Scheme of Arrangement – Surrogate route to bail out entities from liquidation

written by Mohana Roy | May 28, 2019

"The Insolvency and Bankruptcy Code, 2016 is a beneficial legislation which puts the corporate debtor back on its feet, not being a mere recovery legislation for creditors."- Supreme Court of India in*Swiss Ribbons Pvt. Ltd. & Anr. vs. Union of India & Ors.* – Writ Petition (Civil) No. 99 of 2018.

Scheme of Arrangement.

In a string of recent judgments, courts and quasi-judicial authorities in India has found out a surrogate route to bail out ailing entities standing at the verge of liquidation. By permitting liquidators to sell the business of a corporate debtor as a going concern, in case of failed corporate insolvency resolution process as provided under the Insolvency and Bankruptcy Code,2016 ("IBC"), an attempt has been made to provide the real meaning to the objects sought to be achieved by IBC. As the Preamble of IBC nowhere refers to liquidation, which can only be availed as a last option, the primary focus must in all case remain revival of the ailing entity. The National Company Law Appellate Tribunal ("NCLAT") in the case of *S.C. Sekaran v. Amit Gupta*[1] directed the liquidator for revival of the corporate debtor by scheme of arrangement. Further, the NCLAT also directed that the same can be implemented by two ways, first, by sale of the company's assets as a whole, if possible or second, by sale of the company's assets in parts.

Background

On 25th June, 2018 the Mumbai Bench of National Company Law Tribunal ("NCLT") passed an order of winding up of Hindustan Dorr-Oliver Limited and HDO Technologies Limited (herein after referred as "Corporate Debtors") under section 33(1) of the IBC. A corporate insolvency resolution process was initiated against the Corporate Debtors, the resolution applicants were asked to submit better and revised resolution plan however, the resolution applicants failed to do so. In the afore said background, where no resolution plan was arrived at for the Corporate Debtors, the NCLT ordered for liquidation. Aggrieved by the order of NCLT, the Management of the Corporate Debtors (Appellant) filed an appeal before NCLAT.

Contentions Raised

The Appellant contended that the liquidator is supposed to keep the companies as going concern even during the liquidation process. Further, the liquidator may also sell the company to the third party under any scheme of compromise and arrangement.

Judgment

NCLAT while

deciding on the matter put reliance on the Hon'ble Supreme Court Judgment in the case of *Swiss Ribbons Pvt. Ltd. & Anr. vs. Union of India & Ors*.(SUPRA), where in it was observed that the "Preamble does not, in any manner, refer to liquidation, which is only availed of as a last resort if there is either no resolution plan or the resolution plans submitted are not up to the mark. " Further, the NCLAT also relied on *Arcelormittal India Pvt. Ltd. vs. Satish Kumar Gupta & Ors.*[2] under which the Hon'ble Supreme Court opined that the primary focus of IBC is to revival and rehabilitation of the ailing entity, which means the focus should be towards saving the corporate debtor from a death by liquidation and if in case nothing works out then the option of liquidation to be sort.

The apex court also mentioned in its judgment that Regulation 32 of the IBC (Liquidation Process), Regulation 2016, clearly states that liquidator may also sell the corporate debtor as a going concern.

On perusal of the above and in view of section 230 of the Companies Act, 2013 the NCLAT, held that the liquidator shall proceed in accordance with the law and carry on the business of the corporate debtor as a going concern, the liquidator will also take steps under section 230 of the Companies Act, 2013.

Analysis

Scheme of compromise and arrangement for companies in liquidation may sound like a new ray of hope, however, the option of scheme of arrangement for companies heading towards winding up has always been present under our corporate laws. Although, the same had taken a setback for quite some time which is now been rejuvenated by array of recent NCLAT judgments. Section 390(a) of the Companies Act, 1956 defined the term "company" for the purpose of scheme of compromise and arrangement, which also included "company liable to be wound up." In the case of *Meghal Homes Pvt. Ltd. vs. Shree Niwas Girni K.K. Samiti*[3] the company was ordered to be wound up and liquidated in 1984, however, in 1994 during the pendency of liquidation process, the scheme of arrangement was proposed.

In the past it was an established principle that such scheme of arrangements was only for those entities who are at the brink of liquidation. However, the High Court of Bombay in the case of *Khandelwal Udyod and Acme Manufacturing Co. Ltd*[4]. observed that scheme of arrangement as contemplated under section 390 of the Companies Act, 1956 are not meant only

for liquidating companies but also for healthy companies.

Section 391 of the Companies Act, 1956 has now been replaced with section 230 of the Companies Act, 2013. Section 230(1) of the Companies Act, 2013 provides that a liquidator appointed under IBC may also propose scheme of arrangement. However, it is pertinent to note here that the provisions of Companies Act, 2013 and the IBC will overlap each other. Section 29 A of IBC restricts the errant promoters from proposing resolution plans, whereas section 230 of the Companies Act, 2013 has no such restrictions, instead, member or creditors are provided with the power to propose the scheme of arrangement. This power along with the order granted under the NCLAT Judgments making way for scheme of arrangements during the liquidation, may be used adversely by the promoters to perpetuate their stay.

In the recent judgments, NCLAT have not provide with the clarity on how the provisions of section 230 of the Companies Act, 2013 and Section 29 A of IBC will go hand in hand. Apart from the above mentioned restriction on promoter's proposal, there are other issues which requires judicial deliberation, such as voting requirements as prescribed under Section 230. Further, under the NCLAT order in the *S.C. Sekaran v. Amit Gupta* (SUPRA), it has also been directed to the liquidator that the scheme of arrangement proposed under section 230 of the Companies Act, 2013 must be completed within 90 days. This may be a good direction by NCLAT to fix the time period for completion of the scheme of arrangement else it may also be used for delaying the liquidation, however, the period of 90 days may seem to be less for completion of the whole process.

Conclusion - Scheme of Arrangement

The NCLAT, after its judgment in the S.C. Sekaran case has followed its footstep in cases subsequent to it[5] and has directed the liquidator to resort to the scheme of arrangement for revival of the corporate debtor. IBC mainly aims to revive and rehabilitate a corporate debtor so that it can stand on its feet again, paying back the creditors even by death of the company on winding up is not sought by the IBC, in fact winding up can be an option only when all other options are exhausted.

Scheme of Arrangement as a debt restructuring tool has been used sparingly in India. On one hand, it works as an antidote for the ailing companies standing at the brink of liquidation, on the other hand, it may be a difficult process for liquidators to find out persons who are willing to buy such companies. Further, the provisions under the Companies Act, 2013 and IBC are overlapping each other, requires clarity from the judiciary or the legislator. However,

NCLAT in *Shivram Prasad* case (Supra) has provided a little clarity by stating that "*as the liquidation so taken up under the IBC, the scheme of arrangement should be in consonance with the statement and object of the IBC. Meaning there by the scheme must ensure maximisation of the assets of the 'Corporate Debtor' and balance the stakeholders such as, the 'Financial Creditors', 'Operational Creditors', 'Secured Creditors' and 'Unsecured Creditors' without any discrimination*." Thus, from the above it can be concluded that though the philosophy behind the concept is clear, it still requires judicial precedents or codified law guiding towards the procedures to be followed in practicality

Contributed by –Mohana Roy
Designation – Associate, Corporate

---

[1] Company Appeal(AT) (Insolvency) no. 495 & 496 of 2018.

[2] Civil Appeal No.9402-9405 of 2018

[3] (2007) 139 Com Cases 418

[4] (1977) 47 Com Cases 503

[5] Ajay Agarwal Vs. Ashok Magnetic Ltd. Company Appeal (AT) (Insolvency) No. 792 of 2018; Y. Shivram Prasad vs. Dhanapal ; Company Appeal (AT) (Insolvency) No. 224 of 2018

King Stubb & Kasiva,
Advocates & Attorneys
Click Here to Get in Touch
New Delhi | Mumbai | Bangalore | Chennai | Hyderabad | Kochi
Tel: +91 11 41032969 | Email: info@ksandk.com