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**THE CLEAN SLATE THEORY UNDER INSOLVENCY AND
BANKRUPTCY CODE, 2016**

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ABSTRACT

The Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as “**the Code**”), is a huge step forward and is one of the most dynamic legislations. The resolution of Corporate Debtor is the primary legislative intent behind the enactment of the Code. The distinct feature of the Code is that it differs from prior legislations in a way that it does not operate solely as a means of debt recovery route for creditors. The Code attempts to strike a balance between both the interests of the Creditor and the Corporate Debtor by ensuring that the company survives and the creditors' claims are fully satisfied.

You can get a claw or other relief. Review, Basis diligence and determination by resolution professionals challenging antecedent transactions must be applied to the National Company Law Tribunal (NCLT), where an independent judicial mind is engaged to provide appropriate relief in accordance with the Code. The Insolvency and Bankruptcy Code, 2016 (Code) is an evolving law designed to meet stakeholders' needs. The Code's avoidance transaction provisions are notable. The Code provides that due to such transactions (fraudulent transactions, forcible transactions undisclosed transactions and preferential transactions) the value is lost with the parties concerned before two years or in other one year.

Keywords: *bankruptcy Code, NCLT, Judicial, Transactions, Review*

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INTRODUCTION

The *clean slate theory* or *the doctrine of clean slate* is one of the core guiding principles of the Corporate Insolvency Resolution Process (CIRP) and implementation of resolution plan. The clean slate theory states that any pending claims *qua* the corporate debtor (CD) shall be absolved on completion of the CIRP, and the victorious resolution applicant shall take over with a clean slate.² The clean slate theory is derived from Section 32A of the Code, read with Section 31(1) of the Code which the author will analyze in detail in the further chapters. The amendment to the Code to include Section 32A was primarily the result of the *Essar Steel India Ltd*³. landmark judgement decided on 15th November 2019.

Since the conceptualization of the clean slate theory, the same has been widely relied on as a non-negotiable factor to be fulfilled on approval of the resolution plan. This is because the theory is crucial from the point of view of the resolution applicant who bids against the ailing corporate debtor. The absence of the clean slate theory would mean that the resolution applicant winning the bid to run the corporate debtor and its new management would be responsible for the pending claims against the corporate debtor prior to insolvency. If this were to happen, it would not only discourage the prospective bidder/resolution applicant but it would also vitiate the spirit of the code.

The current scenario is that the theory has led to plethora of issues and petitions being filed in forums for extinguishment of the undecided claims of the creditors after the approval of the resolution plan, even though the position and validity of the clean slate theory has been made clear and reiterated by Hon'ble Supreme Court in numerous cases.

In the present paper the author aims to analyze the applicability and the relevant provisions guiding the clean slate theory and the author will also consolidate in brief the legislative and the judicial evolution of the clean slate theory and its recent developments in 2021. Furthermore, the author also makes attempt to examine the underlying concerns and limitations of the clean slate theory.

² Divyani Auti, *Clean Slate Approach under IBC: An Impetus to Insolvency Proceedings*, IRCCL

³ (2020) 8 SCC 531.

CONCEPT OF CLEAN SLATE THEORY – ANALYSIS

To understand the concept of *clean slate theory or the doctrine of clean slate*, it is imperative to analyze Section 31 of the Code. More specifically Section 31 (1) which states that when the Adjudicating Authority approves the resolution plan, it shall be binding on the corporate debtor, employees of CD, creditors, members, guarantors and other stakeholders participating in the resolution.⁴ Also, pursuant to *Insolvency and Bankruptcy Code (Amendment) Act, 2019*, Section 31 (1) was amended (w.e.f 16.8.19) to make the approved resolution plan binding on “central government, state government, or any local authority to whom a debt in respect of the payment of dues arising under any law such as authorities to whom statutory dues are owed”. From the aforementioned it is certain that the clean slate theory under the Insolvency and Bankruptcy Code becomes effective only after the resolution plan is accepted by the Committee of Creditors. To elaborate on the same, Hon’ble Mr. Justice R. F. Nariman opined the following in the landmark Essar Steel Judgment⁵:

“Para 66 - Section 31 (1) of the Code makes it clear that once a resolution plan is approved by the CoC it shall be binding on all stakeholders, including guarantors. The reason is that this provision ensures that the successful resolution applicant starts running the business of the corporate debtor on a fresh slate as it were”.

As a result, the clean slate theory envisages that the resolution applicant cannot be confronted with undecided claims after the resolution plan is approved because the resolution applicant is to start with the corporate debtor's business on a fresh slate.

Section 31 of the Code enumerates the view of extinguishment of additional/undecided claims emerging out of the resolution plan after its approval. The purpose of this legislative provision is to ensure that all valid claims are raised in the approved resolution plan, so that it leaves no vacuum for claims to be raised after the plan has been approved. This ensures that when the resolution plan is implemented, the resolution applicant is not inundated with past claims of the entity prior to CIRP. Resolution applicants are urged to step forward and take over the stressed business by establishing a clear structure that precludes the perpetuity of claims against the corporate debtor.⁶

⁴ The Insolvency and Bankruptcy Code, 2016, Section 31 (1), No. 31, Acts of Parliament, 2016 (India).

⁵ Committee of Creditors of Essar Steel India Ltd. V. Satish Kumar Gupta, (2020) 8 SCC 531.

⁶ Amir Bavani and Rhea Jayakumar, *Guarantors: The Unspoken Exception to the Clean Slate Theory*, SCC Online Blog

ESSAR STEEL JUDGEMENT OF THE SUPREME COURT OF INDIA

The clean slate theory has been propounded by the Supreme Court in the landmark case of *Committee of Creditors of Essar Steel India Ltd. V. Satish Kumar Gupta & Ors. [(2020) 8 SCC 531]*, wherein the Supreme Court while recognizing the binding nature of the Resolution Plan reiterated the doctrine of clean slate in *Para 67* of the judgement, which stated as follows:

“A successful resolution applicant cannot suddenly be faced with undecided claims after the resolution plan submitted by him has been accepted as this would amount to a hydra head popping up which would throw into uncertainty amounts payable by a prospective resolution applicant who successfully take over the business of the corporate debtor. All claims must be submitted to and decided by the resolution professional so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the corporate debtor. This the successful resolution applicant does on a fresh slate, as has been pointed out by us hereinabove.”

Hence, the Supreme Court has interpreted Section 31(1) of the Code to mean that the victorious Resolution Applicant should begin operating the revived company on a fresh slate, based on the doctrine of clean slate. The Supreme Court has laid down emphasis on the revived company beginning with a clean slate, so that the revived business with new management is not burdened by litigation and outstanding debts of corporate debtor.⁷

RECENT DEVELOPMENTS UNDER CLEAN SLATE THEORY

I. Ultra-Tech Nathdwara Cement Ltd v. Union of India

In this case the Binani Cements Ltd. had completed the CIRP proceedings and the Resolution Plan filed by Ultra Tech Cement had been approved and authorized by the Hon'ble NCLAT and the same was also affirmed by the Hon'ble Supreme Court *vide* order dated 19th November 2018.⁸ After which Ultra Tech took over the management of Binani and paid to all creditors, including statutory dues of the Tax Department of Binani as per the Resolution Plan. Despite the fact that the CIRP proceedings were completed, the GST Department Authorities issued new Demand Notices to the Resolution Applicant.

⁷ Shlok Parekh, *Doctrine of Clean Slate and IBC*, legal formats India

⁸ [(2020) SCC OnLine Raj 1097]

The Rajasthan High Court decided that a successful resolution applicant should not be saddled with the dues of statutory operational creditors i.e., GST authorities that are not included in the resolution plan, and should be able to commence the revived business with a clean slate. Further the Court ruled that GST Authorities and other statutory authorities are operational creditors, and the debt owed to them is included in operational debt. The legislative intent of the Code is to ensure revival of the distressed company rather than insisting recovery of every single debt, this is so that the resolution application can take over the corporate debtor with a clean slate. Allowing creditors to make pre-CIRP claims that are already covered by an approved resolution plan would thus defeat its purpose and disincentivize potential resolution applicants.⁹

II. Ghanashyam Mishra and Sons v. Edelweiss Asset Reconstruction Company

In one of the most recent cases¹⁰ on the clean slate theory as on 13th April, 2021, the Supreme Court observed that if additional claims are allowed to be brought against the successful resolution applicant after the plan is approved, the entire plan will become unworkable, defeating the very purpose of the enactment i.e., the revival of the corporate debtor. The Court ruled that such unexpected debts could not be imposed on the resolution applicant because they were not included in the resolution plan. If that is permitted, the calculations on which resolution applicants rely to submit their resolution plans will be thrown off.¹¹

The Court went on to say that section 31 of the Code supports the clean slate theory. The Insolvency and Bankruptcy Code (Amendment) Act of 2019 amended this provision further. The Court determined that this particular amendment was clarifying in nature and thus retrospective in application. As a result, after the resolution plan is approved, any claim, even if it relates to a date prior to the effective date of this amendment, will be denied. The Supreme Court made the observation that this amendment was not even necessary in the first place. This is because, under Section 31, a successful resolution plan is already binding on "creditors." According to the Court, the term "creditor" already includes the Central Government, State Governments, and local governments, as they can be recognized as operational creditors. Even otherwise, they can easily fall under the category of "other stakeholders" under section 31.

⁹ Divyani Auti, *Clean Slate Approach under IBC: An Impetus to Insolvency Proceedings*, IRCCL

¹⁰ CIVIL APPEAL NO.8129 OF 2019

¹¹ Aditya Saraswat, "*Clean Slate Theory*" under the IBC: An Analysis.

SECTION 32A – RECOGNITION FROM THE SUPREME COURT

The *clean slate theory* is also discernible from Section 32-A of the Code, which was added by the Insolvency and Bankruptcy Code (Amendment) Act, 2020. Section 32-A was introduced into the Code post the judgement of *Committee of Creditors of Essar Steel India Ltd. v. Satish Kumar Gupta*. It states that a corporate debtor's liability for an offence committed prior to the initiation of the CIRP ceases, and the corporate debtor cannot be prosecuted for such an offence from the date the resolution plan is approved, if that resolution plan results in a change in the corporate debtor's management or control to someone who is not a related party. Similarly, under Section 32-A (2), no action can be initiated against the corporate debtor's property for an offence committed prior to the commencement of the corporate debtor's CIRP, if such property is a part of approved resolution plan.¹²

The constitutionality of Section 32-A was recently challenged in the case of *Manish Kumar vs Union of India*,¹³ wherein the Hon'ble Supreme Court upheld the validity of Section 32-A observing that the legislature should be given the liberty to experiment with economic laws and recognize the immense need for the Insolvency and Bankruptcy Code in the Indian context, and further 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 stated unequivocally that the successful resolution applicant should be given a fresh start.

The Supreme Court further opined that while Section 32-A is intended to provide a clean slate to the successful resolution applicant, it is surrounded by sufficient safeguards to prevent manipulation. Furthermore, such immunity is contingent on a number of factors, including the approval of a resolution plan and a change in control of the corporate debtor, with the new management being unable to be a disguised avatar of the old management or a related party of the corporate debtor. Furthermore, the new management cannot be the subject of an investigation that has resulted in material demonstrating abetment or conspiracy for the commission of the offence.

The researcher is a view that the fresh slate theory is promising and well-intentioned from the perspective of a successful RA who cannot be burdened with unresolved claims after the resolution plan is approved.

¹² The Insolvency and Bankruptcy Code, 2016, Section 32A, No. 31, Acts of Parliament, 2016 (India).

¹³ [(2021) SCC OnLine SC 30]

Crafty clauses in the resolution plan that treat pending litigation claims as nil or give them an unfair/notional value may warrant a strict review under section 31 of the IBC. Section 30 of the IBC may include a provision to discharge all disputed claims, without which a resolution plan cannot be approved. One cannot deny the possibility of RP/IRP errors, so their role in verifying/determining claims needs further examination.

LIMITATIONS & ISSUES OF CLEAN SLATE THEORY

The various underlying concerns of the clean slate theory are as follows:

1. Even though the recent judicial developments signal a shift towards clean slate theory, it comes with its own practical challenges. The *Ultra Tech Nathdwara* case relied on the *Essar Steel* decision to sustain the clean slate theory. However, the ratio of the *Essar Steel* judgement is based on the reasoning that all claims against a corporate debtor must be referred to and decided by a resolution professional. Whereas, this reasoning contradicts the Supreme Court's decision in *Swiss Ribbons v Union of India*, which held that the resolution professional cannot adjudicate the claims and only has administrative powers to collate them.¹⁴

The *Essar Steel* decision discards the fact that NCLT also has the authority to adjudicate claims under Section 60 (5) of the Code. This is important in situation where the resolution professional may not consider claims that are disputed, uncrystallized, or dependent. Which leaves only one option with creditor i.e., to file a claim with NCLT under Section 60 (5) to contest rejection of such claims by resolution professional. Therefore, if a resolution plan is approved before taking into consideration such claim, these claims would be extinguished qua the corporate debtor, leaving creditor without recourse.

2. Another issue which arises is with respect to proviso to Section 14 which specifies that “moratorium shall cease to have effect from the date of the approval of the Resolution Plan” which appears to imply that adjudication of claims in dispute before the proper forum can continue after the moratorium ends. The inconsistency is to the extent that, if the disputed claims are to be adjudicated after the moratorium ends, the section suggests that the successful resolution applicant should be burdened with unresolved claims even after paying the required amounts as per the Resolution Professional.

¹⁴ Mangesh Krishna and Akshay Sharma, *Extinguishment of Claims under the IBC: A Fresh Slate*, The RMLNLU Law Review Blog.

Therefore, for the sake of argument, this section denies the idea of a clean slate, necessitating the interference of the Supreme Court.

3. The *Essar Steel* judgement has effectively read down Section 60(6) of the Code without providing any justification. The section states that the moratorium period is to be excluded from the limitation period for any suit or application. The rationale for this provision is primarily based on the idea that creditors can pursue their claims against the corporate debtor in other forums even after the resolution plan has been approved. Surprisingly in the case of *B.K Educational Services Pvt Ltd. v Parag Gupta and Associates*, the Supreme Court opined that Section 60 (6) to be a necessary provision under the Code and relied on the same to evaluate applicability of the Limitation Act, 1963 to the Code. Despite this, the Essar Judgment effectively sets aside Section 60(6) of the IBC without explanation.

CONCLUSION

The primary aim of the Insolvency and Bankruptcy Code, 2016 is to get the maximum potential value of a firm's assets and promote entrepreneurship while ensuring credit availability, so as to keep the economy moving by resolution rather than liquidation of an ailing company. Therefore, the doctrine of clean slate theory approves and validates this objective of the Code. From the above analysis of the topic, it is clear that the *clean slate theory* is derived from recently amended and inserted Section 32A read with Section 31 (1) of the Code. Section 32A was primarily inserted subsequent to the *Essar Steel Judgment* decided on 15th November, 2019. Also, from the various discussed case laws in the paper describing the recent development of the theory it suggests that the concept of *clean slate theory* and Sections 31 (1) and 32A have been challenged before the respective forums numerous times. One of the most recent case law being *Manish Kumar vs Union of India [(2021) SCC OnLine SC 30]*, wherein the constitutionality of Section 32A was challenged before the Supreme Court. However, Supreme Court unequivocally upheld the validity of Section 32A and held that “*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.*” This moves on to show that providing a fresh start/clean slate to a resolution applicant taking over the business of corporate debtor is of immense essence to achieve the objective of the Code.

However, as aforementioned the clean theory slate theory comes with many limitations, issues and grey areas which can be challenged time and again before the courts. For example, the *Essar Steel* judgement stated that all claims against a corporate debtor must be referred to and decided by a resolution professional. Whereas, on the contrary in the *Swiss Ribbons v Union of India*, wherein Supreme Court held that the resolution professional cannot adjudicate the claims and only has administrative powers to collate them. This aspect needs to be clarified by the Court in the future cases. Another discrepancy lies wherein the proviso to Section 14 of the Code was not addressed by the Supreme Court in the *Essar Steel* case; the proviso implies that adjudication of claims in dispute before the proper forum can continue after the moratorium ends. Therefore, it is expected that the Supreme Court will have to interpret the notion of clean slate sooner or later. These aspects need to be clarified and notified for effective implementation of the *clean slate doctrine*.