Highlights of MCA Discussion Paper on changes considered to IBC (18th Jan, 2023)

Vinod Kothari & Sikha Bansal
Vinod Kothari and Company

Kolkata:
1006-1009, Krishna Building
224 AJC Bose Road
Kolkata – 700 017
Phone: 033 2281 3742/7715
Email: corplaw@vinodkothari.com

New Delhi:
Nukleus, 501 & 501A,
Salcon Rasvilas,
District Centre, Saket,
New Delhi - 110017
Phone: 011 6551 5340
Email: delhi@vinodkothari.com

Mumbai:
403-406, Shreyas Chambers
175, D N Road, Fort
Mumbai
Phone: 022 2261 4021/ 3044 7498
Email: mumbai@vinodkothari.com

Bengaluru:
Rent A Desk
4, Union Street, Infantry Rd,
Shivaji Nagar
Bengaluru- 560001
Phone: 033 2281 3742
Email: corplaw@vinodkothari.com

Reach us on social media:

Copyright & Disclaimer

- This presentation is only for academic purposes; this is not intended to be a professional advice or opinion. Anyone relying on this does so at one's own discretion. Please do consult your professional consultant for any matter covered by this presentation.
- The contents of the presentation are intended solely for the use of the client to whom the same is marked by us.
- No circulation, publication, or unauthorised use of the presentation in any form is allowed, except with our prior written permission.
- No part of this presentation is intended to be solicitation of professional assignment.

About Us

- Vinod Kothari and Company, company secretaries, is a firm with more than 34 years of vintage
  - Based out of Kolkata, Mumbai, New Delhi and Bengaluru
- We are a team of qualified company secretaries, chartered accountants, lawyers and managers.

Our Organization's Credo:

Focus on capabilities; opportunities follow

A laundry list of the Proposed Amendments (Part 1/2)

1.Use of technology in the IBC ecosystem [1.1]

2. Increasing reliance on the record submitted with the Information Utilities during the Admission Process [2.2]

3. Mandatory to admit an application filed under section 7 where occurrence of a default is established [3.1, 3.2]

4. Restricting the right of the promoters to propose an interim resolution professional [4.1]

5. Decriminalisation of generic default; AA to impose penalties for violations of the Code [5.1, 5.2, 5.3]

6. Fast-Track Corporate Insolvency Resolution Process to be non-adjudicative; application to AA either for moratorium or final stage[6.1]

7. Pre-packaged Insolvency Resolution framework to extend to non-SMEs[7.1, 7.2]

8. Improving outcomes in real estate cases [8.1, 8.2, 8.3, 8.4]

9.a. Multiple/partial resolution plans in respect of the same CD [9.2, 9.3]

9.b. Segregation of resolution and distribution of proceeds [9.5, 9.6]; separate waterfall for resolution

9.c. Mandating the use of Swiss challenge mechanism [9.7]

9.d. CoC to empower monitoring the implementation of the plan [9.8]

9.e. Defects in resolution plans to be made curable by AA orders [9.9]

10. Reinstating CIRP even after commencement of liquidation [10.1, 10.2, 10.3] [read with para 25.1]

11. Intermingling the assets of the CD and its guarantors [11.1, 11.2]

12. Coordinated insolvency for inter-dependent entities [12.2, 12.3]

13. Putting operational creditors at par with unsecured creditors in liquidation [13.1]

14. Statutory security interests not to rank at par with secured creditors [14.2]

15. Disclosure of valuation estimate of assets in the IM [15.1]

A laundry list of the Proposed Amendments (Part 2/2)

16. Ipso facto termination of contractual rights by certain counterparties to be barred [16.1, 16.2]

17. Civil Protection of a resolution applicant post implementation of the resolution plan concerning civil liabilities [17.1]

18. Voting rights not applicable to those not voting [18.1, 18.2]

19. interim finance providers may be taken as non-voting members of the CoC [19.1]

20. Appointment of Administrator by the Central Government in public interest insolvencies [20.1]

21.Power to exempt a class or classes of corporate persons from provisions of this Code [21.1]

22. Individual insolvency related proposals [22.2]

23. Direct Dissolution of the CD [23.1, 23.2]

24. Eliminating duplication of activities between the CIRP and the Liquidation Process [24.2, 24.3]

25. Creditors to manage and take "commercial decisions" during the liquidation process; voting to be based on sec 53 classes [25.1]

26. Replacement of the liquidator by creditors vote[26.2]

27. Stay on the continuation of proceedings during the liquidation process[27.1, 27.2]

28. Realisation of security interest by the Secured Creditor[28.1, 28.2]

29. Exercise of the right to relinquish or realise secured asset where more than one secured creditor holds a pari passu charge[29.1, 29.2]

30. Improving the regulation of service providers[30.1]

One of the most significant overhauls of the law

- IBC has undergone six amendments since its enactment in August 2016
  - besides, several amendments in the respective regulations
- This is, by far, the most important amendment proposal
- Proposed amendments may be classed into the following:
  - Proposals that try to overcome past difficulties:
    - voting in CoCs, direct dissolution, etc
    - Enhancing the scope of pre-packs
  - Proposals that codify amendments in regulations already done or IBBI circulars
    - presumption of relinquishment
  - Proposals to override or respond to some court rulings:
    - Vidarbha
    - Rainbow Papers
    - Gujarat Urja Vikas Nigam
- Fundamental or progressive amendments:
  - Partial resolution
  - Collapsing the levels in the waterfall
  - Separation of resolution and distribution
  - Resurrection of entity from liquidation to resolution
  - Aggregation of assets of guarantors
  - Collaboration for the purpose of group insolvency

Automation and use of technology

Case management system (Para 1)

- Currently, different institutional verticals of the Code namely,
  - MCA, AA, IBBI, IU and other service providers operate on different technological platforms
- It is proposed to streamline the interface by developing an advanced electronic platform
  - For handling several processes in the code in order to
    - improve transparency
    - minimisation of delays
    - more effective decision making
- E-platform is proposed to provide following services-
  - case management system, automated processes to file applications with the AAs, delivery of notices, enabling interaction of IPs with stakeholders, storage of records of CDs undergoing the process, and incentivising participation of other market players in the IBC ecosystem.
- Recently, an AI portal of SC named SUVAS was launched
  - for translating legal papers from English to vernacular languages and vice versa
- Similarly, this can be a potential step towards AI backed adjudication
  - Leading to time bound completion of the process

Initiation of CIRP

Information utility to be the conclusive basis of default confirmation (Para 2)

- Currently, sec 215 (2) requires filing of information with IUs
- for initiation of insolvency, evidence as per IU records is mandatory:
  - vide amendment notification dated 14th June, 2022, filing of information of default with IU made mandatory for OCs as well [Reg. 20(1A) of IU Regs.]
- Proposed amendment:
  - OCs will also be required to register a default in advance with IU
  - in case of OCs the requirement is applicable only if they are interested to proceed under this law
- noting of debt in IUs to be subject to cross verification:
  - that is, IU to give notice to CD or debtor, and a time for responding
- IU records to be exclusive and conclusive evidence of default
- Two points arise:
  - unlike in case of FCs, there is no integration of the debt with the records of the IU
  - The entry of a fact of default will be contested by the debtor, as much as filing of applications are contested now
  - Because operational creditors' claims are based on commercial reasons, it will be impossible for the IU to enter into adjudication role
- Are we, in fact, making IBC filings for OCs even more difficult?
- If IU's recorded event of default is all that is required for insolvency triggering, why not use AI here to lessen the task of the AA?

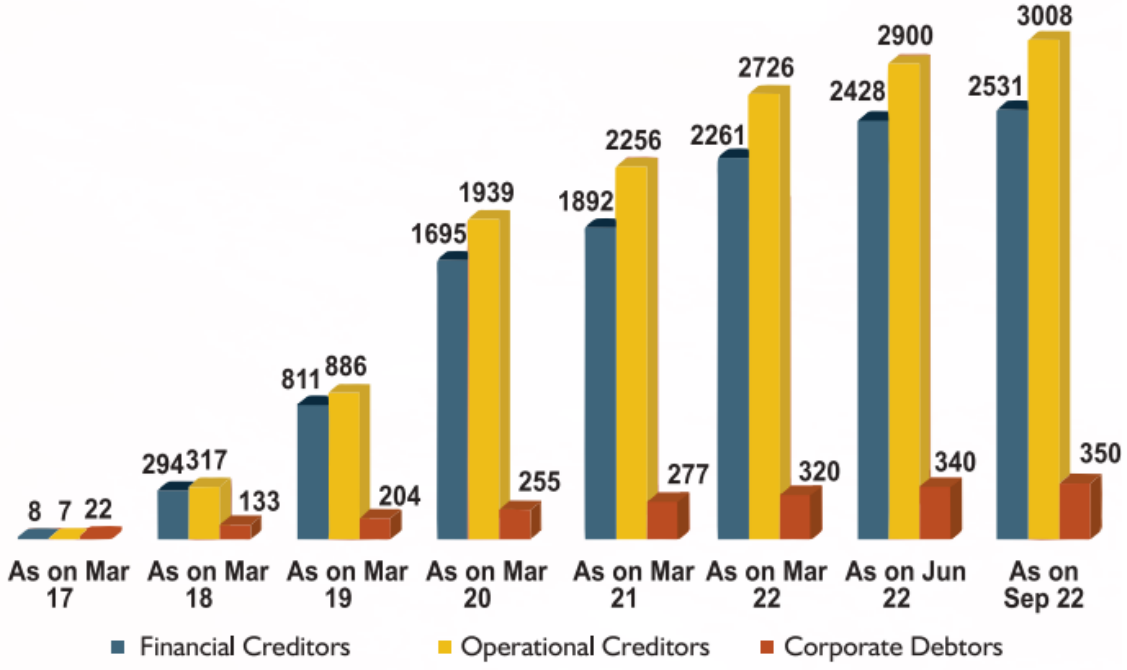
If default exists, insolvency must be admitted (Para 3)

- Currently, sec 7 provides a discretion to AA for admitting CIRP application
- Para 3 seeks to override the law declared in *Vidarbha Industries Power Limited v. Axis Bank Limited*
  - In case of application filed by FC, it is not mandatory to admit the same
- Timeline of 14 days provided u/s 7 is interpreted
  - to include the time for establishing default
- Proposed amendment-
  - Putting a mandate on admission of application if default is established - sec 7 is proposed to be modified to include the same
  - Timeline of 14 days to also include AA's decision to admit or reject the application
- Points for consideration:
  - Is it intended to make the timeline of 14 days mandatory?
  - Large delays have been observed in admission of the CIRP application which leads to asset erosion
- The liquidity test becomes supreme; solvency test becomes irrelevant
  - as was the design of the Code

Promoters not to propose IRPs (Para 4)

- Sec 10 of the code empowers CD to initiate CIRP
- Cases of initiation of CIRP by CDs are quite less; they faded with the introduction of sec 29A
  - As on 30.09.2022, just 350 cases were initiated by CDs
- Currently, sec 10(3) empowers CD to propose name of IP proposed to be appointed as IRP
- Proposed amendment:
  - To take away the right of proposing the name of IRP in case of sec 10 application
  - IRP in such cases be appointed by AA on recommendation of the IBBI
- Amendment is proposed to avoid conflicts of interest in the nomination of an IRP

Stakeholder wise distribution and trends on initiation of CIRP



Decriminalisation of offences

Decriminalisation of offences, and penalties to be imposed by AA (Para 5)

- By law, fines and imprisonment can be done only by criminal courts
- Punishment by way of fines/imprisonment is provided by chapter VII of the Code
- Residual penalty section is sec 235A, which also provides for a fine
- It is proposed to decriminalise, that is, replace fine by penalty in sec 235A
  - empower AA to impose penalties where any person fails to comply with the provisions
  - on application filed by IBBI or any other authorised person
  - As such, role of Special Court does not arise under the omnibus provision
- Malicious or fraudulent initiation of proceedings are currently punishable u/s 65 of the Code
  - Provides for penalty
  - not be less than Rs. lakh but may extend to Rs. 1 cr.
- No punishment is provided in other malicious proceedings filed before the AA
  - Proposal is made to empower AA to impose penalty in case of frivolous or vexatious applications
- Min. penalty that can be imposed by AA in case of frivolous applications
  - Proposed to be increased to Rs. 1 lakh/ day, which may extend to three times the loss caused or unlawful gain, whichever is higher
- Repeat offender under the Code also to be disqualified u/s 29A
  - Discretion to AA to debar a promoter from being a resolution applicant and submitting a resolution plan in the CIRP of any CD

Streamlining CIRPs

Fast track resolution process (Para 6)

- Fast track process is currently limited by its very narrow applicability:
  - The notification u/s 55(2) has prescribed a small co., a startup (other than partnership firm) or an unlisted company with total assets ≤ 1 crore
  - FTRP Regs. specified by IBBI are almost similar to CIRP Regs. - difference in timelines
- seeks to empower unrelated FCs to approve resolution plan by out of court process
  - Same will require approval of 66% of unrelated FCs
- IP to be appointed by the FCs; FCs to oversee the process
  - detailed procedure FTRP will be specified by IBBI
  - for ensuring that out-of-court process retains the core elements
- With respect to moratorium:
  - Same is optional and
  - FCs to reach out to AA for declaring the same
- Concern
  - if the matter anyways has to go for moratorium, then there is as much adjudicative interference

Enhancing scope for prepacks, making them more practical (Para 7)

- Prepacks are currently applicable only in case of MSMEs, and come laden with multiple approvals
  - Approval by shareholders- SR
  - Approval by unrelated FCs- 66%
  - Approval of AA
- 2-stage approval of AA
  - At admission stage - after BRP is prepared
  - At approval stage - BRP vs. BAP
- Reportedly, only 2 cases have been admitted
- MSMEs, given their size and simplicity, cannot afford resolution under the Code
- Proposed amendments-
  - Further categories of CDs are to be prescribed
  - Lower the threshold for approval of unrelated FCs from 66% to 51%
  - Declaration by CD w.r.t. existence of avoidance transaction to be omitted
  - No promoter change or conversion of process into CIRP/ liquidation

- Currently,
  - Reg. 41 requires RP to form an opinion about existence of avoidance transactions, and if so determined, file an application before AA
  - Timeline - for forming opinion within 30 days; determination before IBBI 45 days & application before AA within 60 days
- Potential question-
  - Along with omitting declaration by CD w.r.t. existence of avoidance transaction, whether the obligation on RP w.r.t. the same will also be omitted?
  - The prepack process is still laden with substantial prerequisites

Several changes in insolvency of real estate projects (Para 8)

- Explanation to sec 5(8) clarifies the position of allottees in real estate projects as FCs
  - Being classified as FC, forms part of the CoC
  - However, at times, their dissimilar interest with other FCs do not align with the scheme of the CIRP
- Divergent interest of real estate allottees & other FCs
  - Real estate allottees prefer ownership and possession instead of repayment of advances
  - Other FCs namely Banks have contradictory interests
- Since very inception, various judicial experiments are being conducted
  - to adapt CIRPs to the nature of the real estate sector
  - For instance, reverse CIRP
    - See NCLAT ruling in *Shri Bijay Pratap Singh v. Unimax International and Anr.*
    - See NCLAT ruling in *Pradip Kumar Chaudhuri v. Dagcon (India) Pvt. Ltd.*
- Currently, insolvency resolution of a CD as a whole exist
  - Same is counterproductive as hinders other solvent projects
- Proposed amendments-
  - when an application is filed to initiate the CIRP against CD being promoter of a real estate project, AA, at its discretion, admit the case but apply the CIRP provisions only to such projects, which have defaulted.
  - Leading to segregation of such projects from the larger entity for the limited purpose of resolution
- Additionally, transfer of ownership and possession during CIRP to the allottees with the consent of the CoC is proposed

Multiple resolution plans for the same entity (Para 9.1 to 9.3)

- Pursuant to amendment notification dated 16th September, 2022 CIRP regulations were amended to include provision w.r.t. piecemeal resolution-
  - Reg 36B (6A) - if the RP does not receive resolution plans in response to RFRP, he may, with approval of the CoC, issue RFRP for assets of the CD
  - Reg 37 (1) (m) - Resolution Plan may provide for sale of one or more assets of CD to one or more successful RAs, and the manner of dealing with the remaining assets
- Motives for piecemeal resolution (Discussion paper dated 27th June, 2022)
  - Assets of CD are located at different locations and consist of both functional & non-functional assets
  - RAs interest in functional/assets at 1 location
  - Additional investment in other assets becomes too high and hence RAs are unwilling to put a resolution plan
  - Non-receipt of resolution plan leads to slipping in liquidation where realization is far less than what is expected in CIRP stage
- Regulations provide for first inviting resolution plans for the entire business
- Code is proposed to be amended to enable resolution of individual or collective assets of the CD in one or more resolution plans
  - However, at least one of the plans should provide for insolvency resolution of the CD as a going concern
  - As and when CoC approves a plan, that plan shall be submitted to the AA for approval
  - Upon approval of AA, it shall be implemented pending approval of other plans in CIRP, if any
  - Upon approval of plans for all the assets of the CD and insolvency resolution of the CD as a going concern, the CIRP will be terminated
- Going concern question:
  - by presumption, the entire entity is going concern during resolution

Multiple resolution plans: potential issues (Para 9.1 to 9.3)

- Multiple resolution plans were inserted in the Regs in September, 2022 [reg. 37(m)]
  - Have there been any such plans since then?
- The idea of a fractional or partial resolution implies the following:
  - An entity consisting of multiple "undertakings", each having clearly identified assets and liabilities
    - possibly, security interests are also limited to the assets of the undertaking only
  - Similar to a multiple-cell entity - one company with multiple cell
  - some of these "undertakings" are healthy; others are not
  - or, some of the undertakings may have a better resolution possibility, than others
- Hence, consolidated resolution of the entire entity creates a drag on those that are more liquid, or valuable
- Essentially it is a question of valuation
  - whole vs. sum of all parts
  - $\Sigma(A+B+C) \neq \Sigma(A) + \Sigma(B) + \Sigma(C)$
- Concerns:
  - who are the creditors who approve the resolution? Entity-wide creditors, or enterprise creditors?
  - Most important question is one of waterfall - is the waterfall limited to the undertaking, or does it extend to the enterprise?
    - clearly, it should be entity-wide, and not undertaking-wide.
    - that is the motivation for creditors of the bad undertakings to consent for resolution of the good ones
    - in essence, the resolution is that of the entity, but leaves the rest of the entity unaffected
- The Discussion Paper seems to suggest that it is only the timing of the resolution of some parts which may precede others; it is not envisaging whether the rest of the resolution may not happen at all

Separation of distribution from resolution (Para 9.4 to 9.5)

- Presently, resolution plan provides for distribution of proceeds
- sec. 30(2) examination by AA as to whether the plan confirms for
  - manner of distribution
  - minimum entitlement for the OCs and dissenting FCs
  - other implementation-related requirements
- Proposals
  - Segregate the concept of the resolution plan from the manner of distribution of proceeds
  - Whenever finalised and approved by the CoC, the resolution plan(s) or the scheme of distribution, as the case may be, shall be placed before the AA
  - Introduction of separate waterfall mechanism in the CIRP process [Discussed in next slide]

- Segregation of distribution from resolution
  - Intent is to save time, avoid disputes/litigation on inter-se rights
- The proposal is based on the premise that resolution and distribution are two separate aspects:
  - Presently, the RA also gives the distribution of the amount offered by him
  - It seems that the proposal now is:
    - RA is concerned about the amount that he is paying, and not its distribution
    - Distribution will be the role of CoC
    - of course, the distribution and the consequential haircut will also require approval of AA

Waterfall in case of CIRP (Para 9.6)

- Statute provides an equitable scheme of distribution of proceeds received pursuant to a resolution plan(s) through **a separate waterfall mechanism in the CIRP**
  - Creditors will receive proceeds up to the CD's liquidation value for their claims in the order of priority provided in section 53
  - Any surplus over such liquidation value will be rateably distributed between all creditors in the ratio of their unsatisfied claims
  - Further surplus to shareholders/partners of CD.
- Essentially, this means a rateable and principle-driven waterfall, rather than discretionary one.
- However, the RA is the one who is acquiring the company and may need to have relations with suppliers, workmen, etc.
  - No scope of RA's differential payments to any class
- Proposed waterfall makes reference to sec. 53 only
  - In consonance with well-established principles of vertical comparison approach; where a stakeholder receives the resolution amount in the same proportion as he would have received in case of a hypothetical liquidation
  - Note that, there are proposed amendments in sec. 53 too - we discuss later

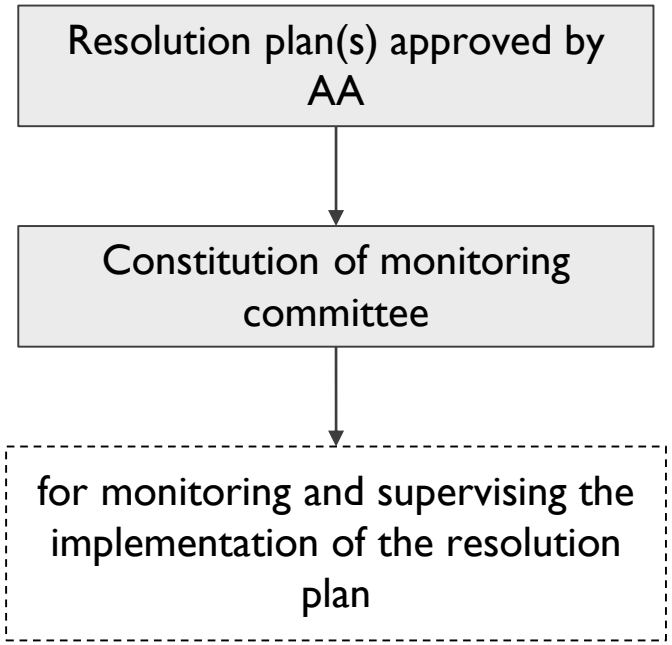
Swiss challenge in resolutions (Para 9.7)

- The Swiss challenge method was introduced in CIRP regulations vide amendment notification dated 30th September, 2021
  - In Indian insolvency regime, same was brought first in prepack insolvency reg. followed by insertion in CIRP reg.
  - Reg, 39(1A)(b) of CIRP reg. provides - "resolution professional may *use a challenge mechanism to enable resolution applicants to improve their plans*"
- Discussion Paper dated 27th August, 2021 discussed the need for the same
- Diverse rulings w.r.t. swiss challenge
  - See NCLT order in *Bank of Baroda v. Mandhana Industries Ltd*
    - Swiss challenge was allowed by the Bench
  - See NCLT order in *Saket Tex Dye Private Limited v. Kailash T. Shah*
    - Swiss challenge was disallowed as similar provision were not expressly present in statute at the time of pronouncement
- What is swiss challenge method?
  - Bidding process
  - Original bidder makes an unsolicited bid
  - once approved, the auctioneer seeks counter proposals against the original bidder's proposal and chooses the best amongst all options
- Proposal is made to make challenge mechanism mandatory

Monitoring the implementation of the resolution plan (Para 9.8)

- Sec 30 (2) (d) makes it a mandatory content of the resolution plan to provide for its implementation.
  - Proviso to Sec 31 (1) empowers the AA to satisfy that the resolution plan provides for its implementation
- During liquidation stage, SCC is empowered to advise the liquidator
  - The decision of SCC is however not binding on the liquidator
  - To ensure monitoring of the deviation, mandatory obligation on the liquidator to report the same to IBBI & AA
- Proposal is made to constitute monitoring committee for monitoring and supervising the implementation of the resolution plan
- Potential questions-
  - Who will form part of the monitoring committee?
  - SCC formed during liquidation comprise of all creditors of the CD
  - Will OCs also get a place?

Instant proposal



AA empowered to cure defects in resolution plan (Para 9.9)

- Various rulings limiting powers of AA to modify the resolution plan
  - SC in *Ebix Singapore Private Limited Vs. Committee of Creditors of Educomp Solutions Limited & Anr.*
    - Resolution plan approved by CoC can not be modified by RA or AA
- Proposal talks about resolution plans being submitted to AA, with certain 'curable defects' which CoC can cure
  - Section 31 may be amended to clarify that the AA can send the resolution plan back to the CoC for curing such defects

- Potential questions-
  - What constitutes a 'curable defect' which CoC can cure?
  - Will the inclusion of such provision not lead to creation of another tier of intercession?

Life after death: Reinstatement of CIRP (Para 10)

- Contravention of resolution plan or rejection of plan u/s 33(1)(b) (non-compliance of mandatory conditions for approval of plan by AA) leads to liquidation
  - Besides, there can be reasons like CoC resolving to liquidate the CD, or CoC did not receive any resolution plan
- Further, liquidation is irreversible
  - Although, there are options like going-concern sales and schemes of arrangement u/s 230
- Proposals
  - In cases as above (contravention of plan, rejection u/s 33(1)(b) and after liquidation, where CD is run as going concern), where CoC believes that CIRP may be reinstated, can apply to AA for reinstatement
  - Final decision with AA
    - to continue with liquidation (if liquidation has already commenced), or
    - to order liquidation, or
    - to reinstate CIRP, or
- While 10.1 talks about reinstatement of CIRP in all cases, it refers to para 25.1 where reinstatement is linked only with certain circumstances
- Critique of the proposal:
  - Corporate death is never a viable alternative, there is a terminal process when other alternatives have failed
  - Essentially going concern sale is "resolution in liquidation", except that the waterfall in that case is that of sec. 53
  - The option of turning back to resolution may give more flexibility
  - However, leaving the entity lurking between life and death may not be ideal
  - Creditors have to understand the finality of the resolution process:
    - either make it succeed, or face the terminal path
  - May be another route to evergreening of a Zombie entity

Sweep of assets of the CD to include assets of guarantors as well (Para 11)

- Code to be amended to include the assets of a guarantor
  - both personal and corporate
- If the assets of the guarantors are charged to the creditors, it becomes easy to include them
- where the assets are not charged, the guarantor in question has to be brought into insolvency, before there is a question of reaching out to the assets
- Basic principle:
  - No creditor can reach out to the assets of a creditor:
    - Except by way of enforcement of security interest
    - or attachment (civil process)
    - or attachment under law
- If indeed the guarantor is brought into CIRP, then this proposal may be akin to group insolvency
- Further, a SARFAESI creditor who has taken possession but not done sale of the asset is permitted to use IBC process for causing consolidated sale of the asset, belonging to guarantor

Group insolvency of interdependent entities (Para 12)

- The subject of group insolvency has been discussed on various occasions:
  - Report of the Working Group on Group Insolvency
  - Report of CBIRC-II on Group Insolvency
- Past instances of group insolvency
  - *SBI v. Videocon Industries Ltd. & Ors.*
  - *Axis Bank Ltd & Ors v. Lavasa Corp Ltd.*
  - *Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Pvt. Ltd. & Ors*
- The proposals provide for a common AA and common RP in these cases:
  - related parties: holding, subsidiary or associate company of the CD, or
  - a subsidiary of a holding company to which the CD is a subsidiary
- CoCs of two or more CDs may provide for coordination
  - If they do, the process thereafter will be as per regulations to be framed by IBBI
- Coordination in case of group insolvency is a globally followed concept
  - See US ruling in *Continental Vending Machine Corp. v. Irving L. Wharton*
    - Consolidation approved- inequities it involves must be heavily outweighed by practical considerations which may occur where the interrelationships of the corporate group are highly complex
  - US ruling in *Vecco Construction Industries, INC and others*
    - Consolidation was approved as difficulty in ascertaining individual assets and liabilities as well as presence of consolidated financial statements or consolidated profitability

A compact version of sec. 53 (Para 13)

Present waterfall arrangement

- Insolvency Resolution Process (if any) & liquidation costs- in full
- workmen's dues for 24 months prior to LCD; & Secured creditors
- Employee dues (other than workmen) for 12 months prior to LCD
- Financial debts owed to unsecured creditors
- Statutory dues for 24 months prior to LCD & Remaining amount towards secured creditors
- Remaining debts and dues
- Preference shareholders
- Equity shareholders

Proposed waterfall arrangement

- Insolvency Resolution Process (if any) & liquidation costs- in full
- workmen's dues for 24 months prior to LCD; & Secured creditors
- Employee dues (other than workmen) for 12 months prior to LCD
- Dues owed to all unsecured creditors (FCs, OCs & any government or authority)
- Preference shareholders
- Equity shareholders

Statutory security interests not to count at par with secured creditors (Para 14)

- 'Secured creditor' defined u/s 3(30) as creditor in favour of whom security interest is created
- In case of priority of secured creditors over tax dues
  - SC has upheld the precedence of secured creditor dues over tax dues
  - See *Sundaresh Bhatt v. Central Board of Indirect Taxes and Customs*
    - SC held that IBC has an overriding effect on Customs Act (which too, creates statutory charge in favour of customs authorities)
  - See *Leo Edibles and Fats Limited v. the Tax Recovery Officer*
    - AP High Court clearly ruled that income tax authorities cannot be equated to secured creditors, and thus cannot claim priority
- However, a contradictory ruling was pronounced in *State Tax Officer v. Rainbow Papers Limited*
  - by virtue of the 'security interest' created in favour of the Government under GVAT, the State is a 'secured creditor' as per the definition in IBC
  - as workmen's dues are treated pari passu with secured creditors' dues, so should the debts owed to the State be put at the same pedestal as the debts owed to workmen under the scheme of section 53(1)(b)(ii)
- Proposal is made to treat all debts owed to CG and the SG equivalent to unsecured creditors
  - This will nullify the ruling of SC in Rainbow Papers
  - More justified as workmen's dues & dues to CG and the SG cannot be treated at same pedestal as discussed in Rainbow papers

Valuation estimates to be given in information memoranda (Para 15)

- Currently, Reg. 35 of CIRP Regulations restricts sharing of fair value
  - Sharing with CoC is allowed upon receipt of NOC
- Vide amendment notification dated 14th June, 2022
  - Reg. 4(3) was inserted in the CIRP Regulations
  - Creditor to provide IRP/RP **last valuation report**
- Sec 29 read with reg. 36 provides the contents of Information memorandum
  - Requirement to specifically provide valuation report not present
- Discussion paper provides for mandatory inclusion of estimation of the valuation of the CD's assets
  - for making the process more transparent
  - help in obtaining better resolution plan from market

Anti deprivation principles to be incorporated into the law (Para 16)

- Present provisions:
  - Sec. 14 (1) - a licence, permit, registration, quota, concession, clearance or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law for the time being in force, shall not be suspended or terminated on the grounds of insolvency
  - Sec. 14(2A) - uninterrupted supply of 'critical goods and services'
- SC ruling in *Gujarat Urja Vikas Nigam Limited v. Amit Gupta & Ors.*
- The court also expressed desire of a statutory response to this
  - This is a matter which raises complex issues of legal policy and a balancing between distinct and conflicting values. Reform will have to take place through the legislative process. The stages through which legislative reform must take place -absolute or incremental – is a matter for legislative change
- Problem statement:
  - OCs do not comply with subsisting agreements with the CD claiming extinguishment of their liability on account of insolvency after the plan is approved
- What is proposed:
  - Extension of anti-deprivation to implementation period, that is, after the resolution plan is approved
  - Anti deprivation provision protection contracts with
    - CG
    - State govt
    - Local authorities
    - Statutory bodies
- However, other contracts do not come within the protection
  - this will be a partial relief against deprivation of the insolvent entity
  - the fact that the statute has a limited provision may actually go against the principle
  - Further, contracting parties need not be operational creditors - they may not be creditors at all

Protection against civil liabilities (Para 17)

- Existing clean state principle imbibed u/s 32A
  - CD shall not be prosecuted for an offence committed prior to CIRP commencement
  - No action to be taken against the property of CD covered under the plan, in relation to offence committed prior to CIRP commencement
    - 'action' includes attachment, seizure, retention or confiscation under applicable laws
- No bar on any action against persons other than CD/RA/buyer in liquidation
- Change in management/control is an essential condition

- What is proposed:
  - post approval of the resolution plan, no proceedings may be commenced or be continued by any government or authority regarding the claims arising before the commencement of the CIRP,
    - unless otherwise provided for in the resolution plan, **and**
  - such claims shall stand extinguished.
- The proposal clarifies the stance for
  - any government, or
  - authority
- The text of the proposal acknowledges it to be a clarification:
  - "Since the resolution plan only concerns the CD, **such a clarification** is not intended to extinguish any liabilities of CD's promoters."
- What about other dues?
  - e.g. workmen dues, etc.

Bringing in more practicality in computation of voting share (Para 18)

- **This may be, by far, the most important change at least when it comes to speedy decision-making by the CoCs**
- Two-fold change:
  - disregard absentees in voting subject to 51% condition (see aside)
  - disregard related parties in assessing proportion
- Voting share defined u/s 5(28) implies share of the voting rights of a single FC in the CoC
  - This is proportion of the financial debt owed to such FC to the entire financial debt owed by the CD
  - This definition leads to inclusion of debt held by related FCs as well in the denominator
  - Since the related FCs are debarred, the same is in contradiction
- To cure the contradiction, it is proposed-
  - voting share be computed as proportion of financial debt owed to the concerned FC to the financial debt owed to the members of the CoC who are eligible to vote
- Further, to address abstention from voting,
  - voting threshold for major decisions proposed be revised to 2/3rd of the CoC members **present and voting** in a meeting and
  - **members approving the decision should constitute ≥ 51% of the total voting share of the CoC**
- **In essence, therefore, abstainers may still deadlock the decision**
  - **This means if 25% or more of the voting rights abstain, that will deadlock the decision**
- Step towards prevention of unnecessary hindrance in smooth conduct of process

Votes of related FCs:

- As for FCs being related party, the votes will be excluded both from voting as also from denominator

Provision for incentivising interim finance providers (Para 19)

- Reg. 2(1)(ea) of Liquidation regulations defines liquidation cost which includes -
  - interest on interim finance for a period of 12 months or for the period from the LCD till repayment of interim finance, whichever is lower
- IBBI Discussion Paper dated 14th June, 2022 proposed to include interest on interim finance till repayment in liquidation cost
  - The amendment notification, however did not reflect the same
- Present discussion paper proposes-
  - to allow interim finance providers to participate in the meetings of the CoC as non-voting members
  - to keep themselves informed about the proceedings under the Code
- The proposal seem to make interim finance providers as 'mute observers'
  - who know everything but can't do anything
- Instead of allowing participation, if interest on whole period is provided
  - may turn out to be more incentivising

Appointment of administrators (Para 20)

- Proposal to let CG appoint administrators for CIRP of certain CDs
  - CG or any other authority as may be prescribed or authorised in this behalf
  - Specific CIRP cases involving public interest
  - "Well-suited for certain CDs requiring a quick and guided resolution under the Code"
  - Administrator to perform all functions of IRP/RP/liquidator
  - Regular process under IBC, except:
    - CoC would not be empowered to remove/replace the administrator; power to remove remains with the CG/authorised or prescribed authority
- Types of CDs to be covered
  - Existing provisions u/s 227 - CG can notify FSPs to be covered by IBC - separate rules notified for appointment of administrator, and conduct of CIRP for notified FSPs
  - Proposal seemingly covers any CD (not necessarily FSP)
- Public interest
  - who decides? - of course, CG
  - Mechanism compared with sec. 241(2) of Companies Act where CG may apply to NCLT for appropriate relief against 'oppression and mismanagement' if it believes that the affairs of the company are being conducted in a manner prejudicial to the public interest
  - very wide interpretation of "public interest" - several SC rulings in the past

Exemption to class of companies from current provisions (Para 21)

- Sec 462 of Companies Act, 2013 provides power to CG to exempt class or classes of companies from Provisions of Companies Act, 2013
- Similar provisions is proposed to be included in IBC framework as well
  - to exempt a class or classes of CD from the applicability of the provisions of the Act, or
  - apply its provisions with certain exceptions, modifications and adaptations subject to procedural safeguards
- Presently, provision of IBC is not applicable on financial service provides
  - Def. of 'corporate person' excludes financial service providers - sec 3(7)
- Other exceptions
  - basis of exception?
  - also, there are proposals for appointment of administrators by CG in cases involving public interest (see previous slide)

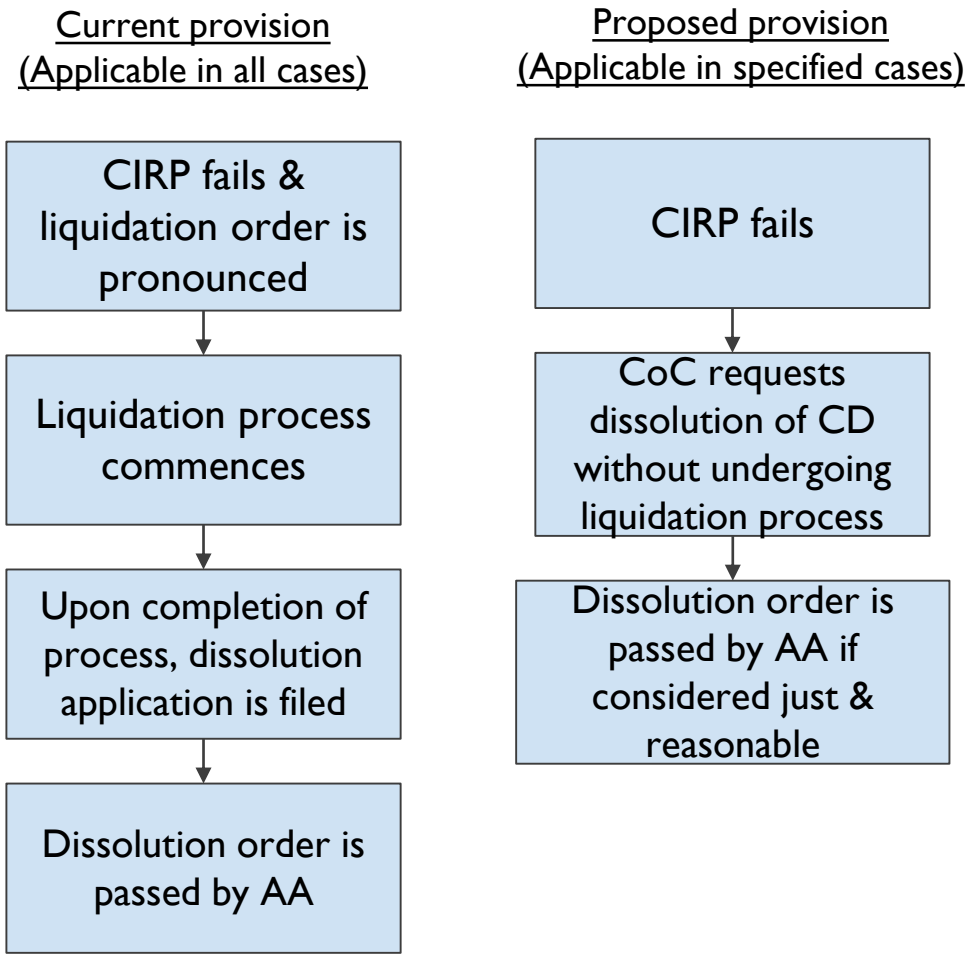
Personal insolvency related proposals

Remodelling of insolvency resolution process of PGs to CDs (Para 22)

- Part III of the Code provides for insolvency of following categories of individuals-
  - PGs to CDs;
  - partnership firms and proprietorship firms; and
  - other individuals
- Currently, said provision is effective only in case of insolvency of PGs to CDs
- Sec 96 deals with declaration of interim moratorium
  - Discussion paper talks about misuse of the process by PGs to take advantage of the interim moratorium
    - Same is proposed to be omitted in case of insolvency of PGs
- Fraudulent transactions come as an inherent risk on insolvency proceedings
  - it becomes crucial to identify such transaction to restore the value lost due to such transactions
  - Existing provisions do not address fraudulent transactions by insolvent individuals
  - New provisions proposed to be inserted in this regard on similar lines with CIRP
- Moratorium implies period of calm
  - hence effects adjudication of avoidance applications filed against the PG in the CIRP of a CD
  - Proposal is considered to exempt avoidance action proceedings pursuant to any CIRP from the moratorium granted
- Additional proposals-
  - Appointment of common RP in case of CD and PG undergoing insolvency resolution process concurrently
  - Compulsory meeting of creditors for cases involving PGs to CDs
  - Liberty to creditors to file for bankruptcy of the debtor in case of non submission of repayment plan

Direct dissolution of CD in certain cases (Para 23)

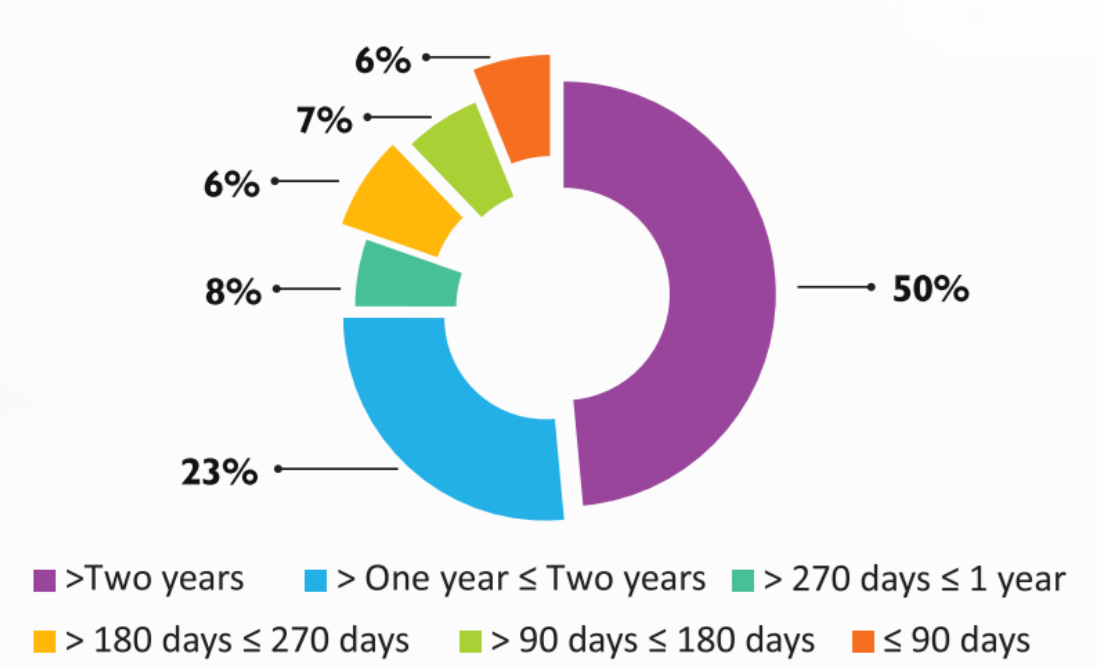
- Presently, the liquidation process is required to be conducted even if CD has no meaningful or recoverable assets
- Early dissolution still allowed u/r. 14 of Liq. Regs.
  - anytime after preliminary report is prepared by liquidator, where
    - realisable properties insufficient to cover liquidation costs
    - affairs of CD do not require further investigation
  - Running an entire liquidation process in such situation becomes cumbersome and exorbitant
  - In practice, AA is seen to have passed dissolution order in such circumstances
    - See order of NCLT Bengaluru in *Synew Steel Private Limited*
    - See order of NCLT Chennai in *Aesys Technologies Private Limited*
- Proposed amendment in Code-
  - Liberty to CoC to request AA to dissolve the CD if it believes that conducting the liquidation process may not be feasible or beneficial for the stakeholders
  - AA to allow direct dissolution if considered just & reasonable



Elimination of duplication of activities between CIRP and Liquidation Process (Para 24)

- Claim collation related proposals
  - Omitting sections 38 to 42
    - require the liquidator to collate, verify and communicate the decision, and enables the creditor to appeal
  - Omitting the requirement of inviting fresh claim during liquidation
    - what about claims arising during interim period between CIRP commencement and liquidation commencement?
  - Verification of claims during liquidation be substituted with maintaining a list of creditors
    - list of stakeholders is anyway required to be maintained
- Avoidance proceedings
  - Power to continue such proceedings if initiated during the CIRP
  - Liquidator to have power to initiate fresh proceedings as and when come across any avoidable transaction
  - Seems more like a clarification

Timeline of ongoing liquidation (as on 30.09.2022)



Liquidation related proposals

Mandatory CoC during liquidation (Para 25)

- Sec. 35(2) empowers liquidator to consult stakeholders entitled to distribution u/s 53
- Presently, concept of broad-based SCC
  - representatives of each class of stakeholders be nominated for participation in SCC
  - voting in proportion to admitted share & decision by ≥ 66% votes in favour
  - deviation from decision along with reasons to be submitted to AA & IBBI within 5 days & inclusion of the same in next progress report
- Proposals
  - CoC should "supervise and support" functioning of liquidator
  - CoC will take commercial decisions
  - CoC may take all decisions by a simple majority of 51% of voting share
  - Composition to be broad-based
    - based on sec 53 waterfall

- Does the proposal seek to superimpose the rules of CIRP in the liquidation process?
- Whether broad-based CoC during liquidation feasible, rationale and desirable?
  - diverse and mutually conflicting interests
  - A collective process works where the interests are united: here, the creditors are placed one over the other, thereby resulting into a direct conflict of their interests
- Will it serve the needs of timeliness?

Creditors' role in liquidation - global practices

- In most jurisdictions, the liquidator works under the direction of the adjudicating authority
  - creditors have the right to participate and advise; however, not to drive the process
- UK
  - In UK, there are obligations on the liquidator to report progress of the proceedings and be accountable to creditors' committee and comply with information requests (rule 17.23 of UK Insolvency rules); however, no express provisions for mandatory decisions of the creditors committee
- Singapore
  - sec. 144(3) of Insolvency, Restructuring and Dissolution Act - The exercise by the liquidator of the powers conferred by this section is subject to the control of the Court, and any creditor or contributory may apply to the Court with respect to any exercise or proposed exercise of any of those powers.
  - Sec. 145 - Liquidator to have regard to directions given by resolution of creditors. May summon meetings to ascertain their wishes. However, must summon meetings where so directed by resolution of creditors/requisition by not less than 10% in value of creditors.
- BLRC report
  - Creditors have no direct interest in the realisation or distribution of liquidation. They can only charge the liquidator to carry out her statutory duties

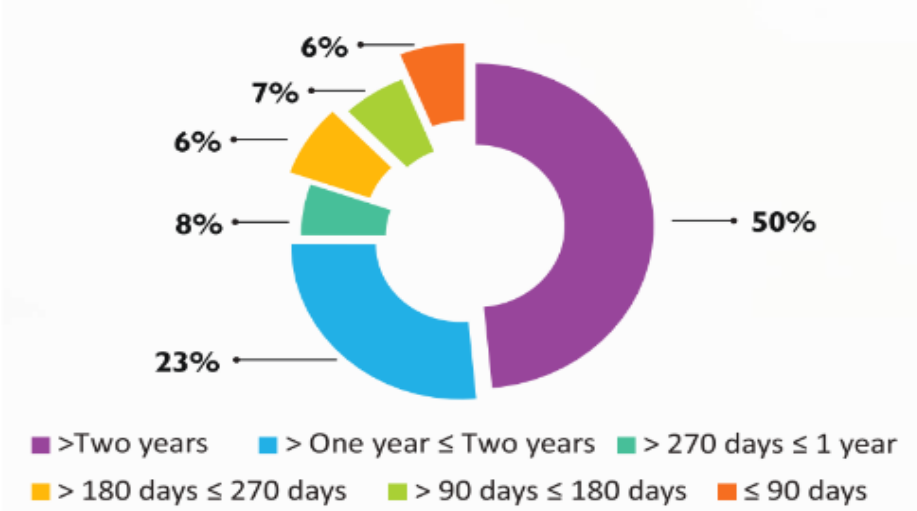
Replacement of liquidator (Para 26)

- IBBI Discussion paper dated 14th June, 2022
  - Discussed the proposal w.r.t empowering SCC to replace liquidator
- Pursuant to amendment notification dated 16th September, 2022
  - SCC may propose replacement of the liquidator with ≥ 66% votes
  - after recording reasons for the same & obtaining consent of proposed liquidator
  - make application to AA
- Sec 27(2) provides for replacement of RP by CoC with ≥ 66% votes
- Present proposals-
  - CoC be empowered to seek replacement of RP from becoming the liquidator with ≥ 66% votes
  - Code be amended to provide for replacement of liquidator at any time during the process by ≥ 66% votes
- Proposal is merely align the provisions of Code and Regulations

Stay on the continuation of proceedings during the liquidation process (Para 27)

- Sec 33 (5) of the Code bars institution of suits or legal proceedings by or against the CD without the leave of the AA during the liquidation process.
  - does not bar the continuation of any pending suit or legal proceeding once the moratorium is terminated
- Sec 33(5) proposed to be amended
  - to prohibit the continuation of the suit or other legal proceedings during the liquidation process
  - apart from proceedings under section 52
  - leave of AA also be required for continuing any suit by or against a CD undergoing liquidation
- Section 446 of Companies Act 1956/ equivalent provision of CA, 2013 provides for all matters of a company in liquidation to come to the company court. Further, no suit or other legal proceeding shall be commenced, or if pending at the date of the winding up order, shall be proceeded with, against the company, without the leave of Tribunal
- Further, almost 73% of the ongoing liquidation has crossed the timeline of one year
- To expedite the process completion, it is proposed that
  - CD may be dissolved under section 54
  - despite the pendency of any legal proceeding concerning a claim against the CD
- Question:
  - Seems a wishful thinking
  - Who handles claims and litigation post dissolution? Once the office of the liquidator stands discharged

Timeline of ongoing liquidation (as on 30.09.2022)



Joint financing and rights of secured creditors to realise/relinquish (Para 28 & 29)

- Sec. 52 - secured creditor can either realise or relinquish
- No guidance in cases involving joint -financing, where secured creditor:
  - may either have pari-passu rights
  - may have senior-subordinated rights
- Guidance u/s 13(9) of SARFAESI Act
- A few rulings under IBC:
  - NCLAT in *Srikanth Dwarakanth Liquidator of Surana Power Limited vs. BHEL*
    - If the secured creditors having 60% of the value in the secured debt decide to relinquish or realize the security interest, such decision shall be binding on the other pari-passu charge holders
  - Also see NCLT order in *Alchemist Asset Reconstruction Company Limited v. Abhijeet MADC Nagpur Energy Pvt. Ltd.*
- Proposal:
  - a presumption that all assets owned by the CD shall form part of the liquidation estate **unless all secured creditors holding pari passu charge over the secured assets of the CD declare to realise their security interest** outside the liquidation process
  - similar approach in case of hierarchy of charges
- That is, all joint creditors holding pari-passu charge should consciously decide to realise
  - unanimous unlike SARFAESI which talks about majority
- Unanimous decision may or may not be a possibility
- Inter-se rules of enforcement should be even across laws to have uniformity?
  - at par with SARFAESI?
- In case of hierarchy of charges, senior charge holder is the decision-maker
  - residual, if any, goes to subordinated charge holder

Improvisation of the regulatory process regarding service providers (Para 30)

- Considering the importance of valuation related services in IBC
  - Proposal is made to empower IBBI to register and regulate a special class of valuers
  - for rendering all valuation-related services during the processes under the Code
- Sec 219 of Code empowers IBBI to issue SCN to IPAs or its member or IU
  - after conducting inspection or investigation
- Proposal is made to allow IBBI to issue SCN without investigation
  - if sufficient material is available on record

CONTACT US

Vinod Kothari and Company

Kolkata:
1006-1009, Krishna
224 AJC Bose Road
Kolkata – 700 017
Phone: 033 2281 3742
Email: corplaw@vinodkothari.com

New Delhi:
Nukleus, 501 & 501A,
Salcon Rasvilas,
District Centre, Saket,
New Delhi - 110017
Phone: 011 41315340
Email: delhi@vinodkothari.com

Mumbai:
403-406, Shreyas Chambers
175, D N Road, Fort
Mumbai
Phone: 022 2261 4021/ 6237 0959
Email: mumbai@vinodkothari.com

Bengaluru:
Rent A Desk
4, Union Street, Infantry Rd,
Shivaji Nagar
Bengaluru- 560001
Phone: 033 2281 3742
Email: corplaw@vinodkothari.com

Website: www.vinodkothari.com