

Liquidation Sale as a Going Concern under the Indian Insolvency Regime

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I. INTRODUCTION

It is trite that in the trajectory of entrepreneurship, not all the business ships reach the shore. Thus, it becomes extremely crucial not just to have a robust legal framework providing for freedom of entry and freedom of doing business to the corporate entity, but also one that provides them

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with the freedom to make an exit and discontinue. The framework should be of such nature so as to be comprehensive enough to cover each stage of the business while providing for a smooth transition between the stages. In the Indian context, the Insolvency and Bankruptcy Code, 2016 (“**Code**”) provides for the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms, and individuals in a time-bound manner. As per the Code, the business operations of the corporate as a going concern shall be carried on by the Interim Resolution Professional until the committee of creditors proposes a resolution plan that would keep the business going after insolvency resolution. The erstwhile liquidation provisions, prior to the Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2018 (“**Amendment**”), provided for liquidation on a slump sale, piecemeal basis etc. It was only through the Amendment that the provision for the liquidation process was amended, from Manner of Sale to Sale of Assets etc, imbibing the ‘going concern’ clauses under Regulation 32 of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016. Through the current piece, the authors have tried to elucidate the concept of liquidation sale as a going concern and the amendments made in the Indian insolvency regime in relation to that. In the last leg, the paper delves into the potential issues attached with the concept vis-à-vis the objective of the Code.

II. GOING CONCERN SALE AS A CONCEPT

A. *Prior to the Enactment of the Code*

Originally, the insolvency framework did not prescribe for the liquidation sale of a corporate debtor as a going concern. However, if looked across the timeline, transfer of a company under liquidation on a going concern basis is not a new concept introduced to the Code. In fact, cues were taken from other statutes in understanding the concept of a going concern even prior to amendments being made to the Code/Regulations.

There was a spate of industrial closures during the 1980s and ergo, the Calcutta High Court was faced with high number of winding up cases.¹ From the analysis of the rulings on the said cases, it becomes pellucid that the underlying rationale for the judges deciding for going concern sale was preserving the interest of the workers along with the interest of the company.

In certain cases, where the corporate debtor had been non-functional, the idea of going concern sales in liquidation was a tough proposition, especially when on the obverse side were the labour force employed and their passing on to the acquirer. In the case of ***Allahabad Bank v. ARC Holding Limited***,² it was stated by the creditors that the factory had been lying dormant and non-functional for more than ten years, and thus, an order that was passed in execution proceedings for the sale of the

¹ Kamaljeet Rattan, 'Ancillary Units and Workers Languish in West Bengal' *India Today* (15 November 1988).

² *Allahabad Bank v ARC Holding Limited* [2000] AIR 2000 SC 3098.

plant, movables lying around, and the machinery of the factory, would not be very difficult to be implemented given the situation of the corporate debtor. However, as per the creditors, any order directing sale of the entire assets of the company as a “going concern” would be difficult. According to the creditors:

“6. 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”.³

The Supreme Court, irrespective of the prior order directing sale of the machinery of the entity and the blanket arguments raised by the creditors, permitted the sales as a going concern owing to the fond hopes expressed by the employees. However, the court took note of the hassles involved in the process due to the entity being non-functional, and therefore, added a timeline for the successful completion of the said sale as a going concern.

B. After the Enactment of the Code

Post the enactment of the Code, the jurisprudence around the sale of corporate debtor in liquidation as a going concern is scant and scattered despite there being numerous case laws where the National Company Law Tribunal (“NCLT”) has directed for liquidation on a going concern basis. One of the foremost cases, where the going concern sale as a

³ *Allahabad* (n 2).

concept was expounded upon was the NCLT Mumbai Bench's order in the case of *Alchemist Asset Reconstruction Company Ltd. v. Abhijeet MADC Nagpur Energy Pvt. Ltd.*⁴ In the said case, the bench defined a going concern as a sale where the acquirer gets all rights, interests, along with the title, and every part of the undertaking, sans any security interest, encumbrance, claim, counter claim or any demur. However, in a similar case, of *Gupta Global Resources Pvt Ltd*,⁵ (involving liquidation sale as a going concern), the NCLT Mumbai bench, had made certain contrary observations. Irrespective of the fact that one of the parties raised the contention that the meaning of the term “going concern” was not clear, the NCLT ruled that when the business of the corporate debtor is being sold on going concern basis, it is presumed that the liabilities of the debtor will be tagged along with its assets. It essentially meant that the sale will not be with a clean slate status, rather the previous liabilities come along with the assets of the corporate debtor.

III. THE CASE OF *GUJARAT NRE COKE* AND THE SUBSEQUENT AMENDMENT

Irrespective of no provision, at the time, prescribing for liquidation on a going concern in the insolvency framework, the NCLT Kolkata directed the liquidator in the case of *Gujarat NRE Coke Limited*⁶ to dispose of the corporate debtor as a going concern. As per the order, the power to issue such directions were derived from the Regulation 32(b)(i) of the

⁴ National Company Law Tribunal [2018] MA 1343/2018 IN CP (IB)-1315/MB/2017.

⁵ National Company Law Tribunal [2019] CP(IB) 1239(MB)/2017, MA 654/2018.

⁶ National Company Law Tribunal [2018] CP (IB) No. 182/KB/2017.

Liquidation Process Regulations, which dealt with the liquidator effectuating assets of a corporate debtor sale on a slump sale basis. It was only after the NCLT's decision that an amendment was made to the Liquidation Process Regulations on March 27, 2018, whereby a new sub-clause (e) was inserted in Regulation 32.⁷ The newly inserted sub-clause permitted the sale of corporate debtor as a going concern. Post the amendment made in March, Regulation 32 was substituted on October 22, 2018, whereby it was prescribed that the liquidator may sell the corporate debtor as a going concern or the business(es) of the corporate debtor as a going concern.⁸ In the discussion paper released subsequent to the above changes, the ambit and definition of the going concern sale were extensively discussed.⁹

The discussion paper expounded that Regulation 32(e) was to ascribe such a meaning that in the situations involving going concern sale, the corporate debtor will not be dissolved, rather it will form part of the liquidation estate.¹⁰ As per the paper, the business, assets and liabilities

⁷ IBBI (Liquidation Process) (Amendment) Regulations 2018.

⁸ IBBI (Liquidation Process) (Second Amendment) Regulations, 2018.

⁹ Insolvency and Bankruptcy Board of India, *Discussion Paper on Corporate Liquidation Process along with Draft Regulations* (April 27 2019).

¹⁰ IBBI (Liquidation Process) Regulations 2016 (Regulations), Regulation 32. Sale of Assets, etc.

The liquidator may sell –

- (a) an asset on a standalone basis;
- (b) the assets in a slump sale;
- (c) a set of assets collectively;
- (d) the assets in parcels;
- (e) the corporate debtor as a going concern; or
- (f) the business(s) of the corporate debtor as a going concern;

Provided that where an asset is subject to security interest, it shall not be sold under any of the clauses (a) to (f) unless the security interest therein has been relinquished to the liquidation estate. (emphasis supplied).

of the corporate debtor were to be transferred along with the debtor. The paper elucidated the definition of ‘Going Concern Sale’ while stating that the said sale implied that the corporate debtor would stay functional as it was prior to the initiation of the insolvency proceedings.¹¹ Further, as per the paper, the term “going concern” meant that the consideration received for the sale was for the transfer of the business of the debtor in entirety, comprising of all the assets and the liabilities which constituted an integral business. It mentioned that any buyer of a corporate debtor under liquidation sale as a going concern must be able to run without any disruption, and such transfer should be of a running business along with its employees.¹² The buyer of the corporate debtor is required to take over the entire operations and business affairs along with the assets, licenses, trademarks etc.

The suggestions provided in the paper were formalized with the Corporate Insolvency Resolution Process (“CIRP”) Regulation and Liquidation Process amendments with effect from July 25, 2019.¹³ The obvious consequence ensuing from the amendment was that the company which was sold off as a going concern, was now provided with an opportunity to preserve its legal identity. Hitherto, under the erstwhile unamended framework, a CIRP had to be completed within a set time frame to be successful. Once the timeline for the said completion of the CIRP was over, the corporate debtor was pushed to the gallows of compulsory liquidation, ergo becoming legally non-existent.¹⁴ However,

¹¹ Discussion Paper on Corporate Liquidation Process along with Draft Regulations n 9.

¹² *ibid.*

¹³ *ibid.*

¹⁴ Insolvency and Bankruptcy Code 2016, s 12.

post the amendment, the situation changed where now, even in cases of timeline failures, the identity of the corporate debtor is not dusted completely and is preserved by being sold as a going concern.¹⁵

IV. MONETARY LIABILITIES VIS-À-VIS LIQUIDATION SALE AS A GOING CONCERN

In reference to the orders passed by the courts, prior to the Code coming into play, it becomes apparent that while giving the direction of liquidation sale as a going concern, the liabilities of the company were generally not tagged along. It was only in cases like *AOP (India) Pvt. Ltd. v. OL*,¹⁶ by the Calcutta High Court, and *Allahabad Bank v. ARC Holding Limited*,¹⁷ by the Hon'ble Supreme Court, wherein it was noted respectively that the purchaser was required to discharge the liabilities of the company under the liquidation and all the liabilities of the company in liquidation will have to be taken over by the purchaser. In every other ruling prior to the insolvency regime, there has been issuance of direction to ensure that the transfer of the company is done as a running unit, while providing a specific undertaking to employ the existing workforce. While none of the cases dealt specifically with the obligation of the purchaser towards the existing liabilities of the company, there was just a direction issued to ensure that the company be

¹⁵ Since, now the liquidation will again be having a safety net in the form of sale as a going concern due to which the identity of the corporate debtor and the synergies of a running business would not be lost.

¹⁶ *AOP (India) Pvt Ltd v OL* CA NO 162 of 2012.

¹⁷ *Allahabad* (n 2).

transferred as a running unit, with specific undertaking to keep the existing workforce employed.

The scenario related to liabilities in a going concern sale did not become less murky even with the introduction of the Code. It may not be out of place to mention that a review application against the order passed by the Mumbai NCLT in the case of ***Gupta Global Resources Pvt Ltd*** was made,¹⁸ wherein it was contended by the applicant that the order relating to going concern sale that also included liabilities:

“was either an obiter dicta, or refers to sales on going concern basis outside of liquidation, and does not refer to going concern sale in terms of Regulation 32 of the IBBI (Liquidation process) Regulations, 2016, or is otherwise not binding in respect of the going concern sale under Liquidation Regulations.”

The Mumbai bench, however, refused to interfere with the impugned order, noting that it did not have the power to review its own order, especially when the order was passed on merits.

It must be taken note of that neither the Insolvency Law Committee in 2018¹⁹ nor the Bankruptcy Law Reforms Committee in 2015²⁰ made the transfer of liability a part of sales as a going concern. In fact, in one of the paras, it was noted by the Insolvency Law Committee, that the phrase “as a going concern” would mean that the corporate debtor will continue to operate in the same manner as it would have been before the initiation of

¹⁸ National Company Law Tribunal [2017] CP(IB) 1239(MB)/2017.

¹⁹ Insolvency Law Committee, *Report of the Insolvency Law Committee* (March 2018).

²⁰ Bankruptcy Law Reforms Committee, *Report of the Bankruptcy Law Reforms Committee* (November 2015).

CIRP, other than the restrictions imposed by the Code.²¹ The framework of identifying liabilities and assets that are to be transferred as part of the going concern sale came into picture only after the release of the discussion paper and the subsequent amendments to the CIRP Regulation and Liquidation Process Regulations.

The transfer of liabilities during sales as a going concern becomes problematic when seen against the backdrop of the fact that what is needed for a unit to stay functional as a going concern is the availability of relevant manpower, licenses, and approvals. It is nowhere contingent on the transfer of liabilities. In fact, the transfer of monetary liabilities as contemplated under going concern sales by case laws carries the risk of creating a parallel mechanism to the waterfall as specified under Section 53 of the Code,²² an issue that was also highlighted during the arguments in the case of *Gupta Global*.²³ If the buyer of the going concern is to be saddled with the liabilities, then the claimants of the liquidation estate, in essence, would be having dual claims i.e., a claim on the liquidation estate, and also a claim on the acquirer of the going concern. In a situation of going concern sale in liquidation, there should not be an issue about liabilities being a part of the undertaking since that will no longer remain a liquidation case but will become a case of business transfer. In liquidation, the settling of liabilities must be from the realisations made and in accordance with the priority mentioned in Section 53 i.e., the waterfall mechanism, and once the distribution is made to the best possible extent, the liabilities should stand extinguished.

²¹ Report (n 19) pp 8.1.

²² The Insolvency and Bankruptcy Code 2016, s 53.

²³ *NCLT* (n 18).

V. APPLICABILITY OF THE CLEAN SLATE THEORY

In a catena of cases, including the landmark judgement of ***Ghanashyam Mishra & Sons Pvt Ltd v. Edelweiss Asset Reconstruction Company Limited***,²⁴ issues of government departments pressing their claims against the corporate debtor after the insolvency process cropped up time and again. In *Ghanashyam Mishra*, the government departments and tax authorities pressed claims against the corporate debtor after the approval of the resolution plan by the Adjudicating Authority. It was contended that the claims which were being pressed against the corporate debtor did not form part of the resolution plan and yet it was urged to be considered. In fact, in one of the matters, the appeal was dismissed by the National Company Law Appellate Tribunal (“NCLAT”), while leaving the creditors open to press their claims before an appropriate forum.²⁵ The Apex Court while setting aside the findings of NCLAT reiterated the law laid down in the case of ***Essar Steel (India) Ltd. (CoC) v. Satish Kumar Gupta***,²⁶ wherein it was ruled that all the claims stand extinguished once the corporate debtor is handed over to the resolution applicant. The corporate debtor is given as a clean slate to the resolution applicant. It was further highlighted that the claims included in the resolution plan have to be dealt with as per the resolution plan, while the claims not a part of the resolution plan will stand extinguished. The rationale behind the clean

²⁴ *Ghanashyam Mishra & Sons Pvt Ltd v Edelweiss Asset Reconstruction Company Limited* [2021] 9 SCC 657.

²⁵ *Edelweiss Asset Reconstruction Company Limited v Orissa Manganese and Minerals Limited & Ors.* Company Appeal (AT) (Insolvency) No. 437 of 2018 & I.A. No. 1830 of 2018.

²⁶ *Essar Steel (India) Ltd (CoC) v Satish Kumar Gupta* [2020] 8 SCC 531.

slate doctrine is to ensure that the corporate debtor remains viable, lest it would be impacted adversely after resolution.

In the case of ***Binani Industries Limited v. Bank of Baroda***,²⁷ it was expounded by the NCLAT that a ‘resolution’ as provided under the Code is not a ‘sale’, since there is no buying of the corporate debtor by the successful resolution applicant. However, it needs to be noted that the primary goal of a resolution plan and a liquidation sale as a going concern remain the same i.e., the corporate debtor’s business revival.²⁸ The issues faced by a successful resolution applicant and sale of a corporate debtor as a going concern are similar, if not the same, and hence, similar reliefs are required to be granted in both the cases.²⁹ Thus, the beneficial doctrine of clean slate as laid down in *Ghanshyam Mishra* ought to be extended to the cases involving liquidation sale as a going concern.

More clarity on the issue of tagging along liabilities with the assets during liquidation sale as a going concern and applicability of the clean slate theory can be provided by taking cue from the case of ***KKR India Financial Services Private Limited v. Kwaliti Limited***,³⁰ decided by NCLT Delhi. In the said case, Kwaliti Limited was engaged in the business of milk and dairy products, and also had milk processing units in the States of Uttar Pradesh and Haryana. There was initiation of CIRP against Kwaliti by one of its financial creditors by way of filing a

²⁷ National Company Law Tribunal [2018] Company Appeal (AT) (Insolvency) No. 82 of 2018.

²⁸ *Sauria Construction v Kohinoor Pulp & Paper (P) Ltd* 2024 SCC OnLine NCLT 235.

²⁹ *ibid.*

³⁰ National Company Law Tribunal [2018] Order dated 21.12.2021 in IA 5208 of 2021 in IB 1440(ND)/2018.

Company Petition. The corporate debtor was sold on a “going concern” basis, and the purchaser in the said case filed an interlocutory application before NCLT Delhi seeking, *inter-alia*, consequential reliefs, in order to enable the purchaser to run the business of the corporate debtor on a going concern basis. Some of the reliefs asked for by the purchaser were that any demands, inquiries, finances and pecuniary liabilities prior to the transfer date be abated. The NCLT did allow the relief to the purchaser as a matter of clean slate status of the corporate debtor, which was deemed necessary and appropriate for the sale of the business and the corporate debtor on a going concern basis. As per the order, it was emphatically clear that a re-constructed company which has undergone liquidation on a “going concern” basis under the Code is free from all encumbrances of the past. In reference thereto, the corporate debtor legally gets a fresh lease of life and all previous dues and encumbrances get resolved and cannot hinder the re-constructed company once it has gone through the process of liquidation as a going concern under the provisions of the Code.

VI. CONCLUSION

The concept of liquidation as a going concern falls in line with the Code’s objective of asset maximization and minimal loss to the substratum of the corporate debtor. It is a workable solution especially against the backdrop of loss to workmen employed and the loss to synergy in case the entity is dusted completely. It needs to be taken note of the fact that the vanquishing of the entire entity leads to a domino effect on all the stakeholders, including the business community. Though the statute initially mentioned liquidation as a last resort, the concept of sale as a

going concern provides a breather to the parties involved by giving a second chance to revive the corporate debtor. In the initial cases there was not much clarity with regards to the treatment of liabilities in relation to a liquidation on a going concern basis. The law has since been broadly settled by the NCLTs/NCLATs wherein it has been established that liabilities stand extinguished once the Corporate Debtor is sold on a going concern basis.

However, this should not lead to discounting of the multiple potential challenges which the concept of ‘liquidation sale as a going concern’ might pose, thereby potentially undermining the very objective of the Code. Firstly, ‘liquidation sale as a going concern’ might come off as a better pay off for the prospective acquirers. The much obvious reasons for the same are that an acquisition through a going concern sale may happen for a price that is lower as compared to a revival of the corporate debtor by way of a resolution plan. Secondly, there is no intense and elaborate level of negotiation as there is no committee of creditors in liquidation as opposed to a CIRP process, which in turn creates scope for the prospective buyers vying for the second chance to acquire the debtor at a much more favourable deal to them. Lastly, the practical issue that still remains is that, despite the corporate debtor having been acquired on a going concern basis, at times, statutory/government authorities still raise and contest their pending claims (as standing against the corporate debtor) against the successful bidder/acquirer, which is counterproductive to the letter and spirit of the Code.