

Ensuring Independence of a Subsidiary During Insolvency Resolution Process Against the Holding Company

INTRODUCTION

The Insolvency and Bankruptcy Code, 2016 (“IBC”) is considered as one of the major reforms introduced in the Indian financial sector. IBC has played a pivotal role in the resolution of stressed assets in a time bound manner and has significantly contributed towards India’s improved ranking in the World Bank’s Ease of Doing Business Report. The objective of the IBC is to reorganise and resolve insolvency of corporate persons, partnership firms and individuals in a time bound manner in order to achieve maximum value of assets of such persons, promote entrepreneurship, ensure availability of credit and balance the interests of all stakeholders. Since its promulgation in 2016, the provisions of IBC have undergone several changes arising due to multiple proceedings before the adjudicating authorities. Given the COVID-19 situation in India, initiation of corporate insolvency resolution process is suspended till September 24, 2020 for any default occurred on or after March 25, 2020, by virtue of Insolvency and Bankruptcy (Amendment) Ordinance, 2020.

Part II of IBC deals with the procedure for insolvency resolution and liquidation of a corporate debtor. Once an application for insolvency resolution is admitted by the adjudicating authority against the corporate debtor, an Interim Resolution Professional (“IRP”) is appointed and a moratorium under Section 14 of IBC triggers. Pursuant to IRP’s appointment, the IRP takes over the management of the corporate debtor and while managing the affairs of the corporate debtor, the IRP has the right to exercise certain powers under Section 18 of IBC. Section 18 (f) of IBC allows the IRP to take control and custody of all the assets over which the

corporate debtor has ownership rights as recorded in the balance sheet of the corporate debtor.

TREATMENT OF SUBSIDIARY’S ASSETS DURING THE INSOLVENCY RESOLUTION PROCESS

Presently, many holding companies carry their business through different verticals and have multiple subsidiaries and joint ventures both in India and in foreign territory. Many a times holding companies do not carry on any material business operations and derive their value from the subsidiaries. Further, as per the accounting standards, it is mandatory for a holding company to consolidate assets and liabilities of its subsidiaries and associate companies. In a scenario, wherein a corporate insolvency resolution process is initiated against the corporate debtor, which is a holding company of multiple subsidiaries, a very fundamental question arises:- Whether the IRP has the right to proceed against the assets of the subsidiary of the holding company? or Whether the liquidator appointed under IBC has the power to take charge over the assets of the subsidiary of the corporate debtor while forming the liquidation estate?

The answer to the abovementioned questions lies under Section 18 and Section 36 of IBC. While Section 18 of IBC illustrates the powers of IRP *vis a vis* taking control over the assets of the corporate debtor, it also limits the scope of “assets” and excludes assets of any Indian or foreign subsidiary of the corporate debtor from the definition of assets. Thereby, the IRP while exercising his powers under Section 18 of IBC cannot take charge of the assets of any Indian or foreign subsidiary of the corporate debtor. Similarly, Section 36(4)(d) of IBC categorically provides that any assets of any Indian

or foreign subsidiary of the corporate debtor shall not form part of the liquidation estate.

NCLT AND NCLAT RULING

The National Company Law Tribunal and the National Company Law Appellate Tribunal (“NCLAT”), while examining and interpreting the scope of Section 18 of IBC have opined that under Section 18 of IBC, IRP has the power to take control and custody of those assets, where corporate debtor has ownership rights, as recorded in the balance sheet of corporate debtor. Interestingly, the NCLAT in the matter of ***Dynepro Private Limited and Ors vs. V Nagarajan***¹ while interpreting Section 18 of IBC, observed that *“as per the explanation for the purpose of Section 18(1), the term 'assets' do not include assets owned by a third party in possession of the corporate debtor held under contractual arrangements including bailment. It also do not include assets of any Indian or foreign subsidiary of the corporate debtor and such other assets as may be notified by the Central Government”*.

CONCLUSION

From the above, it is clear that in an insolvency resolution process initiated against the corporate

debtor, the IRP can only take control over the assets over which the corporate debtor has ownership rights and cannot take charge of the assets of the subsidiary of the corporate debtor unless an order from the competent court/forum is obtained by the IRP.

However, it is pertinent to note that under Section 18 read with Section 36 of IBC, the IRP and the liquidator, respectively can exercise control over the shares of the subsidiary being the assets of the corporate debtor and thereby exercise control over the assets of the subsidiary.

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¹ Company Appeal (AT) (Insolvency) Nos. 229 and 262 of 018, decided on January 30, 2019)