceeds, if any, conducted, despite being aware of the fact of the initiation of liquidation proceedings.

The liquidator replied via email, apprising them that RIICO falls under the category of operational creditors. Therefore, they are required to submit their claim in Form C and cannot send a demand notice at random. They were also apprised that those properties were mortgaged with the banks, and claims of secured creditors had been filed with the liquidator in terms of the provisions of the IBC. Hence, at this point in time, RICO will not have any rights to the property, having legally permitted the company to create mortgages. The company borrowed loans and mortgaged these properties to them, and now the financial creditors are actually exercising their security.

At this point in time, under RICO, can you exactly intervene and demand a sum of money as a financial creditor? If the liquidator or the resolution professional takes the right stand, they say that you are not a financial creditor; you are an operational creditor. Hence, you actually raise your claim in this specific form, which is Form C. Now let's see what the reply to this was. RICO informed the liquidator again that it had cancelled the lease dates. Now, see, we've raised the demand notice; you replied, saying that you know I have to submit a claim in a specific form.

Instead of doing that, I completely canceled your lease, and now the assets are no longer yours; they come back to me as a lessor. This is a specific challenge faced by the RP or the liquidator. Moreover, RICO also informed that they initiated proceedings for taking possession of the aforesaid plots under the relevant order. However, the order dated June 11, 2020, was neither provided nor served to the liquidator nor upon the CD. So now what they are saying is, please evacuate the land because I have an order in my hand that was passed by the court, and therefore now the plots belong to me; your lease is cancelled, vacate.

As a lessor, when I state that I have an order from a competent court, I am supposed to show that order on the basis of which I am seeking eviction. Now, Rico failed to produce any order from the court, though it stated it had an order in hand. Now, let's see what happened after this: RICO, being aware of the liquidation proceedings initiated against the CD by the wide order dated March 4, 2020, acted in complete disregard of the direction passed by the adjudicating authority. Now, what we are saying is that as an adjudicating authority, an order was passed against RICO not to take back the lands while the liquidation proceedings were ongoing, and you know that while the liquidation proceedings are ongoing, there is a moratorium period during which there cannot be any more actions against the estate of the liquidation. Now, when Rico had done this, it was,

you know, understood as a complete disregard of the direction passed by the adjudicatory authority.

It is worthwhile to mention now that Rico informed the liquidator about the cancellation of the allotment of the land without even giving a copy of the order or serving a show-cause notice to the resolution professional during the CIRP. So, there were two stages. One was CIRP, now one is liquidation. They had served a demand notice to the resolution professional during the CIRP, but now cancellation happened during the process of liquidation. Right? So, there is no nexus. Once you have given a demand notice, there must be a show cause notice for cancellation of the lease, which did not come to the resolution professional or to the liquidator. And then there is a moratorium period due to the liquidation process. In total disregard of the principles of natural justice and also of the moratorium period, the RICO canceled the lease of two plots given to the SR foils and tissues.

Now, let us see what happened from here on out. The liquidator of the CD filed an application, and he sought a stay of the cancellation order to understand the implications of this when I, as a liquidator, file an application with the adjudicating authority and say, Please, stay this cancellation order. The moment a stay order is passed, the cancellation order becomes temporarily ineffective; however, it cannot be made permanently ineffective because the evacuation order and the cancellation order were claimed to have been passed with the help of an order from a competent court. So NCLT will not actually get into a dispute with the competent court; therefore, it can only grant a stay; it cannot cancel this order. So, the liquidator sought a stay on such cancellation order passed by the RICO and a consequential order for stay of proceedings instituted by them under the specific Act before the competent authority. The copy of the application was also sent to RICO via email dated August 1, 2020.

Let's see what happened after this. So, the liquidator sought two important reliefs: number one, he said, "I need a stay on the cancellation order passed," and he also wanted a cancellation of the order of evacuation or eviction. These two reliefs are being sought by the liquidator in the next session, so we will see what the adjudicatory authority did and how the entire liquidation was brought to a logical end.

This we will see in session number 60, which happens to be the last session of our IBC.