

M&A Hotline

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GHOSTS OF THE PAST: ANOTHER SHOT IN THE ARM FOR ACQUISITION UNDER IBC

One of the biggest challenges for potential acquirers under the Insolvency and Bankruptcy Code, 2016 ("IBC") has been historical or 'legacy' issues which may linger on post the acquisition. This used to deter potential acquirers since this could attach substantial monetary and criminal liability on the acquirers post the acquisition of the target company under IBC.

This has been an ongoing issue which has divided even the various judicial fora, whereby the question of whether IBC reigns supremacy over other laws has been highly contested. In this backdrop, the courts in India and the government have both come together to clarify various aspects of the IBC which is likely to provide potential acquirers substantial comfort with respect to past liabilities of the target, or the corporate debtor.

LEGISLATIVE AND JUDICIAL EVOLUTION

• Amendment Act of 2019

In August 2019, the IBC was amended by the Insolvency and Bankruptcy (Amendment) Act, 2019 ("2019

Amendment)¹. Section 31 of IBC, which deals with the approval of the resolution plan, was amended to state that once the resolution plan was approved by the National Company Law Tribunal or the 'Adjudicating Authority' ("NCLT"), the approved resolution plan would be binding on the Central Government, the state governments and any other authority to whom any amounts are owed. The intent of the amendment, as noted by the Finance Minister in his speech while introducing the amendment in the Indian Parliament, was to ensure that the governments and statutory bodies respect the IBC process and do not proceed against acquirers (post acquisition of the corporate debtor) for past dues.

This was supposed to be the first among various steps to provide comfort to the potential acquirers. While the amendment was a positive move, it left ambiguity on the status of pending matters and the monetary and criminal liability arising from such pending matters.

• Essar Steel judgement of the Supreme Court

While dealing with the case of ArcelorMittal's acquisition of Essar Steel², the apex court of India, i.e. the Supreme Court was called upon to determine the manner of dealing with claims by creditors who had not raised claims during the corporate insolvency resolution process, or claims which were disputed at the time the claims were being considered. The Supreme Court in its judgement held that the resolution applicant while taking over the corporate debtor would intend to have a fresh start on a clean slate. Therefore, all claims against the corporate debtor would have to be filed, compiled and included in the information provided to a resolution applicant, so that a prospective resolution applicant knows exactly what is required to be paid so that it may then take over and run the business of the corporate debtor. Once, a resolution plan has been approved as per the provisions of the IBC, the same becomes binding on all stakeholders of the corporate debtor, including guarantors and potential creditors. The Supreme Court went on to bar claimants whose claims have not been admitted by the resolution professional (and therefore are not being paid under the resolution plan) from initiating legal proceedings before any adjudicatory forum to claim these amounts, post completion of the insolvency resolution process under the IBC.

The Supreme Court was called upon to provide its views on the monetary implications of any claims arising post the approval of the resolution plan. While the Supreme Court's order provided that the corporate debtor could not be faced with any future claims, it fell short of dealing with the non-monetary implications of any prior period offences / acts.

• Amendment Act of 2020

In December 2019, the IBC was amended by way of an ordinance, which has later been enacted as the Insolvency and Bankruptcy (Amendment) Act, 2020 ("2020 Amendment")³.

The 2020 Amendment introduces a new Section 32A, which primarily protects the interests of the acquirer under the CIRP. The newly introduced Section 32A deals with (a) proceedings against the corporate debtor committed prior to the acquisition; and (b) assets of the corporate debtor pursuant to any offence committed prior to the acquisition.

■ Section 32A(1) states that the upon the acquisition of the corporate debtor pursuant to the CIRP, the corporate debtor shall no longer be liable with respect to any offence committed prior to the acquisition of the corporate debtor, and no proceeding can be initiated against the corporate debtor subsequently for any offence committed to the acquisition. This exemption is available only in case the acquirer (a) was not a promoter or in the management or control or a related party of the corporate debtor prior to the acquisition; or (b) has not abetted or conspired for the offence, in the opinion of the relevant authority, and has submitted or filed a report or complaint to the relevant authority. In case the potential acquirer does not fall within the two conditions mentioned above, the acquirer would

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be exempt from any liability for acts committed prior to the acquisition.

- Similarly, Section 32A(2) protects the assets of the corporate debtor from any action taken by any regulatory authority for an offence committed prior to the acquisition. The benefits of this is also available to persons not falling within the conditions mentioned in Section 32(1) (explained above).

Further, acknowledging the rights of the authorities to proceed for any offence, Section 32A further states that the relevant authority may proceed against the person who was the manager in charge or responsible for the business of the corporate debtor, or who has been directly or indirectly involved in the commitment of the offence. Importantly, Section 32A is a notwithstanding clause, and overrides any other provision of the IBC or any other law, thereby resulting in the IBC reigning supremacy over other laws.

IMPACT

The above changes in the IBC and the Supreme Court's order in Essar Steel indicate, in unambiguous terms, the Indian government's intent to encourage resolution of cases under IBC by encouraging potential bidders to participate in CIRP of companies. The February 2020 Report of the Insolvency Law Committee⁴ in detail provides the intent and seeks to draw a distinction between the corporate debtor prior to the acquisition under the IBC and post acquisition under IBC.⁵

The intent of the Parliament by the 2019 Amendment and 2020 Amendment, and Supreme Court's order in Essar Steel have been upheld and enforced by the courts in India as well. In a recent judgment, the Rajasthan High Court⁶ on an application by the corporate debtor post acquisition, struck down post acquisitions claims made by the Goods and Sales Tax authorities for outstanding GST dues of the corporate debtor prior to the acquisition on account of the amendments to the IBC in 2019 stating that the resolution plan is binding on government authorities. The Rajasthan High Court also cautioned the authorities to raise claims post the completion of the acquisition pursuant to the CIRP under the IBC. The Supreme Court in the Essar Steel case has already dealt with the issue of uncrystallised claims and pending adjudication claims. However, this was the first instance that a High Court has dealt with (a) a writ petition which has been filed by the corporate debtor post implementation of the resolution plan and not the successful resolution applicant for upholding the terms of the resolution plan; and (b) validity of specific clauses of a resolution plan which extinguish (i) pending litigation claims (ii) unassessed claims (iii) unknown liabilities.

This would be a major shot in the arm for potential acquirers, where the liability of the corporate debtor has been ring-fenced and crystallized under the IBC. This would also provide further comfort for acquirers to acquire assets under IBC, as opposed to any other mechanism since 'legacy' or historical issues are reduced to a substantial extent.

CONCLUSION

While the above amendments and changes have dealt with most of the 'ghosts of the past' for potential bidders, it is to be seen how potential contractual disputes for the period prior to the initiation of CIRP which are discovered post the acquisition are dealt with. For instance, in case a contract supplier post the acquisition of the corporate debtor, discovers any monetary claim or claim for fraud against the corporate debtor for the period prior to the initiation of the CIRP, will the corporate debtor post the acquisition be absolved of any liability vis-a-vis such claims. This becomes even more pertinent when the breach or fraud could have been identified prior to the initiation of the CIRP by way of reasonable diligence by the supplier.

Such disputes are one of the last potential concerns outstanding to provide potential bidders an absolute clean slate to acquire targets under the IBC, and time will tell if an amendment or a decision by the judicial authorities would settle this in favor of either party.

— Arjun Gupta, Abhinav Harlalka & Simone Reis

You can direct your queries or comments to the authors

¹ Available online at <https://ibbi.gov.in/uploads/legalframework/630af836c9fbbcd047c42dbdf2aca13.pdf>

² Committee of Creditors of Essar Steel India Limited v Satish Kumar Gupta & Ors., C.A. No. 8766-67 of 2019

³ Amendment Ordinance available at <https://ibbi.gov.in/uploads/legalframework/d6b171ec9b9ea5c54f7423bc36f92977.pdf> and 2020 Amendment available at <https://ibbi.gov.in/uploads/legalframework/d36301a7973451881e00492419012542.pdf>

⁴ Available online at <https://ibbi.gov.in/uploads/resources/c6cb71c9f69f66858830630da08e45b4.pdf>

⁵ Refer to Para 17 of the Report.

⁶ Ultra Tech Nathdwara Cement Limited v Union of India & Ors. In Civil Writ Petition No. 9480/2019

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