

[2019] 110 taxmann.com 502 (Article)Date of Publishing: **October 5, 2019****Consolidation of Group Companies' Insolvency****NIPUN SINGHVI**

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Introduction

1. In Corporate world large conglomerates are generally interlinked and intertwined into multiple companies, where there are systematic division of Company structure into many backward and forward activities like manufacturing companies, production companies, sale companies, R&D Companies, etc. Such companies may be holding companies, subsidiary companies or associate companies. Generally, Corporate Group is a collection of parent and subsidiary companies, which work as separate legal entities having common source of control. It is known fact that the group of companies has been settled *modus operandi* as the same gives synergy in optimum utilization of resources.

It was interesting to see that after marathon hearing of one of the biggest home grown conglomerates 'Videocon' for almost 6 months the Hon'ble NCLT, Mumbai bench has paved the way for consolidation of CIRP of 13 Videocon units under IBC, 2016. It is an order of first of its kind as the IBC completes its 3 years and huge corporates have been under Insolvency and now under Liquidation but not a single consolidation has happened. From Essar to Lanco and now the Jaypee, the Courts have been busy deliberating and debating on the pros and cons of IBC but the basic management structure was not shaken due to some companies of the same promoter group under IBC.

Undoubtedly, the treatment of 'group companies' for the Insolvency purpose is a complex subject, even the same has been deferred by Insolvency Law Committee with following remarks: -

'It was noted that the treatment of group companies within insolvency laws is a complicated subject. The current system of insolvency law is new, and it may be too soon to introduce a complex subject, like the present issue. The UNCITRAL Legislative Guide on Insolvency Law also provides that the treatment of group companies is a very complex subject in relation to insolvency law and has multiple different approaches in different jurisdictions. Since lifting of the corporate veil in insolvency may affect corporate debtor entities significantly, this issue may be dealt with in the long-term once the present system is well established'

Sometime it is too soon to introduce such mechanism of consolidation of CIRP in developing law but such unanswered question resurface so fast which compel to deal urgently leaving no scope for avoidance or any more deferment, thus leaves no alternative but to tackle the 'bull by the horns' as mentioned in Judgment.

UNCITRAL Legislative Guide on Insolvency Law on Group responsibility for external debts

2. 'The common principle of all regimes with laws of this type is that, for a consolidation order to be granted, the court must be satisfied that creditors would suffer a greater prejudice in the absence of consolidation than the insolvent companies and objecting creditors would from its imposition. In the interests of fairness, some jurisdictions allow for partial consolidation by exempting the claims of specific creditors and satisfying those claims from particular assets (excluded from the consolidation order) of one of the insolvent companies. The difficulties imposed by this reconciliation exercise have resulted in such orders being infrequently made in those States where they are available. It should be noted that insolvency laws providing for consolidation do not affect the rights of secured creditors, other than possibly the holders of intragroup securities....'

In present case, there were several applications filed in the Hon'ble Tribunal for Substantive Consolidation of the Corporate Debtors into a single proceeding solely for the purposes of CIRP in accordance with the provisions of the Code and some applications against Substantive consolidation.

Substantive Consolidation - The Doctrine

3. Substantive consolidation is the pooling of the assets and liabilities of technically distinct corporate entities. In substantive consolidation the assets of individual members of a corporate group are pooled and intra-group debts forgiven so that claims of third-party creditors may be satisfied from a single common source during proceeding.

The doctrine of substantive consolidation is well explained under various judgments, Articles of USA, Germany and the European Union Courts.

3.1 'Continental Vending Machine Corp. v. Irving L. Wharton' in the United States Court of Appeals, Second Circuit decided on June 5, 1975 (517F, Docket 74-2233) certain observations made therein are throwing light on the issue of 'consolidation' proceedings in following words, with due permission.

An appeal was filed by a secured creditor James Talcott INC (Talcott), involving Continental Vending Machine Corporation (Continental) and its subsidiary, Continental Apco (Apco). The secured creditor (Talcott) objected to an approved Plan of reorganisation of two debtor companies, which was the plan called for consolidation of proceedings. In the said plan, it was proposed to treat the properties of the two debtors on the basis of merger or consolidation of the said two entities.

The main issue of objection was that the position of the secured creditors and unsecured creditors will change, if the consolidation is done.

Finally, it was ruled that the reorganization plan was recognised being fair and equitable. Interestingly there was a dissent by the Hon'ble Circuit Judge. But on the facts, however, on principle of consolidation while discussing on the necessity for substantive consolidation, it was observed that intertwined dealings of the debtors had not given any indication that the impugned consolidation was used solely for the benefit of one type of creditor. The Hon'ble Tribunal viewed this legal proposition can be laid down that if the consolidation leads to unfairness only then obviously not to be approved.

Consolidation parameters and guidance

4. The Hon'ble Tribunal based upon reading of the history of 'group insolvency', listed the following parameters so that the presence of them can lead to a decisive conclusion of triggering of 'consolidation' of Insolvency process. Undisputedly, also laid down by the courts, before ordering consolidation, a preliminary searching inquiry be ensured, whether consolidation yields benefits to stakeholders by offsetting the harm if not consolidated?

4.1 Areas of inquiry and finding on the facts of case :

- (i) *Common Control* : These companies are promoted by Dhoot Family.
- (ii) *Common directors* : The family members of V.N. Dhoot are directors in all the Videocon group companies.
- (iii) *Common assets* : There are many instances of interdependency between the group companies and the assets are common to such an extent that, for instance, one company has leased its land to another group company to carry on manufacturing.
- (iv) *Common liabilities* : The clauses of the VTL and RTL Agreements have demonstrated that "all guarantees thereof executed by one or more of the other Corporate Debtors are deemed to be one obligations of all the Corporate Debtors. "The company along with 12 other affiliates/entities (collectively referred to as "Obligors" and individually referred to as "Borrower") executed facility agreement with consortium of existing domestic rupee term lenders, in the obligor/co-obligor structure, wherein all the Rupee Term Loans of the obligors are pooled together...." .
- (v) ***Inter-dependence*** : Some corporate debtors are engaged in manufacturing, assembling and distribution of comprehensive range of consumer electronic and home appliances. Also, manufacturing set top boxes, Colour Televisions, DVD Players, Etc., by some Units/subsidiaries in Aurangabad. This is stated to be India's Largest Electronics Retail chain. The uniqueness stated to be is that all are marketed under single license of "Videocon Trademark".
- (vi) ***Inter-lacing of finance*** : Pursuant to the RTL Agreement, a consortium of banks and financial institutions including SBI had agreed to grant 'Rupee Terms Loans' to the RTL obligors under an obligor/co-obligor structure. The Rupee Term Loans under the RTL Agreement were to be utilised for the purposes of refinancing of existing rupee debt of the RTL obligors, funding the capital expenditure in relation to the 'Ravva Field' and the capital expenditure in relation to the consumer electronics and home appliances business of the RTL obligors and such other end users as permitted by the facility agent under the RTL Agreement. Recital C of the RTL Agreement states:

"The Rupee Term loan has been sanctioned by the lenders for the purposes of refinancing of existing Rupee debt of the obligors, funding the capital expenditure in relation to the consumer electronics and home appliances business of the obligors and such other end uses permitted by the Facility Agent". (Emphasis Supplied).
- (vii) *Pooling of resources* : Facts and evidences have demonstrated that there has been common pooling of human resources, liaising and funding. Undisputedly, the directors are common using their contacts and relationship to run all the subsidiaries for which common office staff, accountants and other human resources are mobilised to manage the affairs collectively. Further, common arrangement of capital/funds is an accepted position in Videocon group.
- (viii) *Co-existence for survival* : An interlinked chain of business operations is also evident in this group's case. Electronic gadgets/home appliances are manufactured by a unit. However, distribution and market chain are controlled by another entity. Interdependence upon each other is a unique feature visible in Videocon group.
- (ix) *Intricate link of subsidiaries* : Consolidated accounts, pooling of resources, commingling of assets and business functions are the examples of intricate linkings among subsidiaries.
- (x) *Inter-twined accounts* : The consolidated account of 15 months is one of the evidences to demonstrate that on demand by the lenders, all the subsidiaries have prepared a common position of their assets and liabilities, thereafter, prepared consolidated accounts stated to be duly approved by an auditor.
- (xi) *Inter-looping of debts* : On perusal of the agreements, it is evidenced that the clauses have made a provision of securing the debts owed by subsidiaries of Videocon group.

- (xii) *Singleness of economics of units* : The group is known by its brand name "Videocon". Therefore, the entire economics of the group revolves around this brand name either for the purposes of procuring raw material or finally selling the appliances manufactured. The group as a whole therefore has a common economic feature to sustain and promote the business operations.
- (xiii) *Common Financial Creditors* : As per two Agreements, viz., RTL & VTL the lenders are members of 'consortium of banks' which is common for all. Because the impugned Insolvency Petitions were filed by SBI for itself and also on behalf of the said Joint Lenders Forum already listed above, the names of all the banks forming consortium thus substantiates the fact that the financial creditors are common for the 15 debtor entities.
- (xiv) *Common group of Corporate Debtors* : As per the said two agreements the Debtors are combined together for the purpose of availing of various loan facilities. Therefore, this is a case where all the Debtors are independently as well as jointly liable for the repayment of loans facilities availed.

Dissenting for two companies "No Consolidation"

5. US Bankruptcy law states that consolidation request may be denied. The view was expressed that determination for consolidation hinges on a balancing of the equities favouring consolidation against the equities favouring continued debtor separateness. If the consolidation is not equitable or more disadvantageous to stakeholders, the request for consolidation is denied. Therefore, the burden is on the party objecting to consolidation to demonstrate that prejudice can be posed if consolidation be granted.

Tribunal held that, although in all 15 cases, the accounts are inter-mingled and due to the existence of agreements, yet there is a relationship of obligor and/or co-obligors among all these entities. But it was necessary to further ascertain the position of advantage or disadvantage *qua* the stakeholders. In other words, if an entity is self-serving, self-dependent and self-sustainable, a view can be taken for not granting consolidation.

6. Consolidation is not beneficial for two companies

6.1 KAIL Ltd . - An application u/s 9 against the Corporate Debtor KAIL Ltd. was submitted by an Operational Creditor-Cooltech Appliances, which was admitted vide an order of 08.06.2018. KAIL is engaged in the business of manufacturing and trading of various consumer electronic goods and home appliances, such as washing machines, air conditioners, air coolers, television and other electric appliances. Manufacturing facilities are located in West Bengal. The entity is having annual turnover of more than Rs. 400 Crores and has nearly 350 workers in a factory which is undisputedly owned by the Company. It was submitted that the company was self sufficient, its products were in demand all over the country and its business was also not dependent on the other 14 group companies, this company was capable of maintaining itself as a going concern on its own.

Also, considering interests of the employees and workers of this company, it is seen that this company would be in a better position to pay the dues if kept out of consolidation. It is seen that Infotel (a financial creditor of KAIL Ltd.) had also sought for keeping this company out of consolidation, due to the reason that its own share as a financial creditor would be reduced if the consolidation is allowed. It was held that the company was kept out of consolidation due to the reason that it can function independently and not because the share of financial creditor would be reduced.

6.2 Trend Electronics Ltd. - The company was in the business of manufacturing and selling the dish antenna and Set-Top Box which are mandatory pursuant to the compulsory digitalization by the Ministry of Information and Broadcasting. Set-Top Boxes being in great demand in the country, this company is able to do business despite being referred to the CIRP and is independently capable of maintaining itself as a going concern. Its business was concluded to be not dependent on the other 14 companies. If the

company was under common CIRP with other companies, there would be a common resolution plan and this company, which has a good asset value would be treated at par with the other companies, which may prove to be detrimental to this company's resolution plan.

This is not an exhaustive list and cannot be. These are the elementary governing factors, *prima facie*, to activate the process of 'consolidation', Before ordering consolidation, a Court must conduct a searching inquiry to ensure that consolidation yields benefits offsetting the harm it inflicts on objecting parties. The basic intent of the Code is maximization of value of assets of the Corporate Debtor.

Finally court held that '*Summum Bonum* of Consolidation' is to be utilized as a mechanism to maximise the value of financially stressed group of companies. Economic benefit ought to be the sole purpose and for that a preliminary searching enquiry is suggested which would yield benefit to stakeholders by offsetting any harm, if inflicted, if not consolidated. On due reading of all these judgments, one proposition of law emerges that the motion of 'consolidation' depends upon the facts and circumstances of each debtor/debtors. It is appropriate and suitable to give a ruling at this occasion that there is no single yardstick or measurement on the basis of which a motion of consolidation can or cannot be approved.

Concluding remarks

7. This is welcome judgment in the case of Group Insolvency and goes beyond the strict letter to spirit of the law. It is going to be a milestone and yardstick for future insolvency. This is finest example of '*Stare decisis*' and will result as an precedent for the future Group insolvency proceedings. It shall be 'Judge made law' until the Legislature devises it.

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