

INTERNATIONAL JOURNAL OF LAW
MANAGEMENT & HUMANITIES
[ISSN 2581-5369]

Volume 8 | Issue 3
2025

© 2025 International Journal of Law Management & Humanities

Follow this and additional works at: <https://www.ijlmh.com/>

Under the aegis of VidhiAagaz – Inking Your Brain (<https://www.vidhiaagaz.com/>)

This article is brought to you for free and open access by the International Journal of Law Management & Humanities at VidhiAagaz. It has been accepted for inclusion in the International Journal of Law Management & Humanities after due review.

In case of any suggestions or complaints, kindly contact support@vidhiaagaz.com.

To submit your Manuscript for Publication in the International Journal of Law Management & Humanities, kindly email your Manuscript to submission@ijlmh.com.

No Strings Attached?: Testing the Clean Slate Doctrine under India's Insolvency Code - Judicial Analysis

DR. SIDDHARTH BALANI¹

ABSTRACT

The Insolvency and Bankruptcy Code, 2016 has marked a paradigm shift in Indian Insolvency regime. Prior to the advent of IBC there used to exist different statutes such as SARFAESI Act 2002, RDDBFI Act 1993 etc. These laws used to exist but there were several loopholes because of which these laws were severely criticized. The main reasons for these criticisms were, time consuming, lack of proper remedy to the creditors since they used to be debtor centric. Therefore, this was the need of the hour to introduce a law which can work in a holistic manner. Clean Slate Theory postulates that once a resolution plan is approved, the successful resolution applicant acquires the corporate debtor free from past liabilities. This article explores the origin, legal foundation, judicial interpretation, and policy rationale of the clean slate theory. It also critiques the limits of this doctrine, particularly in light of recent Supreme Court judgments and regulatory clarifications. Also, this paper delves on the harmonisation of the rights of different stakeholders involved and how the courts have helped in balancing the interest of different stakeholders. The paper concludes with recommendations for balancing creditor interests with the Code's revival-centric goals.

Keywords: Clean Slate Theory, Revival Centric Goals, Resolution Plan

I. INTRODUCTION

The impact of introduction of Insolvency and Bankruptcy Code, 2016 (hereinafter referred as IBC, 2016) has created a positive impact. The IBC has changed the entire dimensions of the insolvency regime, since the earlier statutes used to have a rigid approach, but the new approach of IBC is flexible. The other main difference is that the earlier statutes used to primarily focussed on "Loan Recovery" but on the other hand the IBC focussed on "Loan Restructuring", thereby creating a win-win situation for all the stakeholders and thus helping the company to revive while satisfying the claims of the creditors. For the purpose of restructuring the IBC, 2016 provides for the Corporate Insolvency Resolution Process (Hereinafter referred as CIRP), this

¹ Author is an Assistant Professor at Faculty of Law, National Law University, Jodhpur, India.

is the process through which the claims of the creditors are settled and also the Corporate Debtor is transformed to new form. In order to have a deep understanding of the theory of “Clean Slate” a brief understanding of CIRP process is required

In the CIRP process, following steps are involved:

1. An application is filled before the Adjudicating Authority (In this case NCLT).²
2. Once the application is accepted by the Adjudicating Authority, CIRP Process begins and an Interim Resolution Professionals step into and manages all the Affairs of the company.
3. Once the Interim Resolution Professionals step into, the Moratorium is introduced so as to maintain status quo of the company.³
4. The Claims are thus verified and thereby formation of Committee of Creditors (hereinafter referred as COC) takes place.⁴
5. Appointment of Resolution Professional by the COC.⁵
6. Resolution Plan is being prepared and approval of the same takes place.⁶

II. THE THEORY OF CLEAN SLATE

As briefly discussed above in the CIRP Process, that the final steps after the submission of resolution plan by interested parties, this plan submitted as per Section 30(4) need to be approved by the Committee of Creditors by a majority of not less than 75 % of voting. Subsequent to this a final approval is then taken by the Adjudicating Authority if the authority believes that all the requirements mentioned under Section 30(2) of IBC, 2016 is fulfilled.

As per the Clean Slate Theory it is assumed that once resolution plan is approved by the COC and by the Adjudicating Authority then all the claims which are settled or unsettled comes to an end. Thereby, this doctrine helps and ensures that the successful resolution applicant can take over the business once again with no previous baggage and without any previous liabilities. There are multiple judicial decisions which tries to explore the various dimensions of this theory.

² See Insolvency and Bankruptcy Code, 2016, §§ 7, 9 and 10, No. 13, Act of Parliament, 2016 (India): Process of Filing application for CIRP process by Financial Creditor (§7), Operational Creditor (§9), and Corporate Debtor (§10).

³ Insolvency and Bankruptcy Code, 2016, §14, No. 13, Act of Parliament, 2016 (India).

⁴ *Id.* at §21.

⁵ *Id.* at §22.

⁶ *Id.* at §§30 and 31.

III. CLEAN SLATE THEORY AND JUDICIAL OVERSIGHT

As we all know that there is a pivotal role played by the COC, while approving a resolution plan and it is the foremost duty of the COC to tailor the plan in such a way so as to manage all the stakeholders equally and thereby securing the rights of all the stakeholders. Generally, the courts do not interfere with the plan made by COC, and generally it is the commercial wisdom of the COC that prevails. But there are situations in which there are non-compliance with the statutory provisions of IBC, 2016, and in these situations the court ensure that statutory provisions of the code must be followed.

In a landmark Judgment of *M.K Rajagopalan V Dr. Periasamy Palani Gounder*⁷ the Hon'ble Supreme Court held that COC's decisions must be based complete disclosure of the information, also it was held that while coming with these plans it is the foremost duty of the COC to ensure the equitable treatment of Operation Creditors only. The decision emphasised that the CoC's commercial wisdom refers to a well-considered choice made with consideration for the business interests, the corporate debtor's desire to be revived, and the goal of maximising the value of its assets. This ruling has given the CoC a much-needed obligation to make sure that all pertinent information is considered when making judgements. In this judgment court also emphasised on the fact that without full disclosure of information, the core principle of Clean Slate is Compromised. The Hon'ble supreme court in this judgment has again focussed on the importance of the COC and the use of their commercial wisdom while making any resolution plan, but court simultaneously acknowledge that such decision should be in tune with Section 30(2)⁸ of IBC. 2016. Also, in this judgment the court has held that the Adjudicating Authority and appellate authority is vested with the important task to not only check whether the resolution plan meets statutory requirement but to also check that the plan should be made in a manner so as to provide equitable treatment to all the stakeholders. In another landmark

⁷ M.K Rajagopalan v Dr. Periasamy Palani Gounder, Civil Appeal No. 168-1683 of 2022 (India).

⁸ Insolvency and Bankruptcy Code, 2016, §30(2), No. 13, Act of Parliament, 2016 (India): “*The resolution professional shall examine each resolution plan received by him to confirm that each resolution plan--*

(a) provides for the payment of insolvency resolution process costs in a manner specified by the Board in priority to the ²[payment] of other debts of the corporate debtor;

(b) provides for the payment of debts of operational creditors in such manner as may be specified by the Board which shall not be less than--

(i) the amount to be paid to such creditors in the event of a liquidation of the corporate debtor under section 53; or

(ii) the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority in sub-section (1) of section 53,

whichever is higher and provides for the payment of debts of financial creditors, who do not vote in favour of the resolution plan, in such manner as may be specified by the Board, which shall not be less than the amount to be paid to such creditors in accordance with sub-section (1) of section 53 in the event of a liquidation of the corporate debtor.”

case of “*Ghanshyam Mishra V Edelweiss Asset Reconstruction Company Limited*”⁹ In this case, the resolution plan was approved by the Adjudicating Authority (NCLT) under Section 31 of IBC, 2016. This resolution plan approved by the authority did not take account of certain number of claims of the creditors and for the same an appeal was filled in the appellate authority. While deciding the appeal, the appellate authority approved the plan but created an exception and gave liberty to certain class of creditors, these were

1. Workmen whose dues are pending can move to labour court.
2. Outstanding Statutory government dues qualify as an operational debt.
3. Corporate Guarantee can be invoked against the new form of Corporate Debtor.

If we closely observe the decision being given by the appellate authority, we can clearly observe that this judgment defeats the sole intent of the IBC, 2016, since the new corporate debtor will be facing legal hardships even after the successful resolution is passed. Therefore, for the same an appeal was moved to Hon’ble Supreme Court. The Supreme Court, tries to answer the following question that, “*Whether after approval of the resolution plan by the adjudicating authority under section 31 of the IBC, 2016, the creditors can still initiate legal proceedings against the corporate debtor with respect to their claims which do not form a part of resolution plan*”.¹⁰

The Hon’ble Supreme Court gave its answer on this question and held that the resolution plan is of binding nature and once the resolution plan is approved by the adjudicating authority as per section 31 of IBC, 2016, then it provides a clean slate to the new corporate debtor. The court also held that it would be wrong to traumatise the corporate debtor by surprising him with undecided claims after the resolution plan has been accepted. This principle is known as Clean Slate Theory. This ensures that the entity taking over is free from all the previous obligations and thereby providing the entity a protection from the previous claims. While discussing this case, the court also referred the landmark case of “*Essar Steel India Ltd. v. Satish Kumar Gupta*”¹¹. The Hon’ble Supreme court highlighted the importance of Clean Slate Theory. The court stated that due to this theory new management is protected from the previous claims and thus providing a breathing space in which the new management can take over the company and is not going to be hindered by the previous claims. It was also held in this case that Section 31(1)¹² if the IBC, 2016 is binding on all the stakeholders.

⁹ Ghanshyam Mishra v Edelweiss Asset Reconstruction Company Limited, Civil Appeal No. 8129 of 2019 (India).

¹⁰ *Id.*

¹¹ Essar Steel India Ltd. v Satish Kumar Gupta, Civil Appeal No. 8766-67 of 2019 (India).

¹² Insolvency and Bankruptcy Code, 2016, §31(1), No. 13, Act of Parliament, 2016 (India: “*If the Adjudicating*

Also, the court made a mention on the case of “*Ultratech Nathdwara Cement Ltd. v. Union of India*”¹³. In this case the resolution plan submitted by the applicant was duly approved by the adjudicating authority. However, this plan approved by the adjudicating authority was challenged by the Statutory departments like the Indirect tax department and by the state government of Rajasthan on the ground that the plan proposed and approved by the adjudicating authority did not take into considerations their statutory dues, since their dues were substantially reduced in the resolution plan. For the same a writ petition was filled before the High Court of Rajasthan, in the same case it was contented that by the petitioners that these statutory department should focus and promote the revival of the stressed companies. Since once the stressed companies are revived, they further aid to the eco-system since they will contribute to the statutory departments in the form of taxes and therefore a clean slate needs to be provided to the corporate debtor so that they can work in an unhindered manner.

In the recent Judgment of National Sewing Thread Company Limited v. TANGEDCO¹⁴, a new dimension has been emerged and sparked a debate about the ambit of clean slate theory and till what extent, this theory needs to be applied. In 2021, the petitioner National Sewing Thread Company Limited, successfully completed the CIRP process. In 2022, TANGEDCO, respondent raised a demand against the petitioner for outstanding electricity charges from June 2019 of Rs, 32,86,061. The Petitioner invoke the Clean Slate Theory, asserted that these are pre-CIRP claims and since the resolution has been successfully passed and approved by the adjudicating authority therefore the petitioner is free from pre-CIRP liabilities. This claim by the petitioner did not satisfy the respondent, and the respondent disconnected the petitioner electricity connection. The petitioner has taken this matter to Madras High Court, but the Madras High Court did not provide nay relief to the petitioner and held that they are not eligible to get relief as per Clean Slate Theory. While delivering this judgment Madras High Court referred to all the judgement of the supreme court on commercial wisdom of COC. It was held by the Madras High Court that commercial wisdom of COC in approving a resolution plan is based on the fact that the all the relevant information has been shared by the COC. Also, while discussing the principle of “Clean Slate Theory” and relieving the corporate debtors from all

Authority is satisfied that the resolution plan as approved by the committee of creditors under sub-section (4) of section 30 meets the requirements as referred to in sub-section (2) of section 30, it shall by order approve the resolution plan which shall be binding on the corporate debtor and its employees, members, creditors, ¹[including the Central Government, any State Government or any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed,] guarantors and other stakeholders involved in the resolution plan. [Provided that the Adjudicating Authority shall, before passing an order for approval of resolution plan under this sub-section, satisfy that the resolution plan has provisions for its effective implementation.]

¹³ Ultratech Nathdwara Cement Ltd. v Union of India, Civil Writ Petition No. 9480/2019 (India).

¹⁴ National Sewing Thread Company Limited v. TANGEDCO, 2024 SCC Online Mad 2330.

the previous claims, the Madras High Court held that Clean Slate Theory is not an automatic step which comes after the approval of resolution plan, it is only applicable when all the relevant information has been shared with the COC. Also, the Madras High court emphasised that the relevant information includes all the information related to the assets and liabilities of the corporate debtor and which are well within the knowledge of Promoter Group and they are bound to disclose the same. Also, the information which can be extracted by the resolution professional by applying due diligence and reviewing financial statements will also amount to relevant information. The Madras High Court also held that it is the prime duty of the resolution professional to cross verify all the financial statements and the resolution professional can not escape his obligation simply on the ground that the concerned creditor did not submit the claim form.

Also, it was reiterated by the Madras High Court that the NCLT does not play a dummy role in approving a resolution plan merely on the ground that the plan has already been approved by the COC. While approving a plan the Adjudicating Authority must ensure that resolution plan ensure all the requirements mentioned under the IBC, 2016. The Madras High Court ruled that although the Clean Slate Theory might shield a third-party resolution applicant from undisclosed claims, this would not hold true for undisclosed claims that are not included in the Promoter Group's plans, nor could the Promoter Group benefit from their act of suppressing material facts. Consequently, the writ petition was quashed by Madras High Court.

IV. CONCLUSION AND ANALYSIS

If we closely observe the IBC, 2016 we can clearly infer that the code talks about reorganisation. Also, IBC focussed on ways through which a stressed entity can be revived and thereby helping the corporate debtors as well the creditors. The main aim of the code is to revive and for the purpose of revival the main incentivisation is Clean Slate Theory. Without Clean Slate theory no entity will come forward to take the control of corporation after CIRP. It is this theory which provide them a relief that they are discharged of any claims which used to exist before the approval of resolution plan. The main aim of this theory to create a shield and cocooned environment in which the new person can take control of the company and perform all the task in the diligent manner without any fear.

In addition to this Regulation 37¹⁵ of Insolvency and Bankruptcy Board of India (Insolvency

¹⁵ Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, Regulation 37: "*A resolution plan shall provide for the measures, as may be necessary, for insolvency resolution of the corporate debtor for maximization of value of its assets, including but not limited to the following*
a. *Curing or waiving of any breach of the terms of any debt from the corporate debtor*

Resolution Process for Corporate Persons) Regulations, 2016. In addition to this Section 32A also talks clean slate theory.

It is also pertinent to note that in various judgements the Hon'ble Supreme Court has advocated the importance of Clean Slate Theory, but has also highlighted the importance that a fine strike of balance of rights between financial creditors and operational creditors need to be made. Also, the court upheld the validity commercial wisdom of the COC's but also held that, while coming up with any plan they should follow the principles laid down in the code.

Thus, we can say that the Clean Slate Theory is very essential for drawing investors, but the implementation of this theory should be used in most judicious manner. Also, openness and transparency need to be maintained among all the stakeholders so that they can know whether full and true disclosure has been made in the resolution plan or not.

If we apply this holistic method, it would not hold the integrity of the resolution process but also will promote the effectiveness of the code. Therefore, the main aim of the Clean Slate Theory is to provide a shield but not an unjustified one

b. *Reduction in amount payable to the creditors.*"