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The Liquidation Process and its Amended Regulations, 2022 – A Review

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Abstract

This paper has examined the changes introduced in the new Liquidation Process and its Amended Regulations, 2022. With fast changing economy and ways of doing business there was a need for a new law as previously governing act failed to solve the insolvency and liquidation issues effectively. In this paper the comparative analysis and loopholes in the simplification of voluntary liquidation process for corporates for ease of exit and for institutionalising a standard Cross Border Insolvency Process, etc are properly discussed and how IBC has made the insolvency proceedings simpler and time effective as compared to the previous Acts where there was no time limit. The Amendment has no doubt improved the insolvency and liquidation process in India but a lot depends on the effective will in the implementation of the reforms. This paper properly describes the issues which were faced by the companies in liquidation and bankruptcy and thus the reforms., as India has yet not adopted the UNCITRAL model.

Keywords: Liquidation, Insolvency, Amendment, Proceedings & Regulations.

Introduction

Liquidation is the process of converting a company's assets into cash, and using those funds to repay, as much as possible, the company's debts. Liquidation results in the company being shut down. There are three different types of liquidation:

- *Creditors' voluntary liquidation* – is initiated by the company's directors when they are concerned the company can't pay its debts.
- *Court liquidation* – starts as a result of a court order, usually made after an application by a creditor of the company.
- *Members' voluntary liquidation* – is a way for solvent companies (i.e., those not in financial difficulty) to shut down.

Creditors' voluntary liquidation is the most common type of liquidation. Regulation of the Liquidation Regulations as a part of the Insolvency and Bankruptcy Code ("**IB Code**") provides that liquidation process with respect to corporate debtor ("**CD**") ought to be completed within one year from the liquidation commencement date ("**LCD**"). Per contra, the records available in public domain speak differently wherein out of 16, 661 corporate insolvency resolution processes ("**CIRP**") which ended up with an order for liquidation, only in 346 cases liquidators have submitted final reports with the Adjudicating Authority ("**AA**"). Such delay was totally in contrast to the time-bound liquidation process as envisaged in the Bankruptcy Law Reforms Committee report, 2015.

A need was felt to maximise recoveries in a time-bound manner and to mitigate the practical difficulties faced in the liquidation process. In order to facilitate this dynamism, the Insolvency and Bankruptcy Board of India ("IBBI") recently amended the IBBI (Liquidation Process) Regulations, 2016 ("Liquidation Regulations"). The (Liquidation Process) (Second Amendment) Regulations, 2022 ("Amended Regulations") were notified by the IBBI on September 16, 2022. The Amended Regulations have brought radical changes including but not limited to constitution of Stakeholders Consultation Committee ("SCC"), stricter timelines for exploring a compromise or arrangement and conducting auction, filing of claims, replacement of liquidator, treatment of avoidance applications etc. Further, the Liquidation Regulations did not contain any timelines for undertaking and concluding the various stages in auction proceedings, with respect to selling the corporate debtor as a going concern, causing delay in the process leading to value erosion of the assets of the CD. This also caused great difficulty because the liquidator used to conclude the auction in reasonably short period per his whims and fancies. Such act by the liquidators affected the number of effective participants in auction leading to either failure of auction or sale of assets to a buyer, pre-identified in an unfair manner, thereby compromising transparency and fairness of the process. Therefore, amendments were required to ensure fairness in the conduct of auction proceedings. This was also fuelled by the judgment passed by National Company Law Appellate Tribunal ("**NCLAT**"), whereby, during the liquidation process, the liquidator as a compliance used to first explore the mechanism of compromise or arrangement under Section 230 of the Companies Act, 2013 ("**CA, 2013**") before proceeding to auction mechanism. This also led to delay in realization of assets.

Further, The IB Code did not contain any provision for replacement of liquidator on any grounds at the behest of the stakeholders during the liquidation process. The AAs were finding it difficult to replace the liquidator even in existence of valid grounds in absence of a specific provision. The AA, Chennai Bench in *IDBI Bank Limited Vs V. Venkata Sivakumar* relied on the principles of General Clauses Act to replace the liquidator. However, to the contrary, the NCLAT in the case of *Punjab National Bank* v. *Kiran Shah, Liquidator of ORG Informatics Ltd* has held that after passing of the liquidation order, the Committee of Creditors ("**CoC**") has no role to play and they are simply a claimant whose matters are to be determined by the liquidator and it cannot move an application for removal of liquidator in absence of any provisions under the law. Therefore, there was a pressing need to bring an amendment to fill this gap to empower the stakeholders to replace the liquidator. The Liquidation Regulations were also silent on the treatment of proceedings pertaining to avoidance/fraudulent/preferential transactions after the closure of the liquidation process. The confusion escalated after the recent judgments passed by the High Court of Delhi and NCLAT which held that for the purpose of CIRP, the ultimate beneficiary of proceeding arising out of avoidance application must be the creditors of the CD.

Unlike CIRP, the Liquidation Regulations did not contain any mechanism for oversight and monitoring of liquidation process and liquidator by creditors. The existing framework did not stipulate any mechanism for conducting meetings of SCC and scope of consultation given was even limited. The power to consult the SCC during the liquidation process was only discretionary and liquidator had to only record its reasons for taking decisions contrary to the advice given by the SCC. As a consequence, the liquidator(s) use to exercise its discretion to not consult the SCC on important matters like deciding the reserve price for sale, fixing the terms and condition for sale causing inadequate and ineffective participation of stakeholders in the liquidation process. This required changes in existing regulations so as to enhance the accountability of the liquidator, like in the case of the resolution professional and give more power to SCC

Therefore, it was the need of the hour to amend the existing laws to keep up with the challenges and gaps emerging in an expanding financial ecosystem. Progressive steps were required to be undertaken in order to empower the stakeholders involved in the liquidation process including the banks who have been facing massive haircuts in the current framework.

Objective of the Study

The financial eco system should always be an updated one with lesser scope for the wastage of monetary and human resources. As such various bye-laws, regulations, amendments are developed at regular intervals. The present study aims at reviewing and analysing the Liquidation Process and its Amended Regulations, 2022 which was necessitated so as to complete the liquidation process in a time bound manner.

Methodology

The study is purely descriptive in nature. it is mostly based on secondary source as well as primary source. The secondary source has been the various reports, bye-laws and articles of academicians and professionals. Various professionals such as CA, Lawyers, professors also were interviewed to get an insight of the regulations. The review of literature mostly was narrowed down in terms of the need of the reforms in the liquidation process. The study is a proactive approach to determine its effect at a very early stage.

Major Amendments

1. *Constitution of SCC*

- For first 60 days from LCD, CoC as constituted during CIRP based on admitted claims shall continue to function as SCC during liquidation process.
- After adjudication of claims and within 60 days of initiation of process, the SCC shall be re-constituted with voting rights based on amount of admitted claims.
- First meeting of SCC shall be conducted within seven days of LCD.
- Shareholders/ partners and related creditors will have representation in SCC but without voting rights.

2. *Consultation with SCC*

- The liquidator shall put the agendas for deciding on remuneration of professionals, sale under Regulation 32 of the Liquidation Regulations, including manner of sale, pre-bid qualifications, reserve price, amount of earnest money deposit, and marketing strategy, need for fresh valuation, etc. before the SCC.
- The SCC shall advise the liquidator by a vote of not less than 66% of the representatives of the SCC, present and voting.
- In case of taking decision contrary to the advice of the SCC, the liquidator is required to file a form recording reasons for the same and forward to AA.

3. Replacement of Liquidator

- By a vote of not less 66% present and voting, SCC may propose replacement of the liquidator and file an application before the AA for appointment of the proposed liquidator.

4. Proposal for Compromise or Arrangements under Section 230 of the Companies Act, 2013

- Exploring the process of compromise or arrangement, at first instance during liquidation is not mandatory and can be skipped if SCC is of such opinion.
- In case, CoC decides, that process of compromise or arrangement may be explored, only in such case the liquidator shall file application before AA for considering the proposal of compromise or arrangement, within thirty days.

5. Timelines for certain auction events

Submission of Eligibility Documents by Prospective Bidder (Section 29A Affidavit, etc.)	Min.14 days
Data Room Access, Site Visits and Discussion Meeting	Min. 7 days
Submission of Earnest Money Deposit (EMD)	Any time up to 2 days before the auction date

- The above timelines proposed will act as minimum threshold and can be extended in consultation with SCC (except submission of bids which is on 35th day).
- First auction notice to be issued within 45 days if there is no compromise or arrangement proposal by the CoC.
- In the event of failure of an auction, the successive auction notice shall be issued within next 15 days of a failed auction unless SCC agrees to extension of this timeline, on specific grounds as indicated by the liquidator.

6. Treatment of Avoidance Proceedings

- Before application for dissolution or closure of process is filed before AA, the SCC shall decide the manner in which proceedings in respect of avoidance transactions or fraudulent or wrongful trading, if any, will be pursued after closure of liquidation proceedings and the manner in which the proceeds, if any, from such proceedings shall be distributed. This shall be filed as a part of the final report to be filed before AA.

7. Submission of Claims

- If any claim is not filed during liquidation process, then claim collated during CIRP shall be deemed to be submitted for the purpose of Section 38 of IB Code.

Analysis of the Amendment

The Amended Regulations are no doubt laudatory steps which will help to maximize recoveries for creditors since the amendments will lead to concluding the liquidation process in a time bound manner. It will also make the liquidator and the SCC more accountable towards the creditors and prospective bidders. The amendments will empower the operational creditors who are generally at the mercy of the financial creditors during the whole process. This will especially take care of small operational creditors who after filing their claims with the Resolution Professional during CIRP tend to become ignorant about the steps to be taken in liquidation. This is because it involves repeated exercise of filing claims through advocate or other professionals requiring additional money to be spent on this. However, at the same time, certain issues are simmering on the backburner and requires strict scrutiny.

Though the amendments concerning the constitution of SCC in an effort to make the liquidator more accountable is a welcome step, however from the way things stand currently, the Amended Regulations have still not filled the gaps. Pursuant to Amended Regulations, the existing CoC constituted during the CIRP shall function as SCC for first 60 days till the time the SCC is re-constituted basis their claims adjudicated by the liquidator. This means that the existing CoC (functioning as SCC) will advise to the liquidator on certain matters pertaining to the liquidation process which might conflict with the views taken by the re-constituted SCC because of the diverse nature of interests all stakeholders have in the liquidation process. The Amended Regulations does not address this issue which might lead to more litigation thereby delaying the liquidation process.

While it may be understood that prescribing timeline for successive auction may streamline the process, it might also lead to value erosion of assets. Prescribing timeline of 15 days between two auctions will be looked by the prospective buyers as an opportunity to buy the assets or the CD at a reduced prices since in every next auction, liquidator may reduce the sale price and thus no prospective buyers will be coming forward in first round of auction.

Currently, the law is not very clear regarding the beneficiaries of the avoidance or fraudulent proceedings after liquidation. The Amendment Regulations provide that SCC will decide the manner in which the proceeds, if any, from avoidance proceedings shall be distributed appears to be contrary to the latest decision of the NCLAT where it was held that it was not for the CoC to decide the beneficiaries of an avoidance application, and such decision is to be taken by the AA. Another relevant argument might be that this NCLAT Judgment was only in the context of the CIRP. The question of the same being applicable to Liquidation is still debatable. Unless these inconsistencies are resolved, the AA will still be stuck with the question concerning closure application vis-vis pending avoidance proceedings because even after formal closure, the successful bidder or the CD will not have clarity regarding the beneficiaries of the proceedings causing lack of interest in prospective bidders.

In terms of the Regulation 31A (10) of Liquidation Regulations, the role of the SCC is only to advice the liquidator and the liquidator is not bound by the advice given by the SCC. However, the language of the draft regulations doesn’t align with this since it provides that SCC has more power than merely to advise the Liquidator. Like, the Amendment Regulations provides that the successive auction notice shall be issued within the next 15 days of a failed auction unless the SCC agrees indicating that Liquidator cannot take decision to issue the successive auction notice after 15 days in contrary to the decision arrived at by the SCC. Further, the Amendment Regulations provides that SCC shall decide the manner in which proceedings in respect of avoidance transactions or fraudulent or wrongful trading, if any, will be pursued after closure of liquidation proceedings. This is clearly in conflict with the scheme of the IB Code as captured in Regulation 31A (10) of the Liquidation Regulation which provides that SCC will only have advisory role and thus IBBI can probably look to change the language of the Amendment Regulations.

It is important to bear in mind that a lot of these amendments will have a strong bearing on the outgoing liquidation process. Therefore, the Amendment Regulations will not doubt solve a lot of problems being faced by all the stakeholders including the liquidator in the process, the IBBI still needs to clarify the specific applicability of these provisions to the ongoing liquidation, if any.

Thus, it can be perceived that, these amendments can go a long way to strengthen and improvise the current regulatory framework of liquidation process. However, it should be noted that whether the amended reforms can be effective only when the same is implemented in full force. The key lies in the implementation of the amendments so as to achieve the objectives of time-bound resolution of stressed assets while maximising its value. This is also essential to minimise the wastage of government machinery and its resources.

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