LIQUIDATION SALE AS GOING CONCERN:

The Concern Is Dead, Long Live The Concern!

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Editor's Note: *The following is a precursor to the more detailed note titled Enabling Going Concern Sale (*supra*) of the above-note titled "Enabling Going Concern Sale in Liquidation"*

The amendments to the Liquidation Process Regulations, introduced on 28th March, 2018, have made a seemingly small change to Reg. 33 of the Liquidation Process Regulations, permitting the liquidator to sell the "corporate debtor as a going concern". This seemingly small amendment is obviously inspired by a wholesome objective – to retain the going concern nature of the entity even though the entity has gone into liquidation. However, the amendment may raise lots of questions, and create an overall intrigue, as to what is the meaning of sale of the corporate debtor as a going concern.

This article tries to answer some of these complicated issues.

Impact of liquidator order: cessation of going concern status

"THE KING IS DEAD – LONG LIVE THE KING!"

THE MEANING OF THE ADAGE IS THAT THE KING MAY DIE, BUT THE KINGDOM CONTINUES, UNDER THE NEW KING. SIMILARLY, IN GOING CONCERN SALE UNDER LIQUIDATION, THE IDEA IS THAT THE CONCERN MAY SURVIVE AS IS, BUT UNDER A NEW OWNER

One of the significant differences between insolvency and bankruptcy phases of a company is that while the entity is, and is intended to remain, a going concern during resolution, in liquidation, the entity ceases to be a going concern immediately as the liquidation order is passed. Liquidation is the process that entails liquidation, that is, disposal of the assets of the entity. Liquidator does not sit on the task of running the company; his task is to liquidate. Of course, the law has always empowered the liquidator to carry on the business of the company to the extent required for its beneficial liquidation, but this power has been interpreted as being limited to, or subservient to the objective of liquidation. That is, the liquidator may do only such things, and carry only such activities, as are conducive to the immediate objective - liquidation.

Amendment in Liquidation process regulations

The amendment *vide* 28th March, 2018 notification adds clause (c) to Reg. 32 of the Liquidation Process Regulations. The Regulation, as amended, stands as under:

The liquidator may:

(a) sell an asset on a standalone basis; or

(b) sell

(i) the assets in a slump sale,

(ii) a set of assets collectively, or

(iii)the assets in parcels1 or".

(c) sell the corporate debtor as a going concern.

"If the company 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."

Note that the existing clauses (a) and (b) refer to sale of the assets of the company. Plainly read, the newly inserted clause (c) refers to sale of the company itself, as a going concern. That seems to mean, if the company is sold as a going concern, the company survives, and therefore, there will be no need for dissolution of the company in terms of sec. 54.

This would almost seem to be the case of a resolution during the insolvency phase: during insolvency, the company mostly survives, and the company undergoes a resolution plan, which gets the seal of approval of the adjudicating authority. Since the company in question was clearly a bankrupt company, meaning a case of irreparable deficit of assets over liabilities, retention of the corporate existence of the company does not make any sense at all, unless there is a compromise or arrangement, whereby the creditors agree on waivers, write-offs, repayment structure, etc.

Also, if the company 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 strictly speaking, sec 53 of the Code does not apply. The assets stay in the company, and so do the liabilities, along with all attendant claims, limitations, licenses, permits or business authorizations. The company survives as it was – the ownership of the company is moved by the liquidator to the acquirer.

It is important to understand that the role of the NCLT as the adjudicating authority in liquidation is limited – it does not approve any resolution plan. Therefore, there is, prima facie, no intervention of the NCLT in effecting any waiver of liabilities or deferment thereof. So, the issue is – if the company was in a situation of irreparable deficiency prior to bankruptcy, how does the survival of the company in liquidation proceedings help?

Transfer of business as going concern

Going concern itself is a well-established accounting notion, and one of the fundamental assumptions in preparation of financial statements. "Going concern", as an accounting notion, is defined in AS 1 as follows:

The enterprise is normally viewed as a Going Concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

The transfer of business as a going concern is a common concept in the world of commerce. De-merger of an undertaking into another undertaking usually happens by transferring the undertaking to a new company on a going concern basis. Section 2 (19AA) (vi) of the Income-tax Act, 1961

imposes this as a pre-condition to the statutory definition of de-merger. The condition has been interpreted by the Delhi High Court in *Indorama Textile Limited*as meaning if assets and liabilities being transferred constitute a business activity capable of being run independently for a foreseeable future. In *KBD Sugars & Distilleries Ltd., Bangalore vs. Asstt. Commissioner of Income-Tax,* it was held that going concern always means to say 'alive', whether profit-making or not.

Also, the Income tax appellate tribunal (ITAT) held in the above case, for a going concern to mean, that the undertaking constituted a business activity capable of being run independently for the foreseeable future. See also the ruling in *Hindustan Engineering by ITAT, Kolkata*.

In the Central GST Act as well, there is a specific provision for transfer of a business as a going concern – if the transfer of goods happens as a part of a transfer of a business as a going concern, then there is no GST on such a transfer – Item 4 of Schedule II of CGST Act.

Usual pre-conditions of transfer of business as a going concern:

To transfer a business as a going concern, there are certain pre-requisites in absence of which such a transfer would amount to a mere sale or transfer of assets or liabilities. The conditions are:

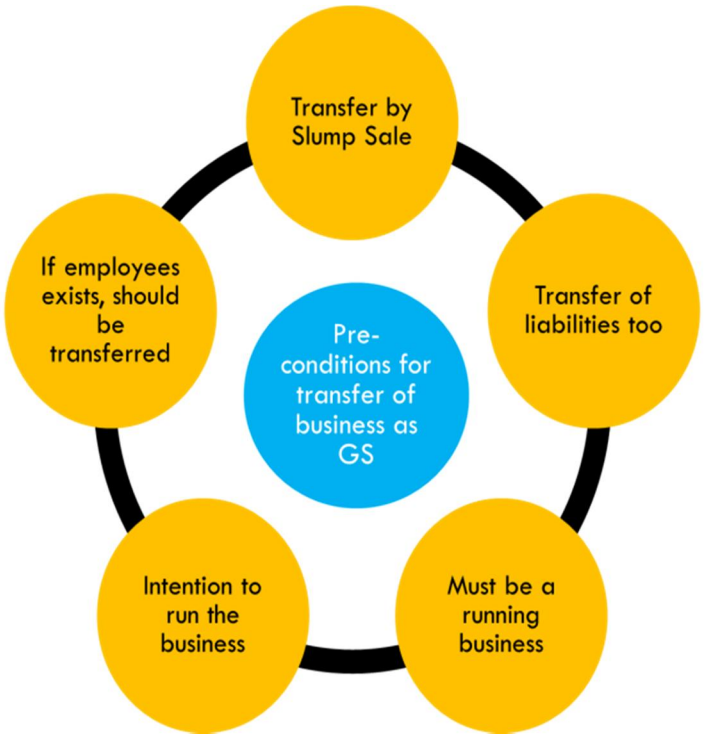

Figure 17: Usual Preconditions for going concern sale

- Transfer to be carried out by a slump sale, not by itemized sale

  That is to say, the sale must be of the assets put together. All such assets which constitute an integral business activity or enterprise must be transferred, and the consideration must be for the entire undertaking as a whole, and must not be for each of the assets individually.

- Transfer of liabilities too

  If there are any liabilities relevant to the business or undertaking being transferred, the liabilities must also be transferred.

- Business must be a running business

The idea of a going concern is normally equated with that of a running concern. If the concern in question has long stopped its operations, it is hard to conceive as to how the undertaking could be a going concern.

- Idea must be to run the business

The idea of the acquirer in case of a slump sale is to run the business, and not to dismantle or cannibalise it.

- If employees exist, the employees should also be intended to transferred

One of the major features of going concern sales, as noted in several insolvency proceedings (see next section) is the continuation of employees.

History of going concern sales in winding up

Transfer of entities as a going concern has been a very popular mode of disposal of entities in winding up proceedings. The 1980s saw a spate of industrial closures, and consequential winding up proceedings before the Calcutta High court rulings. It seems quite clear, looking at the observations of the judges who opted for going concern sale in winding up proceedings, that the judge was inspired by the goal of preserving employees. Justice Manjula Bose while delivering her speech in winding up of *AMCO* stated: "as the Court considered the interest of the workers to be of paramount importance and a matter to be considered along with the interest of the Company, inasmuch as it was the hard labour of the workers which was created the Company to exist all these years. Now that the Company faced closure, it would not be right to throw them out on the street, when there is an offer for the Company to run, and an offer made to re-employ all the workers who had been on the payroll…factory should be sold in running condition so that the factory workers should not be thrown out of work and / or employment."

In another early case before the Calcutta High court where a company was ordered to be sold on going concern basis under liquidation was the *National Tannery Co Ltd. case*. This is an interesting case study of how a committee of management was formed to run the company until its sale on going concern basis, and eventually, how the West Bengal govt. offered to acquire the company on a going concern basis, pay consideration, and also agree to pay the wages of the workmen. See this interesting case study covered in a research paper.

However, while the idea of going concern sales in liquidation was lofty, it sounded quite difficult proposition too, particularly in cases where the entity in question was closed for a long time. The general judicial impression of going-concern sales was that the employees will be passed on to the acquirer, including the closing stock. Several rulings have actually noted that if the entity was shut for some time, it should first be run at least for a day before transfer, and then transferred as a going concern. The impracticality involved in the process has been notedin a Supreme Court ruling in *Allahabad Bank vs ARC Holding and another* in the following words: "But subsequent order directs sale of the entire assets of the company as a 'going concern'. This means revive the company first to make it operational, re-employ its employees, which would involve huge investment by the prospective buyer, a Herculean task, making execution practically infructuous."

In most cases of going-concern sales in winding up proceedings, the acquirer will come with some kind of a compromise settlement with the stakeholders – including workmen. The settlement would be filed for a consent decree before the court.

Going concern transfer under the Code

In light of the above discussion, it will be interesting to find out the purport of going concern transfer, in liquidation proceedings, under the Code.

Evidently, prior to the commencement of liquidation proceedings, resolution has been given a chance, and the same has failed. This is what has pushed the company into liquidation. There already existed the option of slump sale. The slump sale option is with reference to the assets of the company; however, the Liquidation Regulations now permit the liquidator to cause a sale of the company as such, without transferring the assets of the company.

The only potential meaning of this is that the equity shareholding of the company gets transferred, and the acquirer takes over the company, with all liabilities, limitations, licenses, outstandings, assets, entitlements, etc.

Unlike in the case of going-concern transfers in winding up, where the transfer took place under the supervision of the court, the court would give an order, mostly based on a mutual compromise. However, in case of liquidation proceedings, there is as such no intervention of the NCLT – hence, there is, prima facie, no scope for any order of the NCLT giving any phased payment plan, or any forced waiver of the liabilities of the creditors. On the contrary, if the acquirer was to settle all liabilities as they were, that would be counter-intuitive in case of an entity which has failed the going-concern already.

Hence, all eyes will be on the future course of legal proceedings on this issue. If some NCLT takes a view, which, to the humble of the author, is the right view, that the NCLT has the right to pass appropriate orders in case of liquidation proceedings as well, may be using the generic powers in sec. 60 (5) of the Act, there may be a unique possibility of resolution in liquidation!
