NCLAT Ruling - Liquidation holds Precedence

Why in news?

The National Company Law Appellate Tribunal (NCLAT) has ruled that liquidation process of a company under the Insolvency and Bankruptcy Code (IBC) holds precedence over outcome of an arbitration proceeding.

What is the case about?

- Tamil Nadu-based Surana Power was admitted into insolvency under the Insolvency and Bankruptcy Code (IBC) in January 2019,
- It did not receive any valid resolution plans.
- So, it was ordered to be liquidated by the Chennai Bench of National Company Law Tribunal (NCLT).
- During the liquidation proceedings, state-run BHEL (Bharat Heavy Electricals Limited) won an ex-parte arbitration award against Surana Power.
- This gave BHEL complete and undisputed rights over all the assets, equipment, goods lying at the site of the Surana power plant.
- It also gave BHEL title rights over the finished and unfinished buildings.
- BHEL is also one of the secured creditors to Surana Power.
- On liquidation, BHEL would have got the money over other unsecured creditors.
- But its share would have come down by a lot going by IBC's waterfall mechanism *(discussed below)*.
- So, following the award, BHEL, as a creditor, refused to give its consent for liquidation.
- BHEL's refusal was challenged by the liquidator at the Chennai bench of NCLT.
- The NCLT ruled in favour of BHEL.
- It said that BHEL had full rights to realise the security interests it had won as part of the arbitration.

What is the NCLAT ruling now?

- The NCLAT set aside the Chennai NCLT's ruling.
- NCLAT held that the liquidation process of a company under the IBC holds precedence over outcome of an arbitration proceeding.

- So just because BHEL won the arbitration award, the liquidation process would not be stopped to favour it.
- BHEL had claimed that it had the first right over the assets and properties of Surana Power.
- But the NCLAT held this claim as invalid.
- BHEL did not have the minimum 60% value in secured interest; it had 26.24% share.
- So, BHEL could not be allowed to stall the IBC proceedings.
- Moreover, all other creditors had given the assent to liquidate Surana Power ('corporate debtor').
- It would be prejudicial to stall the liquidation process at the instance of a single creditor having 26.24% share (in value), in the secured assets.
- NCLAT ruled that BHEL's charge over Surana Power assets were equal to the other 10 financial creditors.
- So, BHEL could not be given precedence.

What does the NCLAT order mean?

- Essentially, if a corporate debtor is being liquidated, a creditor cannot claim superiority over other secured creditors in the same band.
- Also, everyone must receive a fair share by following the waterfall mechanism of liquidation.

What is the waterfall mechanism for liquidation?

- Section 53 of the IBC deals with the waterfall mechanism for liquidation.
- The waterfall mechanism gives priority to secured financial creditors over unsecured financial creditors.
- Under this, if a company is being liquidated, the secured financial creditors must be first paid the full extent of their admitted claim.
- This should be done before any sale proceedings are distributed to any other unsecured creditor.
- The top most priority, however, is given to costs related to the liquidation process and dues of workmen of the corporate debtor.
- The dues of the workmen include all their salaries, provident, pension, retirement and gratuity funds.
- It also includes any other funds maintained for the welfare of the workmen.

Source: Indian Express



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