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Insolvency and Bankruptcy Board of India vide its notification No IBBI/2022-23/GN/REG084 dated 14.06.2022 has notified IBBI (Insolvency Resolution Process for Corporate Persons) (Second Amendment) Regulations 2022 wherein significant changes have been introduced related to valuation conducted under the aforesaid Regulations by amending Regulation 35

Background and need for the Amendment

Regulation 35 of the CIRP Regulations deals with the manner of conducting the valuation of the Corporate Debtor. The combined reading of Regulation 27 and Regulation 35 provides for the appointment of the Registered Valuer and the manner of conducting the valuation

The Erstwhile Regulation 35 read as under

“35. Fair value and Liquidation value.

1) Fair value and liquidation value shall be determined in the following manner: -

(a) the two registered valuers appointed under regulation 27 shall submit to the resolution professional an estimate of the fair value and of the liquidation value computed under internationally accepted valuation standards, after physical verification of the inventory and fixed assets of the corporate debtor;

(b) if in the opinion of the resolution professional, the two estimates of a value are significantly different, he may appoint another registered valuer who shall submit an estimate of the value computed in the same manner; and

(c) the average of the two closest estimates of a value shall be considered the fair value or the liquidation value, as the case may be

(2) After the receipt of resolution plans in accordance with the Code and these regulations, the resolution professional shall provide the fair value and the liquidation value to every member of the committee in electronic form, on receiving an undertaking from the member to the effect that such member shall maintain the confidentiality of the fair value and the liquidation value and shall not use such values to cause an undue gain or undue loss to itself or any other person and comply with the requirements under sub-section (2) of section 29:

(3) The resolution professional and registered valuers shall maintain confidentiality of the fair value and the liquidation value.”

Clause (b) of regulation 35(1) clearly stated that the third valuer can be appointed only if

(b) if in the opinion of the resolution professional, the two estimates of a value are significantly different

However, there was no clear definition of “significantly different” and there was no power in the hand of the Committee of Creditors for getting a third valuation. The Committee of Creditors who holds utmost responsibility in the entire CIRP process by exercising their commercial wisdom had no say in valuation process.

The led to various controversies wherein on the instruction of the COC directly or indirectly third valuation was done and was found to be against the law/regulations. In most of these cases the IBBI directed against the Resolution Professional for getting a third valuation on the advice/instruction of COC Case Law

Order No. IBBI/DC/22/2020 21st April 2020- Order of Disciplinary Committee (DC)

In this case, an SCN was issued to the RP in which along with other contraventions, the following was also pointed out:

The liquidation value given by the two valuers was Rs 175cr and Rs 215 cr. the Third valuer was appointed in the COC meeting though there was no significant difference in the valuation done by the two valuers. The RP in his reply admitted and agreed that there was no significant difference in the valuation and stated that the third valuer was appointed on the insistence of the Committee of Creditors (COC) and the RP had no ground to challenge the same.

Findings and observations:

The third valuer can be appointed only if the RP is of the opinion that the two valuations are significantly different and this power cannot be delegated to anyone else including the COC. The fee for the third valuation paid in this case was an unnecessary financial burden on the corporate debtor

Conclusion

The DC concluded that this was an of contravention of Section 208(2)(a) and (e) of the Code, Regulation 35(1)(b) of the CIRP Regulations, and Regulation 7(2)(a) and 7(2)(h) of the IP Regulations, read with clauses 2,3,5 and 14 of the Code of Conduct as given in the First Schedule of the IP Regulations.

In the matter of M/s. Rana Saria Poly Pack Pvt. Ltd. – Applicant vs Uniworld Sugars Pvt. Ltd Respondent No 1 NCIRCLE Exim LLP- Respondent No 2 WITH

Simbhaoli Sugars Limited VS Pramod Kumar Sharma – RP of Uniworld,

the Hon’ble NCLAT said that the valuation conducted by a third valuer will be considered only if such appointment is made in accordance with Regulation 35 of CIRP Regulations.

The amended provisions

The amended regulation with effect from 14th June 2022 is an attempt to resolve the issue

In the principal regulations, in regulation 35, in sub-regulation (1), for clause (b), the following clause shall be substituted: -

“(b) if the two estimates of a value in an asset class are significantly different, *or on receipt of a proposal to appoint a third registered valuer from the committee of creditors*, the resolution professional may appoint a third registered valuer for an asset class for submitting an estimate of the value computed in the manner provided in clause (a).

Explanation. - For the purpose of clause (b),

(i) “asset class” means the definition provided under the Companies (Registered Valuers and Valuation) Rules, 2017;

(ii) “significantly different” means a difference of twenty-five per cent. in liquidation value under an asset class and the same shall be calculated as $(L1-L2)/L1$, where,

L1= higher valuation of liquidation value

L2= lower valuation of liquidation value.”

In light of the amended provisions, now if the Committee of Creditors is of the view that a third valuation is required, it may submit a requisition for the same to the Resolution Professional and on receipt of the same, the Resolution Professional may appoint a third valuer. The use of word “may” has made Resolution Professional as the ultimate decision taking authority for getting the third valuation. However, it has at least given an opportunity to the COC who earlier had no say in this process and at the same time was required to ultimately exercise the commercial wisdom in the CIRP process.

Impact on valuers.

The term “significantly different” has been quantified under the amended provisions.

Earlier there was a lack of clarity where very different valuations were submitted by the two registered valuers appointed under Regulation 27. While the regulations required the Resolution Professional to obtain valuation from a third valuer, it did not clarify what will constitute a “significantly different” valuation requiring a third valuation. The Amendment now clarifies that a significantly different

valuation will be a 25% difference in liquidation value which is to be calculated as $L1-L2/L1$, where “L” is liquidation value. This will bring clarity in the valuation of any asset and will help in reducing litigation arising out of valuation mismatches.

However, at the same time greater responsibility is now on the shoulders of the valuers as well because now in case the two values are found to be significantly different as defined in the new definitions, the valuer may have to justify the difference in the values as well. In the case of Ran Saria Poly pack case referred above the NCLT stated in the judgement that

“We also note that the CoC did consider the variance between the two earlier liquidation valuation estimates and the third one and desired explanation regarding the same. The explanation could have been obtained from the three valuers since they had carried out the valuation exercise and would be in a position to explain the methodology and reason for divergence in values. It, therefore, appears surprising that rather than obtain explanation from the earlier valuers, the CEO of the erstwhile corporate debtor, who would have been an interested party and could have had a clouded opinion, was approached to provide this explanation”

Proposed amendment to CIRP regulations vide discussion paper issued by IBBI on 27th June 2022

1. *Proposal: It shall be provided that along with RP, CoC must be given an opportunity to interact with valuers to understand their valuation methods, underlying assumptions, and justifications so that a veritable valuation is accepted. The confidentiality agreements or disclosures may be taken before such discussion is carried out. Proposed amendment: It is proposed that the Regulation 35(2A) may be added under CIRP Regulations which shall state the following:
Regulation 35(2A): The registered valuers appointed under regulation 27 shall present draft valuation report to the resolution professional and committee in a meeting of the committee to brief them about the valuation approach followed and limitations of the reports.*
2. *Proposal: The CoC may decide to repeat the valuation exercise in CIRPs where the timeline has extended beyond the mandatory 330 days due to difficult market conditions or force majeure conditions or legal stalemate.
Proposed amendment: Regulation 35(4) may be inserted in CIRP Regulations which shall state the following:
(4) The committee may choose to repeat the valuation exercise undertaken in terms of this Section where the process has extended beyond the time-limit stipulated under Section 12 for completion of insolvency resolution process for reasons to be recorded in writing.*

In light of above developments, it may be safely presumed that

1. In case of any litigation related to valuation, the valuers may be called for explanation regarding the valuation exercise performed by them
2. If the proposed amendments are enforced, the valuers will be answerable to the COC regarding the valuation approach and methodology adopted.
3. A repeat valuation exercise may be done if the process goes beyond the mandatory period under specified circumstances.