

SALE AS A GOING CONCERN UNDER LIQUIDATION:

A SAFTEY TOOL

The enactment of the Insolvency & Bankruptcy Code, 2016 ('Code') introduced a revamped regime for the liquidation of companies for which insolvency resolution has failed. While the most common form of the process is usually either of the two, i.e. resolution and liquidation, there exists another approach which lies between the two. An attempt to preserve the value, rescue the business yet resulting in the assets changing hands. Sale as a going concern during liquidation is the hybrid approach that strikes a balance between liquidation and insolvency resolution as also discussed in the UNCITRAL Legislative Guide on Insolvency Law¹.

The primary objective of the Code is to maximize worth for the creditors. Keeping in line with this objective, the regulator by means of an amendment dated 25.07.2019 added a new regulation 32A² for the sale of the corporate debtor as a going concern under liquidation. As per this new liquidation regulation, if the committee of creditors or the liquidator is of the opinion that the firm or its small business must be sold as a going concern, then the liquidator in order to maximize the worth shall initially endeavour to sell the complete firm or identified assets and liabilities or the small business as a going concern. The inimitable feature of a going concern sale is that, since the business of the corporate debtor can be transferred as a going concern, there exists a possibility of transfer of a whole of intangibles forming part of a business- contracts, leases, licenses, concessions, operational assets, manpower, technology, and so on.

While the Code recognises going concern sale as one of the methods of sale, however, it does not provide for the definition of "GOING CONCERN". Nevertheless, the term has been analysed by the insolvency law reform committee, and has also been interpreted in various judgements. The reference may be made to the report

¹ https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf

² https://www.ibbi.gov.in/webadmin/pdf/whatsnew/2019/Jul/Liquidation%20Regulations%2025072019%20final%20English_2019-07-25%2020:13:32.pdf

of the Insolvency Law Committee³ dated 26.03.2018, where in the committee examined the term “going concern” as:

“The phrase “as a going concern” imply that the corporate debtor would be functional as it would have been prior to initiation of CIRP, other than the restrictions put by the code.”

In discussion of the Insolvency and Bankruptcy Board of India held on 21.05.2018⁴, the board discussed Gujarat NRE Coke Limited Case, to understand the difficulties in selling corporate debtor as a going concern. Several challenges were brought up, pursuant to which a note was published by IBBI, defining “going concern”, as follows:

“Going Concern means all the assets, tangibles or intangibles and resources needed to continue to operate independently a business activity which may be whole or a part of the business of the corporate debtor without values being assigned to the individual asset.”

In this regard, it was also mentioned that as the company survives, there will be no need for dissolution of the company in terms of Section 54 of the Code. The assets along with all attendant claims, limitations, licenses, permits or business authorizations remain in the company. The company survives as it was; the ownership of the company is transferred by the liquidator to the acquirer. The liquidator shall make an application to the Adjudicating Authority for approval of the sale of the corporate debtor as a going concern.

The term going concern was also examined in the case of Rajashri Foods Pvt Ltd⁵, “A going concern is a concept of accounting and applies to the business of the company as a whole. Transfer of a going concern means transfer of a running business which is capable of being carried on by the purchaser as an independent business. Such transfer of business as a whole will comprise comprehensive transfer of immovable property, goods and transfer of unexecuted orders, employees, goodwill etc.”

³ http://www.mca.gov.in/Ministry/pdf/ILRReport2603_03042018.pdf

⁴ https://ibbi.gov.in/Agenda_03_26062018.pdf

⁵ <http://gstcouncil.gov.in/sites/default/files/ruling-new/06-Rajashree%20Foods-AAR-order.pdf>

The transfer of business as a going concern is a well-known concept, and has been analysed in various tax rulings as well. Demerger of an undertaking into another undertaking usually happens by transferring the undertaking to a new company on a going concern basis. The said condition has been interpreted by the Delhi High Court in *In Re Indorama Textile Limited* (2013) CompLJ1417⁶, as meaning if assets and liabilities being transferred constitute a business activity capable of being run independently for a foreseeable future.

Sale of the corporate debtor on going concern basis and Sale of Business(s) as a going concern:

The sale of a corporate debtor under liquidation by way of Going Concern Sale was not contemplated under the Code, nor did it find any place in the Regulation 32 of Liquidation Process Regulations (*Manner of Sale*), as it was originally framed. The absence of a specific enabling mechanism to allow sale of a corporate debtor under liquidation on a going concern basis, did not deter NCLT, Kolkata Bench to direct the liquidator of Gujarat NRE Coke Limited, with an avowed objective of protecting the livelihood of the workmen of the Corporate Debtor, to attempt to sell the Corporate Debtor as a going concern' through a slump sale, observing that a slump sale is nothing more than the transfer of the whole or part of a business concern of as a going concern.⁷

In pursuance of this aforesaid order and a legislative intent, the IBBI introduced the amendment to specifically provide statutory backing for the proposition of law laid down in Gujarat NRE Coke Limited Case. By introducing the IBBI (Liquidation Process) (First Amendment) Regulations, 2018, the Liquidator was permitted to sell the corporate debtor as a going concern. Subsequently, the Second Amendment Regulations introduced the option of selling the business(s) of the corporate debtor as a going concern. The amendments have been made considering that the acquirer may or may not want to continue with the same legal entity, and may or may not be interested in one or more business(s) of the corporate debtor. Essentially, a corporate debtor may have multiple line of business and each business can be sold separately as a going concern. Also, the business assets will have to be sold along

⁶ <https://indiankanoon.org/doc/135651533/>

⁷ Gujarat NRE Coke Limited In Re CP (IB) No. 182/KB/2017, order dated January 11, 2018 (NCLT Kolkata)

with the business, the non-business or the peripheral assets may be sold separately on piece meal basis or otherwise.

Distinction between sale of corporate debtor as a going concern and sale of business of corporate debtor as a going concern:

It is crucial to identify the difference between sale of corporate debtor as a going concern [Regulation 32(e)] and sale of business of corporate debtor as a going concern [Regulation 32(f)]. Under both the clauses, the assets are not sold by way of slump sale or piecemeal sale, the acquirer buys the business with the assets. The business can either operate under the existing brand and structure of the Corporate Debtor or not. Seemingly the only difference between “the corporate debtor as a going concern” and “the business(s) of the corporate debtor as a going concern” is that in the former situation, the corporate debtor itself will be retained, will not be dissolved, and will be transferred along with the assets. However, in the latter case, the business will be transferred as a going concern, without transferring the legal entity, and therefore, the legal entity will be taken for dissolution.

Recently in a significant order passed by NCLT, Mumbai bench in the case of Gaurav Jain vs Sanjay Gupta⁸ the Hon’ble Bench opined that one advantage of the sale of the Corporate Debtor as a ‘going concern’ is that the Corporate Debtor is retained, it will not be dissolved and the Corporate Debtor will be transferred along with the assets. So, the Corporate Debtor as a legal entity remains as such. Corporate Debtor survives, only the ownership is transferred by the Liquidator to the purchaser. In the recent case of IVRCL, that owed more than 14000 cr to creditors was under liquidation as a going concern following the order of NCLT, Hyderabad.

“This sale is subject to the decision of National Company Law Appellate Tribunal, Delhi in the matter of Company Appeal (AT) on the pending appeal against NCLT order dated 26 July 2019 read with Corrigendum order dated 31st July 2019 ordering liquidation of the company as a going concern and subject to the

⁸ Gaurav Jain vs Sanjay Gupta, Liquidator of Topworth Pipes & Tubes Pvt Ltd. IA No. 2264 of 2020 In C.P. (IB) No. 1239/MB/2018

provisions of IBC, 2016 and liquidation regulation,” IVRCL said in filing to the exchanges.”

Practical Challenges in implementing the Liquidation Regulations:

Though adjudicating authority has approved several cases as corporate debtor to be sold as a going concern under liquidation, there remain few challenges in the liquidation regulations.

1. There is no mechanism in place to allow the liquidator to appoint new board of directors of the Investor and remove the old directors. Normally in the corporate insolvency resolution process, there is a monitoring agency that is empowered to take such decisions. However, in liquidation, there is no such structure or authority provided to the liquidator.
2. Though existing shares of the corporate debtor are extinguished under Section 53 of the code during the distribution process from a liquidation sale, the question is that whether the regulations allow the liquidator to issue fresh equity in favour of the new investor or transfer ownership of the corporate debtor to a new investor.
3. If the corporate debtor is transferred as a going concern, there is no question of disposal of the assets of the company, either by way of a piecemeal sale or a slump sale. Therefore, it may be argued that the waterfall mechanism stipulated under Section 53 of the Code also does not apply. However, in a going concern sale in liquidation, there cannot be a question of the liabilities being a part of the undertaking, as that will be a case of business transfer, and not a case of liquidation. In bankrupt liquidation, there has to be a case of settling the liabilities from the realisations, as per the priority set out in Section 53, and the liabilities shall stand extinguished once the distribution is made to the best extent possible. Accordingly, once sale is concluded and distribution is also done, an application may be made to the, along with the final report of the liquidator, to pass necessary orders for extinguishment of liabilities. The provisions of the Code should accordingly be amended in line of the same.

CONCLUSION

The quintessential feature as to why 'liquidation process on a going concern' basis has triumphed over other processes of sale is that it aims at value preservation of the undertaking including intangible assets. The legal entity survives in a going concern sale and the value of the soft and intangible assets of the company will be preserved. Another major advantage is 'going concern sale' provides a medium to the employees of the company to still retain their jobs as seen in *Gujarat NRE Coke Limited Case* and even acquirer who acquires the undertaking will have a smooth transition as no liabilities will be transferred. However, despite the recent amendments, there is still some requirement to bring in some more changes to resolve the issues faced by liquidators, particularly, in the direction of liquidation as going concern.