

VOLUNTARY LIQUIDATION REGULATIONS- LAST BUT NOT THE LEAST

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Editor's Note: IBC not only provides for insolvency resolution and liquidation of solvent entities, it also covers voluntary liquidation of solvent entities.

The provisions of voluntary winding up have been removed from the Companies Act, 2013 and are now governed by the IBC, 2016. Ministry of Corporate Affairs vide notification dated 30th March, 2017 notified Section 59 of the Insolvency and Bankruptcy Code, 2016 which is relating to Voluntary Liquidation of Corporate persons. On the very next day, the Insolvency and Bankruptcy Board of India (IBBI) vide its notification dated 31st March 2017, notified the [Insolvency and Bankruptcy Board of India \(Voluntary Liquidation Process\) Regulations, 2017](#) which came into effect from 1st April 2017. This note, written soon after the promulgation of the voluntary liquidation regulations, discusses relevant provisions in brief.

IBBI, vide Notification No. IBBI/2016-17/GN/REG010 dated March 31, 2017 has issued the VL Regulations pursuant to section 59 of the Code and has appointed April 1, 2017 as the date on which the VL Regulations shall come into force.

The Ministry of Corporate Affairs vide Notification No. S.O. 1005(E) dated March 30, 2017 has notified April 1, 2017 as the date on which the following sections of the Code came into force:

1. Section 59 – Voluntary liquidation of corporate persons;
2. Section 209 – 215 (both inclusive) – Information utilities;
3. Sub-section (1) of section 216 – Rights and obligations of persons submitting financial information;
4. Section 234 – Agreements with foreign countries; and
5. Section 235 – Letter of request to a country outside India in certain cases.

The discussion below summarises the history of voluntary liquidation provisions in India and takes note of important provisions of the Code and the VL Regulations.

Voluntary Liquidation – Why “Voluntary”?

Voluntary liquidation, as it suggests, is liquidation of a corporate entity at the instance of its members. It is like private liquidation proceeding where the court's intervention is minimised. Voluntary liquidation is opted for several reasons, e.g. when the entity has been formed for a particular purpose and the purpose has been fulfilled; or where the articles provide that the entity shall be liquidated on the happening of an event and the event has happened; or where it is unable to carry on the business.

Law relating to Voluntary Liquidation – Then & Now

Liquidation of corporate entities (compulsory as well as voluntary) has been a subject matter covered under the Companies Acts prevalent from time to time and the provisions have evolved over time.

Part VII of the Companies Act, 1956 was prominently influenced by the provisions of the UK Companies Act, 1948 and provided for the following modes of winding up –

- (i) Compulsory winding up by the court;
- (ii) Voluntary winding up, classified into –
 - 1. Members' voluntary winding up
 - 2. Creditors' voluntary winding up
- (iii) Voluntary winding up subject to supervision of court

Voluntary winding up subject to supervision of the court became redundant – hardly any matter was referred in the category, and it was opined that compulsory winding up would take care of the same [Para 4.3 of the Eradi Committee Report. The provisions were omitted *vide* the Companies (Second) Amendment Act, 2002. And obviously, this mode of winding up was out of the scene in the Companies Act, 2013. Regarding voluntary winding up, while the Companies Act, 1956 distinguished between a members' voluntary winding up and a creditors' voluntary winding up; the Companies Act, 2013 merged the provisions – under the voluntary winding up option, both a declaration of solvency, as also creditors' resolution, were made mandatory. Therefore, companies finding it difficult to make a declaration of solvency (i.e. insolvent companies), were being left with the sole option of compulsory winding up for being unable to pay debts, as the route of creditors' winding up was no more available to them. All this while, the winding up provisions of the Companies Act, 2013 were not enforced.

In the early 2015, the Bankruptcy Law Reform Committee (BLRC) submitted its Interim Report where it stated,

“Reforming the insolvency system will have some benefits for liquidation of solvent companies as well. Many shareholder-agreements for investment transactions (involving foreign and domestic investors) in Indian companies provide for voluntary liquidation of the company as one of the exit alternatives for the investors or as a consequence of a termination event (termination events are grounds on the basis of which a shareholder agreement can be terminated by all or any of the parties). The ability of shareholders to cause the liquidation of a company in the event of breach of obligations by the other shareholders can serve as a disciplining mechanism for all the shareholders (and the management). However, the effectiveness of such a remedy depends on the efficacy of the liquidation regime. If the liquidation regime is efficient, it can go a long way in promoting

Bankruptcy Law Reform Committee:

“ The ability of shareholders to cause the liquidation of a company in the event of breach of obligations by the other shareholders can serve as a disciplining mechanism for all the shareholders (and the management). However, the effectiveness of such a remedy depends on the efficacy of the liquidation regime. If the liquidation regime is efficient, it can go a long way in promoting investor confidence by giving strength to such liquidation provisions in shareholder-agreements “

Voluntary Liquidation Regulations- *Last But Not The Least*

investor confidence by giving strength to such liquidation provisions in shareholder-agreements. Such efficiency could also help commercial certainty on the occurrence of a liquidation event (by enabling parties to weigh legal risks in advance and price them into contracts accordingly).”

Subsequently, in its Final Report, the BLRC recommended that the proposed Code will also provide for voluntary liquidation of corporate persons who have not defaulted on any debt. Where a firm has not defaulted on any debt (or where a firm has no debt), it may make any application to be liquidated voluntarily in such manner as may be specified by the Board.

Consequently, the Code, which has been enacted with the main objective of providing a rescue mechanism for insolvent corporate persons (including liquidation thereof) also deals with voluntary liquidation of solvent corporate persons. Interesting is to note that sections 484 to 520 of the Companies Act, 1956 dealt with voluntary winding up and there were 20 sections (sections 304 to 323) in the Companies Act, 2013 dedicated especially to voluntary winding up (besides the general provisions relating to every type of winding up). Surprisingly, the Code, while dealing with voluntary liquidation of corporate persons (i.e. not only companies, but also limited liability partnerships and other bodies corporate), wraps up the voluntary liquidation provisions under a single section, i.e. section 59.

Voluntary Liquidation under section 59

An overview of section 59 has been provided in the following points –

1. Section 59 deals with voluntary winding up of corporate persons; therefore, financial service providers (excluded from the definition of corporate person) cannot avail this route. However, according to section 227, the Central Government may, if it considers necessary, in consultation with the appropriate financial sector regulators, notify financial service providers or categories of financial service providers for the purpose of their insolvency and liquidation proceedings, which may be conducted under this Code, in such manner as may be prescribed.
2. It is not necessary that the corporate person must owe a “debt” – reference is to “corporate persons” and not “corporate debtors”.
3. Two pre-conditions for initiating voluntary liquidation under section 59 are –
 - (i) the corporate person intends to liquidate itself voluntarily; and
 - (ii) the corporate person has not committed any default.
4. Sub-section (2) of section 59 requires that the voluntary liquidation of a corporate person shall be carried out in accordance with the conditions and requirements specified by the IBBI. The VL Regulations have been issued pursuant to this provision.
5. Where the corporate person is a company, the following procedure must be observed –
 - (i) Majority of the directors of the company shall make a declaration of solvency verified by an affidavit.

- (ii) The declaration shall be accompanied by audited financial statements and records of business operations, and a report of the valuation of assets.
- (iii) Within 4 weeks of declaration, shareholders' approval shall be obtained by ordinary or special resolution, as the case may.
- (iv) Where the company owes debt to any person, creditors' approval is also required. The approval shall be obtained from creditors representing at least 2/3rd in value of the debt of the company.
- (v) The company shall notify the Registrar of Companies and the IBBI of such resolution(s).
- (vi) Once the affairs of the company are being fully wound up, application shall be made to the adjudicating authority (i.e. the NCLT) for the dissolution of the corporate person. The corporate person shall be deemed to be dissolved from the date of the order of the adjudicating authority.

6. Note that –

- (i) The voluntary liquidation shall commence from the date of passing the shareholders' resolution, subject to the creditors' approval.
- (ii) The shareholders shall appoint an insolvency professional to act as liquidator for the purpose of conducting the voluntary liquidation proceedings.
- (iii) The provisions of sections 35 to 53 (relating to liquidation under the Code in respect of insolvent entities) shall apply to voluntary liquidation proceedings for corporate persons with such modifications as may be necessary. These provisions are listed below –
 - (a) section 35 – powers and duties of liquidator;
 - (b) section 36 – formation of liquidation estate, inclusions in and exclusions therefrom;
 - (c) section 37 – power of liquidator to access information systems;
 - (d) sections 38 to 42 – consolidation, verification, admission/rejection of claims; determination of value of claims; application against the decision of the liquidator;
 - (e) sections 43 to 51 – provisions relating to avoidable transactions, namely, preferential transactions, undervalued transactions, transactions defrauding creditors, extortionate credit transactions;
 - (f) section 52 – rights of secured creditors in liquidation proceedings; and
 - (g) section 53 – distribution of assets, priority of payment of debts.

The VL Regulations

A brief summary of the VL Regulations has been given as below:

- **Liquidation commencement date** – Liquidation commencement date has been defined under section 5 (17) of the Code to mean *the date on which the proceedings for liquidation commence in accordance with section 33 or section 59, as the case may be*. As stated under section 59 (5), voluntary liquidation shall be deemed to have commenced from the date of passing the shareholders’ resolution, subject to the creditor’s approval. Similarly, as stated under regulation 3 (3) of the VL regulations, the voluntary liquidation proceedings in respect of the corporate person (other than a company) shall be taken to commence from the date on which the partners, or contributories (as the case may be) resolve as such, subject to the creditors’ approval.
- **Voluntary liquidation of a corporate person other than a company:** Note that sub-section (2) of section 59 requires the Board to specify procedures and conditions for voluntary liquidation of corporate persons, while sub-section (3) provides some detailing as regards voluntary liquidation of a company. Regulation 2 of the VL Regulations lay down similar criteria (as under sub-section (3) of section 59) to be met in case of voluntary liquidation of a corporate person other than a company.
- **“Special majority” of partners** – Section 59 requires special resolution of the shareholders for voluntarily liquidating the company in some cases – sub-section (3) (c) (i); and the regulations, in respect of a corporate person other than a company, requires special majority of partners/contributories. Though the meaning of the term “special resolution” can be easily deciphered from the Companies Act, 2013; however, what constitutes “special majority” of partners/contributories has not been defined under the VL Regulations.
- **Approval of creditors** – Creditors’ approval is also a requirement for the commencement of voluntary liquidation proceedings. It is possible that the creditors refuse to approve such resolution or refuse to accept the liquidator nominated by the shareholders. Approval of creditors’ being a pre-condition in case a company owes a debt, it is opined that the only option left with the company is to move an application under section 271 of the Co Act, 2013.
- **Remuneration of the liquidator** – The Code requires the shareholders to appoint an insolvency professional to act as liquidator. However, unlike the provisions relating to remuneration of the liquidator under the Liquidation Regulations, 2016, there is no prescription as to the manner in which the remuneration of the liquidator shall be determined. The Liquidation Regulations (reg. 4) allow the committee of creditors to determine the remuneration in some cases; while in other cases, the liquidator’s fee is a function of the amount realized net of other liquidation costs, the amount distributed, and the time period within which the amounts are realised and distributed. In the case of voluntary liquidator, the VL regulations require that the remuneration shall be fixed by the shareholders/partners/contributories (as the case may be) under the same resolution as passed under section 59 (3) (c) or regulation 3 (1) (c). Hence, there is no mathematical

formula for computation of liquidator's fee as in case of liquidation of insolvent companies, which is understandable.

- **Eligibility for appointment as liquidator** – The eligibility conditions are the same as those for a resolution professional under the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations) and the liquidator under the Liquidation Regulations. Basic criterion is “independent of corporate debtor”.
- **Liquidator to step down on conflict of interests** – Regulation 6 (4) of the VL Regulations requires the liquidator to step down from acting as a liquidator in two cases –
 - If the insolvency professional entity of which he is director/ partner represents other stakeholder in the same liquidation proceeding; or
 - Any other director/ partner of such insolvency professional entity represents any other stakeholder in the same liquidation proceeding.
- **Public announcement of liquidation** – The public announcement of voluntary liquidation shall be made by the liquidator within 5 days of his appointment. The time limit is same under the Liquidation Regulations. However, in case of insolvency resolution, the public announcement shall be made within three days of the appointment of interim resolution professional.
- **Claims** – Chapter V of the VL Regulations provide for the manner of submission of claims by creditors (including workmen and employees and secured creditors), determination of amount of claims, foreign currency claims, mutual credits ad set-off, verification of claims, etc.
- **Realisation of assets** – Note that the VL Regulations allow the liquidator to value and sell the assets of the corporate person in the manner and mode approved by the corporate person. The provisions are stricter and more specific under the Liquidation Regulations.
- **Reporting requirements** – Pursuant to regulation 8, a liquidator is required to prepare and submit viz., preliminary report, annual status report, minutes of consultations with stakeholders and final report.
- **Preliminary report:**
 - **Submission of preliminary report** – within 45 days from the liquidation commencement date.
 - **Content of the report** – the preliminary report shall provide details of following –
 - » the capital structure of the corporate persons;
 - » estimates of its assets and liabilities as on liquidation commencement date based on the books of the corporate persons;

Voluntary Liquidation Regulations-
Last But Not The Least

- » intention to make any further inquiry in to any matter relating to the promotion, formation or failure of the corporate person or the conduct of the business;
 - » the proposed plan of action for carrying out the liquidation, including the timeline within which he proposes to carry it out and the estimated liquidation costs.
- **Annual status report:**
- » If liquidation process continues for more than 12 months
 - » Status report shall indicate progress in liquidation and shall *inter alia* include the following –
 - ✓ settlement of list of stakeholders,
 - ✓ details of any assets that remains to be sold and realized,
 - ✓ distribution made to the stakeholders, and
 - ✓ distribution of unsold assets made to the stakeholders;
 - ✓ developments in any material litigation, by or against the corporate person;
 - ✓ filing of, and developments in applications for avoidance of transactions in accordance with Chapter III of Part II of the Code and
 - ✓ enclose audited accounts of the liquidation.
- **Minutes of consultations with stakeholders:**
- » The stakeholders shall extend all assistance and cooperation to the liquidator to complete the liquidation of the corporate person;
 - » Any consultation with the stakeholders shall be recorded.
- **Final report:**
- » When to prepare – on completion of the liquidation process
 - » Final report shall consist of –
 - ✓ audited accounts of the liquidation, showing receipts and payments pertaining to liquidation since the liquidation commencement date; and
 - ✓ a statement demonstrating that-
 - ✓ the assets of the corporate person has been disposed of;
 - ✓ the debt of the corporate person has been discharged to the satisfaction of the creditors;

- ✓ no litigation is pending against the corporate person or sufficient provision has been made to meet the obligations arising from any pending litigation.
 - ✓ a sale statement in respect of all assets containing –
 - ✓ the realized value;
 - ✓ cost of realization, if any;
 - ✓ the manner and mode of sale;
 - ✓ an explanation for the shortfall, if the value realized is less than the value assigned by the registered valuer in the report of the valuation of assets under section 59(3)(b)(ii) or Regulation 3(1)(b)(ii), as the case may be;
 - ✓ the person to whom the sale is made; and
 - ✓ any other relevant details of the sale
 - ✓ Final report shall be sent to? – the Registrar, the Board and the Adjudicating Authority.
- **Time period for completion of liquidation** – Regulation 37 of the VL Regulations requires that liquidator shall endeavor to complete the liquidation process of the corporate person within 12 months from the liquidation commencement date. In case the process continues beyond, the liquidation shall call meeting(s) of contributories at intervals specific. The time period suggested under the Liquidation Regulations is 2 years.
 - **Rights of members *inter-se* in case of distribution** – Sections 304 to 323 of the Companies Act, 2013 have been omitted; however, an important part missed in section 59 and the VL regulations is the provision relating to distribution of property of company among the members according to their rights and interests in the company. While in case of an insolvent company, the possibility of shareholders getting a surplus might be bleak; such a provision is of crucial importance in case of liquidation of a solvent company.
 - **Suspension of liquidation** – There is a provision under regulation 40 which states that where the liquidator detects insolvency, he shall make an application to the adjudicating authority to suspend the process of liquidation and pass any such orders as it deems fit.
 - **Dissolution of corporate persons** – On affairs of the corporate persons being completely wound up, the liquidator shall make an application to the Adjudicating Authority for dissolution of corporate persons. The Corporate persons shall be dissolved from the date of order and a copy of the same shall be forwarded to the authority within a period of fourteen days with which such corporate persons is registered.

Transfer of pending proceedings

Rule 4 of the Companies (Transfer of Pending Proceedings) Rules, 2016 provide that “All applications and petitions relating to voluntary winding up of companies pending before a High Court on the date

Voluntary Liquidation Regulations-
Last But Not The Least

of commencement of this rule, shall continue with and dealt with by the High Court in accordance with provisions of the Act". Note that the date of commencement of Rule 4 is 1st April, 2017.

Therefore, the voluntary winding up proceedings pending as on 1st April, 2017 will not get transferred to NCLT, and will be dealt with by the High Court in accordance with the provisions of the Act, 1956, as shown below:

Consequences of shifting voluntary winding up provisions to the Code

Para 16 of the Eleventh Schedule of the Code [pursuant to Clause 255] to the Code calls for omission of Sections 304 to 323 of the Companies Act, 2013 dealing with voluntary winding up provisions. Therefore, the Companies Act, 2013 now have only one mode of winding up – winding up by the NCLT. However, only the insolvency professionals have been allowed to act as liquidators in these modes of winding up, whether by NCLT under the Companies Act, 2013 or winding up of insolvent companies under the Code, or voluntary liquidation of corporate persons under the Code.
