

Insolvency and Bankruptcy Hotline

May 06, 2020

RING FENCING ANTECEDENT LIABILITIES OF COMPANIES: IBC SAVES THE INVESTORS!

INTRODUCTION

By the fourth amendment to the Insolvency and Bankruptcy Code, 2016 ("IBC"), Section 32A was introduced. Section 32A states that any liability of the corporate debtor for an offence committed prior to or during corporate insolvency resolution proceedings ("CIRP") will stand extinguished from the date the resolution plan is approved by the National Company Law Tribunal ("NCLT"). This immunity, however, is subject to conditions set out in Section 32A, which have been analyzed in this article.

The rationale behind the amendment is that an incoming investor, who is going to deploy significant money, resources and time into turning around the corporate debtor should not be punished for offences which the erstwhile management had committed prior to initiation or during pendency of the CIRP.

WHAT IS SECTION 32A?

Under Section 32A, the liability of the corporate debtor for offences committed by a corporate debtor and / or involving its property, and proceedings commenced therefrom ("Proceedings"), will cease from the date a resolution plan is approved by the NCLT. In cases involving property of a corporate debtor, Section 32A covers any action involving attachment, seizure, retention, or confiscation of the property of the corporate debtor as a result of such Proceedings.

However, the immunity under Section 32A is available only when the approved resolution plan mandates a change in the management or control of the corporate debtor to a person who (i) was not a promoter or in the management or control of the corporate debtor; or (b) has not been implicated by the investigating authority, for abetting or conspiring towards the commission of the offence which has cast a liability on the corporate debtor.

Notably, the persons who were in charge of the affairs of the corporate debtor, such as a designated partner of a limited liability partnership or an officer in default as defined in the Companies Act, 2013, will continue to remain liable, if such persons were (a) in any manner in charge of, or responsible to the corporate debtor for the conduct of its business or associated with the corporate debtor in any manner; *and* (b) directly or indirectly involved in the commission of such offence as per the report/complaint of the investigating authority ("Persons in Default"). In these situations, it has been clarified that Persons in Default continue to be liable under the relevant statutory provisions and the immunity afforded to the corporate debtor and its property will not extend to such Persons in Default.

Thus, the key elements of Section 32A are twofold: (i) the corporate debtor / its assets are ring fenced from any liability arising out of an offence alleged against it if such offence was committed prior to or during CIRP, (ii) no protection is afforded to the Persons in Default and thus, who were associated with the corporate debtor and involved in the commission of the offence, continue to remain liable thereunder.

WHY WAS SECTION 32A INTRODUCED?

The amendment can be traced back to the decision of the NCLAT in *JSW Steel Ltd v. Mahender Kumar Khandelwal & Ors.*¹, where the NCLAT had to decide whether attachment of assets of Bhushan Power & Steel Ltd. ("BPSL") (the corporate debtor) by the Enforcement Directorate would be permissible, given that the resolution plan submitted by JSW (successful resolution applicant) had already been approved by the NCLT.

The NCLAT concluded that while stakeholders have the opportunity to voice their objections prior to the NCLT approving resolution plan for a corporate debtor, once a resolution plan is passed, that opportunity ceases to exist and no stakeholder, including a government agency is permitted subsequently, to raise an objection. All stakeholders are to be bound by the resolution plan approved by the NCLT. The MCA went on to state that incoming investor cannot be held responsible for misdoings of the corporate debtor in the past. Subsequent to this order of the NCLAT the Amendment Act was promulgated.

Additionally, in *Deputy Director Directorate of Enforcement Delhi v. Axis Bank & others.*², the Delhi High Court had delved into the interplay of IBC and Prevention of Money Laundering Act, 2002 ("PMLA"). The Delhi High Court had to decide if a company is undergoing CIRP under the IBC, would property / assets of such corporate debtor be available to the Enforcement Directorate for seizure as proceeds of crime.

The Delhi High Court observed that the moratorium imposed in respect of the corporate debtor under Section 14 of the IBC in such situations, cannot come in the way of the statutory authority conferred by PMLA on the Enforcement Directorate for depriving a person of such proceeds of crime, otherwise, it would open an escape route for a corporate debtor by permitting them to get a discharge for their civil liability towards their creditors for the simple reason that such assets were not the corporate debtor's to lawfully claim. The Court went ahead and clarified that as a result, *there was no conflict between the IBC and the PMLA and that the former would not prevail over the latter.*

The court in the above case had also delved into the right of a third party and observed that if asset of the corporate

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debtor in relation to which the third party has acquired rights, was not acquired with the intention of frustrating the PMLA, then such third party has the right to seek enforcement and the PMLA provisions would apply to the residual value of the asset in question, post such enforcement by the third party.

ANALYSIS

The Delhi High Court in *Deputy Director Directorate of Enforcement Delhi v. Axis Bank & others* had held that the provisions of IBC would not prevail over the PMLA. However, given that no liability will get attracted under Section 32 A on the corporate debtor, therefore no proceedings can continue against the corporate debtor. This potentially will reopen the interplay between IBC and the PMLA. Additionally, Section 32A in its present form covers prosecution of corporate debtors and not a group entity. It will be interesting to see the regulatory implication of another entity (for instance a group entity of the corporate debtor) who has committed an offence, and the proceeds of which are parked with the corporate debtor.

Further, certain practical questions arise from the standpoint of the various parties concerned:

(a) Investigating authorities

While the definition of an ‘investigating authority’ has not been provided within Section 32A of the IBC, it is likely that courts may soon clarify which government agencies would constitute investigating authorities. Additionally, though Section 32A does attempt to place adequate safeguards to ensure that this section is not used as a loophole by the Persons in Default, it is to be assessed how effectively an investigating authority may undertake recovery against such Persons in Default when the subject matter of the wrongdoings i.e., the assets of the corporate becomes unavailable for attachment.

(b) Corporate debtor

From the corporate debtor’s perspective, it would be futile for an entity’s recovery, whose financial health has already undergone substantial deterioration and is sought to be revived under CIRP, to continue facing more regulatory action as soon as the CIRP concludes successfully. This amendment provides a perfect balance, while it does not exonerate the liability of the promoter or the erstwhile management, it ensures that the new management has a fresh beginning.

(c) Investor

From an investor’s standpoint, Section 32A comes as a relief, as the IBC provides the promise of a clean slate for a corporate debtor company which has successfully undergone CIRP. Ring-fencing a corporate debtor from future action post approval of resolution plan by the NCLT definitely seems a step in the right direction for safeguarding the interests of the corporate debtor and the resolution applicant, and to give a boost to IBC as a mechanism of effective insolvency resolution. Gradually, as the finer nuances of Section 32A are brought out by courts, and the legislative framework evolves, a balance must be achieved between the interests of the various stakeholders of the corporate debtor to ensure that no one party’s interests are prejudiced.

– Sanjana Rao, Arjun Gupta & Alipak Banerjee
You can direct your queries or comments to the authors

¹ (Company Appeal (AT) (Insolvency) No. 957 of 2019.
² (CRL.A. 143/2018 & Crl.M.A. 2262/2018).

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