ISSUES UNDER THE INSOLVENCY AND BANKRUPTCY CODE PRIOR TO ADMISSION

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Abstract

The Insolvency and Bankruptcy Code 2016 is touted to be the panacea for all the ills of corporate mismanagement that has resulted in the mountain of bad debts. The previous law under SICA had been found lacking in major areas. The IB Code addresses those concerns, all the while making creditors of a corporate entity, the major stakeholders in the resolution process. India, has been far too long been mired with the bad reputation of painstakingly slow judicial resolution, which the IB Code with its mandatory provisions have sought to change. The paper is an attempt to lay out how the law and the Company Law Tribunals have given effect to this vision. Several provisions have come up for interpretation before the Tribunals and the Apex Court, and the resultant position of law on those issues has laid down the foundation for a smooth and quick redressal system. The authorities tasked with the responsibility of effecting these provisions have been trying to give maximum effect to the intention behind the legislation. From restricting the scope for debtors to evade responsibility to insisting on stricter adherence of timelines, the Code can instill the discipline in the corporate entities and lay down foundation for more accountable corporate governance.

I INTRODUCTION

Referring to the data available with the World Bank in 2016, the Apex Court[1] in a case noted that insolvency resolution in India took 4.3 years on an average, which was much higher when compared with the United Kingdom (1 year), USA (1.5 years) and South Africa (2 years). Furthermore, in the World Bank's Ease of Doing Business Index 2015, India had ranked as country number 135 out of 190 countries on the ease of resolving insolvency based on various indicia.

The previous regime under Sick Industries Companies (Special Provisions) Act 1985 (hereinafter referred to as 'SICA') had been heavily castigated for the resultant despicable condition. Explaining the failure of SICA, it was stated in the Indian Parliament:

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1 *Innoventive Industries Ltd.* v. *ICICI Bank and Ors.*, AIR 2017 SC 4084.

> "*[n]ow, the SICA is being phased out,… the object behind SICA was revival of sick companies. But not too many revivals took place. But what happened in the process was that a protective wall was created under SICA that once you enter the BIFR, nobody can recover money from you. So, that non-performing investment became more non-performing because the companies were not being revived and the banks were also unable to pursue any demand as far as those sick companies were concerned, and therefore, SICA runs contrary to this whole concept of exit that if a particular management is not in a position to run a company, then instead of the company closing down under this management, a more liquid and a professional management must come and then save this company. That is the whole object. And if nobody can save it, rather than allowing it to be squandered, the assets must be distributed- as the Joint Committee has decided- in accordance with the waterfall mechanism which they have created.*"[2]

Hence the advent of the Insolvency and Bankruptcy Code 2016 (hereinafter IB Code) which has been founded upon the analysis of more than 10 reform committee reports. Primary amongst them is the Report of Bankruptcy Law Reforms Committee of November 2015 wherein it was stated that "*the limited liability company is a contract between equity and debt. As long as debt obligations are met, equity owners have complete control, and creditors have no say in how the business is run. When default takes place, control is supposed to transfer to the creditors, equity owners have no say.*" However, it noted that this is not how in reality the companies function in India. Hiding behind the corporate veil, there are reckless borrowings and fishing into volatile, risky ventures without any concern for any sort of accountability and complete disregard to the impact of such actions. The promoters are way too powerful and creditors remain powerless even when in cases of default. For far too long, the concept of corporate veil has protected the directors and promoters, which accords a company a separate legal entity, different from its directors and promoters, thereby providing immunity (subject to certain exceptions) to the shareholders from the company's liabilities.[3]

The enactment of the IB Code has been touted to change this, with an object to bring India at the center of the International economic and business savvy stage. The object of the paper is to lay out the issues that have confronted the National Company Law Appellate Tribunal (hereinafter 'NCLAT') when applications seeking initiation of insolvency and bankruptcy proceedings are presented. For the same majority of the judgments rendered by the NCLAT on this particular subject upto February 2018 have been studied and a brief outline of all such major issues has been discussed in

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2 *Id.* para 16. Excerpt from the Speech by Sh. Arun Jaitley, Finance Minister, piloting the Code in the Parliament, quoted in the judgment.

3 *Salomon* v. *Salomon*, [1897] AC 22 (House of Lords).

this paper. However, issues that pertain to post- admission of an insolvency application, for instance, issues pertaining to assets of guarantors post imposition of moratorium or decisions of a Resolution Professional or the Committee of Creditors are out of the purview of the present paper.

II ISSUES PRIOR TO ADMISSION OF AN INSOLVENCY APPLICATION

During the early implementation of the IB Code, there have been several points upon which insolvency applications have been either rejected or disposed off. Some of them have demanded legal interpretation, whereas some have suffered from technical errors. Under this part, all such issues have been discussed which are either put to rest by the Apex Court or as of now settled by the NCLAT as long as the Apex Court does not lay down any final interpretation. Broadly the issues are : i. Legal Validity of a Notice sent by an Advocate, ii. Mandatory and Directory Ingredients in an Insolvency Application, iii. Applicability of Limitation Law, iv. Principles of Natural Justice and Notice to the Debtors, v. Joining of Causes of Action and vi. Miscellaneous.

Legal Validity of a Notice sent by an Advocate

The first year of the enforcement of the IB Code, petitions were being dismissed for being non compliant with the technical requirements of the IB Code and Rules. The NCLAT had been unequivocal in its interpretation over several of these requirements for bringing in an insolvency claim against the debtor. In the case of *Macquarie Bank Limited* v. *Uttam Galva Metallics Limited*,[4] the NCLAT interpreted Section 8 of the IB Code read with the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules 2016 (hereinafter referred to as 'Adjudicating Authority Rules') and decided the essential ingredients for constituting a valid demand notice in terms of Section 8 of the IB Code to the debtor by the operational creditors before initiating an action under Section 9 of the IB Code or under Section 7 of the IB Code with regards to financial creditors. The NCLAT concluded that Section 8[5] of the IB Code read with Rule 5[6] of the Adjudicatory Authority Rules mandate that the only the 'Operational Creditor' or through a person authorized to act on behalf of the 'Operational Creditor', who hold same position with or in relation to the 'Operational Creditor' can apply.[7] The reasoning was predicated upon the perusal of Form- 3 and Form- 4, which stipulated the format of the demand notice under Section 8 read with Rule 5 as:

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4 Company Appeal (AT) (Insol.) No. 96 of 2017. (NCLAT)

5 IB Code 2018, sec. 8 (1).

6 Adjudicating Authority Rules 2016, rule 5.

7 *Supra* note 4, paras. 15,16 and 17.

> "*6. The undersigned request you to unconditionally repay the unpaid operational debt (in default) in full within ten days from the receipt of this letter failing which we shall initiate a corporate insolvency resolution process in respect of [name of corporate debtor].*
>
> *Yours sincerely,*
>
> *Signature of person authorised to act in behalf of the operational creditor*
>
> *Name in block letters*
>
> *Position with or in relation to the operational creditor*
>
> *Address of person signing*" [Emphasis Added]

Therefore, NCLAT concluded that a lawyer's or a chartered accountants' or a company secretary's notice would not constitute a notice as per the requirement of the IB Code.

This position of law sustained over numerous NCLAT rulings,[8] until the Apex Court in the case of *Macquarie Bank Limited* v. *Shilpi Cable Technologies Ltd.*,[9] reversed the NCLAT

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8 *M/S Aruna Hotels Limited* v. *Mr. N. Krishnan*, Company Appeal (AT) (Ins) No. 59 of 2017; *M/s. Bhagwan Motors Pvt. Ltd.* v. *Harshad V. Vora*, Company Appeal (AT) (Ins) No. 113 of 2017; *Centech Engineers Private Limited & Anr.* v. *Omicron Sensing Private Limited*, Company Appeal (AT) (Ins) No. 132 of 2017; *Goa Antibiotics & Pharmaceuticals Ltd. and Anr.* v. *Lark Chemicals Pvt. Ltd.*, Company Appeal (AT) (Ins) No. 184 of 2017; *Ganesh Sponge Pvt. Ltd.* v. *Aryan Mining & Trading Corporation Pvt. Ltd.*, Company Appeal (AT) (Ins) No. 124-125 of 2017; *JAP Infratech Pvt Ltd* v. *Innovation House Industries Pvt Ltd.*, Company Appeal (AT) (Ins) No. 242-245 of 2017; *Jord Engineers India Ltd.* v. *Valia & Company*, Company Appeal (AT) (Ins) No. 158 of 2017; *M/s. J.P. Engineers Pvt. Ltd.* v. *M/s. Indo Alusys Industries Ltd.*, Company Appeal (AT) (Ins) No. 220 of 2017; *M/s. Lease Pal India Pvt. Ltd.* v. *ACPL HR Services Pvt. Ltd.*, Company Appeal (AT) (Ins) No. 312 of 2017; *Shilpi Cable Technologies Limited* v. *Macquarie Bank Ltd.*, Company Appeal (AT) (Ins) No. 101- 102 of 2017; *Uttam Galva Steels Limited* v. *DF Deutsche Forfait AG & Anr.*, Company Appeal (AT) (Insolvency) No. 39 of 2017; *Mass Metals Pvt. Ltd.* v. *Sunflag Iron & Steel Co. Ltd.*, Company Appeal (AT) (Ins) No. 112 of 2017; *M/s Oxygen Communications & Anr.* v. *M/s. Iris Computers Ltd.*, Company Appeal (AT) (Insolvency) No. 264 of 2017; *PCK Buderus (India) Special Steels Pvt. Ltd.* v. *Sungil India Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 311 of 2017; *Ravi Mahajan* v. *Sunrise 14 A/S, Denmark*, Company Appeal (AT) (Insolvency) No. 141 and 146 of 2017; *Mr. Senthil Kumar Karmegam* v. *Dolphin Offshore Enterprises (Mauritius) Pvt. Ltd. and Anr.*, Company Appeal (AT) (Insolvency) No. 154 of 2017; *Shriram EPC Limited* v. *Rio Glass Solar SA*, Company Appeal (AT) (Insolvency) No. 133 of 2017; *Shyam Industries Ltd.* v. *R. L. Steel Energy Ltd.*, Company Appeal (AT) (Insolvency) No. 111 of 2017; *Smartcity (Kochi) Infrastructure Pvt. Ltd.* v. *Synergy Property Development Services Private Limited and Another*, Company Appeal (AT) (Insolvency) No. 80 of 2017; *D. Srinivasulu and Anr.* v. *Dr. Reddy's Laboratories Ltd.*, Company Appeal (AT) (Insolvency) No. 190 of 2017; *Zapp India Ltd.* v. *Maheshwar Textiles & Anr.*, Company Appeal (AT) (Insolvency) No. 157 of 2017.

9 (2017) SCC OnLine SC 1493. (Division Bench)

rulings by conjointly reading the Advocates Act with the IB Code. The Court reasoned on the basis of the precedents of the Indian Courts in consistently recognizing the traditional role of lawyers and the "extent and nature of the implied authority to act on behalf of their clients" held that under section 30[10] of the Advocates Act, the expression "practise" is an expression of extremely wide import, and would include all preparatory steps leading to the filing of an application before a Tribunal.[11]

Mandatory and Directory Ingredients in an Insolvency Application

The IB Code contains provisions which have been incorporated for a quick and effective resolution, which makes the interpretation of all the statutory provisions of the Code in light of this paramount objective and makes time an essence of the IB Code[12] As a corollary, the adjudicatory forums have been presented with numerous cases seeking decision on the provisions prescribing timelines, provisions laying down technical requirements and whether those provisions are mandatory or directory. For instance, an issue arose as to whether it is mandatory for 'Financial Creditor' and 'Corporate Applicant' to propose name of an 'Interim Resolution Professional', and non-mandatory for an 'Operational Creditor', which was answered in affirmative by the NCLAT after perusing various provisions under the IB Code.[13]

Time Limit Prescribed in IB Code for admitting and rejecting a petition

In the case of *JK Jute Mills* v. *Surendra Trading*,[14] the question with respect to sections 7(4) and (5),[15] 9(5)[16] and 10(4)[17] was posed as to whether the timeline prescribed for admitting or rejecting petitions under these respective provisions is mandatory or directory. While section 7(5) pertains to petitions by financial creditors, section 9(5) pertains to operational creditors and section 10(4) stipulates terms for corporate debtors. The respective *provisos* provide for 7 days' time to the applicant/ creditor to rectify the defect in the petition.

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10 Advocates Act, sec. 30.

11 (2017) SCC OnLine SC 1493, paras 44, 45 and 54.

12 *JK Jute Mills Company Limited* v. *M/S Surendra Trading Company*, Company Appeal (AT) No. 09 of 2017, para 31.

13 *Chharia Holdings Pvt. Ltd.* v. *Brys International Pvt. Ltd. & Ors.*, Company Appeal (AT) (Insol.) No. 126 of 2017.

14 *JK Jute Mills Company Limited* v. *M/S Surendra Trading Company*, Company Appeal (AT) No. 09 of 2017.

15 *Supra* note 5; sec. 7(4) and (5).

16 *Id.* sec. 9(5).

17 *Id.* Code, sec.10(4).

The NCLAT held that while provisions laying down 14 days' time to admit or reject the applications are procedural in nature and hence directory, the corresponding provisos laying down 7 days' time for rectifying any defect in the application are mandatory.

The same was overturned partially by the Apex Court in appeal in *Surendra Trading* v. *Juggilal Kamlapat Jute Mills*,[18] wherein it was held that even the provisos to sections 7(5), 9(5) and 10(4) are directory.

Financial Certificate

The IB Code under Section 9(3)(c)[19] mandates a certificate from a 'Financial Institution' maintaining the accounts of the 'Operation Creditor', and section 3(14)[20] defines the term 'Financial Institution'. The problem arose when a foreign company that is neither constituted under the Indian Companies Act nor has any office in India, or any account with any of the Bank or 'Financial Institution' as defined under the IB Code, had to bring in a claim against its operational debtor under Section 9 of the IB Code since such creditors could not procure a financial certificate from an institution that comes within the ambit of section 3(14) of the IB Code.

The NCLAT was in the case of *Macquarie Bank* v. *Uttam Galva Metallics*,[21] confronted with this practical difficulty. The appellant was a foreign that was neither constituted under Companies Act 1956 or/ Companies Act 2013, and had account with one Macquarie Bank, Australia that was not under the ambit of ' Financial Institution' under section 3(14) of the IB Code. The NCLAT had earlier in the case of *Smart Timing Steel* v. *National Steel and Agro Industries*,[22] held the provision of Section 9(3) is to be mandatorily followed and is not directory. Therefore, placing its reliance on its decision in *Smart Timing Steel*, the NCLAT rejected the application of the appellant seeking initiation of proceedings against its operational debtors.

Similar fate befell on the respondents in the cases of *Uttam Galva Steels* v. *DF Deutsche Forfait AG*,[23] *Achenbach BuschhuttenCmbH* v. *Arcotech*,[24] and *Shriram EPC* v. *Rio Glass Solar SA*[25]. In *Uttam Galva*, the Certificate attached by the Respondents had been issued by Misr Bank which was a foreign bank and was not recognised as a 'financial institution'

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18 2017 (11) SCALE 634.

19 *Supra* note 5, sec. 9(3)(c).

20 *Id.* Code, sec. 3(14).

21 Company Appeals (AT) (Insol) No. 96 of 2017.

22 Company Appeal (AT) (Insol) No. 28 of 2017.

23 Company Appeal (AT) (Insolvency) 39 of 2017.

24 Company Appeal (AT) (Insolvency) No. 97 of 2017.

25 Company Appeal (AT) (Insolvency) No. 133 of 2017.

under section 3(14) of the IB Code, whereas in *Achenbach*, the appellant had enclosed one letter relating to 'confirmation of receipt of payment' from foreign institution known as 'Sparkasse Siegen' that too was held to be not covered within section 3(14). In *Shriram*, one 'Caixa Bank', having its Corporate Banking Unit in Madrid had given a chart which has been filed by the Respondent, and the same was also not recognized as 'Financial Institution of India' under the IB Code.

It was in *Macquarie Bank* v. *Shilpi Cable Technologies*[26] that the Apex Court remedied this arbitrary and discriminatory distinction by overruling the NCLAT's decision in *Shilpi Cable Technologies* v. *Macquarie Bank*[27] and holding:

> "17. … *[t]here may also be situations where an operational creditor may have as his banker a non-scheduled bank, for example, in which case, it would be impossible for him to fulfill the aforesaid condition… That such person may have a bank/financial institution with whom it deals and which is not contained within the definition of Section 3(14) of the Code would show that Section 9(3)(c) in such a case would [be] a condition precedent, amount to a threshold bar to proceeding further under the Code. The Code cannot be construed in a discriminatory fashion so as to include only those operational creditors who are residents outside India who happen to bank with financial institutions which may be included Under Section 3(14) of the Code… Equally, … argument that such persons ought to be left out of the triggering of the Code against their corporate debtor, despite being operational creditors as defined, would not sound well with Article 14 of the Constitution, which applies to all persons including foreigners. Therefore, as the facts of these cases show, a so called condition precedent impossible of compliance cannot be put as a threshold bar to the processing of an application Under Section 9 of the Code.*" [Emphasis Added]

In other cases, it has been held by the NCLAT that an application under section 9 of the IB Code is defective if Bank's certificate from a 'Financial Institution' is not enclosed.[28]

Application under Section 10 by Corporate Debtor

In Re Antrix Diamond Exports Pvt Ltd,[29] the corporate debtor initiated proceedings in respect of itself. The NCLT dismissed the application on the ground that the corporate debtor has initiated this application in order to scuttle the proceedings under SARFAESI Act initiated against the company as well as the guarantor- directors. The Court placing

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26 MANU/SC/1609/2017.

27 Company Appeal (AT) (Ins) No. 101 & 102 of 2017.

28 *M/s. Lease Pal India Pvt. Ltd.* v. *ACPL HR Services Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 312 of 2017.

29 Company Appeal (AT) (Insolvency) No. 107 of 2017.

reliance on its previous decision in the case of *Unigreen Global* v. *Punjab National Bank*,[30] held that while looking at the application under section 10, the Adjudicatory Authority cannot base its decision upon extraneous considerations. In *Unigreen*, the NCLAT had held:

> *"20. Under both Section 7 and Section 10, the two factors are common i.e. the debt is due and there is a default. Sub-section (4) of Section 7 is similar to that of subsection (4) of Section 10. Therefore we, hold that the law laid down by the Hon'ble Supreme Court in "Innoventive Industries Ltd. (Supra) is applicable for Section 10 also, wherein the Hon'ble Supreme Court observed as "The moment the adjudicating authority is satisfied that a default has occurred, the application must be admitted unless it is incomplete, in which case it may give notice to the applicant to rectify the defect within 7 days of receipt of a notice from the adjudicating authority".*
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> *21. In an application under Section 10, the 'financial creditor' or 'operational creditor', may dispute that there is no default or that debt is not due and is not payable in law or in fact. They may also oppose admission on the ground that the Corporate Applicant is not eligible to make application in view of ineligibility under Section 11 of the I & B Code. The Adjudicating Authority on hearing the parties and on perusal of record, if satisfied that there is a debt and default has occurred and the Corporate Applicant is not ineligible under Section 11, the Adjudicating Authority has no option but to admit the application, unless it is incomplete, in which case the Corporate Applicant is to be granted time to rectify the defects.*
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> *22. Section 10 does not empower the Adjudicating Authority to go beyond the records as prescribed under Section 10 and the informations as required to be submitted in Form 6 of the Insolvency and Bankruptcy (Application to the Adjudicating Authority) Rules, 2016 subject to ineligibility prescribed under Section 11…*"

In the above- mentioned case, the respondent- financial creditor had referred to pendency of a civil suit, which the NCLAT had held to be an extraneous consideration and could not be a ground to deny admission of an application under Section 10, once all the information in terms of Section 10 of the IB Code and Form 6 has been supplied by a Corporate Applicant. Similar decision was rendered in the case of *Leo Duct Engineers and Consultants* v. *Canara Bank*[31].

Similar decision was rendered in the case of *Krishna Kraftex* v. *HDFC Bank*,[32] wherein the impugned decision of the NCLT was overturned on similar reasoning. However, it is pertinent to look at the reasoning of the NCLT, which seems to give a more involved

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30 Company Appeal (AT) (Insolvency) No. 81 of 2017.

31 Company Appeal (AT) (Insolvency) No. 100 of 2017.

32 Company Appeal (AT) (Insolvency) No.106 of 2017.

interpretation to the provision under section 10:

> "8. *The Petitioner has failed to produce any evidence to show that a claim has been lodged with the Petitioner Corporate Debtor and is lying unpaid. However, Ld. Counsel for the petitioner presses his argument that on the petitioner's showing that if a liability exists as per balance sheet of the Petitioner and the Corporate Debtor is unable to liquidate its liability, the code provides for the insolvency resolution to be set in motion.*
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> *9. We are unable to agree with the ld. Counsel for the applicant. It could never have been the intention of the legislature to consider a matter as serious as placing the Company in the hands of a Resolution professional in a mechanical way without due application of mind of the Adjudicative Authority. Should this have been the case, then every corporate entity, who has no assets in hand and has incurred great liabilities be it acquisition of cars or assets acquired and to personal use of Directors, would resort to a simple way of filing such an application to escape any recovery proceeding or even civil imprisonment on being declared insolvent. Taking a hyper technical view of the provisions would open the flood gates of people forming Companies, incurring expenses in the name of the company and then filing for Insolvency Resolution Process under the Code for enjoying a Moratorium. The object of the Code is not to provide for an escape route to a Company or its Directors who have incurred great debts and are unable to liquidate the liabilities after availing services and goods (stock in trade) from various suppliers, loans from banks, friends and family.*" [Emphasis Added]

Applicability of Limitation Law

There are several related issues with regards to the applicability of limitation law to IB proceedings, *namely*, (a) whether there is a continuous cause of action in case of default of debt so as to prevent any imposition of limitation period, (b) the Limitation Act 1963 is applicable, (c) If yes, then when does it start operating, (d) If no, then whether doctrine of delay and laches and prescription apply.

The issue first rose prominently before the Apex Court in the case of *Neelkanth Township and Construction Pvt* v. *Urban Infrastructure*,[33] where the Court dismissing the appeal on merits, explicitly kept the question of law, regarding applicability of Limitation Act to the proceedings under the IB Code, open. In the proceedings before the NCLAT,[34] the appellant had earlier contended that the claim is time barred as the Debentures were matured between the year 2011- 2013, where the NCLAT answered questions (a) and (b) in the following terms:

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33 Civil Appeal No.10711 of 2017.

34 Company Appeal (AT) (Insolvency) No. 44 of 2017.

> "… *[t]here is nothing on the record that Limitation Act, 2013 is applicable to I & B Code. Learned Counsel for the appellant also failed to lay hand on any of the provision of I & B Code to suggest that the Law of Limitation Act, 1963 is applicable. The I & B Code, 2016 is not an Act for recovery of money claim, it relates to initiation of Corporate Insolvency Resolution Process. If there is a debt which includes interest and there is default of debt and having continuous course of action, the argument that the claim of money by Respondent is barred by Limitation cannot be accepted.*"[35]

Subsequent to the Apex Court keeping these questions open, in the case of *Black Pearl Hotels* v. *Planet M Retail*,[36] the NCLAT opting the safer way left the issue of applicability of Limitation Act to the IB proceedings open, and then proceeded with determining question (c), and held that even assuming Limitation Act was to be held applicable to the IB Code, still under the Code the right to apply under the IB Code accrued only on or after 1st December, 2016 and not before the said date, since the IB Code came into force from 1st December.

Regarding question (d), the NCLAT in the case of *International Road Dynamics* v. *DA Toll Road*,[37] held that even though the issue of application of Limitation Act to the IB Code is left open, still the claimant is required to explain the delay and laches on its part in bringing the claim.

It was in the case of *Speculum Plast* v. *PTC Techno*[38] that the NCLAT categorically rendered a conclusive opinion that the Limitation Act is not applicable to the IB Code and held:

> "…*the scheme of the 'Special Act' i.e. the 'I & B Code', and the nature of the remedy provided therein are such that the Legislature intended it to be a complete code by itself which alone should govern the several matters provided by it.*"[39]

The Court further proceeded with its analysis and answered question (d) by holding:

> "*68. In view of the settled principle, while we hold that the Limitation Act, 1963 is not applicable for initiation of 'Corporate Insolvency Resolution Process', we further hold that the Doctrine of Limitation and Prescription is necessary to be looked into for determining the question whether the application under Section 7 or Section 9 can be entertained after long delay, amounting to laches and thereby the person forfeited his claim.*

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35 *Id.* para 24.

36 Company Appeal (AT) (Insolvency) No. 91 of 2017.

37 Company Appeal (AT) (Insolvency) No. 77 of 2017.

38 Company Appeal (AT) (Insolvency) Nos. 47, 76 and 78 of 2017.

39 *Id.* para 46.

> *69. If there is a delay of more than three years from the date of cause of action and no laches on the part of the Applicant, the Applicant can explain the delay. Where there is a continuing cause of action, the question of rejecting any application on the ground of delay does not arise.*" [Emphasis Added]

As far as the legal position with respect to question (a), i.e., the continuing cause of action is concerned; the same was referred to by the NCLAT in the case of *Neelkanth Township and Construction v. Urban Infrastructure Trustees*,[40] where it was stated:

> "*…[i]f there is a debt which includes interest and there is default of debt and having continuous course of action, the argument that the claim of money by Respondent is barred by Limitation cannot be accepted.*"

The current legal jurisprudence definitely seems to be assisting insolvency resolution and giving effect to the object of financially healthy industries.

Provision of Appeal

The IB Code under section 61 (3) provides for a limitation period of 30 days for preferring an appeal before the NCLAT with a power to condone delay for a period not exceeding 15 days, on the satisfaction of the grounds mentioned in the petition. The NCLAT has been rigorously giving effect to these provisions and categorically holding its limited jurisdiction in condoning the delay.[41]

Principles of Natural Justice and Notice to the Debtors

There are two sets of notices required to be given to the debtor, *namely*, *one* by the creditor to the corporate debtor under section 8 of the IB Code and *other* by the

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40 *Supra* note 34

41 *M/s. Custodial Services (India) Private Limited* v. *M/s. Metafilms (India) Ltd.*, Company Appeal (AT) (Insolvency) No. 183 of 2017; *Forech India Pvt. Ltd.* v. *Edelweiss Assets Reconstruction Company Ltd. & Anr.*, I.A. No. 853 of 2017 in Company Appeal (AT) (Insolvency) No. 202 of 2017; *M/s Lease Pal India Pvt. Ltd.* v. *ACPL HR Services Pvt. Ltd.*, I.A. No. 969 of 2017 in Company Appeal (AT) (Insolvency) No. 312 of 2017; *Nityanand Singh and Co.* v. *Ferrous Infrastructure Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 291 of 2017; *Nikhil Mehta and Sons* v. *AMR Infrastructure Ltd.*, Company Appeal (AT) (Insolvency) No. 07 of 2017; *Shri Shyam Sunder Yadav* v. *M/s Steel India Corporation & Anr.*, Company Appeal (AT) (Ins) No. 212 of 2017; *Shyam Industries Ltd.* v. *R. L. Steel Energy Ltd.*, Company Appeal (AT) (Insolvency) No. 111 of 2017; *M/s Somany Ceramics Ltd.* v. *Era Infra Engineering Ltd.*, Company Appeal (AT) (Insolvency) No. 259 of 2017; *Elecon Engineering Co. Ltd.* v. *Ducon Technologies (I) Pvt. Ltd.*, I.A. No. 29 of 2018 in Company Appeal (AT) (Insolvency) No. 14 of 2018; *Mass Metals Pvt. Ltd.* v. *Sunflag Iron & Steel Co. Ltd.*, Comp. App. (AT) (Insolvency) No. 112 of 2017; *P.K. Ores Private Limited* v. *Tractors India Private Limited*, Company Appeal (AT) (Insolvency) No. 56 of 2017; *S3 Electrical & Electronics Private Limited* v. *Brian Lau*, Company Appeal (AT) (Insolvency) No. 104 of 2017; *M/s. Starlog Enterprises Limited* v. *ICICI Bank Limited*, Company Appeal (AT) (Insolvency) No. 5 of 2017;

Adjudicating Authority to the debtor before admission of insolvency application. The former stipulation is applicable in case of operational creditors, whereas the latter is applicable in cases of claims by both financial and operational creditors.

(a) Notice under Section 8 of the IB Code

The IB Code under section 8 imposes an obligation upon the operational creditor to send a demand notice to the corporate debtor demanding payment of the amount due.[42] Subsequent to the notice, the corporate debtor if seeks to avoid these insolvency proceedings, then shall, within a period of 10 days of the receipt of the demand notice bring to the notice of the operational creditor either (a) existence of a dispute; or (b) show the repayment of unpaid operational debt. It is only after the expiry of the said period of 10 days from the date of delivery of the notice, if the operational creditor does not receive payment from the corporate debtor or notice of the dispute the operational creditor can file an application seeking initiation of a corporate insolvency resolution process.[43]

In the case of *Era Infra Engineering* v. *Prideco Commercial Projects*,[44] no specific notice under section 8 of the IB Code was issued by the operational creditor to the corporate debtor. The creditor contended that a notice was issued to the appellant- debtor under section 271 of the Companies Act 2013 for winding up which is to be treated to be a notice for the purpose of section 8 of the IB Code. The NCLAT however, rejected the contention, holding that it is incumbent upon the operational creditor to necessarily issue a notice under section 8 of the IB Code to the corporate debtor prior to initiating insolvency proceedings against the corporate debtor. Similarly, in the case of *IVRCL* v. *Sanghvi Movers*,[45] when a defective notice under section 8 was issued by the operational creditor to the corporate debtor, the respondent prayed the NCLAT to allow it to withdraw the insolvency application and file afresh after issuing proper notice under section 8. In fact in cases where no notice was duly served on the corporate debtor by the creditor, the same was held to be violative of the mandatory provisions of section 8, 9 read with Rule 4(3) of Adjudicating Authority Rules.[46]

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42 *Supra* note 5: sec. 8(1).

43 *Supra* note. 5; sec. 9. See *Seema Gupta* v. *Supreme Infrastructure India Ltd & Ors.*, Company Appeals (AT) (Insolvency) No.53 of 2017.

44 Company Appeal (AT) (Insolvency) No. 31 of 2017.

45 Company Appeal (AT) (Ins) No. 253 of 2017.

46 *Jammu Paper Pvt. Ltd.* v. *Shiv Pooja Traders*, Company Appeal (AT) (Insolvency) No. 144 & 149 of 2017.

(b) Adjudicatory Authority to issue notice to the corporate debtor prior to admitting insolvency claim against it

The constitutionality of Section 7 of IB Code was considered by the Calcutta High Court in *Sree Metaliks Limited & Anr.* v. *UOI*,[47] wherein while upholding the provision of section 7 of the IB Code, it had favored an interpretation that is more in consonance with the constitutional principles, and stated in the following terms:

> "… *[I]t [NCLAT and NCLT] can regulate it own procedure, however, subject to the other provisions of the Act of 2013 or the Insolvency and Bankruptcy Code of 2016 and any Rules made thereunder. The Code of 2016 read with the Rules 2016 is silent on the procedure to be adopted at the hearing of an application under section 7 presented before the NCLT, that is to say, it is silent whether a party respondent has a right of hearing before the adjudicating authority or not. Section 424 of the Companies Act, 2013 requires the NCLT and NCLAT to adhere to the principles of the natural justice above anything else. It also allows the NCLT and NCLAT the power to regulate their own procedure ... [a] proceeding for declaration of insolvency of a company has drastic consequences for a company. Such proceeding may end up in its liquidation. A person cannot be condemned unheard. Where a statute is silent on the right of hearing and it does not in express terms, oust the principles of natural justice, the same can and should be read into in. When the NCLT receives an application under Section 7 of the Code of 2016, therefore, it must afford a reasonable opportunity of hearing to the corporate debtor as Section 424 of the Companies Act, 2013 mandates it to ascertain the existence of default as claimed by the financial creditor in the application. The NCLT is, therefore, obliged to afford a reasonable opportunity to the financial debtor to contest such claim of default … [t]he proceedings before the NCLT are adversarial in nature. Both the sides are, therefore, entitled to a reasonable opportunity of hearing.*
>
> *The requirement of NCLT and NCLAT to adhere to the principles of natural justice and the fact that, the principles of natural justice are not ousted by the Code of 2016 can be found from Section 7(4) of the Code of 2016 and Rule 4 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016. Rule 4 deals with an application made by a financial creditor under Section 7 of the Code of 2016. Sub- rule (3) of Rule 4 requires such financial creditor to dispatch a copy of the application filed with the adjudicating authority, by registered post or speed post to the registered office of the corporate debtor...*
>
> *Adherence to the principles of natural justice by NCLT or NCLAT would not mean that in every situation, NCLT or NCLAT is required to afford a reasonable opportunity of hearing to the respondent before passing its order.*

47 Writ Petition 7144 (W) of 2017.

> *In a given case, a situation may arise which may require NCLT to pass an exparte ad interim order against a respondent. Therefore, in such situation NCLT, it may proceed to pass an exparte ad interim order, however, after recording the reasons for grant of such an order and why it has chosen not to adhere to the principles of natural justice at that stage. It must, thereafter proceed to afford the party respondent an opportunity of hearing before confirming such exparte ad interim order.*
>
> *In such circumstances, the challenge to the vires to Section 7 of the Code of 2016 fails.*"

In the case of *M/s Innoventive Industries* v. *ICICI Bank*,[48] the NCLAT had read Principles of Natural Justice into the IB Code when it held:

> "*53. In view of the discussion above, we are of the view and hold that the Adjudicating Authority is bound to issue a limited notice to the corporate debtor before admitting a case for ascertainment of existence of default based on material submitted by the financial creditor and to find out whether the application is complete and or there is any other defect required to be removed. Adherence to Principles of natural justice would not mean that in every situation the adjudicating authority is required to afford reasonable opportunity of hearing to the Corporate debtor before passing its order.*"

Subsequently the Apex Court confirmed the above- mentioned law in its landmark ruling in *Innoventive Industries* v. *ICICI Bank*.[49] In *M/s Innoventive Industries* v. *ICICI Bank*,[50] the Appellate Tribunal had held that it is the duty of the Adjudicating Authority to issue notice and not the party. Subsequently, in the case of *M/s Bhagwan Motors* v. *Harshad V. Vora*[51] when the Adjudicating Authority had directed the contesting party to issue notice, the NCLAT overturned the decision of the NCLT admitting the application.

The NCLAT has subsequently in numerous cases rejected applications wherein the Adjudicating Authority has not given any notice to the corporate debtor before admitting the insolvency proceedings.[52] In fact, where notice was indeed issued to the debtor by

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48 Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017.

49 [2017] 205 Comp Cas 23.

50 *Supra* note 48.

51 *M/s Bhagwan Motors Pvt. Ltd.* v. *Harshad V. Vora*, Company Appeal (AT) (Insolvency) No. 113 of 2017.

52 *Agroh Infrastructure Developers Pvt Ltd.* v. *Narmada Construction (Indore) P Ltd.*, Company Appeal (AT) (Ins) No. 57 of 2017; *M/s Bhash Software Labs Pvt. Ltd.* v. *M/s. Mobme Wireless Solutions Ltd.*, Company Appeal (AT) (Insol.) No. 79 of 2017, *para* 7; *Chand Khan, Managing Director CK Infrastructures Ltd.* v. *RCI Industries & Technologies Ltd.*, Company Appeal (AT) (Insolvency) No. 307 of 2017; *Inox Wind Ltd.* v. *Jeena & Co.*, Company Appeal (AT) (Insolvency) No. 103 & 108

the Adjudicating Authority, the same was not deemed to be served if the same was returned on account of insufficient or wrong address.[53]

The exception to this position of law seems to be found in the case of *DR Balakrishna Raja* v. *Indian Bank*,[54] wherein while the appellant- debtor contended that the impugned order was passed in violation of rules of natural justice without notice to the Corporate Debtor, the respondent resisted the argument stating that on the date of admission, the Corporate Debtor appeared through its counsel and had raised all the objections before the Adjudicating Authority. The NCLAT resultantly dismissed the appeal. Similar instance can be found in the case of *Steel Konnect (India)* v. *M/s Hero Fincorp*,[55] wherein the NCLAT held that even if it is presumed that no separate notice was issued by Adjudicating Authority to the Debtor, still the appellant was heard before the passing of the impugned order. Therefore, it was held that there was no question of setting aside the impugned order on the ground of non-compliance of principles of natural justice. The Apex Court in the case of *Innoventive Industries* v. *ICICI Bank*,[56] had also refused to set aside an order admitting insolvency proceedings on the ground of no notice been given to the Appellant before admission of the case since the Appellant intervened before the admission of the case and raised all the objections which were noticed, discussed and considered by the 'adjudicating authority' while passing the impugned order.

Joining of Causes of Action

In *Asian Natural Resources* v. *IDBI Bank*,[57] the financial creditor had moved an application under section 7 of the IB Code, which was admitted. The corporate debtor, amongst other issues, contested the admission proceedings on the ground that financial creditor being a party to the consortium of bankers has signed *Inter- se* Agreement and waived its rights in favor of the lead bank, *namely*, SBI Bank. The NCLAT rejecting the contention held that as per the bare text of section 7, any financial creditor can file an application under section 7, either individually or jointly and any inter-se agreement can operate as a waiver of rights under any statute.

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of 2017; *International Recreation & Amusement Ltd.* v. *S.R. Construction*, Company Appeal (AT) (Insolvency) No. 115 of 2017; *Jammu Paper Pvt. Ltd.* v. *Shiv Pooja Traders*, Company Appeal (AT) (Insolvency) No. 144 & 149 of 2017; *Kaliber Associates Pvt. Ltd.* v. *Mrs. Tripat Kaur*, Company Appeal (AT) (Insolvency) No. 52 of 2017; *M/s Kee Projects Ltd.* v. *Sharda Rawat*, Company Appeal (AT) (Insolvency) No. 139 of 2017; *M/s Starlog Enterprises Limited* v. *ICICI Bank Limited*, Company Appeal (AT) (Insolvency) No. 5 of 2017, paras 6 and 7;

53 Company Appeal (AT) (Insolvency) No. 145 of 2017.

54 Company Appeal (AT) (Insolvency) No. 123 of 2017.

55 Company Appeal (AT) (Insolvency) No. 51 of 2017.

56 *Supra* note 49

57 *Asian Natural Resources (India) Limited* v. *IDBI Bank Limited*, Company Appeal (AT) (Insolvency) No. 60 of 2017.

In *Uttam Galva Steels* v. *DF Deutsche Forfait AG*,[58] two operational creditors filed a joint petition under section 9 of the IB Code against the corporate debtor regarding same cause of action. The corporate debtor had challenged the presentation of the joint petition. The creditors, in turn, contended that in terms of Rule 10 of the 'Adjudicating Authority Rules 2016', and a notification dated 20.12.2016, as per Rule 23A[59] a joint petition can be presented. The NCLAT rejecting the contention of the operational creditor, distinguished the requirements under section 7 and 9 as applicable to financial creditor and operational creditor respectively under the IB Code. While under section 7, [60] joint petitions can be presented, the NCLAT reasoned that before initiating proceedings under section 9, a notice under Section 8 is to be issued by an "operational creditor" individually and the petition under Section 9 has to be filed by operational creditor individually and not jointly. Furthermore, it stated that Rule 23A has not been adopted by Section 10 of the IB Code 2016, and therefore cannot be pressed into any help.

In the case of *International Road Dynamics South Asia* v. *Reliance Infrastructure*,[61] the appellant had moved two separate appeals against two separate debtors. While in the 1st appeal, the claim was regarding outstanding dues on account of 'three different projects' arising out of three separate work orders, in the 2nd appeal, the claim arose out of two different work orders. The NCLAT dismissing the appeal held:

> "*…different claim(s) arising out of different agreements or work order, having different amount and different dates of default, cannot be clubbed together for alleged default of debt, the cause of action is being separate. For the said reasons, we hold that the joint application preferred by appellant under Section 9 is defective, as distinct from incomplete, and, was not maintainable.*"[62]

Miscellaneous

Defects in Application

In the case of *Ms Starlog Enterprises* v. *ICICI Bank*,[63] the NCLAT had overturned the decision of an Adjudicating Authority for having overlooked the "apparent and

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58 *Uttam Galva Steels Limited* v. *DF Deutsche Forfait AG & Anr.*, Company Appeal (AT) (Insolvency) No. 39 of 2017.

59 Adjudicating Authority Rules 2016, sec. 23A.

60 IB Code, sec. 7 (1).

61 *International Road Dynamics South Asia Pvt. Ltd* v. *Reliance Infrastructure Ltd.*, Company Appeal (AT) (Insolvency) No. 72 of 2017.

62 *International Road Dynamics South Asia Pvt. Ltd* v. *Reliance Infrastructure Ltd.*, Company Appeal (AT) (Insolvency) No. 72 of 2017, para 10.

63 *M/s. Starlog Enterprises Limited* v. *ICICI Bank Limited*, Company Appeal (AT) (Insolvency) No. 5 of 2017.

conspicuous mismatch" between the amount demanded by the Respondent from the Appellant in its demand notice and the amount stated to be in default in the insolvency application. The mismatch was construed to be tantamount to an "incorrect claim" and the petition was in turn rejected in appeal.

The same argument was taken up by a debtor in the case of *Tirupati Infra Project* v. *Bank of India*,[64] wherein the application stipulated the default to the tune of Rs. 82.37 Crores, but by way of rectification of defect, the amount of default has been shown to the extent of over Rs. 100 crores. The Financial Creditor submitted that the original amount of default of Rs. 82.37 Crores was shown calculating the interest up to March 2012 and the subsequent statement of uncharged/ differential interest combined with the defaulting amount for the period from April 2012 to mid- May 2017 was added, hence the amount of default surged to over Rs. 100 crores and therefore, the supplementary statement filed by them cannot be termed to be 'removal of defects'. The NCLAT recapitulated its decision in *Starlog* in the following terms:

> *"A defective application can be corrected by removing the defect. Similarly, if an application is incomplete, it can be completed, but if any misleading statement is made in an application no time can be granted to recall the misleading statement and such application is fit to be rejected.*"[65]

and consequently, distinguishing the case of the appellant- debtor in *Tirupati* held that the case of the appellant is not that there is a mismatch between the amount shown in the notice under Rule 4 (3) and the amount of default shown by the 'Financial Creditor' in its original application under Section 7. Since the creditor had explained the difference, according to NCLAT, there was neither any misleading statement made by the 'Financial Creditor' nor any misleading statement of default.[66]

A somewhat lenient approach was taken in the case of *Mintri Tea* v. *Punjab National Bank*,[67] wherein the application under Section 7 of IB Code 2016 while alleged a default of over Rs. 10 crores, 5 months earlier the amount was shown to have been over Rs. 7 crores. The NCLAT, dismissing the argument of the debtor of there being a mismatch in figures, held that the amount of debt, which is the claim amount will always vary with the default of debt amount which may be part of the claim and total amount and

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64 *Tirupati Infra Project Pvt. Ltd. & Another* v. *Bank of India*, Company Appeal (AT) (Insolvency) No. 99 of 2017.

65 *Id.* para 7.

66 *Tirupati Infra Project Pvt. Ltd. & Another* v. *Bank of India*, Company Appeal (AT) (Insolvency) No. 99 of 2017, *para* 8.

67 *Mintri Tea Company Limited and Ors.* v. *Punjab National Bank*, Company Appeal (AT) (Insolvency) No. 237 of 2017.

may include interest. Therefore, relying upon *Innoventive Industries*[68], the NCLAT held that all that is to be seen is whether a debt is due and default has occurred, irrespective of the fact whether the debt is disputed. Similar position was taken in the case of *Mr. Ajay Agarwal* v. *Central Bank of India*,[69] wherein the Appellant raised dispute regarding mismatch of debt amount, but had not disputed that some debt is "due" and is payable to the 'Financial Creditor' and the 'Corporate Debtor' has defaulted in making such payment. The NCLAT, reiterating the position in *Innoventive Industries*, held that an Adjudicating Authority has to merely see the records of the information utility or other evidence produced by the 'Financial Creditor' to satisfy itself that a default has occurred.

Raising New Contentions before the Appellate Tribunal

The NLCAT had consistently maintained its strict jurisdiction as an Appellant Tribunal to the Adjudicating Authority, *namely*, the National Company Law Tribunal. As a corollary, any contention that has not been taken before the Adjudicating Authority is considered to be ousted and the same cannot be taken before the NCLAT. In *Balaji Enterprise* v. *Gammon India*,[70] the Adjudicating Authority rejected the insolvency application of the appellant on the ground of pre- existing arbitration proceedings that were pending. The appellant raised the contention before the NCLAT that the Application under Section 9 of the IB Code was filed with regard to default pursuant to different agreements and therefore, the proceedings under section 9 of the IB Code ought to be admitted with respect to the matters arising out of the agreements which contain no arbitration clause. The NCLAT rejected the plea on several grounds, including one on the ground that the aforesaid plea was not taken before the NCLT. Similarly, in *Diamond Engineering (Chennai)* v. *Shah Brothers*,[71] the appellant- debtor argued that the creditor had not filed a proper bank certificate but the same was rejected on the ground that such plea was not taken before the Learned Adjudicating Authority.

However, in the case of *Ravi Mahajan* v. *Sunrise 14 A/S*, Denmark,[72] albeit a lack of clarity on this particular issue, the NCLAT overruled the Adjudicating Authority on the basis of contentions raised by the appellant- debtor, which the Respondent contested

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68 2017 SCC online SC 1025.

69 *Mr. Ajay Agarwal* v. *Central Bank of India and State Bank of India*, Company Appeal (AT) (Insolvency) No. 180 of 2017.

70 *Balaji Enterprise* v. *Gammon India Limited & Ors.*, Company Appeal (AT) (Insolvency) No. 168 of 2017.

71 *Diamond Engineering (Chennai)* v. *Shah Brothers*, Company Appeal (AT) (Insolvency) No. 65 of 2017.

72 *Ravi Mahajan* v. *Sunrise 14 A/S*, Denmark, Company Appeals (AT) (Insolvency) Nos. 141 & 146 of 2017.

stating that the contentions raised before the NCLAT were raised for the first time before the NCLAT and not taken up before the Adjudicating Authority. The NCLAT did not specifically address this objection by the Respondent and while finding merit in the contentions raised by the appellant, rejected the insolvency application of the Respondent and had set aside the admitted proceedings.

It is submitted that on this particular issue there is still lack of clarity on account of this decision.

Power to Review/ Recall Orders

The NCLAT in the case of *Amod Amladi* v. *Mrs. Sayali Rane*,[73] had been presented with the issue of whether the Adjudicating Authority can review or recall its own order. In this case, an intervention application was filed by one of the investors praying that the order of the Adjudicating Authority admitting the insolvency application against Citrus Check Inns Limited be recalled on account of conclusion between the debtor company's directors and the creditors, which the Adjudicatory Authority had rejected. The NCLAT held had there is no provision equipping the Adjudicatory Authority with the power to recall or review its order and therefore, it had rightly rejected the intervention application.

III DEFINING A FINANCIAL CREDITOR AND FINANCIAL DEBT

The IB Code caters to the interests of mainly two types of creditors, which are classified as "Operational creditor" and "Financial creditor". The financial creditors generally comprise of the banking institutions. However, section 5 (7) read with section 5 (8) defines financial creditors and financial debt, wherein the prominent condition to classify a debt as a financial debt is that the debt must be 'disbursed against the consideration for the time value of money". It has been posited that in order to be considered to a financial creditor, there must be a financial debt and the same must fulfill the query of being lent against 'time value of money'[74] and the test to determine the status of an applicant whether is of a 'financial creditor' for the purposes of initiation of insolvency proceedings has been laid down in the case of *Nikhil Mehta* v. *AMR Infrastructure*[75] and consequently consistently followed in the cases of *Anil*

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73 *Amod Amladi* v. *Mrs. Sayali Rane & Anr.*, Company Appeal (AT) (Insolvency) No. 295 of 2017; *Anant Kajare* v. *Eknath Aher & Anr.*, Company Appeal (AT) (Insolvency) No. 296 of 2017.

74 *Nikhil Mehta and Sons (HUF) and Ors.* v. *M/S AMR Infrastructure Ltd.*, C.P. No. (ISB)- 03 (PB) /2017, para 12. (Principal Bench)

75 *Nikhil Mehta and Sons* v. *AMR Infrastructure Ltd*, Company Appeal (AT) (Insol.) No. 07 of 2017.

Mahindroo v. *Earth Iconic*,[76] *Kamal Dutta* v. *Anubhuti Aggarwal*,[77] *D Muthukumar* v. *A Premkumar*[78].

In order to understand the concept of "time value" the facts in *Anil Mahindroo* v. *Earth Iconic*[79] need to be referred to, which were similar to the facts in *Nikhil Mehta*. In the former, the question was posed whether the purchaser of a flat could be construed to be a 'financial creditor' and the amount paid for purchasing the flat could be termed to be a 'financial debt'. The peculiar facts were that an allotment letter was executed between the purchaser and the builder. The MOU contained an express promise made on behalf of the builder for a guaranteed return on the investment termed as 'commitment amount' till the delivery of actual possession. The purchaser had paid the entire agreed sale consideration, however, the builder stopped paying the commitment amount after a date. The NCLAT finding that the purchaser could be treated as an 'investor' and the amount paid for purchase of the flat be construed as 'financial debt', referred to its previous judgment in *Nikhil Mehta* v. *AMR Infrastructure*[80] with regard to the same query where in similar circumstances the gist issue was framed in the following terms:

> "*From the 'Annual Return' of the Respondent and Form-16A, we find that the 'Corporate Debtor' treated the appellants as 'investors' and borrowed the amount pursuant to sale purchase agreement for their commercial purpose treating at par with 'loan' in their return. Thereby, the amount invested by appellants come within the meaning of 'Financial Debt', as defined in Section 5(8)(f) of IB Code, 2016 subject to satisfaction as to whether such disbursement against the consideration is for time value of money, as discussed in the subsequent paragraphs*"[81] [Emphasis Added]

The interpretation regarding 'time value of money' was therefore, the determining factor in order to ascertain if a debt is a financial debt. The NCLAT relying upon its ruling in *Nikhil Mehta* v. *AMR Infrastructure*[82] held that since the purchaser has paid

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76 *Anil Mahindroo and Ors.* v. *Earth Iconic Infrastructure (P) Ltd.*, IV (2017) BC 128, Company Appeal (AT) (Insolvency) No. 74 of 2017.

77 *Kamal Dutta* v. *Anubhuti Aggarwal and Anr.*, Company Appeal (AT) (Insolvency) No. 329 of 2017.

78 *D. Muthukumar* v. *A. Premkumar & Another*, Company Appeal (AT) (Insolvency) No. 209 of 2017.

79 *Anil Mahindroo and Ors.* v. *Earth Iconic Infrastructure (P) Ltd.*, IV (2017) BC 128, Company Appeal (AT) (Insolvency) No. 74 of 2017.

80 *Nikhil Mehta and Sons* v. *AMR Infrastructure Ltd*, Company Appeal (AT) (Insol.) No. 07 of 2017.

81 *Id.* para 23 quoted in *Anil Mahindroo and Ors.* v. *Earth Iconic Infrastructure (P) Ltd.*, IV (2017) BC 128, Company Appeal (AT) (Insolvency) No. 74 of 2017, para 5.

82 *Supra* note 80

most of the amount, and the builder was ready to pay "monthly committed returns", it was clear that the amount disbursed by the appellants was "against the consideration of the time value of the money".

Furthermore, the NCLAT also referred to the annual returns filed by the builder-Corporate Debtor wherein the amount so raised/borrowed has been shown as 'commitment charges' under the head "Financial cost", which also included "interest of loans" and other charges.[83]

The term "Time Value" has been discussed in the decision of the Adjudicatory Authority in the case of *Nikhil Mehta* v. *M/S AMR Infrastructure*,[84] wherein the Principal Bench of NCLT citing Black's Law Dictionary held it to mean "the price associated with the length of time that an investor must wait until an investment matures or the related income is earned". While the NCLT in *Nikhil Mehta* finds that the question of 'monthly committed returns' arises only when the possession is not delivered, and therefore, there is no time value of money when the investment is made; the NLCAT on the other hand, finds that once there is a delay, there is a time value of money attached.

The decision in *Nikhil Mehta* had given an insight into how builder- purchaser issues could also be invoked under the IB Code. In the *Kamal Dutta* v. *Anubhuti Aggarwal*,[85] the NCLT had admitted the application of the purchaser treating the latter as a 'financial creditor'. Subsequently, however, the NCLAT overturned the decision, without dwelling into the specific merits of the case (mainly because there was compromise between the parties), on the ground that the NCLT did not discuss if the purchaser satisfies the 'time value of the money' ingredient as applied in *Nikhil Mehta* v. *AMR Infrastructure*. It is submitted that the approach of the NCLAT seems to be on a better footing since it takes into account the intention of the parties when entering into the contract as the provision of a 'monthly committed returns' is an essential term of the contract ensuring the financial profitability of the transaction entered into by the purchaser and inducing such transactions.

Similar reasoning was applied in the case of *PEC* v. *Sree Ramakrishna Alloys*,[86] wherein the agreement provided that beyond the period of ninety days, if the amount is not paid, the debtor will have to pay interest @ 14.5% per annum for the delayed period beyond 90 days. The NCLAT held the creditor as 'financial creditor'. It must be however, noted that there are several agreements wherein it is usually stipulated that in case the money is not paid by a particular date, then the same shall carry interest beyond that

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83 *Id.* para 25.

84 *Supra* note 80

85 Company Appeal (AT) (Insolvency) No. 329 of 2017.

86 Company Appeal (AT) (Insolvency) Nos. 225 and 236 of 2017.

stipulated date. By virtue of this reasoning, all such contracts and agreements would be termed to carry a 'financial debt'.

In the *Muthukumar* case, the applicant- debtor contended to be a financial creditor on the basis of the fact that (a) they were seeking repayment of dues, along with the accrued interests, which was not being paid and (b) the Income Tax Return of the debtor showed the amount as 'loan'. The NCLAT on this particular issue held that the debtor has not brought on record any document to prove that the amount has been disbursed by it against '*the consideration for the time value of money*' or that the said money was borrowed by the 'Corporate Debtor' for one or other purpose as shown in section 5 (8)[87] of the IB Code and since the Adjudicating Authority did not address this query, the same was bad in law.

However, the same approach seems to be not applied in the case of *BVS Lakshmi* v. *Geometrix Laser Solutions*,[88] wherein the creditor had contended that she had advanced money to the company and though the terms of debt were not written, it was evidenced by an e-mail from the Managing Director of the debtor company directing that interest should be added for loans advanced by shareholders as well as report of the Auditor of the debtor stating that interest has been credited for loans advanced. However, the NCLAT in a rigmarole reasoning still held that the Appellant has failed to bring on record any evidence to suggest that she disbursed the money has been made against 'consideration for the time value of money' and further found that there is nothing on the record to suggest that the debtor borrowed the money.[89]

Absence of disbursement of loan without any interest has been considered to be a major factor n *Vishwa Nath Singh* v. *M/S Visa Drugs and Pharmaceuticals*,[90] wherein the corporate debtor placed their reliance on its balance sheet which had stipulated the details of "unsecured loans/advances" and wherein the name of the creditor was shown. It was submitted that the unsecured loan having been taken without any interest cannot be termed to be a 'financial debt'. The NCLAT accepted the contention of the debtor held that the respondent does not come within the meaning of 'financial creditor'.

In *Neelkanth Township and Construction* v. *Urban Infrastructure Trustees*,[91] issue arose whether debenture certificates could be termed to be a financial debt. The debtor contended that the 'debenture certificates' issued to the creditor were carrying zero interest and

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87 IB Code, sec. 5 (8).

88 Company Appeal (AT) (Insolvency) No. 38 of 2017.

89 *B.V.S. Lakshmi* v. *Geometrix Laser Solutions Private Limited*, Company Appeal (AT) (Insolvency) No. 38 of 2017, *para* 30.

90 Company Appeal (AT) (Insolvency) No. 234 - 235 of 2017.

91 Company Appeal (AT) (Insolvency) No. 44 of 2017.

another was carrying only one percent interest, hence the same were not issued against consideration for time value of money. The NCLAT, referring to section 5 (8) (c)[92] of the IB Code, held that debentures come within the ambit of this provision. The problem that arises here is that the NCLAT did not discuss whether the debentures were issued against the consideration for the "time value of money". It merely inquired if the debentures fell within the sub- clauses of section 5 (8) of the IB Code, and once it finds it, holds the same to be sufficient enough to be considered to be a 'financial debt'.

Based on the current jurisprudence on this IB Code, the sole way for flat purchasers to contest their grievance against builders would be to present their case in the capacity of a financial creditor. In *Gurcharan Singh Soni* v. *Unitech*,[93] the purchaser contended before the NCLAT that the State Consumer Disputes Redressal Commission had directed the builder to refund the amount with interest and compensation expenses and the same comes within the ambit of the term 'debt' and a default under section 9 of the IB Code. The NCLAT however, held that the purchaser does not come within the ambit of the term 'operational creditor' and since the appellants have not taken the plea that they are 'financial creditors' covered by the decision in *Nikhil Mehta* v. *AMR Infrastructure*, the appeal of the purchaser was dismissed.

In *Pawan Dubey* v. *JBK Developers*,[94] the purchaser moved an application under section 9 of the IB Code wherein amount agreed to be refunded by the builder was not paid. The appellant sought the cancellation of their allotment owing to delay in raising the construction and the purchasers and the builder had agreed to cancel the allotment and refund the amount of Rs. 25,97,940/- along with the interest @ 19% per annum for the delay. As earlier observed, the NCLAT dismissed the appeal on the ground that the purchasers do not come within the ambit of the term 'operational creditor'. Similar was the fate in the case of *Satish Mittal* v. *Ozone Builders and Developers*,[95] wherein the purchaser who had booked the flat but was not allotted one sought refund of the sum paid. The NCLAT again held that the applicant cannot be termed to be an operational creditor.

IV DELINEATING THE SCOPE OF TERM 'EXISTENCE OF DISPUTE'

The IB Code while provides for no admission of insolvency proceedings at the behest of a financial creditor when there is no "existence of a default from the records of an

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92 *Supra* note 5; sec. 5 (8) (c).

93 Company Appeal (AT) (Insol.) No. 55 of 2017.

94 Company Appeal (AT) (Insolvency) No. 40 of 2017.

95 Company Appeal (AT) (Insol.) No. 75 of 2017.

information utility",[96] in the case of operational creditors it provides that if there is an *existence of a dispute*, then application for such proceedings must be rejected[97].

The code defines "dispute" to include a suit or arbitration proceedings relating to- (a) the existence of the amount of debt; (b) the quality of goods or service; or (c) the breach of a representation or warranty.[98] Therefore, once it is brought on record that there is a pending dispute (whether pending before a court of law or not) between the warring creditors and debtors then no insolvency proceedings could be admitted against the corporate debtors.

Threshold to Establish Existence of a Dispute

The most pivotal judgment on this issue was rendered in the case of *Kirusa Software* v. *Mobilox Innovations*,[99] where the NCLAT had held that under section 9 of the IB Code there is no discretion conferred on an adjudicating authority to verify adequacy of the dispute and once there is a *genuine dispute* raised before any court of law or authority, the Adjudicating Authority shall not proceed with the matter. However, it was further clarified that if a dispute is sought to be given any colour of genuineness or is otherwise illusory, or raised for the first time while replying to the notice under Section 8, then it cannot be construed that there is an existing dispute.

The Apex Court subsequently, in an instructive opinion had held:

> *"29. … [w]e have also seen the notes on clauses annexed to the Insolvency and Bankruptcy Bill of 2015, in which "the existence of a dispute" alone is mentioned. Even otherwise, the word "and" occurring in Section 8(2)(a) must be read as "or" keeping in mind the legislative intent and the fact that an anomalous situation would arise if it is not read as "or". If read as "and", disputes would only stave off the bankruptcy process if they are already pending in a suit or arbitration proceedings and not otherwise. This would lead to great hardship; in that a dispute may arise a few days before triggering of the insolvency process, in which case, though a dispute may exist, there is no time to approach either an arbitral tribunal or a court... [i]t is for this reason that it is enough that a dispute exists between the parties.*
>
> *30. …*
>
> *40. …all that the adjudicating authority is to see at this stage is whether there is a plausible contention which requires further investigation and that the "dispute" is not a patently feeble legal argument or an assertion of fact unsupported by evidence. It is*

96 *Supra* note 5, sec. 7(4), 7(5).

97 *Id.* sec. 8(2)(a), read with sec.9(5)(ii).

98 *Id.* section 5(6).

99 Company Appeal (AT) (Insolvency) 6 of 2017.

> *important to separate the grain from the chaff and to reject a spurious defence which is mere bluster. However, in doing so, the Court does not need to be satisfied that the defence is likely to succeed. The Court does not at this stage examine the merits of the dispute except to the extent indicated above. So long as a dispute truly exists in fact and is not spurious, hypothetical or illusory, the adjudicating authority has to reject the application.*"[100]

In the case of *Yogendra Yasupal* v. *Jigsaw Solutions*,[101] the debtor challenged the admission of the insolvency proceedings by referring to some documents including an order passed by the High Court at Madras in an Anticipatory Bail Petition to suggest that there is a 'dispute in existence'. The NCLAT elevating the level of proof to prove 'existence of dispute' held that any observations with regard to individual officer, whether made by a court of law or in a communication made by the 'Operational Creditor', cannot be treated to be an 'existence of dispute', especially when there is no specific objection made by the 'Corporate Debtor' in writing, raising any dispute with regard to the quality of services as claimed to have been rendered by the Operational Creditors.

In the case of *AD Electro Steel* v. *Anil Steels*,[102] the reply to the notice under section 138 of the Negotiable Instruments Act 1881 was to be sufficient to have proven the existence of a dispute. In this case, an operational creditor had issued notice under section 138 of the Negotiable Instrument Act 1881 and made certain claims, in reply to which the corporate debtor raised the dispute about the supply of certain goods.

Similarly in *Vimal Organics* v. *Anya Polytech and Fertilizers*,[103] exchange of letters between the debtor and the creditor conveying the problem in the production due to problem in commissioning the goods after supply, was held to be sufficient to oust the jurisdiction of the IB Code.[104] In fact, communication of dispute vide email has also been accepted to bring the matter out of the ambit of IB Code.[105]

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100 *Mobilox Innovations Private Limited* v. *Kirusa Software Private Ltd.*, 2017 (11) SCALE 754.

101 Company Appeal (AT) (Insolvency) No. 222 of 2017.

102 Company Appeal (AT) (Insolvency) No. 194 of 2017.

103 Company Appeal (AT) (Insolvency) No. 269 of 2017.

104 For other instances where exchange of letters sparing over dispute regarding the delivery or quality of goods delivered, see *P.K. Ores Private Limited* v. *Tractors India Private Limited*, Company Appeal (AT) (Insolvency) No. 56 of 2017; *Smartcity (Kochi) Infrastructure Pvt. Ltd.* v. *Synergy Property Development Services Private Limited and Another*, Company Appeal (AT) (Insol.) No. 80 of 2017.

105 *United Motors Heavy Equipment Pvt. Ltd.* v. *Sundaram Industries Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 118 of 2017; *Design Worx Infrastructure India Pvt. Ltd.* v. *Premier Restaurants Private Ltd.*, Company Appeal (AT) (Ins) No. 73 of 2017; *Elecon Engineering Co. Ltd.* v. *Ducon Technologies (I) Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 14 of 2018; *AS Technosoft Pvt. Ltd.* v. *Goldsquare Sales India Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 331 of 2017.

However, where the corporate debtor neither disputed the claim nor submitted any reply under section 8 (2), the NCLAT declined to interfere against the admission of insolvency proceedings even though the debtor- appellant contended that there is an existing dispute based upon a letter.[106] On the other hand, where the operational creditor did not mention if the 'Corporate Debtor' has raised any dispute pursuant to demand notice, the NCLAT upheld the rejection of the claim.[107]

Winding Up Application

One of the consistent and most effective manner of proving that there is an existence of dispute prior to the issuance of demand notice under section 8, the Company Law Tribunals have given credence to the reply of the corporate debtors to the legal notice received under section 433 (e) of the Companies Act 1956.[108] For instance, in the case of *MCL Global Steel* v. *Essar Projects India*,[109] the debtor had replied to the notice issued under section 433 of the Companies Act 1956, which was replied to by the debtor wherein the entire claim was disputed. The NCLAT had held that there is an existing dispute and consequently the application seeking initiation of insolvency proceedings was rejected. Similarly in the case of *VDS Plastics* v. *Pal Mohan Electronics*,[110] the reply to the notice under section 433 (e) and 434 (1) (a) of the CA 1956 wherein the supply of the goods and services was disputed, was held to be sufficient to prove the existence of a dispute.

Dispute: When to be Raised

In *Yogendra Yasupal* v. *Jigsaw Solutions*,[111] it has been categorically laid down that no dispute can be raised at the stage of submitting of reply under section 8 (2) of the IB

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106 *Paramjeet Singh* v. *Maxim Tubes Company Pvt. Ltd. & another*, Company Appeal (AT) (Insolvency) No. 150 of 2017.

107 *M/s. J.P. Engineers Pvt. Ltd.* v. *M/s. Indo Alusys Industries Ltd.*, Company Appeal (AT) (Insolvency) No. 220 of 2017.

108 For instances, see *M/s. Bhash Software Labs Pvt. Ltd.* v. *M/s. Mobme Wireless Solutions Ltd.*, Company Appeal (AT) (Insol.) No. 79 of 2017; *M/s. Sunil Packaging Pvt. Ltd.* v. *Dishnet Wireless Limited*, Company Appeal (AT) (Insolvency) No. 136 of 2017; *M/s. Meyer Apparel Ltd. & Anr* v. *M/s. Surbhi Body Products Pvt. Ltd*, Company Appeal (AT) (Insolvency) No. 33 of 2017; *Philips India Limited* v. *Goodwill Hospital & Research Centre Ltd.*, Company Appeal (AT) (Insolvency) No. 14 of 2017; *Prem Sarup Narula* v. *ByCell Telecommunications India Pvt. Ltd.*, Company Appeal (AT) (Insolvency) No. 265 of 2017; *Uttam Galva Steels Limited* v. *DF Deutsche Forfait AG and Ors.*, Company Appeal (AT) (Insolvency) 39 of 2017; *M/s. Sunil Packaging Pvt. Ltd.* v. *Dishnet Wireless Limited*, Company Appeal (AT) (Insolvency) No. 136 of 2017; *VDS Plastics Pvt. Ltd.* v. *Pal Mohan Electronics (P) Ltd.*, Company Appeal (AT) (Insolvency) No. 58 of 2017.

109 Company Appeal (AT) (Insolvency) No. 29 of 2017.

110 Company Appeal (AT) (Insolvency) No. 58 of 2017.

111 Company Appeal (AT) (Insolvency) No. 222 of 2017.

Code. In *United Projects Constructions* v. *Aerocon Buildwell*,[112] the creditor alleged that the letter relied upon by the debtor to show existence of dispute is forged and consequently the NCLAT directed the debtor to file additional affidavit enclosing any evidence to suggest that so- called letter was issued and served on the Appellant.

In *Ms Annapurna Infrastructure* v. *Ms SORIL Infra Resources*,[113] the operational creditor had initiated proceedings against the debtor on the basis of an arbitral award which was affirmed even in the proceedings under section 34 of the Indian Arbitration and Conciliation Act 1996. The corporate debtor had contended that the said order is challenged under section 37 and hence there is a pending dispute which was accepted by the NCLT. However, the NCLAT after referring to the provisions of the IB Code held that under section 8 (2) (a) it is the pendency of an arbitration proceedings that has been termed to be an 'existence of dispute' and not the pendency of an application under section 34 or section 37 of the Arbitration Act. Furthermore, after perusing Form 5 of the Adjudicating Authority Rules 2016 it was found that an order passed by the Arbitral Panel has been cited as one of the document, record and evidence of default. In fact in *Kirusa Software* v. *Mobilox Innovations*,[114] the NCLAT had earlier made the following observations:

> "*There may be other cases such as a suit relating to existence of amount of debt stands decided and decree is pending for execution. Similarly, existence of amount of debt or quality of goods or service for which a suit have been filed and decreed; an award has been passed by Arbitral Panel, though petition under Section 34 of Arbitration and Reconciliation Act, 1996 may be pending. In such case the question will arise whether a petition under Section 9 will be maintainable particularly when it was a suit or arbitration proceeding is not pending, but stand decided? Though one may argue that Insolvency resolution process cannot be misused for execution of a judgement and decree passed in a suit or award passed by an arbitration Tribunal, but such submission cannot be accepted in view of Form 5 of Insolvency & Bankruptcy (Application to Adjudicating Authority) Rules 2016 wherein a decree in suit and award has been shown to be a debt for the purpose of default on nonpayment.*" [Emphasis Added]

Under section 36 of the Indian Arbitration and Conciliation Act 1996, an arbitral award is executable as decree but it can be enforced only after the time for filing the application under section 34 has expired and no application is made or such application having been made has been rejected. In other words, an arbitral award reaches finality after expiry of enforceable time under section 34 and/or if application under section 34 is filed and rejected.

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112 Company Appeal (AT) (Insolvency) No. 164 of 2017.

113 Company Appeal (AT) (Insolvency) No. 32 of 2017.

114 Company Appeal (AT) (Insolvency) 6 of 2017.

The NCLAT, in fact, in the case of *MS Ksheeraabd Constructions* v. *MS Vijay Nirman*,[115] had gone a step ahead and had held that pendency of a case before a Court under Section 34 of the Arbitration and Conciliation Act 1996 cannot be termed to be 'dispute in existence' for the purposes of the IB Code.

Furthermore in the case of *Uttam Galva*,[116] it has been stated that for the purpose of section 9, a 'dispute' must be capable of being discerned from notice of corporate debtor.

V CONCLUSION

While there are several instances ranging from issues pertaining to mandatory ingredients in an insolvency application to issues concerning conflict with other statutory laws, the applicability of other laws and legal concepts to the insolvency proceedings is a very delicate subject which has been mentioned in the "Legislative Guide on Insolvency Law of the United Nations Commission on International Trade Law". The same guide has been quoted at length by the Apex Court in *Mobilox Innovations v. Kirusa Software*[117]. The guide states that "*an insolvency law should be transparent and predictable. This will enable potential lenders and creditors to understand how insolvency proceedings operate and to assess the risk associated with their position as a creditor in the event of insolvency. This will promote stability in commercial relations and foster lending and investment at lower risk premiums*" and further adds that an insolvency law should clearly indicate all provisions of other laws that may affect the conduct of the insolvency proceedings (for instance labour law; commercial and contract law; tax law; laws affecting foreign exchange, netting and set-off and debt for equity swaps; and even family and matrimonial law).

Overall, it seems that the Code is on the right track to reaffirm and give substance to the vision of the legislators. The authorities tasked with the implementation of the Code have kept reinforcing their focus on securing the rights of the creditors as well as assist all the stakeholders in procuring the best resolution plan post the admission of the proceedings, all the while provided a modicum of certainty to insolvency applicants regarding the extent of their Rights under the IB Code. Some hyper- technical view taken by the authorities under the IB Code was to some extent addressed by the Supreme Court, but the object has always remained the same which is to provide for a consistent, timely and effective adjudication.

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115 Company Appeal (AT) (Insolvency) No. 167 of 2017.

116 *Supra* note 58 at para 30.

117 *Supra* note 100.