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TRANSFER OF ILLIQUID ASSETS AND ASSIGNMENT OF CREDITOR CLAIMS: IBBI AMENDS LIQUIDATION REGULATIONS TO HASTEN THE PROCESS

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The Insolvency and Bankruptcy Board of India (IBBI) on 13 November 2020 issued the Insolvency and Bankruptcy Board of India (Liquidation Process) (Fourth Amendment) Regulations, 2020 (Amendment) which introduced seminal changes to the liquidation regime under the Insolvency and Bankruptcy Code, 2016 (IBC). The Amendment has been introduced on the back of the discussion paper issued by IBBI on 26 August 2020 on Corporate Liquidation Process (Discussion Paper). This Amendment proposes solutions to resolve 2 major issues which plagued the efficacious and expeditious completion of a corporate liquidation process under the IBC, (a) assignment by a creditor of its claims / interest during liquidation; and (ii) disposal / assignment of non-readily realisable / illiquid assets. In this paper we are analysing these two issues, the manner in which the Amendments modify the corporate liquidation framework vis-à-vis these issues and their impact on the corporate liquidation process.

THE TWO KEY ISSUES

ISSUE 1: ASSIGNMENT OF CLAIMS/INTERESTS DURING LIQUIDATION

During the liquidation process, a creditor is required to file its claim with the liquidator. Subsequently, such claim gets settled pursuant to the realisation of the assets in the liquidation estate of the corporate debtor and its subsequent distribution in the manner set out in Section 53 of the IBC. This is a time-consuming process.

It is relevant to note that the scheme of the IBC allows a creditor to assign its claims in favour of a third party. Sections 5(7) and 5(20) of the IBC stipulate that the assignee of a financial debt or an operational debt shall also be considered as a financial creditor or an operational creditor, respectively. Further, in the context of a corporate insolvency resolution process, a creditor is allowed to assign the debt owed to it by a corporate debtor in favour of a third party in terms of Regulation 28 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations). However, the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations (Liquidation Regulations) did not, until the Amendment, set out an explicit mechanism by which a creditor could assign the debt owed to it by the corporate debtor, in favour of a third party.

Recognising this lacuna, the Discussion Paper proposed that a provision similar to that in the CIRP Regulations may be provided under Liquidation Regulations to enable exit of stakeholders who prefer not to wait until the realisation of assets and distribution of its proceeds. Pursuant to this suggestion offered in the Liquidation Regulations, the

Amendment introduced Regulation 30A to the Liquidation Regulations, which *inter alia*, now stipulates that:

- a. a creditor may assign or transfer the debt due to it or it to any other person during the liquidation process in accordance with the applicable laws dealing with such assignment or transfer;
- b. in case of such assignment, both assignor and the assignee are required to provide the liquidator: (a) the terms of such assignment or transfer; and (b) the identity of the assignee or transferee;
- c. further, pursuant to such assignment, the liquidator shall modify the list of stakeholders of the liquidator in the stakeholders' consultation committee.

Thus, the Liquidation Regulations now provide a mechanism for assignment of claims which is similar to that already provided under the relevant regulations for the corporate insolvency resolution process (CIRP). Accordingly, an assignee of a creditor's claim can be treated as a creditor during liquidation.

ISSUE 2: THE TREATMENT OF NON-READILY REALISABLE ASSETS DURING LIQUIDATION

It is a well settled principle that 2 of the most important objectives of the IBC are: (a) timebound resolution of stress of the corporate debtor; and (b) maximisation of value of the assets of the corporate debtor to ensure maximum recovery of dues by the creditors of such corporate debtor (Twin Objectives). The entire scheme of the IBC, including the CIRP and the liquidation process have been formulated in a manner which, *inter-alia*, ensures that the said Twin Objectives are met in a fixed time frame.

Under the IBC, the legal framework pertaining to liquidation process of the corporate debtor have been set out in Chapter III of Part II of the IBC read with the Liquidation Regulations. The said framework attempts to ensure that the said Twin Objectives are realised to the greatest extent possible. For example: (a) Regulation 44(1) of the Liquidation Regulations stipulates that a liquidator is required to complete the liquidation process within a period of 1 year from the date of commencement of the liquidation process of the corporate debtor; and (b) Regulation 32 read with Regulation 32A of the Liquidation Regulations stipulate 6 different methods by which a liquidator may sell the assets of a corporate debtor.

However, notwithstanding the above, the realisation of the Twin Objectives in the context of liquidation process of a corporate debtor has been severely impeded on account of the presence of 'non-readily realisable assets' (NRRAs) of the corporate debtor. Acknowledging the same, the Discussion Paper elucidated the challenges posed by the presence of NRRAs in the liquidation estate of a corporate debtor and set out the possible solutions to address these challenges. To put the issue in perspective, we have set out below (i) the meaning of NRRAs; (ii) the problems posed by them to the realisation of Twin Objectives; and (iii) means of resolving the problem of NRRAs in a liquidation estate.

Meaning of NRRAs: A liquidator pursuant to its appointment is required to take into his/her custody and control the assets of the corporate debtor, and form the liquidation estate in terms of Section 35 of the IBC. Some of these assets of the corporate debtor may not be readily convertible into cash and distributed among the stakeholders of the corporate debtor and/or may require an indefinite time for their realisation on account of peculiar nature of such assets or special circumstances. These assets include sundry debts (such as refunds from Government and its agencies), contingent receivables, disputed receivables, disputed assets, assets underlying avoidance transactions etc. The Discussion Paper defines such assets as NRRAs.

The Problem Posed by NRRAs: The presence of NRRAs is detrimental to the achievement of the Twin Objectives, that too within the strict timelines prescribed under the IBC. Considering that the time taken to realise NRRAs is uncertain, the completion of the liquidation process and the subsequent dissolution of the corporate debtor may take an inordinate amount of time. This is in stark contravention to one of the most central tenets of the IBC ie., the expeditious and time bound resolution of stress of the corporate debtor. Further, as rightly observed in the Discussion Paper, if the dissolution is kept pending for want of realisation of such assets, then not only the liquidation cost keeps accruing continuously but also the value of the assets keeps on depreciating with time. This prejudicially affects the maximisation of value of the assets of the corporate debtor and as a result prejudicially affects credit recovery for the claimants.

A second conundrum pertaining to NRRAs is that the realisation of NRRAs would require time, effort and most importantly, costs on the part of the liquidator. A liquidator is required to take action to recover the amount receivable from the contingent assets (receivables) which may accrue to a corporate debtor based on an occurrence of uncertain future events over which the liquidator has no control whatsoever. Further, contingent receivables are usually a subject matter of litigation which not only leads to inordinate delays in crystallisation of such contingent claims but also entails the liquidator incurring substantial legal costs. The lack of funding during liquidation severely complicates the matters further for the liquidator. These delays and costs severely depreciate the value of the liquidation estate of the corporate debtor and prejudicially affect the *monies* recovered by the creditors of such corporate debtor pursuant to the completion of the liquidation process. However, if the NRRAs are left unrealised and the corporate debtor is dissolved, then the assets end up getting locked and no stakeholder finds merit in pursuing assets with relevant authorities/forums, which in turn leads to loss in value of unclaimed assets, which could otherwise have been used to maximise recoveries.

Proposed Solution: The Discussion Paper sets out that a viable solution to resolve the issue of NRRAs is to allow the liquidator to assign the NRRAs for any such amount which the market is willing to pay, and distribute the same among stakeholders. Further, the Discussion Paper proposes that when the liquidation estate of the corporate debtor is insufficient to pay the debts, then the liquidators can be provided with the right to assign certain statutory rights of action (such as avoidance transactions actions, contingent claims etc.), to the third parties. This ensures an expeditious conversion of NRRAs into cash. Further, if the liquidator takes proactive measures to assign NRRAs then such assignment can be made for a lucrative consideration prior to the assets of the corporate debtor depreciating in value. Accordingly, allowing the liquidator to assign the NRRAs and thereby ensuring the better realisation of the Twin Objectives in a liquidation process.

Amendment to the Liquidation Regulations: Acknowledging the issue identified in the Discussion Paper and the solution offered to redress this issue, the Amendment introduced Regulation 37A to the Liquidation Regulations which introduces the concept of NRRAs to IBC. Regulation 37A defines NRRAs as an asset which is included in the liquidation estate of the corporate debtor which could not be sold through available options. It further clarifies that NRRAs *inter-alia* include contingent or disputed assets and assets underlying proceedings for preferential, undervalued, extortionate credit and fraudulent transactions referred to in Sections 43 to 51 and Section 66 of the IBC.

Further, Regulation 37A stipulates that a liquidator may assign or transfer a NRRAs through a transparent process, in consultation with the stakeholders' consultation committee set up under Regulation 31A of the Liquidation Regulations. It further sets out that such assignment cannot be made by the liquidator in favour of a person who is disqualified to submit a resolution plan for a corporate debtor undergoing corporate insolvency resolution process under the provisions of Chapter II of Part II of the IBC

(Ineligible Person). This condition is consistent with the general principle set out in proviso to Section 35(1)(f) of the IBC, which sets out that a liquidator cannot sell movable or immovable properties of the corporate debtor or actionable claims of the corporate debtor in a liquidation process to an Ineligible Person.

In addition to the above, the Amendment also modified Regulation 38 of the Liquidation Regulations. Prior to the Amendment, Regulation 38 provided that *"a liquidator may, with the permission of the Adjudicating Authority, distribute amongst the stakeholders, an asset that cannot be readily or advantageously sold due to its peculiar nature or other special circumstances."* The Amendment modifies Regulation 38 of the Liquidation Regulations, and the same now reads as *"a liquidator may, with the permission of the Adjudicating Authority, distribute amongst the stakeholders, an asset that could not be sold, assigned or transferred due to its peculiar nature or other special circumstances."* Vide this amendment to Regulation 38, the Amendment harmonises the language of Regulation 38 with the newly inserted Regulation 37A of the Liquidation Regulations.

Comment:

The issues set out in the Discussion Paper are indeed substantial issues which have been causing serious detriment to the efficacious and swift completion of a liquidation process. The presence of illiquid assets not only hamper the value maximisation of the liquidation estate of the corporate debtor but also substantially slow down the pace of the liquidation process. It is relevant to note that as per the figures set out in the Quarterly Newsletter published by the IBBI for the months of April to June 2020, out of the 955 cases wherein liquidation was initiated, only 88 cases have been finally completed. It is relevant to note that out of the remaining 867, around 428 cases have been under liquidation for more than the period of 1 year, as stipulated in terms of Regulation 44 of the Liquidation Regulations.

The changes introduced by way of the Amendment are expected to effectively address both the aforementioned issues. The right conferred on the liquidator to assign NRRAs will help create a niche market for such illiquid assets allowing the buyers with deep pockets and specialisation to acquire these assets and pursue recoveries. This not only helps in the monetisation of otherwise illiquid assets but also helps speed up the liquidation process by relieving the liquidator of the obligation to invest time and expenses in realising these assets. This is more often in cases where the liquidator does not have sufficient funds to meet the mounting legal expenses. Additionally, as rightly set out in the Discussion Paper, the right conferred on the creditors to assign their exposure in the liquidator, in favour of the liquidator, is to enable exit of stakeholders who prefer swifter recoveries at a fair discount.

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