

Insolvency and Bankruptcy Board of India

Subject: Amendment to Liquidation Process Regulations.

In order to make regulatory framework more conducive, the IBBI engages with stakeholders. With a view to crowdsource ideas, the IBBI invited comments from public, including the stakeholders and the regulated, on the regulations already notified under the Code. It was indicated that the comments received between 4th July, 2017 and 31st December, 2017 shall be processed together and following the due process, regulations will be modified to the extent considered necessary. It was also indicated that it would be the endeavour of the IBBI to notify modified regulations by 31st March, 2018 and bring them into force on 1st April, 2018. A summary of comments received on liquidation regulations are at Annexure A.

2. As part of the work of the Insolvency Law Committee (ILC), MCA invited suggestions from public. In the meeting of the ILC held on 1st February, 2018, the comments/suggestions received were discussed and broadly categorized into regulatory issues to be addressed by the IBBI and other issues requiring amendments in Code/Rules. Accordingly, MCA vide its mail dated 6th February, 2018 forwarded a document of all issues, wherein the regulatory issues were classified by Vidhi Legal Policy with an advice to look into them. The list of issues having a bearing on liquidation is at Annexure B.

3. The Governing Board in its last meeting had decided to amend regulations to provide that liquidation cost shall include interest, at a rate not exceeding Bank Rate, on interim finance till its repayment from the liquidation commencement date. Subsequently, a few members felt that the inclusion of interest, at bank rate or otherwise, in liquidation cost requires more deliberation. Hence this decision was held up for further deliberation in the next meeting of the Governing Board.

4. The comments and suggestions as at paragraphs 1-3 above were placed before the Advisory Committee on Corporate Insolvency and Liquidation in its meeting held 10-11th February, 2018. The minutes of the meeting held on 10th February, 2018 and 11th February, 2018 are enclosed as Annexure C and D respectively. Based on these inputs and subsequent internal discussions, this note proposes certain amendments to the IBBI (Liquidation Process) Regulations, 2016 (hereinafter, Regulations) for consideration of the Governing Board.

5. Regulation 3 deals with eligibility for appointment as liquidator. An IP is eligible if he

“(c) has not been an employee or proprietor or a partner:

- (i) of a firm of auditors or company secretaries or cost auditors of the corporate debtor; or*
- (ii) of a legal or a consulting firm, that has or had any transaction with the corporate debtor contributing ten per cent or more of the gross turnover of such firm, in the last three financial years.”*

This provision is intended to prohibit the auditors who exercise an independent oversight over a corporate. It does not serve much purpose if the company secretaries as such are prohibited while other professionals are prohibited only if they are auditors. It also requires clarity that a person is prohibited if he has been auditor at any time during the preceding three years. Accordingly, it is proposed to substitute the above sub-regulation by the following:

“(c) has not been an employee or proprietor or a partner:

- (i) of a firm of auditors, secretarial auditors or cost auditors of the corporate debtor; or*
- (ii) of a legal or a consulting firm, that has or had any transaction with the corporate debtor contributing ten per cent or more of the gross turnover of such firm, at any time in the preceding three financial years.”*

6. The Code as well as regulations provide for components of insolvency resolution process costs. The Code is silent on liquidation costs. These costs are, however, scattered over the Regulations. For example, liquidator fee under regulation 4(1), remuneration for professionals under regulation 7(1), costs incurred for verification and determination of claims under regulation 24(2), etc. The Advisory Committee suggested that these costs may be consolidated at one place for clarity and control.

7. Regulation 27 provides that a person may claim only for the amount due and unpaid up to the liquidation commencement date in case of rent, interest and such other payments of a periodical nature. The Advisory Committee considered if it is desirable and feasible to include interest on interim finance beyond commencement date in the liquidation cost. It felt that a company under liquidation cannot contract fresh liability and payment of interest on interim finance after commencement of liquidation disturbs the waterfall under section 53 of the Code. Accordingly, it did not recommend any modification of regulation 27. It rather suggested other options to encourage interim finance such as relaxation of provisioning norms for interim finance, removal on restrictions on foreign capital, encouraging participation of Alternate

Investment Funds, and even tax incentives and allow market to appropriately price risks inherent in interim financing. It is proposed to go by the advice of the Advisory Committee.

8. Regulation 32 of the Regulations allow the liquidator to sell the asset in a slump sale. As per section 2(42C) of Income Tax Act, 1961, 'slump sale' means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. Most often slump sale would be sale of the entire business of the corporate debtor as a going concern. There is a likelihood that a corporate debtor has several businesses, and specific businesses generate interest to separate sets of buyers as it would complement their existing businesses. Hence, there is a possibility of some businesses surviving after slump sale of other businesses. If the corporate debtor has only one undertaking and that is sold in slump sale, the corporate debtor continues to exist without any business. Thus, it may be useful to provide the liquidator the option to sell various businesses separately to different buyers as a slump sale or even the entire corporate debtor as a going concern. It is proposed to modify regulation 32 to add one more option, namely, '*(c) sell the corporate debtor as a going concern*'.

9. It is submitted for consideration and approval of the Governing Board.

Public Comments on IBBI (Liquidation Process Regulations), 2016

- (i) The Adjudicating Authority Rules, 2016 apply only to the corporate insolvency resolution process. What is the application procedure / forms to be followed/filed when the liquidator makes the application for liquidation?
- (ii) Upon completion of liquidation, the financial record of the corporate debtors should be destroyed or kept (regulation 5). Liquidator has to preserve certain records for 8 years, which is derived mainly from financials of corporate debtors, should regulations specify the other records?
- (iii) Section 33(1)(b)(ii) states that AA will make the public announcement stating that the CD is in liquidation. However, regulation 12(1) states that Liquidator shall make the public announcement. Is there any clarification required?
- (iv) A real estate project has been admitted for insolvency. Can the persons who have paid advance for flats invoke RERA to hold the insolvency resolution/liquidation process?
- (v) The Code and regulations do not deal with detailed provisions regarding intangible assets. Valuation may not be available from prospective buyer or even in the case of liquidation. This may be prejudicial to creditors and translate into equivalent cash loss for them.

Issues deliberated in the Insolvency Law Committee (ILC) related to Liquidation Process.

1. Interim Finance

- i. Insolvency and Bankruptcy Code, 2016 (Code) treats the amount of any interim finance raised and the cost incurred in raising such finance as cost of insolvency resolution process. Instead of according it super-priority in the waterfall under section 53, the Code treats that as cost of resolution that receives priority in the waterfall. However, the cost of resolution ends with the CIRP. In the event that CIRP fails, the interest on Interim Finance (IF) stops. CIL Regulations related to periodical payments specify that “In the case of rent, interest and such other payments of a periodical nature, a person may claim only for any amounts due and unpaid up to the liquidation commencement date.” This gives an impression that interest on IF availed for the benefit of a CD can only be claimed up to the liquidation commencement date. Since liquidation is usually long process, the lender would not receive repayment of IF for a long period and during this period IF may not earn any interest. Inability to earn interest until repaid in full discourages the financiers to extend IF. Since IF and the costs incurred in raising the same are considered as part of ‘insolvency resolution process costs’, interest payable on IF should also constitute cost of raising IF and, therefore, may not be subject to the restriction in regulation 27. Alternatively, a proviso in the regulation 27 of the CIL Regulations may specifically provide for exclusion of interest on interim finance.
- ii. Under the circumstances, the Committee may deliberate upon modifying Regulation 27 of CIL Regulation to allow interest on IF till full repayment.

2. Liquidation Assets

- i. The IBC combines in a single legislation, the processes for resolution or liquidation of corporate person. In cases where resolution is not possible, an insolvent CD needs to exit with the least disruption and cost and release the idle resources in an orderly manner for fresh allocation to efficient uses.
- ii. The Code and regulations made there under for liquidation provide details of procedures to be reckoned to start with issue of liquidation order under Section 33 of the Code till dissolution order under Section 54 (i.e. Chapter III of Part II of IBC). The provisions governing liquidation offer a comprehensive strategy to implement the process of liquidation. Liquidator is the Insolvency Professional who attempts to evaluate and realise the assets of the company to ease the process of liquidation.
- iii. The Code empowers the liquidator to sell the immovable and movable property and actionable claims of the CD in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels. The regulation enables the liquidator to (a) sell an asset on a standalone basis; or (b) sell the assets in a slump sale, a set of assets collectively, or the assets in parcels. The liquidator shall ordinarily sell the assets of the CD through an auction and may sell the assets of the CD by means of private sale in certain circumstances
- iv. Regulation 33 of the Code relates to mode of sale and provides that the liquidator shall ordinarily sell the assets of the corporate debtor through an auction in the manner specified in Schedule I. Clause 7 of Schedule I states that the liquidator shall sell the

- assets through an electronic auction on an online portal, if any, designated by the Board, where the interested buyers can register, bid and receive confirmation of the acceptance of their bid online.
- v. Previous liquidation regimes were reportedly undermined by cartelisation. Care needs to be taken to ensure that transparent processes, including e-auctions, help address this problem. Besides, promoters, who are wilful defaulters, are also barred from repurchasing the firm's assets under the Insolvency and Bankruptcy (Amendment) Act, 2017. However, the legislative intent is clearly that there should be as many bidders as possible, and that the promoter is free to bid, if otherwise not ineligible. However, if the promoter or a related party bids, the law requires the liquidation professional to report this to the NCLT.
 - vi. There is no formal market place where the assets of the CDs, particularly specialised equipment or high value assets, can be bought and sold conveniently. Notwithstanding the economic principles 'supply creates its own demand' and 'everything sells if price is right', development of market for any asset needs facilitation at least in the initial days. It is necessary to facilitate development of a market mechanism which enables competing bids to buy assets and the sale of the asset to the highest bidder, the objective being the highest realisation for the stakeholders. There is need to create market for stressed assets.
 - vii. The rules and standards may have to be laid down involving the terms and conditions of the sale process which includes, total time of bidding process, extension of time of bidding process in case of inter-se bidding, the notice period, fixation of amount of deposit of earnest deposit and the reserve price, release of payment consideration, format for advertisement of sale notice and tender document etc., standards for due diligence of the prospective bidders, requirement for physical verification of the assets by the prospective bidders, standards for monitoring of whole sale process and security system.
 - viii. Should the Board lay down the basic rules consideration the number of liquidation assets moving into liquidation, need for transparency in the system or it is the Liquidator who shall be responsible to set rules and lay down standards? Or should the Board look up to some developed platforms and suggest their replications?
3. Methodology for estimating claims- While the CIRP Regulations provide for the concept of estimation of claims (Chapter IV), no guidance has been provided under the Code or the Regulations with respect to the methodology to be adopted by a resolution professional for estimation of the said claims. Further the Code or the Regulations do not provide for a mechanism wherein the Resolution Professional / Liquidator can apply to the court for the estimation. The Committee suggested that a methodology may be provided.
 4. The ILC considered that it was necessary to mitigate the Risk of Creditors in handing over control of entire assets of corporate debtor to Insolvency Professional. In this direction, Bonds may be taken from IPs for their performance. This may increase accountability of insolvency professionals. This is a practice followed in countries like UK and US and may be considered part of global best practices. ILC deliberated that the Code may provide for bond/bank guarantee to be furnished by the Insolvency Professional as security for accepting CIRP/Liquidation assignment. Does this enjoin upon the IBBI to provide for a rating basis which the bonds will be priced? What information does it require from the IBBI for a bond to be priced? How should the IBBI structure its processes to ensure such information is available to the issuer of the bond?

5. Valuation process to be finalized in helping the decision-making process. ILC deliberated that valuation is a critical function in CIRP, which enables the most important function of the Resolution Professional to enable better price discovery for the corporate debtor. In this regard, the Board may issue suitable guidelines/provide standards to registered valuers for arriving objectively at enterprise value at the stage of resolution and liquidation value at liquidation stage.