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Clean slate theory cannot be used to extinguish known claims when the promoter of a micro, small and medium enterprise is a successful resolution applicant under the Insolvency and Bankruptcy Code, 2016

The Madras High Court (“**Madras HC**”) in its recent judgement *National Sewing Thread Co. Ltd vs. Superintending Engineer TANGEDCO and Anr.*¹, has held that the clean slate theory (“**CST**”) does not extinguish undisclosed claims under the resolution plan of the erstwhile promoters or management (“**Promoter Group**”). The Madras HC has further held that in relation to such claims, the Promoter Group is jointly and severally liable. This judgement of the Madras HC is significant since it: (a) carves out an exception for the CST, especially when the Promoter Group of Micro, Small and Medium Enterprises (“**MSMEs**”) are the successful resolution applicant; (b) protects the creditors who did not submit claims during the Corporate Insolvency Resolution Process (“**CIRP**”) for want of knowledge and whose claims were deliberately excluded by the Promoter Group in the resolution plan; and (c) fastens personal liability on the Promoter Group for suppression of claims.

Brief Facts

National Sewing Thread Co. Ltd (“**NSTCL**”), an enterprise registered under the MSME Development Act, 2006, was subjected to CIRP under the IBC, by the National Company Law Tribunal (“**NCLT**”), Chennai². During the CIRP, the Promoter Group of NSTCL submitted a resolution plan (“**Plan**”) to take over the company, which was approved by the Committee of Creditors (“**CoC**”) and the NCLT, Chennai³. The Plan provided for payment of 1% of the dues payable to identified operational creditors, which did not include the electricity department. The Plan provided for extinguishment for all prior claims of creditors including that of the electricity department. Later, the Tamil Nadu Generation and Distribution Corporation Limited (“**TANGEDCO**”) issued a demand notice dated January 19, 2022 (“**Demand Notice**”) to NSTCL claiming a payment of INR 32,86,061 (Indian Rupees thirty-two lakh eighty-six thousand and sixty one) which pertained to pre-CIRP period. NSTCL claimed that it is not liable for the claim since the same was not provided for under the Plan; and relied on the principle of CST to contend that such undisclosed claims will stand extinguished. NSTCL subsequently applied for electricity connection, which was rejected by TANGEDCO due to non-payment of arrears of due. Therefore, NSTCL filed a writ petition to quash the Demand Notice; and sought directions against TANGEDCO to provide the electricity connection.

NSTCL contended that the demand notice is against the principle of CST and the spirit of IBC. NSTCL contended that, since TANGEDCO did not submit its claim form during the CIRP and its claim having not been included in the Plan, the claim of TANGEDCO will stand extinguished. NSTCL relied on the judgment of the Supreme Court of India (“**Supreme**

¹ Judgement dated June 7, 2024, in W.P. No. 29845 of 2022

² Order dated August 28, 2019. in IBA/622/2019

³ Order dated December 6, 2021, in IA/IBC/1032/CHE/2021 in IBA/622/2019

Court⁴) in *Ghanashyam Mishra & Sons (P) Ltd. vs. Edelweiss Asset Reconstruction Co. Ltd.*⁴, wherein it has been held that pre-CIRP claims which were not a part of resolution plan will stand extinguished upon its approval. Therefore, NSTCL contended that TANGEDCO's claim having been extinguished, the Demand Notice is invalid, and TANGEDCO is liable to provide the connection.

TANGEDCO contended that it is governed by the Electricity Act, 2003 and Tamil Nadu Electricity Supply Code, 2004, in terms of which all outstanding dues will have to be settled before effecting power connection; and that TANGEDCO's claim will not get extinguished due to CIRP proceedings or approval of a resolution plan under the IBC. TANGEDCO relied on the judgement of the Supreme Court in *State Tax officer vs. Rainbow Papers Limited*⁵ and the judgement of the Madras High Court in *Empee Distilleries Limited vs. The Superintending Engineer, Pudukottai and Ors*⁶ and contended that the Plan having not provided for dues payable to government or its department, is invalid and contrary to IBC.

Findings and Analysis

The Madras HC referring to the judgements of the Supreme Court⁷ on commercial wisdom of CoC held that the CoC's commercial wisdom in approving a resolution plan is subject to all relevant information being placed before the CoC. On the principle of CST and extinguishment of all prior claims, the Madras HC held that the same is not an automatic consequence of approval of a resolution plan and is subject to availability of all relevant information before the CoC.

The Madras HC held that the term 'relevant information', includes all such information relating to assets/liabilities of the corporate debtor: (a) which are within the knowledge of the Promoter Group and which they are obligated to disclose; and (b) which a resolution professional can ascertain by exercising diligence through review of financial statements and claims received pursuant to public notice issued under IBC. The Madras HC has held that a resolution professional cannot evade his obligation to ascertain the liabilities merely because the concerned creditor did not submit the claim form.

The Madras HC reiterated the role of the NCLTs in approving a resolution plan that the NCLT's cannot approve a resolution plan merely because it is approved by the CoC; and it must ensure that a resolution plan satisfies the above requirements.

The Madras HC held that, while the principle of CST may insulate a third-party resolution applicant from undisclosed claims, the same will not apply to the undisclosed claims which are not a part of the plans submitted by the Promoter Group and the Promoter Group cannot take advantage of their act of suppression of material facts. The Madras HC further held that, in such cases, the corporate veil will have to be lifted; and the Promoter Group will be personally liable for such undisclosed claims.

In view of the above legal principles and considering that the Promoter Group were, aware of the dues payable to TANGEDCO; had failed to disclose the same to the resolution professional during the CIRP; and had deliberately excluded TANGEDCO's claim from the Plan for the reasons that no claim form was submitted, the High Court held that TANGEDCO's claim is not extinguished and that it is entitled to refuse effecting electricity connection to NSTCL, even though the order of the NCLT approving the resolution plan has attained finality. Consequently, the Madras HC dismissed the writ petition.

Conclusion

The judgement emphasizes the obligations of the promoters to disclose the known liabilities to the resolution professional, CoC and in their resolution plan; and enables imposition of personal liability on the promoters for

⁴ (2021) 9 SCC 657

⁵ 2022 SCC OnLine SC 1162

⁶ 2022 SCC OnLine Mad 5272

⁷ *State Tax officer v. Rainbow Papers Limited* (2022 SCC OnLine SC 1162); *M.K. Rajagopalan v. Dr. Periasamy Palani Gounder* (2024 1 SCC 42); and *K. Sasihidhar v. Indian Overseas Bank* (2019 12 SCC 150)

suppression of claims even when the concerned creditor does not have lodged a claim form. The judgement reiterates the requirement for fairness and equitable treatment of claims in a resolution plan. The judgement also reaffirms the just, independent and diligent role to be played by: (a) the resolution professionals in ascertaining the liabilities of the company and in conducting the CIRP; and (b) the NCLTs during the approval of a resolution plan. The judgement has created an exception to the rule of 'clean slate theory' *vis-à-vis* the extinguishment of undisclosed claims in terms a resolution plan, in order to protect *bonafide* creditors who were not aware of the CIRP; did not lodge claim forms; and whose claims were deliberately excluded by the Promoter Group in their resolution plan. The judgement will act as a deterrent on the promoters of MSME companies, who intend to misuse the IBC and extinguish the past liabilities by suppression of claims during the CIRP.

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