

# LIQUIDATION PROCESS UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

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**Abstract:** Businesses all over, whether small or big, need efficient and speedy procedures for exit as much as for start-up. As businesses grow in size there is also a possibility that poor management, bad business decisions or even for that matter fraud, may result in a business becoming unviable, the business becoming unfeasible. A close look at the Indian system neither provides an opportunity for speedy and effective rehabilitation nor for an efficient, coherent or a well regulated exit. The Insolvency & bankruptcy laws were scattered in lot more enactments and could not help recovery as it were time consuming, a need was felt that new stringent laws be enacted which would take care of the existing defaulters in a time bound manner. Also the process of liquidation and also the winding up is very costly, witnessing inordinate delays and resulted in almost erosion of asset value. As we all are aware that an effective insolvency system is an important element of financial system stability. The Insolvency & Bankruptcy Code (IBC) received the assent of the President of India on 28th May, 2016. The Parliament enacted this new law for the reorganization and insolvency resolution of LLP, corporate persons, individuals and partnership firms within a time bound manner for maximization of value of assets and to consolidate the existing framework by creating a single law for insolvency and bankruptcy. There is a need to change the negative perception<sup>1</sup> of recovery and litigation associated with the debt recovery mechanism prevalent in India. The IBC is to facilitate a better and faster debt recovery mechanism. The IBC is very clear, only in case there is failure to work out a resolution plan under the corporate insolvency resolution process which is prescribed under the code, then and then only the corporate debtor must be liquidated.

**Keywords:** Liquidation, Insolvency, Bankruptcy

## Introduction

The objective of this new law is to promote entrepreneurship, availability of credit, and balance the interests of all stakeholders by consolidating and amending the laws relating to reorganization and insolvency resolution of LLP, corporate persons, partnership firms and individuals in a time bound manner and for maximization of value of assets of such persons and matters connected therewith or incidental thereto<sup>2</sup>.

There is no doubt that the Indian Banking Industry is in the throes of a crisis. NPA (Non - performing assets) have been piling up in trillions of INR. The input and output of cash needs to be properly balanced in a given system or else there are more chances of collapsing. There is a need for a proper flow of money for the economy to grow and the market to function, therefore freeing up this money is very crucial for the banking sector and in turn for the country.

The object of this article is to analyze and understand the liquidation process in the event that there is a failure to work out a resolution plan under the corporate insolvency resolution process prescribed under the code, only then corporate debtor needs to be liquidated and to make an attempt to address any concerns arising out of the same.

## Background

At the outset, the present regime of laws dealing with the financial failure and matters relating to insolvency and bankruptcy of companies and also of individuals in India is very cumbersome, time consuming as there are multiple overlapping laws and adjudicating forums. There is lot more strain on the Indian credit system, as is evidenced from the prevailing legal and institutional framework which does not aid or help the lenders for the effective and timely recovery or even restructuring of defaulted assets. The Government of India in order to improve the business environment and alleviating distressed credit markets, recognized that reforms are much needed in the insolvency and bankruptcy regime, therefore constituted the 'Bankruptcy Law Reforms Committee' (BLRC) under the Ministry of Finance, based on the recommendation of the BLRC, Government introduced the Insolvency and Bankruptcy Code Bill in November 2015. The legislation of the Code is a historical development for economic reforms in India, its effect will be seen in due course.

The IBC provides for a new institutional framework, consisting of a regulator, insolvency professionals, information utilities and adjudicatory mechanisms that will facilitate a formal and time bound insolvency resolution process and liquidation.

## The liquidation process

<sup>1</sup> negative perception - that it takes more than four years on an average to resolve insolvency in India

<sup>2</sup> Objective - Insolvency and Bankruptcy Code, 2016

The Ministry of Corporate Affairs (MCA), vide Notification, has notified sections 33 to 54 (both inclusive) of the Insolvency and Bankruptcy Code (IBC) dealing with the liquidation process to be effective from 15th December, 2016. A close look at these provisions governing liquidation offer a comprehensive strategy to implement the process of liquidation.

### **Circumstances triggering the liquidation process**

The IBC<sup>3</sup> provides for circumstances wherein the adjudicating authority, NCLT shall pass the liquidation order in respect of the corporate debtor, as follows

- a) Wherein the adjudicating authority does not receive any resolution plan from the resolution professional before the expiry of the insolvency resolution process period, including the extended time, if any.
- b) Where the resolution plan received by the adjudicating authority from the resolution professional is devoid of the requirements of section 31.
- c) If at any time before the confirmation of a resolution plan during the corporate insolvency resolution period, the committee of creditors, decides to liquidate the corporate debtor, and the same is intimated by the resolution professional to the adjudicating authority;
- d) If there is any contravention by the corporate debtor of the resolution plan as approved by the adjudicating authority, and any person other than the corporate debtor prejudicially affected by such contravention makes an application to the adjudicating authority for a liquidation order in respect of the corporate debtor, and the adjudicating authority determines that the corporate debtor has contravened the provisions of the resolution plan.

### **The period of Moratorium**

When a liquidation order has been passed, the moratorium<sup>4</sup> shall commence. As such, no suit or other legal proceeding shall be instituted by or against the corporate debtor. However, a suit or other legal proceeding may be instituted by the liquidator, on behalf of the corporate debtor, with the prior approval of NCLT. Important to note is that the moratorium provisions do not affect the rights of secured creditor as envisaged under section 52. Moreover a public announcement that the corporate debtor is in liquidation has to be issued.

### **Appointment of Liquidator**

The IBC<sup>5</sup> provides for the appointment of liquidator and fee to be paid to him. The resolution professional appointed for the corporate insolvency resolution process shall act as liquidator unless replaced by NCLT. Now this is something very innovative and new, the IBC provides that on the appointment of the liquidator all the powers, not only of the board of directors but also of the key managerial personnel and the partners of the corporate debtor ceases to have effect and are vested in the liquidator.

### **Powers and duties of liquidator**

All the powers of the Board and the management are vested in the liquidator on his appointment. He has wide powers to act on behalf of the corporate debtor, including, among others, to verify and settle claims of creditors, evaluate and sell assets of the corporate debtor, take measure to protect and preserve the assets and properties of the corporate debtor as he deems fit, and also to institute or defend suits and carry on the business of the corporate debtor. The liquidator shall receive or collect the claims of creditors within a period of 30 days from the commencement of the liquidation process.

### **Liquidation estate**

The IBC<sup>6</sup> provides for the creation of a liquidation estate. This is one of the most crucial sections of the code and calls for the formation of a liquidation trust. The assets forming part of the liquidation estate of the corporate debtor, wherein the same shall be distributed by the liquidator in the manner of priorities as laid down under the code itself. The liquidator holds the estate as a fiduciary for the benefit of all creditors. Now the formation of a liquidation trust under the IBC, is something very innovative and there was never any provision as such, under the Indian laws. The liquidation trust or the liquidation estate is nothing but a way to mark the assets of the corporate debtor, for the purpose of distribution in accordance with the rules of priority.

### **Claims**

The IBC<sup>7</sup> provides for consolidation of claims. The financial creditor or the operational creditor shall submit their respective claims to the liquidator along with the supporting documents to prove their claim. A window of fourteen days is provided wherein the creditor can withdraw or vary his claim. On receipt of the claims submitted by the creditors, the liquidator shall verify the claims. The liquidator on verification of the claims submitted by the creditors, may admit or reject the claims, needless to state the liquidator

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<sup>3</sup> S. 33, Insolvency and Bankruptcy Code, 2016.

<sup>4</sup> A temporary prohibition of an activity

<sup>5</sup> S. 34, Insolvency and Bankruptcy Code, 2016.

<sup>6</sup> S. 36, Insolvency and Bankruptcy Code, 2016.

<sup>7</sup> S. 38, Insolvency and Bankruptcy Code, 2016.

shall record in writing the reasons for such rejection. The creditor whose claim has been rejected by the liquidator has a window of fourteen days from the receipt of such decision to appeal<sup>8</sup> before the adjudicating authority, NCLT.

### **Avoidance transactions**

The IBC has another innovative provisions which provides for a look back or relate-back period, wherein certain transactions undertaken during the process of insolvency or even before that can be avoided to overturn their effects on the finances of the corporate debtor, as the liquidator is empowered to seek avoidance and reversal of such transactions by filing an application to the adjudicating authority, NCLT<sup>9</sup>. These provisions find place in insolvency laws of almost all jurisdictions and are better known as 'avoidance provisions'. The rationale being that all the creditors get their dues in an equitable manner. A close look at the IBC<sup>10</sup>, dealing with the avoidance of certain transactions, can be divided viz. preferential transactions<sup>11</sup>, undervalued transactions<sup>12</sup> and transactions defrauding creditors.<sup>13</sup>

For avoiding or setting aside the transactions there is a "relevant period" which is prescribed under various provisions of the code. Transactions undertaken during this "relevant period" only can be avoided. The relevant period in case the transaction relates to a related party, is two years preceding the insolvency commencement date, and if the transaction relates to a person other than a related party then it is one year. The IBC<sup>14</sup> provides for a list of people who are taken as related party for the purpose of this code.

### **Distribution of assets**

The liquidation of a corporate debtor involves the selling of its assets and the distribution of the sale proceeds among its various creditors. The Code also provides for priorities [waterfall] wherein the proceeds from the realization of assets of the entity are to be distributed to its creditors in case of liquidation. The Code significantly changes the priority waterfall for distribution of liquidation proceeds. The proceeds from the sale of assets of the liquidation estate have to be distributed in accordance with the IBC<sup>15</sup>.

After the costs of insolvency resolution process (including any interim finance) and the liquidation costs paid in full, secured debt together with workmen dues for the preceding 24 months rank highest in priority. Under the earlier regime, Government dues were immediately below the claims of secured creditors and workmen in order of priority. There is departure from this practice as under the IBC Central and state Government dues stand below the claims of secured creditors, workmen dues, employee dues and other unsecured financial creditors.

### **Dissolution**

An application shall be made by the liquidator to the adjudicating authority for dissolution of the corporate debtor pursuant to which the adjudicating authority shall pass an order of dissolution of the corporate debtor<sup>16</sup>.

### **Time is of the essence**

A close look at the IBC we find that the code provides for various time limits in the process, whether it is for the resolution process or for that matter it is the process of liquidation. The IBC has introduced an element of 'time' and if we scrutinize the earlier insolvency laws the 'time' element was completely missing, therefore the government has put in all efforts to see that the IBC is so framed that it would take care of the existing defaulters in a time bound manner.

### **Limited judicial role**

Another innovative idea and a very significant deviation from the earlier regime is that the liquidator is in command of the entire process. Off course the liquidator has to submit to the adjudicating authority, NCLT, the preliminary report within 30 days from the date of the order of liquidation and also the Progress report within 15 days after end of every period of 3 months from the date of order of liquidation. The adjudicating authority NCLT needs to look only at some parameters, this is in complete contrast to the earlier regimes.

### **Area of concern**

There is no doubt that the IBC is so designed that liquidation is the last resort that can be undertaken. IBC also provides that the committee of creditors can decide to liquidate the corporate debtor. What is provided under the code is that more than 75% of creditors currently have to agree to a resolution plan<sup>17</sup>, implying that just over 26% can reject it and force a company into liquidation.

<sup>8</sup> S. 42, Insolvency and Bankruptcy Code, 2016.

<sup>9</sup> Ss. 43 to 51, Insolvency and Bankruptcy Code, 2016

<sup>10</sup> Ss. 43 to 51, Insolvency and Bankruptcy Code, 2016

<sup>11</sup> S. 43, Insolvency and Bankruptcy Code, 2016

<sup>12</sup> S. 45, Insolvency and Bankruptcy Code, 2016

<sup>13</sup> S. 49, Insolvency and Bankruptcy Code, 2016.

<sup>14</sup> S. 5(24), Insolvency and Bankruptcy Code, 2016.

<sup>15</sup> S. 53, Insolvency and Bankruptcy Code, 2016.

<sup>16</sup> S. 54, Insolvency and Bankruptcy Code, 2016.

<sup>17</sup> S. 30(4), Insolvency and Bankruptcy Code, 2016.

In my considered opinion the government should have a relook at this provision as the objective of the code is to provide for a resolution plan or the revival of the company and liquidation being the last option, as liquidation of a company has lots of social effects apart from job losses.

### **Conclusion**

The Code consolidates and amends the laws relating to the reorganization and insolvency of corporations, partnerships and individuals. Initially the IBC seeks to achieve reorganization, only on its failure the corporate debtor has no other option and liquidation order is passed by the adjudicating authority, NCLT. A feather in the code is the provision wherein certain transactions that are detrimental to the creditors or which were entered into for the purpose of deceiving creditors can be avoided. It's just around eighteen months since liquidation provisions have been notified, the IBC is still in the process of fine-tuning liquidation procedures. Undoubtedly this code has radically changed and has simplified the entire procedure for the liquidation of corporate persons.