

Insolvency and Bankruptcy Code: Supreme Court of India Endorses the Fresh Start on a Clean Slate Principle

Section 31 of the Insolvency and Bankruptcy Code, 2016 (“**IBC**”) provides that once the Adjudicating Authority (as defined in the IBC) approves a resolution plan, it shall be binding on the corporate debtor, its employees, members, creditors including Central/State Government and any local authority to whom a debt arising under any law in force is owed, guarantors and other stakeholders involved in the resolution plan.

THE ESSAR STEEL CASE

The Supreme Court of India (“**Supreme Court**”) in *Committee of Creditors of Essar Steel India Limited (through authorized signatory) v. Satish Kumar Gupta and Others*¹ (*Essar Steel case*) held that allowing claims apart from those covered in a resolution plan to survive after the approval of a resolution plan militates against the rationale of Section 31 of the IBC. The Supreme Court held that the successful resolution applicant should be given an opportunity to take over and run the business of the corporate debtor on a clean slate. Accordingly, a resolution applicant should not be suddenly faced with ‘undecided’ claims which would throw into uncertainty the amounts payable by a resolution applicant to take over the business of the corporate debtor. Accordingly, the Supreme Court upheld the principle of extinguishment of past liability by interpreting Section 31 to mean that once the resolution plan had been approved by the Adjudicating Authority it would be binding on all stakeholders as it is and no past liabilities or claims could pop up subsequently.

While it was certain after the verdict of the Supreme Court that all claims against a corporate debtor would stand extinguished after the approval of a resolution plan, there was still some uncertainty about the status of criminal and civil proceedings that may be

¹ *Committee of Creditors of Essar Steel India Limited (through authorized signatory) v. Satish Kumar Gupta and Others*, (2020) 8 SCC 531

initiated by statutory authorities for alleged offences or violations under applicable law by the corporate debtor prior to the commencement of insolvency.

EXTINGUISHMENT OF LIABILITY

As background, it will be useful to analyze certain orders issued by regulatory authorities under the Securities and Exchange Board of India Act, 1992 (“**SEBI Act**”) and the Prevention of Money Laundering Act, 2002 (“**PMLA Act**”).

The Securities and Exchange Board of India (“**SEBI**”) had issued show cause notices dated October 18, 2019 to Monnet Ispat & Energy Limited and Alok Industries Limited respectively for alleged non-compliances with certain disclosure obligations under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 stated to have occurred prior to implementation of the respective resolution plans. The SEBI, adjudicating officer in both these matters imposed a monetary penalty² on the corporate debtor for such non-compliances. On appeal, however, the Securities Appellate Tribunal³ (“**SAT**”) recognizing the need for the successful resolution applicants to be given a fresh start pursuant to the IBC process and relying on the Supreme Court’s decision in the Essar Steel case noted that the SEBI ought not to have issued the show cause notice or adjudicate or pass an order of the penalty in relation to violations which occurred prior to implementation of the resolution plans. Further, the SAT noted that once the Adjudicating Authority had approved a resolution plan, it would be binding on all government authorities, including the SEBI. At the time of writing this article, appeals filed by the SEBI against the aforementioned orders of the SAT are pending before the Supreme Court.

The question of the liability of a corporate debtor for alleged offences committed before it successfully underwent the corporate insolvency resolution process under the IBC also arose in the case of acquisition of corporate debtor - Bhushan Power & Steel Limited (“**Bhushan Power**”) by JSW Steel Limited (“**JSW Steel**”). On October 10, 2019 the Directorate of Enforcement of Central Government (“**ED**”) attached the assets of Bhushan Power under Section 5 of the Prevention of Money Laundering Act, 2002 (“**PMLA Act**”). Such action by the ED preceded the Supreme Court’s judgment in *Committee of Creditors of Essar Steel India Limited (through authorized signatory) v. Satish Kumar Gupta and Others* by about a month.

JSW Steel urged before the National Company Law Appellate Tribunal, New Delhi (“**NCLAT**”) that the ED could not attach assets of a corporate debtor after its resolution plan had been approved on the ground of money laundering by the *erstwhile* promoters.

² See Adjudication Order No. Order/SR/SM/2020-21/8025/30 dated June 26, 2020 *in respect of Monnet Ispat & Energy Limited* and Adjudication Order No. Order/SR/SM/2020-21/8433/47 dated July 30, 2020 *in respect of Alok Industries Limited*.

³ *Monnet Ispat & Energy Limited v. SEBI* (Order dated October 29, 2020 in Appeal No. 238 of 2020); *Alok Industries Limited v. SEBI* (Order dated December 1, 2020 in Appeal No. 300 of 2020)

While the matter was still pending before the NCLAT, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 was promulgated and published in the Gazette of India on December 28, 2019 (the “**2019 IBC Ordinance**”). Pursuant to Section 10 of the 2019 IBC Ordinance, Section 32A was introduced in the IBC effectively providing immunity to successful resolution applicants against the offences committed by the erstwhile management of the corporate debtor, subject to certain conditions.

It is also relevant to note that Section 238 of the IBC provides for an overriding clause which states that the provisions of the IBC shall have full effect notwithstanding anything inconsistent therewith contained in any other law in force. It is a well-recognized principle in law that when two non-obstante clauses in two special statutes clash, the statute which is later in time will prevail. Therefore, IBC being the later statute will prevail over the SEBI Act and the PMLA Act.

SECTION 32A OF THE IBC

Section 32A of the IBC expressly provides that a corporate debtor shall not be prosecuted for an offence committed prior to the corporate insolvency resolution process, from the date on which a resolution plan is approved by the Adjudicating Authority, subject to certain conditions. Section 32A further clarifies that if a prosecution is instituted during the corporate insolvency resolution process against a corporate debtor, it shall stand discharged from the date of approval of the resolution plan. The exemptions from liability as mentioned earlier are subject to the following conditions:

1. The resolution plan approved should result in change of management or control of the corporate debtor to a person who was not a promoter or in management or control of the corporate debtor prior to the implementation of the resolution plan, or a related party of such a person; or
2. The relevant investigating authority should not have reason to believe, on the basis of any material in its possession, that the new persons in the management or control of the corporate debtor had abetted or conspired in the commission of the alleged offence with the erstwhile promoters or persons in management or control of the corporate debtor.

The relevant investigating authority is required to file a report or complaint to the relevant statutory authority or court in relation to such abetment or conspiracy to continue with the prosecution against the corporate debtor.

3. The designated partner or officer in default who was in charge of, or responsible to the corporate debtor for conduct of its business or associated with the corporate debtor in any manner, or directly or indirectly involved in the commission of the offence according to the report/complaint filed by the investigating authority, would not be granted such immunity.

Section 32A(2) of the IBC also bars action against property of a corporate debtor in relation to an offence allegedly committed prior to commencement of the corporate insolvency resolution process, subject to similar conditions (as listed above). Section 32A(3) obligates the corporate debtor to extend all co-operation to investigating authorities for investigations relating to the period prior to the commencement of the insolvency.

Taking note of the 2019 IBC Ordinance, the NCLAT in *JSW Steel Limited v. Mahender K. Khandelwal and others*⁴ (*JSW Steel case*) issued notice to the ED and the Central Government seeking a response on whether JSW Steel would be covered by the exemption under Section 32A. The NCLAT while holding that the PMLA proceedings ought to be quashed, noted two important observations – (i) that Section 32A being merely clarificatory, would apply retrospectively; and (ii) Section 32A requires the investigating agency to have reasons to believe that the new management of the corporate debtor had abetted or conspired in the commission of the offence on the basis of material in its possession as on the date on which such investigation authority is called to provide its confirmation with respect to Section 32A. The investigation authority may not keep such confirmation in abeyance until the investigation is complete in all other aspects. At the time of writing of this article, an appeal against the judgment of the NCLAT in this JSW Steel case is pending before the Supreme Court.

Separately, on the basis of a plain application of Section 32A of the IBC, the Delhi High Court in *Tata Steel BSL Limited and another v. Union of India and another*⁵ discharged the accused in proceedings filed against them before the trial court for alleged offences under the Companies Act, 2013, Companies Act, 1956 and the Indian Penal Code, 1860 consequent to approval of Tata Steel Limited's resolution plan for revival of the petitioner (then known as *Bhushan Steel Limited*) under the IBC process.

SECTION 32A OF THE IBC GETS RECOGNITION FROM THE SUPREME COURT

More recently, in *Manish Kumar v. Union of India*⁶ the Supreme Court dismissed a writ petition challenging the constitutional validity of Section 32A of the IBC on the ground that Section 32A is arbitrary and violates Articles 300A, 14, 19 and 21 of the Constitution of India. The Union of India urged before the Supreme Court that the Essar Steel case required the successful resolution applicant to be provided an opportunity to start on a fresh slate and that Section 32A was introduced to give such objective statutory basis. The Supreme Court while observing that the legislature ought be given freedom to experiment with economic laws and recognizing the imperative need for the IBC in the

⁴ 2020 SCC OnLine NCLAT 55

⁵ *Tata Steel BSL Limited and another v. Union of India and another* (Order dated March 16, 2020 in W.P. (CRL) 3037/2019 and CRL.M.A. 39126/2019)

⁶ *Manish Kumar v. Union of India* (Judgment dated January 19, 2021 in W.P. (C) No. 26 of 2020)

Indian context, held that the “*extinguishment of criminal liability of the corporate debtor is apparently important to the new management to make a clean break with the past and start on a clean slate*”. The Supreme Court issued an unequivocal declaration of the need to give the successful resolution applicant a fresh start. Naturally, the decision of the Supreme Court is binding on all subordinate courts and tribunals and we expect that such decision will be implemented by such courts and tribunals in letter and spirit.

It will be interesting to examine whether regulatory authorities will stop issuing notices to successful resolution applicants and/or the revived corporate debtor for offences alleged to have occurred prior to the implementation of a successful resolution plan. It will also be interesting to see how the Supreme Court rules in the aforesaid pending appeals in the matter of Alok Industries Limited, Monnet Ispat & Energy Limited and JSW Steel.

While the legislative prerogative may presently require extinguishment of past liability, going-forward the law may be reconsidered with a change in the economic conditions. The concept of corporate criminal liability is not unknown in India. Further, given that resolution applicants are given extensive due diligence rights, in the future, the legislature itself may treat acquisition under the IBC process at par with any other acquisition. In fact, even in the JSW Steel case, the NCLAT had taken an initial *prima facie* view that if the ED finds that the assets of the corporate debtor were purchased out of the ‘proceeds of crime’ then the amount generated out of the assets will come within the meaning of ‘operational debt’ payable to the ED for which it may file a claim under the IBC. Accordingly, in the future, it is possible that special regulatory authorities such as the ED and the SEBI may participate in the corporate insolvency resolution process by submitting claims against corporate debtors. However, for this, further amendments will be required to the IBC.

TRACES OF RECOGNITION OF THE CLEAN SLATE PRINCIPLE UNDER THE COMPANIES ACT

Interestingly, the Company Law Board in its order⁷ approving the induction of strategic investor – “Tech Mahindra Limited” in “Satyam Computers Services Limited” after the Satyam scam broke out, had granted protection to the strategic investor similar to that contemplated by Section 32A of the IBC. The directors nominated by Tech Mahindra Limited were granted exemption from any civil/criminal liability pursuant to proceedings by the state or central government agencies, for any acts or omissions by the company which occurred prior to the suspension of the *erstwhile* board of directors of the company. The reason for this was to ensure that the directors nominated would be able to carry out their functions without any apprehension of being subject to civil/criminal liability for the past

⁷ *Union of India v. Satyam Computer Services Limited and Ors.*, (2009) 2 CompLJ 293 (CLB)

offences. Therefore, this concept of allowing the new management to operate on a clean slate is not completely alien to the Indian jurisprudence.

Further, in the view of the authors, courts and tribunals must consider applying the clean slate principle on a case to case basis, where the Central Government applies for relief under Sections 241 and 242 of the Companies Act, 2013 when it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest. The clean slate principle serves public interest by ensuring that the company survives and regulatory actions do not linger to the haunt the company and the new management.

CONCLUSION

The Supreme Court in *Manish Kumar v. Union of India* has clearly paved the way forward for courts and tribunals to deal with the recurring question of the continuity of liability of a corporate debtor for past offences. Given that the suspension on filing of insolvency petitions on account of Covid-19 is due to expire shortly, i.e. on March 31, 2021⁸, the authors believe that it would be beneficial if the aforesaid appeals pending before the Supreme Court are disposed of quickly. This would ensure that the potential resolution applicants have better certainty and clarity before offering their resolution plans.

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⁸ Notification (Ministry of Corporate Affairs) dated December 22, 2020, Available at: <https://ibbi.gov.in/uploads/legalframework/df55d4f612f270d6c637ee4b3c8131c8.pdf>