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Evaluation of clean slate theory in insolvency & bankruptcy code

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Abstract
A claw of such value or suitable relief may be obtained. Basis diligence, review and determination by resolution professionals, challenging such antecedent transactions, is required to be applied to the National Company Law Tribunal, wherein an independent judicial mind is engaged and applied to provide appropriate relief in terms of the provisions of the said Code. The Insolvency and Bankruptcy Code, 2016 (Code) is a dynamic law, developed to meet the emerging needs of process stakeholders. The provisions are relating to the avoidance transactions form part of the salient features of the Code. The Code provides that due to such transactions (preferential transactions, undisclosed transactions, forcible transactions and fraudulent transactions) the value is lost with the parties concerned before two years or in other one year.

Keywords: bankruptcy Code, law, IB, IBBI, IBC, insolvency resolution, etc

Introduction

"Section 31 (1) [1] of the Code makes it clear that once a resolution plan is approved by the creditors' committee it will be binding on all the stakeholders including the guarantor. It is for this reason that this provision ensures that the successful resolution applicant begins to run the business of the corporate debtor on a fresh slate as it were. It is also worth noting that an argument was made by the Supreme Court before relying on Section 40 (4) [2], which is against the CD or the period of moratorium for calculating the specified limit for any suit or application. The intention of the legislature behind sec. 60 (6) [3] is to allow litigation to continue even after the CIRP ends.

However this argument was rejected by the Supreme Court in the following words [3]:

"For the same reason, the NCLAT judgment has been claimed to be applicable which may exist in addition to the claims which may be decided by the Professional and Adjudicating Authority / Appellate Tribunal deciding on the proposal, now Sec. 60 (6) may be decided by an appropriate forum. Reference is also against the logic of Section 31 of the code.

The principles of “Clean Slate” remain largely undefined in Indian insolvency law. This principle broadly means that after the culmination of the corporate debtor's corporate insolvency resolution process ('CIRP') [1], the successful resolution applicant must have taken over the Corporate Debtor's business and commenced operations with a 'Clean Slate'. That is to say evaluate the outstanding dues by the resolution professional ('RP') [1] and approve the resolution plan by the Creditors' Committee ('COC') [1] and the Adjudicating Authority, after all dues are met and the satisfied qualification will be met by the corporate. The debtor and corporate debtor will be presented with a Fresh Slate, which will enable it to revive itself [2].

A successful resolution applicant may not suddenly be confronted with "unspecified" claims as presented by him. The resolution plan has been accepted because it will amount to popping up a Hydra head which will throw in an uncertainty amount payable by a potential resolution applicant who has successfully finished the corporate debtor's business. All claims submitted by the resolution professional must be made and decided so that a potential resolution applicant can know exactly in what order to pay and it can run the business of the corporate debtor. This successful resolution makes the applicant on a fresh slate, as here’s what we said. For these reasons, NCA almighty’s decision should also be set aside on this count [4].

In fact, the principle of the Fresh or Clean Slate is that once the resolution plan is approved by the Committee of Creditors (COC) [1], it will be binding on all stakeholders and a sudden resolution applicant (RA) after suddenly unspecified claims May not have to face. The resolution plan gets approved as RA starts the business of CDs afresh. The doctrine finds its root in Section 31 (1) of the IBC and this principle has been given effect by the Hon'ble Supreme Court in the committee of “Essar Steel India Limited vs. Satish Kumar Gupta & Ors.” (Essar Steel decision) on 15.11.2019, in which it was held that Fresh or Clean Slate is that once the resolution plan [2].

Recently, the decision of “Ultra Tech Nathdwara Cement Limited vs. Union of India” passed by the Rajasthan High Court on 7 April 2020 also seems to have discounted the principle of Fresh Slate. Ultra Tech had captured Binani Cements after emerging as a successful RA and paid dues to the department recruited by CIRP in terms of resolution plans [1].

The High Court quashed the demand for GST against Ultra Tech for the arrears of Binani Cements for a period before the resolution plan was finalized and said that once the proposal of RA is accepted and the resolution plan is approved by the appropriate authority. If approved, is binding on all for whom the concern of the industry may be statutory arrears. The Court also observed that no right of audience was given in the proceedings for resolution of operational creditors whether the Central Government or State Governmentas the case may be.

In addition, an amendment to Section 32A [1]. of the IBC

eliminates CD's liability for an offense committed before the commencement of CIRP and protects CD's assets, and only reflects the legislature's intent to provide a new slate is successful R.A.

Doctrine of CST

(COC) and other authorized officers shall stand with satisfied qualifications for all outstanding dues to the corporate lender which will only be provided with a new Slate. This doctrine was included in the committee by Supreme Court in the case of Essar India Limited Vs. Satish Kumar Gupta and Ors. 2019 (16) SCALE 319 [3], where it was held that the resolution plan was later successfully cleared by the authorized officials. No new claims can be made by government officials as well. The Supreme Court held that the words of Section 31 (1) [1] of the Insolvency and Bankruptcy Code, 2016 are very clear about the Doctrine of Clean Slate.

The principle of Clean Slate under the Insolvency and Bankruptcy Code broadly means the initiation of a corporate insolvency process (CIRP) against a corporate debtor and then successfully submitting a resolution plan by the resolution professional and a plan approved by the creditors committee [2].

Electro Steel Steels Ltd. vs State of Jharkhand and Headway in Insolvency Law

The Insolvency and Bankruptcy Code (IB Code) [1] was enacted for the resolution of the corporate debtor so that it remains a 'concern' (i) [3].

In the case of Electro steel, M/s Vedanta Limited emerged as a successful resolution applicant, and its application to handle the petitioning company was approved by the adjudicating authority. Although, the money paid by the company to its creditors was paid in the required proportion, the arrears with the VAT Authorities (tax department) [2] were not considered. The Petitioner, required under Section 13 of the Code, did not make a public declaration in place of his registered office, namely, to invite the claims of creditors in the State of Jharkhand. The Court further said that since the 2019 amendment [v] was promulgated after the resolution plan was finalized, it would not have retrospective effect and thus the tax department would have to claim to recover its arrears [3]. [Note: The Amendment Act of 2019 amended Section 31 to make it clear that the approved resolution plan will be binding on all stakeholders including Government and Local Authorities].

This principle in Indian laws finds its place under Section 31and 32A of the IBC and is further elaborated and interpreted by the Supreme Court in the case of the Committee of Creditors of Essar Steel India Limited through the authorized signatory v. Satish Kumar Gupta (ii) is. 2019) (Essar Steel). Recently, Ultra Tech Nathwara Cement Vs The Union of India [iii] (2020) (Ultra Tech), the Rajasthan HC held that after approval of the resolution plan, the tax authorities cannot raise the pending tax dues from the outstanding applicant. However, in the case of Electrosteel Steels Ltd. v. State of Jharkhand, the State of Jharkhand [iv] (2020) [1]. (Electro steel) overturned the decision of Rajasthan HC regarding the application of the new slate principle and pending tax arrears. Approval of Resolution Plan. - (1) The Adjudicating Authority is satisfied that the resolution plan has been approved by the Committee of Creditors under sub-section (4) of Section 30, as stated in sub-section (2) of Section 30.

The decision in UltraTech sets a fundamental question about governmental entities, with fresh statutory demands for liability, which occur after acceptance and implementation of the resolution plan. The decision in Ultra Tech primarily relies on amendments to Section 31 (1) [4] of the Insolvency and Bankruptcy Code, 2016 ('IBC'), which, after August 16, 2019 [4], reads as follows:

For the same reason, the NCLAT's[3] decision to implement that decision as decided by the resolution professional and the Adjudicating Authority / Appellate Tribunal on the basis of merit, except as decided by an appropriate Forum in terms of Section 60 (6) can go. It is also against the logic of Section 31 of the Code. As a matter of fact, when the Insolvency and Bankruptcy Code (Amendment) Bill, 2019 [2], which was amended in Section 31 (1) [2] as above was introduced in the Rajya Sabha by the Finance Minister, which is the floor is the statement given above. The successful resolution of the house being made available to the applicant in the form of a Clean Slate, was as follows:

"There is also this question about indemnification for the successful resolution applicant. The amendment is now clearly binding on the Government. This is one of the ways we are providing. The Government will not make any further claims.

The resolution will approve the scheme which will be binding on the corporate debtor and its employees, members, creditors, who are the Central Government, a State Government or any local authority for which there is a loan in relation to payment of dues.[1] For the time being covered under any law, such as statutory dues, the guarantor and other stakeholders involved in the guarantee scheme are:

The Rajasthan High Court pronounced its judgment on the larger principle laid down by the Supreme Court in the committee of “Essar Steel India Ltd v. Satish Kumar Gupta &Ors.”[4]

SCALE 319 of 2019 (16) report, as follows:

Section 31 (1) of the Code makes it clear that once a resolution plan is approved by the creditors committee it will be binding on all stakeholders including the guarantor. It is for this reason that this provision ensures that the successful resolution applicant starts running the business of the corporate debtor on the new slate as it were.

No more claims should be made after they are approved. To ensure that the reorganized debtor has the best chance of succeeding, an Insolvency Law may provide for the discharge or alteration of debts and which have been discharged or otherwise changed under the plan.

Therefore, for those who are using the Resolution Scheme, assurance is going to have a major, prominent meaning. Criminal cases will be proceeded against individuals alone, not against the Company.

The legislature's intention to convict the resolution applicant from all angles appears from the fact that apart from compensation from fiscal liability, there is now a provision introduced on the basis of Section 32A, which acquires immunity for corporate debtors from criminal debt. This question is also arises that does offenses committed before the commencement of CIRP?

These liabilities will be present to qualify the corporate debtor and will not burden the company in any way after the culmination of the CIRP [2]

This approach supports the goal of commercial certainty by

giving a binding effect to loan forgiveness, cancellation, or change according to the approved plan.
Business feasibility is evaluated from each financial aspect in bidding for a company undergoing the CIRP process before preparing a resolution plan. It cannot be expected from a resolution applicant to ride a blind horse, and prepare himself to be caught unknowingly, having his plan approved by the majority of the COC [2].

Jharkhand HC overturns Rajasthan HC's judgement on 'Clean Slate"
The distinction between indirect tax laws - the Goods and Services Tax ("GST") and the Insolvency and Bankruptcy Code, 2016 ("IBC") [3]. has been a controversial issue since the inception of the IBC. Both laws are quite contemporary due to not being widely tested by the judiciary. The Rajasthan H.C decision was dealing with a Writ Petition filed by a successful resolution applicant – Ultratech Nathdwara Limited [LSI-212-HC-2020 (RAJ)] [5] and dealing with the writ petition filed in the name of Jharkhand corporate debtor (though via From) Resolution Applicant) - Electro Steel Steels Limited [LSI-277-HC-2020 (JHAR)] [5].
Before we proceed to analyze the decision in Electro Steel Steels (supra), it is important to note that the decision was made in Electro steel Steels (supra) itself after the final hearing in Ultratech Nathdwara (supra) on 10 February 2020. 6 February 2020, therefore, it seems that the decision in UltraTech Nathdwara (supra), which came on 7 April 2020, can be submitted to the Hon'ble Jharkhand High Court, passing the judgment in Electro steel Steels (supra) on 1 May 2020.
In the Electro Steel Steels case (Supra), the Commercial Taxes Department (now the State GST Authority) resorted to unlawful proceedings against the corporate debtor for recovery of pending dues under the Jharkhand Value Added Tax Act, 2005 ("JVAT") [4].
After the resolution plan was approved, the said garnishee proceedings were initiated when the management of Corporate Debater was already taken over by the successful resolution applicant - Vedanta Limited. Further, the process of prohibition was initiated on the strength of the revaluation order (for the assessment years 2011-12 and 2012-13), which was passed by the department after the approval of the proposal plan. On challenging the garnishment proceedings before the Hon'ble High Court, the Court dismissed the petition filed by the Petitioner on various grounds including the following:
(A) The value-added tax ("VAT") [4] in question was collected by the Petitioner from the customers, it is used for business purposes rather than deposited from the Government treasury and thus, criminal misuse of Government money. Is, will not come under its purview. Definition of 'Operational Date' under IBC.
B) Commercial tax department (now state GST officers) [1] had no knowledge of corporate insolvency resolution process ("CIRP") of corporate debtors / petitioners, no public notice was given in the state of Jharkhand and thus they were from claiming deprived. Furthermore, the case relates to the period before the amendment of Section 31 of the IBC [2] and thus the resolution plan was binding only on the stakeholders involved in the resolution process. Therefore, the Commercial Tax Department (now the State GST Authority) cannot be said to be involved in the resolution process and thus the resolution scheme was not binding on them.

Few Debatable Issues
An argument was made in the Ultra Tech decision (supra) and the Electro steel Steels [2] decision which relies on the Essar Steel decision that the amount specified in the accepted resolution plan is final and binding on all parties; whether or not it was heard by RP or COC [1].
Now this leads to a debate on the role of RP. It is important to note that the judgment of the Supreme Court and Electro steel Steels in the Essar Steel decision reaffirmed that RP's role is not a subsidiary but an administrative one. In most occasions, the claims that are clear are duly verified by the IRP / RP.
For example, such situations can occur [1]:
a. The claim that is not accurate is not given the best estimate;
b. The claim is not mentioned in the information memorandum and therefore has not been investigated for payment by the RA [1];
c. The claim is rejected after verification [1];
d. The claim is classified as a disputed claim [1]

It is also notable that the IBC does not provide for extinguishing proceedings. Under Section 14 of the IBC, the provisional (stating that the adjournment motion will come into effect from the date of approval of the scheme) assumes the adjudication of claims in disputes before the due stage is concluded [3].
However, creditors may not have great bargaining power with potential RAs regarding their claims other than those parts of the COC that have not been treated fairly or have been given undue value.
The Stakeholders have resorted to Section 60(5) of the IBC challenging the claims rejected before the NCLT [2]. For example, if the "X" is a financial creditor and according to the resolution plan, financial creditors will receive 60% of their accepted claim, "X" will also be entitled to 60% of its claim if it is admitted by the NCLT / NCLAT [2].
However, the counter to the above argument is that RAS usually has zero amount / nota amount paid for contingent, disputed or unproven claims and they stop writing. And since post-approval, the resolution plan is sacrosanct and binding, creditors may not be entitled to their arguably valid claim [3].

Analysis of the Judgment of the Hon'ble Court
The Court interpreted Section 31(1) of the IB Code stating that the accepted resolution would be binding on "all the stakeholders involved in the resolution process"
[I] and concluded that the resolution plan would be binding only on the parties who participated in the resolution used to process. [II] [2] On the other hand, the Rajasthan High Court in UltraTech case decided on the same question, stating that the plan would be binding on all stakeholders once approved, despite the fact that the creditor or government participated in the resolution process. [III] [2] In the case of Swiss Ribbons v Union of India (2014), Hon'ble Supreme Court was of the view that insolvency proceedings are proceeding, i.e., proceedings in REM will be binding on the public.
[IV] [2] In this case the court misinterpreted Section 31, imposing liability on the Petitioner to pay, as the resolution scheme would be binding on the Tax Authority even though it is involved in the tax procedure. The Hon'ble Jharkhand

HC differentiated indirect and direct taxes, keeping the State Government as an operational creditor. The Court said that indirect tax cannot be considered as operating loan as VAT dispute has been realized from the customers. Therefore, it is not a direct loan of the Petitioner Company towards the State Government so that it can be made an operational loan under Section 5(21). The relevant part of Section 5(21) states that "loans in respect of payment of arrears arising under any law, payable to the Government or any local authority". [V] [2]. The Section does not clearly state 'the difference between indirect and direct loans and any debt payable to the government would fall under the category of operation loans.

This observation made by the court was contrasted with the NCLAT's decision against the instructions of the Director General of Income Tax Department (2019) [2], in which it was stated that 'income tax', 'value-added tax', 'sales tax', and other statutory liabilities are considered operational debts. [VI] [2]. The rationale for this decision was that operating loans are loans that are directly related to the operations of the company, which is a concern. The liability of statutory dues, including taxes, will arise only when the company is in operation, thus establishing a direct relationship with the operations of the company.

Therefore, the tax has been collected, but not paid to the government, the dues to the central government are also paid and as such, the operation will qualify as a loan. As per the law laid down in Ultratech Nathdwara (Supra), the interpretation of Section 31 of the IBC is correct. It appears that the Hon'ble High Court of Jharkhand has not considered various other aspects of the difference between GST and IBC (presumably because these arguments / points were not adequately suppressed / argued) as explained below has been inserted: Reliance on Unpublished Provisions of Section 31 of IBC - Reliance on Unpublished Provisions of Section 31 of IBC[1] is laid to say that the resolution plan is not binding on the stakeholders who are not involved in the resolution process. In our humble opinion, the question of whether the resolution plan is binding for all stakeholders or only those involved was never there. The Clause note of Section 31 of the Insolvency and Bankruptcy

Code, 2015 states that - The scheme shall be binding on the corporate debtors, its creditors, employees, shareholders, guarantees and other stakeholders. "Tax paid, but not paid to the government" is also the payment of dues to the Central Government under a law [2] - the High Court has stated that since VAT has already been recovered from customers, hence it is not a direct loan to the petitioner company. Section 47 of the JVAT and section 76 of the Jharkhand Goods and Services Tax Act, 2017 ("JGST Act") clearly establish this. Considering the non-GST laws which have repealed the VAT laws: The Hon'ble Court has not held that the provisions of the JVAT Act were repealed in light of Section 174 of the JGST Act of the JGST Act [2]. The same, if recoverable, was recoverable as arrears of JGST. And in the present case, similar to the account of section 82 of the JGST Act, could not be recovered. These aspects take into account some specific defaults for RPs that are operating the Corporate Insolvency Resolution Process (and CIRP) and help us arrive at some of the best practices, followed by Electro steel Steels (supra) status can be avoided [3].

Analyzing 'The Claim'

After the CDR is initiated against the CDR, the resolution professional or interim resolution professional (RP / IRP) allows these to submit their claims to operational creditors, financial creditors, secured creditors, unsecured creditors, employees and other stakeholders. Now two scenarios can be [1]

Scenario A: If a claim is made after the approval of the resolution plan: The claim is made after the approval of the resolution plan, relying on the principle of fresh slate and it can be said that its claim has not been settled hence the claimant is entitled to the CD. One cannot recover arrears as it is an approved resolution scheme. Hence we can say that a stakeholder may fail to sleep on his claims and present it on time [1].

Scenario B: If a claim is made before the approval of the Resolution Plan:

Proceedings initiated by government and statutory authorities. These claims need to be scrutinized by the RA [3]. for payment, in whole or in part or not at all, and can eventually be negotiated with the RA by the COC as well. Once the terms of the proposal plan are approved by the successful RA, they are binding on all stakeholders of the CD, and thus, stakeholders will be entitled to their claims to the extent of the amount specified in the resolution plan [4].

Claimants who are not able to submit their claim to the IRP / RP prior to the announcement of the due date may do so but before 90 (nineteenth) days of the bankruptcy start date. In some cases, claims have been allowed after the 90th day and before the acceptance phase of the Resolution Plan [1].

As per Regulation 13 and 14 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, IRP / RP is required to avoid and verify the claims received by it [1]. It is also noteworthy that RP is required to mention contingent, disputed, unquestioned, legal, mature, unproven, equitable, safe or unsecured claims contingent in the information memorandum. Reliance is placed on the definition of 'Claim as per Section 3 (6) of IBC and Regulation 36 (h) of CIRP Regulation, which RP is required to refer to the information memorandum, details of all material litigation and ongoing investigation [2].

Conclusion

The interpretation of Section 31 adopted by the Court in this case, follows the very intention of this principle, which is to provide a Fresh Slate to the corporate debtor.

The Code, being a beneficial law, should be interpreted in a way that does not extinguish conflicting claims that have not been dealt with in the Resolution Schemes. Necessary amendments may be made to the Code to include a provision requiring the discharge of disputed claims, if it follows the postponement by the competent authorities. In doing so, creditors who act contrary to the legislative intent will be repealed.

The justification adopted by the Hon'ble Court makes the binding value of the approved Resolution Scheme ineffective as it can be challenged after the completion of the Resolution Process. The Court also stated that indirect taxes may not amount to operating debt. This observation does not serve as a condition related to the inclusion of indirect tax as the operational debt has already been settled by NCLAT.

The objective of the IB Code is revival and if the binding

effect of the resolution scheme is reduced to zero, it cannot be achieved. If the Government and local authorities are allowed to raise claims even after approval of the Resolution Plan, potential acquaintances will be dissuaded from handling any threatened Company. The status of the post-resolution process of disputed claims remains a gray area in the Indian Insolvency Framework, unless it is broadly decided by the Supreme Court. Although it was touched by the Essar Steel Judgment, there is still a huge difference in understanding.

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