

# Insolvency and Bankruptcy Hotline

February 10, 2022

## DISSECTING THE INSOLVENCY CODE: WILL THREAT OF ATTACHMENT OF ASSETS BY ED RESURFACE DURING LIQUIDATION PROCESS UNDER IBC?

- Authority to attach assets of corporate debtor under PMLA suspended during Liquidation Proceedings *only* after approval of method of sale by NCLT.
- ED could retain power to attach assets of corporate debtor between liquidation commencement date and date of approval of method of sale by NCLT.
- No immunity for corporate debtor from liability arising out of offence committed prior to insolvency resolution process if corporate debtor is being liquidated.

The Legislature has in the recent past introduced certain changes in the Insolvency and Bankruptcy Code<sup>1</sup> ("IBC") to promote the option of liquidating a corporate debtor 'as a going concern'. However, these legislative changes have also raised certain interpretative issues, like the trigger point for applicability of Section 32-A of the IBC in liquidation proceedings. The Hon'ble Delhi High Court in *Nitin Jain Liquidator PSL Limited v. Enforcement Directorate through: Raju Prasad Mahawar, Assistant Director PMLA*<sup>2</sup> ("**Nitin Jain case**"), has dealt with this aspect and provided certain clarifications. However, there are certain issues which still remain unanswered.

This article critically appraises the said judgement and highlights various legal anomalies that have arisen as a result of Delhi High Court's interpretation of Section 32-A.

### THE PROBLEM

The date on which an application seeking initiating of corporate insolvency resolution process ("CIRP") is admitted by the Adjudicating Authority under the IBC, is referred to as the insolvency commencement date.<sup>3</sup> Section 14 of IBC provides that on the insolvency commencement date, the Adjudicating Authority shall, *inter alia*, issue a moratorium prohibiting "the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority".<sup>4</sup> The moratorium issued under Section 14 ceases to have effect from the date when either the resolution plan is approved by adjudicating authority under Section 31(1) or when an order for liquidation of corporate debtor is passed under Section 33 of the Code by the Adjudicating Authority.<sup>5</sup>

The date on which an order for liquidation of a corporate debtor is passed under Section 33, is called the liquidation commencement date.<sup>6</sup> Section 33(5) of the Code stipulates that when an order for liquidation has been passed under Section 33, "no suit or other legal proceeding shall be instituted by or against the corporate debtor".<sup>7</sup>

A conjoint reading of Section 14 and Section 33(5) would thus imply that legal proceedings barred from being continued during the course of CIRP proceedings, can be re-started post the liquidation commencement date.<sup>8</sup>

In order to offer the corporate debtor indemnity from liability arising from offences committed by the erstwhile management of the corporate debtor, the Parliament had introduced Section 32-A in the Code. This section states that liability of a corporate debtor for offences committed prior to CIRP cease when an order approving a resolution plan is approved by adjudicatory authority. Further, it also stipulates that for an offence committed by the corporate debtor prior to CIRP, assets of the corporate debtor cannot be attached or foreclosed if (a) a resolution plan is approved by adjudicatory authority or (b) if those assets are being sold through liquidation. Thus, in case of liquidation of a corporate debtor, especially in a scenario where the corporate debtor or its business is being sold as a going concern under Regulation 32(A) of the Liquidation Regulations, Section 32-A of the Code imposes a bar against regulatory authorities from taking any action against the corporate debtor's property. Two significant issues that emerge are (a) identifying the trigger point when this embargo comes into effect and (b) impact of this embargo on re-kindled litigation post extinguishment of moratorium under CIRP. Following is an analysis of Delhi High Court's attempt to resolve this issue in the *Nitin Jain Case*.

### THE SOLUTION

A writ petition was filed by the liquidator of PSL Limited in the *Nitin Jain case* before the Delhi High Court seeking an order restraining the enforcement directorate from attaching the property of the corporate debtor ("PSL") under Prevention of Money Laundering Act, 2002 ("PMLA"). The order to initiate liquidation proceedings of PSL was passed by the adjudicating authority on September 11, 2020 making the said date, the 'liquidation commencement

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*date*. PSL was sold as a going concern under an order dated September 08, 2021.<sup>9</sup> Exercising its powers under PMLA, the enforcement directorate had issued an order for provisional attachment of the assets of the corporate debtor worth Rs. 274.60 crores on December 02, 2021, holding them to represent proceeds of the crime committed by the corporate debtor prior to initiation of CIRP.<sup>10</sup> It was *inter alia*, argued by the liquidator that the impugned order of attachment passed by the enforcement directorate was barred under Section 32-A of the Code.

Expounding on the scheme and purpose of IBC and Liquidation Regulations, the Court came to the conclusion that the trigger for applicability of the statutory bar under Section 32A would be the approval of the method of sale under liquidation by the NCLT.<sup>11</sup> Therefore, the term '*sale of liquidation assets*' under Section 32-A would imply approval by the NCLT of a measure to be taken for liquidating the debtor entity. Premising on this, the Court further held that once the measure enshrined under Regulation 32 of Liquidation Regulations are '*adopted and approved*' by the NCLT, the power of the enforcement directorate to attach properties under Section 5 of PMLA ceases. However, the Court clarified that there is no bar under IBC which restrains the enforcement directorate from proceeding against the erstwhile management of the corporate debtor.

In the present facts, the Court held that the statutory bar under Section 32-A would be deemed to be in effect from the date when the NCLT approved the sale of the corporate debtor '*as a going concern*' i.e., order dated September 08, 2021.<sup>12</sup> Considering that the order of attachment passed by the ED was after this trigger point, therefore, the attachment was held to be void under the operation of law.

## THE UNANSWERED

The methods for sale of the assets of the corporate debtor which can be adopted by the liquidator are enshrined under Regulation 32 of Liquidation Regulations. It is pertinent to note that there is no explicit provision under either the IBC or the Liquidation Regulations which necessitate the liquidator to get an approval from the NCLT for adopting any of the measures listed under Regulation 32. However, the liquidator is supposed to submit a preliminary report and an asset memorandum under Regulations 13 and 34 of the Liquidation Regulations, within seventy-five days from the liquidation commencement date.<sup>13</sup> These reports, *inter alia*, include (i) a proposed plan of action for carrying out the process of liquidation<sup>14</sup>, and (ii) the intended manner of sale of the assets of the corporate debtor and reasons for the same<sup>15</sup>. Therefore, it can be inferred that the NCLT will be presented with the opportunity of approving the method of sale only after the preliminary report and the asset memorandum have been submitted by the liquidator.

Since Section 32-A can be triggered only after the submission of the preliminary report and the asset memorandum, therefore, till then the proceedings pending before CIRP can be continued and the execution of suits determined before CIRP can be sought. This invariably implies that the enforcement directorate exercising its powers under statutes in the nature of PMLA can pass an order of attachment of the corporate debtor's assets during this period. There is no clarity as to what recourse the liquidator can take in such a scenario.

Further, Section 32(A)(1) which exonerates the corporate debtor of any liability arising out of an offence committed prior to the initiation of CIRP is only applicable where a resolution plan is approved by the NCLT. However, under Section 32A(2) this immunity is not applicable, if the assets of the corporate debtor are being sold in liquidation or if the corporate debtor is being sold as a going concern in liquidation proceedings.

Therefore, if the ED was to attach the assets of a corporate debtor post the liquidation commencement date but before the applicability of Section 32A(2), there is ambiguity as to whether such assets can be sold as part of the liquidation process.

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You can direct your queries or comments to the authors

<sup>1</sup> The Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Regulation 32, - Inserted by Notification No. IBBI/2019-20/GN/REG047 dated 25th July, 2019 (w.e.f. 25-07-2019)

<sup>2</sup> *Nitin Jain Liquidator PSL Limited v. Enforcement Directorate through: Raju Prasad Mahawar, Assistant Director PMLA*, W.P.(C) 3261/2021; Order Dated 15.12.2021.

<sup>3</sup> The Insolvency and Bankruptcy Code, 2016, Section 5(12).

<sup>4</sup> The Insolvency and Bankruptcy Code, 2016, Section 14(1)(a).

<sup>5</sup> The Insolvency and Bankruptcy Code, 2016, Proviso to Section 14(4).

<sup>6</sup> The Insolvency and Bankruptcy Code, 2016, Section 5(17).

<sup>7</sup> The Insolvency and Bankruptcy Code, 2016, Section 33(5).

<sup>8</sup> See, The Report of Insolvency Law Committee, 2018, p. 31, ¶5.3. *Contra, Dewan Housing Finance Corporation Ltd. and Ors. v. SEBI and Ors.*, ¶19.

<sup>9</sup> *Nitin Jain Liquidator PSL Limited v. Lucky Holdings Pvt. Ltd.*, IA/391 (AHM) 2021; Order dated 08.09.2021.

<sup>10</sup> Prior to passing this order, the enforcement directorate had issued emails and summons to the liquidator on January 15, 25 and 27, 2021.

<sup>11</sup> *Nitin Jain Liquidator PSL Limited v. Enforcement Directorate through: Raju Prasad Mahawar, Assistant Director PMLA*, W.P.(C) 3261/2021, ¶101(R).

<sup>12</sup> *Nitin Jain Liquidator PSL Limited v. Enforcement Directorate through: Raju Prasad Mahawar, Assistant Director PMLA*, W.P.(C) 3261/2021, ¶¶6 & 101(T).

<sup>13</sup> The Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Regulations 13 & 34(1) read with Regulation 47.

<sup>14</sup> The Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016, Regulations 13(d).

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