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Sale as a going concern: Alternative in liquidation?

The need for interpretation and amendment of the Insolvency and Bankruptcy Code, 2016 (IBC), has arisen repeatedly since its enactment. A recent instance can be seen in the matter of Gujarat NRE Coke Ltd.

As the committee of creditors failed to agree on a corporate insolvency resolution plan, the National Company Law Tribunal (NCLT), Kolkata, on 11 January 2018 ordered liquidation of the company with a clear direction that the liquidation should be done by sale as a going concern. This is because it had been successfully argued before the tribunal that the company's period of crisis was over and closing the business would adversely affect about 1,178 employees, their families, numerous vendors and job workers – totalling about 10,000 people.

This decision is significant as at the time, the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, provided four viable options: liquidation by way of sale on stand-alone basis, slump sale, sale of assets in parcel and sale of assets collectively. After the NCLT, Delhi, made another order for "beneficial liquidation" of a corporate entity, on 15 February 2018, the regulations were amended to allow for liquidation by sale as a going concern.

The pros and cons, present need and future utility of such a process are briefly assessed below.

Liquidation by sale as a going concern will primarily benefit the employees of the insolvent company. The corporate insolvency resolution process (CIRP) can be triggered by a single instance of default in repayment of ₹100,000 (US\$1,500). When

the CIRP of an insolvent company, whose business is not generally loss-making, fails to culminate into a viable resolution plan, liquidation and sale for scrap value could threaten the jobs and livelihood of everyone who works for the company.

While the case for employees may be rooted in social welfare, liquidation as a going concern of a financially troubled entity also makes sound business sense. Staff who occupy the lower rung in the IBC's "waterfall mechanism" will not need to worry about full recovery of the amounts owed to them after distribution to employees and secured creditors that are given higher priority, as they will earn through their continued employment. Moreover, the presence of those who ran and worked for the company means the new owners will not need to start from scratch.

The quick process of an auction-driven, going-concern sale – particularly in a competitive, open market – maximizes the value of the insolvent entity's assets for distribution to its creditors. This supports the IBC's intent to ensure continuity of the business, without undue erosion of the asset base, so as to ensure maximum value for creditors.

This method could also protect contracts and valuable intellectual property such as trademarks. Finally, a transparent process conducted within a framework in which an independent liquidator carries out and submits periodic progress reports to the NCLT will make it difficult to challenge or object to the outcome of the liquidation.

By way of cons, the main one is that, as a distressed sale is often made on an "as is, where is" basis, the buyer's interests are not

protected by any representations or warranties. The buyer will have limited recourse against the seller if there is any variance in the terms of sale or agreement. This is why the reserve price in a sale by way of liquidation tends to be lower than the value mooted by a resolution plan or a general business acquisition. It is also evitable that the goodwill of a business, cultivated over time, will be lost with the change in management and control of the corporate entity.

It is thus apparent that the insolvency framework has to sustain a fine balance between preserving a business and deriving maximum value from its assets for the creditors, who are, admittedly, supreme. A rising trend in jurisdictions such as the US, UK and Canada is to allow "pre-packaged" sales, where a business is sold as a going concern to individuals from the former management, where found eligible. This is usually done for businesses that are insolvent due to slipups by the management, yet healthy enough to continue with a slightly altered management that already understands the intricacies of the business. This may be a possible scenario under the IBC as well, given the diverse cases that are being admitted. The area of sale in liquidation as a going concern is bound to generate interesting developments in the future, possibly including pre-packaged sales.

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